

Alternative investment funds and their role in portfolio companies - state of art in Croatian law and practice

Braut Filipović, Mihaela; Derenčinović Ruk, Morana; Grković, Nikolina

Source / Izvornik: **Economic and Social Development (Book of Proceedings), 2016, 234 - 244**

Conference paper / Rad u zborniku

Publication status / Verzija rada: **Published version / Objavljena verzija rada (izdavačev PDF)**

Permanent link / Trajna poveznica: <https://urn.nsk.hr/urn:nbn:hr:118:839755>

Rights / Prava: [In copyright](#) / [Zaštićeno autorskim pravom.](#)

Download date / Datum preuzimanja: **2024-08-27**

PRAVRI

Pravni fakultet Faculty of Law



Sveučilište u Rijeci
University of Rijeka

Repository / Repozitorij:

[Repository of the University of Rijeka, Faculty of Law](#)
[- Repository University of Rijeka, Faculty of Law](#)

uniri DIGITALNA
KNJIŽNICA

DIGITALNI AKADEMSKI ARHIVI I REPOZITORIJI



Varazdin Development and Entrepreneurship Agency
in cooperation with
University North
and **Faculty of Management University of Warsaw**



Economic and Social Development

18th International Scientific Conference on Economic and Social Development –
“Building Resilient Society”



Editors:
Damir Mihanovic, Anica Hunjet, Zeljka Primorac

Book of Proceedings

ISSN 1849-7535



9 771849 753006 >

Zagreb, 9-10 December 2016

Varazdin Development and Entrepreneurship Agency
in cooperation with
University North
and **Faculty of Management University of Warsaw**

Editors:
Damir Mihanovic, Anica Hunjet, Zeljka Primorac

Economic and Social Development

18th International Scientific Conference on Economic and Social Development –
“Building Resilient Society”

Book of Proceedings

Zagreb, 9-10 December 2016

Title ■ Economic and Social Development (Book of Proceedings), 18th International Scientific Conference on Economic and Social Development – “Building Resilient Society”

Editors ■ Damir Mihanovic, Anica Hunjet, Zeljka Primorac

Scientific Committee ■ Marijan Cingula, University of Zagreb, Croatia (President); Ayuba A. Aminu, University of Maiduguri, Maiduguri, Nigeria; Gouri Sankar Bandyopadhyay, The University of Burdwan, Rajbati Bardhaman, India; Haimanti Banerji, Indian Institute of Technology, Kharagpur, India; Leonid K. Bobrov, State University of Economics and Management, Novosibirsk, Russia; Rado Bohinc, University of Ljubljana, Slovenia; Adnan Celik, Selcuk University - Konya, Turkey; Angelo Maia Cister, Federal University of Rio de Janeiro, Brasil; Mirela Cristea, University of Craiova, Romania; Sreten Cuzovic, University of Nis, Serbia; Oguz Demir, Istanbul Commerce University, Turkey; T.S. Devaraja, University of Mysore, India; Alba Dumi, Vlora University, Vlore, Albania; Ksenija Dumcic, University of Zagreb, Croatia; Davor Filipovic, University of Zagreb, Croatia; Galina Pavlovna Gagarinskaya, Samara State University, Russia; Fran Galetic, Zagreb University, Croatia; Mirjana Gligoric, Faculty of Economics, Belgrade University, Serbia; Anica Hunjet, University North, Koprivnica, Croatia; Oxana Ivanova, Ulyanovsk State University, Ulyanovsk, Russia; Irena Jankovic, Faculty of Economics, Belgrade University, Serbia; Myrl Jones, Radford University, USA; Ana Jovancai, Univerzitet Džon Nežbit, Belgrade, Serbia; Gorazd Justinek, Graduate School of Government and European Studies, Slovenia; Hacer Simay Karaalp, Pamukkale University, Turkey; Dafna Kariv, The College of Management Academic Studies, Rishon Le Zion, Israel; Salih Katircioglu, Eastern Mediterranean University, Northern Cyprus, Turkey; Hilal Yildirim Keser, Uludag University, Bursa, Turkey; Sophia Khalimova, Institute of Economics and Industrial Engineering of Siberian Branch of Russian Academy of Science, Novosibirsk, Russia; Marina Klacmer Calopa, University of Zagreb, Croatia; Vladimir Kovsca, University of Zagreb, Croatia; Goran Kozina, University North, Koprivnica, Croatia; Dzenan Kulovic, University of Zenica, Bosnia and Herzegovina; Robert Lewis, Les Roches Gruyère University of Applied Sciences, Bulle, Switzerland; Ladislav Lukas, Univ. of West Bohemia, Faculty of Economics, Czech Republic; Pascal Marty, University of La Rochelle, France; Vaidotas Matutis, Vilnius University, Lithuania; Marjana Merkač Skok, GEA College of Entrepreneurship, Ljubljana, Slovenia; Daniel Francois Meyer, North West University, South Africa; Marin Milkovic, Rector, University North, Koprivnica, Croatia; Zsuzsanna Novak, Corvinus University of Budapest, Hungary; Mislav Ante Omazic, University of Zagreb, Croatia; Vera Palea, Università degli Studi di Torino, Italy; Dusko Pavlovic, President DIU Libertas International University, Zagreb, Croatia; Dinko Primorac, University North, Koprivnica, Croatia; Mirosław Przygoda, University of Warsaw, Poland; Nicholas Recker, Metropolitan State University of Denver, USA; Kerry Redican, Virginia Tech, Blacksburg, USA; Robert Rybnicek, University of Graz, Austria; Katarzyna Szymanska, The State Higher School of Vocational Education in Ciechanow, Poland; Ilaria Tutore, University of Naples Parthenope, Italy; Mladen Vedris, University of Zagreb, Croatia; Rebeka Danijela Vlahov, University of Zagreb, Croatia; Ilko Vrankic, University of Zagreb, Croatia; Thomas Will, Agnes Scott College, USA; Li Yongqiang, Victoria University, Australia; Peter Zabielskis, University of Macau, China; Tao Zeng, Wilfrid Laurier University, Waterloo, Canada; Snezana Zivkovic, University of Nis, Serbia.

