STAKEHOLDER RIGHTS AND CORPORATE GOVERNANCE: A CROSS-NATIONAL STUDY OF HOSTILE TAKEOVERS

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ABSTRACT

We argue that organizational practices achieve widespread use only when they are consistent with the interests of the most powerful social actors as enshrined in legal rights. Building on a "stakeholder-power" approach to corporate governance, we examine whether the interests of shareholders, workers and banks are consistent with the practice of hostile corporate takeovers. Regression models using data on 28 countries between 1988 and 1998 lend support to the predictions that hostile takeovers increase in frequency with the extent that shareholder rights are protected, and decrease with the degree to which banking rights are protected. We discuss the implications of these findings for the theory of comparative institutions and for organizational theory.

INTRODUCTION

The modern business corporation is a contested entity. There is little agreement as to who should be involved in its governance or how the risks and rewards associated with its activities ought to be allocated. One point of view holds that the firm is merely a bundle of assets whose true value is to be assessed by the cash flows that it provides to shareholders, the "principals" for whose sole benefit the firm should be managed. Accordingly, transfers in corporate control are deemed to be not only justifiable but economically advantageous, provided that such actions remove underperforming or self-serving managers and increase shareholder wealth. From an opposing perspective, the firm is an integral component of the social fabric and is characterized by the intersecting interests of various stakeholders, including not only shareholders and managers but also employees, banks, and the surrounding community. More than a mere commercial endeavor, the firm is a public institution with its own social obligations and responsibilities. Following this view, the benefits to shareholders that might arise from changes in management and control need to be weighed against any costs that would be imposed upon other constituents (for a summary of the debate, see: Fligstein, 1990; Guillén, 2000; Aguilera and Jackson, 2003; Driver & Thompson, 2002).

We seek to illuminate this debate by examining the hostile takeover, which itself is a highly contested organizational practice that is intimately linked to corporate governance and to the role of the corporation in society (Hirsch, 1986; Davis and Stout, 1992; Allen, Jacobs & Strine, 2002). A hostile takeover is a corporate acquisition that is actively opposed by the target firm's incumbent management or board of directors. Hailed by some as an effective way to discipline managers and maximize shareholder wealth, hostile takeovers are bedeviled by others as one of the worst manifestations of "predatory" capitalism (Hirsch, 1986; Jensen, 1989;

O'Sullivan, 2000, 2003; Stiglitz, 2002). Given the intensity of this longstanding controversy, it may not be surprising to note that the level of hostile takeover activity differs massively across countries. Between 1988 and 2003, for example, 478 hostile takeovers attempts were announced in the United States and 273 in Britain. By contrast, only 19 were announced in each France and Sweden, 18 in Norway, seven in Germany, three each in Japan and Malaysia, two in Thailand, and just one in Chile. While takeover bids remain a rare event in countries such as Germany, the 2000 acquisition of Mannesmann by UK-based Vodafone has raised doubts about whether even prominent German companies are immune from the threats of hostile takeovers (Toth-Feher et al., 2002; Jackson, Höpner & Kurdelbusch, 2004).

In this paper we seek to explain the frequency of hostile takeovers by adopting a "stakeholder-power" perspective on corporate governance. We argue that hostile takeover attempts will occur more frequently when the stakeholders who stand to benefit from these activities have the legally protected power to implicitly or explicitly defend their interests against stakeholders with opposing interests. The stakeholder-power approach differs from the dominant trend in stakeholder research in that the major aim is explanatory and predictive rather than normative and prescriptive (Berman et al., 1999). While previous stakeholder theories have applied subjective conceptions of social justice and economic efficiency often to endorse particular business practices (Donaldson & Preston 1995; Driver & Thomspon, 2002), we seek to examine and predict which types of practices prevail in a given institutional context as a result of power dynamics.

Our theoretical approach combines three prominent and mutually compatible arguments from the sociological literature on corporate governance and organizations. First, we draw insights from research that advances a political or power-based argument. In a pioneering piece, Hirsch (1986) described that hostile takeovers initially emerged as a deviant innovation pursued by economic actors on the periphery of the American business community. Gradually, however, hostile takeovers became an “acceptable form of intercorporate conflict,” and practiced by larger, more powerful and more centrally located firms (1986:813). Stearns and Allan (1996) highlighted how political and economic developments can lead to changes in the status quo, thus enabling a new group of challengers to take on the corporate elite by pursuing predatory acquisitions (see also Palmer & Barber, 2001). Davis & Thompson (1995) also described how shareholders mobilized as increasingly powerful coalition with common interests as a response to the rise in U.S. hostile takeover activity during the 1980s.

Second, we incorporate the idea that there is a normative aspect to power dynamics in corporate governance (Fligstein & Dauber, 1989; Mitchell, Agle & Wood, 1997). Hirsch (1986: 39) pointed out that the colorful language used to describe takeover contests reflected the “instability, stress, or conflict over normative boundaries,” suggesting that the change in rhetoric surrounding hostile takeovers was both a contributor and a consequence of its growing diffusion and legitimacy. According to Stearns and Allan (1996:703), this diffusion was further aided when some firms sought to imitate the actions of early hostile raiders as a result of the “breakdown in the normative order.” Schneider and Dunbar (1992: ***pages***) also build upon Hirsch by suggesting that the narrative accounts of hostile takeovers represent manifestations of disparate meanings that such contests hold for the various actors involved. Takeover contests are at the same time “interorganizational events that threaten organizational identity and integrity,” socially-constructed “arenas in which concerns about esteem, honor, and dignity are being played out,” and a “social drama that reveals underlying social issues of conflict, power, and status.” Many other researchers have also combined power-based and normative approaches to describe and explain hostile takeover activity (Davis, 1991; Palmer, Barber, Zhou & Soysal, 1995; Fligstein, 1995; Palmer, Barber & Zhou, 1995; Davis & Greve, 1997).

Third, we consider the literature that describes the diverse ways in which social actors perceive the firm. Fligstein (1990; 1996: 658) proposed to refer to different views of the firm as "conceptions of control" or "understandings that structure perceptions of how a market works and that allow actors to interpret their world… [They are] simultaneously a worldview that allows actors to interpret the actions of others and a reflection of the world." ***Bill: I am not sure the preceding quote goes all the way to where I put the commas*** According to Fligstein, the finance conception of control argues for the use of short-term financial measures to evaluate product lines, divisions and even entire companies. "Firms are viewed as collections of assets earning different rates of return, not as producers of given goods" (Fligstein 1990:15). By essentially reducing firms to a collection of future cash flows, this conception promotes the use of the hostile takeover on the basis of the idea that shareholder interests and rights take priority over those of other stakeholders (Davis & Stout, 1992; Fligstein 2001). The relationship between hostile takeover activity and the prevailing view of the firm in society has also been described by other researchers (Allen, Jacobs & Strine 2002; Maiejer & Geens, 1990; Armour, Deakin, & Konzelmann, 2003). As Hirsch (1986:829) stated, "the language of takeovers, in facilitating their legitimacy, indirectly reinforced the dominance of the financial perspective in contemporary business." While the United States' unique social and political history have been argued to contribute to an environment where a financial view of the firm dominates (Davis & Stout, 1992; Fligstein, 1990), it has been less thoroughly explored to what extent this perspective extends to other countries (Fligstein & Freeland, 1995; Perrow, 2002).

In sum, sociologists of organizations have approached the study of hostile takeover activity using a combination of arguments related to power, norms and conceptions of control. Their theoretical and empirical approach, however, sought to explain patterns over time in a single country, the United States. Our goal in this paper is to develop a cross-national theory of corporate governance highlighting the power-related, normative and ideational arguments that enable different types of stakeholders to advance their interests in the corporation.

Hostile Takeovers, National Corporate Governance Models, and Conceptions of the Firm

While during the 1970s and 1980s the hostile takeover came to be considered within the American business community as a routine and acceptable governance mechanism (Hirsch, 1986), in other countries it continues to be framed pejoratively as a socially ostracized practice, albeit to varying degrees (Bühner et al., 1998; Guillén, 2000; O'Sullivan, 2003). (Bühner et al., 1998; Guillén, 2000; O'Sullivan, 2003). Prior cross-national comparative research has neither proposed a theory about what factors may drive the institutionalization of the hostile takeover nor used a cross-national sample to test it. Research comparing national corporate governance practices and the occurrence of hostile takeovers has most commonly yielded descriptive and qualitative results. Countries are often compared along one or more relevant dimensions, and then systematically categorized.

