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TAKEOVERS AS AN EFFECTIVE MECHANISM FOR CORPORATE GOVERNANCE

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ABSTRACT

Corporate governance found itself in the forefront of the discourse in the business and academic world as a result of high level scandals which led to the collapse of hitherto strong multinational companies which were once thought to be sure bets. The need for the prevention of a reoccurrence of such scandals and improvement on a company's corporate governance system has prompted this study. This paper aims at examining takeovers regime as an efficient and effective mechanism for regulating corporate governance. It adopts a balanced approach whereby discussion is focused on the nature of takeovers, its various ramifications, justifications, shortcomings and efforts of the European Unions to promote the regime within the Union. The paper found the regime to be very useful subject to certain limitations which caused the need to recommend other mechanisms for regulation of corporate governance than takeovers.

KEY WORDS: *United Kingdom, European Union, Takeovers, market for Corporate Control and Corporate Governance.*

1.0 INTRODUCTION

This paper examines the takeover regime as an effective mechanism to regulate corporate governance. Corporate governance has found itself in the forefront of the discourse in the business world as a result of high level scandals which led to the collapse of hitherto strong multinational companies which were once thought to be sure bets.

Corporate Governance has always been a regular feature in the academic and business world. However, the term corporate governance has in recent years moved more significantly into our consciousness and echoed significantly in the business world. This is a ripple effect of scandals in companies such as Enron and Worldcom which exposed the menace of poor corporate governance and its resultant the catastrophic effect on the company and ultimately the shareholders.

The need for prevention of a reoccurrence of such scandals and improvement on corporate governance methods has prompted a debate on the effectiveness of various available mechanisms towards ensuring good corporate governance in companies. To this end, this paper focuses on the takeover regime which has been suggested to be one of the mechanisms available to combat bad corporate governance in the sense that the regime could serve as an incentive for good corporate governance and a means to weed out firms that have strayed from the path of cost minimization and profit maximization for which they are undervalued.

Two arguments have been advanced to justify takeovers. The first is that companies may be taken over in order to achieve synergies between the Bidder Company and Target Company. Second argument is that the takeover of a company may be necessary in order to discipline the inefficient managers of the acquired company.

On the other side of the divide is another group which is less keen on the use of the takeover regime in the regulation of corporate governance. In their opinion, takeover regime is a sham since control of a company is largely taken over not because of the inefficiencies of its managers but solely for the conservation of corporate wealth. They also state that the pressure of takeover threats and the fear of being acquired at an undervalued price may lead managers of companies to lose sight of their company's long term interest for present gains.

As part of efforts to integrate its citizens and create a common market for Member States, the EU issued a Directive on takeovers to encourage it among member states and harmonise and develop company and securities laws within the Union. The directive is designed to facilitate cross-border takeovers within the EU, ensure proper information to shareholders of a target company, the provision of level playing field and to protect the interest of publicly traded companies and minority shareholders of companies whose control has been acquired. Following from the above, this paper seeks to answer the following questions: To what extent do takeovers on the aggregate advance or hinder corporate governance? Is the takeover mechanism suitable or are there other institutional values to be taken into consideration in order to achieve a better result? If yes, how should the takeover regime be reconciled with the other institutional values? For the purpose of this paper, the ownership structure peculiar to the United Kingdom will be used to explain the theories which birthed corporate governance.

This paper is structured in five sections. This first section introduces topic and includes the questions it attempts to answer. The next section examines the primary basis for the advancement of corporate governance In this section, three prominent theories from which the need for corporate governance emerged and its importance are examined.

The third section analyses the takeover regime in itself, taking into consideration takeover from the perspective of the EU as well. In this section, the paper examines the takeover system vis-à-vis, its importance, aims and the justification for and against the regime. It further discussed the takeover of Mannesmann AG by Vodafone to enhance the European Union harmonization and integration agenda even though this was done before the adoption of the European Union Directive on takeovers.

As a result of the controversies surrounding the takeover regime, the fourth section recommends and analyses other mechanisms to ensure that a company is properly governed. The last section concludes the paper.

2.0 THEORETICAL BACKGROUND OF CORPORATE GOVERNANCE

The term corporate governance has become one of the frequently used phrases in the present global business vocabulary[1] even though the framework that supports the term dates back in time.[2] The recent global financial crisis and credit crunch which affected the financial markets and economies around the world with the bank failures have further put corporate governance in the limelight. The argument put forward is that the weaknesses in corporate governance are reasons for the crises.[3] There is no single accepted definition of corporate governance especially as the concept is evolving and dynamic in its own right but for the purpose of this paper, the term corporate governance is defined as '... the system by which companies are directed and controlled'.[4] Thus corporate governance could be said to be the system through which companies are governed and the aim for which they are governed.[5]

The main frameworks through which corporate governance is explained and analysed are the agency theory, transaction cost theory and stakeholder theory.[6] Each of these frameworks