Review Committee ■ Marina Klacmer Calopa (President); Ana Aleksic; Ayuba Aminu; Mihovil Andjelinovic; Josip Arneric; Lidija Bagaric; Tomislav Bakovic; Sanja Blazevic; Leonid Bobrov; Ruzica Brečić; Ratko Brnabic; Anita Ceh Casni; Mirela Cristea; Oguz Demir; Stjepan Dvorski; Robert Fabac; Ivica Filipovic; Fran Galetic; Mirjana Gligoric; Tomislav Globan; Anita Goltnik Urnaut; Tomislav Herceg; Irena Jankovic; Dafna Kariv; Oliver Kesar; Hilal Yildirim Keser; Mirko Klaric; Tatjana Kovac; Vladimir Kovsca; Petar Kurecic; Angelo Maia Cister; Vaidotas Matutis; Marjana Merkač Skok; Daniel Francois Meyer; Natanya Meyer; Josip Mikulic; Ljubica Milanovic Glavan; Guenter Mueller; Ivana Nacinovic Braje; Gratiela Georgiana Noja; Zsuzsanna Novak; Alka Obadic; Claudia Ogrea; Matko Pajcic; Igor Pihir; Najla Podrug; Vojko Potocan; Zeljka Primorac; Zeljko Radic; Sanda Renko; Souhaila Said; Armando Javier Sanchez Diaz; Tomislav Sekur; Lorena Skuflic; Mirko Smoljic; Petar Soric; Mario Spremic; Ana Jovancai Stakic; Matjaz Stor; Lejla Tijanic; Daniel Tomić; Boris Tusek; Mladen Vedris; Rebeka Daniela Vlahov; Ilko Vrankic; Thomas Will; Zoran Wittine; Tao Zeng; Snezana Zivkovic; Berislav Zmuk.

Organizing Committee ■ Domagoj Cingula (President); Marija Boban; Marina Klacmer Calopa; Erlino Koscak; Mirosław Przygoda; Rebeka Danijela Vlahov.

Publishing Editor ■ Domagoj Cingula

Publisher ■ **Design** ■ **Print** ■ Varazdin Development and Entrepreneurship Agency, Varazdin, Croatia
University North, Koprivnica, Croatia
Faculty of Management University of Warsaw, Warsaw, Poland

Printing ■ Online Edition

ISSN 1849-7535

The Book is open access and double-blind peer reviewed.

Our Books are indexed and abstracted by ProQuest, EconBIZ, CPCI (WoS) and EconLit databases and available for download in a PDF format from the Economic and Social Development Conference website: <http://www.esd-conference.com>

© 2016 Varazdin Development and Entrepreneurship Agency, Varazdin, Croatia; Faculty of Management University of Warsaw, Warsaw, Poland; University North, Koprivnica, Croatia.

All rights reserved. Authors are responsible for the linguistic and technical accuracy of their contributions. Authors keep their copyrights for further publishing.

ALTERNATIVE INVESTMENT FUNDS AND THEIR ROLE IN PORTFOLIO COMPANIES – STATE OF ART IN CROATIAN LAW AND PRACTICE

Mihaela Braut Filipovic

*Faculty of Law University of Rijeka, Croatia
mbraut@pravri.hr*

Morana Derencinovic Ruk

*Croatian Financial Services Supervisory Agency, Croatia
morana.derencinovic@hanfa.hr*

Nikolina Grkovic

*Faculty of Law University of Rijeka, Croatia
ngrkovic@pravri.hr*

ABSTRACT

Alternative investment funds (AIFs) differ from “traditional” investors in their role as shareholders of companies in which they invest. Although traditional institutional investors prevail over alternative ones in the global share of investments, their role in portfolio companies is usually passive due to regulatory and investment restrictions applicable to them (as for example UCITS funds). Specific types of AIFs (private equity/venture capital funds/hedge funds) invest a significant part of their asset in various companies and available comparative data suggests that they are significantly more active in portfolio companies than other shareholders/investors. Through different types of activism, AIFs tend to influence the corporate governance of companies in which they invest. The goal of this article is to determine whether Croatian AIFs play an active role as shareholders in their portfolio companies. Importantly, Croatian AIFs have just recently been regulated in line with known global trends, which further enhance their position on the market. Authors shall analyze available legal mechanisms for shareholders to actively participate and influence the corporate governance of the companies under Croatian law. In order to determine whether AIFs as shareholders employ those mechanisms in practice, authors conducted research among the managers of Croatian AIFs. Research was focused on determining whether Croatian AIFs participate actively in governance of portfolio companies through voting rights, making shareholder proposals, informal influence on the board members or other type of shareholders’ activism. Finally, authors shall elaborate if the current state of AIFs activism in portfolio companies represents a good example of corporate governance from the point of a long-term criticized passive shareholders issue.

