Bank of England Discussion Paper

Corporate governance and the market for companies: aspects of the shareholders' role

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Corporate governance and the market for companies: aspects of the shareholders' role

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The views expressed are those of the author and not necessarily those of the Bank of England.

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Corporate governance and the market for companies: aspects of the shareholders' role

Introduction

The viewpoint from which this paper and its predecessor Panel Paper 25 were written was that the prosperity of manufacturing and service industry in the United Kingdom was of crucial importance to everyone and ought therefore to be a matter of general concern. It is accepted that in any system, a particular enterprise may be well or poorly governed depending on the ability of the individual men and women in it to draw the best from the people they lead. The purpose of my enquiries abroad in the USA, Germany and Japan was to try to discover whether company leadership there operated within laws and conventions that were systematically better, and if so what the principles were which underlay their systems; and how such principles could be applied in the United Kingdom within our framework of law, custom and commercial practice. Panel Paper 25 showed that although all four countries had nominally similar systems, the way in which they were used differed greatly, reflecting historical development, social attitudes and priorities, and financial structures.

Panel Paper 25 dwelt at length on the reasons why it is essential that any large public company board should contain an adequate proportion of independent directors, and it exposed the arguments sometimes adduced against this being made mandatory by law or regulation.

Even with properly balanced boards, however, shareholders have a much more important part to play than has been evident in recent years or would be comfortable for them now. This paper looks more deeply at their role, at the enterprises in which they invest, and the dual market for companies and shares in which they transact their business.

The views expressed are my own and not necessarily those of the Bank of England.

The paper is divided into five parts as follows:

Part I

Positive shareholding: influence without confrontation discusses in more detail shareholders playing a more active role (the use of 'VOICE'); looks at this in relation to index matched funds: and considers briefly wider—and narrower— share ownership.

Part II

Shareholder supremacy looks at other aspects of the doctrine of the supremacy of the shareholder, and why it is important to sustain it. It considers the threat of management buyouts to the shareholders' interests.

Part III

Some implications of the change in the pattern of ownership: the real cause of short-termism

Part IV

Passive shareholders: conglomeration and deconglomeration looks at one result of passive shareholding—unchecked diversification; it considers what stimulates growth and conglomeration: and what makes such companies so vulnerable to takeover. It also looks at Japanese companies and their Keiretsu groupings.

Part V

Mergers and takeovers, some aspects of the public interest considers the nationality of companies: some aspects of competition: financial pollution.

Part VI

Conclusions

Part I

Positive shareholding: influence without confrontation

Introduction

Panel Paper 25 argued that the chain of accountability between management and shareholders had two links. The strength of the first link depended on there being an adequate number of able independent directors, whilst the second depended on shareholders being prepared to use 'VOICE' as well as 'EXIT' when circumstances warranted it. If, in other words, they saw a good company in decline, they should use their influence and, in the last resort, use their powers under the Companies Acts in relation to the composition of the board to cause remedial action to be taken, rather than simply wash their hands of the whole matter by selling their shares and walking away (known in the USA as the 'Wall Street Walk'). Another way of describing the difference would be to differentiate between 'active' or 'positive' shareholding and 'passive' or 'negative' shareholding. In this paper I shall use the expression 'positive shareholding'.

There is no alternative in the UK/US system other than to look to the *shareholders* to use 'VOICE'. In Japan and Germany other influences are brought to bear, notably by banks, suppliers, customers and, to some extent, government: some of them have complex relationships with the company we do not find in the UK/US, and there are specific organisational groupings like the Japanese Keiretsu, which we do not replicate. Influences comparable to them barely exist in the United Kingdom. We have analysts of course who are influential but not at all in the same way, and their interests are very different from those of the shareholders or indeed the board.

Positive shareholding

Positive shareholding implies a recognition that shares in a company are not a special form of gambling chip, but part ownership of a living organisation, the management of which is responsive to the signals it receives; just as the owners for their part respond to the information that reaches them. The CBI task force[1] recommended that companies should strive to keep shareholders better informed so that they and the market were better able to gauge performance and prospects; some companies even now would like to divulge far more than they feel the rules permit. Even so, when a sound programme of investor relations is in place, many shareholders do have a basis for a sensible dialogue, that is to say a two-way flow of information and comment. 'Positive shareholding' in other words follows the CBI's recommendation and extends it.

The purpose of such dialogues is twofold: to ensure that the market is as well informed about the company as possible and values it 'fairly', and to ensure that management is under no misapprehension about the way it is seen. Such dialogues are not confrontational. They do already take place, on occasion, between some major institutions and some companies. A notable feature which also permeates the German and Japanese systems is the quietness of the dialogues they have between various interested parties: effective dialogue is almost impossible through megaphones.

There are, sadly, occasions when such dialogues occur and are ineffective, or do not occur at all, and in either case the companies continue to deteriorate. Perhaps in some cases decline is inevitable: companies cannot all survive and prosper. Like other living organisations they grow, decline and die. But in many other cases spectacular revival has proved possible by timely and effective action. The theme of this paper is that such action might be more often prompted by shareholders were they willing to use VOICE—to be positive in their approach. Why does it not already happen?

Negative management

A decade ago few companies bothered with an organised programme of investor relations. Even today some barely exist. The chairman feels that when the news is bad he should keep his head down, and when the figures are good they speak for themselves. Some chairmen have investor relations programmes but prefer monologues to dialogues: they do not want to listen. Some listen attentively but lack the grip to take the necessary action quickly enough: there are some well known cases where it was the lack of urgency that in the end brought the company down. Perhaps the board was poorly constituted or its dynamics were wrong: some perhaps lacked the courage to face the really drastic overhaul they knew to be essential.

Whose voice is it anyway?

Talking about VOICE in general brings us at once to the central question—whose voice? The shares of a typical major company will be held by thousands of small private shareholders in tiny or relatively small parcels which together sum up to perhaps 20%–35% of the equity. The rest will be held by a wide variety of institutions: they too will differ immensely in size (and in size of holding), and in their purpose. A relatively small number hold between them a significant proportion of most companies' equity. Let us look at the institutions first: we shall examine the position of private shareholders later.

Problems logistical . . .

The institutions have logistical problems. Small institutions with widely spread portfolios might argue that the cost of positive shareholding would be disproportionate. Being in this state is a matter of choice, however, as other relatively small institutions have shown by concentrating their holdings somewhat and taking a more meaningful stake in the companies in which they invest. Selectivity, concentration and positive shareholding is a coherent strategy, and one which appears to be welcome to companies because of the greater degree of interest such commitment implies.

(1) *CBI Task Force Report on the City and Industry: Investing for Britain's future* (14 October 1989).

Some very big institutions, particularly specialised fund managers, have other logistical problems stemming from the quite proper division between the various funds under their command. There may be little co-ordination between the funds in relation to the companies in which they are invested. This means that although the aggregate holding may be substantial, each individual fund manager may have only a small block—and no relationship with the company.

It is often argued that the institutions (and *a fortiori* private investors) lack the necessary depth of information to justify intervention as distinct from selling in the market. Like so many statements it is only partially true. Intervention, ie promoting board changes, is a weapon of last resort after dialogue and influence have failed: the circumstances in which it should occur are generally crystal clear (it is mistaken to believe that company decline is generally concealed and abrupt—it is usually slow and obvious).

. . . attitudinal . . .

Other problems are attitudinal. Just as companies feel inhibited about what they can say, some institutions are inhibited about what they should hear for fear of becoming insiders. Some institutions feel that their shareholding is too small to give them more than a whisper—even if they wanted to say something: as noted above, this is a consequence of their own investment strategy. The big institutions, even though they may have found that when they speak alone (however authoritative they are) they cannot necessarily exercise influence let alone command attention, may yet dislike the idea of acting with others—for two reasons. First, they may dislike sharing research with competitors over whom they are trying to score an advantage, and, second, they may resent the possibility that if they are successful in their enterprise all the other shareholders, institutional and private, may benefit too (the 'free rider' problem, to which we shall return). Their dilemma is understandable. With the 'inevitability of gradualness' immense power has since the war slowly accrued to a relative handful of major institutions, who, whether they like it or not, cannot avoid the responsibility that goes with their wealth and the leadership role this inevitably produces—no easy task for them considering that each of them individually has a responsibility to their own policyholders, or pensioners, or investors, and shareholders.

. . . or organisational . . .

This need for co-ordinated action was perceived years ago, so the idea of an organisation to achieve it is hardly revolutionary. The original Institutional Shareholders Committee did much useful work, particularly on general issues, and in a handful of cases it successfully used collective VOICE. But it worked through its four constituent bodies, a thorough way of proceeding but inevitably slow and, some would say, cumbersome. The ISC has recently reviewed its constitution and is entering a new phase, but with rather different ends. What is still needed is a way of marshalling resources quickly and quietly in such a way that collective influence can be brought to bear and in the rare cases where it proves necessary remedial action can be stimulated—including a strengthening of the board. The more institutions that lend their support to such collective action, the less cause the major ones will have to complain they are obliged to carry the burden at their own cost but for the general benefit. And in so far as major institutions do already use VOICE because EXIT is too expensive, they too have a direct interest in making VOICE effective. Perhaps, with deference to Albert O Hirschman we should now think in terms of CHORUS and not just VOICE!

