

# Chapter 40

## CHOICE OF CORPORATE STRUCTURE

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*What a cast of characters!*

### Section 40.1

#### SHAREHOLDER STRUCTURE

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Our objective in this section is to demonstrate the importance of a company's shareholder structure. While the study of finance generally includes a clear description of why it is important to value a company and its equity, analysis of who owns its shares and how shareholders are organised is often neglected. Yet in practice, this is where investment bankers often look first.

There are several reasons for looking closely at the shareholder base of a company. Firstly, the shareholders theoretically determine the company's strategy, but we must understand who really wields power in the company, the shareholders or the managers. You will undoubtedly recognise the mark of "agency theory". This theory provides a theoretical explanation of shareholder-manager problems.

Secondly, we must know the objectives of the shareholders when they are also the managers. Wealth? Power? Fame? In some cases, the shareholder is also a customer or supplier of the company. In an agricultural cooperative, for example, the shareholders are upstream in the production process. The cooperative company becomes a tool serving the needs of the producers, rather than a profit centre in its own right. This is probably why many agricultural cooperatives are not very profitable.

Lastly, disagreement between shareholders can paralyse a company, particularly a family-owned company.

Studies have demonstrated that control blocks were much more frequent in Continental European countries than in the UK or the US (Becht and Mayer, 2000, argue that more than 50% of European listed companies are controlled by a single block of voting shareholders). Some have linked this fact to the level of minority protection the law provides. In countries with strong legislation on protection of minority shareholders there will be a larger number of companies not controlled by a single shareholder.

#### 1/ DEFINITION OF SHAREHOLDER STRUCTURE

The shareholder structure is the percentage ownership and the percentage of voting rights held by different shareholders. When a company issues shares with multiple voting rights

or nonvoting preference shares or represents a cascade of holding companies, these two concepts are separate and distinct. A shareholder with 33% of the shares with double-voting rights will have more control over a company where the remaining shares are widely held than will a shareholder with 45% of the shares with single voting rights if two other shareholders hold 25% and 30%. A shareholder who holds 20% of a company's shares directly and 40% of the shares of a company that holds the other 80%, will have rights to 52% of the company's earnings but will be in the minority for decision-taking. In the case of companies that issue equity-linked instruments (convertible bonds, warrants, stock options) attention must be paid to the number of shares currently outstanding vs. the fully-diluted number of potential shares.

**Shareholder structure is the study of how power is distributed among the different shareholders and potential shareholders.**

Lastly, without placing much importance on them, we should mention **nominee** (warehousing) **agreements**. Under a nominee agreement, the “real” shareholders sell their shares to a “nominee” and make a commitment to repurchase them at a specific price, usually in an effort to remain anonymous. A shareholder may enter into a nominee agreement for one of several reasons: transaction confidentiality, group restructuring or deconsolidation, etc. Conceptually, the nominee extends credit to the shareholder and bears counterparty and market risk. If the issuer runs into trouble during the life of the nominee agreement, the original shareholder will be loath to buy back the shares at a price that no longer reflects reality. As a result, nominee agreements are difficult to enforce. Moreover, they can be invalidated if they create an inequality among shareholders. We do not recommend the use of nominee agreements.

## 2/ GENERAL FRAMEWORK

Theoretically, in all jurisdictions, the ultimate decision-making power lies with the shareholders of a company. They exercise it through the assembly of a shareholders Annual General Meeting (AGM). Nevertheless, the types of decisions can differ from one country to another. Generally, shareholders decide on:

- appointment of board members;
- appointment of auditors;
- approval of annual accounts;
- distribution of dividends;
- change in articles of association;
- mergers;
- capital increase and share buyback;
- dissolution.

In most countries – depending on the type of decision – there are two types of shareholder vote: ordinary or extraordinary.

At the Ordinary General Meeting (OGM) of shareholders, shareholders vote on matters requiring a simple majority of voting shares. These include decisions regarding the ordinary course of the company's business such as approving the financial statements, payment of dividends, and appointment and removal of members of the board of directors.

At the Extraordinary General Meeting (EGM) of shareholders, shareholders vote on matters that require a change in the company's operating and financial policies: changes in the articles of association, capital increases, mergers, asset contributions, demergers, capital decreases, etc. These decisions require a qualified majority. Depending on the country and on the legal form of the company this qualified majority is generally two-thirds or three-quarters of outstanding voting rights.

The main levels of control of a company in various countries are as follows:

	Supermajority	Type of decision
Brazil	1/2	Changes in the object of the company Mergers, demergers Dissolution Changes in preferred shares characteristics
China	2/3	Increase or reduction of the registered capital Merger, splitup Dissolution of the company Change of the company form
France	2/3	Changes in the articles of association Merger, demerger Capital increase and decrease Dissolution
Germany	3/4	Changes in the articles of association Reduction and increase of capital Major structural decisions Merger or transformation of the company
India	3/4	Mergers
Italy	–	Defined in the articles of association
Netherlands	2/3	Restrictions in pre-emption rights Capital reduction
Russia	3/4	Changes in the articles of association Reorganisation of the company Liquidation Reduction and increase in capital Purchase of own shares Approval of a deal representing more than 50% of the company's assets
Spain	–	Defined in the articles of association
Switzerland	2/3	Changes in the purpose Issue of shares with increased voting powers Limitations of pre-emption rights Change of location Dissolution
UK	3/4	Altering the articles of association Disapplying members' statutory pre-emption rights on issues of further shares for cash Capital decrease Approving the giving of financial assistance/purchase of own shares by a private company or, off market, by a public company Procuring the winding up of a company by the court Voluntarily winding up a company

Shareholders holding less than the blocking minority (if this concept exists in the country) of a company that has another large shareholder have a limited number of options open to them. They cannot change the company objectives or the way it is managed. At best, they can force compliance with disclosure rules, or call for an audit or an EGM.

Their power is most often limited to being that of a nay-sayer. In other words, a small shareholder can be a thorn in management's side, but no more. Nevertheless, the voice of the minority shareholder has become a lot louder and a number of them have formed associations to defend their interests. Shareholder activism has become a defence tool where the law had failed to provide one.

It should be noted that in some countries (Sweden, Norway, Portugal) minority shareholders can force the payment of a minimum dividend.

A shareholder who holds a blocking minority (one-quarter or third of the shares plus one share depending on the country and the legal form of the company) can veto any decision taken in an extraordinary shareholders meeting that would change the company's articles of association, company objects or called-up share capital.

A blocking minority is in a particularly strong position when the company is in trouble, because it is then that the need for operational and financial restructuring is the most pressing. The power of blocking minority shareholders can also be decisive in periods of rapid growth, when the company needs additional capital.

The notion of a blocking minority is closely linked to exerting control over changes in the company's articles of association. Consequently, the more specific and inflexible the articles of association are, the more power the holder of a blocking minority wields.

