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Perspectives and obstacles of the shareholder activism implementation: A comparative analysis of civil and common law systems

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PERSPECTIVES AND OBSTACLES OF THE SHAREHOLDER ACTIVISM IMPLEMENTATION: A COMPARATIVE ANALYSIS OF CIVIL AND COMMON LAW SYSTEMS

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Abstract

The paper outlines shareholder activism development in common law and civil law countries and identifies features of these legal systems that create preconditions and obstacles for shareholder activism. Our findings show that tendencies of shareholder activism depend on the type of the legal system, but also vary within the countries that share the same legal system. Thus, we conclude that the type of legal system is not the chief determinant of shareholder activism. A comparative analysis of shareholder activism in Germany and Ukraine (civil law countries) and the USA and the UK (common law countries) shows that the system of domestic corporate regulation, development of the stock market, companies' capitalization and corporate governance influence the development of shareholder activism in equal measure.

JEL topics: G34, K22, G23

Keywords: Shareholder Activism, Common Law, Civil Law, Hedge Funds, Corporate Governance

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1 Introduction

Shareholder activism is the issue that gains controversial feedback in academic and business circles. It is the way in which shareholders can assert their power as owners of the company to influence its behaviour. In some cases shareholder activism is directed against other large shareholders, not against directors. There may also be cases of collaborative shareholder activism, in particular when it is conducted in private.

There has been witnessed a new wave of interest in shareholder activism in recent years. Supporters of this phenomenon argue that companies with active and engaged shareholders are more likely to be successful in the long term compared to companies without such insistent owners. Adversaries of shareholder activism proclaim it a disruptive populist ranting that weakens strong companies.

There is no agreement on the level of power that shareholders should delegate to boards of directors and the proper time for shareholders to impose direct actions. Worldwide practice and existing legal framework suggest that shareholder activism is majorly developed in Anglo-Saxon countries with a common law system, where individual and institutional investors seem to have more levers of influence on the corporations and boards of directors. On the other hand, the recent research suggests that countries with the civil law system allow more shareholder activism that makes investors less reluctant to influence development of the corporations. At the same time, the nature of activism is changing in the United States. There is heightened interest in new activism players – like hedge funds – and new tactics they use such as derivatives dealing and stock lending.

A particular number of firms and individuals have been connected to this type of activity for decades. Although when shareholder activism came into existence such activity was often charged with corporate raider label. Activist companies and individuals took advantage of their own funds to buy stocks in the company and proceed with the internal contest for the overall control over the board. Later on new methods and players came into existence. Funds collected from other investors got the upper hand over the personal funds in shareholder activism. This increased the scale of the issue and power of the engaged parties. Moreover, activists switched their attention from gaining board majority to influencing corporate strategy by one or two seats on the board. Modern activists still view company breakup as the potential outcome of their activity, but such results as change of the executive management, financial restructuring or operational efficiency are taken into consideration.

During the past decade, the number of activist hedge funds across the globe has dramatically increased, with total assets under management now exceeding $100 billion. Since 2003 (and through May 2014), 275 new activist hedge funds were launched (Preqin, 2014).

Recent academic studies suggest that, by and large, activists are good for companies. An analysis of around 2,000 interventions in America during 1994-2007 found not only that the share prices and operating performance of the firms involved improved over the five years after the intervention, but also that the improvement was greatest towards the end of the five-year period. The firms activists targeted tended to be underperforming relative to their industry. These results hold true for the two sorts of activism that tend to be criticised most: actions designed to increase a firm's leverage, such as taking on more debt or using cash to buy back shares, and actions that are especially hostile to a firm's current management (Bebchuk et al., 2015).

Some corporate executives argue that companies' regulation provides too much power to the shareholders and allows hedge funds to impose a lot of pressure on the activity of the private firms. Groups of experts appear who argue that regulation should be changed however these ideas do not have support among general public and regulators.

This paper will analyse the shareholder activism development in the common law and civil law countries and identify features of these legal systems that create preconditions and obstacles for the shareholder activism. For this purpose the paper is divided into several parts. Literature review provides background information on the issue as well as indicates the points omitted in previous research on shareholder activism. Parts 1 and 2 are devoted to the shareholder activism in civil law system and provide an analysis of the cases of two civil law countries: Germany, as an example of a developed civil law country, and Ukraine as an example of an emerging civil law economy. Part 3 presents the analysis of shareholder activism development in the common law countries: the USA as an example of the country with the developed shareholder activism and the UK as a European country with the common law system. The concluding part of the paper systematizes the main outcomes of the research and outlines issues for future investigations.

2 Literature Review

Scientific research on shareholder activism started in the United States and was mostly focused on public activism by institutional investors in the late 1990s.

Numerous studies have targeted institutional shareholders as activists and connection between their influence on the companies and financial performance of the latter. Smith examined firm characteristics that led to shareholder activism and analyzed the effects of activism on target firm governance structure, shareholder wealth, and operating performance. The firm size and the level of institutional holdings were found to be positively related to the probability of being targeted (Smith, 1996). These results were supported by Klein and Zur who examined activism campaigns by hedge funds and other private investors. The main parallels existing between the groups turned out to be a significantly positive market reaction for the target firm around the initial filing date, significantly positive returns over the subsequent year, and the activist's high success rate in achieving its original objective. Further, it was found out that both activists frequently gained board representation through real or threatened proxy solicitations (Klein and Zur, 2009).

On the other hand, Black surveyed corporate governance activity by institutional investors in the United States, and the empirical evidence on whether that activity affected firm performance. He concluded that institutions achieved little effect on firm performance that way (Black, 1998).

A number of studies view the social aspect of the shareholder activism. Guay et al. explored the role of NGOs in shareholder activism and socially responsible investment claiming that such organization were the main supporters of the socially-oriented shareholder activism (Guay et al., 2004).

