



Department of Business and Management
Master Thesis in Advanced Corporate Finance

Institutional Shareholder Activism in Italy

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1. INTRODUCTION

Shareholder activism has been described as “*the exercise and enforcement of rights by minority shareholders with the objective of enhancing shareholder value over the long term*” (Low, 2004). Activists try to influence managers and directors, acting as the catalyst for changes in the strategy and governance of the firms – without seeking the corporate control. Institutional shareholders played and play a prominent role in activism. Traditional institutions as mutual and pension funds started the activism struggle. Specialized hedge funds followed, with superior results. Eventually, activist shareholders have been regarded as a possible source of balancing of the agency problem arising in corporations. In outsider financial systems – as the UK and US – they could be active monitors of the managers; in insider dominated systems (e.g.: Continental Europe) they could balance the power of the blockholders.

Italy has an insider dominated financial system. Blockholders, as wealthy families and the State, control the corporations owning the relative majority of the shares and enhancing their voting power through mechanisms such as pyramidal group structures and shareholder agreements. In addition, the control is shielded thanks to the recourse to *fiduciary relations*, based on friendship or family ties. The level of control exerted by the blockholders is above the European average. A consequence is a weak minority shareholders’ involvement in the corporate governance. A low level of attendance of the general meetings characterizes Italy.

The institutional shareholder activism was covered by extensive US and UK literature. In addition, studies were provided on insider dominated systems. However, concerning Italy, the empirical evidence is mainly anecdotal. One reason could be the fact that institutional investor activism is a relatively new phenomenon for the country.

The purpose of this work would be to understand whether institutional shareholder activism can have a role in a country characterized by an above average control exerted by blockholders. The *rational apathy* of minority shareholders is a further challenge to any activism effort. In order to investigate

the activists' role in Italy, four case studies will be provided. These cases are characterized by a different behavior of the insurgent, ranging from a confrontational behavior to diplomatic or even relational approaches. The observed outcome will be the activist's capability to have an impact on the corporate decisions. Of course, defining causal relations is not easy. What will be investigated is the existence of developments in line with the insurgent's requests and the role played by the activist as one of the possible triggers. The case studies follow a general description of the phenomenon (i.e.: the institutional shareholder activism) and a specific overview of the environment (i.e.: the Italian financial system) that challenges the activists' action.

This work aims to contribute to describe the shareholder activism in insider dominated countries. In particular, Italy has a not large number of specific studies on activism, if compared to the Anglo Saxon countries. The main limit of this study is that it is focused on public campaigns. The existence of public efforts and their impact are meaningful. In addition, public campaigns make enough information available to draft an analysis. However, evidences from private engagements would provide further insights, especially in a concentrated system. Unfortunately, this limit is common in the shareholder activism literature (see: Becht, 2009, 2010).

Structure

Following the introduction (Chapter 1) of this work, Chapter 2 describes the agency problem arising in modern corporations and delineates the role of shareholders. Moreover, the first chapter reviews the relevant literature on the institutional investor activism. Chapter 3 describes the Italian financial system, providing evidences from empirical studies. Chapter 4 presents the phenomenon in Italy, provides the four case studies and their analysis. In addition, recent developments – contributing to shape a more activist friendly environment – are described. Chapter 5 concludes.

2. INSTITUTIONAL SHAREHOLDER ACTIVISM

2.1. The agency problem and the shareholders' role

In 1932, Professors Berle and Means introduced the concept of separation between ownership and control for the American corporations. In their book, *“The Modern Corporation and Private Property”*, they stated that in the largest US companies “[T]here are no dominant owners, and control is maintained in large measure apart from ownership”. They built their theory on the evidence that the ownership was dispersed among many shareholders, with no single holder controlling a larger portion of the company. The corporate control has been delegated to professional managers, creating a principal-agent relationship. An agency relationship is a contract under which the principal(s) delegates some decision making power to the agent(s) in order to benefit of her (their) services. The welfare of the principal depends upon actions taken by the agent. The latter has better information than her principal and her performance is hard, if not impossible, to be monitored. If both parties are utility maximizers, it is likely that the agent would not always act in the best interests of the principal.

Jensen and Meckling (1976), formalized the description of the firm as a nexus of contracts and identified the shareholders and the other stakeholders as principals and the managers as agents of the contractual relationship. The information asymmetries, that tend to give the control of the firm to the management, arise from the collective action problem implied in the dispersion of ownership. Such a dispersion has been defined as one of the central issues in the corporate governance debate. Becht, Bolton and Röell (2002) identified three main reasons for the phenomenon. First, individual investors' wealth may be small relative to the size of some investments. Second, diversification of the portfolio risk is generally the base of asset management. Third, liquidity: investors would find harder to sell a large stake in the secondary market. It follows that investors don't have enough incentives to own large portions of companies. Furthermore, each individual shareholder has an agenda different from the others' and she cannot communicate with all the stockholders. Therefore, a common action is not possible. This means that shareholders tend to not exert their powers

and duties as owners of the company. They behave as passive holders, considering the shareholding only as an investment, rather than feeling also owners of a portion of the firm. Instead, attached to a share of stock there are several rights and obligations. They have been classically defined as: the right to sell the stock, the right to get dividends, the right to the residual claims in the company's liquidation, the right to vote at general meetings, the right to sue for damages the directors and managers if they breach their duties, and the right to ask to and to receive certain information from the company (Monks and Minow, 2008). The last three can be considered the rights and obligations of an active shareholder behaving as monitor of the company's controllers, balancing the power that had been delegated in the hands of managers and directors. An active shareholder would protect her investment and the other stockowners'. Indeed, every shareholder would benefit of her monitoring activity. Here another problem arises because, to the impossibility of a collective action from all the stockholders, it is necessary to add the free riding problem, arising when a shareholder decides to adopt an active behavior. She would bear all the costs and efforts, but the benefits would be shared among the whole shareholders platform. It is therefore clear that the shareholders' monitoring rights and duties could find strong disincentives to be implemented. The owners' responsibility over the corporation is clearly affected. As Berle and Means (1932) pointed out: *"It has often been said that the owner of a horse is responsible. If the horse lives he must feed it. If the horse dies he must bury it. No such responsibility attaches to a share of stock"*.

These conclusions are valid for financial systems characterized by diluted ownership. They should be adjusted when considering countries with concentrated ownership. Indeed, several authors discovered significant concentration of ownership in countries other than US and UK (La Porta et al., 1999; for Italy see: Barca, 1995; for OECD countries: Corporate Governance Network, 1997; for developing countries: La Porta et al., 1998). Furthermore, other studies showed that even in the Anglo-Saxon nations there are examples of a modest concentration of ownership (Eisenberg (1976), Demsetz (1983), Demsetz and Lehn (1985), Shleifer and Vishny (1986)) – remaining, however, Berle and Means

widely dispersed ownership the predominant stockholding model in UK and US (Cheffins and Bank 2009; Monks and Minow 2008).

Worldwide two major types of financial systems exist: the outsider and the insider system (see: Hopt, 2006). Mainly the UK and US belong to the outsider system, characterized by diluted ownership, separation between management and ownership and highly liquid capital markets. To some extent, the rest of the world has insider financial systems, with clear examples in Germany and Italy and in Continental Europe in general. These systems present few big controlling shareholders – usually families or the State – that, thanks to shareholders' agreements and other control-enhancing means, have the power to appoint managers and directors and to exert relevant decision power over the company. In addition, capital markets are almost illiquid and cross-holdings are common. Several Authors provided different explanations of the causes of these differences in the financial systems, also referring to the legal protection of minority shareholders (La Porta et al., 1998) or to historical reasons (Roe, 2003). In the insider financial system an agency problem arises, different from the shareholders-managers conflict typical of the outsider systems and covered by the classical literature from Berle and Means (1932) to Jensen and Meckling (1976) and beyond. When the ownership – and therefore the control – is concentrated in the hands of a major shareholder, the conflict involves this controlling stockowner and the minority shareholders (LaPorta et al. 1999; Johnson et al., 2000; Becht, Bolton, and Roell, 2002; Denis and McConnell, 2003). The majority shareholders are the agents and the minority shareholders are the principals of an agency relationship. Majorities could extract private benefits of the control at the expense of minorities. These shareholders often have control rights in excess of their cash flow rights, through the use of mechanisms as pyramids, and they participate in the management (La Porta et al., 1999). The lack of monitoring by minority shareholders enhances their power and unaccountability. Denis and McConnell (2003) describe two main ways in which controlling shareholders could extract value from the firm. The first is tunnelling. Johnson, La Porta, Lopez-De-Silanes and Shleifer (2000) define tunnelling as the “*transfer of assets and profits out of firms for the benefit of their controlling shareholders*“ expropriating the minority

stockholders. The second is the capability of the controller to appoint the managers and directors. The management is likely to be captured by the dominant shareholder, that in the end would control the strategic decisions of the company.

In both insider and outsider systems, a promising source of monitoring and balancing of the agency problem has been identified in the shareholder activism (among the others see: Black, 1992). Shareholder activism has been described as “*the exercise and enforcement of rights by minority shareholders with the objective of enhancing shareholder value over the long term*” (Low, 2004). Activism refers to the behavior of those shareholders who try to influence managers and directors in order to change the status quo of the strategy and governance of the firm, without seeking the control of the company (Gillan and Starks, 1998). The actions taken by shareholder activists range from private meetings and engagement with managers to public efforts, including letter writing, shareholder questions at general meetings, shareholder proposals, proxy fights and litigation (Pozen, 1994; Partnoy and Thomas, 2006). These investors deviates from the usual behavior taken by shareholders when they dissent with the management. Generally, shareholders choose the “*exit*” (i.e. the sale of the shares) rather than the “*voice*”, following the so called “*Wall Street Rule*”. This approach considers the transferability of the shares as the only real right of the shareholder. In the case that an investor is dissatisfied with the management of the firm, she has one only way to send a message of disapproval: selling the shares. If a big enough block of investors would “*exit*”, then the stock price would decrease until making the company a potential takeover target. Managers have an incentive to act in the best interest of their principals in order avoid the risk of being replaced as a consequence of a takeover (Manne, 1964; Shleifer and Vishny, 1986). Opposite to the “*Wall Street Rule*” approach, there is the belief that the long term value of the firm would benefit of some long term investors – with interests aligned with those of the company, acting as monitors (Porter, 1992; Monks and Minow, 2008) ¹.

¹ In addition, critics of the “*Wall Street Rule*” say that it would work only if, in the end, shareholders can sell to a buyer able to take over the company, replace the managers and govern the firm in the best interest of its shareholders (Epstein 1986).

2.2. Institutional investors and activism

The origins of shareholder activism can be identified in the 1980s takeover era. Corporate raiders have been seen as the closest antecedents of the modern activists. Raiders adopted innovative financial technologies to take over poorly performing firms and make profits by restructuring the acquired targets. While the market for corporate control was the central issue for corporate raiders, that is not true for activist investors, who don't seek to obtain the control of the firm, but to prompt value enhancing changes by enforcing the rights deriving from their minority position (Gillan and Starks, 1998). However, Bethel, Liebeskind and Opler (1998) found that a relevant portion of the 1980's corporate raiders performed block purchases in underperforming companies aiming to improve performance and encouraging change. At the end of the 1980s, the hostile market for corporate control settled down and a new era came: mutual and pension funds took the field in the activism struggle – with mixed results. In 2000s, a further wave of activism hit corporations: a niche of specialized investors began targeting underperforming firms with the purpose of extracting value through shareholder activism, exploiting the legal and financial advantages of an effective vehicle for activism, the hedge fund.

2.2.1. Traditional institutional investor activism development and effects on firm performance

Since the 1970s, institutional investors such as public and corporate pension plan managers, insurances and mutual funds, have steadily grown their equity ownership – in the US market and in the rest of the world. Theoretically, they have been considered the ideal monitors in the corporate agency relation (Black, 1990; Roe, 1991). As Monks and Minow (2008) pointed out, the value of the rights embedded in the ownership of a share has become really clear just when a new category of investor came into existence, sophisticated enough to understand and to deal with these rights, fiduciary obligated to exercise them if it was prudent and necessary to protect their clients' interests, and big enough to have an impact when exercising them. According to Gillan and Starks (2000), institutional activism expanded heavily in 1986 and 1987 as large US pension

funds – as the California Public Employees Retirement System (CalPERS) and the California State Teachers Retirement System (CalSTRS) – and other institutions began to submit shareholder proxy proposals, both individually and in collaboration. Gillan and Starks (2000), Kahan and Rock (2007) and Klein and Zur (2008), identified two phases of mutual and pension funds activism. A first phase was characterized by a non-confrontational use of shareholder proposals aiming to introduce changes in corporate governance. The voting issues ranged from the abolition of antitakeover provisions to the adoption of cumulative voting and greater board independence. Generally, these proposals were unsuccessful and met with indifference by the market (Gordon and Pound, 1993; Wahal, 1996; Del Guercio and Hawkins, 1999; Gillan and Starks, 2000). In the early 1990s, large pension funds modified their approach beginning a more sophisticated phase of activism. They started to engage in private negotiations with corporate executives and also launched public campaigns to influence corporate policies. These public efforts were characterized by a large use of the media to involve other investors and obtain their support.

The shareholder activism model implemented by traditional institutions – mainly pension funds – had small effects. Karpoff (2001) stated that it caused only small improvements in the corporate governance of the targeted companies and no measurably effect on stock prices or earnings. Del Guercio, and Hawkins (1999) studied the impact of pension fund activism on stock returns and accounting measures of performance in three years following an initial targeting: they found no significant effects in the medium-long term and only non significant small improvements in the short term. In their surveys, Black (1998), Karpoff (2001), and Gillan and Starks (1998) summarized the empirical evidence that pension fund like activism was not firm value-enhancing. Activism by traditional institutional investors is continuing to a limited extent until today, but it left the primary role in the governance debate to the activism of the hedge funds.

2.2.2. Hedge fund activism development and effects on firm performance

During the 2000s hedge funds emerged as activist, intensifying their interventions on target companies. They usually invest in few undervalued firms, owning relevant minority stakes and engaging with the company to obtain changes in the governance or strategy. Hedge funds specialized in activism have been categorized under the event-driven hedge funds category². These funds increased almost monotonically during 2000s. In its studies, the shareholder consulting company Georgeson Shareholders (1996, 1999, 2008) identified only five hedge fund activism cases out of 28 US activism events in 1996, but the figures increased to 10 cases out of 30 in 1999, and 20 out of 46 for 2007. Brav et al. (2008), in their analysis on hedge fund activism in the US, reported 252 activism events by 126 hedge funds in 2006, compared to 97 events in 2001 by 39 funds, with increasing numbers through the period. In 2001, the Wall Street Journal (WSJ) stated that activism was beginning its growth at that time, also thanks to the hedge funds that until then had been relatively passive (Sidel, 2001). In 2005, instead, the WSJ titled “*Hedge Funds are New Sheriffs of the Boardroom*”, referring to the new role that hedge fund conquered in the governance and financial debate (Murray, 2005).

Many authors found positive returns from hedge fund activism. Among the others, Brav et al. (2008) found that the market recognizes a positive effect to hedge funds engagement. They recorded an abnormal return of approximately 7% in a (-20,+20 days) window around the announcement of activism, with no reversal during the subsequent year: they did not find evidence of a negative abnormal drift during the one-year period subsequent the announcement. In addition, they noticed that target companies experience an improvement in firm’ performance, mainly through increases in payout, operating performance, and higher CEO turnover after activism. Klein and Zur (2008) found that companies targeted by hedge funds earn, on average, 10.2% abnormal stock returns in the period around the disclosure of a relevant ownership³ by the hedge fund, and that

² Among others see the hedge fund Strategy Classification System by Hedge Fund Research, Inc.: <https://www.hedgefundresearch.com/index.php?fuse=indices-strand1310776378#ed:a>.

³ In the US this corresponds to the Schedule 13D filing, required for holdings larger than 5%.

firms targeted by non-hedge-fund-activists experience abnormal returns of 5.1%. Boyson and Mooradian (2010) affirmed that hedge funds specialized in activism experience risk-adjusted annual performance about 7-11% higher than non-activist hedge funds. They argued that activist hedge funds are not short-term investors, as others stated, but the average period of activism is around two years. Also Brav et al. (2008) classified hedge funds as non short term investors, defining the average holding period as about one year. Clifford (2008) demonstrated that activist investing provides higher returns even when compared to passive investing: his study on a sample of hedge funds' investments between 1998 and 2005 shows that activist investments generate 21.75% higher raw annualized returns than the non-activist investments of the same hedge fund managers. Evidences of positive returns from hedge fund activism come also from European studies. Becht et al. (2010) analyzed 305 public activist interventions by hedge funds in Europe, from 2000 to 2008. Relevant to notice, 72 cases involved engagement with a blockholder owning more than 20% of the company. Their results confirmed the US studies' findings. For a 20 days window around the disclosure date the abnormal returns were 4.4%. The Authors highlighted some variation across countries. In the four countries with the highest number of observations, the returns were 2.7% for France, 6% for Germany, 2.6% for Italy and 2.8% for the UK. They found also that for activist specialist funds the abnormal returns are higher (6.9%, on 183 cases) than for other styles (0.6% on 116 cases). Furthermore, they confirmed the long term orientation of activists, with an average holding period of 621 days.

2.2.3. A comparison between activist hedge funds and traditional institutional investors

Hedge fund activism difference from traditional institutional investor activism is endogenous. Armour and Cheffins (2009) distinguished the two types of intervention as “*offensive*” for the hedge funds and “*defensive*” for the mutual and pension funds activism. Defensive shareholder activism occurs when the investor disagrees with strategic or governance decisions and reacts to protect or enhance the value of pre-existing holdings. The relevant difference with the offensive

interventions is not the friendly or aggressive attitude towards the management, but the existence of a position in the target company before the decision to intervene. Offensive activists, lacking a sizeable stake in the target, build up one “*offensively*” with the intention of actively prompt changes to maximize shareholder returns. Kahan and Rock (2007) defined mutual funds and public pension funds activism as incidental and *ex post*, compared to hedge funds one which is strategic and *ex ante*. Traditional money managers could become occasionally active if they notice that portfolio companies are underperforming or present threats from a corporate governance perspective. To the contrary, hedge fund managers systematically select underperforming targets that would benefit from intervention, then they enter in a meaningful equity position that would allow to effectively engage in, and make profits from, activism. Hedge funds and traditional institutions pursue different profit strategies. Differently from traditional institutional investors, for specialized hedge funds the activism is a profit making strategy. In the end, hedge fund activism represents a blurring of the line between risk arbitrage and battles over corporate strategy and control (Kahan and Rock, 2007). As a consequence, activist hedge funds and traditional institutional investors differ in their portfolio concentration. The latter respect the risk diversification principle in portfolio building, holding small percentage of many companies, even if they regard some as underperformers. Activists, instead, concentrate their ownership in 10 to 30 stocks (Einhorn, 2008), and in some case even less. The activist hedge fund Knight Vinke invests at any one time in as few as four stocks; the Hermes UK Focus Fund in an average of 13 stocks (Becht et al., 2010). Furthermore, pension and mutual funds would be more likely to engage companies on corporate governance rules, instead hedge funds tend concentrate their efforts on specific aspects of a company’s business or management, such as dividend policy, spin-offs, mergers, composition of the board of directors (Kahan and Rock, 2007).

The differences in the strategy and structure of the hedge funds makes them more successful activists than traditional institutional investors. Indeed, the latter encounter several issues that limit their effectiveness or willingness to adopt an activist behavior. First, pension and mutual funds hold highly diversified

portfolios. The efforts sustained to turn around a specific company would lead only to a small improvement in the portfolio's overall performance, and would also create free riding issues (Brav et al., 2008; Black, 1990; Kahan and Rock, 2007). In addition, institutions are not equipped with specialized staff to engage management at each of the hundreds of corporations in which they have an interest, and because of their thin ownership, they could find difficulties in obtaining a dialogue with targets' managers (Orol, 2009). To this it is necessary to add the collective action costs arising in the communication and coordination with other institutional shareholders. The second type of difficulty that institutions encounter is the conflict of interest in engaging in activism at companies with which they have a commercial relationship or that could be future clients (Romano (2001), Woidtke (2002), Davis and Kim (2007), Kahan and Rock (2007)). Banks typically do not want to lose revenues from current or potential corporate clients; independent mutual funds do not want to compromise relations for their retirement fund business. Davis and Kim (2007) found a strong correlation between the management of corporate pensions and pro-management voting in the US. Conflicts of interest arise also in Europe, where many of the largest asset managers are owned by banks which provide commercial and investment banking services to the firms in which they invest (Becht et al., 2010). Furthermore, critics argued that public pension and labor union funds increase agency costs pursuing self interested agendas not in the interest of, and even conflicting with, the other shareholders (Romano, 1993). The weak personal financial incentives for fund managers are the third issue that limits mutual and pension funds activism (Rock, 1992). Regulatory constraints are the fourth: there exist liquidity requirements, ownership concentration limits and insider trading prohibitions, that inhibit traditional money managers from engaging in activism.