Perhaps the most common classification scheme involves the extent to which various countries rely upon either a shareholder-centered or a stakeholder-centered model of corporate governance (OECD, 1998; Guillén, 2000; Roe, 2000). The United States and, to a lesser extent, the United Kingdom adhere to the shareholder-centered model with firms relying upon liquid equity markets, dispersed ownership, and efficient product markets as "external" mechanisms for disciplining management (Jensen 1997; Roe, 2000). Management's ultimate contractual responsibility is described as being the maximization of shareholder value or wealth: "Public companies are not in the business to reward creditors, inspire devotion of their employees, win the favor of the communities in which they operate, or have the best products. These are all means to an end—making shareholders richer" (Seely 1996:35-36). While the shareholder-centered model does not necessarily deny the rights of other groups, proponents of this approach rely greatly upon market mechanisms to achieve efficient outcomes. Accordingly, the "interests of employees can best be accommodated through the mechanisms of the labor market, managers through the market for managerial labor, customers on product markets, banks on credit markets etc." (Wright, Filatotchev, Buck & Bishop, 2003: 265-266).

In countries where the shareholder-centered model prevails, the hostile takeover tends to play a more frequent role in disciplining management (Roe 1993; Gedajlovic and Shapiro, 1998). Moreover, in such countries hostile takeovers are more likely to be framed as being consistent with economic efficiency and well-being (Hirsch, 1986; Roe, 2000). Samuelson (1970: 505), for example, articulates the shareholder-centered view by stating that "takeovers…represent one of Nature's methods of eliminating deadwood in the struggle for survival. A more open and more efficiently responsive corporate society can result."

Germany and Japan are often identified as exemplars of the "stakeholder-centered" conception of the firm, where corporate control depends upon the support of the various stakeholders (Guillén, 2000). Donaldson and Preston (1995) identify stakeholders as any group that has an interest in the corporation regardless of whether the firm has any corresponding functional interest in them. Accordingly, the stakeholder-centered view of the firm has been defined as the belief that "each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as shareowners" (Donaldson and Preston 1995: 67). As with the shareholder-centered model, a strong stakeholder orientation has been related to a particular conception of the firm's role in society and has been regarded as the product of an ongoing power contest (Roe, 2000; 2002). In the stakeholder-centered model, corporations are expected to forego certain profit-maximizing risks, and to use up capital rather than to rely on such destabilizing measures as downsizing when their capabilities become misaligned with markets (Roe, 2000). To discipline managers, corporations place greater emphasis upon internal mechanisms such as boards of directors that exhibit broad stakeholder representation, including labor, creditors, and regulatory agencies (Charkham, 1994; Prowse, 1995; Lazonick and O'Sullivan, 1996; Dore, 2000). The comparative evidence suggests that hostile takeovers tend to be rare in countries with strong stakeholder orientations (Guillén, 2000; O'Sullivan, 2003).

The shareholder- and stakeholder-centered models of corporate governance exhibit several important similarities with theoretical frameworks developed in related fields. As previously suggested, the shareholder-centered model resembles Fligstein's finance conception of control since they both advocate the use of share price as the most objective and, ultimately, the only meaningful measure of firm performance (Davis & Stout, 1992). Corporate law scholars have also identified the property and entity views as two competing conceptions of the corporation (Allen, 1999; Roe, 2001). According to the property view, the purpose of the corporation is defined by the owners' property rights. Thus, management should be required to place its fiduciary duty to shareholders ahead of other interests. In contrast, the entity view proposes that the purpose of the corporation is to maximize the value that it creates in the long term even if these gains are not captured by current shareholders. Research on the U.S case suggests that judicial decisions on hostile takeover activity often hinge upon whether the property or entity view is upheld (Allen, Jacobs, & Strine, 1992). Cross-national legal scholarship has proposed that countries differ on whether they define the purpose of the firm and allocate the rights of its constituents in terms of property or entity arguments (Maiejer & Geens, 1990).

While the shareholder-stakeholder dichotomy has served as an effective device for highlighting some of the differences in national systems of corporate governance and conceptions of the firm, this classification scheme can also obscure the amount of variation that actually exists across countries. While the German and Japanese systems are often placed in the same category for their similar emphasis on stakeholders, internal constraints, and relation-based corporate governance, their differences are equally evident (see Charkham, 1994; Prowse, 1995; Driver and Thompson, 2002). In fact, some scholars argue that there are some chinks to traditional framework by proposing that certain countries—such as Canada—represent hybrid cases that do not fit conveniently into either category (Gedajlovic & Shapiro, 1998). There has also been little empirical work aimed at testing for specific causal factors. In this paper, we seek to address these concerns by developing a theoretical model that explains differences in the frequency of hostile takeovers from another perspective. Our approach highlights the ongoing conflicts of interest among stakeholders concerning the possibility and occurrence of a hostile takeover. The likelihood and frequency of hostile takeovers will depend on the extent to which each of the stakeholders can further its interests even against the opposition of others.

A STAKEHOLDER-POWER PERSPECTIVE ON HOSTILE TAKEOVERS

We build our theoretical model in five steps. First, we characterize the publicly traded firm as an organization beset by perennial conflicts as to who and to what extent should participate in, and benefit from, its activities. Sociologists (Bendix 2001; Perrow, 1986; Fligstein, 1990, 2001; Guillén, 1994) and organizational scholars (Mintzberg 1983; Pfeffer and Salancik, 1978) have long characterized corporations in this fashion. This assumption, however, is also present in other strands of corporate governance scholarship. Agency theory and the property rights literature propose that the firm is a "nexus of contracts" between groups of stakeholders, and that the architects of the corporate governance system must not only reconcile each group's divergent interests with each other but also allocate resources in a manner that is deemed acceptable by all parties (Jensen and Meckling, 1976; Fama, 1980; Jensen, 2000). The comparative corporate governance literature also underlines conflicts of interest (Roe 1993, 1994; Pedersen and Thomsen, 1997; Bühner, Rosenstein, and Yoshikawa, 1998; Guillén, 2000; O'Sullivan 2003). These separate and often contradictory literatures agree that hostile takeovers are a good illustration of the conflicts of interest that pervade the business corporation.

The second step involves the identification of the most relevant stakeholders. While Freeman (1984:46) suggests that any "group or individual who can affect or is affected by the achievement of the organization's objectives" can be called a stakeholder, theorists often try to narrow their attention towards the most important sets of actors for a given context (Windsor, 1992; Mitchell, Agle and Wood, 1997). Carroll (1994) limits his definition of stakeholder to those actors who possess either a legal or a moral claim over the actions of the firm. Blair (1995) and Aguilera and Jackson (2003) further argue that only stakeholders with a significant firm-specific investment should enjoy influence in discussions about corporate control. While some scholars have studied the relevance of such stakeholders as managers, suppliers, customers, political parties and the surrounding community (for a review, see Donaldson and Preston 1995), we focus our analysis of hostile takeover activity on shareholders, workers, and financial institutions, especially banks, because of their relatively direct claim on the allocation of the company's resources and rewards, and because they are the most frequently mentioned for their potential contributions to cross-national differences in corporate governance (e.g., Franks & Mayer, 1997; Driver & Thompson, 2002; Aguilera & Jackson, 2003; Aoi, 1997; Jackson, Höpner, & Antje, 2002; Phan & Yoshikawa, 2000).

The third step in our model involves defining the interests of each of the three stakeholder groups. Shareholders, workers and banks make different types of claims on the business corporation. As owners, shareholders are interested in maximizing their wealth, i.e. the cash-flows that accrue to them. A simplistic view of workers might indicate that they are also interested in the cash-flows, i.e. wages, paid to them by the firm, which reduce those earned by shareholders. Much cross-national research indicates, however, that workers are also interested in working conditions, intrinsic rewards and employment stability (Bendix 2001), which may have the effect of decreasing cash-flows to shareholders. Financial institutions possess a primary interest in obtaining commercial business from corporations (e.g. billing or payroll operations) and lending them money. Wherever permitted by law, they can also adopt the role of owner of the corporation if they feel that their commercial interests can be better protected in that way, often at the expense of shareholders or workers, or both.

