

# Break-Through in European Takeover Regulation

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# Motive for the Commission's Proposals

- The Commission believes that European industry needs restructuring.
- Takeover markets can play an important part in that restructuring.
- With the existing shareholder structures, takeover markets are restricted.
- Let's make it easier to make (hostile) takeovers

# What's wrong with freedom of contracting?

- Important difference between investor protection to prevent theft and one that disrupts private contract.
- Mandatory bid rule & breakthrough rule disrupts private contracts.
- US and UK approach to takeover regulation has been very different. Former has relied more on freedom of contracting subject to fair price rules; latter on detailed prescriptions restricting particular takeovers and limiting size of share stakes through Company Law, The Takeover Panel and Stock Exchange Listing Rules.
- EU could have chosen US form of regulation but chose UK. Different implications for ex ante efficiency.

# Field & Karpoff (1999): US Takeover defenses in 1019 IPOs 1988-92

- Supra majority to approve mergers/replace directors 28.9%
- Unequal voting rights 5.4%
- Antitakeover provisions 13.7%
- Poison pills 2.3%
- Fair price provisions 9.7%

58% of IPOs incorporate in Delaware in part because of anti takeover statutes

What would you observe in the UK?  
Does it make a difference?

- Mean no. of takeover defenses is 2.6
- Presumably the IPO price reflected these provisions.
- Valuation effects are not obvious. Brickley et al (1994) find + abnormal returns to poison pills where there is a majority of independent directors.

What is the effect on capital markets of disrupting these contracts? Fewer IPOs? Alternatively, rules will be thwarted (as authors recognize) by higher inside ownership so as to thwart break through rule (e.g >25%) or more pyramids?

Also as Bebchuk and Hart (2002) point out: it becomes profitable to acquire a company with dual class shares, strip out the dual class structure, leaving everything else as is. Thus, breakthrough rule will not be limited to takeovers but to any other action of shareholders with reduced voting power.

# Do rule changes matter: Importance of hostile takeovers

‘But even in countries with stronger institutions, dispersed ownership and hostile takeovers are relatively rare’ (p 11)

- But Holmstrom & Kaplan (2001); in 1980s 20-40% tender offers were contested
- 15% or fewer contested in 1990s
- But, these figures exclude hostility in block sales
- Also, threat of takeover may be ‘potent’ force.

# Evidence on size of benefits in contested vs uncontested

<b>Bid Premia for Targets</b>		
	<b>US</b>	<b>UK</b>
<b>Resisted</b>	28%	28%
<b>Non resisted</b>	23%	18%

Sources: UK Franks and Mayer, 1996.  
US Huang and Walking, 1987.

# Bhide (1989)

Examined 47 US hostile takeovers (1985-6) and compared them with a sample of friendly transactions:

- High debt levels reduced by asset sales
- Few cuts in long term investment
- Unbundling of past (unsuccessful acquisitions)
- Target management poor or mediocre

He finds little added value in friendly transactions: he cites 'too many chairs when the music stops.'

Another view: Shleifer & Summers (1988): merger benefits come from disrupting 'implicit contracts' with other stakeholders



# Do we need to dismantle ownership structures to reduce private benefits?

- The evidence seems to suggest that private benefits are large in countries with concentrated ownership and less developed capital markets (Dyck & Zingales 2001).
- But what explains the large variability? Premia for block transactions is: Germany = 10%, Italy = 37%, Canada= 1.3%, UK=1.6%. Which is the odd one out?
- What explains these differences especially since three countries have concentration of share ownership and mechanisms for separating cash flow from control rights?
- Dyck and Zingales: 'a crude attempt to disentangle them ...diffusion of the press, high rate of tax compliance...as the most important.' (page 37)

# What was the UK capital market like without investor protection?

- At the beginning of the Century UK markets were largely unregulated.
- The Law and Finance literature would therefore predict small capital markets and concentrated ownership
- What is the evidence?

- We trace the ownership of companies over 100 years (40 years) at 10 yearly intervals
- We compute insider/outsider ownership and founding family ownership
- We examine the contribution of share issues (rights, placings, IPOs and acquisitions) to growth in issued equity and insider ownership
- We evaluate family and large shareholder representation on boards and occupancy of position of chairman
- We compute a measure of separation of family ownership and board control (i.e. the difference between family representation on boards and ownership of shares)

# Decline in Insider Ownership

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	mean	median
1900	91.61	100
1910	57.97	57.50
1920	53.58	38.51
1930	40.86	24.24
1940	35.70	17.91
1950	28.65	11.99
1960	23.75	9.22
1970	17.80	9.43
1980	14.10	0
1990	8.30	0
2000	9.85	0

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