Labor unions can also play an important role in the shareholder activism. Schwab and Thomas argue that labor unions are aggressively using their ownership power to push corporate-governance reforms. So far, much of their activity is tactical. Lasting changes in corporate governance can occur if unions develop a more strategic model of their role in corporate governance. A strategic model would require unions to concentrate on areas where their interests coincide with other shareholders and where they can demonstrate that their actions will increase firm value. This requires that labor unions adopt a platform of maximizing long-term growth for shareholders and other stakeholders, as well as for themselves. In particular, unions must convince other shareholders that they are acting in areas where they have an informational advantage about the corporation's and management's operations. If labor can demonstrate to other shareholders that it is using its monitoring advantages to take actions to increase firm value by policing management shirking and reducing the agency costs of equity, then other shareholders will be more willing to follow its lead in future voting initiatives (Schwab and Thomas, 1998).

Despite the fact that a lot of studies cover different aspects of shareholder activism or analyse its influence on the target companies' performance, only a few papers take into account country-specific aspects of the issue or consider the effect legal systems have on it. Even less attention has been given to comparative analysis of shareholder activism in common and civil law systems. Girard presents a

legal, theoretical and empirical study to understand distinctive features of successful French shareholder activism. Author's results show that there is a correlation between successful outcomes and the most aggressive influential degree (law suit) with an absence of private engagement. At the same time, Girard points out a new tendency in the French activism process due to the legal enforcement and institutional changes. Contrary to the Anglo-Saxon common law countries, the role played by investor associations is a significant factor in successful French activism. However, in accordance with a global phenomenon, activist hedge funds and proxy professionals are increasingly critical of bad corporate governance (Girard, 2011). Another study performed by Bessler, Drobetz and Holler examined shareholder activism in Germany. The authors found that recent regulatory changes in the German financial system shifted corporate control activities from universal banks to other capital market participants. Particularly hedge funds took advantage of the situation by acquiring stakes in weakly governed and less profitable firms. Results suggest that aggressive hedge funds attempt to expropriate the target firm's shareholders by exiting at temporarily increased share prices (Bessler, Drobetz and Holler, 2015).

Judge et al., however, attempt to study differences in common law and civil law countries with regard to shareholder activism. An empirical study of the matter suggests that (1) firm size is unrelated to financial activism, but positively related to social activism; (2) ownership concentration is negatively related to both financial and social activism; (3) and prior profitability is negatively related to financial activism, but positively related to social activism. These relationships in the case of financial activism are generally stronger in common law legal systems, whereas those in the case of social activism are generally stronger in environments with a greater level of income inequality (Judge et. al. 2010).

This paper does not reflect the results of an empirical investigation but presents an overview of the existing practices and regulations in the field of shareholder activism in the common law and civil law countries.

3 Shareholder Activism in Civil Law System: the Case of Germany

3.1 Major forms of shareholder activism in Europe

Shareholder activism represents a spectrum of activities by one or more of a publicly traded company's investors intended to bring about some changes in corporation.

3.1.1 Hedge fund activism

At the most assertive end of the spectrum is hedge fund activism, when an investor seeks to effect significant changes in corporation's strategy.

Some of these activists have been engaged in this type of activity for decades. In the 1980s, these activists frequently sought the breakup of the company – hence their frequent characterization as "raiders." They used their own money to get a large block of shares and engage in a proxy contest for control of directors.

In the 1990s, new funds expanded on the market niche. These funds got money from other investors and used minority board representation to influence company's strategy. While a company breakup was one of the potential changes sought by activists, many also sought new operational efficiencies, executive management, or financial restructuring.

Modern tactics of today's activists are evolving and include both time-proven tactics and those that fall within capital allocation strategy (e.g., return of large amounts of cash to investors through stock buybacks or dividends, revisions to the company's acquisition strategy). Many of them are spending time talking to the company to negotiate around specific changes to unlock value, before pursuing a proxy contest or other more public activities. They may also spend pre-announcement debates talking to some other shareholders of the company to gauge receptivity to their contemplated changes. These activists are also grappling with the possible impact of high-frequency traders on the identity of the shareholder base that is eligible to vote on proxy matters.

3.1.2 Shareholder proposal

Further down the spectrum is sponsorship of shareholder proposals.

The goal of investors is to encourage one of the types of change below:

– a change to the board's policies or practices, or a change to its composition;

– a change to the executive compensation plans of the company;

– a change to the company's oversight of audit, risk management functions;

– a change to the company's behavior as a corporate citizen (e.g., environmental practices, climate change or resource scarcity preparedness, political spending or lobbying, labor practices).

3.1.3 "Vote no" campaign

Moving down activism forms are "vote no" campaigns if an investor (their coalition) urges shareholders to withhold their votes from director candidates nominated by the board.

These campaigns usually fail to achieve an involuntary ouster of a director since many companies determine the results of the voting by a majority of

outstanding shares – not just a majority of the votes cast at the meeting. Nevertheless, when the challenged director is not the corporation's chair or CEO, such a campaign can push the candidate to voluntarily withdraw from the election. If the level of negative vote was relatively significant, a director may be replaced during his or her subsequent term (PricewaterhouseCoopers, 2015).

3.1.4 Say on pay

As a rule these activities are limited to letters to a company (traditionally directed to the board compensation committee) or meetings/calls with the company (typically involving corporate secretary, the company's general counsel, or compensation committee chair).

The goal of these conversations is to effect a substantive change to the compensation scheme, or to alter how it is described in shareholder communications.

3.2 Shareholders activism in Europe: key figures

Historically, European market was recognized structurally less attractive than the U.S. one for activists, but today they have explored new territories adjusting their tactics.

