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The Place of Shareholder Activism by Institutional Investors in Georgian System of Corporate Governance and Its Influence on International Merger Transactions

Institutional investors, in the course of the international mergers and acquisitions deals, play the particular role and the function. Increase of the role of institutional investors has been entailed with establishment of shareholder activism as the efficient mechanism for improvement of the corporate governance. The activist, by means of consideration of the nature and the forms of the types of the shareholders and the activism thereof, strives to define the feasibility of establishment of shareholder activism practice in Georgian companies and to demonstrate the interdependence between the institutional shareholder activism and the effective protection of the rights of minority shareholders. The article outlines the basics forming due pre-conditions for development of shareholder activism, which serves as a real opportunity for institutional shareholder activism to become the integral part of Georgian system of corporate governance.

The role of the institutional investors, especially of the foreign institutional investors is manifested in exercise of the facilitative function, which in its turn makes the convergence of the corporate governance achievable. Alternative investment funds, through arbitrage transactions and activism related with appraisal of the stock shares, which have already become the integral parts of their investment strategy, facilitate to increase of the transaction price and fair valuation of the shares appurtenant to the minority shareholders. The institutional shareholder activism, based on the surveys, facilitates to extension of the rights of the minority shareholders and effective realization thereof.

Key words: *shareholder activism, convergence of corporate governance, foreign institutional investors, international mergers and acquisitions, hedge funds, merger arbitrage, appraisal activism.*

1. Introduction

International merger is considered as one of the deals characterized for the corporate world, used for obtainment and enhancement of the leading position on the global market. Multinational corporations resort to international merger deals as the instrument for growth, enlargement and introduction to the new markets. The institutional investors play significant role in the process of international merger having capacity to incur significant influence on the deals of such type. Increase of the role of the institutional investors was facilitated with emergence of the shareholder activism. Shareholder activism is the fastest growing American trend of modern corporate governance assuming the responsibility to improve corporate governance and widely spread it worldwide, including in the countries of the Continental Europe.

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The hereby article aims to outline the role of the shareholder activism of the institutional investors within the uniform system of corporate governance and to define impact thereof on international merger deals. Studying the issues related to the shareholder activism, the article strives to define possibility of establishment of the shareholder activism in Georgian companies. Hence, the surveys revealed the basis creating the fertile ground for development of shareholder activism.

Consideration of the shareholder activism of the institutional investors aims at demonstration of inter-relation between protection of rights of the minority shareholders and activism to identify the degree of facilitation of the institutional shareholder activism to extension of the rights of the minority shareholders and even effective application thereof and hence, better protection of interests of the shareholders in minority. Hereof approach to the issue derives from the fact that the institutional investor at most extent takes advantage of the status of the minority shareholder.

Consideration of the issue of the institutional shareholder activism resulted in identification of the role of the international institutional investor upon international merger. The article ends with consideration of convergence of corporate governance approachable by means of implementation of the international merger deals and active participation of institutional investors therein.

The survey provided in the conclusion establishes the recommendations to facilitate to development of shareholder activism of institutional investors in Georgian companies on the one hand and on the other hand to ensure conversion of the institutional shareholder activism into the integral part of Georgian system of corporate governance.

2. Institutional Shareholder Activism as the Tool for Improvement of Corporate Governance

2.1. The Essence and the Objective of Shareholder Activism

The shareholder activism is the highest manifestation of shareholder engagement, the universally recognized definition of which with the opinion reconciled amongst the scientists and practitioner lawyers is currently unavailable. The term is often applied to express any activities implemented by the shareholder. The European Corporate Governance Institute gives the definition to this term as the way to be passed by the company owner shareholders where the shareholders are capable to enhance own powers by impacting the social behavior.¹ Shareholder activism, in the strict perspective, can be delivered prior to involvement of the shareholders in the company management and in wider perspective implies engagement of the institutional investors.² Shareholder activism falls within the area of the market for corporate influence³ where unlike the market for corporate control, the parties struggle to obtain influence by means of application of various strategies and tactics to change the strategy or decision.⁴ Fights on the corporate control market start for further fundamental changes.⁵

¹ See <<http://www.ecgi.org/activism/index.php>>, [28.04.2015].

² *Chiu I.*, *The Foundations and Anatomy of Shareholder Activism*, Oxford, 2010, 3.

³ *Cheffins B.R., Armour J.*, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, *J. Corp. L.*, Vol. 37, Issue 1, 2011, 58.

⁴ For more information see *Rose P.*, *Shareholder Proposals in the Market for Corporate Influence*, *Florida L. Rev.*, Vol. 66, 2014, 2179-2228.

The essence of the shareholder activism is often expressed in active realization and enforcement of the rights prescribed under the law by the minority shareholders entailing consideration of the institutional shareholder activism as the method of prevention of deprivation of interests of the minority shareholders.⁶ The starting point of such definition of the shareholder activism is the rights of the shareholders and protection thereof, which often serves as the argument resulting in justification of active involvement of the shareholders in corporate governance-administration.⁷

The primary objective of the shareholder activism is enhancement of the role, influence and power of the shareholder without introduction of changes to the control.⁸ To be more specified, the objective of the shareholder activism is to increase the shareholder value in long-term perspective achievable by means of influence on the behavior of the heads of the company. Shareholder activism often is the long-term and complex discussion process initiated by one or over shareholders aspiring to better distribute shareholder values in the target company. Shareholder activism can be driven with ecologic and social interests along with economic interests. Some researchers presume that the benefits gained as a result of shareholder activism are one of the varieties of public goods.⁹ Despite, economic interest still remains the greatest motivator of the shareholder activism.

