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An emerging market for corporate control? The Mannesmann takeover and German corporate governance

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An Emerging Market for Corporate Control?
The Mannesmann Takeover
and German Corporate Governance

Martin Höpner and Gregory Jackson

01 / 4

Max-Planck-Institut für Gesellschaftsforschung
Paulstrasse 3
50676 Köln
Germany

Telephone 0221 / 2767 - 0
Fax 0221 / 2767 - 555
E-Mail info@mpi-fg-koeln.mpg.de
Home Page http: / / www.mpi-fg-koeln.mpg.de

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Abstract

Corporate governance in Germany is often described as a bank-oriented, blockholder or stakeholder model where markets for corporate control have not played a significant role. This case study of the hostile takeover of Mannesmann AG by Vodafone in 2000 demonstrates how systemic changes during the 1990s have eroded past institutional barriers to takeovers. These changes include the strategic reorientation of German banks from the "house bank" to investment banking, the growing consensus and productivity orientation of employee codetermination and corporate law reform. A significant segment of German corporations are now subjected to a market for corporate control. The implications for the German model are examined in light of both claims by agency theory for the efficiency of takeover markets, as well as the institutional complementarities within Germany's specific "variety" of capitalism. While the efficiency effects are questionable, the growing pressures for German corporations to achieve the higher stock market valuations of their Anglo-American competitors threaten the distributional compromises underlying the German model.

Zusammenfassung

In der Vergangenheit wurde die Abwesenheit feindlicher Übernahmen als typisch für das deutsche Modell der Unternehmenskontrolle angesehen. Anhand einer Fallstudie zur feindlichen Übernahme der Mannesmann AG durch Vodafone in 2000 wird in diesem Papier argumentiert, dass institutionelle Barrieren gegen feindliche Übernahmen im Laufe der 1990er Jahre so weit erodiert sind, dass in Deutschland ein Markt für Unternehmenskontrolle entsteht. Dazu zählen insbesondere die Umorientierung der Großbanken vom Hausbank- zum Investmentbankparadigma, die fortschreitende Konsens- und Produktivitätsorientierung der Mitbestimmung und Veränderungen des deutschen Aktienrechts. Die Gruppe der Großunternehmen mit gestreuter Aktionärsstruktur sieht sich dem Zugriff des Markts für Unternehmenskontrolle nunmehr ausgesetzt. Die These der Principal-Agent-Theorie, der zufolge feindlichen Übernahmemärkten Effizienzwirkungen zuzuschreiben sind, wird kritisch bewertet. Die Gefahr feindlicher Übernahmen wird zu weiteren Anstrengungen zur Steigerung der Aktienkurse führen. Damit könnten die Verteilungskompromisse, die dem deutschen Modell zu Grunde liegen, unter Druck geraten.

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1 Introduction: German Corporate Governance in Comparative Context[1]

National corporate governance regimes differ along a variety of dimensions: ownership, finance, corporate law, boardroom practices, management pay, and the role of employees. One of the most important and controversial differences relates to markets for corporate control. In countries such as Britain or the United States, markets for corporate control are thought to perform important governance functions in promoting a greater shareholder orientation among corporate management. By contrast, Germany is often described as having a bank-oriented, blockholder, or stakeholder model. Markets for corporate control have not played a significant role in the post-war period. However, since the late 1990s, German corporate governance has undergone sweeping changes, such as the growth of foreign institutional investors and corporate governance reform aimed at facilitating greater shareholder and capital market orientation in large companies (Höpner 2001a; Jackson 2002). In addition, several hostile takeover battles occurred at Hoesch, Thyssen, and Continental.

This paper presents a case study of one unprecedented event, the successful hostile takeover of Mannesmann by Vodafone between November 1999 and February 2000, and examines its significance within German corporate governance. The takeover was one of the largest merger and acquisition (M&A) deals in the world, worth nearly DM 390 billion, and reflects the growing power of stock market capitalization in leveraging the takeover of the industrial giant Mannesmann (30,000 employees, DM 40 billion in turnover, 109 years old) by a newer and smaller rival Vodafone (12,600 employees, DM 11 billion in turnover, only 15 years old).[2] The paper argues that the case of Mannesmann illustrates a paradigmatic change in German corporate governance.

The Mannesmann takeover reflects the erosion of previous barriers to hostile takeovers due to both regulatory reforms and incremental changes in the social organization of capital markets. A small but growing segment of large German corporations is now vulnerable to takeover threats. Consequently, the characteristic governance coalitions within German corporations are changing to reflect the new interests and mechanisms of influence for capital, labor, and management.

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1 The authors would like to thank Jürgen Beyer, Ronald Dore, Werner Eichhorst, and Anke Hassel for their comments on a previous draft; we are also grateful to those attending the 14th International Conference for the Society of the Advancement of Socio-Economics (SASE), July 2000, London School of Economics. Any errors are our own.

2 At the final shareholders' meeting of August 22, 2001, the company name Mannesmann was officially replaced by the name Vodafone.

Growing institutional tensions are arising between the distributive and strategic constraints created by takeover markets, thereby furthering functional changes in the institution of employee codetermination.

The significance of these changes should be interpreted in the context of the existing German "model" of corporate governance. Three features are particularly relevant here (Jackson 2001). First, capital exhibits a strong *financial commitment* to particular enterprises, reflected in stable ownership, a strong role for banks, and the absence of a market for corporate control. German corporate ownership is, on average, more concentrated than in Britain or the United States. The largest owners are usually non-financial corporations and banks (Table 1). These groups often pursue strategic interests related to organizational strategy[3] and long-term relational incentives, since ownership strongly overlaps with a variety other commercial relations (Beyer 1998). These factors make owners more long-term oriented and bound to the welfare of the firm than is typical in liberal countries. There, institutional investors retain a greater capacity to exit and pursue solely financial returns on their shares. As will be discussed later, Anglo-American institutional investors have grown in importance in Germany since in the late 1990s.

Table 1 Ownership of Listed Corporations in Percent, 1990s

	Germany		United Kingdom		United States	
	1991	1999	1991	1997	1990	1998
Banks	12.7	13.5	0.2	0.1	–	–
Non-financial firms	39.4	29.3	3.3	1.2	–	–
Government	2.6	1.0	1.3	0.1	0.0	0.0
Insurance firms	5.5	9.0	20.8	23.5	1.9	3.5
Pension funds	–	–	31.3	22.1	24.4	25.9
Investment firms & other[a]	4.8	13.6	10.4	12.5	15.8	22.3
Individuals	22.4	17.5	19.9	16.5	51.0	41.1
Foreign	12.7	16.0	12.8	24.0	6.9	7.2

a For the U.S., includes bank personal trusts, mutual funds, and other non-household investors.

Sources: DAI (2000); Bundesbank (2000); NYSE (2001). German data is estimated from heterogeneous sources using both market and book values.

3 Different shareholder groups have different sorts of interests. On the distinction between financial and strategic interests in corporate ownership, see Jackson (2000).

Second, employees constitute an important force in corporate governance through the legal institution of codetermination. Codetermination refers to the rights of information, consultation, and codetermination in the decision-making structure of companies through both works councils and the employee representation on the Supervisory Board of German companies.[4] Third, German management has to contend with voice from both capital and labor. The pluralistic nature of corporate governance structure leads management to operate under a duality principle of both long-term profit maximization and employee utility (Aoki 1988).

Germany's post-war competitive success has often been attributed to the strength of these arrangements in building long-term commitments between stakeholders. The *nonliberal* features of the German model partially suspended market mechanisms for both capital (markets for corporate control) and labor (long-term employment) and proved to have substantial institutional complementarities. Management was aided in building long-term organizational capacities by the parallel commitment of capital to patient long-term investment and the high-trust work organization. Thus corporate governance was a key institutional precondition for the dynamic (X-) efficiency of the German production system in lower-volume, high-quality product markets that require high skills (Streeck 1992). These strengths mirrored many perceived deficits of liberal Anglo-American corporate governance during the 1980s, such as short-termism, opportunism, and breaches of trust with employees.

The absence of markets for corporate control can be viewed as a necessary condition for the historical development of the German model (Jackson 2001). Long-term commitments to organization building may be undermined where capital market pressures are too great or existing governance coalitions are broken up through hostile takeovers. Thus an emerging takeover market raises a number of particular challenges in Germany. Will a growing market for corporate control erode the financial commitment of capital? What impact will takeovers have on codetermination? And will the threat of hostile takeovers alter the orientation of German management to long-term organizational building and consensus among stakeholders?

In the remainder of the paper, Section 2 reviews the role of markets for corporate control in light of economy theory and the U.S. experience. Section 3 looks at the institutional features suppressing markets for corporate control in post-war Germany and examines the recent wave of cross-border mergers and acquisitions. Section 4 presents a detailed case study of the Mannesmann takeover, showing

4 Works councils at plant level represent all workers. In contrast, codetermination also includes the Supervisory Board, on which employee representatives have between a third and half of the seats.

how these factors were either absent or failed to have the hypothesized deterrent effects. Section 5 concludes with the implications of the Mannesmann takeover within the larger institutional context of German corporate governance.

2 The Market for Corporate Control

Capitalist economies are characterized by the exchange of commodities within free markets. Yet markets are themselves embedded within social institutions that define what "commodities" can be the object of free market exchange. Product markets are often embedded within spatial boundaries (e.g., domestic free trade, external tariffs) and restricted by regulation (e.g., televisions are traded relatively freely, foods sometimes, electricity only recently, and plutonium never). Free labor markets are the quintessence of industrial capitalism. Nonetheless, political regulation and social insurance historically limited the risks associated with the commodification of labor power. The free capital market also appears as a natural feature of capitalist economies, but has often been limited to the boundaries of the nation state. Markets for corporate control represent the historical development of a distinct fourth type of market, wherein the trading of corporate equity occurs on a very large scale and bestows the power to control these corporations (Windolf 1994). In this context, corporations that combine capital and labor in the production of commodities themselves become commodities.

The economic function of markets for corporate control is most clearly outlined by agency theory. Agency theory addresses the question of how shareholders can assure that once they invest their funds, management will act in their interests. This question arose in the context of the pioneering study by Berle and Means (1932) on the growing "separation from ownership and control" in U.S. corporations. They noted a decline in shareholder control over management as ownership stakes grew smaller and more fragmented among a large number of individuals. Few incentives exist for fragmented owners to actively monitor management because the resources devoted to monitoring can be jointly appropriated by the bulk of "free-riding" shareholders. Individuals therefore diversify their portfolios and prefer exit over voice in response to poor performance. Moreover, small shareholders are rarely informed enough to make qualified decisions or monitor management in detail. In sum, corporate control undergoes a "market failure" that needs to be remedied by several mechanisms to reduce agency costs: legal protection of shareholders, incentive contracts for management, large blockholders with the capacity and incentives to monitor management, or markets for corporate control (Shleifer/Vishny 1996).

In his seminal article, Henry Manne (1965) first described the possible governance function of a market for corporate control: "The lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently." Manne's theoretical innovation was to posit a strong relation between share prices and managerial performance and thereby to discover a new market-based governance mechanism compatible with the exit preferences of small shareholders. As shareholders respond to poor managerial performance through exit, the lower share prices create incentives for outsiders to accumulate control rights, replace the management team, and restructure the underperforming firm. These outsiders can recoup their investment through a share price premium. Markets for corporate control can thus be defined in terms of transactions for control over a company's shares and occur through a variety of methods: open market purchases, block purchases, tender offers, negotiated share swaps, or contests over the control of proxy rights (Bittlingmayer 1998).

Many authors view markets for corporate control as an effective instrument for disciplining poor management.[5] Even the generalized *threat* of takeover places management under greater discipline by institutionalizing a feedback mechanism between corporate decision-making and the stock market. Takeover vulnerability also increases the scope for shareholder voice, since shareholder exit leads to the threat of a takeover. Management must seek to improve returns to capital and not investment in "underperforming" assets, since managers risk their jobs if shares underperform.

Much debate surrounds the merits and implications of markets for corporate control. Management may react negatively to takeover threats by implementing costly defensive strategies such as golden parachutes or poison pills and by seeking legal protection from takeovers. Alternatively, management may respond to capital market pressures by short-term strategies to bolster share prices, thereby sacrificing beneficial long-term projects and investments. Finally, takeovers may damage the position of other stakeholders and thus undermine trust and cooperative relations. The widening influence of "the market" places issues outside the bounds of negotiation by stakeholders, thereby turning management decisions into *de facto* non-decisions: "a decision that results in the suppression or thwarting of a latent or manifest challenge to the values or interests of the decision makers" (Bachrach / Baratz 1963).

