Chapter 2
The Takeover Bids Directive's flawed economics jeopardises our wealth

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1. Introduction

The European Union's Takeover Bids Directive endeavours to facilitate takeover bids 'through reinforcement of the freedom to deal in and vote on securities of companies and the prevention of operations which could frustrate a bid' (EC 2012: 2). Innocent as this objective may seem, it appears to be based on highly questionable theoretical assumptions and assessments of the empirical evidence. As a consequence, the Directive allows plenty of room for perverse takeovers, and more generally lubricates a system that frequently destroys wealth rather than creating it. It therefore jeopardises our wealth. The argument follows from two key issues: the first is the inadequacy of the Directive's underlying theory of the market for corporate control; the second is the empirical evidence on the performance of mergers and acquisitions, including takeovers. This evidence suggests that most takeovers in the domain for which the Directive has been issued are economically undesirable, so that a regulatory framework that discourages those takeovers would be more efficient than the current Directive. I will discuss some of the characteristics of such a framework in the last section before summarising the paper.

2. The theory of the market for corporate control

The term 'market for corporate control', coined for the first time by Marris (1964), refers to the process by which ownership and control of companies is transferred from one group of investors and managers to another. The theory assumes that share prices reflect the quality of company management or, more generally, the relative 'quality' of a firm. According to Marris, if the valuation ratio of a firm is low, it is probable that a raider would put a higher value on that firm than the market does. Thus, the theory claims that if executives do not endeavour to maximise the valuation ratio of the company a takeover bid will eventually follow. With low prices lingering, watchful bidders would recognise a good acquisition opportunity, buy the company and replace or decrease the status of its incumbent management. By implication, the performance of the target firm would benefit. Manne (1965) concluded that, as executives would like to secure their jobs, the market thus would be disciplining executive behaviour. For fear of being fired, 'as within three years of an acquisition, half of all managers at targets are out of work' (Easterbrook and Fischel 1996: 162), every member of the company's management would do his or her best to maximise shareholder returns. The latter is assumed to derive directly from the extent to which executives succeed in bringing the company's assets to full fruition.

If correct, this theory would require a market for takeovers that is free from artificial hurdles, in particular hurdles that have been erected by the target firm to prevent its takeover by another, supposedly more efficient, firm. This is what the Directive tries to accomplish. In the words of a study commissioned by the European Commission (EC) to support the ongoing review of the Directive: 'A well-functioning market for corporate control is part of a continuous auction process around the company's value. As a consequence, the regulatory framework *must create the conditions to stimulate takeovers* over time, and so lower costs of capital' (Marccus and CEPS 2012: 274, italics added).[1]

This idea is naïve for two reasons, however. First, it does not recognise the possibility of what I would call 'functional cheating'. By this I am not referring to Enron-like fraudulent activities (see Froud *et al.* 2004), but rather to actions through which executives try to paint a picture of their performance that extends beyond their 'real' performance. Indeed, boosting the valuation ratio by earnings management or off-balance activities, or by actions that directly please investors, has become common practice, particularly favouring pay-outs through cash dividends or stock repurchases over real investment. Stock repurchases in particular have taken an important position in firm policy, frequently totalling substantially more than dividend pay-outs (Skinner 2008).[2] It is now even

1. Marccus Partners is a subsidiary of the management-consulting firm Mazars and the Centre for European Policy Studies is a Brussels-based think-tank.

2. In the United States, firms spent a staggering USD 900 billion on stock repurchases in 2007 alone (*New York Times*, 21 November 2011, based on data from Dealogic). The total fell somewhat in the wake of the financial crisis, but returned to as high as USD 450 billion in 2011. In Europe, share buybacks have been on the rise as well and now account for hundreds of billions of euros (von Eije and Megginson 2008; Masouros 2013).

common for firms to borrow for dividends or stock repurchasing.[3] Obviously, such policies lead to short-termism.[4]

