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## The rethink about the market for corporate control in United Kingdom

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**Abstract:** The market for corporate control is a market-based mechanism, it plays an important role in corporate governance. It will discuss the history of the market for corporate control and relevant takeover regulations in UK. It shows that the attitude of the UK government towards takeover has changed dramatically because of the market for corporate control, and the government may trust and rely on it excessively. However, numerous potential issues of the market for corporate control may be ignored by the British government and shareholders. Firstly, it may not maximize shareholders' value well in practice. Besides, it also may not optimize resource allocation well in UK. Finally, it may ignore the interests of employees, and they still could not get enough protection. Above problems request the UK government to take more feasible measures to regulate takeovers, and fill the loopholes of the market for corporate control, otherwise, it will hinder the healthy development of British economy. Finally, it suggests the UK government to take measures from three aspects, more eligible bidders, more eligible targets and build a rational takeover process.

**Keywords:** market for corporate control; takeover; shareholder; economy

### 1. Introduction

The theory of the market for corporate control was firstly identified and labelled by Manne in 1965 [1]. According to her opinion, the unsuccessful and inefficient management of corporates will be reflected in the stock market, which means that there is a high positive correlation between the market price of shares of companies and corporate managerial efficiency. Therefore, if the managements are inattentive or incompetent, the profits of company will grow down, it will cause reduction of the dividends to shareholders. Accordingly, shareholders may loss investment confidence, and the stock market will realize this situation, the value of shares of this company will depreciate, therefore, the stock price of the company will decline. Afterwards, this company will be the target of hostile takeover of other potential bidder companies who think that they can manage the company more efficiently and create more wealth. This mechanism has been seen as an effective mean that will benefit the corporate governance from two aspects, on the one hand, it will be helpful to achieve the aim of maximizing shareholder value. Because a successful hostile takeover means that the past managements will be replaced, so it will force the managements to be more concerned about the interests of shareholders, they have to work more efficiently to keep a high stock price. On the other hand, this theory believes that the control of corporates has moved to the hands of people who values it more highly, the

management of the target company will be improved. The bidder company can get high return by changing the management and using the advantage of synergy in the future. According to Weston and Copeland, synergy is that the value of two companies that are combined will be higher than a simple sum of market value of the separate individual companies [2]. In 1984, John Coffee held that, "The claim that hostile takeovers generate a disciplinary force that constrains managerial behaviour cannot seriously be disputed." [3] In short, in this theory, the hostile takeover will promote the benign development of corporate governance.

From above perspective, the market for corporate control seems to solve a problem that has plagued people for a long time, how shareholders can assure that management will pursue interests of shareholders once they invest funds. According to the agency theory, shareholders of corporation are principals who provide capital to build the company, and managers are agents who are responsible for the daily operation and management of the company [4]. Therefore, the control and the ownership of corporation are separated, it means that managers may manage the companies by acting in their own interests but not in the interests of the shareholders. However, it was shown in the research of Berle and Means in 1932, as ownership shares became more and more fragmented, shareholders' control of management was declining [5]. On the one hand, it is really difficult for widely dispersed shareholders to do collective-action to prevent mismanagement. On the other hand, the "free rider" problem and the high cost to investigate cause that dispersed and small shareholders have not enough effective measures to actively supervise management [6]. Therefore, the contradiction between shareholders and management became a tricky problem in corporate governance at that time. However, the market for corporate control bring hope to people.

## **2. An historic overview of the regulation for hostile takeovers in UK**

In UK, hostile takeovers started in the early 1950s, but the attitude of authorities towards takeover was not as friendly as now. They regarded it as a threat to economic policy, which might be out of speculative purposes [7]. Therefore, after the fierce bids for the control of the Savoy Hotel in 1953, in order to curtail this situation, the government restricted takeover funds for bidders [8]. Therefore, at that time, the UK government could not realize the effect of the market for corporate control. However, a turn for the better appeared in the late 1950s, when the second wave of bids began. The authority relaxed the lending restriction, the government encouraged hostile bid for British Aluminum, subsequently, the financial institution's attitude towards hostile bids also had changed [9]. People seemed to realize that the hostile takeovers were beneficial to the UK economy under the correct regulation. In 1959, the Governor of the Bank of England even organized a conference to discuss how to set up a Code of Conduct to regulate takeover [10]. There had also been calls for a special statutory body to oversee takeovers. These proposals came to true later, the drafting committee held the meeting in October 1967, and drew up a draft "Code". After the amendments and approval by all the associations, the "Code" was published and came into force eventually on 27th March 1968 [11]. In the meantime, the "Panel" was established to issue and administer the City Code and give advice on its application [12]. The most important provision introduced by the City Code was the Rule 21, which prohibited the managements of the target company from taking any measures to frustrate the offer without general meeting approval, once it became aware of a bid. Therefore, the UK government accepted the market for corporate control, and it became the main justification to allow takeovers and prevent directors from frustrating them. The policy statement contained in the 1988 White Paper serves explained that: "A

*particular advantage of avoiding government intervention as much as possible in the market for productive assets is that .... the threat of takeover has a salutary effect on the incumbent managements of public companies. They should be under the discipline of having to demonstrate to their shareholders that they are running the company as efficiently as possible. Any government action which places obstacles in the way of takeovers weakens this discipline. There needs to be a strong case for government intervention to prevent a takeover if this advantage of non-intervention is to be set aside.*" [13] Because of this policy stance, during the 1980s, the UK was the best place where companies make hostile takeovers, the policy promoted the quick development of the hostile takeovers in UK [14].

