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Outcry Against European 'Protectionism' Is Misguided

by André Nilsen

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HOSTILE TAKEOVERS VS FOREIGN TAKEOVERS

Most Continental-European governments oppose hostile takeovers. Recent reports indicate that takeover defences will continue to be available in most Member States also after the EU Takeover Directive has been implemented. In addition there have been a number of headlines lately about various governments intervening in specific takeover battles. This has led to an outburst of allegations that 'protectionism' is on the rise in Europe.

These concerns are however wholly without foundation and largely result from confusion between hostile takeovers and foreign takeovers.

MAIN POINTS
The heated accusations that 'protectionism' is spreading in Europe, scaring away investors, and posing a risk to the economy are unwarranted as governments are not opposed to foreign but to hostile takeovers, a long standing policy vital to the comparative advantages of Continental-European economies.

ABOUT THE AUTHOR
André Nilsen is the Chairman and Managing Director of the OCGG and a DPhil candidate in political economy at Oxford. He has an MPhil from Oxford and did his undergraduate studies at Oslo, Washington, Heidelberg, and Harvard. He can be contacted at andre.nilsen@oxfordgovernance.org

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Continental-European governments are not against foreign takeovers, they oppose hostile takeovers, regardless of the nationality of a hostile bidder. This has therefore nothing to do with 'protectionism'. It is also nothing new or bad. It is instead a long standing policy which solid evidence shows is critical to sustaining the comparative advantages of these economies.

Although hostile takeovers generally are detrimental to economic performance in all economies because they usually either destroy shareholder value or simply transfer value from stakeholders to shareholders, they are particularly harmful in Continental-European economies because they undermine the institutions that underpin the distinct comparative advantages of these economies

Since hostile takeovers have these negative effects regardless of whether the hostile bidder is foreign or domestic, opposing them has nothing to do with 'protectionism' but everything to do with promoting economic competitiveness. Both foreign direct investment and domestic corporate restructuring are of course good and necessary but there is no need to do any of it through hostile takeovers since better results can be achieved through friendly takeovers, mergers, or greenfield investments.

GOVERNMENT OPPOSITION TO HOSTILE TAKEOVERS

European governments are at the moment in the process of implementing the EU Takeover Directive before the 20 May 2006 deadline. It has emerged that the choice offered in Article 12 will be exercised by most governments to retain the availability of pre-bid structural defences by opting out of the breakthrough provisions of Article 11 and by many governments to keep also post-bid discretionary defences by opting out of the board neutrality provisions of Article 9. This turns the original intention of the European Commission to outlaw all takeover defences to pave the way for a single European market for corporate control on its head.

Some governments have at the same time made efforts to orchestrate domestic friendly corporate restructuring solutions to frustrate foreign hostile takeover bids. The most notable cases are France backing a merger of Suez with Gaz de France to fend off Enel of Italy, France and Luxemburg supporting Arcelor against Mittal Steel of the Netherlands, and Spain promoting a tie-up of Endesa with Gas Natural rather than Eon of Germany. At the same time Poland is in the wake of the takeover by UniCredit of Italy of HVB of Germany trying to block the merger of their respective subsidiaries Pekao and BPH. Memories are also still fresh of Italy attempting to link Antonveneta with Banca Popolare Italiana to ward off ABN Amro of the Netherlands, which led to the resignation of Bank of Italy governor Antonio Fazio on 19 December 2005, and France succeeding in marrying Sanofi with Aventis to keep Novartis of Switzerland at bay.

DIFFERENT APPROACHES IN FRANCE AND GERMANY

France has so far taken the most proactive stance against hostile takeovers. First, it adopted a decree on 31 December 2005 that enables the government to veto or impose conditions on foreign takeovers in eleven strategic sectors. Second, it recently introduced an amendment to the draft law transposing the EU Takeover Directive that enables companies to deploy poison pills by issuing warrants convertible into shares at a discounted price to existing shareholders which makes a takeover more expensive. Third, it has just outlined plans to boost employee share ownership. Fourth, it has also just presented plans to enable the Caisse des Dépôts et Consignations – which as the manager of Euro 220 billion of state pensions is the largest institutional investor in the CAC-40 and a leading shareholder in among others Suez, Schneider, Accor, Saint-Gobain, Michelin, and Veolia Environment – to become a strategic blockholder that can counterbalance short term institutional investors.

While France has been cautioned it risks becoming the ‘cantankerous neighbour’ in Europe (1 March 2006, Financial Times), Germany has been able to steer clear of the controversies.

Although Germany has signalled it will retain both pre-bid and post-bid defences, it has not interfered in any specific takeover battles. At first glance this may appear to simply reflect the fact that all the German companies recently making headlines have been bidders rather than targets. The most notable cases are Eon pursuing Endesa of Spain, BASF hunting Engelhard of the USA, Linde acquiring BOC of the UK, Eon buying Caledonia after being rejected by ScottishPower both of the UK, Deutsche Post taking over Exel of the UK, Adidas-Salomon purchasing Reebok of the US, and most memorably Deutsche Börse being forced to withdraw its bid for the London Stock Exchange of the UK. The real reason however is that there has always been an arm's length distance between government and business, with the government shaping corporate restructuring through general legislation rather than specific intervention.

'BACK TO 1914' – A NEOLIBERAL BACKLASH

The recent developments have provoked a number of high level policy makers and senior commentators to make acrimonious statements that reveal an appalling lack of knowledge about both history and economics. Some of the more fanciful claims have even drawn parallels to the rise of nationalism in 1914.

