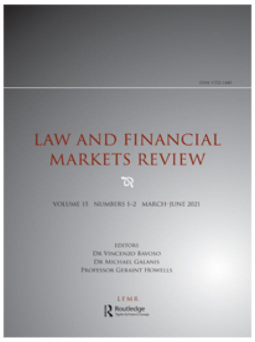


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# Revisiting the takeover efficiency argument and the role of the board

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**ABSTRACT**
Despite the synergistic objective of takeovers, shareholders of acquiring companies can experience loss or limited gains when acquisitions are concluded with high takeover premiums. This article argues that, since takeover premiums are determined by acquiring management boards, and losses to shareholders are unlikely to be remedied via breach of directors' duty, it is desirable to challenge the discretionary role of managements. It suggests that managements should declare their acquisition objective, to enable shareholders to manage their expectations. If managerial objective is to obtain synergistic gains, they should be required to demonstrate the extent to which takeover premiums that are beyond certain premium threshold would yield synergistic gains, to obtain shareholder approval. Alternatively, if their immediate acquisition objective is to obtain the benefits of controlling the target company, then the need for shareholder approval can be dispensed with, as long as the premium paid matches the assets of the target company.

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Acquisitions premium; acquiring companies; regulation; synergy; directors' duties

## A. Introduction

The efficient market hypothesis EMH suggests that the price of shares is determined by relevant information about a company as they become available.[1] Since future information about a company cannot be predicted, it would be impossible to influence the price of shares, and investors should be assured that the value of shares that they buy or sell, represents the best estimate of the intrinsic value of the shares of a company.[2] Despite the assumption of the EMH that the prices of shares are efficiently determined, the scope of EMH in relation to the price of shares appears to be limited to the acquisition of shares for purposes other than

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[1] Eugene Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 The Journal of Finance 383.
[2] Daniel R Fischel, 'Efficient Capital Market Theory, the Market for Corporate Control and the Regulation of Cash Tender Offer' (1978) 57 Texas Law Review 3, 4.

corporate takeovers.[3] Acquirers pay premium; an additional value over the market value of shares, to complete a takeover transaction. Premiums paid to acquire shares for the purpose of takeovers have been suggested to be linked to the acquisition of the 'controlling interest' of the target company, which is considered by acquirers to be an asset.[4] Several corporate acquisitions that have either led to economic gains or losses to acquiring companies and shareholders were concluded via premiums. It is desirable for the efficiency that can be obtained when shares are bought without the desire for 'control', within the scope of EMH to similarly apply when shares are acquired for the purpose of corporate control, via premiums, in pursuit of synergistic gains. This is important because, as indicated in this article, losses arising from negligent and costly acquisitions are unlikely to be remedied by breach of directors' duties.[5]

Various studies have examined the efficiency of the stock market in relation to acquisitions.[6] Some of these studies mainly illustrate the relationship between EMH and different takeover mechanisms, to indicate why acquirers prefer certain takeover mechanisms. For example, it is indicated that tender offers became a prominent method of acquisition over open market bid OMB, as a result of the corresponding increase in the price of shares, as more shares are acquired when OMB is adopted.[7] Further, a study examined various hypothesised sources of gains in acquisitions and the factors that influence the variety of premiums paid in relation to these sources.[8] Whether control premium should be justifiably added to the market valuation of a company has also been examined in relation to the objective of the valuation for an acquisition.[9] It was suggested that where the valuation considers the synergistic gains to be obtained post acquisition, then premiums would be justified, but that acquisition premiums may also be influenced by acquisition motives other than expected synergies.[10] These motives may undermine the link between takeover premiums and expected synergies, despite synergistic gains being the ultimate objective of takeovers. For example, a plethora of empirical evidence show that costly acquisitions can lead to loss of value in acquiring companies,[11] and consequently undermine the economic interest of acquiring shareholders. Yet, extant regulations are mainly aimed at protecting the interests of shareholders in target companies.[12] Further, boards of acquiring companies are unlikely to be held liable for

[3]'Takeovers' and 'acquisitions' are used interchangeably in this article.
[4]Barbara S Petitt and Kenneth R Ferris, *Valuation for Mergers and Acquisitions* (2nd edn, Pearson Education 2013) 9; see also Lucian A Bebchuk, 'Efficient and Inefficient Sales of Corporate Control' (1994) 109 Journal of Economics 957, 962.
[5]See the analysis in D.I. below.
[6]Some of the studies include, Gerald P Madden, 'Potential Corporate Takeovers and Market Efficiency: A Note' (1981) 36 The Journal of Finance 1191; Nick von Gersdorff and Frank Bacon, 'US Mergers and Acquisitions: A Test of Market Efficiency' (2009) 1 Journal of Finance & Accountancy 1; Michael L Wachter, 'Takeover Defense When Financial Markets are (Only) Relatively Efficient' (2003) 151 University of Pennsylvania Law Review 787; Terry S Walter, 'Australian Takeovers: Capital Market Efficiency and Shareholder Risk and Return' (1984) 9 Australian Journal of Management 63.
[7]John Armour and Brian Cheffins, 'Stock Market Prices and the Market for Corporate Control' (2016) University of Illinois Law Review 761; Jeffrey Fear and Christopher Kobrak, 'Diverging Paths: Accounting for Corporate Governance in America and Germany' (2006) 80 Business History Review 1, 24.
[8]Alexander R Slusky and Richard E Caves 'Synergy Hypothesis and the Determinants of Premia Paid in Mergers' (1991) 39 The Journal of Industrial Economics 277.
[9]Bradford Cornell, 'Guideline Public Company Valuation and Control Premiums: An Economic Analysis' (2013) 8 Journal of Business Valuation and Economic Loss Analysis 53.
[10]ibid 67–68.
[11]n 26 below.
[12]For example, the objective of the UK Takeover Code 2021, as indicated in Introduction 2A is to protect the interests of shareholders of target companies. Further, the non-frustration rule embodied in B1 General Principles 3, require

breach of directors' duty resulting in losses suffered by shareholders of acquiring companies caused by costly acquisitions that were concluded negligently.[13] Thus, lack of regulatory protection for acquiring shareholders may be incentivising boards to negligently engage in costly acquisitions, thereby promoting managerial hubris either deliberately or ignorantly. Hence, this article examines the role of management boards in the determination of takeover premiums. The data in Tables 1 and 2 indicate that the top range of the most expensive acquisitions worldwide largely comprise companies in the United States and the United Kingdom; some of these companies encountered significant economic loss. Thus, an evaluation of the regulatory control over managerial acquisition decisions in these jurisdictions is justified. The article identifies the extent to which determinants of acquisition premium may be influenced by managerial hubris. Further to these objectives, three main questions are addressed. First, what factors influence managers in the determination of takeover premiums? Second, to what extent do takeover premiums lead to economic loss? Third, how can acquiring shareholders be protected from managerial hubris and the negative impact of takeover premium on corporate value? The article demonstrates that even though acquisition premiums are influenced by certain exogeneous factors, premiums are ultimately subjectively determined by management boards of acquiring companies. The combined effects of the subjective determination of premiums and the potential for losses occasioned by premiums, indicate that the role of acquiring management boards in takeovers has not been sufficiently challenged. It concludes that, to limit the influence of hubris in management boards acquisition decisions, first, boards should be required to declare their acquisition objectives, which would either be primarily aimed at synergistic gains or obtaining corporate control. Second, management boards with synergistic objectives that are seeking to pay acquisition premiums beyond certain threshold should be required to justify the premium and practically demonstrate how potential losses from the acquisition would be absorbed, before obtaining shareholder approval. An acquisition that is primarily aimed at obtaining corporate control, with long term synergistic gains would place less emphasis on immediate synergistic gains, since other benefits of control,[14] would incentivise shareholders to manage their expectations about short-term synergistic gains.

The rest of the paper proceeds as follows. First, the justification for corporate takeovers and other incidents of takeovers are briefly examined, relative to the effects of costly acquisitions and takeover premiums on synergistic gains. Next, further to the impact of takeover premiums on corporate losses, the role of managerial boards in the determination of takeover premium is examined. Finally, after the analysis on the need for managements to declare their acquisition objectives, the limited scope of directors' duties in addressing challenges relating to losses caused by negligent acquisitions and the relevance of shareholder approval are presented before the conclusion.

managements of companies not to do anything that may indicate that a bid is accepted or rejected without the input of shareholders of target companies. See the US Securities Exchange Act of 1934 s 14(d) (6) and (7) that requires equal treatment of shareholders in target companies when a takeover bid is made.

[13]See analyses in D.I.

[14]See C.II. and C.III.

**Table 1.** Thirty-one largest acquisitions worldwide (source: author).

| | Companies | Year | Mode | Value ($ billions) | Country |
|---|---|---|---|---|---|
| 1 | Vodafone<br>Mannesmann | 1999–2000 | shares | 183 | Germany |
| 2 | American Online<br>Time Warner | 2000 | cash/shares | 164 | USA |
| 3 | Verizone Com<br>Verizone Wireless | 2013 | cash/shares | 130 | USA |
| 4 | AB in Bev<br>Sabmiller | 2015 | cash/shares | 101 | UK |
| 5 | RFS Holding<br>ABN AMRO | 2007 | cash/shares | 98 | Netherlands |
| 6 | Pfizer<br>Warner Lambert | 1999 | cash/shares | 89 | USA |
| 7 | AT&T Inc.<br>Time Warner Inc. | 2016/18 | cash/shares | 85 | USA |
| 8 | Exxon<br>Mobil | 1998 | cash/shares | 78 | USA |
| 9 | Glaxo Welcome<br>SmithKline B | 2000 | shares | 75 | UK |
| 10 | AT&T<br>Bell South | 2006 | share exchange | 72 | USA |
| 11 | Travelers Group<br>City Corp. | 1998 | share exchange | 72 | USA |
| 12 | Comcast Corp.<br>AT&T Broadband | 2001 | shares/debt | 72 | USA |
| 13 | Royal Dutch Shell<br>BG Group | 2015 | cash/share exchange | 69 | UK |
| 14 | Actavis<br>Allergan | 2014 | cash/share exchange | 68 | Ireland |
| 15 | Pfizer<br>Wyet | 2009 | cash/share | 67 | USA |
| 16 | Dell<br>EMC | 2015 | cash/share | 67 | USA |
| 17 | Bayer AG<br>Monsato Group | 2016/18 | cash | 66 | USA |
| 18 | SBB Comm<br>Ameritech (now known as AT&T Inc.) | 1998 | share exchange | 62 | USA |
| 19 | Dow Chemical<br>DuPont | 2015 | share exchange / merger of equal | 62 | USA |
| 20 | National Bank<br>Bank of America | 1998 | share exchange | 61 | USA |
| 21 | Gaz de France<br>Suez SA | 2006 | share exchange / dividend payment | 60 | France |
| 22 | Vodafone<br>Airtouch | 1999 | cash/share exchange | 60 | USA |
| 23 | Sanofi Synthelabo<br>Aventis | 2004 | cash/share exchange | 60 | France |
| 24 | Pfizer<br>Pharmacia | 2002 | share exchange | 59 | Sweden |
| 25 | JP Morgan Chase<br>Bank One | 2004 | share exchange | 58 | USA |
| 26 | Procter & Gamble<br>Gillette | 2005 | cash/shares | 57 | USA |
| 27 | Chartered Communications<br>Time Warner Cable | 2015/16 | cash/shares | 56,7 | USA |
| 28 | Qwest Comm<br>US West | 1999 | shares | 56 | USA |
| 29 | Total Fina<br>Elf | 1999 | shares | 54 | France |
| 30 | Bell Atlantic<br>GTE Corp | 1998 | share exchange | 52.8 | USA |
| 31 | Bank of America<br>Merrill Lynch | 2008 | shares | 50 | USA |