The fourth element of our model deals with the argument that stakeholders are able to realize their own interests against those of the other stakeholders only to the extent that they have power. Following Lukes (1974:54) we "use the vocabulary of power in the context of social relationships [among shareholders, workers and banks, for instance] to speak of human agents, separately or together, in groups or organizations, through action or inaction, significantly affecting the thoughts or actions of others (specifically, in a manner contrary to their interests)." This comprehensive definition of power is the most appropriate for the study of hostile takeovers for three reasons. First, in the business corporation power dynamics occur not only when there is overt conflict of interests but also when it is covert. Second, stakeholders can exercise their power not just by behaving in a specific way but also by not acting, as long as other stakeholders accept their definition of the situation. Thus, the absence of observable behavior by one or more of the stakeholders before or even during a hostile takeover process in no way necessarily indicates that the stakeholder lacks power or the ability to exercise it in order to further its interests. And third, the implicit threat of a hostile takeover can be as behaviorally relevant as its actual occurrence in terms of disciplining the incumbent management team. This point is corroborated by the "inefficient management hypothesis" in the financial economics literature (Jensen 1988; Agrawal and Jaffe, 2003). Hence, analyzing the reasons why hostile takeovers are launched is as theoretically and empirically relevant as studying why, once launched, they are completed (Barber, Palmer, and Wallace, 1995; Davis 1991; Davis and Stout 1992; Driver & Thompson, 2002). In fact, if one recognizes that power dynamics may be at play when the conflicts of interest among stakeholders is latent as opposed to overt, and when there is no observable behavior, the study of why hostile takeovers are announced or launched has the potential of yielding more insights regarding the impact of stakeholder power than the study of which hostile takeovers are completed after being announced. Taking into account just the post-announcement dynamics during which takeovers might be completed or not would seriously bias any assessments of the role that stakeholder power may be playing in deterring the launching of a bid in the first place.

The fifth and last component of our theoretical model is the argument that cross-national differences in the power of the various stakeholders in the firm originate in the legal institutions present in the society. As Weber (1978:926) once noted, "the structure of every legal order directly influences the distribution of power, economic or otherwise, within its respective community." The legal order institutionalizes power, thus reproducing the power structure over time (Pfeffer, 1981; Fligstein, 1996). At the cross-national level, differences in the legal order set countries on separate, path-dependent trajectories. Based on the work of legal scholars (e.g. Roe 1993; Reynolds and Flores, 1989; Glendon, Gordon, and Osakwe, 1994), there has been an increasing realization among both economists (La Porta et al. 1998) and organizational sociologists (Aguilera and Jackson 2003; Guillén 2000) that legal orders pertaining to corporate governance—as implemented in the form of corporate, labor, civil, contract and banking legal statuses—have major implications for the power, and hence the behavior (or inaction), of the stakeholders in the firm regarding key corporate governance practices, especially contentious ones like hostile takeovers. As Fligstein (2001:36) has recently observed, "a system of rules is also a system of power."

Our theoretical approach is consistent with previous power-based models of economic and organizational behavior. Pfeffer & Salancik (1978:24) argue that "to describe adequately the behavior of organizations requires attending to the coalitional nature of organizations and the manner in which organizations respond to pressure from the environment." Moreover, they propose that after "determining who is relevant to the organization, the next step is to recognize that all may not be of equal importance. It becomes necessary to weigh the relative power of the various groups" (Pfeffer & Salancik 1978:85). Having identified the key stakeholders, observed their divergent interests, and proposed the legal order as the origin of cross-national differences in stakeholder power, we now turn to analyzing how each stakeholder defines its interests relative to the practice of hostile takeovers and how much power it possesses under different legal frameworks.

Shareholders

Shareholders have an interest in a hostile takeover of the company in which they own a portion of the capital insofar as they might be in a better position to maximize their wealth by selling to the highest bidder. Hostile takeovers are in effect a contest between the incumbent and the acquiring management teams, which have alternative views as to the best way to extract the greatest possible stream of cash-flows from the firm's assets (Agrawal and Jaffe, 2003; Manne, 1965; Jensen 1988; Jensen and Ruback, 1983). It is in the best interest of an individual shareholder to contribute to the ousting of the incumbent management team if the acquirer offers an amount of money at the time of the takeover that is larger than the net present value of the future cash-flows the firm would generate in the absence of the takeover. Thus, there is agreement in the literature that the interests of individual shareholders are generally furthered by hostile takeovers.

While shareholders have an interest in the occurrence and ultimate completion of a hostile takeover of the company in which they own stock, they must pursue and assert that interest against those of other stakeholders. Comparative legal scholarship (Reynolds and Flores, 1989; Glendon, Gordon, and Osakwe, 1994) and more recent economic analyses (La Porta et al. 1998, 1999) document that shareholder interests receive different degrees of legal protection, specifically against the decisions of the incumbent management team. In particular, shareholder rights are protected in different ways and to different extents depending on the legal tradition that provides the foundation for corporate law: (1) English common law, (2) French, (3) German, (4) Scandinavian, and (5) formerly socialist. The English common law tradition is shaped by the decisions of judges ruling on specific issues. By contrast, French and German law emerged from Roman civil law, which "uses statuses and comprehensive codes as a primary means of ordering legal material" (La Porta et al. 1998:1118). The French Commercial Code was issued by Napoleon in 1807, while the German Commercial Code was adopted in 1897 under Bismarck's influence. Scandinavian legal systems are in part based on civil law.

English, French and German corporate law diffused widely throughout the world following patterns of imperial, military, economic or cultural influence, and resulting in varying degrees of shareholder rights protection. Thus, former British colonies—including the U.S., Canada, Australia, Ireland, and Singapore—adopted English common law. French law spread not only to the francophone colonies in the Near East, Africa, Indochina, Oceania, and the Caribbean, but also to the Netherlands, Portugal, Spain, Italy, and their respective colonies. The German legal tradition shaped corporate laws in Austria, Switzerland, Greece, Hungary, Yugoslavia, Japan, Korea, Taiwan, and China, among other countries. Lastly, the former socialist countries need to be treated as a separate category because their legal systems, while in many cases influenced by either French or German law, have been in flux since 1989, and have largely failed to provide a sound basis for effective corporate governance (Spicer, McDermott, and Kogut, 2000).

A comparative analysis of corporate legal traditions reveals that the best protection of shareholder rights is awarded by English common law, followed by Scandinavian and German law. Compared to these other common and civil law traditions, the French legal tradition provides the worst protection. Shareholders are better protected when certain standards are ensured by corporate law, including: (1) proxy by mail, (2) non-blocking of shares before the shareholders' meeting, (3) cumulative voting or proportional representation for designating members of the board of directors, (4) oppressed minority protection, (5) preemptive right to new issues, and (6) a relatively low percentage of shareholders required to call an extraordinary meeting (see La Porta et al., 1998). In Belgium (French legal tradition) none of these six provisions are part of the law, while five are present in both Canada and the United States (English tradition). Tests of means across legal traditions as of 1996 confirm that the English tradition awards the best shareholder protection (mean of 4.0 provisions), followed by the Scandinavian (3.0), German (2.33), and French (2.33) traditions (La Porta et al. 1998; La Porta et al. 1999).

The variety of ways in which countries define and regulate shareholder rights provides an opportunity for making a theoretical prediction as to the frequency of hostile takeovers, which offer shareholders the opportunity to relinquish ownership and transfer managerial control to the highest bidder. As the Organization for Economic Cooperation and Development (OECD, 1999) contends, the ability to convey and transfer ownership of shares is perhaps the most fundamental shareholder prerogative. Hence, hostile takeovers are expected to be more frequent to the extent that the corporate legal system privileges the interests and perspectives of shareholders. We expect more frequent hostile takeovers to the extent that owners' rights from the incumbent management's discretion are protected because shareholders will be in a more powerful position to fulfill their interests. We thus predict:

> Hypothesis 1: The frequency of hostile takeovers increases with the extent to which the rights of shareholders are protected from the discretion of the incumbent management team.

