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EVIDENCE FROM, THE SCOTTISH OFFICE, THE EDINBURGH UNIVERSITY CENTRE FOR THEOLOGY AND PUBLIC ISSUES, AND MR D. HENRY

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INQUIRY INTO CORPORATE TAKEOVERS IN THE UNITED KINGDOM

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1990

INQUIRY INTO CORPORATE TAKEOVERS IN THE UNITED KINGDOM

The David Hume Institute has been commissioned by The Joseph Rowntree Foundation to conduct an Inquiry into the issues raised by Corporate Takeovers in the U.K. This paper is the thirteenth of a series presenting the results of research undertaken in the course of the Inquiry, and also submissions of opinion received from individuals and organisations which are thought to be of wide general interest. The Institute hopes in this way to keep the public informed of work in progress. The Final Report will appear in the late Spring of 1991.

A note on the Institute and a list of its publications appear on pp. 30-32.

The Institute has no collective views on any public policy question and is not committed to the views of any of its authors.

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MEMORANDUM BY THE SCOTTISH OFFICE

1. The Scottish Office is grateful for the opportunity to contribute a short paper to the Inquiry. We are aware that the Department of Trade and Industry was invited to make a contribution and indeed we have now seen a copy of their memorandum to the Inquiry.

2. This memorandum does not seek to cover again the key issues referred to in the DTI memorandum. Competition policy in the UK is the departmental responsibility of DTI and its Ministers. There is of course only one competition policy in the UK endorsed by Ministers collectively. It follows therefore that there is no divergence of view between Departments about the structure of that policy. But while policy is subject to collective endorsement, the application of that policy in individual cases of mergers or prospective mergers is somewhat different. The Secretary of State for Trade and Industry's statutory role is clear: responsibility for decisions on whether or not there should be a reference to the Monopolies and Mergers Commission, and whether (in the event that the MMC recommend that a merger should not proceed) he should accept that recommendation or allow the merger to proceed nonetheless, are his and his alone. These decisions are not taken collectively but by the Secretary of State for Trade and Industry acting alone. The Scottish Office does not, and indeed could not, therefore take a different position on matters of competition policy. But the Scottish Office has particular areas of responsibility of its own.

3. Inevitably, when it comes to individual cases there is an element of discretion and a degree of judgement involved in determining just how the policy should apply. Neither statute nor policy statements can prescribe with absolute precision how individual cases should be dealt with. It is therefore entirely possible that from time to time different Government Departments, acting within the context of an agreed policy, may have different views on the disposal of a particular case.

These differences of view may only be a matter of degree and not involve a difference over the issue of whether a reference is appropriate or not. But on some occasions views on this may be divided. It should be stressed that the decision whether to refer a case to the MMC remains that of the Secretary for Trade and Industry. But that decision is taken in the light of the advice the Secretary of State has received from the Director General of Fair Trading. In formulating that advice, the Director General has, in the more difficult cases, had the benefit of a discussion by the Mergers Panel, a committee made up of representatives of the interested Government Departments, and including the Scottish Office in appropriate cases. Discussion in the Mergers Panel allows the Director to obtain the facts available to the Departments represented as well as their views on the merger under consideration. But again, the Director General alone is responsible for the advice which he gives to he Secretary of State. Departments' views may vary according to the nature and extent of the information at their disposal and according to the relative weight they place on different aspects of the case.

4. As the DTI memorandum has already made clear, the primary public interest consideration in deciding whether a merger should be referred is the potential effect on competition in the UK. Successive Secretaries of State for Trade and Industry have reiterated this policy. They have also made it clear that they do retain the power to make references on other public interest grounds; but that this will be done only in exceptional cases.

5. As a territorial Department, the Scottish Office is inevitable more likely to be aware of any regional considerations raised by a case involving a Scottish company or companies. A regional consideration may of course come into effect before it is determined whether a competition issue is raised by particular merger. Section 64 of the Fair Trading Act 1973 sets out the criteria determining whether a merger qualifies for investigation in the first place. One criterion is that of 25%

market share, either in the UK or "in substantial part of the UK". It is therefore possible for competition issues and the interests of the customer or consumer to have a regional aspect.

6. While it is clear, and we accept, that competition grounds must be the primary reason for reference, we are also aware that references on other public interest grounds are not excluded. It follows therefore that there may be cases where the regional issues are sufficiently strong to be a contributory factor to, or even in exceptional circumstances the sole reason for, a decision to make a reference. Once a reference is made, the MMC is required to investigate and report on whether the merger is a qualifying merger and, if so, whether it is against the public interest. The latter requirement is elaborated in Section 84 of the Fair Trading Act 1973, which requires the MMC to take account of certain specific aspects of public interest, but which does not provide any exclusive definition. It simply requires them to take into account "... all matters which appear to them in the particular circumstances to be relevant ...". But among the specific aspects to be considered is " the desirability... of maintaining and promoting the balanced distribution of industry and employment in the UK; ...".