1 J. Solomon, Corporate Governance and Accountability, (3rd ed., John Wiley & Sons Ltd, 201 p. 3.
2 B. Tricker, Corporate Governance Principles: Policies, and Practice, Oxford University Press 2009, p. 7.
3 Solomon (n 1) 3.
4 Solomon (n 1) 5.
5 B. Coyle, Corporate Governance, (5th ed., study text, ICSA Information & Training Ltd 200 p 4.
6 C. A. Mallin, Corporate Governance (3rd ed., Oxford University Press, 2010), p. 14.

even with their common attributes, still view corporate governance from different perspectives, arising from different disciplines.[7]

Agency Theory According to Berle and Means, Jensen and Meckling and also Fama and Jensen,[8] Agency theory is the separation of ownership of a company and the control of the company's actions.[9]

Jensen and Meckling explained agency theory to entail one or more owners of a company also known as shareholders (principals) contracting with one or more people also known as managers (Agents) to carry out some service in their company amongst which includes making decisions on their behalf[10]. Under the best situation, the contract between the shareholders and the managers should cover the best interest of both parties who ordinarily should be expected to keep their own bit of the contract. However, the self-seeking nature of individuals has made the best situation usually impossible to attain because the managers, in managing the company on behalf of the shareholders, make decisions which affect their personal welfare as well as the welfare of the shareholders.[11] The capability of the managers to make unsupervised decisions may lead them to make decisions in their best interests but

7 Solomon (n 1) 8.
8 ibid 9; see also, Mallin (n 6) 14.
9 Coyle (n 5) 6.
10 Solomon (n 1) 9.
11 Coyle (n 5) 6; E. C. M. Cheng and S. M. Courtenay, Board Composition, Regulatory Regime and Voluntary Disclosure', The International Journal of Accounting, vol. 41, no. 3, (2006), p. 262.

not the best interests of the owners. Company managers may prefer to pursue personal objectives at the detriment of the company. Such as aiming to gain the highest bonuses possible to supplement their salaries whether or not the company's profit is sufficient to sustain it or as company managers, they may require the use of the company's property or car and holiday packages by virtue of their status in the company.[12]

There also may be instances where there is disparity between the effort which the managers put into work and their remuneration whereby the managers put in insufficient effort towards the justification of their remuneration leading to conflict between the owners and managers. It is posited that where the managers are not the owners of the company, the level of efforts with which they use in running the company is likely to be less the efforts they would ordinarily use should they be the owners of the company.[13]

Another cause of conflict between the owners and the managers may be investment decisions of the managers vis-a-vis the time frame managers spend in the company. Shareholders generally are concerned with the long and short term financial prospects of their company. This interest may not align with the interest of managers who are concerned with short term financial prospect alone, reason being that they may be paid bonuses for short term performance or because they do not

12 Coyle (n 5) 6.
13 ibid.

expect to be in the company for a long length of time.[14] These examples show that a balanced situation between company owners and managers is less likely to be achieved. This then raises the question as to what the company shareholders can do to curb the selfish nature of their managers. Jill Solomon in her book, 'Corporate Governance and Accountability' recommended various monitoring techniques which company owners may adapt to supervise the performance of their managers and ensure that parties' interests are aligned.[15] One of the ways recommended in curbing the self-serving nature of managers is the inclusion of incentives targets in their contract of employment. It is argued that the managers desire to benefit from the incentives will prompt them to meet set targets thus performing the company owners bidding.[16] Where this is the situation, the interest of all parties will be met and consequently the conflict of interest recognised in agency theory will be minimized.

A crucial proposition also made to help curb managers excessiveness, is that made by Brian Coyle in his study text where he recommended the board of directors of companies to be more involved in monitoring the performance of managers.[17] The effectiveness of the board in monitoring the managers can be achieved if every member of the board individually and collectively put their hands on deck.

14 ibid 7.
15 Solomon (n 1) 10.
16 ibid and K. A. Eisenhardt, Agency Theory: An Assessment and Review', The Academy of Management, vol. 14, no. 1,(1989), p. 62.
17 Coyle (n 5) 7.

Another important recommendation worthy of note is that where the contract between the company's owners and managers obliged the latter to disclose information regarding the way the company is managed to the owners; same will go a long way to help curb their selfish tendencies.[18] The logic here is that requiring the managers to give account of their actions, will keep them in check and compel them to act according to their contract of employment so as not to be seen as dishonest. Where this is the situation, the interests of all parties are met and a balanced situation achieved.

It is pertinent to note that monitoring the acts of managers to ascertain that the delegation given to them is not abused has its cost and under the agency theory, same is called agency costs.[19] Agency costs are the expenses arising from mangers abuse of their delegated duties as well as the costs company owners spend in monitoring and disciplining the activities of management.[20]

In summary, agency theory identifies with the separation of ownership from management and the inherent problems caused by its setting. Hence it recommends ways in solving the problems so as to protect the interests of the company shareholders and its managers.

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18 Eisenhardt (n 16) 60.
19 Mallin (n 6) 15.
20 Solomon (n 1) pp. 10-11.