Secondly – and perhaps more importantly for the current argument – the theory does not recognise perverse behaviour, that is, behaviour that is (by implication or explicitly) focused on subverting the mechanism that is at the heart of the theory. Although the Directive endeavours to reduce firms' possibilities for installing or using anti-takeover devices, it does not take into account that some such moves appear to be regular moves when done pre-emptively, that is, long before a takeover bid has even been announced to the target firm. In other words, firms may use takeovers as a headlong rush forward. If pointed at a potential acquirer this may be in the form of a 'pac-man' defence, meaning that the firm undertakes a takeover of the potential acquirer when an upcoming takeover bid is suspected or seen as a possibility. The plain fact is that pre-emptive takeovers cannot be distinguished from 'regular' takeover activity.[5] The evidence on merger and acquisition performance, to be discussed further below, suggests that *many* takeovers have some of these protective elements, either purposively or embedded in firm strategy.

It is important to note that the theory of the market for corporate control assumes so-called 'market efficiency'. The market for corporate control is therefore, necessarily, assumed to be populated by 'smart' and 'not-so-smart' investors, firms and decision-makers. The smart are able to search the market for promising investment opportunities and the not-so-smart will try to protect their assets from a takeover once such a search has zoomed in, or is about to zoom in on them (in the parlance of the Directive, 'post-bid' or 'pre-bid'). Unfortunately, practice is not always loyal to theory. There is no way in which one can distinguish between the

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3. For example, during the first and second quarters of 2014, Apple bought back approximately USD 23 billion in shares, which it funded, for tax avoidance reasons, with USD 17 billion in loans, despite having available approximately USD 150 billion in cash reserves. Approximately USD 12 billion of the buy-back was done from an investment bank, which essentially shorts the stock by borrowing shares (typically from its clients), which it then delivers to Apple for a fixed, upfront price. Over the term of the buy-back agreement, the investment bank then seeks to buy shares to replace those it has borrowed. See, for example, appleinsider.com of 25 April 2014.

4. The same reasoning would apply to the arguments of agency theory. Linking executive remuneration to share performance – which, following Jensen and Meckling (1976), is seen by agency theory scholars as a means to discourage executives from focusing on their own rather than shareholders' interests – is even likely to encourage functional cheating.

5. In a similar vein, Sjåfjell (2009: 383) has noted that if the pac-man defence is used as a 'pure business strategy, independent of the acquirer's', then it would fall outside the scope of the Directive.

smart and the not-so-smart, except if their relative prices are assumed to be an indicator of this. Especially over the past fifteen years, it has become abundantly clear, however, that the way in which the prices of firms develop – the prices one has to pay in order to obtain their shares – is one of the fuzziest processes in the economy and certainly not an efficient one (for example, Akerlof and Shiller 2009).

The theory's riposte would be that, ultimately, 'the market' will punish firms that cook their books or pursue perverse takeover strategies, but again this presumes market efficiency. More particularly, and keeping in mind that by far most takeovers take place during acquisition waves, firms that undertake perverse takeovers can restructure by selling off acquired entities when takeover popularity decreases, thus forestalling eventual punishments by 'the market' in the longer run. The evidence suggests that perhaps as many as five out of every ten acquisitions are unwound in the time that lapses between two merger and acquisition peaks (Schenk 2006). Clearly, these are not the takeovers that we would want to see encouraged.

3. Empirical evidence on the performance of takeovers[6]

The basic assumption behind the theory of the market for corporate control, as we have seen, is that once a bidder has acquired an undervalued firm, he would engage in corporate restructuring with a view to bringing about an increase in the value of the target firm. It is sometimes argued that hostile takeovers outperform friendly acquisitions as the former benefit from greater clarity of purpose, better pre-bid planning, clearer identification of sources of value creation, employment of superior management and optimal exploitation of a target's assets (Sudarsanam 2010). It is important to note, however, that the term 'hostile bid' is not set in stone. In the economics literature it is most often used to describe offers that have been resisted by the target's board, as

6. Technically speaking, a takeover requires a public bid for (a controlling part of) the shares of a target firm. Such a bid may come as a surprise or after negotiations with the target firm's management. It may be hostile or friendly (see main text). In any case, if successful, it will end up in some sort of merger between the acquiring firm (or investor) and the target firm. Since most 'mergers' by far are in fact acquisitions (approximately 90 per cent) – which implies that one party acquires the ownership of another party – most performance research has simply focused on the aggregate category of mergers and acquisitions (M&As).

