Takeover: an unavoidable panacea for governance in the corporate world

Striking a balance between flexibility and clarity in takeover regulations is becoming crucial given that takeover as a mechanism of exercising corporate control, despite the attendant controversies, is clearly here to stay in an efficient market system

Together with the important role played by capital markets in the growth and development of a country's economy by channelling available funds towards growing businesses, corporate control is an important device for ensuring that the corporate governance environment of firms is kept in check at all times and is enhanced where possible.

In this context, a takeover serves as one of the key means by which the control of a company can be changed, as it involves the purchaser ('bidder') acquiring the shares in the company ('target') directly from its shareholders.

From a global perspective, corporate control transactions occur for several reasons. In countries with less concentrated ownership, control can be achieved in a hostile attempt by a bidder who believes that company value can be increased. Friendly or hostile deals can also be executed for reasons of expected synergies between the acquirer and the targeted company. Whether the bidder succeeds in obtaining control of the target company will depend on if sufficient numbers of target shareholders accept the bidder's takeover offer, which is made to them individually.

What is the debate surrounding takeovers?

A takeover invariably gives rise to a number of conflicting interests between the parties involved, for instance, the opposing objectives of the bidder and the target shareholders in relation to the price paid for the shares and the amount of information provided by the bidder. In a hostile takeover situation, the directors of the target also have a conflict of interest as they are likely to lose their positions if the takeover succeeds.

In addition, there is considerable debate concerning who should be entitled to the control premium paid by the acquirer. While on the one hand, it is considered that those shareholders who have sufficient shares to deliver control to the bidder should be entitled to receive the premium, it is also argued, on the other hand, that the non-controlling or minority shareholders should be able to receive an equal share of the control premium by selling their shares to the bidder at the same price.

In view of all the above aspects, takeovers remain the most controversial corporate governance mechanism. The debate is further compounded by the question of whether regulation should promote or impede attempts to acquire control of a corporation by making an unsolicited offer directly to shareholders, and reflects the internal logic of two conflicting positions. According to pro-takeover commentators, takeovers are generally beneficial for corporate governance as they can displace poorly performing managers. On the other hand, those who oppose hostile takeovers argue that they can disrupt well-functioning companies and encourage short-termism, as opposed to long-term commitments for the creation of shareholder value.

Why are Takeover Acts important?

Takeover Acts are laws that are passed specifically to foster takeover activity by reducing barriers to M&A transactions, encouraging information dissemination, and increasing minority shareholder protection.

The increasing use of regulatory discretion in takeover regulation over time has raised tensions between allowing flexibility in the operation of the provisions and providing certainty for business. There is also a school of thought that propounds that takeover regulation should neither hamper nor promote takeovers, but instead allow individual companies to decide the contestability of their control. However, amid all these debates, the crux of the matter remains as to who should decide whether a hostile takeover goes forward.

There are three obvious candidates. First, the board may be given the power to block an offer. Second, the board may be restricted from acting to hinder a takeover, thereby allocating the decision to shareholders. Third, the final decision could be left to the courts.

Who should regulate takeovers?

This brings us to the question of whether national securities market regulation should be left essentially to self-regulatory or non-government bodies, like the City Panel on Takeovers and Mergers (UK Panel).

It has been argued, for instance, that the UK Panel is only concerned with the limited function of scrutinising takeovers and mergers and is therefore a body without legislative investigatory powers or the authority to apply government sanctions that would not deal successfully with matters involving 'inquiry into fraud or abuse'.

On the other hand, the advantages of having an independent Panel as opposed to a government body rest on the ease of decision-making as achieved through speed, informality, and uniformity. There are a number of features of a Panel like the UK one that relate to those attributes and which could be viewed as reflecting its ability to adopt a commercial approach instead of an approach based on a regimented and inflexible set of rules and regulations devoid of any business sense.

Indeed, a Panel is viewed as being able to make its decisions based on the spirit as well as the letter of the law, with the application of the principles underlying takeover provisions allowing greater flexibility in outcomes. Also, it is argued that a Panel would be likely to adopt an approach that is less technical and would thus avoid undue legalism in its proceedings.

Does a hybrid system offer the perfect solution?

A hybrid system based on detailed legislation and regulatory discretion could as well be contemplated and would be seen as a perfect recipe to address takeover situations in some jurisdictions where, for instance, the corporate environment needs to have some sort of legal backing in addition to commerciality in deal making. At the same time, it cannot be denied that flexibility has the tendency to create uncertainty for market participants.

Indeed, the challenge for every jurisdiction where takeover laws are being enacted for the first time or are otherwise being revamped in accordance with modern trends will continue to be to achieve an appropriate balance between flexibility and clarity in the application of regulatory discretion under takeover provisions. Moreover, in the present environment where the global economy has been plagued by COVID-19 together with all its attendant inhibitions relating to physical movement and global flows, there is a lot of uncertainty surrounding business continuity at least in the short to medium term.

In the midst of these testing conditions, it will be interesting to see how the M&A world will thrive. While there will certainly be fresh targets that will become prey to both disposed and indisposed acquisitions, it remains to be seen how the corporate world, including regulators, will react in the following months to this changed paradigm where cross-border reach is severely hampered all around the world and in every particular jurisdiction, with the new environment being impregnated with rampant nationalism and individualism.

By Shamin A. Sookia,
Managing Director,
Perigeum Capital Ltd

A takeover is a key mechanism to change the control of a company