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ABSTRACT

Hostile Stakes and the Role of Banks in German Corporate Governance*

This paper uses clinical evidence to show how the German system of corporate control and governance is both more active and more hostile than has previously been suggested. It provides a complete breakdown of ownership and takeover defence patterns in German listed companies and finds highly fragmented (but not dispersed) ownership in non-majority controlled firms. We document how the accumulation of hostile stakes can be used to gain control of target companies given these ownership patterns. The paper also suggests an important role for banks in helping predators accumulate, and avoid the disclosure of, large stakes.

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Keywords: corporate governance, block trades, takeovers, banks, Germany

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NON-TECHNICAL SUMMARY

The German system of corporate finance has long been characterized as 'bank-based', meaning that Germany's universal banks are seen as fulfilling two central functions: they are the main source of funding and they monitor management through their positions on supervisory boards and via the voting rights they hold both directly (through direct equity stakes) and indirectly (as the holders of proxies on shares deposited with them). This stylised framework was believed to contrast with the Anglo-Saxon 'market-based' system, where public bond and equity markets are viewed as the primary source of funding and scrutiny by shareholders is believed to act as a check on managerial discretion.

The first part of this convenient characterization has recently been shown to be incorrect: there appears to be very little difference between Germany and the Anglo-Saxon countries in the use and importance of bank debt. This has led to a revision of the paradigm, which now views Germany as having an 'insider' system where different stakeholders (including banks) are involved in corporate governance, while the United States and the United Kingdom operate within an 'outsider' system based on the infrequent intervention of dispersed shareholders. One consequence of the new distinction is the belief that managerial failure is corrected via hostile takeovers in Anglo-Saxon countries, whereas in Germany, where there are allegedly no hostile takeovers, received academic wisdom still sees German banks as important monitors.

One source of these alleged cross-country differences is the different degrees of ownership concentration: the United Kingdom in particular has widely dispersed shareholders, very few of whom own stakes greater than 3% in stock-market listed companies, whereas large block holdings are common in Germany. Large blockholders clearly have more of an incentive to scrutinise managerial behaviour than do atomistic shareholders who are prone to a free-rider problem: they would rather that someone else monitors management.

The purpose of this paper is to provide empirical evidence on the widespread belief – which underlies the above paradigm – that the German system of corporate governance operates with a very low level of hostility. The paper first investigates the ownership structure of all quoted German companies: which companies have large blockholders, how large the blocks are, how many blocks exist, whether there are voting restrictions or other impediments to takeover, and the maximum size of the remaining free float. Using this

information we estimate that of the 558 quoted German companies in 1991 *at most* around 140 could conceivably be taken over by a hostile predator. Taking account of the likely impact of voting restrictions and other takeover barriers a more likely estimate would be around 100. Very few of these conform to the Anglo-Saxon pattern of *dispersed* shareholdings; instead, they typically have a number of non-majority blockholders, a pattern which we call *fragmented* ownership.

Against this background, it is hardly surprising that there have been virtually no hostile Anglo-Saxon style *tender* offers in Germany: in the presence of single or multiple blockholders and low outside share ownership, a tender offer, targeted at non-blockholding outside shareholders, is unlikely to lead to a change of corporate control. The accepted conclusion that there are no hostile control changes in Germany is erroneous, however. We identify an alternative mechanism by which corporate control is exercised: the accumulation of *hostile stakes*. Drawing upon the recent theoretical literature on the importance of large blocks we find a number of cases in recent years where companies and individuals have sought to gain effective control (or, in some cases, cooperation and influence) against the wishes of the incumbent management. The process of accumulating hostile stakes frequently involves forming coalitions with, or buying out, existing blockholders as well as through open market purchases. Outside minority shareholders are bought out, if at all, only once majority control has already been established. Germany's weak protection of minority shareholders explains why such buy-out offers are predominantly on disadvantageous terms. Importantly, the main difference between UK-style hostile takeovers and Germany's hostile stake-building is neither raiders' intentions nor the outcome, but only the mechanism through which control is acquired.

Control changes are, of course, very frequent even in Germany. Indeed, the Financial Times Mergers and Acquisitions (FTMA) database which we use covers 2,500-odd changes in ownership structure between the late-1980s and December 1996. The challenge, however, is to identify those control events which were opposed by incumbent management (our definition of hostility). We do this by concentrating on non-majority owned companies as identified in our ownership breakdown, and analysing all available information about the circumstances of the control event as publicly reported. Having applied a number of filters to the FTMA listings we find 17 cases where companies have been subject to hostile stake-building. As a proportion of the 100 or so companies that are potentially subject to such attention, this represents quite a high level of hostility.

For each of these 17 cases we investigate the dynamics of the stake-building, the defensive and offensive coalitions, and the role of banks. The appendix provides short case studies on each of these, which reveal a number of interesting patterns. First, attempts to influence corporate control via hostile stake-building have a high success rate. There were only three cases where the target was generally successful in fighting off the predator, in two of which the cartel office effectively blocked the predator, while in the remaining case court decisions on voting restrictions were the decisive factor in thwarting the bidder (though the supervisory board nevertheless dismissed the CEO). Control changed hands in 11 cases, and typically incumbent management is removed or resigns. In two of the 17 cases the bidder ultimately cooperated with the target in return for influence over corporate strategy and board representation.

Second, we illustrate the complex role that banks can play in corporate governance. Far from being a substitute for Anglo-Saxon outside monitoring, we document that banks play an active role in assisting predators pursuing a strategy of hostile stake-building. We document many cases where banks play a pivotal role in assembling, brokering and concealing stakes. In contrast, it is striking how few examples we find of banks actively *defending* target companies from a hostile stake-builder. Such behaviour may, of course, be compatible with the view that banks actively monitor German companies and help to effect changes in corporate governance in the case of failing firms. It is important to recognise, however, that this role is performed not by the companies' *house banks* (who are often believed to be acting as monitoring intermediaries drawing on their privileged information), but by the banks assisting the predator. This role has not previously been recognised.

Finally, we discuss some of the policy implications of these findings. First, critical to the success of the hostile stake-building approach are Germany's relatively weak rules on ownership disclosure and parties acting in concert: the less information a raider has to disclose to both target management and potential sellers of blocks, the easier (and cheaper) it is to assemble stakes of sufficient size to mount a control challenge. A number of recent policy changes have sought to address these issues, though we doubt how effective they will prove. Second, in our view the Takeover Code which Germany has recently introduced will do little to protect the minority shareholders who are so often the losers in these bid battles. With German banks tending to reduce the size of their equity holdings, and a general move towards giving greater emphasis to 'shareholder value', we envisage that the market for stakes, of both a hostile and friendly nature, will become increasingly active in the future.

We do not, at this stage, wish to claim that hostile stake-building is an efficient substitute for Anglo-Saxon hostile takeovers. Which system of ownership and corporate governance ultimately performs 'better' is an important question which remains to be investigated.

I Introduction

There is a widespread belief that the German system of corporate governance exhibits a very low level of hostility (Franks and Mayer 1995). In the stereotypical view of German finance, Krupp's recent (ultimately unsuccessful) bid for rival steel producer Thyssen is seen very much as exceptional. And indeed so it is, except not due to its hostility—which this paper argues is much less unusual than is commonly believed—but due to the fact that it was possibly Germany's first-ever truly Anglo-Saxon tender offer: being open to all shareholders and offering a 25.5% premium. Whilst it is thus true that there are extremely few recorded instances of hostile tender offers, we suggest that there is a much greater incidence of companies accumulating *hostile stakes* or blocks in an attempt to gain control.

German corporate law is particularly weak in terms of requiring share stakes to be made public, preventing parties from acting in concert, and protecting minority shareholders. As a result, it is possible to seize control of a public company without ever having to make an offer to shareholders in general. In the next section, we document Germany's high ownership concentration, the predominance of corporate cross-shareholdings, the presence of multiple large shareholders, the low levels of free float in most quoted companies, and the presence of takeover defences. In such a setting, it is not surprising that the market for corporate control operates via stake changes rather than tender offers: unless a majority of the target company's equity is widely held, the success of a tender offer ultimately depends on non-atomistic shareholders' willingness to part with their stakes. In the presence of such pivotal shareholders, the efficiency with which the stock market can correct managerial failure and reallocate resources to their highest use will depend crucially on whether large shareholders can be persuaded to break ranks by selling to a possibly hostile outsider. In fact, we show that only about one sixth of all listed companies seem at all at risk from hostile takeovers.

The virtual absence of Anglo-Saxon hostile tender offers has led many authors to characterise Germany as a 'bank-based' financial system, with banks (rather than markets) playing an important role in the financing and control of German corporations. However, doubts have recently started to emerge about both functions. In terms of financing there is growing evidence that, in aggregate terms, German banks provide similar proportions of total finance to their domestic corporate sector as do their counterparts in the supposedly 'market based' financial systems of the US and UK (Rajan

and Zingales 1995; Corbett and Jenkinson 1996). In terms of control, serious doubts are emerging regarding the 'monitoring intermediary' role that banks are said to perform[1] through their direct and indirect equity holdings and through representation on the supervisory boards of companies. Various authors have questioned what incentives exist for banks to provide a free monitoring service for outside shareholders, and how effective any such monitoring is likely to be given that the major banks, through their holdings of proxies, essentially control themselves (Edwards and Fischer 1994; Roe 1990). Recent spectacular failures of corporate governance, such as the cases of Metallgesellschaft, Klöckner-Humboldt-Deutz and, some would argue, Daimler-Benz, have encouraged a renewed attempt to understand how corporate control is actually exercised in Germany (Franks and Mayer 1990; Kaplan 1994; Wenger and Kaserer 1996; Frankel and Palmer 1996).

This paper contributes to this debate by analysing a number of cases where hostile stakes have been accumulated, and where changes in corporate control have been attempted. The case studies show the dynamics of stake accumulation and suggest that the market for corporate control in Germany is rather more active—and hostile—than has previously been claimed. Our results throw doubt on the general view of Germany having an 'insider' system of corporate governance: after all, outsiders do try to get control. We also analyse the behaviour of banks in such battles and find their role to be far more complex than has previously been documented. Far from "protect[ing] firms from interference from external parties, in particular from hostile takeovers" (Franks and Mayer 1990, p. 208), German banks have, on a number of occasions, been actively involved in bringing about hostile changes of control by facilitating stake building. For example, we show how banks can assist predator companies in the accumulation of hostile stakes, and how beneficial ownership can be obscured. We also consider how the regulatory environment allows such stake accumulation to occur and whether recent important changes—such as the introduction of Germany's first Takeover Code—will influence the way that corporate control is exercised in the future.

Our focus on the use of share blocks as a mechanism for changing corporate control is closely related to the recent theoretical literature on the role of share blocks in explaining corporate performance. This literature has investigated the monitoring role of large but non-controlling blockholders who occasionally acquire control via tender offers (Shleifer and Vishny 1986); the optimal size of *controlling* blocks given the benefits and costs of market monitoring (Holmström and Tirole 1993); monitoring by outside activist financial investors such as CalPERS (Smith 1996); the

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[1] Examples of the traditional view include Grundfest (1990, p. 105), "...in both Germany and Japan, corporate investors and intermediaries are able to reach deep into the inner workings of portfolio companies to effect fundamental management change. They do so without the need for a hostile takeover or proxy contest."

creation of toehold stakes in tender offers (Shleifer and Vishny 1986; Bulow, Huang and Klemperer 1996); and the private control benefits that large blocks may confer.

An early paper by Barclay and Holderness (1989) identified that even in the US, where corporate ownership is typically more dispersed than in Germany and other continental European countries, significant share blocks were surprisingly common.[2] These blocks typically trade at a premium to the market price when sold, which the authors suggest is consistent with there being private benefits of control. In a later paper, Barclay and Holderness (1991) investigate the impact of negotiated block trades upon corporate control. They find that in those companies that are not subsequently acquired by the blockholder, in a third of cases the CEO is replaced within a year of the trade. This is interpreted as evidence of blockholder monitoring.