. . . and motivational

Perhaps the greatest obstacle of all is motivation. There is the simple question for the fund manager 'Why should we bother?' He will in the first place have bent his skills to avoiding investing in poorly run companies. He will sell his shares in those that disappoint, or transfer them into a 'recovery' fund if he runs one. Indeed, he may buy certain shares because he sees that the price is depressed as a result of the company's poor management in the hope that this will attract a predator. This might be dubbed the 'Micawber' management of funds, ie the fund manager holds or buys shares on the basis that something may turn up. They would argue that this is a more realistic way to proceed than to engage themselves in the companies' affairs in a manner for which (in all modesty) they consider themselves unfitted. But to argue thus is to misunderstand the limitations of influence, and the statutory power on which it rests. They are *never* called upon to manage but have a right to ensure that the board insists it is decently done—and to change the board if it does not.

Positive shareholding pays

The reason why fund managers should bother is that it would collectively pay them handsomely to do so (and would incidentally be beneficial to UK industry as a whole). After all, if they do succeed over time in dumping their shares on the market without ruining the price, they will nearly all go to other institutions: one man's ex-growth fund is another man's recovery fund. The chances are however that after a certain point any institution with a sizable holding will find itself locked in. If something did turn up regularly and quickly the Macawber policy would be justified. But even a cursory glance at some companies' performance proves that the inevitable can be exceedingly slow.

The strange thing is that in the occasional case where the institutions *did* in the last resort cause major board changes to take place, it has paid them well—much better than a takeover would have done. The arithmetic is simple. Say a company has been underperforming for some time and its share price is 100. If dynamic management is introduced there is every chance of the price forging ahead. And the shareholders get all the benefit. If however the company is taken over say at 130 (to allow for the bid premium), who gets most of the benefit when the company is revitalised? Why, the shareholders in the purchasing company. Apart from the heavy transactional costs of takeovers, this is why the question always needs asking: 'why change ownership if all the company needs is a change of management (especially if the structure that emerges is no better or even worse)?'

But the advantages of positive shareholding are much broader than the occasional drama just mentioned, spectacular as they are. They include the benefits that inevitably flow from continual informed dialogue to give the company a better feel of market perception and the market a better feel for the company's strategy. The use of 'VOICE' is legitimate. Its aim would cause eventually a change in the value of stocks to reflect changes in fundamentals and it is the opposite of market rigging which is a purely financial operation affecting share prices but not fundamentals. Of course, institutions using VOICE would avoid dealing in stock at points when special knowledge had made them insiders, but such periods would be few and short. The whole essence of this use of VOICE is that it is long term and directed at fundamentals.

Indexation and positive shareholding

It is not the purpose of this paper to evaluate indexed funds: the following paragraphs simply look at how they sit with the notion of positive shareholding. As has been widely observed there are some signs of changes in portfolio management strategy, born no doubt of the cost of running a portfolio actively, coupled with the evidence from the USA that only between a quarter and a third of managers in any given year 'beat the index', and that the struggle to do so year after year is relatively unavailing.[2]

Some do, of course, and actively managing a fund is more interesting for the managers than 'buying the index'. It is however more costly and the number of indexed matched funds is rising. This is not sheer laziness. It is founded on the principle that as the market already captures and weighs all the available data, it cannot be beaten consistently except by those whose judgment of enough companies, sectors and the economy is greatly superior to that of the market. In the old days insider information was often the core of the apparent superiority of judgement, but today the law rules this out. Beating the index legally and consistently requires judgment of a high order—and (bearing dealing costs in mind as well) much above the average: it needs luck too, as the index captures all bid premiums, some of which a fund manager may miss.

If the trend towards index matched funds continues either in their 'pure' form or in a modified version, two very interesting points emerge. The first is that by definition the shareholders will have a long term holding in many companies. Changes in the weighting of these companies in the index will in true index matching require a corresponding change in the portfolio, but even so these will be at the margin. There will be a substantial number of companies in which the fund will be a long-term shareholder; being effectively locked in is both a reason and an opportunity for positive shareholding. Second, a fund, relieved of the expense of researching in depth all the companies in the index, could concentrate its resources on those where improvement seemed prima facie possible. There might be real recovery funds instead of today's Micawber funds.

Positive shareholding and the private shareholder: private meetings . . .

It would be unrealistic to suppose that private shareholders could individually enter into the kind of dialogue with a company that major institutions do. Sid (or Aunt Agatha) does not and cannot equal the Pru. The more positive stance urged on institutions in this paper is however not inimical to their interests. The institutions after all act for them as shareholders, pensioners or policyholders: and in so far as the institutions help raise the standards of corporate governance however indirectly, they will benefit the private shareholders in the company too.

. . . and general ones

Both private and institutional shareholders could make better use of general meetings than they do. The institutions generally feel that they do not need to do so because they can obtain the dialogues they require. Even so, a more public stance on some issues and some results would not come amiss. It is easy to underestimate the significance of such intervention for chairmen and boards. It takes a great deal of courage for private shareholders to intervene, and few count themselves sufficiently well informed to do so, whatever their misgivings about the company: they need a lead. It is a pity there are not more bodies dedicated to giving private shareholders the support they need—and even perhaps in the last resort to organising proxy contests.

Wider share ownership

The campaign for wider share ownership is based on the premise that direct ownership of companies (as well as indirect ownership through life insurance and a pension), enhances a general sense of involvement in and commitment to the general prosperity. It might perhaps help both the campaign itself and companies if more stress could be placed on the fact that a shareholder's rights extend beyond his dividends and the market value of his holdings. It is not the purpose of wider share ownership to induce shareholders to see their shares as a rather special form of gambling chip nor to view the

(2) '. . . the average unit trust consistently under-performs its index. In fact, only one unit trust in five manages to out-perform the relevant index, and though a successful fund may manage to do so for the odd year or two, not one trust has out-performed it consistently over a 10-year period. So, a fund which can match the index will actually achieve above-average performance. This is especially true when it is remembered that to match the index, a fund must beat it slightly in order to cover its management and dealing costs.' [*Investors Chronicle*, 28.7.89]

underlying companies as having as little or possibly less meaning to them than the teams in Australian football leagues.

In any case that is not how wider share ownership is viewed. They are seen as serious investors in real assets and among the virtues of small private shareholders are counted loyalty and stability. Even so, little thought seems to have been given to how they can exercise the effective relationship envisaged by the Companies Acts, which gives shareholders other rights, and in particular the right to attend general meetings, to speak, and to vote on issues presented to them including the election of the board. If there is one lesson we should learn from the USA it is that even when boards are properly constituted in the formal sense, the shareholders must continue to see they are operating effectively and in the shareholders' interests.

Narrower share ownership . . .

It is ironical that, viewed in one way, takeovers result in narrower share ownership. Assuming a company that is taken over still retains its identity whether as a subsidiary or division, it finds itself in effect with one shareholder rather than a plurality. It is true that the *new owning group* still has a multiplicity of shareholders (if it is publicly quoted), but the *company* does not. The consequences of this emerge very clearly in discussions with the management of such companies, which find themselves having to trade the uncertainties of the market for the disciplines of accountability. Which is more agreeable to them depends on the circumstances and personalities, but it is not at all safe to assume they regard the market as preferable.

What seems to have happened is that an additional chain has been added to the link of accountability, viz: company management—group management—board—shareholders. The first link is the strongest and, as we have seen, the last is the weakest.

One other consequence of takeovers has slipped by almost unnoticed, viz the great concentration of power that may land up in the hands of the firms backing leveraged buyouts. At one point in 1988, KKR alone had under its wing companies which had over 330,000 employees. KKR is itself unquoted. What has been noticed(3) is that this concentration of power is a modern form of positive shareholding, which has something in common with Japanese groupings (see Part IV), and also follows the vacuum left by the investment and commercial banks relinquishing their monitoring role.

Total share ownership

It is often argued that the divorce of ownership from management that exists in most public companies in the USA and United Kingdom means that management puts its own personal goals before those of its shareholders: and it is pointed out that many of the continental economies, eg Germany and Italy, where the board still controls the company (and may wholly own it) seem to have done comparatively well. This argument is adduced in favour of LBOs in which management emerges once again with a big stake in the business. In fact it is perfectly clear that some public companies where the managers have minimal stakes are well run by any standards: and that some family controlled businesses are not. Not all LBOs work either despite the use of elegant words like 'restructuring' to disguise failure. In any case it is unrealistic to expect the clock to be put back in the USA or United Kingdom. That is all the more reason for shareholders to assert themselves.

Summary

Unlike Germany and Japan, UK company management lacks both regular sources of sympathetic influence and, in the rare cases where it is essential, the stimulation of remedial action: the system depends wholly on the company market which does not necessarily produce the most cost effective answer or the best in structural terms, or give the bulk of the rewards to those who might have enjoyed them. The Companies Acts give shareholders the necessary powers to use this influence, but for various reasons they seldom do so. It would be to their advantage collectively if they did.

The decisions fund managers make do not always relate to the particular company in whose shares they are dealing—they may be more to do with the balance of the fund, the state of a sector or of the market or of the economy. One of the great virtues of the equity market is its flexibility. Even so, shares are not just gaming chips and if they are treated as if they were, and if both institutional and private shareholders continue to neglect the introduction of ways of performing the limited duties the Companies Acts confer upon them, the industrial system will continue to underperform and that may in time cast a shadow on the Companies Acts themselves. To argue that shareholders cannot realistically be expected to play their part is to invite a reconsideration of alternative structures such as the two-tier board which would facilitate their participation, and open the possibility of the participation of others.

(3) See the statement of 1.2.89 by Professor M C Jensen of Harvard Business School to the House Ways and Means Committee. It might be argued that this is a circuitous and expensive way of doing what shareholders and other might have done anyway.

