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Institutional Investor Activism in a Context of Concentrated Ownership and High Private Benefits of Control: the Case of Italy

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Abstract

This is a draft chapter for a forthcoming volume, The Research Handbook on Shareholder Power, edited by Randall Thomas and Jennifer Hill (Cheltenham:Edward Elgar). This chapter describes the experience with activist institutional investors in an apparently unfavorable corporate environment (Italy), commonly depicted as one of concentrated ownership, notoriously inadequate legal protection for minority shareholders and an apparent disregard for their interests by controlling shareholders. We document a non-negligible volume of "core" active institutional investment, together with some idiosyncratic forms of activism (the appointment of "minority" directors on the boards of Italian listed companies). We attempt to evaluate whether what we see is genuine shareholder-value oriented activism or a strategy to engage in a privileged relationship with controlling shareholders, in order to share in private benefits of control extraction. We find no sufficient evidence to support a "dark side" view of shareholder activism, at least as a general explanation. Instead, we provide recent anecdotal evidence of initiatives effectively aimed to curb the extraction of private benefits by dominant shareholders.

Keywords: shareholder activism, institutional investors, hedge funds, corporate governance, concentrated ownership, private benefits of control, general meeting

JEL Classifications: G34, G38, K22

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Abstract

This is a draft chapter for a forthcoming volume, *The Research Handbook on Shareholder Power*, edited by Randall Thomas and Jennifer Hill (Cheltenham:Edward Elgar). This chapter describes the experience with activist institutional investors in an apparently unfavorable corporate environment (Italy), commonly depicted as one of concentrated ownership, notoriously inadequate legal protection for minority shareholders and an apparent disregard for their interests by controlling shareholders. We document a non-negligible volume of "core" active institutional investment, together with some idiosyncratic forms of activism (the appointment of "minority" directors on the boards of Italian listed companies). We attempt to evaluate whether what we see is genuine shareholder-value oriented activism or a strategy to engage in a privileged relationship with controlling shareholders, in order to share in private benefits of control extraction. We find no sufficient evidence to support a "dark side" view of shareholder activism, at least as a general explanation. Instead, we provide recent anecdotal evidence of initiatives effectively aimed to curb the extraction of private benefits by dominant shareholders.

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Information about individual cases is gathered from *Il Sole-24 ore*, Italy's main financial newspaper.

I. Introduction

At first sight, Italy looks like an unfavorable corporate environment for shareholder activism: concentrated ownership, inadequate legal protection for minority shareholders (Shleifer and Vishny 1997), and an apparent disregard for their interests by controlling shareholders (Macey 1998; Enriques 2002) are no welcoming signs for those interested in stirring for change to maximize the return on their investment. Yet, we find a non-negligible volume of "core" active institutional investment (pressing on management, usually on governance issues and/or corporate strategy and specific transactions, possibly accompanied by "voice" at shareholder meetings), together with some idiosyncratic forms of activism (the appointment of "minority" directors on the boards of Italian listed companies). The research question we thus address is whether we see genuine value-oriented activism or just another strategy to engage in a privileged relationship with controlling shareholders to share in private benefits of control. Anticipating our conclusion, we find no sufficient evidence to support this "dark side" (Rock 1994) view of activism. Quite to the opposite, we provide anecdotal evidence of activist initiatives aimed to curb the extraction of private benefits by dominant shareholders.

For space reasons alone, our focus is on activism by institutional investors (mutual, pension, and hedge funds). In a companion paper, we extend our analysis to individual investors and entrepreneurs, who have been fairly active in the last two decades (Croci 2007). Unlike institutions, such investors often stir for co-option in the controlling group rather than for shareholder value-oriented change (Belcredi and Enriques 2014). Therefore, if individual

investors and entrepreneurs were included in the analysis, our anticipated conclusion on the positive role of activism in Italian companies would need to be qualified.

After an introduction to Italian corporate governance (section II) and to the relevant legal framework (section III), we identify the potential players in the activism game (section IV). Consistent with Gilson and Gordon's (2013) observation that active institutional ownership is based on the interplay of active and passive institutions at general meetings (GMs), we describe the various institutional owners in Italian companies: Italian mutual funds, foreign asset managers, and hedge funds. We leave aside Italian banks and insurance companies, because they usually act as allies to controlling shareholders (Bianchi and Bianco 2006). Neither does our inquiry extend to sovereign wealth funds: while they are invested in Italian shares (Del Giudice and Petrella 2013), they seem either to remain passive or to be co-opted into the controlling group by having their own representatives appointed to the board in the same slate as the majority. We finally leave private equity and venture capital funds out of the picture, because of their different role, as current or prospective controlling shareholders, in corporate governance.

In section V we provide a picture of the main kinds of institutional shareholder involvement in Italian companies' governance. In an ascending order of pro-activism, we document cases where shareholders voiced their discontent with regard to strategies and/or specific managerial decisions, including remuneration policies. We then describe the phenomenon of minority slates presented by institutional investors, and finally focus on core activist initiatives aimed to obtain changes in strategies and control structure or to oppose specific transactions. Section VI assesses our findings and concludes.

II. Corporate ownership and control in Italy

The Italian stock market is the fifth by market capitalization in the Euro area (after France, Germany, the Netherlands and Spain): total market cap was around EUR 360 billion at the end of 2012. The single largest company (Eni) accounts for 18% of total market cap, while the first 5 (10) companies account for 44% (61%) of the aggregate.

Family firms represent the backbone of the Italian economic system. Households and private non-financial companies hold more than 50% of the share capital of listed companies (the European average is 30%). A second feature of Italian capitalism is the relatively large (10%; the European average is 5%) share of capital owned by the State and other public entities: though still large, it is less than one third of what it was before large scale privatizations in the 1990s and a wave of family-controlled firms IPOs in the 2000s. Around two-thirds of Italian non-financial listed firms are under the control of a family, holding on average a 51% block (Belcredi et al. 2013); 8% are controlled by the State or other public entities, 6% by financial institutions, 12% by other subjects, while 6% are widely held.

