

## Business Associations II, Simulation 1: Bouygues

While Business Associations I is a pre-requisite for Business Associations II, I recognize that students have taken BA I with different professors and in different semesters. Therefore, the introductory section of our course will be devoted to “leveling the playing field” and providing/reviewing information you will need as a basis for this course. For this introductory section, please read the following two articles:

(1) From THE ECONOMIST, June 16, 2007, p. 73 (those who took BA I with me will recognize this article). Focus on how the soccer team is to be managed: what are the pros and cons of the proposed decision-making process, and what alternatives can the team adopt instead.

(2) Also from THE ECONOMIST, Dec. 2, 2006, pp. 71-2 (this is just part of the article). We will only discuss the events in “Snapshot one”; I left the other two “snapshots” in case you want to read about other transactions that present interesting legal questions, but these are not required reading. In this article, focus on what the Bouygues family is trying to achieve in the “Snapshot one” transaction, how would you analyze whether the transaction violates fiduciary duties to the shareholders of Bouygues SA, and how should the company’s board of directors act to minimize its legal risks while going ahead with the transaction.

See you in class!

Shareholder democracy

### Here comes Fanchester United

Buying a football team used to be a rich man's game. Not any more


**Y**OUNG football fans dream of playing for their favourite teams; older fans dream of buying them. For most people, however, a club is beyond their means, so they must indulge their managerial ambitions in other ways, such as fantasy-football games or computer simulations. But now Will Brooks, a British football journalist, has devised a novel scheme to allow fans to own and manage an English club for real.

Through his website, launched in April at myfootballclub.co.uk, Mr Brooks hopes to sign up at least 50,000 fans prepared to pledge £35 (\$70) each. (So far he has signed up nearly 35,000.) The syndicate will then use at least £1.4m of its funds to target a team for a takeover bid. Mr Brooks stresses that this is a non-profit venture for genuine fans who want to make a real difference to a club in need.

Because the acquisition will not be financed by debt, there will be no interest payments, and since no money will be taken out as dividends, any profits can be reinvested. “The club should therefore be on a much more secure financial footing than the standard shareholder-ownership structure,” says Mr Brooks.

Leeds United is top of the fans’ shopping list, according to votes cast online. Catastrophic financial mismanagement and spiralling debts lie behind the club’s demotion from the top flight of English football to a division two tiers below in only five seasons. Last month the club said it could not even afford to pay the expenses of medical volunteers who attend its matches. But Leeds may not be the eventual takeover target. Mr Brooks has brought in Michael Fiddy, a lawyer and former managing director at Fulham, to make sure that the target club is in good financial order.

Once a club has been bought, every decision—from picking players for the squad to choosing tactics to identifying candidates for transfers—will be made by the syndicate’s members. Instead of a manager the club will have a coach who will say what he thinks is best for the team; his proposals will then be put to an online vote. It may not be easy to find a coach willing to agree to these terms, but if the club is successful, the coach “will become well known and respected for having the courage to try something new,” says Mr Brooks. And if things go wrong? For once, the fans will not be able to blame the manager.



## Creative construction

How the Bouygues brothers worked from within to gain control of one of France's best-known groups

**M**AKE no mistake: virtually anybody who has invested in Bouygues SA over the past quarter of a century is better off for having done so. Shares in the French conglomerate, which includes the world's second-largest construction group as well as mobile-telecoms, television and engineering arms, are worth 60 times what they were in 1979, compared with a twentyfold increase in an index of nearly 250 leading French companies.

Behind this undeniable success lies a story of how the founding family manoeuvred during many years to call the shots. In the mid-1980s the Bouygues family (pronounced *Bweeg*) was still a relatively small investor in the company that bears its name. However, today the Bouygues brothers rank as the dominant shareholders of a firm with a stockmarket value of around €15 billion (\$19.7 billion). This they accomplished without launching a takeover bid or paying a premium for control.

Instead their power has come about gradually, through a highly complex series of transactions. *The Economist* has studied dozens of private- and public-company filings covering nearly 20 years to build up five snap-shots of the group's ownership and structure. The story that emerges is a

convoluted one, full of dealing in which the interests and the assets of the Bouygues family were repeatedly mingled with those of Bouygues SA. It could worry investors that all this could be done without breaking the law, especially as other families with quoted firms have had comparable schemes.

