Antecedents of hedge fund activism in French listed target firms

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ABSTRACT

This article seeks to examine the antecedents of hedge fund (HF) activism in the French context, an area that remains underresearched in contexts outside the US. We focus on the following question: What are the antecedents of hedge fund activism in French listed firms? Hedge funds pursuing activist strategies tend to reduce management discretion in order to improve wealth creation in target firms. Since large shareholders can expropriate minority shareholders by neutralizing governance mechanisms which attempt to discipline management, we focus on the relationship between corporate governance and hedge fund activism in French listed target firms. Drawing on a total population of 36 French listed firms from 1998 to 2013, we propose a model based on an integrated approach to take into account the specificity of the French context. We find a significant relationship between the probability that a firm is targeted by a HF and determinants of HF activism, such as voting rights concentration, institutional and employee voting rights, firm size, debt ratio, operating performance, quality of information disclosure, proportion of independent directors and CEO duality.

1. Introduction

Shareholder activism has been frequently discussed last years among professionals, regulators and researchers (Brav et al., 2015; Norli et al., 2015; Wang and Mao, 2015; Aslan and Kumar, 2016; Krishnan et al., 2016; Jory et al., 2017). Media attention on hedge fund activism has been increasing. Hedge funds (HFs) specializing in shareholder activism are appearing as new players in terms of value creation by triggering corporate change and intervening in management’s decisions. Almost all of the previous research has examined HF activism within the US (Brav et al., 2008; Clifford, 2008; Klein and Zur, 2009; Boyson and Mooradian, 2011), although Croci (2007) sheds light on European countries’ attempts to allow more shareholder activism. Recently, American HFs have been exerting a growing activist pressure on French firms. However, until now, the research results and the respective conclusions with regard to HF activism refer mainly to the US. Given this, the legal context and the specific characteristics of French corporate governance mean that greater interest should be paid to the antecedents of HF activism in French target firms, an area that is largely unexamined outside the US (Hernandez-Lopez, 2003).

The French legal context is characterized by weaker protection of minority shareholders, as observed by La Porta et al. (1998) when comparing countries that follow a legal tradition of civil law (such as France) with those that operate according to common law. This does not leave many opportunities for activist shareholders, such as HFs, to exert influence on important strategic and financial
decisions. However, we observe that the French regulatory framework has evolved considerably and is today more protective of minority shareholders (Vienot Reports, 1995, 1999; NRE law, 1; 2001; Bouton Report, 2002; Financial security law, 2; 2003; Mansion Report, 2005; Decree No. 2006-1556 of 11 December 2006). The emergence of HF activism in France is concomitant with French legal evolution. The characteristics of French corporate governance are a product of a relatively complex ownership structure. Unlike the Anglo-Saxon model of corporate governance, firms are in the main concentrated and family controlled (Faccio and Lang, 2002). In France, the one-share, one-vote principle does not apply, so there is a divergence between ownership rights and voting rights. The separation of ownership and control is due almost entirely to the presence of dual-class shares and pyramid-affiliated firms.

What are the antecedents of HF activism in French listed target firms? To answer this question, we conducted a study covering a total population of 36 French listed firms from 1998 to 2013. We propose a model based on an integrated approach to take into account the specificity of the French context. We find a significant relationship between the probability that a firm is targeted by an HF and determinants of HF activism, such as voting rights, family as the major shareholder, institutional and employee voting rights, firm size, debt ratio, operating performance, quality of information disclosure, proportion of independent directors and Chief Executive Officer (CEO) duality.

Our research contributes to filling a gap in the literature in the French context. To our knowledge, HF activism studies performed in the French context are only in the form of monographs (Albouy et Schatt, 2004; 2009; Bessière et al., 2011; Girard and Gates, 2012). The results on firms and profiles targeted by HF s may not, therefore, be generalizable. Moreover, to the best of our knowledge, our study is a first attempt to investigate the relationship ex ante between corporate governance mechanisms and HF activism. Major American works predicting HF targeting focus on financial variables (such as capital structure, performance and investment features) and employ a governance index. They also rely on shareholder model different from the French stakeholder model mobilized in this paper. Our article also helps to alleviate the opacity of HF activism in France and can also contribute to the European regulatory debate on the supervision of HF activity. Understanding the targets’ profiles is, therefore, crucial to assessing whether policy measures should address them jointly or separately. It can also contribute to the debate on the pros and cons or European HF regulation. It is also likely to help French firm managers to protect themselves against the occurrence of HF and shareholders activism to reduce the marginal cost of activism.

This article is structured as follows. We present our theoretical framework and develop our hypotheses in section II. We outline our methodological approach in section III and then present our results and discussion in section IV. We conclude and offer our comments in section V.

2. Theoretical framework and hypotheses

HFs pursuing activist strategies tend to limit management discretion in order to improve wealth creation in target firms. However, large shareholders can expropriate minority shareholders by neutralizing governance mechanisms which attempt to discipline management.

We reveal governance mechanisms that are likely to be effective in overseeing management and consequently induce greater improvements in value creation. This is likely to attract HF s, since target firms offer favourable prospects for improving wealth creation.

2.1. Separation between ownership and control

One consequence of the increasing separation between ownership and control was first shown by Berle and Means (1932), Fama and Jensen (1983) posit that in concentrated ownership firms, owners are more able to control their investments and manager’s conduct. The owners’ wealth is directly linked to shareholder value and is not influenced by the free rider problem (Shleifer and Vishny, 1986).

Shareholder activism in Europe was discussed in the seminal work of Croci (2007). The author observes that the UK is the country most targeted by financially-motivated activist shareholders. The agency problem between shareholders and managers revealed by Berle and Means (1932) is not, then, prevalent as the main theoretical explanation and may be influenced by the ownership structure in each country. In this sense, La Porta et al. (1998) advance that in many economies we could consider that the main agency problem is due to the expropriation of minority shareholders by the controlling shareholders and not foremost by the managers.

Unlike the Anglo-Saxon model of governance, the more relevant conflict is not that between managers and shareholders but, rather, between large and small shareholders (Shleifer and Vishny, 1997). Large shareholders can extract private benefits at the expense of small shareholder wealth (Achleitner et al., 2010). As they have a blocking minority, blockholders hold substantial rights to influence firm strategy.

French firms are characterized by concentrated ownership (La Porta et al., 1998; Claessens et al., 2000). In France, the one-share, one-vote principle does not apply: a pyramidal ownership structure and double voting rights are the most commonly used practices in French firms. The presence of dual-class shares and pyramid-affiliated firms enables control blocks through holding a small

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1 The New Economic Regulations law (2001) has been adopted by the French parliament to improve both business regulation through a reform of company law and financial regulation by reinforcing the rules governing takeover bids.

2 The Financial Security Law (2003), similar to the American Sarbanes–Oxley Act, has been adopted by the French parliament to strengthen the corporate governance of the French listed firms.

3 The governance index tracks takeover defences that a firm can adopt, as well as the laws of the state in which the targets are incorporated (Brav et al., 2008).
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