Workers

The ability of workers to influence organizational arrangements, strategic decision-making and performance outcomes at the national, industry, and firm levels of analysis is one of the earliest and best documented findings of cross-national comparative research on organizations (Bendix, 2001; Cole, 1985; Guillén, 1994). The bulk of this research suggests that the interests of workers generally oppose corporate reorganizations and their often disruptive effects. Consistent with this prior research, we argue that workers will view most hostile takeover activity unfavorably because of its negative consequences on jobs, working conditions and pay. As a group, workers tend to emphasize job security and solidarity over efficiency and profitability. As a method of corporate reorganization, the hostile takeover may perhaps help achieve efficiency and profitability but frequently at the cost of reducing job security. Hirsch (1986:801), for instance, noted the "ominous implications for workers and managers of the target corporations." This argument is accepted not only by sociologists (e.g. Aguilera and Jackson, 2003) but also by economists. According to Shleifer and Summers (1988), for instance, a hostile takeover affords the incoming management team with a special opportunity to violate the implicit long-term contract between the target firm's incumbent management and its workers. This breach of contract often takes the form of layoffs and an increase in the demands imposed upon the remaining workers. Moreover, hostile takeovers tend to affect not only the workers in the target firm but also those in the acquiring firm.

The available empirical evidence conclusively demonstrates that hostile takeovers—more so than friendly ones—tend to result in job cuts (Conyon et al. 2001, 2002). Case-study research has shown that organized labor tends to oppose hostile takeovers. The German unions' track record is frequently invoked as an illustration (e.g., Baums 1993; Franks & Mayer, 1997; Roe, 2003). This research highlights that workers have a better chance of preempting or resisting a takeover when they have institutionalized legal mechanisms at their disposal. For instance, workers were able to discourage and/or defeat the hostile takeovers of Feldmüle Nobel and Hoesch thanks to their statutory representation on supervisory boards and works councils (Franks & Meyer, 1997; Sebenius, 1998). The rare exceptions to this trend also prove revealing. In the case of the ultimately successful Vodafone hostile takeover of Mannesmann, for example, labor's stance was uncharacteristically ambivalent as employee representatives tried to pressure the target company's management into restructuring (see Jackson, Höpner & Kurdelbusch, 2004). Similarly, employee representatives on Continental Gummiwerke's supervisory board proved willing to consider a merger with the Italian hostile raider Pirelli, despite the management board's continued objections. While Pirelli's takeover efforts failed, this event led to the dismissal of the management board's chairman in favor of a replacement who was more sympathetic to employee preferences (Franks & Meyer, 1997).

Workers have historically sought to obtain legal protection of what they perceive as being their rights to association, representation and collective bargaining (Bendix 2001). As in the case of shareholder rights, legal scholarship documents that there are profound cross-national differences in the extent to which worker rights are protected (Glendon et al. 1994). We expect that a better protection of worker rights will make this stakeholder more powerful within the firm and militate against practices that have the potential of eroding the well-being of workers by disrupting employment arrangements. Thus, we propose:

> Hypothesis 2: The frequency of hostile takeovers decreases with the degree of protection of workers' rights of association, representation and collective bargaining.

Banks

Banks are the third important stakeholder in the firm highlighted by the cross-national corporate governance literature. The role that commercial banks perform in the economy and in corporate governance differs substantially across countries (Prowse 1995; Glaeser and Shleifer, 2000). In the United States, for instance, banks largely serve as lenders and face severe restrictions in their ability to own shares in non-financial corporations and to engage in such stock market activities as underwriting, brokering, and dealing. While the limited role for American commercial banks became solidified in part as a result of growing populist sentiments during the Great Depression, both Roe (1991; 1994) and Davis and Thompson (1994) describe the power contest between managers and banks that contributed to this long-term outcome. In other countries, banks fulfill a more central and powerful role in the economy and corporate governance not only by providing loans but also by acting as prominent stock market intermediaries and equity holders. Moreover, in many countries banks exercise a monitoring function on behalf of customers of theirs who own small amounts of equity in firms. This is accomplished through the mechanism of proxy representation and vote at the annual shareholders' meeting. Thus, it is not uncommon in certain countries for a bank to exercise more than half of a company's voting rights even though the bank may only own 10 or 15 percent of its stock (Roe, 1993). Banks are more powerful actors in countries in which they can directly own stakes in non-financial firms.

Banks that directly control large blocks of stock in non-financial companies could be seen as benefiting from a hostile takeover in the same way that other shareholders would. In reality, however, the literature points out that banks generally prefer stable systems of corporate control over the potentially destabilizing effects of hostile takeovers. Deutsche Bank director Ellen Schneider-Lenné (1993:22) offers an illustrative example of this perspective by denouncing the "excesses of takeover battles such as those witnessed in America and Britain," the "resultant high indebtedness of companies involved," and "the practices of corporate raiders who, after taking over a company, strip its assets to make a quick profit." Even within the United States, Dobbin and Dowd (2000) chronicle how banks and other financiers withheld capital during the late 19^{th} and early 20^{th} centuries to fight a business model based upon predatory acquisition and to promote a more cooperative and stable alternative.

There are three main reasons why banks are likely to oppose a takeover attempt over a company in which they hold equity or exercise representation and voting rights. First, banks with large shareholdings and voting privileges are insiders to the firm, and operate from a position of strength that typically enables them to dispatch directors to the board and to appoint the CEO. Thus, they have little need to mount a hostile bid in order to exercise influence and control (Davis and Stout, 1992).

Second, in many countries banks become large owners of non-financial companies in order to ensure an exclusive access to lucrative commercial transactions. Electrical utilities or telecommunications operators serve as salient examples because they need a "house bank" in order to handle their banking needs, including financing infrastructure projects, and managing their extensive commercial payments and receipts operations. Thus, while the shareholding bank obtains income in the form of dividends, these revenues tend to pale by comparison with those obtained from the commercial relationship between the bank and the firm in which it owns stock. An unsolicited outside bid for the company would disrupt this profitable commercial relationship from the point of view of the bank (Roe, 1993; Bühner, Rosenstein, and Yoshikawa, 1998). In fact, comparative research indicates that in countries in which banks are important stock owners, non-financial companies have twice as much bank loans on their balance sheets and two to three times greater debt-to-equity ratios (Steinherr and Huveneers 1994; Guillén, 2000).

Third, the highly visible and central position that banks with shareholdings in other companies hold in some economies suggests that they are often placed under intense scrutiny by other stakeholder groups. Consequently, banks might often find that reputation costs associated with negative public opinion could easily outweigh any tangible financial gains from a hostile takeover (Baums 1993). Bühner, Rosenstein, and Yoshikawa (1998) found this to be precisely the case when Deutsche Bank tried to finance steel manufacturer Krupp's hostile takeover of its competitor Thyssen. After announcing its intentions, Deutsche Bank faced a public relations crisis when steel workers began picketing the bank's Frankfurt headquarters, and the unions and workers threatened to withdraw money from their accounts at Deutsche. In response to the media outcry, the bank ceased to support the takeover, which only took place after the two companies agreed to a friendly merger one year later. For these three reasons, we expect that hostile takeovers will be less likely to the extent that the banks' right to own stakes in non-financial firms, and hence their power, is protected by legislation. Thus:

> Hypothesis 3: The frequency of hostile takeovers decreases with the extent to which banks are legally allowed to own stock in non-financial firms.

DATA AND METHODS

Sample & Dependent Variables

The unit of analysis in our empirical study is the country-year. We collected data on 37 countries for the eleven years between 1988 and 1998. Hostile takeover data from 1987 were also collected to calculate the lagged value of the dependent variable for the initial year of our study. Information on takeover activity was taken from the Securities Data Company's SDC Platinum database of Worldwide Mergers and Acquisitions. This source seeks to include data on "all corporate transactions involving at least 5 percent of the ownership of a company where the transaction was valued at $1 million or more (after 1992, deals of any value are covered) or where the value of the transaction was undisclosed" (SDC, 1999:27). The SDC database includes both public and private transactions. International coverage begins in 1985, but the quality of the data during the initial two years is not appropriate for our purposes. Our findings did not change when the records from these early years were included in the analyses.