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5 While large blockholders in Germany may be effective monitors, high ownership concentration has other disadvantages: lack of capital liquidity, lack of risk diversification, costs for small shareholders unable to share the private benefits of control accruing to large blockholders, etc.

2.1 The U.S. Experience: Efficiency or Opportunism?

In assessing the impact of the market for corporate control, it is useful to review empirical studies from the United States (Davis/Robbins 2001). During the 1960s, U.S. companies pursued extensive unrelated corporate diversification through mergers and acquisitions. The performance of the new conglomerate firms was, on the whole, disappointing.[6] Diversified firms became increasingly undervalued by the stock market – the so-called "conglomerate discount." In this context, the Reagan administration loosened the antitrust regime to allow greater scope for horizontal mergers compared with past interpretations of the Celler-Kefauver Act of 1950 (Fligstein 1990). The Supreme Court also overturned many takeover restrictions found in state laws through the 1982 *Edgar vs. MITE* decision (457 U.S. 624). In addition, new innovations in financial markets increased the supply of high-risk capital, most notoriously through the issue of "junk bonds" to corporate raiders.

These factors contributed to an unprecedented wave of takeovers during the 1980s, resulting in the de-conglomeration of U.S. corporations (Davis et al. 1994). Diversified firms were taken over at very high rates, split into component business, and sold to acquiring firms within the same industry.[7] Takeovers allowed corporations to pursue strategic motives of consolidation, since acquiring companies could keep related parts of the target company but recoup a large share of the purchase price through selling unrelated business to other buyers in those industries (Bhagat et al. 1990). Few target firms resumed diversification strategies, and others began to proactively divest unrelated assets in order to focus on a core competence. This takeover market has cooled considerably. Only 23 of the Fortune 500 firms received tender offers between 1990 and 1996, and no more than six takeovers were classified as hostile (Davis/Robbins 2001). Diversification no longer impacted the likelihood of takeover, nor did poor performance. U.S. corporate diversification continued to decline in the 1990s and consolidated the notion of corporate focus.

Do takeover targets perform worse than comparable firms, and does their performance improve after takeovers? A large body of literature empirically shows the performance impact of takeovers to be rather weak and heavily dependent on the country, time period, method, and criteria of performance. Some studies of

6 The economic rationale of the conglomerate firm was related to its role in internalizing the allocation of capital and managerial expertise.

7 In a comprehensive survey of takeovers among Fortune 500 companies during the 1980s, Davis et al. (Davis/Diekmann/Tinsley 1994: 588) demonstrate that diversified conglomerates faced much higher risks of becoming takeover targets than non-diversified firms.

the United Kingdom and the United States fail to confirm that target firms have poorer performance prior to takeover bids (Franks / Mayer 1995; Davis / Stout 1992). Regarding *ex post* performance, most studies agree that shareholders of target firms gain large share price premium (Bittlingmayer 1998: 28). However, the impact for shareholders of the acquiring firm are often negative.[8] Post-takeover company performance also remains mixed. For example, the risk of hostile takeover had little impact on productivity in U.K. companies, but significantly lowered levels of investment and raised dividends, consistent with popular views of short-termism (Nuttall 1999).

Critics argue that takeover "premiums" often result from redistribution rather than productivity gains. Even Manne (1965) anticipated the enormous impact of takeovers on the distribution of wealth: "Given the fact of special tax treatment for capital gains, we can see how this mechanism for taking control of badly run corporations is one of the most important 'get-rich-quick' opportunities in our economy today." First, the stock market may often value corporations below their true market value (Kraakman 1988). A correct valuation of management strategy is central to the effectiveness of a market for corporate control. However, capital markets often take myopic, short-term views of investments, follow speculative trends that make valuations very volatile, or fail to respond to bad management because shareholders are uninformed. Second, takeovers are often motivated by profit-seeking redistribution of stakeholder wealth that makes little positive contribution to long-term company performance. The transfer of wealth from stakeholders to shareholders accounts for a large proportion of takeover premiums and leads to net losses of efficiency due to breaches of trust (Shleifer / Summers 1988; Chelma 1998). Employees face the dangers of assets being stripped from the target company, employment being rationalized, and existing labor agreements being renegotiated. Third, takeovers allow bidders to pursue managerial interests in the power, prestige, or higher salaries associated with larger firm size. Just as markets for corporate control provide a potential means for disciplining management, active markets also increase the ability of management to act opportunistically by acquiring companies using other people's money. While bust-up takeovers remain infrequent, speculative takeovers with purely financial motives have been a theme from the earliest hostile bids by Jim Slater in the United Kingdom during the 1950s to the junk bond excesses in the United States during the 1980s.

8 One German study finds no profitability effects for bidders' shareholders, but reports a roughly 9 percent premium for targets' shareholders (Gerke et al. 1995).

2.2 The Absence of Hostile Takeovers

Given the conflicting evidence on takeovers, what can be said about the *absence* of takeover threats in Germany? De Jong (1996) argues that takeover threats subject British firms to the "straight jacket" of the capital market: In order to generate sufficient shareholder returns, firms are constrained from growing beyond a level at which the marginal returns to equity diminish. Conversely, their absence allows firms to retain the option of pursuing strategies other than maximizing return on equity (Ide 1998):

- firms can pursue higher market shares through strategies of forward-pricing;
- firms can spend more on capital investments and / or R&D;
- firms can absorb higher raw materials costs;
- firms can concentrate on market segments offering lower returns but having large market size and relatively low risk;
- firms can absorb higher labor costs, thus avoiding layoffs more easily during cyclical downturns and thereby protecting employee morale and firm-specific human capital.

In German corporations, a higher share of value-added goes to employees and a lower share to capital than in Britain (De Jong 1996). This distributional pattern helped accommodate industrial citizenship as corporations specialized in strategies of "diversified quality production" (Streeck 1992). Faced with the "beneficial constraints" of high wages and employment rigidity (Streeck 1997), German firms have strong incentives to invest in high skills and to target market niches that utilize high-skill and high-productivity production. Conversely, the cooperative institution of workplace codetermination is an asset in helping firms develop large reserves of internal flexibility and employee support for incremental innovations in products and processes (Boyer 2002). Such strategies are beneficial in servicing lower growth markets or particularly in "catch-up" patterns of technological diffusion and improvement within established markets. Backed by capital committed to long-term investment, industrial citizenship can function as a "beneficial constraint" supporting flexible and high-skill internal labor markets. The patient nature of capital markets has a strong institutional complementarity with codetermination.

However, why do shareholders tolerate receiving less of the corporate pie in Germany? The answer is that marginal returns to shareholders were actually quite favorable and gave German investors little incentive to defect. The difference is that two "equilibria" exist giving the same rate of return to investors, but having very different distributional and strategic consequences for corporations. High share prices are sustained by high earnings, or low prices with low earnings. This can be demonstrated by the following equation:

(earnings / share price) * (dividends / earnings) = dividend yield

where

earnings = retained earnings + dividends = value added – depreciation – labor – taxes – interest

These patterns are illustrated in Table 2 with reference to German and British corporations. The first group of indicators shows that price–earnings ratios and dividend yields are quite similar in both countries. Based on current profitability, investors have little reason to exit in favor of the other country. However, the second group of indicators shows that stock market valuations are lower in Germany than in Britain, both in terms of absolute market capitalization and relative to real assets. As a consequence, the third group of indicators shows that British corporations sustain higher stock market valuations by generating higher earnings. However, the German corporations have higher turnover and, importantly, are able to sustain nearly double the number of employees.

German companies thus follow a "low level" equilibrium – low earnings and dividends corresponding to lower share prices. Shareholders receive competitive rates of return as long as market capitalization remains low, i.e., ownership re-

Table 2 Corporate Performance, Selected Averages 2000

	Germany	**United Kingdom**
Real returns to capital		
Price-earnings ratio	17.8	21.5
Dividend yield	2.7%	2.6%
Return on equity	18.2%	20.4%
Market valuation		
Market value (mill. euros)	20,754	42,337
Ratio of market value to turnover	0.51	2.14
Market value per employee (mill. euros)	0.14	0.97
Price-book ratio	2.5	4.6
Sales, profits, employment		
Turnover (mill. euros)	38,122	22,015
Return on sales (EBIT to sales)	9.4%	19.2%
Employees	138,072	60,676

Source: Handelsblatt Europa 500, Handelsblatt June 11, 2001. Averages are calculated from the 19 largest British and 20 largest German industrial firms belonging to the "Europa 500." For computational purposes, negative values or price-earnings ratios exceeding 50 were dropped.

mains concentrated among existing stable shareholders.[9] By contrast, U.K. firms have higher share prices, but require higher payments to investors to maintain comparable returns to capital. Increasing market capitalization relative to the real economy leads to declining rates of return and puts pressure on firms to generate higher profits and distribute greater portions of their value-added to shareholders. Reversing the trend may be difficult. As market values rise relative to real economic flows, firms cannot move back down to a lower equilibrium without being punished.

The key point here is that the German "equilibrium" is not sustainable under an open market for corporate control. First, the lower market to book values (price–book ratio, PBR) make corporations more vulnerable by leaving more scope for takeover premium through restructuring. Where PBR is less than 1, the book value of assets exceeds the market value. Raiders would be rewarded by simply busting up the company and selling the assets. Second, lower *relative* valuations in the stock market make corporations vulnerable to takeover through share swaps. Here, corporations with greater market valuations can use their shares as a currency to give premiums to shareholders of the target firm. In either case, if corporations lack protection against hostile bids, incentives exist for takeovers aimed at restructuring operations.

3 The Role of Takeovers in Germany

Germany has traditionally had relatively low merger activity.[10] During the 1970s, an average of 373 mergers were reported to the Federal Cartel Office. This number increased to an annual average of 827 during the 1980s and to 1,653 between 1990 and 1998. A large wave of mergers with East German firms followed German unification in the early 1990s, and the number of cross-border mergers increased dramatically in the late 1990s due to the integration and liberalization of European markets. The DM 51 billion value of M&A in 1991 increased threefold to DM 152 in 1997 and to DM 442 in 1998 through the DaimlerChrysler merger (Jakobs / Landgraf 1999). In the same period, worldwide M&A activity grew more than fivefold from an estimated $ 379 billion to $ 2105 billion (Hulsa 1999). Including the Mannesmann deal worth some DM 388 billion, M&A International

9 German stock market performance (index growth plus dividends) has been similar to or outperformed U.S. performance in every postwar decade except the 1990s.

10 One study of Europe's 1000 largest corporations between 1985 and 1991 ranked Germany just eighth out of 11 European countries in terms of merger activity, having just 87 percent of the average level compared with 137 percent of the average level in Britain (Dietrich 1994).

Table 3 Mergers by Type of Diversification

	1973–1990	1991–1998
Horizontal	8,470 (68%)	11,468 (85%)
… without new products	6,331 (51%)	6,124 (46%)
… with new products	2,139 (17%)	5,362 (40%)
Vertical	1,698 (14%)	473 (4%)
Conglomerate	2,228 (18%)	1,470 (11%)
Total	12,396	13,429

Source: Das Bundeskartellamt, Tätigkeitsbericht, various years.

reported a record transaction value of DM 935 million and 1,972 transactions in Germany during the year 2000 (Lückmann 2001).

What are the characteristics of German M&A? Given the density of intercorporate networks and the high concentration of ownership, mergers are generally negotiated on a friendly basis among large blockholders rather than occurring through public tender offers, including hostile bids. These mergers are based less on financial or governance logic than they are on industrial logic: horizontal and vertical mergers between firms in the same industry aim at rationalization and economies of scale, while horizontal mergers diversify into new but related product areas (Table 3). To some extent, German corporations also followed the global trend toward conglomerate mergers involving unrelated diversification throughout the 1970s and 1980s. Compared to the U.S. levels in the post-conglomerate era, the rate of highly diversified firms was higher in Germany (36 percent in 1994) than in the United States (23 percent), but similar to the United Kingdom and Japan (Lins / Servaes 1999). German corporations have also followed the United States in de-institutionalizing the conglomerate form and focusing on core competencies. Whereas 70 of the largest German companies were active in an average of 2.4 sectors (measured by two-digit NACE codes) in 1992 / 1993, their diversification reduced some 9 percent to 2.2 sectors by 1996 / 1997.[11] Listed companies declined more dramatically, down some 22 percent from 3.3 sectors to 2.6 sectors in the same period, which can be attributed to their exposure to a conglomerate discount in the stock market (Zugehör 2001). Today, a growing share of mergers are horizontal mergers with new related products.