**A blocking minority does not give its holder control over decisions taken at ordinary shareholders meetings (dividend payout, etc.). It gives veto power, not direct power.**

### **3/** THE DIFFERENT TYPE OF SHAREHOLDERS

#### **(a)** The family-owned company

By "family-owned" we mean that the shareholders have been made up of members of the same family for several generations and, often through a holding company, exert significant influence over management. This is still the dominant model in Europe. Faccio and Lang (2002) analysed the ultimate ownership of 5232 firms across Western Europe and concluded that over 44% of firms are still family-owned. British firms are mostly widely held (63% versus 24% family-owned) and the majority of Continental European firms are family-owned (except in Northern Europe where ownership is more balanced).

	Europe(%)	France(%)	Germany(%)	UK(%)	Italy(%)	Spain(%)
Free float	37	14	10	63	13	26
Family and nonlisted shareholder	44	65	65	24	60	56
State	4	5	6	0	10	4
Other listed company	2	4	4	1	3	2
Financial institution	9	11	9	9	12	12
Cross shareholding	1	1	3	0	1	0
Other	3	0	3	3	1	0
<b>By size (% with the free float as the largest shareholder)</b>						
20 largest	45	60	45	90	35	45
50 mid-sized	29	14	10	65	8	34
50 smallest	25	8	14	42	14	36

Source: Faccio and Lang (2002).

However, this type of shareholder structure is on the decline for several reasons:

- some new or capital-intensive industries, such as telecoms, media and energy/utilities, require so much capital that a family-owned structure is not viable. Indeed, family ownership is more suited to consumer goods, retailing, services, processing, etc.;
- financial markets have matured and financial savings are now properly rewarded, so that, with rare exceptions, diversification is a better investment strategy than concentration on a specific risk (see Section Two of this book);
- increasingly, family-owned companies are being managed on the basis of financial criteria, prompting the family group either to exit the capital or to dilute the family's interests in a larger pool of investors that it no longer controls.

Lastly, there are generally no tax incentives for a company to remain family-owned. In fact, family members who are passive investors in the company may be penalised through inheritance taxes and wealth taxes.

### (b) Business angels

Business angels are generally former executives or majority shareholders. They invest a few tens or hundreds of thousand of euros, bringing advice and their networks to help entrepreneurs to launch their companies. Some get lucky, like the business angels that financed Facebook when it was based in a Harvard University student's room. Their failure rate is very high as they invest at the most risky stage of a company's life.

### (c) Private equity funds

Today, private equity funds, financed by insurance companies, pension funds or wealthy investors, play a major role. In most cases these funds specialise in a certain type of investment: venture capital, development capital and LBOs, which correspond to a company's different stages of maturity.

Venture capital funds focus on bringing seed capital, i.e. equity, to startups to finance their early developments, or to struggling companies, buying their debts to take them over and restructure them.

Development capital funds give an acquisitive company in a consolidating market the financial resources it needs to achieve its goals.

LBO funds invest in companies put up for sale by a group looking to refocus on its core business or by a family-held group faced with succession problems, or help a company whose shares are depressed (in the opinion of the management) to delist itself in a **public to private** (P-to-P) transaction. LBO funds are keen to get full control over a company in order to reap all of the rewards and also to make it possible to restructure the company as they think best, without having to worry about the interests of minority shareholders.

Some private equity funds take a minority stake in listed companies, a PIPE (Private Investment in Public Equity), helping the management to revitalise the company so as to make a capital gain. Thus, in 2007 and 2008, Wendel bought a 20% stake in Saint-Gobain.

Managed by teams of investment professionals whose compensation is linked to performance, these funds have a limited life span (no more than 10 years). Before the fund is closed, the companies that the fund has acquired are resold, floated on the stock exchange or the fund's investments are taken over by another fund.

Private equity funds are playing a growing role in the economy and are a real alternative for a listing on the stock exchange. They solve agency problems by putting in place strict reporting from the management which is incentivised through management packages and the pressure of debt<sup>1</sup> (LBO funds).

<sup>1</sup> See Chapter 44 devoted to LBOs.

They also bring a cash culture to optimise working capital management and limit capital expenditure to reasonably value-creating investments. Private equity funds are ready to bring additional equity to finance acquisitions with an industrial logic. They also bring to management a capacity to listen, to advise and to exchange which is far greater than that provided by most institutional investors. They are professional shareholders who have only one aim – to create value – and they do not hesitate to align the management of companies they invest in with that objective.

### (d) Institutional investors

Institutional investors are banks, insurance companies, pension funds and unit trusts that manage money on behalf of private individuals.

Collectively they can be the longest-standing shareholder of many listed companies and play mainly a passive role. However, new regulations on corporate governance may push them to vote at annual general meetings to defeat some resolutions they do not like (share issue without preemption rights, voting limits, too generous stock option plans, etc).

Some of them have started to play a far more active role and are called **activist funds**. They publicly put pressure on underperforming managements, suggesting corrective

measures to improve value creation. One of them, TCI, prompted the dismantling of ABN-Amro in 2007.

### (e) Financial holding companies

Large European financial holding companies such as Deutsche Bank, Paribas, Mediobanca, Société Générale de Belgique, etc. played a major role in creating and financing large groups. In a sense, they played the role of (then-deficient) capital markets. Their gradual disappearance or mutation has led to the breakup of core shareholder groups and cross-shareholdings. Today, in emerging countries (Korea, India, Colombia) large industrial and financial conglomerates play their role (Samsung, Tata, . . .).

### (f) Employee-shareholders

Many companies have invited their employees to become shareholders. In most of these cases, employees hold a small proportion of the shares, although the majority in a few cases. This shareholder group, loyal and non-volatile, lends a degree of stability to the capital and, in general, strengthens the position of the majority shareholder, if any, and of the management.

The main schemes to incentivise employees are:

- **Direct ownership.** Employees and management can invest directly in the shares of the company. In LBOs, private equity sponsors bring the management into the shareholding structure to minimise agency costs.
- **Employee Stock Ownership Programmes (ESOPs).** ESOP consist in granting shares to employees as a form of compensation. Alternatively, the shares are acquired by shareholders but the firm will offer free shares so as to encourage employees to invest in the shares of the company. The shares will be held by a trust (or employee savings plan) for the employees. Such programmes can include lock-up clauses to maintain the incentive aspect and limit flow-back (see Chapter 30). In that case the shares allocated to each employee will vest (i.e. become available) gradually over the time.
- **Stock options.** Stock options are a right to subscribe to new (or existing) shares at a certain point in time.

For service companies and fast growing companies, it is key to incentivise employees and management with shares or stock options. For other companies, offering stock to employees can be part of a broader effort to improve employee relations (all types of companies) and promote the company's image internally. The success of such a policy largely depends on the overall corporate mood. In large companies, employees can hold up to 10% (BNP Paribas 6%). Bear Stearns, the US investment bank, was one of the listed companies with the largest employee shareholdings (c. 33%) when it melted down in 2008.