Transaction Cost Theory The transaction cost theory is related to the line of reasoning of Coase[21] and Williamson whose arguments were built on Coase work. The early advocates of this theory view companies not just as economic entities but rather as an organisation comprising different people having different intentions and aims.[22] The theory is focused on the management of contractual relationships in ways that leads a company to spending lower costs in the allocation of its resources.[23] The company's costs include amount spent in the set-up of a company, the costs for running the company as well as other costs that arise from a shift in initial agreements.[24]

The expounders of the theory posit that in a competitive environment, the business of the company can be carried out either in-house or through market transactions, depending on the way in which the company is organised.[25] For example, a company in need of a storeroom can choose to either spend money maintaining its products at a rented storeroom or build its storeroom within its business premises and not have to pay costs renting a storeroom for its products or having to purchase land at another location to build its storeroom. What then influences a company to carry on business operations in-house or through market transactions? It is advised that the company should make its decision based on the mode

21 Tricker (n 2) 223.

22 Solomon (n 1) 13.

23 R. Kochhar, Explaining Firm Capital Structure: The Role of Agency Theory vs. Transaction Cost Economics', Strategic Manual Journal, vol. 17, no. 9,(1996), p. 713.

24 ibid.

25 Solomon (n 1) 13 and Coyle (n 5) 8.

of business operation that is cheaper for the company.[26] However, it is important to state that where the company decides to carry on business operations in-house, it will need an organisational structure, shareholders and a hierarchy of authority with senior management at the top.[27] The act of carrying on business operations in house is referred to as vertical integration.[28] Williamson argues that internalising operations in-house saves a company production costs, transaction costs as well as removes the risks and uncertainties about prices and quality of products and services as well as the risk of dealing with suppliers to an extent.[29] The elimination of the risks of dealing with unnecessary higher pricing of goods, quality of products and untrustworthy suppliers removes information asymmetries, saves the company's resources, and reduces its business risk.[30] For example, a company that owns its storeroom removes the costs of renting a storeroom and this is advantageous to the company.

In spite of the advantages of internalisqing business operations in-house, transaction costs theory recognises the proclivity of two examples of human nature which affects business operations carried on in-house.[31] These are:

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26 Coyle (n 5) 8.
27 ibid.
28 O. E. Williamson, Transaction Cost Economics: The Governance of Contractual Relations', Journal of Law and Economics, vol. 22, no. 2, (1979), p. 234.
29 M. J. Leiblein and D. J. Miller, An Empirical Examination of Transaction- and Firm-Level Influences on the Vertical Boundaries of the Firm', Strategic Management Journal, vol. 24, no. 9, 2003, p. 841.
30 Solomon (n 1) 13.
31 Leiblein and Miller (n 29) 841.

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Bounded Rationality: Bounded rationality as defined by Jill Solomon in her book, is the behaviour that was deliberately rational but within limited understanding.[32] A hypothetical example will be where managers of a company take decisions in good faith but still accrue more costs than they should on their company as a result of their limit in understanding a particular business venture or their inability to anticipate actions of competitors or where the managers take a risk that backfires on them. Where this occurs, transaction costs theory recognises the managers good intentions albeit the cost of same on the company.

Opportunism: This is defined by Jill Solomon as 'self-interest seeking with guile'.[33] An example is where managers manage the company for their selfish interest or where they act in good faith, but still have to deal with 3rd parties who are opportunistic in nature. The former example is the reason why shareholders have to control their agents be it through the use of contracts or other means. This is where the similarity of transaction cost theory with agency theory lies as both present the rationale for company owners to control management.[34] while the latter example present the reason why it is in the interest of the company to internalize transactions as much as possible.

32 Solomon (n 1) 14.
33 ibid
34 ibid

Although agency theory and transaction cost theory view corporate governance from different perspectives, they both agree on the need for shareholders to control managers.

Stakeholder Theory

Stakeholder theory developed gradually after the agency and transaction costs theories. It has gained more prominence in the wake of the recent global corporate scandals.[35] Unlike the previous discussed theories, stakeholders' theory does not only describe current situations or predict business relationships, rather, it recommends a balance of accountability, responsibility, attitudes, structures and practices in a company.[36] The theory asserts that managers of a company have a duty to their company owners as well as other parties that contribute either voluntarily or otherwise to the creation of a company's wealth.[37] These other parties' may be beneficiaries and or risk bearers in the company.[38] Therefore, managers should consider their interest together with that of the shareholders when making decisions on behalf of the company. The supporters of the stakeholder's theory state that the goal of managers should be to balance making profit for the company owners alongside meeting the interests

35 ibid.

36 T. Donaldson and L. Preston, The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications', The Academy of Management Review, vol. 20, no 1, (1995), pp. 66-67.

37 S. Letza et al., Shareholding versus Stakeholding. A Critical Review of Corporate Governance, Corporate Governance: An International Review, vol. 12, no. 3, (2004), p. 244. See also, H. J. Smith, The Shareholders Versus Stakeholders Debate', MIT Sloan Management Review, vol. 44, 2003, p. 85.

