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RESPONSE TO BIS CALL FOR EVIDENCE ON A 'LONG TERM FOCUS FOR CORPORATE BRITIAN', October 2010. Evidence to be submitted by January 14th, 2011

Evidence submitted by Ian Clark, Department of Management, The University of Birmingham, UK.

January 10th

To whom it may concern,

I have been encouraged to submit a response to this call for evidence by several colleagues and interested parties. I recently provided input to the Treasury Select Committee in its deliberation on Private Equity and some of the points I raised there and in some of the published academic work with which I am associated may be pertinent to these deliberations. I have enclosed a copy of my CV and some copies of recent publications in journals which are rated as 4* world leading and 3* internationally excellent. I have not provided answers to all the questions as some of the questions lie beyond my areas of competence. Further, in each case I have attempted to answer the questions briefly and to the point. Please contact me if you require me to provide further detail on any points. You can check my credentials by examining my page on the University website. I am responding as an interested academic who has researched and published extensively in these areas. My views and the evidence that supports them is in some cases funded by ESRC research but does not relate to the view of the University of Birmingham or any of the bodies interviewed in the collation of the empirical research. Further, much of the research cited and drawn on in this response has been published in 4* world leading and 3* internationally excellent peer reviewed academic journals, see the ABS report, 2010, (google Association of Business School).

Yours sincerely,

Ian Clark

Director of Education, Department of Management.

CONSULTATION QUESTIONS

The Board of Directors

1. Do UK boards have a long-term focus – if not why not?

It is not possible to provide a simple or definitive answer to this question. The answer is bound to be one of definition and sector driven. Some of the UK's most successful manufacturing firms do take a longer term approach and that is why they are successful world class manufacturers, for example Rolls Royce aero engines and British Aero Space. Other firms such as Tesco who operate in food retailing and consumer services take a longer term approach in terms of the manner in which a brand has been built over the past 20 years. However, these longer term approaches are informed by the nature of the sector and precisely defined corporate objectives and one can argue that they have been achieved in spite of the short-termism which is endemic to the UK.

Short-termism is as the consultation document makes clear a question of definition. If short-terms means a focus on short-term financial returns rather than those over the longer term, in general UK boards do have a short-term focus. Many academics argue that this has always been the case. However, in the contemporary period a conjunction of events have combined to reinforce this tendency blunting further any longer term focus. These events can be summarised as:

a, Globalization of investment opportunities and sources.

b, The popularity of approaches to corporate governance and the management of the employment relationship which focus on investor and shareholder value.

c, The associated diffusion of new and innovative business models, particularly prior to the onset of financial crisis, centred collateralization and securitization of future revenue streams to fund investment opportunities.

As a template for organizational change these events have ushered in short-termism as a priority for performance management metrics and reflects the prevailing wisdom among institutional investors and financial economists that instinctively managers and employees are prone to opportunistic, self-serving irrational behaviour at the expense of investors and shareholders, (Jensen, 2007). A central operating presumption of this approach is that active owner-investor engagement, often through the board, not only creates the market for corporate control but in addition promotes efficiency by incentivizing Directors and employee managers to explicitly act in the interests of investor-owners, (Jensen and Murphy, 2009). So in summary many of the new business models associated with these events for example, the private equity business model aim to grow promising businesses, re-structure them if necessary, incentivize employees to think as owners do with the aim of securing a profitable exit from the business via an initial public offering of shares or a trade sale in the secondary private equity market. That is the prevailing popularity of these models operates in a short-term framework. In addition to this, the success achieved by emergent business models such as private equity backed firms across all sub-sectors has resulted in a best practice dimension to the business model. Acharya et. al., (2009) and Achleitner, et. al. (2009) demonstrates that firms which are not governed by the private equity business model have successfully 'mimicked' strategies associated with private equity to raise efficiency levels. That is, mimic strategies the success of which is borne out of a short-term focus on immediate financial returns.

2. Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

This too is a question of definition and framework which surround the boards! There is in the UK a prevailing orthodoxy of short-termism which is historically embedded in the UK's liberal market economy and its associated business system but which is moreover now subject to the academic and practitioner popularity of business strategies and models which are explicitly investor and shareholder focused on a short-term basis. Take for example the Kraft acquisition of Cadbury. No one can argue that Cadbury was an underperforming firm but its board of directors succumbed to the Kraft bid with all the information they needed at

their finger tips. This did not encourage them to turn the bid down because they were increasingly drawn into the conjunction of short-termism described in my response to question one. The Cadbury board was not really required in other than a cursory manner to examine how Kraft might fund the acquisition. The fact that Cadbury is now in-effect a portfolio firm of Kraft debt funded by special purpose investment vehicles generated by Kraft and RBS is of no concern to members of the Cadbury board either as board members or now as individuals. These debts are likely to be leveraged on the Cadbury balance sheet and are of little or no concern to board members even though critics of the deal and its likely funding arrangements were fully available to board members at the time of the deal. Hence the question is not one of availability but one of relevance to the actors.