Noting that European internal market commissioner Charlie McCreevy warned already four months ago of a 'strong wind of protectionism' blowing through the EU, the Financial Times argues that 'today, that wind has turned into a storm that is threatening to tear apart some of the principles on which the Union is founded', with McCreevy commenting that it 'strikes at the very heart of the freedoms enshrined in the treaties' (1 March 2006, Financial Times).

Italian economy minister Giulio Tremonti even suggested on 1 March 2006 that 'if the Commission does not act, my advice would be for it to close down because of a failure to meet its mandate'.

The Financial Times further contends that 'Europe's current protectionist shenanigans […] are driven by a wider political nationalism and economic insecurity' (2 March 2006, Financial Times). It in particular singles out France for 'lurching from one ill-considered plan to another in a desperate attempt to prevent more hostile takeovers of French companies', denouncing the Suez-GdF merger as a 'shotgun betrothal' and referring to the CDC plan as 'the latest half-baked wheeze' (3 March 2006, Financial Times).

Dominique Moisi adds to the chorus in an op-ed in the Financial Times, arguing that '"economic patriotism" will be Europe's undoing' and asking whether 'the European ideal [could] be confronted with the same fate as communist ideology in the Soviet Union, moving from faith to dogma and from dogma to irrelevance'(6 March 2006, Financial Times).

Less melodramatic and more to the point, European Commission president José Manuel Barroso appealed to governments on 1 March 2006 to abstain from 'nationalist rhetoric' that undermines the single market. Former European internal market and competition commissioner Mario Monti echoes these concerns in an op-ed in the Financial Times, arguing that the 're-emerging economic nationalism' means that 'the single market, a key pillar of the European Union since its foundation, is in danger' and suggesting that the incompatibility of 'this revolt against the single market' with the needs of the Euro is 'a recipe for poor economic performance' (2 March 2006, Financial Times).

VARIETIES OF CAPITALISM

These concerns are however grossly exaggerated. While French prime minister Dominique de Villepin's populist call for 'economic patriotism' understandably has provoked accusations of protectionism, most of the government actions in both France, Germany, and other Member States are in fact aimed at hostile takeovers and not foreign takeovers.

In France the government has always played a key role in coordinating the economy, finance, industry, and corporate restructuring. In Germany there have always been a high degree of strategic coordination among blockholders, banks, managers, workers, and suppliers who all have been able to build trust, make credible long term commitments, and cooperate with each other due to the presence of takeover defences.

There is no evidence to suggest any of this has been detrimental to their competitiveness. Quite the contrary, current research suggests the French and German approaches are distinct 'varieties of capitalism' alongside the British approach, all of which in the long term perform more or less equally well based on unique comparative advantages in different sectors. Talk about the need for Europe to liberalize if it is to cope with globalization is not only wrong it is in fact exactly the opposite of the truth.

Hostile takeovers, the evidence suggests, usually has negative effects on the particular companies involved in takeover battles in all types of economies. The reason is that they in most cases either destroy value or simply transfer value from stakeholders to shareholders (the inverse Robin Hood effect).

Hostile takeovers, moreover, always have negative effects on the general institutions that sustain the comparative advantages of two of the three types of economies.

It is only in the Anglo-American variety that an uninhibited market for corporate control can be compatible with the institutions coordinating the economy; this is not the case in the Continental-European varieties. The reason is that in these types of economies hostile takeovers undermine the institutions that reproduce the comparative advantages of these economies such as skilled workers, innovative technology, industrial peace, stable ownership, and quality products.

Accordingly, although even governments in Anglo-American economies should be cautious about embracing an unconstrained market for corporate control, governments in Continental-European economies would in fact be deeply irresponsible if they did not oppose hostile takeovers outright either by continuing to make defences available or by orchestrating corporate restructuring solutions.

LOOKING AHEAD

Continental-European government currently opposing hostile takeovers is therefore an indicator that their economies are set to retain their comparative advantages for the foreseeable future and that their companies will be able to increase their value in sustainable ways, which should reassure foreign investors that Europe will remain an attractive destination for both foreign direct investment and institutional portfolio investment.

There is however no room for complacency. There is increasing reason to worry about the effectiveness of government efforts to oppose hostile takeovers against the backdrop of record high domestic and cross-border European M&A activity. The buzzing market is fuelled by high corporate profitability, strong cash flow, healthy balance sheets, cheap credit, improving shareholder confidence, and attractive price/earnings ratios and motivated by the need to build scale given market deregulation and global competition in a context of low organic growth (24 February 2006, Financial Times). These market developments are further aided by regulatory pressures with the European Commission already in the process of taking action against France, Spain, and Poland. Companies like <u>UniCredit</u>, <u>Eon</u>, and possibly even <u>Mittal</u> may therefore very well at the end of the day prevail over the governments challenging them.

Continental-European governments should therefore go on the offensive in rejecting the claims about 'protectionism' and setting the record straight with regards to the overwhelmingly negative effects of hostile takeovers on economic performance. Takeover defences should be recognized as vital features of the institutions that sustain the competitiveness of Europe. The European Commission should be reigned in and forced to abandon its dangerous neoliberal drive to establish a single European market for corporate control. Instead the European Union should adopt a common set of pre-bid and post-bid defences available to companies in all Member States. Investors should keep in mind that playing with the system rather than taking actions that undermine its strengths will yield the highest returns in the long run.

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Registered Address:
141 Rampart Rd
Salisbury SP1 1JA
United Kingdom

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