Keywords: *active shareholders, alternative investment funds, corporate governance, managers of alternative investment funds, private equity*

1. INTRODUCTION

The Croatian capital market is relatively young. The development of Croatian investment funds began approximately twenty years ago, when a first mutual fund was founded in 1997 [Čulinović-Herc, Grković, 2013, pp. 53-60]. The regulation of mutual funds, especially of UCITS funds, was under the heavy influence of the European Union (further in text: EU), even before Croatia became a full Member State. On the other hand, alternative investment funds (further in text: AIFs) have

just recently been regulated in line with known global trends and new types of AIFs are introduced in the Croatian capital market. As on the EU level, we can divide Croatian investment funds into UCITS funds and AIFs. Due to considerable differences in investment strategies and objectives, pension funds fall out of the scope of this article. Opposite to UCITS funds, AIFs represent a heteronomous group of funds which are mostly unburdened by the legislative restrictions in their investments. This research is limited to Croatian AIFs that invest in equity instruments of Croatian listed public companies and/or private companies. One part of the research therefore explores the shareholders' mechanisms which AIFs may employ, i.e. it contains an analysis of available legal mechanisms that allow AIFs to be active shareholders in Croatian companies. Portfolio companies are in most cases established as a public limited liability company (*dioničko društvo*) (further in text: PLLC) and a limited liability company (*društvo s ograničenom odgovornošću*) (further in text: LLC). Therefore, the basis of AIFs' available mechanisms is explored in this context. Authors acknowledge that AIFs are typically divided into specific types (such as private equity, venture capital, hedge funds, etc.) according to the investment strategies which they usually employ. Nevertheless, in some cases this distinction becomes blurred. Although the type of AIF may indicate the level of activist approach, it is not necessarily the case. Croatian AIFs that invest in equity as well as their foreign twins, AIFs on the global capital market, may employ investment strategies not necessarily connected with their type. Therefore, authors focused on the shareholders' active mechanisms regardless of whether such mechanisms are a result of the investment strategy usually connected with a specific type of AIF. In that regard, authors conducted research among Croatian managers of AIFs (further in text: AIFM) in order to determine if their AIFs are active shareholders in portfolio companies and if they are, which legal mechanisms they are using. The overall goal of this article is to provide an answer whether the Croatian AIFs as institutional investors play a role of an active shareholder comparable to trends in comparative capital markets.

2. AIFs AS ACTIVE SHAREHOLDERS – COMPARATIVE MARKET PERSPECTIVE

The prevailing literature regarding AIFs as active shareholders is focused specifically on hedge funds, as they are known to have the most proactive strategy. Comparative data suggest that AIFs invest significantly less in equity than traditional institutional investors [Çelik, Isaksson, 2013, pp. 100-102]. However, when they do, the question arises whether AIFs actively participate in corporate governance of the portfolio company and show higher degree of shareholders' activism than traditional investors. It is a topic that recently gained more attention, although shareholder activism is not a new element in capital markets (it dates at least from the 1980s for the USA) [Gillian, Starks, 2007, pp. 57-59].

Authors note that AIFs can influence the company through derivative positions (such as options, convertible preference shares and other), share loan agreements, empty voting and other techniques [Stowell, 2013, p. 269] as well. The activism of AIFs and their influence on the companies in capital market is higher when taking that into account [AIMA, Simmons&Simmons, 2015, p. 29]. Likewise, besides the visible techniques that AIFs can employ in portfolio companies, authors acknowledge the existence of unofficial or “behind-the-scenes” pressures that AIFs can exercise on management boards. It seems that such behavior is reportedly very often in the practice [Becht, Franks, Mayer, Rossi, 2015, p. 225; AIMA, Simmons&Simmons, 2015, p. 5].

Shareholder's position in the company depends primarily on the size of the stake it holds. Comparatively, in European countries the average stake size that AIFs hold in their portfolio companies amounts from 6.1% to 9.7% [Becht, Franks, Grant, 2010, p. 20]. Such a result indicates

that AIFs prefer the position of a minority shareholder (with the exception for private equity and venture capital funds). They influence the company governance through various mechanisms, but they are avoiding costly public takeovers.

Generally, traditional institutional investors such as mutual funds, pension funds and other are not active shareholders, mostly due to organizational and investment restrictions applicable to them. If they are active, they use the "passive" form of activism [Kahan, Rock, 2007, p. 1043]. This mainly consists of making formal shareholder proposals, voting in favor or against shareholder proposals, informal discussions with management board etc. Although it represents a certain type of influence, it inclines towards only moderate changes in corporate governance at the smaller price for active shareholders [Kahan, Rock, 2007, p. 1044].

