

Chapter 19

Corporate Governance and the International Market for Corporate Control

- 19.1 The Terminology of Mergers and Acquisitions
- 19.2 Corporate Governance
- 19.3 The International Market for Corporate Control
- 19.4 The International Evidence on Mergers and Acquisitions
- 19.5 Summary

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Corporate governance

- **Corporate governance** refers to the way in which **stakeholders** exert control over the corporation
- There are 3 ways to obtain **control** over another firm's assets
 - acquisition of another firm's assets
 - acquisition of another firm's stock
 - merger or consolidation
- **Mergers and acquisitions** are becoming increasingly important

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Corporate governance systems

➤ Market-based

Australia Canada Ireland
U.K. U.S.

➤ Bank-based

Germany Japan

➤ Families or the State

| | | | |
|---------------------|-----------|----------|--------------|
| Family/State | Indonesia | S. Korea | Saudi Arabia |
| Family | Mexico | Italy | Spain |
| State | China | N. Korea | Singapore |

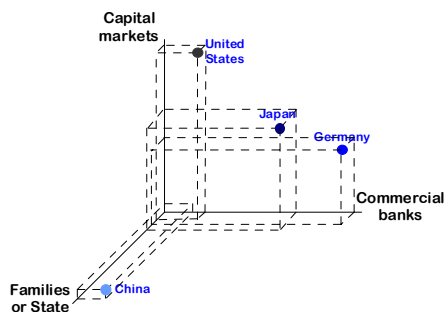
Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Corporate governance systems

| Country | Equity concentration | Bank ownership of equity | Supervisory board | Hostile acquisitions |
|----------------------|---|---------------------------------------|---|---|
| Germany | High - lead bank | Unlimited equity ownership | Outside directors, bankers, labor representatives | Rare - approval of lead bank and 75% of shareholders |
| Japan | High - main bank; keiretsu or business partners | Limited equity ownership (5% maximum) | Inside managers, bankers, keiretsu members, business partners | Rare - blocked by cross-holdings with keiretsu or business partners |
| United States | Low | No direct equity ownership | Inside managers, outside directors | Proxy contests and tender offers |

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Corporate governance systems



Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Financial modernization in the U.S.

➤ Gramm-Leach-Bliley Financial Services Modernization Act (1999)

Repealed Glass-Steagall separation of

- commercial banking
- investment banking
- insurance
- brokerage

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Universal banking in Germany

- German banks offer a wide range of financial services, including
 - commercial banking
 - investment banking
 - insurance
 - brokerage

Japanese keiretsu

- Types
 - Horizontal keiretsu
 - Vertical keiretsu
- Characteristics
 - Extensive share cross-holdings
 - Personnel swaps
 - Strategic coordination
 - Commercial transactions

Mitsubishi's horizontal keiretsu

| Mitsubishi Corporation | Bank of Tokyo-Mitsubishi | Mitsubishi Heavy Industries |
|---|--|--|
| Automotive Mitsubishi Fuso Truck Bus Mitsubishi Motors Shin Caterpillar Mitsubishi | Finance & insurance DC Card Diamond Lease Meiji Life Mitsubishi Auto Credit Mitsubishi Securities Mitsubishi Trust & Banking Tokio Marine and Fire | Industrial equipment Mitsubishi Electric Mitsubishi Kakoki Mitsubishi Precision Toyo Engineering Work |
| Electronics & telecom IT Frontier Mitsubishi Research Inst Mitsubishi Space Software Nikon Space Communications | Transportation & dist Mitsubishi Logistics Mitsubishi One Transport NYK Line | Industrial materials Asahi Glass Dai Nippon Toryu Mitsubishi Aluminum Mitsubishi Cable Indus Mitsubishi Materials Mitsubishi Plastics Mitsubishi Rayon Mitsubishi Shindoh Mitsubishi Steel |
| Resources & energy Nippon Oil Mitsubishi LPG Mitsubishi Nuclear Fuel Mitsubishi Paper Mills | Chemical & pharmaceutical Dai Nippon Toryu Mitsubishi Chemical Mitsubishi Gas Chemical Mitsubishi Petrochemical | Consumer goods & foods Kirin Beverage Kirin Brewery Ryoshoku |
| Real estate & construction Mitsubishi Estate P.S. Mitsubishi | | |

The post-war keiretsu

| | |
|---|--|
| Mitsubishi Bank of Tokyo-Mitsubishi Mitsubishi, Nikon, Kirin Beer | Fuyo Fuji Bank Marubeni |
| Sumitomo Sumitomo Bank NEC | Dai-Ichi Dai-Ichi Kangyo Bank Nissan, Canon |
| Mitsui Sakura Bank Toshiba | Sanwa Sanwa Bank Kobe Steel |

Financial modernization in Japan

- **Mitsubishi Tokyo Financial Group**
 - Bank of Tokyo-Mitsubishi
- **Mizuho Holding Financial Group**
 - Dai-Ichi Kangyo Bank (Dai-Ichi Keiretsu)
 - Fuji Bank (Fuyo Keiretsu)
 - Industrial Bank of Japan
- **Sumitomo Mitsui Banking Corp**
 - Sumitomo Bank (Sumitomo keiretsu)
 - Sakura Bank (Mitsui keiretsu)
- **UFJ - United Financial of Japan**
 - Sanwa Bank (Sanwa keiretsu)
 - Tokai Bank (Tokai keiretsu)