Italy is typically considered a country where low investor protection allows controlling shareholders to enjoy high private benefits (Zingales 1994; Caprio et al. 1994; La Porta *et al.* 1997; 1998 and 2000, Nenova 2003, Dyck and Zingales 2004) and, consequently, firm ownership remains concentrated (as in Bebchuk and Zingales 2000), often in the hands of the founding family; to retain control with a limited investment, a number of control-enhancing mechanisms are used, such as dual class shares, pyramiding, etc. According to Belcredi and Rigamonti (2010), in 1988 around 50% of the listed companies were part of a pyramidal group: for instance, the Agnelli group counted 27 listed firms at the time, with interests ranging from

cars to retail distribution and insurance.. The final result is high separation of ownership from control, no role for the disciplining effect of hostile bids, exacerbated conflicts of interest and a high risk of expropriation for minority investors (Bebchuk et al. 2000; Villalonga and Amit 2006; Barontini and Caprio 2006).

This picture is, however, outdated in many respects. On the one hand, as shown in section III, the legal framework has changed over time. Investor protection, at least in terms of rules "on the books" has increased remarkably (although enforcement has arguably lagged behind). Minority shareholders are far from defenseless, and they have, in several instances, become active to influence corporate decisions and/or to avoid expropriation.

On the other hand, separation of ownership from control via pyramids and dual class shares has decreased remarkably over the last two decades: while controlling shareholders' voting rights remained – on average – quite stable (around the 50% threshold), cash-flow rights increased to 49% in 2008. Hence, the wedge has almost disappeared (2.6% in 2008) (Bianchi and Bianco 2006, Belcredi and Rigamonti 2010). This is due both to a wave of IPOs where no recourse was made to control-enhancing mechanisms (Rigamonti 2008) and to transactions (mergers with subsidiaries, dual class unifications: Bigelli et al. 2011) aimed at changing governance structures increasingly unpopular amongst investors. Finally, the voting premium has decreased remarkably (Linciano 2002; Caprio and Croci 2008).

III. The legal framework: from activist-repellant to broadly friendly

The legal environment affects shareholder activism along three main dimensions: first, it may (may not) empower investors by granting them broad (narrow) governance rights and by making

exercise thereof easy (difficult) and inexpensive (costly). Second, it may or may not favor profitable stake-building, by allowing investors to do so in a stealthy way or by imposing disclosure of their stake early on. Third, it may or may not grant investors bargaining leverage vis-à-vis insiders, mainly by making it more or less easy to orchestrate campaigns aimed at forcing change.

Consistent with its once notorious corporate governance environment (Shleifer and Vishny 1997; Macey 1998), Italy's corporate law has long been unfavorable to activism along each of these dimensions. We focus here on governance rights and bargaining tools. Ownership disclosure rules have traditionally been unfavorable to anyone building a stake in a listed company in Italy, although they have become less so in the last fifteen years, the regime for mutual funds and (regulated) hedge funds being now no worse than elsewhere in Europe (Belcredi and Enriques 2014).

Shareholders of Italian companies have traditionally held much greater collective power than their US counterparts. As in many other European countries (Cools 2005), Italian companies' GMs have always decided on a broad set of matters, including dividend policy and new issues of shares. And insulation from shareholders has always been hard to achieve for managers, whom shareholders at the GM could (and can) remove at will (Enriques et al. 2009; in the absence of cause, a director can obtain damages equal to compensation the company would have owed him until the end of his term). However, such greater power has long been *de facto* useful only to dominant blockholders, allowing them to keep managers on a tight leash (Stanghellini 1995). In the many companies with a majority shareholder, it is clear why. In companies with a more fluid control structure, it was still hard to take advantage of such greater

power for *outside investors*, due to a legal framework and corporate practices that discouraged minority shareholder coordination and the exercise of shareholder rights, first and foremost the right to vote.

To this effect, a 1962 law in place until 2004 imposed share blocking five days prior to the meeting; notice of the meeting was not easily accessible, and information on items on the agenda was traditionally scant and only published close to the meeting date (Unanyants-Jackson 2007); a 1974 law practically banned proxy solicitations (Bianchi and Enriques 2005), which had been hitherto commonly undertaken by *avant la lettre* activists in companies where ownership concentration was low (Scalfari and Turani 1974).

Finally, restrictions on voting and the lack of effective shareholder remedies significantly weakened the bargaining position of any potential activist: there were simply few effective threats she could make against insiders in negotiations over a company's governance, management or specific transactions.

Reforms enacted between 1992 and 2012 made this picture outdated. A number of self-enforcing rules (especially on voting) and a broader set of minority shareholder rights have made today's Italian legal environment no less friendly to activist investors than most other jurisdictions.

A. Empowering shareholders: GM powers and slate voting

First of all, shareholders have nowadays a wider say on a company's governance and control. The range of issues that have to be decided by GMs has broadened by including (since 1998) authorization of defensive tactics against hostile takeovers (unless, since 2010, the company has

opted out of the so-called board neutrality rule) and of stock option plans (since 2005). Since 2012 a non-binding "say on pay" (SOP) vote on the company's compensation policy is required.

Also, since 1998 all changes to the company's charter (including new issues of shares, mergers and spin-offs) require a supermajority of two thirds of the shareholders represented at the meeting.

One peculiar feature of current Italian corporate governance regulation is minority shareholders' power to present a slate of candidates for both the board of auditors and the board of directors, and to have at least one candidate appointed even where another slate gains a higher number of votes (so called slate voting).

Slate voting was first introduced in 1994 for privatized companies: Law 474/1994 provides that the charter of such companies adopt slate voting for board elections (both board of directors and board of auditors). Shareholders holding at least 1% of share capital may submit slates, at least 1/5 of board seats being reserved to candidates from slates other than the most voted one (Belcredi et al. 2013).

In 1998, the Consolidated Law on Financial Intermediation mandated slate voting for the election of boards of auditors in all listed firms.

After the Parmalat scandal, lawmakers further strengthened slate voting, first of all by imposing it on all listed companies also with regard to the election of directors: at least one seat must be reserved to candidates from a slate submitted by shareholders with no direct or indirect relationships with those submitting the most voted slate. Consob has effectively monitored the process, requesting additional information – in a number of cases – on possible relationships

among shareholders submitting different slates. Almost invariably this led to the controversial minority slate being withdrawn before the GM.

B. Facilitating voting

The reform which had the greatest impact on institutional shareholders turnout at GMs, the ban on share blocking, came in two steps. First, in 2003, the record date became the statutory default for listed companies. However, companies' charters might still provide for share blocking up to two days prior to the meeting. Then, to implement the Shareholder Rights Directive in 2010, the voting record system was mandated for all listed companies.