Along similar lines, Zwiebel (1995) considers the reasons why US companies often have large numbers of relatively small blockholders who individually would be unable to exercise significant control. He reports that in 1981 the average Fortune 500 company had 10.5 investors with blocks exceeding 1% of the equity, and 4.7 investors with blocks exceeding 2%. Zwiebel attempts to explain these ownership patterns by suggesting that private benefits of control are divisible, and can be shared by a number of individual blockholders who form controlling coalitions. However, the existence of a large blockholder will tend to discourage small blockholders, who would then find it more difficult to form controlling coalitions. Hence, in equilibrium, Zwiebel suggests three general ownership structures: (i) firms with plenty of small blocks but no large blocks; (ii) firms with one large and several small blocks, and (iii) firms with one very large blockholder and no small blocks. Hence, large blockholders tend to 'create their own space', i.e. their presence dissuades others from building a share block in the firm.

An interesting aspect of Zwiebel's paper is that he considers the dynamics of multiple potential blockholders, all pursuing a share of the (divisible) private benefits of control. However, whilst our paper similarly documents multiple competing blockholders, we focus on a very different motivation for block building, namely to effect a control change via the accumulation of a majority or controlling stake. In the cases that we consider there are often *multiple* large blockholders who are engaged in trades (often of a clandestine nature) to build a controlling majority (or dominant) stake. Hence, whilst the 'private benefits of control' literature tends to view the benefits as being derived from existing management, and taking the form of perquisites, favours conferred by the

management, or access to privileged information, what we observe in our cases is the role of stake building in effecting a hostile change in control.

Not all recent papers have focused on private benefits of control as the main motivation for block holding. For example, Bolton and von Thadden (1996) have considered the trade-offs between shareholder structures with a large blockholder as opposed to more dispersed ownership. They suggest that the existence of a large blockholder is likely to result in better monitoring and control of management, but, in contrast to Barclay and Holderness and Zwiebel, assume that the blockholder incurs net *costs* (rather than benefits) from exercising control. This assumption is justified on the basis that if control bestowed net private benefits, corporate control problems would collapse onto the issue of selecting among the many competing investors who would bid to accumulate a large block. However, Bolton and von Thadden also suggest that the existence of a large blockholder will result in reduced levels of liquidity in secondary markets, which will tend to depress the value of the firm. Hence, a trade-off exists between control and liquidity. Probably the closest paper to ours, albeit drawing on US evidence, is Denis and Serrano (1996) who consider the role of blockholders in effecting management and business restructuring and preventing the use of value reducing defensive tactics during control contests.

Our paper is also related to the literature on optimal takeover regulation, since we focus particularly on the ability of hostile stakes to be built up without the knowledge of other market participants—something that the existing block literature assumes away. For example, as Burkart (1996) notes, it is critical whether stake building, and hostile intentions, can be obscured because as soon as such a strategy becomes transparent free-riding (along the lines suggested by Grossman and Hart 1980) is likely to result. Loose disclosure and acting-in-concert regulation will provide the opportunity for hostile control changes to be effected via stake building and for such behaviour to be profitable. Such loose regulation exists in a number of continental European countries including, in particular, Germany. Hence, the behaviour that we focus on in this paper is, in a sense, quite predictable, although no previous paper has, to our knowledge, provided systematic evidence on the importance of hostile acquisitions in Germany via stake building.

The only previous paper to consider the importance of share stakes in Germany is Franks and Mayer (1995), who document a large incidence of stake changes, such changes being the most significant influence on the turnover of supervisory board members—which is not surprising since owner-

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[2] They quote figures from a 1984 survey by the SEC that around 20% of NYSE and AMEX companies have at

representatives usually form the core of the supervisory board. However, they do not consider the nature of these sales, and in particular whether they are part of a strategy aimed at seizing control in a clandestine or hostile fashion. Within our case studies we can analyse how stakes are accumulated and whether they are hostile.

The remainder of the paper is organised as follows. In Section II we analyse ownership patterns in Germany and outline our research methodology and our data sources. Section III presents evidence on hostile stake accumulation for a number of recent cases (detailed chronologies of which are provided in an appendix). Section IV concludes by discussing a number of policy issues regarding corporate governance that are raised by the case studies.

II Data and Methodology

2.1 Ownership structure in Germany

Ownership of German companies is highly concentrated. Table 1 gives a complete breakdown of the ownership structure of all listed German firms in September 1991 by the size of the largest disclosed block (or pooled block where a pooling contract exists). There are five economically significant block sizes as defined by the rights of minorities and the discretionary powers of the dominant blockholders. A *block of 90%* or more severely restricts the residual rights of minority shareholders, who for instance can no longer make the management or supervisory boards liable for detrimental decisions; above 95%, the controlling party can compulsorily acquire the minorities' shares. A *block of 75%* (super-majority) or more gives the controlling party complete discretion in matters of supervisory board elections and profit-transfer and/or control agreements (without any requirement to buy out minorities) which tend to give rise to minority dilution opportunities. A *block of 50%* or more gives management control of the company, but is subject to limits on the controlling party's discretion due to the existence of a blocking 25%+ minority. A *block of 25%* or more gives veto powers on corporate charter amendments, supervisory board changes, and profit-transfer and control agreements. In the absence of other large shareholders, a 25% stake can provide substantial influence given an average presence of no more than 57% of votes at AGMs (Baums and Fraune 1994). Finally, a *block of less than 25%* gives relatively little minority protection.

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least one outside shareholder owning more than 10% of the common stock.

As can be seen from Panel A of Table 1, just under three quarters of all listed companies have a majority owner: 23.1% have blocks in excess of 90% of capital (or votes, if different), 18.4% are super-majority controlled, and 30.5% have a simple-majority owner. Only a quarter of companies—141 firms—are not at least majority-controlled by one blockholder. Panels B and C take a closer look at these 141 firms. 86 of these have one or more blocking minority stakes (Panel B), where of course two or three such stakes would have amounted to combined majority or super-majority control had the various blockholders pooled their votes (which to our knowledge they had not). The remaining 55 firms, in Panel C, have no stakes in excess of 25%. Thirty-seven of these have one or more disclosed non-blocking stakes, while 18 firms are classified as widely held because no stakes were disclosed at all (though Baums and Fraune 1994 claim that banks, despite owning only an average of 13% of widely-held firms' equity, control more than 80% of votes via proxies).

From the point of view of corporate governance the firms in Panels B and C are very interesting. In the absence of a majority owner, there are three alternatives for how these companies are controlled. They may either be (i) run by a coalition of non-pooling blockholders, or (ii) be controlled by the dominant blockholder with the connivance of the remaining blockholders, or (iii) run by management without much shareholder influence at all, in a way reminiscent of widely held firms in the US or the UK. Given the presence of sizeable and often multiple blocks, ownership in these firms is certainly not dispersed, but rather fragmented. This, we would argue, increases the scope for hostile stake building, especially where blockholders are in disagreement over corporate policy or where blocks are up for sale.

Table 2 lists the frequency of four types of takeover defences for all of Germany's listed companies in September 1991: instances where only non-voting preference shares are publicly traded; voting right restrictions which cap the number of votes any individual shareholder can cast; limitations on the transferability of shares (which give the target's board the option not to register the shares in the new shareholder's name, thus effectively disenfranchising the stake); and departures from the principle of one-share-one vote, as when certain classes of shares (usually held by friendly parties and not traded) have greater voting power at all times or under certain circumstances (for instance, for board elections). These forms of takeover defences are clearly rather widespread. A total of 21 companies, for instance, had voting rights limits ranging from 0.1% to 20% of votes. These firms all lacked a majority owner, being either widely held or having no more than blocking-minority stakes. 37 firms, mostly at least majority-controlled, chose only to list non-voting shares, 25 firms limited the transferability of shares, and 32 firms had shares with multiple voting power.

How many of the non-majority controlled firms could potentially become targets of hostile stake building? Clearly not all of them: firms with three blocking-minority shareholders would be relatively hard to buy into, if only because each blockholder, being pivotal, would demand a control premium. To answer the question we propose four increasingly difficult stake building strategies; see Table 3. First, a hostile bidder could attempt to build stakes in firms which have a free float of 50% or more, without buying any existing blocks. The companies which potentially fall into this category are widely held firms; companies with one blocking-minority stake; and firms with one or more non-blocking minority stakes. Checking for the presence of additional disclosed stakes and computing free float, we find 77 companies with a free float of 50% or more.[3] Second, a bidder could take over a company by buying one or more or all existing non-blocking stakes; there were seven firms potentially at risk from this strategy. Third, a more demanding takeover strategy is to buy out one existing blocking-minority stake and to make up the difference to 50% via open-market purchases. Thirty firms had one or two blocking minority stakes and enough free float for this strategy potentially to allow a majority takeover. The final strategy involves a bidder buying out two existing blocking minority stakes, for instance in companies which have two or three such stakes and too little free float to make any of the other strategies viable. This is clearly the most demanding strategy as the existing blockholders' veto power probably raises the control premium. In total, we have identified 139 firms which could potentially become targets of hostile stake building.

If the defensive features summarised in Table 2 are effective, some of these 139 firms are unlikely to be taken over. Table 3 takes this into account by looking in detail at the nature of the defensive arrangements in place. Two companies, for instance, listed only non-voting preference shares, making them virtually immune to hostile stake-building.[4] A further 20 had voting right restrictions, though we will argue later that the empirical effectiveness crucially depends on the level of the cap. Of the eleven companies with limited transferability, eight restricted transferability sufficiently to make a bidder's life difficult. Finally, of the 21 companies which had multiple classes of stock, one

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[3] This is the maximum number of firms with free float of 50%+. Where there are undisclosed stakes, true free float may be less than the level we calculated.

[4] Non-voting shares need not always be an effective takeover barrier. 95% of the voting shares of Nixdorf, a computer manufacturer, were in the hands of members of the Nixdorf family directly (25%) and via two charitable trusts controlled by the family and the management (70%), with Deutsche Bank owning a further stake; only non-voting preference shares were publicly traded. However, this did not prevent rumours of Nixdorf becoming a takeover candidate, partly because one family member was alleged to be looking to sell out. Nixdorf's CEO, Klaus Luft, was publicly and persistently opposed to any takeover bids. Since German corporate law stipulates that preference shares become enfranchised if a company passes the preferred dividend in two consecutive years, a condition which in the Nixdorf case was met, there was a real risk of a takeover bid eventually succeeding. As soon as Luft resigned from the board (without giving any reasons) Siemens AG took over control by buying 51% of the voting shares from the family in a move masterminded by Deutsche Bank.

had sufficiently privileged stock to block hostile approaches. Depending on the effectiveness of each of these takeover barriers between 108 and 139 firms remain at risk from hostile stake building.

2.2 *Methodology*

The cases were identified using the Financial Times Mergers & Acquisitions (FTMA) database. FTMA contains structured templated information on changes in ownership structure of European firms, covering (i) listed and unlisted firms; (ii) takeover bids and stake purchases; and (iii) transactions which are completed as well as those merely rumoured or still under negotiation. All 'forms' compiled by FTMA between the late 1980s and December 1996 were obtained for transactions involving German companies as targets.[5] This yielded 2,511 forms, some of which pertain to the same firm at different points in time, or to different bidders for the same firm at the same point in time. Two types of filters were used to manage this very large amount of raw data. 'Negative' filters were used to eliminate, without further investigation, FTMA-reported transactions with a low likelihood of being motivated by 'hostility'. These negative filters were

1. cases of apparent initiation of cross-shareholdings
2. "participation in capital increases via subscription" (which presumably are agreed between buyer and target, and thus not hostile)
3. unlisted companies other than those captured using a positive filter (see below)
4. complete or partial disposals of divisions or other operating units
5. privatisations by the Treuhandanstalt

Second, we used positive filters designed to identify cases with a high probability of being motivated by hostility, and devoted more time to these cases:

1. firms known to be potential takeover targets using our knowledge of their ownership structure discussed above (no majority owner, no pooled majority etc.)
2. multiple filings over time for the same firm
3. cases where FTMA reported transactions by 'undisclosed bidders'

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[5] The following combinations of keywords were used in the searches: agree/negotiate/... to "acquire interest in", "... acquire additional interest in", "...acquire majority interest in", "...acquire remaining interest in", "merges with" and "agrees bid for".