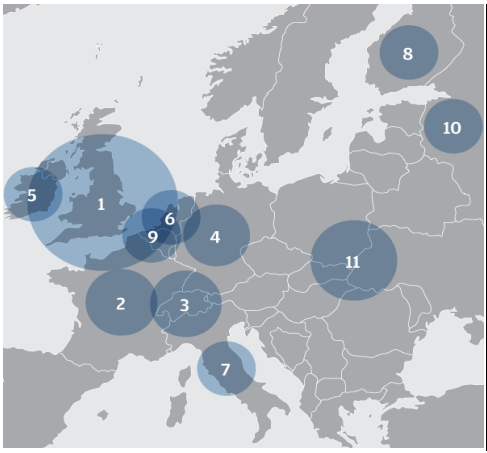
There are several specifics of the European shareholder activism:

– a fragmented market: Europe is defined by a myriad of local regulations, including EU directives and national stock market rules;

– new exceptions to the rule: significant insider ownership and cross-shareholdings have tended to keep activist prominence subdued amongst large companies. However, current exceptions include Knight Vinke's campaign at ENI (Italy), The Children's Investment Fund's campaign at Airbus (France) and Findim Holdings campaign at Telecom Italia (Italy);

– equity landscape: some of European stock markets are considered to be less liquid, which can pose an innate hurdle to building a meaningful undetected stake, and then, being able to exit a position;

– a fertile economic environment: activity tends to track the health of the stock market and, in turn, the broader economy, which in Europe has generally lagged behind the U.S. recovery, but is now seeing emerging signs of renewed growth.



	Country	No. of campaigns	% of total European activity
1	United Kingdom	103	43.1
2	France	26	10.9
3	Switzerland	20	8.4
4	Germany	16	6.7
5	Ireland	9	3.8
6	Netherlands	8	3.3
7	Italy	8	3.3
8	Finland	7	2.9
9	Belgium	6	2.5
10	Russia	6	2.5
11	Rest of Europe	30	12.6

Figure 1. Primary geographies for shareholder activism in Europe (2010–2014)
Source: J.P. Morgan European activism database, July 2014

While the jurisdictions have seen the most activity, there are early indications that activists alongside other investors are looking at Southern Europe with increasing interest. Main activists in Europe include the following:

– beyond location: while today most activist hedge funds are headquartered in North America, Europe is still a key regional investment focus, targeted by 40% of activists when considering funds that have either European or global investment flows;

– rising investor expectations: the aforementioned confluence of events, which has led to more funds with more capital pursuing an activist investment strategy, has resulted in increasing pressure for activist funds to find specific opportunities to generate returns their investors have come to expect. This is considered to be fueling an increased interest in Europe as fertile ground to deploy capital with an activist strategy;

– the less travelled ground: 21% of all hedge fund managers are located in Europe relative to the 15% of total funds that are based in this region, signaling a potential under-representation of activist hedge funds in Europe, which supports the expectation that activity in Europe will rise (J.P.Morgan, 2014).

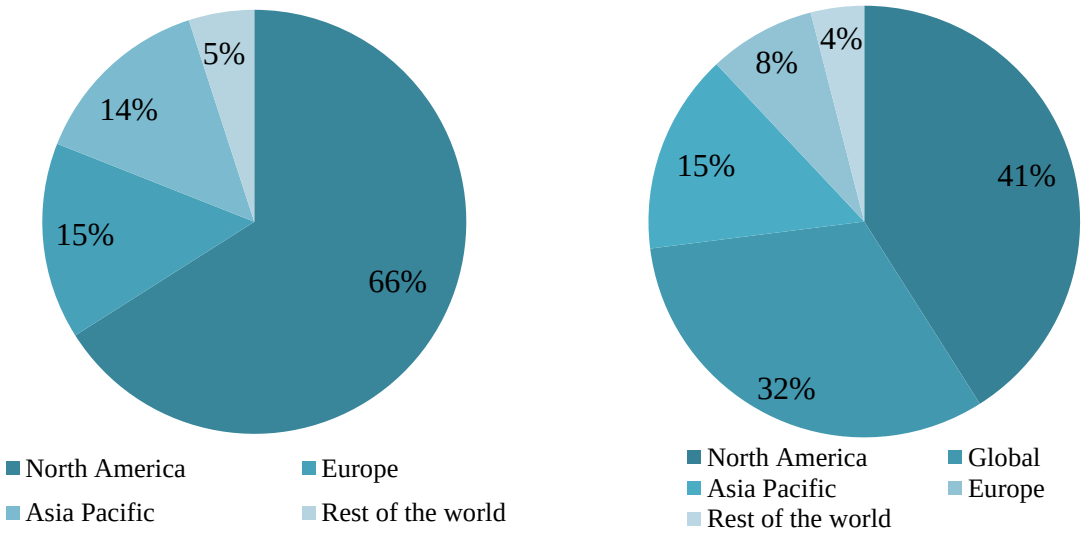


Figure 2. Regional location and focus of activist hedge funds
Source: Preqin Hedge Fund Analyst, 2014; J.P. Morgan European activism database, 2014

Shareholder activism in Europe includes the following aspects:

– there are various attributes that attracts activism, such as change in strategic direction, relative underperformance, capital allocation, corporate governance, balance sheets, and returns policies;

– governance-related campaigns often misrepresent the motives particular activist shareholders may have in waging a campaign against the board of the company;

– approximately half the time, activists get what they set out to achieve, but it is not an indicator of whether their campaigns or initiatives lead to value creation;

– only a limited number of activists targets operational matters, and typically only they have industry experience or particular insights.

Table 1. European activism campaigns by outcomes (2010–2013)

	Campaign objective	2010-2013	% of total campaigns	Outcome
Governance related	Gain board representation	28%	52%	
	Replace board members	12%		
	Management remuneration	8%		
	Change management	3%		
M&A related	Sale of/Bid for the company	13%	30%	
	Business portfolio optimization	11%		
	Other M&A	6%		
Balance Sheet	Return capital to shareholders	6%	9%	
	Capital raising/Restructuring	3%		
Operational improvement	General cost cutting	5%	9%	
	Change in strategy/focus	4%		
	Successful	Partially successful		
	Unsuccessful	Ongoing		

Source: J.P. Morgan European activism database, 2014

3.3 The legislative road to a "say on pay" in Germany

It took a few steps for the final enactment of the current "say on pay" provision. The following sections seek to give a short account of this process by depicting the relevant stages on the road to a "say on pay" in Germany.