Regardless of the type of company and its motivation for making employees shareholders, you should keep in mind that the special relationship between the company and the employee-shareholder cannot last forever. Prudent investment principles dictate that

*2 Enron's and Lehman's employees can confirm this!*

the employee should not invest too heavily in the shares of the company that pays their salaries, because in so doing they in fact compound the “everyday life” risks they are running.<sup>2</sup>

Basically, the company should be particularly fast-growing and safe before the employee agrees to a long-term participation in the fruits of its expansion. Most often, this condition is not met. Moreover, just because employees hold stock options does not mean they will be loyal or long-term shareholders. The LBO models we will study in Chapter 44 become dangerous when they make a majority of the employees shareholders. In a crisis, the employees may be keener to protect their jobs than to vote for a painful restructuring. When limited to a small number of employees, however, LBOs create a stable, internal group of shareholders.

### (g) Governments

In Europe and the USA, governments' role as the major shareholders of listed group is fading even if they are still playing a key role in some groups like Deutsche Telekom, EADS, EDF or banks due to partial nationalisation to avoid collapses (RBS, Citi, ING, etc.).

At the same time, **sovereign wealth funds**, mostly created by emerging countries and financed thanks to reserves from staples, are gaining importance as long-term shareholders. They are normally very financially minded, but their opacity, their size (often above €50bn or €100bn) or their strong connections with mostly undemocratic states are worrying some. The most well known SWFs are GIC and Temasek (Singapore), Adia (Abu Dhabi), KIA (Kuwait), etc.

## 4/ JOINT VENTURES

Most technological or industrial alliances take place through **joint ventures**, often held 50/50, or through joint partnerships that perform services at cost for the benefit of their shareholders.

These often-ephemeral companies can easily fall victim to boardroom paralysis. When business is booming, one or both of the partners may want to take it over entirely. Conversely, when the joint venture's fortunes are fading, both partners may be looking for the exit.

Preparing the potential future exit of one partner is key when creating a JV. Joint venture agreements often have **exit clauses** intended to resolve conflicts. Some examples are:

- a buy-sell provision, also called a **Dutch clause** or a **shotgun clause**. For example, shareholder *A* offers to sell his shares at a price *X* to shareholder *B*. Either *B* agrees to buy the shares at price *X* or, if he refuses, he must offer his stake to *A* at the same price *X*. Another form calls for a simple auction among shareholders;
- an appraisal clause, which states that the price of a transaction between shareholders shall be determined by independent appraisal.

In sum, the joint venture company – like any company – must have a coherent strategy and set of objectives. A 50/50 sharing arrangement injects numerous difficult-to-resolve problems into the management equation.

## 5/ SHAREHOLDERS' AGREEMENT

Minority shareholders can protect their interests by concluding a shareholders' agreement with other shareholders.

A shareholders' agreement is a legal document signed by several shareholders to define their future relationships and complement the company's articles of association.

Most of the time, the shareholders' agreement is confidential except for listed companies in countries which require its publication in order for it to be valid.

They mainly contain two sets of clauses:

- clauses that organise corporate governance such as breakdown of directors' seats, nomination of the Chairman, of the CEO, of the auditors; how major decisions are taken, including capex; financing, dividend policy, acquisitions, share issues; how to vote during annual general meetings; what kind of informations is disclosed to shareholders, etc;
- clauses that organise the sale or purchase of shares in the future: nontransferability, first refusal right if one shareholder wants to exit, tag-along or drag-along, ceiling and floors, etc.

As we will see below, the stock exchange probably offers the minority shareholder the best protection.

### Section 40.2

#### BECOMING LISTED

Theoretically, the principles of financial management that we have developed throughout this book find their full expression in the share price of the company. They apply to unlisted companies as well but, for a listed company, market approval or disapproval, expressed through the share price, is immediate. Today, a stock exchange listing offers distinct benefits: **it enables financial managers to access capital markets and obtain the market value for their companies.**

When you see that several billion euros can change hands on financial markets in the course of a few hours (a few days if you take into account the preparation of the transaction), you can understand that markets constitute a very different means of exchange than the complex negotiations necessary to obtain private financing.

“Paper” – i.e. financial securities, can be placed on financial markets so quickly because:

- financial analysts periodically publish studies reviewing company fundamentals, reinforcing the market's efficiency (see Chapter 15);
- listing on an organised market enables financial managers to “sell” the company in the form of securities that are bought and sold solely as a function of profitability and risk. Poor management is punished by poor share price performance or worse – from management's point of view – by a takeover offer;
- listed companies must publish up-to-date financial information and file an annual report (or equivalent) with the market authority.

## 1/ TO BE OR NOT TO BE LISTED

Whether or not to float a company on the stock exchange is a question that first and foremost concerns **the shareholders** rather than the company. But technically, it is the company that requests a listing on the stock exchange.

When a company is listed, its shareholders' investments become more **liquid**, but the difference for shareholders between a listed company and a nonlisted company is not always that significant. Companies listed on the market gain liquidity at the time of the listing, since a significant part of the equity is floated. But thereafter, only a few shares are usually traded every day, unless the market "falls in love" with the company and a long-term relationship begins.

### An IPO is always to the advantage of the minority shareholders.

In addition to real or potential liquidity, a stock market listing gives the minority shareholder a level of protection that no shareholders' agreement can provide. The company must publish certain information; the market also expects a consistent dividend policy. If the majority shareholders sell their stake, the rights of minority shareholders are protected (see Chapter 42).

Conversely, a listing complicates life for the majority shareholder. Liquidity gives him the opportunity to sell some of his shares in the market without losing control of the company. Listing can also allow the majority shareholder to get rid of a bothersome or restless minority shareholder by providing a forum for the minority shareholders to sell their shares in an orderly manner. But, in return, a majority shareholder will no longer be able to ignore financial parameters such as P/E multiples, EPS, dividends per share, etc. (see Chapter 27) when determining his strategy.

Once a majority shareholder has taken the company public, investors will judge the company on its ability to create value and communicate financial information properly. Delisting a company to take it private again is a long, drawn-out process.

For the company, a stock market listing presents several advantages:

- the company becomes widely known to other stakeholders (customers, suppliers, etc.). If the company communicates well, the listing constitutes a superb form of "free" advertising, on an international scale;
- the company can tap the financial markets for additional funding and acquire other companies, using its shares as currency. This constitutes invaluable flexibility for the company;
- the company finds it easier to incentivise employees in the success of the company through stock options, stock-based bonuses, etc.;
- in a group, a mother company can obtain a market value for a subsidiary by listing it, in the hope that the value will be high enough to have a positive impact on the value of the parent company's shares.

Now for the warning flags: a stock market listing does not guarantee happy shareholders. If only a small percentage of the shares are traded, or if total market capitalisation is low, i.e. less than €500m, large institutional investors will not be interested, especially if the company is not included in a benchmark index. Volatility on the shares will be relatively high because the presence of just a few buyers (or sellers) will

easily drive up (down) the share price significantly. In Section 40.5 we will look at the different types of discounts that can affect a listed stock.