Shareholders and their Role in Equity Markets

3. What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

As the consultation document makes clear in the UK firms are in theory owned by shareholders who should again in theory determine the outcome of ownership decisions, for example those concerning takeovers. In answering this question it is important to point out that shareholders are not necessarily the same as investors. One implication of the changing nature of UK share ownership is the diffusion of new types of business models and new patterns of investing in British firms. For example business models associated with private equity investment, hedge funds and sovereign wealth funds from overseas states. Take private equity investment; the private equity sector is an asset class which raises capital from investors who commit monies to a private equity fund for a period of ten years. Fund managers invest in organizations (which become portfolio firms) on behalf of investors. The sector has three segments, venture capital, mid-market buy-outs of private firms and funds which specialise in taking listed firms private via the private equity business model (PEBM) which is designed to re-structure established listed, that is, publicly quoted firms, (Wilson et. al. 2010, Morgan, 2009). A distinguishing feature of the short-term performance of the PEBM and a measure of its success is the decisiveness of management re-structuring and the link between this and the ability of private equity owners to generate cash for institutions

which have invested in their funds. The key point is this; private equity funds and sovereign wealth funds (who themselves may invest in private equity funds) are an intermediary between shareholders and investors. Many investors in the UK shareholdings may be from different business systems and have different approaches to those embedded in the British business system, for example in the case of Cadbury even before the recent Kraft approach and acquisition at least 50% of the Cadbury shareholding was owned by US investors, a similar figure prevails in BP. So whilst firms are nominally British in that they are registered and incorporated in the UK the ownership base may be very international and if the investment base operates within new business models which are centred on investor and shareholder value the competitive rules of operation may gradually change to one where the extraction of value is the main imperative. Similarly many erstwhile British firms may no longer be 'British' take for example Alliance Boots which is now a Swiss registered firm. Thus, at a higher level of abstraction the British business system may be moving from a form of managerial capitalism to one where the ideas of globalized financial capitalism predominate.

In summary the growing globalization of shareholding in the UK by investors and investor intermediary vehicles is gradually breaking the link between ownership and control further complicating the principal-agent problem. The PEBM and overseas investment in UK firms via sovereign wealth funds represent a method of business control where investors in a fund and the partners overseeing the deployment of business and human resource strategies in portfolio firms are wholly separate, both operationally and contractually from a portfolio firm. Acquisitions supported by the PEBM represent at least 30% of all private equity acquisitions in the UK and across the EU buy-outs of existing businesses account for 70% of all private equity investment, (PSE:2007:45, WEF:viii, 2008, and Gilligan and Wright, 2008:14). In 2008 public to private deals utilizing the PEBM represented 39% of all private equity deals slightly down from 42% in 2007, returning to 40% in 2009, (CIMBOR, 2008, 2010a&b).

Questions 4., 5. and 6. are beyond my areas of competence.

7. Is Short-termism in Equity Markets a problem, and if so, how should it be addressed?

As I have commented in some of my points above short-termism is embedded in the British business system. The problematic of short-termism is its association with vogue business strategies and associated business models which look to the extraction of value on the basis of investor and shareholder value rather than the generation of value on the basis of more rounded stakeholder interests. Hence, in the UK the embeddedness of a short term bias has in many ways welcomed and made easier the diffusion of new more narrowly defined interests associated with investor and shareholder value. However, the wave of private equity innovation during the last five years has, empirically, produced mixed findings on industrial relations, HRM and economic performance.