Part II
Shareholder supremacy

Whatever shadows shareholders' current inertia may ultimately cast on the structure of joint stock companies, there is no doubt that currently, under UK law, they are technically supreme. The board which they alone elect is accountable to them. It is their interests which directors must further. This is true of all companies, large and small, public and private. In some companies, usually private, the supremacy is concentrated in a particular class of shareholder, with the remainder having limited rights.

A debate has raged for years about this supremacy, with critics contending that there are other constituencies—employees, suppliers, customers, community, management and the State—and that shareholders are in fact a rather unimportant part of the scene. They point out that in Germany and Japan, with nominally similar structures, the shareholders do not have such a supremacy, nor do they expect it: when a famous chairman of a major German bank was asked what he would do about a bid for a company in which they held a major block of shares, he replied 'I would go and ask the management what they wanted to do'.

Of course the reality is that shareholder supremacy is far from total in the United Kingdom too. Boards do not only have shareholders' interests in mind when they take decisions. They *do* think about all the other constituencies. In so far as they think about shareholders at all, it is generally in the context of producing a performance acceptable enough to the market not to make them ever more vulnerable to takeover. As to the election of directors, the number of cases where shareholders have refused to endorse a nominee of the existing board is minute. If directors are removed it is far more likely to be a result of action by their colleagues or by the chairman than it is to be the result of anything shareholders have done.

In fact shareholders have all but abdicated. As a rule the only time they do anything that matters is when they assent, or refuse to assent, their shares when a bid is made. It was said of Charles I that there was nothing truly kingly in his life except the leaving of it. So it is with UK shareholders: their only kingly act is when they sell out.

If a doctrine such as shareholder supremacy is so much more honoured in the breach than the observance—and that over many years—it tells us that most of the obvious alternatives are worse. It does not however tell us that the present situation is perfect and any complacency we may feel on the subject ought to be dispelled by a consideration of our relative economic performance for many decades.

The great merit in the present doctrine is its clarity and simplicity. Although directors do not always serve shareholders' interests as they should, at least there is no doubt about where their duty lies: give them other masters too and confusion would reign. Given the compromises always necessary in practical life, the board would lack even rudimentary bearings. Besides, the shareholders' interests cannot generally be served without serving those of others first. For a shareholder to prosper because a company is doing well surely implies growth, which in turn implies satisfied customers, competent suppliers, and well motivated employees. It is idle to suppose that shareholders could flourish if all around them did not. Even in the United Kingdom, and despite their nominal supremacy, they are in fact towards the end of the queue.

Let us assume for the time being that this nominal supremacy is to continue. Does it matter that in reality the shareholder's role has become so limited: or is it perhaps a good thing? In Part I, I argued that from the point of view of ensuring the maintenance of good corporate governance, it would be better if shareholders were more positive and active, and the arguments I used were economic. It would pay shareholders better if they were, because over time it would improve companies' economic performance.

There are, however, other arguments of a more political nature which tend in the same direction. A crucial element of our political system is the answerability of the government both to Parliament and the electorate: and the ability of the electorate at periodic intervals to change the government peaceably. In this way, and with the help of the courts, is the use of power controlled—which is what makes it safe in the first place to entrust the government with power.

Now the boards of companies exercise economic power—sometimes very great power indeed. Some companies' incomes exceed those of small states. The framers of the Companies Acts, which enabled this power to accumulate by dint of the economic concentration the Acts facilitated, saw only too clearly that there had to be a line of accountability for it—to the shareholders. The shareholders are as it were the electorate of the industrial world, and this is literally true in the sense that they do elect the board and can remove it from office. If we do not vote as citizens we shall get the governments and local authorities we deserve. If we do not exercise our rights as shareholders we shall get (and in some cases now have) the boards we deserve.

The statement 'The price of liberty is eternal vigilance' was made in a political context, but it is true of companies too. If shareholders' vigilance disappears what is left is power without responsibility.

This brings us perilously close to saying that shareholders, if they want to retain their supremacy, have duties as well as rights, and unfashionable as this may be as a concept, there is much to commend it because to some extent the integrity of the system depends upon it. Some would go so far as to say rights should only be preserved if shareholders do their duty: ie that those who do not vote forfeit their voting rights next time round. I do not espouse this extreme view, which goes beyond what we are prepared to contemplate in the political sphere, and would in any event be difficult to enforce, but there is, I believe, a political as well as an economic case to be made for trying to persuade shareholders to take a more positive view generally of their very limited duties, especially as in the United Kingdom boards appear to be more or less immune to shareholder suits.

It is interesting to compare the situation in the USA. The Federal government is not much involved in aspects of corporate governance (other than through the legislation the SEC administers). It is left to the Stock Exchanges to regulate the composition of company boards; their requiring companies to have audit committees as a condition of quotation meant that boards had to have a proportion of outside directors. Companies incorporate under the laws of various States which differ and indeed compete. Delaware is the market leader and the decisions of its courts are accordingly influential. Wherever a company is incorporated however there is a legal PROCESS which is nation-wide, which facilitates access to the courts thanks to derivative suits, class actions and contingency fees. The US courts will not however doubleguess management decisions (the business judgment rule), so long as they are properly reached: judges do not want to find themselves running companies. There is however a growing tendency to look at the process of decision-making (Smith v Van Gorkom) to see whether it was reasonable. In addition to all this there are signs of US institutional investors flexing their muscles. I am *not* advocating greater legal activity here. I am saying that if it does not take place it places greater emphasis on the need for more real accountability to the shareholders. The process of judicial review, valuable though it is, is not and should not be a substitute for this.

This point about accountability is of course not lost on our continental colleagues, especially in Holland and Germany. What the upper tier of the two-tier board does is precisely to create a structure in which accountability is facilitated. It does not ensure it, since that depends on personalities. But the lesson from these systems is that erosion of the doctrine of shareholder supremacy is less significant if there is scope for external influence on the board by other means. It is true that on the upper tier of a German board, the Aufsichtsrat, the chairman who comes from the shareholders' 'side' always has a casting vote: even so, management has in practice ceased to be exclusively answerable to the shareholders' nominees and the shareholders themselves.

The implications are clear enough. If shareholders do not see it as being in their own interests and in those of companies to take more positive action, they will encourage two sets of development: activity in the takeover market to remedy poor management and take advantage of the market's characteristics, and political activity to make boards once again more accountable. All the takeover activity in the world does not settle the issue of accountability—indeed, as the entities get bigger, the problem of accountability gets worse. And as takeovers get bigger the instability of the market increases. It is often asserted that Japan and Germany will one day pay the price of excessive stability because it may lead to rigidity. It seems a little curious for those not in the pink of condition to worry about the prospects of rigor mortis in the most healthy.

Management buyouts: the shareholders outflanked

Throughout this paper and Panel Paper 25 there runs the assumption that the Companies Acts provided shareholders with the means of preserving their own interests if they chose to use them, thereby balancing the interests of the management if the two diverge, as in reality they often do. There is however one circumstance in which it must be doubted whether shareholders are adequately protected—the total management buyout, ie one in which the existing management or part of it seeks to buy the whole business from its existing owners (if it borrows heavily to do it, it may also be called a leveraged buyout).

The issue

The issue can be simply stated. The board of directors is accountable to the shareholders and owes them a duty of care. It is almost as if they were trustees for the shareholders. This means that if someone seeks to purchase all the shares in a company it is the board's duty to secure the highest price for them. In a total management buy-out, because of the way in which British boards are constituted, it is most probable that a large proportion of its members who have executive duties will be part of the faction which wishes to purchase the business. These people must want to pay as little as possible for the shares, and yet it is their duty as directors to secure as high a price as possible. They have ineluctably a conflict of interest.

Partial MBOs

There is no problem of principle in the purchase by its management of a part of a business; the board with which it is negotiating has the information it needs (or has an absolute right to require it or make whatever investigation it deems fit), to act with due diligence on behalf of the shareholders. The management cannot realistically use resignation as a threat. And the timing of the deal—which can be all-important to the price—does not have to be conducted to suit management. If, as in some cases, it looks subsequently as though the existing management has secured a bargain (and that the company's board was ill informed about the value of what it was selling), the shareholders have every right to question the board's judgment.

Motivation

The main motivation for total MBOs is that the existing management feel they can make more money that way.

Fair enough, but they cannot hide behind the argument that they are seeking freedom from the board's constraints, since for the most part they are the board or have a great influence over it. Nor can they argue that they are seeking their freedom from constraining shareholders since it is quite likely that they will have more supervision after the MBO (from those supplying the finance) than they ever had from their shareholders. Some contend that an MBO helps them escape from market pressures but this argument wears thin if, as so often, re-quotation is sought fairly soon afterwards. It seems to be commonly accepted nowadays that managers should have a greater share in the fruits of success which they themselves have earned and this is why various types of incentive schemes, such as share options, have been widely introduced. Such schemes are based on the premise that a significant share in ownership affects managerial behaviour. MBOs go further than this, however, and seem to wish to turn the clock back to a company's early days when to a large extent ownership and management were united and outside participation in the fruits of success was extremely limited—in the confident expectation that greater value will be added as a consequence.

Information and timing

Be that as it may, in the case of an offer by the management of a company for the shares of its shareholders, the management stands on both sides of the transaction for it is buying from the very people whose interests it is paid to protect. In the normal course of events these people cannot obtain as much information about the business as the managers possess (which incidentally offends against market principles). This is true both of big institutional shareholders and private shareholders, but it is far more true for the latter. The shareholders have no control over the timing of the bid and an opportunistic management is naturally likely to seek a moment that suits it best.

Hobson's choice?