On the other hand, when AIFs and especially hedge funds act as active shareholders, they are often active in portfolio companies as a part of their strategy, i.e. they invest in certain companies because their analysis suggests that they will profit from active engagement [Kahan, Rock, 2007, p. 1069; Stowell, 2013, p. 269]. AIFs are generally not burdened with requirements for diversification and other organizational issues, which enhance the likelihood of their involvement as active shareholders [Clifford, 2008, p. 326; Klein, Zur, 2006, p. 7]. They strive towards changing the corporate control in the portfolio companies in order to issue a decision which is favorable for them, as are blocking the takeover of the company, acquiring the company for themselves and other [Kahan, Rock, 2007, pp. 1029-1043]. Such activism is certainly more expensive, but also more efficient with prompt results.

However, although helpful, such distinctions are relative. In fact, many AIFs employ techniques usually connected with traditional investors. In a study from 2015, it was found that even 52% of activism by AIFs relates to improving corporate governance of the portfolio companies, i.e. to the passive form of activism [AIMA, Simmons&Simmons, 2015, p. 31].

A hostile takeover is a notorious notion often connected with the investment techniques of AIFs, especially of hedge funds. However, available data shows that AIFs predominantly use non-hostile types of actions in order to gain corporate control in portfolio companies [AIMA, Simmons&Simmons, 2015, pp. 37-39; Brav, Jiang, Partnoy, Thomas, 2015, p. 273]. It confirms the findings that AIFs use similar activist methods as traditional institutional investors. Thus, they rather seek to influence the corporate governance through constructive methods (such as making formal shareholder proposals, informal influence on management board, being represented in the management and supervisory board and other), than employing aggressive methods (such as takeover of the company, litigation against the company or its directors and others).

It is often discussed whether shareholder activism by AIFs represents a positive or negative impact on portfolio companies and other shareholders. There are many studies which measure impact of shareholders' activism on target companies. The most frequent criteria used for analysis are short and long-term reactions of stock market on shareholders' activism, successfulness of shareholders' proposals, and influence on the management board.

Available academic literature supports the findings that active AIFs create values for other shareholders [Brav, Jiang, Kim, 2012, p. 208; Becht, Franks, Mayer, Rossi, 2015, p. 246]. Some authors argue that active AIFs improve corporate governance of the target companies and especially that their presence influences the CEOs whose compensation usually drops and becomes more tied with the performance results [Brav, Jiang, Partnoy, Thomas, 2015, p. 298]. It is considered that management boards start improving the corporate governance of the target company as soon as upon announcement of the investment.

Available data demonstrates that activism by AIFs regularly achieves short-term abnormal price returns in the shares of target companies [Brav, Jiang, Partnoy, Thomas, 2015, p. 286; AIMA, Simmons&Simmons, 2015, p. 48]. However, reasons for such a reaction are not clear. In the ideal scenario, a positive market reaction would be due to the expectations that AIFs shall add the company value by improving the company management. It can also be a sign to other investors that AIF detected an undervalued company worth of investing. As such it can bring additional value to the shareholders of the target company, but without long-term positive activism of the AIF in the company; the positive return is short-term and it affects the shareholders but not the company.

It is much less clear whether company performance improves in long-term period after the AIFs investment. There are mixed results regarding this issue [Coffee, 2015, p. 697]. AIFs as active shareholders can contribute to the welfare of the company only if they act in the interest of the company and not in the interest of their investment solely. Some AIFs are known to enter the company with the goal to strip the company from its assets, thus maximizing their immediate profit, but seriously damaging the company in the long term [Seretakis, 2013, p. 216]. Thus, it is understandable that AIFs raise justifiable concerns, especially for the management boards who should act in the best interest of the company and not individual investor's benefit.

To conclude, although activism by AIFs obviously raises certain concerns, the overall view in the academic literature towards AIFs as active shareholders is positive. Furthermore, there is a study that shows that even among the AIFs, those who employ strategy of the active shareholder achieve larger average annual return than passive AIFs [Clifford, 2008, p. 325]. Finally, the success rate for active AIFs is very high. AIFs achieve their goal as active shareholders in around 60% of cases [Klein, Zur, 2006, p. 30-31; AIMA, Simmons&Simmons, 2015, p. 33].

3. REGULATION OF AIFs UNDER CROATIAN LAW

Croatian AIFs have recently been regulated in line with global trends. That was done by the Alternative Investment Funds Act from 2013, which was amended on 11 December 2014 (further in text: AIF Act) with the aim to further harmonize Croatian law with the Alternative Investment Fund Managers Directive (further in text: AIFMD). According to AIF Act (art. 3/2), AIF is an investment fund established for the purpose of raising capital through a public or private offering and investing this capital in different types of assets in accordance with a predefined investment strategy and objective, but to the exclusive benefit of unit-holders in the AIF concerned. An AIF may be an open-ended (separate pool of assets, without legal personality) and a closed-ended investment fund (a legal person established in the form of a PLLC or a LLC). AIF with private offering may be of any kind, in accordance with Croatian laws and regulations, including, but not limited to, basic AIF and special kinds of AIF, such as private equity, venture capital, real-estate, fund of funds, specialized AIFs, hedge funds, EuVECA and EuSEF. There are also several AIFs established during 2010 as funds for economic cooperation (*fond za gospodarsku suradnju*) in cooperation with the state, which basically function as private equity funds.