Besides, the takeover regulations in UK may be looser than other countries. In the US, there is also a free market economy like the UK. However, unlike UK, after the explosion of takeover activity 30 years ago, the US authority introduced anti-takeover statutes, the US courts support defenses including the 'poison pills' [15]. The study shows that the state of Delaware has become a popular place for American companies to incorporate, because the poison pills is upheld in the courts [16]. In Europe, the ownership of company is more concentrated, which causes that the regulations of hostile takeover are stricter. In Germany, a famous case, the takeover of Mannesmann by Vodafone, has led to the introduction of the WpÜG takeover law [17], an important point is that the takeover is not self-regulatory. It means that takeovers can be challenged in court. Besides, the two-tier board structure can protect German companies, it means that supervisory boards can have great influence to discourage takeovers. Supervisory boards are formed by employees and former directors. Therefore, their interests can get good protection. In France, takeover activity is discouraged by the multiple or weighted voting. In 2014, France authority has published the law to boom the real economy again, the Florange Act. According to the new regulation, the law will automatically attribute double voting rights for shareholders who hold the share at least two years [18]. It is useful to limit the hostile takeovers.

It should be admitted that the market for corporate control has great significance in UK. In UK, the main conflict in corporate governance is between strong managers and widely dispersed and weak shareholders. Because the shareholders in UK are more dispersed than other countries [19]. The market for corporate control mainly focuses on the interests of shareholders. At least, in the theory, it will provide protection for shareholders, it will protect the freedom of shareholders to sell their shares to others when they are not satisfied with the performance of management. From the perspective, at that time, it may be the best choice for UK that the government regulated takeovers loosely, for example, the law prohibits the managements of the target company from frustrating the hostile takeover offer. It not only is helpful to alleviate the above basic contradiction between shareholders and managers, but also avoids a lot of litigation caused by management taking frustrating measures. It will increase the success rate of hostile takeovers and save judicial resources [20]. Especially, at that time, many other theories, such as the efficient markets hypothesis, the maximum of shareholders value, the synergy theory, seem to prove that the market for corporate control will work well, and it will achieve the right aim—maximizing shareholders value and protecting free market. However, the British government may only realize the positive impacts of the market for corporate control in theory, but ignore many potential issues in practice.

### **3. The problems of the market for corporate control in UK**

#### **A. Not maximize shareholders' value well**

The first problem is that the market for corporate control in UK may not maximize shareholders' value well in practice. There are more and more studies and researches showing that the bidders in a hostile takeover cannot get appropriate economic returns. The study of Chris Parkinson about the effect of hostile bids on shareholder wealth in UK showed that shareholders of bidder companies receive gains much lower than the shareholders of target company [21]. There was a study that focus on research about returns to 90 bidder firms involved in hostile takeovers in the UK at the announcement of the offer. The results show that bidders' shareholders in hostile takeovers suffer losses at the announcement of the offer. In addition, bidder shareholders had paid expensive premium that was much higher than market price. The losses of shareholders of bidder were very difficult to get satisfactory compensation in the future [22]. To make matters worse, some bidders even suffer the risk of bankruptcy, the Royal Bank of Scotland did a hostile takeover of ABN-AMRO in 2007. However, the research showed that RBS did over-paid in the takeover. The management of RBS also underestimated the challenge of managing the risks arising from the takeover. Finally, this takeover caused the collapse of RBS [23]. This phenomenon was also found in US, in research of Sirower, he found that the returns of bidder shareholders were negative during the 1970s and 1980s in US. The data shows that the average returns to bidder companies were significantly negative, there were only approximately 35% of hostile takeovers having positive stock market returns [24].

What prevent the bidder's shareholders to gain appropriate gains? One viewpoint is that the bidder's management may initiate a hostile takeover for improper purposes. They are not in order to create more benefits for the company's shareholders, but for the purpose of expanding the size of the company. The deeper aim is to keep their company from becoming a target of other companies. There is an incentive to increase scale, because it becomes more difficult and more expensive for potential bidders to get enough shares and control the company. Malatesta firstly held that "managers are encouraged to expand their companies at the expense of shareholders" [25]. Subsequently, more and more scholars began studying this issue, in study of Cosh, in order to secure their position and prevent the company from being the target of hostile takeover, managers might mount hostile takeover bid for other companies [26]. Harris also held that the threat of hostile takeover could impel management to mount hostile takeover [27].

Another possible reason may be that management overestimate their own management skills and ability. In a successful hostile takeover, the target company's share price plus the premium offered by the bidder should be lower than the estimated value for the target company. In this case, the interests of the shareholders of the bidding company can be protected. However, according to the 'Hubris Hypothesis' of Roll, the management of bidder company may overestimate their own management ability, they may be over-optimistic about the future of target. As result, they may overvalue the target company, and pay exorbitant premiums for target shareholders, but they cannot complete the target enterprise's integration successfully [28]. Eventually, it causes that the bidder shareholders have to suffer the losses. Therefore, in the market for corporate control, the interests of shareholders of bidder company are not maximized in practice.

However, some people may hold that though shareholders of bidder company may suffer losses, but the sacrifice of a minority shareholder of bidder companies will create the threat of hostile takeover

to all management of companies, and it will force them to defend the interests of all shareholders. Comparing the advantages and disadvantages, it still maximizes shareholder value overall. However, the effect of threat of hostile takeover may be exaggerated. As mentioned above, the threat of hostile takeover is the origin to force managements to act in shareholders' interests. However, from this paper, the following issues need to be discussed. (1) Are there any negative impacts of the threat of hostile takeover? (2) Does the threat of takeover really work well now in UK?

There are negative impacts of the threat of hostile takeover, which may damage the interests of shareholders. At first, this paper argues that there is a problem that may be ignored by UK government, is the threat of takeover fair to all management of companies in UK? Cosh, Hughes and Singh had found that "a large relatively unprofitable company will have a much greater chance of being immune from takeover than a much more profitable but smaller company." [29] Therefore, there is an imbalance, the management bear greatly different threat who come from these companies of different size. This imbalance may pose a hidden danger to corporate governance. The management of large companies enjoy a more secure position because they are under very little threat of takeover. This is understandable, because large companies issue more shares and have higher share prices than smaller ones, so it is more difficult for bidders to acquire enough shares to gain control of the company. Then the market for corporate control might fail in the management of large companies. It is difficult for the management of large corporations to be supervised well by the threat of hostile takeovers, so the interests of the shareholders of these corporations are probably not maximized. More significantly, a large company tends to have more shareholders.