For IPO techniques, see Chapter 30.

## 2/ CHOOSING A MARKET FOR THE IPO

With rare exceptions, the natural market for the listing is the company's home country. This is where the company is best known to local investors who are the most likely to accord it the highest value. Only a very small number of companies from major European countries are not listed in their home country.

The next question is whether there should be a second listing on a foreign market.

Listing on a foreign market generally constitutes a constraint on a company, because it requires additional financial reporting. Also direct and indirect costs are incurred. We see three justifications for bearing these costs:

- financial: facilitate capital increases through access to a larger pool of investors, enable share-based takeovers of foreign companies, reduce the cost of equity capital or, equivalently, increase the value of the company's shares;
- commercial: make the company and its brands more widely known internationally, thereby facilitating the relationship with customers and suppliers;
- social: create a new type of compensation (stock options) for the employees of foreign subsidiaries.

Reducing the cost of capital is the most intellectually valid reason. It is based on the observation that international markets remain segmented. Domestic investors still have strong incentives – legal, tax or cultural – for investing in securities listed on their home markets. Multiple listings enable a company to access a greater pool of investors. Listing on a foreign exchange will also help to reduce information asymmetry because the company must comply with the same stringent disclosure rules as other companies the securities of which are traded in the market in question. Finally, foreign listings put the company in a more favourable light back home. A company that has successfully run the SEC,<sup>3</sup> the London Stock Exchange or the Euronext gauntlet will command more respect in its home market as US, UK or European regulation is considered by investors as a reference.

<sup>3</sup> *Securities and Exchange Commission.*

This said, statistical analysis has not shown that multiple listings significantly lower the cost of capital. Experience shows that liquidity begets liquidity and that transaction volume gravitates very quickly and virtually irreversibly to the most liquid market.

Only groups from emerging countries, when their local market is underdeveloped, have a clear advantage to get a secondary listing in London, Amsterdam, Paris or New York.

### Section 40.3

## BECOMING PRIVATE AGAIN

A company (or the shareholders) will consider a public to private move when the reasons why it decided to list its shares in the first place start to become irrelevant. It has to weigh

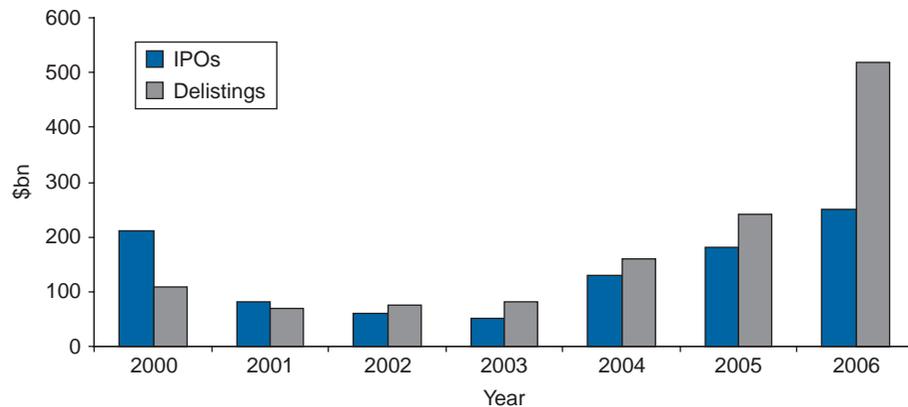
<sup>4</sup> *Direct costs: Stock exchange fees, publication of annual report, meetings with analysts, employment of investor relations staff. Indirect costs: requirement to disclose more information to the public and hence to competitors, market influence on strategy, management's time spent talking to the market, etc.*

the cost of listing<sup>4</sup> against the benefits of listing when deciding whether the company should remain listed or not. This is especially the case if:

- the company no longer needs large amounts of outside capital and shareholders themselves are able to meet any requirements it may have. The company no longer has any ambition to raise capital on the market or to pay for acquisitions in shares;
- the stock exchange no longer provides minority shareholders with sufficient liquidity (which is often rapidly the case for smaller companies which only really benefit from liquidity at the time of their IPO). Listing then becomes a theoretical issue and institutional investors lose interest in the share;
- the company no longer needs the stock exchange in order to increase awareness of its products or services.

The second reason why companies delist is financial. A large shareholder, whether a majority shareholder or not, may consider that the share price does not reflect the intrinsic value of the company. Turning a problem into an opportunity, such a shareholder could offer the minority shareholder an exit, thus giving her a larger share of the creation of future value.

IPOs AND DELISTING (IN \$BN)



Source: McKinsey Global Institute.

<sup>5</sup> *Often 90% or 95%.*

A public tender offer must be launched in order to delist a company. Delisting is possible if the majority shareholder exceeds a threshold,<sup>5</sup> as it is then obliged to acquire the rest of the shares. This is known as a squeeze-out. In practice, this amounts to forcing minority shareholders to sell any outstanding shares. Because this is a form of property expropriation, the price of the operation is analysed very closely by the market regulator. In most countries, a fairness opinion has to be drawn up by an independent, qualified financial expert.

But let's not delude ourselves – no matter how the company's share has performed, minority shareholders will insist that the price they're offered reflects the intrinsic value of their shares. If it doesn't, they won't tender their shares in the offer. Accordingly, it is not surprising to note that, even though there is no change in control, tender offers launched for the purpose of delisting a company are made at a premium that is equivalent to the premium paid for takeovers.

If an investor is below the squeeze-out threshold, she has first to launch an offer on the company's shares, hoping to go above the squeeze-out threshold so as to be able to take the company private. It is a P-to-P, Public-to-Private deal.

Being listed is never a dead end because a company can become private again and come back on to the stock exchange years later.

## Section 40.4

### HOW TO STRENGTHEN CONTROL OVER A COMPANY

Defensive measures for maintaining control of a company always carry a cost. From a purely financial point of view, this is perfectly normal: there are no free lunches!

Measures to preserve control are not only costly to put in place but also effectively preclude the company from accessing certain financial instruments. These costs are borne by current shareholders and ultimately by the company itself in the form of a higher cost of capital.

With this in mind, let us now take a look at the various takeover defences at the disposal of a European company. We will see that they vary greatly depending on the country, on the existence or absence of a regulatory framework and on the powers granted to companies and their executives. Certain countries, such as the UK and, to a lesser extent, France and Italy, regulate anti-takeover measures strictly, while others, such as Germany and the USA, allow companies much more leeway.

Broadly speaking, countries where financial markets play a significant role in evaluating management performance, because companies are more widely held, have more stringent regulations. This is the case in the UK and France.

