

Takeover Regulation Reforms in Europe and Corporate Governance Convergence

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- Introduction
- Debate on best system
- Corporate governance functions of takeover regulation
- Reforms of Takeover Regulation in Europe
- Conclusion

Introduction

- Two polar systems of corporate governance
 - Market-based system (UK and US)
 - Case law emphasizing enforcement of shareholder rights
 - Dispersed ownership of firms
 - Well-developed stock markets
 - Managers are disciplined via the market
 - Blockholder-based system (Europe and most of Asia)
 - Codified law focusing on the protection of stakeholders
 - Concentrated ownership and control
 - Illiquid stock markets
 - Stakeholder monitoring

Introduction

- Economic globalization has started a debate
 - Best corporate governance system
 - Barriers to achieving a single system

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Debate on Best System

- Some argue that market-based system is superior (La Porta *et al.* 1997)
 - Better investor protection
 - Cheaper and easier access to financing
 - Fosters long-term growth
- Proponents of alternative systems
 - Chief advantage is way conflicts between managers and shareholders are addressed
 - Interests of shareholders and stakeholders not necessarily at odds

Debate on Best System

- Hansmann and Kraakman (2003)
 - Increased acceptance by international business of superiority of market-based system
 - Corporate law reforms will follow
 - Global convergence towards market-based system
- Global competition hypothesis
 - Systems should borrow best practices from each other
 - Hybrid model

Debate on Best System

- Bratton and McCahery (1999)
 - National systems should resolve their weaknesses
 - No need for global convergence
- Roe (2002, 2003) and Coffee (2000)
 - Those predicting convergence base themselves on economic efficiency
 - However, there are political and institutional barriers
 - Move towards suboptimal system

Debate on Best System

- Gilson (2000)
 - Contractual convergence
 - Firms choose to deviate from national standards
 - However, Bebchuk and Cohen (2003) and Bebchuk and Ferrell (2001) show that contractual convergence may lead to a ‘race to the bottom’

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Corporate Governance Functions of Takeover Regulation

- Not only a mechanism to ease corporate restructuring
- But also a device to mitigate conflicts of interests between different stakeholders

Corporate Governance Functions of Takeover Regulation

- In a system with dispersed ownership
 - Hostile takeovers discipline bad managers
 - Regulation should minimise costs and inefficiencies of hostile takeovers
- In a system with concentrated ownership
 - Managers are monitored by large shareholders
 - Danger of minority shareholders being expropriated
 - Regulation should provide an ‘exit on fair terms’

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Reforms of Takeover Regulation in Europe

- 1968 UK introduces City Code on Takeovers and Mergers
- Late 1980s Continental Europe introduces voluntary codes
- Mid-1990s Voluntary codes are replaced by binding codes
- Late 1990s Start of national reforms
- 2002 First draft on EU Takeover Bids Directive
- Apr 2004 EU Takeovers Directive is approved