opposed to 'friendly bids' that are implemented with the approval of the target's management. However, the board of the offeree firm might have a good reason for rejecting a bid even though it is privately considering the bid as a welcome development, for example simply because it is soliciting a higher price than offered, either from the original bidder or any other bidder (as was the case with Vodafone's USD 181 billion bid for Mannesmann in 1999–2000[7] and has been the repeated reaction of AstraZeneca to Pfizer's USD 118 billion bid in early 2014). Thus, in practice it is difficult to judge whether a bid is really 'hostile' or 'friendly'. Many takeovers contain elements of both.

What, then, does the literature say on the economic performance of takeovers? By now, this literature has become fairly voluminous, with many thousands of mergers, acquisitions or takeovers having been assessed. Table 1 (p. 56) provides a quick overview of the most common findings, but we will discuss the most important studies here as well.

The performance of mergers, acquisitions or takeovers can be measured by tracking any effects on the share price as a dependent variable (usually done in so-called event studies and resulting in estimates of so-called abnormal returns, that is, returns that deviate upwards or downwards from the standardised normal returns). In Table 1, these studies are summarised in column 1. Performance can also be tracked by measuring effects in real terms, such as profits, productivity or market share, which is usually done in so-called accounting studies (column 2 in Table 1). Column 3 summarises a third type in which effects on ratios of market and real variables are measured. Event studies typically assume that the share price (thus, the shareholder or market value of the firm) is a reflection of real performance expectations among investors. Real value studies are, obviously, closer to the true effect but more laborious to carry out, which is why by far the most merger performance studies are event studies.

The early US empirical literature supported the theory of value enhancement by takeovers. Jensen and Ruback (1983) provided a review of studies looking at short-term abnormal returns to takeovers following tender offers, covering the period 1958–1981. The evidence indicated that,

7. Mannesmann, indeed, succeeded in increasing Vodafone's bid from €240 to €353 per share (*Wall Street Journal*, 4 February 2000).

Table 1 **General characteristics and findings of idealised merger and acquisition performance studies**

	Type of study		
	Event studies	Accounting studies	Combination studies
Methodological focus	Effects on shareholder value (market value)	Effects on real business variables, for example, profits over sales, EBITDA, return on investment (ROI), firm productivity, market share, registered patents	Effects on ratios between market value and real business variables, for example, market-to-book value (Tobin's Q)
Acquisition effect studied	Cumulative abnormal return (CAR) around event (merger announcement or consummation), typically immediately around event (a few days to a week), sometimes extending towards a longer time horizon (in a few cases extending towards multiple years)	Pre- and post-acquisition (ratio and nominal) comparisons, sometimes for several years, in a few cases to more than a decade post-acquisition	Pre- and post-acquisition ratio comparisons, sometimes averaged over several years
Counterfactual proxy	Cumulative normal returns	Matched non-acquiring control group	Matched non-acquiring control group
Findings on short-term effects	Target CAR increases substantially, Acquirer CAR increases margin-ally or breaks even	No noticeable effects	Because market value increases marginally or breaks even, non-substantial effects on ratios between market value and real variables
Findings on medium- to long-term effects	Acquirer CAR decreases substantially (target has been delisted)	Acquiring firms underperform control group substantially	Because market value decreases substantially, substantial effects on ratios between market value and real variables

overall, tender offers generated significant positive returns for target shareholders (around 30 per cent) and smaller positive returns for the bidding firm owners (around 4 per cent). Further evidence suggested that opposition by management can bring additional value to target shareholders, but only if the bid eventually succeeds. If the takeover is unsuccessful, the target's owners appeared to suffer 11.7 per cent losses ten months after the initial bid. Jensen's and Ruback's conclusion was that managerial action against takeovers should be curtailed. Jarell, Brickley and Netter (1988) confirmed these findings, looking at an even larger sample of transactions from 1960 to 1980. However, they already noted that winners of bidding contests could suffer significant stock price declines as often as they enjoyed increases in returns. More recently, Bhagat *et al.* (2004) investigated a comprehensive sample of tender offers over a period of 40 years, from 1962 to 2001. By using the customary short-term assessment window of a few days around the takeover announcement they showed that the average return to the target shareholders had been a statistically significant 30.01 per cent, while the average bidder enjoyed 0.18 per cent. The authors concluded that both friendly and hostile takeovers improve value for shareholders.