For firms not eliminated by the negative filters, all electronically available news story headlines were read, and where appropriate the story itself,[6] around the year indicated in FTMA to establish the nature of transaction: friendly, negotiated, don't know, openly hostile etc. At this stage a 6th negative filter was used, by excluding companies in financial distress where the change in ownership structure presumably reflects rescue operations. Most effort was spent reading about transactions which passed the positive filters.

On the basis of these readings, 17 *prima facie* hostile cases were identified. We make no claims as to the comprehensiveness of search strategy: our filters may well have filtered out hostile cases, particularly amongst unlisted firms. The filters were necessary, however, given the otherwise unmanageably large number of FTMA filings, each of which would have required a news search to establish the background.

All news stories before and after the FTMA date were then read *line by line* for these 17 cases. In some instances, this involved reading more than 1,000 articles (e.g., 1,283 articles on the Continental case). From these readings, we established the players, the sequence of events, information on ownership changes and prices paid (where available), the bidder's motivation, the target's response, the outcome etc. We augmented the news information with security price data (from Datastream) where we had information on dates (e.g., date of block purchase) and with ownership data from the standard German sources: Hoppenstedt's *Saling* stock market yearbook; Commerzbank's *Wer gehört zu wem?* tri-annual register of corporate ownership; and the electronic *Amadeus* database which uses ownership files compiled by Creditreform, a credit reference agency.

III The case studies

The seventeen cases of hostile stake building provide an insight into the way corporate governance is exercised in Germany. Brief summaries of each individual case are provided in the appendix, but in this section we analyse common trends that can be seen across the cases. We consider, first, the different types of control battle that are observed and their outcomes. We then turn to the various strategies employed by bidders, including the formation of coalitions, the role of banks and ways to avoid disclosure. Finally we consider the defensive actions taken by targets, including voting restrictions, denial of board representation and the use of defensive coalitions and white knights.

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[6] Electronically available news sources are: Reuters Textline, German and international newspapers, and newswires such as Press Association.

3.1 The nature of hostile stake-building

One of the most noticeable characteristics of the case studies is that the stake-builders mostly operate in the same industry as their targets. Indeed, many cases are reminiscent of Jensen's (1993) over-capacity argument. In very few cases are the takeovers of a conglomerate nature. This strong horizontal (and vertical) bias results in the cartel office being involved in a relatively high proportion of the cases. It may also help to explain why, in a number of cases, the stated aim of the stake-builder is to gain 'influence' (or, perhaps, co-operation) rather than majority control (see, for example, the AMB case). Such influence can manifest itself in a number of ways. Blockholders often seek seats on the supervisory board[7], changes in management and changes in corporate strategy. In Table 4 we summarise the cases and note the changes in control brought about by the stake holders.

Given the typical ownership structure described in Section 2, with ownership being concentrated in the hands of a few large blockholders and free floats being limited, a successful takeover via stake building is often contingent upon the breakdown of existing coalitions of blockholders. On a number of occasions this is what we observe. Blockholders often enter into 'pooling agreements' with each other to establish effective joint control of the company. However, such agreements are time-limited and are occasionally violated (such as in the case of Bopp & Reuther). More often, the entry of a hostile stake builder results in at least one member of the original pooling agreement allowing the agreement to lapse and selling their stake to the predator (such as in the cases of BIFAB and Goldschmidt). As we shall discuss below, banks often play an important role in both arranging such offensive coalitions and, significantly, helping predators build rival controlling stakes.

Table 4 also summarises the outcomes of the 17 cases. Given the differing objectives (influence or control) and the fact that these are not hostile *tender offers*—where, at least in the UK, there is typically an unambiguous result—classification of outcomes requires some care. There were three cases where the target was generally successful in fighting off the predator. In two of these cases the cartel office effectively blocked the predator. In the remaining case (Continental) court decisions on voting restrictions were the decisive factor in thwarting the bidder—though Conti's supervisory board nevertheless dismissed the CEO for his alleged intransigence in dealing with Pirelli's bid. Control changed hands in eleven cases. Of these, in six cases control was gained by the initial stake-

builder; in two cases control passed to rival bidders (in one case after the initial bid was blocked by the cartel office); in another case a bank acquired a controlling stake which it then sold on to another company and in the remaining two cases white knights (or, perhaps more accurately, grey knights) took control. In two of the 17 cases the bidder ultimately co-operated with the target in return for influence over corporate strategy and board representation. In both of these cases the CEO of the target firm resigned or was removed. The remaining case (Wünsche) is unresolved.

In those cases where majority control was gained it is interesting to see how minority shareholders are treated. Under German corporate law[8] there is neither a requirement to buy out minority shareholders nor a rule that such minorities should receive 'equal treatment' in the terms offered. As can be seen from the final column of Table 4, in the few cases that tender offers have been made to minority shareholders, such offers have typically been at a significant discount to the price offered in the course of gaining control.

Once a company gains majority control it is able to enter into a control and/or profit transfer agreement whereby the profits from the controlled company are effectively transferred to the parent. In practice, such an agreement is likely to require nearer 75% control as such schemes can be blocked if opposed by 25% of votes. The protection of minority shareholders in such controlled companies is notoriously weak. Subject to ensuring the economic survival of the dominated company a controlling shareholder can dilute minorities in a variety of ways. First, group losses can be foisted disproportionately onto minorities, while profits can be transferred out of the dominated company. Second, hidden reserves (typically land and share stakes whose book value is below market value) can be sold and the proceeds transferred to the majority owner. Third, group assets can be bought and sold at prices that are advantageous to the dominant shareholder.[9] Fourth, while minority shareholders must be offered the alternative of a guaranteed fixed dividend should they wish not to sell out to the controlling shareholder, neither the bid price nor the guaranteed dividend

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[7] Although, as can be seen in the Dywidag case, even a stake as large as 40% does not guarantee even a single seat on the supervisory board in the face of target opposition.
[8] We discuss below the possible impact of the new Takeover Code that was introduced in October 1995, which does have a requirement that minorities should receive an offer when majority control changes hands.
[9] For instance, minority shareholders in Volksfürsorge, an insurance company, recently suffered dilution twice within a short space of time. Volksfürsorge was first made to buy a stake in its parent's health insurance subsidiary which KPMG had valued using a particularly low discount rate of 2.9%. Subsequently, Volksfürsorge was ordered to sell its legal insurance subsidiary to its parent who had commissioned a valuation on the basis of a much higher discount rate of 12%!

need in any way be related to the share price, or the price the bidder paid to acquire control.[10] Both options are, in most cases, relatively unattractive: Wenger and Hecker (1995) show that for 45 buy-out bids made to minority shareholders between 1983 and mid-1992 the price offered was 27.1% *below* the market price two days before the announcement.

We similarly find evidence that minorities are offered prices below the prevailing market price (or the price paid to gain control). In three out of the four cases where offers have been made to minorities the discounts have ranged from 15% to 64%, although in one case (BIFAB) minorities were offered a 10% *premium* to the market price.

Many such offers (such as the Boge case we examine) result in lengthy litigation during which minority shareholders attempt to increase the attractiveness of the terms they are offered. The average court case takes 5.3 years to conclude (Wenger and Hecker 1995). There is, in general, no right of final appeal to the Supreme Court, which has led to different second-level courts of appeal passing contradictory verdicts, all of which have binding character. Neither the law nor the courts have established any consistent framework for valuing a company or assessing its risk. [11] As to offers being made below trading prices, the courts have adopted the line that market prices are nothing to do with fundamental value—which can 'only' be found by accountants acting as expert witnesses. Even when the courts do find in the plaintiffs' favour, the average imposed increase in bid prices or guaranteed dividends of 25% (Wenger and Hecker 1995) is not sufficient to close the discount to the market price before the buy-out announcement. Finally, the law gives the majority owner explicitly the right to cancel the control and/or profit transfer agreement if the court's decision is unfavourable.[12]

The implications of these rules regarding minorities can be seen in the takeover of SEN by KW. Rival stake-holder APV had no realistic chance of taking majority control of SEN since KW owned 50.01%. However, its 40% stake had considerable value as it could be used to block KW's merger with SEN. In some respects, blocking minority stakes (in excess of 25%) can be used for green-mail:

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[10] There is a third option: minorities can be offered a certain fraction of the controlling parent's dividend, which, since the law does not specify what dividend policy the parent has to follow, allows for minorities to be diluted without any compensation whatsoever.

[11] One appeals court decided in 1990 that the compensation should be based solely on the basis of future cash flows, without regard to hidden reserves or other peripheral assets, both of which could be realised solely for the benefit of the majority shareholder. Recently, another appeals court chose a discount factor significantly above the risk-free rate to calculate the required minority compensation, after having used a discount factor *below* the risk-free rate in a previous decision.

[12] This option will be optimally exercised once the dependent company has insufficient capacity to generate enough cash to pay the guaranteed dividend post-dilution.

in the event, KW bought APV out at a premium to its purchase price and then proceeded to offer a coercive dilution deal to the remaining (non-blocking) minorities. The FeNo case similarly involved a substantially lower bid to minorities once Stora had gained control.

This ability to dilute the value of minority shareholdings does, of course, provide a powerful incentive for takeover and is likely to reduce Grossman-Hart (1980) free-rider problems. However, the sense of inequity resulting from such dilution frequently results in protracted law-suits, and is likely to have been a reason why the Ministry of Finance recently introduced its voluntary Takeover code, which limits (but specifically does not remove) the ability to dilute minority shareholdings.

3.2 Bidder tactics

Hostile stakes can be formed either via open market purchases or by purchasing blocks from existing shareholders. As Table 5 shows, stakes are often built partially through open market purchases, but the limited secondary market liquidity that we documented in Section 2 typically precludes a controlling stake being accumulated without also buying (or forming coalitions with) existing blocks. Two particularly relevant considerations are, first, the rules governing disclosure of stakes and, second, given the horizontal nature of many of these takeovers, the threshold beyond which cartel office approval is required.

Disclosure problems are of particular concern since most German companies—unlike British or American ones—issue bearer shares, which make it hard to know who one's shareholders are. Rules governing disclosure have been progressively tightened in recent years. Until recently, company law required only holdings in excess of 25% and 50% to be revealed. As a result of court rulings and the new securities trading law two lower reporting thresholds—5% and 10%—now also exist.[13] The ability of a bidder to build a stake without other market participants realising is important as it reduces the likelihood of other shareholders eliminating potential takeover gains by free-riding (Shleifer and Vishny 1986), and it prevents the potential target from initiating some form of anti-takeover protection such as limiting the votes that can be cast by any individual shareholder. However, whilst the disclosure threshold has been greatly reduced, it is unclear whether this in itself limits the ability to build a secret stake. Banks or other friendly parties can help companies to build large stakes by combining a number of smaller stakes that individually do not have to be disclosed.

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[13] The Berlin Supreme Court ruled in 1991 that if asked at their AGMs, companies have a duty to disclose shareholdings of (i) 10% or more or (ii) a minimum market value of DM100m. The market value threshold means that share stakes of less than 1% in DAX-30 companies are now declarable.