SDC classifies a takeover as "hostile" when the target firm's board of directors officially rejects an offer but the acquirer persists with the takeover. In a comparison of four operational definitions of hostile takeovers based upon a sample of 2,346 takeover contests occurring between 1975 and 1996, Schwert (2000) found SDC's designation to be the most highly and positively correlated with the one used by the Wall Street Journal/Dow Jones News Retrieval Service (WSJ/DNJR). SDC Platinum's categorization can be regarded as a relatively conservative definition of hostile takeovers in that it produced higher counts of hostile takeovers than WSJ/DJNR but significantly lower counts than classifications based on non-negotiated bids or an evaluation of pre-bid events. For the purposes of this study, SDC holds the obvious advantage of being the data source with the best worldwide coverage. SDC draws on over 200 English and foreign language news sources, SEC filings and their international counterparts, trade publications, wires and proprietary sources of investment banks, law firms, and other advisors. While such important issues as variations in reporting standards and data availability should always raise concerns regarding the validity of cross-national tests, SDC is often regarded as the best resource for drawing inferences on global takeover activity (Guillén, 2000; Prowse, 1995).

For the majority of our regression analyses, we used the count of announced hostile takeover bids as our dependent variable. To construct this measure, we first downloaded SDC's complete listing of corporate takeover bid announcements for the years under investigation. Next, we classified these records by year, by the attitude of the corporate transaction (hostile or otherwise), and by the home country of the target firm. Over 218,000 of SDC's records for the countries and years in the study were successfully classified, with less than one percent of the total number of entries being omitted due to missing information regarding one or more of these three categorizations. This classification process yielded aggregate count data for hostile and non-hostile takeover announcements in each country and year. Since the question of whether any hostile takeovers attempts occurred in a country during a given year represents a theoretically and empirically important question, we also constructed a binary measure that was set equal to one if there were one or more attempts for each country-year, and zero otherwise. This binary measure was used as the dependent variable for all other models.

To gain a better understanding of the actual corporate events that constitute our study, we used SDC, Bloomberg, COMPUSTAT and other financial and archival news databases to gather deal-level information for each of the 952 hostile takeover attempts in our sample. Even in the case of U.S. takeover battles, many of the deals involved target companies that were only listed on secondary or minor exchanges. Therefore, we were able to uncover minimal information for many of these deals. Despite this difficulty, we found several news media reports and academic cases studies that highlighted the roles played by powerful stakeholders in hostile takeover bids in different countries.

We focus on hostile takeover bids, rather than consummated deals, largely for theoretical reasons. Many financial economists and corporate governance scholars emphasize that it is the threat of a takeover that provides the broader and more enduring impact on managerial behavior (Jensen, 1986; Davis, 1991; Davis & Stout, 1992; Driver & Thompson, 2002). Unsuccessful hostile bids can serve as “early warning signals” to firms and also often lead to labor force reductions, financial and operational reorganization, or even changes to incumbent management (Bhagat et al, 1990; Chatterjee, Harrison, & Bergh, 2003). In counties with little hostile takeover activity, just a few announced bids can lead to speculation among managers, policymakers, scholars, and the press about a growing market for corporate control (Blass, Yafeh & Yosha 1998; Toth-Feher et al., 2002; Neff, 2000; Scott, 2004). From an empirical standpoint, the determination of whether a completed deal was ultimately hostile or friendly can also sometimes prove problematic (Davis & Stout, 1992). For example, the management and board of the target might eventually accept the revised terms for an amicable merger, but only after a prolonged period of initial resistance. Alternatively, the target might agree to be acquired by a third-party “white knight” who would not have come into play had the original hostile takeover attempt not been launched (Hirsch, 1986).

Based upon the 329 completed deals where information was available, we calculated the average time between the announcement and completion to be 140 days. While the ending date for unsuccessful bids is often more difficult to determine, these unconsummated deals appear to possess an even longer average duration. Narrative accounts provided by SDC and other sources of the major events relating to each hostile takeover deal indicate that, even for unsuccessful bids, both target and prospective acquirers, committed substantial resources in battling for corporate control. Overall, we found that about 35 percent, or 336 out of 952 attempts were eventually completed. (See the note to Table 1 for a breakdown of the data by country.) This percentage may represent an underestimate, however, since we found some cases where SDC had not updated the status of the takeover bid when that attempt was completed in a calendar year different than the one of its announcement. We attempted to account for these omissions whenever possible using other data sources.

Independent Variables

We measure the extent to which shareholder rights are protected with the "antidirector rights index" developed by La Porta et al. (1998). This index ranges from zero to six, and is calculated by adding one point for the presence of a provision protecting six representative shareholder rights in the country's commercial code or company law. The provisions are: (1) allowing shareholders to mail their proxy vote at a shareholders' general meeting; (2) not requiring shareholders to deposit their shares before attending the general shareholders' meeting; (3) the presence of a legal mechanism enabling minority shareholders to challenge the decisions of management or assembly; (4) the ability to vote cumulatively on appointments to the board of directors (or to be guaranteed proportional representation); (5) preemptive rights for new share issues for all current shareholders; and (6) a minimum percentage of shareholder capital of 10 percent or less in order to call a special shareholders' meeting.

Building on LaPorta et al's (1998) cross-sectional index for 1996, we constructed a time-varying measure for each country in our sample during the 1988-1998 period by referring to a number of sources. As our primary reference we used the <u>Commercial Laws of the World</u> series (Foreign Tax Law, 2002), which provides full-text, English-language translations of the corporate legislative codes for a large number of countries. Based upon the date of the original law and the dates of any subsequent revisions or addendums, we were able to create annual scores. In cases where this main reference did not provide the documents for a particular country, when addendum dates were not documented, or when information was out of date, we used a number of additional sources including Commercial Laws of Europe (European Law Centre, 1999) and Capital Formation and Investment Incentives around the World (Diamond and Diamond, 1999). In some cases, we examined the national corporate or commercial laws in the original language. To ensure consistency in our coding and interpretation of legal provisions across countries, we developed coding rules that were consistent with LaPorta et al.'s (1998: 1122-1123) description of each variable. When a particular legislative code was regarded as regarded as ambiguous, the relevant portion was reviewed by each co-author separately. This precaution yielded no disagreements in the coding of shareholder rights between the two co-authors. Thus, we achieved perfect inter-coder reliability.

We used two alternative measures of labor rights, both of which were based upon each country's ratification of International Labour Organization (ILO) labor standards, as reported in the ILOLEX database. The ILO refers to its standards, or conventions, as "the only universally accepted benchmark …by which the rights and conditions of human beings at work have been measured" (ILO, 2002). The UNESCO World Culture Report (2000) also suggests that ILO ratification records could be used to quantify country-level differences in worker rights. As of December 2003, the ILO had 57 conventions in effect. For the first of our alternate labor measures, we focused on a narrow type of labor rights, directly related to workers' ability to further their interests, including the four ILO provisions that guarantee "Freedom of Association, Collective Bargaining, and Industrial Relations." This indicator ranges between zero and four. We also created a second, broader indicator that included, in addition to the ratification of the provisions included in the narrower measure, the ratification of provisions having to do with basic human rights, conditions of employment, social & employment policy, employment services, labor inspection, occupational health & safety, social security, and the protection of wages, hours of work and weekly rest. This indicator ranges between zero and 45. We excluded from both measures four conventions that only applied to a specific group (such as agricultural or rural workers).

We measure banks' rights to participate in the ownership and governance of non-financial companies using the four-point scale created by Barth, Caprio, and Levine (2000:14). Scores of 1 (unrestricted ownership) or 2 (permitted but limited) suggest a more central role for banks in the national economy and corporate governance while scores of 3 (restricted) and 4 (prohibited) reflect a system in which banks have a more limited influence in corporate governance. We traced changes in legislation over time in order to construct a time-varying measure. Since higher scores indicate greater restrictions, we multiplied the original variable by -1 so that it is increasing in the banks' rights to participate in the ownership and governance of non-financial companies.

Control Variables

We control for various other factors that might be related to the level of hostile takeover activity. We use the World Bank's (2003) World Development Indicators as the source unless otherwise noted. All controls are time-varying in nature. The most common economic explanation for hostile takeovers is that they are brought about by financial underperformance (e.g., Manne, 1965; Jensen 1988). We used data from ***source*** to control for each country's inflation-adjusted annual stock market total return. Both financial economists and organizational scholars convey the importance of macroeconomic factors, especially the business cycle and macroeconomic uncertainty (Becketti, 1986; Haunschild, 1993; Dobbin & Dowd, 2000). Thus, we included the GDP growth rate as a proxy for the business cycle, and Servén's (1998) measure of macroeconomic uncertainty.[1] We also controlled for economic development by including the log of GDP per capita.

