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MARKET VS. REGULATION IN THE MARKET FOR CORPORATE CONTROL: INTERACTIONS BETWEEN TAKEOVERS AND INDUSTRIAL POLICY IN SPAIN

Benito Arruñada

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Abstract

This work analyzes the causes and consequences of the lack of competition which prevails in most European markets for corporate control. Focussing on the Spanish case, it is argued that the existence of an oligopoly in the takeover market has constrained the specialization of risk-bearing and management, relating to some negative characteristics of the firms: small size, predominance of private companies, sparse presence in foreign markets, and conservative investment policies. After an introduction to the theory and empirical evidence, the paper criticizes the regulations which limit the competition for corporate control. The negative consequences of the absence of this competition are examined, with concentration on the Government involvement in corporate restructuring. It is argued that some of these interventions become a vicarious form of takeover market.

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* Facultad de Ciencias Económicas, Universidad de Oviedo (Av. del Cristo de las Cadenas, s/n, 33071-Oviedo, Spain). Part of this work was done while visiting the Harvard Law School Program in Law and Economics. The author would also like to acknowledge financial support from the Fundación Banco Herrero and the Universidad de Oviedo. Furthermore, the work has benefitted from comments to earlier drafts by Jorge Roldós, as well as the invaluable editorial assistance of Dorothea Franzosa.

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1. The Market for Corporate Control

The so-called "separation of ownership and control" has been the most prominent feature of modern corporations. This specialization of management and risk-bearing provides several benefits, mainly risk diversification — shareholders being allowed to invest in several firms.[1] On the contrary, maximum specialization of such functions aggravates the conflict of interests between managers and shareholders, causing additional transaction costs, since managers make decisions on other peoples' goods, acting as agents for shareholders.[2]

To reduce this conflict of interests between managers and stockholders, conventional mechanisms are put into practice, which are of general use in all organizations;[3] along with others which are specific to public corporations.[4] Only the role of one of these instruments will be considered here: the "market of corporate control," understood as the competition among management teams for the control of corporations and the management of their resources.

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1 Moreover, investment projects are more easy to finance, given the removal of limits on the availability of capital. Additionally, it makes possible to develop specialized management skills, avoiding the no coincidence of managerial ability and wealth, promoting productive efficiency and the use of the information necessary for decision-taking. See Fama & Jensen (1983a and 1983b).

2 Or, from a legal standpoint, as agents of the corporation. See Clark (1985).

3 Among the most important of these are: a formal hierarchy in which each level monitors decisions initiated and executed by managers in the subordinate level, the mutual control among managers in the same level, and contractual compensation schemes which explicitly tie some measure of performance to compensation. See: Fama & Jensen (1983a and 1983b), Jensen & Smith (1985), and Baker *et al.* (1988).

4 In particular, two characteristics of corporations allow the separation of the functions of control and risk-bearing: limited liability and free alienability of shares. Limited liability makes monitoring of the solvency of the corporation and other shareholders unnecessary. On the other hand, the possibility of selling shares favors the building of social consensus, because dissident shareholders can leave at any moment. It also provides the possibility of using price movements as indicators of management quality and makes possible the existence of the corporate control market. The ability with which stock alienability works as a control instrument depends on the extent to which the stock market has low transaction costs and is efficient, in the sense that prices rapidly incorporate a certain amount of information. For this reason, one of the main goals of regulations should be to favor that the market reaches high levels of efficiency, reducing its transaction costs.

In what can be considered the most typical operation of this market, after observing incumbent managers not maximizing the value of the firm, an alternative management team would try to purchase the shares making a tender offer to the shareholders, offering them a premium well above the previous price of the shares in the stock market.

The existence of a market of corporate control provides the economy an essential service, favoring the specialization of management and risk-bearing. In absence of the external pressure of such a market, it is easier for managers to make decisions in their own interest, and against the interest of shareholders. Anticipating that possibility, shareholders protect themselves by putting in place costly mechanisms of direct control and/or not delegating decision power. From this perspective, professional managers benefit from an efficient takeover market, because the workings of this market increase their contractual possibilities over the long term, in the same way that any economic agent benefits from lower transaction costs.

The consequences of the takeover market go far beyond the few companies directly affected by its operations. Its activity constitutes an implicit threat which freely provides a control mechanism for all corporations. For this reason, to value its importance it is necessary to take into account not only the actual contests for control but the change in managerial behavior induced by the implicit threat of potential takeovers. The very existence of alternative management teams able to bid for control sets stricter limits on the discretion that incumbent management of any company can enjoy. The role of the takeover market has been probably the main force behind the restructuring spree that has presided over the life of American corporate life during the eighties' decade.

Additionally, one may contend that the takeover market indirectly increases competition in product markets. Managerial teams used to compete only against teams in the same industry. A high level of takeover activity ensures that a defeat in the product market will imply a faster replacement of unsuccessful managements. On the contrary, when the takeover market is inactive, such replacements only take place in extreme circumstances, when firm survival is jeopardized. In an efficient takeover market, a more direct competition among managements can be exercised, with the consequence that lower deviations from profit maximizing behavior are tolerated; therefore, more firms are going to be managed in the production-possibility frontier, increasing the minimum level of efficiency required for firm survival in the industry.

In the corporate control market, goods are not the object of exchange but the control of the whole corporate resources is. This characteristic makes it easy to forget it is an actual market, where resources flow to whoever values them the most: those managers able to maximize the value of the firm. Likewise, their efficiency depends on its transaction costs, what makes crucial to consider the extent to which the regulatory framework could be obstructing its development. An alternative management team tries to control a company not only if it can optimize its resources (benefitting the social interest), but also if it achieves an acceptable return on the costs incurred in the process. To the extent that there are not barriers to entry in the takeover market, this return will be normal, except for the most efficient or innovative participants (as it is the case in any market.) For the reasons stated below, it is possible that in the Spanish case (typical of continental Europe) many takeovers which would have been socially desirable were not implemented because of the high costs of accomplishing them. The reason for these prohibitive costs is to be found in regulations which make it possible for incumbent management teams to enjoy an oligopolistic status with respect to the control of their companies, especially when they are large enough to attract regulatory attention.

2. Empirical Evidence

A substantial body of evidence has been assembled regarding several aspects of the takeover market: the retributive consequences on shareholders; the origin of the revaluation of targeted companies; and the effects of defenses installed by incumbent managements.