11 We are grateful to our colleague Rainer Zugehör for this calculation.

3.1 Institutional Factors Suppressing a Market for Corporate Control

What are the reasons for the friendly nature of German M&A and the absence of markets for corporate control (Schmidt 1997: 128–130; Baums 1993; Daum 1993)?

1. Ownership Structure. The number of potential takeover targets is quite small in Germany due to the high level of ownership concentration. As Table 4 shows, 57 of the 100 largest firms[12] were majority owned in 1998, an increase from the 53 majority-owned companies in 1978. Majority owners were divided among families, foreign companies, and the state. Furthermore, only 71 of the 100 companies had the legal form of joint-stock corporations, and only 51 were actively traded on the stock exchange. No open market for shares exists for unlisted corporations and private companies operated as GmbHs, since their sale requires the consent of other owners. Even among listed corporations, large blockholders are still significant. Taking the largest 49 listed firms, an average of 51.2 percent of all shares were widely held and yielded the following distribution: 23 companies with over 50 percent fragmented holdings, 18 companies with between 25 percent and 50 percent of shares fragmented, and nine companies with less than 25 percent fragmented holdings.[13] Looking at fragmented ownership, only 23 of the largest 100 companies appear highly vulnerable to hostile takeover bids. Under the assumption that one blockholder might be willing to sell, 41 companies might be viewed as vulnerable to hostile attempts at control.

Despite the apparent stability of concentrated ownership over the last 20 years, the decline in ownership concentration is likely to accelerate. A central factor facilitating the unwinding of intercorporate and bank holdings is the tax policy for 2002 (the so-called Eichel plan) that eliminates capital gains tax on the sale of corporate shares (Höpner 2000b). Due the large discrepancy in reported book values and actual market values of large blocks held over long periods of time, German financial institutions have been reluctant to liquidate holdings because of the large tax burden. However, the large stakes held by banks and insurance companies, as well as pyramidal holdings within German conglomerates, may now be disposed of in two ways: through gradual sale on the stock market leading to

12 The calculations in this section are based on data from the 100 largest firms by value-added as of 1996, compiled in the MPI Enterprise Database.

13 A similar picture is confirmed by 1991 data on a broader sample of 558 listed companies (Jenkinson/Ljungvist 1999): 72 percent had majority control, 15 percent (86 firms) had blocking minorities of over 25 percent, and only around 10 percent (55 firms) had no blocking minority control. At least 55 corporations are vulnerable to hostile tender offers. However, corporations with blocking minorities may also be subject to "hostile" stake-building when multiple minority owners have competing interests. Giving this looser criteria, the German market for corporate control encompasses up to 141 corporations.

Table 4 Ownership Stakes in the 100 Largest German Companies, 1978 to 1998, in Percent

	1978	1980	1982	1984	1986	1988	1990	1992	1994	1996	1998
Majority held by single individual, family, or foundation	18	18	25	24	23	21	23	19	17	19	18
Majority held by foreign company	20	22	16	19	18	16	17	16	18	14	17
Majority held by government	11	8	11	10	14	13	8	11	13	13	13
Other majorities	4	5	5	6	4	4	6	5	5	6	9
Dispersed ownership[a]	22	23	23	23	25	28	30	29	29	27	22
No clear majorities	25	24	20	18	16	18	16	20	18	21	21

a Over 50% of ownership is fragmented (possible minority blockholders).

Sources: Hauptgutachten der Monopolkommission, various years.

dispersion of ownership, or through the sale of entire blocks to strategically interested companies as part of M&A transactions. In the short term, the latter method may lead to both fragmentation and concentration in different parts of the corporate network, as illustrated by the planned merger of Allianz and Dresdner Bank.[14] However, in the long run, this step will greatly accelerate the unraveling of strategic blocks and increase the dominance of financially oriented investors who are likely to support hostile bids given appropriate share premiums. These changes will likely gain momentum through positive feedback. Corporations with fragmented ownership are more likely to adopt shareholder-value policies that in turn encourage divestment by intercorporate ownership. Moreover, growing divestment reinforces the change in the orientation of banks away from relationship banking and toward investment banking.

14 On the one hand, mergers through share swaps lead to a larger circle of shareholders and decrease the relative strength of existing blocks. On the other hand, some renewed concentration may occur when blocks held in a common receiving company are consolidated, such as the stakes in Aachener und Münchener Beteiligungs AG held both by Allianz (5.1 percent) and Dresdner Bank (4.6 percent).

2. Influence of Banks. Even among firms with fragmented ownership, banks are often thought to play a defensive role. Apart from the large blocks of direct ownership, banks can also influence corporate control through proxy voting and Supervisory Board seats. A study of shareholder voting at 24 widely held firms during 1992 demonstrates the importance of proxy voting: An average of 58 percent of share capital was represented at the annual general meetings, and nearly 61 percent of votes were cast by bank proxy (Baums/Fraune 1995: 102). Until recently, banks have generally opposed hostile takeovers. Baums (1993) notes that private banks are usually also widely held corporations and have little interest in being exposed to hostile bids themselves. For example, 95 percent of the shares at Deutsche Bank and Dresdner Bank are widely held. At the 1992 shareholders' meeting at Deutsche Bank, less than half of the share capital was represented, some 55 percent of votes were cast by proxy by the five largest German banks, and 32 percent of votes were controlled by proxy by Deutsche Bank itself (Baums/Fraune 1995). Among fragmented firms, banks control the majority of shares voted at the shareholders' meeting through the proxy votes exercised by the depository banks. Proxy votes can be used to support management by amending corporate statutes with anti-takeover provisions.

Over the last decade, the behavior of German banks has changed substantially. Some banks have been important actors in *supporting* hostile bids. The takeover of Hoesch by Krupp in 1991 was a hallmark case. Krupp was informally supported in its takeover attempt by its house bank WestLB, which accumulated a 12 percent stake in Hoesch. Likewise, Deutsche Bank was supposedly informed and supported the Krupp bid despite its role as Hoesch's house bank and its seat chairing Hoesch's Supervisory Board. Similar cases exist in which house banks are rumored to have helped acquiring firms accumulate stakes, e.g., Buderus or Holzmann. Banks face growing dilemmas regarding their governance role as they shift from traditional "house bank" relations toward investment banking services. This is well illustrated by the battle for control over Thyssen in 1997. Deutsche Bank was active in advising Krupp in the unfriendly takeover bid, while its management held a seat on Thyssen's Supervisory Board. The implied conflicts of interest received sharp public criticism and protest from the industrial union IG Metall.

3. Codetermination. The rights of employees also have a negative impact on takeover activity. First, employee representation on the Supervisory Board lessens the direct influence of shareholders. Employee representatives are likely to support defensive actions taken by management in the event of takeover battles. Codetermination can be particularly decisive if the shareholder side of the Supervisory Board is divided among competing factions. The "parity" codetermination rules for companies falling under the Codetermination Act of 1951 (*Montanmitbestimmung*) create an additional barrier in takeover attempts, since the Supervisory

Board is chaired by a "neutral" person entitled to cast a tie-breaking vote that can block changes in management. Second, the institutional protection of employment and consensus in corporate restructuring reduces the capacity of hostile raiders to engage in *ex post* redistribution of wealth following takeovers.

4. Accounting and Disclosure Issues. German accounting and disclosure rules are generally considered to lack transparency. Substantial discretion exists in the creation of hidden reserves and the valuation of assets. Traditionally, German accounting has stressed very conservative prudence rules (*Vorsichtsprinzip*) and creditor protection. These rules favor a long-term business conservatism allowing firms to build up substantial reserves for rainy days. For example, up to 50 percent of profits can be dedicated to reserves with the approval of the Supervisory Board and the shareholders' meeting. Furthermore, the valuation of assets at book rather than market prices leads to hidden valuation reserves. By contrast, both international standards (IAS) and U.S. rules (GAAP) are more investor oriented and are guided more exclusively by the notion of providing capital market participants with the necessary information to estimate true company value. U.S. rules therefore stress market valuations and precise definition of profits. While large reserves might make German companies attractive targets, the general impact of accounting standards would seem to deter takeover activity since the uncertain risks to bidders is large: Liabilities remain undisclosed, and true levels of profit may be hard to gauge (Schmidt 1997: 128–129). In addition, strict capital protection rules in German accounting prohibit the use of certain financial techniques during takeovers. Most importantly, this inhibits takeovers financed through the assets of target firms such as the large levered buyouts (LBOs) in the United States.

Another strategic issue concerns the disclosure of ownership stakes. Until recently, disclosure was required only for stakes exceeding 25 percent compared with the disclosure thresholds of 5 percent in the United States and 3 percent in Britain. Likewise, most firms issue bearer shares which make the identity of shareholders hard for the company to determine. Lack of disclosure has contradictory effects on takeover strategies and defenses. On the one hand, bidders have the advantage of being able to accumulate quite large stakes without being detected. This was the case in the Krupp-Hoesch deal, since Krupp was able to secretly accumulate a 24.9 percent stake through Credit Suisse prior to attempting a takeover (Jenkinson / Ljungvist 1999: 29). However, on the other hand, lack of transparency might discourage potential bidders, since they cannot estimate the power of minority blockholders acting as white knights in defending the target company either. Minority blockholders can easily hide their true influence by dividing stakes among family members or formally separate organizations. Similar to accounting rules, lack of disclosure makes takeover battles even more uncertain and risky than would otherwise be the case. Other things being equal, such

rules likely lower the level of takeover activity. Disclosure regulations were changed in 1998 to require reporting of stakes at the thresholds of 5, 10, 25, 50 or 75 percent.

5. Company Law. Corporate law discourages hostile bids by separating voting rights from the factual ability to control. Under the two-tiered board structure, shareholder representatives on Supervisory Boards can only be removed before their term expires with a super-majority of 75 percent of votes cast. At the Management Board level, management is usually appointed for five-year terms by the Supervisory Board (rather than by the shareholders' meeting) and can only be dismissed for cause. Baums (1993) notes that such dismissal is valid until nullified by a court and that management is likely to leave voluntarily after a hostile bid has been successfully completed. Nonetheless, majorities at the shareholders' meeting are not enough to guarantee control over the Supervisory Board or the Management Board. In some cases involving hostile stakes, existing minorities can deny blockholders representation on the Supervisory Board and thus thwart their influence, at least temporarily.

Another important aspect in the Mannesmann case was the so-called law of groups of companies (*Konzernrecht*). This law addresses control rights associated with company groups in order to protect minority shareholders and creditors of subsidiary companies. In cases such as Vodafone, where the acquirer is another company, German law requires the conclusion of a "conglomerate contract" (*Beherrschungsvertrag*) in order to protect the interests of the subordinate company. In the Mannesmann case, the sale of a recently purchased British telecom company, Orange, was at issue. The sale of Orange would be viewed as against the interests of Mannesmann and only possible through a contract requiring both a 75 percent super-majority shareholder resolution and compensation for affected parties.

6. Competition Law. Mergers must be approved under competition law by the Federal Cartel Office. While German antitrust law lacks any strong bias against mergers when compared internationally, the European market is now increasingly taken as a reference point for economic concentration rather than the national market. This change in competition policy can be considered to have had a pro-merger effect since the mid-1990s.

7. Defensive Actions. Managerial defenses against takeovers are common in the United States. Many Anglo-American defenses are not allowed under German law (or at least have not been until recently), including share buy-backs, shares with multiple voting rights, and poison pills. Much attention has been paid to poison pills and golden parachutes, which are particularly uncommon in Germany. However, German management has a number of other defenses available.