2.2. Types of Activist Shareholders and the Nature of their Activism

2.2.1. Retail Investors

Retail investors compose the smallest group of the activist shareholders. Most of the retail investors, as a rule, invest by means of mutual and pension funds which allows professional management of invested funds.¹⁰ Another part of the retail investors implement activism independently.

The essence of the shareholder activism of the retail investors is manifested in achievement of the retail shareholder to not only put the issue into the agenda but to trigger further solution thereof.¹¹ Critics of the shareholder activism note that activism shall not be the end in itself for the retail shareholder.¹² Individual activism often fails to give tangible outcomes, which is the basis for criticism to consider that the shareholder shall not resort to activism for the purpose of noise only, which results in no positive outcome.¹³ Actions of the activist shareholder shall express the sense of

⁵ *Kahan M., Rock E.B.*, Hedge Funds in Corporate Governance and Corporate Control, U. Pa. L. Rev., Vol. 155, Issue 5, 2007, 1040.

⁶ *Low Ch.K.*, A Road Map for Corporate Governance in East Asia, Nw. J. Int'l L. & Bus., Vol. 25, Issue 1, 2004, 185-186.

⁷ *Armour J., Cheffins B.R.*, The Rise and Fall (?) of Shareholder Activism by Hedge Funds, ECGI Working Paper № 136, 2009, 2009, 2.

⁸ *Gillan S.L., Starks L.T.*, The Evolution of Shareholder Activism in the United States, Journal of Applied Corporate Finance, Vol. 19, Issue 1, 2007, 58.

⁹ *Nili Y.*, Missing the Forest for the Trees A New Approach to Shareholder Activism, Harvard Bus L. Rev., Vol. 4, 2014, 167.

¹⁰ *Cahn A., Donald D.*, Comparative Company Law, Cambridge UP., Cambridge, 2010, 799.

¹¹ In details see *Gulinello Ch.*, The Retail Investor Vote Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board's Presumption of Authority, *Utah L. Rev.*, Vol. 2010, Issue 3, 2010, 547-604.

¹² For more information, see *Langevoort D.*, The SEC, Retail Investors, and the Institutionalization of the Securities Markets, Va. L. Rev., Vol. 95, Issue 4, 2009, 1025-1083.

¹³ *Harris L.*, Missing in Activism Retail Investor Absence in Corporate Elections, Colum. Bus. L. Rev., Vol. 104, Issue 1, 2010, 104-204.

rationality dictating to implement activism in the event solely when expected profit exceeds the costs.¹⁴ Activist shareholder¹⁵ always has to choose between impact on or provision of high liquidity of the share. Retail investors mostly choose the second option.

2.2.2. Traditional Institutional Investors

The institutional investors constitute the greatest part of the activist shareholders the level of activism of which drastically exceeds the index of the retail investors which derives from holding of the larger shares of stocks. Increase of the role of the institutional investor is facilitated with establishment of the stewardship theory, which is one of the most applied theories amongst the theories of corporate governance, considering the institutional investor in the role of the steward.¹⁶

Institutional shareholder activism is of a defensive nature as a rule and is characterized with the responsive properties.¹⁷ The shareholder activism of the mutual investment and public pension funds is accidental and is implemented *ex post*, namely when the top management of the funds notice that corporate governance and activity are being developed in undesired directions in which they have invested.

The institutional investor is not usually involved in routine activity, though some of them still attempt to and thus, are being exposed to criticism. In general, it is considered that the institutional investors shall abstain from involvement in routine activity. The institutional investor interferes in governance-management issues when the long-term interests of the society fall under danger.¹⁸ Disclosure of information often fails to give a whole scene which entails necessity to apply other supplementary mechanisms to influence the society. The professor *S. Brainbridge* considers that influence of activism of the institutional investors on corporate governance of the society is minimal.¹⁹ Some of the scientists presume that the institutional shareholder activism means excessive control over the behavior of management, which is the costly procedure subject to be applied in the event of necessity solely.²⁰

2.2.3. Alternative Institutional Investors

The alternative institutional investors compose the group of activist shareholders of a brand new type, the structure of which is completed with the alternative investment funds.²¹ The hedge

¹⁴ *Black B.*, Protecting the Retail Investor in an Age of Financial Uncertainty, *Dayton L.U. Rev.*, Vol. 35, 2009, 64.

¹⁵ Retail as Well as Institutional Investor.

¹⁶ In details see *Chiu I.*, Institutional Shareholders as Stewards Toward a New Conception of Corporate Governance, *Brook. J. Corp. Fin. & Com. L.* Vol. 6, 2012, 387-432.

¹⁷ *Cheffins B.R., Armour J.*, The Past, Present, and Future of Shareholder Activism by Hedge Funds, *Corp J. L.*, Vol. 37, Issue 1, 2011, 58.

¹⁸ For more information, see *Sharfman B.*, A Theory of Shareholder Activism and its Place in Corporate Law, *Tenn L. Rev.*, Vol. 82, Issue 4, 2015, 101-134.

¹⁹ *Bainbridge S.*, The New Corporate Governance in Theory and Practice, Oxford UP., Oxford, 2008, 22.

²⁰ For more information, see *Romano R.*, Less is More Making Institutional Investor Activism A Valuable Mechanism of Corporate Governance, *Yale Journal on Regulation*, Vol. 18, Issue 2, 2001, 174-252.