Given that democratic regimes tend to offer better protection of individual freedoms and property rights, and therefore could potentially influence the frequency of hostile takeovers (Jensen & Meckling, 1983; Driver & Thompson, 2002), we controlled for the ten-point democracy score included in the Polity IV database, which takes into account three elements: institutions that enable the people to express its political preferences; checks and balances on the executive's power; and "the guarantee of civil liberties to all citizens in their daily lives and in acts of political participation" (Marshall and Jaggers, 2002:12).

To measure the overall level of economic and corporate activity in each country, we included the total number of people in the labor force and the number of listed companies. Some of our models would not converge when we included listed companies as either a single linear term or in its logarithmic transformation. Therefore, we included both linear and squared terms.

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[1] Servén (1998) proposes to calculate the natural logarithm of the conditional variance of nominal GDP growth in a given year fitted by using a generalized conditional heteroskedasticity (GARCH) specification, a model originally suggested by Bollerslev (1986):

$$y_{it} = \alpha_1 t + \beta_1 y_{i,t-1} + \varepsilon_t \,; t = 1,\ldots,T;$$
$$\sigma_t^2 = \gamma_{i,0} + \gamma_{i,1}\varepsilon_{i,t-1}^2 + \delta_i \sigma_{i,t-1}^2$$

with σ_t^2 denoting the variance of ε_t conditional on the information up to year *t*, which is estimated separately for each country.

The results for all hypothesized variable were materially the same when compared against the models with simpler transformations of this variable that did converge. Since it could be argued that the level of hostile takeover activity might largely represent a function of the overall M&A activity, we also controlled for the logged number of non-hostile takeovers.

Several empirical studies suggest that both predatory and non-predatory acquisitions occur in waves, and that bandwagon processes amongst economic actors cause the number of acquisitions in one year to help determine the level in the next (Haunschild, 1993; Stearns & Allan, 1996; Dobbin & Dowd, 2000). To account for this possibility, we included a lagged measure of our dependent variable, which was either an integer or binary value depending on the model, a technique recommended so as to address unobserved heterogeneity (Heckman and Borjas's 1980; Beck 2001:290-291).[2]

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[2] Several of our variables of interest exhibit limited cross-temporal variation within countries. Although this does not violate any of the assumptions of our statistical models, the inclusion of a lagged dependent variable raises an important caveat. The coefficients for explanatory variables with little variation could be understated, since their impact on the hostile takeover activity might be captured by the lagged dependent variable. In auxiliary tests (not reported here, but available from the first author upon request), we tested models with the lagged dependent variable term omitted. Aside from one exception discussed in the results, our findings remained the same. We chose to leave this variable in our model due to the prominence placed on mimetic processes in past explanations of corporate acquisition activity, and because it provides a more rigorous test of our hypotheses. We thank the Editor, Donald Palmer, and an anonymous reviewer for their guidance and for initially drawing our attention to this issue.

Theories on diffusion also suggest that a country's hostile takeover activity might also be impacted by the prior use of this practice in other countries. If so, the magnitude of this effect would probably be conditioned by the extent to which the focal country is connected economically to all others. We measured this influence by using SDC data to calculate the percentages of non-hostile takeovers in the focal country that involved acquiring firms from other countries. Next, we multiplied these percentages by the number of hostile takeover attempts that occurred in each "acquiring" country during the prior year. Finally, we added the resulting values to create our estimate of the impact of foreign hostile takeover activity, which we included as a control in all analyses.

Prior research also points to some other important factors that might affect our dependent variable. Within counties in which the majority ownership of firms tends to be concentrated amongst just one or two shareholders, for instance, hostile takeovers can be relative rare (Franks and Mayer, 1996; Guillén 2000). Furthermore, variations in antitakeover provisions could also lead to differences in the ease with which transfers of corporate ownership can be accomplished. Unfortunately, reliable measures for these factors do not exist for a large number of countries and years. We have taken steps to control for these and other sources of unobserved heterogeneity. As mentioned above, we include a lagged measure of hostile takeover activity in all models and use country fixed-effects specifications. We also incoporporate three variables to measure differences in industry compostion by counting the percentage of non-hostile takeovers that involved target firms in agriculture and mining, services, and industry. Finally, we added annual dummies to guard against unobserved heterogeneity across time.

Estimation Method

The main dependent variable for our analysis (the number of hostile takeover bid announcements) has certain important characteristics: (1) it is nonnegative; (2) it is integer-valued, denoting counts of hostile takeovers; (3) it exhibits overdispersion, with 85 percent of the values equaling zero or one; and (4) it is longitudinal, including observations per country and year. When the outcome variable is nonnegative and integer-valued, Poisson regression is more appropriate than ordinary least squares. To adjust for overdispersion, we used the negative binomial model, a generalization of the Poisson model where the assumption of equal mean and variance is relaxed (Hausman, et al., 1984; Cameron, and Trivedi, 1998).

We accounted for the longitudinally clustered nature of the data in two separate ways: (1) using a generalized estimating equation (GEE) approach; and (2) specifying country fixed effects (FEs). GEE and FEs approaches provide different benefits and disadvantages. (For a detailed comparison, see Hardin and Hilbe, 2003). The GEE algorithm accounts for correlation between records within the same cluster thus providing efficient estimates of coefficients and improved standard error estimates (see Liang and Zeger, 1986; Zeger, Liang, and Albert, 1988; Allison, 2000). Since the GEE approach is less computationally intensive than either FEs or random effects, it often proves less subject to instability and convergence problems. Since FEs models are more widely used, their properties have been extensively studied and are more thoroughly understood. FEs models are generally regarded to provide a better control for unobserved heterogeneity. Since FEs methodologies cannot account for any clusters in which the dependent variable remains unchanged across the sample period, GEE has been argued to be more widely applicable and to use the information available in the panel data more efficiently (Hardin & Hilbe, 2003; see also Allison, 2000).

Since our cross-national sample included some countries in which hostile takeovers did not occur in any time period, FEs methods could not be used to evaluate these countries. Therefore, we had to rely on different sample sizes. Our full sample, which was tested using the GEE approach, includes all country-years in which we had complete data for the above variables (n=367). Since, the United States and Great Britain constitute significant outliers in terms of hostile takeover activity, we conducted another GEE test after excluding these two countries (n=345). Next, we used both GEE and FEs in successive model runs on a reduced sample that excluded the eight countries that had zero hostile takeover attempts for all years (n=287; see Table 1). For all GEE models, we used an exchangeable correlation structure, which assumes equal correlation between all records within the same country cluster. To further test for robustness, we estimated a GEE logit specification on the full sample for models in which the dependent variable was a binary measure of whether at least one hostile takeover attempt occurred during the country year or not. For the logit models, a FEs specification would not be useful since the inclusion of country dummies would eliminate countries in which hostile takeover attempts occurred in every year as well as those in which no hostile takeover was ever announced.

While we were sometimes unable to find all of the data necessary for each of the ten annual records for each country, there was no reason to suspect that yearly information was made unavailable due to the (potentially unfavorable) nature of the data. Therefore, we estimated the models using an unbalanced panel. Table 1 presents the sample descriptive statistics and correlations. The sample used in the analysis contains a mix of developed and developing economies located on all five continents (see the footnote to Table 1). While our methodology has been updated to account for advances in statistical methodology, our overall approach is consistent with past studies in which the dependent variable is an acquisition count (e.g. Haunschild, 1993; Amihud & Lev, 1981).

RESULTS

Table 2 shows the regression results with levels of significance reported for two-tailed tests. Models A, B and C show results of negative binomial regressions using GEE as the estimation method, while Model D is the negative binomial fixed-effects specification. Model E reports GEE logit results using a dichotomized dependent variable. We find robust support for two of our three predictions. Model A lends support to the hypotheses that the greater the protection of shareholder rights the higher the number of hostile takeovers (H1) and that the greater the protection of banking rights the lower the number of hostile takeovers (H3). The indicator of labor's rights to freedom of association, collective bargaining and industrial relations (H2) fails to reach significance in the models using the count of hostile takeovers as the dependent variable. This pattern of significance holds in Model B, in which observations for the U.S. and the U.K. are excluded from the sample, and in Model C, in which observations for countries with zero hostile takeovers across all years in the sample are excluded in order to be able to compare the results with those in the fixed-effects Model D. We also obtain support for hypotheses 1 and 3 in the fixed-effects model. In the logit Model E, we find support for all three hypotheses. Thus, the empirical support for the shareholder and banking rights hypotheses is robust to the elimination of outliers, sample size, and estimation method.