By making a bid, management puts the shareholders into a difficult position. To refuse the offer is to risk management's resignation or to be forced to continue with a management that has said plainly that it regards shareholders' interests as subordinate to their own. The shareholders could require their resignations but they know that it is difficult to act in concert to find replacements. Yet they know the information they have about the company is inferior to what is possessed by those bidding for it. It is therefore not surprising that they feel they are under pressure to accept a premium over the pre-existing market price, even though they may suspect that a much better one might be achieved. There are numerous cases in the USA where subsequent events have shown beyond any doubt that the management bought the company at a bargain price: it is for consideration why the market price should have languished, and what responsibility, if any, management bore for this.

Ban total MBOs?

There are those who argue that the conflict of interest is so fundamental that MBOs should never be allowed. If the management wishes to buy a business it should resign first. Most commentators, however, do not take so absolute a view. They argue MBOs may be of value to the economy: that one should not interfere with the workings of the market and that the conflict of interest is so well signalled that shareholders should always be on their guard if an MBO is proposed.

Solutions

Assuming that it is not felt to be desirable to ban MBOs altogether, what steps can shareholders take to protect themselves? Should there be any changes in the laws and rules?

As soon as an MBO is seen on the horizon, shareholders should fly the pennant 'Caveat vendor'. That goes without saying. They may simply refuse the offer—but as we have seen, this may leave them in an awkward position *vis-à-vis* management. A solution may divide into two parts—information and process.

The proper operation of the market requires parties to the negotiation to be adequately informed. The management are, but the shareholders are not. The problem is accentuated if the company's advisers, on whom shareholders might have depended as the outsiders most knowledgeable about the company, feel that their own interests are best served by lining up with the management, thus depriving shareholders of their help when it is most needed. This of itself is a matter which requires consideration. As it is, there is clearly an imbalance which needs to be redressed if shareholders are not to be unfairly disadvantaged. The problem could be elegantly solved if there were always enough able independent directors on the board, who are not associated with the MBO, to safeguard shareholders' interests. Unfortunately, the authorities have so far failed to follow the American lead and insist that boards of PLCs include them, and there are many UK companies where the independent element is not strong enough (if it exists at all) to shoulder the burden. The solution that therefore seems most appropriate is for there to be, at the company's expense, a body specially set up for the purpose to advise the shareholders: it is for consideration whether, if the shareholders are not able to act themselves, the authorities should require it. It would have access to all the information available to management (but would ensure that it was not published if it were commercially sensitive). The body would be appointed *ad hoc* and would include all the independent directors who were not 'on the management side', plus any professional help they deemed necessary. If the independent element on the board were strong enough to carry the burden, they could comprise the whole body. Such a committee would be set up even when the MBO was a counterstroke to an open market offer: even in those circumstances management's conflict of interest remains, because it still wishes to obtain the company as cheaply as possible.

We now turn to the process. At the moment an MBO is treated like all other takeovers in terms of the rules and timetable, although the circumstances are different. In an ordinary takeover the board of the target company are already in possession of all the facts and will have probably worked out a defensive strategy against a bid well in advance. In an MBO the shareholders are caught, without warning and without a plan. The people they relied upon to protect their interests have changed sides. If the shareholders are to form a view about the bid they need to accumulate the appropriate information, but it is far more difficult for them to do this than it is for the managers—even if there are non-executive directors to help. Furthermore, it takes time to find alternative buyers and organise an auction. There is moreover a difficult point about equality of information. The Takeover Code requires management to give equal information to all bidders and not to give preferential treatment to some. If however management, with all the facts, are one of the bidders, how can anyone else be put in a similar position without revealing sensitive information (especially as an outside bidder may well be a competitor)? Again one is driven back to the need for a body that can handle the situation, ie look after the shareholders' interests without damaging the company. For these reasons the Takeover Panel should consider whether a new and longer timetable should be introduced for MBOs. The interests of shareholders would be better served by having more time to marshall information and find alternative buyers: the inconvenience of having a more protracted process either to them or the company would be small by comparison. This change is desirable whether or not the proposition in the preceding paragraph is implemented.

Whether or not a committee is appointed as recommended, there may be circumstances in which it is felt (and indeed a committee might feel) that the future was sufficiently hazy for the shareholders to be particularly cautious in selling out. It is almost impossible to police plans and intentions, and shareholders may consider it prudent to secure the opportunity of obtaining some sort of equity interest in the new entity so as to capture a reasonable participation in additional profits the management realises, either as a result of exploiting opportunities it had previously perceived or, more generally, as a result of doing after the MBO what in many cases it should have done before.

Summary

The doctrine of shareholder supremacy still holds the field *faute de mieux*. There are political as well as economic reasons for positive shareholding in order to validate the system. Shareholders are at risk in an unforeseen way in total management buyouts where they lack both information and time to guard their interests; steps need to be taken to deal with this.

Part III

Some implications in the change of the pattern of share ownership: the real cause of short-termism

When joint stock companies were created the assumption was that the savings channelled into them in the form of shareholdings came almost exclusively from individuals. The advantage of shares over Consols was the possibility of the growth of capital and income; their comparative disadvantage was the risk of losing both. Purchasers could be active or passive, investors or speculators. They were seldom trustees because of the legal limitations imposed upon the choice of investment. They could be as patient as they chose and allow non-economic factors to affect their decisions. This is all still true for private investors who may eschew certain shares for political, ecological or health reasons, and buy others for the converse reasons. However they act and for whatever reason, one thing is true about all of them—the performance of the shares they hold, whether a tiny clump or huge portfolio, is a private matter. If they do use a manager to run their portfolio or advise on it, they can decide on the instructions. There is no pressure on them or on their fund managers other than those they choose to exert.

None of this is true for the other shareholders, all of them, who hold their shares effectively as, or for, trustees. Their freedom of action is circumscribed as the judgement in the coal miners' case in April 1984 bore out. Sir Robert Megarry said that the overriding duty of trustees was to act in the best interest of the fund's beneficiaries—and that normally meant their best financial interests. In considering investment, trustees had to put aside their personal views and could not make 'moral gestures'. A fund manager, engaged by trustees to assist them discharge their obligations, cannot be any freer than they are to introduce their conception of the public interest as a determinant of investment decisions.

Private individuals now hold a decreasing minority of UK shares—much less than half. Most shares are held by insurance companies and pension funds and unit trusts and are managed by professional fund managers *who are publicly measured.*

It is a well known management adage that measurement motivates. The question has often been asked therefore whether the mode of measurement of performance of fund managers is appropriate for their function. If the view is sustainable that deeper relationships between companies and shareholders are in the interests of both, it may not sit comfortably with the pressures a fund manager must feel to be buying and selling in the market to make sure he does not fall behind the pack of his competition on a quarterly basis. Incidentally, why quarterly? He could be quite easily measured weekly. The selection of a given period of time is quite arbitrary. Some might consider that annual tables should be enough. They might go further and ask whether the fund's trustees get and impart appropriate instructions.

The argument still continues on whether or not the short time horizons forced on fund managers by the time scale on which their performance is measured feeds through to the boards of the companies in which they invest. Many assertions are made in either direction but the main point is generally not mentioned—viz: if fund managers do see themselves as being under such short-term pressures it must preclude their taking a long-term view of most companies in their portfolios and of establishing relationships with them. The more they are inclined to view the shares they hold as trading counters the less they will be sympathetic to the longer term view which is concerned with the underlying quality of a business and its management. It is perhaps this aspect of our system which is the most deleterious.

Similar considerations apply to the way in which shareholders react to takeover bids, though here the picture is more complex because of the incidence of capital gains tax. The private shareholder could always (and still can) allow non-economic considerations to prevail and could opt not to assent his shares for reasons of loyalty or prejudice or even because his confidence in the long term future of the target company made him ready to resist the 'enhancement of shareholders' immediate values'. Since 1965 CGT has been a factor affecting the decision whether to accept cash.

As Panel Paper 25 pointed out, institutional shareholders (many of whom have no CGT to worry about), are under much heavier pressure to assent their shares if they fear the price will fall back if it fails. Here too their time horizons of potential success by the target company may well be foreshortened by the opportunity to cash in now. German and Japanese institutional and financial shareholders seem to have different criteria in general when it comes to takeovers. Their institutions and banks, partly because of their complex relationships with companies (they may be bankers or suppliers of services as well as shareholders), but partly also because of their view of the public interest, feel themselves free to reject the possibility of substantial short-term gains. Contested bids never succeed: some would argue that this is wrong too, in the sense that it deprives their markets of the 'long stop' discipline that is necessary when all else has failed. But that is to overlook the inner corrective mechanisms which produce the same result, with the minimum of public fuss and without a gladiatorial contest. In the United Kingdom it is more surprising that a contested bid should fail than that it should succeed.

Do the pressures for short-term performance on what is now the bulk of UK shareholders present any issues of public interest? To say that there is a public interest does not mean automatically that there is a case for government intervention every time someone asserts it is being threatened. There is always a price for intervening to be paid in distortions to the market, and in direct and indirect costs. If, therefore, intervention is advocated to meet any particular deficiency in the way the market works, it must clearly be shown that the benefits *clearly* outweigh the disadvantages. And those who seek to establish such a case must also show that the particular public interest can be defined in such a way that measures to protect it are *capable* of being administered effectively.

Having said all that, an uncomfortable feeling remains that the gradual shift in control towards the institutional fund managers, coupled with the intense public pressures to which they are subject, must interfere with their relationship with companies in a way not originally intended or devised. I believe this is a matter of public interest which is worth further investigation and probably remedial action.

