

Transcript of the Viewpoint article which appeared in the Financial Times on 31 May 2002

**Fighting the wrong problem
An End to hostile takeovers will not achieve the corporate restructuring Europe needs**

Erik Berglof and Mike Burkart**

European capitalism is to be given a new face. A report from a group of eminent experts under the leadership of Jaap Winter seeks to open up Europe for corporate takeovers by letting the all-powerful manager replace the controlling shareholder at the helm. After decades of failed attempts and the stinging defeat in the European Parliament last year the Commission remains committed to the idea of a pan-European takeover directive. The thinking is that more takeovers will lead to more restructuring, and Europe badly needs more restructuring.

The Report embraces much of the rejected takeover directive. It requires shareholders, not management or unions, to approve any defensive measures once a bid has been launched. It also mandates that the bidder pay the same price to controlling and small shareholders. But the Report goes much further. The Winter Group also wants to impose “one-share-one-vote” (voiding dual-class shares) in votes on takeover defenses. And most controversial, the Report introduces a new break-through rule that allows any bidder who has acquired 75 per cent of equity capital to exercise a corresponding percentage of votes.

The new rules in the Report target companies with controlling minority shareholders, meaning shareholders owning a majority of votes but not of equity capital. Today firms like these are well insulated from hostile takeover threats. The Winter Group wants to remove the controlling owner’s veto power in order to encourage hostile bids.

But these new rules are at odds with the mandatory bid rule inherited from the draft takeover directive. The mandatory bid rule, intended to let small shareholders participate in the takeover gains, shuts down the market for trades in control blocks, increasing the cost for the bidder and making a takeover less likely to succeed. The Winter Group’s proposed break-through rule has the opposite effect. It will allow a bidder to succeed without paying any premium to either controlling or small shareholders, encouraging takeovers.

How will the Report change Corporate Europe? Controlling minority shareholders are unlikely to stay put. Owners with deep pockets can simply increase their stakes. This may not be all bad, but it will not promote takeovers. An alternative response is to create more opaque control structures involving pyramiding and cross-ownership. Nonetheless the proposed combination of break-through rule and mandatory bid rule will make many controlling owners decide to get out of the business altogether leaving the stage to all-powerful managers of firms with dispersed owners.

But when we do not like the music, it is not obvious that we should blame the pianist. It may well be that the score is bad or the piano out of tune. The presence of controlling owners reflects weaknesses in the legal and institutional environment. In this environment large blockholders can help by monitoring management on behalf of all shareholders - their large stakes give them incentives and powers to do so. Large blockholders could also be stealing from naïve minority shareholders who, inexplicably, keep “coming back for more”. Whether controlling owners monitor or steal is still debated. The evidence suggests they do both.

In the current European environment the objective of the Winter Group to get more widely held companies with more powerful managers will most likely make things worse. Who really thinks that

the Enron debacle would have been handled better had it happened in say Belgium or Spain? And had the ABB pension scandal been resolved more favorably for shareholders in a company controlled by Barnevik himself? After all, the controlling minority owners forced him to pay back half his pension.

It is too early to shoot the pianist, but not too late to change the score. Europe needs a better corporate governance environment with more transparency about ownership and control, and about what owners and managers do. And we need more rules holding them accountable and better enforcement. In this way controlling shareholders may become redundant.

Finally, this massive intervention at the heart of European capitalism rests on the assumption that hostile takeovers are the solution to the restructuring problem. Over the last decade hostile takeovers have become more or less extinct in the United States, and yet we see large-scale restructuring in U.S. industry. Maybe the Winter Group and the Commission should also rely less on hostile takeovers to tune up Corporate Europe.

***Erik Berglof** and **Mike Burkart** are affiliated with SITE at the Stockholm School of Economics, CEPR and ECGI. The authors are currently working on an article on European takeover regulation commissioned by the journal Economic Policy (www.economic-policy.org).