

International Comparison of Corporate Governance

External mechanisms of CG: the market for corporate control

基礎企業ガバナンス論

16 December 2011

Mechanisms to control the actions of top managers

I. Internal mechanisms

- The annual general meeting (AGM) of shareholders, the board of directors (BoD)

株主総会、取締役会

II. External mechanisms

- The market for corporate control, shareholder lawsuits, government regulations (e.g. company and securities laws), codes of best practices (CG codes)

企業コントロールの市場、株主訴訟、政府の規制(会社法・証券法)、行動規範(コーポレート・ガバナンス規則)

The market for corporate control (I): M&A

Has a disciplining effect on the management because:

- **(1) Companies with lower-than-average performance tend to become “targets” of M&A (esp. hostile takeovers)**

吸收合併、敵對的買收

- **(2) If the M&A is successful, the new owners will probably decide to replace the management**



- **Therefore, the management will try to improve the company's performance to avoid becoming the “target” of M&A**

The market for corporate control (II): mergers 合併

- Two companies, A and B, voluntarily decide to combine into a new legal entity (e.g. company C) → the shareholders of A and B receive shares of C according to a predetermined exchange ratio
事前に定められた交換比率
- For example, if 1 share of A is exchanged for 1 share of C, and 1 share of B is swapped for 1 share of C → *“a merger of equals”*
- Classical example: the merger of UK pharmaceutical firms Glaxo and SmithKline into GlaxoSmithKline Plc in 1999

Another example: DaimlerChrysler

- In 1998, two famous car manufacturers, the German *Daimler Benz AG* and the US *Chrysler Corporation*, merged to form *DaimlerChrysler AG*
- The merger was also called “a merger of equals”, but most analysts believed that it was actually a takeover of Chrysler by Daimler Benz



The failure of DaimlerChrysler

- The merger was eventually dissolved in 2007 when DaimlerChrysler sold the US part to a private equity firm, Cerberus Capital Management
- The result: two separate companies (Daimler AG and Chrysler LLC)
- **In 2009: Chrysler LLC filed for Chapter 11 bankruptcy and the Italian Fiat took a 20% stake in the new company Chrysler Group LLC**
- **In 2011: Fiat increased its stake in Chrysler to 53.5%**

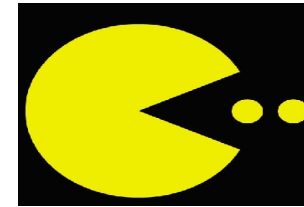
Market for corporate control (III): acquisitions/takeovers 買収

- Company A (called “the bidder”/“the acquirer”) acquires control of the company B (“the target”) → as a result, the shareholders of B get either cash (for ex., \$10 per share) and/or shares of A according to a predetermined exchange ratio
- For example, 1 share of B is exchanged for 0.5 shares of A
- Classical example: the takeover of the German telecom company Mannesmann AG by the UK’s Vodafone Group Plc in 2000
- Mannesmann’s shareholders got 49.5% of the combined company

Types of takeovers

I. Friendly 友好的買收

- Step 1: the bidder makes an offer to buy the target to the target's board of directors
- Step 2: negotiations
- Step 3: the target's board recommends the shareholders to accept the bidder's offer



II. Hostile 敵對的買收

- (1) either at Step 3, the target's board rejects the bidder's offer, or
- (2) the bidder makes an offer without informing the target's board beforehand

Mannesmann's takeover I

- Started in Nov. 1999 as a hostile takeover because the board (especially the employee representatives) was against the deal
- There was a weird exchange of ads between Mannesmann and Vodafone during the takeover battle
- (1) Vodafone published an ad showing a mother feeding its baby with the caption:
“Every Mann (a reference to Mannesmann) knows that if you want to grow, you need a good mother.”
- (2) Mannesmann replied with a revised version of its original baby ad:
“A hostile mother is the worst thing in the world.”