²¹ Along with the hedge-funds, Private equity funds, exchange traded funds and sovereign wealth fund also are included into the alternative investment funds *Çelik S., Isaksson M.*, Institutional Investors as Owners Who Are They and What

fund can be outlined from the alternative investment funds, which is the most dynamic activist shareholder²² capable to act like real owner.²³ The activist hedge funds along with private equity funds have occupied the area remaining vacant by the credit rating agencies, market for corporate control, rational application of voting rights and accountability of the directors.²⁴

The first hedge funds appeared in USA. The historical predecessor of the modern hedge fund was the fund founded by Alfred Winslow Jones in 1949, which was not subordinated to the requirements of *the Investment Company Act of 1940*. The term itself is related to Carol Loomis who used it for the first time in 1966 to characterize the fund. The investment fund of the sophisticated (experienced) investors is the Georgian analogue of the hedge fund.²⁵ The circle of investors of the hedge fund is composed of the accredited and qualified investors solely. Similar to the hedge fund, only sophisticated (experienced) investor can become the participant of the investment fund of the sophisticated (experienced) investors.²⁶ Unlike the traditional institutional investors, hedge funds hold more concentrated portfolio and mostly finance the deals by means of the credits.

Activism of hedge funds differs from the activism of the traditional institutional investors with the qualitative and quantitative indices.²⁷ The main concern around the activity of the hedge funds implied reckon on the short-term objectives and interest during the years.²⁸ The activity of the hedge funds increases likelihood of systemic risks²⁹ which played a significant role upon financial crisis and further is explained with application of credit derivatives.³⁰ Necessity of intensive regulation of the hedge fund can often be explained with reduction of the credit risk,³¹ generated upon application of the credit derivatives by the hedge funds.³² Activism of hedge funds fall under criticism due to the empty voting as well which is no rare event accompanying the merger deals.³³ Empty voting, as manipulative sale and purchase of the suffrage, derives from the strategy of realization of suffrage and separation of economic interests and describes the situation when the interest of a shareholder to

Do They Do? OECD Corporate Governance Working Papers, №11, OECD Publishing, 2013, 8. Available on, <<http://dx.doi.org/10.1787/5k3v1dvmfk42-en>>, [16.09.2015].

²² *Kahan M., Rock E.B.*, Hedge Funds in Corporate Governance and Corporate Control, U. Pa. L. Rev., Vol. 155, Issue 5, 2007, 1028.

²³ *Ibid*, 1047.

²⁴ *Macey J.*, Corporate Governance Promises Kept, Promises Broken, Princeton UP, Princeton, 2008, 272.

²⁵ See the sub – § “b” of the paragraph 3 of the Article 3 of the Law of Georgia on Investment Funds.

²⁶ See the §59 and 57 of the Article 2 of the Law of Georgia on Securities Market.

²⁷ *Kahan M., Rock B.*, Hedge Fund Activism in the Enforcement of Bondholder Rights, NW. L. Rev., Vol. 103, 2009, 282.

²⁸ *Katelouzou D.*, Worldwide Hedge Fund Activism Dimensions and Legal Determinants, J. Bus. L., Vol. 17, Issue 3, 2015, 791.

²⁹ *Hawley J., Kamath J., Williams A.*, Corporate Governance Failures The Role of Institutional Investors in the Global Financial Crisis, Penn UP, Philadelphia, 2011, 14.

³⁰ In General see *Stout L. A.*, Derivatives and the Legal Origin of the 2008 Credit Crisis, Harv. Bus. L. Rev., Vol. 1, 2011, 1-38.

³¹ *Shadab H.*, The Law and Economics of Hedge Funds Financial Innovation and Investor Protection, Berkeley Bus. L. J., Vol. 6, 2009, 260.

³² *Wynkoop N.*, The Unregulables? The Perilous Confluence of Hedge Funds and Credit Derivatives, Fordham L. Rev., Vol. 76, Issue 6, 2008, 3096.

³³ For more information, see *Zanoni A.*, Hedge Funds' Empty Voting in Mergers and Acquisitions A Fiduciary Duties Perspective, Global Jurist, Vol. 9, Issue 4, 2009, 41-79.

vote is much more important than his/her economic interest.³⁴ Despite, the recent surveys confirm that hedge fund activism does not imply the harmful strategy in long-term perspective.³⁵

Activism of hedge funds consists of sundry stages,³⁶ is of offensive nature and is implemented *ex ante*, namely the manager of the hedge fund starts with estimation of the potential target in terms of profitability to further acquire the share and enact.³⁷ Activism of the hedge funds is presented somewhere between risky sale and purchase of securities and the fight for the corporate strategy and control.³⁸

Hedge fund activism is considered as the corrective mechanism of the corporate governance, capable to facilitate to increase of the shareholder value by means of introduction of changes to the management board and the strategy of the company, as well as to ensure improvement of the corporate governance system in the target company by means of provision of the valuable information for the top management.³⁹ Hedge fund activism allows real growth of the shareholder value in long-term perspective by means of activities ensuring early warning and notification of the upper link (Board of Directors) of the company concerning expected ineffective decision-making by the lower link (management) by means of provision of information and issue of recommendations.⁴⁰

2.3. Fiduciary Duties of the Activist Shareholder and their Importance

Emergence of the institutional investors and increase of their role, as well as development of the shareholder activism enabled the shareholders to increase own influence in the company. Increased influence converted the shareholders into better informed and active shareholders, making their interests more heterogeneous. Increase of influence of the activist shareholder entailed danger that the increasing influence would serve not for the interests of the society, namely for improvement of corporate governance and provision of accountability of top management but for personal interests solely mostly at the account of the rest of the shareholders.⁴¹

³⁴ In details, see *Hu h., Black B.*, The New Vote Buying Empty Voting and Hidden (Morphable) Ownership, *S. Cal. L. Rev.*, Vol. 79, 2006, 811-908.

³⁵ In details, see *Bebchuk L., Brav A., Jiang W.*, The Long-Term Effects of Hedge Fund Activism, *Colum. L. Rev.*, Vol. 115, Issue 5, 2015, 1085-1156. Also see *Katelouzou D.*, Myths and Realities of Hedge Fund Activism Some Empirical Evidence, *Va. L. & Bus. Rev.*, Vol. 7, 2013, 459-504.