Turning back to Europe, studies of UK takeover activity showed similar results: there are large gains for target shareholders around the announcement dates and moderate or zero returns to bidders. Higson and Elliott (1998), looking at a period of three months before and after takeovers completed between 1975 and 1990, reported 38 per cent and 0 per cent abnormal returns for the acquired and the acquirer, respectively. For the seven years between 1993 and 2000, Goergen and Renneboog (2003) calculated a 29 per cent increase for the target shareholders using a window of 60 days before and after the acquisition. Goergen and Renneboog also looked at tender offers in continental European countries (Germany, Austria, France, Benelux, Switzerland) and found a 15 per cent and 1 per cent increase for target and bidder shareholders, respectively.

Although these studies seem to provide encouraging results for the proponents of the theory of the market for corporate control, it should be noted that all of them concentrate on (very) short-term effects, commonly of less than one week post-announcement and only very rarely extending to a few months, which still qualifies as a short-term assessment. Looking at long-term consequences brings to light different and disturbing results. According to Mueller (2003: 178), 'Evidence that M&As destroy wealth can ... be found in the event study literature, if one examines the returns to the acquirers over a sustained period after the M&As occur'. Mueller quotes a large number of studies that estimated abnormal returns over five-year post-announcement periods for the 1950s, 1960s, 1970s and 1980s. Positive results were obtained only for the 1970s and these were not statistically significant. Andrade *et al.* (2001) confirmed that long-term event studies measuring abnormal returns over three to five years following merger completion cast doubt on traditional short-window findings. Martynova and Renneboog (2005: 23) also provide a review of the empirical literature indicating a 'decline in [relative] share prices several years following the transaction'. Obviously, long-run performance studies are fraught with difficulties, as much 'noise' has to be filtered out. Andrade *et al.* (2001) challenge the precision of long-term abnormal returns estimates because tests of such returns are inevitably joint tests of stock market efficiency and a model of market equilibrium. Zhao *et al.* (2008) cite authors arguing that stock returns become positively cross-correlated in large samples, causing mis-specified test statistics. However, the short-term methodology does not lack criticism either. For example, it is possible that investors are not able to assess quickly enough the full impact of the corporate transaction, and wealth-effect analysis over a few days brings flawed results. More importantly, however, they are much more likely to suffer from the effects of so-called 'animal spirits' (Akerlof and Shiller 2009).

A follow-up study of 155 European takeovers between 1997 and 2001 by Martynova *et al.* (2006), investigates the long-term performance of merged companies. The authors look at EBITDA, a measure of profitability in which earnings are calculated before interest, taxes, depreciation and amortisation. To capture only the effect of the takeover and account for company differences in size, they divide cash flow by, first, book value of assets and, second, sales. To adjust for possible industry trends, the authors compute the difference between the merged company's cash flows and the cash flows of peer firms that have not gone through an acquisition. Median profitability of the three years prior to the takeover is compared with median profitability over the three years subsequent to the merger. The results show that the profitability of the combined entity decreases significantly after the merger. More importantly, the study tries to differentiate between tender offers and negotiated deals, and shows that a firm created as a result of the former is likely to experience the worst deterioration in performance, thus indicating that non-negotiated takeovers have a negative effect on long-term company profitability.