38 ibid.

of other groups in a relationship with the company as this will aid the company's ability to remain a going concern.[39] The basis for this line of thought is because the company enters into a wide range of legal relationships with other persons or groups besides its legal relationship with its owners, hence under the duty to protect such relationships.[40] Who then are the company's stakeholders and how are they identified? The stakeholders of a company have been identified to include employees, creditors, customers, suppliers, the communities in which the company operates, the government and the general public.[41]

Having discussed the primary background that supports the advancement of corporate governance, this paper in the next section will now examine the takeover regime as one of corporate governance mechanisms designed to ensure that companies are properly managed, kept in check and disciplined where the company falls short of good corporate governance practice.

3.0 THE JUSTIFICATION FOR TAKEOVER REGIME AS CORPORATE GOVERNANCE MECHANISM

A takeover in corporate law is the act or the instance of a company assuming control or ownership of another

39 Smith (n 37) 86.
40 Solomon (n 1) 15.
41 ibid; see also, A. J. Hillman and G. D. Keim, Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line?', Strategic Management Journal, vol. 22, no.2, (2001), p. 126.

company.[42] Takeovers can either be friendly or hostile.[43] It is friendly when the takeover is chosen or accepted by the company being taken over (the target company), on the other hand, a hostile takeover is that which is opposed by the target company.[44]

Much of the empirical support for takeovers as an efficiency-increasing form of regulation comes from a new genre of statistical research.[45] Gershon Mandelker published the first merger event study rooted in the logic of the Capital Asset Pricing Model and ever since scores of papers have been written on how the announcement of a merger, takeover or related corporate control transaction affects the normalized stock prices of target and acquiring firms[46]. The corporate control debate suggests two hypotheses examinable under this approach. First, if tender offers are precipitated by incumbent management failures, tender offer targets should be less profitable than peer companies in similar industry groups. Second, if takeover displaces inefficient management or in other ways facilitates a movement to higher profit business strategies, post-takeover profitability should rise relative to pre-takeover profitability, conditions in the acquired unit's home industry being held constant.[47]

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42 C. Forstinger, Takeover Law in the EU and the USA: A Comparative Analysis, (Kluwer Law International, 2002), p. 4.
43 ibid.
44 ibid.
45 F. M. Scherer, Corporate Takeovers: The Efficiency Arguments', Journal of Economic Perspectives. vol. 2, no. 1, (1988), p. 74.
46 ibid.
47 ibid.

As written in the earlier sections, the selfish nature of the management of companies has given rise to the use of mechanisms to keep management in check, among which is the takeover regime also known as the market for corporate control as coined by Henry Manne.[48] What then is a well-functioning market for corporate control? The foundation of the market for corporate control theory is said to be the relationship between a company's management activities and the price of its shares.[49] A well-functioning market may be defined as one where the price of goods or services is more than half the value and less than twice the value.[50] Hence, if inefficient managers who do not take the necessary actions to maximise the worth of their company's shares and where the management of a company is inefficient in the sense that the price of shares fails to reflect the company's true potential, this would create an avenue for the company to be targeted for a takeover and indeed taken over so that the new management can then maximise the company's share price to its full potential.

Generally, it is argued that hostile takeovers maximise shareholders interest by weeding out inefficient management and replacing them with efficient management to increase the value of the company by redirecting the company's resources

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48 ibid 69; see also, J. Coffee, Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance', Columbia Law Review, vol. 84, (1984), p. 1199.

49 C. Bradley, Corporate Control: Markets and Rules', Modern law Review, vol. 53, no. 2, (1990), p. 170.

50 Scherer (n 45) 72.

to more profitable uses.[51] In an environment that facilitates hostile takeovers, using the United Kingdom as a case study[52], it is argued that same provides management with a strong incentive to maximise their company's value53 and it also aids company owners with inefficient management the ability to maximise their investment in the company when the company is acquired.[54] Thus make interest on their investment which is the primary aim of company owners.

In addition to the above, some scholars like Morck, Shleifer and Vishny; Martin and McConnell and Ikenberry and Lakonishok, view takeovers as an effective external tool to be used to curb managers autonomy in running a company for the fear of it being used to correct managerial failure in the event that the company is not properly run.[55] The argument posited by these scholars is that the acquiring companies generate economies of scale or scope; apply superior knowledge or skills; or provide a value improving synergy for the acquired company.[56]

Also, advocates for the takeover regime further state that takeovers are not only beneficial to the company owners

51 Forstinger (n 42) 5.
52 ibid 71.
53 F. Easterbrook and D. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer', Harvard law Review, vol. 94, (1981), p. 1174.
54 Forstinger (n 42) 5.
55 J. Dahya and R. Powell, Ownership Structure, Managerial Turnover and Takeovers: Further U.K. Evidence on the Market for Corporate Control', Multinational Finance Journal, vol. 2, no. 1,(1998), p. 2.
56 J. Stein, Takeover Threats and Managerial Myopia', Journal of Political Economy, vol. 96, no. 1, (1988), 61.

of target companies but takeovers also provide substantial benefits to the economy and to the society at large.[57] These benefits come in the form of competition in the economy markets and in improving the productivity of companies so that the goods and services that reach the consumers get to them for a lower price albeit their money's worth and still enable an environment for effective competition between companies in a global products market.[58] Again, the removal of the inefficient management of a company emphasises the threat of removal to the management of other companies tempted to be inefficient in the management of their company.[59]