³⁶ Hedge-funds can be sub-categorized into entry, trade, discipline and exit stages. In details, see *Katelouzou D.*, Worldwide Hedge Fund Activism Dimensions and Legal Determinants, *J. Bus. L.*, Vol. 17, Issue 3, 2015, 797.

³⁷ *Cheffins B.R., Armour J.*, The Past, Present, and Future of Shareholder Activism by Hedge Funds, *J. Corp. L.*, Vol. 37, Issue 1, 2011, 57.

³⁸ *Kahan M., Rock E.B.*, Hedge Funds in Corporate Governance and Corporate Control, *U. Pa. L. Rev.*, Vol. 155, Issue 5, 2007, 1069.

³⁹ *Rose P., Sharfman B.*, Shareholder Activism as a Corrective Mechanism in Corporate Governance, *BYU L. Rev.*, Vol. 2014, Issue 2, 2014, 101-135, also available at <<http://ssrn.com/abstract=2324151>>, [07.12.2014].

⁴⁰ For more information, see *Sharfman B.*, Activist Hedge Funds in a World of Board Independence Creators or Destroyers of Long-Term Value? *Columbia Business Law Review*, Forthcoming. Available at, <<http://ssrn.com/abstract=2576408>>, [24.03.2015]. If we adjust this approach to Georgian reality, we will enable the institutional investors to inform the Supervisory Board concerning the detected shortcomings in the decisions made by the Directors.

⁴¹ *Geczy Ch., Jeffers J., Musto D., Tucker A.*, Institutional Investing When Shareholders Are Not Supreme, *Harv. Bus. L. Rev.*, Vol. 5, Issue 1, 2015, 75.

In compliance with the situation modified according to development of the shareholder activism of the institutional investors, the doctrine and the judicial practice have gradually started application of the fiduciary duties to the activist shareholders of traditional concept and underlined the essence and importance of the fiduciary relations with respect to each other.⁴² Modern institutional shareholder activism implies responsible behavior of a shareholder equipped with the fiduciary duties as towards the whole corporation so towards the rest of the shareholders and serves as the watchdog for improvement of corporate governance and protection of interests of the company and the shareholders in long-term perspective.

2.4. Forms of the Shareholder Activism

2.4.1. The Initial Stage of Activism: The Wall Street Rule and Relative Investment

Institutional shareholder activism can be exercised in various different forms. The easiest form of the shareholder activism constitutes exit from the company by selling the stocks. The shareholder, instead of becoming activist and attempting to have influence, expresses own experience in this manner.⁴³ Sale of the shares of the shareholders is one of the forms of the shareholder activism on the basis of the presumption that sale of the shares appurtenant to the institutional investors is an alarming sign negatively impacting on the image and the reputation of the society. Sale of the large package appurtenant to the institutional investor may have negative impact on the price of the stocks.⁴⁴

The Wall Street Rule affects when the costs of discipline of the top management and expected benefit are less than the benefit to be obtained from the sale of the stocks and cannot outweigh the discipline costs. Mostly, it is the retail investor walking the Wall Street who prefers sale of the stocks against the fight. The strategy of exit of this manner is justified when the level of concentration of the shareholder structure reduces as it is considered that when concentration is high, the top management is more disciplined. In other words, discipline of the top management with activism is more rational.⁴⁵

The shareholder, still tending to stay in the company, starts own activism in relatively easy form. The initial form of the shareholder activism is relative investment envisaging establishment of long-term partnership relations and creation of the cooperative environ by means of written correspondence, tête-à-tête relationship, meetings, private discussions, negotiations and other forms of active communication with the top management.

Relative investment is the private form of the shareholder activism unlike wide-scale campaigns and public debates, attributed to more public forms of activism.⁴⁶

⁴² *Anabtawi I., Stout L.*, Fiduciary Duties for Activist Shareholders, *Stanf. L. Rev.*, Vol. 60, Issue 5, 2008, 1260.

⁴³ *Admati A.R., Pfleiderer P.*, The Wall Street Walk and Shareholder Activism Exit as a Form of Voice, *The Review of Financial Studies*, Vol. 22, Issue 7, 2009, 2650.

⁴⁴ *Rock E.*, Shareholder Eugenics in the Public Corporation, *Cornell L. Rev.*, Vol. 97, 2012, 856.

⁴⁵ *Ibid.*

⁴⁶ *Gillan S.L., Starks L.T.*, The Evolution of Shareholder Activism in the United States, *Journal of Applied Corporate Finance*, Vol. 19, Issue 1, 2007, 51.

2.4.2. Activism Related to the General Meeting

After the initial stage of the shareholder activism is over, it is time to apply the forms related to the general meeting of shareholders, concluding independent inclusion of a separate paragraph into the agenda of the meeting, voting by proxy and application of e-communication forms upon voting. As the negotiations with the top management fails, shareholder proposal and demand to include the shareholder proposal into the agenda replace the main mechanism in the struggle for corporate influence.⁴⁷ USA and Europe have long ago started practicing inclusion of a separate paragraph into the agenda of the general meeting of shareholders. The Rule 14a-8 adopted on the basis of the Securities Exchange Act in USA⁴⁸ and the article 6 of the Directive on Exercise of Certain Rights of Shareholders in Europe⁴⁹ serve as the normative basis of the hereof form of the shareholder activism.⁵⁰ The American Rule simplifies communication and coordination between the shareholders and the main advantage thereof lies in evasion of costs for development of the application on proxy and the disadvantage is that it shall be submitted six months prior to convocation of the general meeting and the list of the issues is limited at some extent. Introduction of the proposals on the issues related to the corporate governance shall be implemented in compliance with the Rule 14a-8, entitling the shareholders to include the initiated issue and the supportive statement of at least 500 words into the application on proxy, further submission of which to the shareholders shall be ensured by the corporation.