Our case studies show how weak, in practice, the disclosure rules are in Germany. For example, by splitting up his 38% stake between himself and some of his companies and two children, Walter avoided revealing his ownership interest in Dywidag. In the FeNo case, the Flick brothers were able to assemble a secret 40% stake via open market purchases and undisclosed agreements with institutional blockholders; indeed, having sold this stake to Veba, the Flick brothers secretively assembled a *second* stake which they used to extract further surplus from Veba. Effective stakes can also be hidden by the use of option contracts, such as in the Axel Springer Verlag case, where the predator had a disclosed stake of 10% but an undisclosed option on a further 16%.

The second relevant threshold is that stakes in excess of 24.9% must be reported to the Cartel Office, whose permission is required before they are increased. Furthermore, a 25% stake will often give the holder considerable power as a blocking minority, preventing a majority owner from diluting minorities or executing significant changes in corporate strategy. However, even the Cartel Office rules can be stretched. For example, in the Hochtief case, Commerzbank enabled its client to acquire an effective stake in excess of the 24.9% threshold by purchasing an additional block and granting a call option on it to Hochtief. Commerzbank was paid an undisclosed fee to finance the cost of carry; hence all the economic risks were borne by Hochtief who, in all but title, thus 'owned' the stake.[14]

Monopolies Commission reports have highlighted a number of other such cases. A particularly interesting one is the 1985 takeover of Deutsche SB-Kauf AG by Asko, a rival retailer. Acting in concert with three banks, Asko avoided a Cartel Office investigation by arranging for all parties to hold no more than 24.9% each, thus accumulating a stake of 99.6%! The critical issue is clearly the regulation of parties acting in concert, which historically has been very weak in Germany. Such matters are likely to come under review by the German courts in the wake of the case brought by the Cartel Office in the Hochtief–Holzmann bid. However, whilst there may be some tightening of the rule regarding breaching the Cartel Office's 24.9% threshold, it seems less likely that regulations regarding the disclosure of beneficial ownership or, more crucially, effective control, will be changed sufficiently to remove the ability to build secret stakes significantly in excess of the formal

[14] Hochtief later went a step further and signed a purchase agreement for the stake with Commerzbank, effectively raising its holding in Holzmann to 35.15%. The agreement and exchange of title and consideration were contingent on Hochtief winning its appeal against the Cartel Office's ruling that it should not be allowed to increase its stake above 20%. This ruling prevented Hochtief voting any excess shares pending regulatory approval, but the purchase agreement bound Commerzbank 'not to act against Hochtief's interests', a clause which would almost certainly tie Commerzbank's hands at Holzmann's AGM. When these transactions came to light, the Cartel Office started an investigation into the legality of Hochtief's dealings with Commerzbank and another bank (BfG), threatening the three companies' managers with fines of up to DM1m each.

disclosure limits. Note also that since no notification is required under any law for stake changes between 25% and 49.9%, a company could clandestinely build a near-controlling stake.

Turning to the source of the stakes and the role of coalitions, the case studies reveal a number of interesting features. First, in contrast to the theoretical literature (such as Zwiebel 1995) there are usually *multiple* large blockholders in our cases. This greatly increases the complexity of the game for each individual blockholder. In particular, each blockholder will fear *not* being part of a controlling coalition when a hostile stake-builder emerges (given the risk of being diluted). It is not altogether surprising, therefore, that in a large number of cases existing pooling agreements break down in the face of a hostile stake-builder. For example, in the Goldschmidt case the family shareholders had a pooling agreement with Allianz which gave the coalition majority control. When VIAG emerged as a stake builder, Allianz let its pooling contract expire and sold out to VIAG, who thereby gained control.

Second, as Table 5 shows, banks held significant stakes in a number of the cases, and often sided with the predator (either through sale or pooling). In some cases the bank stakes appear to have been long-held, although there are also examples where investment banks essentially build stakes in partnership with a bidder, and appear to play a pivotal role in brokering a controlling coalition. Perhaps the most interesting example is the Hoesch takeover, where three banks held significant stakes: Deutsche Bank (Hoesch's house bank); WestLB (Krupp's—the bidder's—house bank) and Credit Suisse (who were acting for Krupp). An initial 24.9% stake was secretly accumulated by Credit Suisse on behalf of Krupp. Later in the battle, Credit Suisse accumulated a further 20% stake, which they pledged in support of Krupp. Whilst WestLB did not declare its 12% stake in support of Krupp during the battle (to avoid voting restrictions) it later worked with Krupp to have voting restrictions removed and seal the takeover. Interestingly, Krupp also enjoyed the support of Deutsche Bank, which was estimated to control around 12% of the votes (partly via proxies)[15].

[15] This case demonstrates that the conventional view that a German house bank will defend its client from takeover is not generally accurate. In an interview with the Frankfurter Allgemeine Zeitung, Hilmar Kopper, chief executive of Deutsche Bank, said he had known of Krupp's planned takeover of rival steel group Hoesch beforehand. "It has my full support because it makes good industrial sense," Kopper said. In his view, Deutsche Bank (whose management board member Herbert Zapp headed Hoesch's supervisory board) had no obligation to defend Hoesch against the bid: "How [should Deutsche Bank have defended Hoesch]? Everyone knew someone was buying shares, but no one knew who. Secondly, why should Deutsche Bank defend Hoesch? Does Hoesch have a right to a defence? Or is Deutsche Bank obliged to maintain structures?"

3.3 Defensive actions

While German firms are prevented by law from using such popular Anglo-American defence tactics as share buy-backs, issuing shares with multiple voting rights, or recapitalisations targeted at white knights, they do have a number of other defences against hostile stake-builders. As Table 6 shows, almost all the target companies in our sample attempted to forge (or maintain) a defensive alliance of friendly blockholders, perhaps as in the Dywidag case by entering into cross-shareholdings (by law, cross-shareholdings cap each partners' votes at 25%). As mentioned above, however, existing pooling arrangements frequently broke down when a rival coalition emerged. In most cases one or more of the pooling partners chose not to renew a pooling agreement, although there are some cases (such as Bopp & Reuther) where a bid is initiated by the violation of an existing agreement. In a few cases white knights were sought by the incumbent management, in some cases apparently motivated, at least in part, by a desire to thwart a foreign bidder. This was certainly the case in the battle for BIFAB where the board "resisted a takeover by a foreign firm" and found a white knight in Langenscheidt, who ultimately took the firm private. Similarly, the attempted takeover of Boge by Italian rival Sogefi was resisted in favour of a German white knight (Mannesmann). However, white knight defences do not always work as expected. For example, Advanta adopted the role of white knight in defence of Dywidag against the unwelcome attention of Walter, but then sold the critical controlling stake to Walter!

The second main defence that we observe is denial of representation on the supervisory board. There are a few examples of such behaviour, which can certainly thwart blockholder attempts to change management or corporate strategy. However, in some cases where the initial goal of the bidder was "co-operation and influence" such denial by the target can provoke a full takeover. For example, the board of Goldschmidt denied major blockholders Veba and VIAG (who between them held nearly 46% of the shares) representation on the supervisory board. Initially Veba and VIAG were demanding a "change of direction" but their frustration ultimately resulted in VIAG assembling a controlling stake, without offering to buy out the family blockholders who had denied a seat on the supervisory board.

A much more potent form of defence is the use of voting restrictions. These typically limit the proportion of votes that can be cast by any individual shareholder, or, in some cases, groups of shareholders operating under a pooling agreement. However, voting restrictions can also take the form of limited transferability of voting rights. As shown in Section 2, such voting restrictions are very common in Germany, and as Table 6 shows they are even more common amongst our cases. Indeed, in some of our cases they were the main obstacle to the hostile stake builder. For example,

Continental had a restriction that no shareholder could exercise more than 5% of the votes. Not surprisingly, this resulted in numerous blockholders holding precisely 5% blocks. When the Pirelli bid emerged, a group of minority shareholders demanded an extraordinary general meeting to remove the voting right restriction. This required a simple majority and was duly carried. However, this decision was later over-turned in the courts when Continental alleged that Pirelli had acted in concert with its allies.[16] The predator group should, therefore, have been subject *collectively* to a 5% voting limit. Continental continued to deny Pirelli and its allies votes in excess of 5% and this restriction was clearly critical in thwarting the attempted takeover. While it is not unheard of that a firm institutes voting restrictions *after* a hostile bidder has emerged, as in the FeNo case, more usually restrictions are already in place.[17]

Voting right restrictions are, however, much less potent as a defence when they are set at slightly higher levels. For example, the 15% voting right restriction in Hoesch's corporate charter was not an effective defence against Krupp. Such a restriction meant that it was only necessary for Krupp (with its 24.9% stake) to convince two other significant blockholders to vote in favour of removal of the voting restriction. One of these was WestLB, its house bank, who had a 12% stake but, significantly, at no stage declared its support for Krupp—thus avoiding accusations of acting in concert. Surprisingly, Deutsche Bank, who also controlled about 12%, also sided with Krupp despite being Hoesch's house bank. Hence, this case illustrates the significant difference between voting restrictions of 5%, which can be a major impediment to hostile stake-builders, and restrictions of 15%, which are typically much less effective in defending a target company.[18] It also illustrates that a target cannot, as a matter of course, rely on its house bank for its defence. While Deutsche Bank successfully used its proxy votes to defend Conti, its proxies proved ineffectual in defending FeNo when shareholders decided to accept Stora's bid. In general, though, proxies do give banks both substantial influence (voting restrictions do not apply to proxy votes which are ultimately not owned by the banks themselves) and valuable information about changes in ownership which could be used to obstruct, or accelerate, a bid's progress.

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[16] This information came to light when it emerged that Pirelli had entered into contracts with some of its allies guaranteeing to compensate them for any fall in Continental's share price. Fall it duly did (by around 45%) and Pirelli's exposure became known when its banks exerted pressure to cover its position.

[17] It is interesting to note that the Frankfurt Landgericht (court) ruled a *contingent* charter amendment inadmissible which would have allowed the Dresdner Bank management board to institute a 10% voting right restriction in the event of a hostile bidder emerging, subject to the supervisory board's approval.

[18] It is interesting to note that limiting the transferability of shares can also be a major impediment to a predator, as in the case of AGF's stake in AMB. In this case the court upheld the refusal of AMB's board to register the shares on the grounds that a board has a right to defend itself against a hostile stake-builder.

IV Conclusions

In some countries, notably the US and UK, ownership of companies is dispersed and control is exercised, at least in part, through tender offers to shareholders. However, such a pattern of ownership is the exception rather than the rule. In many other countries, ownership is concentrated in large blockholders who, either individually or in coalition, exercise control. If the US/UK corporate governance problem is one of "weak owners, strong managers", in continental Europe, and many other countries, the corporate governance problem is rather one of "strong block owners, weak minorities".[19] Whilst a theoretical literature on blocks has recently developed, there is little systematic empirical evidence on their importance or their impact on corporate control. This paper provides such evidence for Germany.

The paper challenges a number of conventional views of the way corporate control is exercised in Germany. First, there is a widespread belief that there is a very low incidence of hostile acquisition. Whilst there are almost no cases of hostile *tender offers* for German companies, we have documented a far more important and common means of gaining control: through the building of *hostile stakes*. Given the pattern of ownership of German listed companies (summarised in section 2), with around 87% of firms having at least one blockholder owning 25% or more, it is not surprising that a relatively active market exists in stakes, both for liquidity reasons and for friendly as well as hostile changes in control. We identify 17 cases that can be classified as hostile stake-building. Given that *at most* around 140 firms are possible hostile acquisition targets, this suggests a rather high incidence of hostility in Germany.