Notice of the meeting has been made more easily available (it is published also in the issuer's website). Companies have to provide detailed disclosure on the items in the agenda and directors must publish a report on each item by the time the meeting notice is published.

One feature of Italian law apparently remains less activist-friendly than in other jurisdictions (in particular, the US): no Italian institutional investor is under a legal obligation to exercise its voting rights in investee companies.

C. Bargaining tools

For activists to negotiate successfully with management, it helps being able to threaten the exercise of shareholder powers to force change. Minority shareholders of Italian listed companies enjoy much greater powers today than 20 years ago. In addition to those mentioned in section III.A., minority shareholders holding more than 2.5% of the shares have a right to include new items (or to amend management proposals) on a GM agenda. New items and amendments may also be submitted at the GM itself. However, shareholders may not submit proposals or amendments on matters where specific law provisions require a special board report. Such is the

case of merger proposals, new issues of shares, and the approval of annual accounts (Picciau 2008). Election and removal of directors are not among the exceptions.

Shareholders holding at least 10% of the shares may call for a GM, provided their proposal is not one which they may not add to the agenda of an already called meeting.

Redress to courts has never been an easy avenue for aggrieved shareholders in Italian companies. The legal design of derivative suits is not shareholder-friendly, also due to the notorious length of civil trials in Italy. Other legal remedies may prove more effective: first, shareholders holding at least 5% of the shares may petition a court for the appointment of a judicial expert in charge of inspecting the company to find out about improper management (a mere suspicion of serious irregularities is sufficient to this end); this may lead to judicial removal of directors and appointment of a judicial administrator. Second, shareholders holding at least 2.5% of the shares may force the board of auditors to conduct an internal audit and report to the GM. Finally, any shareholder may petition public prosecutors and Consob to conduct investigations or exercise their enforcement powers. It is relatively frequent for Consob to respond to such petitions by requesting companies to make disclosures of facts that investors may use in their initiatives.

A significant help for activism aimed to oppose individual transactions has come from Consob's increased attention to related party transactions (RPTs). Starting in 2007, Consob has required ad hoc, detailed disclosure on announced RPTs. Then, in 2010 it issued a regulation on RPTs both imposing immediate disclosure of material RPTs as a general rule and providing for procedural safeguards on how to enter into them.

It is fair to conclude that Italy's notoriously bad corporate law system from an investor protection perspective is behind us. True, formal enforcement of corporate and securities laws, and especially private enforcement, is still far from working effectively. But the kind of self-enforcing corporate law features highlighted in this section appear to be of greater importance for activists than remedies they seldom use even where they are available.

IV. Activist shareholders in Italy

The overall stake held in Italian companies by private financial institutions, including banks and insurance companies, is comparatively low: 23%, versus 31% at the European level. The difference is mainly due to a lower weight (14% in Italy, versus 23% in Europe: FESE 2008) of domestic collective investment vehicles (pension funds, insurance companies, mutual funds and collective financial investment companies).

A. Italian Mutual Funds

Mutual funds are rarely expected to be activists, although they may support the efforts of other investors (Gilson and Gordon 2013). Because, with few exceptions, Italian mutual funds are managed by subsidiaries of banks and insurance companies, we should expect even less activism than in countries, like the US, where their managers are often independent.

Italian mutual funds have been quite active since the mid-1990s along three main lines: (1) they have put "pressure" on listed companies (and regulatory bodies) to improve corporate disclosure and to obtain investor-friendly rules of the game, especially via changes in individual company charters and practices; (2) they have used their voice and given negative votes at GMs, where either disclosure was perceived to be insufficient or a deal could imply minority

shareholders' expropriation; (3) they have submitted slates for board elections. Consistently with other countries' experience (Armour and Cheffins 2012), mutual fund activism has typically been low-cost and focused on governance issues (Croci 2011).

The stake held by Italian mutual funds in the domestic stock market has declined steadily, from around 8% in 1998 to less than 1%.

This phenomenon is due both to increasing international diversification by individual investors, and to increasing competition from other asset classes, such as "flexible" funds.

B. Foreign asset managers

The equity stake held in Italian companies by foreign institutions is comparatively low. According to FESE (2008), the aggregate shareholdings of foreign institutions and individuals were around 14% of the total in 2006 (the lowest in Europe after Cyprus; the European average is 37%). Furthermore, contrary to what happened in most European countries, the stake held by foreign institutions and individuals has remained substantially stable over time.

In Italy, foreign asset managers long followed the "Wall Street Rule": this made sense, given the high costs of pursuing active strategies in an internationally diversified portfolio and the obstacles to the exercise of voting rights. Following reforms which have made voting less costly and the increasing role of proxy advisers in orienting institutional investors' voting choices, foreign institutions have become more active, and some of them have repeatedly voted against management proposals and/or supported proposals from other investors.

US-style active pension funds (Gillan and Starks 2000 and 2007) are substantially absent in the Italian context.

The only remarkable case of a "pension fund" actively targeting Italian companies has been Hermes Focus Fund (HFF) (Becht et al. 2009). HFF, established in 1998, has invested in a number of Italian companies over the years: it acquired a stake higher than 2% in 10 cases (six stakes were acquired in the first year of European activity). Although Hermes prefers quiet negotiations, it took a confrontational position in some cases. Examples include Parmalat (where HFF complained about insufficient disclosure, one could say with good cause), Banca Popolare di Milano (BPM) (with requests for governance reform and more efficient management of corporate assets), and Olivetti-Telecom Italia (tackling governance issues and some aspects of the parent-subsidiary merger proposal). HFF may, however, be better categorized as a hedge fund in which Hermes (the pension fund of British Telecom employees) and other pension funds have invested.

C. Hedge Funds

Hedge funds are an elusive category. Their distinctive feature has long been their freedom from restrictions on their investment strategies, differently from regulated categories such as mutual and pension funds (Brav et al. 2008). A number of subjects may fall in this category. Their activist strategies are, unsurprisingly, quite diverse.