However, for management of small companies, they have to face more hostile takeovers, in UK, they are not able to do defensive measures, which put them in a more difficult situation. This management may work very efficiently, and also protect interests of shareholders well, but the extremely high premium still prompts shareholders to sell their shares to bidders. This may lead to mistrust between management and shareholders, and the management of a small company has to look out for their own interests, because even when they work for the interests of the whole company, and protect the interests of shareholders well, but shareholders will still ruthlessly abandon management when they receive a satisfactory premium. In fact, what shareholders really care is the satisfactory return of investment, because improving the value of share is main objective of investors [30]. In British law, management are prohibited from acting upon a hostile takeover, but they will be prepared in advance. The only other way for managers to consolidate their control of the company is to expand the company so that it can issue more shares. In addition, the company may be eager to raise the stock price in a relatively short period of time. This would ostensibly maximize shareholder value. In the long run, however, this can cause the short-termism. In there, long-term and short-termism debate should be discussed. Ideally, managers should take measures to achieve the long-term value of company [31]. However, if the company wants to survive, short-term results also need to be achieved [32]. Therefore, it is important for management to keep a balance between the long term and the short term. As David and Laurie said, there are two possibilities, one possibility is that the short-term actions can cause optimal long-term consequences. Management myopia, or the inability to assess the long term is reasonable in this situation. However, another possibility is that short-term actions may be taken by management at the expense of the long term, and it will undermine the development of firm [33]. Therefore, for these companies, in order to increase the share price and avoid the hostile takeovers, taking short term measures could be the second possibility, it will ultimately harm the shareholders'

value. In addition, it could tempt management to take over other companies to expand scale more easily in shorter time, but not by increasing the investment in R & D and expand the production scale.

Besides, it is also important to consider whether the threat of hostile takeover still work efficiently if hostile takeovers are becoming less and less in UK. The study shows that six hostile bids were announced during 2017 in UK [34], but only three hostile bids were announced during 2018 [35], there were also only three hostile bids in 2019 [36], and all of them failed. Finally, there was no hostile takeover offers announced in 2020 [37]. Therefore, the data shows a downward trend of hostile takeovers in UK. Some people may confidently believe that it can show the positive influence of this theory. Because of the threat of hostile takeover, management works more efficiently, so that there are not enough appropriate targets. However, this paper holds that there may be other possible reasons, the high risk and low return (even losses) may cause less hostile takeovers. According to the normal logic, because of the profit-seeking nature of capital, if an investment is very difficult to bring investor satisfactory returns, especially, making a hostile takeover is a high risky investment behavior, high risk but low returns will cause them to lack motivation to make hostile takeover. Accordingly, the number of hostile takeovers should continue to decrease, and the less hostile takeovers will lead to a reduction of the takeover threat to corporate management. In fact, corporate management may also realize this situation. If management does not feel threat of hostile takeovers, there may a failure of the market for corporate control. It may also imply that the inefficient management may be likely to survive under a fragile threat. Therefore, the threat of the market for corporate control may not play the role to force managements to act for interests of shareholders in practice. Therefore, the market needs more profitable takeovers, which can make the management feel the threat. Another possible reason may be that the great majority of managements are more or less embracing the Short Termism, this will lead to a false boom in the stock market in UK, so that the bidders who really want to be more successful by the takeover cannot find an appropriate target, but other bidders with improper motives may not really care about the share price. As a result, there is a vicious circle in the hostile takeovers of UK.

Finally, this paper also researches where the management goes after they have been replaced by the new management. This question may be ignored by people, because people believe that no management wants to be replaced. Therefore, the threat of hostile takeovers can force management to work for the interests of shareholders. However, in fact, the situation may be different if the management can easily get another job and even a better job after they have been replaced by the new management. Because research shows that there are 385 hostile takeovers in UK between 1985 and 2018 [38], it is difficult to research whether all of these managements of these 385 target companies can easily get another job. Therefore, this paper will research some famous and typical cases, such as Kraft's takeover of Cadbury, Softbank's takeover of ARM, Allied' takeover of G4S. For example, Roger Carr became the Chairman of Cadbury plc in June 2008. However, he resigned on 3 February 2010, because the company was controlled by Kraft Foods with a hostile takeover. However, he found another job quickly, he became the president of the CBI in 2011 [39]. Besides, Carr joined the Board of BAE Systems as the chairman. In Softbank's takeover of ARM, Stuart Chambers previously served as chairman of ARM Holdings plc until 2016 when Softbank did a hostile takeover to control ARM. However, after Stuart left the ARM, he immediately joined the board of Travis Perkins plc as a non-executive director in 2017 and eventually became the chairman [40]. In the latest case, Allied' takeover of G4S, John Patrick Connolly served as the chairman of G4S from January 2012 until May 2021, when G4S shareholders approved the takeover by Allied. However, in fact, Connolly still served as the

chairman of Amec Foster Wheeler [41], besides, he also founded Cogital by himself [42]. Therefore, the negative impact of a hostile takeover on him may not be large. Although above three examples cannot prove that all of these managements of target companies can easily get another job or just get limited negative impact in UK, it may still show that the threat of hostile takeover in UK is limited in practice. This paper holds that management may not really worry about losing the job in a hostile takeover, in fact, they may care about their reputation more. Because a good reputation means a lot for managers and directors in the management industry, it will affect their working prospects directly in the future. However, above examples may show that the relationship between the reputation of managements and the hostile takeover may be not enough close in UK. The market lacks specific information about the management of target company in takeover, it may be not clear enough whether the management really perform incompetently in corporate company. Logically, if management is ineffective or they do not protect shareholders' interests well, then their reputation should suffer after they leave the company because of the takeover. Therefore, they cannot find another job so quickly and so easily. If these managers and directors who are replaced do not have proper punishment, losing a job will only mean changing jobs for them, therefore, the threat of a hostile takeover would be greatly diminished, and the interests of shareholders may not be protected well. Besides, above situation may also cause a problem, if the management is the reason why the target company is undervalued, though they are replaced by the takeover, they will have the risk to harm other shareholders of other companies, if they find another job very easily.