7. From time to time Scottish companies and other Scottish-based interests press for protection, on an individual or general basis, for Scottish companies against unwelcome bidders. Scottish Office Ministers' position is clear. They take the view that the economic health of the UK as a whole is secured by maintaining commercially diverse and dynamic regional economies. But they are equally clear that competition policy is not to be used as an arm of regional policy; and that any sort of policy, formal or informal, of regional protectionism would be inconsistent with UK competition policy; would hinder the development of competition to the disadvantage of customer and consumer; and would ultimately be to the detriment of the health of business in Scotland. Scottish Office Ministers believe that strong Scottish-based companies, with Scottish-based headquarters and drawing on Scottish-based financial

and business services, have an important contribution to make to the Scottish economy; but that their strength and indeed the attraction of Scotland as a business location for both indigenous and incoming industry would decline rapidly if these businesses were to be protected against competition and acquisition. Inward investment would be discouraged and powerful positive incentives to performance and development would be lost.

8. The Scottish Office consider the possibility of a reference decision on regional grounds alone as a rare event, but a possibility nevertheless in an appropriate case. Our view remains that the fact that this avenue has been kept open, albeit only in exceptional cases, confirms that the regional consequences of a merger, either alone or with other issues, may be sufficient reason for reference; and therefore that when a case is referred the MMC is required to take account of certain regional factors.

9. The considerations taken into account and the position taken on a case with Scottish implication is perhaps best illustrated by a recent example. The Elders IXL bid for Scottish and Newcastle Breweries potentially affected certain Scottish interests. The Scottish Office took a close interest in the case. The Department took the view that the case should be referred to the MMC, as indeed it was; and the Department subsequently presented evidence to the MMC in the course of its investigation. We argued that on competition and on other grounds, the merger was likely to be against the public interest and should not therefore be allowed to proceed. The main grounds for reference were, that, given the nature of the industry, the effect of a merger on competition was likely to be detrimental to competition in a number of areas, and to consumer choice. We argued also that there was likely to be a loss of some or all of Scottish and Newcastle's independent headquarters functions and the purchase of associated services from Edinburgh. This would make it more difficult to attract

and retain high calibre people in the Scottish economy and contribute to a longer term process of erosion of indigenous entrepreneurial capacity. We suggested there could be job losses in parts of England, and expressed our concern about the borrowing proposed to fund the acquisition, which we felt might lead of necessity to the sale of assets and possibly reduce levels of investment in the business. The MMC in the event concluded that the merger in contemplation would be against the public interest on a number of competition-related grounds. Having reached this conclusion the MMC did not pursue to a conclusion the other issues of regional effect, possible asset sales and the funding of the bid.

10. The fact that the Secretary of State for Trade and Industry can refer cases on public interest grounds other than competition means that regional and other non-competition considerations may be taken on board. The Scottish Office will continue to look at cases as they arise, and consider whether a proposed merger gives rise to legitimate regional concern.

MEMORANDUM BY THE UNIVERSITY OF EDINBURGH CENTRE FOR THEOLOGY AND PUBLIC ISSUES

1. **In the first place** we would like to say that takeovers of themselves are neither good nor bad. There are times when a takeover will be of benefit to the community and times when it will do no harm to the community. Also it is not necessarily the case that too many takeovers are happening at the present time. (Here we would be fully in sympathy with what Sir Gerald Elliot says about the need for re-grouping and responding to changing situations.) What is happening is that there are too many takeovers of the wrong sort.

2. **Our concern** arises from the fact that:-

a) **Too many takeovers seem to be founded on a too narrow view of what a company really is.** They are motivated by short term thinking which sees the company merely as a vehicle for money making and financial speculation. Such a view disregards the many social and human factors which make up the real ethos of the firm and give it an important place in society. It ignores the commitment of employees to the company and of their justified expectation of life-fulfilment for themselves and their families. And it is unheeding with regard to the effects of a takeover on the complex relationships between a firm and its suppliers, its customers and the community in general. The gap between the thinking of the City and that of people in Industry is one of the most distressing features of our economic life. Some of us would, indeed, go so far as to say that an almost complete gap has opened up between money and stocks and shares on the one hand, and on the other hand the real wealth in human and productive terms which money, stocks and shares represent.

b) **Further, our concern arises from the fact that the real owners - the shareholders - are largely passive and do no exercise the responsibilities which come with ownership.** This

is not so much by design as by the evolution and convenience of financial institutions. But the fact is that in law as in intention they have given instructions to their representatives to the effect that 'financial return' is to be the only criterion for managing their funds. And yet as shareholders they have final legal responsibility for the life and destiny of the company and of its employees.

