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The State, an
impossible shareholder?

JANUARY 2017

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*There is no desire more natural
than the desire of knowledge*

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NOTE - JANUARY 2017

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FOREWORD

After 15 years in the SNCF Group, including four years within its Executive Committee, and experience in the private sector, both in France and abroad, I became Head of the French State Holdings Agency (*Agence des Participations de l'État - APE*), a role I devoted myself to for two years, working for attentive and determined ministers and supported by an unfailingly committed team.

I had accepted this mission convinced that it could lead to a thorough modernisation of the French State, providing support for the companies in its portfolio and, furthermore, benefiting the national economy.

I was certainly conscious of the tension existing between the concepts of State and shareholder, calling this an “oxymoron” in my contribution to the newsletter of the Ministry’s legal department. Nevertheless, like my predecessors no doubt, I believed that this tension could be minimised through technical and legal means, as well as with more professional teams.

With hindsight, questioned successively by the Council of State in June 2016 during the symposium on public corporations, by the French Institute of Directors (*Institut Français des Administrateurs - IFA*), and by the Court of Auditors, I reflected on this experience and came to the conclusion that I had made a mistake, that the concepts of State and shareholder are inherently incompatible, and that we must consider the consequences.

In doing so, I do not wish to express an opinion about the business activities which the French Nation deems appropriate to control. I merely suggest that, as regards these activities, such control must be exercised in an exclusive manner and be based on specific rules of law and governance that recognise the profoundly unique nature of the State, without using the inappropriate term of shareholder.

For other companies, my conviction is that, as in many other cases, it is not possible both to give and to retain, and that the disadvantages of direct State shareholding outweigh the benefits offered to our industries and our economy. Even worse, the fact that the State is a shareholder in a few emblematic companies acts as a ploy, reinforcing the idea among our leaders and citizens that this is an industrial strategy tool, even though the real levers are elsewhere and are sometimes neglected.

It is this analysis - made purposefully simple so as to be more accessible - that the following memorandum offers up for debate.

The State, an impossible shareholder?

When considering the State as a shareholder, we must approach the issue on two levels. Before examining the performance of strategic and financial State shareholders, we should first question the relevance of public-sector involvement in the capital of commercial companies. The two questions are not, however, unrelated. Indeed, the inherent ability or inability of the State to act as a strategic or financial shareholder should be taken into account if we are to pragmatically assess whether the State should be given this role.

There are of course matters of principle which could lead us to question whether the State should ever own shares in commercial companies. For instance, is it reasonable for public entities levying taxes to also be able to make financial investments based on fiscal resources at no cost to themselves and with a virtually unlimited debt capacity? But beyond such questions, the main obstacle to public ownership in a capitalist and liberal economy lies in the contradiction - which the author of this memorandum deems irreconcilable - between the aims and rules of public action and those of the private sector. Like oil and water, these principles and rules can only be combined by dint of a constant effort, without which they quickly return to their original and incompatible state. At the very heart of this irreconcilable contradiction is the fact that, in the long term, publicly-owned companies decline in the face of global competition and, ultimately, the financial and especially industrial foundations of our country are also affected.

In view of this, the following recommendations should be heeded: to limit the direct public ownership of shares in commercial companies to a very limited number of situations and aims; to massively reduce the State's listed shares; and to create or apply measures other than shareholding to achieve strategic goals on a national and European level.

It will likely be difficult to quickly implement such recommendations in a country marked by three centuries of Colbert-inspired economic policies, and in which the administrations - and those who work within them - are undoubtedly keen to maintain the *status quo*. The inability to question a portfolio of State holdings with no clear objectives, and which is not very efficient from a financial perspective, has sociological roots close to those that prevent us from questioning many different forms of public intervention; this hinders the transformation of our State and the control of our public spending. Insularity is nourished by the close relations between public administrations, ministerial cabinets and corporations. The only convincing

explanation for maintaining such a State portfolio is above all sociological: those who look after it, or who aspire to do so, do not wish to let go for multiple reasons.

In the absence of such ambition, some useful adjustments to the State holdings management system could nevertheless be implemented. There is no doubt that the Court of Auditors, which is currently examining the topic, will be able to propose some judicious adjustments which will undoubtedly form part of the gradual, but nevertheless useful, improvements embarked upon since the creation of the State Holdings Agency (*the Agence des participations de l'État, henceforth APE*). But we should not delude ourselves: these marginal adjustments will never be sufficient for the State to become a relevant and effective direct shareholder in the long run. Therefore, unless there is a shortcoming in the private sector, or unless the cost of relying on this sector is prohibitive for public authorities, public ownership should be kept to a minimum. The corresponding funds should be devoted to measures through which the State can develop an industrial strategy without playing at being a business leader¹, a secondary role in which it does not excel.

After first attempting to show that the aims, rules and culture of the State are largely incompatible with those of a shareholder (1), this memorandum proposes a reconstruction of public ownership, accompanied by the development and implementation of industrial policy tools (2).

¹ The comments of Alain Vidalies, State Secretary for Transport, in the Figaro newspaper of 3 June 2016, illustrate this ever-present temptation: "It is always the responsibility of the (Transport) Minister," Alain Vidalies stressed. "The SNCF is a public company. It belongs neither to the Unions nor to the Management, but to the French people. The Government is the one making the decisions."