The study also shows that many takeovers concern well-performing targets, which one would not expect on the basis of the market for corporate control theory. Moreover, both acquiring and target firms significantly outperform the median peers in their industry prior to takeover. Referring to a number of previous studies, Burkart and Panunzi (2006) confirm that only a few hostile takeovers are targeted towards poorly performing or troubled firms. The more relevant motive for unfriendly bids would be the size of the target. Mueller (2003: 176) notes that 'every study which has regressed the gains to the acquiring companies' shareholders onto the gains to the targets has found a negative relationship, which is inconsistent with a synergies-creation hypothesis and the market-for-corporate-control hypothesis'. A team at Erasmus University Rotterdam split up a sample of 100 European mergers and acquisitions undertaken during the fifth takeover wave (with the rising tide between 1995 and 2000) into year-cohorts and calculated abnormal returns for 400 post-merger days for each of the cohorts. The study revealed that only the 1995 cohort generated shareholder wealth. All other cohorts destroyed wealth, the most recent cohort performing worst, saddling the acquirers' owners with an average cumulative loss of almost 25 per cent (see Schenk 2006). Similarly, in a study of about 12,000 (American) acquisitions from 1980 to 2001, Moeller *et al.* (2004) found that while shareholders lost throughout the sample period, losses associated with acquisitions after 1997 were 'dramatic'.

Dickerson *et al.* (1997) found for a panel of almost 3,000 UK-quoted firms that acquisitions undertaken during the period 1948–1977 had a systematic detrimental impact on company performance as measured by the rate of return on assets. Not only was the coefficient on acquisition growth much lower than that on internal growth, but there appeared to be an additional and permanent reduction in profitability following acquisition as well. More specifically, for the average company, the marginal impact of becoming an acquirer was to reduce the rate of return relative to non-acquirers by 1.38 percentage points (in the year of the first acquisition). Taking all subsequent acquisitions into account, acquiring firms experienced a relative reduction of 2.90 percentage points per annum. Because the mean return across all non-acquiring firms was 16.43 per cent, this translates into a shortfall in performance by acquiring firms of 2.9/16.43, which is around 17.7 per cent per annum.

Gugler *et al.* (2003) demonstrate that from most studies it can be inferred that if takeovers *do* show profit improvements, these are usually either not merger-specific or due to the creation of additional market power rather than efficiency. The lack of merger-specificity has, perhaps, been most clearly demonstrated by a large number of real merger effects studies in the banking industry (which we will not discuss here, see Schenk 2006). Finally, a meta-analysis in which 93 studies involving more than 200,000 mergers and acquisitions were jointly investigated showed just negative results except for those amalgamations that were assessed for very short post-acquisition windows (King *et al.* 2004). Adding a few newer studies in their review, Tuch and O'Sullivan (2007) conclude that mergers have an insignificant impact on shareholder wealth in the short run, but produce overwhelmingly negative returns in the long run.

The evidence, in short, suggests that it is unlikely, to say the least, that the market for corporate control works in the way assumed by the Directive. At best, economic returns are positive only in the very short run, motives might be flawed and long-term consequences might be dire for the merged firms (and, given the recurrent size of the phenomenon, also for the economy as a whole). Because during an acquisition wave, receiving (target) shareholders quickly after the takeover become acquiring shareholders themselves, thus joining in with bad acquiring performance results, it is likely that negative effects permeate throughout an economy, as long as takeover incidence is sufficiently large. In this respect, it is quite embarrassing that most takeovers occur during acquisition waves and that such waves thus far have all ended up in recessions or worse (Schenk 2005).

Although the main point is that mergers, acquisitions or takeovers do not occur in the manner presumed in the Directive, it is still worth looking at the causes of this economic misfortune. It appears that in particular the payment of transfer premiums is a cause of trouble (for example, Sirower 1997), particularly when market values have already become inflated as a result of antecedent acquisition incidence; thus after an acquisition wave has set itself in motion.[8] The problematic aspects of mergers would therefore seem to be particularly worrisome when listed firms are concerned, precisely the domain for which takeover regulation has been developed. Second, it appears that the larger the firms involved are, the less likely it is that economies of scale (or more generally, synergies) will be realised. Of course, all this begs the question of why such firms would undertake such acquisitions at all?