Hence it is not only the acquiring company benefiting from a takeover but the market, the economy and the society at large. It is however important to state that the advocates for the takeover regime base their hypothesis on the market being efficient to fully reflect available information on companies whose shares are traded on a stock exchange and on this premise submit that takeovers are unlikely to occur just because a company is undervalued based on the information relating to the market, rather, a takeover is more likely to occur because the acquiring company is of the opinion that it would be able to realise profits by reorganizing the company.[60]

57 Forstinger (n 42) 5.
58 ibid.
59 ibid 7.
60 ibid.

The advocates of this school of thought recommend takeover mechanisms as the last resort when all other mechanisms fail to put management to order or boost the financial as well as other performance of companies.[61]

As with all other philosophies, the takeover regime is also controversial despite its aim.

Arguments against Takeover Regime

Scholars like Jeremy Stein, F. M. Scherer and David Ravenscraft who are less enthusiastic about the takeover regime are of the view that the pressure of takeovers and the fear of being bought at an undervalued price can be damaging to a company because the fear tends to lead the management sacrificing the long term interest of their companies for immediate gains.[62] They also argue that if takeovers were necessary for efficiency purposes as submitted by its advocates, how have countries like Japan and France continued to perform well even though hostile takeovers are practically nonexistent and company ownership is often separated from management control as obtainable in the United Kingdom? [63] As this is a rhetorical question, there is no satisfactory answer to same.[64]

Again, those who argue against the takeover regime submit that company managers tend to maximise the size of their

61 Stein (n 56) 61.
62 ibid.
63 Scherer (n 45) 70.
64 ibid.

companies as opposed to maximising shareholder value.[65] Management's decision to pursue size maximization, even when it is not in the interests of shareholders perhaps may be for any or all of a variety of the following reasons:

(a) The larger the size of the company, the more likely management tends to get higher compensation;

(b) A larger company implies better security from a takeover or other forms of control contest;

(c) A larger company enhances reputation and psychic salary package is associated with increased size and national prominence;

(d) A larger company often translates into oligopolistic market power;

(e) A larger company offers opportunities for portfolio advancement to the management staff of the bidding firm.[66] Where the desire to control another company stems from any of these reasons, neither performance efficiency, nor discipline control is the justification for any takeover tender, rather wealth maximization seems to be the aim on the part of the bidding company's management.

Using this line of thought, F. M. Scherer and David Ravenscraft carried out a survey of the performance of acquired companies using unprecedentedly detailed Line of Business data collected by the Federal Trade Commission of 471 companies

65 Coffee (n 48) 1167.
66 ibid 1167-1168.

in the United States of America and found that most acquired companies even after being taken over, continued to have slightly inferior cash flow and sales performance.[67] To this end, some of the acquired companies were either sold off voluntarily by its new management or involuntary for fear of takeovers and their threats by other companies.[68] Hence, the argument that takeovers improve performance is not supported as the divesting and subsequent sale of the acquired company or some divisions of the company certainly is not a means of disciplinary mechanism neither does it justify the premium paid, rather it raises the question of what really motivated the bidder's tender? It seems to be that as John Coffee submits, the management of the bidder company perhaps placed a tender because a greater size of their company tends to correspond with higher compensation for management.[69]

Another argument against the takeover regime is that, it is the shareholders of the bidding company and not its managers that suffer the brunt of the takeover tender being that the shareholders are the ones that pay for the takeovers which are always carried out at a premium at the loss of the acquiring company's shareholders but gains to the target shareholders.[70] This argument seems to suggest that acquisitions are motivated by the objectives of the managers rather than the shareholders because of the pursuit of their

67 Scherer (n 45) 74-76.

68 ibid at 77.

69 Coffee (n 48) 1167.

70 S. Bhagat et al., Hostile Takeovers in the 1980s: The Return to Corporate Specialization', Brookings Papers on Economic Activity. Microeconomics, vol. 1, (1990), p. 3.

own goals, hence the willingness to overpay the shareholders of the target companies.

From the above arguments, a big distrust has surfaced in the takeover regime, hence the uncertainty in it being an effective corporate governance mechanism. This situation certainly calls for the development of alternative corporate governance mechanisms towards ensuring good corporate governance in companies.

The European Union Market for Corporate Control: Takeover Directive and the Need for Harmonisation

Previously, there was no uniform takeover regulatory system within the European Union to govern takeover tenders among its Member States. Instead, companies were governed by the law of the country in which they were incorporated, hence a significant variation in the regulatory schemes concerning takeover tenders among the Union's Member States.[71] The United Kingdom however, is one of the few countries whose market for corporate control can be studied because it has in place fewer anti-takeover provisions provided for in either its corporate charters or state legislation,[72] and as such has been the pioneer within the European Union providing a guide for a harmonised European legislation which will facilitate

71 Forstinger (n 42) 52.
72 J. Franks and C. Mayer, Hostile Takeovers and the Correction of Managerial Failure', Journal of Financial Economics, vol. 40, no. 1, (1996), p. 165.

takeovers, improve on the European Union's integration scheme among and within its Member States and provide a level playing field for all takeover bids.[73] A central regulatory problem however for the European legislators was to determine the optimal balance between harmonization and diversity within its Member States regulations on takeovers. After several proposals on a takeover directive to reflect this harmonization and diversity, a balance was struck which birthed the adoption of the Thirteenth Company Law Directive.[74] The Directive has contained in its framework six general principles which member states must comply with and also sets out other general requirements which Member States will have to respect through detailed implementing rules.[75] These principles however are to be seen as minimum requirements of the Union's takeover regulation as the Directive expressly authorises Member States to lay down additional conditions and provisions more onerous than those of the Directive for the regulation of takeover tenders.[76] How then does the Directive achieve its aim of creating a level playing field as indicated in the introduction of this paper?

