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The role of governments in hostile takeovers – Evidence from regulation, anti-takeover provisions and government interventions

Maximilian Rowoldt, Dennis Starke*

Ruhr-University Bochum, Chair of International Accounting, Universitätsstr. 150, 44780 Bochum, Germany

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ABSTRACT

This paper addresses the role of governments in hostile takeovers by analysing 263 hostile takeover bids in Europe and North America during 2000–2014. Our results suggest that governments may influence the openness of the domestic hostile takeover market through takeover regulation, potentially implementing protectionism. The corresponding features of the regulatory regime may in turn stimulate the deployment of anti-takeover provisions by entrenched target managers. Rather than increasing takeover premiums, anti-takeover provisions are associated with lower success rates of hostile bids, and may thus harm corporate governance. Governments' direct intervention in hostile takeovers is more likely in case of a foreign bidder, large transactions, high unemployment and high GDP growth rates, pointing to both protectionist and populist motives. The hostile bid failed in all cases of government intervention identified in our sample. Direct government intervention may thus serve as ultimo ratio in order to block unwanted transactions.

1. Introduction

Hostile takeover bids emphasise the conflicting interests of shareholders, managers and governments (Romano, 1988; Shleifer and Vishny, 1997). While targets' shareholders are interested in maximising their return on investment, targets' management may seek to entrench themselves and protect their job position by deploying anti-takeover provisions (ATPs). The misalignment of shareholder and management interests is especially pronounced in the case of hostile takeover bids (Armour and Skeel, 2007; DeAngelo and Rice, 1983; Jensen and Meckling, 1976). Against this background, the role of governments is of particular importance as they define the playing field for hostile takeovers through takeover regulation. Furthermore, governments may directly intervene in corporate takeovers. Takeover regulation and direct intervention in hostile takeovers may therefore follow national interests.

The recent developments in France illustrate the role of governments in takeovers. First, the loi Florange introduced changes to French takeover regulation in 2014 which may help to block unwanted foreign takeover bids. In particular, the French government eliminated mandatory board neutrality and shifted to a system which enables managers to deploy ATPs without shareholder approval (Johnson, 2015).[1] Second, in June 2014 the French government directly intervened in takeover negotiations for Alstom SA's energy assets. The French finance minister Montebourg stated that "it's a prerequisite that France takes 20 percent of the capital. If that's not realised, GE's bid will be blocked" (De Beaupuy et al., 2014). Governments may thus influence takeovers indirectly through takeover regulation or directly through active interventions (Dinc and Erel, 2013; Rickford, 2009).

* Corresponding author.
E-mail addresses: rowoldt@iur.rub.de (M. Rowoldt), starke@iur.rub.de (D. Starke).

[1] Besides abandoning managers neutrality against hostile bids, the law also introduced double voting rights to long-term shareholders of French companies. The full text of the law (Loi no 2014-384 du 29 mars 2014 visant à reconquérir l'économie réelle) can be found on the website of the French Government: http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000028811102&dateTexte=20150812 (retrieved on 21 Oct 2015).

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In this paper we examine the role of governments in hostile takeovers and its implications on corporate governance. We focus on hostile takeover bids as they pronounce the conflict of interest between strong corporate governance and protection of the domestic industry. Our analysis involves three steps. First, we focus on the direct effects of takeover regulation. We analyse whether national takeover regulation is a potential protectionist tool for governments. In particular, we test whether the existence of a board neutrality rule (BNR) affects the openness of the domestic hostile takeover market to foreign bidders as measured by the likelihood of cross-border hostile bids and the deployment of ATPs by the target's management. Second, we turn to the implications of takeover regulation on corporate governance by examining whether ATPs stimulate management entrenchment as measured by the success rate of hostile bids or benefit shareholders by strengthening their bargaining power. We measure bargaining power as the likelihood of bid increases and the final takeover premium. Third, we analyse determinants of direct government intervention in hostile takeovers and its consequences on the bid success.

Our results indicate a lower probability of cross-border hostile bids in case no BNR is considered in takeover regulation of target countries. Takeover regulation may thus limit the openness of the domestic hostile takeover market to foreign bidders. This supports the notion that takeover regulation may serve protectionist motives of governments as indicated by the implementation of the European Takeover Directive[2] (Davies et al., 2010). As board neutrality is only one feature of the legal environment, we additionally use alternative measures of shareholder protection in our analysis and find similar results. Thus, our results may be driven by the general legal environment and not necessarily the BNR alone. However, the recent reform of the French takeover law and the implementation of the European Takeover Directive emphasise the particular importance of board neutrality as a potential protectionist tool (Hopt, 2009). Moreover, not only board neutrality but also the general regulatory environment fall into governmental responsibility and may thus be used by governments to implement protectionism.

