A healthy appetite for the right price

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If British takeover battles were decided on personal chemistry and corporate culture, rather than how much money the shareholders are offered, Kraft's hostile $16.2bn (€10.8bn, £9.8bn) bid for Cadbury would be doomed.

Having irritated Roger Carr, Cadbury's chairman, by dropping in for tea and talking about money, Irene Rosenfeld, Kraft's chief executive, felt the chill of British contempt. Her bid was dismissed as a "derisory" offer from a "low-growth conglomerate".

The message, couched in terms the Takeover Panel would accept, was clear enough. Just because American soldiers came over here with their Hershey bars in the war and took our women, don't think an American woman can come back with dollars and take our Dairy Milk.

Takeovers in the UK are not, however, decided by such things. Unlike in the US, where boards can erect barriers to hostile bids under the jurisdiction of Delaware where most large companies are incorporated, money decides. "It is bloody difficult to imagine a board recommending the lower of two offers," says one City banker.

It is tempting, when the maker of Kraft Cheese Slices attempts to wrest Cadbury's Creme Eggs from the sweet world of family-owned and founded chocolate-makers, to regard this as a shame.

Surely Hershey of Pennsylvania or Ferrero of Italy, whose shy patriarch Michele Ferrero is sometimes compared to Willy Wonka, would be a better partner, even if they offered less to Cadbury shareholders? That could twin the model towns of Bournville and Hershey.

Tempting but incorrect. The focus on price that characterises the City of London allows investors to make up their own minds without being stymied by directors. That is more likely to lead to a sound outcome than the murky US alternative.

The Cadbury takeover battle is a good example of how the UK's Takeover Code works at least as effectively as the Delaware Court of Chancery in deciding on mergers.

First, and deceptively simply, it compels everyone to act transparently. Ms Rosenfeld floated the notion with Mr Carr in August and announced a potential offer in September but was forced by the Takeover Panel to make her formal bid by November 9, a deadline that Kraft only just met.

Second, it stops target companies from putting up the kinds of artificial barriers to block unwelcome takeovers that are common in the US, from the "poison pill" defence to stopping shareholders being able immediately to vote out boards that stand in the way of bids.

Delaware law allows boards to apply “business judgment” in treating offers differently, depending on how the board feels. In Cadbury’s case, however, the shareholders were in the driving seat from the moment a formal bid emerged.

This does not mean any offer will succeed – Cadbury has mounted what seems to be an effective campaign to persuade shareholders that it is worth more than Kraft has so far offered. But Mr Carr has had to visit the top 30 shareholders in the US and UK to put its case.

What he has not done, because it would be useless, is to say Kraft would be a bad “fit” for Cadbury and leave it at that. Even though he dislikes the idea of a chocolate-maker with growth prospects in India and Brazil and a long tradition of corporate social responsibility being eaten by a US processed food giant, he has to argue on financial value.

On the face of it, price does not capture many things that decide whether a merger will work. The two cultures may clash and executives may over-estimate what can be delivered, only to disappoint their shareholders. History is full of examples of mergers born in high hope that failed dismally. Of course, this need not matter to the shareholders of a company being acquired because they can take cash or sell shares they receive for their old ones. If Kraft’s offer, or a raised one, eventually succeeds then a lot of British shareholders of Cadbury would not want its shares.

Even for those who stick with the merged company, price is often a good guide to a merger’s potential. The UK process gives everyone a chance to put their case to investors: not only does a target company do so but the acquirer must justify its offer to its shareholders.

Cadbury seems to like the idea of Hershey or Ferrero making their own bid, or perhaps a joint one. But Hershey, which is a much smaller company, could struggle to raise the money without taking on too much debt or diluting its shareholders, led by the Milton Hershey Trust.

So, while a Kraft-Cadbury takeover faces cultural obstacles, a merger between Hershey and Cadbury could be encumbered by financial leverage. Shareholders have to weigh up the conflicting risks, and these are usually reflected in share prices during the offer period.

Allowing shareholders to decide is not perfect but it is better than the alternatives. Research by Lucian Bebchuk, a Harvard professor, found that US companies with mechanisms to block takeovers underperform those that lack them.

“The evidence is that giving managers the power to decide is not in the long-term interests of shareholders. Markets can get it wrong, but are the best aggregators of judgment,” he says.

Cadbury currently stands a decent chance of remaining an independent company. Alternatively, Kraft may raise its offer or Hershey and Ferrero may get drawn into the contest.

Whatever happens, all investors will get a chance to vote. Cadbury cannot ask for more than that.