Until the year 2000, company law allowed corporations to have special voting rights or voting rights restrictions within their company statutes. Jenkinson and Ljungvist (1999) mention the following defenses among listed companies in 1991: 6.6 percent only listed non-voting shares on the stock exchange, 3.8 percent had caps on voting rights, 4.5 percent limited share transferability, and 5.7 percent departed from "one share, one vote" principles. Among widely held firms, caps on voting rights were particularly common, typically restricting votes to 5 percent of company stock and being important in several prominent takeover battles such as Continental vs. Pirelli and Feldmühle Nobel. A final very important takeover defense relates to the registration of shares. A fair number of corporations, including listed corporations, retain a system whereby management has discretion in registering shares. Management can refuse to register the shares of the acquirer or delay registering, thereby denying or delaying the exercise of shareholder rights.

8. Corporate Culture. Several aspects of German corporate culture also tend to discourage hostile takeover bids. German management was traditionally strongly oriented toward production and engineering. Financial specialists rarely became the speaker of the Management Board. Thus a "financial conception of corporate control" (Fligstein 1990) never became the dominant organizational paradigm in Germany, and the firm was not viewed merely as financial revenue streams to be optimized. An emphasis on structural and operational aspects of management leads to greater importance being placed on the organizational compatibility of two firms during a merger. Another aspect is the strong orientation toward consensus decision-making within the Board itself. German law sees the Management Board as a collegial entity with collective responsibility for corporate decisions. Many boards did not even elect a spokesperson until the late 1980s (Höpner 2000a). This consensus orientation entails strong veto rights and may work against both initiating takeover bids and undertaking radical restructuring after takeovers.

More broadly, the German public has a relatively weak "equity culture." Stock market activity is viewed as inherently risky and speculative. The U.S. experience with hostile takeovers, bust-ups, corporate downsizing, and shareholder value was widely considered ruthless "Wild West" tactics in Germany. Thus public acceptance of takeover battles and arguments relating takeovers to efficiency have generally been viewed with skepticism.

Germany has no law that specifically regulates takeover bids, and the proposed European directive on takeovers has not been passed. Lack of binding takeover regulations might be considered a deterrent to takeovers due to the uncertain legal status. In particular, management may be able to initiate value-destroying defensive tactics that make the target unattractive. Germany did introduce a volun-

tary takeover code in 1995 to protect shareholder interests during takeover bids. The code was developed by a small committee within the Ministry of Finance (*Börsensachverständigenkommission*) and was passed without any large input from companies and business associations such as the Federation of German Industries (*Bundesverband der Deutschen Industrie*) (Vitols et al. 1997). The takeover code was strongly influenced by the British code and is monitored by an Office of the Takeover Commission (*Geschäftsstelle der Übernahmekommission*). Compliance with the code has been very weak: 540 of some 933 listed companies comply, as do 79 of the DAX-100 corporations (Bundesministerium der Finanzen 2000). Low compliance may relate to legal ambiguities in the code and to the lack of effective sanctions. For example, unlike in Britain, companies cannot be delisted for failure to comply. Although the code includes provisions for mandatory public bids, overall the code is bidder-friendly compared with the British code and should not be considered a deterrent to hostile takeovers.

3.2 Hostile "Stake-Building" as a Mechanism of Control?

Despite the lack of public tender offers, the control of German corporations can be challenged by building hostile stakes. Unlike the more open markets in liberal market economies, hostile changes of control in Germany are often triggered by the breakup of an existing coalition among several large shareholders, leading to new alliances. Jenkinson and Ljungvist (1999) identified 17 cases of hostile stake-building between 1988 and 1996. In terms of ownership, eight target firms had no blocking minority stakes of more than 25 percent, seven firms had one or more blocking minority stakes, and two firms were majority owned. Most predators were other companies operating in the same industry as the targets rather than individuals. Only two cases involved conglomerates. Non-German predators were involved in nine cases, thus accounting for a large proportion of hostile attempts at control. Predator firms were successfully fought off in only three of 17 cases, twice due to intervention by the Cartel Office and once because of voting right restrictions at Continental AG. In two further cases, target firms capitulated and agreed to "friendly" cooperation. Although hostile stake-building resulted in changes in management, the performance effects of control battles appears to be rather weak.

Unlike hostile stake-building, the Mannesmann case was unprecedented in post-war Germany as a successful hostile takeover bid made on the open market. Whereas other hostile attempts at control were decided by relatively small coalitions of large blockholders, the fate of Mannesmann was decided by a much larger number of dispersed shareholders, including the general public. The case thus represents a new mechanism of corporate control that raises numerous

questions examined in the next section, including the degree to which Mannesmann is an exceptional case or whether it suggests change within German corporate governance.

4 The Case of Mannesmann[15]

Mannesmann was founded in 1890 by Reinhard and Max Mannesmann, the inventors of a new method for the production of seamless tubes. The brothers raised capital through their personal connections, these leading to Werner Siemens and Georg Siemens at Deutsche Bank. Deutsche Bank was soon instrumental in wresting control of the ailing firm away from the Mannesmann brothers and installed a new Management Board in 1893. Through World War I, Deutsche Bank held positions on the Supervisory Board, controlled proxy votes, and had a virtual monopoly in the credit business. The strength of this influence by a bank was unique among German heavy industry at the time (Wellhöner 1989: 125–146). The company expanded into coal and steel at the beginning of the 20th century. From the early 1970s onward, Mannesmann again transformed itself into a multinational corporation with a successful machine tools division and integrated an automotive division in the 1980s. However, the most radical change began in the 1990s. Following the liberalization of the German telecommunications market, Mannesmann set up a new mobile phone network, D2. Between 1990 and 1999, some two thirds of total investment went to telecommunications. Whereas engineering and automotive products are still seen as being a "value driver," the sale of the historic tubes division was planned. Through acquisitions of domestic and foreign companies,[16] Mannesmann had become a central player in European telecommunications next to Vodafone, British Telecom, France Telecom, the Dutch KPN, and Deutsche Telekom. By the late 1990s, telecommunications accounted for the largest share of turnover among the divisions.

In May 1999, Klaus Esser succeeded Joachim Funk as chair of the Management Board. Esser holds a doctorate in law, and his managerial career began at Mannesmann in 1977. He was the financial officer of the Board from 1994 to 1998 and

15 The authors would like to thank the following people for interviews between Fall 1999 and Summer 2000: Gerd Kappelhoff, IG Metall, union representative Thyssen-Krupp; Roland Köstler, legal officer, Hans-Böckler Foundation; Werner Nass, works council Thyssen-Krupp; Horst Urban, ex-chairman Continental AG; Christoph W. Stein and Fabian Kirchmann, Mannesmann AG, Department of Investor Relations; Rainer Schmidt, IG Metall, union representative Mannesmann.

16 Mannesmann purchased majority stakes at Arcor (D), Otelo (D), Infostrade (I), Omnitel (I), Telering (A), and Orange (UK).

was acting chair in 1998. The promotion of financial officers to Board chair is still somewhat unusual in Germany, because engineers tend to have a stronger position in industrial firms (Höpner 2000a). In October 1999, Esser announced the spin-off of the classic industrial business areas and a future specialization solely on telecommunications. Institutional investors had demanded focus on a core competence, but Esser sought to build telecommunications internally until the division could survive alone in the market. Esser argued for the restructuring in order to offer capital markets a stock with a clear financial logic, since telecommunications are valued much higher in the market than traditional machine tools and automotive businesses. The IPO of these two divisions as a separate company was planned for the year 2000.

4.1 Ownership, the Stock Market, and "Shareholder Value"

Share prices at Mannesmann have risen dramatically during the last few years. Mannesmann was one of the largest firms of the DAX-30 index, accounting for 11.5 percent in 1999, and its outperformance made a major contribution to the growth of the DAX in the late 1990s. Whereas Mannesmann stock was valued at 34 euros in 1996, shares could be sold at 300 euros in February 2000. As with leading telecommunications companies, the market valued Mannesmann at astronomically high levels, reflected in its price–earnings ratio (PER) of 56.1 in September 1999 (quite similar to Vodafone's PER of 54.4). However, Mannesmann and Vodafone continued to represent the different "equilibria" discussed in Section 2.2 with regard to German and British corporations. In 1992, Mannesmann's PBR was just 1.4, but grew over the 1990s to 10.2 in 1999. Meanwhile, Vodafone had a PBR of 7.7, which grew to some 125.5 in 1999. Despite their roughly equal market capitalization (Vodafone was worth some 175 billion euros and Mannesmann 160 billion euros in February 2000), Vodafone was valued much higher relative to its real assets, sales, and employment.

Despite this strong share performance, Mannesmann was not part of the vanguard of the shareholder-value movement in German corporations. Mannesmann received very good ratings for investor relations, alongside DaimlerChrysler and SAP. However, its accounting practices were considered to lack transparency. Unlike many German corporations of its size and international orientation, Mannesmann had not yet adopted IAS or U.S.-GAAP standards, nor had it pursued a listing on the New York Stock Exchange. Moreover, managerial compensation was not tightly coupled to share prices. Few shareholder value-oriented performance criteria, such as discounted cash flow, had been implemented on the operational level. On the whole, Mannesmann management remained less capital market oriented than would be predicted on the basis of indicators such as size, in-

ternational orientation, level of diversification, and ownership structure (Höpner 2001a). However, Esser's tenure undoubtedly marked an increasing shareholder orientation, especially by the refocusing of the business and efforts at increased information for shareholders, in contrast to the situation under Joachim Funk, where, as one Board member put it, the Supervisory Board "had to chase after every piece of information." Even its investor relations department characterized its own attitude toward publicity as "conservative." Mannesmann also began a policy oriented toward value creation known as the "value increase process" (VIP). VIP procedures were targeted at optimizing current investments in areas with above-average rates of return. The primary target within the VIP scheme was a 20 percent gross return on assets, a figure that Mannesmann also communicated to external investors. The figure measures the operating profitability and is a firm-specific version of the more general return on investment measure. Mannesmann was criticized by a number of analysts and investors, who were more interested in return on equity. Decentralized targets were set for the various divisions.

The ownership structure of Mannesmann was uncommon in Germany. For a long time, Mannesmann had had the most international ownership structure of any German firm (excluding foreign subsidiaries), with over 60 percent of its shares held by foreign investors and 40 percent alone by U.S. and British investors. Up until the takeover of Orange, there were no large shareholders and 100 percent of the shares were fragmented. Ownership fragmentation led to very low voting participation at the shareholders' meetings: just 37 percent of capital was represented and 90 percent of these votes were cast through the proxy rights of banks, the highest rate of any German corporation (Baums / Fraune 1995).

After the share swap with Orange, the ownership structure changed through the introduction of Orange's largest shareholder, the diversified Hong Kong conglomerate Hutchison Whampoa.[17] Hutchison now owned a 10.2 percent stake in Mannesmann. Hutchison was a large shareholder willing to back the existing management in the takeover battle. In addition, an estimated maximum of 7.5 percent was individually owned by some 40,000 employee stockholders. During the takeover battle, John Sweeney of the American union federation AFL-CIO claimed that some 13 percent of shares were held by pension funds directly or indirectly in union control. This amount has never been confirmed and is likely extremely inflated. At the time of the takeover bid, a realistic estimate may therefore be that 15 percent of Mannesmann shares were in loyal hands.

17 Hutchison Whampoa controlled a 49 percent stake in Orange PLC.

Table 5 Largest Shareholders at Mannesmann AG, 1999

Shareholder	Country/Number	Percent
Hutchison Whampoa	Hongkong	10.2
Capital Research & Management	U.S.	2.8
Schroder Investment Management	UK	2.1
Janus Capital Corp.	U.S.	1.8
Templeton Investment Management	UK / Hongkong	1.8
Deka Deutsche Kapitalgesellschaft	D	1.8
Deutsche Asset Management	D / U.S. / UK	1.6
Alliance Capital Management	U.S.	1.5
American Express Asset Management	U.S.	1.1
DWS Deutsche Gesellschaft für Wertpapiersparen	D	1.0
Fidelity Management & Research Company	U.S. / UK	0.9
Foreign & Colonial Management	UK	0.9
Putnam Investment Management	U.S.	0.7
Commerzbank Investment Management	D	0.7
Dresdner Bank Investment Management	D	0.7
MFS Investment Management	U.S.	0.7
Union Investment Gesellschaft	D	0.6
Oppenheim Kapitalgesellschaft	D	0.6
UBS Brinson	CH / D	0.6
Allianz Kapitalanlagegesellschaft	D	0.6
Robur Kapitalfervaltning	S	0.6
Frankfurt Trust Investment Gesellschaft	D	0.5
Allfonds Bayerische Kapitalanlage	D	0.5
Universal-Investment-Gesellschaft	D	0.5
Mercury Asset Management	UK	0.5
Adig Allgemeine Deutsche Investment	D	0.5
Inka-Internationale KAG	D	0.5
Cumulative total, stakes of 1% or more	**10 shareholders**	**25.7 (15.5)**[a]
Cumulative total, stakes of 0.5% or more	**27 shareholders**	**36.3 (26.1)**[a]
Cumulative total, stakes of 0.1% or more	**63 shareholders**	**44.3 (34.1)**[a]
Subtotal Germany		13.1
Subtotal UK, USA		19.2

a Totals in parentheses shown excluding Hutchison Whampoa.