The most common form of the shareholder activism is realization of suffrage by means of proxy and e-communication, considered as the basic leverage of the shareholder activism.⁵¹ Increase of the role of the institutional investors conditioned replacement of shareholder primacy with the voter primacy paradigm.⁵² Voting by proxy and by e-form facilitates to mobilization of votes, which increases raising the issues at the general meeting and likelihood of decision acceptable for the activist. Transformation of the practice of voting by proxy has been entailed with establishment of new type of advisory service, focused on voting by proxy in corporations directly. Proxy advisory services are rendered to all the institutional investors or the proxies thereof, realizing suffrage at the general meeting of the shareholders by proxy.⁵³ Proxy advisory companies, often in view of inquiry of the proxies, play the role of the intermediaries with the shareholders of the target society.

⁴⁷ *Rose P.*, Shareholders Proposals in the Market for Corporate Influence, Florida L. Rev., Vol. 66, 2014, 2180.

⁴⁸ See 17 CFR 240.14a-8 – Shareholder Proposals.

⁴⁹ See Directive 2007/36, EC on the Exercise of Certain Rights of Shareholders in Listed Companies, O.J. L 184, 14,7, 2007, 17-24.

⁵⁰ The Hereof Article has Triggered Establishment of the Shareholder Activism Movement. *Masouros P.*, Is the EU Taking Shareholder Rights Seriously? An Essay on the Importance of Shareholdership in Corporate Europe, European Company Law, Vol. 7, Issue 5, 2010, 200. Despite, lots of legal impediments remaining, hindering to due development of the institutional shareholder activism in Europe. See *Santella P., Baffi E., Drago C., Lattuca D.*, Legal Obstacles to Institutional Investor Activism in the EU and in the US, Eur. Bus. L. Rev., Vol. 23, Issue 2, 2012, 257-307.

⁵¹ *Masourous P.*, Is the EU Taking Shareholder Rights Seriously? An Essay on the Impotence of Shareholdership in Corporate Europe, European Company Law, Vol. 7, 2010, 201.

⁵² *Haan S.*, Voter Primacy, Fordham L. Rev., Vol. 83, Issue 5, 2015, 2655.

⁵³ *Dent G.*, A Defense of Proxy Advisors, Mich. St. L.Rev., Vol. 2014, Issue 5, 2014, 1290.

2.4.3. Class Action of the Lead Plaintiff

Application of innovative approaches has largely facilitated to diversification of the forms of the shareholder activism, which conditioned interest of the activist shareholder in protection of the rights through litigation. Application to the Court has become an outstanding, however the contradictory form of the shareholder activism.⁵⁴ Litigation initiated by the activist shareholder is recognized as the most effective and unique form of the shareholder activism.

Along with the direct and derivative actions of the shareholder, the securities class actions have appeared on the shareholder activism theatre, which serves as the mean of private enforcement of legislation on securities and is the form of the representative action.⁵⁵ Engagement of the institutional investor in the litigation initiated in relation with breach of the legislation on securities has become possible due to inculcation of the institution of the lead plaintiff, envisaged under the Private Securities Litigation Reform Act of 1995.⁵⁶ Practice of the lead plaintiff allowed the institutional investors applying the class action in capacity of one of the forms of activism.⁵⁷ Participation of the institutional investors in the actions filed on securities fraud is attached with utmost importance and they have full support therein.⁵⁸ Participation of the institutional investors in the litigation related to the merger deals on behalf of the lead plaintiff along with the actions filed on securities fraud is the judicial form of the shareholder activism, which generates one of the varieties of the traditional judiciary forms of the shareholder activism.⁵⁹

In the litigation initiated on breach of the law on securities, the company itself represents the respondent. The retail investor does not resort to the institute of the lead plaintiff as he/she is considered as a less sophisticated investor.⁶⁰ Some of the researchers suppose that the representative action fails to adequately reflect interests of other shareholders due to which it would be expedient if other group of the shareholders as well is engaged in capacity of the respondent.⁶¹

3. Role of the Institutional Investors upon International Mergers and Acquisitions

3.1. Foreign Institutional Investor as a Facilitator

The foreign institutional investors play one of the central and key roles in the process of international merger transactions, taking active part in every stage of development-planning, conclusion and

⁵⁴ *Perino M.*, Institutional Activism Through Litigation An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions, *Empir J., Leg. Stud.*, Vol. 9, 2012, 368.

⁵⁵ *Choi S., Fisch J.*, On Beyond CalPERS Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance, *Vand. L. Rev.*, Vol. 61, 2008, 316.

⁵⁶ *Choi S., Silberman L.*, Transnational Litigation and Global Securities Class Action Lawsuits, *Wisc. L. Rev.*, Vol. 2009, 479.

⁵⁷ *Thomas R.*, The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation, *Vand. L. Rev.*, Vol. 61, 2008, 300-301.

⁵⁸ *Silver Ch., Dinkin S.*, Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions, *DePaul L. Rev.*, Vol. 57, Issue 2, 2008, 471.

⁵⁹ *Webber D.*, Private Policing of Mergers and Acquisitions An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions, *Del. J. Corp. L.*, Vol. 38, Issue 3, 2014, 907.

⁶⁰ *Webber D.*, The Plight of the Individual Investor in Securities Class Actions, *Nw. U. L. Rev.*, Vol. 106, Issue 1, 2012, 180.