Summary

Amid all the debates about short-termism, in which it is asserted that the pressures on and by trustees and fund managers to show short-term performance feeds back to the governance of companies itself, the fact is overlooked that the resultant failure of those same shareholders to fulfil the role allotted to them by the Companies Acts is far more important. If therefore we examine the system to see whether the public interest is being best served, we might well conclude that excessive pressures on institutional fund managers may perhaps be unhelpful in that it is the threat to the basic fabric of the Joint Stock Companies brought about by shareholder passivity that in our system constitutes a significant danger to its long-term efficiency.

Part IV

Passive shareholders: conglomeration and deconglomeration

In Panel Paper 25 we showed how there was a connection between the buying and selling of companies in the stockmarket and the failure of a board to run the company as well as the market thought it should. Passive shareholders let the board preside over its decline and the bid premium provides the incentive to financial engineers to put the company into the hands of those who may make better use of its assets. Because there is always a premium for control, this process takes place in all types of company: at best it is an expensive way of changing management (but necessary in the last resort if shareholders are passive). At worst it can lead to asset stripping of a wholly short-term and negative nature.

In this paper we will now look at the special factors surrounding 'deconglomeration' because here we encounter not just a change of ownership in order to change management, but also dismemberment. In order to do this, it is useful to remind ourselves of the general background—albeit in a broad brush way. In this rapid *tour d'horizon* we shall look at what causes companies to grow: what kind of company emerges: what role the shareholders play or should play in its development: how the market deals with 'conglomerates': and consider some interesting aspects of the Japanese Keiretsu.

Corporate governance: the pressures for growth

Companies are like escalators. They move upwards or downwards and are seldom stationary except in case of a breakdown. The exceptions are those which achieve a state of equilibrium, such as the local village store or a company which has a market niche: they can stay the same size for years. Other companies which appear to have reached equilibrium are in fact often running fast up the down escalator just to stand still. The equilibrium is delicate—any upset and they go rapidly downwards.

There are good reasons for growth—internal and external. A person starts or joins a business, among other reasons, because he or she has confidence in the goods or services it provides. As this is so, there is a natural and laudable aim to provide more of them. With growth (as long as it is profitable) go better careers, higher incomes, prestige and reputation. Such motivations are evident in businesses of all sizes, and are so to speak *internal* to them. There are also *external* pressures, especially those from the market if a company is public. A record of profitable growth naturally impresses the market and it tends to rate the company more highly, which in turn makes it easier for it to use its paper to make further acquisitions. A higher rating also makes a takeover more expensive and less likely.

Organic growth

Growth then, is an inevitable and normal business aim and desirable for the economy. In a company's early stages it generally concentrates on increasing market penetration and on extending the market. Later on, when it has become sufficiently large, it may decide to extend vertically as well, that is to say by manufacturing components or assuming direct responsibility for sales, or both. The company will be attempting to ensure that profit accompanies volume, often in markets in which international competitors can give greater emphasis to market share because the pressures on them for quick increases in profit are less: those who fund them are more patient.

Most companies grow from an identifiable core business and many prosper greatly without diversifying far from it, if at all, whether they expand entirely by organic growth or by acquisition too. Many however meet the relentless pressure for growth by diversifying, and becoming what is loosely termed a 'conglomerate', that is to say, a multifunction business. The Malvolio theory of management identifies three different species:

- those that are born conglomerates
- those that achieve conglomeration
- those which have conglomeration thrust upon them.

The born conglomerates are those which from the very beginning, or very soon afterwards, had no core business. Depending on the way one looks at them they are wholesalers of businesses, hospital wards for businesses, and management experts—and there is probably a touch of all three at various times. Their *raison d' être* is that superior management skills provide important value added, and can be applied universally to produce a better utilisation of assets. The continuing benefit these conglomerates provide is not simply the financial discipline (which new masters could copy), but access to finance and supervision. Looked at another way, they perform the shareholders' role actively by adding an extra link to the chain of accountability (see page 7).

Companies which 'achieve conglomeration' are those which expand from their core business by separating various facets of it and developing them, and by developing variations in cognate industries whilst staying broadly in the same field. The range of products produced by some chemical manufacturers might often put them into this category. It would be typical of such companies to have shared or cognate scientific or technical bases, and for its management to be relatively interchangeable between parts of the business. Some vertically integrated companies would be so classified. In all such cases the group will draw strength from its (limited) diversity. Dismemberment cannot be so easily and cleanly accomplished and its long-term benefit is less obvious: indeed, it would diminish the value added that group unity provides.

The most interesting and baffling category is those which have diversified because they felt that the pressures for growth outweighed all other considerations, and that therefore conglomeration was thrust upon them. This is sometime characterised as megalomania on the part of an ambitious chief executive who wants to see his business climbing up the *Times 1000*, which ranks companies by size of turnover. There may at times be a touch of this, but there are many other motives, such as:

- the defensive protection of greater size (not as valuable as it was)
- to even out variations in results by joining up with a countercyclical business
- to lessen dependence on a core business.

In relatively rare instances, company management finds that it has come to the end of the escalator. It may not be able to go any higher either because it already has as large a share of the market as government regulation will permit or, alternatively, because its product may face either a decline in growth, or stagnation over the span of the working lives of executive management. Tobacco is a case in point. The world prospects over the next 50 years for tobacco are not for sustained volume growth.

Given the internal and external pressures for growth such a situation presents company management in an acute form with the problem of achieving growth. Years ago a management consultant pointed out that the survival of carriage-makers at the turn of the century depended on whether they regarded themselves as being in the carriage business or in the transportation business. If the former they were doomed to die, if the latter they might well become automobile manufacturers—as indeed some did. This kind of redefinition of the business is however not easily made when the core product is not naturally part of anything else. Tobacco is tobacco—unless one wants to consider it part of the family of drugs and the implications of this are horrific.

When company management reaches the conclusion that its natural horizons are limited its freedom of manoeuvre will, of course, be defined by the size of the surplus funds the business generates. On the assumption that these are considerable and far in excess of any investment required by the core business, there is a difficult choice facing them, which in an over-simplified way can be described as distribution *versus* diversification. We have noted above that all the internal pressures are in favour of diversification—pay, prestige, prospects and the negative ones too, such as they fear that recruitment and retention of high quality staff will become more difficult in a static business. These however would not be enough by themselves. There have to be positive reasons why shareholders' surplus funds should not be handed back to them: bigger distributions might make them less vulnerable to takeover.

The arguments for diversification rather than distribution seem to fall broadly into two groups—tax and 'trust us'. The tax arguments were at their strongest in days when capital gains tax was set at 30% and income taxes ran up to 98% (though even in those days they did not apply to the tax exempt institutions). The underlying premise was that as distributions were penally taxed the company could make better use of surplus cash flow than shareholders by judicious investment which would enhance share values in due course. Since the Chancellor equalised the top rates of income tax and CGT, the argument is of course greatly weakened. In certain companies there was and still remains an ACT problem because a large proportion of their income is generated abroad so that excessive distributions (which would be subject to ACT) would have no corporation tax against which the ACT could be set: and this would cost the shareholders dear.

Many US companies buy in shares as a way of crediting the remaining shareholders with surplus cash: this option has only become available in the United Kingdom recently. It is a matter for consideration whether shareholders collectively should have the option of a cash distribution, whenever management proposes buying in shares. It is after all the shareholders' money that is being used; should they not have the right to say which they would prefer (even if they have to pay tax)?

The 'trust us' arguments are based on the premise that investors showed their confidence in management by buying shares in the original business and will trust the same management's skills in new ones. This argument does indeed hold in the case of the 'born' conglomerates: but there the shareholders never bought a core business in the first place. And it is true of those that achieve conglomeration, since the accent is more on complexity than diversity.

Observation suggests that diversification right away from a core business is notoriously difficult both in human and financial terms, because it involves differences of culture, technologies and markets. Furthermore, unless the company purchased is of a size significantly to affect the group's profits, it is always in danger of being so inconsequential as to be neglected. Many a good company has come to grief when embraced, however lovingly, by a large group with a huge core business: the skills shown in running the core business did not translate.

Size is subject to fashion. Today we are witnessing a revolution against 'excessive' size because of the bureaucracy it so easily engenders and the constraints it can impose on component businesses which blunt their cutting edge. On the other hand, it is easy to forget that in world markets group size can increase 'clout' and that at the very least the parent company may provide more patient funds than a subsidiary could obtain were it still independent. Unfashionable as it may be to say so, some conglomerates have shown themselves adept at participating in skilful restructuring both of themselves and of the sectors in which they operate.

When one looks at companies one should remember the old couplet 'For forms of government let fools contest, Whate'er is best administered is best'. Although it is true that 'born' conglomerates are usually good at wringing more profit from existing activities, this is their bread and butter. Their jam and Devonshire cream comes from one-off savings after an acquisition; and from a dismemberment of other conglomerates. The second group is straightforward enough and may be viewed as the multifaceted development of a core business with all the characteristics of sound organic growth, but the third group is an enigma. Shareholders generally have conceded to management the right to use their money to diversify without impediment—and this is in the face of some appalling disasters. It might well strike the disinterested observer as odd that sophisticated investors should be so willing to cede to others the power to spend so much of their money in ways that could not have been foreseen when they invested.

This is especially curious because investors know that the stockmarket is not concerned with these niceties of differentiation of cause or motive. What the market sees before it in a conglomerate is in effect a convoy of companies. The price it puts on the convoy at any one time may well depend as much on fashion as on analysts' careful forecasts for the various vessels. The task of evaluating a complex conglomerate with various operations expanding at uncertain and different rates can never be other than difficult. It is no wonder therefore that there is a tendency to regard the whole convoy as sailing at the speed of the slowest big ship. What this means is that the dual pricing that exists in the case of all shares will be much more marked. In addition to the premium for control there is a second premium—the break up premium. This too is inevitable given that the market's evaluation of any kind of multifunction business tends to pay particular regard to the more poorly performing functions.