Source: Wirtschaftswoche, January 20, 2000, data provided by Thomson Financial Securities Data.

The real battle was over the support of various institutional investors holding dispersed stakes. First, all shareholders holding stakes of 0.1 percent or more were institutional investors such as mutual funds and asset management companies (with the exception of Hutchison mentioned above). Of these, German funds controlled only 13 percent of Mannesmann, compared with over 19 percent by British and U.S. funds. Second, ownership was highly dispersed (see Table 5). The ten shareholders holding stakes of 1 percent or more controlled a total of 25.7 percent, and 63 shareholders holding states of 0.1 percent or more controlled a total of 44.3 percent of Mannesmann (or 34.1 percent excluding Hutchison). Thus these shareholders lacked stakes large enough to exert coordinated control and did not have strategic incentives for holding shares.

4.2 The Takeover Bid

Vodafone and Mannesmann were publicly considered alliance partners up until Fall 1999.[18] Unlike Mannesmann, Vodafone focused on mobile networks and has no fixed-line communications network. Another difference was the large number of minority stakes held by Vodafone in 13 European and ten non-European countries, reaching some 31 million customers. In Britain, Vodafone was market leader ahead of OnetoOne (taken over by Deutsche Telekom), Orange, and British Telecom. After its 1999 takeover of Airtouch (USA), Vodafone became the world's largest mobile telecommunications provider. Mannesmann and Vodafone shared joint participation in E-Plus, and Vodafone came to control a 34.8 percent stake in Mannesmann Mobilfunk previously held by Airtouch. Vodafone sought to expand these joint activities prior to the takeover bid.

In late October 1999, Mannesmann made a takeover bid for Orange (UK) worth some 30 billion euros scheduled for November 9. This move threatened Vodafone's home market, and rumors quickly spread that Vodafone might react by making a takeover bid for Mannesmann. These speculations fueled Mannesmann shares to new highs, and on November 14 Vodafone's Chris Gent traveled to Düsseldorf to make a friendly merger offer. The offer involved a swap of 43.7 Vodafone shares for one Mannesmann share. Esser refused this offer as unacceptable. By this time, the stock market anticipated a hostile takeover attempt by Vodafone. Mannesmann's Supervisory Board approved Esser's refusal of the friendly merger at the end of November. Chris Gent then announced that he would take the swap offer directly to the shareholding public. This move began a

18 In an N-TV interview on July 17, 2001, Klaus Esser said that Vodafone had indicated to him that it intended to place a merger bid for Mannesmann some 8 months prior to the actual takeover bid.

campaign of interviews, advertising, and arguments unprecedented in German economic history. The media battle was underway before the official takeover bid was made on December 23, 1999. The bid improved upon the original offer, proposing a swap of 53.7 Vodafone shares for one Mannesmann share as a pure swap with no cash component.

Vodafone's published takeover bid stressed the economies of scale through the merger. A merged Vodafone, Airtouch, and Mannesmann would be represented in 25 countries and have majority stakes in 13 countries, a total of 42.4 million customers. The central focus of Gent's argumentation was that the market value of a combined company would exceed the sum of the two separate companies. Gent also used the media to address the employees of Mannesmann, arguing about the industrial logic of a merger. He distanced himself from the aggressive practices of hostile takeovers common in the United States during the 1980s, stressed the industrial rather than speculative motives for the takeover, and made assurances that no closures or redundancies were planned. Instead, between one half and one billion euros would be invested. In its news ads, Mannesmann was portrayed as a baby that needs a good mother, Vodafone, in order to grow.

Another element of Gent's rhetorical strategy repeatedly became apparent: he acknowledged the fact that hostile takeovers had generally been viewed as morally bad in Germany. Gent attempted to portray Vodafone in the role of the victim rather than aggressor. The takeover of Orange had betrayed Mannesmann's role as a strategic ally and had made it a fierce competitor. Discussions of a joint European strategy had been thrown out by Mannesmann's sudden and unannounced takeover, stabbing Vodafone in the back as it were. By contrast, Gent described Vodafone as being appropriate, honest, and playing by the rules. Vodafone would abide by the rules of Germany's voluntary takeover code, although the German code is actually more bidder-friendly than the British code, since it allows subsequent improvements to the offer, permits pure share swaps without cash, and is more restrictive of defense measures by the target firm's management.

4.3 The Defensive Strategy Pursued by Mannesmann

Mannesmann's defensive strategy was more complex. Before 1998, Mannesmann management had not generally considered a hostile takeover bid as a realistic threat. Thus little defensive planning was done before 1999. In addition to an attempt to portray Vodafone's offer as a value-destroying measure, technical arguments were presented to call into question the success of the bid. Paramount were a series of procedural questions about the necessary divestments of Orange.

It is remarkable that a particular rhetorical strategy was not used by Esser: He did not question the legitimacy of a hostile takeover in principle and did not call for the participation of other stakeholders in the decision. In the published statements made by Mannesmann, there is no reference to the dangers of job losses or the expected erosion of Supervisory Board codetermination after conclusion of a "control contract." Esser never questioned that the shareholders alone should decide the fate of the company. During the hostile attacks on Thyssen by Krupp (1997) and Continental by Pirelli (1991), defensive rhetoric was full of such references.

In its official statement, Mannesmann's Management Board laid out its plans for the development of the company. The heart of their strategy was the integration of mobile communication networks, fixed-line networks, and the Internet. This strategy was designed to increase customer loyalty over the long term, raise the value of sales per customer, and lower customer turnover rates. Vodafone's argument that fixed-line networks had no future was refuted, and Vodafone was criticized as underestimating the importance of the Internet. According to Mannesmann, the future of communications technology lay in the combination of these two previously separate technologies. By not investing in an integrated strategy covering both areas, shareholder value would be destroyed. Vodafone's strategy of achieving scale through minority participations in so many countries was also criticized, since bringing together cross-platform networks requires more integrated control and entrepreneurial initiative.

Esser used a further argument to win shareholder loyalties for the existing management: the presence of Mannesmann in the German stock index (DAX) and Euro-Stoxx. The investment strategy of many international funds reconstructs and matches these indices. A successful takeover would remove Mannesmann from the indices and force the divestment of index funds, leading to sinking share prices. Esser estimated that index funds held 30 percent of Mannesmann share capital. Esser obviously did not point out that this disadvantage would be partially offset by the increasing weight of Vodafone in the FTSE-100 from its 3.03 percent share.

As the takeover battle continued through to the end of January 2000, technical and procedural questions stemming from German company law and takeover code dominated the discussion. Before approving the merger, the European Union competition regime would likely require divestment of Orange in order to prevent a monopolistic market position for Vodafone in Britain. Mannesmann argued that, under German law, divestment of Orange required a "control contract" between Vodafone and Mannesmann. In turn, a control contract requires a cash payment to any minority shareholders not exchanging their shares, which could amount up to some 60 billion euros and bring the company into financial

difficulties. A control contract also requires a 75 percent majority at the shareholders' meeting, thus raising the quorum for control.[19] The alternative route would involve a long process: the election of a new Supervisory Board with a simple majority at the next shareholders' meeting, the installation of a new Management Board that would sell Orange, and only then completion of the merger. Without a control contract, the Management Board would have to make decisions in the interests of the company as a whole, and why should it be in the interests of the company to sell Orange just after its acquisition? In short, Orange was portrayed as a "poison pill" to deter a hostile takeover.

This discussion sparked legal debate over the prerequisites for successful divestment. Vodafone denied the claims regarding control contracts and argued that a simple majority was sufficient to complete the merger. German legal experts remained divided over the issue. For example, whereas the prominent corporate lawyer Theodor Baums supported the Mannesmann interpretation, other lawyers suggested that divestment of Orange did not go beyond a routine managerial decision as defined in German law[20] and thus required only a normal majority.

Another peculiarity of German law entered into the discussion without playing such a decisive role. The tax on speculative stock trading (profits on stock held for less than one year) might require a de facto doubling of the time limit, since 12 months would have to elapse after the stock swap before shareholders could take their profits without tax. Finally, Esser also argued that Mannesmann's share price increase made a swap unattractive as the price of Mannesmann shares climbed before the deadline of the share swap. The IPO of the automobile and engineering divisions was brought forward to capture such effects, and an announcement that the company was seeking a separate listing for Internet activities was made in January.

4.4 Banks and Investment Bankers

German banks are often cited as one of the main barriers to hostile takeovers, as well as providing a functional substitute in corporate monitoring. However,

19 The legal basis for control contracts is sec. 291 of the German Corporation Law. Sec. 304 outlines the obligation to make compensatory payments to minority shareholders. These provisions are designed to prevent control contracts from being used in the interests of a single majority shareholder to exclude minority shareholders from their share in profits.

20 The argument was that sale of a subsidiary is covered under sec. 311, which states that control cannot be used to the detriment of the interests of a subsidiary company unless compensation is given.

banks played no role in Mannesmann's defensive strategy. Mannesmann lacked strong relations with a house bank, although Deutsche Bank manager Josef Ackermann was a member of its Supervisory Board. More generally, German banks have been attempting a dramatic reorientation toward investment banking and away from traditional banking relationships. While these two strategies were in competition with one another in the mid-1990s, or were difficult to reconcile, it is increasingly unlikely that banks will be involved in actively mobilizing takeover defenses as in the past. The banks have learned that it is virtually impossible to act both as an investment bank according the rules of the international marketplace and to simultaneously support the old style of relationship banking by taking sides in a defensive strategy against takeovers. A revealing quote was made by Klaus Breuer (Deutsche Bank, now Management Board chair) with reference to the Krupp-Thyssen takeover in 1997: "I very much hope that a first large case [takeover] will set an example within our financial culture" (*Spiegel* 13/1997: 94).

As consultants and advisors, investment banks play a central role in mergers and acquisitions. Particularly during hostile battles, investment banks are doubly involved: as consultants to the bidder firm and in the development of defensive strategies for the target. More money is made when the takeover is successful through the advice and refinancing provided during the post-merger restructuring. As early as 1998, Mannesmann is alleged to have hired Morgan Stanley and Deutsche Bank to develop defensive strategies to hostile bids from its six largest competitors. During the takeover battle, Mannesmann was advised by Morgan Stanley, Merrill Lynch, and J.P. Morgan. Meanwhile, Vodafone worked closely with Goldman Sachs and Warburg Dillon Read. This list shows the importance of U.S. investment banking, even in takeover contests between two European firms.

Table 6 shows the ten most important investment banks in the 1999 M&A market. Due to the high concentration, target firms may have difficulty in finding advisors that are not involved with the bidding firm (Huffschmid 1999: 78). In November 1999, Klaus Esser demanded that Goldman Sachs should stop advising Vodafone. Since Goldman Sachs had advised Orange in its friendly merger with Mannesmann, Esser argued that Goldman Sachs had access to inside information: "I don't think it's a clean procedure if Goldman Sachs takes our documents to Vodafone." As a result, Goldman Sachs temporarily halted its consulting activity. Meanwhile, Mannesmann filed a petition at the High Court in London to have Goldman Sachs suspended from acting as a consultant, but the suit was refused on the grounds that the information involved was not confidential enough to warrant it. In addition, the reverse situation also became public: Morgan Stanley had also advised Airtouch during its takeover by Vodafone, but was now advising Mannesmann.