Some contributors to the debate about short-termism argue that new business models pose a distributional question where a template of value extraction focuses efficiency on downsizing the scale and scope of assets and commitments and entitlements to existing stakeholders particularly labour, (Froud and Williams. 2007, Thornton, 2007, Morgan, 2009). In contrast, other studies suggest that portfolio firms governed by a template for the PEBM can exhibit a strategy of renewing value. Here an injection of cash from outside owner investors can overcome the limitations of previous ownership templates often pushing a firm in the direction of resource based approaches to managing business strategy and human resources, (see Bacon et.al. 2010.) However, this is often achieved on the basis of a more 'minimalist organization' where new investor owners who operate on the basis of renewing value over the longer term or extracting value over the short term seek to re-define relationships with employees, that is, undertake decisive re-structuring (see Rodregues and Child, 2010:1324-5). Recent reviews of the published studies on new business models conclude that the employment, wage and HRM effects of buy-outs on work organization, management and employees are mixed but not necessarily negative whereas the efficiency effects are more clearly positive, (Morgan, 2009, Wright, et. al. 2009:5010-515). Despite the mixed empirical evidence on the effects of ownership under new business models associated with short-termism what is not in doubt is that within portfolio firms the pursuit of investor and shareholder value is a primary managerial objective of investor-owners. This development demonstrates the potency of 'financialization' in the British business system.

'Financializaton' refers to structural change in capitalist economies wherein the role of finance capital comes to dominant economic and financial activity beyond financial markets in the operation of national business systems, (Clark, 2009b, Dore, 2008, Epstein, 2005:3). The embedded practices of firms in relation to work systems, employee reward and employee governance combine to form a distinctive institutional configuration often defined as a historically embedded national business system, (see Whitley, 1999). The British business system is described as a liberal market economy where coordination problems in and between institutionalised actors are managed in a contractual manner. The short-termism inherent in this approach often stimulates conflict bound relations between actors. However, whilst the British business system exhibits short-termism, institutionally it has proved capable of rapid innovation in the diffusion of new business models and associated business strategies, (see Hall and Sockice, 2001.) Hence whilst the British business system exhibits short-termism this characteristic is itself disrupted and re-shaped by financialization in three ways. One, competitively, the contemporary period has witnessed institutional investors becoming far more transaction oriented where achieving significant financial returns may be disconnected from the production or provision process in portfolio firms, (Soros, 2008). In the case of portfolio firms this development may further weaken the commitment of British employers to management development. Many private equity investors favour managing portfolio firms in accordance with the 'best practice' strategy outlined in the BVCA's guide lines monitoring group document for effective portfolio firm management, (GLMG, 2009:16). This involves managing portfolio firms through a series of advisory panels or consultants. In addition to this deployment of the PEBM in 'portfolio firms' reifies the idea of an investment portfolio to 'living' firms which supply goods and services, employ labour and include diverse stakeholder interests. The institutional interests of all stakeholders are theoretically insignificant in comparison to the interests of private equity firms and their investors who aim to extract value from mature asset-rich listed firms. Two, and directly related contemporary financial demands increasingly dictate the behaviour of firms and change the basis of competitive rules. Thus, at business system level owner-investor management strategies re-connect finance, ownership and corporate capital but at firm level can disconnect corporate strategy from established stakeholder interests. This is particularly the case in secondary

private equity deals where portfolio firms or components of a portfolio firm, that is, a firm already governed by the PEBM is sold on to another private equity firm. Secondary buyouts have dominated private equity activity in 2010 accounting for 60% of market activity whereas private equity buy-outs account for over 70% of UK merger and acquisition activity, (CIMBOR, 2010 a & b). Disruption to the British business system and embedded approaches to employment relations and HR is captured in the argument that competitively employers, particularly under the PEBM, find it more difficult (even if they aim to) to keep their side of the bargain as a result of developments in the financial circuit of capital, (Thompson, 2003:366, Clark 2009a). That is, there is a significant tension between financialization at business system level and the demands of high performance work systems and resource based approaches to the management of human resources at firm level. Third, grounded, observable examples of the contemporary crisis, associated with short-termism, have the potential to de-stabilize the real economy of business systems, including institutional interests in the labour market, which are geographically, economically and politically unrelated to the source of such volatility, (Clark 2009b). For example, the global and European Union wide financial crises caused by the diffusion of sub-prime mortgages in the USA followed by the uncovering of the depth of Greek and Irish sovereign debt. Thus, financialization provides a contextual background within which the diffusion of new business models has emerged across the British business system to reinforce embedded patterns of short-termism. This is the case as financialization appears to further reinforce embedded features of the British business system, some of which support diffusion of new business models such as the PEBM whereas the absence of supportive institutional coordination inhibits its longer term diffusion on the basis of resource based approaches to management in portfolio firms. Thus, the PEBM and the associated template for portfolio firm operations may as Bacon et. al. (2010) demonstrate lead to the diffusion of longer term value adding resource based approaches to business and human resource strategies. However, the embedded presence of more minimalist approaches to the inclusion of the human resource function in formulation of business strategy identified by Rodregues and Child (2010) may inhibit or disconnect such an approach, particularly when short-termism and immediate financial returns are more imperative in the context of financial crisis.