The third problem is that the market for corporate control may led shareholders to have excessive dependency on it. The participation of shareholder is an irreplaceable part of corporate governance. However, in UK, the shareholders trust and rely on the market for corporate control extremely, and may ignore their own role in corporate governance. In their opinion, the market for corporate control can force management to work efficiently and protect shareholder's interests well. As Patrick Diamond pointed out that the British shareholders are enjoying unusual levels of power, because they have ability to push through hostile takeovers, even in the USA, shareholders cannot have such powerful ability [43]. As a result, the British shareholders may think that the only thing they should do is waiting for the right moment to sell their shares. They need not to do anything to supervise management, because the stock market and the potential bidders have done this work under the market for corporate control, and the stock market and the potential bidders even do this job much better than themselves. There is a strong possibility that British shareholders will have such a mistaken awareness. It can help them to save a lot of money costs and time costs in monitoring shareholders. Besides, even though the management of company do not work efficiently and not maximize shareholders value, there may be other bidders buying their share in a high price, and they can still get satisfied premium. In fact, in UK, shareholders have been less motivated to participate in corporate governance, institutional investors don't have much enthusiasm to participate in corporate governance [44]. In Myners Report, he found that many fund and asset managers do not want to engage in corporate governance [45]. Lord Myners also stated that hedge funds have become ownerless corporates, shareholders did not monitor the performance of managers. With the effect of the market for corporate control, shareholders believe that relying on hostile takeovers and selling shares will be the better choice. As a result, those shareholders are reluctant to participate in corporate governance, the situation is becoming worse and worse.

Furthermore, the regulators in UK also highly trust the market for corporate control, and have not taken specific and feasible measures to promote shareholders to perform duties in corporate governance. For example, in UK, Although Myners recommended government to take more regulatory intervention to promote Institutional Shareholders to engage in corporate governance [46]. The UK government did not take any regulatory intervention, because government confidently thought that the market can solve this problem well by themselves—Institutional Shareholders Committee (ISC) published Statement of Principles at that time [47]. To some extent, this outcome may be caused by the effect of market for corporate control. As a result, UK regulators may have exacerbated this situation where shareholder divorce themselves from corporate governance, then it may lead to a chronic lack of effective shareholder oversight to management. Based on the above discussions, the interests of bidder shareholders may be not maximized, in some cases, it may even harm shareholders value.

### **B. Not optimize resource allocation well**

In the second part, this paper will discuss that the market for corporate control may not optimize resource allocation well in practice in UK. As mentioned above, this theory believes that the control of companies will move to the hands of people who values it more highly, the new management is more competent, so the management level of the target company will be improved, this company will also create more value. These people hold that takeovers represent a necessary external discipline, it means that inferior management will be displaced by other management with better management skills. Jensen said that: *"The market for corporate control is creating large benefits for shareholders and for the economy as a whole. The corporate control market generates these gains by loosening control over vast amounts of resources and enabling them to move more quickly to their highest-valued use. This is a healthy market in operation, both on the takeover side and the divestiture side."*[48]

However, the reliability of this viewpoint is doubtful, this paper will discuss this problem from three aspects. At first, the market for corporate control assumes that the share price is a good indication of quality of management. It means that there is a high positive correlation between the market price of shares and corporate managerial efficiency [49]. This opinion has to rely on the efficient market, because the efficient market can show the management level by the share price. As Daniel said, "Efficient capital market theory implies that if a publicly traded company is poorly or less than optimally managed, the price of its securities will reflect this fact accurately and promptly." [50] Therefore, this point of view may get the support from the efficient markets hypothesis of Eugene F. Fama [51]. However, in fact, the efficient markets hypothesis is controversial, on the one hand, the market cannot always work well, the market failure should be considered. On the other hand, stock market is complex, the share price is not only affected by the management level. As Robert J. Shiller pointed in 'Market Volatility', public opinion or psychological factors may play an important role in share price [52]. It implies that the share price is affected by many factors beside the management efficiency. In 2003, Lynn Stout also held that "efficient market theory fails, in some fundamental respect, to capture the reality of securities markets." In her opinion, after people have experienced through the crash of 1987 and the technology stock bubble in 1990s, they should be suspicious about whether the share price can show the real value of companies [53]. Gort also pointed out that the current market price of shares is determined by trading at the margin, in his opinion, the secondary capital market and the market for corporate control should be distinguished. Therefore, people cannot get the 'true' valuation from the current market price. Although the share price can be seen as the 'true' valuation

under normal trading conditions, its reliability will be reduced significantly when there is "economic disturbance" [54]. In 2008, the banking crisis of UK could be also a good example to show the shortcomings of the efficient market hypothesis. After the crisis, Lord Turner reviewed and made recommendations about how to reform UK and international approaches to banking regulations. In March 2009 Turner Report was published, which pointed that some criticisms about the efficient markets hypothesis have got more and more effective support from theoretical and empirical arguments [55]. According to Behavioral economic theories, the markets are vulnerable to socio-psychological factors such as herding, noise, and bubbles. The conclusion of Turner Report holds that enough evidence can prove that there are pervasive and systemic biases in the marketplace. Regulators should recognize the truth that "all liquid traded markets are capable of acting irrationally, and can be susceptible to self-reinforcing herd and momentum effects." [56] Besides, some scholars also put forward that derivatives trading may show the weakness of the efficient market hypothesis [57]. A significant basis of the efficient market hypothesis is that an even flow of information through to the market. However, the experience in practice has shown that derivative trading can lead to information asymmetries and ultimately price inefficiencies in the marketplace. The asymmetry exists between informed contracts for difference holders and uninformed investors. The financial system is becoming more and more complex.

Based above discussion, the correlation between the market price of shares and corporate managerial efficiency may be not always high positive in all time. Therefore, the stock market and the share price may release the wrong signal to bidders, because of the market failure and the complexity of stock market, there are not only two cases between share price and efficiency of management. The share price of company that has low efficient management will be low, the share price of company that has high efficient management will be high. There are still other possibilities, for example, the share price of company that has high efficient management may be low, it may cause that the management of target company with high efficiency may be replaced. This will not optimize resource allocation well. However, the share price of company that has low efficient management may be high, but this company may not the target of bidders, therefore, it will also not optimize resource allocation well.