## B. The justification for takeovers

Traditional finance theory suggests that corporate entities that are 'poorly managed' are likely to be takeover targets, because the acquiring-investor believes that, with an optimal management team, the value of the firm can be enhanced beyond its current state.[15] The justifications for corporate acquisitions include, obtaining corporate control,[16] and the expected synergistic gains to the combined company post-takeover.[17] The benefits that can be obtained from controlling a corporate entity include, the right to appoint operational management and the board of directors, acquire, lease, or liquidate business assets, including plant, property, negotiate and consummate mergers and acquisitions and liquidate, dissolve, sell out, or recapitalise the company,[18] among others. The list is endless. Managers tend to promote synergistic gains more than the long list of benefits of control, because synergy is more attractive to shareholders since it is a direct consequence of obtaining control and it projects quick financial gains.

The synergy hypothesis suggests that corporate takeovers are motivated by the desire to create wealth, through a combination of the resources of acquiring and target companies. This can occur in such a way that the value of the combined entity would be greater than the sum of the separate entities' values.[19] These include, operating, managerial and financial synergies,[20] among others. Since the synergy hypothesis aims at enhancing the value of the combined companies and since the combination of their resources can lead to a greater value than the sum of their separate values, it implies that either the target or acquiring company is performing at optimal level, based on return on investment. This can provide an attractive proposition for the combination of companies in similar industries, to strengthen their market power[21] and ultimately enhance their economic value as a combined entity.

Other incidents of takeovers include the dismissal of managements of target companies and managerial hubris. Takeovers can lead to the dismissal of managers of target companies, to arguably eliminate inefficient managers.[22] Hence, managers may oppose takeover bids to retain their positions. However, they can also adopt defensive measures to ultimately enhance the bid price on behalf of shareholders of target companies. The

[15]Michael C Jensen, 'The Takeover Controversy: Analysis and Evidence' in John C Coffee, Louis Lowenstein and Susan Rose-Ackerman (eds), *Knights, Raiders and Targets: The Impact of the Hostile Takeover* (Oxford University Press 1988) 318; David Hirshleifer and Anjan V Thakor, 'Corporate Control through Board Dismissals and Takeovers' (1998) 7 Journal of Economics & Management Strategy 489, 511.

[16]See the analysis in C.II. and C.III.

[17]Roberta Romano, 'A Guide to Takeovers: Theory, Evidence and Regulation' (1992) 9 Yale Journal on Regulation 119.

[18]See the long list in Shannon Pratt and Alina V Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* (5th edn, McGraw Hill 2008) 385.

[19]Lynn Hodgkinson and Graham H Partington, 'The Motivation for Takeovers in the UK' (2008) 35(1) Journal of Business Finance & Accounting 102. Even though takeovers appear to discipline 'non-performing managers', the quest for synergy remains the driving force for takeovers. See Michael Jensen, 'Takeovers: Folklore and Science' in Peter J Buckley and Pervez N Ghauri (eds), *International Mergers and Acquisition: A Reader* (Thompson 2002) 71; Peter Dodd and Richard Ruback, 'Tender Offers and Stockholder Returns: An Empirical Analysis' (1977) 5 Journal of Financial Economics 351; Michael Bradley, 'Interfirm Tender Offers and the Market for Corporate Control' (1980) 53 Journal of Business 345; Michael Bradley, Anand Desai and Han E Kim, 'The Rationale Behind Interfirm Tender Offers: Information or Synergy'? (1983) 11 Journal of Financial Economics 183.

[20]For other motives of takeovers, see Cornell (n 9).

[21]See the discussion on *market power* in C.I. below.

[22]Richard A Brealey, Stewart C Myers and Franklin Allen, *Principles of Corporate Finance* (12th edn, McGraw-Hill/Irwin 2017) 814–818.

**Table 2.** Takeover premiums and losses from acquisitions (source: author).

| | Companies | Acquisition Premium in % | Fail / Loss |
|---|---|---|---|
| 1 | Vodafone<br>Mannesmann | 160 | £28b loss |
| 2 | American Online<br>Time Warner | 70 | Fail / 99b loss |
| 3 | Verizone Com<br>Verizone Wireless | nil | – |
| 4 | AB in Bev<br>Sabmiller | 50 | – |
| 5 | RFS Holding<br>ABN AMRO | 70 | fail |
| 6 | Pfizer<br>Warner Lambert | 34 | |
| 7 | AT&T Inc.<br>Time Warner Inc. | 35 | |
| 8 | Exxon<br>Mobil | 26 | |
| 9 | Glaxo Welcome<br>SmithKline B | nil | |
| 10 | AT&T<br>Bell South | 17.9 | |
| 11 | Travelers Group<br>City Corp. | 8 | spin off |
| 12 | Comcast Corp.<br>AT&T Broadband | nil | |
| 13 | Royal Dutch Shell<br>BG Group | 52 | |
| 14 | Actavis<br>Allergan | 54.2 | |
| 15 | Pfizer<br>Wyet | 29 | $6b restructuring costs |
| 16 | Dell<br>EMC | 28 | $1.5b |
| 17 | Bayer AG<br>Monsato Group | 44 | |
| 18 | SBB Comm<br>Ameritech<br>(now known as AT&T Inc.) | 27 | |
| 19 | Dow Chemical<br>DuPont | nil | |
| 20 | National Bank<br>Bank of America | nil | |
| 21 | Gaz de France<br>Suez SA | 3.9 | |
| 22 | Vodafone<br>Airtouch | 16 | |
| 23 | Sanofi Synthelabo<br>Aventis | 3.6 | |
| 24 | Pfizer<br>Pharmacia | 36 | $3.59b |
| 25 | JP Morgan Chase<br>Bank One | 14.5 | |
| 26 | Procter & Gamble<br>Gillette | 18 | $8b goodwill written off |
| 27 | Chartered Communications<br>Time Warner Cable | 14 | |
| 28 | Qwest Comm<br>US West | 30 | $30b goodwill written off |
| 29 | Total Fina<br>Elf | 26 | |
| 30 | Bell Atlantic<br>GTE Corp | nil | |
| 31 | Bank of America<br>Merrill Lynch (ML) | 70 | $15b<br>(losses from ML) |

disciplinary hypothesis suggests that the value of a company is likely to be enhanced if the company has an effective management-team than it presently has.[23] This is mostly applicable where the prospect of synergistic gains is clearly determined pre-acquisition, since managers may be dismissed for alternative reasons. For example, firms that engage in horizontal acquisitions may downsize the composition of the board as a result of duplicated managerial positions, irrespective of the performance of the members of the combined boards. Further, an acquiring company with access to vast investment capital and cash flow, may acquire a target company and enhance the value of the company having increased the market base of the newly acquired company. Thus, the need for an effective management team is not the only determinant of synergistic gains arising from managerial dismissal.

In certain circumstances, takeovers may provide little or no significant economic gains to acquiring companies. This could be as a result of different factors, including managerial hubris; an overestimation of the bid price, which makes the bidder to pay too much for the acquisition. This occurs when the average increase in the target firm's market value is more than offset by the average decrease in the value of the bidding firm, in such a way that the combined gain to the target and bidding firms is non-positive.[24] It is indicative of zero gains to the combined company post-takeover.[25] Empirical research indicate that high costs of shares in takeover transactions can lead to zero or negligible gains for acquirers post-takeover, whereas target shareholders almost certainly reap bountifully from the sale of their shares.[26] Further, the post-takeover challenges to acquiring shareholders that are caused by costly acquisitions can lead to corporate re-structuring, such as the closure of plants and employee dismissal.[27] For example, during negotiations for the proposed takeover of *AstraZeneca Plc* by *Pfizer Inc.,* in 2014, the Chief Executive of *Pfizer*, while appearing before the UK House of Commons' *Business Innovation and Skills Committee,* stated that *Pfizer* cannot guarantee that the jobs in *AstraZeneca* would be 'safe' after the acquisition.[28] This indicates that some of these challenges may be anticipated before takeovers are concluded.

Although the hubris hypothesis does not indicate that managements deliberately pay higher premiums,[29] it has been suggested that previous successes, and the inability of

[23]David Scharfstein, 'The Disciplinary Role of Takeovers' (1988) 55 Review of Economic Studies 185, 192.

[24]Richard Roll, 'The Hubris Hypothesis of Takeovers' (1986) 59 The Journal of Business 197, 201–203; Elazar Berkovitch and M P Narayanan, 'Motives for Takeovers: An Empirical Investigation' (1993) 28 Journal of Finance and Quantitative Analysis 347, 351. See also John Dobson, Size Matters: Why managers Should Pursue Corporate Growth at the Expense of Shareholders Value' (2004) 23 Business and Professional Ethics Journal 45.

[25]ibid Berkovitch and Narayanan, 352.