Reforms of Takeover Regulation in Europe

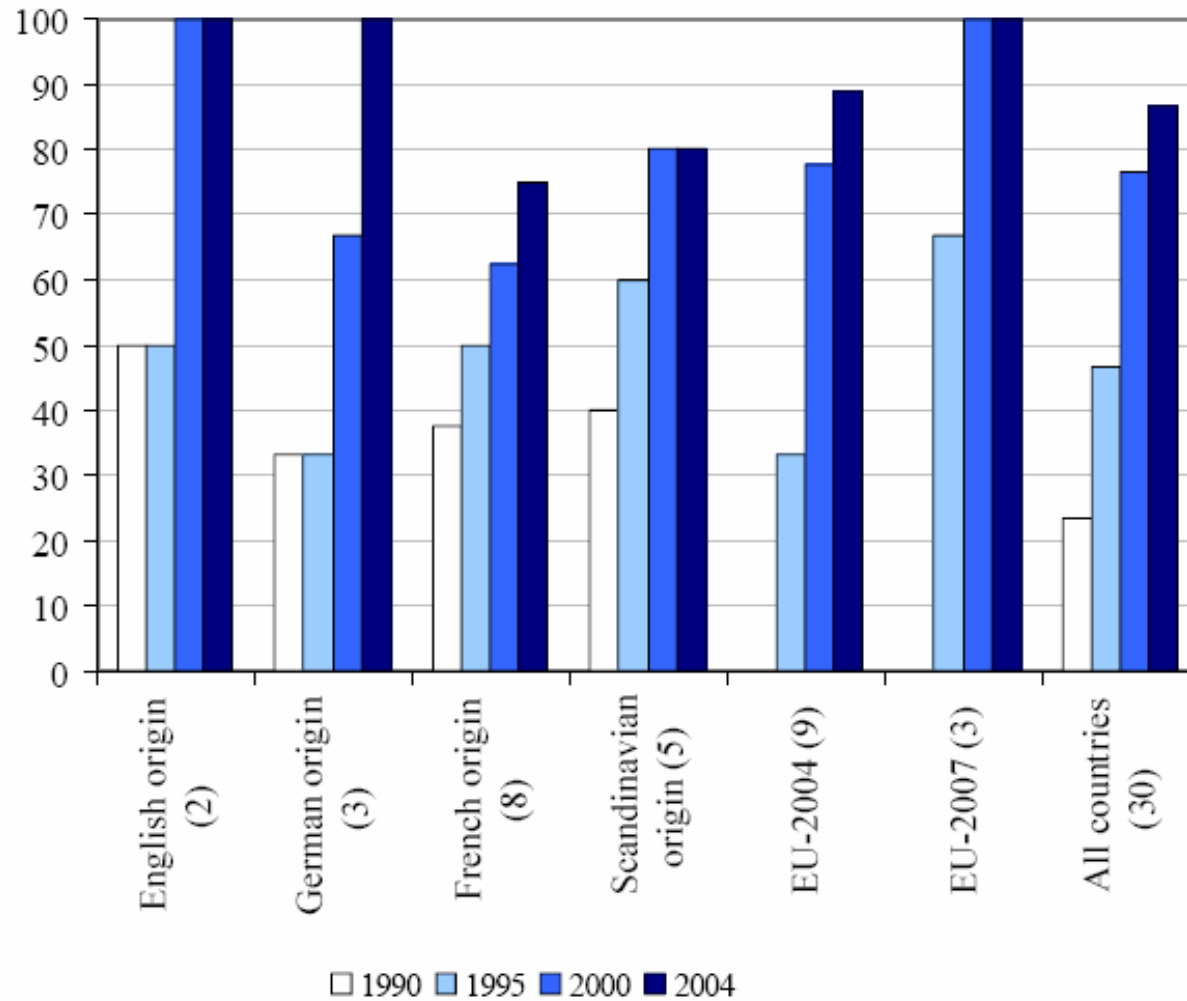
- Mandatory-bid rule
- Principle of equal treatment
- Squeeze-out and sell-out rules
- One-share-one-vote principle
- Break-through rule

Reforms of Takeover Regulation in Europe

- **Mandatory-bid rule**
 - Enables minority shareholders to exit on fair terms
 - Bidder must make tender offer beyond a certain threshold
 - Rule also normally prescribes price of tender offer
 - **Protects minority shareholders against expropriation**
 - **Reduces likelihood of value-creating restructuring**

	<i>Minority shareholder protection</i>	<i>Ownership concentration</i>
<i>Block-holder system</i>	Increases	Increases
<i>Market-based system</i>	Increases	No impact

