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THE INFLUENCE OF SHAREHOLDER ACTIVISM ON THE BOARD OF DIRECTORS

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This thesis is written as completion to the master Business Engineering, at the Louvain School of Management in Louvain-La-Neuve. The main part of this thesis was done in Louvain-La-Neuve between 01/15 and 05/15. Before this, a big part of the literature study was done during my exchange at the Indian Institute of Management Calcutta between 09/14 and 12/14. The local university library had a lot of intriguing dissertations surrounding the main topic of my dissertation, shareholder activism.

I would like to thank all the interviewees whom were so kind to answer the questions of an investigating master student. All of them welcomed me with great enthusiasm and answered my questions rigorously. I thank my promoter, Gerrit Sarens for his quick responses when I needed them and his remarks that were crucial to steer this dissertation in the right direction. Further on, I would like to mention Sebastiaan, a fellow student and friend who altered my vision, through a small brainstorm on the train from Louvain-La-Neuve to Leuven. Lastly, I would like to thank my girlfriend, family and friends for believing in me and detecting spelling mistakes in my draft versions.

With this thesis I conclude an important chapter of my life. I will leave the academic life behind me (for now). The work performed for the qualitative part of this dissertation gave me important insights about how to implement academic knowledge in the professional working environment. These are insights I would like to put into practice in subsequent years.

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INTRODUCTION

The activism of shareholders against the management and board of their firm is a practice already performed for many decades. Notwithstanding, the literature on shareholder activism has only received a considerable boost in the last decade. One of the main motives being the early 2000 governance failures of Enron and their companions. A more recent example is the 08' subprime crisis. Shareholders had the feeling that they were betrayed by their company, by their board of directors and as such wanted to claim firmer control over the enterprise. There are several ways in how to establish that, which I will discuss in detail in succeeding chapters. The previously mentioned context provided the academic world with a platform to conduct their research around shareholder activism. I would like to use this platform to partly fill in the current gap of research about non-listed firms. The circumstances vary significantly with listed firms, but they also apply their own forms of shareholder activism.

This dissertation will try to answer one main question: which influence does shareholder activism have on the board of directors and its company? At first, I will try to sketch a picture of the current literature and opinions about shareholder activism. On the basis of the available literature, secondary topics like the board of directors, power and the Belgian corporate market, will be explored in further detail. The different ways in how shareholders influence the board of directors will be thoroughly discussed. This question can be split up into two parts. On the one hand the kind of target firm will be important. Different categories are rather limited on the macro level; as such I will take the financial health of the company as prime attribute. On the other hand there is the kind of action this shareholder commits, the way in which they try to exercise influence. I expect the two variables to have a profound effect on the influence perceived.

In this paper a qualitative study of different shareholder examples will be conducted. In total, I will share the findings of four shareholders and three executives about the influences perceived through shareholder activism. In case of the shareholders, I will look for a general overview on their strategy and targets. The executives are asked to confirm or refute the shareholders' story. The qualitative study will be conducted in a non-listed firm's environment. Which was a limitation I had to work with, as listed firms were not eager to cooperate.

Throughout the qualitative study, I will spot trends and connect the two earlier mentioned variables with the influence exerted on the company. Furthermore, I will formulate recommendations concerning the listed firm's environment as well, based on the research findings.

LITERATURE STUDY

SHAREHOLDER ACTIVISM

Shareholder activism (and corporate governance) finds its origin in a conflict of interest between management and shareholders. That conflict of interest is called 'the agency cost' (Dalton, Hitt, Certo, and Dalton, 2007). Shareholders are the main providers of the corporate capital and are as such the 'owners' of the company. They recruit a management to manage the company and they want the management to run the company in a manner that provides increased shareholder value. Though management may have a personal agenda that does not necessarily contain the maximization of shareholder value.

The dispersion of ownership is an important reinforcer of this agency problem (Coffee Jr., 2010). Most firms have hundreds or thousands of shareholders and therefore the monitoring process does not get facilitated. In the past the grand majority of the shareholders were extremely passive, hoping for dividends or their share price to go up. Most of the shareholders simply 'voted with their feet' meaning that they sell their shares when the future of the company looks dim. The other extreme is the market for corporate control. If a company is not performing, as it should, other companies/investors/shareholders, who think to have the capacities to do a better job, will try to acquire the company. In between these two extremes shareholder activism is located (Gillan and Starks, 2007, p. 55). This starts with shareholders deciding not to run away from the companies' problems, but to take up arms and try to induce a change. It is an important change in the shareholders' mind-set. The rights on dividend and voting that a shareholder receives upon the purchase of a share in the company also comes with the responsibility to use it wisely, to act as an owner of the company.

Tirole (2006, p. 27) defines shareholding activism in the following manner: "Active monitoring consists in interfering with management in order to increase the value of the investors' claims." Another angle on shareholder activism is found with Rose (2012, p. 269-270) who defines it as:

“activities initiated by minority shareholders to influence directly or indirectly the decisions on the general agenda as well as in the board room.” The activist who wants to interfere with management has several possibilities at his disposal. According to Gantchev (2013) these options consist out of a sequence of actions. The majority of activists start their negotiations behind closed doors. If that does not suffice they will go for board representation. The activist’s last resort is the (expensive) proxy fight. The activist only goes to the next stage if he does not obtain his objectives and if he still thinks this objective is a feasible goal. This financial perspective I could also retrieve with Poulsen, Strand, and Thomson (2010). They consider shareholder activism rational when: “shareholders balance the expected costs and benefits and only take action when the benefits exceed the costs.”

The single most important tool that a shareholder has is his right to vote at the general meeting. There he elects, fires or replaces directors on the board and votes on important corporate decisions. Some shareholders have the opportunity to post shareholder resolutions as well. In the ‘aggregate’ section I will discuss the activist’s tools in a more elaborated fashion. To conclude, I would like to define shareholder activism as a denominator for all kinds of activities undertaken by the shareholder whereby they try to exercise their rights (as holder of a share of the company) for the benefit of the long-term shareholder value.

OPINIONS

Bebchuk (2004) makes a case for more shareholder power. Mostly referring to the limited power that shareholders had in 2004 concerning major corporate decisions. If they wanted a change, they could have tried to influence the board of directors by getting one of their directors on the board or by getting their proposals accepted. Nowadays this has been facilitated somewhat. Nevertheless the fact remains that it is a rather harsh action if shareholders are not agreeing on one certain point. Both the SEC as the European Union have planned reforms that mostly aim at more freedom for the proxy contest which gives the traditional shareholder activist more gunpowder to bring to the fight. There also exists a possibility for shareholders to submit their own proposals on the general meeting and they can even convey a special general meeting if they have enough shares in their name. The requirements for these actions differ from country to country.

The present situation is still a long way removed from the idea Bebchuk had about shareholders' immediate interference in big corporate decisions. It stays, to say the least, a lengthy process. Renneboog and Szilagyi (2010) confirm the usage of the proxy process by shareholders as a valuable monitoring tool and a disciplinary mechanism. They even prove the existence of positive stock price effect because of the proposals announcements in the proxy statement. Granting shareholders more rights results in higher firm value, profits, sales growth and fewer corporate acquisitions (Akhigbe, Madura, and Tucker, 1997; Gompers, Ishii, and Metrick, 2003). The presence of shareholder activists in a company influences the management to maximize shareholder value (Klein and Zur, 2009) and induces a raise in payout, operating performance and CEO turnover (Brav, Jiang, Partnoy, and Thomas, 2007). Campbell, Campbell, Sirmon, Bierman, and Tuggle (2012) show significant positive reactions on the raise of shareholder influence over the directors' nomination process. That reaction was also economically beneficial.

Not everyone believes that shareholder power is a good idea. Although it has lost the bad reputation it had years ago, (The Economist, 13th Feb 2014) there are still enough people criticizing it. For example institutional shareholders might not always have the firm's best interest at hand, but instead may have a hidden agenda of their own. This hidden agenda can conclude a search for more power, politics, a personally beneficial merger or acquisition and so on (Black, 1998; Bainbridge, 2006; Strine, 2006;

Prevost, Rao, and Williams, 2008). Others believe that not all shareholders have enough 'business' knowledge to make adequate choices. That their competence is questionable (Lipton and Rosenblum, 1991; Bainbridge, 2006; Strine, 2006). Also the usage of proxy proposals was called into question. That is mainly due to the non-binding nature of the proposals. That makes them, according to some, non-effective as a control mechanism (Gillan and Starks, 2000; Prevost and Rao, 2000).

In recent years I can only conclude that legislature seems to consider shareholder activism as a force for good. Both in the USA as in Europe there have been new initiatives to return power and decision making to the shareholders, to grant them more rights. A shared idea that the two economic superpowers have is to reinforce the shareholders through extending the possibilities of proxy voting. In 2010 The SEC gave its approval to a new proxy access rule. The purpose is to facilitate the large long-term shareholder (holding more than 3% shares for more than 3 years) influence the nomination process, by letting them directly nominate potential directors.

In April 2011, The European commission released a green paper on (among other things) shareholder activism. In the paper they express their vision on shareholder engagement: "Shareholder engagement is generally understood as actively monitoring companies, engaging in a dialogue with the company's board, and using shareholder rights, including voting and cooperation with other shareholders, if need be to improve the governance of the investee company in the interests of long-term value creation." As a part of shareholder democracy, they should not incur any cost while voting, regardless their geographical location. The green paper addresses that problem by demanding an increase in cross-border share ownership and voting rates by cross border shareholders, but also a decrease in cross-border voting costs (Rose, 2012). The green paper reveals that on the one hand the European Commission considers voting and high voting turnouts as important corporate governance features. On the other hand they also realize that the use of proxy advisors can be dangerous and as such they demand transparency (Van der Elst, 2011A). The commission specifically mentions the role of institutional investors in the markets. The green paper accuses them of only thinking on the short term and gives shareholder activism as a realistic solution (Van der Elst and Vermeulen, 2011).