CHAPTER I

THE AIMS, RULES AND CULTURE OF THE STATE ARE LARGELY INCOMPATIBLE WITH THOSE OF A SHAREHOLDER

1.1. THE STATE CANNOT (AND MUST NOT) RESOLVE TO BE A SHAREHOLDER

Shareholders have a simple goal: the return and protection of their assets. Individual or institutional shareholders, in whatever form and however complex they may be, usually have a goal which is simple and comprehensible for all stakeholders: to increase the value of their holdings, or at least preserve it. Of course, arbitration capacities, investment horizons and ROI objectives vary for each shareholder. A pension fund, a hedge fund, a private equity fund, sovereign funds, a family office, a shareholder-entrepreneur and a small individual shareholder do not have the same backgrounds, the same cash flows, or the same expectations. But ultimately, the message that directors, as well as employees, suppliers and customers receive is simple: the aim of the company is to become cost-effective (which does not mean merely profitable²). And if that goal cannot be achieved, the company will be restructured or ultimately abandoned by its shareholders, who will sell their shares and assets, since their liability is only limited to the capital they have invested.

Merely asking ourselves whether a minister or a government could publicly assume this definition of a shareholder, allows us to clearly see that the State will never be able to embrace such a role.

Moreover, in a globalised economy, shareholders have no borders. Their resource allocation decisions ignore geography and most often aim to achieve the best possible risk/return ratio. Yet would French citizens accept the idea that the State could invest heavily in foreign companies, or promote the international growth of companies in which it holds shares, to the detriment of businesses based in France? The answer to this question is self-evident³.

² It is certainly striking that in French, the term “*rentable*” (loosely translated as “cost-effective”), is used to express both the idea of simply being profitable and of generating a return on investment, two radically different concepts. This leads to a confusion whereby nobody is shocked that 80% of the TGV (Fast Trains) fleet, a business considered to be “cost-effective” (“*rentable*”), has been written down to zero by the SNCF.

³ In 2010, this approach was exemplified by the intervention of the French President in the merger operations between Keolis and the British Arriva Group, which was in the end bought out by Deutsche Bahn.

Finally, shareholders are strategically mobile. They project themselves into the future and call into question past investment decisions if these no longer provide the expected return. They anticipate problems and seek to react before their holdings suffer any negative effect. Shareholders cannot rely on empty words or stand by their mistakes in the name of a glorious past or national myth.

Again, the manoeuvrability and reaction time of an average shareholder and of the State cannot be the same. A government has almost no capacity to soberly absorb bad news. Its tendency to push back a decision which citizens find tough to swallow is on the other hand very strong, and influenced by the electoral calendar⁴. The speed with which the government adopts changes in technologies or consumption patterns is extremely slow: both in its remarks and in its legislative⁵ and regulatory output, it considers the postal service, but not internet access, and long-distance rail transport, but not air transport or long-distance coach services, to be public services.

It is both logical and reassuring that the State cannot apply the brutal and simplistic reasoning of shareholders. Its purpose is not to make profit⁶ and ignore its other missions - citizens and businesses expect it to play a different role. However, it would be sensible for the State to recognise this fundamental limitation and accept its consequences, especially since at more technical and operational levels, its limits are also evident.

1.2. THE STATE HAS NO RIGHT TO BE A SHAREHOLDER (AND IS NOT ENTITLED TO BE ONE)

The legal framework that relates to the State as shareholder in France - particularly in cases where it has direct interests - often proves to be in contradiction with the laws regulating the companies it has invested in. In addition, French administrative law, practice and organisation are especially inapplicable to the role of shareholder.

⁴ These lines were written a few weeks prior to the announcement of the French Government's rescue plan for Alstom Belfort. There could hardly be a better illustration than this.

⁵ The laws concerning the rail transport sector are particularly telling in this regard.

⁶ The fact that the State needs to ensure a satisfactory performance and not just a profit, or even «balanced accounts», is thus poorly understood by public opinion. While the presence of other shareholders can sometimes help explain this imperative, the same does not hold true for 100% publicly-owned companies where, incidentally, the question of capital cost would merit a more informed public debate.

Here we will not seek to make a full inventory of the legal tensions that exist between the public laws governing the French administration, and the corporate and financial market laws governing the activities of companies and their governance - a whole thesis would not suffice. Rather, we will proffer some examples to demonstrate the ways in which the two legal universes are often strictly incompatible.

The field of corporate governance is a fine example of the contradictions that ultimately weaken both the State and the company. The executive officers of companies controlled mainly by the State, including listed companies, are appointed by the Council of Ministers following Parliamentary approval, as is the case for the highest civil service positions within the government. Yet their role involves managing legal entities under private law, which in no way constitute a State-run agency. How can we justify calling into question the power that the Board of Directors has to appoint corporate executives (a power enshrined in the French Companies' Code)? No doubt by recalling the fact that unlike any other private shareholder, the State has limited itself (by means of a law concerning the democratisation of the public sector) to no more than one third of the directorial seats within a controlled company. A 2014 ruling removed this limit, but maintains the requirement that one third of the seats on the Board be reserved for staff representatives. In such circumstances - and given the obligation to maintain a reasonable number of independent directors when the company is listed - the State is reluctant to appoint more than half of the directors, is unable to ascertain their loyalty, and therefore cannot fully rely on the Board of Directors, as illustrated by the EDF Board of Directors' review of the Hinkley Point project. This example demonstrates how the rules applied to the State lead to the *tour de force* of weakening the State and then invoking special legislation in order to rectify the situation.