3.3.1 The German Corporate Governance Code

The Code puts forward significant statutory regulations for listed stock companies and contains the best standards for responsible governance in order to make the German corporate governance system understandable and transparent for local and international investors.

According to Article 161 of the German Stock Corporation Act, listed stock companies have to declare whether or not they comply with the Code's recommendations annually, and if not, explain the reasons for not doing so. While the initial version suggested that the figures of the executive compensation of the members of executive board "should be individualized", its revision in May 2003 turned this proposal into a recommendation and outlined that compliance with it had to be publically disclosed by the company. However, most corporations rejected the recommendation and did not disclose the compensation of executive directors on an individualized basis. Instead, only the overall compensation for the members of management board was reported.

3.3.2 The EC Commission's Recommendations of 2004 and 2009

The EC Commission's Recommendation of 2004 sets an appropriate scheme for the remuneration of directors of the listed companies. Level and structure of directors' compensation are matters falling within the competence of companies and their shareholders, the EC Commission named some recommendations applying to the listed companies:

– remuneration policy disclosure;

– recommendation concerning the disclosure of individual directors' remuneration;

– active participation of shareholders regarding executive compensation.

In the wake of global financial crisis the EC Commission changed some aspects of its initial recommendation (December 2004) to take account of false incentives in compensation schemes, which were one of the most important reasons of financial crisis. Thus, in its recommendation of April 2009 the Commission extended the framework of 2004 mainly with regard to the requirements on remuneration policy of the corporation. The Commission's objective was to ensure that the structure of compensation is in scope with company long-term sustainability and that remuneration is based on measurable and predetermined performance criteria, while termination flows must be subject to precisely quantified limits and must not be a reward for failure. Additionally, share-based remuneration policy should be better linked to the long-term value creation and performance of the firm.

3.3.3 The Act on the Disclosure of Management Board Compensation-VorstOG (2005)

Following the European thrust, German law mandated the individualized disclosure of remuneration of executives for every listed company in the notes of its financial statement or in its managerial reports for business years beginning with January 1, 2006.

3.3.4 The Act on the Appropriateness of Management Board Compensation-VorstAG (2009)

The Act on the Appropriateness of Management Board Compensation introduced several changes to the German Stock Corporation Act. Their main focus was especially targeted on the supervisory board intending to reinforce its responsibility and role in designing the system of executive compensation. Moreover, the legislation was aimed at making the compensation of executive directors more transparent to shareholders and public.

3.3.5 Recent initiatives

On 8 May 2013 the German government announced its intentions to alter Article 120 of the German Stock Corporation Act. Seemingly influenced by the success of a referendum concerning managers pay in Switzerland, the German government offered to prescribe a mandatory and binding annual shareholder vote on executive remuneration system. It is envisaged that shareholders must be informed of the maximum amount of remuneration that executives may claim under the respective compensation schemes.

3.4 Hedge fund activism in Germany

The financial crisis had severe impact on hedge funds' activity in Germany. The number of funds registered and established under the German Investment Act fell from 31 in 2009 to 20 as of September 2011 according to figures published by the German Federal Financial Supervisory Authority.

3.4.1 Legislative trends on regulation of hedge funds

German regulation of hedge funds has increased after the financial crisis, with German regulation often going beyond European standards or requirements.

For example, Germany rushed ahead in May 2008 when the BaFin banned short sales in some companies in financial sector. BaFin decrees in May 2010 extended a ban to naked short sales of debt securities of Eurozone countries that are traded on German stock exchanges in regulated market, as well as a ban on CDS where the reference debt is from a Eurozone country and which do not serve to hedge against the risk of default. In July 2010 both BaFin decrees were codified into statutory law under the Act on the Prevention of Improper Securities and Derivatives Transactions (URIA, 2012).

In March 2010, the BaFin offered the new transparency regime governing net short-selling positions in shares of certain financial sector issuers, based on the requirements of the Committee of European Securities Regulators for a pan-European short-selling regime. The regime was extended to 25 March 2012 shortly before its expiry on 31 January 2011. The BaFin's regime has since been expanded and codified into statutory law under the Act on the Prevention of Improper Securities and Derivatives Transactions, with such rules becoming effective on 26 March 2012.

The rules of disclosure on stakebuilding were widened under the German Risk Limitation Act (2009). In order to prevent creeping acquisitions or stakebuilding and to increase transparency, these rules will be extended to apply to financial instruments. The new rules are part of the Act on Strengthening Investor Protection and Improving the Functionality of the Capital Markets which was enacted in April 2011.

These legislative actions are expected to decrease German hedge fund activity or at least to refocus of activity on other classes of investments or assets (e.g. foreign currencies, non-regulated financial instruments).

3.4.2 Activism and behavioural trends

In general, hedge funds do not play a major role in large German companies' investments or in large scale transactions. However, the most recent exception was the takeover bid of Spanish ACS for the German company Hochtief AG, in which hedge funds acquired about 15% of shares and performed an active role in rejecting and supporting the bid.

Over the last years there has been a direct trend for activist hedge funds to invest in companies that are midcap. In 2009 many funds invested in MDAX-companies in Germany were considered as a tool to influence corporate restructurings and strategy. However, current shareholding structures in midcap companies, which often have majority shareholders, have made it difficult for the hedge funds to achieve their goals.

Other longstanding hedge fund strategies remain unchanged, e.g. seeking changes in the composition of board members.

The most recent trend to emerge from restructuring scenarios is for hedge funds, which have a stake in the company to become lenders to that corporation through acquiring bank loans or credit claims, and then to push for restructuring. In February 2011, hedge funds with interests in German Conergy AG pushed for a shareholder resolution on additional capitalization allowing for a debt-for-equity swap of their loan claims – a step which was without precedent for a publicly listed company in the German market.