These guidelines were initiated some time ago with The Cadbury Commission. They asked the institutional investors to be more active owners, to have contact with management on a regular basis and to be fully aware of their strategy. Because they had the power to do so (Rose, 2012).

Not everyone agrees that shareholders are in need of a lot of legislature. Some argue to hand shareholders the freedom and to not constrain them with a weighty legislature (The Economist, 7th Mar 2013).

WHO IS AN ACTIVIST?

A significant amount of activists are institutional investors, which is not a big surprise as they have large resources and the possibility/the need to wait for long-term value. The best way to redeem their long-term obligations is to be actively involved in their target firms (Van der Elst, 2011A). Examples of that kind of investors are hedge funds, pension funds, sovereign wealth funds and insurance companies. In Renneboog and Szilagyi (2011) sample of 2800 proposals and more than 2000 (non-) target firms between 1996 and 2005, union pension funds accounted for one third of the proposals.

Individuals are another big group. A great example is the ‘corporate gadfly,’ a person who invests in a lot of companies and tries to induce change through the use of shareholder proposals. In the Renneboog and Szilagyi (2011) sample individuals were responsible for just under 50% of the proposals.

Labour Unions can also buy-in in their own company and try to influence the course of their firm.

Minority shareholders in general do not have the resources to actively threaten management. This does not mean that they cannot collaborate with other investors and form voting blocs.

WHAT DO THEY TARGET?

The literature shares the opinion that activists target large underperforming firms (Karpoff, Malatesta, and Walkling, 1996; Martin and Thomas, 1999; Smith, 1996). Favourable characteristics are low leverage (Cziraki, Renneboog, and Szilagyi, 2010) (Becht, et al. 2008), a poor governance structure (Renneboog and Szilagyi, 2011) and a possibility of successful engagement and a realistic opportunity to make a 20% difference in profit with the target firm (Becht, 2008).

One of the biggest threats shareholder activists are facing in the future is that the supply of underperforming, bad-governed firms would be insufficient for the present activist. This is positive on the one hand because it would imply that (among others) shareholder activism has made companies more alert and focused on the shareholder value. On the other hand activists can start targeting well-running firms, which could have bad consequences. Shareholder activism would no longer be perceived as a positive reinforcement (The Economist B, 7th Feb 2015).

WHAT DO THEY DEMAND?

Cziraki et al. (2010) divide activist demands in nine categories: (i) election or removal of directors; (ii) corporate governance issues; (iii) pro-management loosening of corporate governance; (iv) asset restructuring; (v) capital structure; (vi) payout policy; (vii) corporate social responsibility; (viii) routine issues related to the general meeting; and (ix) other miscellaneous issues. While Ertimur, Ferri, and Stubben (2010) remain with five categories of proposals based on their content: Board, Defence, Executive Compensation, Shareholder Rights, and Others. Gantchev (2013) used 1164 hedge fund campaigns in the period 2000-2007. He prefers a separation in four categories: Strategic direction & alternatives (55.56%), Capital structure (19.84%), Opposition to a proposed merger (12.50%) and Corporate Governance (12.10%). The main four groups of Renneboog and Szilagyi (2011) consist out of: Antitakeover issue (35%), Executive compensation issues (22%), Board issues (18%), Voting issues (13%). The categories named across the different literatures are heterogeneous. I can even find discrepancies in the weight of the same categories. Of course these enumerations are not exhaustive and behind closed doors the variety of demands will be more exotic.

FINANCIAL AND SOCIAL

Whether shareholder activism is financially beneficial remains an open question. To start off I must define who is asking the question. For the activist there can be an extensive cost (referring to the price tag that comes along with a proxy fight). Gantchev (2013) did research about the cost of shareholder activism. He concluded that on average the activist investor that has to go through a proxy fight barely makes a break even. Becht, Franks, Mayer, and Rossi (2008) retrieve significant profits for an activist hedge fund, for the majority gained through private talks with management. In a more recent study Becht, Julian, Jeremy, and Hannes (2014) also find abnormal returns on hedge funds activist engagements and this over three continents (Europe, North-America and Asia). From the stakeholder's perspective there is a positive correlation between shareholder proposals and stock price augmentation (Barber, 2007; Renneboog, and Szilagyi, 2010).

A big financial obstacle for shareholder activism is the free rider problem. That displays itself in the cost incurred by the activist while fighting for their demands. The other shareholders benefit (free ride) from the raise in shareholder value and do not face any of the activist's costs. Also other shareholders like the creditors of the firm react positive on more shareholder activism. To be more specific they benefit when shareholders have more power concerning the director nomination (Campbell, 2012).

Shareholder activism does not always have a financial objective. For some activists the social objective is far more important (Judge, Gaur, and Muller-Kahle, 2010). However this does not mean both objectives cannot be attained (Cespa and Cestone, 2007). Other researchers deem social activism as 'poor' activism, stating that it would be the responsibility of the government, the agent for correcting market imperfection (Woidtke, 2002).

In practice the story of a shareholder activist is one of success. The activist institutional investors or individuals take up about a 5% share in a company. From that position they try to influence management/board of directors/other shareholders to collaborate and create more shareholder value (The Economist A, 7th Feb 2014).

GEOGRAPHICAL DIFFERENCE

Although we are living in a world where globalisation is an important evolution, a majority of the literature mentions a significant geographical difference. In the past decades, shareholder activism has already been a very popular phenomenon in North America. Currently it is gaining more and more popularity in Continental Europe (Sudarsanman and Broadhurst, 2012). The spread of shareholder activism is mainly through the American investors taking their customs and practices with them to other European companies. Although it reaches even further, an example being Nigera (Adegbite, Amaeshi, and Amao, 2011).

In general the Anglo-Saxon model (UK & US) is more acceptable for shareholder activism. The reasons therefore being corporate dispersion and clear defined shareholder rights. The continental European model differs a lot with concentrated corporate ownership, significant differences in between countries and weak rights for shareholders.

DIFFERENCE IN CORPORATIONS

There is a lot of difference between companies/countries mostly because of the corporate ownership. This is also country bound. Countries with strong shareholder protection have firms with low ownership concentration (Kim, Nofsinger, and Kitsabunnarat-Chatjuthamard, 2007).

Poulsen et al. (2010) explain that in firms with dispersed ownership activism becomes politics. Shareholders have to form coalitions and as such collect support from their colleagues.

VENTURE CAPITAL

In an early stage all kinds of benefactors support non-listed firms, one of the principal being venture capitalist. They give capital for the company to grow and in return perform their activism mostly through the board where they demand an appropriate amount of directors. In the board they want to offer their knowledge, experience and network to the company, to help them grow (faster). This information can exist in multiple formats. Busenitz, Fiet, and Moesel (2004) found that marketing and strategic learning aids did not make a significant difference in the venture LT growth. Penalizing firm performance through firing management had a negative influence and procedural fairness between the venture capitalist and the management had a positive impact. In other words creating processes to ensure faire decision-making and create fair information exchange would help the firm grow.

An important part of shareholder activism is that the returns also follow out of the actions performed after buying the stock and are not only derived from stock picking. This is also the case for ventures. It is mostly in the short term that the venture capitalist can add a lot of management expertise (Baum and Silverman, 2004). This gives the venture the chance to get on its feet. If the venture capitalist has chosen well, that is the most important thing to help the venture on their way to become a profitable firm.

BOARD OF DIRECTORS

The board of directors officially are the representatives of the shareholders. They should find the optimal corporate decision while respecting all (competing) shareholders (Ingley and van der Walt, 2004). Shareholders need the board because (for most listed and some private companies) there are too many shareholders to make decisions efficiently. As such the shareholders elect directors to speak on their behalf and to monitor their employees, the management.

A very important question in modern economy is: to whom is the board responsible? There are two big schools of thought concerning this topic: shareholder primal or stakeholder. According to the shareholder model, the shareholders are the owners because they bought a piece of the firm and the firms' mission should be to maximize shareholder value. The stakeholder model claims that the firms have become so huge (having more revenue than some countries GDP) and global that they are partly responsible for everyone having a 'stake' in them. This can be the local economy, environment, creditors, clients, workers and so on. For them, the objective of a firm is to maximize the stakeholder value.

I am more inclined to the enlightened shareholder vision. It is a compromise between the two earlier mentioned extremes. The shareholders own the company that must maximize shareholder value. But a part of this shareholder value is the social cost that they incur if they neglect their stakeholders. In summary, if one wants to maximize the shareholder value, the stakeholder value is already enclosed.

The board of directors should represent the shareholders and monitor the executives. A problem occurs if these directors get their job through management, which is the case for the majority of directors. Because of this nomination the directors are no longer truly independent. Numerous articles and guidelines have made this constation over the last decades. Legislature is trying to make board accountable for their actions towards the shareholders.

Principle 8 of the Global Corporate Governance Principle (ICGN, 2009) entails: "Boards should do their utmost to enable shareholders to exercise their rights, especially the right to vote, and should not impose unnecessary hurdles"; voting-

related rights whereby the exercise of ownership rights by all shareholders should be facilitated; and shareholder rights of action such that shareholders who are treated inequitably have rights of redress.” The directors should pursue long-term value. Within this value lies not only the shareholder value, but also the stakeholder value. (Malin and Mellis, 2012) One should not forget that an efficient board of directors is the driving power for a better-governed company. They are in the position to commence reforms for the better (Ray, 2005).