Besides, in the viewpoint of supporters of the theory, the motive of hostile takeover is pure, high-quality management just want to replace inefficient management, through more efficient work and more reasonable business plan to create more profits. However, that may be not true. The motives for hostile takeovers are complex, and they are good at disguising their true intentions. The management of the bidder company, for example, may not want to make a profit from a hostile takeover, but just want to increase the size of the company and reduce the risk that they may be controlled by other bidders by a hostile takeover. In this case, they will not improve the management of the bidder company. In addition, in order to increase the scale of company, many bidders will try to control target companies in other industry. In the research of Shamsheer Mohamad and Nassir in 1991, it found that, in UK, "takeovers are more frequent between firms in seemingly unrelated or loosely related businesses." [58] However, there may be potential problem, bidders may have no management experience in that industry. As a result, they may not have the ability to improve the management level of target company. On the contrary, it may reduce the level of management of the target company. Besides, a hostile takeover may also be aimed at eliminating a competitor or preventing the target company from being controlled by its competitors. After the takeover is completed, the target company may be marginalized, because the management of the target company is not the focus of the bidder. Finally, there are some managements

who do not know their own capacity, and even overestimate themselves, they will not optimize the allocation of resources.

Finally, these people who support the market for corporate control may not realize that there are other ways for new management to get profits, besides improving the management efficiency. Actually, many studies have shown that the new management prefer to increase share price by reducing research and development funds, making job reductions, cutting staff training and wages, selling assets and so on [59]. These measures are beneficial to cut the costs of company. By these methods, management can improve financial figures and increase share price returns in short time. Therefore, management will keep themselves in a safer situation, because shareholders will not feel disappointment about them [60]. However, as discussed above, these ways are short-termism, they cannot make sure the long-term healthy development of companies. In fact, the management may just seek to advocate swings in stock prices, but ignore to improve management and create new wealth of society. Therefore, in practice, the market for corporate control may not achieve the aim to optimize resource allocation.

Therefore, under the market for corporate control, by hostile takeovers, the control may not move to the people who value it more highly, but to the people who are more rapacious. The rapacity will cause the short-termism, to make matters worse, the short-termism of bidder's management has also affected the whole corporate governance in UK. In order to satisfy their shareholders and avoid hostile takeovers, other public companies could also prefer taking short-term measures. As Cosh, Hughes & Singh explained, they have shortened the corporate time horizon and raised the target rate of return on investments [61]. Therefore, this paper holds that these approaches do not actually improve resource utilization, because they do not scale up production or innovate through increased investment in research, then relying on innovation to increase productivity. In short, the new management mainly focus on how to save cost, but ignore how to create new value.

Finally, the UK government may connive the hostile takeover, the government trusts the market for corporate control excessively, though more and more negative impacts of hostile takeover have been pointed or found in practice. In fact, the British people may be paying for the price. Some researchers criticize that "decades of a non-interventionist approach by the UK government, combined with the narrowing of the public interest test have undermined the British business environment." [62] The study shows that "the UK's productivity slowdown appears to have been larger than in almost any other country." [63] In 2015, UK productivity was 19 percentage points below the rest of the G7 average [64]. Manufacturing output of UK also constantly goes down, the percentage of manufacturing output in GDP has gone down from 16.67% in 1990 to 8.39% in 2020 [65]. The manufacturing employment of UK also continues to fall down, the data shows that in the five years between 2011 and 2016, manufacturing jobs only grew by almost 5 per cent, but it declined 33 per cent between 2001 and 2011 [66]. Besides, in UK, manufacturing investment also has reduced constantly [67]. Simon Deakin held that the most important reason why the UK's productivity slowdown is the relatively high incidence of merger and acquisition activity in the UK [68]. For example, as discussed above, merger and acquisition activities, especially the hostile takeovers will spend a lot money in taking over target companies and expanding scale, then the weakness in manufacturing investment has reduced the quality of equipment employees. Dr. Cole held that "the prohibition of takeover defences in UK may be one of the reasons why productivity growth, often associated with higher levels of spending on research and development, is much lower in Britain than other nations" [69]. These data may show that the market for corporate control may not optimize resource allocation well in UK.

### **C. Not protect interests of employee well**

Finally, this paper argues that the market for corporate control may ignore interests of employee in UK, because its aim is to protect shareholders. However, the interests of employees cannot be ignored by the market for corporate control, they have contributed to the development of the company and their interests are closely related to social interests, such as employment issues. Actually, many people have stressed that the market for corporate control ignores interests of employee of target companies. As discussed above, after the hostile takeover, the new management may prefer to reduce cost by the reduction of employees' wages or benefits, and even layoffs. In the study of Denis, he found that after the takeovers, the employment of target companies had reduced 17 percent [70]. Another similar study also shows that, compare with friendly takeovers, hostile takeovers will cause larger decrease of employment [71]. In UK, the case of Cadbury and Kraft is good example to show the employment problems caused by hostile takeovers. After the takeover, the bidder, Kraft closed a factory of Cadbury at Somerdale, as a result, about 500 employees lost their jobs [72]. However, shareholders will not care about employee's difficult position, shareholders' interest is unaffected, and they even get benefits from the higher dividend and higher share price because of more cash flow of company. In the past, the market for corporate control assumes that the contracts between company and employee can completely protect interests of employees. However, in fact, though employees normally sign an expressed contract with company to protect their rights. There are also some implicit contracts between employees and the company, which can also influence employees' interest, because employees need more certainty about the unpredictable future. However, implicit contracts are different with expressed contracts, the implicit contract has no legal unbinding, therefore, implicit contracts can only be fulfilled by a trust, employees cannot ask the court to enforce this kind of contract. Obviously, the trust relationship is directly built between management and employees. It means that, for increasing shareholders' interest, implicit contracts will not be fulfilled after the new management replaces the past management. Shleifer and Summers pointed that hostile takeovers have provided the convenience for the bidders to breach the implicit contracts between companies and employees by setting up the new management team. The new controller will not admit the previous implicit contracts, because the people who make implicit contracts with employees are not them, they can arbitrarily renege on the promise and expectations established by previous management [73].