⁶¹ *Burch E.*, Optimal Lead Plaintiffs, *Vand. L. Rev.*, Vol. 64, 2011, 1115.

implementation of the deals and thus, simplifying the process.⁶² The foreign institutional investor increases the chances of the merger deal to obtain international nature. The institutional investors tend to seek for the potential partners abroad. The foreign institutional investors link the companies of various countries on international level and thus, act in capacity of the facilitators of the international market for the corporate control, facilitated with the international networks of the deals and connections available for the institutional investors, which simplifies exercise of the hereof function by the facilitators.⁶³

The initial stage of the process of international takeover is characterized with lobbying of the takeover bid, resorted to by the institutional investors and arbitrageur and thus, attempting to incur pressure on the Board of the Directors of the target corporation in view of approval thereby. Often, institutional investors, in view of obtainment of the proxy, aspire to replace the members of the Board of Directors through the specialized companies by means of accumulation of the votes.⁶⁴ Occupation of the positions of the members of the Board of Directors and the Audit committee facilitates the candidates protecting the interests of the foreign institutional investors to implement due oversight of the corporation and hence, exercise the role of the facilitator. The foreign institutional investor often independently resorts to due diligence procedure in view of better implementation of the function of facilitator and studies the target corporation selected for merger.

The role of the institutional investors increases when the preliminary consent of the initiator of merger regarding application of one or another tactics is obtained. The acquired corporation, through communication, provides the institutional investors with the information concerning the expected offers and proposes to apply the warehousing tactics. Upon warehousing the stock shares, the institutional investor acquires the stocks of the target society with the purpose to further resell them to the initiator of acquisition at the price of the future market.⁶⁵ Lobbying acquisition and application of the warehousing method simplify acquisition of the package of shares for the offer or.⁶⁶

The institutional investors and other alternative investment funds facilitate to fund-raising for implementation of international merger and acquisition deals. Investment in stocks is one of the sources of financing. Hedge funds and private equity funds often play the role of the financiers in the deals,⁶⁷ gaining ordinary or preferred shares of the acquirer corporation.⁶⁸

The institutional investors play the key role in reduction of informative asymmetry mostly characterizing the international deals of merger and acquisition. The foreign institutional investors, as being the investors in the developed countries, hold more expert experience and skills, which in its turn, facilitates to better implementation of the function of facilitator. Importance of the insti-

⁶² *Krishnamurti Ch.*, *Mergers, Acquisitions and Corporate Restructuring*, Response, London, 2008, 187.

⁶³ *Bragg S.*, *Mergers & Acquisitions A Condensed Practitioner's Guide*, Wiley, Hoboken, 2009, 53.

⁶⁴ *Depamphilis D.*, *Mergers and Acquisitions Basics*, Elsevier, New York, 2011, 181.

⁶⁵ The hereof practice enables circumvention of the requirements of the *William Act* but the Commission on Securities and Exchanges does not always hail application of such tactics. *Brown R.*, *Mergers, Acquisitions and Divestitures*, Palgrave Macmillan, New York, 2007, 71-72.

⁶⁶ *Bragg S.*, *Mergers & Acquisitions A Condensed Practitioner's Guide*, Wiley, Hoboken, 2009, 53.

⁶⁷ Alternative Institutional Investors mostly Implement Financing by two Means – Investment and Issue of Loans. *Depamphilis D.*, *Mergers, Acquisitions and Other Restructuring Activities*, 6th ed., Elsevier, New York, 2012, 29.

⁶⁸ Along with the hedge-funds and the private capital investment funds, additional fund-raising can be implemented from the strategic and angel investors. See *Sherman A., Hart M.*, *Mergers & Acquisitions from A to Z*, 2nd ed., Amacom, N. Y. 2006, 143-146.

tutional investors further increases when the target corporation is located in the countries not characterized with high level of corporate governance and minority shareholder protection. It as well is noteworthy that due to absence of friendly relations of the institutional investors with the local companies, they are capable of better supervision over the corporations.⁶⁹

3.2. Merger Arbitrage

Institutional investors and especially alternative investment funds often pursue strategies of event-driven activism and merger arbitrage which are event-driven investing strategies in the process of accomplishment of international mergers and acquisitions.⁷⁰ The structure of deal acquires particular importance in the process of application of the strategy of merger arbitrage on which depends the duration for accomplishment of deal, which in its turn, has an effect on number of deals and acceptable profit.⁷¹

Merger Arbitrage is concomitant phenomenon for fulfilment of international merger in particular at a stage of deal announcement. Arbitrage transactions are conducted in connection with shares of the target corporation from the moment when merger has been announced which gains are calculated from difference between buying and selling and creates merger arbitrageurs profit.⁷² The shares of target corporation are being sold relatively at low price as a rule at the moment of announcement of mergers and acquisitions transactions than has been offered by initial party. Merger arbitrageurs take a long position on stocks in the target corporation to attempt grasping the difference between going market price and asked price what makes their gains and will be only obtained in a case of successful completion of merger. Security trading lasts until the merger is completed or that moment when merger is declared to end in failure. Acquiring party encourages hedge funds to acquire more and more shares in the process of hostile takeover with the reason for buy-out from them later and, thereby, increases the chances of successful completion of declared deal.⁷³ There is a high probability of successful accomplishment of mergers and acquisitions announcement, and not in rare cases, deal announcement is declared to meet with failure. Merger arbitrage is known as risk arbitrage because of the risk that is associated with completion of deal.

Number of arbitrage transactions being conducted in connection with shares of target corporation participating in international mergers and acquisitions deal has appreciably increased during the time that was explained by multiplication of hedge funds and their enhanced impact. The application of merger arbitrage as the strategy of risk arbitrage begins from the moment of merger announcement and causes unexpected, contingent and illogical fluctuation in share prices of the target corporation. Such dynamics concerning shares of the target corporation participating in merger might be completed by important increasing in share value at short run from the moment of announcement.