Monitoring by an independent board of directors is seen as one of the three primary mechanisms to induce a reduction in firm value’s residual loss (together with the external market for corporate control and incentive alignment through executive compensation) (Campbell, Campbell, Sirmon, Bierman, and Tuggle, 2012; Leblanc, 2013). Independent directors encourage more transparency / lower information asymmetries (Felo, 2010; Goh, Lee, Ng, and Yong, 2014), higher CEO turnover (Laux, 2006) and more shareholder rights (Kim et. al., 2007). An independent director that stays independent can be beneficial for the information symmetry between bigger and smaller shareholders (Wang and Chiu, 2013). Most of the time, shareholders only have the option to choose the directors recommended by the management, which does not benefit the independence of the board.

There can also be dissertations found that do not detect a significant correlation between board independence and firm performance. Fernandes (2005) found significant evidence concerning an executive board encountering less agency problems and Sivaramakrishnan and Kumar (2007) take note of decrease in shareholder value when the board becomes more outsider dominated. Volker (2006) encounters negative effects when having a very independent board. He states that the board is very active, but lacks effectiveness.

One of the main means to improve the board of directors’ independence is the composition. According to the European Corporate Governance Service Board of Directors report from 2014, a ‘good’ board composition bears the following characteristics:

- Board size between 8 – 16 members (not the case for 22% of the European companies)
- Board chairman cannot carry (or have carried) any executive tasks in the company (only a fact for 43% of the companies)
- Rate of the independent directors in the board should exceed 33%. (checks out for 81% of the companies)
- Audit committee should exist for 50% out of independent directors.
- 20% of the directors should be feminine. (36% of the companies fail to manage the threshold)
- Average seniority of directors should not exceed 12 years.

There also exist other features that entail a bad corporate governance structure. One of the most important ones is the staggered board. A staggered board structure guarantees that every general meeting only a certain percentage (a class) of the directors can be replaced. This structure is put in place to protect the firms from being acquired in a hostile fashion. It does have some externalities. The most important negative externality is that the directors can avoid immediate consequences from their behavior. Hence the board decreases their responsibility against the shareholders. A staggered board ultimately reduces the firm value (Bebchuck, Cohen, and Ferrel, 2009; Cohen and Wang, 2013).

Earlier it was mentioned that the board of directors is the firms' monitoring body. Nowadays more and more institutions raise the question whether the board of directors themselves should not be monitored in a more appropriate fashion. In a perfect situation, shareholders would monitor the board. In the real world this is not a given: theory and practice are two different worlds. Past decades, the only monitoring present was located internally: directors evaluated themselves, and in some cases also their colleagues. Modern corporate governance guidelines worldwide now advise to implement external control for the board of directors (Shultz, 2012).

BELGIUM

In Belgium, the annual general meeting is no longer seen as the supreme body of a Belgian public limited liability company. The residual powers shifted to the board of directors (Van der Elst, 2011A). The country that lies in the center of Europe has (as most European countries) a corporate governance code. This code consists of nine main principles, with the latest revision in 2009. The fourth principle of the code emphasizes the importance of a “rigorous and transparent procedure for the appointment and evaluation and its members.” Within this principle, the committee gives more detailed guidelines. 4.11 for instance: “Under the lead of its chairman, the board should regularly (e.g. at least every two to three years) assess its size, composition, performance and those of its committees, as well as its interaction with the executive management.”

While the Belgian Corporate Governance Code is made for a listed company target audience, there is also a code for non-listed companies. Code-Buyse II is a good enumeration of guidelines. The code mentions the importance of an active board of directors and the presence of outside directors among many other things.

BELGIAN CORPORATE MARKET

This section is, arguably, one of the most important parts of this literature study. Geography is a significant factor when discussing aspects of corporate governance. There exist considerable differences between common and civil law, insider and outsider structures, corporate landscape, ownership structure, culture and so on.

Van der Elst (2011A) thinks that the different classes of shareholders (which is one of the big characteristics of the continental European system compared with the Anglo-Saxon system) show a different outcome in voting engagement. Ownership concentration and structure influence this voting engagement as well.

Belgium is an insider-dominated system. The Belgian companies have a unitary board system. Shareholders in Belgium do not receive a very thorough protection. They do not have as many rights as other developed countries. Belgian companies one can find a significant amount of pyramid structures, shareholder agreements and shareholders within the same company with different rights (Becht, Chappelle, and Renneboog, 2003; Van der Elst, 2008). This is in line with the findings about continental Europe, where there is a high level of ownership concentration (Barca and Becht, 2002) and where shareholder's interest is not the firms' highest priority.

At the general meeting shareholder's voting turnouts are significantly different because of the companies' ownership structure. In general, Belgium has low turnouts, certainly for small shareholders, and a lot of items on the agenda. Van der Elst (2004) monitored Belgian listed companies' annual meetings during a decennium (1994-2003). He came up with an average of 57,2% share representation and 38 shareholders attending the general meeting.

Large shareholders that have control over more than 50% of all the votes can be found in half of the Belgian 'Bel-20' firms. The largest shareholder in a company has an average of 42 % shares. In the other European countries the averages lies between 20-30% (Van der Elst, 2011A). Belgium scores the highest in Europe concerning the average voting bloc, which is created by the largest shareholder in the company (Van der Elst, 2008).

Belgium has weak shareholder rights and reaches a high ownership concentration (Kim et al. 2007). Over the years, shareholders have been receiving more and more rights. From having just 20 different shareholder rights in 1994, up to 25 in 2005 (Van Der Elst, 2010). The corporate ownership dispersion has also been augmenting from the start of the new millennium (Van der Elst, 2008).

The ownership structure in Belgium has changed from a majority of non-financial entities in 1995 to a more dispersed structure of individuals, foreign investors, financial and non-financial entities in 2005 (Van der Elst, 2008). Family shareholders play a very important roll in Belgium. The percentage of family-owned companies is the largest in Europe (Hodgets, Luthans, and Doh, 2007).

Foreign control over listed firms has been growing slowly, but steadily. In Belgium, about 30% of the largest stakes (exceeding 5%) are from a foreign origin. Half of the companies listed in Belgium have at least one big (+5%) foreign investor. From these foreign investors, 20% are the controlling shareholder. These foreign investors include Belgian families that invest through Dutch trusts as well (Van der Elst, 2010).

With the result previously mentioned, there can be concluded that Belgium is not the perfect example for corporate governance. It has a structure of highly concentrated ownership. This used to be mainly attributed to Belgian family patrimonies, but in recent decade foreign investors replaced these families. Nonetheless, the Belgian families still own a lot of power. On top of that, the voting turnouts are very low, even for European averages.

POWER

Plato once wrote: “The measure of a man is what he does with power.” History has shown us that power can be put to good, but just as well can be used for non righteous ends. Hence what would the concept of power induce in a large shareholder or a director?

Power is a function of dependence. One does only have power over another person when that person depends on him. This can be translated to a business environment. The management needs the (large) shareholders for capital. Hence shareholders have power if they wish to seize it.

I must be careful not to mistake power for leadership. Leadership focuses on the downward influence upon followers, power does not. So is shareholder activism more power or leadership? Every shareholder activist has some kind of power, but only the ‘right’ activist is a leader. Shareholder activism helps the firm as well as the shareholder activist. The objective does not only consist out of one hundred per cent selfish reasons.

The power of a shareholder originates from multiple origins. A shareholder has **formal power** because of:

- Coercive power: A power that is dependent on fear for the negative results due to noncompliance
→ Board or management afraid of being fired
- Reward power: Compliance achieved based on the ability to distribute rewards that others view as valuable.
→ Extra bonus/remuneration.
- Legitimate power
→ Shareholder rights

(Robbins and Judge, 2013)

AGGREGATE

In a perfect market shareholder activism towards the board of directors would be redundant as it is in the directors' mission to represent and protect the shareholders' interest. This however is not the case. In this section, I will give a detailed summary of the different actions a shareholder activist can initiate to influence the board of directors.

An activist has two choices when he wants to influence the board of directors, these are made in public or behind closed doors. Both approaches have their advantages and disadvantages.

PUBLIC

The scenery for a public approach is the annual general meeting of the company. It is the place where shareholders can vote on proposals and submit their own shareholder resolutions.

Voting

One of the most powerful weapons a shareholder possesses is his right to vote. This can be used to back a proposal they like or to oppose a proposal they think is not beneficial for the firm.

The voting turnout is a first very important factor for shareholders. A factor that positively influences the turnout is the election of director. The turnout differs the most in response to the ownership structure. Concentrated ownership will create a higher turnout, but there is a difference between large and small shareholders turning up for a vote. A shareholder generally shows up for a general meeting only when he thinks he can contribute something. As such large shareholders will be more inclined to participate in the general meeting. When the large shareholders in the firm are families or non-financial entities, small shareholders will show up in fewer numbers. In family-owned corporate Belgium that results in a 12% attendance of small shareholder in 2010 (Van der Elst, 2011B).

The last decade the most important shareholder's right has received some extra support. The addition of facilitated proxy voting in most legislatures gives the demands of shareholder activist more strength. Hence they are in a better position to impose their influence on the board of directors. Van der Elst (2011B) shows that the majority of large shareholders attend the meetings in form of proxy voting.

Proxy voting also has a lot to do with the ownership structure. Whenever the ownership of a firm is more concentrated, the degree of proxy solicitation diminishes (Cziraki, 2010). This is rather logic as firms with more dispersed ownership will utilise proxy voting as a mean to connect several (smaller) shareholder blocs within the company.