The significant effects of shareholder and banking rights are not only significant but important in magnitude. Using the coefficient estimates from Model C in Table 2—a regression that does not include fixed-effects—a country with one additional shareholder right protected in its corporate legislation witnesses on average 30 percent more hostile takeovers than an otherwise comparable country ({exp[0.262]-1}×100). A country coded with one additional point on the banking rights scale has on average 27 percent fewer hostile takeovers ({exp[-0.309]-1}×100). The interpretation of the magnitude of the results obtained with fixed-effects regressions is different. Using the estimates from Model D in Table 2, a year-on-year change of one additional shareholder right results in a 609 percent increase in the number of hostile takeovers, while a one point year-on-year change on the banking rights scale results in an 85 percent reduction. Caution should be exercised in interpreting the fixed-effects coefficient of shareholder rights because only three countries (Australia, New Zealand and Switzerland) changed the relevant legislation during the period under investigation, all in the direction of increasing shareholder rights. Thus, in the fixed-effects Model D the significant coefficient is capturing the increase in hostile takeovers in these three countries over the relevant time period. Besides the magnitude of the effect, what is important to underline is that the fixed-effects results are consistent in sign and statistical significance with the GEE results, thus providing further reassurance about the robustness of the impact of shareholder and banking rights.

Several of the control variables in the regressions reported in Table 2 turned out to be significant and in the predictable direction, including the business cycle (GDP growth rate), macroeconomic uncertainty, democratic freedoms, foreign hostile takeover activity, and the total number of non-hostile takeovers. The lagged number of hostile takeovers, which corrects for unobserved time-varying differences across countries, did not always reach significance. Controls accounting for the level of economic development (GDP per capita) and the number of listed companies did not reach significance. One control (size of the labor force) exhibits the opposite sign to the expected one in some models. Stock market performance only reached significance, and in the predicted direction, in the fixed-effects specification. It is worth noting that past research has also found mixed empirical support for stock market performance (Palmer et al., 1995; see Agrawal & Jaffe, 2003 for a recent review). In supplemental tests, we found that for the 602 hostile takeover attempts for which data were available, the price/book ratio for the target firm about one month prior to the announcement was significantly lower than the national stock market average ($p < .001$), but the price/earnings ratio was actually higher, though not significantly so ($p = .61$, $n = 621$). Some researchers have found overall stock market performance to be positively related to aggregate corporate acquisition levels (see Nelson, 1959; Golbe & White, 1988).

Table 3 shows results using the broader labor rights variable. The pattern of significant results for shareholder and banking rights is the same as when using the narrower labor measure in Table 2. In addition, we obtain robust support across samples and estimation methods for the hypothesis that the stronger the labor rights the lower the number of hostile takeovers (H2). In sum, we obtained robust and consistent support for our hypotheses, although in the case of labor rights only when using the broader empirical measure.

DISCUSSION AND CONCLUSION

This study demonstrates that the business firm is a contested entity in which different types of stakeholders seek to advance their interests. We further argued and established empirically that stakeholders pursue their interests within the structure of legally institutionalized power prevalent in their society. We used the hostile takeover as a practice whose occurrence (or non-occurrence) reflects the balance of power among stakeholders in a given context. Using a cross-national and longitudinal dataset, we found strong and robust support for the predictions that the legal protection of shareholder and banking rights are, respectively, positively and negatively associated with hostile takeovers. We only found support for the prediction that the protection of labor rights reduces the number of hostile takeovers using a relatively broad measure. Thus, our stakeholder power approach to corporate governance yields insights that help explain why practices are more prevalent in certain countries and periods of time than in others.

While there is no agreement as to whether hostile takeovers are “good” or “bad,” our analysis provides a deeper understanding of the drivers of this important phenomenon. The power of the various stakeholders characterizes countries in fundamental and momentous ways. Companies and their practices look so different from one country to another because countries themselves vary substantially in terms of legal provisions, political history, and stakeholder power and influence. Our point is that discussing the virtues of hostile takeovers is only one way of looking at the problem; examining the extent to which they are consistent with the structure of stakeholder power is another, perhaps complementary way that yields further insights.

This paper also speaks to the differing ways in which the public corporation is conceived across countries. Our results indicate that hostile takeovers are more prevalent when the institutional conditions in a country are more consistent with the view of the firm as a bundle of financial assets than with the view of the firm as a social entity. Thus, our approach can be used to assess the conception of the firm that tends to predominate in different societies. While much research in organizational theory has emphasized the fact that the corporation is embedded in a wider social context, on which it depends for critical resources (e.g. Pfeffer and Salancik, 1978; Perrow, 1986), almost no evidence has been produced to show that there is a systematic pattern of institutional variables that accounts for the differences across countries.

Our empirical results also shed some light on the debate over the convergence in corporate governance practices across countries as a result of globalization (Guillén, 2000). On the one hand, if differences across countries can be traced back empirically to institutional and structural characteristics of countries, one cannot assume that corporate governance practices, no matter how desirable or efficient, will diffuse effortlessly. Widespread diffusion can only be expected if the relevant institutional features converge across countries. Previous research has pointed out that legal institutions, for instance, are unlikely to change in the foreseeable future (La Porta et al., 1998; Roe, 1993). Our empirical evidence suggests that hostile takeovers are consistent with certain distributions of power among stakeholders, but not others. Thus, we expect differences across countries in the level of hostile takeover activity to persist into the future to the extent that legal institutions and stakeholder power remain unchanged. On the other hand, however, we found the measure of foreign influences on hostile takeover activity to be positive and significant. As more hostile takeovers take place across-borders, one should expect convergence across countries even with resilient structures of stakeholder power.

Finally, the paper speaks to the comparative study of institutions. Our theoretical and empirical analysis confirms the usefulness of examining the power structures in which organizational structures, behaviors, and practices are embedded. Institutions provide the foundations for organizational life, the taken-for-granted regulative and normative pillars that enable and shape action. Our analysis shows that national institutions can be conceptualized and measured in a way that captures institutional variations across a large number of countries, which then can be used to explain differences in an outcome variable of interest. This approach lends itself to examining dependent variables defined at many levels of analysis including the organization, the industry, and the country.

Our theoretical and empirical analysis is limited in several respects. We have focused on explanations at the country level of analysis. We envision several ways of refining and expanding the analysis of corporate governance practices reported in this paper. First, other corporate practices could be studied cross-nationally using a similar institutional framework of analysis, including board of director composition and employee stock options. Second, rather than aggregating the dependent variable at the country level of analysis, one could also test for firm-level explanations, although carefully matched representative samples of firms in each country should be designed and the relevant data collected. Finally, case studies of firms across many national settings could be useful in generating more nuanced hypotheses and in understanding the basic underlying causal processes. These research avenues will provide fertile ground for formulating and testing institutional propositions about corporate governance practices and about the role of the corporation in society that strike a balance between large-scale cross-national differences and micro-level processes.

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TABLE 1

Sample Descriptive Statistics and Correlations (N = 367 country-years, 37 countries, 1988-1998)

	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. # of hostile takeovers	2.59	8.96															
2. Shareholder rights	3.16	1.28	.27*														
3. Worker rights (narrow measure)	2.21	1.24	-.20*	-.26*													
4. Worker rights (broad measure)	16.75	8.11	-.18*	-.14*	.76*												
5. Banks' rights	2.13	.84	-.07	.01	.30*	.11											
6. GDP Growth Rate	3.54	3.44	-.03	.16*	-.25*	-.33*	.02										
7. Stock Market Performance	.12	.41	-.01	-.01	-.01	.02	-.00	.04									
8. Macroeconomic Uncertainty	-7.44	1.00	-.11*	.24*	-.34*	-.30*	-.19*	.16*	.04								
9. Democratic Freedoms	8.33	2.71	.17*	-.15*	.30*	.45*	.22	-.31*	-.03	-.38*							
10. GDP per capita (logged)	9.15	1.37	.18*	-.19*	.34*	.43*	-.01	-.27*	-.05	-.35*	.61*						
11. Foreign hostile takeover activity	6.76	7.11	-.09	-.04	-.01	.05	-.08	.05	-.07	.03	-.03	-.06					
12. Lagged # of hostile takeovers	2.77	9.91	.87*	.42*	-.41*	-.19*	-.14*	.02	-.02	-.11	.17*	.18*	-.09				
13. Number of listed companies	773.52	1460.82	.66*	.34*	-.38*	-.33*	-.16*	.03	-.03	-.10	.16*	-.03	-.11	.68*			
14 Number of listed companies squared (millions)	2.72	10.48	.66*	.27*	-.20*	-.33*	-.07	.09	-.01	-.09	.12	.01	-.09	.69*	.95*		
15. Size of Labor Force (millions)	31.32	68.05	.16*	.36*	-.39*	-.27*	-.08	.09	.01	-.24	-.01	-.44*	-.00	.17*	.67*	.67*	
16. # of non-hostile takeovers (logged)	4.86	1.68	.52*	.09	.08	.24*	-.05	-.23	-.08	.04	.42*	.61*	-.13	.52*	.43*	.43*	-.00