Table 6 Investment Bank Consultants in M&A Deals, 1999

Bank	Value of transactions Billion U.S. $	Number of deals
Goldman Sachs	1278.6	415
M. Stanley Dean Witter	1131.3	446
Merrill Lynch	1026.0	376
Credit Suisse First Boston	526.9	327
J.P. Morgan	514.6	240
Warburg Dillon Read	489.2	278
Salomon Smith Barney	455.6	275
Lazard Houses	375.0	164
Lehman Brothers	310.8	193
Deutsche Bank	290.9	223

Source: Handelsblatt, January 3, 2000. Data from Thomson Financial Securities Data.

4.5 The Role of Labor: Works Councils, Employee Share Ownership, and Unions

Codetermination was also discussed above as an institutional element that might act as a poison pill to prevent hostile takeovers. Mannesmann was one of the corporations with the most extensive parity model of codetermination (*Montanmitbestimmung*). Following World War II, Mannesmann very much belonged to the iron, coal, and steel industries governed by the strictest codetermination laws. Two differences from the "normal" model of codetermination are worth mentioning here. First, whereas the chair of the Supervisory Board is normally elected by shareholders and holds a "double vote" to break deadlocks, here the chair is a "neutral" person jointly agreed upon by the shareholder and labor representatives. Second, the labor director within the Management Board is appointed with the consent of the labor representatives. For over 20 years, Mannesmann sought to flee the jurisdiction of these laws and even contested them in court. Mannesmann first removed steel production from the jurisdiction of the holding company by creating a separate subsidiary (Mannesmann Röhrenwerke AG). As steel accounted for less than 50 percent of turnover, Mannesmann legally contested the application of the law and caused considerable conflict with IG Metall in 1980/1981. This conflict resulted in a special law that extended the old rules for another six years and in 1988 in a revision lowering the threshold for the coal, iron, and steel sector from 50 percent to just 20 percent of sales (Kittner 1997: 1105). In May 1999, the Constitutional Court ruled that Mannesmann no longer falls under the jurisdiction of the Codetermination Act of 1951 by declaring these special laws

unconstitutional. Nonetheless, the labor director elected under these laws, Siegmar Sattler, remained on the Management Board throughout the takeover battle.

The crucial institution during the takeover battle was the conglomerate-level works council (*Konzernbetriebsrat*). This institution has a largely coordinating function, as a meeting place for the representatives of all eight subsidiaries and the negotiation of framework agreements for the entire corporation, such as in the area of part-time work for older workers. Most legal codetermination rights are vested at lower levels and realized by the works councils of the individual subsidiary companies (*Gesamtbetriebsrat*) or a "committee of the works councils" (*Arbeitsgemeinschaft der Betriebsräte*) as a contractually based simplification of these structures. Due to the company's status as a diversified conglomerate and holding company, the corporate cultures and strength of codetermination at the different subsidiaries differ widely. Codetermination is particularly strong in the traditional areas such as steel, but less developed in the area of telecommunications, which has lower rates of union organization.

Much discussion took place about the compatibility of capital market-oriented management and codetermination in Germany. The measures taken to reorient Mannesmann toward shareholder value were largely welcomed by IG Metall and the works councils. The growing transparency of corporate information was praised by labor representatives profiting from better information. More surprising is that the planned breakup of Mannesmann into legally separate corporations was not only welcomed, but actively promoted by labor. The explanation lies in the heterogeneous structure of the company. Telecommunications had become the focal segment and attracted a growing proportion of funds for investment. A union member of Mannesmann described the situation as follows: "The development of telecommunications was gradually becoming dangerous for the other divisions. At the same time as billions were being spent on the acquisition of Orange, we had to fight for every hammer in the classical businesses." The return on investment for the traditional businesses was lower, but the risks were also much lower too. Organized labor supported the separation of these firms in order to allow these business to continue an "undisturbed" development. Conversely, the telecommunications business was arguably also restricted by its position within the larger business. Financial theory suggests that a diversified corporation undergoes a "conglomerate discount" in the stock market that makes acquisitions more expensive, although in practice Mannesmann was increasingly overvalued rather than undervalued.

The example of Mannesmann shows that spin-offs and return to corporate specialization can be undertaken with a consensus between shareholders, management, and labor. Here, capital market orientation and codetermination via "co-management" are hardly irreconcilable opposites. Both groups share common

interests in promoting competitiveness and managerial accountability, even if their class interests may conflict in other areas such as wages. Class conflicts have lost some of their sharpness since the mid-1990s relative to employee concern over questions of risk management, transparency, business strategies, and perverse incentives given to management. In these areas, the differences between investors and employees are not diametrically opposed; instead, each actor may prefer different approaches to reach similar goals.

Labor representatives were justifiably afraid of job losses following a successful takeover and resulting reorganization. As a result, the works council and union cooperated to prevent the takeover. It is notable that the friendly or hostile nature of the takeover did not play a central role in their argumentation. Instead, labor stressed their demands regarding industrial strategy: the integrated telecommunications strategy (fixed-line networks, mobile networks, Internet) should remain intact, the planned strategy for Mannesmann Röhrenwerke should also remain intact, and the planned IPO of the engineering and automotive businesses should go ahead. In mid-November, some 500 white-collar employees took part in a warning strike by leaving their offices five minutes before noon to demonstrate against the hostile bid. At the same time, the various works councils held a joint press conference. The union and works councils view it as a success that the telecommunications workers were as much involved in the protest activities as those from the industrial businesses. IG Metall boss Klaus Zwickel, a member of the Supervisory Board at Mannesmann, repeatedly voiced his position on the takeover: Mannesmann is a healthy company with excellent prospects and has a superior strategy to Vodafone, he said. Astonishingly, little conflictual reactions came from labor, in sharp contrast to the mass demonstrations and emotions during the 1997 takeover attempt of Thyssen by Krupp (Höpner 2001b).

Up until February 2000, an estimated maximum of 7.5 percent of share capital was held by individual employee owners. Opponents of the takeover sought to mobilize the loyalty of this block to refuse the offer. Employee shareholders have an ambivalent function in such battles. On the one hand, employee stock ownership plans (ESOPs) are often given by shareholder value-oriented corporations to focus their employees on profitability targets. On the other hand, employees are strategic owners with long-term interests in the corporation beyond the maximization of shareholder returns. The employee stake at Mannesmann therefore does not automatically translate into a unified 7.5 percent block of votes against the takeover. In addition, many stocks may have already been sold by employees, thereby reducing the total to far below 7.5 percent. Thus the representation of employee-owned shares at the shareholders' meeting is not usually very high. Following the Mannesmann takeover, a growing number of companies[21] are at-

21 Pioneering associations were created at Siemens, Salzgitter, and Deutsche Lufthansa,

tempting to organize employee owners into associations in order to bundle their votes and assure representation by an elected proxy. Lacking any such organization, the Mannesmann works council appealed to employees not to sell their shares. But at the end of November, the magazine *Wirtschaftswoche* reported that following the dramatic appreciation of share prices after the bid, a notable portion of employee owners had sold shares. In the end, employee ownership played no decisive role.

The results of the sensational announcement by the American AFL-CIO that 13 percent of Mannesmann was held by funds in union control was ultimately ineffective too. According to William Patterson, Director of the Office of Investment, "This decision is not just about the takeover, but about a basic principle. It involves the question of whether the Anglo-American or European model creates more value for investors over the long-term. We believe that the European model, which seeks consensus between employees and employers, is the more successful" (*Handelsblatt*, November 24, 1999). By late November, it had become clear that only 1 percent to 2 percent of shares were under the direct control of the AFL-CIO. Union President John Sweeney sent an eight-page letter to some 50 U.S. investment managers holding Mannesmann stakes, appealing to them to refuse the takeover bid. "The managers of the employees' capital have a responsibility to invest in funds that promote the interests of investors in the *long-term*," wrote Sweeney (emphasis added). However, the AFL-CIO is unlikely to influence funds outside its direct management. This union involvement did spark an intensive discussion among German unions about using pension funds and employee stock ownership to promote employee-oriented corporate governance. In February 2000, the chairman of the union federation, Deutsche Gewerkschaftsbund (DGB), Dieter Schulte proclaimed it a bold notion that the DGB could make up some of its lost influence over corporations through share ownership. German unions are anticipating the move toward a greater role for pension funds in the social security system and arguing that labor should have a voice in the resulting investment decisions.

4.6 "Germany – Where Capitalism Operates a Little Differently": Corporate Culture in Politics, Press, and Public

The above headline from *The Guardian* (November 23, 1999) symbolizes the public ambivalence over the resistance to the Vodafone bid. Was this a legitimate attempt to defend German institutions or a nationalistic reaction to an inevitable development of global finance? Those expecting that the "national card" might be played to fight off Vodafone were taught otherwise. Only marginal "nationalis-

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for example.

tic" reactions were apparent at the outset. For example, the German tabloid *BILD* carried the title, "0173 [the prefix of Mannesmann's mobile network] stays German!" In the British press, German reactions were condemned as hysterical and nationalist. However, such statements remained marginal and probably less pronounced than British reactions to the friendly acquisition of Rolls Royce by Volkswagen. On the whole, German public debate was dominated by sober discussion and a shareholder-oriented perspective. Given the memory of German military aggression toward Britain, it might be conjectured that Germany faced very substantial barriers to public argument. For example, arguments against the takeover as eroding distinctive "German" institutions of corporate governance would be predisposed to be seen as nationalistic. Here the politics of institutional diversity dovetail with geopolitics and history.

In terms of political reactions, representatives of both the Social Democratic (SPD) Government and the Christian Democratic (CDU) opposition openly opposed the hostile takeover in Mannesmann's home state of North Rhine-Westphalia. For example, CDU official Jürgen Rüttgers said that hostile takeovers were a throwback to raw Manchester capitalism and did not belong within the context of a social market economy. Likewise, North Rhine-Westphalia Minister President Wolfgang Clement (SPD) spoke at the Mannesmann employees' assembly and assured the works council of his support. The Federal Government was considerably more moderate. Chancellor Gerhard Schröder (SPD) warned that hostile takeovers threat to destroy corporate culture that had grown up over time.

The takeover battle also coincided with the early phase of discussion over a German takeover law in anticipation of the European Union directive. As discussed above, Germany does not have a takeover law and only recently developed a voluntary code. The code is surprisingly bidder-friendly, allowing bids to be improved mid-way and not requiring any cash component. It is not surprising that the takeover of Mannesmann has raised demands for a more target-friendly law that would protect domestic firms. At the time of writing, consultations over a takeover law have not been completed. One remarkable aspect is the demand made by the President of the umbrella organization of the German Chambers of Industry and Commerce that the breakup of corporations should be prevented by law following hostile takeovers in order to prevent American-style conglomerate bust-ups. Such provisions are very unlikely to be incorporated into the law.

Given that an open political conflict was avoided, Mannesmann and Vodafone engaged advertising companies in an unprecedented campaign for the loyalty of shareholders. Mannesmann reported investing some 170 million euros on takeover defenses and 20 million euros for advertisements related to the takeover battle alone, while Vodafone spent some three times this amount. Mannesmann's agencies such as KNNSK/BBDO in Hamburg were hired to counter Vodafone's

ads and vice versa. Thus a bizarre exchange of ads began, in which companies themselves were the goods being sold.

Figure 1

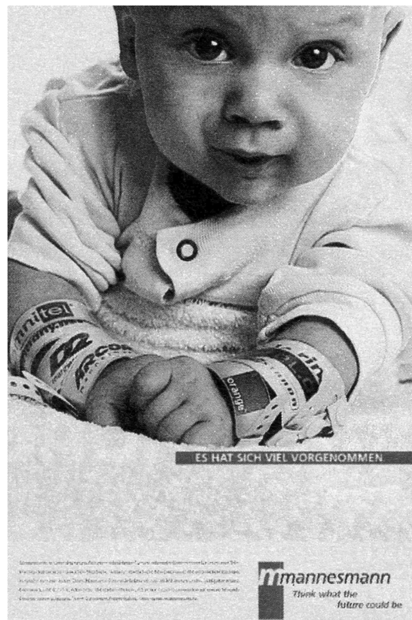


Figure 2

Figure 3

The first ad from Mannesmann (Fig. 1) in December 1999 shows a baby with the name of its subsidiary telecommunications company with the caption "It has a lot planned." Vodafone (Fig. 2) responded with an ad showing a mother feeding its baby with the caption, "Every *Mann* (a reference to *Mannesmann*) knows: If you want to grow, you need a good mother." Mannesmann again replied with a new version of its original baby picture, this time with the caption "A hostile mother is the worst thing in the world." A further series of ads (Fig. 3) displays the German signs for construction sites. Mannesmann captioned the ad "Warning! Vodafone will turn your stock portfolio into a construction site." Vodafone's reply shows the medieval fools' hat used in the Rhineland carnival season with a caption suggesting that Mannesmann were making fools of its shareholders. German newspapers and magazines enjoyed high demand for full-page ads for the next three months, often with the ads displayed opposite one another. Shareholder activists are appalled at the high sums spent in the name of the shareholders' interests, and in December 1999 a lawsuit was filed to halt the spending but was refused by the *Landesgericht* (higher court of first instance) in Düsseldorf.