In summary the key element in the answer to this question is one of perception and position. Short-termism reduces longer term competitiveness which is in turn defined by market position and sectoral dynamics – Rolls Royce Aero Engines operates successfully in a business system with an embedded short-term bias but its sector takes a longer term approach - and systematic risk and increasingly uncertainty. Short-termism always poses risks to competitiveness but in recent times the changing nature of shareholder ownership and the models informing this ownership have become uncertain as demonstrated by the financial crisis.

8. What action if any, should be taken to encourage a long-term focus in UK Equity markets? What are benefits and costs of possible actions to encourage longer holding periods?

In the UK shareholding market several factors inhibit a long-term focus. First the presence and unregulated operation of hedge funds who may or may not entertain short-selling and private equity funds which in the deployment of the PEBM aim to re-structure and hollow-out many large firms, that is extract short-term value. (Both hedge funds and private equity may be subject to some minimalist regulation via the EU's alternative investment funds manager's directive). Second and related, the market for corporate control where hedge funds and private equity are active players. Bearing in mind that short-termism is embedded both institutionally and culturally in the British business system it cannot be magically removed, it can however be better regulated. The ease with which British firms are subject to acquisition is a factor in reinforcing short-termism both at firm level in board views and systematically across institutions. However, if the share market and investor entry within it is free and open friendly or hostile bids for firms are difficult to control and market participants may argue any such efforts will reduce market efficiency. Takeover rules a so-called 'Cadbury law' to prevent hostile overseas acquisitions may be of some utility.

9. Are there agency problems in the investment chain and, if so how should they be addressed?

I have already noted the distinction between investors and shareholders in the British business system and the intermediary effects of new types of business model and associated investors. The key problem that exists in the investment chain is the problem of 'disintermediation' and 'deniability'. Disintermediation is a banking term that refers to the

de-regulation of banking systems and investment chains. De-regulation in banking systems combined with long investment chains separates owners of capital (such as a local authority investor in a private equity fund) and the final investment destination of an investment made by a capital investor (the business they part fund, but only indirectly own and its business and human resource strategies and practices). In political parlance this gives investors contractual and legal deniability.

Once outside investors have majority control of the shares in a portfolio company they become the dominant majority shareholder and shares may no longer be traded. Tor example, Private equity firms acting on behalf of a series of institutional investors or a sovereign wealth fund buy listed firms the way that individuals purchase houses, that is, with a deposit supported by mortgage finance often in the form of 'balloon mortgages' where the size of payments grows over time, for example, those which funded Manchester United or Liverpool or Tata's acquisition of Jaguar Land Rover. However a critical difference is that homeowners pay their own mortgages whereas the PEBM ensures that portfolio firms take out these loans making them not the private equity investors responsible for the loans, both as a portfolio firm and if the private equity investors have sold the firm. Prior to the onset of the global economic and financial crises private equity firms typically aimed to re-sell a portfolio firm before more onerous repayments became due. The PEBM represents a method of business control where investors in a fund and the partners overseeing the PEBM and its deployment in portfolio firms are wholly separate, both operationally and contractually from a portfolio firm. In the case of success this is not necessarily a problem other than identifying who the owner is in the case of marginal disputes in employment tribunals. However, in the contemporary period of financial distress the absence of transparency has become extremely problematic.

The onset of financial crisis has witnessed the commercial failure of many portfolio firms governed by new business models informed by contemporary approaches to short-termism. The commercial failure of a portfolio firm or the failure to sell-on a portfolio firm has significant debt and liquidity consequences for debt holders and investors but more significantly often unreported or less visible consequences for employees in portfolio firms.