In the US literature (Brav et al. 2008, Klein and Zur 2009), active hedge funds are often identified through their filing a Schedule 13D, revealing an activist fund's investment in a target firm. In Europe, where EU ownership disclosure obligations do not contain equivalent information about an acquirer's intentions, financial institutions falling under disclosure obligations are usually categorized as hedge funds on the basis of various information sources

(the press, commercial databases and/or the very institutions' websites: Croci 2007, Mietzner and Schweitzer 2008, Erede 2013, Becht et al. 2010, Drerup 2012, Croci and Petrella 2014). Unsurprisingly, the samples used in different studies are only partially overlapping, and often include institutions which might also be categorized otherwise. Given the uncertain boundaries of the category, and also the flexibility of their strategies, using a broad definition seems justified.

Preliminary evidence (Belcredi and Rigamonti 2014) shows that asset managers have increasingly become the second-largest shareholder in Italian firms. This happens in 29% of the firms where a second relevant (>5%) shareholder is present in 2008 (up from 22% in 1998; their presence was below 10% in previous decades). Such institutions can prevalently be categorized as hedge funds.

To track hedge fund activism in Italy we considered all mandatory filings of shareholdings (>2%) published in the Consob database from January 2001 to April 2013. We gathered information on the nature of institutional investors included in the database from Bloomberg Businessweek and company websites. We identified 369 hedge funds "transactions," defined as cases where a hedge fund acquires an equity stake above 2% in a listed company, a transaction ending when the stake held by the hedge fund falls below 2%, which does not imply that all shares have been actually sold. Their number goes down to 134 at the 3% (and to 83 at the 5%) threshold (Table 1).

Insert Table 1 about here

Hedge funds have been active traders on the Italian market: we identified 99 institutions which may be categorized as HFs investing in Italian listed companies (Drerup (2012) reports 111 HFs investing in German firms). Each of them carried out 3.7 transactions on average. A few institutions were more active: eleven HFs carried out more than 10 transactions each (up to a maximum of 34 in the case of Amber Capital LP).

The number of hedge fund transactions in Italian listed firms (369) is higher than that reported for Germany (Mietzner and Schweitzer report 67 transactions over a 7-year period – 2001-2007 – at the 5% threshold. Drerup (2012) reports 278 events over a 12-year – 1999-2011 – period, based on corporate news, and potentially covering investments below the regulatory disclosure threshold). The number of transactions peaked in 2007 and declined afterwards. The average (median) duration of a transaction is around 13 (8) months; however, it may vary from a few days to 8 years and a half.

The number of listed companies in which HFs have invested is also large: we counted 167 firms over the entire period. A handful of companies were targeted by numerous HFs (up to a maximum of 14, in the case of Parmalat): in 5 cases 5 or more HFs invested in a company at the same time.

Hedge funds are not necessarily activists. As section V shows, their strategies are similar to those reported in other countries.

V. Activists in play—The Italian experience

A. General pressure to improve corporate governance

In March 1994, Assogestioni (the association of Italian asset managers) established a Committee, composed of executives of its main associates, to act as a "*watchdog of ethical behavior in the market*" and "*to monitor transparency and fairness of corporate transactions*". The activity of this Committee initially pressed the management of listed companies (and regulators) to improve disclosure: the Committee concentrated on general topics, such as the timing (and quality) of interim financial statements and the disclosure provided by listed firms tapping the market for new equity.

In the following years, Assogestioni took a leading role in the corporate governance debate in Italy (Assogestioni 1996). Its lobbying activity was quite successful: a number of proposals (e.g. on interim financial statements, mandatory slate voting for corporate elections, and the introduction of a "record-date" system for GMs) have made it into statutory law over the years. An important component of this activity was participation to the Corporate Governance Committee in charge of drafting the Italian corporate governance code, first adopted in 1999 and periodically revised.

B. Voicing discontent at the GM

B.1. In general

The first instance of mutual funds' engagement with listed firms dates back to 1986 (i.e. three years after their introduction in Italy): a major Italian asset manager (Arca, led by general manager Attilio Ferrari) voiced its discontent with a transaction aimed at entrenching the CEO of Montedison and abstained from voting on a proposal to recapitalize the same company. Back then, this event was perceived as a threat to the status quo of "relational capitalism." It also spurred a wide debate on the role of mutual funds as stewards of their subscribers. However, this

episode remained isolated until 1995, when the representatives of three mutual funds, protesting against insufficient disclosure, abstained from voting on the approval of Gemina's financial accounts.

Similar episodes became relatively frequent in the following years and were sometimes complemented by public statements by the Assogestioni Committee. Active investors targeted various situations: from the approval of financial accounts to M&A transactions taking place at unfavorable conditions.

The number of shares commanded by asset managers was generally insufficient to affect voting results (Bianchi and Enriques 2005). An exception was the Falck-Montedison merger proposal, rejected by Montedison shareholders in February 2001. Montedison had acquired a 74% stake in Falck (a company which had dismissed its assets in the steel industry to invest in energy production) through a takeover bid. The heirs of the founder (the Falck family), however, had not tendered their 18% block. The management of Montedison then proposed a merger at conditions which implied – for Falck shareholders – a 50% premium over the previous bid price. Assogestioni criticized the exchange ratio in a letter to the board of Montedison (and to the market watchdog) one month before the GM called to approve the deal. The required 2/3 supermajority was not reached: while the bulk of dissenting votes came from two privatized banks and two private investors, mutual funds opposing the transaction, though voting a limited number of shares, were pivotal for the outcome. So far, however, the Falck case has remained unique.

In 2004 Assogestioni bought a few shares in order to intervene directly at the annual GMs of Italian blue chips. The association's representatives urged boards to take investor-friendly

measures concerning slate voting and requested additional explanations on the annual corporate governance report and on existing stock option plans (for which no prior shareholders' approval was required at the time). This activity ceased after a couple of years. A possible reason was that many of Assogestioni's requests had made it into law provisions.

B.2. Say-on-Pay.

Italian mutual funds have been inconspicuous in the first season of SOP votes (2012) (Table 2). Given their prior track record, their passive behavior looks surprising.

Insert Table 2 about here

They participated to SOP votes in 53 cases in 2012 (i.e. 21% of the aggregate). In 33 cases none of them voted against the remuneration policy (or, equivalently, abstained from voting). In the remaining 20 cases, dissenting Italian institutions usually accounted for a negligible (<1%) equity stake. The only exceptions were Fondiaria-Sai (an egregious case of excessive pay and consumption of private benefits) and Mid Industry Capital (a small cap company, where a single asset manager, Kairos, was virtually the only dissenter).