Adoption of the Mandatory-bid Rule

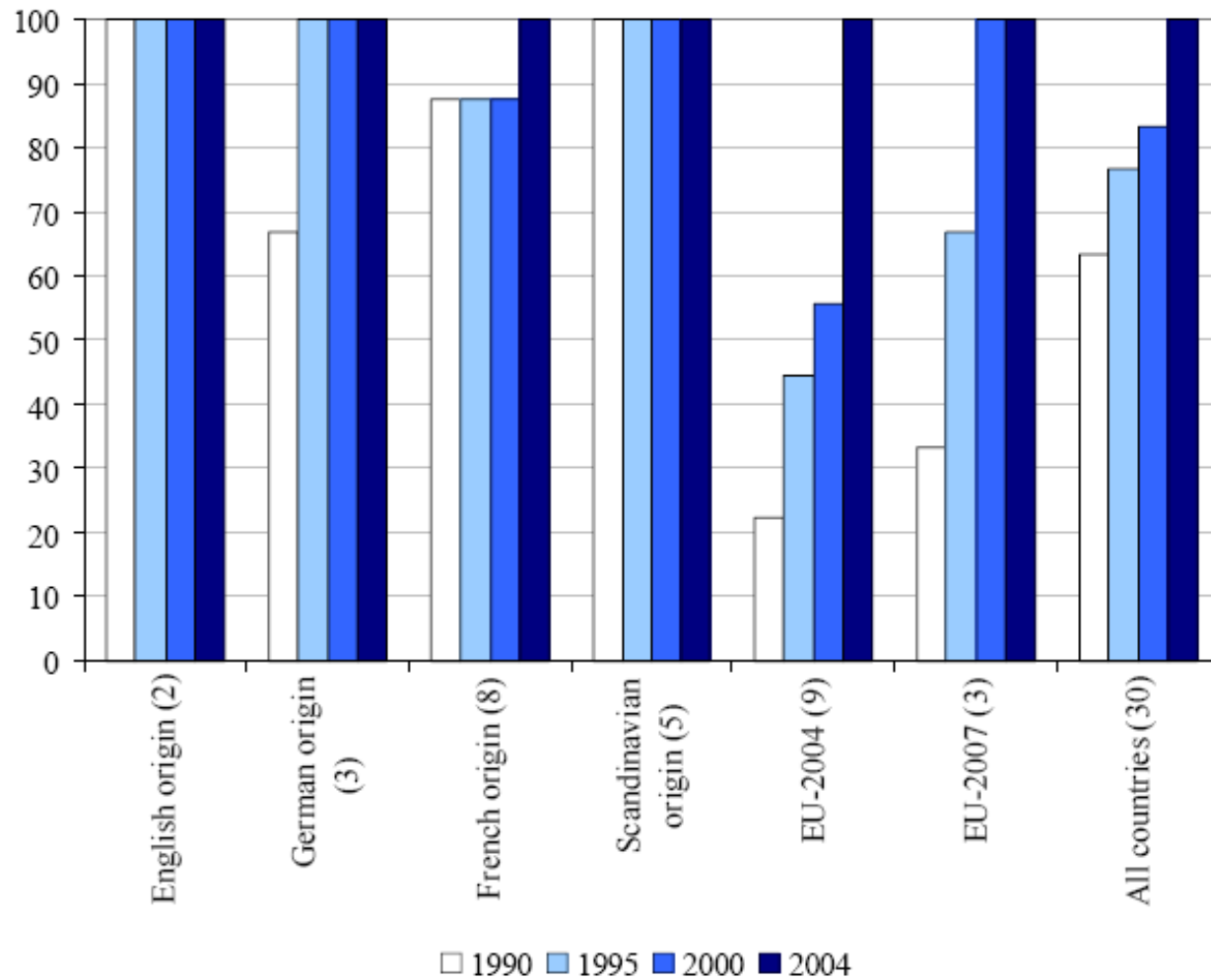


Reforms of Takeover Regulation in Europe

- Principle of equal treatment
 - Minority shareholders exit on same terms as blockholder
 - Combined with mandatory-bid rule increases cost of acquisitions

	<i>Minority shareholder protection</i>	<i>Ownership concentration</i>
<i>Blockholder system</i>	Increases	Decreases
<i>Market-based system</i>	No impact	No impact