[26]Sara B Moeller, Frederik P Schlingemann and René M Stulz, 'Do Shareholders of Acquiring Firms Gain From Acquisitions'? (2003) National Bureau of Economic Research Working Paper Series, 9523 <http://www.nber.org/papers/w9523> accessed 11 February 2021; Mahendra Raj and Michael Forsyth, 'Hubris Among UK Bidders and Losses to Shareholders' (2003) 8 International Journal of Business 1, 8–15; Berkovitch and Narayanan (n 24) 351; Robert F Bruner, 'Does M & A Pay? A Survey of Evidence for the Decision Maker' (2002) Journal of Applied Finance 48, 64–65; Michael Firth, 'Corporate Takeovers, Stockholder Returns and Executive Rewards' (1991) 12 Managerial and Decision Economics 421, 425–27.

[27]Myeong-Gu Seo and N Sharon Hill, 'Understanding the Human Side of Merger and Acquisition: An Integrative Framework' (2005) 41 Journal of Applied Behavioral Science 422.

[28]Rupert Neate and Jennifer Rankin 'Pfizer Admits Takeover of AstraZeneca Would Lead to Cuts in UK Jobs and R&D' (*The Guardian* 13 May 2014) <http://www.theguardian.com/business/2014/may/13/pfizer-astrazeneca-uk-job-cuts-mps-hostile> accessed 11 December 2020.

[29]Roll (n 24) 213–214; Nejat H Seyhun, 'Do Bidder Managers Knowingly Pay Too Much For Target Firms'? (1990) 63 Journal of Business 439, 453.

managers to focus on realistic gains as a result of overconfidence,[30] may indicate that managers negligently engage in costly acquisitions.[31] Agency conflict have also been suggested to lead to overpayments.[32] Even though managers may not be able to increase their salaries and allowances after an acquisition,[33] they are likely to enhance their personal interests through outside directorship.[34] The acquisitions that they had concluded may be a signal that they have the required skills and experience to manage a large enterprise, irrespective of whether the acquisitions actually led to an increase in corporate wealth.[35] In light of the synergistic objective of takeovers, more evidence is needed to determine whether hubris is a deliberate act of managers.

## *I. Methodology*

Tables 1 and 2 contain a list of the most expensive acquisitions worldwide. These acquisitions depict the highest level of costs that have been associated with corporate acquisitions until 2016. The list was obtained by conducting a search for acquisitions that were concluded for at least $50 billion until 2016. [36] The search produced a list of thirty-one (31) acquisitions worldwide, excluding spin outs and shareholders acquisition of subsidiaries. A benchmark of takeovers worth at least $50b was used as the selection criteria to ensure that only the top range of costly acquisitions are selected. 2016 is selected as the most recent year of acquisitions to ensure that sufficient time would have passed to determine whether the latest acquisitions on the list have indicated losses or gains.

The focus of the study is to examine the extent to which management boards effectively determine the costs of acquisitions, since EMH does not apply to takeover transactions. A review of the most expensive acquisitions and the premiums paid by acquiring management boards, relative to the extent to which losses or gains were recorded would aid the objective of the study. Data from the thirty-one most expensive acquisitions does not indicate that costly acquisitions and large premiums paid for shares always lead to losses post acquisition; there is a mix result of losses and economic gains. An extensive search for the 100 or 500 costliest acquisitions would not necessarily aid the

[30]Ulrike Malmendier and Geoffrey Tate, 'Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction' (2008) 89 Journal of Financial Economics 20, 42; Kose John, Leonard N Stern, Yue Liu and Richard J Taffler, 'It Takes Two to Tango: Overpayment and Value Destruction in M&A Deals' (2010) <https://pdfs.semanticscholar.org/0541/d3500457a4d775901eeedd8e24ae58aad30c.pdf?_ga=2.188380840.1013409997.1523114821-357005184.1523114821> accessed 11 December 2020. In the absence of obvious projected gains to acquiring shareholders, it has been suggested that managements should be prudent when they make acquisitions. See Bruner (n 26) 64–65; Gerald Vinten, 'Employee Relations in Mergers and Acquisitions' (1993) 15 Employee Relations 47, 48–50.

[31]The value attached to control and the desire to gain additional market power can incentivise managers to engage in costly acquisitions, hence managers are admonished to shun the habit of blindly increasing the size of their corporation. See Cyrus A Ramezani, Luc Soenen and Alan Jung, 'Growth, Corporate Profitability and Value Creation' (2002) 58 Financial Analysts Journal 56, 65.

[32]Slusky and Caves (n 8) 290.

[33]*The Enterprise and Regulatory Reform Act*, *2013*, s. 79, entitles shareholders of quoted companies to vote on remuneration policy. Also, *The UK Corporate Governance Code 2018* (5) recommends that executive remuneration should be appropriately linked to performance.

[34]See generally Christopher Avery, Judith A Chevalier and Scott Schaefer, 'Why Do Managers Undertaker Acquisitions? An Analysis of Internal and External Rewards for Acquisitiveness' (1998) 14 Journal of Law, Economics and Organisation 24.

[35]ibid, see also Francis N Botchway, 'Mergers and Acquisitions in Resource Industry: Implications for Africa' (2010) 26 Connecticut Journal of International Law 51, 62.

[36]For a list of the most expensive acquisitions worldwide, (including spin outs and shareholders acquisition of subsidiaries) see data from The Institute of Mergers Acquisitions and Alliances. <https://imaa-institute.org/mergers-and-acquisitions-statistics/> accessed 22 January 2021.

objective of the study, since an extension of the list would produce less costly acquisitions, which is not the focus of this study. An extension of the list would likely produce similar mix results of losses and gains in higher proportions.

The size of the sample nevertheless limits the results of the analyses, especially lack of similarity in the line of business of companies in the data. For example, it does not reflect industry-based acquisitions. However, the research objective was not undermined by these limitations since the extent to which management boards effectively considered post- acquisitions economic gains in the determination of the premiums paid, would be determined by the actual gains or losses from these acquisitions. Future research that extends the scope of the data to focus on particular industries may lead to alternative results.

Table 1 contains details of the thirty-one most expensive acquisitions across the world until 2016. It shows the names of the acquiring-target companies, the year of acquisition, the mode of acquisition (cash or share exchange or both), the value of the acquisition and the country where the acquisition occurred.

The premium values of the takeover transactions in Table 1 are indicated in Table 2. It shows the difference between the market value of the shares of the acquired companies and the value at which the shares were acquired. Further, it shows the extent to which premiums paid for shares led to losses post-acquisition.

## *II. Data analysis*

The data in Table 1, and particularly Table 2, indicate that there is a risk of loss of corporate value where the acquisition premium is about 30% of the market value of the shares of the target company. At 70% premium, there is higher risk of significant loss of corporate value or total corporate failure. This can be observed from the significant losses of £28b after the *Vodafone – Mannesmann* takeover at about 160% premium, $99billion after the acquisition of *Time warner* at 70% premium and the collapse of *RFS Holding* after the acquisition of *ABN AMRO* at about 70% premium.

Despite these corporate losses, the data in Table 2 does not indicate that costly acquisitions and large premiums paid for shares always lead to losses post acquisition. There is a mix result of losses and economic gains. It can be observed that some costly acquisitions did not lead to corporate failure or losses. For example, Royal Dutch Shell and BG at 52% premium, Pfizer and Warner Lambert at 34% premium and AB InBev and SABMiller at 50% premium did not indicate losses. However, financial challenges leading to diversification appear to undermine the synergistic objectives of some of these takeovers. For example, not only did the share price of AB InBev plummet by 26% since October 2016, after the acquisition was completed, by July 2019 the company was still in debt of about $106b that was obtained to finance the acquisition deal.[37] Further, its Australian business was sold for about $11.3b and it has also sold off parts of SABMiller.[38] This indicates that premiums that are paid for shares, for the purpose of corporate acquisitions can either lead to corporate gains, losses or forced diversification.

[37] Arash Massoudi and Leila Abboud 'How Deal for Sabmiller Left Ab InBev with Lasting Hangover' (*Financial Times*, 24 July 2019) <https://www.ft.com/content/bb048b10-ad66-11e9-8030-530adfa879c2> accessed 11 January 2021.
[38] ibid.

Although higher acquisition premiums are mainly associated with losses or outright failure of the acquisition, as indicated in Table 1, the table does not clearly indicate the optimum level of premium at which synergistic gains would be considered to likely occur post-acquisition. What is indicated is that there is a greater chance of loss or corporate collapse when acquisitions are concluded at premiums above 70%.

The Tables also indicate that companies in the United States and the United Kingdom make up most of the companies on the list of the top range of the most expensive acquisitions worldwide. The losses were also dominated by companies in these jurisdictions. Thus, it is imperative to ascertain the extent to which losses caused by negligent acquisitions can be remedied in any of these jurisdictions for the following reasons. Since data in Tables 1 and 2 show that the US and the UK account for both the most expensive acquisitions and most of the losses from acquisitions worldwide, it indicates that management boards in these jurisdictions dominate the acquisition market. Consequently, ascertaining the extent to which directors in either the US or UK would be held liable for losses would be of much concern to relevant stakeholders in these jurisdictions and other jurisdictions with less acquisition traffic. These include shareholders of acquiring companies, management boards of acquiring companies and regulators. For example, shareholders in these jurisdictions would be interested in ascertaining the extent to which directors can be held liable for losses caused by negligent and costly acquisitions. This will also be relevant for directors that are yet to engage in negligent acquisitions that led to losses, as it can potentially influence the conduct of management boards in future acquisition decisions in these jurisdictions and beyond. Thus, a review of the role and conduct of management boards in these jurisdictions is justified, to determine the extent to which they can be held liable for negligent acquisitions and whether a regulatory review would potentially address the challenges of losses caused by costly and negligent acquisitions.

The factors that are considered by management boards when they make acquisitions are important, because these factors should be considered relative to the extent to which a particular acquisition premium would match both the 'market value' of the shares to be acquired and the additional 'value of control'. Both values should add up to a takeover premium that is optimal for synergy to materialise post-acquisition, to ensure that losses or corporate failures are averted.

Since acquiring managers determine the premiums to be paid for acquisitions, the extent to which optimal levels of premiums can be achieved, would be dependent on the role of managers in relation to other exogenous factors that can influence managerial preferences. These are examined next.