Proposals

Activist shareholders have more tricks up their sleeves than simply voting. They can also submit proposals themselves. These proposals have control benefits over the board of directors and management (Renneboog and Szilagyi, 2010). Literature tells us that shareholder proposals do not receive a lot of attention in Continental Europe. Cziraki (2010) found that in Continental Europe the voting support for shareholder proposals averaged only 21,1% of the votes. However, this is already some progress compared to previous years. The amount of proposals and the voting on these proposals have been inclining since 2003-2004.

Different attributes incur different effects on the proposal success. The type of the proposal and the shareholder pressure are the main factors. Targeting the board has the highest success rate of all proposals (Cziraki, 2010). For the shareholder pressure, the main determinants are the outcome of the vote and the power of the shareholder proposing (Renneboog and Szilagyi, 2011). The proposals have a higher success rate when there is a bad corporate governance structure present, for instance an entrenched board (Ertimur, Ferri, and Stubben, 2008). Financially, there are also consequences applicable on shareholder resolutions. If they do not pass, they will bring negative stock price effects with them (Cziraki, 2010).

If shareholders resolutions pass a shareholder vote, the board of directors will have to enforce them for the majority of the European countries. That is not the case in the US. These non-binding proposals have an advisory role, which might be enhanced when there is a significant conflict of interest between other shareholders and the

activist (Levit and Malenko, 2011). In recent years more than 40% of the non-binding proposals got implemented, which is a considerable raise compared with the end of 20th century (Ertimur, Ferri, and Stubben, 2010). The main decisive factor for the board to pass a non-binding proposal is the voting outcome. When companies do not implement the proposals, they risk being put on a focus list or to receive a lower corporate ranking (Renneboog and Szilagyi, 2011). Levit and Malenko (2011) attribute that non-binding votes are more effective than binding votes, because of the sturdy threshold binding votes offer. This threshold does not adapt to the nature of the proposal. While non-binding votes offer a variable threshold, with the main value being the addition to shareholder value.

Appointing directors

More shareholder influence in appointing directors brings along a positive reaction concerning the firm value. This effect is stronger for boards that are more dependent and closer aligned with management boards (an example being the earlier mentioned staggered boards). The effect is also stronger when there are more shareholders that can participate in the nomination process through the ownership structure (Campbell et al., 2012). In the majority of the companies it is the management who plays a rather important role in the selection of directors (Shivdasani and Yermack, 1999). Henceforward, these directors have a loyalty towards the management. Though, this loyalty should lie with the shareholders (Chidambaran, Liu, and Prabhala, 2010). In America the SEC allowed shareholders who have at least 3% of the shares for at least 3 years to nominate their own candidates (Campbell et al., 2012). Giving shareholders the right to nominate their own candidates, has a positive effect on the firm value (Ryan, and Schneider, 2002) and it also gives the board more incentives to serve the shareholder's interest (Latham, 1999). The raise of shareholder interest in the board of directors induces a board with a more ethical representation (Ray, 2005).

A shareholder can endorse a proposal with his vote. Another tactic is to commence a 'vote-no campaign'. The intent of such a campaign is to oppose an election of one (or several) director(s). In practice, a shareholder actively propagates against an election, achieves it and tries to make sure the election does not achieve a necessary majority (Del Guercio, Seery, and Woitke 2008).

PRIVATE

Communication behind closed doors has a twofold effect. It will improve the conversation, reduce the dead weight loss for both parties and the activists will probably get a better personal result. The fact that the conversation occurs behind closed doors also means that the transparency diminishes for the other shareholders and stakeholders. Which is against every solid corporate governance measure.

Because these talks mostly happen in private, the literature concerning this specific topic and its effectiveness is scarce. After the HERMES UK Focus Fund allowed access to sealed information about their operations, Becht (2008) found evidence for shareholder activism to receive abnormal returns. It has been suggested that these returns should not only be attributed to careful stock selection (as most hedge and pension funds do). In addition it should be attributed to the engagement that the fund shows with the firms they invest in. The activist fund manages this engagement mostly by talking in private with executives and as such the article has some onus for the effectiveness of this technique. Concerning Bechts' conclusions, I may not generalise them, knowing that the dissertation is a case study. Not withholding it is very valuable information and probably the tip of the iceberg.

Only when the board and/or the executives reject the shareholder activists' proposals, the information of these conversations will become part of the public knowledge. This case is generally followed by a realisation of the activist threat to start a proxy fight.

RESEARCH QUESTION

CONSTRAINTS

In practice it is not self-evident to gather information concerning my topic. Evidently, I want to have Belgian companies. As I am having a qualitative approach, I do not consider the companies' sector as a significant variable. Hence the company can operate in every sector.

The size of the company has a significant impact on my topic. The shareholder activism utilised in a multinational or in a start-up, can be quite different. The main causes of this difference are the dissimilarity of the ownership structure and the kind of investor the company attracts. Large companies have a tendency towards a more dispersed ownership, which makes it more difficult for shareholders to obtain enough shares to be relevant. They have to collaborate with other shareholders. Their influence will be more indirect. For smaller companies it is more clear-cut. The majority of these companies have a relative limited amount of shareholders. This is logical, as the capital constraint is not as high. These shareholders exert their power in a more direct fashion. For example, they can demand representation by electing their own directors in the board with more ease.

Another difference between companies with different magnitude has to be mentioned. Bigger firms are much more likely to have done an IPO and as such are listed. Smaller companies are reversely less likely to be public. The shareholder activism within a public and a private firm is vastly different. If an investor wants to take a participation in a public firm, he will have to go on the market and buy the stocks from multiple parties. However, this participation in a private firm, by definition, has to be two parties that want to work together.

For our qualitative approach, I will be aiming for smaller companies. Bigger companies could unnecessarily make our research a lot more difficult. In addition, the search for willing parties to conduct an interview with is an utmost difficult task for bigger companies.

RESEARCH

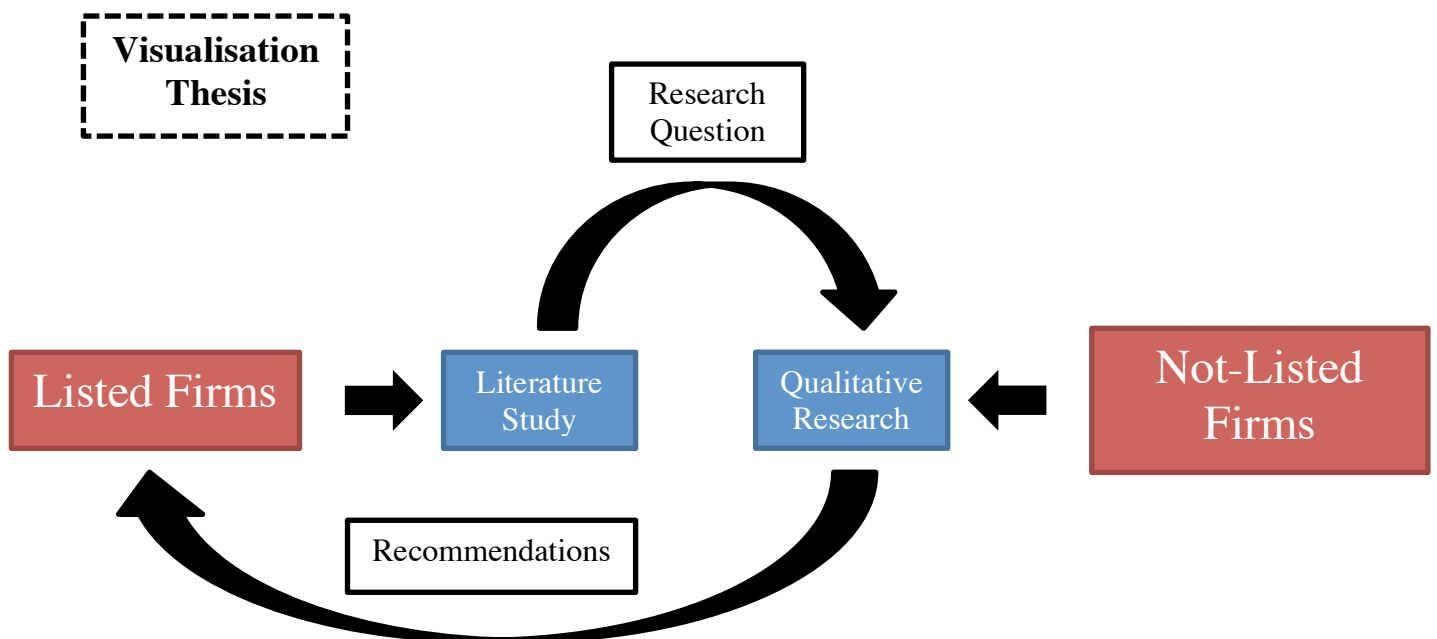
I would like to investigate how shareholder activism interacts with two different factors:

- The kind of target company
- The kind of shareholder (strategy)
 - Main goal
 - Size
 - Experience
 - Investment Horizon

The kind of shareholder will be very important in the analysis. I expect the strategy of a shareholder to have a severe impact on the activism. The difference between having a financial-only goal or a broader mission could be quite significant. This mission is the basis of the strategy and will also be decisive for the kind of influence exercised on the company.

I also expect the target company to be a relevant factor. The financial health of the company will be the characteristic. If the management notices that the company is in trouble, they will probably welcome outside help. They might even be willing to sell at a cheaper multiple. Whilst a financial stable company could be harder to convince and ask for more guarantees or rights.