Conversely, countries where capital is concentrated in relatively few hands have either more flexible regulation or no regulation at all. This goes hand-in-hand with the articles of association of the companies, which ensure existing management a high level of protection. In Germany, half of the seats on the board of directors are reserved for employees, and board members can be replaced only by a 75% majority vote.

Paradoxically, when the market's power to inflict punishment on companies is unchecked, companies and their executives may feel such insecurity that they agree to protect themselves via the articles of association. Sometimes this contractual protection is to the detriment of the company's welfare and of free market principles. This practice is common in the US.

The extremely long discussions over the European Directive on public offers (which was finally adopted in 2004) demonstrate precisely this difficulty: how to coax very different stock market regulations from one country to another toward a common standard. In the UK, the sanctity of the market is the rule, whereas Germany prizes its respect for employee rights. France stands somewhere between the two. The Directive attempts to generalise certain guiding principles. In particular it states that management should

have only limited ability to implement defensive measures without prior consultation with shareholders. Defensive measures fall into four categories:

- Separate management control from financial control:
  - different classes of shares: shares with multiple voting rights and non-voting shares;
  - holding companies;
  - limited partnerships.
- Control shareholder changes:
  - right of approval;
  - pre-emption rights.
- Strengthen the position of loyal shareholders:
  - reserved capital increases;
  - share buybacks and cancellations;
  - mergers and other tie-ups;
  - employee shareholdings;
  - warrants.
- Exploit legal and regulatory protection:
  - regulations;
  - voting caps;
  - strategic assets.

## 1/ SEPARATING MANAGEMENT CONTROL FROM FINANCIAL CONTROL

### (a) Different classes of shares: shares with multiple voting rights and non-voting shares

As an exception to the general rule, under which the number of votes attributed to each share must be directly proportional to the percentage of the capital it represents (principle of one share, one vote), companies in some countries have the right to issue multiple-voting shares or non-voting shares.

In the Netherlands, the USA and the Scandinavian countries, dual classes of shares are not unfrequent. The company issues two (or more) types of shares (generally named A shares and B shares) with the same financial rights but with different voting rights.

French corporate law provides for the possibility of double voting shares but, contrary to dual class shares, all shareholders can benefit from the double voting rights if they hold the shares for a certain time.

Multiple-voting shares can be particularly powerful, as the following example will illustrate. Electrolux, the Swedish home appliance group, has 309m shares outstanding of which 9.5m are A-shares carrying 10 times the voting rights of the rest of the shares. Investor, a holding company for the Wallenberg family, owns 11.9% of the share capital but 28.2% of voting rights because it owns 87% of A-shares. These dual class shares can appear as unfair and contrary to the principle that the person who provides the capital gets the power in a company. Some countries (Italy, Spain, the UK, and Germany) have outlawed dual class shares.

Issuing non-voting shares is similar to issuing dual class shares because some of the shareholders will bring capital without getting voting power. Nevertheless, issuing non-voting shares is a more widely spread practice than issuing dual class shares. Actually, in compensation for giving up their voting rights, holders of non-voting shares usually get preferential treatment regarding dividends (fixed dividend, increased dividend compared to ordinary shareholders, etc.). Accordingly, non-voting (preference) shares are not perceived as unfair but as a different arbitrage for the investor between return, risk and power in the company.

### **(b) Holding companies**

Holding companies can be useful but their intensive use leads to complex, multi-tiered shareholding structures. As you might imagine, they present both advantages and disadvantages.

Suppose an investor holds 51% of a holding company, which in turn holds 51% of a second holding company, which in turn holds 51% of an industrial company. Although he holds only 13% of the capital of this industrial company, the investor uses a cascade of holding companies to maintain control of the industrial company.

A holding company allows a shareholder to maintain control of a company, because a structure with a holding disperses the minority shareholders. Even if the industrial company were floated on the stock exchange, the minority shareholders in the different holding companies would not be able to sell their stakes.

Maximum marginal personal income tax is generally higher than income taxes on dividends from a subsidiary. Therefore, a holding company structure allows the controlling shareholder to draw off dividends with a minimum tax bite and use them to buy more shares in the industrial company.

Technically, a holding company can “trap” minority shareholders; in practice, this situation often leads to an ongoing conflict between shareholders. For this reason, holding companies are usually based on a group of core shareholders intimately involved in the management of the company.

A two-tiered holding company structure often exists where:

- a holding company controls the operating company;
- a top holding company that holds the controlling holding company. The shareholders of the top holding company are the core group. This top holding company’s main purpose is to buy back the shares of minority shareholders seeking to sell some of their shares.

Often, a holding company is formed to represent the family shareholders prior to an IPO. For example, Portman Baela SL is a holding company formed to hold the del Pino family’s stakes in Ferrovial.

### **(c) Limited share partnerships (LSP)**

A limited share partnership introduces a complete separation between management and financial ownership of the company.

A limited share partnership is a company where the share capital is divided into shares, but with two types of partners:

- several limited partners with the status of shareholders, whose liability is limited to the amount of their investment in the company. A limited share partnership is akin to a public limited company in this respect;
- one or more general partners, who are jointly liable, to an unlimited extent, for the debts of the company. Senior executives of the company are usually general partners, with limited partners being barred from the executive suite.

The company's articles of association determine how present and future executives are to be chosen. These top managers have the most extensive powers to act on behalf of the company in all circumstances. They can be fired only under the terms specified in the articles of association. In some countries, the general partners can limit their financial liability by setting up a (limited liability) family holding company. In addition, LSP structure allows a change in management control of the operating company to take place within the holding company. For example, a father can hand over the reins to his son, while the holding company continues to perform its management functions.

Thus, theoretically, the chief executive of a limited share partnership can enjoy absolute and irrevocable power to manage the company without owning a single share. Management control does not derive from financial control as in a public limited company, but from the stipulations of the by-laws, in accordance with applicable law. Several large listed companies have adopted limited share partnership form, including Merck, Michelin and Hermès.

## 2/ CONTROLLING SHAREHOLDER CHANGES

### (a) Right of approval

The right of approval, written into a company's articles of association, enables a company to avoid "undesirable" shareholders. This clause is frequently found in family-owned companies or in companies with a delicate balance between shareholders. The right of approval governs the relationship between partners or shareholders of the company; be careful not to confuse it with the type of approval required to purchase certain companies (see below).

Technically, the right of approval clause requires all partners to obtain the approval of the company prior to selling any of their shares. The company must render its decision within a specified time period. If no decision is rendered, the approval is deemed granted.

If it refuses, the company, its board of directors, executive committee, senior executives or a third party must buy back the shares within a specified period of time, or the shareholder can consummate the initially planned sale.

The purchase price is set by agreement between the parties, or in the event that no agreement is reached, by independent appraisal.

Right of approval clauses might not be applied when shares are sold between shareholders or between a shareholder, his spouse or his ascendants and descendants.