Hedge funds are a different investment vehicle, more suitable for activism. Hedge funds do not have regulatory requirements obliging them to keep diversified portfolios, therefore they can hold larger stakes in target companies than other investors. Furthermore, they usually require investors to lock-in their funds for a longer period, from six months to several years. Hedge funds are independent from banks and other institutions; they raise money through private

offerings to a relatively small number of investors, who are limited partners of a partnership entity (the fund) managed by a general partner. Investors have a passive role with almost no say on the fund's business. Therefore hedge funds managers suffer less, if any, conflicts of interest in pursuing activism than traditional money managers (see: Partnoy and Thomas, 2006). Moreover, hedge fund managers have interests aligned with those of their investors because their remuneration is strongly performance-based: they typically charge a fixed annual fee of 2% of the fund's assets and a fee based on the percentage of the fund's annual return, usually 20% (see: Partnoy and Thomas, 2006). This creates an incentive towards shareholder activism as a profit making strategy. In addition, hedge funds rely on leverage and derivatives to reduce the cost of concentrated exposures in the target companies⁴.

2.3. Activism investing

Financial innovation and the rise of hedge funds have paved the way to a new concept of shareholder engagement. Activism has been regarded as an investment tactic, profitable for those who undertake it, and value enhancing for the other shareholders. It follows that investing in activism could be considered an effective solution to the agency conflict in corporations. Hedge fund managers has largely benefited from it. Also other institutions can follow this approach taking advantage of solutions that would allow to overcome some of their limits. For instance, Monks and Minow (2008) refer to a new kind of institutional shareholder, in partnership with traditional institutional investors, that would buy shares in undervalued companies, push for governance reforms, and benefit from the value of those reforms. One example is Hermes, the fund manager owned by the British Telecom Pension Scheme. Hermes manages money on an index

⁴ Two common strategies are record date capture and short equity swaps. Record date capture involves borrowing shares just before the record date for a shareholder meeting (the date on which the shareholders entitled to vote are determined), and returning them after. In a share loan agreement, the borrower acquires voting rights but no economic ownership, while the lender has economic ownership without voting rights. The other strategy involves the use of equity swaps. In a cash-settled equity swap the long equity side acquires the economic return on shares (but not voting rights) from the short side. The combined position (long shares, short equity swaps) conveys voting rights without economic ownership. In this way the hedge fund can exercise the voting rights but hedging the economic risk embodied in the stock. See: Hu and Black (2007); Christoffersen, Geczy, Musto and Reed (2007).

approach, and at the same time engages in activism on a small number of targets through its U.K. Focus Fund. The engagement will produce superior returns in the Focus Fund portfolio but also in the indexed investments. In this way Hermes mitigates the free riding problems associated to the activism. Becht et al. (2009) performed a clinical study on Hermes U.K. Focus Fund, finding that the fund's activism has a substantial effect on corporate activities and produces "*economically large and statistically significant*" returns.

2.3.1. Activism and value investing

Activist investing has its roots in value investing and it has been considered a new variant of a classical value approach (among the others see: Bratton, 2007). The basis of value investing were established in the 1930's by Benjamin Graham and David Dodd at the Columbia Business School. Value investing is founded on the idea of buying securities with underpriced fundamentals. Among their basic principles there were the conviction that the investment in a stock involves the ownership of a portion of a business, with an underlying value not depending on the market price. Indeed, the market has been seen as over-reactive to both positive and negative information, often making securities too expensive or too cheap. A value investor seeks bargains on the market: underpriced stocks with strong fundamentals and good long-term prospects. This implies to not follow the buying or selling behavior of the other investors, but relying on own fundamental analysis of the company. Then, it is necessary to be patient while waiting that the market recognizes the actual value of the stock, even if this means holding the investment for a long time period. Furthermore, Benjamin Graham stressed another important principle of value investing: the necessity of a margin of safety. A margin of safety arises when the price at which the stock is purchased is below the intrinsic value estimated by the investor. Obviously, this estimation is a crucial point. Generally, the intrinsic value coincides with a measure of a company's assets in place, not considering the value of the growth opportunities. In "*The Intelligent Investor*", Graham (1949) pointed out that "[the margin of safety] is available for absorbing the effect of miscalculations or worse than average luck".

In addition, he clarified that the concept of a safety margin distinguishes investment from speculation⁵.

The Canadian value investor Peter Cundill summarized Graham's approach as follows:

*“The essential concept is to buy under-valued, unrecognized, neglected, out of fashion, or misunderstood situations where inherent value, a margin of safety, and the possibility of sharply changing conditions created new and favourable investment opportunities. [...] The intrinsic value was defined as the price that a private investor would be prepared to pay for the security if it were not listed on a public stock exchange. The analysis was based as much on the balance sheet as it was on the statement of profit and loss.”*⁶

Aswath Damodaran (2003) identified three forms of value investing. The first is the classical passive screening, where the companies are considered suitable for investment only if they present certain requirements. Commonly, passive screeners buy stocks that: trade at low price-to-earnings multiples; trade at low price-to-book ratios and at discount to tangible book value (book value net of intangible assets, such as goodwill); have easily marketable assets; have low debt; provide high dividend yield. The second form of value investing is contrarian investing, based on the idea that the market, on the one hand, punishes too much companies that experienced poor past performance or had negative news, on the other, it rewards too much those that seem to be good investments. Contrarian investing includes strategies like buying the biggest losers in the market in the previous period, but also more complex strategies as vulture and distressed security investing. Finally, the third form is activist value investing. Like a classical value approach, it relies on fundamental analysis to identify undervalued or poorly managed companies. But then it breaks with the traditional value approach: instead of waiting that the market recognizes the actual value of the

⁵ This idea had already been developed in *“Security Analysis”* (Graham and Dodd, 1934), where the Authors defined the investing activity as follows: *“An investment operation is one which, upon through analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative.”*

⁶ From the book: *“There's always something to do: the Peter Cundill investment approach”* (Risso-Gill, 2011).

stock, the activist investors themselves intervene and push for the changes that would unlock the hidden value. To put it in other words, the activists lack the pure value investors' patience: they look for value but want it realized in the short or medium term (Bratton, 2007).

In specific cases also classical value investors could behave as activists. For instance, Warren Buffett, has followed an activist approach serving on boards of the Washington Post and other companies and even operating as interim chairman of Salomon Brothers during the early 1990s. Generally, pure value investors might become "*reluctant activists*" if they perceive to have fallen in a "*value trap*" and see no other way to escape from it; or also if they have so much capital under management that they have no choice but to intervene. In addition, there are value investors that include activism investing in their strategies, or specialized activists that split their portfolio between activism and passive value investing. Furthermore, most value investors engage privately with executives, often making the line between value investing and activist investing blurred (Orol, 2009).

Brav et al. (2008) demonstrated empirically that activists are value investors⁷. They found that the companies targeted by activists present market value relative to book value lower than peer companies – although they are profitable, with positive operating cash flows and return on assets. The Authors affirm that these findings are, in most of the cases (two thirds of their sample), supported by the activist investors' publicly stated belief that the company is undervalued (as often reported in the regulatory filings). In addition, the Authors provide evidence that the above average returns obtained by the activists are not due only to *stock picking*, but also – and mainly – to the *value improvement* consequent to the activist's intervention. The main reasons are the following. First, in the Authors' relevant sample, hostile tactics provided a higher return if compared to more friendly ones. Second, the activists mentioned in the regulatory filing the intention to intervene, not just to buy an undervalued stock. Third, the Authors found that after that the dissident investor has exited, the market had no reaction if the activist has had success, and it had a negative reaction if the activist has failed.

⁷ Klein and Zur (2008) confirmed this finding.

This pattern is not consistent with the simple *stock picking*. The price improvement due to activism usually occurs around the disclosure of the intention of performing an activist effort, not at the exit time because the market has already incorporated the expectations of some positive changes in the firm. Fourth, activists don't sell just after that the market recognizes the undervaluation of the security, as a value investor would do, but they hold for a longer period. The explanation of this longer holding-period is the following. The price improvement usually occurs around the disclosure of the intention to engage (usually in the regulatory filing). The activist investor cannot exit the investment without engaging in activism and at the same time enjoying an abnormal return: it would take too much time to sell the entire position before the price adjusts for the new negative information (the activist's exit before intervention). In addition reputational issues should be considered.

2.3.2. Activism in practice: the targets

Activists select target companies on the basis of a value approach, seeking to identify undervalued firms with high potential for improvement. But, differently than pure value investors, activist investors target companies where there are inefficiencies in the governance, business strategy, capital structure and M&A strategy that can be improved with the investor's intervention. In addition, target firms have higher institutional ownership than peers: it is crucial for activists to rely on the support of other shareholders, given their minority position. The sophistication and the responsiveness of the shareholder base is an important targeting factor.

It is possible to identify different types of activism, on the basis of the main objectives of activist campaigns: capital structure, business strategy, sale of target company, and corporate governance (Brav et al., 2008).

1) Capital structure activism. Activists focus on cash in excess, under-leverage, and payout policies. They may also ask for new equity issuances, debt restructuring or recapitalization. Companies with high level of cash and securities are possible targets, especially if they do not have announced the intention to use

that cash for investments or acquisitions or to distribute the liquidity in excess to shareholders through share buybacks or special dividends. The engagement in 2007 of the U.S. hedge funds Jana Partners LLC and D.E. Shaw Group against the Dutch giant Philips Electronics is an example⁸. Managers usually defend their choice arguing that the company could benefit of high cash available in the case of future better investment opportunities, economic downturn, or major anticipated expenses. Activists answer that cash in excess can lead managers to avoid making critical cuts necessary during recessions, and, more relevantly, it lowers the share price of the company: the cash in excess should be invested in the growth of the business, if this would give a satisfying rate of return. Otherwise it should be distributed to shareholders. In general, higher dividends and buybacks are one of the most common requests of activist investors. Indeed, activists target companies with lower payout ratio than peers. Another common target are low debt companies. Activists agitate to increase the leverage and to use the proceeds of the new financing to buy back shares, to issue a special dividend to shareholders, or to invest in the business. This is the case of the US game and player terminal manufacturer Multimedia Games Inc., urged by its shareholder Liberation Investment Group to increase the debt and distribute part of the proceeds to investors (See: Orol, 2009).

2) Business strategy activism. This type of strategy seeks to prompt changes in the operational efficiency of the company as well as in its major strategic decisions. Activists target firms with lack of focus on their core activities and propose business restructurings and spin offs. Complex conglomerates with lack of strategic connections are a common target: the activist values each division more than the company as a whole and considers the conglomerate structures open to break up. For instance, in October 2010, the activist hedge fund Pershing Square has build up a 11% stake in Fortune Brands, a conglomerate with three main divisions – spirits, golf equipment and home products – and it has

⁸ See: Harro ten Wolde, "Hedge funds seek talks with Philips on performance", *Reuters*, 10 December 2007.

pushed to split-off some of its parts⁹. Also, activists select companies with noncore assets to divest or with unrelated units with low market value relative to apparent asset value.

3) Sale of target company or of its main assets, as in the case of The Childrens' Investment Fund against ABN Amro¹⁰. Activist investors can push for the sale of a company and even look for potential bidders. Furthermore, activists may intervene in mergers and acquisitions seeking to stop a deal or to obtain better terms.

4) Corporate Governance. Firms with stronger shareholder rights have higher firm value and higher performance than peers (Gompers, 2003). Activist investors invest in companies with poor corporate governance and lobby to introduce improvements. They focus on: general disclosure of relevant information, board independence and fair shareholders representation, executive compensation, related-party transactions. Notably, when the campaigns became hardly confrontational, activists might also seek to oust the CEO or the chairman – as in the case of Eckoh plc's chairman who resigned in December 2007 after the pressure of the dissident shareholder ORA Capital that asked to resign considering him responsible of the poor governance of the UK firm¹¹.

2.3.3. Activism in practice: the process

Activism investing is a long process, based on research and stock picking in the first phase, on relational capabilities and persistence afterwards. The process begins with the identification of the target. Activist funds typically have a research team that reviews undervalued companies, spending significant time to understand the business and finally identifying the opportunities. In the next stage, the investor takes an initial position in the target – ranging typically from 5% to

⁹ See: Anupreeta Das, Gina Chon and David Kesmodel, "Fortune May Cooperate With Ackman", *The Wall Street Journal*, 13 November 2010. As of the time of this work, the activist has raised its stake at 13%: see Mihir Dalal, "Pershing Square Capital raises Fortune Brands stake", *Reuters*, 10 August 2011.

¹⁰See: Norma Cohen and Peter Thal Larsen, "TCI urges ABN shake-up", *Financial Times*, February 21 2007.

¹¹See: RiskMetrics - Chris Young. 2009. *The M&A and Hedge Fund Activism Landscape*. Yale Law School Alumni Breakfast presentation, 12 November.

15% (Brav et al., 2008; Boyson and Mooradian 2010; Becht et al., 2010), built over time or bought in one block. As several Authors emphasized, the market tends to react strongly to the presence of the investor on the register if the shareholder announces activism purposes or if it is recognized as a specialized activist.

After certain time, the investor starts a private correspondence with the company, seeking meetings with key management and board members to discuss her perspectives on the firm's business; frequently activists also send 'formal' letters to the board setting out perceived short-comings in current strategy and suggested improvements. Usually activists try to maintain a soft behavior and prefer to keep their engagement private (Becht et al., 2009). However, if a quiet approach fails, they can decide to criticize the management in public and organize campaigns on the media, with open letters and news paper advertising, seeking the support of other shareholders. The ultimate threat – other than a legal action – that activist shareholders can use against the company's managers is a proxy fight. In this case, dissenting shareholders make proposals against the management at the annual general meeting, or they can even request an extraordinary shareholders meeting to discuss the issues raised. They typically seek to replace incumbent directors with own representatives on the board rather than requiring specific action. However, given the activist's minority position, securing board control is not a priority: the proxy contest is more a mean to make public pressure to the management – if the activist is able to obtain the backing of other shareholders. In addition, proxy battles signal to potential future targets that the investor is ready to make every effort to achieve her objectives. Activist investors declare that they try to avoid proxy fights because of the high cost implied (Economist Intelligence Unit, 2008). Nevertheless, Klein and Zur (2008) showed that activists that threaten or go through a proxy contest generally have more possibilities to succeed in their goals. The last, extreme, step of activism might be a lawsuit against the company's directors. However, this is hard to occur because of the high costs and uncertainties involved in litigation.

2.3.4. Activism in practice: the cost-benefit analysis

Shareholder activism can be considered as a sequence of decision steps, in which more hostile tactics are carried on only after that a less confrontational behavior had failed. At each step, the insurgent shareholder decides whether to continue in the engagement on the basis of a cost-benefit analysis. This analysis involves two evaluations. First, it is necessary to balance the expected benefits with the expected costs of the intervention. Second, the net benefits should be compared with the selling value of the activist's stake of ownership (Gantchev, 2011). Such analysis is further complicated by the free rider problem implied in the shareholders' engagement. Activists must bear all the costs of the campaign but would enjoy only a portion of the benefits – in proportion to their share's ownership. Indeed, the net benefits expected should be weighted by the activists' ownership percentage, therefore decreasing the prospective surplus on the whole amount of the costs. The other shareholders, instead, will receive their fraction of the benefits without bearing any cost. Consequently, activists' intervention will be subordinated to the satisfaction of the following inequality: $c_i < \alpha b_i$, (with $0 < \alpha < 1$), being c_i the costs and b_i the benefits of the activist action, and α the insurgent's stake percentage (Bebchuk et al., 2001). It follows that it is relevant to own a consistent stake in the target company to overcome the free riding issue. The financing and liquidity costs and the risk that this implies are a potential disincentive to activism investing. This is the main reason why pension and mutual funds do not include shareholder activism in their business model but are only “*reluctant activists*” in specific situations¹². And, as well, this is why a specialized investment venture, structured to hold relevant stakes and perform engagement, is more suitable for activism.

Armour and Cheffins (2009) identified two major categories of costs of activism: transaction costs and financing costs. Transaction costs include search costs, buying/selling costs, and communication and other campaign-related costs. Generally speaking, a sizeable portion of the expenses is constituted by the unobservable costs of activism: time and effort of the fund manager. Clifford

¹²The “*reluctant activist*” definition comes from the classical paper “*Institutional Investors: The Reluctant Activists*” by Pozen (1994).

(2008) and Gantchev (2011) argued that the unobservable costs, if measured, could be higher than the legal expenses.

Search costs arise in the first phase of the activism investing process, researching and investigating appropriate target companies. Costs occurred in buying and selling the shares include stock-broking commissions and the bid-ask spread on the price. Communication and other campaign related costs, arising in the event of a proxy fight, include advertising expenses, charges for the preparation and distribution of the proxy materials to shareholders, fees for advisers such as investment banks, lawyers and proxy solicitors.

Financing costs are typically incurred in order to build up a sizeable equity position in the target company. The funding capability is a pre-requisite for activism investing and therefore a barrier to entry for this investment tactic. In addition, further financing costs arise in relation to the riskiness of holding a concentrated portfolio and to the sacrifice in terms of liquidity due to the relevant stake held in the company. Moreover, the lack of diversification makes the activist a risky borrower and therefore increases the cost of debt. However, financial innovation (e.g.: record date capture and short equity swaps) can lower the cost of financing and therefore the overall cost of activism. In addition, more activists can act together and increase their funding capability¹³.

Costs are a relevant issue for activist investors. For example, Gantchev (2011) criticizes the recent academic work on activism performance – including the contributions of Brav et al. (2008) and Clifford (2008) – claiming that it is focused only on the returns ignoring the costs of activism. The Author points out that the primary objective of the academic research has been to establish a relation between shareholder activism and firm performance, not considering the net gains for the insurgent: he concluded that subtracting costs on average reduces returns by two thirds.

¹³ Commonly labeled “*wolf packs*”: see Briggs (2007).

2.4. The Corporate perspective. How companies should deal with activism¹⁴

Activist investing has become an absolutely not negligible phenomenon both in the US and in Europe. Along with activists sophistication, companies and consultants have increasingly specialized in dealing with this type of investors, developing best practices and an overall higher awareness of the phenomenon.

Ideally, in order to prevent activism, companies should avoid to appear vulnerable and they should have a shareholder oriented approach. Managers must always monitor valuation metrics and peers comparison: in the event of declining values, they should immediately concentrate on rectifying financial performance demonstrating focus on shareholder value. Indeed, waiting for the sector or economic conditions to improve is unlikely to satisfy potential activists. Moreover, a careful review of the investor base and of its trends plays an important role. Specialized information agents¹⁵ can help in monitoring the shareholders and the debt and convertible securities' holders. Indeed, companies should actively build-up a supportive investor base, maintaining a proactive and constant dialogue with all classes of investor. In addition, trading volumes and ownership trends should be actively monitored. Admittedly, capital structure and dividend policies are sensitive issues for potential activists. The more a capital structure is efficient and dividends are constant and sizeable, the better it is to avoid being targeted. Also, portfolio optimization is a key topic. Companies should evaluate regularly whether the mix of businesses and activities is optimized, seeking to focus on core competencies and to monetize low grow assets. Furthermore, strategic guidelines and takeover defenses have to be actively reviewed. Eventually, it is important to ensure supervisory board and non executive directors' support, bearing in mind that a board that is used to be involved in the company's affairs is more likely to support management in a crisis than a pure "*ceremonial board*".

¹⁴ Contents of this paragraph are based on information provided by a leading investment bank.

¹⁵ An information agent is a financial institution or a similar entity responsible of the investor record-keeping and communication, on behalf of the equity issuers.