In order to fully understand the Croatian state of play regarding the AIF market, it is also important to note that Croatia provides a different regime for (i) AIFMs when the cumulative AIFs under management fall below the threshold of EUR 100 million; and (ii) AIFMs that manage only unleveraged AIFs that do not grant investors redemption rights for 5 years and when the cumulative AIFs under management fall below a threshold of EUR 500 million [art. 5/1 of AIF Act]. In comparison to many other EU Member states this actually means that only one Croatian AIFM, which manages only one AIF (with private offering and has only 2 investors), falls within

the full scope of regulation under AIMFD. All other Croatian AIFs are well below the threshold from AIFMD. However, even “small” AIFMs, which fall out of the scope of the AIFMD, are regulated and supervised in Croatia.

4. ACTIVE SHAREHOLDERS – POSSIBILITIES UNDER CROATIAN LAW

Croatian companies are regulated by the Croatian Companies Act (further in text: CA). Position of shareholders is determined by the CA, thus authors shall analyze which mechanisms AIFs can employ as shareholders in Croatian companies. As already stated, the focus in this article is put on PLLCs where authors make no distinction whether these companies are listed or not, and LLCs are often related as private companies.

4.1. Active shareholders in public limited liability companies

Generally, shareholders’ rights in PLLCs (*dioničko društvo*) are divided into management and property rights [Barbić, 2010, p. 521]. Management rights provide basic tools for active shareholders. Those of particular interest are shareholders’ rights to participate in general meeting of the company and taking part in discussions, amending the agenda of the general meeting, making formal shareholders’ proposals on the general meeting, and voting rights.

The general meeting is a central place for shareholders to exercise their rights and to influence the management of the company. The CA in art. 274/1 explicitly provides that shareholders have the right to participate in the general meeting of the company. Authors emphasize the right of the shareholders to request the management board to convene the general meeting. This right is even given to the minority shareholders who hold 5% of share capital or less (if the lower limit is set in the statute of the company) [art. 278/1 of CA]. Thus, if an activist shareholder holds at least 5% of share capital, it shall be able to convene the general meeting. It is self-understood that once the general meeting is convened, shareholders have the right to partake in discussions regarding various decisions on agenda [Čulinović-Herc, Hasić, p. 51].

Also, shareholders have the right to propose and amend the agenda of the general meeting. The CA gave this right to minority shareholders as well [art. 278/2 of CA]. When making a proposal, shareholders must accompany it with explanations and a proposal of the decision. It is possible for activist shareholders to simultaneously request the convening of the general meeting and to propose the agenda of what should be discussed [Barbić, 2010, p. 1091]. The significance of this right is clear as the CA in article 280/4 provides that general meeting cannot discuss issues which are not put on the agenda of the general meeting.

Further, active shareholders have the right to make formal shareholders’ proposals regarding the decisions discussed, either before the general meeting is convened or at the general meeting [art. 282/1 of CA]. It actually means that the shareholder who makes the proposal calls for a different decision than the one suggested (usually) by the management board. Shareholders’ proposals are an important tool given to shareholders in order to influence the management of the company. Of course, whether a proposal shall be accepted depends on the voting of the shareholders at the general meeting. Such proposals should be viewed as constructive for the company, but there is a very interesting finding that stock market reacts negatively when a shareholder’s proposal occurs [Cziraki, Renneboog, Szilagyi, 2015, p. 139]. The reasons are that it raises concerns for the company’s performance and existence of corporate governance issues.

The right to vote is the fundamental right of each shareholder. Every share gives to its shareholder the right to vote at the general meeting [art 169/1 of CA], except preferred shares without the voting right [art 169/2 of CA]. Voting rights are tied with the amount of share capital which a

shareholder has invested into the company [Barbić, 2010, p. 545]. Although voting for or against the proposed decision at the general meeting is a “passive” form of activism, it can be a strong tool to influence the corporate governance of the company, especially if the shareholder holds a majority block of shares. Authors acknowledge various mechanisms which active shareholders can employ in order to gather necessary votes such as shareholder agreements, empty voting and other.

Shareholders have the right to choose the supervisory board in a two-tier [art. 256/1 of CA], and non-executive managers in a one-tier system [art. 272.c/1 of CA]. The election is usually done at the general meeting. However, certain shareholders can have the right to directly choose up to a third of members of the supervisory board [art. 256/3 and art. 272.c/1 of CA]. Further, as the supervisory board chooses the members of the management board/executive officers [art. 244/1 and art. 272.l/1 of CA], shareholders can influence the choice of managers as well. By having this right, active shareholders can more effectively monitor the business performance of the company and indirectly influence its management.

To conclude, AIFs as active shareholders in Croatian PLLCs can use various mechanisms in order to influence the corporate governance of the company. These mechanisms are in line with comparative solutions, especially with company laws of other EU Member States.