## C. Determinants of takeover premium

Although the price of shares in a takeover transaction is outside the scope of the EMH, since the value of shares in a takeover transaction is more than the market value of the shares,[39] the efficiency argument of takeovers, particularly its synergistic objective, suggests that the price of shares reflects an expected efficient outcome. The additional costs of shares beyond its market value, being the premium paid for the acquisition of

[39]Bernard S Black, 'Bidder Overpayment in Takeovers' (1989) 41 Stanford Law Review 597.

'control' would be expected to be reflected post acquisition, but this may not occur. Lack of synergistic gains or losses post-acquisition is an indication that certain factors influence the role of acquiring managements in the determination of the price of shares when acquisitions are concluded. These factors arguably include the quest for market power, value of control, competitive bids, future unrealisable gains, and managerial defences.

Even though these factors influence the price of shares in a takeover transaction, it is argued that management boards of acquiring companies ultimately determine the price of shares. It would also be shown that losses to corporate value resulting from costly acquisitions, carelessly or negligently made by management boards would not likely be remedied by reference to directors' fiduciary duty or common law duty of care.

## *I. Market power*

The quest for additional market power by acquirers of companies in the same line of business can motivate acquiring managers to pay for shares beyond their market value.[40] While the desire for additional market power may arguably be justifiable, the nexus between additional market power and efficient outcomes is unclear.[41] Importantly, the extent to which takeover premiums that are influenced by the need to obtain additional market power are accurately predicated on post-acquisition efficiency is unclear. Since the application of the EMH is excluded in the determination of the price that acquirers are willing to pay in takeovers, and in furtherance of the efficiency argument of takeovers, the level at which share prices would most likely achieve synergistic gains ought to be specifically considered. Some acquirers may not have effectively considered synergy as the basis for determining the share price, especially where the quest for market power predominantly influenced the acquirer's objective. In such instance, synergy would merely be an objective of the acquisition, without essentially linking the price of shares to synergistic gains. For example, the deal for the largest corporate acquisition in the telecommunications industry was motivated by the need to enhance market power. The acquisition was completed in February 2000 when *Vodafone acquired Mannesmann* for about \$183 / €204 billion, (including liabilities of about \$17b)[42] at €353 / share against the market value of about €143. This represented a premium of about 160%.[43] Further, the acquisition of *SABMiller Plc*, a United Kingdom based brewer, by *Anheuser-Busch InBev*, the world's largest brewer, headquartered in Belgium, for about \$100b in 2016 was motivated by the need to enhance its market power.[44]

[40]Donald M DePamphilis, *Mergers, Acquisitions and other Restructuring Activities: An Integrated Approach to Process, Tools, Cases and Solutions* (9th edn, Academic Press United Kingdom 2018), 15.

[41]Bruce A Blonigen and Justin R Pierce, 'Evidence for the Effects of Mergers on Market Power and Efficiency' (2016) Finance and Economics Discussion Series 2016-082. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2016.082 accessed 17 March 2021.

[42]CNN Money (4 February 2000) <https://money.cnn.com/2000/02/04/europe/vodafone/> accessed 11 July 2018. Edmund l Andrews and Andrew Ross Sorkin 'Europe's Megadeal: The Overview; \$183 Billion Deal in Europe to Join Two Wireless Giants' (*New York Times*, 4 February 2000) <https://www.nytimes.com/2000/02/04/business/europe-s-megadeal-overview-183-billion-deal-europe-join-2-wireless-giants.html> accessed 15 February 2021.

[43]Previously intended offers included 76% premium of €253 valuation of *Mannesmann*. Carol J Williams, 'As in Mannesmann Deal, Globalization Forcing Germany Inc. Out of Business' (*Los Angeles Times*, 14 February 2000) <http://articles.latimes.com/2000/feb/14/business/fi-64162> accessed 11 January 2021; Terry Barwick et al., Director of Corporate Affairs 'Intended Offer to Mannesmann Shareholders' 29 December 1999 Press Release <https://www.vodafone.com/content/index/media/vodafone-group-releases/1999/press_release29_11.html> accessed 11 January 2021.

The offer of about £44/share to *SABMiller's* shareholders represents a premium of about 50% of the market value of *SABMiller* shares.[45] The quest for additional market power was clearly indicated when the Chief Executive of *Anheuser-Busch InBev* stated that the combination was about accelerating revenue growth.[46] Substantial financial post-acquisition challenges lingered on in AB-in Bev in 2019, despite having completed the acquisition in 2016.[47]

Similarly, the acquisition of *Time Warner* by *America Online* (AOL) in year 2000 for over $160b in addition to about $17 billion liabilities of *Time Warner,* also involved companies in similar industry.[48] Just like the *SABMiller* and *Mannesmann's* acquisitions, the acquisition of *Time Warner*, which is currently the largest takeover in the United States, was driven by the need for additional market power, with a takeover premium of about 70% over the market price of $64.75 of *Time Warner* shares, at the rate of $110 *per* share.[49] The combination of *AOL* and *Time Warner* was later described as a misguided idea by the Chairman / Chief Executive of *Time Warner*, after synergies between the combined companies failed to materialise, and a loss of about $99 billion was recorded.[50] This led to the separation of *AOL* from *Time Warner* in December 2009 with plans to disengage one tenth of *AOL*'s 7,000 workforce.[51] The premium of 70% and the post-acquisition challenges indicate that the acquisition was completed to enhance the market power of *AOL* in the media industry, with limited consideration of efficient outcomes, by reference to the level at which the premium would match synergistic gains.

Further, in October 2007, a consortium of the *Royal Bank of Scotland Group (UK) RBS, Fortis (Belgian)* and *Banco Santander (Spanish)*, known as *RFS Holdings B.V*. in a deal considered to be the largest acquisition in the banking sector, acquired the Dutch bank *ABN AMRO Bank N.V*. for about €71 billion, almost $100B. The deal represented (79% cash) a

[44]The acquisition of *SABMiller Plc* by *AB InBev* for £79 billion in 2016 is the largest acquisition in the United Kingdom, involving the world's two largest brewers. 'SABMiller Shareholders Back Biggest Takeover Deal in UK History' (*Sky News online report*, 6 June 2017) <https://news.sky.com/story/sabmiller-shareholders-back-biggest-takeover-deal-in-uk-history-10596745> accessed 11 January 2021; Philip Blenkinsop in Brussels and Pranav Kiran in Bengaluru (*Reuters*, 1 August 2016) <https://uk.reuters.com/article/us-sabmiller-m-a-abi/ab-inbev-and-sabmiller-expect-megabrew-merger-to-complete-october-10-idUKKCN10C2XC> accessed 11 January 2021.

[45]Matthew Davies (*BBC online*, 13 October 2015) <http://www.bbc.co.uk/news/business-34513520> accessed 11 January 2021.

[46]Scheherazade Daneshkhu, 'Hard Work on AB InBev Mega Deal Begins Now' (*Financial Times* 9 October 2016) <https://www.ft.com/content/7fa29f5a-8ae4-11e6-8cb7-e7ada1d123b1> accessed 25 February 2021.

[47]See n 37 and 38 above.

[48]While *Time Warner* uses the mainstream media in producing films, music, TV shows and magazines, *AOL* delivers its media contents using the online platform.

[49]Ianthe Jeanne Dugan and Ariana Eunjung Cha, 'AOL to Acquire Time Warner for 183 Billion Merger' (*The Washington Post*, 11 January 2000) <https://www.washingtonpost.com/archive/politics/2000/01/11/aol-to-acquire-time-warner-in-record-183-billion-merger/f3bf2f07-c32b-4052-b5a6-8489bb9d7013/> accessed 25 February 2021; 'AOL Buyout of Time Warner: Merger Frenzy Sweeping Corporate America' (*World Socialist Web*, 14 January 2000) <https://www.wsws.org/en/articles/2000/01/merg-j14.html> accessed 25 February 2021; Seth Sutel, 'AOL Buys Time Warner for $162 billion' (*ABC News*, 10 January 2000) <http://abcnews.go.com/Business/Decade/aol-buys-time-warner-162-billion/story?id=9279138> accessed 25 February 2021.

[50]Emma Barnett and Amanda Andrews, 'AOL Merger was 'The Biggest Mistake in Corporate History', Believes Time Warner Chief Jeff Bewkes' (*The Telegraph*, 28 September 2010) <https://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/media/8031227/AOL-merger-was-the-biggest-mistake-in-corporate-history-believes-Time-Warner-chief-Jeff-Bewkes.html> accessed 25 February 2021.

[51]James Quinn, 'AOL Officially Splits from Time Warner After 10 years' (*The Telegraph*, 9 December 2009) <https://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/6774324/AOL-officially-splits-from-Time-warner-after-10-years.html> accessed 30 April 2018; Emily Steel, 'AOL-Time Warner Divorce Is Official' (*The Wall Street Journal*, 10 December 2009) <https://www.wsj.com/articles/SB10001424052748704825504574586393655471238> accessed 11 January 2021.

premium of about 70% at €38.40 / share.[52] One year after the acquisition, the UK government bailed *RBS* from an impending demise. *RBS'* vulnerability to failure was largely because of capital strain from the acquisition.[53] The Dutch Government nationalised the *ABN AMRO* Bank in 2009 and took control of the *Fortis* operation of the bank in the *Netherlands* as part of the bailout plan, after the bank experienced serious solvency problems after the acquisition by the consortium.[54] Similarly, the Belgian government in collaboration with the Netherlands and Luxembourg announced a bailout plan for *Fortis,* under certain agreed terms.[55] The ambitious attempt to create the biggest market in the banking sector influenced the desire to pay the 70% premium over the market value of *ABN AMRO's* shares. The decision to pay about 70% premium for the *ABN AMRO's* shares led to the withdrawal of *Barclays Bank* from the takeover battle, after *Barclay's* offer was eclipsed by the $98.2 billion offered by the *RBS* consortium.[56]

The *ABN AMRO* takeover and other earlier examples indicate that the payments of premiums were largely influenced by the pursuit of market power. The extent to which efficient outcomes were considered to justify the premiums paid by the acquiring managements remains to be seen. Particularly, it is problematic for companies in the same line of business where they fail to achieve synergistic gains, since it would be expected that factors such as customer base and human resources, among others, should immediately positively impact the combined company.[57] Acquirers are expected to project anticipated gains to be obtained from such acquisitions, since they are operating in a familiar territory. Even when losses occur, they could be attributed to business risk, after all, companies that do not engage in acquisitions can also experience losses. Thus, where significant losses occur after a takeover has been concluded with significant premium, the premiums paid would be difficult to justify.