In the event that a company is targeted by activists, a clear and unified message is the basis of a reaction. In order to build it, the management should follow a structured approach. As first, they have to assess the credibility of the activists, of their approach and proposals. An evaluation of the insurgents' reputation, ownership position, financial capacity and strategy would be instrumental to this purpose. Also historical behavior, track record and past alliances are a key component of the assessment. Once the company is aware of the activists' profile, managers – in concert with the board of directors – should prepare a response strategy, developing internal and external communication and anticipating possible questions. In the case of public activism, an effective communication involves the development of public relations campaigns oriented to a direct dialog with shareholders, through roadshows and one-on-one meetings. Nevertheless, managers should take care also of the communication with the other stakeholders, such as employees, proxy advisors¹⁶ and governance groups, rating agencies, banks, and bondholders. The response has to highlight flaws in activists' proposals, but also propose acceptable near-term initiatives. Managers should be ready to proactively alter their plans and, if appropriate, implement components of the activist agenda.

¹⁶ Proxy advisors research proxy issues and make voting recommendations for their clients, mostly institutional investors.

3. THE ITALIAN FINANCIAL SYSTEM

3.1. Overview of an insider dominated system

Italy has an insider financial system characterized by the presence of controlling blockholders, strong connections among companies and a weak role of the market. Zattoni (2006) defined the Italian model as a *latin system*, comparable the financial models of France, Spain, Belgium, Portugal and Greece. Compagno et al. (2009) stated that the Italian corporate governance system is insider dominated and relations-oriented.

The agency problem among Italian companies generally occurs between a strong blockholder able to control the firm – thanks to absolute or relative majority – and the weak minority shareholders (Molteni, 1997; Melis, 1999, 2000; Zattoni, 2006). Bianchi et al. (2005) identified two main ways that historically have been followed to separate the control from the ownership in the Italian corporations. The first way has been having recourse to *fiduciary relations*. Under this solution, the founder of a company has involved in the venture her family members or friends, who brought new capital without directly controlling the firm. However, the weakness of this approach has been the limited level of separation: only a small number of investors can be fiduciary related to the company's controller. The second solution has been the use of *control enhancing mechanisms* (CEMs) that do not follow the proportionality principle (i.e.: one share-one vote), but allow the blockholders to have stronger control thanks to a higher voting power respect to the percentage ownership held in the company. The most common CEMs implemented among Italian companies have been pyramidal corporate groups and shareholder agreements.

The majority of the Italian firms are characterized by the dominant role of the families and the State as controlling shareholders (La Porta, 1999; Zattoni, 2006; Bianchi et al., 2005; Bianchi and Bianco, 2006; Tiscini and di Donato, 2009). In general, the most common type of company in Italy is the family controlled medium and small enterprise, characterized by a simple legal and organizational structure (Zattoni, 2006). However, among the blue chips –

representing about 80% of the total capitalization of the Italian stock market (Drago et al., 2011) – the typical structure is the pyramidal group, with a holding company controlling a number of legally independent entities connected by shareholding bonds. The holding company acts as the decisional center for the whole group, that *de facto* becomes a sole corporation although being legally separated. The large Italian groups are composed by pyramids with a high number of levels: often there are some sub-holding companies in addition to the holding company, with different characteristics and purposes, but in any case acting as intermediaries between the top of the pyramid and the operating companies. In most of the cases these groups are controlled by a family. Often the controlling shareholder takes advantage of the shareholdings of friend groups or companies, creating a network of shareholdings that, together with the diffusion of interlocking directorates¹⁷ among these firms, enhances the controlling shareholder's voting power. Historically, the Italian investment bank Mediobanca has played the role of white squire in this system, purchasing non-controlling stakes in key companies and facilitating the control to the existing relevant shareholders (Drago et al., 2011; The Economist, 2010; Zattoni, 2006). Santella et al. (2007) found that the collusion established through interlocking directorates is centered around the Italian blue chips. Barker (2010) surveyed the literature on the Italian corporate governance system recording that many Authors claimed that the shareholdings' network, the board interlocks and the shareholder coalitions improve the ability of the dominant stockowners to expropriate the minorities, extracting private benefits from the control. Drago et al. (2011) described the differences between the shareholdings' network among Italian blue chips in 2008 with respect to ten years before. They stated that in 1998 a network of shareholdings enabled a few banking stockholders and families to control a group of blue chips – called by the Authors "*the Mediobanca Galaxy*" – using the board interlockers as communication channels. The shareholdings' network and the phenomenon of interlocking directorates played a marginal role for the rest of the

¹⁷ Interlocking directorate refers to the practice of members of a corporate board of directors serving on the boards of multiple corporations. A direct interlock occurs when two firms share a director or when an executive of one firm sits on the board of a second firm. An indirect interlock occurs when two corporations have directors who each also serve on the board of a third firm.

blue chips. In 2008 new shareholders had been included in the Galaxy and the Galaxy itself has been able to reach, through board interlockers, an increasing number of companies within the rest of the blue chips. The Authors concluded that this network could be considered the cornerstone of the Italian economy since it involves also State-owned companies, identifying, to some extent, a politically-oriented capitalism.

Concerning the family ownership of Italian firms, Tiscini and di Donato (2009) performed a study covering 2001-2006 data on a sample of Italian listed companies (excluding financial firms and State controlled public utilities). They found that on average 56% of the companies were family controlled. The Authors identified four degrees of involvement of the family in the governance: managerial family-company, personalized family-company, family-company run by the founder, paternalistic family-company. In the managerial family-company the CEO comes from outside, the family members are involved only in the most relevant strategic decisions and they hold few seats on the board of directors. The personalized family-companies have an external CEO as well, but the board is composed by a high percentage of family members. In the family-company run by the founder, the latter has the sole control of the strategic decisions not involving her family members. The paternalistic family-companies have a member of the family as CEO and most of the board members come from the family as well.

The State ownership has been an historical consequence of the developments of the Italian capitalism at the beginning of the XX century. Since that time the Italian State intervened massively in the economy and it continued also after the Second World War, until the privatization process started in 1992. The main Economic Public Corporations have been transformed in listed joint-stock companies, with the State as controlling shareholder. The industrial sectors where the State holds controlling positions are those related to the social welfare, as the railways and the energy industry. The size of such companies is generally medium-large because they operate in capital intensive businesses or in some cases in monopoly environments. The shareholding structure of the State owned enterprises is highly concentrated because the State wants to keep a strong control

over such companies, that generally are key players in sectors of national interest. The control over the company is exercised by politicians as the Minister of Economy and Finance and the top managers politically appointed. Therefore, the property and the control are highly separate because the company is controlled by persons that do not own any right on the cash flows, which belong, in the proportion of the State stake in the corporation, to the citizens. This could raise some issues in the corporate governance (Zattoni, 2006).

The presence of the State and of families as owners and decision makers in the Italian firms is strong if compared with the other European countries. Faccio and Lang (2002) analyzed 5,232 listed corporations in 13 Western European countries finding that in 59.6% of the Italian firms families held the ultimate control and 10.3% were State controlled. The European average recorded by the Authors was 44.3% for the family ultimate control and 4.1% for the State. Franks et. al (2008) studied the evolution from 1996 to 2006 of a sample of the 1000 listed and unlisted largest (in terms of sales) firms for each of the following countries: France, Germany, Italy and the UK. After the exclusion of wholly owned subsidiaries and foreign owned firms, their results showed that in 1996 Italy accounted for 67.7% of family owned companies, above the level of France (51.1%), Germany (48.4%), and the UK (17.8%). The Authors noticed that in France, Germany and Italy family companies were of similar size than non family companies, whereas UK family firms were smaller in size than non family companies. In addition, family owned firms in the UK had a lower chance of survival in that form. Only about 38% of the 1996 sample of UK companies owned by a family survived in the form of family firm over the decade from 1996 to 2006, compared with 62% in Germany and almost 78% in Italy. In 2006, the Italian sample (in part composed by firms from the 1996 sample and the rest by new firms) was 59% composed by family owned firms, against 43.1% for the French sample, 41.9% in the German, and 17.2% in the UK's. Similar numbers were recorded if considering only the listed companies in the samples for Italy,

almost lower results in the other countries¹⁸. State ownership was significant in all countries except the UK. In 2006 the Italian sample had 12.3% of listed and non-listed companies owned by the State, compared to 8.9 % in France, 10.8% in Germany, and the 2.3% in the UK. The comparison with 1996 showed a certain decline in the State ownership, especially among the listed firms (for Italy the decline among listed companies was more relevant than for the other countries¹⁹).

Given the high ownership concentration and control exercised by the blockholders, the shareholder general meetings of Italian firms only formalize the decisions taken outside by the majority shareholders (Bianchi et al., 2005). This is true in the companies with a blockholder owning the absolute majority of the shares, but also in those where the majority is only relative. Minority shareholders attendance at the general meetings is low in Italy, in absolute terms and also if compared to the rest of Europe. However, also in the rest of continental Europe the concentrated ownership structure of companies crowds out minority shareholders, eroding their relative influence. In the end, it makes them disinterested in exercising their voting rights. ISS (2010) recorded the average attendance at the 2010 shareholder meetings of the European listed companies and analyzed the voting behavior of free-float shareholders (i.e.: owners of less than 5% of a company's capital). Italy showed an average proportion of free-float shareholders at the general meetings below the European level. ISS related the low meeting attendance of the free-float investors to the concentration of the ownership structure. Indeed, Italy presented one of the highest levels of ownership concentration of the sample.

In addition, one of the issues that has historically contributed to the low general meeting attendance in Italy, especially for institutional investors, has been a technical aspect of the process to submit the vote in the shareholders meetings.

¹⁸ Italian listed family companies were 67.1% in 1996 and 61.3% in 2006. In Germany 38.2% in 1996 and 32.3% in 2006. In France 49.2% in 1996 and 48.1% in 2006. The UK recorded 6.3% of listed family firms in 1996 and 5.3% in 2006.

¹⁹ The ownership percentages of State owned listed and non listed companies in 1996 was: 15.8% for Germany, 12.1% for France, 2% for the UK, and 13.7% for Italy. Narrowing the focus only to listed companies, the 1996 results were: 14.5% for Germany, 8.6% for France, 0.4 % for the UK, and 19% for Italy. In 2006 Italy accounted for 12.9% of listed State owned companies, Germany for 6.1%, France for 7.4%, and the UK did not presented any listed large firm owned by the State.

Until 2010, Italy applied a share-blocking system, requiring shares to be non-transferable for some days before the shareholder meeting in order to process the votes. After the implementation of the EU Shareholders Rights' Directive 2007/36/EC on 27 January 2010, the share-blocking system has been abolished and replaced by a record date set at seven business days before the general meeting (first call). A record date system allows those investors holding shares seven business days before the shareholder meeting to cast their votes, no matter if they sell the shares during these seven days. A share-blocking system makes the vote more expensive, because shareholders would be limited in their right to transfer the shares. This is even more true for non-long term holders and in particular for institutional investors.

Because of the low general meeting attendance, minority shareholders risk to lose their monitoring function with respect to the controlling blockholders' actions. However, the Italian company law provide some tools, as the *Voto di Lista* mechanism for board elections, that could enhance the effectiveness of the minorities' participation, despite their weak voting power. Furthermore, the change from a share-blocking to a record date system makes cheaper to vote in the general meetings. Thus, minority shareholders could have some space in the governance of Italian firms.

3.2. Recent empirical evidences on the ownership and control of the Italian listed companies

Recent research confirmed the high concentration of the ownership and control of the Italian firms. The majority of the Italian listed companies has a concentrated ownership and the most common form of control is the one operated by a sole shareholder. According to the Annual Report of the Italian market regulator CONSOB (2011), covering all the companies listed in Italy, as of 31 December 2010 the average ownership percentage of the first relevant shareholder²⁰ was equal to 44.9%. The other relevant shareholders owned on average 18% and the remaining 37.1% was free float on the market. In order to

²⁰ In Italy, the ownership disclosure threshold corresponds to 2% of the ordinary shares outstanding, defining relevant shareholdings.

understand how static is this equilibrium on the Italian system it is useful to consider that these data are consistent with the average measures of the 1998 (first shareholder: 46.7%; other relevant shareholders: 14.1%; free float: 39.2%).

A relevant variable for shareholder activists is the level of presence, in the companies where they invest, of institutional investors, from which insurgents could potentially have support. CONSOB (2011) data (Table 1) reported that in Italy, as of 31 December 2010, institutions held relevant positions (i.e.: more than 2%) in 44% of the listed companies (41% as of 31 December 1998), with an average shareholding of 7% (7.1% in 1998) – showing a consistent trend in the previous years. Italian and foreign institutional investors' holdings had different developments from 1998 to 2010. The number of companies with Italian institutions' relevant holdings had a noticeable decrease: in 1998 they held relevant positions in around one company out of four, decreasing to 8% of the listed firms in 2010. Their average ownership in these companies was 5.1% in 2010 (3.9% in 1998). To the contrary, the number of foreign institutional investors' relevant positions increased appreciably. In 1998, non-Italian institutions had an ownership greater than 2% in one listed corporation out of four, reaching about 40% of the companies in 2010. On average, the relevant ownership by foreign institutional shareholders was equal to 6.8% in 2010 (7.5% in 1998).

Table 1. Italian listed companies: institutional investors' relevant¹ ownership

In %

	1998	2008	2009	2010
Companies with institutional investors as relevant shareholders ²	41	49	51	44
Avg ownership of institutional investors when relevant shareholders ³	7.1	7.2	6.8	7
Companies with Italian institutional investors as relevant shareholders ²	26	14	12	8
Avg ownership of Italian institutional investors when relevant shareholders ³	3.9	5.7	4.4	5.1
Companies with foreign institutional investors as relevant shareholders ²	25	42	44	39
Avg ownership of foreign institutional investors when relevant shareholders ³	7.5	6.6	6.6	6.8

Source: CONSOB (2011)

¹Institutional investors owners of at least 2% of the voting shares²Ratio of the number of companies with the presence of relevant institutional investors and the total of Italian listed companies for each year³Average ownership stake (on the total share capital) of institutional investors when they hold relevant positions

The shareholder consulting company Georgeson Shareholders (Georgeson, 2011) has provided data for a sample of 32 out of the 40 companies belonging to the FTSE MIB index²¹, covering the years 2009 and 2010. These data were compared to a further sample of 29 FTSE MIB companies referred to the year 2005. The ownership structure (see Table 2) of the representative samples of Italian companies appears heavily concentrated, but it also shows a relevant role for non-Italian institutional investors. Indeed, in 2010, the strategic shareholders²² owned on average 42.7% of the ordinary share capital. However, among the

²¹ The FTSE MIB is the primary benchmark Index for the Italian equity markets. Capturing approximately 80% of the domestic market capitalization, the Index is comprised of highly liquid, leading companies. The FTSE MIB Index measures the performance of 40 Italian equities and seeks to replicate the broad sector weights of the Italian stock market. The Index is derived from the universe of stocks trading on the Borsa Italiana main equity market. Each stock is analyzed for size and liquidity, and the overall Index has appropriate sector representation. The FTSE MIB Index is market cap-weighted after adjusting constituents for float.

²² The strategic shareholders category include those shareholders able to control the company directly, *de facto*, or indirectly through shareholder agreements.

minority shareholders, foreign institutional investors accounted the highest shareholding, owning on average 24.7% of the capital. Retail shareowners followed with 17.2% and Italian institutional investors recorded 13.5% of voting shares. Table 2 shows the FTSE MIB sample's average data and the minimum and maximum share of capital for each shareholder category in 2005, 2009 and 2010. In these years the concentration of the ownership in the strategic shareholders' category showed a decreasing trend. This decrease could be explained by another trend, detailed in the following paragraphs. In brief, strategic blockholders largely rely on low minority shareholders' attendance at general meetings and on the use of *control enhancing mechanisms* in order to control *de facto* the firm, with a lower (but still high) ownership. These patterns seem to be unfavorable for shareholder activism. However, a potentially positive issue for activists is the increasing interest in investing in Italian companies demonstrated by non-Italian institutional shareholders. Italian institutions and retail investors appeared consistent over time in their share ownership. Concerning the controlling shareholders, their average stake decreased to 24.7% in 2010 from 49% in 2005. Relevant to notice, in the 2005 sample, the minimum ownership percentage for the strategic shareholders was equal to 27.4%, instead, since 2009 there have not been controlling shareholders in at least one of the companies of the FTSE MIB sample. Indeed, in 2009 Parmalat and in 2010 Parmalat²³ and Prysmian were real public companies. Not considering these two exceptions, the 2010 minimum value would reach 22.5%, anyway showing a decreasing trend if compared to the 2005 data. For what concerns the minority stockowners, retail shareholders and Italian institutional investors maintained their average holdings almost stable. Foreign institutional investors, instead, presented the most interesting trend, opposite to the decreasing direction followed by strategic blockholders. Non-Italian institutions' average shareholdings increased from 19.5% of the total share capital of the companies in the 2005 sample to 24.7% in 2010.

²³ In 2011 Parmalat lost the characteristics of a widely held corporation after being acquired by the French competitor Groupe Lactalis, indirectly owner of 83.3% of the Italian firm (as of the date of this work).

Table 2. FTSE MIB: ownership structure by shareholder category

Average, minimum, maximum stake on total capital; in %

	Avg			Max			Min		
	2005	2009	2010	2005	2009	2010	2005	2009	2010
Strategic Shareholders	49	43.7	42.7	73.4	74.1	74.4	27.4	0	0
Italian Institutional Investors	12.5	12.9	13.5	36.2	34	33	3.7	3.5	4.0
Foreign Institutional Investors	19.5	24.8	24.7	48.9	65.9	70	5	8	8.8
Retail Shareholders	17.8	16.8	17.2	39.4	37.5	30	1	4	4
Treasury Shares	1.2	1.9	2	10.7	11.5	11.6	0	0	0

Source: Georgeson (2011)

Concerning the type of control of Italian listed corporations, the CONSOB (2011) data in Table 3 show that in 2010 about two companies out of three were controlled either *de jure* by a majority shareholder (i.e.: owner of more than 50% of the voting shares) or *de facto* by a relevant shareholder able to lead the general meeting. Comparing the 2010 with the 1998, the number of companies controlled by a majority shareholder is more or less the same, but the weight of their market capitalization on the total capitalization of the Milan Stock Exchange decreased from 31.2% in 1998 to 20.6% in 2010. This trend appears more meaningful if compared to the increase in the number of companies controlled *de facto*, grown from 34 in 1998 to 49 in 2010. Their capitalization has been equal to 43.2% of the Italian listed companies in 2010 (40.8% in 1998), being the relevant shareholding the most common type control. In addition, from 1998 to 2010 the number of companies controlled by coalitions through shareholder agreements almost doubled and their capitalization weight increased from 8.3% to 12.1%. Italy, therefore confirmed to be a country with concentrated ownership and even more concentrated control. However, it is interesting to notice the positive trend of the widely held public companies, increased from 22 firms in 1998 to 32 in 2010, with a corresponding growth in weight from, respectively, 16.6% to 20.7%.

Table 3. Italian listed companies: type of control

		1998	2008	2009	2010
<i>De iure</i> controlled ²	number	122	137	135	129
	weight ¹	31.2%	17.4%	16.5%	20.6%
<i>De facto</i> controlled ³	number	34	55	50	49
	weight ¹	40.8%	48.8%	38.3%	43.2%
Coalitions ⁴	number	28	57	57	53
	weight ¹	8.3%	13.4%	15.1%	12.1%
Cooperatives ⁵	number	10	8	8	8
	weight ¹	3.1%	5.2%	4.4%	3.4%
Non-controlled ⁶	number	22	32	29	32
	weight ¹	16.6%	15.2%	25.7%	20.7%
TOTAL	number	216	289	279	271
	weight ¹	100.0%	100.0%	100.0%	100.0%

Source: CONSOB (2011)

¹Ratio of the market capitalization of the companies in each category and the market capitalization of all listed companies.

²*De iure* controlled companies are controlled by a shareholder who owns more than 50% of the voting shares.

³*De facto* controlled companies are controlled *de facto* by a shareholder who owns enough voting shares in order to lead the general meetings.

⁴Coalitions include: a) Companies not controlled by a sole shareholder and with a shareholder agreement covering at least 20% of the ordinary shares outstanding; b) Companies controlled by a non-listed company, itself not controlled by a sole shareholder and with a shareholder agreement covering the majority of the ordinary shares outstanding.

⁵Cooperatives are companies that apply the “*one-member one-vote*” principle.