Exchange of ads I

Figure 2



Exchange of ads II

- A further series of ads displayed the German signs for construction sites
- (3) Mannesmann published the following ad:
“Warning! Vodafone will turn your stock portfolio into a construction site.”
- (4) Vodafone’s reply showed the medieval fools’ hat used in the Rhineland’s carnival season suggesting that:
“Mannesmann are making fools of its shareholders”

Exchange of ads II

Figure 3



ACHTUNG! MIT VODAFONE WIRD IHR AKTIENDEPOT ZUR BAUSTELLE.

Ein Aktiendepot ist das, was Vodafone hat. Bitte ist:

- Zeitaufwändige IT-Grundlegung
- Zeitaufwändige Umstrukturierungen
- Geplante Entwicklung für mind. 12 Monate
- Hohe Liquidität für Sie: Verursachen großer Wartezeiten

Lassen Sie sich nicht unter Druck setzen. Beachten Sie die Folgen: Hohe Kosten, Profitieren Sie vom höchsten Wachstum einer unabhängigen Mannesmann-Aktie.

FRANZOSENSTRAßE
Handelsregister-Nr. 150700
 Amtsgericht Köln

Tel. 0900 / 2000 550



Kreider & Co. AG



Vorsicht: Narrenfreiheit.

Die Deutsche Telekom AG ist ein Unternehmen der Deutschen Telekom AG. Die Deutsche Telekom AG ist ein Unternehmen der Deutschen Telekom AG. Die Deutsche Telekom AG ist ein Unternehmen der Deutschen Telekom AG.

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**vodafone
airtouch**
LEBENSZEIT FÜR VIELFRAGEN

Mannesmann's takeover II

- In Feb. 2000, a friendly takeover deal was finally reached (for the price of \$183 bln.)
- An improved offer for Mannesmann shareholders to exchange their shares in the ratio of 58.96 Vodafone's shares for one Mannesmann share (the previous offer was 53.7:1)
- The chair of Mannesmann's supervisory board, Klaus Esser, gave up his executive responsibilities with a "golden handshake" worth nearly 15 million euro

How can a hostile takeover succeed?

- (1) The bidder takes a minority stake in the target company
- (2) The bidder starts and wins a proxy fight to change the target's board of directors → the newly elected board approves of his offer to buy the controlling stake of the target company

株主提案、委任状争奪戦、企業の支配権

- (3) The bidder makes a public takeover bid (TOB) to the shareholders of the target company → an offer to buy their shares at a price higher than the current market price → eventually the bidder buys the controlling stake

株式公開買付け

Success or failure of the TOB

- The bidder offers to buy a predetermined amount of target company's shares at a fixed price during a specified period (the TOB period)

買付け期間、買取価格、買取株式数

- **If the bidder manages to buy the planned amount of shares within the TOB period, then the TOB should be considered a success**

- “Control premium”: the amount that the bidder is willing to pay above the current market price of a publicly traded company

「買収プレミアム」: TOB 発表前の株価と公開買付け(買取)価格との差

The battle for the control of Arcelor (I)

- In January 2006, *Mittal Steel*, the world's largest steel company, announced a \$23.3 bln. takeover bid for *Arcelor*, the second largest (based in Luxemburg; the result of the merger of Spanish, French and Luxemburg steel companies)
- At first, Arcelor's board rejected the bid and tried to defend the company by increasing dividends and using a “white knight” defense
- “Economic nationalism” in continental Europe and the desire to have “national champions”

白馬の騎士

保護主義、自国企業促進

The battle for the control of Arcelor (II)

- In May 2006, Mittal Steel increased its offer for Arcelor to \$32.4 bln. or \$47.34 per share
- **Goldman Sachs and other investment banks rallied shareholder support for an extraordinary shareholder meeting → a strong pressure on Arcelor's board to accept the improved offer**
- **In June 2006, Arcelor's board accepted a further sweetened offer of \$50.68 per share → Mittal Steel took over Arcelor and created *Arcelor Mittal* (the world's biggest steel company)**

Takeover defenses: “poison pills” (I)