Second, we have illustrated the complex role that banks can play in corporate governance. The dominant role accorded to German banks in much of the academic literature[20] is as major providers of finance and also—via their representation on supervisory boards, their direct equity ownership and their control of proxy votes—as important monitors of corporate performance. We believe that this stereotype is, at best, only partially accurate. There is growing evidence that banks do *not* provide a higher proportion of finance for investment in Germany than elsewhere, and that the effectiveness of the monitoring role has often been overstated. In this paper we identify another important roles for banks, namely their role in assisting companies pursuing a strategy of hostile stake-building. We document many cases where banks play a pivotal role in building, brokering and

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[19] This point was noted by Patrick Bolton.

concealing stakes. In contrast, it is striking how few examples we find of banks actively *defending* target companies from a hostile stake-builder. Such behaviour may, of course, be compatible with the view that banks actively monitor German companies and help to effect changes in corporate governance in the case of failing firms. However, it is important to recognise that this role is performed not by the companies' *house banks* (who are often believed to be acting as monitoring intermediaries drawing on their privileged information), but by the banks assisting the predator. This role has not previously been recognised.

An important question remains: given the ownership structure that exists in Germany, how efficient is the system of corporate control we observe? A full answer is beyond the scope of the present paper, but there are certainly a number of areas of concern. First, the ability of a controlling blockholder to expropriate minorities could raise significantly the cost of capital. It is interesting to observe that the recently introduced Takeover Code in Germany—the adoption of which is voluntary[21] for firms—makes some attempt to protect minorities. Companies acquiring stakes in excess of 50% are now *required* (provided they have adopted the Code) to make an offer for the outstanding shares, but the regulations regarding the terms of such offers provide very little, if any, additional protection for minorities and are far weaker than those operating in other countries.[22]

Second, corporate governance in Germany is both unpredictable and lacking in transparency. Battles often involve a protracted, and clandestine, shuffling of stakes between rival coalitions and the revising of pooling agreements. Even large blockholders can find themselves, without warning, as members of the suppressed minorities. Furthermore, once a hostile stake-builder appears there is

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[20] For example, Allen and Gale (1994, p. 9) suggest, "Banks are heavily involved in the control of industry and form long term relationships with firms. There is little publicly available information about firms and there is no active market for corporate control."

[21] By September 1996, one year after it came into force, only around one-third of listed companies in Germany had actually adopted the Code. The Takeover Commission reviewed twelve cases in its first year, only one of which led to a public censoring.

[22] A party which acquires a stake in excess of 50% (be it via open-market purchases or a private deal) must make an offer to buy out minority shareholders *unless* the acquiring company has merged with the target company or entered into a profit transfer and/or management control agreement within the first 18 months after gaining control. In the absence of a merger or control agreement the controlling company is required to make a public offer for the remaining shares within the next three months. If, during the initial 18 month period after having gained control, the acquiring company has not bought additional shares the price offered to minorities must not be less than the price paid on purchases during the six months before gaining control *minus 25%* (denote this price P_1). If the acquiring company has made additional purchases since gaining control the price offered to minorities must be the maximum of P_1 and the weighted average of the prices paid on such additional purchases. To those who have grown accustomed to observing bid *premia* being offered to shareholders in the event of a takeover such arrangements will hardly appear too onerous for the bidder! This contrasts, for example, with the UK City Code on Takeovers which demands that a full bid is launched once a shareholder

frequent recourse to the courts, whose decisions are, on occasion, unpredictable and lack consistency. As a result, some of the bids considered in this paper took over 5 years to reach their conclusion. If a guiding principle for the design of corporate governance systems is reasonable speed and certainty, the German system frequently fails to achieve either.

The market for stakes is likely to become more liquid in the future. Banks are, in general, reducing their stakes in companies, in response to tax changes and a general shift in opinion regarding their role in corporate governance. The latter has many roots: the recent string of embarrassing failures of control and monitoring at Schneider, Balsam, Metallgesellschaft and Klöckner-Humboldt-Deutz; the increasingly global financial outlook of many large German companies; and the new focus on shareholder value permeating many German companies and banks. As banks reduce their stakes, and their influence over corporate governance, cases of hostile stake-building will surely increase. An important gap in the existing theoretical literature is the analysis of control battles where *multiple* large blocks exist, and this remains an area for future research.

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obtains a stake in excess of 30%, and that the price offered be no worse than the highest price that the bidder paid during the previous 12 months.

Appendix

Aachener und Münchener Beteiligungen (AMB)

The control contest began when French insurer AGF built a 25%+1 share stake in a bid to become "actively involved in insurer AMB's management", but was rebuffed by AMB's board who refused to register AGF's votes (though the board could not prevent AGF from voting Skandia's 1.8% stake with whom AGF was acting in concert). AGF's legal challenge against AMB's refusal to register failed in a lower court on the grounds that a "board has a legitimate duty to defend itself against a hostile takeover." Part of AMB's cross-shareholdings unravelled when Royal Insurance decided to sell its 18.8% stake. Fondiaria, the third party to the original cross-shareholding structure, exercising its right of refusal, bought part of this stake (at a 5.5% premium over the market price), increasing its 6% holding to 21%. Meanwhile, another 10% block came on the market which AMB was eager for another German insurer, Volksfürsorge, to buy (AMB had recently acquired a majority interest in Volksfürsorge thanks to Fondiaria). Hostilities ended when the chairman of AMB's supervisory board brokered a deal with AGF, against the opposition of his own CEO, who subsequently resigned. The peace agreement entailed a partial registration of AGF's votes, operational co-operation, and a commitment by AMB to take a 5% noyeau dur stake in AGF in preparation for AGF's planned privatisation. Fondiaria, opposed to AGF's accommodation, sold its 21% holding to a consortium of German banks and insurers (in preference to AGF's counter-offer). These German institutions then controlled 38%, in response to which AGF increased its stake to 33.55% via purchases from UK institutional investors (at the time, a draft EC Directive muted harmonising the blocking minority threshold to 33 1/3 %). Following subsequent skirmishes between AGF and the German institutions over the chairmanship of the supervisory board, AGF finally entered into a standstill agreement not to increase (or decrease) its block (with a registered 27.49% of the votes) until December 1999, forestalling—at least for some time—a majority takeover of AMB.

Asko

The control contest began when rival retailer Metro increased its declared (and indeed so far friendly) 10% stake in open-market purchases, while two close allies of Metro (including its house bank) also held 10% each. Asko's supervisory board chair (who was CEO for 18 years and founded the firm) opposed Metro's bid for control, despite Asko's financial difficulties. In an attempt to fight off the predator, Asko revealed that 50% of the votes in its main trading subsidiaries were held by a foundation close to members of its supervisory board, implying that a new owner could not control Asko's operations. (This was part of a defence structure erected in response to two hostile takeover attempts by rival retailer co op AG in 1978 and 1981.) Asko itself had a 5% voting restriction. The battle ended once the supervisory board removed its chairman in a vote of confidence, unravelled the special rights of the foundation, and removed the voting right restriction. Metro then increased its stake to 55%, in the open market and from other blockholders (believed to be its associates though the sellers' identity was never confirmed).

Axel Springer Verlag

The control contest began when, following the flotation of the company and the death of its founder, three rival blockholders emerged at this publishing house: the family (which though in a minority controlled the boards), the Burda brothers Franz, Frieder and Hubert (to whom the late founder had tried to give majority control, which was blocked by the cartel office), and an outsider, Leo Kirch. Initially, Franz and Frieder Burda co-operated with the family to contain Kirch's influence, denying him a seat on the supervisory board and not removing the CEO, as he demanded. Then they surprisingly agreed to pool their 25.9% stake with Kirch's declared 10% and his undeclared option on a further 16%, giving the new coalition majority control. Only a month later, however, Franz and Frieder Burda sold their block to the family. The family was not yet safe, though: claiming he had first refusal on his brothers' stake, Hubert Burda challenged the sale in court. As defensive measures, the Springer family refused to register Kirch's additional 16% of votes, signalled they would not register Hubert's block should he win in court (which he finally did not), and entered into a cross-shareholding agreement with Monti of Italy. (In a further twist, the family and Monti later fell out, with Monti threatening to sell its 10% to Kirch.) Eventually, Kirch and the family came to an arrangement, electing first one of his associates and later Kirch himself onto the supervisory board. Throughout the ten years of control battles, there was extremely high turnover amongst top executives, including four fired CEOs in one twelve-month period.

Bibliographisches Institut & F.A. Brockhaus (BIFAB)

The control contest began when Maxwell Communications Corp. plc privately approached BIFAB's board with a takeover offer at a 53% premium to the share price. At the time, there were three blockholder groups: the Brockhaus family with around 15%, its pooling partner the Meyer family with around 38%, and Rheinpfalz Verlag with 27.34%. While it is not known what prompted Maxwell's bid, the fact that the Meyer family did eventually sell out hints at either of: (i) its desire to divest its stake for some unknown reason, which put BIFAB in play and prompted Maxwell's bid; (ii) the imminent breakdown of the controlling coalition of the two families; or (iii) the possibility that the large premium Maxwell was willing to offer tempted the Meyer family into considering a sell-out. BIFAB's board responded to Maxwell's approach by saying it "resisted a takeover by a foreign firm" and was reported to be looking for a (German) white knight to stave off Maxwell's "hostile takeover bid". The Brockhaus family added to this opposition claiming it would not sell under any circumstances, nor would it tolerate a sale to Maxwell by the Meyer family. A white knight was quickly found in rival publishing house Langenscheidt KG, which bought the Meyer family's 38%, giving it majority control in coalition with the Brockhaus family (whose patriarch joined Langenscheidt's board). Langenscheidt shortly afterwards increased its stake to 65.34% by buying out Rheinpfalz. One year later Langenscheidt and Brockhaus jointly took BIFAB private; the buy-out offered minority shareholders a 10% premium to the trading price.

Boge

The control contest began when rival car-parts company Sogefi SpA, controlled by Carlo de Benedetti, emerged as the holder of a 24.9% block in Boge, assembled in the open market. In response to Sogefi's acquisitions and newspaper speculation that De Benedetti sought a majority stake, Commerzbank and Boge's industrial partner VDO Adolf Schindling, who at Boge's flotation 18 months earlier had each taken a 10% stake, increased their stakes to 15% and 17.5%, respectively, and claimed that they, together with an unnamed third blockholder, controlled a majority of Boge's votes. Both Boge and VDO rejected Sogefi's proposal for a three-way merger, stating they wished to remain independent. At Boge's subsequent AGM, Sogefi disclosed an increased stake of 28.3%, which they increased to over 45% over the following year. Meanwhile, doubts had emerged over the actual existence of that third blockholder and thus over Boge's ability to muster a friendly majority coalition against Sogefi. Boge's management eventually placed a 6% stake with its US joint venture partner, TRW Inc., openly expressing its preference for closer co-operation with TRW over Sogefi. When Sogefi further boosted its stake, to 47.88%, Commerzbank revealed that a friendly pool now controlled a slim majority: Commerzbank (24%), VDO (17.6% plus 2.5% held by its Swiss subsidiary) and TRW (6%). Free float at this point was a mere 2%, down from 80% when the company went public three years earlier. When over the following year the co-operation with TRW went sour and TRW put its stake up for sale, Commerzbank sought a friendly buyer of the 50.1% pooled block. (TRW's 6% was clearly pivotal. However, it is likely that TRW was prevented by the pooling contract from selling it to the highest bidder if that bidder was unacceptable to its pooling partners.) One bidder, US car parts group Arvin Industries, was publicly rebuffed, prompting Arvin to consider a public counter-offer or to buy Sogefi's near-majority block. Interestingly, while Boge's management favoured Arvin as its new majority owner, its current majority owners, led by Commerzbank, instead sold their stakes to Mannesmann (to whom Commerzbank shortly afterwards also brokered the sale of VDO) at an undisclosed price in a deal described as "a defensive measure to prevent De Benedetti from taking over". A few months later, Sogefi also sold its stake to Mannesmann. Mannesmann proceeded to offer to buy out the remaining 2% minority shareholders, at a 64% discount to the price it paid Sogefi, offering one Mannesmann share for every two Boge shares (1:2). Though a shareholder lawsuit aimed at annulling the forced integration of Boge was unsuccessful, Mannesmann nevertheless increased its offer to 1:1 plus a cash payment of DM80/Boge share. The control contest lasted 2.5 years in total.