Foreign (especially US) institutions have instead been active. In the same year, international institutional investors (including hedge funds) participated to 164 SOP votes (i.e. 64% of the aggregate, three times more often than Italian ones). At least one of them voted against (or, equivalently, abstained from voting) the remuneration policy in 123 cases (six times more often than their Italian counterparts). Dissenting foreign institutions usually accounted for a small equity stake (2.4% on average; however, this is six times higher than the dissent by Italian

institutions). In 24 (8) companies, they represented more than 10% (20%) of voting capital. While dissent was seldom explicitly motivated, insufficient disclosure was apparently the most common issue (ISS 2013; Belcredi et al. 2014). Available data for 2013 show a similar picture (Georgeson 2013).

C. Minority representation on corporate boards

The most peculiar form of activism from a comparative perspective involves submitting and voting minority slates at corporate elections. Slate voting was first introduced in 1994 for privatized companies. Italian asset managers soon exploited this new opportunity: in the first board election with the new voting system (at insurance company Ina, in November 1994) a minority slate submitted by asset managers prevailed on the slate submitted by employee-shareholders.

Mutual funds gained minority representation in a small number of privatized firms in the next few years (e.g. Imi in 1995, Eni in 1996, BNL in 1998, Enel in 1999, Finmeccanica in 2000).

The Assogestioni Committee has so far played a coordination role in selecting candidates and submitting slates. According to its Principles published in 2013, candidates are drawn from a list of names prepared by a primary executive search consultant. Mutual funds collectively holding the needed percentage of shares then submit the slates.

The success of slate voting for board of auditor elections (mandated since 1998) was much smaller than in privatized enterprises. Although the quorum required to submit a slate was relatively low (2.8% on average), minority auditors had been appointed in 63 companies (23% of

the aggregate), as of 2007. Further, mutual funds appointed representatives only in a handful of companies (often, the same privatized firms where they already appointed minority directors). The low number of mutual fund slates has three explanations: (1) asset managers rationally concentrating their effort on a small number of blue chips in which their investment was long-term (and the visibility of their initiative was greater) in order to minimize transaction costs; (2) the rapid decrease of mutual fund investment into the Italian stock market after the peak in 1998 (see Section 2); (3) the presence of other large shareholders, holding on average a 9% stake, which could easily prevail on a mutual fund slate (Belcredi et al. 2013).

The situation did not change after slate voting was mandated for directors' elections in 2007. Mutual funds kept appointing minority representatives in a small number of blue chips characterized by higher political relevance and also better governance quality, consistent with the findings of Chung and Zhang 2011 (for the US) and of Barucci and Falini 2005 and Bianchi et al. 2011 (for Italy).

Interestingly, mutual funds have submitted slates where monitoring is less needed (in companies performing better than average: Belcredi et al. 2013). Together with the fact that they focus on the largest companies, this finding suggests a political explanation for Assogestioni's involvement in board elections. Nominating high-profile directors, such as former business leaders and university professors, in highly visible and often politically sensitive firms is exercising real power, from which the association's representatives may well personally gain in political clout and prestige.

A major change took place with the introduction of the record date system in 2010. While costs associated with candidates' selection and slate submission remained untouched, the new

regulation greatly reduced transaction costs associated with GM participation and voting. This proved to be important especially for foreign institutional investors, which had hitherto been reluctant to vote their shares in Italian companies. Given the decrease of mutual fund investment into the Italian stock market, the support by foreign asset managers has become increasingly crucial for the success of mutual fund slates.

Under the new regime both the presentation of minority slates by Italian mutual funds and support by other institutional investors increased substantially (Figure 1).

Insert Figure 1 about here

The support for minority slates has grown much more than the number of slates. The final outcome, in terms of minority directors actually elected, however, does not show a parallel increase (Figure 2). Mutual fund representatives have often taken the place of other minority directors.

Insert Figure 2 about here.

According to Erede (2013) hedge funds have been passive in corporate elections. This is not entirely true. While hedge funds, as a rule, are not interested in submitting their own slate, they have sometimes supported other investors: one example is the successful cooperation of Amber with Hermes Focus Fund in electing a candidate to the board of auditors of Italmobiliare (the holding company of the Pesenti-Italcementi group) in 2011.

And hedge funds have submitted slates for corporate bodies in various occasions. Unsurprisingly, this form of engagement has usually been instrumental to pursuing further goals. A prominent example is the announcement, in January 2011, by the Scandinavian hedge funds Skagen and Zenit and the Canadian asset manager Mackenzie (holding collectively 15.3% of Parmalat shares) that they would submit a slate for the impending board election. One of the objectives was to remove the incumbent board, criticized for not re-investing the huge cash accounts (about 1 bn. Euro) held by the company (as a result of previous litigation and retained profits).

The funds' slate, however, never made it through: in March, the three funds sold their stake to French dairy company Lactalis, which had accumulated a further 14% on the market and became the de facto controlling shareholder of Parmalat (later launching a voluntary bid on 100% of the shares for a price, 2.6 EUR per share, 7% lower than what it paid to the three funds).

An interesting and still open question is whether (and how) Italian mutual funds are able to cope with conflicts of interest arising from their ownership structure (they are mostly controlled by banks and insurance companies). While Assogestioni has adopted a number of measures in order to keep such risk under control (including separation between selection of candidates, by a Committee based at the association, and submitting and voting individual slates, by individual asset managers) such solutions may not always be effective. Italian mutual funds are apparently less active in financial listed firms and when they activate problems can arise: in 2013, interference with the nomination of mutual fund candidates to the board of Intesa Sanpaolo (the second largest Italian bank) by representatives of affiliate asset managers reportedly led to

resignation of the Assogestioni Committee Chairman, a lower support by foreign institutions at the GM and, finally, a lower number of candidates being appointed.

D. Core pro-active initiatives

D.1. Corporate strategies

A typical, pro-active, high-cost form of engagement takes place where hedge funds push for changes in company strategy (e.g. entering or exiting a particular industry, focusing on core company activities or diversifying into new businesses, etc.), suggest a specific transaction, or press to alter the firm financial structure or its dividend policy (Partnoy and Thomas 2007).