The activity of the takeover market generates substantial increases in the value of the companies involved. On average, the shares of the target companies increase in value between 30 % historically, and 50 % recently — at the same time bidder's shares go up approximately 4 %, with a total revaluation of 7.4 % for the aggregate value of both companies.[5] The profits obtained by the stockholders of American companies between 1977 and 1988 resulting from takeovers are equivalent to 50 % of the dividends paid by all corporations in the same period.[6]

Generally, the losses inflicted to the debtholders and the increase of monopoly power tend to be rejected as having a large impact on the revaluation of the shares.[7] On the con-

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5 These numbers are averages of the results obtained in several studies concerning companies in the New York Stock Exchange, calculated by Jensen & Ruback (1983), Jensen (1988), and Bradley *et al.* (1988). Those empirical measurements, known as "event studies," reflect the exclusive consequence of each type of event. For this to happen it was necessary to eliminate the influence of changes in price attributed to market-wide movements and factors specific to each company.

6 Jensen (1989, p. 65).

7 Asquith & Kim (1982), Eckbo (1983), and Stillman (1983).

trary, the dissemination of new information, and the increase of efficiency seem more likely to be possible sources of the revaluation experienced by a company which is subject to a control contest. Other redistributive effects are controversial, because their importance varies from case to case.

The most reliable hypotheses are increases in efficiency and dissemination of information. In the first case, control changes can generate efficiencies, because of either technological or organizational synergies, or better control of agency costs (including bankruptcy costs.) On the other hand, it is considered that the takeover situation triggers the arrival of additional positive information about the value of the firm even though the subject of the information is actually totally unrelated in its origin to the takeover. The takeover market contributes, in this way, to the efficiency of the stock market, therefore to a more efficient allocation of resources. However, the observed revaluations would be pure adjustments of the price to the knowledge of new conditions which are not actually caused by the takeover market itself.

The defenses put in place by incumbent managers usually harm the stockholders, giving way, on average, to a drop in share prices. In general, the most negative effect is observed when the defenses are adopted by management without submission to shareholders' vote, whereas the effect is less for most of the charter amendments, which do require the approval of shareholders.[8] On the contrary, the acquisition by a so-called raider is generally profitable for shareholders, even when it ends with greenmail (the repurchase of his shares at a premium.)[9] The study of other managerial strategies seem to indicate that it is possible to keep control and, at the same time, maximize firm value: stock repurchases, increase in financial leverage and leveraged buyouts.[10]

The discussion about how to evaluate the efficiency of the operations of the takeover market is not more than a particular version of the general discussion about how to evaluate the efficiency of the firm. The arguments about wealth transfers point to the fact that the stock market evaluation does not include all the repercussions of the changes in control. As an indicator of the social efficiency obtained through such changes, it is biased (more or less in different cases) because of the existence of external effects — with a productive nature — and wealth redistributions, which have not been taken into account. However, the

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8 The defenses commonly voted by shareholders are, usually, poison pills, greenmail and standstill agreements. See: Jarrell & Poulsen (1987 and 1988), Dann & DeAngelo (1983), Malatesta & Walkling (1988), and Ryngaert (1988).

9 Mikkelson & Ruback (1985), and Holderness & Sheehan (1985).

10 Dann (1981), and DeAngelo *et al.* (1984).

consequences not accounted for by the market are not necessarily negative; and if transaction costs do not increase, efficiency is not harmed. The activity of the takeover market, as in any other market, has external effects both positive and negative. On the negative side it would appear that some kind of implicit contracting might become impossible.[11] Conversely, there are positive effects, such as the free dissemination of information about the techniques used to achieve the control, and, above all, the lowering of transaction costs between stockholders and managers (when the discretion of managers is diminished, it makes possible more specialization of functions, which benefits both groups, being viable to contract at a lower cost.) In order to evaluate the wealth transfers, the possible existence of previous transfers in the opposite direction cannot be ignored. Neither should one overlook that these wealth transfers tend to be a precondition for the survival of the firm within the limits of a competitive economy.

It is possible that takeover operations redistribute wealth against workers and incumbent managers. Casual evidence is provided by the frequent opposition of unions and managers to changes in control, and the wage reductions and dismissals which supposedly follow many takeovers, although unions' opposition is addressed more against the further restructuring than to the takeover itself. Wage and employment levels are not necessarily reduced after takeovers. But even if in most hostile acquisitions, job tenure were threatened and the level and stability of wages were reduced, it is necessary to refrain from the mistake of comparing wage levels "before and after" the takeover.[12] It is crucial, otherwise, to estimate its repercussion on workers' compensation by likening wage levels "with and without" such a change in control. The reason is that continuity of the incumbent management team does not guarantee either wage or level of employment. Furthermore, in many circumstances, wage reductions are a precondition for the firm to survive, independent of which management is in charge. In short, the workings of the takeover market has to be compared to its real alternatives, frequently the bankruptcy and closure of the firm, or, when the State assures its continuity, the subversion of the criterion of competitive survival.

3. Oligopoly and Nonexistence of the Market for Corporate Control

The lack of activity of a takeover market is due to the low return expected from its operations, either because their costs are too high or because the potential compensation is too

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[11] See Shleifer & Summers (1988).

[12] Cf. Shleifer & Summers (1988).

low. These forces are not mutually exclusive; for instance, in the Spanish case (for the most part very similar to other countries in continental Europe) both factors hinder the efficiency of the takeover market and could be sufficient to justify their inactivity when compared to other countries.

Regarding benefit opportunities, the number is reduced, mainly because companies in financial distress are ruled out as candidates to be a takeover target. The reason for this is that the restructuring of these companies is only possible within Government planned processes of reorganization, since this is the only means for the State to assume the costs of the rigidities which the State itself imposes on the labor market.

On the other hand, operations are expensive for bidders, because of a set of rules which favor the defensive activities of incumbent management teams. Additionally, the regulatory framework hinders the operation of the takeover market in several other ways: imposing heavy taxes on capital gains which become apparent as a result of the takeover, determining the inefficiency of the stock market, and limiting the entry of foreign specialists.

These institutional constraints and the moderate size of the Spanish economy have contributed to the maintenance of an oligopoly in the takeover market. This oligopoly can be equated with inactivity or nonexistence of such a market. Until 1987, there was an understanding in the financial establishment that all parties would behave according to unwritten rules of conduct which would not threaten the positions of other parties. The equivalent of the competition in the market was replaced by the so-called "gentlemen's agreement." Lack of competition for control was parallel to high protective barriers which reserved product markets for Spanish companies, lessening the need to maximize efficiency.