In order deal with this problem, the UK government has made some efforts. For example, in the Thirteenth Directive, some provisions were introduced to limit the negative impact of takeovers on employees [74]. Besides, after the case of Kraft, the Panel revised the City Code, one important aim is to ensure that greater account can be taken to protect these persons affected by takeovers, most notably employees of target company. The new regulation require offeror to provide disclosure of their intentions regarding the offeree company and its employees, such as the disclose plans for the offeree's employees, especially in areas such as layoffs [75]. Therefore, admittedly, there are some improvements in the provision of information to employees involved in hostile takeover. However, this paper holds that above measures may not really protect employees enough in practice. It is clearly that these new regulations still only protect employees' right to know the takeover. This paper suggests that, though the Code has done some revisions, there are still some areas which may lack effective employee rights to consultation. New regulations merely allow employees or their representatives to have the chance to express opinions, as for whether these opinions will be taken into account, it is uncertain. Because

shareholders have no formal obligation to consider these opinions, what they care about most is the premium. In the study of Michael Gold and Chris Rees, it shows that “Opinions were given in only 28 of the 1,077 firm offer proposals registered by the Takeover Panel (2.6%), involving a total of 42 separate opinions (3.9%), given multiple opinions in some cases.” [76] Therefore, in practice, only very few opinions have actually been given from 2006 to 2017, including the time after new regulations published. Besides, in the research, almost one third complain about lack of information. It implies that, on the one hand, many employees may lack the awareness to express opinions, and the company also not provide convenience for them to express opinions. On the other hand, though they express their opinions, these opinions may be not professional and useful. Besides, their opinions are less likely accepted by managements and shareholders, so that they lost their enthusiasm to express their opinions. A problem may be the lack of effective sanctions, so that the company can breach their promises easily, and they will not bear enough and effective sanctions. In short, a number of factors limit the ability of the new rules to protect employees’ interests in practice. Employees’ exercise of the right to know and give opinions has become formalism.

#### **4. The possible ways to change this situation**

##### **A. Eligible bidders**

A confusing phenomenon is why there are constant hostile takeovers in the UK, if it is hard to make bidders profitable. There are two possible reasons for this. One is that in the takeover, management does not take profit as its primary purpose. For example, the management does it for their own interests. Another possibility is that not all hostile bids have a negative return, so there are still bidders trying it. Therefore, how to prevent management from using hostile takeover to serve their own interests is the key problem. Therefore, are the management of the bidder subject to adequate supervision in the decision to make a hostile takeover? Can shareholders be involved in this decision? Are shareholders capable to give professional advice on hostile takeovers? These questions need to research.

In order to ensure bidders are eligible, improving the internal supervision is the first way. The law should correct the low participation of shareholders of bidder companies, when the management plans to make a hostile takeover. On the one hand, the law needs to force the shareholders to supervise the decision of management about the hostile takeover, but not leave this work to the market again. Some viewpoints hold that if the manager and directors of company cannot make a cautious decision about the takeover, it will be the next target company, so it can be corrected again by the mechanism [77]. However, this thought may be naive, the larger scale will increase the difficulty of firm to be taken over. Besides, it is uncertain whether the takeover will occur or not, it is also uncertain whether the next bidder is good or bad, people cannot shift the supervisory responsibility to an uncertain future. Though it needs to be admitted that encouraging shareholders to participate the corporate governance is a difficult work, as the share registers of UK companies become increasingly globalized and dispersed. However, there are still some major shareholders in companies, not all shares are held by small individual investors. Besides, in modern society, transportation and communication are also very convenient, financial institutions can do more in corporate governance. Therefore, the law can require that all hostile takeover should be passed by the shareholders. However, this process cannot be a formalism, because shareholders may be not very professional about the business strategy, such as the evaluation of target company. Therefore, the law can encourage shareholders to hire the professional

third party to provide suggestions. The relevant expenses can be taken by the company, otherwise the shareholders will lack enthusiasm. However, at present, the shareholders of bidder company just get the information provided by the management, who may not tell shareholders the whole truth. Therefore, the law should ensure that the bidder shareholders get more information and have their own independent judgment, rather than being a puppet of the management. Therefore, shareholders can prevent management from arbitrarily raising the premium for their own benefit, or prevent management from easily falling into the trick of 'Hubris Hypothesis'. Besides, the company management should provide the convenient conditions for shareholders. Management should maintain good communication with shareholders, especially when management offers a price to the target shareholder. Shareholders should be immediately notified when there is any increase in the price. If shareholders believe that the price is beyond the reasonable range, shareholders can call off the takeover. The study shows that if a bidder wants to control the target company by a hostile bid, then they have to get enough acceptances or win enough votes of target company shareholders during a meeting. During this period, there are only little communication between management and shareholders. When more than one company vies for a single target, in the long process, the managements usually will not ask investors' opinion until after they are defeated by the rival bidders [78]. Therefore, this situation should be changed.

The second way is improving the external supervision. In UK, the Panel on Takeovers and Mergers (the Panel) plays an important role in overseeing the hostile takeover. Panel is made up of the most authoritative and professional experts in the field of acquisition in UK. Some people usually think that the Panel will oversee every aspect of the takeover. However, in fact, it is a misunderstanding, the Panel will not check the rationality and feasibility of the hostile takeover in all aspects. Actually, the Panel is not concerned with the financial considerations of any deals, it also doesn't care about whether a good offer is being made or not. Its main aim is just to simply make sure everyone is treated fairly and that the process is transparent. For example, if a bidder gains control of more than 30% of the voting rights in a target company, then the bidder must make a cash offer to all other shareholders, besides the price should be equal to the highest paid price in the previous 12 months [79]. Otherwise, the Panel will not pass the takeover, it can protect these small shareholders of target company. Therefore, the Panel will not really consider whether the hostile takeover can bring satisfactory return to shareholders of bidder companies, the Panel will also not oversee whether the management may be utilizing the takeover for their own interests. Besides, the UK laws also seem to force the bidders to provide the higher price for target shareholders. The law also encourages the contested bids, because it will protect the target shareholders to get higher premium. However, the Panel never inform the bidders that they should stay rational. The Panel is professional, but it is unwilling to give any appropriate suggestions to bidders. Because the Panel may think that it is not their work, this is bidder's work. Besides, the market will force the bidders to make a prudent decision. However, as mentioned above, the management may not always make the right choice, because of improper aims, Hubris, or the market failure. This paper argues that this action may be not reasonable, the UK regulators should recognize that the higher premium may not mean the better outcome. Because the extremely high premium may imply that the management of bidders are squeezing their own shareholders, or the management of bidders will squeeze the stakeholders in the future, such as employees. In this situation, though all target shareholders get a satisfactory outcome, but the overall result is not good. Therefore, The Panel should conduct a more thorough and in-depth investigation into hostile takeovers, as a more responsible 'gatekeeper of takeover'. When the purchase price is obviously unreasonable, the Panel cannot keep quiet. If the price