Another illustration of the incompatibility between the rules governing the State and those governing investments in listed companies is the handling of inside information. Stock market regulators are increasingly sensitive to the risks of insider trading, and therefore strictly regulate the holding and circulation of inside information⁷. In short, information must be accessed on a need-to-know basis, and this access must be traceable through daily insider lists which specify the nature of the information held. Insider information includes not only the company's results prior to their publication, but also its business plans and proposed Board nominations, not to mention the planned public decisions that could influence the behaviour of investors if they were

⁷ See for example the European Regulation known as MAR (Market Abuse Regulation), effective July 4, 2016.

in the know. Full compliance with these rules would require efforts to limit access to this information as much as possible. Yet this imperative is utterly incompatible with the functioning of the State, which requires information to be quickly transmitted up through the hierarchy, and which is organised such that information is automatically disseminated among a large number of people⁸. The State's administrative processes simply do not consider the rules of the stock market. This situation not only risks jeopardising the individuals who possess this information and work for the State, but also the corporate executives who have shared it with them. It also prohibits the shareholder from shifting assets, even beyond the closed periods imposed on directors. In practice, the question arises as to whether the State could ever shift its EDF securities at all, given its permanent access to inside information, both in regard to this company and to the regulation of the whole sector.

As for the European State Aid law, which is more well-defined since it frequently acts as an analytical framework for the APE, it also places a constraint on the State, keeping it from being a full shareholder. As a result of this law, the State is the only shareholder forbidden from acting as a prudent shareholder in certain situations. In cases where a company is experiencing difficulties, but a restructuring - including of its capital and debt - would allow it to bounce back and move forward, it can be very well-advised for a shareholder to increase the company's share capital, or for a third-party investor to come in and "disrupt" the business. As a matter of principle, the State is forbidden from doing so without first conforming to the requirements of the European Commission, which will oblige it to undergo a "prudent investor" assessment based on a fictional situation, since it is often prohibited from injecting additional funds to reduce losses, which a private investor could very well do. This assessment considerably slows down the action of the State as shareholder, and may even deprive the company of any chance of restructuring.⁹

Finally, setting ownership thresholds, in addition to being a particularly crude method, is another example of strict public regulations that severely penalise the companies to which they apply. It is a particularly crude method since everyone knows that the level of effective control over a company does not strictly depend on

⁸ When there are changes in management within a defence company, for example, this information will reach at the very least: 6 to 8 people at the State Holdings Agency (APE); 4 people at the Finance Ministry, including the Minister; 4 people at the Ministry of Economic Affairs, including the Minister; 4 people at the Defence Ministry; 2 or 3 people at the French Defence Procurement Agency (*Direction Générale de l'Armement*, or DGA); 5 people at the Prime Minister's offices, including the Prime Minister; 5 people at the President's office, including the French President - a total of almost 40 people.

⁹ The liquidation of Seafrance in 2012 is a good example of this type of situation.

the rate of security ownership¹⁰. It penalises companies because it prohibits paper operations and even reduces their liquidity, leading both to deflation and an increase in volatility of the securities concerned¹¹.

1.3. THE STATE DOES NOT KNOW HOW TO BE A SHAREHOLDER

Being a shareholder is an ill-defined role with very fluid limits. From the hedge fund to the index fund, from passive shareholders who are content buying and selling without exercising their voting rights at the general meeting, to the exclusive shareholder who controls all of the strings of governance, and not forgetting the activist fund that relies on a small stake and a loud public presence, the scope and methods of intervention can vary a great deal. However, each shareholder must only intervene directly in corporate affairs when this action is in the best interests of the company.¹²

On this first point, the culture of the State, be it that of ministers or high-ranking officials, appears to sharply contradict these principles. In practice, since they are used to a system of top-down authority and supervision, and are pressured by the press and the public to intervene in the name of State action, public actors are unable to limit their influence to that of a shareholder. And when their voice is not heard because it is constrained by law or by a management conscious of its power, their authority is flouted in the eyes of the citizens. Are the inevitable accusations of being feeble and two-faced not a high price for the State to pay for the mere pleasure of pretending to control the future of a major French corporation? A particularly good illustration of this phenomenon is the very recent controversy over the closure of Alstom's Belfort site, which was amplified by the fact that the State controlled 20% of the voting rights (easily equated with direct holdings by most reporters).

¹⁰ The legislature highlighted this by making the 33% shareholding threshold in Engie equate to 33% of voting rights - the effective control of a company indeed results from many other factors aside from the percentage rate of economic ownership.

¹¹ The stock market performance of CNP is a good example of this phenomenon.

¹² Nobody would claim that Vincent Bolloré, a minority shareholder in Vivendi, does not involve himself in the management of this group and its subsidiaries. It should however be noted, from a formal perspective, that he was appointed Chairman of the group's Supervisory Board, which gives him a clear legitimacy: he is no longer acting as a shareholder but as a designated company representative. It seems difficult to imagine, if only because the law prohibits it, that the head of the APE, the main shareholder of Orange, could be named non-executive Chairman of its Board of Directors.