The latter are emergent industrial relations issues as the sector and the model moved into what is often described as a 'distressed phase' since 2008. Prior to this favourable economic and political conditions witnessed a weakening of regulatory and underwriting standards. In turn this led to substantial growth in leveraged loan commitments where internationally compliance and regulatory guidelines for risk management were tested (now evidently) to destruction exposing the uncertainties contained in new business models, (GAO, 2008:45). In short, short-term financial engineering associated with these models often included 'collateralising' revenue streams from portfolio firm assets by pledging or selling-on assets such as a pension fund and its management and property portfolios whilst transferring workers to loss making subsidiaries. Subsidiaries are not loss-making in the sense that they are not going concerns but because on creation they often have no assets but are created as an adjunct to special purpose investment vehicles used to purchase portfolio firms. Trafficking capital and human resources in this way enables loss making subsidiaries to be placed in pre-packaged administration. This arrangement enables owner-investors to buy portfolio firms back at a knock-down price, (so-called fire sales) whilst administrators are often able to traffic pension liabilities and redundancy payments to tax payer funded government assistance schemes, (Bailey, et.al., 2010, Harmer, 2008). In addition to this in the current economic climate many portfolio firms can only be secured by more draconian 'vulture re-financing'. The regulatory issue centres on stakeholder interests following the administration, collapse or sale of a portfolio firm where workers may struggle to secure redundancy payments or access to accumulated pension payments or any information on ownership decisions taken by private equity owners because of the disintermediation in and therefore deniability over responsibilities within a long investment chain. In summary agency problems always exist but are exacerbated by the emergent issue of a difference between investors and shareholders the business models that are currently being deployed and the increasingly contractual nature of these models and the contractual deniability built into such models in periods of success and distress. Thus a key agency issue is one of transparency and regulation.

10. What are the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

Private equity fund managers, particularly the venture capital and mid-market buy-out sub-sectors once occupied a niche where public policy has developed supportively and informally. The result of this is that these sub-sectors but more particularly the PEBM have developed into substantial but unregulated financial and investor-owner actors, (Gilligan and Wright, 2008 *forward*). Whilst empirically outgrowing this niche the PEBM retains the preferential taxation arrangements and opaque regulations for disclosure and regulation of stakeholder interests in portfolio firms. Moreover, methodologically the model traffics risks and uncertainties associated with credit exposure in acquisitions to other stakeholders, for example their investors, the portfolio firm and its employees, customers and taxation authorities. The regulation of market activity aims to internalize the risks associated with this type of traffic that is, the otherwise externalized costs of individual and systematic risk. Individual or systematic risk results from a decision to which a possible range of outcomes may result when objective probabilities (probable likelihoods) can be assigned to these outcomes. Moving beyond risk there are incalculable uncertainties of outcome which can result from particular actions to which objective probabilities cannot be assigned. Many such uncertainties are associated with new business models which emphasise short-termism precisely because these models utilise untried untested and uncertain methods of financial engineering. For example, 'PIK' or payment in kind notes which were utilised to part finance leverage buyouts on the PEBM model in the boom years before 2008. PIKs allowed borrowers to roll up interest payments and pay them off later albeit with high interest rates. In boom conditions the uncertainty associated with this in terms of final payment figures was not a particular problem as rising asset prices and profitable exits from portfolio firms allowed private equity investors to pay off any PIKs or transfer them to portfolio firms and secure their own investment and pay a good return to their investors. However, in more uncertain conditions associated with the current financial crisis the uncertainties associated with the PEBM are threefold; those associated with financial engineering, the private costs of business failure and the social costs of systematic collapse across the sector and the wider financial system. Each of these uncertainties is in evidence across the EU; uncertainties in parts of the UK banking sector led to system collapse across the sector which was only secured by nationalization of several large banks. In Greece and Ireland the costs of financial

engineering in the banking and financial sectors and in the management of sovereign debt has led to massive business failures and systematic collapse of entire financial systems to the extent that Ireland is in effect a portfolio economy owned by the European Central Bank. The Regulation of market activity creates conflicts of interests for market participants as invariably regulatory efforts to protect stakeholder interests restrict the regulated from achieving a preferred position and therefore reduce profit and return on capital. Regulation of market activity can take several forms such as regulatory and supervisory discretion where market participants must comply with best practice guidelines, that is, self regulation which in its contemporary form emphasises 'stress tests' for bank balance sheets to see if they can withstand shocks similar to those experienced in 2007-2008. In contrast to this regulation can take the form of market oversight by a regulator. In the boom years in the UK the Financial Services Authority undertook this role but emphasised 'light touch' regulation. Finally, a market can be regulated by legislative intervention forbidding certain types of activity under penalty of law. As an alternative to regulation capital gains and profits from market activity can be taxed. In the UK during the booms years for the PEBM successive British governments provided for light touch and self regulation of the sector combined with a taxation regime which provided generous income tax breaks.