A number of cases of "strategic activism" have been recorded in Italy over the last decade. For example, in June 2004 the Centaurus Alpha Fund bought a stake in Marzotto, a group whose main business units focused on textile manufacturing and luxury goods brands – including Valentino and Hugo Boss (Becht et al. 2010). These divisions were significantly undervalued, due to the conglomerate structure of the group. Centaurus met privately with the company, apparently in a non-contentious way, and helped the Marzotto family spin off the luxury brands into a separate listed entity, Valentino Fashion Group (VFG). Centaurus then sold its stake at a remarkable profit.

Erede (2013) reports three attempts by hedge funds to change a company's dividend policy. Amber successfully challenged the dividend policy of Iride, a utility company controlled jointly by the cities of Turin and Genoa. Titan Value (a Swiss hedge fund) challenged the management of FNM (a local railroad company controlled by the regional Government of Lombardy) to obtain the company's first distribution of dividends in fifty years. Its efforts, coupled with wider criticism of FNM's management and its controlling shareholder's conflicts of

interest (the regional Government of Lombardy being also the regulator of the local transportation system), found no support amongst other shareholders and Titan ultimately decided to divest its holding. Finally, Stark challenged Parmalat's dividend policy: the dairy firm had emerged from bankruptcy in 2005 as a widely held company, and its board of directors had been drawn from a slate submitted by Lehman Brothers, with the support of other financial institutions, including Stark. In 2008 Stark aimed to remove a cap on dividends (50% of profits) from the company's charter. Following the board's refusal, Stark called a special meeting to vote on the proposal. However, shareholders representing less than the 20% statutory quorum registered for the meeting and the proposed amendment could not be put to a vote.

Hedge funds sometimes pursue complex objectives. An example is hedge funds' pressure on Pirelli's management when the company sold its stake in Telecom Italia in 2007. As described in Bellini (2009), hedge funds led by Amber and Centaurus pressed for the distribution of a substantial part of the cash inflow (€3.3 billion) that the company was about to receive from the sale, urged a break-up of Pirelli, and opposed the repurchase of a 38.9% stake in the subsidiary Pirelli Tyre, previously sold to a group of financial institutions. In December 2007, Pirelli's GM resolved to distribute an extra dividend of €827 million.

Hedge funds have also voiced their discontent openly at the GM: well-known cases are interventions by US activist Knight Vinke at ENI's GM, where it pushed for a breakup. In other cases (Algebris in Assicurazioni Generali, Amber and DKR Capital, together with mutual fund Fidelity, in BPM), hedge funds targeted both the business strategy and corporate governance issues (Croci 2011). These GM interventions are likely the last stage of unsuccessful engagement with management through quiet negotiations. For sure, GM engagement on specific proposals

was quite hopeless: where a control group is present (like in all of the above cases), the voting outcome is known in advance.

D.2. Control transactions

A second form of engagement is corporate control activism (Kahan and Rock 2007, Greenwood and Schor 2009): hedge funds acquire shares to push for a control change or to influence the outcome of a corporate control contest. At first sight, one could expect limited activity in this field, control being typically concentrated in the hands of a control shareholder (often a family) or a number of blockholders tied by a shareholders' agreement. Hostile takeovers are rare in Italy.

Hedge funds, however, have found their own ways to profit from corporate control transactions in this environment. First, share ownership is not always concentrated: companies with a dispersed ownership structure have often been targeted by hedge funds, anticipating a possible takeover bid. In a number of cases a tender offer actually followed: an example is Guala Closures, where the largest blockholder held a 14% stake. The company went public in 2005 and a wolf-pack of hedge funds immediately targeted it. A vehicle owned by Credit Suisse launched a tender offer three years later, leading to the company's delisting.

Second, control is not necessarily stable: hedge funds frequently buy equity stakes anticipating relevant ownership changes (Greenwood-Schor 2009). This kind of activism looks more promising where the control block is scattered amongst many shareholders and/or members of the controlling group either disagree on fundamental strategic issues or are struggling to control the company. The history of family capitalism in Italy is rich with similar examples, such as the case of Gruppo Coin in 2003-05, when a dispute between two brothers led to the firm

being targeted by a wolf-pack of hedge funds (K Capital Partners, Kairos, Hermes and Centaurus Capital, all acquiring stakes above 2%) and finally to the friendly acquisition by a private equity fund.

Companies dominated by coalitions are prone to this form of activism. Interestingly, since the mandatory bid rule implies additional costs for acquisitions of stakes higher than 30%, a number of companies are actually governed by shareholders with a stake below that threshold. Such ownership structures are inherently unstable and offer opportunities for hedge funds. An example is Impregilo, the largest Italian general contractor, where three shareholders collectively owned 29.96% of equity through Igli, an unlisted vehicle. Impregilo was (unsuccessfully) targeted by a number of hedge funds over the last decade, probably anticipating a control transaction.

In 2011-12, two shareholders sold their stake in Igli to the third one (the Gavio group). At the same time, one of Impregilo's competitors (Salini Costruttori, a privately owned company) started buying Impregilo shares, building a 29,18% stake in a few months. In March 2012, Amber also started to accumulate shares. At the April 2012 GM, while Salini criticized the incumbent board and its strategy and abstained in the vote on annual accounts, shareholders rejected the company' compensation policy in a tight SOP vote. Amber, with its 5% stake, was pivotal. Even though the vote was non-binding, the negative result was perceived as anticipating a showdown between Gavio and Salini. The showdown actually took place three months later, in a further GM called by Salini to remove the Gavio group-dominated board. Italy's fiercest proxy contest in decades ensued. The GM removed the incumbent board with a tight majority vote (51% vs. 49%) and appointed the directors proposed by Salini, once again with Amber's pivotal

vote. Amber sold its stake at a profit when Salini launched a tender offer on the remaining shares in February 2013.

A darker shaded case is the control sale of Valentino Fashion Group (VFG), the company Marzotto span off under the pressure of Centaurus (Becht et al. 2010). In July 2006, one branch of the controlling family (Marzotto) aimed to strengthen Valentino as an independent label and pursue an acquisition strategy, while other family members were looking for an opportunity to sell their stake. Leonardo Capital, a London based hedge fund, acquired a 2% stake in VFG and then persuaded the sale-inclined family members to contribute their shares to a newco (ICG), with Leonardo also contributing its VFG shares to it. ICG's stake in VFG was 29.6%, i.e. just below the 30% mandatory bid threshold and enough to control VFG. In 2007, ICG sold its VFG block to Permira, a private equity firm, at a 50% premium over the price paid by Leonardo for its block. Only later did Permira decide to buy out other members of the Marzotto family, thereby crossing the 30% and launching a mandatory bid for the remaining shares at the price paid to ICG.