In general, German hedge funds seem to continue to act in the background and most of their activities are not publicly disclosed: only about 10% of hedge fund activities become public in the German market.

4 Shareholder Activism in Civil Law System: the Case of Ukraine

4.1 Corporate governance in Ukraine

Taking into account the fact that quite a few enterprises choose joint stock form of capital organization in Ukraine, the instance of growing interest in corporate rights, corporate relations and corporate governance improvement is considered a positive tendency. Successful development of corporate sector in Ukraine is closely related to development of civilized corporate governance, and improvement of the latter, in its turn, ensures reliable protection of owner`s rights to national and foreign investors, resources for further development – to production, effective management of processes on securities market – to the state.

Development of corporate governance in Ukraine is provided by implementation of the Law of Ukraine «On Joint Stock Companies», which embodied world practice of corporate relations. An important moment in implementation of innovations of corporate governance, introduced by the Law of Ukraine «On Joint Stock Companies», lies in bringing the internal documents of joint stock company to conformity with current legislation. With this aim there is an urgent need of development of typical articles of association of public and private joint stock companies, regulations on corporate secretary, regulations on information policy of a joint stock company, etc. (OECD, 2003).

According to data provided by issuers, in 2013 compared to the previous year, the number of joint stock companies which disclosed information on the state of corporate governance as well as the number of companies which held general shareholders meetings has been decreasing. Detailed information on such changes is shown in Table 2.

In 2013, among 5275 joint stock companies which provided information on the state of corporate governance there were 4834 joint stock companies (92.64 %) which held general shareholders meetings,

including unscheduled ones – 1622 (33.55 % of the total number of joint stock companies which held general shareholders meetings).

Control over the process of registration of shareholders or their representatives for participation in the last general shareholders meetings (if any), which were held during 2013, in most cases was performed by shareholders which own more than 10 percent as a whole (1420 joint stock companies or 26.92 % of the total number of joint stock companies which submitted information on the state of corporate governance in 2013).

Table 2. Main indices of the state of corporate governance of joint stock companies (OJSC and PJSC) in 2007 – 2013

Indices	2007	2008	2009	2010	2011	2012	2013
Number of companies which disclosed information on the state of corporate governance	6091	6104	4936	6479	7784	7241	5275
Number of companies which held general meetings	5029	4996	4067	5006	7171	3681	4834
- including unscheduled ones	*604*	*652*	*629*	*1844*	*2704*	*1243*	*1622*
Authority which performed registration of shareholders for participation in the last general meeting							
- mandate commission, appointed by the board	*3664*	*3625*	*1555*	–	–	–	–
- board	*687*	*670*	*342*	–	–	–	–
- independent registrar	*1309*	*1341*	*2437*	–	–	–	–
- register commission	–	–	–	*3179*	*5952*	*5956*	*4414*
- shareholders	–	–	–	*325*	*420*	*288*	*205*
- registrar	–	–	–	*1354*	*697*	*331*	–
- depositary	–	–	–	*23*	–	–	*68*
Number of companies which established revision commission	5406	5474	4379	4867	6369	5918	3222
Number of representatives of shareholders which own less than 10 percent of shares, in the supervisory board (% of the total number of representatives)	71.48	70.38	58.68	57.12	51.15	47.17	43.47
Periodicity of audits of joint stock companies conducted by external auditors during the last three years (% of the total number of companies which disclosed information on periodicity of audits)							
- not conducted at all	*0.82*	*0.81*	*0.76*	*0.74*	*1.63*	–	*1.00*
- less often than once a year	*1.46*	*1.36*	*1.36*	*1.24*	*7.94*	–	*3.58*
- once a year	*86.20*	*86.73*	*87.09*	*87.03*	*82.94*	–	*87.65*
- more often than once a year	*11.52*	*11.07*	*10.79*	*10.98*	*7.48*	–	*7.78*
Number of companies where revision commission performed revision of financial and economic activity of a joint stock company in the previous year (% of the total number of joint stock companies which indicated authority which performed revision)	58.25	58.41	57.96	57.11	59.26	–	58.35
Number of companies which plan to include their shares to the listing of stock exchanges	250	478	546	775	760	636	501
Number of companies which have their own code (principles, rules) of corporate governance	66	75	82	145	524	640	677

Source: NSSMC, Ukraine

In most cases the committees of strategic planning are established in the supervisory board (in 36.31 % of the total number of joint stock companies which submitted information on the membership of the supervisory board in 2013). At the same time, in 2013, 389 out of 5275 joint stock companies (7.34 %) established special positions or units responsible for relations with shareholders.

Besides, members of supervisory board receive no remuneration in the majority of joint stock companies (89.42 % of the total number of joint stock companies which submitted information on the assessment of the amount of remuneration to the supervisory board members), and 10.05 % of joint stock companies have established fixed remuneration.

According to the legislation of Ukraine the executive body makes all the decisions on activities of joint stock companies, except those which are within the competence of the general shareholders meetings and supervisory boards of companies. 32.36 % of joint stock companies' articles of association or internal documents contain provision on the conflict of interests (i.e. contradiction between personal interests of the official or related persons and the duty to act in the interest of a joint stock company) (VRU, 2003).

Among joint stock companies there is a widespread practice to develop internal documents. Most often additional regulation by internal documents are needed by provisions on general meeting of shareholders (21.99 %), provisions on the

supervisory board (21.88 %), provisions on revision commission (21.68 %) and provisions on the executive body (board) (21.57 %). Among the most non-transparent issues there is information on the amount of remuneration of officials of a joint stock company and information on shareholders which own 10 and more percent of equity capital.

4.2 Shareholder activism in Ukraine

Shareholder activism is not popular in Ukraine compared to other European countries. Various forms of activism (proxy battles, negotiations with management and shareholder campaigns) are rarely exercised due to uncoordinated and diversified actions and interests of minority shareholders.