Unable to limit itself to the role of shareholder (as is to be expected), and always tempted to interfere in corporate management, the State is also very often unfit to make swift and cool-headed decisions as an active shareholder must do. This is not the least of the paradoxes. What are the key levers available to an active shareholder? First, the power to appoint and dismiss executives, and, before resorting to this extreme step, the power to set their salaries. Second, the power to block or approve capital transactions. Finally, the power to yield its shares or securities to demonstrate its diminished confidence in the company's project. There is no need to debate the fact that yielding in order to display a loss of confidence is in practice not possible for the State (neither can it increase its stakes in the company to show its confidence in the strategic project).¹³

The State does exercise its power over capital transactions, but too often for the wrong reasons. Judging that it does not have the necessary funds to accompany a transaction, the State - even when it is not legally bound to do so - uses its influence to avoid capital increases, sometimes delays them with the risk of putting the company in a difficult position, and at other times prefers to block paper transactions to avoid diluting shares, thereby reducing the company's strategic options.

But it is through its relationship with corporate executives that the State's actions prove to be most harmful to its interests as a shareholder, since it can neither influence salary levels in order to align its interests with those of executives, nor to instantly penalise the latter when they fail to deliver the required results, or when they engage in a strategy without the support of shareholders. As far as salaries are concerned, the 2012 decree resulted in a paradoxical situation in which the executives of the largest State-controlled companies have no variable compensation, with fixed-rate salaries based on the authorised limit which is well below the lowest market rate¹⁴. As for dismissal, this penalty is only very rarely applied, as political authorities can hardly take upon themselves what would appear to be a crisis of governance, preferring instead to wait until the normal expiry of the mandate. The difficulty is compounded by the multitude of governmental actors involved, each of

¹³ This essentially applies to the State as a direct shareholder, whether there is a rise or fall in share prices; in contrast, Bpifrance has, on many occasions, increased its shareholdings in companies which it deemed to have a significant valuation potential.

¹⁴ Furthermore, it may well seem legitimate for the public shareholder to have a doctrine regarding executive compensation and to use its power on the Boards to assert it. However, the need to resort to a decree in order to influence this matter reveals, on one hand, the State's lack of control on the Boards of companies where it holds a majority, and, on the other hand, a rigidity and lack of pragmatism that contradict with the expected behaviour of a responsible shareholder. The purpose of this regulation is clearly also to allow State shareholders to shun their responsibilities by hiding behind a text.

whom nurtures direct relations with the company executives and holds frequently divergent opinions about them. Without a consensus, the *status quo* is often maintained at the expense of both the company and its main shareholder.

Another feature of the State that is strictly incompatible with the function of shareholder: absolute aversion to risk. The most common saying among the public administrators in charge is often: “we shouldn’t give them cause for blame”. This position is understandable, since every political and administrative authority, as well as the press, has expectations of the State which have no equivalent in the private sector. Asked to justify everything they do, politicians and public officials quickly find themselves paralysed. Since they fear being accused of selling off securities below their purchase price,¹⁵ they wait until the price has completely collapsed without yielding. Since they fear not fully grasping the potential of a security whose value is growing, they postpone the decision to sell until the pendulum swings back and paralyses them yet again. Faced with ambitious mergers and acquisitions, the memory of old failures leads to greater caution, when in fact none of the people who could have learned from those failures are still present.¹⁶ Shareholders must exercise judgment, consider their options, and act with the risk of making mistakes. But since their performance is evaluated in a wider context and over time, they do not have to justify each of their actions on a case by case basis, unlike politicians or public officials. As such, this feeling of being permanently in the spotlight paralyses public shareholders when they should in fact take action once the information has been absorbed, and leads them to make on-the-spot decisions which are not thought through and often detrimental in the long term.

The clocks of these two worlds are also deeply out of sync: the pace for the political and administrative calendar is set by electoral periods, while that of companies is based on performance cycles. This difference is well recognised. But it is not the most significant. The most important gap in perception is the sense of urgency related to funding needs. The company’s cash resources represent its lungs: without them, death is at hand. Similarly, for listed companies, their instantaneously measured stock price is both a permanent indicator of investor confidence and, in the event of a collapse, an early warning of serious financial difficulties with potentially fatal consequences. In such contexts, corporate leaders cannot delay measures that

¹⁵ Or even at a lower rate than that previously reached, even if the securities were never purchased, or purchased at a much lower value.

¹⁶ The average length of a position within the EPA is around two years for investment managers, the linchpin of business analysis and performance as well as of transactions.

they deem necessary, however brutal these may be. Yet no such decisions can be made by the world's top-rated States. Since resources appear to be infinite, the action time-line can stretch on forever.¹⁷ Procrastination therefore becomes the default mode of the public shareholder. Protected by the "implicit State guarantee" and its presumably proactive approach, companies with majority public capital are threatened by the same affliction - all the more reason for the State to give up its shares in order to incite them to tackle their problems while they still have a chance.

We could proffer many more examples of this cultural gap between the world of capitalist enterprise and the public sphere, and I will bring up just two more: the relationship to the law and the relationship to information, which in fact derives from the former.