$^{*}p < .01$

Note: The reduced sample contains all countries that had hostile takeover attempts from 1988 to 1998. They are twenty-eight countries included in the reduced sample are: Australia (67 of 110 attempts completed), Austria (0 of 2), Belgium (0 of 2), Canada (30 of 88), Chile (1 of 1), Denmark (0 of 1), Finland (0 of 1), France (8 of 20), Germany (1 of 5), India (0 of 1), Ireland (5 of 10), Israel (0 of 1), Italy (3 of 6), Japan (1 of 1), Malaysia (1 of 3), Netherlands (1 of 4), New Zealand (3 of 8), Norway (6 of 10), Portugal (1 of 2), Singapore (1 of 1), Spain (3 of 5), Sri Lanka (0 of 1), Sweden (5 of 11), Switzerland (2 of 7), Thailand (0 of 1), Turkey (0 of 1), United Kingdom (99 of 219), and United States (97 or 429). The thirty-seven countries in the full sample are those in the reduced sample plus the nine countries that had no hostile takeover attempts. These additional countries are: Argentina, Brazil, Egypt, Greece, Mexico, Nigeria, Pakistan, Peru, and Venezuela.

TABLE 2: Regression Results on the Number of Announced Hostile Takeovers, using the narrow measure of labor rights

	Hypothesis	GEE Full Sample Model A	GEE exc. US & UK Model B	GEE Reduced Sample Model C	Fixed Effects Reduced Sample Model D	GEE Logit Full Sample Model E
Shareholder rights	H1: +	.264**	.274**	.262**	1.960*	.292†
		(2.80)	(3.17)	(2.69)	(2.41)	(1.90)
Worker rights (narrow measure)	H2: -	-.118	-.202*	-.012	-.597	-.431**
		(-1.17)	(-2.40)	(-.11)	(-1.30)	(-2.62)
Banking rights	H3: -	-.241*	-.285*	-.309**	-1.890**	-.418*
		(2.07)	(2.46)	(2.75)	(2.61)	(2.18)
Stock market performance		.258	.551	.190	-2.570*	.713
		(.55)	(1.19)	(.40)	(-2.10)	(.96)
GDP growth rate		.146***	.134**	.116**	.243†	.202*
		(3.52)	(2.84)	(2.83)	(1.83)	(2.29)
Macroeconomic uncertainty		-.208	-.362*	-.096	-.259	-.549*
		(-1.33)	(-2.44)	(-.66)	(-.46)	(-2.29)
GDP per capita		-.283	-.362	-.418	1.180	-.589
		(-1.00)	(-1.22)	(-1.53)	(.53)	(-1.61)
Democratic freedoms		.523***	.420***	.438***	.967	.549***
		(4.99)	(6.21)	(5.37)	(1.18)	(4.85)
Size of labor force		-.009	-.030*	-.088†	-.048	-.052*
		(-.73)	(-2.33)	(-1.74)	(-.62)	(-2.57)
Number of listed companies[a]		3.339	-4.827	3.370	-30.538	-7.213
		(.83)	(-.97)	(1.00)	(-1.27)	(-1.12)
Number of listed companies sq[a]		-.001†	.004*	-.000	.002	.006**
		(-1.79)	(2.58)	(-1.54)	(.78)	(2.95)
Foreign hostile takeover activity		.056***	.054**	.070***	.096†	.056
		(3.96)	(3.03)	(4.74)	(1.85)	(1.61)
Lagged # of hostile takeovers		.022	.107***	.024†	.155**	.786*
		(1.61)	(5.48)	(1.79)	(2.60)	(2.31)
# of non-hostile takeovers		1.07***	1.06***	1.01***	.246	1.403***
		(6.60)	(6.72)	(5.97)	(.694)	(6.48)
Country fixed effects					Included	
Annual dummies		Included	Included	Included	Included	Included
Industrial composition		Included	Included	Included	Included	Included
Intercept		-11.808	-12.839	-.893	93.863	-15.743
N (number of country-years)		367	345	287	287	367
Number of countries		37	35	28	28	37
Wald Chi-Square		2303.28	2638.46	9572.22	62.25	721.19

Notes:
[a] Coefficient multiplied by 1,000.
z scores shown in parentheses beneath regression coefficients.
*** $p < .001$ ** $p < .01$ * $p < .05$ † $p < .10$ (two-tailed tests)

TABLE 3: Regression Results on the Number of Announced Hostile Takeovers, using the broad measure of labor rights

	Hypothesis	GEE Full Sample Model A	GEE exc. US & UK Model B	GEE Reduced Sample Model C	Fixed Effects Reduced Sample Model D	GEE Logit Full Sample Model E
Shareholder rights	H1: +	.368**	.387***	.394***	2.136*	.459*
		(3.40)	(3.70)	(3.52)	(2.51)	(2.32)
Worker rights (broad measure)	H2: -	-.050**	-.061***	-.044**	-.233*	-.088**
		(-3.38)	(-3.90)	(-2.73)	(-2.51)	(-3.04)
Banking rights	H3: -	-.341**	-.438***	-.371***	-2.491*	-.587**
		(3.00)	(4.60)	(3.53)	(2.29)	(3.32)
Stock market performance		.330	.643	.252	-2.781*	.897
		(.70)	(1.36)	(.53)	(-1.99)	(1.15)
GDP growth rate		.142**	.132**	.115**	.384**	.183*
		(3.32)	(2.62)	(2.65)	(2.66)	(2.03)
Macroeconomic uncertainty		-.286†	-.447**	-.199	-.320	-.610**
		(-1.75)	(-3.01)	(-1.22)	(-.53)	(-2.64)
GDP per capita		-.314	-.442	-.408	.743	-.682†
		(-1.21)	(-1.60)	(-1.60)	(.35)	(-1.96)
Democratic freedoms		.575***	.487***	.491***	1.415	.642***
		(5.98)	(7.58)	(6.34)	(.82)	(4.91)
Size of labor force		-.007	-.030*	-.006	-.041	.049
		(-.58)	(-2.39)	(-1.18)	(-.39)	(-2.65)**
Number of listed companies[a]		-.166	-.923†	-.802	-5.011*	-11.372
		(-.04)	(-1.94)	(-.20)	(-1.99)	(-1.61)
Number of listed companies sq[a]		-.000	.004**	-.000	.003	.001**
		(-1.12)	(3.09)	(-.80)	(1.18)	(3.18)
Foreign hostile takeover activity		.055***	.052**	.072***	.109*	.051
		(3.83)	(2.86)	(4.76)	(2.07)	(1.44)
Lagged # of hostile takeovers		.019	.105***	.023†	.134*	.836*
		(1.45)	(5.73)	(1.69)	(2.18)	(2.42)
# of non-hostile takeovers		1.227***	1.277***	1.184***	1.367†	1.582***
		(7.18)	(7.55)	(6.41)	(1.87)	(6.72)
Country fixed effects					Included	
Annual dummies		Included	Included	Included	Included	Included
Industrial composition		Included	Included	Included	Included	Included
Intercept		-22.674	-25.516	-16.849	22.190	-18.166
N (number of country-years)		367	345	287	287	367
Number of countries		37	35	28	28	37
Wald Chi-Square		1144.90	6115.01	6103.02	44.84	236.79

Notes:
[a] Coefficient multiplied by 1,000.
z scores shown in parentheses beneath regression coefficients
*** $p < .001$ ** $p < .01$ * $p < .05$ † $p < .10$ (two-tailed tests)