The major form of shareholder activism is commenced through litigation. Shareholders can bring claims to court in case of their rights' and legitimate interests' violations, and Ukrainian law does not stipulate derivative actions.

In accordance with Resolution of the Plenum of the Supreme Court of Ukraine (from October 24, 2008, No. 13), the law does not stipulate the rights of shareholders to apply to court for the protection of rights or interests of a company beyond the representation relations. The Supreme Court recommended commercial courts to dismiss shareholders' cases related to the amendment, execution, invalidation or cancellation of contracts if there is no violation of corporate rights of shareholders.

Additionally, Ukraine does not have special law on remuneration. The JSC Law protects the interests of a JSC from overpaying its directors by setting a rule that the directors' remuneration is at the exclusive discretion of the council and should be set by this organizational structure (VRU, 2008). According to the Law, remuneration issues cannot be delegated to other corporate bodies or officer, the only exception being general meeting of shareholders, which can resolve any corporate matter as the most powerful body in the company.

Historically, informational disclosure of the company to its shareholders was restricted. Only a small number of majority shareholders had real access to internal information of the company via the board council. This situation changed when the JSC Law was introduced and established some mandatory levels of access to information on JSC activity.

Firstly, the council, the auditor or internal audit commission and the board of directors must report to the shareholders at least once a year at the annual general meeting. Secondly, the JSC Law guarantees free access for all shareholders to quite a broad statutory list of documents on the activity of JSC. These documents are obligatory provided to a shareholder upon its written request. Thirdly, public JSC must have an official website where required public and statutory information is disclosed. Fourthly, the JSC is obliged to have a corporate secretary who is responsible for communications of JSC with its shareholders. Finally, the Securities Law and regulations established special disclosure requirements related to a JSC's information (SCSSM, 2003).

Considering past practices of corporate non-transparency and non-disclosure of information, even if the disclosure was required by regulatory acts, there is a reasonable possibility that some new disclosure provisions of the JSC Law and the Securities Law may be violated and that there may be lack enforcement in practice by majority shareholders and boards.

In addition, another important source of information about the activities of the company is its top management. Even despite the weak Ukrainian law, which stipulates the equality of shareholders' access to information and establishes the liability for wrongful treatment of insider information, practically controlling shareholders organize unofficial communications and meetings with management of the company to get inside knowledge or keep in mind all the company's latest activities.

The JSC Law specifies terms of notice about general shareholders' meeting and information to be included therein. This notice is sent to each shareholder or to a nominal holder personally in written not later than 30 days prior to the day of general shareholders' meeting and includes the agenda thereof. Moreover, the JSC is obliged to publish in the National Securities and Stock Market Commission's (NSSMC) official printed matter the notice on general shareholders' meeting. Any further changes in this agenda should be brought to the notice. Starting from the day of sending the notice to the shareholders, a JSC must provide them with an opportunity to become acquainted with all the documents and information they may need in order to make decisions at the general shareholders' meeting.

Proxy solicitation is not typical for Ukrainian practice as there are no special rules to regulate this procedure. In most cases, proxy solicitation is exercised by management of large public joint stock companies with thousands of shareholders who do not attend the general shareholders' meeting for purposes of voting.

Table 3. Dynamics of individuals' written requests from 2009 till 2013

Year	Central Office	Regional Offices	Number of requests
2009	1686	4629	6315
2010	1292	2217	3509
2011	1295	2438	3733
2012	957	1526	2483
2013	1001	2424	3425

Source: NSSMC, Ukraine

4.3 Investors' rights protection in Ukraine

During 2013 NSSMC of Ukraine received 3425 written requests from individuals concerning violations of their rights and legitimate interests on the securities market. It is on 38 % more than during 2012.

Almost 78 % appeals were the complaints of minority shareholders on the activity of joint stock companies. Like in previous years typical violations of shareholders' rights remain the following:

– violation of the right to equal treatment to all shareholders;

– violation of the right to participate in the management of the company;

– violation of the right to receive information about the activities of joint stock company;

– defaults on obligations under securities foreseen by the conditions of their placement;

– violation of the rights of shareholders within additional issuing (NCSSM, 2015).

Most part of complaints is letters from individuals who have consigned property privatization certificates, compensation certificates and cash to financial intermediaries. Besides, the individuals are not informed on activities and location of companies because of the fact that most part of companies has stopped activities of their representative offices in the regions of Ukraine. Typical questions are as follows:

– none information on activities of companies and impossibility to determinate their location for many years;

– none dividends from the results of companies' activities;

– nonconfidence in information on null profits from business activities provided by companies and impossibility to revise its reliability.

Individuals' proposals and informational requests constitute insignificant percent of general number of requests. 98 % belong to complaints and appeals of individuals.

Repeated appeals are 3,7 % of the total number of appeals. Usually the main reason for repeated appeals is insufficient understanding of securities laws and the inability to carry out protection of rights and legal interests in court.

In conclusion, the level of corporate governance practices in Ukraine, although is not perfect, but is under active development. It should be noted that the current domestic economic realities do not allow explicitly adopt and replicate the experience of developed countries in terms of corporate governance. This is reasoned by the national features of business and banking activity in Ukraine. Since Ukraine became independent the track of the development and reforms in the sphere of corporate governance practices are clearly defined, and in addition during this time many laws and regulations, adapted to modern business environment, appeared, which have formed a legal framework that promotes corporate relations development. The study of corporate governance practice in Ukrainian companies and banks allows to summarize that there are no significant differences in the level of development of corporate standards, but due to the specificity of banking activities, in particular in terms of risk management, the banking sector is facing more stringent regulation, including corporate governance issues.

The importance of having the adequate corporate governance system is connected with such key element in decision-making processes of potential investors as their interests' protection. Business is the game with its own rules, and these rules are international. Ukrainian and foreign companies have to deal with similar problems; tools developed abroad can successfully be used in Ukrainian corporate governance with national characteristics and changes in standards of business conduct, albeit with some delay, come into Ukrainian businesses.