Companies and those holding positions of responsibility within them take the law very seriously. Their personal and corporate responsibility can be brought into play, with consequences for both themselves and their shareholders. Everyone could bring up a few examples of corporate fraud or infringement, sometimes at a very high level, but these few trees must not hide the forest of individuals who never act without the advice of their legal department and, above all, who consider that a contract is binding, and that trust is the cornerstone of business relations. On the side of public authorities, the end often seems to justify the means, and circumventing the law or opportunistically modifying it are often seen as legitimate means of public action. How often are public officials summoned by the Minister or his cabinet to formulate new mechanisms in order to bypass existing legislation? In the same manner, a fundamentally divergent approach to contractual matters often leads public authorities to consider that their commitments are only binding to those who stand by them. From this perspective, a company's objection based on legal or contractual requirements comes across to the public shareholder at best as an act of bad faith, and at worst as insubordination. This is therefore detrimental to the State's relationship with the executives of publicly-owned companies.

This irreducible gap is highly apparent when it comes to the treatment of information, and in particular financial information. Listed companies cannot make things up as they please: the factual information they provide is probed, ex-ante, by auditors and market regulators under threat of sanctions, their projections are scrutinised

¹⁷ People may counteract with the examples of State intervention in favour of banks, or of the Obama administration's support of car manufacturers. Yet these cases are not convincing because the State was not generally a shareholder prior to the crisis.

by analysts and, if their profit warnings do not come to pass, the market penalty is immediate. Nothing of the sort applies to the State and its Ministers who can, with no penalty other than ridicule, state what they like about the performance and prospects of the companies in their portfolio. Again, the hiatus between corporate executives and the public shareholder can prove to be colossal, and declarations made by public authorities, taken literally by the markets, can have an instant and significant impact on a company's value.

1.4. THE STATE WILL NEVER BE CONSIDERED A NORMAL SHAREHOLDER

The last obstacle, and by no means the least, that the State faces in its role as shareholder is the fact that, whatever its actions and however closely it conforms to the rules of corporate governance, it will never be considered by the other stakeholders as a normal shareholder.

As a result, corporate governance is disrupted and its strategic capacities are undermined.

Within governing bodies, the State is never seen as a normal shareholder, and its representatives on the Board are judged on two fronts: on the one hand, independent shareholders and those representing other shareholders see State representatives as puppets¹⁸ subject to unpredictable political instructions¹⁹ and without the necessary legitimacy; on the other hand, staff representatives constantly challenge them on the grounds that the State should be defending something other than the profit motive.²⁰ And a strange phenomenon exists: the mere presence of a State representative on the Board most often leads independent directors to withhold any criticism of Management and instead express solidarity with it and against the State. This is simply explained by the fact that the public representative inevitably expresses a view which is not (or barely) compatible with the company's best interests; this then leads the independent shareholder - often ideologically predisposed - to defend the company against the Predator State.

¹⁸ Since being equipped with Blackberries during Board of Directors' meetings, APE heads have all received direct instructions from the ministerial cabinet regarding the position they should take.

¹⁹ For example, consider the successive and contradictory positions taken by the State in relation to the governance of the Thales group in 2014 and 2015, which even led to the postponement of a general meeting.

²⁰ It is thus significant to note that employed SNCF directors have always expressed their opposition to rate increases, calling for "a different transport policy".

Two phenomena greatly contribute to the weakness of these public representatives. Firstly, for statutory reasons, many administrations absolutely insist on having representatives present, but do not know what role they should play. These individuals therefore see themselves more as the eyes and ears of their administration than as members of a Board responsible for the company's corporate interests. Secondly, there is an excessive turnover, which means that State representatives do not have the time or experience needed to develop sufficient personal influence within the Board.

In practice, this sometimes leads to a very split Board and prevents a double consensus from being reached - between Board members, and between the Board and Management - which is central to good business operations. The companies facing this challenge are therefore intrinsically more fragile and less able to respond to difficult circumstances.

Adding to this, because the publicly owned company is a demigod, the labour force power balance strongly limits the possibility of any new compromise. Since the company is perceived as not risking anything, employees are not willing to concede on any level.²¹

From a strategic perspective, State shareholdings also prove to be a frequent obstacle in implementing strategic transactions with foreign companies and family-run businesses.

Often, private shareholders see the State as blocking the whole system, and refuse to accept it, even indirectly, as a shareholder.²²

Moreover, foreign governments are more wary of cross-border transactions when the French State is among the shareholders²³. The French State dreams of using its position as shareholder in large French groups to encourage more corporate partnerships within Europe. Yet we might legitimately consider that this State influence is in fact a foil that sometimes keeps such partnerships from forming. We may recall, for example, that the EADS merger only succeeded because the French government agreed to dilute its shareholdings in the joint venture for the benefit of private shareholders, a strict requirement on the part of the Germans.

²¹ The State's shareholdings in SNCM undoubtedly delayed the inevitable restructuring of the company, much like its shareholdings in Air France are seen by many internal and external observers as preventing a consensus on the degree of necessary restructuring.

²² Bpifrance executives can testify to the fact that family shareholders refuse its support capital for fear, for example, that the public shareholder may restrict their remuneration policy.