⁶Non-controlled companies are a residual category

Georgeson (2011), using a slightly different categorization of the model of control and a smaller sample than CONSOB (2011), confirmed that Italian companies are mostly controlled *de facto* by relevant shareholders, with large use of shareholder agreements. In 2010, 20 out of the out of the 32 companies in the Georgeson’s FTSE MIB sample were controlled by a shareowner with a relative majority of the voting shares (i.e.: less than the absolute majority of the shares outstanding, but enough to lead the general meetings), in eight cases relying on shareholder agreements to reach such majority position. Other ten companies were controlled by blockholders owning the absolute majority of the shares (i.e.:

more than 50%), in four cases through the existence of agreement among two or more relevant stockowners. The last two companies in the sample were widely held.

The diffusion of the *de facto* control among Italian corporations is mainly due to two phenomena. The first, is represented by the use of control enhancing mechanisms (CEMs). The second, is the low attendance of minority shareholders at the general meetings. These phenomena allow the blockholders to lead the shareholder meetings despite holding less than the absolute majority of the shares outstanding, and to exercise a voting power higher than their cash flow rights.

3.3. Control enhancing mechanisms

The control enhancing mechanisms (CEMs) are deviations from the proportionality between ownership rights and control rights (the proportionality would be: “*one share-one vote*”). CEMs allow the blockholder to enhance her control on the firm through a stronger voting power than the proportion of equity held. ISS et. al (2007) quantified the recourse to the CEMs in 16 European countries²⁴. The main finding regarding Italy was that 59% of the companies presented one or more CEMs, increasing to 75% if considering only the 20 largest companies in the Italian sample. If compared to the other countries, Italy had an above average presence of companies with one or more control enhancing mechanisms. Indeed, the European average was 44% of companies presenting CEMs; 52% if considering only the largest European companies. Shareholder agreements and pyramid structures has been identified as the most common mechanisms used in Italy. Shareholder agreements are present in 23% of the Italian companies included in the ISS sample; the percentage in the other countries with the largest presence of shareholder coalitions in Europe was: 31% for Belgium, 18% for France and 13% for Spain. Pyramid structures were present

²⁴ The EU countries covered in the study are Belgium, Denmark, Estonia, France, Finland, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Poland, Spain, Sweden and the UK. The original sample was composed by 20 companies for each of the 16 EU jurisdictions. These 320 companies represented 58.3% of the total EU market capitalization as of 31 December 2005. In addition, the sample included 161 smaller companies at that time recently listed, from the same 16 EU jurisdictions. After some exclusions, the final sample analyzed was composed of 464 companies in total.

in 28% of the Italian companies analyzed, compared with 48% in Sweden, 34% in Belgium, 32% in Hungary – the other countries with the largest use of pyramids in Europe²⁵. In addition, a fair presence of savings shares (i.e.: non-voting preference shares), voting right ceilings, and golden shares (i.e.: special rights for governmental authorities) was recorded in Italy.

In the pyramid structures, a company, or a family or the State, controls a corporation that in turn holds a controlling stake in another corporation, repeating the process several times in order to create a chain of controlled companies. Minority shareholders can be involved at the various levels of the chain, obtaining external equity resources and at the same time keeping a strong control. Pyramids allow the controlling shareholder to leverage voting power and thus blockholders enhance their control. The longer the chain, the higher the deviation from the proportionality principle of ownership and control (i.e.: one share-one vote). Indeed, controlling shareholders hold a strong (indirect) control over the companies in all the linked companies, but gradually lower cash flow rights going down the levels of the chain. This indirect control exacerbates the conflict of interests between the blockholder controlling the pyramid group and minority shareholders. The former would be more interested in the results of the company at the top of the pyramid, on which they hold higher economic rights, rather than in the companies along the chain. Indeed, pyramid structures could create favorable conditions for the expropriation of private benefits through infra-group transactions and internal group restructuring (Bianchi and Bianco, 2006; Zattoni, 2006).

Shareholder agreements are formal or informal pacts among shareholders. These agreements generally include binding provisions concerning the coordination of the voting rights of the participants and often aim to achieve a specific composition of the board of directors. Indeed, in many cases the stated objective is to exercise control over the company and to influence its corporate

²⁵ Italy and Belgium have been identified as the European countries where most of the companies that combine pyramids and shareholders agreements within the same company came from. Pyramids were combined with shareholders agreements in 9 companies of the ISS (2007) sample.

governance. In addition, pacts that include preemption or lock-up clauses for two or three-year terms are very common in Italy (ISS et. al, 2007). According to some (Bennedsen and Wolfenzon, 2000; for Italian listed companies: Volpin, 2002), shareholder agreements would lead to a better governance. Others (Bianchi et al., 2005), argued that formal and informal coalitions could present transparency issues, mainly due to their non public governance and decision making processes. Gianfrate (2007), analyzing a sample of Italian listed companies, found that the announcement of a new/renewed agreement is considered as a bad news by the stock market, and the termination of a pact as a good news.

Bianchi et al. (2005) and Bianchi and Bianco (2006) showed a specific trend in the Italian corporate control – confirmed by the CONSOB (2011) and Georgeson (2011) results. They argued that, since the 1990s, together with a gradual decrease in ownership concentration, the number of shareholder coalitions within listed companies has increased. In addition, the Authors claimed that the increase in the use of stockholder pacts has been at the expenses of the other common CEMs – pyramids and dual class shares. The internationalization of the capital markets has been identified as one of the main reason of the decline in the use of pyramidal structures and of saving and privileged shares²⁶. Indeed, international institutional investors prefer one share-one vote equity structures (Bianchi et al., 2005; Bianchi and Bianco, 2006; Bigelli et al. 2008). The use of the shareholder agreements could be seen as an alternative model to separate ownership and control, enhancing the blockholders' voting powers. In the end, shareholder pacts could have a similar function then the pyramidal structures, allowing the blockholder to control the company just with the majority of the coalition. However, the governance of the agreements can include complex rules for the selection of the pact's majority, in order to protect the minority participants in the coalition.

²⁶ For saving and privileged shares, also changes in the regulatory provisions played a relevant role (See: Bianchi and Bianco, 2006; Bigelli et al. 2008).

3.4. Shareholders attendance at the general meetings

Empirical evidence on the shareholder meeting attendance in Italian listed companies has been provided by Georgeson (2011). The study analyzed the annual general meetings of samples²⁷ of companies belonging to the FTSE MIB index, covering the years 2005, 2009, and 2010. The first finding was that on average 52.3% of the shares outstanding attended the 2010 annual general meetings (55.8% in 2005). Table 4 provides a break down by shareholder category of the share capital present in the meetings. The strategic blockholder on average held 79.6% of the shares attending the general meeting, dominating the shareholders' debate. Relevant to notice, blockholders obtained this strong voting power holding on average less than the absolute majority of the shares outstanding (the Georgeson study on the same sample recorded an average ownership of 43% of the ordinary shares in the hands of the strategic shareholders); this is due to the *rational apathy* of the minority shareowners. However, the blockholder average voting power experienced a decrease from the 85.1% value recorded in 2005. The Italian institutional investors decreased their average voting power from 7.1% in 2005 to 4.2% in 2010. More marked has been the evolution in the maximum value: in 2005 in at least one company the Italian funds held 43% of the shares in the meeting, decreasing to 23% in 2009 and 2010. The retail shareholder category registered a marginal 0.94% presence in the 2010 general meetings (1.33% in 2005). The most interesting evolution is the increasing trend in the international institutional investor category's voting power. Foreign institutions represented on average 6.4% of the shares voting in the 2005 annual meetings, more than doubling in 2010 when their average voting power reached 15.3% of the general meetings. Certainly, a contribution to the 2010 results was provided by the existence of Parmalat and Prysmian, at that time both widely held companies²⁸ largely owned by foreign institutions. Indeed, the maximum value recorded for the voting power of foreign institutional investors increased from 17.6% in 2005 to 94.3% in 2010, meaning that at least in one case almost all the general meeting

²⁷ More specifically, a sample was composed by 32 out of the 40 companies belonging to the FTSE MIB index, covering the years 2009 and 2010. These data have been compared to a further sample of 29 FTSE MIB companies referred to the year 2005.

²⁸ At the time of this work Parmalat is no longer a widely held corporation.

was in the hands of foreign funds. Considering the distribution of the voting power among the minority shareholder categories, in 2010 the foreign funds lead the non-controlling shareholders at the meetings, with on average about 75% of the minorities' voting power.

Table 4. FTSE MIB: voting power in annual meetings by shareholder category

Average, minimum, maximum stake on the capital attending the meeting; in %

	Avg			Max			Min		
	2005	2009	2010	2005	2009	2010	2005	2009	2010
Strategic Shareholders	85.1	79.6	79.6	98.9	95.4	98.3	49.6	0	0
Italian Institutional Investors	7.1	4.4	4.2	42.9	23.1	22.5	0	0	0
Foreign Institutional Investors	6.4	14.7	15.3	17.6	85.4	94.3	0.2	2.9	3.5
Retail Shareholders	1.3	1.3	0.9	23.3	10.9	8.2	0	0	0

Source: Georgeson (2011)

The CONSOB (2011) analysis of institutional investors' attendance at the 2009 annual general meetings confirmed the trends outlined by Georgeson (2011). The CONSOB sample included all the Italian listed corporations, excluding cooperative companies. On this broader sample, 3.7% of the shareholders attending annual general meetings were institutional investors. More in detail, only 0.7% were Italian funds and 3% were foreign institutions. Narrowing the sample to only the FTSE MIB and Mid Cap companies (i.e.: considering only the larger firms) the results kept the same trend: the international institutional investors were largely more present than Italian institutions in the general meetings of Italian companies – although, in general, institutional investors lack of interest in voting at Italian shareholder meetings. In 2009, institutional investors held on average 7.5% of the share capital present in the general meetings; international institutions dominated with an average voting power of 6.6%, against almost 1% of the Italians.

3.5. The *Voto di Lista* system for board elections

The *Voto di Lista* (VDL) system, compulsory for directors and internal auditors election in all Italian listed companies, is a potentially powerful tool for minority shareholders. Indeed, it allows minorities to obtain board representation and enhance their monitoring function within the firm. In particular, shareholder activists can profit from this potentially effective instrument to increase their voice, being even more incisive with respect to their stake of ownership in the company. The VDL mechanism calls for shareholders to vote on slates of nominees, submitted by both the controlling shareholder and the minorities. The slate with the most votes makes up the board but a minimum of one member from the second most voted slate is appointed as director. The VDL offers to minority shareholders a voice in the boardroom. In addition it should promote cooperation among minorities. This system also presents some drawbacks as the bundling of elections.

The VDL is typically employed when the entire board is up for election. In case of vacancies (for instance, following a director's resignation), the board may appoint a new director, who serves until the next annual meeting and must be confirmed by shareholders via a standard majority vote. The capital requirement for shareholders to submit lists of candidates ranges from 0.5% to 2.5%, depending on the market capitalization of the company. This requirement becomes 4.5% in case market capitalization is below €375 million, the float is higher than 25% and there are no shareholder pacts representing the majority of the votes (CONSOB 11971, May 14, 1999, Article 144-quarter). Lists of nominees must be deposited at the company's headquarters at least 25 days prior to the meeting date (first call) and the company is required to publish the lists deposited at least 21 days prior the meeting first call. Italian company law requires that, as a minimum, one board member must be elected from a minority slate, while some companies in their bylaws allow for more. For example, at Banca Monte dei Paschi di Siena, half of the board members are elected from the majority slate, meaning that the rest is taken from the minority lists. Conversely, Fiat and many other Italian companies, allow for just one candidate from minority lists to join the board.

The Assonime (2011) study on Italian listed companies analyzed the minutes of the shareholders' meetings in which the entire board(s) was (were) elected²⁹. Data refer to the 2008-2010 period. The first finding was that minority shareholders presented slates (i.e.: one or more minority slates were presented in addition to the majority shareholder's one) in about 100 firms, representing around 40% of the sample³⁰. Minority slates were presented in 102 directors election and in 101 statutory auditors elections. The use of the VDL appears an important resource for minorities, but still it is used in less than half of the Italian listed companies. This issue seems to be due more to investors' *rational apathy* rather than to the Italian concentrated ownership structure. Indeed, thresholds to present minority slates are not high, therefore seeking board representation is not extremely costly in terms of shares to own. An empirical evidence is provided by the Assonime study. Among the 152 companies where no minority slates were submitted for the directors elections, 126 cases presented shareholders that decided to not take advantage of the VDL despite they held enough shares to submit a slate. Similar evidence was offered by internal auditors elections. In 145 companies only majority slates were submitted, despite in 128 cases there were shareholders entitled to present candidates. In addition, even where no single shareholder can submit a slate, more stockholders could form a coalition and present candidates together. Moreover, neither the level of free-float seems to influence the willingness to submit slates of board candidates. Indeed, the average free-float level was the same in the group of companies in which minority slates were submitted and in the one in which only majority shareholders suggested

²⁹ The study considered only the companies which were listed on the Italian Stock Exchange at the end of March 2009. Minutes were available in 254 cases out of 272.

³⁰ Assonime (2011) identified eight categories of minority shareholders who submitted slates of nominees. a) Several individual shareholders (presented 4.7% of the minority slates submitted for directors elections; 7.1% for internal auditors); b) State and other publicly-owned entities (1.6% and 2.7%); c) Foundation - almost all are bank holding foundations (7.8% and 7.1%); d) Private equity and other funds acting independently, not in concert with other similar funds (13.3% and 12.4%); e) Italian mutual funds, acting under the coordination of Assogestioni, the association of Italian investment companies (8.6% and 12.4%); f) Financial institutions - banks or insurance companies (10.2% and 6.2%); g) Industrial partners - primary firms, Italian or foreign, operating in the same industry as the listed company (7.8% and 3.5%); h) Family members of the control blockholder, possibly acting in concert with other shareholders (2.3% and 4.4%); i) Private shareholders - all the remaining cases (43.8% and 44.2%).

candidates. This finding was true for both directors and internal auditors elections³¹.

Concerning the outcome of the board elections in the 2008-2010 period, Assonime (2011) reported that the average number of directors and statutory auditors elected from minority slates was respectively 1.9 and 1.1 per company. The candidates elected by minority shareholders represented 18% of the total number of directors elected in the companies where minority candidates obtained a seat; the number corresponded to 34% for the internal auditors elections. The results of directors elections fairly change when considering the size of the companies in the sample. The largest firms, belonging to the FTSE MIB index, elected on average three directors per company, equal to 20% of the total number of directors. The Mid Cap companies elected on average 2.4 directors (20% of the total) and the Small Cap 1.3 directors (16% of the total). To the contrary, internal auditors elections outcomes did not present relevant differences with the change in the size because in Italy, in the large part of the cases, the boards are composed by three members (one of which should come from the minorities). Anyway, the number of board seats obtained by minority shareholders' candidates was well below the number of places reserved to this category by the corporate bylaws of Italian firms. In the Assonime sample, the directors (internal auditors) elected from minority slates corresponded to 56% (44%) of the reserved places. This finding confirms the *rational apathy* of minority shareholders in Italy.

3.6. Some considerations on the Italian system

The characteristics of the Italian system show that the founders of the firms (and their inheritors) are not willing to open the venture to the market, seeking a strong control. The same is true for the State as owner. The level of control is considered a priority. Nevertheless, an higher separation between ownership and control would provide more financial and managerial resources,

³¹ In the Assonime study, minority slates were submitted in 102 directors elections (101 statutory auditors elections); free float, in such cases, was on average 37.9% (36.7%). This result was totally comparable with the situation in companies where no minority slates were presented (36.2% average free float in the companies with directors elections; 35.8% for those with internal auditors elections).

coming from outside the blockholder's environment. Bianchi et al. (2005) saw the blockholders' willingness to exercise a strong control over the firm as a limit to the growth of Italian companies. Several issues could explain the Italian corporate ownership concentration. The first issue concerns the cultural characteristics of the Italian population. Italians have a strong sense of the family and therefore they would prefer to keep smaller the size of their businesses, rather than convert them in complex organizations. However several authors (see: Bianchi et al., 2005; Cuomo and Zattoni, 2009; Zattoni, 2006) prefer alternative hypothesis, in line with the *Law and Finance* approach (La Porta et al., 1998). They mainly address the cause of the Italian blockholding model to the historical inefficiency of the Italian corporate governance system, although they recognize that recent legal reforms enhanced shareholder protection. Under their hypothesis, the controlling shareholder is unwilling to open the company beyond a certain threshold to external equity investors because she feels to be not enough sheltered. The opposite model is the US widely held corporation, where the founder, or the controlling shareholder in general, do not lock her money to hold a controlling stake of the company because she can rely on several entrenchment opportunities that allow to keep the control of the firm being the CEO. Bianchi et al. (2005) added another possible explanation to the ownership concentration. Companies could decide to be relatively closed to external investors and management to be less exposed to external screens with respect to fiscal, regulatory and other issues.

The ownership concentration and the enhancement of the blockholders' control (through *fiduciary relations* and CEMs) generate agency costs due to the possibility that the controlling shareholders have to extract private benefits of control. The most efficient way to avoid the risk of expropriation would be the existence of a reactive market for corporate control, where the control would be transferred any time that it would be exercised in a way that destroys shareholder value. However, this would be possible only in a system with fractionated ownership. In the Italian system, a suitable solution to the agency problems could be the *monitoring* from shareholders and other subjects, e.g. the independent directors. Anyway, free-floating shareholders suffer free riding and collective action problems, and independent board members alone seem to be not enough.

Relevant non-controlling shareholders, instead, could be reliable monitors. Defensive and offensive activists could play a role in Italy. However, the structural characteristics of the financial system make complicated to shareholder activists to have some influence over the company managers and the controlling blockholders. A key weakness is the low general meeting attendance. Not all the activists campaigns would end into a proxy fight, but a reliable threat of a contest in the shareholders meeting would make more effective the activist effort (see: Klein and Zur, 2008). Notwithstanding, activists could leverage the existing minority shareholder rights – as the VDL elections system – to obtain a stronger position when engaging with the companies.

4. INSTITUTIONAL SHAREHOLDER ACTIVISM: THE ITALIAN PERSPECTIVE

4.1. Activists' presence in Italy

Italy presents an unfriendly environment for shareholder activists. Blockholders have a strong control over the companies, characterized by ownership concentration above the European average and control enhancing mechanisms that allow to have stronger voting power than the cash flow rights. The financial system appears relations-oriented and reluctant to be really open to the market. The shareholder debate is therefore dominated by the blockholders. Minorities are on average unwilling to take advantage of their voice rights, although they would have some effective tools. This seems to be mainly due to the structural characteristics of the Italian system, together with the *rational apathy* common to non-strategic shareholders all around the world.

The available empirical evidence on institutional investor activism in Italy is mainly anecdotal, but demonstrates that activism in Italy exists and in certain cases could also play a role in the corporate decisions. In addition, a few studies provide some more comprehensive view on the phenomenon. The first evidence on institutional shareholder activism in Italy is the nationality of the activists. Indeed, they are almost all non-Italian institutions (Santella et al., 2008; Becht et al., 2010). Activist interventions were recorded among foreign institutional investors (see: Becht et al., 2010; Erede, 2009). Both domestic and foreign investors suffer the same disincentives related to the ownership structure and control of Italian firms. Therefore, the lack of domestic activists seems to be due to other issues. A theory supported by many (Bianchi and Enriques, 2001; Scatigna, 2001; Kruse, 2005; Santella et al., 2008; Georgeson, 2011) argued that Italian institutional investors are not enough independent and suffer conflicts of interests that prevent them to use their voice in the general meetings or to engage in any form of shareholder activism. De Rossi et al. (2008) reported that the Italian mutual funds owned by banks and insurance companies have about 85% market share. The Authors found also that the boards of these funds are composed mainly by directors who are also executives in the controlling bank or insurance

company; the number of independent directors sitting on such boards is very low. Therefore, the theory argued that such lack of independence has discouraged Italian mutual funds – together with their owners – to engage against current or potential banking or insurance clients.

Shareholder activists operating in Italy are mainly foreign institutional investors. Most of them are hedge funds. Empirical evidence of their activity has been provided mainly for public engagements, because of confidentiality issues – as generally occurs in the shareholder activism literature, with some exceptions³². Becht et al. (2010) analyzed the hedge fund activism in 15 Western European countries³³. They identified 305 public engagements operated by hedge funds between 1 January 2000 to 31 December 2008. The Authors recorded 29 cases in Italy, operated by eight UK or US based hedge funds. Interesting to notice, Italy was one of the countries with most observations, together with France (22 cases), Germany (43), the Netherlands (21) and the UK (133).