The majority of this literature study concerns listed companies. The qualitative study talks about non-listed companies. That is where an idea arose for a secondary research goal. Due to my constraints, I endeavour to see what works (best practice) for non-listed firms and which of these practices can be used for listed firms.



In summary, the intention is to extract different manners shareholders use to influence the board and management. Further on, I will try to establish a link between certain influences perceived and the kind of shareholder tactic/target company utilised. Finally, I will look into which of the non-listed practices would be suitable to be used or transformed to a public firm environment.

METHOD

The research will be done in a qualitative fashion. I will select a limited amount (three/four) of subjects. Each subject will be an enterprise-board-shareholder relationship. To assess the situation with the least possible bias, the intention is to conduct three one-hour interviews with the three parties:

- The shareholder activist
- An executive (management)
- An independent director (if existent)

The interviews will be based on a series of open questions. (Annexe 1 & 2) In order to maximize the comparability between the subjects and parties, these questions will be the same for every subject party. There will also be an alignment between the questionnaires of all the parties.

I start off with researching and contacting companies that are active within the Belgian private equity and venture capitalist world, presuming that this party will be the hardest to reach. The interview will not instantaneously specify the relationship between them and a concrete company they took a participation in, for the simple reason this company will not have been identified yet. Instead, I will persuade the person to sketch a general, standard image of how they interact with their participations.

After the first interview with this shareholder I will contact a suitable example where the shareholder had/has a participation in. A suitable example preferably has the following features:

- EXIT already made
- As standard as possible
- Allowed by the shareholder

For the second interview, with the executive, the questions become more focused on the specific relationship the company had/has with their shareholder. With this method, I would like to test whether the general intention of the shareholder's participations is consistent with the managements' perception.

The third interview will only take place if there was an independent director present in the board during the shareholder's participation. This third interview will be conducted to offer me an outsider's look on the influence that the shareholder had.

FINDINGS

SUBJECTS

A structured overview can be found in Annexe 3.

SHAREHOLDERS

Indufin

Kind of shareholder

Private Equity firm (hereinafter PE firm) not working with funds.

Investment Strategy

Indufin aims at firms with a strong management presence; this is their number one condition. The company must have shown profitable results in the past and have reasonable expectations to grow in the future. The majority of growth opportunities are located in internationalization. Furthermore, a heavy indebted situation is not preferred.

Indufin does not have a sector speciality/focus and as such does not have any constraint concerning that area. They aim for a (standard) five to seven years investment horizon. This, of course, fluctuates depending on the specific situation. There is a mid-long investment horizon present in a majority of the PE firms. The ownership structure does not impose any constraints either. For mostly majority stakes, Indufin's investment radius is between three to thirty million euros.

The main goal of the participation is financial. This goal can be combined with social and/or ethic boundaries. Indufin would not sell the participation to parties with bad intentions.

Influence

The shareholder agreement composed and signed at the beginning of the process is one of the most important mean for Indufin to impose its influence. The ground rules are displayed in this document. The main elements consist out of selling rules (exit scenarios), veto decision rules and info sharing rules.

Indufin also imposes their influence through the board of directors. They always demand for at least one director is this board, depending on the specific acquired participation. Indufin uses the board of directors to formalize agreements and decision, but they emphasize an active informal relation. It is, in their opinion, the most important aspect of their acquisition strategy. They support weekly contact between management and the Indufin director(s). By doing so, they create an environment of trust, which aids both parties and is beneficial for the shareholder value as a whole. This is quintessential as Indufin considers five annual board meetings insufficient to govern a firm.

Indufin is not specialised in a sector and because of that they leave the operational side to the management. They do support the management and board through financial incentives. The private equity firm's directors add value through their network, financial knowledge and help concerning internationalisation aspects (recruiting in sales and distribution).

Relation

Indufin's core competence is creating a sustainable partnership with management. They influence their acquisitions in a rather informal manner and contribute through their experience. The interviewee also mentioned that this influence is a two way street. They also get influenced through management and other shareholders.

Other

It is also important to mention that this informal relation, between Indufin and the acquisition, can also have its downsides since the exit stage of the process could be more difficult. It is a phase where Indufin must look after its own interest. This interest does not always align fully with the interests of management and other shareholders.

Indufin's core competences are pre screening firms for a management that is a good match and keeping a sturdy informal relation with them (weekly contact). They contribute in know-how about financials, network and a bit of internationalisation (recruiting) where wanted or needed. They do not mix in with the operational and they do not specialize in a certain sector. They basically create the environment for a firm to continue the work that has already been done satisfactory in the past.

Sofindev*Kind of shareholder*

Private Equity firm with funds

Investment Strategy

Sofindev targets companies with proven growth record, positive cash flows and reasonable potential to maintain this growth. They want companies to be in a solid market position, for example companies within a niche market or market leaders. A significant part of their participations are owner-buyouts. Their participations vary between five and fifteen million for both minority as majority stakes. For Sofindev, it is important to be able to go in (and out of) the participation with already existent management. This is done in order to create continuity in the well performing target firm. Also some structure needs to be present in the target firm.

The investment horizon is mid- to long-term, *i.e.* four to six years. In Sofindev's opinion this is about the length of an entire business cycle after which they would not be able to keep on giving added value. Because of the shareholders structure behind, Sofindev and the use of funds this constraint is quit sturdy, but exceptions are made. As most PE funds their goal is financial, to reach a certain profitability for their shareholders

Influence

Indufin contributes to extra enterprise value through helping the company to become more professional. This is usually done through defining a company's management structure. Current management gets supported, but responsibilities are being further defined and split in order to give everyone the opportunity to excel in their own area. The main reason of this strategy is making the company more sustainable. Since, due to the structure, the company is more saleable, added shareholder value is envisioned.

The shareholder agreement is from utmost importance to Sofindev. In this document they line out almost everything that can happen in the companies' future cooperation with Sofindev. This is necessary because according to Sofindev the exit needs to happen for 100%. Furthermore, veto rules are an important mean to control the

participation. They only support (investment) decisions if these are profitable within Sofindevs' time horizon.

Sofindev demands at least one and maximum four directors on the board. They contribute financial and strategic knowledge through their experienced directors. Sofindev also puts their network at the firms' disposal.

The PE fund only engages in informal contact when it deems it necessary. This includes new client opportunities or investment decisions. If not it confines its influence to the board of directors.

Relation

The relation between Sofindev and the firm or other shareholder is perceived as professional. In a lot of participations, shareholders are at loggerheads with management in the beginning of the process. After a while both parties realize they have the same mission: maximization of shareholder value.

Other

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Sofindev helps promising firms, with an already good track record, reach their full potential as a company, through advice and change in structure. They do wield investment constraints because of their particular horizon. This horizon is imposed because of the use of funds.

Gemma Frisius Fund

Kind of shareholder

Seed Capital Fund

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The fund consists out of three shareholders whom are not that different in their mission. KUL, KBC and BNP Paribas Fortis all see their mission somewhat more ample than only financial. They want a more thriving Belgian economical and scientific landscape. An indication of these intentions is the decision to make the fund go into evergreen modus.¹ The earnings from successful exits are also reinvested in the fund.

Investment Strategy

GFF targets a rather specific group of ventures: KUL spin-offs. They are looking for a good team, able to lead the venture, both technological as managerial. The technology needs to be validated in an adequate fashion. This is to make sure that the risk of bringing the product to market is manageable. Intellectual property is from utmost importance. That is why the 'Freedom To Operate' is significant as patents are from crucial importance with these types of ventures. Market validation is necessary because GFF wants their target ventures to be sustainable. There needs to be a viable customer base and revenue model.

The social goal is from extreme importance because the fund aims at enterprises in a very early stage. This is perceived as too risky for most of the investors, which resulted in a gaping hole in the market.

The fund's investment horizon is rather long-term as it starts with companies at a very early stage, *e.g.* ventures who do not have a final product or client base. They prefer to stay with the company for more then one business cycle.

Because of the fact the fund's contributions are limited, *i.e.* between 50'000 and 500'000 euros, GFF almost always acquires with at least one other investor, this is also to distribute the risk.

¹ A British term that describes a revolving credit arrangement in which the borrower periodically renews the debt financing rather than having the debt reach maturity

Influence

The fund gives added value through two things:

First of all, it helps the team (even before taking a participation) to create a good business and financial plan. It does not only help the fund in the search of financial and technological viable ventures, it also helps the management team. They get feedback from the fund's advisory board on how they can improve their file, to make the way clear for an investment and a potential sustainable future. Both the advisory board and the board of the directors give a lot of added value through their experience and network.

Secondly, GFF is both at the initial process (the majority of spin-offs is done with at least one co-investor) and during the lifespan of the investment an intermediary. They negotiate between parties (*for example* during Exit procedures) and help by raising more capital through new investment round, which is a common necessity for these kind of ventures

In the shareholder agreement GFF tries to emphasise democracy in the venture. They want to insure that the power and control of the venture is located in the hands of one party, *for example* by creating veto-rights.

Relation

The relation between management and GFF is rather good in the majority of the participations. This is a direct result off GFF's social mission. They truly want to help the firm make the most out of it.

Other

GFF supports the use of independent directors, as they believe this independence adds to the value of the firm as is mostly concerns start-ups with very specific non-trivial core competences in niche markets. The fund always tries to save at least one seat on the boards' table for an independent director.

GFF is a very special shareholder that is able to combine a more ample social mission with a profitable margin, while operating in a risky environment of spin-offs. This is mostly due to their experience, contacts with other investors and the support they offer the ventures.