4.7 The Conclusion of the Takeover Battle

By mid-January 2000, it had become increasingly clear that the majority of Mannesmann shareholders would sell to Vodafone. Foreign shareholders seemed clearly in favor of Vodafone, and they alone already held a majority of shares. Among domestic shareholders, opinions were generally estimated to be split 50:50. The takeover battle was decided when Klaus Esser's final and most spectacular defensive strategy failed: the search for a white knight. In the second week of January, rumors emerged that the French conglomerate Vivendi might become a partner in the takeover defense. Mannesmann surprisingly announced that Vivendi was its strongest partner and shared the same strategic vision. Amid merger rumors, Mannesmann announced it was developing plans for a merger of its core businesses with the telecommunications division of Vivendi. At the same time, Esser announced that a merger with Vodafone was being considered if Mannesmann shares made up a clear majority in the new company, with 58.5 percent being given as a realistic figure. Chris Gent offered Mannesmann shareholders only a 48.9 percent share of the new company. By the end of January, Vodafone entered into negotiations with Vivendi and sought to win them as a possible buyer of Orange following the takeover battle. The fronts shifted, as Vivendi announced a joint Internet portal with Vodafone if the takeover succeeded. The white knight strategy had failed.

On February 3, 2000, an agreement was announced between Vodafone and Mannesmann. Klaus Esser accepted an improved bid giving Vodafone a 50.5 percent and Mannesmann a 49.5 percent share in the merged company. In addition, the agreement made a number of promises regarding the continuation of the integrated telecommunications strategy at Mannesmann, and all fixed-line network and Internet activities were to be moved to Düsseldorf. Assurances were given that Mannesmann subsidiaries Arcor and Infostrada would not be sold and that the IPO of the engineering and automotive businesses would proceed as planned in Summer 2000 without the divisions being broken up and sold as subunits. The Supervisory Board approved the plan on February 4 with the consent of the labor representatives. Klaus Zwickel (IG-Metall) expressed his satisfaction with the agreement: "The employee representatives on the Supervisory Board accept the merger on this basis." The merger agreement largely laid to rest fears of large-scale dismissals, despite the fact that no formal guarantee was made. Shareholders had gained some 100 million euros, constituting a 120 percent rise in the share price between mid-October 1999 and February 3, 2000. Thus shareholders were able to realize short-term gains through the takeover battle as a result of the increased percentage given to Mannesmann shareholders in the share swap.

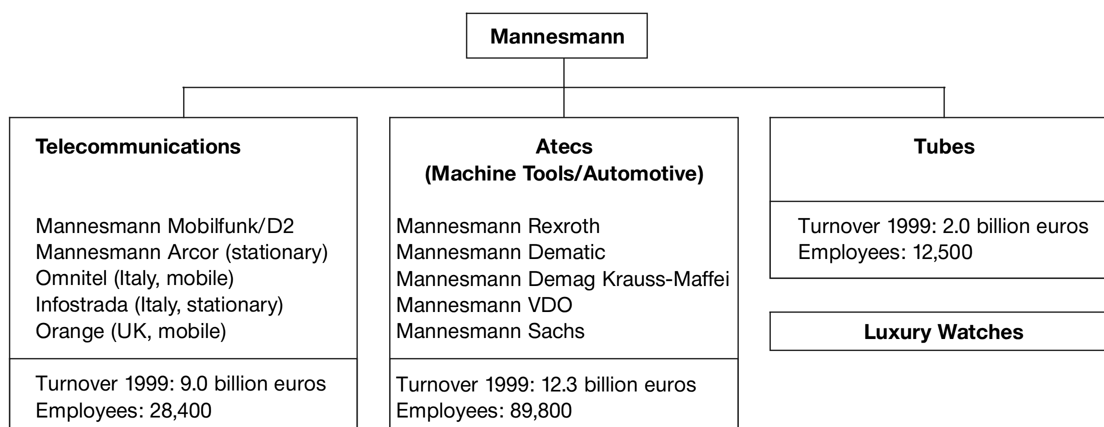
The main motivation for the capitulation of Mannesmann management appears to have been the failed alliance with Vivendi. On February 7, Klaus Esser was quoted as saying that "until Vivendi entered its alliance with Vodafone, we had a clear advantage in the loyalty of the shareholders. After this announcement, we began a series of calls to the largest investors. After that, it became clear that Vodafone would receive at least 45 percent." The agreement between Vodafone and Vivendi over a common Internet strategy rebuffed some of Esser's strategic arguments that Vodafone was blind to the Internet. An open question remains whether the Supervisory Board continued to support Esser even after the failed negotiations with Vivendi or whether it pushed management toward accepting a friendly deal with Vodafone. Past takeovers such as Continental and Thyssen show that the Supervisory Boards of the target companies often make great efforts toward achieving a friendly merger. However, no definitive answer can yet be given in the case of Mannesmann. Following Vodafone's second offer, newspapers increasingly reported rumors that Esser was having difficulties in maintaining the support of the Board, although Esser denied these claims. Speculation remained that Supervisory Board members Jürgen Schrempp (DaimlerChrysler) and Henning Schulte-Noelle (Allianz) had pushed for a friendly merger. However, a labor representative of the Supervisory Board denied any notable differences of opinion. In such intense media battles, strategic misinformation can also be an important tactic to influence public opinion: Rolf Breuer (Deutsche Bank) was reported to support the takeover bid, but was in fact not even a member of the Supervisory Board.

4.8 Post-merger Reorganization

The months following February 2000 were characterized by intense discussion over the modalities of reorganizing Mannesmann (see Figure 4). However, the reorganization is fraught with conflicts. First, the planned listing of Atecs (the automotive and engineering divisions) did not go ahead, despite opposition from Klaus Esser and Joachim Funk. Atecs has some 90,000 employees, accounting for 70 percent of Mannesmann employees and some 53 percent of turnover. Vodafone's demand for cash led to the quick sale of Atecs to the highest bidder, going to Bosch and Siemens for 9.75 billion euros in April 2000. Many accused Chris Gent of breaking his promise that Atecs would become independent. Bosch and Siemens pledged that no redundancies would be made before the end of 2003. However, Atecs' various businesses are being further split up, and subsidiaries outside Siemens' core areas sold. A growing number of white-collar employees in management have sought other jobs, and only some 170 of 440 remain. Second, Salzgitter AG bought the tube production facilities from Mannesmann. Histori-

cally the core business of Mannesmann, this division suffered large losses in recent years and was sold for the symbolic price of DM 1. Finally, the secondary business of luxury watches was also sold in July 2000.

Figure 4 Core Participations of Mannesmann, 1999



Vodafone also restructured the telecommunications businesses in line with its past strategy of mobile networks. As expected, the European Commission approved the merger on the condition that Orange be sold, going to France Telecom for 48 billion euros in May 2000. The high price paid represented a profit of 9 billion euros from the purchase and resale of Orange over a period of a few months. Contrary to the assurances given by Chris Gent about an integrated strategy, the Italian fixed-line network company Infostrada was sold to Enel Spa and its subsidiary Wind for some 11 billion euros. Mannesmann Arcor now remains isolated as the last fixed-line network business, despite its strength as the main competitor of Deutsche Telekom. Given the distrust that exists toward the British parent, employee morale remains particularly low at this division, and a growing number of employees are being lured away by competing firms. The planned IPO of Arcor has been delayed due to new demands from its minority shareholder, Deutsche Bahn AG.

In retrospect, the takeover allowed Vodafone to further its focused strategy on mobile communications by gaining control over two strategically key businesses, Mannesmann Mobilfunk / D2 and Italian Omnitel. This strategy is highly favored by analysts, wary of falling prices for fixed-line communications. Whereas the integrated strategy pursued by Mannesmann was designed to compete with the integrated telecommunications monopolies such as Deutsche Telekom, these firms are splitting their holdings into separate businesses. While the takeover was

paid for by a share swap alone, Vodafone demanded cash as it sold Mannesmann's other divisions and created a gold mine of liquidity for refinancing. Vodafone now has the most UMTS licenses in Europe and lower debt than major competitors, and its share price has suffered less from the downturn in the telecommunications industry, sinking some 40 percent rather than the sector average of 60 percent. The brand name "Mannesmann" is being replaced by Vodafone.

The final shareholders' meeting of the independent company of Mannesmann took place in June 2000. A total of 98.71 percent of share capital was present: 98.6 percent held by Vodafone and the remaining 0.11 percent by small shareholders, of which some 300 individuals were present. The remaining shareholders sharply criticized both the management and new owners. Shareholder activists Hort Steinharter and Jörg Pluta accuse Esser of ripping off shareholders by not seriously negotiating with Vodafone and by spending large amounts on takeover defense against the interests of shareholders. They also criticized Esser for having received not only the DM 28 million specified in his contract, but an extra DM 31 million "achievement award" upon departure at the initiative of large shareholder Hutchison Whampoa (Slodczyk 2000; *Manager Magazin* 3/01, 156). This award prompted an investigation into Klaus Esser on corruption changes by the Düsseldorf court. Although the court initially dismissed a suit brought by two German lawyers, the court opened an investigation in March 2001 on the suspicion that Esser and other members of Mannesmann management had been promised financial rewards for consenting to the takeover.[22]

The new management structure at Mannesmann reduced the Board to just three members: Julian Horn-Smith (Vodafone), Thomas Geitner (formerly of the German company RWE and OtelO), and Albert Weismüller (Mannesmann). Five members of the past Management Board left over the next few months. Weismüller had been planned as an internal appointment before the takeover, scheduled for February 2000. This new Management Board structure sparked conflicts with the labor representatives of the Supervisory Board. Past labor director Sigmar Sattler left Mannesmann, but remained labor director of Atecs AG. Unexpectedly, Vodafone rejected the idea that employees should approve the appointment of a labor director to the Management Board, the traditional procedure at Mannesmann. As a result, labor representatives boycotted the shareholders' meeting and abstained from voting during the appointment of Julian Horn-Smith as spokesman of the Mannesmann Management Board. The issue also created great uncertainty about the role of Mannesmann within the new company, e.g., whether Düsseldorf would retain strategic competence in coordinating the European strategy. Klaus Zwickel (IG Metall, Mannesmann Supervisory Board) said that "we won't take it lying down." On July 12, 2000, the Supervisory Board gave

22 This investigation remains open at the time of writing.

Alfred Weismüller additional functions as labor director, alongside his functions as finance officer. The Supervisory Board itself was also changed: four shareholder representatives (including ex-manager Joachim Funk) left, and three Vodafone Board members and one prominent German corporate lawyer were appointed. Meanwhile, three Mannesmann Supervisory Board members became non-executive directors of Vodafone: Josef Ackermann (Deutsche Bank), Jürgen Schrempp (DaimlerChrysler), and Henning Schulte-Noelle (Allianz).

5 Conclusion: Hostile Takeovers and the Institutional Change in German Corporate Governance

It was demonstrated above that the institutional barriers to hostile takeovers (Section 3.1) proved to be absent or insufficient in practice to protect Mannesmann in the hostile takeover battle with Vodafone. Is Mannesmann an exceptional case or a paradigmatic event that points to major underlying changes in German corporate governance? This paper argues that since the late 1990s, the institutional context for large listed German companies has changed sufficiently to make hostile takeovers a real threat. A limited but growing number of German corporations are exposed to a market for corporate control. The concluding section will review the role of various institutional barriers in the Mannesmann case and examine the degree to which similar parameters apply to other German corporations.