In general, the activists' efforts at Italian companies rarely reach the shareholder meeting. The shareholder proposals are an uncommon item in the meeting agendas of the Italian firms. In order to provide an evidence of the rare use of this tool by the activists, a research was performed on the database of a leading shareholder advisor³⁴. The database was supposed to cover all the annual and extraordinary shareholder meetings of all the Italian listed companies. From 2008 to 2010, the meetings with at least one shareholder proposal on agenda were 15 (for 13 companies). Among the identified shareholder proposals, only four were submitted by institutional shareholders pursuing an activism effort³⁵ (see table 5). In the rest of the cases, the proposals were submitted by the majority shareholders (in most of the cases) and by minority shareholders other than

³² For instance Becht et al. (2009; 2010) analyzed both public and private activism by the activist Hermes (Becht et al., 2009) and in general in Europe (Becht et al., 2010).

³³ Countries analysed: Austria, Belgium, Finland, France, Germany, Greece, Italy, France, Netherlands, Norway, France, Spain, Sweden, Switzerland, UK.

³⁴ The advisor systematically codes the agendas of all the annual and extraordinary shareholder meetings for all the Italian listed companies. Then it performs the analysis only on the agendas of the companies of which its clients are shareholders.

³⁵ The identification of the cases of institutional shareholders' activism was possible thanks to information provided in the reports of the proxy advisors, in the companies' press releases, and in the Factiva news database and in the press.

activist institutional investors. Among the activists' proposals, two failed (at Italmobiliare and Parmalat), one was a nonvoting item (at Pininfarina) and one was not voted because the activist sold its position (at Permasteelisa).

Table 5. Shareholder proposals submitted by institutional investors with activism purposes³⁶

Proposals submitted in the shareholder meetings of Italian listed companies

Period: 2008-2010

Target	Activist(s)	GM Date	Shareholder Proposal(s)
Italmobiliare	Hermes Focus Asset Management Europe (ownership 2.8%)	30 April 2008	Proposal for the optional conversion of company savings shares into ordinary shares
Pininfarina	Willcox International Funds and Fimag Investments Co (2.5%)	29 April 2008	Approve strategies for the valorization of the brand also through the transfer
Parmalat	Stark Offshore Management and others (12.1%)	3 June 2008	Amend bylaws to increase the threshold of 50 % of the distributable earnings
Permasteelisa	Amber Capital (19%)	16 Sept 2009	Revoke directors, elect directors and approve their remuneration

Source: Shareholder advisor database; minutes of the shareholder meetings; Factiva press database.

It seems fair to argue that the shareholder proposals were almost unused by the activists because of the stronger voting power held by the majority shareholders. Nevertheless, activists could leverage the *Voto di Lista* (VDL) mechanism to obtain higher voice and to influence the management, without suffering the majority shareholders' strong voting power. Enriques (2009) and

³⁶ For a description of the activism efforts refer to the following sources. For Italmobiliare refer to the case study provided in this work. For Pininfarina see: Finanza e Mercati. 2008. *I fondi attivisti bussano anche alle porte di casa Pininfarina*. 22 April. For Parmalat see: Livini, E. 2008. *Bondi incassa la conferma e rilancia - "Per Parmalat è l'ora dell'espansione"*. *Fondi esteri in pressing: più dividendi*. La Repubblica, 10 April. For Permasteelisa see: Chiesa, F. 2009. *La doppia assemblea di Permasteelisa e il pressing di Amber*. Corriere della Sera, 11 July 2009.

Erede (2009) stated that the election of one (or more) minority member(s) of the board of directors and of the board of auditors represents one of the most powerful instruments for activists. However, Erede (2009) himself provided empirical evidence on the scarcity of the use of the VDL elections by activist shareholders. The Author formed a list of the activist hedge funds with holdings in Italian companies higher than 2% of the ordinary capital, as of April 2008. He found that many funds did not submit slates of nominees at the 2007 and 2008 elections, even in the cases where they had enough ownership to do it. Erede argued that activists in Italy have pursued “*an opportunistic acting passive strategy*”, considered a form of “*relational investing*”. He stated that insurgents seemed to be apparently passive, deciding to not exercise their minority rights (i.e.: submitting minority board members candidates), in exchange of some benefits from the controlling shareholder. The Author argued that these benefits were clearly shared among all the shareholder (e.g.: distribution of extra dividends) only in few cases. In most of the cases, instead, the activists lacked a clear reason to not leverage their minority rights, although it was fair to expect an interest in engaging with the company – because of their activist nature and because of the large size and long duration of the investment. The Author suspected that these activists were performing a “*bad relational investing strategy*”, seeking private benefits from their passivism. However matters stand, Erede provided an empirical evidence of the passive behavior in the general meeting characterizing several shareholders with a name for activism that invest in Italy.

4.2. Case studies

In order to analyze the institutional shareholder activism in Italy, a study of four representative cases is provided³⁷. The selected cases are characterized by public disclosure of the key developments and by a large press echo. Financial press, brokers, and in some cases also academic research were interested in these activism efforts. In addition, the decision of the activists to go public implied the disclosure of relevant information to involve the public opinion in the debate, and often forced the companies to publicly reply. For the purposes of this work, the media echo of the cases allowed to obtain satisfying information to draft an analysis. In addition, it revealed a strong interest by the society in the shareholder activism phenomenon, even in a financial system with highly concentrated ownership. However, the focus on public examples of activism has the limit to not consider the private dimension of the phenomenon, which is supposed to be relevant – especially in a concentrated system.

The selected cases are the activism efforts of: Algebris Investments at Assicurazioni Generali; Amber Capital at Banca Popolare di Milano; Hermes Focus Asset Management Europe at Italmobiliare; Knight Vinke Asset Management at Eni. All the shareholders are UK or US based funds, specialized in value investing and activism. Knight Vinke defined itself as “*a highly focused and research driven institutional asset manager [...] that identifies] value creation potential in complex public companies. [...] Knight Vinke unlocks this value by engaging both in private and in public with the management, board and advisors of these companies*”³⁸. The fund’s activism track record include: the merger of Royal Dutch and Shell Transport (the activist raised governance issues), the takeover of Electrabel's minority shareholders by Suez (deal conditions), the restructuring of the merger of Suez and Gaz de France (deal conditions), the engagement with HSBC on governance and strategy. These efforts denote

³⁷ The main sources used to draft the cases are: researches on the news database Factiva and on the main newspaper; the target companies’ and the activists’ documents available on their web sites, including press release, letters sent by the activists and the companies’ replies, reports on the items in agenda at the shareholder meetings and minutes of the meetings; researches on the broker reports database of Thomson ONE Analytics; the main proxy advisors’ reports; academic studies.

³⁸ Source: Knight Vinke web site.

expertise in the energy sector, to which the target Eni belongs. Hermes Focus Asset Management Europe is a fund belonging to Hermes Fund Managers, that acts as the executive arm of the BT Pension Scheme. The fund manager described its strategy as follows: “*We invest in a small number of fundamentally sound companies that are not valued to their full potential due to factors that can be remedied by the company and where we believe shareholders can act as a catalyst for the change required to unlock value*”³⁹. Hermes Focus Asset Management has been a pioneer of activism in Europe. Its case was quoted as an example by Monks and Minow (2008). Becht et al. (2009) performed a clinical study on the Hermes U.K. Focus Fund, finding that its activism had a substantial effect on the corporate activities and produced “*economically large and statistically significant*” returns. Concerning Amber Capital, it is a US hedge fund with sizeable investments in a number of Italian companies and with a name for activism⁴⁰. In a press interview, the hedge fund’s founder, Joseph Oughourlian, declared: “we are financial investors [but] we want to give an institutional contribution. Because of that, we attend shareholder meetings, we propose independent candidates at board elections, and we engage with the management”⁴¹. Successful cases of activism operated by Amber Capital in Italy were recorded by some Authors (Erede, 2009; Bigelli and Mengoli, 2009). Another case analyzed in this work involved the hedge fund Algebris Investments. The fund was at its early activism attempt⁴², considering that it was founded in 2006 – the same year of the first investment in the target company Assicurazioni Generali⁴³.

The proposed cases allow to analyze the institutional shareholders’ activist behavior in companies presenting some of the typical characteristics of the Italian market. Italmobiliare and Eni are illustrative examples of the ownership features depicted in the previous chapters. Italmobiliare is a family controlled holding

³⁹ Source: *Hermes Focus Asset Management - Boutique Overview*, available on the company website.

⁴⁰ See: Greco, A. 2006. *Amber Capital punta Piazza Affari*. La Repubblica, 15 April.

⁴¹ Greco, A. 2007. *Né locuste né speculatori l' Italia è una grande occasione*. La Repubblica, 23 November.

⁴² Michaels, A. 2007. *Algebris joins activists’ ranks*. Financial Times, 24 October.

⁴³ See: Zucca, P. 2007. *Activist in salsa tricolore*. Il Sole 24 Ore, 3 November.

company presenting a high use of control enhancing mechanisms, as dual class shares and pyramid structure. Indeed, the activist focused most of its efforts on these characteristics. The energy company Eni is State controlled because it represents a strategic player for the country. In the Generali case, one of the core issues raised by the activist was the influence of Mediobanca, that in the previous chapters of this work was presented as a white squire for the Italian system. The activism at Banca Popolare di Milano is a specific case for Italy. The company is a cooperative (mutual) bank, governed through the “*one-member, one-vote*” principle and controlled by some shareholder associations. The activist adapted its behavior to the specific environment and created its own shareholder association to influence the corporate governance.

Two out of the four cases (the Generali case and the first phase of the Italmobiliare case) are characterized by the recourse to the shareholder general meeting by the activist – in one case (Italmobiliare) with a shareholder proposal and in both cases with the submission of slates of nominees through the *Voto di Lista* system. In addition, these cases are featured by a highly confrontational approach against the management and the controlling shareholder. In the other two cases (Banca Popolare di Milano and Eni) the activist adopted a behavior to some extents less confrontational and it did not bring its claims in a shareholder meeting vote. After the general meeting vote, also the activist at Italmobiliare adopted a softer behavior. In all the cases the results were mixed. However, the confrontational general meeting voting was a failure. The activists lost even the minority board representative elections.

4.2.1. Algebris Investments – Assicurazioni Generali

One of the most contentious campaigns in Italy was the UK based activist hedge fund Algebris Investments⁴⁴ (Algebris) effort to prompt changes in the governance of Assicurazioni Generali (Generali) – the biggest Italian insurer, one of the largest in Europe. On 24 October 2007, after a number of private

⁴⁴ Algebris Investments had been shareholder of Assicurazioni Generali since the end of 2006; see: Zucca (2007). At that time the fund owned around 0.3% of Assicurazioni Generali. As of April 2008 the activist owned 0.52% of the company.

meetings⁴⁵, the fund manager wrote a letter to the board of directors of Generali, criticizing the governance structure of the company⁴⁶. The activist argued that Generali, due to weak corporate governance and misaligned management incentives, was undervalued by the market. Algebris claimed that Generali was delivering only 60% of its potential earnings, or 75% assuming full achievement of the 2009 business plan, making the company undervalued by about 40%.

Algebris asked three major changes⁴⁷. First, to decrease the executives' compensation – the activist claimed that the chairman's remuneration was "*unacceptable by European standards*". Second, to modify the governance structure: moving from two CEOs to a single chief executive; from one executive chairman to a non executive one; and appointing senior managers with higher international experience. Third, to solve the conflict of interests that Algebris argued was existing between the major shareholder – the Italian investment bank Mediobanca⁴⁸ – and Generali. The activist adopted a confrontational behavior, targeting as main objectives of its campaign the chairman, Mr. Bernheim, and the major shareholder, Mediobanca⁴⁹. Algebris wrote that the chairman's compensation of €8.71 million had no "*clear justification in terms of company size, value creation for shareholders or responsibilities within the company*". In addition, it noted that Mr. Bernheim was the oldest business leader in the sector and that he had little contact with investors. Furthermore, Algebris criticized the "*remarkable influence*" exerted by Mediobanca on Generali, indirectly accusing the investment bank of the governance issues raised at Generali.

Despite Generali chairman asked to the board of directors the authorization to formally reply to the activist, the board decided to not provide an official

⁴⁵ According to a Generali press release of 24 October 2007: "*The [Generali] Group's management [...] has met with representatives of Algebris Investments on a number of occasions*".

⁴⁶ See: Corriere della Sera. 2007. *L'attacco dei fondi alle Generali*, 25 October. The Algebris' letter disclosed the activist's investment in Generali.

⁴⁷ See: Corriere della Sera. 2007. *L'attacco dei fondi alle Generali*, 25 October.

⁴⁸ The shareholders owning more than 2% of the ordinary shares as of 31 December 2007 were: Mediobanca (15.7%), Unicredito Italiano (4.7%), Bank of Italy (4.5%), B&D Holding di Marco Drago E C. (2.5%), Premafin Finanziaria (2.4%), Carlo Tassara (2.3%), Intesa Sanpaolo (2.2%), treasury shares (2%). Source: CONSOB database.

⁴⁹ See: Di Biase, A. 2007. *Caccia grossa al Leone*. Milano Finanza, 27 October.

answer to the criticisms, aiming to not improve the media echo⁵⁰. However, company representatives replied that the positive performance of the group was a justification for its corporate governance structure. Meanwhile, Algebris actively contacted other shareholders, seeking their backing. The activist organized roadshows in the USA, in Italy and in other relevant markets, obtaining some support⁵¹. The insurgent's main aim was to involve foreign institutional investors in its campaign. On 11 January 2008 the US asset manager Franklin Templeton, shareholder of Generali, sent a letter to the Italian insurer's board⁵², backing Algebris arguments. In addition, Franklin Templeton complained about the company's stated intention to invest in M&As in the USA. Generali representatives, again, defended the chairman and the company's governance, strong of the positive financial performance.

Algebris saw the annual general meeting as the occasion to obtain some representation in the target company. Indeed, Algebris (holding 0.52% of Generali share capital) submitted a minority slate of nominees for the internal auditors appointment⁵³ – on election at the April 2008 shareholders meeting. In addition to the majority slate submitted by the board of directors, and to the Algebris's candidates, other two slates were presented: one by the fund managers' association Assogestioni and one by the Benetton family's Edizione Holding (the family's holding company, owner of almost 1% of Generali's shares). The Benetton's slate created a harsh debate⁵⁴. Algebris pointed out that Edizione Holding (Edizione) was related to Generali's major shareholder Mediobanca because Edizione was in a shareholder pact in Mediobanca. Therefore the Benettons would not be allowed to present a minority slate. The market regulator CONSOB supported the activist's claims, arguing that Edizione could not be considered a minority shareholder independent from the blockholder and therefore

⁵⁰ Di Biase, A. 2007. *Bernheim silenziato su Algebris*. Milano Finanza, 14 December.

⁵¹ Di Biase, A. 2007. *Generali, Serra fa proseliti negli USA*. Milano Finanza, 30 October.

⁵² The letter has been sent by Franklin Templeton's subsidiary Franklin Mutual Advisers, and disclosed on early February by the Financial Times. See: Michaels, A. 2007. *Templeton increases pressure on Generali*. The Financial Times, 3 February.

⁵³ There was one seat devoted to the minorities on the auditors board. The minority representative would lead the board as chairman.

⁵⁴ Di Biase, A. 2008. *Generali, Algebris attacca Benetton*. Milano Finanza, 4 April.

entitled to submit minority slates. The Benetton's company decided to not vote its own slate, following the regulator's statement. In the end, the minority lists running for one seat in the statutory auditors board were two: the slate of Assogestioni and the one of Algebris. The activist lost the elections. Assogestioni was able to elect the minority representative in the board of internal auditors thanks to 29.3% of the votes, corresponding to 12.8% of the shares outstanding. Instead, 8.3% of the shares attending the meeting voted for Algebris's slate, corresponding to 3.64% of the ordinary capital⁵⁵. However, the activist obtained the support of more than 200 international institutional shareholders and the backing of the most influential proxy advisors⁵⁶.

On early July 2008, Algebris tried a further action. The activist sent a denunciation at the attention of the newly elected board of internal auditors⁵⁷. The insurgent asked the statutory auditors' intervention regarding some investments made by the insurance company⁵⁸. The issues raised concerned: the investments in Telco (i.e.: the main shareholder of the telecom company Telecom Italia) and in Banca Carige; the accounting practices concerning the stakes in the companies RCS and Autogrill. These issues had in common the conflicting role of Mediobanca. The main complaint was related to the Telco operation. The activist pointed out the riskiness of the operation through which Generali converted its direct investment in Telecom Italia (listed on Milan stock exchange) into a stake in the company's controlling shareholder Telco (non listed). Mediobanca was involved in the operation, converting its Telecom Italia stakes as well. Algebris claimed that Telco was highly leveraged and that it was less liquid than a direct investment in Telecom Italia. In addition, it stated that the book value of this stake (i.e.: Generali's stake in Telco) in the 2007 accounts was not prudently calculated. The other issue concerned the capital increase of the bank Banca Carige. Generali bought the residual new issued shares, reaching a stake more than proportionally

⁵⁵ The majority slate, submitted by the board obtained 53.7% of the votes, equal to 23.5% of the capital outstanding. No votes have been received by Edizione's slate.

⁵⁶ The leading proxy advisor ISS supported Algebris's slate. Among the other major players, ECGS backed Algebris and Glass Lewis recommended to vote for the management slate.

⁵⁷ At that time, the board was chaired by the representative elected from the Assogestioni's slate, opponent of the Algebris's candidate at that year elections.

⁵⁸ For a summary of the letter see: *Il Sole 24 Ore*. 2008. *Algebris attacca Generali su Telco*, 8 July.

higher than the existing one. The activist claimed that the investment was not convenient for Generali shareholders, because: it had been too expensive compared to a peers' valuation; Banca Carige was almost illiquid on the Italian stock exchange; no business partnerships could be expected. Algebris argued that the purchase was due to the fact that Mediobanca had been the arranger of the operation, committed to purchase the unsold amount of shares. The activist defined the Banca Carige investment as a related party transaction. Concerning the RCS and Autogrill stakes, Algebris complained that they were not included in the 2007 financial statements of Generali, although they were linked through a "special connection" between the Benetton family and Generali, through Mediobanca, as established by CONSOB in the recent Edizione Holding issue (i.e.: the CONSOB statement after that Edizione submitted a slate at the 2008 statutory auditors elections). However, the internal auditors rejected the activist's accusations. In their report on the 2008 financial statements, they disagreed with Algebris and certified the lack of evidence of law/bylaws' violations from the management.

After the 2008 activism efforts, Algebris sold almost all the stake in Generali⁵⁹. The fund attended the 2009 annual general meeting with 0.05% of the shares outstanding, against the 0.52% ownership brought at the 2008 meeting. Algebris founder, Davide Serra, declared that his fund sold the stake in the company because of the rejection of its requests⁶⁰.

Recently, part of the changes asked by the activist have been implemented by the company. On April 2010, the company appointed a sole Group CEO. Furthermore, on April 2011, Assicurazioni Generali adopted a governance model characterized by a non-executive chairman. In addition, the company established an Investment Committee and a Governance Committee.

⁵⁹ See: Di Biase, A. 2009. *Algebris dà l'addio alle Generali*. Milano Finanza, 21 April.

⁶⁰ For instance see the recent interview to Davide Serra: Pons, G. 2011. "Generali deve diversificare di più e non investire in partite di potere"; *Parla Davide Serra*. La Repubblica, 12 February.

4.2.2. Amber Capital – Banca Popolare di Milano

In 2007, the US fund Amber Capital (Amber) publicly engaged the Italian bank Banca Popolare di Milano (BPM). BPM is a cooperative (mutual) bank, meaning that it is governed through the “*one-member, one-vote*” principle. In cooperative banks only mutual funds can hold more than 0.5% of the share capital. Furthermore, the simple fact of owning shares does not automatically give voting rights to shareholders, as every stockowner has to be registered and accepted by the board. There are two categories of shareholders: normal shareholders and “*voting shareholders*” (i.e.: shareholders that requested acceptance and obtained voting powers).