The changes in the Spanish Economy since the entry in the European Economic Community (EEC) have damaged the balance in this oligopoly. Appearance of new foreign investors and managers and the integration into the EEC has forced national management teams to reconsider their attitude with respect to corporate control.[13] The first hostile op-

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[13] The sale of Spanish companies to foreign firms during the second half of the eighties made clear that the transferred resources have a higher value when they are handled by foreign managers. That is possibly due to reasons related to the need to adapt fast to foreign markets and competition. The economic development was once oriented to replace imports. As a consequence many firms are not able to compete abroad, because their origin and survival have been based on being the sole supplier for the internal market. The lowering of barriers to import of foreign products since the entry into the EEC is showing that many Spanish managers are not capable of coping with a competitive environment. Membership in the EEC has also reduced the barriers to Spanish exports to EEC countries. Because of a better knowledge of these markets, foreign management in charge of Spanish

eration, perceived by part of the financial community as a "loss of etiquette," was the beginning of the competition in the takeover market, previously closed to such events. Given the special nature of this market, whose product is a second-order right on control rights, this competition equates to the market being brought into existence.

The next sections analyze the main conditioning rules which have promoted the inactivity of the takeover market and which continue to limit its operations.

4. Regulations External to the Market for Corporate Control

Labor market

The constraints imposed on the labor market have made it impossible to reorganize troubled companies without State protection, since staff reduction costs would be prohibitive in this case. When employment level reductions are required, restructuring must be postponed until the State regulates the crisis solution, including the means through which the State itself assumes the cost of reducing or maintaining employment.

Moreover, to the extent that the increase in value caused by takeovers has its origin in staff or wage reductions, takeover activity is directly discouraged by the disappearance of cost-savings opportunities in those countries whose labor regulation make wage renegotiation or staff reductions difficult.[14]

Tax treatment

Capital gains from investment in stock are taxed by the individual income tax, whether they are reinvested or not. That increases the cost of tender offers, since the tendering of shares usually causes an immediate tax liability, whether the payment is received in cash or

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companies is more capable of utilizing the advantage presented by the barriers' removal. Management moves in accordance with the same market logic as any other productive resource. The phenomenon can be understood as "import" or "lease" of managerial services, rather than a sale of companies to foreigners. The discussion of its consequences may be restated in the same terms as the old controversy concerning the adequate degree of autonomy in economic development, replacing "import substitution" for "management by nationals."

14 This affects every country member of the EEC, as a consequence of Directive 77/187/CEE *(Official Journal of the European Communities* — hereafter, *OJEC* —, no. L 61, 5 Mar. 1977), which guarantees the maintenance of workers' rights after a merger or acquisition. The Spanish situation is peculiar, because more stringent limitations are imposed by general labor rules, but specific limits on flexibility after takeover are also contained in art. 44 of the workers' rights Act (Ley 8/80, *BOE*, no. 64, 14 Mar. 1980).

securities.[15] This anticipation of the tax burden, apart from discouraging resources' mobility, increases transaction costs for takeovers. Furthermore, it forces bidders to offer target shareholders at least some cash payment as part of the compensation package, in order to avoid the inconvenience derived from the necessity of having to fund their tax liability.

Other aspects of the tax burden play a less important role. For instance, the revaluation of assets caused by most mergers, whether or not preceded by tender offers, create capital gains at the firm level, which usually qualify for tax exemptions The Treasury has some discretionary power regarding these exemptions, which adds uncertainty to the risks inherent in the takeover process, harming its development.

Juridical protectionism and judicial efficiency

Spanish Corporate Law assumes as an objective the protection of the "weak" parties in the corporation, which are judged to be the non-controlling shareholders. This protecting function is unrelated and can conflict with the safeguard of an efficient contracting process. Alternatively, unconstrained contracting and the development of new contractual instruments can be seen as the main way of solving conflicts of interests between the parties of the corporate contract. From this standpoint, the role of corporate Law should be limited to define the general contractual rules, making it unnecessary to specify all the clauses in each social contract. Far from that, protective regulation tends to increase transaction costs through prohibitions which lead the parties to waste resources with the sole purpose of effectively "contracting out" of the regulated framework.[16]

The coercive character of the companies Act, as well as the need to change and enlarge its scope, are often defended on the grounds that parties must be protected against potential abuses and their own mistakes. There is controversy regarding to what extent its regulations achieve the goal of protecting weak parties. In the discussion, the role played by reputation as the best possible guarantee of equity for economic relations (indispensable to exercise any on-going activity in the market) is often ignored.

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[15] The empirical evidence collected from the experience of the USA appears to reject the contention that tax reduction is the driving force in takeovers, although the complexity of the tax system makes unreliable any estimation (Auerbach & Reishus, 1988a and 1988b). The persistent worry of merger and acquisition specialists regarding taxes can be accounted for by the possibility that the losses derived from neglecting the tax effects would be substantial, even though positive tax benefits are not significant.

[16] Section 5 discusses the regulations more directly concerned with the takeover market, related to tender offers and mandated disclosure. For a detailed analysis of the reformed Spanish corporate Law and takeover regulation, see Arruñada (1989, chs. 8 to 10).

The effect of the Act on transaction possibilities and contractual innovation has deserved less attention. It is overlooked that coercive legal rules do not allow the spontaneous establishment of safeguard mechanisms which would be capable of alleviating the conflicts of interests for which regulations were believed to be necessary. In some cases, regulation is so distant from the desire of the parties, that they implement some kind of "regulatory reverse engineering," in order to avoid the regulatory constraints. Therefore, resources are wasted with the sole aim of diminishing the costs imposed by regulation, instead of toward the development of better contractual arrangements.

In the same context, the Spanish judicial system imposes high costs on its users. That deprives the parties of a means to enforce contractual performance, raising *ex-ante* the costs of those arrangements which, in case of breach of contract or any other disagreement, would make it necessary to resort to court.

In general, it can be argued that problems related to the existence of contractual "weak parties," which are commonly handled with a narrow-minded protectionism, would have a more economical and effective solution within simpler legal rules, making the administration of justice easier. This does not mean that there is a trade-off between judicial and legal solutions, because the level of effective protection provided by an inefficient judicial system is very low. Nevertheless, this kind of legislation usually produces high costs in terms of unnecessary prohibitions and reduced competition.

Financial regulation

The regulation of banking activity has hindered the development of appropriate instruments and specialists able to provide resources to potential bidders in the takeover market, favoring the establishment of implicit nonaggression agreements. Under such conditions, almost no control was exercised over management from outside the corporations, and only some limited competition was allowed to exist within each management team.