Definition: devices that make the takeover bid prohibitively expensive or disadvantageous to the bidder

毒薬

- Example #1: “the macaroni defense”
- If the takeover is successful, the bidder will face damaging financial commitments
→ such as the redemption of a large number of high-yield bonds of the target company

買収が成功すれば、買収される企業(ターゲット)の高利回り社債の償還をしなければならない

Takeover defenses: “poison pills” (II)

- Example #2: if the bidder manages to buy a large part of the shares, he/she would not be able to acquire control of the target company because of:

→ the automatic issue of warrants diluting the bidder's stake

買収する企業がターゲット株式の15%以上を取得すれば、買収する企業以外の株主を対象に新株予約権が自動的に発行され、買収する企業の保有率が引き下げられる

→ the automatic division of shares into multiple voting (class A) and ordinary (class B) shares

買収する企業以外の株主が保有する株式は自動的に種類株に転換される

The poison pill defense introduced by News Corporation

- The media boss, Rupert Murdoch and his family → 29.5% of *News Corporation*
- The US cable group *Liberty Media* owned 9% of News Corporation and wanted to raise its shareholding to 17%
- But News Corporation's articles of association were changed, allowing existing shareholders to increase their stakes if anyone else bought more than 15%
- **Pre-bid defense 「事前警告型買取防衛策」**



Other takeover defenses

- “White knight” 白馬の騎士
- “Scorched earth” 焦土作戦
- “Crown jewel” 王冠の宝石

買収者にとって魅力的である優良資産を売却することにより、ターゲットの魅力を引き下げる

Example from Japan’s recent takeover history:

★ during the 2005 battle for control of Nippon Broadcasting (日本放送), Nippon Broadcasting tried to sell its Pony Canyon subsidiary to Fuji TV to prevent takeover by Livedoor

The 2007 battle for control of Bulldog Sauce (I)

- *Bulldog Sauce: a Japanese “tonkatsu” sauce manufacturer*
- **The US hedge fund, *Steel Partners*, had a 10% stake in *Bulldog Sauce* and launched a hostile takeover bid**
- Steel Partners offered the other shareholders 1,700 yen per share, a 25.8% premium to Bulldog’s 12 month average share price
- Bulldog’s board issued 3 warrants per share to each shareholder but Steel Partners was barred from exercising its warrants



The 2007 battle for control of Bulldog Sauce (II)

- As a compensation, Bulldog Sauce paid Steel Partners in cash 396 yen per warrant → a total of 2.3 bln. yen (about \$19.3 mln.)
- Steel Partners challenged the decisions of Bulldog's board in Tokyo District Court but the court ruled in favor of the management
- Result: Steel Partners could not get control of Bulldog Sauce but received a nice return on its investment → on the other hand, Bulldog wasted 2.3 bln. yen for the defense
- Post-bid defense 「事後型買収防衛策」