This is not the place to discuss merger theories (for this, see Schenk 2006) in detail, but Mueller (2003), for example, has suggested that the pattern found would support the hypothesis that takeovers are fuelled by speculation, which he suggests is particularly eminent during periods of business euphoria. Schenk (1996) has suggested that the lion's share of takeovers are done for 'minimax-regret' reasons; in other words, takeovers occur mainly because firms prefer the lower regret attached to 'sharing

8. Notice that the takeover process would come to a virtual standstill if acquirers were not prepared to pay takeover premiums.

acquisition failure with others' to the higher regret of 'having forgone advantages that peers have enjoyed'. In other words, if some peer firm has carried out an acquisition with uncertain, but potentially advantageous results, other firms are likely to undertake a similar acquisition just to avoid regretting not having done so if it turns out that the first mover's takeover was successful. In order to distinguish the latter type from wealth-seeking acquisitions, such triggered acquisitions have been identified as 'purely strategic' (Schenk 2006). Obviously, both explanations connect well with the perverse takeovers discussed above. The difference is only a methodological one: the perversity of a takeover is defined by it not being in conformity with what mainstream economics would define as 'normal', while a purely strategic takeover is a positive explanation of the occurrence of takeovers that do not seem to be motivated by economic gains. Of course, there is no a priori reason to expect real firms to behave like the hypothetical firm of efficient market theories; after all, the behaviour of firms is a matter of empirical evidence, not one of theoretical presumption.

4. Implications for the Directive

The evidence we have discussed suggests that the creation of economic wealth would be jeopardised by any regulation that harbours a pro-merger, acquisition or takeover bias. Because it appears that most mergers destroy – or at least do not create – wealth, certainly during acquisition waves, and because by far most takeovers occur during such waves, a regulator's presumption should be against rather than in favour of takeovers. The Takeover Bids Directive 2004/25/EC was built on the idea that mergers, acquisitions and takeovers are effective means of creating wealth. Therefore, it cannot possibly be effective in a world that is not in essence compliant with its justificatory theory of the market for corporate control: in other words, the real world.[9]

9. Notice that the European Union's Merger Control Regulation (MCR) 4064 of 1989, amended as Regulation 139 of 2004, is built on the same naïve foundations. It was adopted to prevent mergers, acquisitions or takeovers that are likely to hurt the consumers' interest, not to prevent amalgamations that may hurt the economy. The MCR assumes that firms would undertake mergers in the pursuit of profits, either by strengthening market power (which we would not like) or by creating synergy (which would be beneficial to economic efficiency). Mergers that do neither are assumed to be impossible, at least in a structural sense, because these would not serve the postulated economic interests of the parties involved. From the main text, it can easily be derived that this idea builds on market efficiency theories as well (for elaboration, see Schenk 2006). Unfortunately, the EU's population and its politicians have wrongly been led to believe that the EC's regulatory system also protects the economy against destruction of wealth creation processes.

Consequently, amending the Directive would amount to much more than matters of application, consistency, technique or execution, which thus far have made up the lion's share of assessment analyses. Most importantly, the Directive must abandon its basic idea that firms should not be allowed to protect themselves against takeover. This idea shows itself most strongly in Articles 9 and 11 of the Directive, Article 9 (the 'board-neutrality rule') requiring that any post-bid defences should be explicitly approved by the general shareholders' meeting (thus could not be arranged unilaterally by the target company's board) and Article 11 (the 'breakthrough rule') enabling a bidder to break through pre-bid defences (for an elaborate discussion, see Nenova and Schenk 2011). In a somewhat similar vein, Enriques (2010: 15) argues that the European Commission should adopt a neutral approach, namely 'neither subsidizing nor hampering takeover activity'. Instead, he recommends allowing individual firms to choose which rules they would like to implement, or to give the board a chance to exercise veto power on hostile bids, making the use of other defensive measures redundant. Kirchner and Painter (2000: 50) have argued that 'Europe could, and should adopt its own version of the modified business judgment rule' as used in the United States. This would entail that target firm directors be allowed to block a takeover, on condition that they act in good faith after reasonable consideration that the takeover would be a significant risk to the company.