On 8 August 2007, Amber Capital, together with two other BPM institutional shareholders, Fidelity International and Dkr Capital⁶¹, wrote a letter to the management complaining about the governance and the external growth strategy⁶². The activists sent the letter also to the Bank of Italy. The trigger for the public criticisms was the failed merger attempt between BPM and another Italian cooperative bank, Banca Popolare dell’Emilia-Romagna (BPER). The two banks signaled their intention to merge in May 2007, however, one month later the deal was stopped by the opposition from some board members, who had previously backed the merger. Afterwards a Strategy Committee was established to define potential partnerships and extraordinary deals. In that occasion, the Bank of Italy asked BPM to provide more disclosure on the Committee’s purposes. Amber and the other investors criticized the creation of the Committee and claimed that the strategic impasse in the external growth was the outcome of BPM atypical governance structure and of the “*influences of some lobbies*”, moved by objectives other than the shareholder-value creation. Indeed, BPM has historically been controlled by its employees’ associations. At that time, the board of directors

⁶¹The shareholders owning more than 2% of the ordinary shares as of 30 June 2007 were: Amber Capital (2.2%), Credit Suisse Group (2.6%), Julius Baer Investment Management (2.1%), JP Morgan Chase & Co. Corporation (2.7%), Caisse Federale Du Credit Mutuel Centre Est Europe (2%). Source: CONSOB database. Amber Capital has been BPM shareholder since 2001, see: Masoni, D. 2008. *BPM shareholder Amber Capital says bank is too small, its governance inadequate*. Forbes, 24 January.

⁶² The letter was disclosed on 30 August 2007. See: Il Sole 24 Ore. 2007. *Bpm: fondi in pressing, cda aperto per lo sviluppo*, 30 August.

(elected in 2006) was composed by 20 members, 16 of which appointed from the majority slate⁶³, submitted by Amici della BPM – an employees association controlled by the unions. The minority members were: two directors elected from the slate of the former BPM employees (association: Insieme per la BPM) and two from a slate presented by the bank's clients and other subjects (under the association Comitato Soci non Dipendenti). Relevant to notice, institutional investors had no representative on the board. As Crédit Agricole Cheuvreux pointed out in a 2008 equity report⁶⁴, the employees controlled the board owning only a small share of the firm's capital. BPM had 8,700 employees and 90,000 shareholders, of which 50,000 were registered members (i.e.: voting shareholders). The bank was basically controlled by less than 3% of the capital and 6-7% of the registered members (i.e. the employees). As a result, institutional investors, with 55.4% of the capital, had only 284 votes and no board representation, while employees controlling just 2.87% of the capital could take advantage of 8,164 votes and control the board. The employees association, Amici della BPM, has kept a strong control over the bank thanks to a favorable governance structure and to a large enough general meeting attendance of its members, benefiting of its union-controlled association form. Under Exane Paribas estimates⁶⁵, Amici della BPM, counted approximately 7,000 members, of which between 2,000 and 3,000 has usually attended the shareholders meetings. The 2006 general meeting attendance among the associations controlling the 2006-elected board was: around 2,160 members of the employees association (Amici della BPM); about 1,650 out the 3,000 members of the former employees' association (Insieme per la BPM); and around 1,421 out of the 3,900 members of the non-employees committee (Comitato Soci non Dipendenti).

⁶³ Two members elected under the majority slate were representatives of Crédit Industriel et Commercial (Credit Mutuel group) and of the Cassa di Risparmio di Alessandria foundation, as agreed in shareholder agreements between BPM and the two financial institutions.

⁶⁴Crédit Agricole Cheuvreux. 2008. *Banca Popolare di Milano. Democracy vs. capitalism*, 19 February. The report defined BPM governance as an "unbalanced system".

⁶⁵ Exane BNP Paribas. 2008. *Bca Pop Milano equity research*. 5 March.

On 17 September 2007, BPM chairman Roberto Mazzotta replied to the activists' letter, refuting the issues raised. The press⁶⁶ reported that the insurgents replied, still complaining on governance and external growth issues.

In addition to the strategic and governance issues, Amber Capital requested to be accepted by the company as a voting shareholder. However, the board of directors responded negatively, because Amber controlled its stake in BPM through a subsidiary based in a fiscal heaven, which was against the bank's voting-shareholders acceptance rules. However, some top executives started supporting Amber requests⁶⁷.

In early 2008, Amber changed its behavior, adopting a non-conventional strategy for an activist. Indeed, the insurgent adapted its effort to the Italian-specific cooperative firms' environment. On 18 January 2008, Amber founded a new BPM shareholder association, called BPM 360 Gradi⁶⁸. The association's representatives stated that the mission was to encourage the participation and the full representation of all BPM shareholders. This would mean that the group's aim was to involve those shareholders not represented by the associations sitting on the board, i.e.: the institutional investors. Amber involved in the projects reliable members of the Italian system. The chairman of the association was Mr. Davide Croff, who was BNL former CEO and senior advisor to Texas Pacific Group. Furthermore, one member of the advisory board of the association was Giulio Sapelli, professor of economic history experienced in Italian cooperative banks. It is relevant to consider that BPM 360 Gradi stated aim was to change BPM governance via moral suasion. However, its representatives stressed that the association was supporting the mutual company form, not willing to challenge the "one-member, one-vote" principle⁶⁹. The association claimed that the bank would need to grow through mergers or partnerships. This, however, had been not possible because of the internal strategic impasse due to fact that the board was

⁶⁶ Graziani, A. 2007. *Bpm, fondi esteri in rivolta su Unipol*. Il Sole 24 Ore, 9 October.

⁶⁷ Agenzia Giornalistica Italia, AGI 7 December 2007 - *BPM : Viola, fare in modo che fondi entrino in libro soci*; Graziani, A. 2007. *Bpm, Mazzotta apre ad Amber*. Il Sole 24 Ore, 13 December.

⁶⁸ Balestreri, G. 2008. *Amber, un'associazione per cambiare la BPM*. Il Sole 24 Ore, 19 January.

⁶⁹ See: Balestreri, G. 2008. *Amber, un'associazione per cambiare la BPM*. Il Sole 24 Ore, 19 January.

captured by the employees, owning a minority of the share capital and having interests conflicting with those of the other shareholders – especially as regards the external growth strategies. The main requests of BPM 360 Gradi were a less strong employees board-representation and more space for institutional shareholders. The ease of the recognition as voting shareholder was a further issue for the association. In addition, BPM 360 Gradi asked the publication of the shareholder contacts in the stockowners list made available by the company (until that time the list contained only the shareholders' names)⁷⁰. This was an essential point to allow non-organized shareholders' collaboration (i.e.: the collaboration between the shareholders non belonging to the existing associations).

Amber initiative was in line and ostensibly interconnected with the aims of two important stakeholders of BPM: the chairman Mr. Mazzotta and the Bank of Italy⁷¹. Mr. Mazzotta openly criticized the unbalanced governance of BPM, claiming that it made the bank “*ungovernable*”, avoiding any external growth plan⁷². The chairman unsuccessfully tried to convince the directors to resign before their official expiry date in 2009, in order to reshape the board and overcome the strategic impasse⁷³. Also the Bank of Italy was concerned about BPM governance. In December 2008, the Italian Central Bank launched an official enquiry on BPM. The main issues under monitoring were the governance, the internal control system and the financial statements.

BPM 360 Gradi's representatives advocated the dissent through press interviews; they made successful efforts to involve other shareholders in the association; and they intervened in the 2008 shareholder annual meeting, although Amber was not entitled to vote. Indeed, the board of BPM had refused the voting-shareholder status to Amber again in February 2008. In the 2008 shareholder meeting, the financial director of the BPM 360 Gradi association (Mrs. Vidra) made a confrontational address against the unbalanced power of the employees

⁷⁰ Di Biase, A. 2008. *Bpm, Mazzotta trova un alleato*. Milano Finanza, 25 January.

⁷¹ See: Di Biase, A. 2008. *Bpm, Mazzotta trova un alleato*. Milano Finanza, 25 January.

⁷² Crédit Agricole Cheuvreux (2008) stated that: “The Chairman had the backing of the organisations that appointed the BoD in spring 2006 (i.e. union/employee-friendly allies). Now, he seems to be taking a more radical approach to defend his own power base”.

⁷³ Pica, P. 2008. *La mossa di Mazzotta chiama l'affondo di Amber*. Corriere della Sera 28 January.

associations. This address found the backing of the non-employee shareholders and of the chairman Roberto Mazzotta. Instead, the employees association, Amici della BPM, defended the bank's governance structure.

Some key developments for the activist have occurred starting from June 2008. As concerns Amber Capital's requests on the status of voting-shareholder, the BPM board of directors opened to the activist for the first time on 3 June 2008. The board modified the acceptance rules, stating that the change was aimed to meet the pressures received from the market⁷⁴. The company decided to disclose the stockowners' contacts in the shareholders' list and to replace the "*fiscal heaven-black list*" acceptance criteria (i.e.: to deny the vote to shareholders based in fiscal heavens) with a transparency based criteria. On 20 January 2009, Amber and other eight funds⁷⁵ were accepted as voting shareholders. Relevant to notice, the admission was on time to allow the shareholders to vote to the 2009 board elections.

The governance equilibriums and the employees' powers have been a central issue at BPM, with relevant developments since July 2008. On 8 July the general manager Mr. Viola left the company because in disagreement on governance issues⁷⁶. On 14 July, the representatives of the Bank of Italy exhibited to BPM directors the results of the Central Bank's enquiry started in December 2007 and ended in May 2008. They asked to rebalance the powers within the board of directors through a change in the bylaws allowing greater representation to minority shareholders⁷⁷. The request was not legally binding, however the Bank of Italy could decide to undertake harsh measures in order to achieve its purposes. In order to self-reform the bank's governance, the majority shareholders (i.e.: the employees) had to vote a reduction of their influence on the company. Some unions openly disagreed with the Central Bank's critics⁷⁸. The association BPM 360 Gradi asked for actual, not just formal, bylaws changes, supporting the Bank

⁷⁴ See: BPM press release 3 June 2008.

⁷⁵ Interfund Equity Italy, Fideuram Fund Equity Italy, Fonditalia Equity Italy, Fonditalia Global, Pioneer Italian Equity, Ducato Geo Italia, Imi Italy and Pioneer Azionario Crescita. See: Reuters. 2009. *Pop Milano, cda ammette a libro soci 9 fondi tra cui Amber*, 20 January.

⁷⁶ See: Borsa e Finanza. 2008. *BPM Tutti contro tutti, in attesa di Draghi*, 12 July.

⁷⁷ Di Biase, A. 2008. *Giro di vite di Draghi sulla Bpm*. Milano Finanza, 15 July.

⁷⁸ Gualtieri, L. 2008. *Pop Milano, la Fabi contro Draghi*. Milano Finanza, 1 August.

of Italy's claims. In the end, the employees accepted to modify the board composition rules. On 13 December 2008, an extraordinary general meeting modified the bylaws allowing a board greater representation of the minorities. Previously, the board of directors was composed by 16 members picked from the majority list and by not more than four directors coming from the minorities. After the bylaws changes, the board size was reduced to 16 members in total, plus two directors appointed by the business partners (i.e.: Crédit Industriel et Commercial and of the Cassa di Risparmio di Alessandria foundation). The majority list appoints 50%+1 members (of the total of 16+2 members) and the rest of the board comes from the minority lists.

Therefore, the activist obtained some changes in line with what requested. However, the final results were mixed. At the April 2009 board elections, neither Amber Capital nor the BPM 360 Gradi association submitted their own slate of nominees. According to the CONSOB database, as of 16 December 2008, Amber decreased its stake in BPM under the 2% disclosure-threshold⁷⁹.

4.2.3. Hermes Focus Asset Management Europe – Italmobiliare

Hermes Focus Asset Management Europe (Hermes), the fund manager owned by the British Telecom Pension Scheme, was protagonist of a highly confrontational campaign against an Italian family company. Since the fall 2006, Hermes has been shareholder of Italmobiliare⁸⁰, an holding company 47.3% (as of 30 April 2008) controlled by the Pesenti family⁸¹. Italmobiliare is the majority shareholder (60.3% ownership) of Italcementi, a leading group in the cement and construction materials industry (Hermes has been a shareholder also at

⁷⁹ As of 14 June 2007 the activist owned 2.16% of BPM.

⁸⁰ Disclosure of the initial date of the investment was given by Hermes in the report on its shareholder proposal at the 2008 annual meeting. Furthermore, CONSOB has disclosed Hermes stake in Italmobiliare (because higher than 2%) since December 2006.

⁸¹ The shareholders owning more than 2% of the ordinary shares as of 30 April 2008 were: the Pesenti family (47.3%), the Strazzera family (10.3%), Mediobanca (9.5%), Arnhold & Bleichroeder (First Eagle)(4.6%), Hermes (2.8%), treasury shares (3.9%). Considering the total share capital (both ordinary and saving shares), each of the previous mentioned shareholder owned: the Pesenti family (27.2%), the Strazzera family (5.9%), Mediobanca (5.5%), Arnhold & Bleichroeder (First Eagle) (1.8%), Hermes (3.3%). Source: minutes of the 30 April 2008 annual general meeting; Hermes report on its shareholder proposal at the meeting.

Italcementi). In addition, Italmobiliare has significant investments in the financial and publishing sectors.

On 4 January 2008, Hermes sent a letter to the board of directors of Italmobiliare and of Italcementi⁸², following some unsuccessful private engagement with the management, started in May 2007⁸³. The activist claimed that both Italmobiliare and Italcementi were undervalued on the market because of: the lack of transparency in the governance; the highly diversified investments; and the shareholders' capital structure⁸⁴. Hermes argued that the lack of transparency was due to the Pesenti's familiar ownership. In addition, the diversified investments in the industrial (Italmobiliare: controlling shareholder of Italcementi; Italcementi: majority shareholder (79.5%) of the French listed company Ciment Français), financial (stakes in Unicredit, Mediobanca, Mittel, and others) and publishing (stake in RCS Mediagroup) industries had led both companies to suffer a sizeable conglomerate discount. Furthermore, the activist stated that both Italmobiliare and Italcementi presented an unbalanced dual class share capital, with a too large portion of saving shares if compared to the ordinary shares. Italmobiliare replied refuting the issues raised⁸⁵.

Hermes decided to bring the debate in the shareholder general meeting. On 8 April 2008, it requested to the Italmobiliare board of directors to add a shareholder proposal to the agenda of the upcoming annual general meeting. The proposal concerned the conversion of the outstanding saving shares into ordinary shares, with a 1 to 1 exchange ratio (without any cash settlement). This would dilute the Pesenti's voting rights from 47.3% to 27.2%. Two days later, the board accepted to add the proposal to the agenda. The company's decision can be seen as a move to avoid further debate (e.g.: a legal action following a deny to the

⁸² Disclosed in February. See: Greco A. 2008a. *Il fondo Hermes attacca i Pesenti "Risultati scarsi e poca trasparenza"*. La Repubblica, 6 February.

⁸³ See: Hermes report on its shareholder proposal at the 2008 annual meeting. In addition see: Greco, A. 2008. *Pesenti respinge le critiche di Hermes*. La Repubblica, 7 February.

⁸⁴ Greco A. 2008. *Il fondo Hermes attacca i Pesenti "Risultati scarsi e poca trasparenza"*. La Repubblica, 6 February.

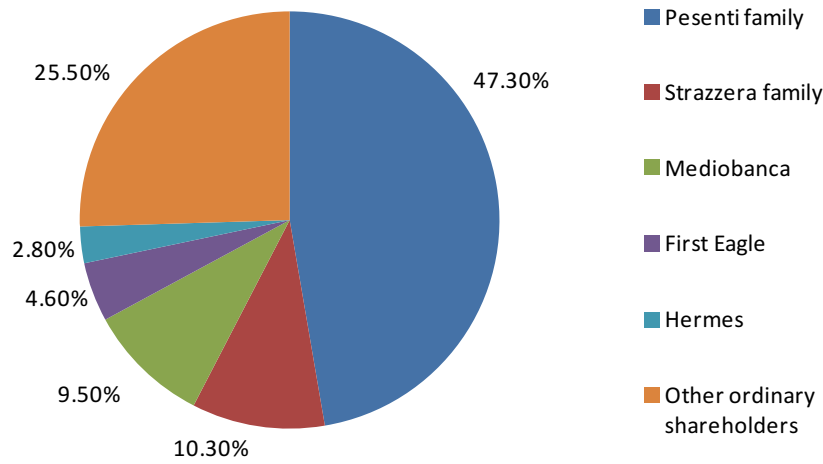
⁸⁵ After the disclosure of the Hermes letter in early February 2008, the company's representatives replied informally. On 13 Feb 2008 Italmobiliare disclosed that the chairman Giampiero Pesenti replied to the activist with a formal letter, in concert with the board of directors.

shareholder request) rather than a substantial opening to the activist⁸⁶. Indeed, the Pesentis were able to block the proposal thanks to their strong voting power. In addition to the shareholder proposal, Hermes submitted two minority slates for the elections of the board of directors and of the internal auditors, each list composed by one independent candidate. The fund was seeking to obtain the board seat devoted to minority shareholders.

In order to explain its shareholder proposal, Hermes published a report on the item added to the general meeting agenda. In the same document the fund provided a comprehensive analysis of all the issues raised against both Italmobiliare and Italcementi. Furthermore, it asked some specific changes in the governance and strategy of the two companies. The dual class shares, together with Italmobiliare group structure were the main concerns of Hermes, and the main cause addressed to the group's undervaluation on the market. The activist claimed that Italmobiliare, with 42.4% of the total capital composed by saving shares, presented an inefficient capital structure. The fund argued that, given the higher dividend provided by the saving shares (saving shares have higher dividend but no voting rights), this class of shares should be traded at a premium respect to the ordinary shares. Instead, they historically were traded at a discount. Hermes stated that the reason was that saving shareholders represented 42.4% of the capital, but because they lack of voting rights, the Pesentis were entitled to control the company owning 27.2% of the (total) capital – corresponding to 47.3% of the ordinary capital: See figure 1 and figure 2. Also Italcementi had a large proportion of saving shares, equal to 37.3% of the total capital.

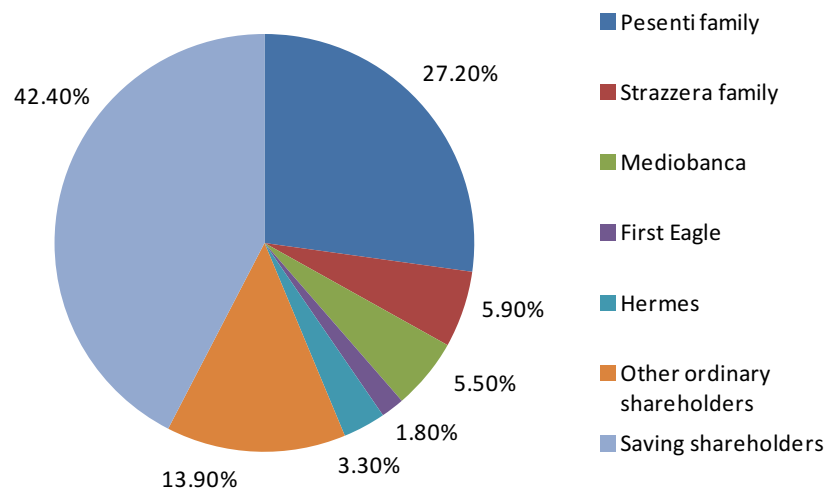
⁸⁶See: La Repubblica. 2008. *I Pesenti "aprono" al fondo Hermes*, 10 April.

Figure 1. Italmobiliare ordinary share capital.
As of 30 April 2008



Source: minutes of the 30 April 2008 annual general meeting.

Figure 2. Italmobiliare total share capital (both ordinary and saving shares).
As of 30 April 2008



Source: minutes of the 30 April 2008 annual general meeting; Hermes report on its shareholder proposal at the meeting.