is too low, the Panel should remind the target shareholders. If the price is over high, the Panel should also remind the bidder's management to make a prudent decision, and communicate with the bidder's shareholders.

Furthermore, the Panel also should consider more about the eventual outcome of the hostile takeover, but not just open the door for bidders. This paper holds that it may be feasible to ask the Panel to make a more comprehensive assessment about the specific performance of the bidder's management after takeover. If the bidder's management reneges on previous commitments, management needs to justify it. Otherwise, the management will be punished, which will also affect whether the company can make hostile takeovers again in the future. Through this restriction, it will prevent management from making false promises in order to gain the support of the Panel. Linking the results of previous takeover to the company's ability to make further takeovers in the future will force bidders' management to be more cautious. Because if the company fails to operate it properly, then it will be difficult for the company to make the next takeover. This threat may be more effective than the market threat for managers and directors who use hostile takeovers as a way of expanding a company to protect their own interests. Because after the takeover, if they do not strive to improve the level of management, or just take the short-termism measures, the company will be difficult to continue to expand further. Besides, it also prevents some managements repeatedly launching takeover.

Finally, this paper holds that it is necessary to establish a clear accountability system that can make clear the management's responsibility in takeover decisions and the subsequent management results. In simple words, if the management of bidder company cannot keep their promise to get satisfactory return to shareholders, they should take accountabilities. If the management of bidder company causes losses to the company's interests, they also should take accountabilities. In the viewpoint of this paper, in UK, there may be lack of an effective accountability system about takeover. The lack of accountability will greatly increase the probability that the management does not carefully perform duties in the takeover. The Royal Bank of Scotland (RBS) is a good example, in this case, though the management has made the wrong decision in the hostile takeover of ABN-AMRO, and it also caused the huge damage to company and shareholders. However, in this case, no any directors or managers were subject to individual liability [80]. According to the company law of UK, if directors do not perform duties, they can be enforced by shareholders by derivative litigation. However, in fact, the cases about civil enforcement against directors are few in the UK [81], in takeover field, the situation may be worse. Therefore, in UK, shareholders may not use this right well, on the one hand, the law should encourage shareholder to protect their interests through derivative litigation, and avoid management to make hostile takeover illegally or unreasonably. On the other hand, the UK regulators can establish a clear accountability system and promote the reform of the remuneration system. Making sure that the compensation of management should be linked with their actual performance after the takeover.

By using above ways, there will be more and more eligible bidders, who have the proper motivation and have the efficient and responsible management. It means that the bidder will do more thorough due diligence, and the premium will be more reasonable. The return of hostile takeover to bidder companies will raise in general, therefore, the interests of bidder shareholders can be protected. Furthermore, when the hostile takeover is really profitable, it will attract more and more profitable takeovers. Eventually, the threat of the hostile takeover will be strengthened in UK.

## **B. Eligible targets**

How to make sure that the target company is eligible? As discussed above that large but unprofitable companies have more possibility to avoid hostile takeover than the more profitable but smaller company. Therefore, the market for corporate control should be reformed to avoid that the smaller but better management companies are easily taken over by other larger companies but with worse management. This paper holds that it is necessary to give the management the appropriate power to defend the hostile takeover. Some people suggest that the UK should learn the takeover system of the USA, and introduce an anti-takeover law, giving all public companies a reasonable chance to defend themselves. However, it may cause that the corporate governance in the UK to move from one extreme to the another. Because if the managements of target companies have too much power to affect the decision of hostile takeover, some shareholders will loss the freedom to sell their shares. Besides, it will deprive these eligible bidders' chances. Furthermore, this is still a threat of hostile takeover in market, though it may be failure in some situations, but it still has positive impacts to force management to care more about interests of shareholders. The present situation of UK seems to be in a dilemma. Is there any way to not only retain the autonomy of shareholders, but also give all public companies a reasonable chance to defend themselves? This paper holds a possible way, establishing a shareholder vote system to decide whether to give the company's management the right to resist a hostile takeover. Besides, this voting result has a time limit, and the time limit can be extended or reduced by the voting, it is a key point of this system. Furthermore, the voting results will be announced to the public. When the period expires, the shareholders should vote again, the next meeting will be held regularly. By this way, shareholders will still have the initiative, and at the same time, it will give managements of public companies a reasonable chance to defend themselves. The management also have to work efficiently and protect shareholders' interest, otherwise, shareholders will cancel the right of management to resist hostile takeover, and the management will feel the threat of takeover directly. They have to work harder and more efficiently next time to win the support of shareholders. Because the voting results will be announced to the public, it will be a kind of signal that will be sent to the market quickly—the management of this company may not have a good performance, it may be a good target. In the past, under the market for corporate control, if shareholders are not satisfied with the management, they can sell their shares and leave the company. Now, they can also vote to decide whether give the management the power to against the takeovers, it is a new kind of warning. Shareholders will have more chances, the management and the company will also have more chances. Besides, if the management has good management ability, though it may be small, the more profitable but smaller company will not be easily taken over by other larger companies. This company can focus more on the healthy development of the company, but not focus on expand the scale of company as soon as possible in the short-termism. Finally, this paper argues that this way may also be helpful to rebuild the trust between management and shareholders. The management can clearly realize that if shareholders vote to give them the chance to defend themselves, it means that shareholders really trust them, they will work hard to avoid betraying the trust. As a result, these companies with ineffective management will be forsaken by shareholders because of their bad performance. Then, these companies will become the eligible targets, and this management will be replaced.