4.2. Active shareholders in limited liability companies

Croatian LLCs (*društvo s ograničenom odgovornošću*) equity instruments cannot be listed on the stock-exchange market. Their investors do not have a “share,” but a “unit” which gives them similar rights as shares do to shareholders. Authors shall refer to them as unitholders.

Unitholders’ rights resemble the ones described for shareholders. However, there are some fundamental differences. They primarily stem from the basic features of the LLCs, which are construed as companies with simpler and more elastic organizational structure, and some basic unitholders’ rights are left to autonomous regulation within the company. A crucial difference is that organs of the company are in a hierarchy, where the general meeting and thus the unitholders are at the top [Barbić, 2013, p. 7]. Bearing this in mind, authors shall further discuss the most relevant management rights for AIFs, which are active shareholders.

Unitholders as shareholders have the right to participate at the general meeting and to partake in discussions. Decisions can be made in writing, even without convening the general meeting if all unitholders give their consent to such a modus of deciding [art 440/1 of CA]. This speaks of less formal requirements in functioning of general meetings. The biggest difference is that the general meeting is the first in the hierarchy of organs. This means that the unitholders’ decision brought at the general meeting is binding for the management board [art. 427/1 of CA]. In other words, AIFs as unitholders can directly influence the management board by making obligatory decisions, at least those who fall under the jurisdiction of the general meeting.

The voting rights of unitholders are arranged differently than those of shareholders. Every 200.00 Croatian kuna of ground capital gives the right to one vote [art. 445/2 of CA]. However, voting rights can be organized differently, providing that each unitholder has at least one vote and that such an arrangement is provided in the memorandum of association [art. 445/3 of CA]. In other words, AIF as a unitholder can negotiate for higher voting rights, for veto power or other privileges, even as a minority unitholder [Barbić, 2013, p. 267].

After 2012, Croatian legislature introduced the simple LLC as a subcategory of the LLC. Even though there are some differences, unitholders can employ the same techniques to actively influence the corporate governance as in the LLCs.

To conclude, AIFs as unitholders can have an easier access to the management of the company and the influence on the management board can be done with less formal requirements. Also, there is no risk of negative perception by the public if for e.g. AIF makes a formal shareholder proposal at the general meeting. The main advantage is that there is a higher degree of autonomy where AIFs can bargain for a better position within the company.

5. CROATIAN AIFs AS SHAREHOLDERS

According to the publicly available data on the website of the Croatian Financial Supervisory Agency (September 2016), the Croatian AIF market consists of 14 AIFMs who manage 30 AIFs. Authors conducted research among AIFMs by compiling a questionnaire. Questions were divided into 5 groups: choice of portfolio company, modus of entering, activism in the company, time period of investments, and exit strategies. Research was limited to equity investments, excluding the influence which AIF can exercise through derivative positions, share loan agreements, empty voting, and other techniques.

Out of 12 received answers, 2 were not taken into account as the AIFs invested in bonds only, and additional 2 because the answers did not concern the AIFs under management but rather a general standpoint of the managers in question. Thus, the final sample consisted of 8 answered questionnaires, which covered around 50% of AIFs in Croatia who invest in equity.

In choosing the target company, AIFMs were asked about the most important risks of investment they were taking into account before investing. Among various risks offered, in the first place is the risk that the management board of the target company is not a good team. All AIFMs chose this risk, which loudly speaks of its importance. The risk of inadequate exit strategy came in the second place. The first two are followed closely by the risk of loss of the entire investment, risk of competition, risk that the company will fail to adapt its idea to the market, risk of transparency and accuracy of information and financial reports of the target company, risk of change of the legal and tax system, risk of change of circumstances on global, regional and local market and other.

As for the modus of entering, AIFMs were asked about the threshold of equity investment. 5 of them answered that their AIFs remain minority shareholders in the portfolio company. These funds are careful not to cross the threshold for takeover of the company (25% plus one voting shares). The remaining two declared that they prefer the position of majority shareholders (venture capital funds), while one answered that it depends on the particular company. This result is in line with the comparative findings elaborated earlier in the text.

AIFMs were questioned what legal form of portfolio companies they prefer. Only one answered that LLCs are preferable as a portfolio company, regardless of its more simple structure that allows more bargaining freedom to its unitholders. Thus, Croatian AIFMs dominantly opted for PLLCs as their portfolio companies.

Regarding the perception of investment, all AIFMs answered that both the management boards and the shareholders of target companies view the entering of AIFs in the company as being positive. One AIFM even emphasized that they do not invest in the company if it is viewed negatively by other shareholders and management boards. Thus, Croatian AIFMs do not use a hostile approach in entering a company.

As to the activism, 7 of 8 AIFMs reported at least some form of influence which they exercise in portfolio companies. All 7 reported that they consider that AIFs as shareholders should have an active role in the companies in which they invest. The main reasons for activism are the protection of investment and interest of the investors of AIFs. Some of them mentioned the improvement of corporate governance and influence on important business decisions of portfolio companies as

goals, which means that managers view activism as a tool for gaining some degree of control in the portfolio company. AIFMs were offered a selection of actions typical for active shareholders. Authors analyzed their answers in the following table.