The activist claimed that the use of dual class shares, together with the pyramidal structure of the group, allowed the Pesenti family to control the subsidiaries along the pyramid with a small indirect investment. For instance, the family has been able to control almost 80% of the voting rights at Ciment Français (a listed company 79.5% owned by Italcementi), with an indirect investment equal to 8.5% of the capital⁸⁷. Moreover, Hermes stated that the use of control enhancing mechanisms (CEMs) was exaggerated. Italmobiliare and Italcementi were among the Italian companies with larger use of dual class shares. In private meetings with and in letters to the management, Hermes proposed to buyback the saving shares. The fund received negative feedbacks, therefore decided to propose the shares conversion to the general meeting. The activist argued that the conversion would improve the shares liquidity and the company's governance, receiving a positive market reaction. Hermes was very confrontational against the Pesentis. Indeed, it stated that the group structure seemed to be aimed to extract private benefits of control rather than to pursue shareholder value creation. In addition, the CEMs caused a lack of transparency in the governance: the activist stated that it was uncertain whether Carlo Pesenti, Italcementi CEO (and Italmobiliare CEO) was appointed because of his skills or of his family ties. Moreover, the insurgent claimed that both Carlo Pesenti and Giampiero Pesenti (Italmobiliare chairman and CEO; Italcementi chairman) had offices in a too high number of other companies to have enough time to properly manage the Italmobiliare group. Hermes wrote that Italmobiliare had been managed as a non-transparent "*family office with a high risk profile*", rather than as a modern investment company with a professional investment strategy (i.e.: Italmobiliare lacked a chief investment officer). In the insurgent's opinion, the consequence had been to have risky investments with low returns, bringing as example the non satisfactory performance of the Irish subsidiary Italmobiliare International

⁸⁷ The Pesentis owned 27.2% of Italmobiliare ordinary shares, corresponding to 47.3% of the votes (because of the dual class shares structure). Italmobiliare held 39% of Italcementi ordinary capital and 60% of the voting rights. Italcementi was the owner of 79.5% of Ciment Français. Therefore, the Pesenti family had an indirect 10.6% stake in Italcementi (through Italmobiliare), and a 8.5% indirect position in Ciment Français (through Italmobiliare and Italcementi). However, the family was able to control 79.5% of Ciment Français (thanks to the control on Italmobiliare that controlled Italcementi that controlled Ciment Français).

Finance – claiming that it was providing lower returns than the interests paid by Italmobiliare itself on its debt.

Hermes requested a number of changes in the group's governance and strategy. As first it asked to implement a professional investment strategy at Italmobiliare, introducing the role of chief investment officer. Among other claims, the activist asked to justify the investment in the Irish subsidiary Italmobiliare International Finance. Furthermore, Hermes requested a reduction of the saving shares, through buybacks or a conversion. Moreover, the activist argued that the lack of transparency in the governance could be improved with an increase in the number of independent directors. The insurgent asked also to solve the Pesenti family conflict of interests. Regarding Italcementi, it requested to restructure the Italian assets, considering also to sell some of them; to purchase the residual floating shares of Ciment Français or to merge the company with Italcementi; to sell the Mediobanca and RCS stakes, because non related with the group's industrial business⁸⁸.

At the directors and internal auditors 2008 elections, the Pesenti family submitted a majority list of candidates, Hermes a minority list, and another shareholder of Italmobiliare, the Strazzera family, submitted a further minority slate of nominees. Hermes claimed that the Strazzera family, the Pesentis, and Mediobanca were linked by a non disclosed cooperation agreement, making the Strazzera family's slate unable to run for a minority seat. The activist asked the market regulator's intervention. CONSOB required Italmobiliare to clarify the situation and the company denied any relation among the shareholders⁸⁹. Moreover, the Pesenti family increased the number of independent directors in its slate of nominees to six candidates, compared to three directors in the expiring board. This could seem in line with the activist's requests. However, Hermes

⁸⁸ See: Hermes report on its shareholder proposal at the 2008 annual shareholder meeting; minutes of the 2008 meeting.

⁸⁹ Ninfolo, F. 2008. *Nessun patto occulto su Italmobiliare*. Milano Finanza, 25 April.

questioned the independence of five candidates out of six, claiming that they were non-independent⁹⁰.

As predictable, at the shareholder meeting Hermes was not able to pass the saving share conversion plan⁹¹. The voting power concentrated in the hands of the Pesenti family prevented a dilution of their (ordinary) ownership. The activist was even not able to elect minority board representatives. Indeed, the Strazzera family appointed its candidates at both the directors and statutory auditors elections. At both the elections⁹², Hermes obtained around 10% of the votes – corresponding to about 8% of the ordinary shares outstanding; the Strazzera family's result was 15.7% of the shares attending the meeting – equal to 12.5% of the shares outstanding (the family alone owned around 10% of the ordinary capital). Hermes had the backing of First Eagle, an US hedge fund with a name for activism (owner of 4.6% of Italmobiliare ordinary shares), and of Assogestioni, the institutional investors' association⁹³. First Eagle has been an active shareholder at both Italmobiliare and Italcementi, successfully submitting the candidacy of the saving shareholders representative at Italmobiliare (at the 2011 saving shareholder meeting) and at Italcementi (2010 meeting), and appointing one minority director at Italcementi (at the annual general meeting 2010)⁹⁴.

The annual general meeting was the event chosen by the Pesentis to reply to the activist's questions. Chairman Giampiero Pesenti rejected the accusation of running the company as his own family office, defended the independence of his candidates, and pointed out the financial purposes for not selling the stakes in Rcs (reasons: binding shareholder agreement; not good moment to sell because of the shares undervaluation) and Mediobanca (binding shareholder agreement)⁹⁵. In

⁹⁰ MF-Dow Jones Global. 2008. *Italmobiliare: le contestazioni di Hermes su indipendenza consiglieri*. 30 April.

⁹¹ The voting results of the shareholder proposal (saving shares conversion) have been as follows. The votes FOR the shareholder proposal have been 10%, corresponding to 7.9% of the shares outstanding. The votes AGAINST 90%, corresponding to 71.2% of the ordinary capital.

⁹² The majority slate at both elections obtained 74.2% of the votes, corresponding to 58.8% of the ordinary shares outstanding.

⁹³ See: Ninfolè, F. 2008. *Italmobiliare respinge Hermes*. Milano Finanza, 1 May; Bennewitz, S. 2008. *Hermes resta in Italmobiliare, aperti al dialogo con Pesenti*. La Repubblica, 5 May.

⁹⁴ See the minutes of the shareholder meetings.

⁹⁵ Refer to the minutes of the 2008 annual general meeting of Italmobiliare.

addition, Italcementi CEO Carlo Pesenti at the company's general meeting stated that the intention of the firm was to delist Ciment Français, but it would take time⁹⁶.

On 5 May 2008, in a press interview⁹⁷ following the defeat at the shareholder meeting, Stephan Howaldt, Hermes general manager, stated that the activist's aim was to be a long term investor in the company, willing to dialogue with the Pesentis. He declared that positive signals from the controlling family would be: a share conversion or buyback; the purchase of the residual minority stakes in Ciments Français; a step back by the family at Italcementi: the family should leave the executive positions in the firm and manage only the holding company Italmobiliare. The following year, at the April 2009 annual general meeting the Hermes representative recognized some positive developments at the group, in line with the activist's requests. The facts were: the proposal of a merger between Italcementi and Ciments Français; an acceleration of the restructuring of Italcementi Italian assets; a decrease in the exposure in the Irish subsidiary Italmobiliare International Finance⁹⁸. However, the merger Italcementi - Ciments Français did not occurred because the company could not reach an agreement on deal condition with some bondholders⁹⁹. On June 2009, the activist decreased its stake in Italmobiliare below the 2% threshold¹⁰⁰. Nevertheless, it continued its engagement with the company. At the 2011 directors and auditors elections – the next elections after the 2008's – Hermes, together with the activist investor Amber Capital, was able to elect one minority internal auditor. Indeed, the two investors submitted a joint slate. At that time (April 2011) Hermes and Amber Capital owned together 1.8% of the ordinary capital¹⁰¹. The two institutions were able to appoint the statutory auditor because their slate was the sole minority slate.

⁹⁶ Refer to the minutes of the 2008 annual general meeting of Italcementi.

⁹⁷ Bennewitz, S. 2008. *Hermes resta in Italmobiliare, aperti al dialogo con Pesenti*. La Repubblica, 5 May.

⁹⁸ Ansa. 2008. *Italmobiliare: fondo Hermes loda gestione, pace con Pesenti*. 29 April. In addition, see the minutes of the 2011 annual general meeting of Italmobiliare.

⁹⁹ Bennewitz, S. 2009. *Salta la fusione Italcementi-Ciments. Pesenti: "Colpa dei fondi americani"*. La Repubblica, 28 June.

¹⁰⁰ CONSOB communication, 11 June 2009. As of the 2009 annual general meeting, Hermes still owned 2.8% of the ordinary shares, source: minutes of Italmobiliare 2009 annual general meeting.

¹⁰¹ Refer to the minutes of the 2011 annual general meeting of Italmobiliare.

The Strazzeria family submitted a slate only to the directors elections (the sole minority slate submitted). Relevant to notice, no public activism was noticed behind 2011 elections. After the 2008 activism efforts, Hermes kept a non-confrontational behavior – at least in public.

4.2.4. Knight Vinke Asset Management – Eni

The US based activist investor Knight Vinke Asset Management (Knight Vinke) targeted the Italian integrated energy company Eni. The firm has a market capitalization on the Milan stock exchange of approximately €59 billion (as of October 2011, source: Bloomberg). Eni is 30.3% owned by the Italian State¹⁰². Since 2007, Knight Vinke has been one of the largest shareholders of the company holding almost 1% of the shares. The investment in Eni represents almost one third of the activist's portfolio¹⁰³.

In the fall 2009, Knight Vinke disclosed its activism effort oriented to prompt changes in the structure of the Eni group. The activist publicly criticized the conglomerate nature characterizing the firm. Differently from its peers, Eni holds in the same group both upstream and a downstream businesses. The upstream business includes the following divisions: *Exploration and Production* (for oil and natural gas); *Refining and Marketing*; *Petrochemicals*; *Engineering and Construction* – including a 43% stake in the Italian listed company Saipem, international contractor in the oil & gas industry; *Other, Corporate and Stakes*. The downstream business is composed by the *Gas and Power* division, including: gas supply and marketing; the 50% stake in the Italian listed company Snam Rete Gas (SRG), focused on Italian transport, regasification, storage, and distribution; the international gas transport infrastructure; and the gas equity stakes – including the 33% stake in the Portuguese listed company Galp Energia (Galp), an integrated energy operator with activities in the oil and gas industry. Knight Vinke pointed out that the upstream business was fast growing but unstable and risky; the downstream had a slower growth, but steady returns and low commodity price

¹⁰² As of 6 October 2010 the shareholders owning more than 2% are: the Italian State 30.3%; Bnp Paribas 2.3%; Blackrock 2.7%; in addition treasury shares are held by Eni 7.5%. Source: CONSOB

¹⁰³ See the letter sent by the activist to Eni CEO of 4 November 2009 and published on the Financial Times on 14 January 2010.

risk. The activist claimed that the conglomerate structure had led the company to be undervalued on the stock market for €50 billion (as of September 2009), trading at lower multiples than peers. The insurgent added that Eni was financially constrained, as demonstrated by the dividend cut occurred in 2009. In order to not dilute the stake of the Italian State, Eni relied mainly on debt as external financing. However, the company had already reached a larger debt level considering its structure. Indeed, the group in its conglomerate form was unable to borrow as much as the sole downstream utility could do on its own. In addition, the high growth of the upstream business had not been reflected in the company's shares performance; on the contrary, the group's shares traded at a lower multiple than the peers. At that time (i.e.: the fall 2009), the activist proposed two restructuring activities to the target company. The first proposal, preferred by the insurgent, consisted in splitting Eni in two specialist companies, a GasCo and a OilCo, through a spinoff of one or the other to Eni's shareholders. The GasCo would be constituted by Eni *Gas and Power* division, including SRG (i.e.: the downstream business), and some of the most mature assets of Eni; the OilCo would contain the residual activities (i.e.: the upstream business, excluding some of the most mature assets). Given that half of Eni's € 18 billion of consolidated debt (as of September 2009) was already sat within SRG, the OilCo would therefore be completely debt free. The second, alternative, proposal consisted in the spinoff of a NewCo, composed by SRG and the international gas infrastructure.

The disclosure of the activism effort occurred on 2 September 2009, with a press release where Knight Vinke revealed its shareholding in Eni, specifying the activism purposes of the investment¹⁰⁴. In actual fact, the press release confirmed the content of the *Lex* column of the Financial Times of the same day. The newspaper made public Knight Vinke's activism at Eni, and backed the insurgent's argument. The public disclosure of the effort followed several private

¹⁰⁴ The investment size, tenor and activism nature have been disclosed by Knight Vinke in a press release of 2 September 2009, titled: *Knight Vinke confirms its holding in ENI and calls for a debate on the structure of the energy industry in Italy*.

meetings between the activist and the target company's management¹⁰⁵, and a formal letter sent to the company on 31 July 2009. The company CEO, Paolo Scaroni replied to the letter on 1 September 2009¹⁰⁶. The CEO defended the conglomerate structure of the group. He stated that: Eni had already satisfactory restructured the regulated gas businesses with the sale of Italgas (Italian gas distribution) and Stogit (Italian gas storage) to SRG; the gas marketing has dissimilar operational characteristics than the regulated business (consisting in SRG) to sit in the same company; there exist synergies between the gas marketing and the oil and gas exploration and production. The synergies have been explained as follows: buying gas from countries as Algeria, Libya, Egypt and Russia provides a competitive advantage to Eni in order to obtain exploration and production business¹⁰⁷. The CEO recognized the existence of some conglomerate discount in the market valuation of Eni. However, he disagreed with the almost 100% undervaluation calculated by the activist and affirmed that the discount would be in any case lower than the benefits granted by the synergies.

On 30 September 2009, Knight Vinke organized a conference in Milan to explain its opinions to the market. The activists presented a Sum of the Parts valuation of Eni, arguing that the group appeared undervalued for €50 billion and proposed the restructuring as a solution to unlock the hidden value. Relevant to notice, Eric Knight, founder and CEO of Knight Vinke, affirmed that his fund would not force the company with a proxy fight or any other effort in the shareholder meetings. Instead, the activist aim would be to promote the public debate around the restructuring issue¹⁰⁸. Mr. Scaroni replied referring to his letter of early September. On 4 November 2009, Knight Vinke responded to Mr. Scaroni with a letter, later published by the activist (on 14 January 2010) in the

¹⁰⁵ See: Boland, V. 2009. *Knight Vinke urges Eni break-up*. Financial Times, 30 September.

¹⁰⁶ Disclosure was provided only at the end of September. See Eni press release of 30 September 2009, titled: *Summary of the letter sent by Paolo Scaroni on September 1st in response to Knight Vinke letter dated July 31st*.

¹⁰⁷ Mr. Scaroni provided an explanation of the synergies in a recent press interview. He mentioned the example of Algeria, saying: "*Since we buy from Algeria 5bn cubic metres of gas every year, of course we are number one in exploration and production in that country. [...] We send them a cheque of several billion euros each year. I mean, people love people coming with a big cheque*". Betts, P. 2011. *Rome's emperor of energy*. Financial Times, 15 May.

¹⁰⁸ See: Reuters. 2009. *Eni va divisa in due, valore nascosto per 50 mld*. 30 September.

form of a two pages advertising on the Financial Times, translated in Italian. The original letter (available on Knight Vinke web site, as all the relevant documents made public by the activist) contained the Sum of the Parts valuation of Eni presented at the Milan conference and an analysis of the synergies' issue, raised by Eni CEO Mr. Scaroni. Concerning the synergies, the activist recognized that some benefits could be provided by having the gas marketing and the exploration and production under the same roof, but it claimed that no synergies appeared to exist between upstream activities and gas infrastructure, especially in Italy (i.e.: with SRG). In addition, Knight Vinke stated that the existing synergies would not be an acceptable reason to hold the conglomerate structure: Eni had historically traded at a discount to both the oil sector as well as the utilities sector, meaning that the market put no value on the synergies. On the contrary, the market had identified the group's structure as a cost. Furthermore, the activist requested Mr. Scaroni to provide a financial valuation of the synergies.

On 25 January 2010, the activist obtained a positive result. In a press interview¹⁰⁹, Eni CEO declared that the company would be open to sell the gas infrastructure, including SRG. However, Mr. Scaroni repeated that Eni would not consider the sale of the gas marketing, because of the synergies. In addition, he affirmed that any structural change would take time. Soon after, Knight Vinke sent a letter to Mr. Scaroni, communicating its willingness to be flexible concerning the gas marketing issue. The activist would be ready to support the decision of keeping the gas marketing together with the upstream activities if the synergies were proved. Indeed, Knight Vinke was more concerned on the sale of the gas infrastructure, because, according to the activist's opinion, it would unlock most of the hidden value. In an interview¹¹⁰, Eric Knight repeated that his fund was not willing to make any confrontational action in the shareholder meeting, however, Knight Vinke was in contact with 700 Eni shareholders, representing 25% of the share capital and backing the activist's arguments.

¹⁰⁹ Panara, M. 2010. *Scaroni: "Eni alla campagna d'Africa"*. La Repubblica, 25 January.

¹¹⁰ Published on: Livini, E. 2010. *Knight: Un Eni diviso in due libererà 50 miliardi di valore*. La Repubblica, 8 February.

Together with the activist pressure, also the European Commission's Antitrust authority pushed for a restructuring at Eni. On early February 2010, Eni agreed the divestment of its controlling stakes in the international pipelines TAG, TENP and Transitgas¹¹¹. Furthermore, the European Directive 2009/73/EC concerning common rules for the internal market in natural gas required the independence of the gas transportation. The directive provided two alternatives to Eni. The first consisted in the sale of SRG; the second consisted in maintaining the ownership, but granting the independence of the *transmission operator* (i.e.: SRG) through a system of controls (including the monitoring from the authorities) avoiding any influence by Eni on SRG. On 3 May 2010, Knight Vinke published a legal and an accounting advice on the consequences of the implementation of the Directive for Eni. The experts consulted by the activist declared that whether the first or the second alternative would be chosen, Eni should deconsolidate SRG from its accounts. The activist argued that the market would award a deconsolidation of SRG, if this would be the first step for the sale¹¹². On 19 May 2010, the rating agency Standard & Poor's lowered Eni's rating (the long term rating was cut from AA- to A+) because of the group's debt level¹¹³. Knight Vinke suggested to reduce Eni's debt through the sale of SRG and Galp¹¹⁴.

Since summer 2010, the activist started to address its claims directly to Eni major shareholder, the Italian State. On 19 July 2010, Mr. Knight published a comment on the Financial Times, arguing that Italy could ease the State's debt pressures by selling sell part of or all its holding in Eni. On 25 February 2011, the insurgent wrote a letter to Italy's Minister of Economy and Finance. Knight Vinke was concerned about the consequences of the implementation of the European Directive on the internal gas market (Directive 2009/73/EC). The activist repeated that Eni should deconsolidate SRG from its accounts, also if the company would keep Snam Rete Gas as an independent company (i.e.: the second alternative provided by the Directive). In the end, the Italian Government has implemented

¹¹¹ See: Cerretelli, A. 2010. *Eni trova l'accordo con Bruxelles*. Il Sole 24 Ore, 5 February.

¹¹² See the interview to Mr. Knight, published on: Agnoli, S. 2010. *L'Eni senza Snam vale di più. Tesoro, un bonus da 30 miliardi*. Corriere della Sera, 20 May.

¹¹³ For the reasons of the rating change, see the Standard & Poor's research update of 19 May 2010, titled: *Italian oil and gas major Eni ratings lowered to 'A+/A-1' On increased debt burden*.

¹¹⁴ Reported by Agnoli (2010).

the European Directive with the Legislative Decree 1 June 2011, n. 93, deciding to allow Eni to keep its stake in SRG, granting the independence of the latter. However, Eni did not agree with Knight Vinke regarding the deconsolidation. Despite the issues concerning the implementation of the European Directive on gas, the activist shareholder obtained a confirmation of Eni management's openness to a disposal of SRG. On March 2011, at the presentation of the 2011-2014 strategic plan, Eni CEO Mr. Scaroni declared that the group would consider the sale of SRG under three conditions: the identification of a buyer (i.e.: no spinoff to the shareholders); the existence of a premium on the deal price; the assent of the Italian State¹¹⁵. Therefore, Knight Vinke continued to focus its efforts on the controlling shareholder, Italy – considering the State's high sovereign debt. On 10 August 2011, following the downgrade of the Republic of Italy by the rating agency Standard & Poor's, Knight Vinke published a letter in the Italian newspaper *Il Sole 24 Ore*. The activist proposed to the Italian Government to dispose SRG and subsequently to sell the 30% stake of Eni, at a price that would benefit of the disposal of SRG. The deal could be structured to grant the Italian Government some governance mechanisms allowing the preservation of the national interests.

As of the date of this study, some major change occurred towards the restructuring of Eni. First, the management adopted a open attitude in relation to the disposal of SRG – even if this event would require time and the occurrence of a number of conditions. Second, Eni was in talks with potential buyers for the stake in Galp¹¹⁶, and on early October 2011 at a presentation to the analysts, the company communicated that negotiations were still open¹¹⁷. Third, as agreed with the European Commission, Eni divested its stakes in the international pipelines TAG (sold to the Italian Government's fund *Cassa Depositi e Prestiti* on June 2011), TENP and Transitgas (both sold to the Belgian company Fluxys on

¹¹⁵ See: Maisano, L. 2011. *Scaroni: potremmo cedere Snam con il sì del governo*. *Il Sole 24 Ore*, 11 March.