With regards to providing a level playing field for its Member States, The EU decided that the shareholders in the company be given the ultimate right to decide whether to tender their

73 B. Clarke, The Takeover Directive: Is a Little Regulation Better Than No Regulation?', European Law Journal, vol. 15, no. 2, (2009), pp. 175-177.
74 Council Directive 2004/25/EC of 21 April 2004 Directive of the European Parliament and of the Council on Takeover Bids [2004] OJ L 142/12; see also, ibid 175.
75 ibid 178.
76 ibid.

shares and at what price.[77] Hence, where a takeover bid has been tendered, the target company managers must first seek the permission of its shareholders in general meeting before taking any step to frustrate the bid. In particular, shareholders consent must be sought before the issuing of shares which may have the effect of a lasting impediment on the takeover tender[78] The Directive however provides that managers can find alternative bidders without first seeking shareholder's consent.[79] This provision is to prevent target company managers from selfish behaviour and from benefitting from a takeover tender to the detriment of their company owners while still in office in the case of an unwanted takeover bid, for when faced with a hostile takeover bid, target managers may prefer regulations that are less protective of their company owners interest, hence the need to have a harmonised takeover rules to particularly protect the interest of the company owners especially those in the minority as well as to promote the establishment of an efficient European capital market.[80]

The Directive also requires that shareholders approval be sought where a takeover tender is made after a company's decision on some issues affecting it but before implementation of such decisions, be it partly implemented before the tender or not.[81] Where the decisions however are part of the company's

77 Council Directive (n 74) Article 3(1)(c).
78 ibid Article 9(2).
79 ibid.
80 Forstinger (n 42) 157.
81 Council Directive (n 74) Article 9(3).

normal activity, Shareholder's consent need not be sought.[82] This is so, so that the bid is not frustrated.

In addition to the above, the Directive also provides for the rights of employees. However, the rights only cover employees' right to information and consultation alone.[83] The target board is required to form its views on the possible outcome of the tender with regards to all the company's interests and specifically employment.[84]

The EU's aim of creating a level playing field is guided by a second principle which is proportionality between risk bearing and control[85]. The Directive introduces the break-through rule which purpose is to increase the number of takeovers within the European Union by eliminating provisions which hinder takeovers.[86] In a Report submitted to the Union, it was argued that provisions which hinder takeovers in Member States company law was generally contradictory with the principle of the rights of shareholders to decide on a tender.[87] Hence, once a takeover tender is made, provisions in the articles of association of the target's and bidder's company which restricts the transfer of securities shall not apply during the time allowed for the acceptance of the tender.[88] Also, the Directive states that where the articles of association

82 ibid.
83 ibid Article 6(3)(i) and 9(5).
84 Clarke (n 73) 184.
85 ibid 185.
86 Council Directive (n 74) Article 11.
87 Clarke (n 73) 185.
88 Council Directive (n 74) Article 11(2) and (3).

of the target company restricts voting rights and also contain restrictions on voting rights in contracts between the target company and its shareholders or between shareholders who entered such contracts after the adoption of the Directive shall not apply at the general meeting of shareholders' deciding on any defensive measures to be taken once a tender is announced.[89] In addition, the Directive provides that multiple-vote securities will carry one vote each at the general meeting of shareholders which decides on any defensive measures against a takeover tender. The Directive further provides that where following a tender, the bidder holds up to 75% or more of the capital-carrying voting rights, none of the above restrictions and none of the extraordinary rights of shareholders in the articles of association with regards the appointment and or removal of board members shall apply.[90] Furthermore, multiple-vote securities will carry one vote each at the first general meeting of shareholders following closure of the tender, called by the bidder to amend the articles or appoint and or remove directors. The bidder is entitled to call such a meeting on short notice once as long as at least two weeks' notice is given to attend the meeting.[91]

It is important to state the cancellation on restrictions of the transfer of securities during the time allowed for the acceptance of the bid, the Directive provision of multiple-vote securities carrying one vote each at the general meeting

89 ibid.
90 ibid Article 11(4).
91 ibid.

of shareholders which decides on any defensive measures against a takeover tender and the provisions of Article 11(4) do not apply where the restrictions are compensated for by specific pecuniary advantages or where the rights are held by member states.[92]