Table 1: Activism by Croatian AIFM

Nomination/selection of members of the supervisory board	87,5 %
Personal attendance in portfolio companies	87,5 %
Telephone conversations with the management of portfolio companies	87,5 %
Forming business strategies of portfolio companies	75 %
Business monitoring of portfolio companies	75 %
Nomination of members of the management board	62,5 %
Support in managing portfolio companies	62,5 %
Recommendations in selection of the management	62,5 %
Making formal shareholders’ proposals at the general meeting	62,5 %
Help with acquiring financial means	62,5 %
Giving financial support to portfolio companies	37,5 %

Importantly, all 7 active AIFMs highlighted the importance of their representation in the supervisory board. In relation to their right to make formal shareholders’ proposals, some even pointed out that they avoid situations in which that would be necessary, as their goal is to achieve influence through the supervisory board. Needless to say, if AIFMs are represented in the supervisory board, they can directly influence the election of the management board, which represents the highest form of influence on the management of the portfolio company.

When influencing the nomination of members of the management board, 62.5% answered that it is important to select an expert from the field of business of the portfolio company. Interestingly, one answered they would opt for a financial expert, while one for a cross-sector expert who could cast a new perspective on the management of the company. As to the time period of investment, it is often emphasized that while traditional investors aim towards long-term, AIFs prefer short-term investments. However, recent studies show that the average time period of investment for AIFs in portfolio company is two years [AIMA, Simmons&Simmons, 2015, p. 40]. Croatian AIFMs declared that their period of investment ranges from 3 to 7 years. This demonstrates that Croatian AIFs have even longer time periods of investment than on the comparative level. For private equity funds comparative data show that the time period of investment is much longer, ranging from 5 to even 10 years [Kaplan, Strömberg, 2015, p. 499]. Croatian private equity funds follow this trend, as their managers report that the time period of investments is on average between 5 and 7 years.

AIFMs were questioned if they have some predefined mechanisms to protect their interest if during the investment the portfolio company fails to achieve business objectives. Only 4 AIFMs answered confirmatively. There are three main mechanisms equally represented. These are the change of management of the portfolio company, higher influence on the business strategy of the management, and earlier exit from the investment. As for the exit strategy, 87.5 % of AIFMs reported the sale of shares privately or in the open market as their exit strategy. This is in line with the comparative study that shows that the sale of shares in the open market forms almost two-thirds of AIFs exits [AIMA, Simmons&Simmons, 2015, p. 41]. Only one AIFM reported liquidation and one AIFM reported division/merger of the portfolio company as an exit strategy. To conclude, Croatian AIFMs, which participated in this research, showed a high degree of shareholders’ activism. Even 7 out of 8 declared some type of activism in the portfolio company.

However, authors highlight that these results should be interpreted in light of the fact that 5 out of 8 analyzed questionnaires belong to AIFMs who govern private equity/venture capital funds, which are known for their active involvement in portfolio companies. Interestingly, the prevailing opinion of the practice and of public perception is that Croatian AIFs are usually passive shareholders. In this regard, the results of this research are somewhat surprising. To interpret them correctly one should bear in mind that this research covered only around half of equity investments by Croatian AIFs, and that within that half most of them fall into the category of private equity/venture capital funds industry, which is by default known for a high degree of shareholders' activism.

6. CONCLUSION

In this article, authors contributed to the comparative studies of AIF's activism in portfolio companies by conducting research among the Croatian AIFMs. As to the authors' knowledge, it is the first research of this type in Croatia. Comparative studies repeatedly report that AIFs are significantly the more active shareholders in portfolio companies than traditional institutional investors. According to this research, Croatian AIFs follow this trend. The majority of AIFs are careful not to cross the threshold for takeover of the company, but nevertheless employ mechanisms of influence. Statistically speaking, investments are predominately made in PLLCs. As to the types of actions, Croatian AIFs reported a “passive” or a rather traditional form of activism. The most important tool Croatian AIFs use is the nomination/selection of the members of the supervisory board. Through that, AIFs can actively control and directly influence the management of the portfolio company, especially by election of the management board. A direct access to the management of the company renders other shareholders' mechanisms as rather superfluous, such as convening the general meeting, amending the agenda, shareholders' proposals and other. It seems that Croatian AIFs have even longer time periods of investment that on the comparative level, excluding private equity funds. As this research did not analyze long-term consequences of AIFs activism, it is difficult to say whether activist mechanisms employed by Croatian AIFs represent a good example of corporate governance. It is clear that AIFMs view active involvement in portfolio companies from the aspect of protecting the interest of their investors, however, it is indicating that some AIFMs reported that in the case that a portfolio company is not doing well, they would try to influence the business strategy and management of the company. Presumably, they would do so in order to improve the company's welfare, which would have a positive effect on both the company and shareholders. This would certainly be the case where the interests of AIF (on the one hand) and the company and shareholders (on the other) are aligned. Other scenarios may create more complex situations. Complexity arises from the fact that AIF as a shareholder has the duty to act in favor of the portfolio company, while at the same time it has a legal obligation to act in the interest of AIFs' investors.