In the absence of a clear explanation for losses caused by costly acquisitions, managerial hubris may be argued to be the default reason for such losses. Although costly

[52]Lina Saigol, 'The Real Deal: The Sobering Message of RBS's Sky-High ABN Bid' (*Financial Times*, 1 October 2007) <https://ftalphaville.ft.com/2007/10/01/7720/the-real-deal-the-sobering-message-of-rbss-sky-high-abn-bid/> accessed 22 January 2021; FSA Board Report, 'The Failure of the Royal Bank of Scotland' (2011) 415 <https://www.fca.org.uk/publication/corporate/fsa-rbs.pdf> accessed 22 January 2021.

[53]FSA Board Report, 'The Failure of the Royal Bank of Scotland' (2011) 407. <https://www.fca.org.uk/publication/corporate/fsa-rbs.pdf> accessed 22 January 2021; Harry Wilson, Philip Aldrick and Kamal Ahmed 'The Royal Bank of Scotland Investigation: The Full Story of How The Biggest Bank in the World Went Burst' (*The Telegraph*, 5 March 2011) <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8363417/Royal-Bank-of-Scotland-investigation-the-full-story-of-how-the-worlds-biggest-bank-went-bust.html> accessed 28th January 2021.

[54]'Nationalisation of ABN AMRO' <https://www.government.nl/topics/state-owned-enterprises/nationalisation-of-financial-institutions-abn-amro-asr-and-sns-reaal/nationalisation-of-abn-amro> accessed 28 January 2021; ABN AMRO Bank Press Release 'Completion of ABN AMRO Bank and Fortis Bank Nederland Legal Merger' 30 June 2010 <https://www.abnamro.com/en/newsroom/press-releases/2010/completion_of_legal_merger.html> accessed 28 January 2021; Yvette Essen 'Financial Crisis: Fortis' Dutch Assets are Nationalised' (*The Telegraph*, 3 October 2008) <https://www.telegraph.co.uk/finance/financialcrisis/3131247/Financial-Crisis-Fortis-Dutch-assets-are-nationalised.html> accessed 28 January 2021.

[55]Tina Wang 'Fortis Pulled Back from the Brink' (*Forbes,* 28 September 2008) <https://www.forbes.com/topstories/2008/09/28/fortis-bailout-pingan-markets-equity-cx_tw_0928markets01.html> accessed 22 January 2021; Ian Traynor Brussels 'Fortis: Belgium Acts to Prevent Financial Group's Collapse' (*The Guardian*, 29 September 2008) <https://www.theguardian.com/money/2008/sep/29/insurance.europeanbanks> accessed 22 January 2021.

[56]'Timeline: Key Events in the Battle for ABN AMRO' (*Reuters*, 20 July 2007) <https://www.reuters.com/article/us-abnamro-barclays/timeline-key-events-in-the-battle-for-abn-amro-idUSL3018365520070730> accessed 28 January 2021.

[57]See generally Harry Igor Ansoff, *Corporate Strategy: An Analytic Approach to Business Policy for Growth and Expansion* (McGraw-Hill 1965); Lois M Shelton, 'Strategic Business Fits and Corporate Acquisition: Empirical Evidence' (1988) 9 Strategic Management Journal 297.

acquisitions do not always lead to losses as indicated in Table 2, managements should ensure that the propensity for economic loss is significantly lower for acquisitions that are concluded at great cost. The reason for this legitimate expectation of shareholders is that, if a management board wishes to engage in costly acquisitions, the stakes and risks would be expected to be high, and losses would likely be significant. Hence management boards should establish practical and realistic links between the cost of acquisition and the expected economic gains before concluding takeover transactions at great cost.

Post-acquisition challenges from costly acquisition may also be influenced by other components of the takeover deals, such as the debt and cash ratio, not just the premiums paid. For example, the second largest acquisition in Australia was concluded in 2007 when *Cemex,* the world's third largest cement maker – acquired *Rinker Group Limited,* Australia's largest building materials maker for over US $14 billion, at the rate of US$15.85 / shares.[58] With a premium of 27% over Rinker's closing market price,[59] the acquisition was mainly financed by debt. Signs of post-acquisition challenges in *Cemex* emerged in 2011; the company struggled with the huge debt profile.[60] This appears to be consistent with the view that acquisitions involving large deals could be too big to succeed irrespective of the premium paid by the acquirer.[61] However, additional evidence is required to particularly show the link between the threshold of premium and the level of debt that would most likely undermine the synergistic objective of takeovers. The desire to obtain 'control' over a corporation can also enhance the price of shares beyond its market value, as indicated below.

### *II. Value of 'control'*

In a takeover transaction, the cost of acquiring control of the target company is reflected in the price of the shares of the target company, beyond its market value.[62] Control is the capacity to choose directors, and the controlling investor(s) can influence the board of directors.[63] Acquiring investors believe that there is a potential realisable value in target companies and that they can manage the firm more efficiently than the current management team and promote their private benefit if they gain control of the firm.[64] Hence, control is considered to be an asset.[65] The benefit of controlling the target

[58]Shu-Ching Jean Chen, 'Rinker Accepts Sweetened Cemex Offer' (*Forbes*, 10 April 2007) <https://www.forbes.com/2007/04/10/rinker-cemex-takeover-cx_jc_0410markets2.html#4fa1bac521c9> accessed 22 January 2021.

[59]Press Release 'Cemex offers to Acquire Rinker for $12.8 Billion' (27 October 2006).

[60]Adam Thomson, 'Cemex: Rinker Comes Home To Roost' (*Financial Times*, 11 October 2011) <https://www.ft.com/content/5e9dadd4-2b24-31d5-884b-4b10fad67f17> accessed 28 January 2021; Quyen TK Nguyen and Alan M Rugman, 'How Emerging Economy Firms Lose Money' <https://s3-eu-west-1.amazonaws.com/assets.henley.ac.uk/legacyUploads/2-1-PoV-emerging-economies-firms-lose-money.pdf> accessed 28 January 2021.

[61]George Alexandridis, Kathleen P Fuller, Lars Terhaar and Nickolaos G Travlos 'Deal Size, Acquisition Premia and Shareholder Gains' (2013) 20 Journal of Corporate Finance 1.

[62]Petitt and Ferris (n 4) 9.

[63]See the classical definition in Adolfe A Berle, 'Control in Corporate Law' (1958) 58 Columbia Law Review 1212, 1213.

[64]Aswath Damodaran, *Damodaran on Valuation: Security Analysis for Investment and Corporate Finance* (2nd edn, John Wiley & Sons Inc 2006) Ch. 13; Henry G Manne, 'Mergers and the Market for Corporate Control' (1965) 73 The Journal of Political Economy 110; Paul Hanouna, Atulya Sarin and Alan C Shapiro, 'Value of Corporate Control: Some International Evidence' (30 September 2013) USC Finance & Business Econ. Working Paper No. 01-4 <https://ssrn.com/abstract=2333799> accessed 24 February 2021.

[65]Bebchuk (n 4) 962; Sanford J Grossman and Oliver D Hart 'One Share One Vote and the Market for Corporate Control' (1988) 20 Journal of Financial Economics 175; Mike Burkart, Denis Gromb and Fausto Panunzi, 'Agency Conflicts in Public and Negotiated Transfers of Corporate Control' (2000) 55 The Journal of Finance 647; See generally Adolfe A Berle and Gardinar C Means, *The Modern Corporation and Private Property* (Macmillan 1932); Mohamed-Firas Thraya

company is enormous. The belief held by the acquirer is based on the information that they had obtained about the prospect of the target company; that controlling the company has potential realisable value. Thus, when shares are acquired with the dominant objective of having control over the target company, the acquiring investor is incentivised to pay more than the market value of the shares.[66] The market value of shares has been suggested to represent a minority holding valuation.[67] It has been argued that shares that are traded on a daily basis are insignificant minority holdings because the market value of the traded shares is determined by the last trade of the day.[68] Hence, market value as represented in the minority valuation is the base value from which control premium is negotiated.[69] This suggests that the market value of shares is only a fraction of the actual value of the shares. Even though the market value only represents the minority valuation of the shares of a company, the premiums paid for shares would nevertheless be calculated by reference to whatever market value that is assigned to the shares. Thus, the minority valuation does not detract from the advantage of obtaining control as an underlying objective of corporate acquisition. Where the actual value is fully reflected in the shares, the objective of acquiring control would nevertheless enhance the price of the shares beyond the market value in a takeover transaction.

Where acquirers are influenced by the desire to obtain control of the target company, the takeover efficiency argument may be undermined if the premiums that are paid are not accurately aligned with the expected benefits of control. Shareholders in target companies and their managements boards appear to be smarter; they tend to ensure that they receive appropriate financial gratification before they transfer control to acquirers. Thus, to demonstrate that their acquisition objective is not influenced by managerial hubris, management boards should justify the premiums that are paid to obtain control of target companies.

## *III. Loss of control – future unrealisable gains*

While the desire of acquiring investors to obtain control over a target company is an incentive to pay premiums, shareholders of target companies are also incentivised to demand that their shares should be acquired at a price beyond the market value, to compensate for loss of control and any unrealisable future economic benefits. Hence, premiums that are paid for shares can mirror the combined incentives of acquiring investors to acquire shares and target shareholders' incentive to sell their shares. The value of control is enormous, it includes the capacity to appoint or change members of

and Jens Hagendorff, 'Controlling Shareholders and the Acquisition Premiums Paid in European Takeover Bids' cahier de recherche n 2010-10 E2. 2010. <https://core.ac.uk/download/pdf/47760315.pdf> accessed 22 January 2021.

[66]DePamphilis (n 40) 22; Nikhil P Varaiya and Kenneth R Ferris, 'Overpaying in Corporate Takeovers: The Winner's Curse' (1987) 43 Financial Analysts Journal 64, 64. It has also been suggested that acquirers of firms may not be risk averse as ordinary investors (who buy shares for reasons not related to acquisitions) hence bidder prices are higher than market prices. See Jeffrey N Gordon and Lewis A Kornhauser, 'Efficient Markets, Costly Information and Securities Research' (1985) 60 New York University Law Review 761, 825.