Several regulations of the financial market have impeded the workings of the takeover market. In the banking field, commercial banks were allowed to act as investment banks, oligopolistic practices were promoted by regulations and barriers to entry of new and foreign intermediaries were implemented.[17] Over several decades, these features facilitated the control of large conglomerates by banks. Each bank has operated as the head of each

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[17] Consider that, even in the much more competitive American market, it has been important the innovative role played by financial intermediaries that were either new or did not pertain to the financial establishment.

respective industrial group and control has been exercised by small management teams with little equity participation, voting treasury shares, as well as the shares deposited in custody by its customers and making extensive use of reciprocal, circular and pyramidal shareholdings.[18] Given this dominant role played by the banks it is logical that they were the protagonists of the first important operations of the Spanish takeover market.[19]

Actually, deposit insurance and, especially, the pricing of its premiums independently of the risk level and capital of each bank, unintentionally favors the retention of control by means of reciprocal shareholdings with subsidiaries and treasury stock.[20] This is made

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18 Pyramidal shareholdings consist of successive holdings in a series of subsidiary companies, each one having a majority of the shares of the subsidiary in the next level. The percentage "owned" by the controlling shareholder of the head company decreases drastically with the number of layers, providing a leverage for control. In the case of reciprocal o circular participations, one or several subsidiaries own stock of the parent company, stock which is voted by its control group. When legal constraints to this voting are overcome, such cross-holdings allow to retain total control owning no capital in any of the companies. The new text of the Spanish companies Act tries to limit the use of these devices to exert control, imposing additional limitations. Some banks have placed treasury stock in the hands of customers and employees. To sweeten the sale, they provided the buyers with loans at interest rates lower than market rates. This kind of credit lines amounted, for the main banks, to 100,000 MPta (approximately 800 million dollars). For some banks, these credits represented 9.12 % of the total market value of the equity (Pereda, 1989). The total shares owned by directors in the main banks used to be low, ranging from 1 % for the largest bank to, approximately, 5 % for a family-controlled bank (Vidal, 1987).

19 Almost all the management teams in control of the main banking groups have experienced in recent years a challenge for that control: (a) The regulatory authorities imposed or affected managerial changes in the banks Hispano Americano and Banesto. (b) The banks Popular and Vizcaya repurchased significant shareholdings which had been acquired by hostile investors. (c) The attempt by Bancobao to take over Banesto was a main event for the mass media in 1987 and called public attention to mergers and acquisitions. (d) This failed transaction triggered several reactions: a consummated merger between Bancobao and Vizcaya, an unsuccessful proxy fight in the Central bank, and an attempt to merge Banesto and Central. Additionally, banks were heavy buyers of their own shares after the stock market crash of October 1987 (the authorities promoted this behavior, at least in the aftermath of the crisis.) Simultaneously, several banks sold the same shares to customers, employees and foreign investors at a discount (over the intervened price), accompanied in the first two cases by loans at lower-than-market interest rate. Additionally, banks have installed legal and financial defenses against hostile takeovers. New regulatory constraints were also introduced by the banking disciplinary Act in July, 1988.

20 The accumulation of treasury stock undermines the democratic principles of corporate governance, especially when treasury shares are voted by incumbent management in stockholders' meetings in favor of their proposals, circumventing the rule which establishes that votes pertaining to this stock should not be exercised (art. 43 of the companies Act *[Boletín Oficial del Estado* — hereafter, *BOE* —, no. 218, 18 Jul. 1951], reformed by Ley 19/89 *[BOE*, no. 178, 27 Jul. 1989]). During this period, banks used to acquire their own shares in the Spanish stock market, selling them from time to time in recurring operations in for-

possible by the insurance provided by the Fondo de Garantía de Depósitos (FDG),[21] which is backed, in fact, by the State. In absence of deposit insurance, the fear that creditors (depositors) and market participants would realize that the bank is not well capitalized, places an automatic limit on the possibility of managers to accumulate treasury stock, which results in equity reduction. Deposit insurance removes that natural barrier. In fact, increasing its treasury stock, a bank maximizes the value of the guarantee supplied by the FDG, whose cost is, for the bank, constant with its risk level. These perverse incentives provided by the regulation pave the way to future and recurrent banking crises.

5. Regulations Specific to the Market for Corporate Control

The costs of merger and acquisition operations appear to differ substantially with the existence of specific legal rules. Their effect is frequently to increase the costs and restrict the activity of those looking to take over other companies. This is the reason operations taking place after the establishment of restrictive rules tend to present higher returns, since only the most profitable operations can afford to pay for a level of artificially inflated costs.

Early mandatory disclosure of significant purchases of securities and detailed rules for the tender offer process have been in place in the USA since 1968 (Williams Act amendment to the Securities Exchange Act of 1934.) The empirical contrast of the impact of these rules denies their beneficial effect on shareholders. On the contrary, the evidence supports the notion that the regulations eliminate incentives for external monitoring activities of corporations.[22]

5.1. Regulation of tender offers

The present section critically analyzes the regulatory framework provided to tender offers in Spain.[23] The focus is placed on rule 279/84, because the general guidelines intro-

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eign stock markets. It happened that shares were frequently sold abroad at at a discount under the national — intervened — price. There was a trend for these *exported* shares to reappear shortly afterwards in the national exchanges.

[21] The Fondo de Garantía de Depósitos, which is equivalent to the American Federal Deposit Insurance Corporation (FDIC), is the Spanish deposit insurance agency. It was created in the last seventies, in the middle of several banking crises.

[22] See, mainly, Jarrell & Bradley (1980), and Bradley *et al.* (1988).

[23] Tender offers have been regulated in Spain since 1980. The current regulations are Real Decreto 279/84 *(BOE*, no. 40, 16 Feb. 1984) and art. 60 of the stock market reform Act (Ley 24/88, *BOE*, no. 181, 29 Jul. 1988). The European Commission has proposed a

duced by the stock market reform Act have not yet been developed, and the related EEC Directive is in the process of being formulated. Nevertheless, there is not a large lost of generality, since the three regulations share a similar approach and coincide on many points. Furthermore, specific comments related to the main differences amongst the three rules are included, whenever deemed appropriate.

The most important aspects of this regulation are: the obligatory character of tender offers to gain control; the requirement to acquire minority interests after gaining control; the dubious protection given to shareholders against abusive terms in tender offers; the overseeing of the process by an administrative agency; and the impediments created to the revision of bids.

Obligation to make a tender offer

The obligation of presenting a tender offer in order to achieve a legally predetermined fraction of any public corporation is costly, because it forces the buyer to use a specific procedure, without letting him to choose alternative means, specifically, creeping purchases in the stock market or purchases of large shareholdings. At the limit, any transaction of large blocks of shares is forbidden, due to the obligatory use of a tender offer and the existence of a prorating provision for oversubscribed tender offers.[24]

Mandatory buy-out of minority interests

The process of gaining control through a tender offer is distorted by the legal obligation of making a tender offer for all the shares and/or, when more than a certain percentage of shares is intended to be reached, making a second offer for the remaining shares.