¹¹⁶ For instance, in a press release of 4 January 2011 (*Eni: clarification on Galp Energia share*), Eni affirmed to have been in talks with the company *Petroleo Brasileiro* as buyer of its stake in Galp. However, later the press reported that the deal did not occurred because of the disagreement between buyer and seller on the pricing.

¹¹⁷ Refer to the slides of the Eni presentation *Exploration & Production Update* of 6 October 2011.

September 2011). However, the restructuring remains an open issue. *Big Oil* companies are slow to accept change. Moreover, the control of the Italian State further complicates the process.

4.3. Evidences from the case studies

a. The public debate

The first evidence regarding the four cases is the large media echo raised by the activists' action. Public shareholder activism represented a relatively new approach to corporate governance in Italy and the financial community was highly interested. The insurgents' claims found the backing of several brokers, financial press and governance advisors. In the Generali case, brokers supported the activist on the governance issues but were skeptical about the impact on the firm valuation calculated by the activist¹¹⁸. The Financial Times described the Algebris' effort as "*a fresh approach for corporate Italy*"¹¹⁹. Moreover, leading proxy advisors such as ISS and ECGS backed the activists' proxy efforts. Concerning Banca Popolare di Milano, brokers supported Amber claims by considering the governance of the bank "*unbalanced*"¹²⁰. The Hermes activism at Italmobiliare did not obtain specific broker coverage; the proxy advisor ISS supported the insurgent claims. Knight Vinke efforts at Eni received mixed broker opinions. Some stressed the role of the synergies and did not support the activist requests¹²¹, others focused on the undervaluation of the company's shares and backed the break-up proposals¹²². The reaction of the financial community and the press echo contributed to persuade the target companies to reply and even to have a public dialogue with the activists. Such process seems to be important. Indeed,

¹¹⁸ Merrill Lynch, 2007. *Generali equity report - Generali receives a letter*. 26 October; JP Morgan Cazenove, 2007. *Generali equity report*. 30 October; Exane BNP Paribas, 2007. *Generali is not ABN-Amro!*. 25 October.

¹¹⁹ Michaels, A. 2007. *Algebris joins activists' ranks*. Financial Times, October 24.

¹²⁰ Crédit Agricole Cheuvreux. 2008. *Banca Popolare di Milano. Democracy vs. capitalism*. 19 February. In addition, see: Citi. 2008. *Banca Popolare di Milano. Still A Lot to Do*. 5 December.

¹²¹ See: Exane BNP Paribas. 2009. *Eni equity report – Activist shareholder claims structure lead to dividend cut*. 2 September; Mediobanca. 2011. *Eni equity report. Forget break-up. Buy the growth*. 14 February.

¹²² Bernstein Research. 2009. *Eni - Is it really a good idea to split the company? Dissecting the Knight Vinke proposals*. 25 November; JP Morgan Cazenove. 2011. *Eni - Revisit the restructuring story*. 7 July.

the first step for public activism should be to exert moral suasion through a debate involving the company stakeholders. The second step would be to involve other minority shareholders in the campaign. And the third would be to convince the majority shareholder to implement the requested changes. Concerning the last two steps, the evidence from the case studies are mixed – presenting, however, some relevant patterns.

b. The confrontational recourse to shareholders' vote

The Generali and Italmobiliare cases were characterized by the strongly confrontational behavior of the activists and by the recourse to the shareholders' vote. The shareholder meeting results were unsatisfying for the insurgents, not able to appoint their minority board candidates. The activists lost against other minority shareholders: a family owning a large stake in the Italmobiliare case (i.e.: the Strazzera family, owning around 10% of the company's ordinary shares); in the Generali case the association of Italian institutional investors Assogestioni which obtained the backing of a shareholder owning a sizeable stake, the Bank of Italy (owner of 4.5% of the company). In the Italmobiliare case, Hermes unsuccessfully opposed to the family's voting power the support of some institutional shareholders: the activist obtained votes from the institutional investor First Eagle (owner of 4.6% of the firm's ordinary shares) and from Assogestioni. At Generali, more than 200 foreign institutional investors supported Algebris against the Italian funds' association, but it was not enough. In a M&A Edge note, the proxy advisor Institutional Shareholder Services (ISS)¹²³ interpreted the backing of many Italian shareholders to the Assogestioni slate as “*an elegant way of supporting a minority candidate while at the same time not breaking the unspoken rules of conduct by supporting an outspoken dissident hedge fund like Algebris*”. In both cases, it seems that the confrontational approach and the decision of performing a sort of proxy contest (i.e.: proposing candidates at the VDL elections as part of a public activism strategy) did not paid. In the Italmobiliare case, the pool of institutional investors supporting Hermes did not overcome the Strazzera family's voting power presumably because of the low

¹²³ Institutional Shareholder Services (ISS). 2008. *Generali: “Back to Normal?”*. M&A Edge Note , May 15.

general meeting attendance characterizing Italy. Indeed, it seems fair to expect that if more institutional investors attended the meeting, they would have supported Hermes. Regarding the Generali elections, the confrontational behavior of Algebris could be a reason that lead the Italian investors to support the other minority slate – to not break the “*unspoken rules of conduct*” of the Italian system.

The first relevant evidence from the two cases seems to be the failure of the recurs to the shareholders’ vote as part of a confrontational activism strategy. However, the final outcome of the Generali and Italmobiliare cases was different. After losing the elections, Algebris kept a publicly confrontational behavior (e.g.: the letter sent to the new auditors board) and soon sold most of its ownership, justifying the exit as a consequence of the lack of responsiveness to its claims. Even though a few years after the company implemented some changes in the governance in line with Algebris requests, this took place after the insurgent’s exit. Hermes had a different approach after the failure at the 2008 shareholder meeting. The activist declared its willingness to have a dialogue with the company and the controlling shareholder and to be a long term engaged shareholder. Hermes changed its approach towards a non confrontational behavior, at least in public. This represents the second main evidence form the two cases. One year after the 2008 voting failure, the insurgent acknowledged that some achievements had been obtained – even though more should be done to fulfill the activist’s requests. This statement appears important: the activist itself recognized to have had a certain impact on the corporate decisions. Moreover, at the directors and auditors board elections of 2011, Hermes succeeded to elect a minority statutory auditor – however after having decreased a sizeable part of its ownership in Italmobiliare. The differences with the previous elections (2008), where the activist lost both the directors and the auditors elections, are that: after 2008 Hermes did not performed public activism; in 2011 Hermes proposed a candidate only for the auditors board; the Strazzera family – that some saw as management friendly – submitted a slate only to the directors elections. An explicit private settlement or an unspoken understanding following the change in the activist’s

behavior could be fairly assumed. In exchange of a softer public approach Hermes obtained to appoint a minority auditor.

The recurs to less confrontational and even relational approaches are illustrated in details in the other two cases, Eni and BPM.

c. Diplomatic and relational approaches

In the other two cases – Eni and BPM – the activists were less confrontational and did not use the shareholder meeting's vote. In the Eni case, the activist adopted a diplomatic approach different from the previous activism cases performed at Generali and, in the first phase, at Italmobiliare. Knight Vinke CEO affirmed that the fund would not bring its claims in the general meeting and referred to Algebris' effort at Generali as an opposite activism model respect to his fund's one¹²⁴. The activist's CEO declared to be backed by a sizeable portion of Eni largest shareholders¹²⁵. However, he recognized that should he go for a proxy fight, he would be defeated. The Financial Times reported that according to some observers, Algebris and Hermes failed because they were too confrontational. To the contrary, Knight Vinke based its approach on valuation, providing detailed analysis of strategic issues. The activist did not attack the management or the controlling shareholder, but tried to build a dialogue¹²⁶. Considering the Knight Vinke diplomatic approach, it is important to stress that the controlling shareholder of Eni is a Sovereign State. As of the time of this work, the activist obtained that the management demonstrated an open attitude towards the less radical form of restructuring requested. The company declared to consider the sale of Snam Rete Gas and to be in talks with potential buyers for Galp Energia. In addition, Eni decided to solve the Antitrust issues concerning the gas infrastructure raised by the European Commission by selling the international gas pipelines. Two issues should be considered. First, a restructuring at a large State-controlled energy company would presumably take long time. Second, it

¹²⁴ See: MF-Dow Jones Global, 2009. Eni: K.Vinke, nostro obiettivo non è raccolta voti. 30 September.

¹²⁵ Eric Knight declared to be in contact with the first 700 Eni shareholder, representing 25% of the capital and supportino his claims. See: Livini, E. 2010. *Knight: Un Eni diviso in due libererà 50 miliardi di valore*. La Repubblica, 8 February.

¹²⁶ Boland, V. 2009. *Radical shake-up of Eni looks unlikely*. Financial Times, 1 October.

would be hard to directly link any major change to the efforts of the activist. However, Knight Vinke held the merit to have raised the debate on the Eni restructuring, obtaining a constructive dialogue with the management. In a recent equity report, JP Morgan Cazenove recognized to Knight Vinke the credit of having brought the ENI restructuring issue “*to the forefront of ENI's equity story*”, although such speculation was not new among the financial analyst community¹²⁷.

In the BPM case, Amber initially proposed the classical scheme followed by the activists. However, it soon decided to adapt itself to the specific model of BPM, and founded a shareholder association. With this move, the activist decided to be relational rather than directly confrontational. The association, sponsored by Amber, found an ally in the chairman and in other top executives. To some extent the new association was confrontational against the employees' association which was controlling the board. However, the activist (and its association) never attacked the cooperative governance form, which could be considered the first source of the institutional investors' under-representation. The activist requested gradual changes (i.e.: obtaining the voting shareholder status; the disclosure of the shareholders' contacts; and more balanced board representation) rather than a radical shake up – unlikely to be achieved. Amber obtained that the company modified the acceptance rules in order to facilitate the recognition of institutional investors as voting shareholders. In addition, BPM made available the shareholders' contacts, granting a potentially higher cooperation among the minorities. It is important to notice that the company declared that the changes were due to the pressures received by the market, providing an almost direct link with Amber's action. Regarding the other request made by Amber – i.e.: greater board representation for minority shareholders, what asked by the Bank of Italy was in line with the activist's claims. The fund decreased its stake in BPM under the 2% threshold just after that these changes had been implemented. Moreover, neither Amber nor the new shareholder association submitted a slate of nominees at the 2009 board elections. Erede (2009) reported that sometime after the activist's campaign at BPM, the target company decided to make a cross investment in Amber itself. The Author, also analyzing a number of other

¹²⁷ JP Morgan Cazenove. 2011. *Eni - Revisit the restructuring story*. 7 July.

investments of Amber in Italy, concluded that the activist designed its investments forming strategic alliances rather than employing more aggressive methods. Generally speaking, the Author stressed that, in a number of cases, activists in Italy seems to have extracted private benefits (i.e.: not shared with the other shareholders) from the non-public settlement of the public engagement efforts. In any case, what is primarily interesting in the case of Amber is the relational behavior undertaken.

Further indication of private settlements were provided by the developments in the engagement of Hermes at Italmobiliare, after the 2008 confrontational efforts. However, whether or not a settlement occurred, it seems that no private benefits extraction has taken place in this case.

4.4. Recent developments and expectations on the support to the activists

The concentrated ownership structure of Italian companies and the low shareholder meeting attendance has provided a non-favorable environment for shareholder activists. However, there are some trends that could lead to higher support to insurgents in the future. The ownership and meeting attendance of foreign institutional investors was increasing in the last years (see: Georgeson, 2011; CONSOB, 2011). If these trends will be confirmed in the future, higher support for activists could be expected. Indeed, international institutional investors have been recognized as more sophisticated and responsive than other shareholder concerning the governance of the firms. Aggarwal et al. (2010) argued that the presence of international institutional investors improves corporate governance mechanisms and has positive effects on firm value and board decisions. The proxy advisor ISS stressed the importance for activists of having a responsive shareholder base¹²⁸. Naming also the case of Italy, ISS argued that it is difficult for activists – that usually are US/UK based hedge funds – to achieve traction with local investors. International institutional investors are more independent than local shareholders, and therefore more reactive to activism. This

¹²⁸ Institutional Shareholder Services (ISS). 2008. *“Local” Ownership and Hedge Fund Activism*. M&A Edge Note , 10 December.

is more true for US/UK based institution, which are more used to shareholder activism because of the outsider nature of their home markets. ISS linked the level of voting support to activists with the relative percentage of shares owned by the activists and US/UK investors in the target company.

Activists operating in Italy are expected to benefit of a boost in the already increasing trend in the shareholder meeting attendance after the implementation of the EU Shareholder Rights Directive 2007/36/EC (SHRD), transposed into Italian law on 27 January 2010. Nevertheless, being the shareholder meeting participation below the European average, any meaningful improvement would require time. The SHRD has been applied to shareholder meetings called after 31 October 2010. This has granted to stockholders more information and lower costs to vote in the meetings. One of the main changes in the legal framework has been the abolition of the share-blocking system, replaced by a record date at seven business days before the first call of the meeting. In a share-blocking system, in order to vote in the general meeting the shares have to be blocked (i.e.: non-transferable) for few days before the meeting. In a record date system, no limits to the shares transferability are applied. Investors owning the shares as of the record date (i.e.: seven business days before the first call of the meeting) are entitled to vote in the forthcoming shareholder meeting, no matter if they sell the stocks meanwhile. This provision has removed a disincentive to the participation in the general meetings, eliminating the costs associated with blocking the transferability of the shares before the vote.

In addition to the record date, other improvements have been introduced by the SHRD. The directive has granted to shareholders more time to access and evaluate meeting documentation, as well as more information on the post-meeting voting results. More detailed provisions have been introduced concerning the shareholders' right to add items on the meeting agenda, and more time has been given to shareholders to add new items. In addition, shareholders have been entitled to ask questions to the company before the meeting. Moreover, the directive has facilitated the participation in the meeting by means of proxies and it has liberalized and eased the proxy solicitation process. The participation in the

meeting by means of electronic vote has been allowed, but it has been considered as non mandatory.

The introduction of a record date seems to be the main innovation of the SHRD, able by itself to increase the general meeting attendance – in particular by international institutional investors. Several Authors identified the limits of a share-blocking system. Among the others, Santella et al. (2008) reported that the share-blocking was considered by the vast majority of institutional investors as one of the greatest obstacles to share voting. Many institutions would choose not to vote rather than be prevented from selling their shares at any time. Bruno (2010) commented that the SHRD can be considered one of the instruments that would increase the minority shareholders' powers, allowing them to balance the blockholders' control. The Author stressed the role of the information as catalyst for the shareholder monitoring, forecasting an increasing diffusion of general meeting-related information in the future. Indeed, the SHRD followed this direction.

Eckbo and Paone (2011) stated that the implementation of the directive has represented an important step forward towards removing the existing obstacles to shareholder meeting attendance in Italy, especially as regards cross-border voting. The Authors argued that the SHRD has improved the voting process and made voting Italian shares easier and less costly. However, they highlighted the following important voting impediments that are still present in Italy. First, the right to participate in the shareholder meetings by electronic means is not compulsory. Companies are free to decide whether to provide or not this right. Second, the general meeting attendance is limited by the complexity of Europe's intermediated share-holding systems. The length of the share-voting chain and the complexity of the identification and authentication of shareholders increase the costs of share voting, especially in a cross-border context¹²⁹.

The new provisions following the Italian implementation of the SHRD impacted on the 2011 proxy season (i.e.: the annual general meetings held in

¹²⁹ Eckbo and Paone (2011) suggest the recurs to a centralized registration system, that would reduce the voting-chain complexity. The Authors suggest the example of the Nordic countries.

Spring 2011). The effects of the lower cost of voting and easier access to information have been appreciable. In several cases, the general meeting attendance had a sizeable increase, allowing unexpected developments. For instance, at the annual meeting of the State controlled electric utility Terna, the increased participation of foreign institutional investors¹³⁰ allowed a private minority shareholder to elect three directors at the expenses of the minority shareholder Enel (State controlled energy provider). Enel was not able to obtain any seat, although it has historically appointed directors to the board of Terna¹³¹. At the industrial machinery producer Interpump, some bylaws amendments on agenda did not pass because of the opposition of institutional investors¹³². The amendments were bundled in one only item and included the introduction of antitakeover measures. In other cases, the increased general meeting participation – and often a higher level of dissent – attracted the attention of the financial press¹³³. The consulting company Georgeson Shareholders (Georgeson) provided data on a selected sample of FTSE MIB companies for the 2011 proxy season¹³⁴. Georgeson recorded an increase in the average overall meeting attendance, from 52.3% of the shares outstanding in 2010 to 61.5% in 2011. Concerning only the minority shareholders, the data boosted from 10.7% to 20.7%. ISS (2011) analyzed the impact of the SHRD on a sample of board elections of FTSE MIB companies between 2008 and 2011. An increased general meeting participation by institutional investors was registered after the implementation of the SHRD. Such higher attendance impacted on the *Voto di Lista* elections. Indeed, the study recorded a higher support for slates submitted by minority shareholders.

¹³⁰ Il Sole 24 Ore. 2011. *Quei 700 fondi da 30 Paesi*. 14 May.

¹³¹ See: Rendina, F. 2011. *Terna, Enel resta fuori dal cda*. Il Sole 24 Ore, 14 May. In addition, see the voting results summary provided by the company on its web site.

¹³² See the voting results summary provided by the company on its web site.

¹³³ For instance, the following cases have been quoted in the Italian press: Prysmian, Ansaldo Sts, Assicurazioni Generali, Enel Green Power, Telecom Italia, Unicredit, Eni. See: Sabbatini, R. 2011. *Piazza Affari scopre la contendibilità*. Il Sole 24 Ore, 17 April; Meoni, C. 2011. *Rivoluzione a metà. Più partecipazione ma meno attivismo*. Borsa&Finanza, 25 June; Serafini, L. 2011. *L'effetto record date spinge i gestori su Egp*. Il Sole 24 Ore, 27 April.

¹³⁴ Georgeson. 2011. *La partecipazione e l'attivismo assembleare delle minoranze alla luce della Direttiva 36/2007*. Presentation delivered at the seminar of the Associazione Italiana Investor Relations, 28 June.

The implementation of the SHRD and the already existing trend towards a higher involvement of international institutional investors in the corporate governance could provide favorable developments for the activists operating in Italy. If these trends will be confirmed in the future, it could be expected an increase in the responsiveness to shareholder activism. However, any meaningful change would require time and must face cultural and structural obstacles.

5. CONCLUSION

Several studies argued that institutional shareholder activism can have a role in balancing the agency problems arising in both insider and outsider financial systems. In Italy, corporations have an ownership concentration above the European average and most of the minority shareholders are *rationaly apathetic*. Such context could be fairly defined as unfriendly for activists.

This work analyzed the role of institutional shareholder activism in Italy providing a general overview of the phenomenon, empirical data on the environment and its trends, and four representative case studies. The Italian case studies confirmed the dynamics of activism investing described by the general literature. In addition, the selected activists' campaigns showed that, in order to have an impact on Italian blockholders' decisions, activists should adapt their behavior towards a less confrontational style. The described efforts of bringing the activists claims in the shareholders meeting, as part of a confrontational strategy, failed. In these cases, the activists were unable to elect a minority member, even though their claims had been considered well-founded by many. More diplomatic or relational approaches could somehow impact on the majority shareholder's decisions. Generally, providing a direct link between the occurred changes and the activist's action is not possible, but there are evidences that the activist could influence the decision-making process. Nevertheless, even in the cases where some impact could be assessed, the final outcomes are mixed. Above all, it seems that a long term orientation is important. Any changes in a insider dominated system, as the Italian one, would require time and are expected to be evolutionary rather than revolutionary.

It seems that, under certain conditions, activists were able to influence the governance of Italian corporations. Nevertheless, they would exercise a stronger impact if they found more support from other institutional investors. The key issue in performing activism in a country as Italy is to be able to exert moral suasion on the blockholder – i.e.: the decision-making subject. However, the other minorities' backing would be instrumental to this.

This work provided evidence of the activists' capability to have certain influence in Italy. In addition, it described a trend towards a greater involvement of the minorities in the governance of Italian corporations. These issues offer a worthy reason to study this topic in the future. Further research would benefit from an investigation of both the public and private dynamics of institutional shareholder activism in Italy.

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