[67]Andrew Strickland, 'Control Premiums in Business Valuation: A Scrutton Bland Guide' (2015) 5.

[68]ibid 3.

[69]Christopher Z Mercer and Travis W Harms, *Business Valuation: An Integrated Theory* (2nd edn, John Wiley & Sons 2008) 65, 87; note 18 above, 384.

the board or management, liquidate, sell off or recapitalise the company, or take any decision in relation to the company.[70]

A transfer by a controlling shareholder who is desirous of disposing of shares at a value that may not be considered efficient by other minority shareholders may lead to a reduction in the value of the remaining minority shares of the company. For example, if the transaction is induced by a distress sale, by the controlling shareholder, the premium value would likely be low. This could affect the value of the remaining shares of the company if the transaction triggers a mandatory bid.[71] Minority shareholders may refuse to sell their shares when the mandatory bid is triggered, with the hope of enhancing the value of their shares when the acquirer enhances the value of the firm;[72] subject to squeeze-out provisions, if triggered.[73] However, even though some minority shareholders refuse to sell their shares, the acquirer can successfully acquire the required majority of the shares that are needed to obtain voting control of the target company. Thus, the efficiency of transactions that involve the sale of controlling shares may be determined by the private arrangements between the acquirer and the holders of the relevant number of shares that are required to obtain control. This implies that the premium value attached to control remains largely determined by the conditions under which the shares in target companies are sold. Ultimately, the successful sale of shares at a premium to compensate for potential loss of control can be determined by managerial acquisition ambition, which may be influenced by hubris where costly acquisition is not justified and significant losses occur. Acquiring managers can simply refuse to buy shares; they can also withdraw their bid if target shareholders demand for outrageous prices for their shares. For example, *Barclays Bank* withdrew its bid for *ABN AMRO Bank N.V* when *RBS* led a consortium of banks to acquire *ABN AMRO*.[74] Similarly, *Pfizer* withdrew its takeover bid for *AstraZeneca*, when it felt that the bid price would likely not lead to efficient outcome, based on their valuation of *AstraZeneca.* The Chief Executive of *Pfizer* observed that, 'We continue to believe that our final proposal was compelling and represented full value for AstraZeneca based on the information that was available to us'.[75] These indicate that management have control over takeover premiums, and they should determine the extent to which takeover premium would lead to synergistic gains rather than being influenced by the desire to merely acquire control.

[70]Pratt and Niculita (n 18) 385.
[71]Although this has the potential to undermine the mandatory bid provision, nevertheless, minority shareholders are not obliged to tender their shares by the UK City Code on Takeovers and Mergers 2021 r 9.
[72]Sanford J Grossman and Oliver D Hart, 'Takeover Bids, the Free-rider Problem, and the Theory of the Corporation' (1980) 11 Bell Journal of Economics 42, 43; For an alternative free-rider problem model see Lucian A Bebchuk, 'Takeover Bids below the Expected Value of Minority Shares' (1989) 24 Journal of Financial and Quantitative Analysis 171.
[73]*General Corporation Law of the State of Delaware, 8 Del. C. 1953, § 253* entitles a parent company, owning at least 90% of the shares of a subsidiary to merge with that subsidiary, and to pay off the minority shareholders in cash. See also UK Companies Act, 2006, s, 979. Conversely, minority shareholders can insist that their shares should be bought by exercising the sell out right, see the Companies Act, 2006 s 983.
[74]Reuters (n 56).
[75]Ben Hirschler and Bill Berkrot, 'Pfizer walks away from $118 billion AstraZeneca takeover fight' (*Reuters*, 26 May 2014) <https://www.reuters.com/article/us-astrazeneca-pfizer-idUSBREA3R0H520140526> accessed 20 February 2021.

### IV. Competition among bidders

When there is a competitive takeover bid between or among different bidders, the value of each bid is dependent on what the bidders estimate to be the value of the target company. Heterogeneous investors' opinions of stock value, account for the reason that some acquirers are willing to make improved bids to outbid other bidders when a takeover bid is competitive. The incentive of bidders is based on the view that certain stocks that are under-priced should be acquired and those that are overprized should not be acquired.[76] If the premium is determined by reference to the expected synergistic gains or benefits of control post-takeover, then, irrespective of the number of bidders that engage in a bidding war, the bid price should generally not exceed certain level. Ideally, there should be a bid price equilibrium that can be economically aligned with post-acquisitions gains; at least closely, if not exactly. The nature of a competitive bid is that it has the tendency to increase the bid price.[77] Each bidder seeks to out-bid other competitors and there is no price ceiling that must not be exceeded by bidders to avoid managerial hubris and triggering losses post-takeovers. If a price limit is identified by efficient value-maximising managements[78] and offered by a bidder, ideally, there should be no further competitive bids, since other bidders would be aware that there would likely be zero or negligible gains if they bid beyond that threshold.

Thus, increased bid prices that are influenced by competitive bids may imply that certain bidders derive alternative incentives for making enhanced bid prices. Managers may have been influenced by hubris if the enhanced bid price leads to significant losses. Alternatively, availability of cash flow has been suggested to be one of the encouraging factors.[79] These suggest that acquiring managements should carefully assess the potentials for deriving post-acquisitions gains and consider the possibility of distributing excess cash to shareholders where there are no clear positive net present value projects or investments.[80] It is not suggested that acquiring managers deliberately engage in unproductive acquisitions, however, high costs of acquisitions can guarantee an increase in the wealth of shareholders in target companies, with limited prospect of post-acquisition gains for acquiring shareholders. While it may appear that competitive bids signify the operation of efficient market, the extent to which takeover premiums are aligned with synergistic gains or quantifiable benefits of control, should be the primary focus of acquiring managers. This will ensure that the efficiency argument of takeovers is justified, thereby avoiding the potential for managerial hubris.

[76]Lynn A Stout 'Are Takeover Premiums Really Premiums? Market Price, Fair Value and Corporate Law' (1990) 99 Yale Law Journal 1235, 1246; Irwin Friend, Randolph Westerfield and Michael Granito, 'New Evidence on the Capital Asset Pricing Model' (1978) 33 The Journal of Finance 903.

[77]Michael Bradley, Anand Desai and Han E Kim, 'Synergistic Gains from Corporate Acquisitions and their Division Between the Stockholders of Target and Acquiring Firms' (1988) 21 Journal of Financial Economics 3.

[78]Slusky and Caves (n 8) 282.

[79]Larry HP Lang, Rene M Stulz and Ralph A Walkling, 'A Test of Free Cash Flow Hypothesis: the Case of Bidder Returns' (1991) 29 Journal of Financial Economics 315; Larry HP Lang, Ralph Walkling and Rene Stulz, 'Managerial Performance, Tobin's Q and the Gains from Successful Tender Offers' (1989) 24 Journal of Financial Economics 137–154; Vijay B Gondhalekar, R Raymond Sant and Stephen P Ferris, 'The Price of Corporate Acquisition: Determinants of Cash Takeover Premia' (2004) 11 Applied Economics Letters, 735; see also Strickland (n 67) 5.

[80]A takeover may be considered as a positive net present value project, depending on whether post-acquisition returns are highly likely. See Paul M Guest, Magnus Bild and Mikael Runsten, 'The Effect of Takeovers on the Fundamental Value of Acquirers' (2011) 40 Accounting and Business Research 333.

It can be observed from the analyses above that these determinants of the price of shares in acquisitions transactions are subject to the role of acquiring management boards. Boards ultimately determine the premiums to be paid to win competitive bids, enhance market power and obtain the right to control the target company. Thus, the extent to which acquisitions would yield economic gains for corporations and shareholders, is largely dependent on the role of boards in identifying clear prospects of synergies and benefits of control, relative to the costs of acquisitions.

The mix results of losses and gains post acquisitions as shown in Table 2 is an indication that takeover premiums are not generally responsible for losses, since acquisitions concluded with premiums are nevertheless leading to post-acquisitions economic gains. However, certain factors, such as the threshold of premiums may be key determinants of gains or losses post-takeovers. Since managements of acquiring companies determine the premiums that are paid to conclude acquisition deals, managements should be challenged and encouraged to transparently explain their acquisition objective. As argued below, this would aid in the determination of the extent to which they would be required to justify the premiums that would most likely result in synergy or whether the premiums paid match the assets of the target company and equals the benefits of control.

## D. Acquisition objectives and shareholder approval

The primary objectives of corporate acquisitions include obtaining control over the target company and to promote synergistic gains. Managements often use the latter to justify acquisitions premiums. A framework that reviews the acquisition objectives of management has become necessary in view of the challenges caused by overambitious acquisitions. This framework seeks to mitigate losses to acquiring shareholders and diminished corporate value post-takeovers, without undermining the role of managements in making investment decisions.

From the analyses above,[81] it can be observed that, even though several factors influence managerial decisions relating to takeover premiums, management boards ultimately determine what they are willing to pay as acquisition premium. Further, as shown in the analysis of Tables 1 and 2, despite paying premiums to conclude acquisition deals, some acquirers did not incur losses. This indicates that costly acquisitions can lead to synergistic gains if managements carefully consider the extent to which the premiums that they are willing to pay would likely lead to synergistic gains. Managements should be clear about their acquisition objectives, to enable shareholders and other stakeholders to manage their expectations. If the aim is to obtain synergistic gains, then premiums must be specifically linked to the prospect of synergistic gains.

Since management boards owe fiduciary and common law duties to their companies, in the interest of their shareholders,[82] they should act honestly and competently. This is particularly important in view of the combined effects of increased prospect of loss where certain threshold of premium is paid and the limited scope of remedies available to shareholders where significant losses occur because of negligent acquisitions. Since previous

[81]See C. above.

[82]Particularly in the UK, Companies Act 2006, ss 170 and 172 and in Delaware, see *Harris v. Carter*, 582 A.2d 222, 234 (Del. Ch. 1990).

shareholders' approvals of acquisitions have led to losses without remedies for shareholders, where an acquisition premium is beyond certain threshold, management boards should justify the premium and practically demonstrate how potential losses from the acquisition would be absorbed. This justification mechanism would ensure that shareholders only approve acquisitions that pose limited risk to the economic interests of corporate entities. This would likely enhance the confidence of boards in not merely obtaining shareholder approval, but it would also challenge boards to focus on value-yielding acquisitions, with limited scope for post acquisitions losses.