The equality of conditions amongst target shareholders does not only make impossible two-tiered tender offers, depriving the market of the positive consequences that they appear to carry for the competitive struggle for control,[25] but it promotes a passive attitude

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Directive aiming to harmonize the different national rules concerning takeover and other general bids *(OJCE*, COM[88] 823 final, no. C 64, 14 Mar. 1989).

[24] Until now, this aspect of the regulation was irrelevant, given that takeovers could be accomplished by other means. (Interestingly enough, they were unsuitable for taking over large corporations.) However, the stock market reform Act, which insisted on maintaining the rule, closed these loopholes.

[25] In "front-loaded" or "two-tiered" tender offers, a higher premium is offered for the shares which allow the accumulation of a percentage sufficient to exercise control than the premium paid for the remaining shares. On the consequences of this type of offer, see Comment & Jarrell (1987).

by shareholders, who will receive the same premium, whether they tender their shares or not to the initial bid. That endangers both the tender offer's success and its own presentation. This rule, which has dubious constitutionality, increases the cost of takeover operations. Takeover specialists are forced to culminate the seizure of control offering to purchase the remaining shares at a minimum price. Fewer takeover contests are implemented, harming mainly the shareholders of potential target corporations — the group that the rule was originally intended to protect.

Overload of bidders and ineffective protection of small shareholders

One of the concerns of the rule-maker is to provide a leveled field, where shareowners will be given the same treatment independent of the size of their holdings. According to the empirical evidence available to this date, such a goal is reached in a way that can not be considered successful. The equality is obtained neither by means of increasing the compensation of small shareholders nor reducing large blockholders' compensation, but by diminishing the total expected return of both groups of shareholders with respect to an unregulated situation. The reason for this is that the number of bids tends to decrease as the takeovers are made more costly.

The fact that the regulation obtains equality between small and large shareholders is not beneficial if that result is reached at the price of bringing down the compensation of all the parts involved in the process. Moreover, it is open to question the fairness of considering small shareholders a weak party, when they are in fact free-riding in the profits produced by the takeover contest, without having contributed to the costs incurred to obtain them.

Protection of target shareholders against abusive clauses

Regulators are fearful of giving bidders freedom to set up the conditions of tender offers. Presumably, one of the worst risks involved in that respect is that they would establish discriminatory conditions, favoring the first shareholders who tender their shares, or giving them priority in oversubscribed offers. This fear is not based on solid grounds. It is true that the acquisition price can be raised by placing obstacles in the way of potential bidders. But a global analysis shows that the result is achieved at the price of reducing the number of bids.[26] To see that, one must consider more than one separate operation and pay attention to the long-term workings of the takeover market as whole. Thus, for example, the forced prorata purchase of oversubscribed offers (as well as the nullification of

[26] The empirical results of Jarrell & Bradley (1980), stated previously, validate this assertion.

previous tenders to the first offer when a competing offer is presented at a later time), discourages the fast tendering of shares, hindering the appropriation of the benefits produced by the presentation of the initial offer.

Administrative involvement in tender offers

Before it can be presented to shareholders and made public, a governmental agency must revise the validity and fairness of a proposed tender offer, before giving approval. That provides incumbent managements of the target corporation with the ability to use this administrative instance as a defense. Basically, they can influence the agency's decision to retard the offer or prevent it from reaching shareholders. In practice, given the complexity of the rules, any outcome is possible, depending on the parties' strength and the autonomy of the agency. In any case, the defensive maneuvering of target management is facilitated by their advanced knowledge about the impending tender offer. That knowledge is ensured by the number of people involved in the course of the administrative decision.

Impediments to the revision of bids

The constraints imposed on the modification of the terms of a tender offer hinder the bargaining process between the target's and the bidder's management teams. Bidders can not raise or alter their bids, except for the first bidder (and, in this case, just once and with constraints), which obliges them to show, in their first proposal, the highest price which they are willing to pay.[27] They are locked into their first offer, which they can neither improve nor restate during a one-year term. (Restatement is not viable, if another bidder, after gaining control, has already restructured the company in a less than optimal way.)

Under these rules, the premium paid for control is an one-step decision made by one party — the bidder — months before it is accepted by target shareholders. This separation from a bargaining situation is inconsistent with the size of the transactions involved. It is understandable that the activity of a takeover market suffering from this regulation has been low, given the level of risk faced by prospective bidders. Contributing to this risk is the rule prohibiting the retirement of offers once they are presented.

Conclusions on tender offer rules

Tender offer regulation, trying to balance a supposedly uneven field, makes prohibitively expensive the bidding process. Corporate shareholders are harmed, because the

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[27] The proposed EEC Directive on tender offers allows the introduction of changes to the terms of the bids.

rule increases the difficulties to discipline management, undermining the *ex ante* contractual arrangements intended to specialize both functions, management and risk-bearing.

Facing poor prospects for the success of any contested bid, fewer entrepreneurs will invest resources to detect deficiently managed companies, aiming to gain control and change their strategy and/or management (and they do this only occasionally.) When such a contest for control takes place, it is triggered by other reasons than the discipline of management who have distanced themselves from value-maximization. On the contrary, these cases have more to do with the accomplishment of a business strategy of the bidders, in pursuit of synergistic gains or personal benefits. In other words, it is remarkable that the regulation harms mainly the occurrence of the most characteristic takeovers: those aimed to displace uncontrolled or incompetent management. On the contrary, mergers and acquisitions grounded on operational synergies are less affected, since they are not so hostile to incumbent management.

The consequences of the Spanish regulation could be analogue to those of the Williams Act. Nevertheless, being extremely restrictive, its effects have been more extreme. In the American case, the rule appears to have reduced the pace of takeover activity (even if it rose substantially in the eighties, due to some extent to increased competition in the financial markets.) The Spanish counterpart has obstructed the way of hostile tender offers targeted to large corporations.[28] It is an example of how an excessive degree of regulation can undermine the very existence of the regulated matter. Instead of directly protecting the parties, rulemakers should focus their attention on safeguarding the market, whose competitive activity could provide, indeed, a more effective protection to the parties.