In summary the benefits of greater transparency are more certainty and less risk in deal making. The costs of transparency make markets less competitive and fast moving. For example, the argument and debate about the EU Alternative Investment Fund Management Directive, (AIFM). In October 2008 the European Parliament agreed on the PES report (2007) which recommended centrally designed pan-European legislative regulation of hedge fund and the private equity fund managers and the sectors. However, by summer 2009 the EU commissioner for internal markets and services promoted voluntary self regulation in the form of codes of conduct across the EU on the UK's voluntary best-practice model. Similarly, the AIFM directive seeks to regulate the activities of managers not the sector as a whole, the PEBM, the types of deals which managers deploy or templates for workplace relationships which private equity owners who utilize the PEBM aim to diffuse in portfolio firms. The narrowness of this proposed regulation was supported by then Labour government which argued that the AIFM directive and efforts at legislative regulation of the sector as a

whole are driven by political rather than economic concerns. These views were reinforced by Sweden's presidency of the EU which commenced in July 2009 when the PES report was further downgraded as over zealous regulation. Thus, EU regulation of the sector, the PEBM and fund managers in the AIFD is now moving away from pan European legislative regulation towards self regulation on the UK model where national 'watch dogs' such as the UK's financial services authority[1] will have a key role in implementing any rules via the 27 nation committee of European Securities Regulators, (CESR). The BVCA Walker code in the UK has established no regulations at all but alternatively it oversees disclosure issues and risk for funds which come within its definition of a portfolio firm. Similarly the EU AIFM directive merely requires managers to register as such, submit data on funds under management in order to quantify but not necessarily limit leverage. Finally, managers of non-EU funds offered in the EU must meet certain requirements in order to offer these funds across the EU. These requirements can be summarised as authorisation for a workable AIFM passport. The AIFM must be transposed into national law by 2012 at the latest. The costs of transparency appear marginal in good economic times but have become extremely problematic in financial crisis and distress.

Director's Remuneration

11. What are the main reasons for the increase in director's remuneration? Are these appropriate?

Several factors are relevant here, the globalized marketplace, innovations in remuneration packages centred on shares and share options, and sweet equity related to short-term performance targets and or share price metrics. Evidence in the literature points to all these factors. In addition to this the diffusion of innovative business models which aim to address the principal-agent problem by incentivising employees to act like owners has further ramped up short-termism. These reasons appear appropriate at the level of the individual firm but have led to systematic short-termism which inhibits longer term approaches to corporate

[1] The new Con-Dem Coalition announced its intention to abolish the FSA and transfer its regulatory responsibilities to the Bank of England in June 2010.

governance and firm management in some cases because such approaches would render a firm liable to attack in the market for corporate control.

Questions 12, 13 and 14 beyond my immediate area of competence

Takeovers

15. Do boards understand the long-term implications of takeovers, and communicate the long term implications of bids effectively.

Yes and no! because it is not in their interests to do so, they recommend acceptance of takeover bids on the basis of share price offerings nothing else. Take for example the recent example of Cadbury. In 2007 Nelson Peltz, an American activist investor acquired 3% of the then Cadbury Schweppes. Peltz was aiming to force the firm to de-merge as separately Cadbury and Schweppes were worth around £16 billion rather than £12 billion. Due to the onset of the financial crisis the private equity backers for Peltz'z bid fell away and by 2008 the Cadbury board recommended de-merger to create pure shareholder value. In less than a year Cadbury became subject to a hostile bid from Kraft which the board ultimately recommended. The key point is it is the prior decisions taken by boards which need examination. In this case the quest for investor and shareholder value borne out of de-merger placed Cadbury in a position where it became liable to a hostile take over. As Cadbury-Schweppes it would have been too large for Kraft to acquire. The long term implications of actions in this case as in many others were not addressed because of the bias of short-termism: What was the longer-term impact of the de-merger? Does ownership and share nationality matter in respect of values, ethic and corporate governance? Was the bid to be recommended? The latter was the only pertinent question and that was measured purely on price and value to investors and shareholders the long term implications of this for workers and managers were of no relevance.

16. Should Shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

It is not feasible to do this. If an acquisition is by an overseas based firm the UK cannot really impose rules on different territories. That is, UK regulatory authorities cannot impose rules

on corporate governance in other national territories other than if they are negotiated within the framework of the European Union. It might be possible to do this in the case of domestically based firms who seek to acquire a particular firm. At the moment boards make recommendations to shareholders and to alter this arrangement is a possibility but unlikely to have significant benefits

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