RSQ investors / Quanteus

Kind of shareholder

Private Equity firm

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RSQ Investors is a private equity firm born out of Quanteus, a management consulting with an entrepreneurial spirit. They mostly specialise in finding solutions for promising firms with a history of bad decisions/investments. From that spirit, they decide upon trying to go the extra mile and actually invest in these firms, hence the creation of RSQ Investors.

Investment Strategy

RSQ aims at companies in financial trouble. An advantage of aiming at these kinds of firms is the low multiple, they could be available at. A critical aspect is the acceptance from shareholders and management of the difficulties, and a willingness to do something about it. The companies' turnover should be between ten and fifty million. The firm should have an established position on his market and a clear company structure. The present management is irrelevant as it lies in RSQ intentions to replace them in the short term.

Because they thrive on their value-based handling, the mission is broader than just financial. RSG firmly believes in a stakeholder theory that tries to take into account all parties involved. According to them, they encompass this while acquiring a company.

Influence

Their acquisition process has two important parts:

- Short-term (6-12 months) -> restructure, reach break-even / financial stability
- Long-term -> make it into a sustainable company

If they take a participation, they also take operational control from day one, replacing key management position(s). This enables them do to what they do best: restructuring a company and make it profitable again. This is a hard, emotional process that asks a

lot from all parties involved. The interim manager(s) also get helped and challenged by the board of directors (mostly consisting of RSQ directors).

If the company is financially healthy they search for management replacement preferably from within the company. In this part, the board of director has an even more important roll. RSQ also creates an advisory board, which is their alternative to an independent director in the board. The advisory board consists out of third-party experts in the specific industry. According to RSQ, this is very important because their intention on the long-term is to grow. Lastly, their expertise is very valuable in the pursuit of reaching this goal.

Relation

The relation is also twofold. At the start employees can see RSQ as their opponents because they take away operational control and make tough, but necessary, decisions. When the changes are starting to pay off, employees start to acknowledge RSQ as a force for good. RSQ tries to facilitate this first stage through only selecting firms where the board and management realise there is a distress present.

Other

RSQ does not work with independent directors, but they do rely on a self-created advisory board.

RSQ investors provide a private equity service specialised in restructuring companies with financial difficulties by taking operational control. They envision long-term growth through their directors on the board and through creating an advisory board.

Constatation

After the first round of interviews, I am pleased with the variety the different shareholders offered. It gives me the opportunity to keep a rather ample scope. Between the shareholders, there were some striking similarities and differences.

Similarities

None of the shareholders gave a lot of importance to the annual general meeting. It was considered an obligatory paper exercise. The reason behind this could be the concentrated ownership that I encountered with unlisted firms. The involved investors are mostly limited in number and as such a majority of them has a presence in the board of directors. The place of discussion is reassigned from the general meeting to the board. This has its up- and downsides. It is positive that shareholders do not have to wait one year to react and/or influence the company. This gives them the opportunity to be more reactive, as in one year a lot can happen. A negative point is that the board is less formalised and does not receive the same attention in legislature as the general meeting does. That can invite misconduct by parties whom show a conflict of interest.

Further on, the shareholder agreement seems to be taking a rather (varying with parties) important role. This is an utmost important aspect of non-listed acquisitions and is something new compared with listed firms literature. Many possibilities of shareholder activism are prescribed in the agreement. Hence it is worth to negotiate great lengths for this. The Code Buyse II considers the shareholder agreement as an important element with non-listed firms.

All of the shareholders had a long-term investment horizon. The intention is to keep the stake in the company for at least one business cycle. Hereby it can be confirmed that the actions of the shareholders fall under shareholder activism, as I defined it at the start of the literature study. They truly strive for long-term shareholder value.

The shareholders did not give that much importance to the ownership structure of the target firm. Though it does matter, not one shareholder had an explicit preference, which was not expected.

Finally, every shareholder indicated that the reason for his or her success consists of a mixture between picking the right target as well as influencing this target once acquired (shareholder activism).

Differences

The most important difference between the groups, is the social aspect of their **mission**, their main goal. The two pure private equity funds (Indufin & Sofindev) were very financial, RSQ has somewhat of a social part integrated in its mission: aiming at companies in difficulties. GFF, by far, had the most social mission as it is in their pillars to support the Belgian economy and scientific landscape. These missions also impose a difference in kinds of target firms.



Depending on the focus, some consequences can be derived. Shareholders with a rather financial drive seem to be aiming at financial healthy targets. This could be perceived as the most risk-averse option. With these targets the shareholders do not interfere with the operational component. Hence forward, one of the most important prerequisites is the already existing strong management team, where a partnership can be created. The shareholder activism seems to be contained through their directors. These directors supervise the shareholder interest and try to aid the firm through their network and relevant experience. For Sofindev, this mostly takes place at the board of directors' meetings. Indufin focuses more on the informal contact between the company and its directors.

At the left end of our arrow the Gemma Frisius Fund is placed. They have a clear social trademark. They support ventures before even making the investment. The financial aspect remains a part of their mission, as they also try to be profitable and do not invest in every spin-off. They invest seed capital. As such, the target does not really have much of a venture before the investment. They act out their influence through their directors, but also through the fund as a whole (their advisory board and board of directors)

RSQ investors is located in-between these two extremes and frankly it is a special case. In Belgium, they do not have an equivalent. Their main focus is on restructuring poorly performing firms with potential. Within this focus lies a social point. By doing this, they support the Belgian economy and all the stakeholders of the company. Besides their different target, compared with the other examples, RSQ also has a different way of influencing the company. They do this in a direct fashion, taking operational control from day one. Except for operational control, they also run the board of directors and establish an advisory board. The operational strategy aims at the short term, while the two boards are put into place for future growth.

*MANAGEMENT***Traficon (Indufin)***Kind of company*

Distribution.

The company is specialised in video imaging processing for traffic analysis.

Before

It was a sustainable family company, employing 80 people and having good financial results. They were present within a niche market with only a handful of big players globally. The main revenue stream came from exporting.

The shareholder structure consisted out of the founder, his family and his friends. The founder was quit old and was thinking of quitting. As such a succession plan had to be installed. The founder was still hesitant, but the other shareholders (present as directors in the board) were pressing for a buy-out. Management was ready and eager to take his place. Hence they were actively looking for a financial partner to arrange the succession with.

Entry

Indufin had a competitive offer after several rounds. The informal attributes they brought to the table (not obligatory to show forecast and growth reports every week) also aided in their selection.

The private equity firm wanted the founder to stay present both as minority shareholder (and director) as operational for at least a year. They demanded this because of the firms' continuity. In the shareholder agreement it was described that after one year a succession plan would come into action with the head of sales taking up the CEO roll. Management was not very pleased with this decision; they wanted the founder out of the operational aspect. Furthermore, Indufin had four out of the seven directors in the board. The other three directors were executives: Founder, CFO and future CEO. The discussed time period was long term: around 7-10 years. Finally, they also installed a two year period in which selling of shares would not be possible.

During

The remaining presence of the founder on the operational level resulted in unpleasant situations. The other executives wanted to implement certain changes but the founder impeded them. After the first year, the succession took place and with it, the problems were reduced.

The management-shareholder relation was perceived as pleasant. The shareholders trusted management and had a genuine interest in the company/products. Indufin gave management the freedom to grow. As long as the growth was there, the freedom was maintained. Indufin also offered help with a Traficon acquisition and their financial constructions. The Indufin network was useful to provide the management with business opportunities.

Exit

The exit was executed rather early, after 4 years. There had always been some industrial parties interested in acquiring the firm. After the first bids, which they declined, shareholders and management arranged a meeting where they concluded on a price, when if reached they would accept a bid. Not long after, a bid came from an American industrial party reaching the agreed amount. Management stayed reluctant; because of the possibility of change in culture as the party was a big (3000 employees) company. Indufin applied some pressure; as for them it was a pleasant, profitable exit. Eventually, management conceded because, in the end, the agreed amount was attained.

After

The exit already happened 2.5 years ago. 30% of the employees have quit or have been replaced. For Traficon they remain in process of finding their own place in the concern. They do not truly regret the decision they made, but the 'what if' thoughts are still present.

Other

The choice of keeping the founder present (to guarantee continuity) was deemed a mistake, both for management as Indufin. It made the first year unnecessarily more difficult.

Continuity with shareholder story

Broad strokes add up.

Okapi Sciences (GFF)

Kind of company

Veterinary Biotech

They focus on anti-viral medicines for animals.

Before

It was a professor at the KUL with an idea, but no time on his hands. The idea (anti-viral medicines for animals) was the first of its kind in the world. He shared this idea with a befriended entrepreneur.

This duo contacted the GFF, which aided in finding a necessary extra person for the venture. This person had to add more management talent and he had to be able to work fulltime for the project. Furthermore, GFF also facilitated the demand for licences. In addition, they gave some minimal feedback on the business plan.

Entry

One year after the idea GFF and other investors made the investment. Okapi's management found these other investors, the official GFF support did aid. This support is considered as a necessity when a venture is a KUL spin-off. GFF took a rather small participation.

The board of directors consisted out of nine directors. Eight of these directors represented the different shareholders (one for GFF). There was one independent director who also was a chairman. This was agreed among all parties. The board aided the management in networking and making decision towards investments.

During

A follow-up investment took place that aided Okapi in making a partnership. This is a typical phenomenon for biotech ventures. Their income is zero in the first years because of the lengthy R&D phase.

The relation with GFF was maintained through contact because of new technologies and licences. The fund kept on supporting Okapi.

Exit

From the partnership on, veterinary enterprises started to notice Okapi. To keep on growing the company needed more capital. There were two options: a capital increase or an acquisition by another industrial party.

