

REVIEW ARTICLE

CORPORATE TAKEOVERS AND THE PUBLIC INTEREST¹

by Alan Peacock and Graham Bannock

Reviewed by John Scouller, Department of Economics, University of Strathclyde

The 1988 contested takeover of Rowntree by the Swiss corporation Nestlé came in the middle of the greatest takeover boom in British history and at a time when British firms and foreign firms were buying one another at an unprecedented rate. For various reasons this single takeover caused a particular furore despite the fact that Nestlé paid more than twice what the British stock-market had previously valued Rowntree. One of the positive benefits of the furore was that the Rowntree Foundation commissioned a study of the takeover mechanism the result of which is the text under review.

It should be said first of all that given the limited resources at their disposal and the time constraint they faced that Alan Peacock and his associates have produced a creditable piece of work and a substantial contribution to the public debate on the issue. One has to wonder of course why it was that a government apparently wedded to the notion of competition failed to commission such a study itself in view of the enormous level of takeover activity during the late 1980's. The only serious government investigation of the issue was carried out in 1978 at a time when merger activity was relatively quiescent and research into the issue in its infancy (HMSO, 1978). Because of the subsequent boom in research we now know a lot more about takeovers than we did a decade ago and the Peacock report makes good use of this knowledge.

The Report follows a logical approach to the issue. First, it seeks to establish the facts about the scale of takeover activity in the UK which it does with characteristic thoroughness. Unfortunately space constraints mean that there is only a limited presentation of the statistics in the report itself so the interested reader will necessarily have to turn to the numerous research reports commissioned by the inquiry team. (Full details, and brief summaries, of all the research reports can be found in an appendix of the Peacock report).

Second, the report considers the factors favouring takeovers in the UK concentrating in particular on the increasing separation between beneficial ownership of equity and effective control of the enterprise. (What Drucker has called 'pension fund socialism'). In passing the issues of corporate taxation and accounting

procedures are also covered.

Third, the report examines the consequences of the takeover mechanism. It considers the consequences for the acquiring and the acquired businesses, for the economy in general, for regions within the economy, and for what it calls the ethics of business behaviour. Central to this part is a lengthy but reasonably painless discussion of the meaning of efficient capital markets correctly identified as of fundamental importance to the debate.

Finally, the report turns to the policy issue. It sets out current UK and EC policy, provides a substantial critique of current policy, and goes on to make a number of recommendations for improving policy.

What we have then in an all too brief 100 pages of text is a logically coherent, well-written (in good old-fashioned English, for which much thanks), perceptive, thorough analysis of an issue of great importance to us all which is not taken nearly as seriously as it should be by the government. The report deserves to be widely read and debated and if the British took democracy seriously it would be. I fear, however, that it won't be and that its fate will be to become a convenient source of excellent notes for economics students.

Before considering my major criticism of the report I will note some minor criticisms. First, the authors report that they knew of no studies of the relationship between takeover and innovation. I thought of three without much trouble (see references). Second, the authors sometimes become rather unscientific as in their argument that, "common observation supports the view that large companies which have grown by internal expansion have a more distinguished record (for innovation) than acquisitive companies". I think they may well be correct but for the simple reason that companies with opportunities to grow by innovation will naturally be less interested in acquisition. In any case common observation is simply not an acceptable standard of proof in these matters. Third, in their discussion of the causes of mergers the authors fail to distinguish between the underlying motivations for takeovers (why they happen) and their timing (when they happen). This is rather

¹ Report of an Inquiry conducted by the David Hume Institute, Published by Aberdeen University Press, 1991.

important because one of the interesting characteristics of merger activity in Britain is its highly cyclical nature. We need to know why British companies spent fifteen times as much on acquisitions in 1989 as they spent in 1981. The report would have benefitted greatly from a deeper analysis of this issue.

Finally, the report gives serious attention to the issue of particular concern in Scotland, the regional impact of inward acquisition but becomes uncharacteristically opaque when discussing what to do about a trend which has left Scotland without a single major locally controlled world ranked industrial company. The authors suggest that regional issues are best left to regional policies, which is all very well until you recall that regional policies are about as scarce as locally controlled businesses these days.

The major fault of the Report concerns its central theme which is stated as follows:

"...corporate takeovers are more a symptom of the major defects in the working of the free market system than a principal instrument for ensuring that it works efficiently".

The Report identifies the key issue as the increasing separation between ownership and control in Britain and the growing dominance of the financial institutions as shareholders. The problem with this, it is said, is that it makes the takeover process easier first because there are fewer people that a bidder has to convince to sell, and second because institutional shareholders are more likely to suffer from "short-termism" because they are under competitive pressure to produce good quarterly results. Thus rather than intervening directly to replace under performing managers the institutions prefer to sell out to another group of managers prepared to offer a price premium on the shares they hold. This analysis leads the authors of the Report to make their prime recommendation the removal of the strong tax bias in Britain in favour of saving via institutions such as pension funds. This will lead eventually to more personal ownership of companies and less of the "short-termism" associated with institutional ownership.

I have two problems with this. First, whilst generally sympathetic with the analysis and familiar with the Japanese corporate system which eschews contested takeovers completely I am not yet wholly convinced that the net benefit of a system based on the takeover mechanism is necessarily less than one that is not. I would want more evidence to be as convinced as the authors are of their case.

The second problem I have is that I am rather unconvinced that the report's prime recommendation will solve the problem. What I fail to see is how decreasing the proportion of shares held by institutions and increasing personal shareholding will remove the temptation of short-termism (i.e. selling out to a higher bidder). Will it make Lord Hanson's job harder if he has

to convince a million small shareholders to sell their ICI shares rather than just a few pension fund managers? Sheer inertia apart I see no reason to believe that it will. Some small shareholders are remarkably loyal to "their" companies and hold on no matter what. But most I suspect are far too sensible to refuse an offer such as Nestlé made for Rowntree, or BP made for Britoil. Rowntree's own employee-shareholders were reportedly enthusiastic about the bid which more than doubled the value of their holdings. And who could blame them?

Therefore whilst the Report's prime recommendation may be worth pursuing for other reasons (tax neutrality), I do not see it as a solution to the problem of excessive takeover activity. Many of the Report's other recommendations seem sensible (improved accounting standards, more active institutional investors) and well-worth pursuing as part of a concerted effort towards improving the effectiveness of the corporate system. However the overwhelming impression I have is that the private interests which benefit from the continuation of the takeover game will make sure that the game goes on even if some of the rules have to be tightened at the margin.

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