For example, acquisitions that require the payment of at least 50% premium over the market value of the shares of target companies should be subjected to a justification mechanism before the deal is completed. Managements should demonstrate the extent to which synergistic gains would accrue post-acquisition and outline how losses if any, would be absorbed. The 50% threshold is necessary because of the propensity for large scale financial losses when high rate of premium is paid for takeovers. In Table 2, significant losses were recorded in takeovers above certain thresholds. The *RBS*-led *acquisition of ABN AMRO Bank N.V*. was concluded for about 70% premium over the market value of the shares of *ABN AMRO*, the losses led to government bailouts.[83] The acquisition of *Time Warner* by *America Online* (AOL) at about 70% premium led to a loss of $99b.[84] The *Vodafone-Mannesmann* acquisition was completed by share exchange at about 160% premium. It was expected that financial strains would be mitigated or avoided. However, the high premium led to a write-down of £28 billion five years after the deal was completed.[85] It was admitted that *Vodafone* paid too much for the acquisition.[86] As part of the review process, acquiring managements should prepare a draft memorandum containing the synergistic projections of proposed acquisitions for shareholder approval. The memorandum should justify the premium and show how potential losses from the acquisition would be absorbed. These should include operational, managerial, and economic synergies and the financial risk levels.

Alternatively, acquisitions may be aimed at obtaining control of the target company, with the prospect of long-term synergistic gains. Such acquisitions would seek the immediate benefits of controlling the target company, such as appointing the board of directors, determine management compensation, lease, or liquidate business assets, register the company's equity securities for an initial or secondary public offering, register the company's debt securities for an initial or secondary public, declare and pay cash and/or stock dividends,[87] among others. Then the need for shareholder approval could be dispensed with if the premiums paid are justified by reference to the assets of the target company. The reason for this is that the assets of the target company would not be reflected in the market value of the shares since a minority valuation[88] would not

[83] n 53–55.
[84] Barnett and Andrews (n 50).
[85] Kevin Reed, 'Vodafone's Goodwill Write Down Sends Shock Waves through City' (*Accountancy Age*, 9 March 2006) <https://www.accountancyage.com/aa/analysis/1751470/vodafones-goodwill-write-sends-shock-waves-city> accessed 11 February 2021; 'Vodafone Books $40.9 Billion Loss' (*CNN International*, 30 May 2006) <http://edition.cnn.com/2006/BUSINESS/05/30/vodafone.earns/> accessed 11 February 2021.
[86] Lina Saigol, 'Vodafone Hope to Banish Ghost of Acquisition Past' (*Financial Times*, 12 June 2013) <https://www.ft.com/content/7ead3928-d342-11e2-b3ff-00144feab7de> accessed 14 February 2021.
[87] Pratt and Niculita (n 18) 385 for an extensive list.
[88] See n 67 and 68 above.

reflect the assets of the target company[89] without the premium. Although synergy and benefits of control can ultimately occur post acquisition, if the immediate objective is to control the target company, synergistic economic gains would be considered as an aftermath of control. In certain circumstances, the line between synergy and control may be blurred since synergy cannot be attained without obtaining control. This is part of the reasons that boards need to be clear about whether economic synergistic gains would almost immediately materialise, such as enhanced profits from increased customer base and access to capital, among others. Alternatively, control can be exercised, pending the attainment of economic gains. This includes plants closure or assets disposal almost after the acquisitions, employee dismissal and the introduction of new systems of work, to fuse and enhance the operation of the combined companies. Some of these may lead to further costs being incurred to reposition the combined company towards productivity. Hence, while economic synergistic gains would material later, the benefit of control would be immediate. Consequently, a delay in synergistic gains would likely be permitted in the circumstance. However, management boards could use 'control' as the default reason for engaging in acquisitions, perhaps to conceal their motives or avoid shareholder scrutiny. To address this concern, boards should demonstrate how a significant part of the long list of proven benefits of control[90] would be attained, if 'control' is the primary motive for an acquisition.

### *I. The limited scope of directors' duty*

As indicated in Table 2, companies in the *United States* and the *United Kingdom* make up most of the companies on the list of the top range of the most expensive acquisitions worldwide. Losses were also dominated by companies in these jurisdictions. The extent to which management boards in these countries can be held liable for breach of the common law duty of care or fiduciary duty for either engaging in botched acquisitions or for negligently 'misleading' shareholders to approve acquisitions is limited. In the absence of a 'special factual relationship' between directors and shareholders in relation to directors' advice to shareholders to make or accept a takeover bid, directors would likely not be held liable.[91] Directors' duties are owed to the company, not to shareholders specifically.[92] For example, series of actions[93] were instituted by shareholders of Lloyds Banking Group, *Sharp v Blank*,[94] in relation to its botched acquisition of Halifax Bank of Scotland HBOS. In 2008, Lloyds acquired HBOS for $22b, at about 58% premium.[95] The bank suffered severe financial challenges after the acquisition. This led to a government bailout and subsequent privatisation of the bank after the bailout sum was repaid.[96] Over 5,800 shareholders as claimants, argued that Lloyds' directors should not have

[89]Pratt and Niculita (n 18) 845.
[90]Pratt and Niculita (n 18).
[91]*Peskin v Anderson* [2001] 1 BCLC 372, [379]; A Company Re [1986] BCLC 382.
[92]Companies Act 2006, s 170(1); in Delaware, *Harris v Carter* 582 A.2d 222, 234 (Del. Ch. 1990).
[93]Earlier, *Sharp v Blank* [2015] EWHC 3220 Ch.
[94][2019] EWHC 3096 (Ch).
[95]Steve Slater, 'Lloyds Rescues HBOS in $22 Billion Deal' (*Reuters*, 18 September 2008) <https://www.reuters.com/article/us-lloyds-hbos-idUSLI31193420080918> accessed 11 January 2021.
[96]Jill Treanor *and* Larry Elliott, 'Lloyds bank bailout repaid in full, says Philip Hammond' (*The Guardian*, 21 April 2017) <https://www.theguardian.com/business/2017/apr/21/lloyds-bank-bailout-repaid-in-full-philip-hammond-claims> accessed 14 February 2021.

recommended the acquisition and that they should have provided further information to shareholders about the Lloyds and HBOS deal. Lloyds Bank had made loans of £2.4b and £7.5b to HBOS in September and October 2018 respectively; the Bank of England also made a collateralised emergency facility available to HBOS in October as 'emergency liquidity assistance'.[97] These indicated that HBOS was experiencing severe financial challenges and that it was not a viable target company. The board of Lloyds Bank recommended to their shareholders that HBOS should be acquired, and that although HBOS had been adversely affected by turmoil in the financial markets, it remained a good strategic acquisition for Lloyds. The board did not disclose the extent of the turmoil and the loan facilities to their shareholders. The shareholders argued that if the directors had not recommended the acquisition or if they had made further disclosures, the acquisition would not have been approved and the consequential loss in value by dilution of their shareholding would have been avoided. They sought to recover the loss in the value of their shareholdings attributable to the takeover. The court dismissed the action. It was held that the directors of Lloyds did not owe a duty of care personally to the shareholders of the company; the duty was owed to the company.[98] Although the court held that the misstatements made by the directors constituted a breach of the 'sufficient information duty',[99] it observed that the directors were not liable and that the shareholders would have reached similar conclusion even though they had been provided with sufficient information.[100] The additional information would have clearly shown that HBOS was undergoing financial challenges and that any investor that acquires the bank would do so at great risk. The decision of the court in *Sharp v Blank,* reflects majority of the earlier judicial decisions in the UK and Delaware where shareholders argued that directors breached their fiduciary and common law duty of care in decisions relating to acquisitions. For example, the year 2000 is a significant year in the history of corporate acquisitions. The most expensive acquisitions that led to significant losses occurred in 2000; the *Time Warner* acquisition led to $99b losses soon thereafter and $28b write down was recorded about five years after *Vodafone* acquired *Mannesmann* in year 2000. A case search was conducted for shareholder litigation in the UK and Delaware between January 2001 and July 2019, to ascertain the extent to which shareholders grievances which arise from acquisitions are determined in favour of shareholders. The courts decided mainly in favour of company directors.[101] Thus indicating that fiduciary duty and the duty of care would not likely provide suitable remedies for shareholders, despite the magnitude of risk associated with costly acquisitions. In limited circumstances, directors may be held liable for breach of duty. For example, in the UK, an action against directors for acquisitions-related losses suffered by shareholders may succeed if it can be shown that a special relationship existed between directors and shareholders that would make the directors personally accountable to the shareholders.[102] In Delaware, shareholder action may only succeed if the business judgement

[97] [2019] EWHC 3096 (Ch) [14], [15].
[98] ibid [616], [769]
[99] ibid [859], [885].
[100] ibid [964].
[101] See Francis Okanigbuan Jnr, *Corporate Takeover Law and Management Discipline* (Routledge 2020) 174–191.
[102] See *Peskin v Anderso*n [2001] 12 WLUK 421, [2001] BCC 874; *Briess v Woolley* [1954] AC 333, HL; *Allen v Hyatt* [1914] 30 T.L.R. 444, PC.

rule[103] is pierced, as observed from the decision of the Delaware Supreme Court in *Smith v Van Gorkom*.[104] The defendant directors of the target company were held to have breached their duty of care, for failing to adequately inform themselves of all information relating to the essential aspect of the acquisition deal that would enable them to determine the fair value to be recommended to their shareholders.[105] The recommended price was based on a mere assumption, it was not supported by any valuation information. Having held that the directors breached their fiduciary duty in *Smith v Van Gorkom,* the Delaware Supreme Court consequently remanded the case to the Court of Chancery, to conduct an evidential hearing to determine the fair value of the shares. The court awarded damages against the directors to the extent that the fair value of the shares of the target company exceeds $55 per share. This requires the directors to pay the additional value as damages to the affected plaintiff shareholders, after the fair valuation is determined by the Court of Chancery. The top end valuation during the period of negotiation for the acquisition was $65 per share.[106] If the Chancery Court, after evidential hearing rules that the value was $65 per share, the damages would be $133,577,580. Thus, to avoid the risk, the directors settled the case for $23,500,000.[107] Despite the case being decided in favour of shareholders, they nonetheless incurred losses.