### **(b) Pre-emption rights**

Equivalent to the right of approval, the pre-emption clause gives a category of shareholders or all shareholders a priority right to acquire any shares offered for sale. Companies whose existing shareholders want to increase their stake or control changes in the capital use this clause. The board of directors, the chief executive or any other authorised person can decide how shares are divided amongst the shareholders.

Technically, pre-emption rights procedures are similar to those governing the right of approval.

Most of the time, pre-emption rights do not apply in the case of inherited shares, liquidation of a married couple's community property, or if a shareholder sells shares to his spouse, ascendants or descendants.

Right of approval and pre-emption right clauses constitute a means of controlling changes in the shareholder structure of a company. If the clause is written into the articles of association and applies to all shareholders, it can prevent any undesirable third party from obtaining control of the company. These clauses cannot block a sale of shares indefinitely, however. The existing shareholders must always find a solution that allows a sale to take place if they do not wish to buy.

## **3/ STRENGTHENING THE POSITION OF LOYAL SHAREHOLDERS**

### **(a) Reserved capital increases**

In some countries, a company can issue new shares on terms that are highly dilutive for the existing shareholders. For example, to fend off a challenge from activist shareholders, the Philadelphia bank, Sovereign Bank, issued 25% of its share capital to the banking group Santander in 2006.

The new shares can be purchased either for cash or for contributed assets. For example, a family holding company can contribute assets to the operating company to strengthen its control over this company.

### **(b) Mergers**

Mergers are first and foremost a method for achieving strategic and industrial goals. As far as controlling the capital of a company is concerned, a merger can have the same effect as a reserved capital increase, by diluting the stake of a hostile shareholder or bringing in a new friendly shareholder. We will look at the technical aspects in Chapter 42.

The risk of course is that the new shareholders, initially brought in to support existing management, will gradually take over control of the company.

### **(c) Share buybacks and cancellations**

This technique, which we studied in Chapter 38 as a financial technique, can also be used to strengthen control over the capital of a company. The company offers to repurchase a portion of outstanding shares with the intention of cancelling them. As a result, the percentage ownership of the shareholders who do not subscribe to the repurchase offer increases. In fact, a company can regularly repurchase shares. For example, Peugeot regularly uses this method in order to strengthen the control of the family shareholders.

#### (d) Employee shareholdings

Employee-shareholders generally have a tendency to defend a company's independence when there is a threat of a change in control. A company that has taken advantage of the legislation favouring different employee share ownership schemes can generally count on a few percentage points of support in its effort to maintain the existing equilibrium in its capital. In 2007, for example, the employee-shareholders of Eiffage rallied behind management in its effort to see off Sacyr's rampant bid. The various forms of employee share ownership include profit-sharing plans, stock option plans, capital increases reserved for employees, and stock-based company pension plans. Employee savings plans almost always enjoy favourable tax treatment.

#### (e) Warrants

The company issues warrants to certain investors. If a change in control threatens the company, investors exercise their warrants and become shareholders. This issue of new shares will make a takeover more difficult, because the new shares dilute the ownership stake of all other shareholders.

This type of provision is common in the Netherlands (ING or Philips), France (Pernod Ricard, Suez) and in the US.

### 4/ LEGAL AND REGULATORY PROTECTION

#### (a) Regulations

Certain investments or takeovers require approval from a government agency or other body with the vetoing power. In most countries, sectors where there are needs for a specific approval are:

- media;
- financial institutions;
- activities related to defence (for national security reasons).

**Golden shares** are special shares that enable governments to prevent another shareholder from increasing its stake above a certain threshold or the company from selling certain of its assets (Suez, Total, Telecom Italia, Eni, Cameroon Airlines are some examples).

#### (b) Voting caps

In principle, the very idea of limiting the right to vote that accompanies a share of stock contradicts the principle of "one share, one vote". Nevertheless, companies can limit the vote of any shareholder to a specific percentage of the capital. In some cases, the limit falls away once the shareholder reaches a very large portion of the capital, (e.g. 50% or 2/3).

For example, Danone's articles of association stipulate that no shareholder may cast more than 6% of all single voting rights and no more than 12% of all double-voting rights at a shareholders' meeting, unless she owns more than two-thirds of the shares. Voting caps are commonly used in Europe, specifically in Switzerland (12 firms out of the 50 largest use them), France, Belgium, the Netherlands and Spain. Nestlé, Total, Alcatel Lucent and Novartis use voting caps.

This is a very effective defence. It prevents an outsider from taking control of a company with only 20% or 30% of the capital. If he truly wants to take control, he has to “ante up” and bid for all of the shares. We can see that this technique is particularly useful for companies of a certain size. It makes sense only for companies that do not have a strong core shareholder.

### (c) Strategic assets (poison pills)

Strategic assets can be patents, brand names, or subsidiaries comprising most of the business or generating most of the profits of a group. In some cases the company does not actually own the assets but simply uses them under licence. In other cases these assets are located in a subsidiary with a partner who automatically gains control should control of the parent company change hands. Often contested as misuse of corporate property, poison pill arrangements are very difficult to implement, and in practice are generally ineffective.

As a general matter change of control provisions on key contracts can play the role of poison pills. These contracts can be JV agreements, distribution contracts or even bank debt contract.

## Section 40.5

### FINANCIAL SECURITIES' DISCOUNTS

When a financial security trades at a discount – i.e. when the market value of the security is less than the value as we have defined it throughout this book, the market is inefficient. For example, if you cannot sell a bond for more than 80 when its discounted present value is 100, the market is inefficient.

#### When a security sells at a discount, the market is inefficient.

With this definition in mind, we examine below the different types of discounts on equities.

### 1/IPO OR “LIQUIDITY” DISCOUNTS

When a company is first floated on the stock market, its share price generally rises (see Chapter 30). Statistics show, for example, an average rise of 9% in the UK, and 15–16% in the US and France. The discount reflects the fact that sellers on the one hand and investors or intermediaries on the other have different information. The former have more information on the company’s prospects, while the latter have a good idea of market demand. A deal is therefore possible, but price is paramount. In this asymmetrical situation, signal theory says that the sale of shares by the shareholders is a negative signal, so the seller is obliged to “leave some money on the table” in return for ensuring that the IPO goes off smoothly and to investors’ satisfaction.

In an unlisted company, minority shareholders who want to sell their stakes are likely to suffer a liquidity discount. They know the value of the shares they want to sell, but cannot obtain that value unless the majority shareholder also decides to sell. We have seen cases where the liquidity discount was above 50% as the minority shareholders had to

wait 13 years before the majority shareholder decided to make such a low price offer, which was seized by the former as they had no other choice. We have also seen a zero liquidity discount when the sale of a minority stake changes the control of a company. We find the same phenomenon in a listed company with a narrow **free float** and whose capital is controlled by one or a few shareholders. A minority shareholder can only exit at the listed market price, which depends on the principal shareholder's financial communication policy. Many small and medium size listed companies are chronically undervalued because of insufficient liquidity of their shares.