Fashion itself appears to have affected the esteem in which conglomerates are held. At times it believed in synergy in the oddest places so that 2 + 2 = 5. Now the convoy principle is in vogue and 2 + 2 = 3, as the market's sceptism about the ability of boards to run overdiversified businesses may be somewhat indiscriminate about the degree of diversity. Such a thesis may be difficult to prove conclusively, but it is hard to avoid given that the market has demonstrated how rich the pickings are for anyone equipped to break companies up. If a conglomerate has followed a conservative distribution policy and the market has rated the shares accordingly, the perception may be that the speed of the entire convoy has slowed and it will on that account be even more vulnerable to attack.

We can now see that there are internal pressures on corporate management one way or another to push towards conglomeration (aided and abetted by the financial sector), and that in most cases shareholders regard this with approval; in others they acquiesce. The markets on the other hand value such companies in a way which inevitably makes it profitable to dismember them. A sort of San Andreas Fault runs through the terrain: the ground is fundamentally unstable, and is likely to remain so.

As so often it is interesting to look towards Japan by way of comparison. Two interesting facts emerge. The first is a tendency for companies to stick to their last. The following table is drawn from Rodney Clark's book 'The Japanese Company'.

The company as member of an industry in selected industries, 1975–76

	Turnover(a) fiscal 1975	Percentage of turnover in: A(b) The given industry	B(b) Related industries	C(c) Unrealated industries
	¥ billions			
The Paint Industry				
Dai Nippon Toryo	49.9	78	12	10
Nippon Paint	55.4	90		10
Kansai Paint	60.4	84		14
Shinto Paint	22.6	84		16
Toa Paint	16.7	89		11
Chugoku Marine Paint	21.1	82		18
Rock Paint	16.3	75		25
Nippon Oils and Fats	59.6	30		70

Source: *Japan Economic Yearbook*, 1976–77, pages 296–327.

(a) Companies have different year ends so that turnover figures are not strictly comparable.

(b) The author assigned products to categories A and B as follows: Paint Industry: A, paint of any kind, thinner, and lacquer; B, lead chemicals, fluorescent products.

(c) All other products are assigned to category C. Since some firms count such components of turnover as installation charges and spare parts as 'other products', the effect of this classification is to understate the extent to which Japanese companies confine themselves to industry.

The author presented comparable data for the cable and wire industry, the construction machinery industry, the camera industry, and the beer industry.

The second aspect is the use of loose groupings which amongst other things achieves the benefits of the multifaceted company without the 'convoy' effect of stock exchange pricing. The Keiretsu groups are in some ways heirs to the pre-war Zaibatsu groups but they are no longer centrally controlled. Individual companies have separate quotations: although there are cross holdings within the group the majority of shares are generally outside it (although often in firm hands, as in the case of most major companies). Take, for example, Mitsubishi Chemical Industries, a leading company in the group. In the Spring of 1988, 11.7% of its shares were held by Mitsubishi companies. Leading institutions held 20.6% and foreigners 8.2%. The shareholdings in Sumitomo Chemical were: Sumitomo companies 16.8%, institutions 18.1% and foreigners 6%. Both these companies are quoted separately from each of the other companies in its group and as far as the investing public is concerned are virtually independent.

The consequence of such arrangements is that the virtues of independence can live alongside the virtues of support and co-operation (at various levels within the group): and that their market standing can reflect the rating of a particular industry at any given time, as well as the performance of the management of that particular part of the business. The cross holdings provide some cement but not absolute protection. In the Japanese culture 'hostile' bids are deemed uncivilised whether or not a company is a member of a Keiretsu group. In our market membership of a group would still leave a company exposed to a bid (unless enough shares were in 'safe' hands). Even so, it is an interesting way of securing the benefits of differentiation whilst solving management's dilemma when a core business gets stuck for good. And it tends to produce a more efficient market.

Summary

There is no holy writ which says of conglomerates 'That which management has joined together shall by no entrepreneur be torn asunder'. But the market does have a genuine problem because it is not easy to value multifunction businesses; the break-up premium when added to the bid premium creates high potential instability. Perhaps other forms of grouping may be worth a second look. Meanwhile, shareholders might well have more to say about diversification away from a core business.

Part V
Mergers and takeovers: some aspects of the public interest

Introduction

Few aspects of corporate governance, shareholders' rights and duties and takeover bids escape partial and interested views, since so much money is at stake. London may perhaps lack a lobby as powerful as the one Wall Street commands in Washington DC, but those financial engineers who do so well from helping industrialists assemble companies, do at least as well when someone else wants to take them apart. Their industry and efficiency is much to be admired and they provide a useful service in assisting our economic model to work smoothly by easing the transfer of assets to those who can employ them best. But their views and testimony about the process, its use and shortcomings are not and cannot be impartial. There are knots to be disentangled for which quiet calm deliberation is certainly needed. This paper will consider three: The Nationality of Companies : Competitition : and 'Financial Pollution'.

The nationality of companies

It is not at all surprising that nationality should stir emotion: EEC or not, nationality still manifests itself in Europe quite often in company matters. We still see subtle (and not so subtle) pressures to achieve a national solution. An American may feel indifferent about a company changing its headquarters from Pittsburgh to Atlanta after a merger: a Frenchman will not feel the same about a Parisian headquarters being transferred to Rome—nor did many Englishmen about a transfer from York to Vevey. All the more reason therefore in this increasingly international world to look at what really matters.

For most practical purposes a company's nationality is determined by the place in which ultimate managerial control is exercised—where its head office is situated: this paper does not consider the question of domicile and its attendant legal consequences, important as they are in their own way.

Many foreign companies operate in the United Kingdom. Some have been grown here: some result from 'friendly' mergers: others result from 'hostile' takeovers. The same classification applies to United Kingdom companies operating abroad. No takeover can be consummated without the agreement of the controlling shareholders, so the word 'hostile' refers not to shareholders' attitudes but to the board's views. Whether a merger has the board's blessing ('friendly') or not ('hostile'), or whether a company has been grown here organically is immaterial in considering the long-term implications of a given company's nationality. Issues relating to nationality should be addressed for all foreign operations not just the relatively few 'hostile' bids which catch the headlines and arouse the strongest emotions.

All companies are ethnocentric to some degree, in reality as well as in appearance. Style and ethos sit alongside language and law as factors we ignore at our peril. To say they do not matter flies in the face of experience: the question is how much. We examine briefly in turn the headquarters effect: suppliers: taxation: decision making and career opportunities.

The headquarters effect

In the United Kingdom large headquarters have been going out of fashion for some years, perhaps because they presented potential predators with such an obvious scope for saving. Functions have been decentralised whenever possible. Even so, they retain some important high quality work which is available nowhere else in the company, and other high quality work, such as research and development, will tend to remain in the same country as the group headquarters. Talented people who find themselves redundant because of the transfer of top jobs after a takeover may well find their skills much in demand elsewhere. Even so, the elimination of the jobs may well have an adverse effect on the career prospects of remaining staff (see below).

Head offices need professional services and tend to prefer those that are close at hand and operate under a familiar legal system. One of the attractions of a major centre like London is that the choice is so wide. When a head office moves country, such professional business tends naturally to move too: and when a company is bought, much of it will be lost to the country concerned—though companies usually need some local professional services.

Suppliers

Whether a subsidiary is being established abroad from scratch or whether a foreign company is being acquired, there is an understandable inclination to favour suppliers of capital goods, components and other supplies with whom relationships have long been established. (This shows up even in the Japanese trade figures: when they are shifting production offshore they export indigenous machinery for the new plant.) As time progresses there is often a shift towards locally made components, as is happening in the United Kingdom with locally produced Japanese cars. The EEC rules exert pressure in this direction, since the percentage of local content affects cars' marketability.

The tax effects

The tax effects of foreign control are not often mentioned but may be significant if, for instance, the United Kingdom entity has to support a heavy burden of debt the interest on which is paid to a lender resident abroad for tax purposes. In such a case the Revenue would not receive corporation tax, tax on dividends or tax on the interest. The reverse situation may produce advantages for the United Kingdom. In the case of a foreign takeover for cash, the Revenue does have the consolation of a once-for-all payment of capital gains tax from those shareholders obliged to pay it, but whether this will compensate for the revenues it stands to lose in the longer term depends on how much of the capital released is in the hands of United Kingdom residents and what use they make of it.

Decision making

Companies cannot survive if they take too many bad economic decisions, irrespective of nationality, about sources of supply, the siting of plants, marketing, personnel, or anything else of major importance. That said, there are many options and borderline cases in which decisions can go either way, eg supplier X or Y, Mr Alpha or Beta, investment in country A or B. There is in all walks of life a preference for the known and familiar and for safety rather than risk, and there is in companies a centripetal force. Strengthening this force, especially in difficult times, there may be subtle or not so subtle political pressures. When for instance a decision to retrench is inevitable, *other things being equal* (or not too unequal) home tends to suffer last: boards tend to be more sensitive to publicity on their own doorstep. In short, there is an element of bias in the decision-making process which favours the home country.

Career opportunities

The nationality of companies is among the many factors which affect career opportunities. In Western and Far Eastern countries alike, numerous private (and some public) businesses present limited career prospects with no chance of taking top jobs—because these are reserved for the family. Bigger businesses naturally offer more scope and recruit accordingly: the way to the top may even be open if the family has ceased to dominate. Big businesses, however, which span several industries may restrict most staff to a career in a particular part, and even refuse as a matter of policy to promote from within to the main board (finance directors tend to be the exception to both these practices).