Of equal importance is the provision of the Directive which gives member states the right not to require target companies registered in their jurisdiction to apply the prohibition on frustrating action as contained in Article 9 and or the break-through rule in Article 11.[93] However, if Member States make use of this option, they must still grant companies the reversible option of applying the Articles.[94] Further to this, the concept of reciprocity was introduced in the Union. The concept allows Member States to exempt companies in their jurisdiction that have opted to apply the Directive the leeway to opt out of the Directive if they become tender targets by a company that has opted out of the Directive or a company controlled by such a company.[95] For a company to avail itself from this provision, the shareholders have to give their consent in a meeting convened no more than eighteen months before the tender was launched.[96]

A real life example of where a Member State company in the Union has acquired control of another Member State

92 ibid Article 11(6) and (7).
93 ibid Article 12(1).
94 ibid Article 12 (2).
95 ibid Article 12(3).
96 ibid Article 12(5).

company is the takeover of Mannesmann AG by Vodafone. Mannesmann AG was a German Company which originally produced seamless steel tubes. Over the years, it acquired other companies and became a diversified conglomerate. It became Germany's second largest fixed line telephony and internet provider company. Vodafone a United Kingdom company also into the business of mobile phones initially tried to partner with Mannesmann in 1991 but the partnership never came to be. Hence, Vodafone bid to acquire Mannesmann which was resisted by the company until 2000 when it was obvious that the shareholders of Mannesmann were going to sell their shares to Vodafone. This resulted to the two companies agreeing to a friendly merger after the bitter battle.[97]

From the above provisions of the Directive, surely a harmonised tthe application of individual country's regulation within the Union as the Directive removes the problem of having to deal with the Member States laws respectively in a takeover tender. Most especially the Directive enhances the integration of the Union's Member States which is of utmost importance to it while providing a level playing field for Member States.

Also, the adoption of the Directive will assist to promote the European Union market position in the global market and at the same time enable the Union put in place a standard level

97 M. Höpner and G. Jackson, An Emerging Market for Corporate Control? 'The Mannesmann Takeover and German Corporate Governance', MPIfG Discussion Paper, September, 2001.

of investor's protection as proof that its market is attractive and secure to do business.

Despite the aims which the Directive seeks to achieve, its provisions are not without its gaps. For the purpose of this paper, two of these criticisms are discussed. Whilst the board of directors of the target company is required, under the Directive Principles, to advise, with reasons, on the consequences of a launched takeover on the company, its business and the attractiveness of the terms of the bid for the shareholders bearing in mind the interest of the company as a whole, no reference is made to the composition of such board regarding whether directors with a particular conflict of interest should step down or not.[98] This omission is a fundamental failure on the part of the Directive to fully protect the interest of shareholders and to provide a level playing field.

Also, in considering the effectiveness of the Directive, the opt in and out option contained in the Directive has led to greater controversies than gain.[99] Commissioner Bolkestein maintains that the optional provision which enables Member States to opt out of the provisions of the Directive not only defeats the purpose of the Directive, it also sends out the wrong message to the market.[100]

98 Clarke (n 73) 188-189.
99 ibid 191.
100 ibid.

Consequently if the takeover regime and the Directive of the European Union on takeovers does not entirely meet its aim, what other mechanisms are there to regulate the corporate governance of companies?

4.0 CONCLUSION/SUGGESTIONS

This paper examined takeover as an effective and adequate mechanism for regulating corporate governance to engender proper company management and eliminate or reduce problems associated with agency theory.

It adopted a balanced approach to the discussion concerning the market for corporate control and other corporate governance mechanisms by touching on such relevant theories as agency, transaction costs and stakeholder theories and their importance to the primary goals of curbing managers' inefficiencies, reduction of agencies' problems and promotion of transparency and accountability in corporate governance.

The paper started by looking at three fundamental theories namely, Following from this, the research examined the takeover regime also known as the market for corporate control and the justification for same. In this section, the research mentioned two kinds of takeover namely friendly and hostile takeovers but concentrated on the latter because the former is done with the consent of the target company, whereas in the case of the latter, the target company opposes the takeover tender of the bidder. The justification for takeovers includes the need to discipline inefficient managers of failing companies or create synergy with the acquired company. The paper in this section among other justifications for takeover regime submitted that the economy and public at large benefits from a takeover and not only the shareholders of the target companies. Despite the arguments in favour of a takeover regime, there are also scholars less enthusiastic about the takeover regime. Hence the research examined the views of the displeased scholars. Those less excited about the takeover regime argue against the regime on various grounds after their empirical research found that after some companies were acquired, no considerable discipline and profit were seen and made by the acquired companies, instead some of these acquired companies were overtaken only to be resold. The scholars also found that some mangers of the bidder companies launched a bid only for wealth accumulation as a larger company raised their salary package and status in the society. These acts of the managers of the bidder company therefore question the takeover regime as a whole. The arguments against takeover regime suggest that the market for corporate control does not therefore function as a disciplinary device for poorly performing companies, even though agreeable on some study cases, takeovers may promote economic efficiency as well as discipline erring managers.

Accordingly, those against the takeover regime submit that before a takeover would be seen as justified, the management of a target company would either have to have used a greater portion of the company's value through inefficient performance or selfish dealings or have convinced the market that recurrent substantial deviations from the goal of shareholder profit maximization were likely to reoccur in the foreseeable future.