In a widely held listed company, things are different. Minority shareholders are to a large extent protected by the regulatory authorities, which watch out for their interests. This brings us back to the debate in Chapter 32 over control premiums.

**The only rationale for a liquidity discount is the IPO discount that the seller would have to accept in an IPO. Nevertheless, the urgency of the sale or the balance of power between several blocs can alter this nice rationality.**

## 2/ HOLDING COMPANY DISCOUNTS

A holding company owns minority or majority investments in listed or unlisted companies either for purely financial reasons or for the purpose of control.

A holding company trades at a discount when its market capitalisation is less than the sum of the investments it holds. This is usually the case. For example, the holding company holds assets worth 100, but the stock market values the holding company at only 80. Consequently, the investor who buys the holding company's stock will think he is buying something "at a discount", because he is paying 80 for something that is worth 100. The market value of the holding company will never reach 100 unless something happens to eliminate the discount, such as a merger between the holding company and its operating subsidiary.

The size of the discount varies with prevailing stock market conditions. In bull markets, holding company discounts tend to contract, while in bear markets they can widen to more than 30%.

Here are four reasons for this phenomenon:

- the portfolio of assets of the holding company is imposed on investors who cannot choose it;
- the free float of the holding company is usually smaller than that of the companies in which it is invested, making the holding's shares less liquid;
- tax inefficiencies. Capital gains on the shares held by the holding company may be taxed twice: first at the holding company level, then at the level of the shareholders. Moreover, it takes time for the flow of dividends to come from the operating company up to the ultimate holding company;
- administrative inefficiencies: the holding company has its own administrative costs which, discounted over a long period, constitute a liability to be subtracted from the value of the investments it holds. Imagine a holding company valued at €2bn with administrative costs of €10m p.a. If those costs are projected to infinity and discounted at 8% p.a., their present value is €125m before tax, or 6.25% of the value of the holding company.

These factors can generally explain a statistical discount up to the 15–25% range. Beyond that, the discount is probably more indicative of a power struggle between investors and

holding companies. The former want to get rid of the latter and finance the operating assets directly. The disappearance of many listed holding companies over the last few years, such as Olivetti and IFI in Italy, Eurafrance in France, Cobepa and Electrabel in Belgium or Compagnie Financière Michelin in Switzerland, has demonstrated how effective investor pressure can be.

### 3/ CONGLOMERATE DISCOUNTS

A conglomerate is group active in several, diverse businesses. Whether the group combines water and telephones or missiles and magazines, the market value of the conglomerate is usually less than the sum of the values of the assets the conglomerate holds. The difference, the **conglomerate discount**, generally reflects investors' fears that resources will be poorly allocated. In other words, the group might de-emphasise profitable investments in order to support ailing divisions in which the profitability is mediocre or below their cost of capital.

Moreover, investors now want "pure play" stocks and prefer to diversify their holdings themselves. In a conglomerate, investors cannot select the company's portfolio of assets; they are in fact stuck with the holding company's choice. As in the case of holding companies, head office costs absorb some of the value of the conglomerate. Finally, a company can suffer both a conglomerate and a holding company discount if some of the company's activities are lodged in a listed subsidiary.

A persistent conglomerate discount usually leads to a spin-off<sup>6</sup> or a hostile takeover bid.<sup>7</sup>

Some conglomerates are valued without a discount (General Electric, Bouygues) because investors are convinced that they are efficiently managed.

<sup>6</sup> See Chapter 43.

<sup>7</sup> See Chapter 42.

## Section 40.6

### ORGANISING A DIVERSIFIED GROUP

Imagine you were suddenly at the helm of a diversified industrial group. What sort of organisation should you choose? Should you set up a separate company for each major business unit with a holding company overseeing them, or a single legal entity with several divisions?

#### 1/ LISTING SUBSIDIARIES?

Listing certain subsidiaries brings in minority shareholders and increases the capital available to the group while offering investors a slice of the assets that interest them the most. The same reasoning holds for bringing financial investors into the capital of the subsidiaries.

Opinions vary widely on this topic. The company gains access to equity financing without fundamentally changing the capital structure of the group. Carried too far, however, the parent company becomes a financial holding company with the problem of the holding company discount.

We note, however, that in certain sectors of the economy, legislation requires the presence of a financial partner or a public listing. In Luxemburg, for example, a shareholder

may not hold more than 25% of the capital of a radio station; in France no-one may own more than 49% of a free-to-air TV channel. Researchers have shown that the share price performance of the subsidiary improves when the parent company's stake falls below 50%! A company that creates a new subsidiary and sells a stake on the stock exchange is said to perform a **carve-out**.

Depending on market conditions, valuations and strategies, sometimes it will be advantageous to list subsidiaries and bring in minority shareholders and sometimes it will be better to do the opposite and delist a subsidiary. Many companies – EDF, Iberdrola, to name just two – listed their wind power or similar subsidiaries in 2007. This was to take advantage of the high multiples the market was ascribing to the sector in the hope of paying for future acquisitions with the shares of their newly-listed subsidiaries rather than with cash. This strategy works well when valuations are high because when acquisitions are paid in paper, the question of price becomes one of parity. At the same time, many more mature companies – Généralei, Allianz, Lafarge stand out as examples – bought out minority shareholders in their listed subsidiaries. Moral: nothing is irreversible.

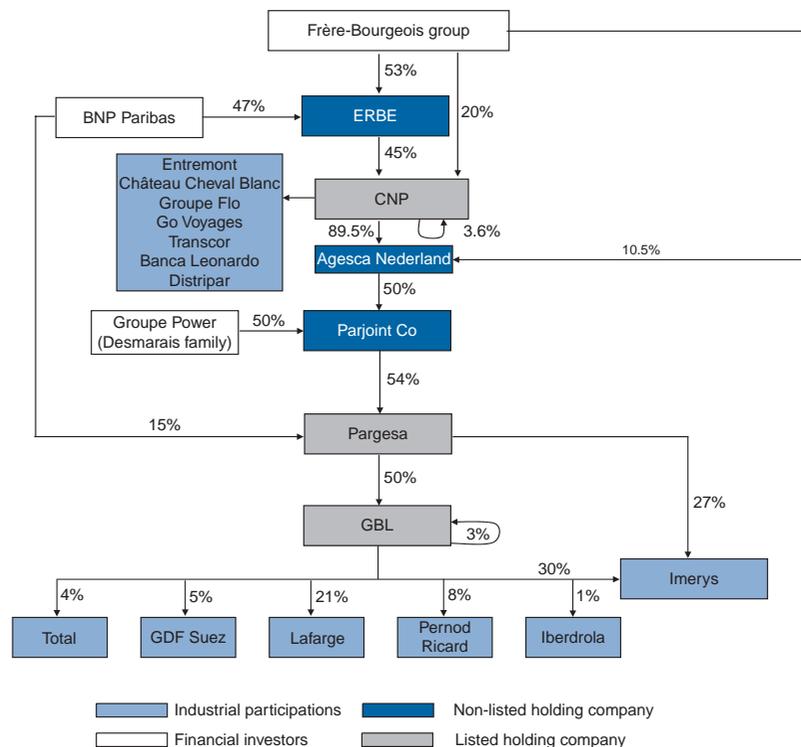
## 2/ CASCADE STRUCTURE

As a newly-minted CEO, you may be tempted to structure your group as a Russian Matryushka doll, like Groupe Arnault and LVMH or Olivetti and Telecom Italia, or like the current Albert Frère group:

### SIMPLIFIED ORGANIGRAM OF THE FRÈRE GROUP (DECEMBER 2008)

Although the group controls 20% of Lafarge, the Frère family's financial interest in the cement group is only 1.5%.