These factors do not change simply because a company changes nationality. Indeed, in many parts of a business and at many levels, employees may not know where control ultimately rests. They may look upon their company as locally owned—particularly if its local directors are home nationals and central accountability is exercised with a light touch.

If a company operates abroad its employees may regard this as a mixed blessing. Some enjoy the challenge of change and travel: others find the uprooting of young families disagreeable and destructive. Many a career has been truncated because a promising executive has declined transfer abroad even on promotion. This however is true also of the nationals of the company. Whether or not a United Kingdom resident declines to uproot his family for a promotion in Tokyo, New York or Sydney will not mainly depend on the nationality of the company, but on other factors such as the family's demands, further promotion prospects and alternative possibilities. Where choice and opportunity exist there can be no grounds for complaint.

A company operating abroad will inevitably employ many local nationals. If it does so it has to face the twin problems of deciding what kinds of career opportunity to present, and of recruiting and training accordingly. At one end of the spectrum lies the company which tends to keep some (if not many) of the top posts abroad for its own nationals. This implies a policy of recruiting locally only those with limited prospects. If their progress to the top of their local company is restricted they certainly will not go further in the company generally. There are foreign owned companies like this in the United Kingdom today, and United Kingdom companies like this abroad, but probably fewer than there were. At the other end of the spectrum are companies which aim to recruit at least some of the best foreign nationals they can, and offer them the prospect of getting to the very top if their talents warrant it.

Most companies lie between the two extremes: and many change policy as a particular foreign operation expands. The bigger and more important it becomes the greater the chance that a satisfying career can be obtained within it: the company recruits accordingly. In the United Kingdom, Ford and IBM are good examples of this development. Even so, many companies still seem to set bounds on foreign nationals' advancement.

United Kingdom directors are poor linguists. Ambrosetti's survey shows that 76% do not speak a second language fluently and that 37% of companies have boards on which no one speaks a second language. So, at least for Britons, language is often an obstacle. It is even more often an excuse, particularly if a language is clearly difficult: and it can be an excuse for companies who do not want other nationals to be promoted too far or are not prepared to help them.

Limiting the effects of nationality

Whether or not a company intends to grow organically or by merger/acquisition, or both, it is in the general interest to consider how the effects of nationality which are averse to the countries in which foreign operations take place can be limited. Only then can chauvinism, protection and government interference ultimately be kept at bay.

The main board

An examination of the main board of most multinationals shows that in some countries foreign nationals are already being appointed to the top board. This is a highly significant development and a hopeful one, because *their presence will affect the process of decision making.* (If a country has a two-tier system foreign nationals ought ideally be present on both.)

It is clear however that this broadening of the main boards has scarcely begun, even in the United Kingdom, as even a cursory glance at the boards of most multinationals will show. Likewise Korn Ferry International report that in the USA only one corporation in eight with $1 billion sales or more has a foreign national on the board, and 10 years ago it was 2 in 8. There is no reason why, given the will, the situation should not be remedied rapidly in almost every country except Japan.[4] Such broadening implies better linguistic skills.

Japan poses a particular problem because its boards are virtually wholly executive, and in any case are instruments for formal approval rather than for the determination of policy. To get into the decision-making process of a Japanese company means integration in a way hitherto thought impossible and, by them, possibly undesirable, though there has recently been one much publicised appointment. It would in any case have long-term implications for recruitment, training and personnel policy, which are considered below.

Advisory boards

Some companies in various countries already employ the device of advisory boards on which foreign nationals often serve. These may not be what their name suggests, for some are in fact part of the decision making process. On the whole however most tend to meet infrequently and to provide broad general advice and particular contacts. Those who serve on them find the contacts they make useful. They may therefore be valuable, but it is doubtful whether they do much to mitigate the national bias in a company's decision-making process. That is not among their aims.

Subsidiary boards

Many international companies, either as a matter of policy or to meet local legal requirements, have a separate board for a subsidiary, and it may be mainly or wholly composed of local nationals. This device may often go with a quotation for the subsidiary's shares on the local stock exchange, or with local part ownership of the company, even if unquoted. The extent to which such a board is intended to ensure—and will in fact ensure—independence for a subsidiary will depend upon many circumstances such as local law, shareholdings, profitability, company policy and personalities. All variations exist, from a subsidiary board which is purely advisory and not particularly influential to the local company which is virtually independent and is run by its board accordingly. As a practical matter, PRO NED finds no unwillingness to serve here on the United Kingdom board of a subsidiary of a foreign company, provided it has a real function.

Personnel management

The other path to true internationalisation is to remove bias from personnel policies. This means approaching foreign establishments in the same spirit as indigenous ones, with the same rules for recruitment, and advancement and mobility: but it also means being prepared to ensure that appropriate overseas staff—ie those with both the potential and will—are properly trained in the relevant language(s). The alternative to such policies is a situation in which countries begin to feel that foreign enterprises impose upon their establishments a deliberate distinction between 'Spartans and Helots'. In countries where there are few foreign controlled businesses this may not matter, but the United Kingdom is particularly vulnerable as it (correctly) pursues a policy of welcoming inward investment for organic growth, and is (less happily) at the same time more open to hostile takeovers than any other European country. Nor is the size of its businesses such as to deter US purchasers, especially if the alignment of the currencies were ever to move sharply in favour of the dollar. It could become a matter of concern if eventually United Kingdom residents found career opportunities severely restricted.

The elements of a policy

As noted earlier, although consequences of nationality surface most emotionally in the case of a hostile takeover, like Nestlé/Rowntree, they may also be manifest in all other organisations where there are offshore operations, however acquired or built up. The presence of group headquarters *does* bring advantages to the home country and control *does* help home established suppliers of goods and services. There are also tax effects. We can already see that if the size and scale of a foreign operation warrants a high degree of delegation (and if there are no artificial restraints on the levels to which the employers can aspire), many of the most important consequences of nationality are mitigated. As it is inevitable that companies will seek to operate more internationally, it would be futile and counterproductive to try to prevent this. A far more constructive and useful approach would be to encourage them to become more truly international in character.

The public interest

It is clear from this analysis that there are indeed issues of the public interest which flow from the nationality of companies; the answer however in an increasingly international world, is not to retreat into nationalism but to make internationalism of companies more real and less 'ethnocentric'. To this end, the European Commission and governments generally might encourage companies of all nationalities which have substantial *operations* abroad:

(i) to broaden the *main* board by including foreign nationals so as to lessen the natural ethnocentric bias in decision making. It may also help if local boards are appointed for foreign subsidiaries when their size and strength warrant it, but only if enough authority is delegated to give them a real role;

(4) Ambrosetti have analysed (1989) a number of UK boards and produced the following table:

Per cent	Where the turnover is	Country of origin of directors on the main board
United Kingdom	46	88
North America	24	6
Mainland Europe	17	4
Rest of the world	13	2

(ii) to adopt even-handed personnel policies to make it possible for foreign nationals to aspire to posts at all levels anywhere in the company which home nationals can reach; and, as part of this,

(iii) to provide the necessary facilities for or access to training in language so as to demolish that barrier for those who have the will and capacity to advance.

Most of the arguments about foreign contested bids have concerned reciprocity, ie the extent to which quoted companies in other countries are protected. In reality such bids are a tiny fraction of the merger activity that occurs (which often involves unquoted companies anyway). It would be much better to concentrate on the issues listed above, that matter in all mergers for all kinds of company. Reciprocity is a subject of valid concern but extremely difficult to tackle because the protection foreign companies enjoy owes more to the attitudes of their shareholders and bankers (sometimes 'inspired' by the governments) than anything else. The troublesome asymmetry derives in part at least from shareholders (including the institutions and banks) in many countries feeling they have a right (and even a duty) to refuse an offer in a contested bid, whereas as we have seen, our institutional shareholders feel themselves under an obligation to accept if the price is right. And underlying the difference is a basic divergence of view of the purpose of companies in society.

One weapon governments might use, which has not been debated, is to insist that if a *contested* bid is to be permitted, the board of the bidding company should include a reasonable proportion of non-nationals: this would address to some extent the real issues.

Competition

Officialdom is not expert in company structure, does not pretend to be and should not aspire to be. These are matters on which it is for management and bidders to propose and for shareholders to dispose. We have however already seen that most shareholders' judgement must be governed by their interests and only those. Is it just possible that there is a public interest in the company which needs attention which the shareholders are not obliged to take into consideration? Is the market producing effects which although pleasing to shareholders, are inflicting countervailing damage in the longer term?

If for example a takeover is proposed which may leave a company (or a substantial part of it) weakened so that it is markedly less well able to compete, has the state any interest? In the Goodman Fielder Wattie bid for Rank Hovis MacDougall, the Office of Fair Trading thought the point worth considering, but that was in the context that bread was virtually a duopoly already. A highly leveraged operation even in a more competitive environment for instance might mean a company having to rein in its expenditure on R&D or marketing or necessary new machinery, because of the strain on its cash flow. In a word, should the government, in policing competition policy (which everyone agrees is essential), include as a matter of course the longer-term threat to competition that might arise from a particular competitor being severely weakened? Companies of course become more or less well able to compete every day of the week according to their competence and external events: but takeovers are different. They are in a sense a gratuitous risk, the motivation for which may come from outside the company (and may be none the worse for that).