What matters, though, is that the non-family shareholders have not fully benefited from deals over the years. Moreover, because of these transactions, investors have lost influence over their company to a dominant shareholder. In essence, the Bouygues' financial cunning enabled the family to acquire stakes in companies that arguably should have been entirely in the hands of Bouygues SA. But the dealing was extremely subtle; any ordinary investor living through the drawn-out creation of the Bouygues family's stake would have found it almost impossible to follow.

This raises a broader lesson. Investors battered by scandals over stock-options and golden parachutes sometimes look to family-run companies for salvation. Although professional managers, with the advantages of time and inside knowledge, can run a business to suit their own interests, family owner-managers are often

thought to be less prone to such "agency risk". Yet the story of Bouygues SA suggests that family capitalism, so common in continental Europe, can sometimes backfire as much as any share-option scheme.

Martin Bouygues is a high-ranking member of France's corporate elite. He has run Bouygues SA, one of the pillars of French industry, since taking over in 1989 as chairman and chief executive from his father, Francis, the group's founder. As one of that country's most powerful businessmen, his friends include politicians such as Nicolas Sarkozy, France's interior minister and a likely presidential candidate.

### The inheritance

By the time Mr Bouygues inherited his father's crown, the company was Europe's biggest construction group. Mr Bouygues diversified into mobile telecoms and the arm that he started, Bouygues Telecom, is now France's third-largest operator. Shareholders have also gained from the group's controlling stake in TF1, which runs France's most popular television channel. In April the group agreed to pay the French government €2 billion for its 21% holding in Alstom, an engineering group.

Mr Bouygues's position at the head of the listed company is secure. Through SCDM, a private holding company, he and his brother, Olivier, are Bouygues SA's largest shareholder, with a stake of about 18%, worth at least €2.7 billion. Because of the double-voting rights granted to shares held in the same name for more than two years, they control 27% of the votes. And employees hold another 18% of the votes (including double-voting rights).

It was a very different story in the 1980s. Near the end of that decade, Francis Bouygues's stake amounted to just under 8%, though he could count for backing on the group's then largest shareholder, Crédit Lyonnais, at the time one of France's largest banks. On his death in 1993, this stake, which had been diluted to only 5% and now amounts to only 1.6%, passed to his widow, who presumably votes with her sons. So long as the employees also side with the family, the brothers can call on a virtually impregnable 46% of the vote.

Lawyers for the Bouygues family say that at all times the family and the board of Bouygues SA have acted correctly. Where necessary, they say, transactions were endorsed by legal and other professional opinions. Bouygues SA's excellent performance, they assert, is the best proof that the company has been properly managed and that shareholders have prospered under the stewardship of the family.

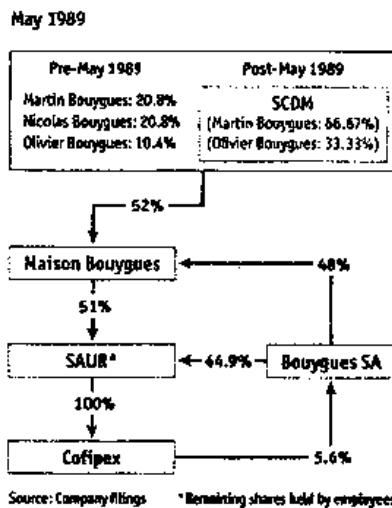
Yet Martin and Olivier Bouygues have done even better. They started with nothing except their father's name and now dominate a company worth €15 billion. How did this happen?

#### Snapshot one: The House of Bouygues

The beginnings were modest enough. After joining the family business in 1974, Martin Bouygues cut his business teeth by setting up Maison Bouygues, which sold prefabricated houses, with his two brothers (one of whom, Nicolas, later left the business). Founded in 1979, the company was France's second-largest of its kind within five years, with sales of FF1.4 billion (then \$160m). But Bouygues SA failed to benefit fully from the venture because it was not the new firm's only, or even its majority, shareholder. The Bouygues brothers subscribed for a total of 52% of Maison Bouygues's shares and Bouygues SA the other 48% (see chart 1).

On the face of it, Bouygues SA's decision to share the risk with the brothers was an odd one. The business was a natural extension of the Bouygues group's existing housebuilding activity. With just FF5m in initial share capital, the business was cheap to set up and, because Maison Bouygues's customers put down deposits, its financing costs were low. Lawyers for the brothers say that the board of Bouygues SA decided on the size of the firm's stake. The most likely explanation for the brothers' controlling stake is that their father wanted them to be in charge.