Adoption of the Equal-treatment Principle

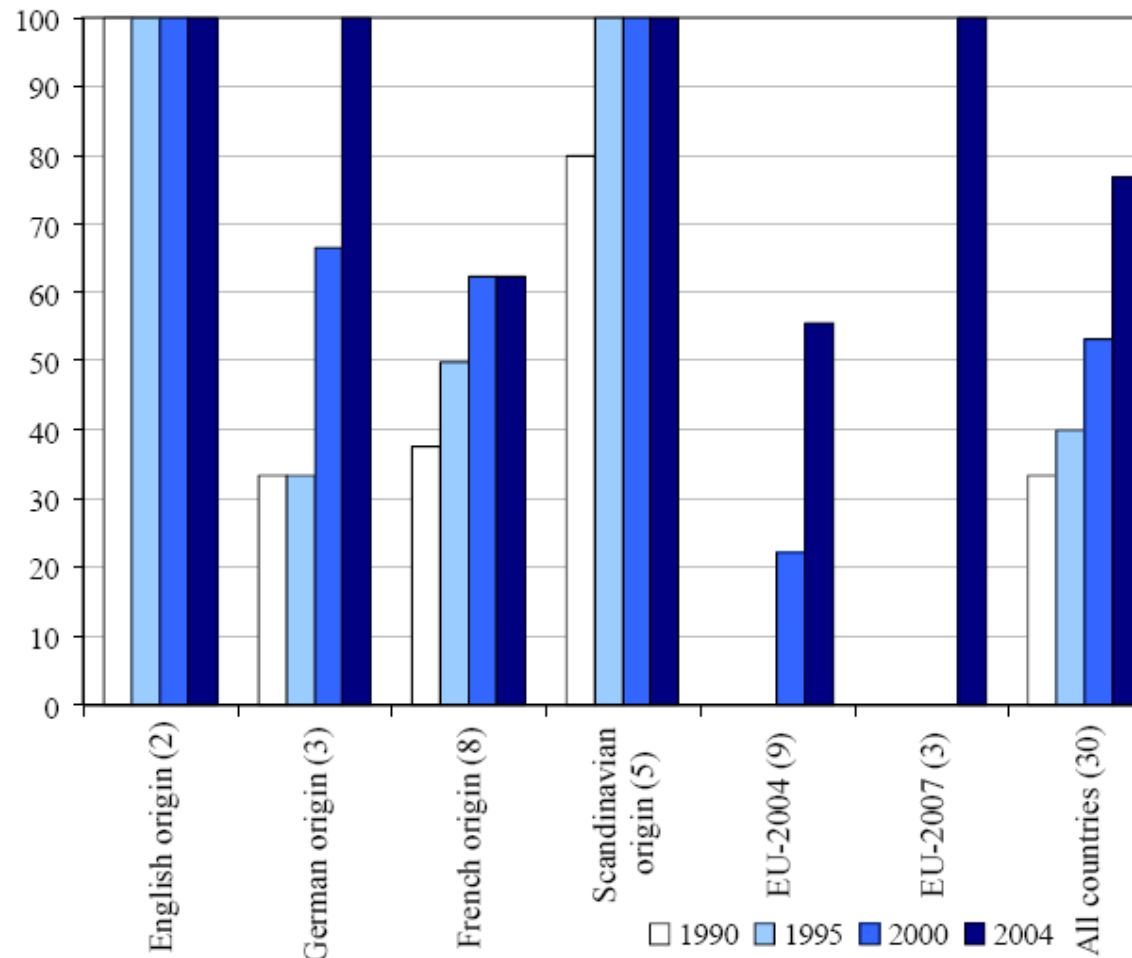


Reforms of Takeover Regulation in Europe

- Squeeze-out and sell-out rules
 - Squeeze-out rule forces remaining minority shareholders to sell
 - Sell-out rule is counter-provision

	<i>Minority shareholder protection</i>	<i>Ownership concentration</i>
<i>Block-holder system</i>	Increases	Decreases
<i>Market-based system</i>	Increases	No impact