Logic demands that on such a premiss, takeovers should also be considered in relation to the predator as well as the target—and in the case of a 'friendly' merger, all the parties should be considered. It is arguable moreover that a complete study of each case would need to cover not only the financial implications but also the managerial consequences. (Indeed, in all paper transactions the immediate financial implications may be minimal.) And experience shows that the reason for the failure of many takeovers and mergers is likely to be as much managerial/cultural as it is financial. Coley and Reinton, writing in the *McKinsey Quarterly* in Spring 1988, said:

> 'We have looked closely at the value-creation performance over time of the largest companies in the United States and Britain and have compared in detail the 25 best and worst performing companies in each country. The best actively kept their core businesses healthy, were willing to return cash to their shareholders if they could not invest it prudently (19 of the 25 in the United States repurchased stock), redeployed assets through sale, spin-off, liquidation, or leveraged buyout and vigorously pursued internal growth.
>
> Twelve of the top 25 in America made acquisitions, but only three of them produced significant value for their shareholders. In Britain, the figure was somewhat higher, with two-thirds of the companies making significant acquisitions, and one-half of those having a material effect on corporate performance. Among the bottom 25, however, one-half in the United States and one-quarter in Britain made sizable acquisitions which turned out poorly enough to drag down the parents' long-term performance.
>
> ### A recipe for failure
>
> The sharp contrast between myth and reality in acquisitions prompted us to take an even closer look at how far (and with what success) the *Fortune* '250' companies and the top 150 in the *Financial Times* '500' had used acquisitions to enter new markets.
>
> Of the 116 merger program studies, 16% could not yet be judged a success or a failure—the measure of success being a company's ability to earn back its cost of capital or better on the funds invested in the program. By this standard, 23% were successful and 61% were not. More to the point, the larger the acquisitions and the greater the diversification, the smaller their likelihood of success.'

On one view, there is nothing significant in these figures. The market will work itself out. The recent sustained period of growth may have masked the perils of stretched financing; so be it. If companies fail someone will pick up the pieces and others will learn the lesson. Besides, no one sensible is going to finance such risky deals. We must assume that banks know their business, the buyers of junk bonds know theirs, the shareholders know theirs. They cannot all be wrong—at least for most of the time. Risk capital is what it says it is, so some losses are inevitable.

The sceptics say that in an extreme case this is tantamount to arguing that one can passively watch a Rolls Royce go downhill and over a cliff, because one can always sell the remains on the beach below for scrap: and it presupposes that all the other vehicles on that same downslope still have brakes in working order.

There is a delicate question of balance. Companies do not live for ever. They must take risks if they wish to grow and even to survive. Some failure is inevitable and even desirable for it implies that risks are being taken—which is absolutely essential. At what point, if at all, does the public interest require there to be any intervention in this process beyond that of market players themselves? It must be remembered that intervention can only follow examination and that examination itself affects the market process; and that with EEC legislation it is most probable that the right to intervene will be taken out of the hands of EEC national governments altogether for very big mergers/takeovers. It is also possible that the grounds for intervening may be very limited.

The 200 page Brancato report to a US Congressional Committee[5] views leveraged buyouts from every angle but reaches no firm conclusion. Yet a certain sense of unease remains. Would it make any substantive difference if a regime were in force which required all major mergers (not subject to EEC scrutiny) to be submitted to the Office of Fair Trading with the remit that they should be examined not only for their short-term *monopolistic* implications, but also for evidence that longer-term *competitiveness* were likely to be seriously impaired? A conjectural response is that few proposals would actually fail, if only because mergers/takeovers in future would be structured in such a way to make sure they did not. Would such a regime work for or against the public interest? It would slow up the process. It would deter some schemes, and cause others to be modified. Would the cost of this necessarily outweigh the gains?

Financial pollution

The other issue that may affect the public interest is the effects a takeover/merger may have beyond the company. The arguments about the employment effects in a particular location have been well rehearsed elsewhere: this paper concentrates on the financial effects, especially of highly leveraged bids.

The Brancato report concludes its telling section on the deleterious effect of LBOs on the US bond market with the following warning:

> 'There can be no doubt that the current restructuring is altering the corporate landscape and the balance of power between certain institutional investors, pools of investors, shareholders, bondholders, management and employees. Whether these changes will lead to a massive realignment of capital which will ultimately be more efficient or whether they will produce externalities and erode confidence in capital markets and our industrial base remains to be seen.'

Well before the Brancato report, the US Federal Reserve decided it was taking no chances and told its inspectors to keep a careful eye on the size and quality of banks' exposure to LBO debts. The case has not yet arisen in the United Kingdom but would no doubt evoke a similar response.

Tackling the problem is rather like third world debt. When originally incurred each single transaction appeared tolerable and not to be cause for concern. Looking back we can now see that it was the cumulative effect which produced the danger. Even with the benefit of hindsight it is difficult to see the precise point at which restraint should have been imposed, how, and by whom. So it is with LBO lending. The only differences perhaps are that the LBO sums may already be greater and the spread of banks wider. It is widely supposed that syndication of loans includes massive participation by banks from countries which do not tolerate contested takeovers in their own domains. The whole field is beset by irony—like the willingness of some conglomerates to join in the financing of the dismemberment of others.

As far as the United Kingdom is concerned, at the time of writing (autumn, 1989) the risk of financial pollution as defined above seems small, and the public interest seems to demand no more than that the authorities remain alert to the dangers if big accumulations of LBO debt build up.

As to 'junk' bonds, the picturesque name seems to have clouded realism. Bonds always have and always will carry a degree of risk and the level of interest reflects this. That high yielding bonds were necessary to finance takeovers and LBOs tells its own story. In the USA the early issues turned out to be much less risky than their coupons suggested, and the holders prospered. This created a market opportunity for the issue of bonds in which risk and reward were less well matched—a greater danger of default and yet a lower interest premium. The consequences are beginning to be manifest in the USA; increasing defaults and diminishing liquidity, both of which spill over into the rest of the bond market—a different and general kind of financial pollution (as distinct from the specific problems which can arise for existing bond holders when high yielding bonds are issued subsequently as part of an LBO transaction). The lesson is clear, basic and old, and as true in London as in New York (though we have not yet had a problem to face). Match risk to reward and never ignore threats to liquidity.

(5) 101st Congress, 1st Session: Committee Print 101–K. 'Leveraged buyouts and the pot of gold: 1989 update.' A Report prepared for the use of the sub-committee on Oversight and Investigations of the Committee on Energy and Commerce, US House of Representatives. July 1989.

Part VI
Conclusions

It begins to look as if the model of the Joint Stock Company has stood the test of time, but is beginning to show its age. Events have moved on. Boards have become dominated by management. Shareholders, the majority of whom act as or for trustees, have for the most part withdrawn from playing actively even the limited part the Companies Acts gave them.

It has been the contention of these papers that the public interest would be better served (and companies would in the long run perform better), if:

(i) It became *mandatory* for the boards of major plcs to have a minimum proportion of independent directors but without any formal differentiation of duties.

(ii) The major institutions were to take the lead in marshalling the remainder in such a way as to ensure effective dialogue with companies and where necessary effective action to strengthen the board.

(iii) The pressures on instititional shareholders for ever shorter term performance were mitigated.

(iv) Private shareholders too—who will include those encouraged by the government's sponsorship of wider share ownership—were also to have some means of assistance for expressing an active interest.

(v) The debate on the nationality of companies were to focus on the issues of decision-making, board membership and unfettered careers which are the ones that matter most.

(vi) In total management buyouts the shareholders were given much better information and more time to consider it.

(vii) The idea was examined that all major mergers should be examined by the OFT/MMC for the longer-term effects of financial debilitation (other than those caught by the EEC).

(viii) Vigilance is maintained on the threat of financial pollution if many massive highly leveraged take-overs occur.

(ix) Shareholders had more to say when companies set about diversifying.

(x) Considerations were given to other kinds of grouping with the Japanese Keiretsu not as a model but as a broad indication of a different kind of approach.

The joker in the pack

As was stated at the very beginning the viewpoint from which these papers were written was the need for the success of United Kingdom industry. If our market system and our company structure appear to work well and (subject to the suggestions listed above), to serve the public interest, the relatively greater success of our competitors must be ascribed to something else—training and education perhaps, better union structures, and so forth. This must be so since by and large our western competitors have market systems too—not a single one of them has a dirigiste, centrally controlled, corporatist system.

Is it just possible however that by feeding different assumptions into their model of the market system (whether they are theoretically 'right' or 'wrong' in economic terms), they can put themselves into an advantageous competitive position? If, for instance, firm A has to compete in a market with firm B, and one is under pressure to achieve payback and profitability in half the time of the other, which is more likely to win market share and—ultimately—be more profitable? Is there a rule of investing that patient money will invariably beat impatient money? In the western model the money continuously flows towards ever shorter payback projects. But some markets are not like that. Is that why we are being edged out of so many?

Again, it comes back to the shareholders. Our competitors know their economic textbooks just as well as we do. It is just that their shareholders, and other providers of finance, are not in so much of a hurry. 'VOICE' produces confidence and confidence begets patience—much easier in countries in which more virtue attaches to it. Contrast our world in which we hear so much about enhancing shareholders' *immediate* values as a sound rationale for takeovers.

Is there just the slightest possibility, in other words, that our market system, so excellent when viewed in isolation, may be put at a disadvantage in international competition by those who have superior linkages and lines of accountability within it, and a greater sense of patience?

Bank of England Discussion Papers

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1-5, 8, 11-14, 16-17, 19-22	*These papers are now out of print, but photocopies can be obtained from University Microfilms International (see below).*	
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