Similarities in executive turnover

- Cross-border similarities in top executive turnover
 - Higher executive turnover in firms suffering a sharp decline in equity value
 - Higher executive turnover in firms reporting poor earnings performance

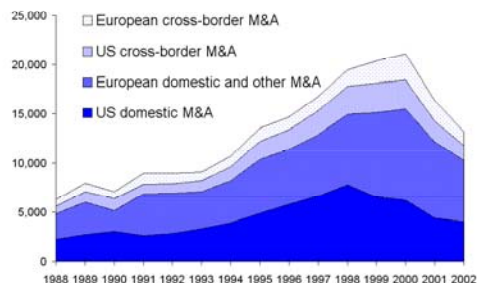
Differences in executive turnover

> Cross-border differences in top executive turnover

- In bank-based systems, turnover tends to be initiated by the lead bank (Germany) or the principal shareholders (Japan)
- In market-based systems, control contests are held through proxy contests or directly in the marketplace through tender offers

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

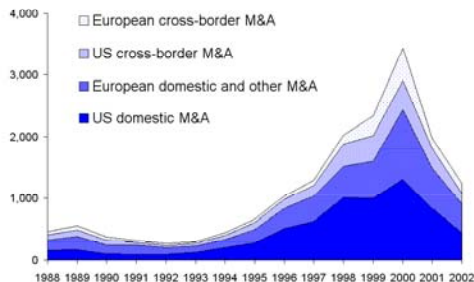
M&A activity



Compiled from *Mergers and Acquisitions*.

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

M&A values (\$ billions)



Compiled from *Mergers and Acquisitions*.

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Cross-border financial service M&A

> Commercial banking

- 2001 **Citigroup** buys Grupo Financiero (Mexico) for \$12.8b
- 2000 **HSBC** buys Credit Commercial de France for \$11.1b
- 1998 **Deutsche Bank** buys Bankers Trust for \$9.7b

> Investment banking

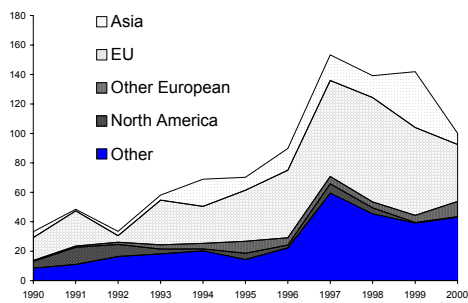
- 2000 **UBS AG** (Swiss) buys PaineWebber Group for \$16.5b
- 2000 **Credit Suisse** buys Donaldson Lufkin Jenrette for \$13.5b

> Insurance

- 2001 **Fortis** (Belgium) buys Fortis (Netherlands) for \$12.5b
- 1999 **Aegon NV** (NL) buys TransAmerica for \$10.8b
- 1998 **Allianz AG Holding** (Germany) buys Assurances Generales de France for \$10.0b

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Privatizations and equity market growth



OECD *Financial Market Trends*, June 2001

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Privatizations of state-owned enterprises in transition economies

> Privatizations of state-owned enterprises are usually conducted as a

- Voucher program
- Management buyout (MBO)
- Mass privatization program (MPP)

> Effective legal and corporate governance systems are prerequisites for a successful transition to a market economy

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Russia's troubled privatization

- **Russia: 1992 through 1996**
 - State-owned enterprises were privatized through **vouchers** distributed to Russian citizens
 - Managers repurchased these shares and retained controlling interests in most firms
 - **Fraud** was rampant, and foreign investors were often disenfranchised
 - **Financial oligarchs** established control over Russia's commercial banks and natural resource firms
- **Russia's privatization program had trouble because it was conducted without concurrent reforms in Russia's legal, regulatory, and administrative systems**

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Relatively successful privatizations

- **Poland: 1991 through 1995**
 - Poland promoted the growth of free enterprise
 - State-owned assets were slowly sold to investors
 - Strong labor unions monitored managers
- **Czech Republic: 1991 through 1995**
 - Assets of 350 state-owned firms were sold to investors
 - 1,800 firms were privatized through vouchers
 - Most vouchers were reinvested in diversified investment funds that promised to monitor managers
- **These transitions were relatively successful because these countries developed institutions that promoted good corporate governance**

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

The winners and losers

- **Target firms**
 - Target firms shareholders receive large gains during the announcement period
- **Bidding firms**
 - The shareholders of U.S. acquirers may or may not win
 - The shareholders of acquirers from outside the United States are more likely to win

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Contributing factors

- **Method of payment** - Cash offers are more likely to benefit bidding firm shareholders
- **Free cash flow** - Firms with free cash flow often waste it
- **The tax environment** - M&A can facilitate the transfer and realization of tax benefits
- **Real exchange rates** - A strong domestic currency helps domestic acquirers

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

The benefits of multinationality

- **A firm's multinationality contributes to its success in cross-border M&A**
 - Multinationality increases the value of firm-specific, intangible assets
 - Multinationality increases the value of cross-border acquisitions in related businesses
 - Prior international experience increases the value of entry into new markets

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e

Caveat

- **Further research will surely modify and extend the conclusions reported here**
- **Indeed, increasing competitiveness in the international market for corporate control is likely to change some of the conclusions**

Kirt C. Butler, *Multinational Finance*, South-Western College Publishing, 3e