With this respect, the regulatory choices made by governments may affect corporate behaviour. In specific, board neutrality determines whether target managers are able to deploy ATPs without shareholder approval. Our results show a negative association between BNR and the application of ATPs by targets' management, confirming that if takeover regulation grants the option to deploy ATPs to the targets' management, they are likely to exercise it.

Regarding the role of ATPs in corporate governance, our results indicate that the application of ATPs does neither increase the likelihood of bid increases nor the final takeover premium offered. On the contrary, ATPs seem to decrease the likelihood of a successful completion of a transaction. This finding supports the management entrenchment hypothesis. A regulatory framework that favours ATPs may therefore increase managerial power and in turn decrease the effectiveness of the corporate government system (Humphery-Jenner, 2012; Masulis et al., 2007).

Finally, our results suggest that direct government intervention is more likely in case of a foreign hostile bidder, pointing to protectionist motives for government interventions and supporting prior evidence provided by Dinc and Erel (2013). Additionally, we find positive associations between negative government interventions and transaction size as well as the unemployment rate in the targets' nation supporting the idea that government intervention follows populist motives in search for votes (Hopt, 2009).

[2] The full text of the directive (Directive 2004/25/EC of the European Parliament and of the council of 21 April 2004 on takeover bids) can be found on the website of the European Commission: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:142:0012:0023:EN:PDF (retrieved on 21 Oct 2015).

Besides, the hostile takeover bid failed in all of the identified cases of negative government intervention. Due to this missing variation in the bid outcome in case of a negative government intervention in our sample, we are unable to empirically assess the corresponding relationship. However, this observation potentially points to the role of direct interventions for governments as ultimo ratio to block hostile takeovers of domestic companies.

Our analysis makes three contributions to the existing literature. First, takeover regulation may serve as a potential protectionist tool for governments by supporting an insulation of domestic companies from the hostile takeover market. Although several papers discuss the issue from a theoretical point of view (Aktas et al., 2007; Davies et al., 2010; Hill, 2010; Hopt, 2009, 2014), to the best of our knowledge we are the first to provide empirical associations on the matter.

Second, the deployment of ATPs by targets' management is related to takeover regulation. Takeover regulation may thus impact corporate governance. If takeover regulation grants the option to deploy ATPs to the targets' management, they are likely to exercise it. Focusing on the long-term effects, previous empirical evidence implies a negative relation between indices of ATPs and firm value, long-term stock returns (Bebchuk and Cohen, 2005; Bebchuk et al., 2009; Cremers and Nair, 2005; Gompers et al., 2003) as well as a positive correlation with value destroying investments (Masulis et al., 2007). Our analysis focuses on the relation between the actual deployment of ATPs and bid outcome. By supporting the management entrenchment hypothesis, our results complement the inconclusive discussion surrounding the management entrenchment and stockholder interest hypothesis (Bebchuk et al., 2002; Comment and Schwert, 1995; Pound, 1987; Subramanian, 2003; Varaiya, 1987).

Our third contribution relates to direct government interventions in hostile takeover transactions. With the exception of Dinc and Erel (2013), empirical evidence on this topic is scarce. We add to the discussion by extending the empirical evidence on the determinants of government interventions. Besides protectionist motives, governments may intervene in search for votes and popularity. Furthermore, direct intervention may serve as an ultimo ratio of governments in order to prevent the acquisition of domestic targets.

The remainder of this paper is structured as follows: Section 2 outlines the institutional and theoretical background of our analysis. In Section 3 we develop our hypotheses while Section 4 describes the data and variables. Section 5 presents our research design, provides the main results of our multivariate tests and their limitations. Section 6 concludes this study.

2. Background and related literature

Hostile takeovers and takeover regulation are important features of the corporate governance system (Goergen et al., 2005; Shleifer and Vishny, 1997). Shareholders may benefit from hostile takeovers due to synergies and more efficient allocation of resources. The mere threat of a hostile bid may force the incumbent management to readjust its strategy and to align its interests more closely to those of its shareholders (Armour and Skeel, 2007; Deakin and Slinger, 1997; Easterbrook and Fischel, 1981; Jensen and Ruback, 1983; Manne, 1965; Scharfstein, 1988; Van Apeldoorn and Horn, 2007). Additionally, a successful hostile bid can lead to an increase in a company's performance, for example by taking advantage of synergies or by a more efficient use of the company's resources (Burkart, 1999; Deakin and Slinger, 1997; Manne, 1965). Despite, the sheer threat of being subject to a hostile takeover bid may discipline managers to act in the best interest of their shareholders as they are likely to be removed in the wake of a takeover