Bopp & Reuther (B&R)

The control contest began when IWKA AG acquired a 42.9% block from a group of family shareholders following years of poor performance. Two years earlier, the family owners of B&R had sold a 25.1% stake to financial investor Hannover Finanz GmbH (HF) in preparation for a possible subsequent stock market listing. The twenty-odd family shareholders and HF had signed a pooling agreement which secured pre-emptive rights over share stakes and "a say in any important decisions affecting the company's future". This pooling agreement was violated when some family members sold their 42.9% block without notifying either the company's board nor their pooling partners. Hinting at resistance against IWKA's intrusion from the remaining 32% family blockholders (led by B&R managing director Carl-Friedrich Reuther), IWKA affirmed its wish to majority-control B&R and to "exercise its influence on the management or supervisory board with a view to improving the company's poor operating performance", and consequently offered to buy out the remaining shareholders.

B&R's board countered by pointing out that a 54% majority was still bound via a pooling contract between some of the remaining family shareholders and HF (though that contract was due to expire within eleven months and even the board had to admit that the pool did not agree on the desirability of IWKA's new stake; the 54% figure also suggests that 3.1% of the family holdings did not rally around Reuther's defence). Reuther himself was engaged in negotiating the sale of the combined 54% block held by the remaining family shareholders and HF to Britain's Siebe plc. (It later emerged that the family had offered to buy out HF at 170% of book value, and that Siebe's 195% bid for the 54% majority stake valued the company more highly than IWKA's 180%.) However, within two weeks, IWKA had secured HF's support (in spite of the latter's pooling commitment) and intended to dismiss B&R's board at the forthcoming extraordinary annual meeting. The deal with Siebe fell through once HF switched its support to IWKA, and HF was later sued by family members for violation of the pooling contract (the outcome of this suit is unknown). Following the EGM, the remaining family shareholders gave up and sold their 32% stake to IWKA at the lower price of 180% of book value. IWKA exchanged the management, began to restructure the company, and a few years later also bought out HF.

Buderus

The control contest began shortly after Metallgesellschaft floated its 79.9% stake in Buderus in a public offering lead-managed by Deutsche Bank and co-managed by Dresdner Bank and Commerzbank with a mandate to spread the shares widely. At the time of the book-building Buderus announced that a number of institutional investors had taken stakes of between 1 and 3% and jointly (though not in coalition) controlled a majority of votes. Buderus' management welcomed the fact that the company no longer had a majority owner; it is known that Buderus' management and Metallgesellschaft had considered selling to a single investor instead of placing the shares in the market, but that this option had been rejected to ensure Buderus' independence. However, shortly afterwards Commerzbank and Dresdner revealed they had each taken a 10% stake "as a long-term financial investment and not for resale to potential takeover bidders". A month later Bilfinger und Berger (B&B) revealed at Buderus' AGM that it had assembled a 15% block and planned to discuss its long-term strategic vertical involvement with Buderus' management. While Buderus did not openly condemn the emergence of this block, its management did declare their intention to keep the company independent of outside influence (curiously motivated as being in the interest of Buderus' core customers!). Significantly, Dresdner Bank acts as B&B's house bank, is its only declared blockholder (25.1%), and chairs its supervisory board. This constellation led to speculation that Dresdner Bank had facilitated the assembly of B&B's 15% stake (possibly in connection with the IPO) and might have taken its own 10% stake for the benefit—if not on behalf of—B&B. Not surprisingly, therefore, B&B applied to the Federal Cartel Office to increase its Buderus stake to 25%, prompting Buderus to declare that it could not see any synergy gains and did not need B&B as a strategic partner. Only once the Cartel Office ruled against the stake increase did Buderus soften its tone and entered into a dialogue with its 15% shareholder and supervisory board member B&B. To date B&B has not divested its Buderus stake.

Continental (Conti)

The control contest followed a year of heavy trading (7.6 times total Conti share capital) and persistent stock market rumours—repeatedly denied by Conti and the subsequent bidder, Pirelli—that a takeover bid was imminent. In the run-up to Pirelli's intentions being confirmed, the Italian tyre manufacturer—faced with world-wide over-capacity in the tyre industry—privately approached Conti with a merger proposal, and reportedly received encouragement from two members of the supervisory board: Ulrich Weiss, of Deutsche Bank (Deutsche Bank was Conti's house bank, chaired the supervisory board, and held 5% of its shares) and Friedrich Schiefer, a management board member of 5% shareholder Allianz, the insurance company. Having assembled a 5% stake in open-market purchases, Pirelli eventually announced its bid for control in the form of a reverse takeover by Conti of Pirelli's tyre division, adding that it had already secured the support of an unnamed majority of Conti's shareholders; Conti's share price fell by 7%. Pirelli was at pains to stress that its proposal was friendly. Behind the scenes, Conti CEO Horst Urban enlisted Morgan Grenfell (Deutsche's investment banking division) to advise on the takeover defence and lobbied his board to reject the proposed merger. Urban also promised his unions that there would be no redundancies if Conti stayed independent—which is a significant form of defence as employee representatives controlled half the supervisory board. Though allegedly originally in favour of Pirelli's approach, supervisory board chairman Weiss helped defeat (with the votes of the employee representatives) the other board members' suggestion that management be instructed to negotiate with Pirelli. Urban then publicly declared the proposal "a hostile takeover attempt, despite all assurances to the contrary." The share price continued to fall. Over the following few months, stakes of up to 5% each were disclosed by some of Pirelli's backers, including two of Pirelli's own shareholders (Italian merchant bank

Mediobanca and Sopaf SpA), Fiat, Allianz' Italian subsidiary and Merrill Lynch, Pirelli's advisors. After an unusually public war of words, Conti demanded a standstill agreement as a precondition for talks, including a commitment that Pirelli abstain from attempting to remove Conti's 5% voting right restriction. Pirelli rejected this demand. Morgan Grenfell was actively engaged in finding a white knight or at least a 25% blocking coalition, a solution publicly favoured by Urban. Pirelli had still neither named its alleged majority supporters nor launched a public tender offer. Events took an unexpected turn when a group of minority shareholders demanded an extraordinary general meeting to repeal the voting right restriction (which required a simple majority) and force a decision on the merger proposal (which required the approval of 75% of votes at the EGM). Deutsche Bank and Morgan Grenfell put together a defensive coalition of banks, proxy votes and car manufacturers large enough to block the merger proposal: Daimler Benz (in which Deutsche Bank held a 28.3% stake and whose supervisory board it chaired), Volkswagen (whose CEO was Urban's predecessor at Conti), and BMW; Conti's share price fell by 5.5%. Nevertheless, at the EGM the voting restriction was overturned with a 65.97% majority (though this was later to be opposed in the courts by a minority shareholder as well as Conti itself); Conti's share price rose 5.2%. Conti still vowed to defend its independence. Interestingly, the arithmetic of the EGM indicates that Pirelli did not in fact control a majority of votes. Shortly afterwards Conti's supervisory board relieved CEO Urban of his duties reportedly for his continued opposition to talks. Unconditional talks were resumed and continued over the next eight months, though the management board was still publicly divided on the merits of a merger. Conti began to restructure by closing overseas factories and selling off non-core divisions. Just before a cross-shareholding deal between Conti and Pirelli was to be announced, it emerged that Pirelli had given its backers indemnity guarantees to reimburse any losses on Conti shares. As Conti shares had lost roughly 45% of their value since Pirelli and its partners bought their stakes, Pirelli came under pressure from its banks to find funds to cover its position and was eventually forced to call off the deal and restructure and refinance its balance sheet. However, Pirelli also bought options on its allies' combined 32.4% in Conti. At that point, Conti appealed to the courts alleging Pirelli had broken securities laws by acting in concert and not disclosing the contracts with its allies. This challenge, later accepted by the court, invalidated the EGM's decision to remove the voting right restriction. Over the next four moths, new Pirelli allies bought stakes in Conti and Pirelli tried again: at the next AGM it moved to have the restriction lifted, a proposal deemed "hostile" by Conti's new CEO who called Pirelli's intentions "sinister". Conti refused to let Pirelli and its allies vote all their shares at the AGM, on the grounds that they constituted a concert party and as such were limited to 5%; Pirelli's motion was defeated, though Pirelli managed to obstruct Conti's proposed capital increase. When finally a superior court resurrected a decision of a pre-bid AGM to raise the majority required to remove the voting right restriction form 50% to 75%, Pirelli gave up and let its 5% stake and the options it held be placed by Deutsche Bank with German companies friendly to Conti. These placements were supported by a financial guarantee from the state of Lower Saxony where Conti is headquartered. The control contest lasted 2.5 years in total.

Deutsche Beamten-Versicherung (DBV)
The control contest began soon after public-sector insurer DBV was privatised via a public offering of 50% minus 2 shares. The IPO was lead-managed by Commerzbank which not only took a 25% + 1 share stake (another 25% + 1 share block still being in the public sector) but also bound itself not to increase the size of its block and agreed that DBV was to remain independent. One way to ensure independence was the choice of restrictedly-transferable shares which require the board's registration before votes can be exercised. However, when DBV's share price soon began to fall below the offer price, Commerzbank, perhaps in an effort to support the share price, acquired a further 23.3% over the following few months from an unnamed investor. This stake increase ostensibly had the approval of DBV's board, and anyway was accompanied by Commerzbank's pledge not to have the votes of the additional shares registered, its assurance that the overall stake would be reduced back to 25.1% in due course, and, it appeared later, its agreement that DBV could veto Commerzbank's choice of buyer. When Zurich Insurance emerged as a possible buyer, DBV's management expressly declared they would block any attempt at a hostile takeover and that they would not allow any shareholder to build up a majority or dominant stake—which would seem a credible threat given (i) the restrictions on votes, (ii) the free float of below 50%, and (iii) Commerzbank's earlier commitment to ensure DBV's independence. The talks with Zurich Insurance collapsed, partly because DBV opposed Zurich Insurance's insistence on majority control. Four months later, in spite of its long-standing commitment not to hold more than a blocking minority stake, Commerzbank increased its stake to 50% + 1 share via open-market purchases. Once it controlled DBV, the bank swiftly proceeded to sell majority control to Winterthur, a Swiss insurer. As DBV's CEO was chosen to head all of Winterthur's German subsidiaries, it seems unlikely that DBV objected to the sale; however, since Commerzbank had acquired majority control opposition on DBV's part was, one presumes, no longer an attractive proposition.

Dyckerhoff und Widmann AG (Dywidag)
The control contest began at a time when Dywidag's ownership structure at the time was highly fragmented, with a maximum free float of only 21% and the two largest blocks owned by Holzmann AG, a rival construction company whose shareholding was viewed as friendly, and industrialist Max Aicher (Figure 1 in the main text summarises the ownership structure in 1987). During the late 1980s, Ignaz Walter, acquisitive owner of several regional construction companies, embarked on what he later called a 'strategy of slow takeover' of Dywidag by clandestinely buying up minority blocks from various sources, including a stake held by his house bank, Bayern LB, a 2% bought on the open market. While there was speculation that Walter was behind the stake purchases, he repeatedly denied being a blockholder in Dywidag. By the end of 1991, Walter controlled 40% of Dywidag's votes, which he had previously failed to declare, and explicitly denied having; it appears that technically he never crossed the 24.9% disclosure rule simply by spreading the 40% stake over various associated parties, including his children. Once Walter declared his stake as well as his intention to take over the company, Dywidag's management strongly and publicly resisted his hostile endeavours. Despite being the largest shareholder, Walter was even denied a seat on the supervisory board. In December 1991, a financier called Dieter Bock proposed a "friendly" takeover of Dywidag, a move that was welcomed by the board (the shareholding structure at this time is presented in Figure 2 in the main text). Rather than inviting all Dywidag's shareholders to tender their shares, Bock proposed to consummate the takeover via the negotiated friendly acquisition of two key shareholders' large stakes: the 24.9% stake held by Holzmann, and the Aicher block, which by now had been increased to 24.7%, along with the small stake owned by Dumez of France via a cross-shareholding arrangement. This 51% stake would block the 40% stake owned by Walter. However, events did not turn out as expected. Bock duly acquired the Holzmann stake, but then announced, in May 1992, that Advanta had failed to complete the assembly of a controlling stake in Dywidag, blaming Max Aicher for reneging on the sale contract (a view disputed by Aicher). Bock also disclosed that Advanta had sold the 24.9% stake in Dywidag it had acquired from Holzmann to Walter, finally giving Dywidag's hostile suitor majority control! Dywidag's CEO resigned. No buy-out offer was made to minority shareholders. The Cartel Office subsequently fined Walter DM500,000 for failure to register changes in its ownership interest in Dywidag.