However, both suggestions leave open the possibility that potential target firm managements would *not* take protective measures, even though these would be warranted from the point of view of economic wealth creation. For example, target managements might act upon the prospect that they themselves would benefit from an acquisition, which, in fact, happens frequently (in contradistinction, again, to what the theory would predict).[10]

Thus, we would need a guarantee against target managers and shareholders squandering, for some reason, the firm's assets. At the same time, however, the Directive should not provide a safe harbour for incompetent

10. See, for example, Hartzell *et al.* (2004). Sometimes it is argued that executive pay effects dominate merger rationales. Indeed, Bodolica and Spraggon (2009) show that no matter what the performance outcome, executive pay always goes up after an acquisition (as does the likelihood of obtaining paid supervisory board memberships in other firms). In itself this might seem a sufficient explanation for exuberant merger activity. However, we would then need a theory of pay volatility that is consistent with takeover volatility. Such a theory, thus far, does not exist.

managements. Similarly, it should also to some extent protect the right of ownership that is so central to our societies. Evidently, setting up a Directive that runs with the hare and hunts with the hounds is not an easy task; but, then, nobody ever said that it was. However, once the correct principle is embraced, the rest will be a matter of juridical fine-tuning.

In this sense, it will be important to recognise the special role of the firm's employees. For, ultimately, employees have a longer-term interest in the firm's success than both managers and shareholders. This is because shareholders can exit the company by just selling their shares, which is precisely what they do very frequently. As Bolton and Samama (2012) have shown, there has been a secular trend towards shorter and shorter holding periods of stocks by shareholders. For example, for stocks listed on the NYSE, the average holding period decreased from eight years in the 1960s to approximately one year by 2005. Consequently, it is justified to ask whether the owners of listed firms – the sort of firms for which the Directive has been designed – can still properly be regarded as owners of a firm rather than owners of equity.

The firm's top managers almost always have severance arrangements that allow easier exit as well. For example, Rau and Xu (2013) find that at around 68 per cent of S&P 1500 firms had explicit severance contract terms in 2004 and that this proportion was much higher than was apparent from earlier studies. Moreover, many executive contracts include ex ante exit arrangements in case of a takeover. For workers, exiting the company and finding another job is much more difficult as it is likely that they have accumulated firm-specific skills, whereas redundancy compensation is usually very modest at most. Seen in this light, it almost goes without saying that the idea that shareholders are the only residual claimants in a firm and therefore should be adorned with full discretionary powers is unworldly, especially if, as Zingales (2000) has argued, we are living in a world in which human capital has become the firm's most important asset. Therefore, an efficient takeover regime must aspire to fairly balance all the major interests involved, especially those of employees.

Obviously, this currently is not the case. In some member states, employees (or their representatives, in some cases the unions) do have some say in strategically important matters. For example, the Dutch system of worker representation entitles employees to speak out against or in favour of management decisions through its works council.

However, this only goes so far as to allow the works council to submit advice to management. Management may simply reject such advice. If so, the works council may file an appeal against the management decision with the Amsterdam court (in its so-called Enterprise Chamber). This court may find that the management decision lacks fairness, upon which it may instruct management to uphold or even rescind its decision.[11] The Dutch case, however, currently represents perhaps the most advanced that can be found in business practice. Nevertheless, it can be regarded as only a first step towards implementing the consequences of recognising that employees share in residual gains and risks to a significant extent, in particular in the area of takeover.

In any case, an efficient system of takeover regulations would include full acceptance of defensive mechanisms *and* a significant role for workers in all decision-making pertaining to such mechanisms. The following two options would seem to merit further discussion. First, works councils could be given the right of assent (as, in the Netherlands, they already have in the domain of working conditions) and/or the right to nominate or appoint members of the non-executive or supervisory board. Such board members could be given blocking powers in the case of takeover. Second, as Oostwouder and Schenk (2014) have suggested, an efficient approach to takeover regulation would amount to adding an independent Special Administrative Entity to corporate governance, as indeed some Dutch firms have already done in the past in the form of a foundation (in Dutch: 'Stichting Administratiekantoor').[12] The company's shares would be placed with this intermediary vehicle. In turn, the Entity would issue so-called certificates of shares that could be sold privately or be quoted on public exchanges. Under normal circumstances the holders of certificates would be granted the authority to vote at the general shareholders' meeting. However, under special circumstances, such as a takeover, the Entity would have the authority to withdraw such voting rights. Because of its independent status, the Entity would subsequently be well placed to decide on the modalities of the special circumstances.