5.2. Mandatory disclosure of major securityholdings

Several disclosure requirements have been imposed on major corporate investments and shareholdings. Acquisitions of more than 10 % of the outstanding shares of any corporation (either public or private) must be reported to the company, as well as the purchase of any additional 5 %. More importantly, transactions of stock exceeding 5 % (and any multiple of 5) of companies traded in the stock market, as well as shares of banks, must be

[28] The potential candidates with separation between ownership and control are the bank-centered conglomerates referred to in Section 3. The sole significant attempt to take over one of these groups by means of a public offer occurred in 1987. The proposal, made by Banco de Bilbao, to present a tender for the shares of Banesto was retired after being rejected with dubious legalisms by a now extinct stock market self-regulatory agency. After this occurrence, the contest for the control of the Banco Central group has been fought on grounds resembling a proxy fight.

reported to the supervisory authorities. Also, the EEC has adopted a Directive establishing similar, even though less stringent, requirements.[29]

Effects of the regulation

Disclosure rules are crucial to takeovers. Normally, after disclosure, prices increase, because they would now include the expected premium for control. Thereafter, the bidder must pay full price for any further accumulation of stock. The rules are apparently consistent with one regulatory concern — the allocation of takeover premiums to those who were shareholders before the takeover contest. This deprives bidders of appropriating most of the benefits produced — or, at least, triggered — by their activity. [30] Because they are forced to share their profits with all the shareholders, the compensation of bidders is reduced, independently of the outcome of the contest for control.

From this perspective, disclosure rules expropriate the property rights on the information produced by the bidder. Those shareholders who did not incur any cost in the takeover process would still share its benefits. As previously stated, a common criticism applies to these rules: they reduce the incentives for economic agents to engage in takeovers (both, on an occasional basis, and from specialization in this activity.)[31] This probably results in a lower number of observed bids and a lack of professional bidders.

On the contrary, the mandatory disclosure of the number of shares owned by managers and directors could facilitate the formulation of takeover bids. The advanced knowledge of the extent of insiders' ownership reduces the risks faced by the bidder, who can then figure more precisely his chances of success. These disclosures do not necessarily bring to light the actual prevalence of weak ownership structures, based on stock pyramids and reciprocal or circular shareholdings. Therefore, the relevance of such disclosure is open to question. Additionally, regulators can be expected to be more tolerant of incomplete disclosure

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[29] The new rules are contained, respectively, in the new text of the companies Act (Ley 19/89, art. 45.a.7); the stock market reform Act (Ley 24/88, art. 53); the banking disciplinary Act (Ley 26/88, *BOE*, no. 182, 30 Jul. 1988); and Directive 88/627/EEC *(OJEC*, no. L 348, 17 Dec. 1988).

[30] In the USA, specialists appear to have gained approximately 13.9 % of the total benefits (Jensen, 1988), which may produce a suboptimal level of activity in the takeover market, from the social as well shareholders' standpoints. This factor is more important when stock market turnover is low (as is the case of the Spanish market), making prices more sensitive to significant purchases made during the crucial period between crossing the threshold and disclosing the position (seven days as a maximum).

[31] The requirement of keeping tender offers open for a minimum period deserves similar criticism, since it paves the way for other bidders, who take advantage of the discovery made by the first.

by insiders, because there is no one directly interested in demanding disclosure, as opposed to the case of an incumbent management after a hostile investment.

In addition to the effects on returns and incentives, the early disclosure of intentions and toehold investments might hamper the success of potential contests for control by eliminating the surprise element, making it impossible to accumulate a substantial voting power before incumbent management initiates defensive manoeuvres. This fact supplies incumbent management with additional time to display defensive weapons.

The regulation of the banking disciplinary Act

As previously stated, the role of the Spanish banking industry in corporate control is particularly important, since it plays an unusually critical part in controlling the largest industrial conglomerates. Not surprisingly, disclosure requirements for banks were implemented before the general rule, and are accompanied by greater doses of administrative intervention.

The banking regulation requires prior authorization for purchases exceeding 15 % of the capital of any bank. This *ex ante* clearance system hinders hostile takeovers in two ways. To the criticisms already addressed regarding general disclosure, it must be added that the Act grants authority to the Bank of Spain to decide on the suitability of aspirants to controlling positions of banks.

It is futile to trust that those powers will be used according to the public interest. Apart from the difficulties to define such a interest, and without doubting the good faith of the public servants, rules should be malevolent-proof. There is a risk that the regulations might be used to support those management teams who conform to the interests of the regulators. Generally, they will be prone to favor Spanish managers, since native managers are less able to resist the regulatory guidelines.[32]

Within the banking regulatory framework, especially because of the the existence of State-supported deposit insurance, it can be argued that management selection facilitates regulatory monitoring. However, this does not appear to be the real concern of the regula-

[32] It is tempting to relate the declared purpose of the Act, concerned to guarantee "through disclosure and communication to the supervisory authorities, the transparency of ownership" with the goal of "maintaining under control of Spanish capital the main centers of our banking system, preventing it from becoming a subsidiary of larger foreign groups" through the mergers of national banks (statement made by the President of the Bank of Spain before its Board, according to a news release *[El País*, 1 June 1988]).

tors, who have impeded or completely obstructed takeovers of Spanish banks by foreign banking groups whose solvency was not ever questioned.

This attitude contrasts sharply with the tolerance previously shown by the regulators with respect to the practice of keeping control of Spanish banking groups through small shareholdings — via pyramidal and reciprocal shareholdings. That short equity interest has probably exacerbated their perverse incentives to assume excessive risks, free riding on the deposit insurance provided by the State.[33]

6. Negative Consequences of an Inefficient Market for Corporate Control

External competition for corporate control is triggered into action after the failure of internal control mechanisms — board of directors, stockholders' meetings, mutual control. In this way, the takeover market establishes an upper limit on managerial discretion with respect to perfect contractual performance. The effectiveness and importance of this external control depends on the regulatory framework which defines its operating conditions, the cost of its operations and the existence of proper financial means and contractual "technologies."

When the functions of management and risk-bearing are more specialized, control instruments become more relevant, as is the case of the most developed corporations. For them, the alternative control mechanisms are useless, the primary reason being that each individual shareholder does not have the incentive to monitor managerial performance. That makes the case for a takeover market more appealing as a control device of last resort. The possibility of limiting the conflict of interest between managers and shareholders, and the full development of the corporation as an organizational form, fulfilling specialization to a maximum, depends upon the takeover activity.

This development as full-specialized corporations is crucial to firms competing in global product markets with companies monitored by an efficient takeover market. When it is not possible to specialize in risk-bearing and management, firms are deprived of the organizational structure most capable of undertaking investment projects characterized by high risk levels and extensive outlays. When specialization is ruled out, firms use sub-optimal organizational forms, mainly companies managed by owners, without stock market trading.