Feldmühle Nobel (FeNo)
The control contest began when the Flick brothers Friedrich Christian and Gert-Rudolf (the former owner's grand-nephews) accused the management of not maximising the sale price of various assets. When a hostile tender offer was rumoured, FeNo's management restricted voting rights to a maximum of 5% per shareholder, aided by Deutsche Bank which controlled about 55%, mostly via proxies but also via its 8% stake in FeNo. A year later, the Flicks and five associated parties sold a previously undisclosed 40% block (assembled with the help of Merrill Lynch via open-market purchases and secret direct agreements with institutional blockholders) to Veba AG, which Veba then boosted to 51%. However, when Veba failed to remove the 5% restriction and take control of FeNo, the Flicks assembled another stake of between 10 and 20% and began to oppose Veba for not launching a full bid. The Flicks' actions are consistent with a strategy of trying to maximise the bid value in the ensuing auction, which they were well-placed to do given that their 10-20% stake, spread over several parties, gave them more clout than Veba derived from its 51% stake. Two further suitors emerged in the form of Sweden's Stora Kopparberg and SCA, both of which bid for the company. Veba eventually sold its block to Stora, who also bought out the block jointly held by the Flicks and Merrill Lynch as well as SCA's 5% toehold stake. Once Stora owned 85%, minority shareholders were offered a buy-out price 15% below the bid price paid to Veba. The firm was split up and restructured, in spite of the management's opposition. The control contested lasted 15 months.

Th. Goldschmidt
The control contest began when two conglomerates, VIAG and Veba, independently and potentially in rivalry, bought stakes from an existing corporate shareholder and part of the family. When management and the remaining family shareholders affirmed their desire to remain independent, the new blockholders pooled their 45.8% stakes and demanded "a change of direction", but were kept at bay by the insiders who refused to grant representation on the supervisory board. The contest was resumed when (i) Veba came under pressure from its shareholders to sell its 27.95% stake (25.02% of votes) and (ii) the family's coalition with insurer Allianz broke down, when Allianz chose to let its pooling contract (via which the family controlled the firm) expire in 1996 and put its 10.38% stake (9.29% of votes) on the market. VIAG beat the family to both stakes, and in April 1997 controlled 50.34% of the votes to the family's 39.94%. No offer to the minority shareholders was made.

The control battle lasted five years in total.

Hoesch

The control contest began when high trading volumes in Hoesch shares throughout 1991 prompted speculation of a possible (foreign) takeover bid. In October 1991 Krupp, a rival steel maker, revealed it had bought a 24.9% stake secretly accumulated on its behalf by Credit Suisse. Hoesch's share price fell by 9.7% in response, while Krupp's rose by 8.6%. Krupp made clear its intention to acquire a majority block, a plan for which it claimed to have received the prior support of various banks and financial institutions with holdings in Hoesch. One of these was WestLB, Krupp's house bank and chair of its supervisory board, which declared it had a 12% Hoesch stake on its trading books, though it denied to have pledged the shares or the votes to Krupp. This is not altogether surprising, since a formal agreement would have reduced Krupp's influence given Hoesch's corporate charter which capped the votes of any stake or formal pooling of votes at 15%. Deutsche Bank was Hoesch's house bank and chaired its supervisory board. Nevertheless, there were persistent rumours that Deutsche Bank controlled a block of perhaps 10% which was friendly to Krupp! Krupp's CEO, Gerhard Cromme, was at pains to stress this was no hostile bid, but a defensive move as Krupp would have suffered had Hoesch been taken over by a (foreign) rival. The initial reaction from Hoesch's management was muted with no particular indication of opposition, except perhaps grumblings about not having been informed until a few days before Krupp made its public announcement. Initially, it was only Hoesch's unions which called Krupp's bid a hostile takeover. Hoesch's CEO, Kajo Neukirchen, subsequently developed a more confrontational tone in public, and eventually Hoesch's supervisory board declared its opposition to the clandestine nature of Krupp's stake building, though it was in principle willing to consider merger plans on the basis of a voluntary discussion amongst equals. At the same time, it took the unusual step of suspending two members of the management board who were believed to favour Krupp's bid, widely seen as a hardening of positions. For a brief moment, it looked as if British Steel might step in as a white knight to rescue Hoesch. Krupp's Cromme reacted by noting that he would take over Hoesch whether or not Hoesch co-operated. Significantly, he also claimed Deutsche Bank had been notified of the impending bid some two weeks in advance, and had welcomed it, which contradicted Deutsche Bank's public insistence on its uninformed and neutral role. When Hoesch demanded evidence of Krupp's alleged majority coalition, Cromme provided notary evidence of the support of a further 30.4% of the votes, including a 20% block held at Credit Suisse, but excluding WestLB's 12%. Shortly afterwards, Krupp announced it had bought a further 26% (likely to have included at least part of Credit Suisse's 20% stake) at an undisclosed price, thus increasing its 24.9% stake to a majority block; Hoesch's share price fell by 4%. Krupp had still not made a formal tender offer. Over the next few months, Krupp and its allies removed the voting right restriction, sealed a merger agreement and saw off legal challenges from three minority shareholders. Amongst its allies were not only WestLB, its own house bank, but also Deutsche Bank, Hoesch's house bank, which controlled an estimated 12% of Hoesch via proxies. Hoesch's CEO Neukirchen resigned. Krupp's CEO Cromme was elected "Manager of the Year" by TopBusiness and Manager Magazin. The contest only lasted a few months.

Philipp Holzmann AG

The control contest began when Advanta GmbH, a company controlled by financier Dieter Bock (see above: Dywidag) announced it had acquired, from an unnamed source, a 10.25% stake in Holzmann, Germany's largest construction company by turnover. At the time, a key 20% Holzmann shareholder was Hochtief AG, Germany's second-largest construction company. Bock's ultimate intentions were unclear until Advanta sold its stake to BfG, one of its house banks. That BfG simultaneously granted Hochtief a call option on the stake only became apparent when Hochtief notified the Federal Cartel Office of its intention to raise its 20% stake via exercising the BfG option, thus triggering a mandatory anti-trust review. Furthermore, Hochtief declined to rule out increasing its stake further, raising the spectre of a takeover. While analysts welcomed the potential bid, Holzmann's board issued a statement reaffirming its commitment to remaining independent. At the same time there was speculation—first denied and later confirmed—that Deutsche Bank, Holzmann's house bank, dominant shareholder and chair of supervisory board, was willing to contemplate reducing its 25.9% to 10%, thus deserting its client (Deutsche Bank was doing brisk trade with Hochtief's majority owner, RWE). Holzmann's main line of defence, therefore, was the anti-trust card which duly paid off: the Cartel Office ruled against Hochtief on competition grounds, blocking any future increase in Hochtief's Holzmann stake from the pre-bid level of 20%. Hochtief arranged for Commerzbank, its house bank and minority shareholder, to purchase the 10.25% block from BfG, paid Commerzbank an undisclosed fee to finance the cost of carry, and eventually signed a purchase agreement for the stake with Commerzbank contingent on Hochtief winning its appeal against the Cartel Office's ruling before the superior court in Berlin. When these transactions came to

light, the Cartel Office started an investigation into the legality of Hochtief's dealings with Commerzbank and BfG, threatening the three companies' managers with fines of up to DM1m each. Simultaneously, Hochtief also purchased the 4.9% stake in Holzmann which Commerzbank had acquired 13 years earlier. In a filing with the Cartel Office, Hochtief later disclosed it had held a call option on the 4.9% stake all along, though neither Hochtief nor Commerzbank had previously disclosed this. Indeed, Commerzbank had declared the disputed stake as its own until the very onset of hostilities, thus helping Hochtief obscure its true ownership interest in Holzmann. These revelations followed assurances by Commerzbank and Hochtief that there were no undisclosed stakes or contracts pertaining to such stakes; Commerzbank and Hochtief only eventually disclosed their contractual arrangements due to requirements under the new securities trading law. Pending Hochtief's appeal, the control contest is still open.

Kolbenschmidt
The control contest began when T&N plc acquired options on a combined 52.5% block after financially troubled Metallgesellschaft put its 47% block on the market (the remainder were options on 2.5% from Magna International of Canada, and 3% from institutions which held a combined stake of 10%). As a horizontal merger, the deal was subject to cartel office approval. Within three months target management asserted their desire to remain independent of any majority shareholder, sought a different, friendly, but minority buyer (Dana, Inc.) for a 25% block, and organised a workforce petition in protest against T&N's planned takeover. Due to cartel office opposition and problems over its UK asbestos liabilities, T&N failed to exercise its options by their expiry, prompting its bank, Commerzbank, to acquire a total of 49.99% on T&N's behalf and grant T&N a new option (Magna's 2.5% option was extended). Shortly afterwards, the cartel office blocked the deal and T&N appealed. After a further options extension, T&N appealed—unsuccessfully—to the EU competition authorities to overrule the German decision. Finally, Commerzbank placed half of its stake with Rheinmetall, another car parts maker, which subsequently received cartel office clearance to take management control of Kolbenschmidt. Within a few months, Rheinmetall took management control by purchasing T&N's option on the remaining 24.99% stake still held by Commerzbank and buying a further 3% in the open market. No buy-out offer to minorities has so far been announced.

Seitz-Enzinger-Noll (SEN)
The control contest began when SEN's minority shareholders, and then its own board, objected to the forced merger with a division of its 50.01% parent, Klöckner-Werke (KW). In that climate, APV plc managed to acquire a 40% block from a local savings bank (BaKoLa) and the Seitz family, and offered to buy out both KW's controlling block and outside shareholders (prompting KW to offer to match APV's bid). APV won support for this deal from the SEN board and the trade unions, arguing that unlike KW, APV would not rationalise the firm. In coalition with the remaining minority shareholders, APV then obstructed KW's attempts at controlling SEN, for instance by voting against supervisory board appointees; while KW sought an EGM to sack the 10 out of 12 supervisory board members hostile to it. In the end, APV abandoned its control bid and sold out to KW, making a 14.6% return over one year on the stake sale. Controlling 90% of votes, KW then forced a profit transfer and control agreement on SEN, and offered to buy-out minorities at a 12.9% discount to the price it paid APV, and an 18% discount to the market price.

Wünsche
The control contest began when the family coalition, which in total controlled over two-thirds of votes, broke down. After being dismissed from the management board by his brother (the CEO and 44% blockholder) for alleged insider dealing, W-J Wünsche turned vociferous critic of the management and supervisory boards, lobbying to oust the supervisory board for failing to carry out its control duties. Wünsche eventually sold his 26% blocking minority stake to two outsiders at a 24% discount to the market price. The new blockholders, one of whom wanted the company broken up, pooled their votes and—even though they were still bound by Wünsche's original pooling agreement with his brother—put pressure on the CEO to eventually step down.