Acquisition was the preferred choice because the other investors were not ready to offer a realistic valuation. The exit process went very fast between three representatives: Management, Board and Industrial party.

After

GFF kept on acting as a sounding board for potential ideas or investments.

Other

The need for a business plan was not that necessary in this case, two of the three founders had experience in start-ups.

The interviewee expressed that in his opinion it was a missed opportunity that in Belgium the capital increase for a biotech venture could only happen at a far inferior valuation.

The interviewee also had another experience with GFF through his first start-up. After the 'official' interview we talked about this first venture. Within the process of the spin-off, GFF had an explicit role in forming the business plan and as an intermediary.

Continuity with shareholder story

Broad strokes add up. This example was maybe not as typical, but the atmosphere of the other start-up influences was exactly how the GFF told me.

The House Of Marketing (RSQ Investors/Quanteus)*Kind of company*

Consultancy

Market leader in Belgium for marketing consultancy and interim-management

Before

Good operational results, but non-ideal investment in real estate. When the financial crisis came along shareholder structure became more concentrated on associate level and operational results had a small decline. 75% of the shares were allocated with the two founders. An associate owned the other 25%. There were grievances between these two parties. Against these circumstances the founders decided upon trying to find a party to realise a buy-out.

Entry

Quanteus was selected because of the fit of values and corporate culture. It was important for the founders that THOM kept on existing with respect for the continuity of the enterprise. This made them the preferred party although other parties offered a higher valuation.

Quanteus asked the founders to stay on the operational level to ensure continuity. This was not the initial intention of the founders but they agreed as the operational responsibility was transferred to Quanteus.

Quanteus got all the directors in the board and put one of their own in CEO position. There was a plan for a CEO succession after a 'certain' time. This new CEO could be recruited from the outside or from within the company.

An advisory board was created. This board contained the CEO, a Quanteus employee, a THOM employee and two independent marketing experts.

During

Continuity worked out, all clients and employees stayed.

The advisory board was a good intention, but in fact not very streamlined. They did however already add something on the macro level through going on a strategy

weekend with some THOM managers. The advisory board also gives very specific advice towards the operational level. They give advice on specific clients. Some members of the advisory board even have fixed client portfolios.

The biggest influence on the firm is done through the CEO; he also has a seat on the board of directors and the advisory board. The fact that the board of directors only consist out of colleagues within Quanteus does not really add in making the board a more effective control organ. They do not really challenge the CEO or other executives on operational decisions. The advisory board also has some influence on both the macro as the operational level.

Exit

Not really envisioned for this particular case. After 3 years the founders may stop the collaboration, which would translate to the founders not being in the operational level anymore.

After

/

Other

This shareholder–company relation is atypical for RSQ because the company was not in real operational distress. The exit has also not been made. This is because, for the moment, RSQ has not yet realised an exit with any of its participations.

The envisioned intention for the advisory board is to not only use it for THOM, but also for other acquisitions.

As the company is not in real distress the fact that the CEO is still (firmly) in charge strikes as strange. It might have been better to already have a succession plan with timeline arranged at the entry.

Continuity with shareholder story

There are some discrepancies between the influences portrayed by the shareholder and the actions perceived on the working floor. In this specific situation the management, board of directors and advisory board do not operate in the way, as I understood after the shareholder interview.

For the management, the story from RSQ/Quanteus mentioned that they would only have their own management in place to make the firm reach break-even again. If they reach that target they would arrange succession. THOM never had trouble reaching that break-even on the operational aspect and as such the placement of the CEO (from Quanteus) and non-succession seems not to match RSQ's intentions.

The board of director was supposed to lead the company, challenge the operational side and aim for long term growth. The board at THOM has limited influence and does not attain the proposed objectives. The reasons behind this are the strong grip on the operational level, which is still present, and the fact that the board consists out of working colleagues, among them the Quanteus interim CEO.

The advisory board interferes directly with the operational level (clients). This is not how I understood it after the shareholder interview. The advisory board should give an outside look about the company and advise them on big picture things. During the strategy weekend they had seemed more located towards their scope. The composition of the advisory board only had two externals (out of 5 members) and yet again the Quanteus interim CEO. So it does not only consist out of outside experts.

Constataion

This round of interviews had the intention to put into question the stories of the shareholders. I went from the more general intention of the shareholders to a very specific example concerning a company. The question was in which manner these general intentions passed the test in a real environment. How were these intentions translated?

With Indufin and the GFF I can only ascertain that their stories match for these specific examples. A little remark being that for GFF it might not have been the perfect example, but as the interviewee also had experience with the shareholder from an anterior spin-off the stories synced close to perfect.

With RSQ Investors / Quanteus I did see a clear difference between the shareholders' intention and how it actual played out on the work floor. In my opinion, the influence of the organs did not work out perfectly how and when they were planned to do so. The operational control was not necessary for restructuring reasons and certainly not for a prolonged time. Also the role of the board of directors for the long-term growth was not perceived. The advisory board was only for 2/5 independent and also advised on specific clients.

INDEPENDENT DIRECTORS

Unfortunately, only one of the relations had an independent director present, whom was unable to give his view on the process. There can only be concluded that the independent director is not as present with private firms as it is with their listed counterparts. This is most probable due to the (even more) important roll and responsibility allocated to the board of directors to influence the company. I did ascertain that there are other available options *e.g.* RSQ Investors option of advisory boards.

AGGREGATE

TARGET

I observed three different targets:

1. Financial healthy firms with grow prospective (Indufin, Sofindex)
2. Financial weak firms that show promise in case change occurs (RSQ Investors)
3. KUL spin-offs with a valid idea and business plan (GFF)

The first group targets financial healthy firms. This had a clear influence on how they filled in the term shareholder activism. For both shareholders, the single most important document was the shareholder agreement. Basically, this is a blueprint for the entire process of the participation. In this shareholder agreement they want to include measures to ensure the continuity of the firm after the acquisition. The private equity firms steer clear of the operational aspect of their acquisitions. They do demand some (depending on the specific participation) directors on the board. Making sure their interests are being protected. Through these directors they try to aid the company in reaching a maximum growth of the shareholder value. During the literature study, the reviewed articles agreed upon targeting companies in trouble for shareholder activism purposes. The targeting of financial healthy firms is an addition brought through the non-listed firm's environment.

The second group aims for financial weak firms that could show promise. This translates rather clearly to taking over the operational control in the short term. Furthermore, they demand directors and set up an advisory board for the long-term growth.

The third group has a rather narrow field of targets. The targets are not in operative mode at the first point of contact. This translates in GFF's approach of heavily interacting with the spin-off, even before the investment. They offer their network (other investors) and experience with start-ups in order to get the spin-off of the ground. The majority of spin-offs need multiple capital rounds. At those stages GFF also plays an important role as intermediary.

SHAREHOLDER STRATEGY

Our second preliminary question concerned the strategy of the shareholder, once they acquired their target. We have seen some clear differences between shareholders and the effect these differences had on the influence perceived by the company/board. In my opinion, the best way to classify these different strategies is to start from the mission, as I did in the ‘constatation’ section of the shareholders part.

1. Financial mission (Indufin, Sofindev)
2. Financial mission with a social aspect (RSQ Investors)
3. Social mission with a financial aspect (GFF)

To commence, I would like to emphasize yet again that having a financial mission does not mean the shareholder does not have an ethical awareness. This is something all parties possessed in sufficient amounts.

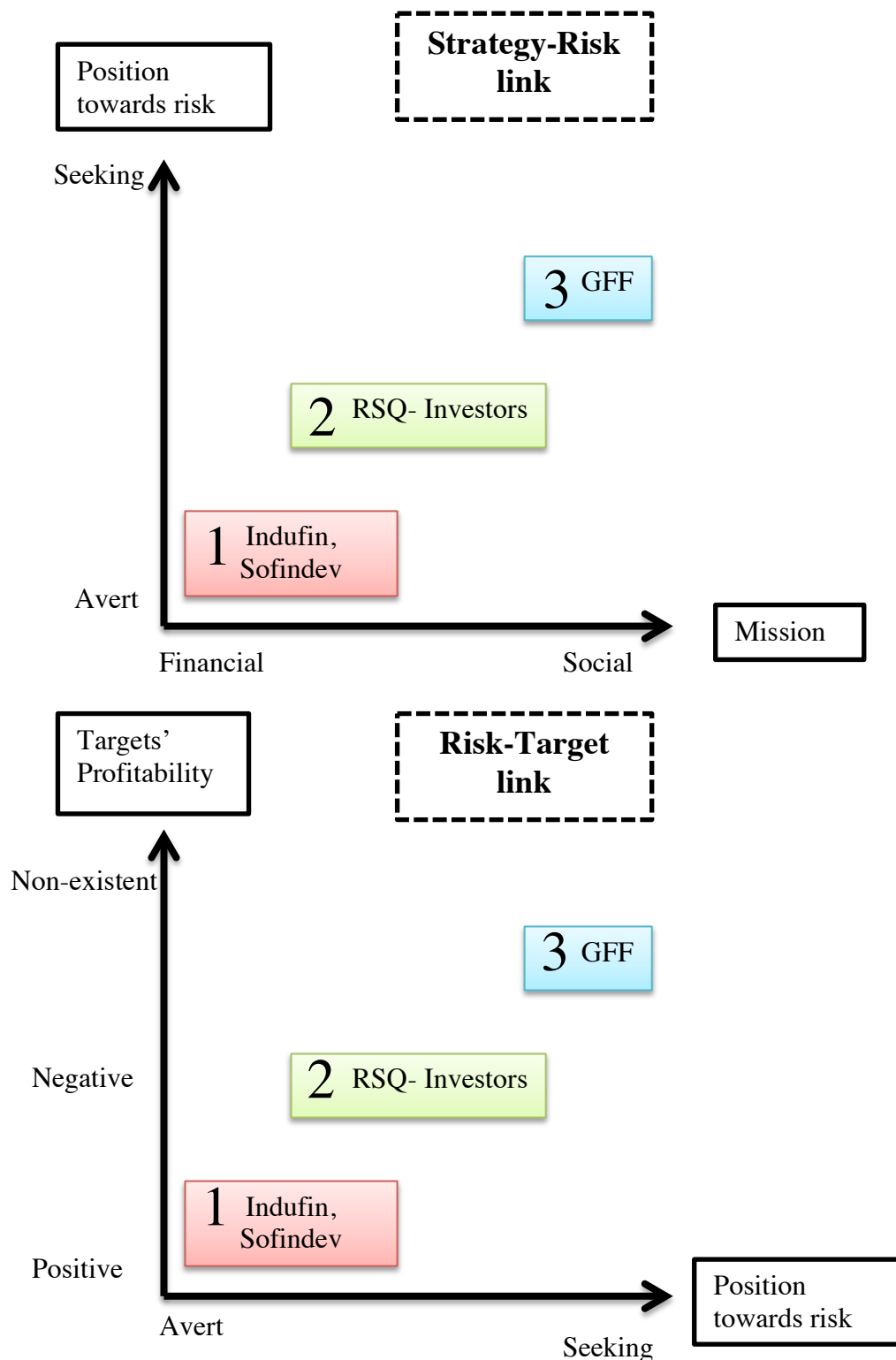
The financial mission translates in relative big investments (3-5 million euros) for a mid- to long-term horizon (4-7 years). They choose non-risky investments, which will most probably result in positive yield, supervised by the board of directors.