Although the decision in *Smith v Van Gorkom* applies in relation to shareholders in target companies, it is argued that the business judgment rule would apply similarly to shareholders in acquiring companies. Shareholders in acquiring companies may only succeed in an action for breach of duty in the event of losses caused by negligent costly acquisitions, if it can be shown that the board had undermined the business judgement rule. Proactive measures that would limit corporate losses and promote accountability would be less contentious than directors' liability for losses or seeking to promote directors' duties towards shareholders.

In *Sharp v Blank*, shareholders sought damages of £385m from five former directors for breach of duty of care. It is arguable whether the directors would have been able to afford to pay the compensation if the court had ruled in favour of the shareholders. Further, the extent to which directors' liability insurance would apply in relation to such damages against the board is unclear. If it applies to significant damages of up to £385m, the company will likely incur higher insurance premium afterwards, paid from the commonwealth of the shareholders. Hence, preventing or limiting losses caused by costly acquisition is desirable.

## *II. Shareholder approval*

The requirement for shareholder approval of acquisitions through the voting mechanism has been mooted for acquisitions in the United States.[108] However, the extent to which

[103]It is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. See *Aronson v Lewi*s 473 A.2d 805, 812 (Del.Supr.,1984).
[104]488 A.2d 858 (Del.Supr., 1985).
[105]ibid 893.
[106]ibid 867.
[107]Florence Shu-Acquaye, 'Smith v Van Gorkom Revisited: Lessons Learned in Light of the Sarbanes-Oxley Act of 2002' (2004) 3 Depaul Business & Commercial Law Journal 19, 36.
[108]Afra Afsharipour, 'Reevaluating Shareholder Voting Rights in M&A Transactions' (2017) 70 Oklahoma Law Review 127.

shareholder voting mechanism without additional commitment from managements would address the challenges of costly acquisitions is doubtful. This requirement applies in the UK in limited circumstances. The approval of acquiring shareholders in the UK is required when a takeover that is considered as a 'class 1' transaction is to be concluded in the UK.[109] What is required is that; first the acquiring company must be a listed company with premium listing; second, the size of the target company and the value of the consideration should be 25%, or more of the acquiring company,[110] or 100% in reverse takeovers.[111] Shareholder approval does not sufficiently challenge the roles of managements of acquiring companies during takeovers because it applies to those categories of takeovers that would ordinarily draw the attention of the shareholders of acquiring companies in view of the size of the target.

There is mixed evidence on the extent to which acquiring shareholders voting mechanism can address overambitious acquisitions. Some studies indicate that shareholder voting mechanism can provide a regulatory and monitoring role over managements, discourage managerial opportunistic behaviour, overpayment and enhance the prospects of synergistic gains.[112] In relation to the UK, it was indicated that requiring mandatory voting to approve acquisitions enhances shareholder economic interests; and without voting, shareholders can record economic losses.[113] This would require regulatory control to promote its enforcement. Alternatively, it has been argued that shareholder voting mechanism does not significantly challenge managements. Shareholder voting mechanism was suggested to create additional costs without a corresponding benefit to acquiring shareholders.[114] The requirement for shareholders to approval acquisitions is an attempt to use corporate governance mechanism to restore the operative role of takeover as a mechanism of the market for corporate control. This means that even though takeovers are meant to function as an alternative to corporate governance rules, agency problems that can undermine corporate governance functions are also present in the market for corporate control. Corporate governance challenges have not been successfully addressed by shareholder voting mechanisms. For example, the agency problem of conflict of interests is alternatively addressed by the disciplinary function of takeovers.[115] The mere requirement for shareholder approval of acquisition may not be conclusive proof that managerial overambitious acquisition objectives will be successfully addressed.

[109]UK Listing Rules r 10.5., r 10.2 (3), R 10 (annex 1.1) (1G, 2R); The United Kingdom Listing Rules (Release 27 April 2018); Slaughter and May, 'A Guide to Takeovers in the United Kingdom, (November 2018) 5.
[110]ibid.
[111]UK Listing Rules 5.6.3.
[112]See Jim Hsieh and Qinghai Wang, 'Shareholder Voting Rights in Mergers and Acquisitions' (2008) 1–59; Kai Li, Tingting Liu and Julie Wu, 'Vote Avoidance and Shareholder Voting in Mergers and Acquisitions' European Corporate Governance Institute (ECGI) – Finance Working Paper No. 481/2016, revised 12 January 2018. <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2801580> accessed 15 November 2021.
[113]Marco Becht, Andrea Polo and Stefano Rossi, 'Does Mandatory Shareholder Voting Prevent Bad Acquisition'? (2016) 29 Review of Financial Studies 3035.
[114]Paul Mason et al., 'Does Shareholder Voting Matter? Evidence from the Takeover Market' (2018) 53 Wake Forest Law Review 157; Donald C Langevoort, 'The Behavioural Economics of Mergers and Acquisitions' (2011) 12 Tennessee Journal of Business Law 65.
[115]Manne (n 64) 113; Scharfstein (n 23); James P Walsh and Rita D Kosnik, 'Corporate Raiders and their Disciplinary Role in the Market for Corporate Control' (1993) 36 Academy of Management Journal 671; Kenneth J Martin and John J Mcconnell, 'Corporate Performance, Corporate Takeovers, and Management Turnover' (1991) 46 Journal of Finance 671; Pieter W Moerland, 'Alternative Disciplinary Mechanisms in Different Corporate Systems' (1995) 26 Journal of Economic Behavior & Organization 17; VA Kennedy and RJ Limmack, 'Takeover Activity, CEO Turnover and The Market For Corporate Control' (1996) 23 Journal of Business Finance and Accounting 267.

Managements can convince shareholders to support their acquisition ambitions by proposing the actualisation of synergistic gains which may never be achieved. For example, the *RBS* led acquisition of *ABN AMRO* failed to achieve synergistic gains even though shareholders of *RBS* voted in favour of the acquisition; shareholders were convinced by management that the acquisition would lead to efficient outcome. Also, the *AOL* acquisition of *Time Warner* received shareholder approval, but about $99 billion loss was recorded by the combined company. These suggest that while shareholder voting mechanism may constitute an attempt towards addressing managerial overambitious tendencies, it may not effectively address post-acquisition challenges without additional requirement.

In light of the determinants of premiums, and the certainty of obtaining control without the certainty of synergistic gains, if synergies are to be expected, the combined effects of shareholder approval and managerial commitment, based on managerial justifications for paying premiums should be required. If the objective is to acquire control and to obtain the immediate benefits of control,[116] then the need for shareholder approval may be dispensed with, if the benefits of control are justifiably linked to the cost of acquisition. Thus, acquiring boards should clearly state the objective of acquisitions, so that shareholders can have reasonable expectations about their acquisition objectives.

The justification of managerial objectives may not be pleasing to managers, because of the apparent mistrust that it appears to suggest. However, managements with reasonably proposed costs of shares, should be less concerned about the role of the justification process. The justification should be considered as an opportunity for managements to exhibit and demonstrate how their acquisition objective is linked to synergistic gains and the benefits of control. This is particularly important because, the role of managements boards and the objective of the justification process are ultimately aimed at promoting corporate value.

## E. Conclusion

Although corporate acquisitions may be considered as investment decisions that management boards should ordinarily have the liberty to make, pursuant to their role in the company, however, the scope of economic loss that may occur because of costly acquisitions, puts the role of the board on the spotlight. Thus, this article examined the role of acquiring managements, particularly in relation to takeover premiums paid for acquisitions. It was argued that, since the price of shares is not determined by reference to the efficient market hypothesis EMH when an acquisition is made, the additional premium that is paid by acquirers when acquisitions deals are concluded should either be specifically linked to post-acquisition synergistic gains or linked to the benefits of controlling the target company.

Data of the top range of the most expensive acquisitions worldwide, show that losses post-takeover appear to be associated with high level of takeover premiums. The data does not particularly suggest that loss is bound to occur when premiums are paid, since some of the acquisitions led to synergistic gains, even though premiums were paid. This implies that takeover premiums can either lead to synergic gains or losses, depending on the role of management boards in the determination of the price of shares. To promote the synergistic objective of corporate acquisitions, an appropriate

[116]See Pratt and Niculita (n 18).

link between takeover premiums and synergistic gains is desirable. Where the objective is to obtain synergistic gains, management should be willing to demonstrate how synergistic gains would be achieved and clearly show how losses would be absorbed if premiums beyond 50% of the market price of shares are recommended. This will incentivise boards to scrutinise the price of shares to be paid for acquisitions. If the objective is to obtain the immediate benefits of controlling the target company, the need for shareholder approval can be dispensed with, if the acquisition premium matches the assets of the target company.

Takeover regulations are mainly aimed at protecting the interests of shareholders of target companies,[117] without a corresponding protection of acquiring shareholders from significant losses post acquisitions. It was argued that the limitation of directors' fiduciary duty and the duty of care in relation to acquiring shareholders' remedy for loss arising from costly acquisitions[118] justify the need to challenge the role of management boards of acquiring companies for the following reasons. First, management boards determine the price of shares, and they are incentivised to engage in costly acquisitions since they are not challenged to specifically make objective decisions. Second, costly acquisitions, especially beyond certain premium threshold would likely lead to corporate losses. Third, managements are unlikely to be held liable when they engage in negligent acquisitions. Lastly, the role of management boards in the determination of the price of shares in acquisitions can be challenged without necessarily undermining their role as investment decision-makers.

The data presented in this article reflects takeover premiums across different industries. Further research is needed to identify the extent to which levels of takeover premium can be considered to be capable of leading to average synergistic gains or losses in specific industries. This would determine whether there is industry-specific link between post-takeover challenges and premium thresholds. Further, the size of the sample limits the results of the analyses. However, the research objective was not undermined by this limitation because, the objective was to identify the extent to which losses post-acquisition are linked to takeover premiums and costly acquisitions. Hence, future research that extends the scope of the data and considers various industries may lead to additional and alternative results.

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[117]See n 12 on target shareholder protection in the UK; Afsharipour (n 110) 141.
[118]D.I. above.