5.1 Mannesmann in Context

The vulnerability of Mannesmann primarily stemmed from its lack of a committed ownership structure: Its shares were highly fragmented among institutional and foreign investors typically holding less than 1 percent of the share capital. Mannesmann had a somewhat exceptional ownership structure for a German company, but is not an isolated case. With regard to ownership distribution among the largest 100 corporations, 75 percent of company shares are widely held in 11 companies, and the majority of shares are widely held in 23. Thus a key segment of the German corporate economy is similarly exposed. Ownership fragmentation will likely accelerate, given the strategic reorientation of German banks toward investment banking and as a result of the tax policy to eliminate capital gains tax for the sale of intercorporate shares in 2002. Where ownership is fragmented enough to leave corporations vulnerable to hostile bids, the other in-

stitutional factors that discourage takeovers are no longer enough to mobilize effective resistance.

Whereas German banks once played a major governance role, banks are increasingly unlikely to provide takeover protection. At Mannesmann, bank ties were not particularly strong. Despite the fact that there was a Deutsche Bank director on the Supervisory Board and a high level of proxy voting by banks, none of the German banks held a major equity stake. No known attempt was made to mobilize the influence of banks. More generally, German banks have begun a major reorientation toward investment banking, where the business of advising M&A deals stands in conflict with past relationship banking. The major private banks, Deutsche Bank, Dresdner Bank, and Commerzbank, have all made substantial moves in this direction. Consequently, the number of Supervisory Board seats in the largest 100 companies held by banks declined from 29 in 1996 to just 17 in 1998. In its corporate governance guidelines of March 2001, Deutsche Bank announced that it will no longer hold the chair on the boards of non-financial corporations (Deutsche Bank 2001). Likewise, banks have reduced the size of their largest ownership stakes and diversified their investments (Böhm 1992).

Codetermination also failed to have its expected deterrent effect. Mannesmann employees made little effort to mobilize resistance against the legitimacy of the bid. What was the reason for this weak opposition? The fear of job losses may have been relatively low, since Mannesmann is part of the booming telecommunications sector and the split with older industrial divisions was already planned. Thus employees may have had varied interests, and the most direct impact was expected in the telecommunications divisions that had lower rates of union organization. More generally, German labor unions may have also become resigned to the inevitability of takeovers.[23] During the watershed case in 1997, IG Metall was unsuccessful in uniting both the Thyssen and Krupp workforces in opposition to the bid. Here, employee interests as producers outweighed their common class interests in opposing the merger.[24] Consequently, Mannesmann labor representatives focused efforts on securing a favorable post-merger business plan. In this context, post-takeover restructuring shows that labor was ineffective in enforcing several major promises made by Vodafone: the Atecs division did not become independent, the integrated telecommunications strategy was abandoned, the Düsseldorf headquarters lost its strategic importance, and the name Mannes-

23 The union position in the debate over German takeover law is also revealing (Deutscher Gewerkschaftsbund 2000). Whereas the industry associations favor a wider range of defensive tactics for target firms, the unions support a more restrictive version, including Supervisory Board codetermination of defensive action taken by management.

24 On the distinction between the class and producer interests of employees, see Streeck (1993).

mann was dropped in favor of Vodafone D2.[25] It is obviously difficult to predict whether such a "breach of trust" will have learning effects for German labor, either in increasing future resistance to takeover bids or in obtaining binding concessions from predator firms. However, the cases of Mannesmann and Thyssen-Krupp show that mergers involve complex questions of industrial strategy in which organized labor strongly considers its company-specific producer interests, often at the expense of its wider class interests.

In the absence of active resistance from stakeholders, the various regulatory factors discussed earlier (accounting rules, corporate law, competition law, and other defensive actions) were insufficient to ward off a hostile bid or to construct an adequate defense. German accounting rules did not discourage the takeover bid. In addition, past caps on voting rights in the Mannesmann corporate statutes were voided by the *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* (Act on Control and Transparency in the Corporate Domain, KontraG), passed in 1998, and went into effect mid-2000. However, Mannesmann did invoke other features of German company law during its takeover defense, particularly the need for a super-majority to gain effective control and carry out the sale of Orange. While the issue loomed large for a short period during the battle, this factor alone was also insufficient protection. Competition law was also a consideration because of Orange. However, the very strong M&A market in European telecommunications left little doubt that Orange could quickly be sold at a high price, thus failing to act as a decisive factor. Given the lack of institutional protection, the main defensive action taken by Mannesmann management was the search for a white knight. White knight strategies are always uncertain, and the failure to secure an agreement with Vivendi certainly sealed the outcome of the takeover battle.

Finally, Mannesmann also exemplifies the substantial moves already made toward a corporate culture of "shareholder value." The spin-off of traditional businesses was already planned before the takeover and was no longer an issue in the takeover battle. Although the two competing management teams did propose substantially different corporate strategies, both alternatives were within a similar spectrum circumscribed by the capital market.

As the institutional barriers to takeovers weaken, German corporations with dispersed ownership will increasingly face the threat of takeover. This claim is independent of the other economic factors that drive M&A. In the Mannesmann case, M&A was rife within the booming telecommunications sector, and the bubble in technology stocks at the time of the merger made Vodafone shares extremely at-

25 However, some post-merger policies of Vodafone were also supported by factions of the union IG Metall (although not the works council), in particular the sale of Atecs.

tractive. However, the telecommunications sector is not exceptional in either regard. During the late 1990s, cross-border takeovers in Europe were more or equally prevalent in the banking industry, utilities, electronics, and chemicals. Moreover, the hostile takeovers in the United States during the 1980s were targeted at conglomerates in low-growth industries. British and U.S. firms also have consistently higher valuations *relative to* German companies in the *same sector*, thus reproducing their relative advantages in takeover contests nationally. Hostile bids will thus remain a persistent threat despite the cyclical nature of M&A.

5.2 Political Regulation of Takeovers

The direct impact of the Mannesmann case was the renewed discussion over the urgency of a binding takeover law in Germany. The law should not only protect the interests of shareholders, but also create clear procedures for the bidding process. In March 2000, the Chancellor's Office set up an expert commission to make recommendations.[26] The Ministry of Finance then presented a draft law in June 2000 and a revised draft in March 2001 (Bundesministerium der Finanzen 2000; 2001). Both drafts restrict defensive actions taken by management by requiring the Management Board[27] to be "neutral" and to refrain from issuing shares, undertaking share buy-backs, or engaging in measures that have a significant impact on company balance sheets. White knights would thus be the only active defense permitted. This clause was praised by various shareholder associations, but was criticized by German corporations and unions. The opposition stalled the quick passage of a law.

At the same time, surprising developments occurred at the European level.[28] In June 2001, a special mediation committee reached agreement on a draft takeover directive for submission to the European Parliament. Among its liberal provisions, this compromise draft included the controversial requirement of manage-

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26 The controversial recommendations made by the expert commission included mandatory tender offers at a level of 30 percent, no requirement for cash payment, and the neutrality of the Management Board with regard to defensive measures (Bundespresseamt 2000).

27 This notion of neutrality is much more restrictive than prohibitions on "frustrating actions" in the British code, which prevent management from taking actions that intentionally destroy value and go against the interests of the company.

28 The EU has been unsuccessful in developing a takeover directive since the initial draft in 1989. The main points of debate were: the control threshold for requiring tender offers, requirements for cash payments to slow takeover activity, time limits for the acceptance of a tender offer, information rights for employees, and the scope for defensive tactics that management is allowed.

ment neutrality. The dramatic vote by the European Parliament was 273 in favor, 273 against, and 22 abstentions. The directive thus failed to be passed, because the President Nicola Fontaine abstained. Germany was sharply criticized in the press, being viewed as responsible for the failure after having withdrawn its support in the last few days before the vote. In particular, Volkswagen chairman Ferdinand Piëch, BASF finance officer Max Dietrich Clay, and union leader Hubertus Schmoldt (IG-BCE) were cited as having had an influential political lobby for more protective regulation. Their two main arguments both pointed to German firms being put at a disadvantage in takeover contests: U.S. managers are allowed much more freedom to implement takeover defenses and, unlike Germany, other European countries retain "golden shares" that give the state power to block takeover attempts. The result was greeted by both the Federation of German Industries and the German Banking Association.

Subsequently, the German Government moved quickly to present another revised takeover law scheduled for a vote in the Bundestag in Fall 2001 (Bundesministerium der Finanzen 2001). While drawing largely on the previous draft law, the neutrality rule has been replaced by the option for defensive actions with shareholder approval. Specifically, the shareholders' meeting can empower management to take defensive actions for an 18-month period with a 75 percent majority vote. The law also requires the Management Board to publish the stance of the works council on takeover bids as part of the official response. The content of the final law remains open at the time of writing. However, given its present form, the law is unlikely to create major barriers to takeovers or to radically accelerate the market for corporate control as the original European proposal may have done.

5.3 Institutional Change and the German "Model" of Corporate Governance

The main conclusion of this paper is that, given the erosion of previous institutional barriers to hostile takeovers and unlikely political prospects for strong restrictions, Mannesmann will not remain an isolated incident in Germany. What implications does the emergence of a market for corporate control have for the institutional change in German corporate governance? The various "institutional" schools of thought view institutions as the social and political rules for economic action, leading to different norms and incentives for actors and shaping their identities over time. Markets for corporate control are qualitatively different from individual markets for products, capital, and labor, and this fourth market is a qualitatively new institution in which entire organizations combining the other factors of production are bought and sold (Windolf 1994). Takeover markets cre-

ate new incentives and constraints for organizations and alter the interests of major actors and the distributional compromises embedded within previous corporate governance coalitions. The emergence of a market for corporate control, even on a limited scale, demonstrates that Germany can no longer be described without qualification as having a bank-oriented, insider, or stakeholder model of corporate governance. While true international convergence remains far off, Germany is developing a novel "hybrid" model of governance characterized by the institutionalized participation of labor within an increasingly open capital market (Streeck 2000; Vitols 2000; Jackson 2002).

Three implications may be drawn from the case of Mannesmann as to the contours of an emerging hybrid: First, takeovers are likely to have distributive effects. Whereas labor normally captures a high share of the value-added, markets for corporate control make the "equilibrium" of lower market capitalization and lower distribution of value-added for shareholders increasingly difficult to sustain (Section 2.2). A growing number of corporations report concern about hostile bids and are attempting to strengthen share prices and engage in preventive M&A that increase their own size relative to international competitors. Together with the expanding "supply side" for equity capital and higher stock price valuations, markets for corporate control will thus reinforce broader efforts to implement corporate practices oriented toward shareholder value. Consequently, widely held German corporations are increasingly divesting diversified business (Zugehör 2001). Moreover, German corporations with highly dispersed ownership pay out significantly higher shares of value-added as dividends, and those implementing shareholder value programs have a smaller labor share due to reductions in overall employment (Beyer/Hassel 2001). Mannesmann was already moving down a path of changing its corporate culture or the "conception of control" (Fligstein 1990). The capacity to buy and sell entire companies as marketable commodities is closely linked with a tendency by management to view organizational units in terms of their financial contribution to increasing corporate value on the stock market.

Second, markets for corporate control further the functional change of codetermination as an institution. Codetermination historically emerged as a political component of economic democracy aimed at putting capital and labor on a more equal footing (Jackson 2001). The market for corporate control forces employee representatives to increasingly internalize the reactions of international capital markets to company policy. While codetermination as a legal institution remains unchanged, employee representation increasingly adopts functions of co-management in serving the competitive interests of corporations. Takeovers fall outside the realm of codetermination and upset the existing set of implicit contracts between stakeholders. While the Supervisory Board of Mannesmann ac-

cepted the bid on the basis of promises about maintaining an integrated telecommunications strategy, the strategic plans and the independence of business units were dramatically changed as a result of the transfer of ownership, and labor had little capacity to enforce promises made at the time of the takeover.

Third, markets for corporate control create new opportunities for corporate managers to exercise power and may make relatively little contribution toward improving managerial efficiency. According to leading theories, markets for corporate control are a mechanism for correcting "managerial failure" and pose an effective solution to the agency problems of dispersed shareholders having little means of controlling management. Mannesmann shows that takeovers are also about the exercise of power and that "good" companies can also lose. Takeover markets provide a new means for pursuing strategic interests by eliminating competitors and gaining control of strategic resources. Vodafone was able to strengthen its own position and capture the rewards of restructuring and spin-offs. While takeover markets may be an inevitable development in Germany and may improve short-term returns for shareholders, takeovers are only a very imperfect substitute for mechanisms of internal control that increase accountability and enable long-term investment in building organizational capacities.

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