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[33] The selectivity in choosing bank shareholders contrasts with the control structure devised for Savings Banks, whose governing boards are filled by political appointees representing entities which simultaneously are among the biggest debtors of these banks.

This hampers risk diversification and liquidity of ownership claims. (Additionally, to fill top executive positions, confidence tends to prevail over managerial competence.)

6.1. Primary consequences

Suboptimal investment level. In an owners-managed firm, the personal wealth level and diversification objectives of the shareholders constrains growth in several ways (Fama & Jensen, 1985, pp. 118-119.) Owners' wealth would tend to limit the investments and the size of the firm to levels lower than optimal, therefore, debt would tend to be higher. However, debt can not replace equity capital, because financial leverage exacerbates the *ex-post* conflicts of interest between creditors and debtors, with a consequent increase in the *ex ante* cost of debt. The smaller size of the firm causes it to miss economies of scale, hindering productivity and delaying the undertaking of investment opportunities.

The observed lack of investment in research and development can be explained by the bias against equity financing. For creditors, it is more difficult to control owners-managers when a large percentage of company assets are of intangible nature.[34] This makes growth strategies viable only to the extent that investments are directed more towards tangible assets rather than to intangible ones.

The financial nature of these limitations is illusory, because their roots develop from a basic contractual deficiency, affecting the separation of ownership and managerial functions, and the possibility of diversified ownership. Firm growth requires full specialization of these functions,[35] which would allow the issuance of more equity claims, the increase of debt and the undertaking of all investments with a positive net present value. However, such an organizational structure would incur costs, because it would not be possible to solve the conflict of interests between management and shareholders. When these costs are prohibitive, the choice of organizational forms is constrained below an efficient level of specialization.

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[34] By intangible assets is meant optional growth opportunities ("real options"), whose value depends on the continuity of the firm and the discretionary undertaking of additional investments which will demand the issuance of new equity (Myers, 1977). These options provide a poor guarantee, because of their discretionary nature and the fact that, in situations close to bankruptcy, it is not optimal for shareholders to invest additional funds. Consequently, if a high proportion of firm value is in the form of growth opportunities, equity financing will be favored.

[35] The case of firms with low growth prospects might call for an organizational arrangement with closer monitoring of managerial decisions by risk-bearers, in order to avoid the misuse of "free cash flow" — funds above the level required to finance the positive value investment opportunities of the firm. See Jensen (1986 and 1989), for an explanation based on these premises of the privatization of American corporations.

6.2. Palliative regulations

Governments tend to implement several corrective policies in order to avoid the negative consequences produced by the impossibility to specialize management and risk-bearing. In this respect, four courses of action are worth mentioning (even if the argument provides a dubious rationale for this protective activity, because the new interventions try to correct problems which are caused by previous regulations, instead of eliminating them.)

Protection of national producers against foreign competitors. The Government can protect firms' survival by imposing a burden on consumers. Traditionally, this protection was the general rule for Spanish companies, even if the level of effective protection for specific sectors is unknown. The situation has changed with the entry in the EEC, beginning a new age where firm survival is decided to a larger extent by the market (at least, by European-wide competition.) That makes it necessary to adapt the institutional environment in order to provide firms more efficient organizational possibilities. In this context, survival demands an adaptation of "contractual" technologies, as opposed to "real," technologies.

Assumption of entrepreneurial activities by the State. An alleged lack of private initiative has been used as a justification for the State to assume the role of promoting or undertaking supposedly necessary investment projects. Applying the argument, the reasoning would run as follows: private companies can not carry out these investments because they lack the adequate contractual instrument — the fully developed and controlled corporation. The interventionist "solution" consists of state-owned firms. This partially accounts for the concentration of state-owned firms on capital-intensive industries and/or activities oriented to research and development. It must be understood that, in many cases, State-supported projects are not worthwhile under any organizational umbrella. It is beyond of the scope of this paper to address the ability of Government to judge investment projects. The discussion in this text tries to provide an additional explanation regarding the forces moving toward Government intervention, whose opportunities are enhanced by the lack of private initiative induced by insufficiencies of the available organizational structures.

Protection of privately owned firms. The government implements policies supporting the structural deficiencies of private firms, without assuming ownership. This is accomplished by providing subsidies of several kinds: credit, guarantees, favorable tax treatment, etc. In Spain, the most important mechanism was — until the late eighties — the direct control of the credit market, reallocating funds towards sectors in which it was judged that private investment would not, otherwise, be willing to invest.

Granting of a banking oligopoly. In this context of intervention the role of banks is crucial. In some sense, it could be argued that the barriers to entry in the banking industry — complemented by freedom to own and trade equity securities — works as a subsidy to an artificial concentration of control. That has made the banking-centered conglomerates able to obtain some degree of specialization between management and risk-bearing. (As it became clear through the banking crises of the seventies and eighties, the main bearers of risk in this artificial framework were not the shareholders, but the taxpayers.)

6.3. Two-sector economy

The final result of this system — governed by protectionism and a predominance of banking groups — is a dual-sector economy where firms are separated into two distinct categories: those affiliated to banking groups and state-owned firms ("protected" sector) and the independent firms ("free" sector.)

The bank-controlled firms tend to prevail in industries of heavy investment (mainly: utilities, highways, smokestacks, energy, oil refining and chemical firms) because of two reasons: they are easier to control and they make use of the banks' advantage in providing funds. These firms tend to show a financial structure characterized by higher leverage — lending being less costly to contract inside the group — and public and widely diversified equity ownership — made possible by the oligopolistic position of the banks and, frequently, of their subsidiaries. Apparently, they suffer a lower number of crises, because most problems are solved by cross-subsidies inside the banking group. (Their larger size plays a contributing role in the same direction.) However, given the impossibility of controlling banks' managers, there is an inherent tendency to a higher number of crises at the group level, frequently triggered by failures in the non-financial subsidiaries.

As it was previously analyzed, firms independent from banks are constrained, not only by the common limitations to separate management and risk-bearing, but also by the inferior position they enjoy, once the big banking and State-run conglomerates are in place. Two types of consequences follow from the artificial development of the protected sector. First, the use of resources is subsidized in this sector, making them more costly for firms in the free sector. In the second place, future regulations can be expected to continue providing additional advantage to the protected sector, given that its concentrated power facilitates "rent-seeking" activities.