ACKNOWLEDGEMENT:

- 1. This paper has been supported in part by the Croatian Science Foundation project no. 9366 “Legal Aspects of Corporate Acquisitions and Knowledge Driven Companies' Restructuring” and in part by the University of Rijeka project no. 13.08.1.2.01 “Protection of beneficiary on the Croatian and European financial services market”*
- 2. The views and opinions of the author expressed in this article are personal views and opinions of the author and do not reflect the views of the Croatian Financial Services Supervisory Agency.*

LITERATURE:

1. Act on Open-Ended Investment Funds with a Public Offering. 2016. *Official Gazette*, 44/16.
2. AIMA, Simmons&Simmons. (2015). *Unlocking value: the role of activist alternative investment managers*. Retrieved 5.10.2016 from http://www.shareholderforum.com/access/Library/20150223_AIMA.pdf.
3. Alternative Investment Funds Act. 2013. *Official Gazette*, 16/13, 143/14.
4. Barbić, J. (2010). *Pravo društava, Društva kapitala: Dioničko društvo* (fifth edition). Zagreb: Organizator.
5. Barbić, J. (2013). *Pravo društava, Društva kapitala: Društvo s ograničenom odgovornošću* (sixth edition). Zagreb: Organizator.
6. Becht, M., Franks, J., Grant, J. (2010). Hedge fund Activism in Europe. ECGI Working Paper Series in Finance. Retrieved 20.10.2016. from <http://www.ecgi.org/tcgd/2011/documents/Becht-Franks-Grant%20Hedge%20Fund%20Activism%20in%20Europe%202010.pdf>.
7. Becht, M., Franks, J., Mayer, C., Rossi, S. (2015). Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund. In W. W., Bratton, J. A., McCahery (ed.), *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation* (pp. 223-260). Oxford: Oxford University Press.
8. Brav, A, Jiang, W, Kim, H. (2012). Hedge fund activism. In P, Athanassiou (ed.), *Research Handbook on Hedge Funds, Private Equity and Alternative Investments* (pp.195-217). Cheltenham; Northampton: Edward Elgar.
9. Brav, A., Jiang, W., Partnoy, F., Thomas, R. S. (2015). Hedge Fund Activism, Corporate Governance, and Firm Performance. In W. W., Bratton, J. A., McCahery (ed.), *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation* (pp. 261-304). Oxford: Oxford University Press.
10. Çelik, S, Isaksson, M. (2013). Institutional investors and ownership engagement. *OECD Journal: Financial Market Trends*, 2013 (no. 2), pp. 93-113.
11. Clifford, C. (2006). Value Creation or Destruction? Hedge Funds as Shareholder Activists. *Journal of Corporate Finance*, 2008 (no. 4), pp. 323-336.
12. Coffee, J. C. Hedge Fund Activism: What do we Know nad not Know? In W. W., Bratton, J. A., McCahery (ed.), *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation* (pp. 694-706). Oxford: Oxford University Press.
13. Companies Act. 1993. *Official Gazette* 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 152/11, 111/12, 144/12, 68/13, 110/15.
14. Cziraki, P., Renneboog, L., Szilagyi, P. G. (2015). Shareholder activism through proxy proposals: the European perspective. In W. W., Bratton, J. A., McCahery (ed.), *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation* (pp. 105-145). Oxford: Oxford University Press.
15. Čulinović-Herc, E, Grković, N. (2013). Povijesni razvoj i pravni izvori. In E, Čulinović-Herc (ed.), *Pravno uređenje UCITS fondova na tržištu kapitala* (pp.23-102). Rijeka: Pravni fakultet Sveučilišta u Rijeci.
16. Čulinović-Herc, E., Hasić, T. (2011). Sudjelovanje dioničara u radu glavne skupštine dioničkog društva prema noveli zakona o trgovačkim društvima. *Zbornik pravnog fakulteta Sveučilišta u Rijeci*, 2011 (no. 32), pp. 31-71.
17. Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, OJ L 174, 1.7.2011, p. 1–73.

18. Gillian, S. L., Starks, L. T. (2007). The evolution of shareholder activism in the United States, *Journal of Applied Corporate Finance*, 2007 (no. 1), pp. 55-73.
19. Kahan, M., Rock, E. B. (2007). Hedge funds in corporate governance and corporate control. *University of Pennsylvania Law Review*, 2007 (no. 5), pp. 1021-1093.
20. Kaplan, S. N., Strömberg, P. (2015). Leveraged Buyouts and Private Equity. In W. W., Bratton, J. A., McCahery (ed.), *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation* (pp. 492-516). Oxford: Oxford University Press.
21. Klein, A., Zur, E. (2008). Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors, ECGI Working Paper Series in Finance No. 140/2006. Retrieved 20.10.2016. from <https://archive.nyu.edu/bitstream/2451/27451/2/SSRN-id913362.pdf>.
22. Seretakis, A. (2013). Taming the Locusts? Embattled Hedge Funds in the EU. *NYU Journal of Law & Business*, 2013 (no.10), pp. 115-153.
23. Stowell, D. P. (2013). *Shareholder Activism and Impact on Corporations* (second edition). Oxford: Elsevier.