The second group acquires more risky ventures that they can acquire at a good multiple because of it. As a part of their social aspect, they ‘rescue’ firms with the intention of making them profitable again. It has to be mentioned that, after the interview with THOM, some doubts arose around the completion of the indented strategy for this shareholder.

Lastly, there are the shareholders with a social mission. They are specialized in very risky early investments, a position with hardly any investors present. They aid their firms in every way possible, composing a main goal that is social in nature. They do have a financial aspect that translates in expecting a positive return from their investments.

INTERLINK

The attentive reader has undoubtedly noticed that a shareholder's strategy and the kind of firms targeted are very much interlinked. They both have an approximately equal and similar effect on the influence exerted on the companies and the board. I can connect the two variables through their position towards risk.



Every group has a specific approach towards shareholder activism. These approaches have been discussed thoroughly throughout the section 'findings'. In summary:

The first group has a hands-off approach. They monitor their interest through their directors in the targets' board.

The second group has an intrusive hands-on approach. They overtake the operational control from day one. They also demand directors on the board and bring an advisory board to live. These actions are compulsory for the target company.

The third and final group offers a lot of means that their targets can use. The influence on the venture can be significant, but it can be close to non-existent as well, depending on the ventures' choice and their need of aid.

LESSONS FOR LISTED FIRMS

After a literature study about the practices of listed firms and a qualitative study about non-listed firms, the purpose is to close the circle through extracting conclusions/recommendations from this qualitative study for shareholder whom deal with listed companies.

If a shareholder is aiming for a hands-off approach, he/she will probably be best of buying shares from a financial healthy company. If the shareholder buys a big enough stake, he can strive for a director in the board to protect the shareholders' interest. In a listed company not a lot of shareholders are in a position to do this, because of the absolute capital needed to get a big enough stack. If they are not one of the lucky shareholders, they will have to be responsible shareholders: attending the general meeting and voting in their interest. This approach is the listed variant from group 1.

If the shareholder has more of an activist in him/her, he/she should aim for a company in financial trouble. However the company must be able to achieve a turnaround when changes are made. Preferably the management and board of the company are aware of the problems and want to do something about it (an important demand from RSQ Investors). Once the stocks are bought, the shareholder activist should endeavour to turn the company around through targeting the envisioned problem. The activist has the choice between all the means mentioned in the literature study. Every combination of management, board of directors and envisioned problem requires a specific approach. When management and the board accept that the current situation is far from ideal, a behind the scene approach can be the easiest and cheapest to execute. When this is not the case, shareholders should take the 'public' means. That could go from simply voting on a certain proposal to a full-on proxy fight. This approach is the listed variant from group 2.

CONCLUSION

What is the influence of a shareholder activist on the board of directors? This was not as straightforward a question as expected. I learned that shareholder activism can be a very ample term and that the difference of this shareholder activism is quite significant in between listed and non-listed firms. Even more important was the encountered gap in literature, concerning shareholder activism in non-listed companies. After exploring the topic of shareholder activism, I identified two factors that might have an effect on the perceived influence. These factors are the target firm & the shareholder strategy.

I found four shareholders with a different placement concerning the two variables. My first observation was the apparent link between my two variables. I deemed 'the shareholders' main goal' as one of the most significant attributes concerning the shareholder strategy. For the target firm a similar reasoning was executed and the 'firms' profitability' was deemed a key attribute for that variable.

I was able to identify a trend among the findings of the qualitative research. Both attributes had a correlation with the amount of risk aversion perceived with the shareholder; this tendency to risk became my intermediary attribute.

The shareholders were split up into three groups. I linked these groups (and their specific attributes) to the kind of influence inflicted on their acquisitions. Based on my observations, it became clear that shareholders with a financial mission were more risk-averse and thus aimed at financial healthy targets. The applied influence is hands-off in nature. The shareholder with a financial mission and social aspect went for targets that were not profitable at that time. By restructuring, the shareholders' core competence, the target could become financial healthy and growing again. The shareholder influenced his targets in an obligatory hands-on fashion. Finally, the shareholder with a social mission and financial aspect was the most risk seeking and aimed at university spin-offs. The influence perceived was the optional hands-on approach.

After transforming two of these groups (the first and the second) to a listed firms' environment, I extracted some lessons from the qualitative study concerning the shareholder activist's options, depending on their initial intentions.

This paper offers an insight into shareholder activism in the private company atmosphere. Furthermore, it connects the shareholders' target and strategy to the influence they exert.

To my knowledge, this is the first research about specific influences shareholders exert on their non-listed companies in Belgium. It could provide further research questions as in which target and/or tactic can be the most lucrative for shareholders.

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ANNEXES

ANNEXE 1 - QUESTIONNAIRE SHAREHOLDER

QUESTIONNAIRE FOR QUALITATIVE INTERVIEW SHAREHOLDER ACTIVIST

Define the **kind of company** u work for (hedge fund, PE, VC) and what **differentiate** the firm from it competitors?

What is your **role** in this company?

What is the **investment strategy**?

- Criteria of target firm
 - Stage
 - Ownership Structure
 - Financial Stability
 - Growth opportunities
 - ...
- Main goal of investment (financial / social)
- Time period (short / long)

How do you **(in)directly influence** the company?(how do u exert the power of your shares?)

- Aid with strategy, operation, finance (Endebtment), ...
- Economies of scope/scale with other investments, synergies
- Pay out Policy
- Remuneration Policy
- Proposals
- Directors in the board
- Voting
- Behind closed doors
- ...

Has the main goal **always been achieved**?

Is this mostly due to careful handpicking of firms or by heavily influencing once selected?

How do u perceive your **relation** with the target companies (management / board / other shareholders)

Does operating in a **Belgian economical landscape** gives your firm (dis)advantages?

Can u give me (a) concrete **example(s)** of a current Belgian investment?

How do u perceive your relation with the company (management / board / other shareholders)

ANNEXE 2 - QUESTIONNAIRE MANAGEMENT

QUESTIONNAIRE FOR QUALITATIVE INTERVIEW MANAGEMENT

Define the **kind of company** u work for and what **differentiate** the firm from it competitors?

What is your **role** in this company?

Can u describe the situation **before** shareholder activist X bought a participation in your company?

- Financial Situation
- Private Situation
- Ownership structure

Why and when did u feel like working together with shareholder X?

Did u **engaged** in contacting them?

Why this **specific** shareholder?

How did the enter **process** go?

- Shareholder agreement?
- Directors?
- Independent directors?
- Time Horizon

Has shareholder X pos./neg. **influence** (improved) the company?

How did he do this?

What was the firms health **during** the process?

How was the relation between **u** and shareholder X?

Between shareholder X and **other shareholders**?

Between shareholder X and **Board** (independent directors)?

How did the **exit** process go?

What was the firms health **after** the process?

How was the relation after the exit?

In **hindsight** are u happy with the collaboration?

Would you have done **anything else**?

ANNEXE 3 - PARTIES SCHEME

	Indufin	Sofindev	GFF	RSQ Investors
KIND	PE	PE	Venture Capit.	Restructuring
TARGET	Strong Mid Size with growth persp.	Strong Mid Size with growth persp.	KUL Spin-offs	Weak performing with promise
MISSION	Financial	Financial	Social with Financial aspect	Financial with Social aspect
AVG. Investment (million euros)	€3-15m	€5-15m	€0.05-0.5m	/
Time Horizon	5-7y	4-6y	7-10y	/
	↓	↓	↓	↓
NAME	Traficon	/	Okapi Sciences	The House Of Marketing
SECTOR	Distribution		Bio-Tech	Consultancy
SIZE	SME		Start-Up	SME
TIME	4y		6y	/
EXIT	Industrial		Industrial	/