To this end, the research paper examined the takeover Directive of the EU. This section discussed the need for a harmonized law to govern takeovers within the EU and the eventual adoption of the Thirteenth Company Law Directive. Its provisions were examined to evidence the aim of the EU in relation with the takeover regime, which is to create a level playing field for its Member States, enhance the European capital market position in the global market and at the same time enable the Union put in place a standard level of investor's protection as proof that its market is attractive and secure to do business. Most especially, a harmonised regulation meets one of the core agendas of the EU which is for its Member States to integrate. The case Vodafone takeover of Mannesmann AG was also discussed in this section even though the takeover happened before the advent of the Directive. However, the Directive of the Union is not without its gaps and these were highlighted. A crucial loophole created by the Directive is the opt-in and opt-out option given to Member States.

Hence, the loopholes in the takeover regime as well as the gaps in the Thirteen Company Law Directive calls for alternative mechanisms to regulate corporate governance and may be another Directive for the EU or the removal of some provisions in the present Directive. This is written considering that the effectiveness of the Directive as a corporate governance tool is yet to be tested.

The fourth section of this paper recommended the use of other institutional mechanisms of corporate governance which it opines that if used alongside the market for corporate control would curb to the barest minimum agency problems. To this end, the research recommended the use of other corporate governance mechanisms to curbs managers inadequacies by spotting such inadequacies almost immediately when they occur. These mechanisms include an effective board, shareholders participation in their companies and mandatory/voluntary disclosure.

Although this paper agrees that the market for corporate control can and does perform a socially desirable function in monitoring and deterring managerial inefficiency, as well as play a substantial role in reducing agency costs, it is of the opinion that the market for corporate control alone cannot be used to ensure good corporate governance for the reasons discussed in the body of the paper, thus the need for other mechanisms that would respond to inefficiencies as soon as they occur in order to ensure that a company is efficiently and effectively run.

There is the need for Effective Board Management. The quality of the members of the board cannot be over emphasised as they are the ones that directly monitor the affairs of the management company. The members of the board should be capable of exercising objective independent judgement on corporate affairs.[101] This is achievable when members of the board commit themselves effectively to their responsibilities be it through training whether in-house or external so as to keep abreast of the happenings in the company, relevant laws and regulation because in principle, it is the board that has access to confidential information about the company, hence should be the first to know about managers inefficiencies before the market, thus take necessary steps to protect the company from managers exploitation.[102] On the company's part, it should provide the board members with accurate, relevant and timely information in order for them to fulfil their responsibilities.[103]

Similarly, there is the need for Shareholders Activism. Shareholders activism may be viewed as the act of the shareholders giving regular responses to corporate performance.[104] The ways in which shareholders can monitor management as an agent has been discussed under the agency theory. The primary question is whether shareholders involvement can affect corporate decision making? At one extreme are the shareholders who buy and sell their shares at

101 Grant Kirkpatrick, The Corporate Governance Lessons from the Financial Crisis', Financial Market Trends © OECD, vol. 1, 2009 p. 23.
102 ibid.
103 ibid 24.
104 S. Gillan and L. T. Starks, A Survey of Shareholder Activism: Motivation and Empirical Evidence', 1998, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=663523, (accessed 05 October 2014) p. 3.

will[105] and by virtue of their initial purchase and subsequent sale may be referred to as actively participating in the market. At the other extreme are those that buy into a company and actively participate in its governance. Shareholders, especially institutional investors have a potential to fulfil the role of actively engaged owners.[106] Indeed, large intermediary can help solve agency problem because of the shareholders ability to take advantage of economies of scale and diversification.[107] Also important is Mandatory Disclosure. This refers to the different information generated by companies, such as its annual report which contains the director's report which must include amongst others, a business review, the profit and loss account, balance sheet, cash flow statement and other required items.[108] These generated reports are the main ways through which companies communicate with their shareholders and potential investors.[109] At the moment, some companies have raised the notch by not only producing mandatory reports, but report also on items which relate and affect their type of business to prove their worth to current and potential investors , such information is called voluntary disclosure as they go beyond the mandated minimum.[110] This act is encouraged as it improves transparency which is one

105 ibid.
106 Solomon (n 1) 115.
107 ibid.
108 ibid at 152.
109 P. M. Healy and K. G. Palepu, Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature', Journal of Accounting and Economics vol. 31, 2001, p. 406.
110 ibid.

of the objectives of corporate governance, reduces agency problems, fosters confidence of the investors on their investee companies and reduces information asymmetry.
Also, at the European Union level, there are provisions which cater for the mandatory disclosure of companies of Member States trading on its platform.[111]

The above mechanisms if followed to the spirit and letter would deter poor corporate governance by managers and their acts which are detrimental to the company. These mechanisms could enable the discovery of discrepancies almost as soon as they occur and curb managers' actions without waiting for the market for corporate control to come to the company's rescue.

111 Class notes from Professor Emilos Avgouleas, University of Manchester, March 2011, pp. 5-12.