²³ It is thus likely that the US gave its authorisation, through CIFUS (the Committee on Foreign Investment in the United States), for the EADS-BAE merger on the condition that the French State significantly dilutes its shareholdings in the new group.

CHAPTER II

THE STATE MUST LIMIT ITS INTERVENTION AS A DIRECT SHAREHOLDER TO A FEW SPECIFIC SITUATIONS AND CONSIDER RELYING ON OTHER MORE RELEVANT MEASURES TO INFLUENCE INDUSTRIAL POLICY.

Since the State is obliged, by its very nature, to delay its actions, reduce companies' strategic options, disregard corporate interests and disrupt corporate governance, it can hardly claim that its shareholdings in commercial companies serve the national interest, considering the extent to which the disadvantages outweigh any barely visible benefit. It must therefore give up its role as shareholder as far as possible, since this role necessarily clashes with its other missions, and since its officers - both at the political and administrative level - are neither prepared, nor equipped, nor often seen as legitimate by other stakeholders.

The issue would be slightly different if the State delegated its management to an independent entity, since many of the incompatibilities highlighted above would disappear or be significantly reduced. This is especially true for minority shareholdings.

However, for majority shareholdings, and especially for exclusively controlled shareholdings, delegating control would likely not be fruitful. In such cases, a distinction would have to be made. On the one hand, there will be companies that constitute a State agency, whose ownership and control will have to evolve to reflect an increased public liability. On the other hand, the State will need to immediately or gradually give up its shareholdings in certain companies, after "transferring" to a delegated management entity.

2.1. THE STATE MUST GREATLY REDUCE THE SCOPE OF ITS PORTFOLIO AND FOCUS ON THE ENTITIES THAT REFLECT A PUBLIC SERVICE RATHER THAN A CAPITALIST APPROACH

Given its inherent inability to correctly perform the job of controlling shareholder, the State must limit itself to permanently controlling only certain companies which, in reality, cannot be fully considered companies at all.

By this we mean entities that in fact resemble public agencies due to three main characteristics: firstly, they provide services that are considered to be public services, and are *de facto* (or *de jure*) largely monopolies; secondly, the involvement of political and public officials - a permanent and almost daily reality - affects their management and their financial balance; and lastly, most of their resources come from (or will come from) taxpayers rather than clients, which, on a structural level, does not make them particularly cost-effective entities.

The SNCF's domestic activity, the RATP, and French public broadcasting clearly fall into this category.²⁴ We could also question whether the many restrictions imposed upon certain other activities and companies in France do indeed affect their cost-effectiveness in the long term.

In these cases, I believe that the State should exclude all minority interest - even public ones -, exclude listed companies, and establish a way of governing which gives it a clear and direct control over the companies' governance bodies. It can notably do this by slightly reducing the influence of employee representatives and maintaining the same level of independent shareholders.

Nevertheless, in order to maintain a relationship similar to that between a parent company and a fully owned subsidiary, the status of these companies/agencies will need to ensure that their executives have the necessary degree of autonomy over everyday operations. A useful means to achieve this could be the French public enterprise status (EPIC). However, it must be recognised that the governance rules of a public limited company provide more protection and are therefore more frequently chosen, and that the financial discipline imposed by the French Commercial

²⁴ The case of Bpifrance is rather different, since it is indeed the State's "development arm", but its joint ownership, and especially the fact that it is subject to governance constraints imposed by banking regulations and monitored by the ECB, protect it from the ambiguities and interference observed within industrial and service sector companies/agencies.

Code necessarily offers an advantage to the State as owner, protecting the current leadership from a permanent temptation to “misuse corporate assets”.²⁵

The need for the exclusive controlling shareholder to speak with a single voice should also be fully recognised. The only institutional solution would be to place the steering and control bodies of these companies/agencies under the auspices of the Prime Minister, thereby guaranteeing that the position adopted is clearly that of the State and its agencies.

Last but not least, it is necessary to integrate the entire debt of State-controlled agencies/companies into the public debt, reflecting the Maastricht debt level, and acting as the British Treasury has always done. This must be undertaken in order to recover France’s real Public Accounts, to reduce tensions between executives and shareholders related to the ongoing temptation to make these agencies/companies levers for the reduction of the public budget, and to hold the State accountable. As long as this is not done, none of these agency/company leaders will have a clear sense of direction, nor will they be able to stand their ground against corporate ownership, and the transfer of public debt²⁶ to the next generations will continue on an even greater scale.

Aside from these agencies/companies, there is only one possible justification for maintaining a public shareholding: the “bailout”²⁷ of financial, industrial and service companies whose bankruptcy would have an intolerable impact. This is well known and indeed accepted by EU rules. We shall not expand further upon this topic here, except to say that once bailed out, these companies should not remain under the exclusive and direct control of the State.

Monopolies do not seem a sufficient justification for public ownership, since their management is only temporarily handed over as part of a concession. Most public

²⁵ The following are two examples of what might be termed misuse of corporate assets within a public limited company: first, forcing SNCF Mobilités to acquire material that it did not need (with much of the TGV (fast train) fleet having been subject to an accounting write-down, from an economic perspective we can see that SNCF Mobilités now has a large surplus fleet); second, forcing SNCF Mobilités to sign an onerous public service contract for TET (regional train) operations.