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Table 1: Ownership of German stock-exchange listed companies, 1991.

		number of firms	% of sample
Panel A: Majority control			
single or formally pooled 90%+ block		129	23.1%
single or formally pooled super-majority (75%+) owner		103	18.4%
of which have ...			
1 additional disclosed blockholder	*11*		
2 or more additional blockholders	*2*		
single or formally pooled majority (50%+) owner		170	30.5%
of which have ...			
1 additional disclosed blockholder	*59*		
2 or more additional blockholders	*22*		
		402	**72.0%**
Panel B: Blocking-minority control			
one blocking minority (25%+) block		47	8.4%
of which have ...			
1 additional disclosed blockholder	*8*		
2 or more additional blockholders	*12*		
two blocking minority (25%+) blocks		28	5.0%
of which have ...			
1 additional disclosed blockholder	*8*		
2 or more additional blockholders	*3*		
three blocking minority (25%+) blocks		11	2.0%
of which have ...			
1 additional disclosed blockholder	*3*		
		86	**15.4%**
Panel C: No blocking minority control			
one or more non-blocking blocks (<25%)		37	6.6%
of which have ...			
1 block	*12*		
2 blocks	*9*		
3 blocks	*5*		
4 or more blocks	*11*		
widely held (no blocks disclosed at all)		18	3.2%
		55	**9.8%**
ownership information not available		15	2.7%
Grand total		***558***	***100.0%***

Source:
Own calculations based on "Saling 1992", Hoppenstedt's stock market yearbook.

Notes:
The law requires disclosure of blocks of more than 25% and more than 50%. Frequently, smaller blocks are also disclosed (as in Panel C). Non-disclosure need not imply non-existence.

Table 2: Defensive share structures of German stock-exchange listed companies, 1991.

number of firms with ...	only non-voting shares listed	cap on voting rights	limited share transferability	departures from one-share-one-vote
Panel A: Majority control				
single or formally pooled 90%+ block	22		3	4
single or formally pooled super-majority (75%+) owner	6		6	4
single or formally pooled majority (50%+) owner	5		5	11
	33		**14**	**19**
Panel B: Blocking-minority control				
one blocking minority (25%+) block		2	3	3
two blocking minority (25%+) blocks	1	1	3	4
three blocking minority (25%+) blocks	1			
	2	**3**	**6**	**7**
Panel C: No blocking minority control				
one or more non-blocking blocks (<25%)		10	3	1
widely held (no blocks disclosed at all)		7		2
	0	**17**	**3**	**3**
ownership information not available	2	1	2	3
Grand total	***37***	***21***	***25***	***32***

Source:
Own calculations based on "Saling 1992", Hoppenstedt's stock market yearbook

Table 3: Potential Targets for Hostile Stake-Builders

firms which could become the target of hostile stake-building (in order of increasing difficulty)	**number of firms**	***minus:* only non-voting shares listed**	***minus:* cap on voting rights**	***minus:* limited share transfera-bility**	***minus:* departures from one-share-one-vote**
Strategy 1: could (potentially) take over in the open market (free float > 50%) *widely held firms;* *firms with 1 blocking-minority stake and a free float of 50%+;* *firms with 1 or more non-blocking stakes and free float of 50%+*	77	77	60	58	57
Strategy 2: in addition, could (potentially) take over if bought out one or more or all existing non-blocking stakes *the remaining firms with 1 or more non-blocking stakes*	7	7	6	5	5
Strategy 3: in addition, could (potentially) take over if bought out one existing blocking-minority stake plus open-market purchases *firms with 1 blocking-minority stakes and a free float of 25%+;* *firms with 2 blocking-minority stakes and free float of 25%+*	30	29	28	25	25
Strategy 4: in addition, could (potentially) take over if bought out two existing blocking-minority stakes *firms with 2 blocking-minority stakes and a free float of less than 25%;* *firms with 3 blocking-minority stakes and free float of less than 25%*	25	24	23	21	21
Grand total	***139***	***137***	***117***	***109***	***108***

This table is based on an analysis of the companies which appear in Panels B and C in Table 1 (minus two firms with insufficient information). In the final column, the number of potential takeover targets was reduced if and only if the existing limits to share transferability or multiple voting rights applied to a sufficiently large number of votes to effectively rule out hostile stake-building.

Table 4: Summary of cases

Target	*Bidder*	*Bid outcome*	*Summary*	*Management board changes*	*Supervisory board changes*	*Tender to minorities*
AMB	AGF (France)	Co-operation with bidder	AGF won voting rights on blocking stake after AMB's supervisory board turned against CEO	CEO resigned		
Asko	Metro (Switzerland)	Bid succeeded	Supervisory board chair ousted. Voting restrictions then removed and takeover welcomed		Chairman removed	×
Axel Springer Verlag	Kirch group (vs. Burda brothers vs. Springer heirs)	Co-operation with bidder	Kirch and Burda family initially pooled stakes against the Springer family. This broke down when part of the Burda stake was sold to the Springer family, who ultimately co-operated with Kirch	Multiple CEO resignations	Bidder initially denied then given seat	
BIFAB	Maxwell Communication Corp. (UK)	White knight found	The bid prompted the breakdown of a pooling agreement, with Langenscheidt gaining control and later taking BIFAB private			Yes, at 10% premium
Boge	Sogefi (Italy)	Defensive coalition sold to "grey knight"	A defensive coalition successfully formed. The controlling group sold out to Mannesmann. Sogefi also sold out to Mannesmann a few months later			Yes, initial offer at 64% discount
Bopp & Reuther	IWKA	Bid succeeded	IWKA bought 43% stake. Defensive pooling agreement broke down when Hannover Finanz sided with IWKA, who then bought remaining stakes	Management dismissed		×
Buderus	Bilfinger & Berger	Blocked by Cartel Office	Bidder bought a 15% stake, tried to increase it to 25% but was blocked		Bidder given seat	
Continental	Pirelli (Italy)	Thwarted by court decisions on voting rights	Pirelli and allies each bought 5% stakes, but the bid was ultimately defeated by the fall in Continental's share price and the failure to remove voting restrictions	CEO removed; management board split		
DBV	Commerzbank/ Winterthur (Switzerland)	Bank gained control then sold majority stake	Commerzbank held a 25% stake, which it undertook not to increase. The stake was gradually increased to 50% and then sold on to a Swiss insurer			×
Dywidag	Walter Group	Bid succeeded	Walter constructed a 40% stake in Dywidag with a view to takeover. Dywidag responded by welcoming a "white knight" bid by Advanta, who then sold on a critical 25% stake to Walter		Bidder denied seat (despite 40% stake)	×
Feldmühle Nobel	Veba vs. Stora (Sweden) vs. SCA (Sweden)	2nd bidder gained control	Initial bid by Veba blocked by voting restrictions. Flick brothers then built a stake in opposition to Veba. Stora took control by buying both stakes			Yes, at 15% discount
Th. Goldschmidt	Viag vs. Veba/Rütgers	Bid succeeded	Viag and Veba both bought stakes, which they pooled and sought board representation. This was denied. Viag then bought Veba's stake and a stake owned by Allianz to gain majority control		No representation granted to stakeholders	Not yet
Hoesch	Krupp	Bid succeeded	Krupp built a 24.9% stake and its advisor Credit Suisse also took a 20% stake. Along with other blockholders a voting rights restriction was removed. Among Krupp's allies were its house bank and Hoesch's house bank	Management board members suspended		Yes, share offer
Holzmann	Hochtief	Blocked by Cartel Office	Hochtief had long held a 20% stake, which it increased by taking options on stakes held by banks			
Kolbenschmidt	T & N (UK)	Blocked by Cartel Office. Controlling block sold to 2nd bidder	T&N built a controlling block, but were prevented from taking control by the Cartel Office. Pending an appeal, Commerzbank acquired the block and granted options to T&N. Ultimately, Commerzbank placed 25% with Rheinmetall, who later also acquired the remaining 25%			×
Seitz-Enzinger-Noll (SEN)	Klöckner Werke vs. APV (UK)	Bid succeeded	Rival bidder opposed controlling shareholder Klöckner Werke, but ultimately sold its stake to the latter	Management board opposed forced merger	Rival bidder blocked seats for controlling shareholder	Yes, at 18% discount
Wunsche	WCM and Diekell	Not yet decided	A family feud resulted in one brother being removed from the management board. He then sold his 26% stake to two outsiders, who pressured the CEO to resign	CEO under pressure to resign		

Table 5: Stake-building strategy

Target	*Source of stake*	*Acting in concert*	*Bank stake*	*Bank assists bidder*	*Disclosure problems*
AMB	AGF bought 1.8% block from Skandia AB (with whom they acted in concert) and boosted this via open market purchases	✓	✓		
Asko	Metro and its house bank WestLB bought 10% each from Asko (which Asko owned via a subsidiary) to cement a joint venture; however, Metro then bought further shares in the open market	✓	✓	✓	
Axel Springer Verlag	Kirch bought 10% at the IPO; claimed also to have option on 16%, source unclear; Burda brothers bought 24.9% stake from Axel Springer (the deceased founder)	✓			✓
BIFAB	Langenscheidt bought initial stake from Meyer family in response to Maxwell's targeted bid	✓			
Boge	Open market				
Bopp & Reuther	IWKA bought stake from a group of family shareholders, despite pooling agreement	✓	✓	✓	
Buderus	Unknown, but possibly at time of IPO		✓	✓	
Continental	Open market	✓	✓	✓	✓
DBV	Commerzbank took a stake at the IPO, ostensibly to protect DBV from takeover threats; bought a further stake later to gain majority control		✓	✓	
Dywidag	hostile bidder Walter acquired total of 38% from the founding family, Siemens AG and its house bank; "white knight" Advanta bought Holzmann's pivotal 24.9% stake; Holzmann's intentions were to prevent Walter from gaining control by selling stake to white knight—who sold stake on to Walter	✓			
Feldmühle Nobel	Stora bought out the two nephews of former owner and their coalition of 5 others (40%, originally secretly assembled) once the coalition failed to win proxy contest due to house-bank supporting incumbent management	✓	✓	✓	✓
Th. Goldschmidt	Veba: 20% from Metallgesellschaft, increased to 25+% from family shareholders; origin of VIAG's rival 20% unknown; the two new blockholders emerged when there were rifts in the family shareholder coalition and rumours of a rift between management and family shareholders	✓			
Hoesch	Open market purchases	✓	✓	✓	✓
Holzmann	Hochtief bought (options on) stakes from Advanta GmbH (10%) and Commerzbank (4.9%), its house bank	✓	✓	✓	✓
Kolbenschmidt	T&N bought stakes from Metallgesellschaft (47%) who were in liquidity crisis; Magna International Canada (2.5%); and other institutional investors (3%)		✓	✓	
Seitz-Enzinger-Noll (SEN)	APV offered options on 40% holding by SEN minority shareholders (stake held by Badische Kommunale Landesbank) to foil forced merger of SEN with KW's subsidiary (KW had bid for the 40% block); APV tender for remainder at DM175		✓		
Wünsche	Possibly to end a long-standing feud with his brother, W-J Wünsche sold 25% + 1 share stake (of which 6% were parked with a bank) to WCM and Dieckell, who pooled; this sale was welcomed by brother Kai Wünsche, the CEO of Wünsche. The stake was allegedly sold at 25% discount to market price	✓	✓	✓	

Table 6: Defensive actions

Target	*Defensive alliances*	*Bank assists target*	*White knight*	*Deny supervisory board seat*	*Caps on total votes per block*	*Limited transferability of stock*
AMB	✓					✓
Asko					✓	
Axel Springer Verlag	✓			✓		✓
BIFAB	✓		✓			
Boge	✓	✓	✓			
Bopp & Reuther	✓		✓			
Buderus						
Continental	✓	✓			✓	
DBV						
Dywidag	✓		✓	✓		✓
Feldmühle Nobel	✓	✓			✓	
Th. Goldschmidt	✓			✓		
Hoesch	✓				✓	
Holzmann						
Kolbenschmidt	✓		✓			
Seitz-Enzinger-Noll (SEN)	✓		✓	✓		✓
Wünsche						