As originally planned by Leonardo, however, the sale of the 29.6% control block would have allowed it to share in the control premium (i.e. the expected value of private benefits: Gilson and Gordon 2003) with the family to the exclusion of other shareholders.

D.3. Specific transactions

Finally, hedge funds may engage to oppose a specific transaction. In Italy, RPTs have long been a favorite way to extract private benefits, making them obvious targets for activists' opposition. Recently, Amber effectively challenged controllers' self-dealing by taking advantage of (1)

remedies provided for by corporate governance reforms, (2) rules allowing minority representation in corporate bodies and (3) increased procedural safeguards and disclosure on RPTs. In two cases, Amber's strategy has aimed either to seek redress for damages stemming from RPTs or to block, or at least obtain better terms, for a given RPT.

In one case, Amber sent a petition to the board of auditors of insurance company Fondiaria-Sai in October 2011, inviting it to investigate on a number of RPTs which the company had disclosed upon Consob request (in particular, transactions with members of the controlling Ligresti family). In response to this petition, the board of auditors issued a 114-page report, included in the materials for the 2012 GM. When the top management of Fondiaria-Sai (and the whole Ligresti family) underwent criminal investigations for securities fraud in 2013, public prosecutors extensively drew from this report, which was also the basis for a €280 million liability suit against family members and directors.

Amber occasionally exploited the opportunity to elect minority representatives in the corporate bodies of listed firms as a powerful way to leverage on its minority rights. At the May 2012 GM of Parmalat, Amber got two seats on the board of directors. Amber also voted against the approval of annual accounts and harshly criticized the proposal, announced by the board of Parmalat in October 2011, to acquire the US subsidiary of the controlling shareholder Lactalis, for a consideration of around $900 million. After some time, Amber submitted a petition to the court, arguing that a number of violations had been committed in approving the transaction.

It is still too early to fully appreciate the results of this initiative, the legal controversy being far from over as we write. So far, the court of Parma has issued two decisions. The first one, in March 2013, held that a number of violations of procedural rules on RPTs had been

committed and, among other measures, appointed a court trustee with the task of giving an opinion on the transaction's procedural and substantial fairness. With the judicial proceeding still ongoing, in May 2013 Lactalis agreed to a $ 130 million reduction in the purchase price, in application of a reverse earn-out clause provided for in the original acquisition contract. The second decision, in November 2013, confirmed that procedural violations had occurred and removed one independent director who had repeatedly favored Lactalis' interests in his capacity as chair of the special committee of independent directors in charge of giving a binding advice on the transaction. While the purchase price revision may not – *per se* – be attributed to Amber, its activism has undoubtedly added pressure on management in the negotiation that followed, thereby benefiting all minority shareholders.

VI. Assessment

Active investors may alternatively seek to become part of a control coalition to share in private benefits extraction or take an adversarial stance, aimed at monitoring the control shareholder, especially where the latter does not hold a majority stake. We have analyzed institutional activism in Italy, a country with concentrated ownership and a reputation for high private benefits of control and weak investor protection.

Though broadly in line with the general assumption that mutual funds' activism is low-cost and ex-post, while that of hedge funds tends to be ex-ante and high-cost, active institutional investors' behavior in Italy escapes simple classifications, for two main reasons: a) active investors are a broad and diverse family, and even the members of a single class may follow different business models; b) they often adopt flexible strategies, i.e. they may, alternatively, be

pro-active or reactive, and collude with large shareholders or take a monitoring role, depending on the circumstances.

Italian mutual funds' activism is surprising: mutual funds hold small stakes, their investment horizon is typically short-term and activism may negatively affect their portfolio liquidity. Mutual fund activism may, however, be properly understood within the Italian capital markets framework: since a relatively small number of companies account for a large stake of market capitalization, equity funds wishing to "buy Italy" have no real alternative to buying blue-chips. A considerable part of this investment is, actually, long-term and may justify active behaviour (Belcredi et al. 2013).

Italian mutual funds have been extremely successful in their lobbying effort but much less so in exerting their voice at individual companies. From a general standpoint, it might even be argued that voice was instrumental to a more effective lobbying activity. Mutual fund participation to slate voting in board elections is on the rise, especially after the introduction of the record date system. However, coordination costs remain substantial and the general trend of investment in the Italian stock market has made the support from foreign investors a necessary ingredient for the success of mutual fund slates.

Hedge funds have been quite active in Italy over the last decade. They have pursued flexible strategies, along pretty much the same lines as in other developed countries, targeting companies whose strategy and/or corporate governance was controversial, and firms where control changes were expected. Hedge funds are often stock-pickers and not necessarily activists, even though it is difficult to give precise statistics, since public engagement is typically the last

part of a multi-staged process (Gantchev 2013). Though anecdotal in nature, the available evidence suggests that hedge funds have been rather successful in their efforts.

A particularly interesting strand of activism has developed in the last few years, with hedge funds aggressively targeting listed companies engaging in controversial transactions: in doing so they successfully resorted to legal tools and remedies made available by reforms in the last two decades. According to Zingales (2013), the first opinion by the court of Parma on the Lactalis-Parmalat transaction has "revolutionized Italian corporate governance, striking relational capitalism at its root."

Erede (2013) argues that in Italy hedge funds sometimes act as allies to controlling shareholders to pursue business opportunities or obtain special deals. His evidence is, however, partial and indirect: it relies on rumors reported in the press, on the fact that funds affiliated to a bank (BPM) invested in a hedge fund (Amber) a few months after it targeted the bank, and on the finding that hedge funds otherwise known for activism have often been passive or supportive of incumbents. We identified only one instance of an activist hedge fund having sided with control shareholders to share in private benefits extraction via the sale of a control block (Leonardo with part of the Marzotto family). However, even in that case, subsequent events triggering the mandatory bid rule led to an outcome no less favorable to minority shareholders than to the activist hedge fund.