²⁶ The question of whether the SNCF and RATP debts are legally “public” is largely misleading, and ignores the issue of whether or not these entities are explicitly or implicitly guaranteed by the State. The conditions under which they borrow - when in fact their economic fundamentals should not allow them to access such conditions, and should even deny them any access to liquidity - is objective evidence that investors consider themselves to be lending to the State when they lend to these entities. No doubt that a deficit on the part of the RATP or SNCF would be considered a deficit on the part of France, which would impact the conditions of French sovereign debt.

²⁷ The term is used here in its wider sense, and not only as concerns the EU.

monopolies can be structured in this way, without being controlled through public shareholdings (the State retains control by setting the terms and conditions of the concession).²⁸

As for the other reasons mentioned as part of the doctrine of the State as shareholder,²⁹ they either appear to be the result of an ex-post rationalisation, or to only apply for a limited transition period.

In any event, and except for agencies/companies, they do not justify the control, let alone the direct control, by a State department. Delegating management would prove to be a much better option, since it would reduce the number of barriers faced by a professional shareholder.

2.2. EXCEPT IN THE CASE OF AGENCIES/COMPANIES, THE STATE MUST STOP ACTING AS A DIRECT SHAREHOLDER AND INSTEAD DELEGATE MANAGEMENT TO A THIRD PARTY WHICH IS NOT INFLUENCED BY POLITICAL MATTERS ON A DAILY BASIS

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After yielding corporate control in cases where full State control is not justified, the State should transfer/bring all of its minority shareholdings to a delegated entity under its control, and act solely through this intermediary. It should also remove all purely symbolic legislative thresholds, and deal with the few existing monopolies either by breaking them apart in the rare cases where this is possible, or by restructuring them into franchises.

An organisation that can undertake this mission already exists and is called Bpifrance. Its governance system allows its Management to have the necessary operational autonomy, while strategic decisions are closely monitored by its shareholders (or rather its shareholder since the Caisse des Dépôts is a public body).

²⁸ However, a low level of State shareholdings could be conceivable, coupled with a presence on the Board to make up for the varying amount of information held by those with different share percentages. Other mechanisms are also possible, such as the presence of a Government Commissioner for instance.

²⁹ Document available in French on the APE website: "*Lignes directrices pour l'État actionnaire*".

Bpifrance is not directly subject to the rules which encumber the State's capacity for immediate action. It employs a sufficient number of professionals and is subject to banking regulations which limit many of the risks outlined above. By statute, the employees of Bpifrance are not involved in public decisions, avoiding any conflicts of interest.

Finally, Bpifrance is structured and equipped to monitor and measure the performance of its shareholding management. This is absolutely not the case for the APE, whose indicators, established by the French legislation governing Finance Laws (LOLF), are of little significance.

With Bpifrance in the management seat, the State would in no way be deprived of its dividends or proceeds from disposals. One could also question whether using these flows to replenish the general budget is appropriate, when the ownership of moveable and immovable French assets is probably the only equivalent to a small gas or oil annuity that French citizens can boast of. Would it not be better to confine this capital and utilise its yields to prepare for the future, rather than to mitigate our national inability to control public deficits?

A new public holding company could of course be established to replace the APE, but how could such a doubling-up be justified when the new listed portfolio would only be composed of minority shareholdings, and when an interdepartmental APE would still be supervising the agencies/companies?

Finally, we should not dismiss the role that companies/agencies can play as sub-holding companies within their sector: since they are further removed from political issues, they face less interference and fewer conflicts of interest. It is important to note that without SNCF shareholdings in Geodis, and without those of la Poste in GeoPost, today there would probably be no more French actors in large-scale logistics management.

2.3. RELY ON TOOLS OTHER THAN SHAREHOLDING - AT THE NATIONAL AND EUROPEAN LEVEL - TO ACHIEVE ITS STRATEGIC, INDUSTRIAL AND SOCIAL OBJECTIVES

The State as shareholder has many non-economic objectives. Nevertheless, we can attempt to group them into a few broad categories and to examine, without purporting to do so exhaustively, the measures that the State relies on, or could rely on, in place of public shareholding.

a. Protecting strategic interests against the stranglehold of foreign powers. This is the logic which is ostensibly used to justify maintaining public shareholding in Airbus, Thales, DCNS, STM and Safran. Yet there are counter-examples of French companies that are just as essential for France's national defence and security, such as Dassault Aviation or ATOS since the acquisition of Bull, and in whose capital the State has virtually no influence. It should also be noted that many States, foremost among them our most important NATO allies - the United States and Great Britain -, feel absolutely no need to be shareholders in their military suppliers.

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In this area, strengthening the existing legislative and regulatory mechanism, and elevating it to a European level in order to avoid suspicions of protectionism from Member States, would not mean desisting from financial relations with non-EU countries. Employing the wide array of methods already used by the US executive (like "proxy boards"³⁰ for example) would be as effective as holding capital.