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Source: Annual reports

At each level, it makes sense to create a new company only if it will house different businesses. The most profitable activities must be as close as possible to the controlling holding company. Otherwise, if it is the company at the bottom of the “cascade”, cash flow will have trouble reaching the controlling holding company, and shareholders will have the impression their money is working for free!

What are the advantages and disadvantages of such a cascade structure?

The **multiplier effect** is maximised. With capital of 100, you can control a set of businesses with a capital of 2500! Even more leverage can be obtained if intermediate structures borrow, but we strongly recommend against this practice. As they do not hold the operating assets directly and depend solely on dividends for their livelihood, borrowing would make the intermediate structures even more fragile. Remember that a chain is only as strong as its weakest link.

These cascade companies generally trade with a deep discount (between 20% and 50%). If a parent company wants to participate in its subsidiary’s capital increase in order to maintain control over it, it must in turn carry out a capital increase. But because of the holding company discount, the new shares of the holding company will be issued at a heavy discount, increasing its cost of capital. In effect, the cost of capital for a parent holding company which has stock that trades at a 50% discount is twice the cost of capital of the operating subsidiary.

These structures have fallen a bit out of fashion. Investors are afraid of being caught on the least liquid and most fragile part of the ladder and suffering an accumulation of discounts.

Shareholder structure explains how power is distributed among a company’s different shareholders or groups of shareholders. Major shareholder categories are as follows:

- employee-shareholders. Normally these shareholders are loyal and non-volatile, lending a degree of stability to the capital;
- family shareholders. This model is in decline. New industries require too much capital for a family-owned structure to be viable. Funding requirements make capital markets become increasingly important;
- financial investors and investment funds, whose objectives vary: business angels, LBO funds, institutional investors, venture capitalist, etc;
- governments whose importance is rising due to sovereign wealth funds mainly originating from emerging markets.

Listing a company on the stock market enables majority shareholders to increase the liquidity of their shares but, in return, it requires them to submit their strategy to the scrutiny of the financial community. Defensive measures for maintaining control of a company’s capital carry a cost, because they prevent investors from taking advantage of the potential opportunities a takeover might offer.

## SUMMARY

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These measures include:

- separating management control from financial control through double voting shares, holding companies, limited share partnerships, investment certificates and non-voting shares;
- controlling shareholder changes through right of approval clauses or pre-emption rights;
- strengthening the position of loyal shareholders by carrying out reserved capital increases, buying back shares, merging, encouraging employees to become shareholders and issuing warrants;
- exploiting legal and regulatory opportunities: specific regulations, voting rights limitations, and poison pills.

Tax considerations aside, whether a group is made up of subsidiaries or divisions depends on control and organisational factors. Listing certain subsidiaries gives the group access to additional equity capital without changing the shareholder structure of the group. But such carve-outs risk transforming the parent company into a financial holding company.

Lastly, remember that shares with low market liquidity, shares of a holding company or conglomerate, or shares without voting rights, often trade at discounted values. These discounts increase the cost of capital.

## QUESTIONS



- 1/What techniques can be used for choosing shareholders?
- 2/What sort of general meeting must be held to approve capital transactions?
- 3/What power does a shareholder with a blocking minority have?
- 4/What purpose does a “Dutch clause” serve?
- 5/Why can management compensation in the form of stock create value?
- 6/How would compensating employees in stock run contrary to financial theory?
- 7/Are there any voting rights attached to a tracking stock?
- 8/What advantages are there in buying 100% of the capital of a limited share partnership?
- 9/Why do so many conglomerates continue to survive, despite the loss of value they generate? Can this situation last?
- 10/What is the advantage of cascade structures for the majority shareholder? And for other shareholders?
- 11/What is the difference between a holding company discount and a conglomerate discount?

- 12/A company manager has a 55% stake in his unlisted company, in which a competitor also has a 32% stake. The former is keen to dilute the shareholding of the latter, without diluting his own stake at the same time. What should he do?
- 13/Why is the shareholding of a family-run business unstable in the long term? What is the likely future of such a business? How can this process be slowed down?
- 14/Two managers have a 25% and 75% stake respectively in a company. They are keen to bring in a capital investor with the minimum dilution to their shareholdings. How should they go about solving this problem?
- 15/Why would a company with an 85% stake in a subsidiary launch a takeover bid for the remaining 15%?

- 1/ Provide a description of the shareholdings and management in the following situations:
  - Company 1: capital split between investors each holding the blocking minority;
  - Company 2: large group holding absolute majority, rest widely held;
  - Company 3: no shareholder has more than 5% of shareholders' equity;
  - Company 4: trade buyer with blocking minority, capital investor with shareholding significant but below blocking minority, rest widely held;
  - Company 5: trade buyer just below simple majority, rest widely held.

## EXERCISES

### Questions

- 1/Approval, pre-emption, A and B shares, etc.
- 2/Extraordinary General Meeting (where applicable).
- 3/Blocking decisions at EGMs.
- 4/Use dissuasion to limit strategic divergence among shareholders.
- 5/Because it permits reduction of agency costs.
- 6/Their risks are not diversified.
- 7/No, only in very limited circumstances.
- 8/None (see chapter).
- 9/It is in the interest of management – power, prestige. No, because sooner or later there will be pressure from shareholders.
- 10/Secure control with limited resources. None.
- 11/See chapter.
- 12/Reserved capital increase if some minority shareholders vote with him so as to get the EGM's approval, contribution of assets, etc.
- 13/The principle of portfolio diversification renders the principle of a family shareholding structure unstable. It will be sold to pay taxes (wealth and inheritance taxes). Provide them with tax breaks.
- 14/By creating a holding company or issuing convertible bonds.
- 15/In order to get rid of minority shareholders and unlock the sought-after group synergies.

## ANSWERS

*Exercise*

- 1/ *Stable shareholding structure – Companies 2, 4 and 5.*  
*Unstable shareholding structure – companies 1 and 3.*  
*Managers: 1 – highly controlled. 2 – stable. 3 – only risk is risk of a takeover bid.*  
*4 – stable (but risk of takeover bid could exist, depending on relationship with capital investor. 5 – stable (risk of takeover bid not excluded).*

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