On the ground that it was Maison Bouygues's largest shareholder, Bouygues SA claimed to be the firm's controlling shareholder. This meant it treated Maison Bouygues as a subsidiary for accounting purposes. So all of Maison Bouygues's sales counted as part of the Bouygues group's overall turnover, all of its profits as part of the overall profits and so on. Per-



haps this was attractive because it put the best complexion on the sales and profits of Bouygues SA, but, intentionally or not, it obscured the fact that Bouygues SA did not own more than 50% of Maison Bouygues.

The Maison Bouygues episode is simple and on a modest scale. But it set the pattern for other deals. Not only were shareholders in Bouygues SA deprived of a commercial opportunity, but their interests were also mingled with those of the Bouygues family.

#### Snapshot two: Down the drain

That pattern was to be repeated far more ambitiously in the water industry. The two giant utilities, Générale des Eaux and Lyonnaise des Eaux, which dominated the running of water and sewerage for local authorities, were diversifying into construction. Francis Bouygues wanted to move into their industry.

In 1984 he negotiated the purchase of 96% of SAUR, France's third-largest water company, for FF424m. Bouygues SA's management reported that the company had acquired a majority stake in SAUR. But, as with the prefab-housing business, this was not strictly true: Bouygues SA bought only 45%. In fact, SAUR's majority shareholder was Maison Bouygues, which snapped up the other 51% (leaving 4% with SAUR's employees—see chart 1).

Again, the effect of this arrangement was to put Bouygues SA's investors at a disadvantage. Taking account of its shareholdings in SAUR directly and indirectly, through Maison Bouygues, Bouygues SA's overall economic interest in SAUR was 69.5% and the brothers' interest a mere 26.5%. But the splitting of Bouygues SA's interest into a direct stake and an indirect stake deprived its investors of control of SAUR. On the other hand it was hugely advantageous for the brothers: they controlled Maison Bouygues, so they could also call the shots at SAUR.

So why did Bouygues SA not have a di-

rect stake of 69.5% in SAUR? Or, indeed, why was SAUR not a wholly owned subsidiary of Bouygues SA? Lawyers for the brothers say only that Bouygues SA's board, which included representatives from Crédit Lyonnais, the largest institutional shareholder, approved the size of the firm's stake.

#### Snapshot three: The house of bricks

With these companies under their control, the brothers set about using them to amass a big stake in Bouygues SA. There was no doubting the family's dynastic ambitions. In the mid-1980s Francis had commissioned a grandiose headquarters near Paris that was modelled on the Palace of Versailles. Francis was determined to create a commercial dynasty. He appointed Martin to the board of Bouygues SA as early as 1982, followed by Olivier in 1984. Given his own relatively small shareholding, even those appointments could create the impression he was confusing the family's interests with shareholders'.

But that lack of a large holding in the group left Bouygues SA vulnerable to a hostile bid. That must have been a grave concern to the brothers, because it threatened to deprive them of their patrimony. (By contrast, Bouygues SA's other shareholders gained from the possibility of a bid, because it could boost the value of their shares.)

SAUR was the ideal vehicle for buying shares—it had a stable cashflow and almost no debt. In 1988 it channelled borrowed money into Cofipex, a subsidiary, which then bought shares in Bouygues SA. Lawyers for the brothers explain that the share-buying was designed to see off the late Robert Maxwell, a crooked British media magnate, who was raiding the stock market for shares in Bouygues SA. Maxwell could, they claim, have got his hands on the group and would have broken it up.

By mid-August 1988, Cofipex had bought at least 5% of Bouygues SA. An unusually large number of Bouygues SA's shares—equivalent to one in six—was traded in the last two weeks of September, when the press speculated about possible raiders, including Mr Maxwell. By the end of 1988, Cofipex (with a subsidiary) owned nearly 10%, making it the second-largest shareholder.

From the brothers' point of view, this purchase was highly attractive. Bouygues SA's shareholders were, in effect, footing most of the interest bill on SAUR's borrowings, because they had the greater economic interest in Maison Bouygues and SAUR. Yet the brothers controlled the shares; they, rather than the rest of Bouygues SA's shareholders, controlled Cofipex. That was a consequence of the fact that legal control did not reflect the underlying economic interests.