As for the problem about the relationship between the reputation of managements and the hostile takeover may be not enough close in UK. This paper suggests that it may be helpful to commend the

managers and directors of target companies who have performed well and criticize the poor one in corporate governance after the hostile takeover. The regulation can ask the company to do this work by publishing a public announcement in the relevant industry. The public announcement will synthesize all evaluations that come from the shareholders, employees, costumers, and members of management team. As a result, on the one hand, it will strengthen the relationship between reputation of managements and the hostile takeover, so that the personal interests of management and the corporate governance will be closely linked. The management of the eligible target company with bad performance will get appropriate punishment. Melrose's takeover of GKN could be an example, share price of GKN collapsed after a shock profits warning related to problems in its aerospace division. The collapse of share price caused the hostile takeover, in order to handle the takeover, GKN announced that Kevin Cummings would not be taking over as chief executive, because he had been running that division and made the wrong decision [82]. This announcement clearly shows that Kevin Cummings's bad performance caused the hostile takeover, therefore, there is no any information show that Kevin Cummings get new job after being discharged. More cases like GKN will enhance the threat of hostile takeover. The announcement that includes more comprehensive evaluations may work better. Besides, it will also encourage management to do better performance in corporate governance. The efforts of the good management can be seen and admit by others, though this company may be takeover target. This way also prevents the reputation of good management from being adversely affected by hostile takeovers. On the contrary, the incompetent management in eligible targets will not get new job easily, it will reduce the risk that they harm other shareholders' interests in other companies.

### **C. Rational takeover process**

At first, the government should do more efforts to improve employee participation in the takeover process. In many other EU countries, such as France, and Germany, the law regulates that management has a clear legal obligation to inform and consult with representatives of the employees genuinely [83]. However, in UK, the similar regulations are weaker. Besides, the British courts do not have the power to reverse any decisions made in breach of employment law in this area [84]. Because according to the *Carlen v Drury (1812)*, normally, a court cannot intervene in business management or matters of corporate governance [85]. However, the interests of employees should not be ignored. This paper holds that, on the one hand, the UK government should learn the experience of France and Germany, giving employees more power to explain their opinions, establishing a more perfect compensation system for employees. On the other hand, the law should require the company to train employees, improve their knowledge about takeover, and let them recognize their rights given by law. Because low employee participation may also be due to their lack of relevant legal knowledge. Furthermore, when the Panel examines the hostile takeovers, it should care about more about the interests of employees, finally, after the takeover is approved, the Panel should do a return assessment about the actual implementation of the bidding company's employee plan. In fact, the Panel has the ability to do this assessment, because the number of successful hostile takeovers is very small, it will not create a very heavy workload for regulators. Regulators should also impose tough penalties on companies that do the unreasonable job cuts, it will reduce the similar situations.

In addition, the government also should make more measures to correct the short-termism in the takeover process. Some investment vehicles should be prohibited by the government to use in hostile takeover. For example, the hedge funds or private equity should be prevented to be used to finance

mergers and takeovers. Besides, it should be avoided that short-term investment vehicles from having a say in mergers and takeovers [86]. In UK, if a listed company accepts a takeover offer, at first, the target company's shareholders must vote to agree it. British rules require a simple majority of all shareholders in the target company to vote to accept the offer with at least 75 per cent of the shareholders voting. Therefore, raising the proportion of shares to accept the takeover, it will make it harder to succeed unless the bidder can persuade more shareholders that it is in their interest to sell [87]. Furthermore, this paper also suggests that if the Panel cannot have enough energy to carry on the effective supervision to the bidder's actual performance. The company can hire "takeover practitioners" to monitor the company and prevent management from misbehaving for short-term gain, just like the insolvency practitioners in the Company Voluntary Arrangements. However, if the British government puts this idea into practice, there is a potential problem: who pays for the hiring of experts? Shareholders are not willing to pay for it because that means more investment. Bidders are also reluctant because management will not agree to pay someone to supervise themselves. The government is also unlikely to fund it, as hostile takeovers are a business and it will add to government spending. This paper argues that the government can offer tax relief to the company and offer tax incentives to the shareholders, if the bidder employs supervisor. This will not have a big impact on the government's tax revenues, as there are not many bidders each year in UK. In addition, it will encourage more supervision in the takeover process, this will be conducive to the healthy development of the company, in the future the company will create more tax revenue. However, the government should take measures to avoid "takeover practitioners" being bribed by the management of bidders.

Finally, a very important thing is that, the British government may be cautious to regulate takeover. This loose regulation has worked more than 50 years in UK from 1968. The government may realize the negative impacts of hostile takeover, and the market for corporate control may be not trustworthy in some ways, but they are worried that the reform may bring more problems. This paper holds that the UK government can take reforms in one industry or some industries in advance, identify problems, take steps to solve them, and get enough experience before the government extends the reform to all industries in UK. Therefore, the worst outcome is that the reforms do not succeed in a particular industry, however, because the reform scope is small, the negative impact is also limited, and the government can stop the reform in time. It is important to stress that the UK government cannot remain blind to these problems, the UK government may need more courage in reform.

## **5. Conclusion**

In conclusion, in UK, the government and the shareholders may trust and rely on the market for corporate control excessively. Therefore, the regulations of takeover are looser than other countries. However, the market for corporate control has many potential problems, at first, the market for corporate control may not maximize shareholders' value well in practice. Besides, it may also not optimize resource allocation enough in UK. Finally, it does not protect the interests of employees well. The UK government should take measures to deal with these issues, the attitude of the government and the shareholders towards the market for corporate control should be more prudent. This paper suggests the UK government to take measures from three aspects, more eligible bidders, more eligible targets and build a rational takeover process. The British government needs to act more decisively to promote the healthy and long-term development of the British economy.

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