5 Shareholder Activism in Common Law System: the Case of the USA and the UK

Conflicts of interest and disagreement on strategy development inevitably arise in any company. However, intelligently chosen corporate governance system can minimize and solve potential problems. Types of corporate conflicts are determined by:

– legal environment, cultural and political traditions in the country;

– ownership and control structure in the company.

The legal environment with ineffective system of minority shareholders rights protection has great private benefits of control due to the fact that the controlling owner has more control over the company in favor of himself, ignoring the interests of other shareholders. Empirical studies have found a

significant negative relationship between the quality of the shareholders' rights protection and the size of private benefits of control (Dyck and Zingales, 2004). At the same time in the countries with worse legal protection of shareholders the market valuation of companies with respect to their fundamental indicators (assets, profits, reserves ratio, etc.) is lower (La Porta, 2002).

Dispersal or concentration of ownership serve as responses to the potential conflicts and, at the same time, provide prerequisites by themselves to certain types of conflicts. Thus, it is believed that in the Anglo-Saxon countries, with a dispersed type of ownership, the main conflict is a conflict between shareholders and corporate governance system. Minority shareholders due to the lack of coordination are not able to control properly the managers who can exploit it for personal gain. In continental Europe and countries with emerging markets, which have concentrated ownership structure, basic conflict between majority and minority shareholders appears. Some researchers believe that the concentration of ownership in Europe is determined by political traditions. For instance, European social democratic values, in which social equality has priority over the maximization of shareholder value, resulted to the simultaneous strong influence of trade unions and the high ownership concentration. The concentrated ownership is the balance of trade unions influence and vice versa.

A few years ago, empirical data suggested that shareholder activism had no significant influence on corporate governance in the USA, since shareholders activism was a fairly rare phenomenon and led to an extremely slight improvement of the companies' objectives (Gillan and Skarks, 2007). The activists were mainly institutional investors, which, although have criticized imperfections in the corporate governance practice, but try to avoid aggressive actions against management. Recently, however, there has formed a new category of activists in the USA - specialized hedge funds, which use activism as one of the main strategy to make profits.

In American and British corporate practice the straightforward regulation of shareholder power is intensified by a lot of other rules that indirectly block shareholders from applying significant control over corporate decision-making process. There are three main control mechanisms, which are widely used in the USA and the UK, such as:

– disclosure requirements regarding major shareholders;

– voting procedure for shareholders and communication rules. The comparison of voting rules and practice of voting procedure in the USA and the UK are presented in the table 4;

– insider trading and short swing profits rules.

This can influence shareholders in two different ways. On the one hand, they disincline the development of big stock blocks. On the other hand, such mechanisms discourage communication and connection among investors.

Various studies show that that shareholder activism has significantly increased over the last decade. According to the latest HFR Global Hedge Fund Industry Report, total global hedge fund industry capital rose to the 11th consecutive quarterly record level in 2015 (HFR, 2015). Markets of the USA and the UK are among leaders in such growth.

Table 4. Voting rules and practice of voting procedure in the USA and the UK

	The USA	The UK
Regulations	SEC Rules	The Companies Act (1985): -section 376 -section 368
Qualifying sponsor	Ownership of 1 % of voting capital (or minimum USD 2000 in market value) for at least one year before the annual meeting	More than 5 % of voting capital, or 100 shareholders with no less than GBP 100 per holder to call AGM
Limits for the proposal	No more than 500 words	No more than 1000 words
Quantity of proposals, which can be submitted for one meeting	One	More than one
Expenses covered by	Company	Proposal sponsor
Obligatory of resolution	No	Yes
Voting coalition	Hard to form	Easy
Voting system	Proxy voting	Proxy voting/show on hands
Electronic vote	Yes	No
Do company release voting results	Yes	No
Voter turnout	High	Low

Source: Shareaction, 2013

The development of shareholders activism, predetermined by the US hedge funds, was picked up in Europe, where it was strengthened by both overseas and European funds. With regard to the goals and methods, British activism is similar to the US one, although there are some differences due to the fact that European legislation specifies the framework for a few different implementations of activism strategies. For instance, in Great Britain, it is typically more complicated for a minority shareholder to file a lawsuit against the Board of Directors members, but easier to nominate a representative to the Board of Directors or to convene an extraordinary shareholders meeting.

The US and British corporate governance systems have enough similarities. They are realized under Common law legal system, which have strong minority shareholders protection in comparison with Civil law system. Moreover, the USA and the UK have a large market capitalization corresponding to GDP, dispersal of ownership structure, developed capital markets, and advanced sphere of M&A operations. Another significant similarity is the considerable equity stake, which is generally held by corporate investors. Both American and British corporate investors, who have more than 50% in statutory capital, have been considered passive (Mayer, 2001). Nevertheless, modern situation calls for shareholders and minority shareholders in particular, to gain more control over decision-making process, which will help to increase firm profit. For instance, large US pension funds such as CalPERs and TIAA-CREF started their shareholder activism program in the late 1980s. The Hermes Focus Fund was established in 1998 as the first experiment of shareholder activism in the UK (Teall, 1999).

British investors have enough mechanisms, which they can use to influence on the decision-making process and strategy of company development. The Stewardship Code in the UK, which was presented by the Financial Reporting Council, is a set of rules and recommendations for institutional venture capitalists when investing in the UK listed companies. Such practice implements a "comply or explain" background and basically forwards to companies who operate with assets on behalf of institutional investors, such as pension funds, investment companies and insurance companies). The Stewardship Code suggests that shareholders should provide fair instructions on time and manner of activism expansion in accordance with company`s strategy. The process is likely to begin with basic debates on a confidential ground, in the course of which shareholders may consider to intensify their activism by using such mechanisms as: (1) holding additional shareholders meetings with directors; (2) discussing concerns with firm advisers; (3) meeting with the Chief Executive Officer or Chairman; (4) intervening together with other institutions on the burning issues; (5) making a public statement in advance of additional shareholder meetings; (6) submitting resolutions and talking at Annual general meetings; (7) requesting an Annual general meeting, (8) and in some cases suggesting directors to the board.