When does the hostile takeover mechanism work? Part I

Three conditions must be met

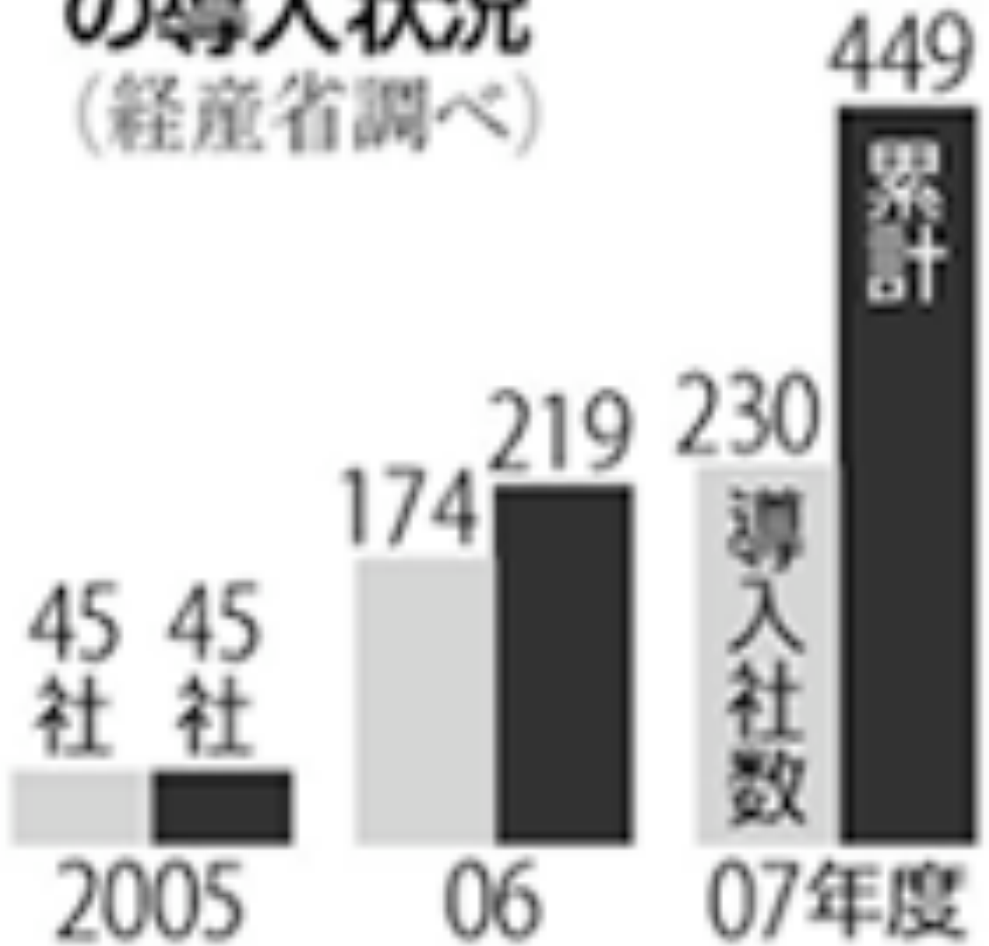
- (1) the target company's ownership must be widely dispersed (as in the "outsider model")
- (2) the bidding company must be convinced of the benefits of the acquisition (e.g. higher profits, larger market share, access to strategic resources, etc.)
- (3) the majority of the target's shareholders must have an orientation toward short-term financial gain (as in the "outsider model")

When does the hostile takeover mechanism work? Part II

- In the Anglo-Saxon countries where company ownership is dispersed and there are no stable shareholders
- In continental Europe, hostile takeovers are rare because of the concentrated company ownership and the strong role of employees in CG
- In Japan, also rare due to the existence of stable shareholders (e.g. banks and other related companies)
- But the proportion of shares held by stable shareholders has been decreasing → some Japanese companies had to introduce takeover defenses (“poison pills”)

Increasing use of takeover defenses by Japanese listed companies

● 上場企業の買収防衛策の導入状況 (経産省調べ)



Mandatory TOB rules

- To prevent “creeping takeovers” – getting control of the target without the knowledge and the consent of the other shareholders

株式公開買付けの義務

- Example: the UK City takeover code
- (1) The duty of all listed companies to disclose large shareholders having more than 10%, 20%, 30%, etc.
- (2) The duty of a potential bidder to announce a takeover bid for all shares of the company if its' shareholding exceeds 30%

Questions for discussion

- Pros and cons of hostile takeovers in general
- Pros and cons of hostile takeovers by foreigners
- Should soccer/baseball teams be bought and sold like companies (for example, what do you think about Murakami's idea to list Hanshin Tigers)?
- What are the reasons for success or failure of mergers/takeovers?
- Additional terms: “Wimbledon effect” (ウィンブルドン現象), “greenmail” (グリーンメール), “sokaiya” (総会屋), “locusts” (イナゴ), “speculative investors” (秃鷹投資家)

Photo of a locust

(大勢のイナゴに作物を食い荒らされる危険性)