⁶⁹ *Gaughan P.*, *Mergers, Acquisitions and Corporate Restructurings*, 5th ed., Wiley, New York, 2011, 273.

⁷⁰ *Holber Th.*, Full of Hot Air? Evaluating the Airgas Court's Reservations about Shareholders' Short-Term and Long-Term Interests in Takeovers, *Fordham J. Corp. & Fin. L.*, Vol. 18. Iss. 1, 2012, 134.

⁷¹ *Kirchner Th.*, *Merger Arbitrage: How to Profit from Event-Driven Arbitrage*, Wiley, Hoboken, 2009, 108-112.

⁷² *Stowell D.*, *An Introduction to Investment Banks, Hedge Funds, and Private Equity: The New Paradigm*, Elsevier, London, 2010, 229.

⁷³ *Depamphilis D.*, *Mergers, Acquisitions and Other Restructuring Activities*, 6th ed., Elsevier, New York, 2012, 181.

3.3. Appraisal Activism

Activism being connected with appraisal rights is just one characteristic feature of merger transactions that has recently been arisen in the United States of America and gradually spreads to the Continent.⁷⁴ Activism being connected with appraisal rights is absolutely new type by its nature of activism which derivation and evolution were determined by several factors. The major reason for the popularity of appraisal activism was active development of shareholder activism movement itself that promotes to increase in number and what is mostly notable the efficiency of exercising the right to appraisal.

Institutional investors and especially hedge funds begin to acquire the target corporation shares in amount of about 5-10 percent from the moment of the spread of information on announcement or expectation of merger with a single reason to bring an action before the court and demand fair value for their shares. The judicial appraisal of shares as a rule is more high therefore more acceptable for plaintiff than receiving fair value of shares being defined into merger agreement. The difference between them is sometimes so great that covers judicial expenses related to appraisal right and then remains the plaintiff into profitable position.

The profitability of appraisal activism aroused interest among hedge funds for which makes a profit by conducting arbitrage transactions was familiar method. The judicial proceedings related to appraisal right and arbitrage transactions are so widespread and acceptable tactics for hedge funds and other activist shareholders that has become the part of their investing strategy. Appraisal arbitrage is often considered as a special investing strategy⁷⁵ being based on appraisal right to be used mainly by hedge funds with a single reason to acquire shares of stock from the moment of announcement to make a profit as a result of exercising the right to appraisal and indeed have no intention of remaining as shareholder into the corporation newly formed or survived from the merger. Appraisal arbitrage is unconventional form of merger arbitrage which might be appeared as means of internal control that provides protection for interests of minority shareholders in merger transactions.⁷⁶ The arbitrageurs prepare the prolific ground for effective exercise of appraisal right by way of resolving collective action problems that are so characteristic for shareholder activism. In addition, it has to be noted that appraisal arbitrage promotes increasing the value of minority shares at the expense of reducing the risk of infliction of possible harm on minority shareholders.⁷⁷ The divergent view indicates that appraisal arbitrage may create the risk for abuse of the process of exercising appraisal right.⁷⁸

The origin of appraisal arbitrage was conditioned with such growing influence that hedge funds are enjoyed based on financial situation and aggressive character of their activism as well as important part was contributed by common development of law. The multiplication of such

⁷⁴ See in detail *Papadima R.*, Appraisal Activism in M&A Deals: Recent Developments in the United States and the EU, *European Company Law*, Vol. 12, Iss. 4, 2015, 188-198.

⁷⁵ *Korsmo Ch., Myers M.*, Appraisal Arbitrage and the Future of Public Company M&A, *Brooklyn Law School, Legal Studies Research Paper* № 388, 2014, 1. Available at <http://ssrn.com/abstract=2424935> [16.06.2015].

⁷⁶ *Ibid.*, 3.

⁷⁷ *Ibid.*

⁷⁸ In re Appraisal of Dole Food Company, Inc., № 9079-VCL.

decisions concerning appraisal right in judicial practice that have created great opportunities for development of such strategy promotes growth of appraisal arbitrage.

The main reason for the origin of appraisal arbitrage is considered one particularity of appraisal right that isn't characteristic for other types of proceedings. The circle of investors is unlimited in the process of bringing a suit for exercise of appraisal right which means that having by persons the right to bring a suit not only who are holders of shares of stock at the moment of deal announcement but also who acquires the shares after announcement. The Delaware court of chancery noted in one decision that record day is immediately day of voting and not more earlier date for example the day of registration for such shares be entitled by appraisal right which participate in voting.⁷⁹ It gives an opportunity to investor to examine carefully the conditions of merger and acquire shares several hours earlier prior to voting or in last hour in order to bring a suit before court for exercise of appraisal right. There was a case in which was achieved the most high results within the framework of appraisal activism that was connected with *Carl Icahn* campaign against *Dell Corporation* where the threat to bring a suit with claim of exercise of appraisal right was among several factors that has conditioned substantial increase of offer price for buy-out.⁸⁰ The interest of development of appraisal activism is just in that the appraisal of value of shares should be made as maximum as possible.⁸¹

3.4. Shareholder Rights Plan

The role of institutional investors is immeasurably great on triggering of international hostile takeover, during its running and in the process of deciding the issue of application of defense measures. Institutional investor activism can not only promote triggering of tender offer but also have an influence on it. The indirect influence of institutional investors may be expressed in having an impact on board of directors and management of the target corporation before the start of takeover. Hedge fund who is the most active among institutional investors, who is hedge fund of target corporation of takeover can push target corporation by using own strategy that this later has promoted to come to logic completion of takeover.⁸² The direct or even indirect participation of institutional investors in planing of deal can determine price of takeover transaction and entirely success of deal.