Moreover, greater thought should be given to the idea of relying on French controlling shareholders, whether family or institutional, as a substitute for the State. The agreement between the State and the Dassault family, negotiated before Airbus' exit from the Dassault Aviation share capital, is a good case in point.

b. A sector-based approach, relying on the idea that a publicly-owned sector leader is better able to create products or services which ensure the continuation and development of a national industrial fabric. Here, we must recognise the

³⁰ A "proxy board" is a governing body within a company, entirely made up of citizens from the country in which the company originated, and responsible for its corporate management. This mechanism allows the company to protect any and all "sensitive" information from foreign investors. In the United States, this is a prerequisite imposed by the Defense Security Service.

historical influence of France's major postwar programmes. These initiatives have been mythologised through a national narrative that always places the limelight on State Planning rather than on private entrepreneurial success. And yet, for one Airbus, how many failures, how many lost investments, how much national oversupply has been produced for supposed exports that never materialised? On the other hand, how many national successes have there been in which the State played no role, or simply that of purchaser or R&D financier, with no shareholding involved?

In this area, steering through public procurement and research programmes, particularly in the military field, seems to be a much more powerful and flexible lever than public ownership. Similarly, policies concerning education, research and vocational training are probably more useful than public shareholding in the development of a favourable ecosystem for new economic actors.

A well-managed competition policy is also a more powerful lever of innovation than direct shareholding.

- c. Dealing with market failures** may also come across as a reason for the State to become shareholder. Aside from promoting a planned economy, and in the case of the above-mentioned agencies/companies, this is a role which the State only needs to take on if the market is flawed. Before concluding that the answer lies in public intervention, we must look at other economic and fiscal policy measures that can encourage private investment.

In doing so, a number of paths may be explored: for instance, we should consider French tax policies and the implicit savings allocation choices that they entail, or the transformation of a national culture largely nurtured by a State hostile to entrepreneurship. This can all be done in parallel to the actions of Bpifrance, which should also be recognised as an instrument of this cultural change. But once its mission is complete, will it be able to step aside?

- d. The promotion and defence of a social or employment model** is also frequently used to justify State shareholdings, with public companies being presented as a kind of vanguard of socially responsible management. Such statements are sometimes more of an *ex-post* justification of a situation resulting from a balance of power that favours employees, rather than a deliberate desire to establish, *ex-ante*, an innovative social model. But quite aside from this issue, we may

question why the State would have only the employees of publicly-owned companies benefit from measures that it does not judge to be fair, or necessary, to impose upon others.

In this respect, protecting jobs often appears to be a primary aim, and it has objectively been shown that redundancies are far less frequent in publicly-owned companies, while reductions in staffing positions are common. This situation would only make sense if public capitalists had a philosopher's stone allowing them to be as efficient as private capitalists, while positively impacting French employment rates. For the time being, there has been no evidence of this, and we may express concern that, in the medium-term, the State as shareholder could negatively impact both its companies and employment in France by delaying certain necessary adjustments, for example in order to adhere to the rate of natural turnover. Today, one can observe the position of Orange and Air France in their respective business rankings without acknowledging the results of decisions taken too late in the game, or at least once their competitors had already made a quick and determined headway. These competitors now have war chests that we were unable to amass, seeing as a modest profit (a proof of "cost-effectiveness") is enough to satisfy the public shareholder.

In these areas, the State can rely on employment regulations, restructuring mechanisms, the Interministerial Committee on Industrial Restructuring, and many intervention credits. Should it, in addition to this, be involved as a shareholder?

- e. **Regional planning** relies on fairly similar mechanisms to those mentioned above. The State as shareholder is known to promote a geographically balanced business creation and to fight against an excessive concentration of business activities in the most attractive regions. Aside from the fact that this type of interventionist approach inevitably has a detrimental impact on the company involved, one cannot fail to see this as a rather rich ambition, coming from a fundamentally ultra-centralised State in which the political, administrative and economic power is centred around the capital, to a greater degree than in any other OECD country.

Here once again, the State has a range of measures at its disposal to render a particular region more attractive. Is it therefore legitimate that it should use its power as shareholder to compel a company to act in a certain way, when all of these measures failed to persuade? Or, even worse, that these measures be made

solely available to companies with no public ownership, because the State deems it less onerous in terms of its public finances to merely coerce a company which it controls?

f. Maintaining corporate governing bodies in France is a legitimate and oft-quoted goal. However, a sounder and more appropriate approach would seem to be to make France's regions more attractive and more competitive, both overall and on specific local levels, rather than to use public shareholdings to coerce corporations. The examples of Airbus or Gemalto, companies that have chosen to locate their operational headquarters in France, even though their legal seat is in the Netherlands, show that this is not a lost cause.

CONCLUSION

To observe the performance and utility of the State as shareholder from a clear and unprejudiced viewpoint, is to cast serious doubt as to the relevance of maintaining a portfolio which is shaped more by history and sociology than by any strategic or financial considerations. The State should only control companies in exceptional cases, and it should only possess minority shareholdings in the instance of market failures and with an openly capitalist approach.

If they were made available, these locked-in assets, whether representing capital or annuities, would be an extraordinary lever of change, and there are abundant liquidities that could invest in place of the State.

Promoting such action should not mean abandoning national goals which have been incorrectly and unmanageably assigned to the public shareholder; however, in parallel, the State must design and implement appropriate mechanisms to support and protect French corporations, and foster a business-friendly ecosystem at the national level.

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