11. In quite a few cases the court has spoken in favour of works councils' demands, yet works councils do not easily go to court because that may cause polarisation in their relationship with management.

12. Oostwouder and Schenk made this suggestion for the case of ABN Amro bank. The bank was the target of a successful takeover by a consortium of Royal Bank of Scotland, Banco Santander and Fortis, valued at approximately USD 98 billion (70 billion euros at the time) in 2007. Soon after the merger, and just before the financial crisis erupted, all parties contracted 'acquisition indigestion', ultimately leading to government bailouts of ABN Amro and RBS and a break-up of the newly formed bank.

Which circumstances would be seen as 'special' would typically be defined in the Entity's charters. From this chapter it follows that takeover bids would certainly have to be included, and possibly 'outgoing' acquisitions as well. An advantage of the Oostwouder-Schenk option is that it would allow the holders of certificates a normal assessment of the incumbent management's performance so that it cannot be used to offer a safe haven to management. It should be noted that the Oostwouder-Schenk option would not suffice to reject takeover bids indefinitely. At least according to current Dutch law, once a would-be acquirer has succeeded in acquiring the majority of certificates, it could also demand structural voting rights in the general shareholders' meeting, thus surpassing the Entity's power.

The terms of the Entity's independence should be laid down in the Directive. One can easily imagine that these terms would be similar to those that are currently defined in Germany's codetermination system or the Netherlands' Social and Economic Council. The composition of the latter is one-third representatives of employers, one-third of representatives of labour and one-third independent experts. At the level of the firm, this could be mirrored by a similar tripartite composition of the Entity's board. Shareholders as well as employees would be given the right to appoint two-thirds of the board, thus doing justice to their interests, especially the workers' long-term interest in the sustainability of the firm, while independent members would offer effective protection against partisan behaviour.

5. Conclusion

The biggest flaw of the Takeover Bids Directive is its most basic assumption, namely, that the market for corporate control is economically efficient in the sense that takeovers are an efficient means to increase economic wealth. A brief review of the empirical literature on merger performance demonstrated that most acquisitions fail to create economic wealth, except when performance effects are measured as short-term (target) shareholder wealth. If takeovers do not create *shareholder* wealth, they do not make sense from a shareholders' point of view. If they do not create *economic* wealth, they do not make sense from the wider perspective of economic progress. Obviously, from a regulator's perspective it is the latter that counts. It is a rather awkward twist of theory that economic wealth creation is assumed to be identical to shareholder wealth creation (except in cases that would be likely to be blocked for competition reasons), and that shareholders would never undertake (or vote in favour of) acquisitions that do not create shareholder wealth. Takeovers that do not create shareholder wealth are simply assumed to be impossible (at least in a structural sense), just as it was assumed for quite some time – on the basis of similar theoretical assumptions – that financial innovations, and the operation of financial markets more generally, could only be beneficial to our economies. Obviously, *some* financial innovations can be beneficial. Similarly, *some* takeovers may create wealth. But a regulatory system that presumes such effects to be the normal result surely misses the point. Such a system can be legitimised only on the basis of biased economics and therefore jeopardises our wealth.

True, the European Commission notes that 'although takeover bids promote economic efficiency in theory, this is not always the case in practice because the conditions of rational behaviour, fully informed market participants and absence of transaction costs are not always met' (EC 2012: 4). But this rather appears to be a note in passing, made to suggest that the Commission has given various *a contrario* arguments ample consideration while actually proceeding with business as usual.

It is therefore very unfortunate that the European Commission has so firmly set its agenda on encouraging takeover activity across Member States. Rather one would wish that takeover policy would discourage acquisitions in such a way that only really promising instead of speculative or 'purely strategic' takeovers would be the standard. While such a new policy would allow the European Union to ensure better management of companies, decrease market volatility, help mitigate recession risk and contribute to better economic performance, this is easier said than done. This chapter has argued, however, that alternative regulatory specifications are possible. For example, empowering employees or adding a Special Administrative Entity charged with independent decision-making on takeovers would be instrumental in limiting takeover predilections in our economies, as well as takeover euphoria during merger waves. Obviously, a combination of the two would be even better.

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