7. Takeovers as an Alternative to Industrial Policy

Takeovers trigger corporate restructuring policies. Arguably, these reorganizations extend the life of the companies, since it is thought they would not have survived otherwise. The lessening of the crises atmosphere also eliminate opportunities for the Government to intervene in rescue operations. Takeovers and Government perform in this instance closely related functions (in part substitutive, in part overlapping.) To a certain extent, when regulations make the existence of an active takeover market too expensive, its role is assumed by State industrial planning. When a comparison is made with the continental European markets, the higher degree of development of the American takeover market correlates with a lower governmental intervention in industrial policy in the USA.

The policies adopted by the Spanish Government with respect to corporate crises — which are listed below — are representative of the variety of means that have been utilized to apply an interventionist approach. It is worthwhile to observe that, for the former management teams, the consequences, even in the worst instance, do not have a very negative impact.

Barriers to entry. Traditionally, the establishment of barriers to entry through import tariffs, quotas or technical rules has played a fundamental role. Seen from a takeover perspective, they allow managements of national companies to stay in control. The role of these barriers regarding firm survival is usually overlooked, because of the age and gradual development of the protective process. The novelty in this area in the Spanish case is that the entry into the EEC has triggered a barriers' abatement process, as well as a change in the locus of power capable of providing them in the future (from Madrid to Brussels.)

Nationalization of firms The most direct political approach to firm crises is their takeover by the State. This activity — which differs in goals and consequences from the entrepreneurial role of the State, previously discussed — was carried out assiduously by the Spanish Government, especially during the economic crises of the seventies. After the takeover, new top-level management, generally proceeding from the civil service, were be brought in. Survival of these firms was, at least momentarily, taken away from the market logic.

The solutions given to bank crises constituted a special case. In the most common version, managements were replaced provisionally by executives relatively independent of the public service. They were charged with the duty of taking the bank out of insolvency, and selling it after the State or its deposit insurance agency paid all the debts.[36]

Industrial restructuring. In most of these programs, firms kept their management teams, even when they were forced to merge with others firms which were in a better financial condition. When this was the case, the result in terms of top level continuity were unpredictable, with frequent infighting for control. In these programs, the State provides explicit and implicit support for restructuring. On the explicit side, transfers in the form of cheap financing, subsidies, or tax exemptions, can be partially understood as a way for Government to assume the cost of employment reductions — made prohibitively costly by a rigid labor regulation which forbids dismissals. On the implicit side, the main role of the State is to act as an enforcement agent of oligopolistic agreements, which allow the participating firms to make a partition of a reserved national market.

Transformation of failed firms in cooperatives. Attempts to prolong the life of dying firms after a labor takeover were prevalent for small and medium-size businesses.[37] These reorganizations have tended to fail or to be followed by a heavily subsidized reprivatization. Cooperatives do not appear to be a viable way of enhancing the survival possibilities of troubled firms.[38] These restructurings were successful only in providing a disguised channel for the transfer of wealth to parties in these firms. To that extent, they deserve a criticism for impeding the information gathering by voters and taxpayers about such transfers.

In the utilization of the supporting processes just described, there was a tendency toward more indirect policies, which provide the Government more flexibility when cutting down the subsidies — mainly through reorganization plans, as opposed to nationalizations.

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[36] The political treatment dispensed to the banking merger spree in the late eighties appeared to initiate a new policy. Although the stated goal was to induce concentration, regulators interfered in several ways with the replacement of management teams. (The practices have ranged from forcing top-level appointments in troubled institutions, to supporting hostile takeovers of those unwilling to abide to such changes.)

[37] A specific legal form — the "labor corporation" — was developed to overcome the constraints imposed by the companies Act (Ley 15/86, *BOE*, no. 103, 30 Ap. 1986). See Pérez Pérez (1988, pp. 855-857).

[38] A case in point was that of several former corporations, whose managements were unsuccessfully assumed after bankruptcy by the Mondragón cooperative. The remarkable thing about these takeovers is the undeniably good quality of the new cooperative management. (The Mondragón concern is the largest industrial cooperative in the western world, constituting an unexplained anomaly to the supremacy of private enterprise.)

All these policies operate on vantage grounds over market forces to guide firms through survival crises. Namely, part of the subsidies they provide pay for the cost of reducing the work force. From this standpoint, the policies can be ascribed to two distinctive categories: reorganization plans addressed to industry-wide crises unsolvable without substantial lay offs, and occasional protection of plainly inefficient firms. In the first case, there is some rationale for the protection, in order to correct the negative effects caused by previous interventions, hoping to restore a situation closer to the one provided by the workings of the market. The second type is to be judged on grounds merely political, lacking any economical justification.

Apart from the advantage in overcoming labor force redundancies, State industrial policy hampers the activity of the takeover market (and of any survival-enhancing mechanisms guided by market forces), through its impact on parties' expectations. A history of State-financed salvage of firms damages the bargaining position of any management team trying to achieve wage or productivity concessions in a survival-threatening situation. These concessions are preconditions of survival when a firm loses a competitive advantage — after deregulation, or a substantial tariff reduction — which made viable to pay salaries above opportunity cost, sharing in monopoly rents.

To some extent, takeovers and industrial policy can be thought of as alternative approaches to the adaptation of firms to environmental changes. When making a comparison, the following factors should be considered: the speed of adjustment provided by each process, their redistributive consequences, and their external effects. It appears clear that the political interference slows down the implementation of any change, in some cases to a scale of time measured in decades (the coal industry being a good example.) This time lapse raises the cost of the process in terms of resources spent in rent-seeking activities, while the parties painstakingly realize that the firm is not viable. From a distributive standpoint, the usual concern about the existence of biases in politically-directed transfers of wealth are present in this case. Firms which are small in size, located in unimportant or politically-unfriendly districts, or having an unorganized labor force, are discriminated against. The external effects of the industrial policies are pervasive and controversial. Among them, it should be taken into account the increase in the amount of resources spent in rent-seeking;[39] the intangible costs and benefits in terms of social unrest; and a long-

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[39] Because of a prevailing political concern with unemployment, small-size firms in critical condition were induced to overload their labor force in order to increase their access to "survival insurance."

term reduction of the incentives to enhance productivity in healthy firms whose survival is guaranteed.

On the contrary, an efficient takeover market would provide faster and timely corrections to troubled firms, anticipating distressful conditions caused by managerial incompetence or self-interest. Public interest, however defined, should benefit from the resulting reduction in the number of actual bankruptcies and the costs caused by them.

Actually, the comparison between takeovers and industrial policy parallels the general argument about which kinds of goods must be removed from the scope of activities assigned to the freewheeling functioning of the market, in other words, which markets are allowed to exist. In this case, the "good" in question — the firm, or the corporation in a narrower sense — has very special features. As a consequence, differences among the underlying theories or beliefs about the firm preclude any consensus in either the academic or political debates of the issue.

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