Adoption of the Squeeze-out Rule

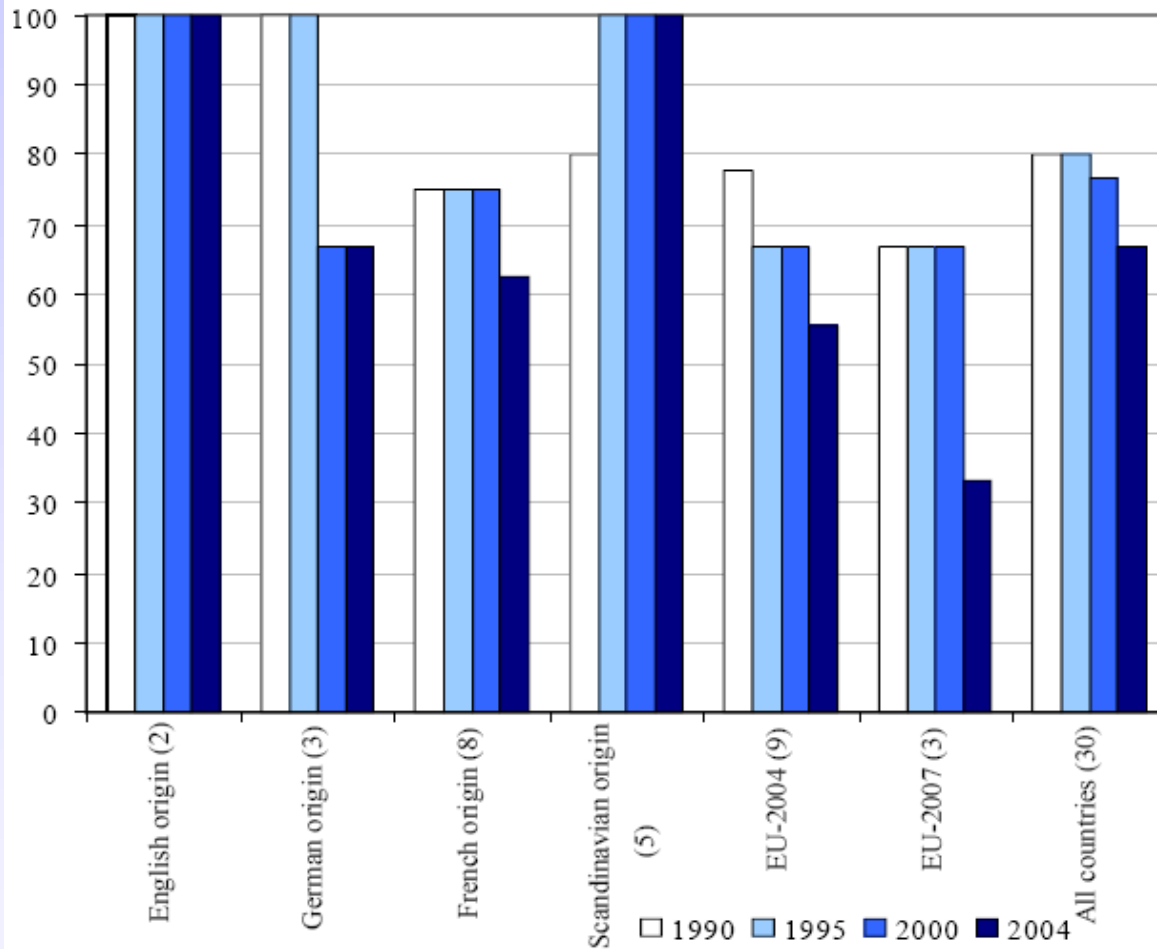


Reforms of Takeover Regulation in Europe

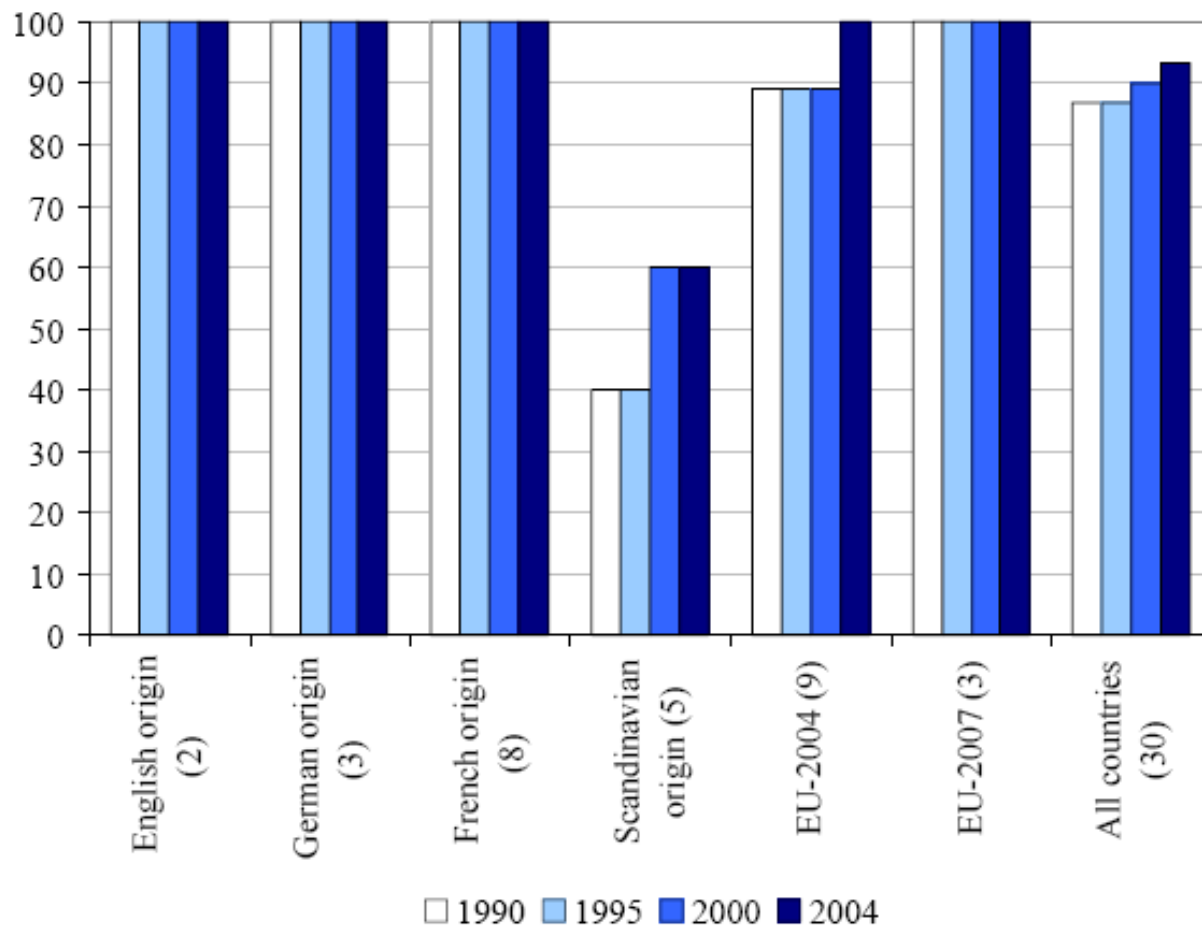
- One-share-one-vote principle
 - Prohibits restrictions on voting rights
 - Removes barriers to takeovers
 - Increases private benefits of control

	<i>Minority shareholder protection</i>	<i>Ownership concentration</i>
<i>Block-holder system</i>	?	?
<i>Market-based system</i>	?	No impact