It is worthwhile noting that interdependence between board of directors and active shareholders and grows up dramatically. Both parties need to be advised on problematic issues, and procedures of public discussion of the issues which can greatly affect the company's reputation, primarily through social media. Nowadays, the key goal for both shareholders and directors is to set up and develop the company's strategy, which in turn will increase financial ratios, company's position on the market etc.

Shareholder activism in the UK has taken considerable time to develop and become a part of British practice. As reported by the law firm Freshfields, aggressive US-style of shareholders activism is still at the beginning stage of its evolution in Europe in comparison with the USA. There have been just 24 cases since 2012, of which eight were in the UK. But, during 2012, activists intervened heavily in what was called the "shareholder spring" the key problems, which were under consideration, concerned the issues of directors' remuneration (Financial Times, 2014).

The uprise of the shareholder activism in the common law countries can be traced despite the limited control instruments provided to the shareholders by the legislation. However, even with the limited opportunities shareholder activists in the USA and the UK gain sufficient control over the targeted companies and achieve their aims. These aims may or may not (which is often the case) correspond with the current plans and strategy of the targeted companies. This brings new challenge to the executives and board of directors. However, the issue of protecting the company from shareholder activists is not the subject of this study and may be developed further in the next paper.

Conclusions

In this paper we have presented a comparative analysis of shareholder activism development in common law and civil law countries. The examined data allows us to conclude that legal system is not the dominant factor that drives shareholders to be more or less active, for shareholder activism of every country under discussion turns out to be determined by a set of characteristics which includes the system of domestic corporate regulation, development of the stock market, companies' capitalization, and corporate governance traditions.

One of the most important issues with respect to the shareholder activism in civil law Germany is hedge funds activism. Examples of the targets of modern activist hedge funds may include, but are not limited to, return of large amounts of cash to investors

through stock buybacks or dividends, revisions to the company's acquisition strategy etc. Despite the difference in the legal systems, hedge funds activism is also in the uprise in the USA and the UK. Alongside with the aforementioned targets, activists in the analysed common law countries also pursue such aims as breakout of the companies, change of the executive management, and increase in the operational efficiency.

Small on-tier boards in the USA and the UK provide the activist investors with the opportunity to influence targeted companies having only one or two seats on the board. However, the specifics of the civil law model in Germany may raise difficulties in effecting any changes with such a small representation on the board. Nevertheless, it should be noted that these differences are majorly provoked not by the legal system background but by the models of corporate governance.

German civil law model is quite advanced from the point of view of the shareholders rights protection and transparency of the companies. It combines domestic regulations and recommendations and European legislation which put forward significant statutory regulations for listed stock companies and contains standards for responsible governance that allows shareholders to fulfill their interests in the various forms of activism. This has brought Germany to the 4th place in Europe by the level of activism, after the UK, France and Switzerland. As for the activity of the hedge funds, who are the most active players with regard to the shareholder activism in common law countries, German hedge funds seem to continue to act in the background and most of their activities are not publicly disclosed: only about 10% of hedge fund activities become public in the German market.

In the USA and the UK corporate regulation indirectly blocks shareholders from exercising significant control over corporate decision-making process compared to the civil law Germany. Common law legal system developed in the analysed countries has strong minority shareholders protection in comparison with civil law system. Moreover, the USA and the UK have a large market capitalization corresponding to GDP, dispersal of ownership structure, developed capital markets, and advanced sphere of M&A operations. Civil law legal system in Germany together with the developed banking market allows the corporate activists to gain concentrated ownership stocks and force their stronger representations on the boards of the targeted companies.

Ukraine stands as an outsider in shareholder activism. Being a civil law country but with the undeveloped mechanisms of the corporate governance it can not provide decent instruments for the activists to pursue their aims. The positive tendency in the development of the joint stock form of capital organization in Ukraine that together with the improvement of corporate rights, corporate relations and corporate governance provide a solid foundation to the development of the shareholder activism in this civil law country. At the moment shareholder activism is not popular in Ukraine compared to other European countries. Various forms of activism (proxy battles, negotiations with management and shareholder campaigns) are rarely exercised due to uncoordinated and diversified actions and interests of minority shareholders. The major form of shareholder activism is commenced through litigation. Shareholders can bring claims to court in case of their rights' and legitimate interests' violations, and Ukrainian law does not stipulate derivative actions.

The development of shareholder activism in Ukraine is well under way being fostered by the favourable conditions of the civil law legal system and halted by the underdeveloped mechanisms of the corporate governance which fail to provide suitable instruments for activists to pursue their aims.

Various forms of activism (proxy battles, negotiations with management and shareholder campaigns) are rarely exercised due to uncoordinated and diversified actions and interests of minority shareholders. The major form of shareholder activism is commenced through litigation. Shareholders can bring claims to court in case of their rights' and legitimate interests' violations, and Ukrainian law does not stipulate derivative actions.

However, the observable tendencies to the improvement of corporate rights, corporate relations and corporate governance provide a solid foundation to the further development of the shareholder activism in this civil law country.

Thus, we can conclude that shareholder activism has many common characteristics in the analysed civil law and common law countries. The main players, their methods, aims and instruments appear similar. Nevertheless, activists in the civil law countries (Germany in particular) have more opportunities to gain substantial control over the targeted companies whereas activists in the USA and the UK achieve their aims with comparatively small stocks of ownership and board influence due to the legislative obstacles and dispersed stock market. Shareholder activism has strong preconditions for further development both in the civil law and common law countries. Its development, however, will vary depending on the power provided to the shareholders by the regulations.

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