Our serendipity was that, in a context of low investor protection, high private benefits and concentrated ownership, evidence of the "dark side" of relational investing would emerge. Our inability to find diffuse evidence of this kind of activism may well mean that institutional investors have been particularly good at hiding their misdeeds. In a context where relational

investing has traditionally been common, and efforts by insiders to keep newcomers out of the gate should be intense, we find this unlikely. Of course, the picture might be substantially different once other subjects (i.e. individual investors and entrepreneurs) are considered. This is left for future research.

Our strong impression is that corporate governance reforms implemented over the last 20 years have considerably strengthened investor protection, thereby increasing the scope for value-enhancing activism and curbing opportunities for "dark side" relational investing. Enforcement remains crucial in this regard. Albeit anecdotal, our evidence is overall consistent with improved monitoring and investor protection.

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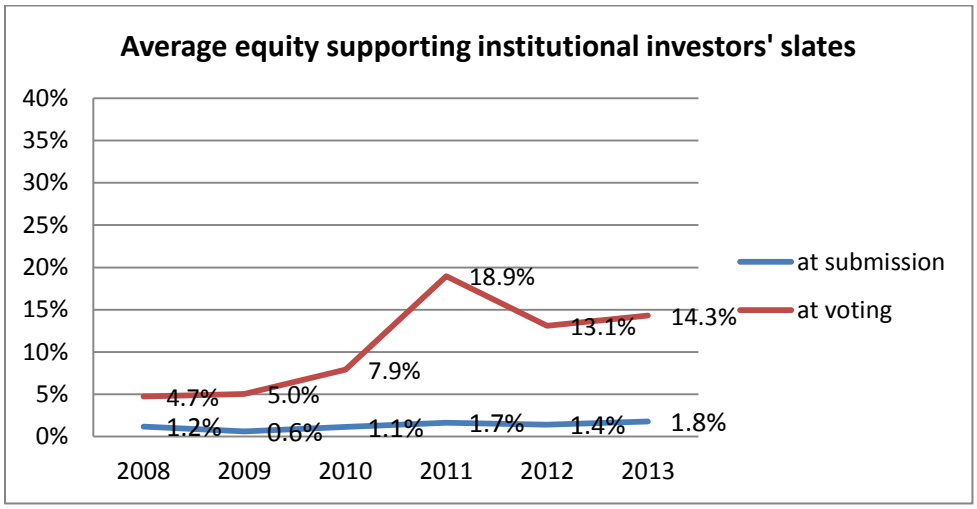
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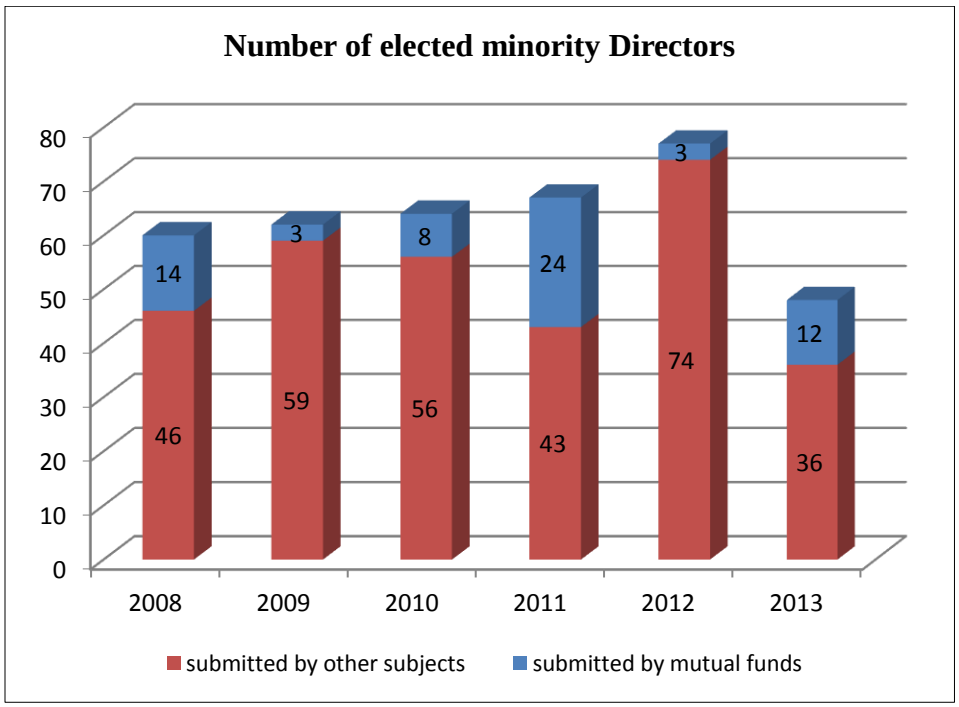
Tables and Figures

Figure 1



Source: our elaborations on the Assonime-Emittenti Titoli database, various years.

Figure 2



Source: our elaborations on the Assonime-Emittenti Titoli database (various years)

Table 1: Hedge Fund transactions on Italian listed firms

	No. of transactions			
Year	Started at the 2% ownership threshold	Closed	Net	Still open at year end
2000	11	1	10	10
2001	20	9	11	21
2002	30	23	7	28
2003	17	21	-4	24
2004	22	18	4	28
2005	40	23	17	45
2006	65	44	21	66
2007	76	50	26	92
2008	28	78	-50	42
2009	13	25	-12	30
2010	14	15	-1	29
2011	15	22	-7	22
2012	17	12	5	27
2013	1	5	-4	23
Total sample	369	346	23	

	No. of transactions			
Year	Started at the 5% ownership threshold	Closed	Net	Still open at year end
2000	4	0	4	4
2001	4	2	2	6
2002	8	4	4	10
2003	3	3	0	10
2004	4	2	2	12
2005	7	3	4	16
2006	15	7	8	24
2007	18	4	14	38
2008	2	18	-16	22
2009	4	8	-4	18
2010	3	6	-3	15
2011	4	7	-3	12
2012	6	2	4	16
2013	1	4	-3	13
Total sample	83	70	13	

Source: our elaborations on Consob public database

Table 2

Dissenting institutional investors in SOP votes (2012), in % of voting capital		
	Italian	Foreign
No. of annual GMs where at least one shareholder of the category:		
was present	53	164
dissented	20	123
Average dissent	0.6%	5.2%
Median dissent	0.0%	1.1%
MAX dissent	15.0%	40.4%

Source: our elaborations on annual GM minutes

european corporate governance institute

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI produces and disseminates high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It draws on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

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