The first noisy cases of active participation of institutional investors in the process of takeover and solution of issue on application of defense measures took place yet in the 1980s. The most big takeover among international acquisitions transactions when vodafone made hostile takeover bid to Mannesmann, majority of shareholders of this later was foreign institutional investors therefore offeror as well as management of target corporation mainly were focused on group of investors in time of carrying on fight for gaining support of shareholders. The parties to mergers and acquisitions

⁷⁹ In re Appraisal of Transkaryotic Therapies, Inc., C.A. No. 1554-CC (Del. Ch. May 2, 2007). This decision is debatable. The defendant noted that the goals of appraisal right becomes unachievable by such approach and therefore transforms the right aiming to create stability for dissident shareholders into investment tool for arbitrageurs.

⁸⁰ *Katelouzou D.*, Worldwide Hedge Fund Activism: Dimensions and Legal Determinants, *J. Bus. L.*, Vol 17, Iss. 3, 2015, 828.

⁸¹ *Papadima R.*, Appraisal Activism in M&A Deals: Recent Developments in the United States and the EU, *European Company Law*, Vol. 12, Iss. 4, 2015, 188.

⁸² *Armour J., Skeel D.*, Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of U.S. and U.K. Takeover Regulation, *Geo.L.J.* Vol. 95, 2007, 1727.

transactions often communicates with institutional investors in order to have an impact on results of voting at general meeting and on shareholders' decisions at the time of tender offer.

Institutional shareholder activism as the shape of shareholder power was formed in parallels with hostile takeover transactions particularly when corporation management (board of directors) was applying any efforts for the purpose of adoption and implementation of defense measures. The shareholder rights plan so called poison pill is being separated out among these defense measures in which institutional investors are the most interested in resolving of issue to adopt or not to adopt and takes the most active part of discussion and resolving of this issue.⁸³ Institutional investors often promote and being in the role of initiators, or vice-versa put up categorial resistance against adoption of defense measures.⁸⁴

3.5. Convergence of Corporate Governance

The convergence of corporate governance has become usual event in the era of international business on which demand is more and more being increased. The competition passing in global level pushes the countries for convergence of corporate governance.⁸⁵ The aim of corporate governance convergence is the spread of the principles and standards of good corporate governance throughout the world. The convergence of corporate governance strives to improve corporate governance there where this necessity exists. The developing countries attempts on the one hand to create proper preconditions for development of local business and on the other hand to arouse desire foreign investors to enter into the country by way of convergence of corporate governance.

international mergers and acquisitions transactions and active participation of institutional investors therein promotes convergence of corporate governance. Institutional shareholder activism has beneficial influence on corporate governance, conditions its improvement and by this creates proper conditions for convergence of corporate governance. Foreign institutional investors are main agents of globalization, and international mergers and acquisitions transactions are primary contractual instruments which promote process of approximation of corporate systems by introduction of foreign element into corporate relationships.⁸⁶ The convergence of corporate governance takes place in the process of accomplishment of international mergers and acquisitions transactions as at the level of countries as well corporations participating into deal.

The foreign institutional investors are engaged in export of good corporate governance practice from developed countries to less developed ones. Foreign institutional investor who enters the country and is being appeared in the role of major or minority shareholder of domestic corporation importing such rules and principles of corporate governance which are characteristic for its country

⁸³ *Briggs Th.*, Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis, *J. Corp. L.*, Vol. 32, Iss. 4, 2007, 693.

⁸⁴ *Magnuson W.*, Takeover Regulation in the United States and Europe: An Institutional Approach, *Pace Int'l L. Rev.*, Vol. 21, 2009, 231.

⁸⁵ *Coffee J.*, Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications, *Nw. U. L. Rev.*, Vol. 93, Iss. 3, 1998-1999, 643.

⁸⁶ See in detail *Gevurtz F.*, The Globalization of Corporate Law: The End of History or a Never-Ending Story, *Wash. L. Rev.*, Vol. 86, Iss. 3, 2011, 475-521.

of origin wherewith carries out introduction of good corporate governance practice what in its turn promotes process of convergence of corporate governance systems of different countries.

The convergence of corporate governance does not imply loss of uniqueness and identity for national system of corporate governance what may promote becoming its as a copy of any recognized system. It is to be taken into account that the interest of maintenance of national systems of corporate governance for what the process of approximation should be directed in this way to maintain real essence of convergence. The convergence of corporate governance should be conducted in this way that convergence wouldn't lose essence and not have acquired divergent direction. Today convergence of corporate governance means right perception of idea, aspiration and purpose of modern corporate governance.

4. Conclusion

Institutional shareholder activism is the efficient mechanism for improvement of corporate governance which has considerable impact on the level of minority shareholders protection. Shareholder activism promotes broadening the rights of minority shareholders and protect them more effectively. It is important for evolution of shareholder activism in Georgian companies to perfect institutional, legislative and regulative basis promoting institutional investors activities that one of the most important direction ought to be comprised encouraging practice of voting by proxy and means of electronic communication as well as supporting usage of voting that includes element of crossing the border. It is expedient for integrating shareholder activism of institutional investors into the Georgian system of corporate governance also promoting practice of appraisal rights and providing private enforcement mechanism of legislation on securities market. It is also significant for activist shareholders to be given the opportunity to put important question for them as separate item into day order of general meeting independent from convening extraordinary meeting that allows shareholders or group of shareholders holding 5 percent of any class of shares to enjoy such right.

To summarize briefly, it can be noted that institutional investors take active participation in international merger deals and by that support to achieve the goals of corporate governance convergence. Foreign institutional investors are the agents which transfer modern standards of corporate governance from one country to another and thereafter promote their introduction. The convergence of corporate governance are reached by performance of the function of active facilitator by foreign institutional investors in international mergers and acquisitions transactions.