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German takeover barriers

Obstacles to foreigners are nothing but a myth

By Dr Hans-Jochen Otto

A widely shared attitude exists among European mergers and acquisitions specialists that corporate Germany can defend itself against international M&A activities, and in particular against unsolicited takeovers.

This is supposedly accomplished through irresistible structural obstacles and a corporate culture dominated by the big German banks thought to be hostile to most Anglo-American financial innovations of the last decade. This thesis was outlined in a magazine article illustrated with a picture of German First World War air forces, and the caption: "Defending fortress Germany from the M&A raiders doesn't require much effort. The structural obstacles preventing fully-fledged market activity remain intact and are likely to stay that way for the foreseeable future."

This concept of the impenetrable German capital markets is ill-founded and risks becoming a self-fulfilling prophecy. A look at the argument shows up its fallacies.

Voting rights limitations, introduced by many large German corporations, restrict the voting powers of single shareholders to, for instance, 5 per cent regardless of the size of their stake. This forms the most obvious impediment to unwelcome bids. Yet is this really effective? The bid may be made contingent on shareholders abolishing such a voting rights clause in the corporation's by-laws. Such a motion can be put to the vote by the bidder if he or she has already acquired shares to the nominal value of DM1m.

Little doubt remains that shareholders would vote in favour of such a change in the by-laws if the bidder offers them an attractive premium on the share price.

Another tactic which gets around the voting rights restrictions is the pooling of votes by a group of (non-related) shareholders working together in the takeover, as is the case in the attempted takeover of the tyre maker Continental by Pirelli. In addition, private shareholder organisations backed by prominent politicians have recently filed motions to delete voting rights clauses at the annual meetings of several large German corporations. In the case of Continental, they were nearly successful (missing only 1 per cent of the votes) even though there was no tender offer imminent. Such efforts will continue and have even been approved by some big German banks.

Another mythical obstacle to takeover activities is the German two-tier board system which allegedly makes it difficult, if not impossible, for bidders to install their own management after having acquired a majority share. The common belief is that, according to existing legal provisions, a 75 per cent majority is required to oust the supervisory board which has exclusive authority for appointing and replacing the board of management. This assumption is grossly erroneous – the by-laws of nearly all German corporations have been modified to allow a simple majority of the present votes to be sufficient.

Takeover bids are made even simpler because German law, unlike British or French law, allows partial bids, thereby ensuring that financing requirements for mounting a bid can be kept relatively low. Finally, the requirement under German labour law for half the board members to be elected by employees, another alleged barrier to takeover, does not obstruct a change in management control; in a dispute with supervisory board members elected by the employees, the presiding board member elected by the shareholders has the decisive vote.

Perhaps the greatest mystique surrounds the alleged powers of the big German banks which are believed to be capable of fending off any unwelcome takeover bid for a German blue chip corporation. Yet German banks are normally not important stakeholders. Their proxy powers relate to their role as depositories and may only be exercised in support of resolutions backing incumbent management unless the private shareholder-depositors instruct the bank otherwise. Such specific shareholders' instructions would be expected if an attractive tender offer was made which would allow shareholders to realise the value of their shares.

In addition, the banks as depositories are obliged to send complete offer documents to all shareholder-depositors. For these reasons the banks' influence is valid under "normal" circumstances but wanes significantly if the usually dormant private shareholders are roused by the chance to make a substantial and, moreover, tax-free capital gain by accepting the bidder's offer.

So what remains of fortress Germany's takeover barriers? Is it an alien corporate culture that intimidates foreign would-be acquirers? Mr Helmut Loehr, a management board member of Bayer and by no means an enthusiast of hostile takeovers, has stressed the positive aspects of Anglo-American-style takeovers and buy-outs in its creation of shareholder value. He expects substantive corporate restructuring activity in Germany soon.

Deutsche Bank's acquisition of Morgan Grenfell certainly demonstrates acceptance of the Anglo-Saxon financial culture. Moreover, all leading German banks have established special corporate finance subsidiaries for buy-out and venture capital purposes and are increasingly engaging in such transactions. The argument can no longer be advanced that buy-outs are acceptable only if targets are restricted to non-quoted medium-sized companies.

Finally, since the combined Siemens/GEC hostile takeover of Plessey, any British company certainly has the best arguments on its side should it one day decide to invest in a German blue chip without asking the board for permission.

Could it be that the most daunting obstacle facing foreign M&A practitioners is quite simply their own allegiance to a self-perpetuating myth? It is clearly more realistic to recognise that the German market remains one of the most liberal and least regulated of the western world.

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