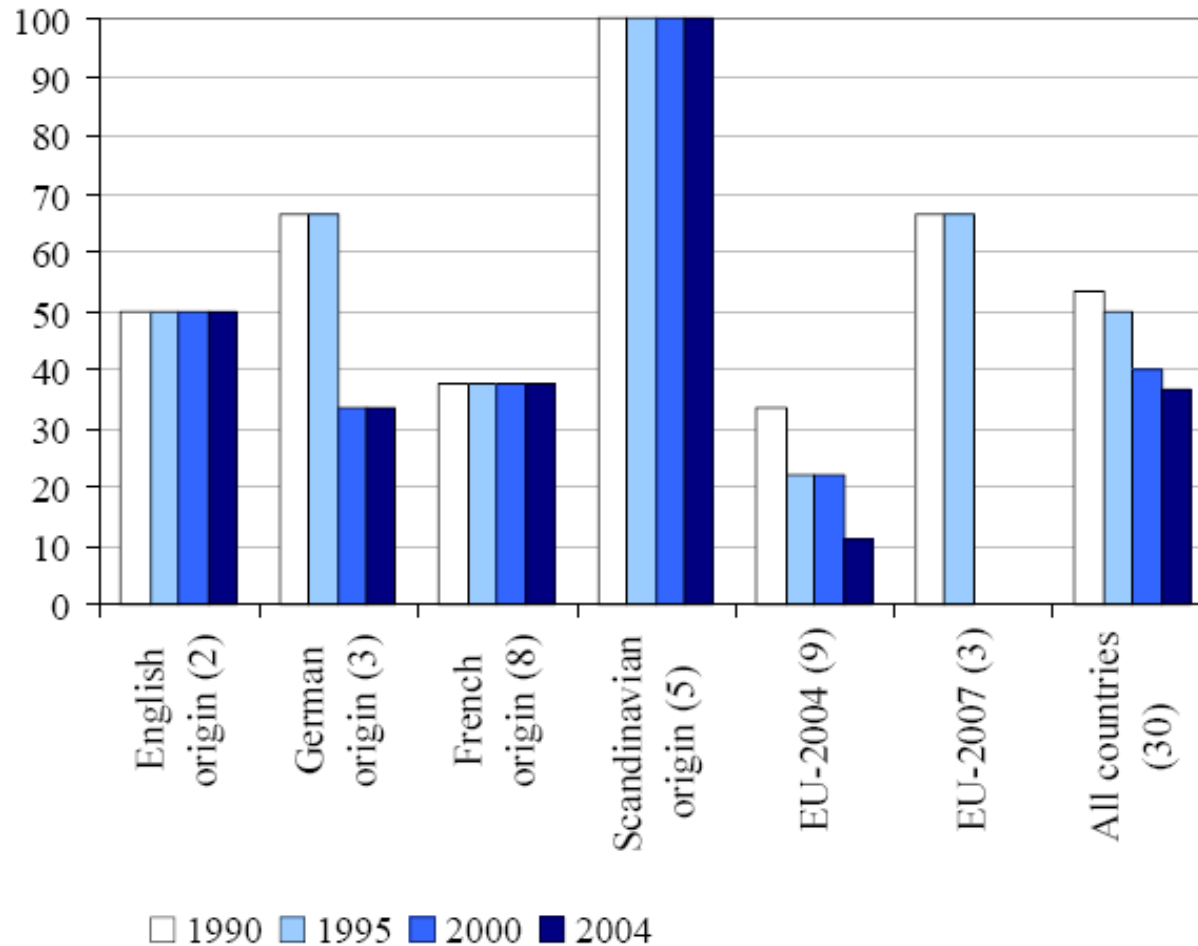
The Use of Voting Caps



The Use of Non-voting Shares



The Use of Dual-class and Multiple Voting Shares

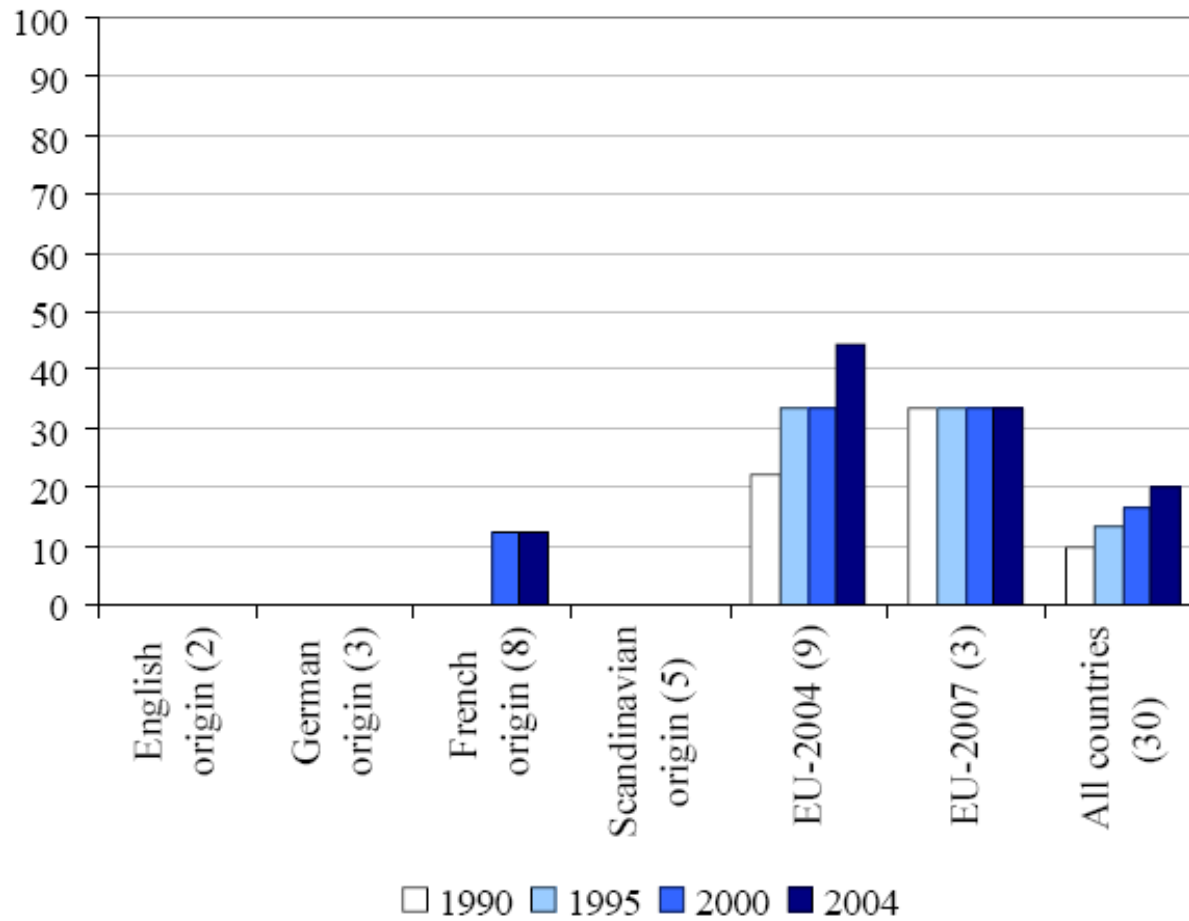


Reforms of Takeover Regulation in Europe

- Break-through rule
 - Enables bidder to circumvent voting restrictions
 - Violates principle of shareholder decision-making
 - Makes inefficient bids possible
 - May increase use of pyramids

	<i>Minority shareholder protection</i>	<i>Ownership concentration</i>
<i>Block-holder system</i>	Decreases	?
<i>Market-based system</i>	Decreases	?

Adoption of the Break-through Rule



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Conclusion

- European countries have taken steps towards convergence of
 - Takeover regulation
 - Corporate governance rules
- However, similar regulatory changes may have different effects within different systems
- Not clear whether corporate governance regimes are converging towards single system