c) **We are concerned about the adverse effect of the threat of a takeover on the performance and decision making of managements.** This has been well documented elsewhere and we would have little to add to what has already been said by such as Sir Hector Laing. We do recognise, however, the danger of the threat of takeovers leading managements to go for short term success to the neglect of long term development.

d) **We are concerned because there seem to be increasing doubts about whether takeovers do in fact lead to a more efficient use of resources.** Facts known to some members of the Group suggest that this is by no means always the case and the extra time spent in re-organisation and personal (as well as personnel) re-adjustment can severely limit the hoped for increase in efficiency. The fact that Germany and Japan have efficient industries without the trauma of takeover battles suggests that there are other ways of achieving efficiency, and it is no accident that in the case of these two countries the ownership of industry has established itself on co-involved and consultative lines, rather than on the detached and adversarial lines familiar in the UK. In Germany and Japan, as in many other capitalist countries, industry tends to be regarded as an enterprise in which the nation and society share, rather that as a battleground for financiers alone.

e) **We are concerned because too often the motive for a takeover is not the industrial logic of the case but rather the greed, ambition and desire for empire building on the part of one or more business men** who enjoy the power game but are heedless of the wider human consequences of their actions.

You can't make people good by legislation but the law must protect the community (especially the most vulnerable) from the activities of such men.

f) **Allied to this we are concerned about the growth of a financial services industry which needs 'to make things happen' and which exerts a sinister influence by encouraging business men to make bids from which the brokers and merchant bankers will earn healthy fees.** Admittedly they have an attentive audience but their true 'service' should be a different one.

g) **We are concerned because takeovers usually represent a centralisation of power** (although we recognise the good features of the trend towards 'unbundling'). A healthy democratic society depends on the dispersal of power and the maintenance of independent centres of economic activity. The danger of centralisation is a vital one for a region or for a nation like Scotland not least because takeovers often have the effect of draining away talent and removing leadership from a community.

h) **We are concerned because of the abuse of the right to compete in a free society.** Competition is a natural component of a healthy industrial/commercial society. But in some takeover "battles" we see competition run riot. When people begin to use military terms, negotiation and rational debate are usually left far behind. In a well integrated society there is surely a place for an informed and constructive debate about a company's future in the course of which due weight should be given to the company's business, to the people whom it employs and to its importance in the wider community.

3. Underlying Convictions

a) **Wealth Creation is important for the life and health of a nation and its people.** In this regard we in this country have inherited a strong industrial base which needs to be continually renewed in each generation. We have a responsibility to be

good stewards of the real wealth of our nation and its communities. But money creation is not necessarily wealth creation. And where money creation is not related to wealth creation a society is in danger.

b) **Ownership of wealth brings responsibilities which cannot be shrugged off or passed on to someone else.** The danger of our situation is that, in the person of the shareholder, ownership has become separated from responsibility - because of the growth of institutions aimed at making investment simpler and safer. Many of the problems with takeovers stem from this abdication of responsibility by shareholders. (This seems to apply also to their representatives, the fund managers, who often would rather 'walk away' from a deteriorating situation than organise a common recovery programme, as would tend to happen, for instance, in other European Community countries.)

c) **There is always a danger in making money the measure of success - or indeed the measure of true wealth.** Wealth in the form of money easily distances a person from the responsibilities which come to the holders of wealth. It is assumed that "I have a right to do what I like with my own money". And yet it represents power over people when it is used and therefore carries responsibility.

d) **The issue of takeovers raises a question of simple Justice.** It is basically unjust that a company which has taken many years to build up and has given (and continues to give) good service to the community in which it is set and with which it has deep and strong relationships, should have its fate sealed in a matter of weeks by a hostile bid which promises short term gains to institutional shareholders who have no interest in the real purposes of the firm apart from immediate financial return.

4. Proposals

a) **Limitations on the rights of short-term of speculative shareholders**, such as withholding voting rights on shares until a year after purchase; allowing differential voting rights on different classes of capital; increasing the Capital Gains Tax burden on shares traded within a year of buying (other than when such share are forcibly acquired after the success of a bid) etc. Such limitations would not diminish the rights of shareholders in general. Indeed, they would increase the rights and influence of long-term shareholders by guarding them against dilution by the actions of short-term speculators.

b) **New mechanisms for helping individual investors to exercise their responsibility as owners.** The first step here should be a campaign by companies, the Government and industry as a whole to bridge the "indirect share ownership consciousness gap", whereby most of the many millions of people who own shares through participation in pension schemes, life assurance and other collective savings enterprises simply do not realise that they are shareholders in companies and that, hence, takeovers and takeover policy are matters of direct and immediate consequence to them.

c) **Changing the remit of fund manager** in two ways: **first** by mobilising public and industrial opinion to discourage the growing belief that short-term (often quarterly) performance statistics are the measure of such managers' success, rather than a more prudent three or five years; and, **second** by changing the law (where such changes are required) to allow trustees or directors of pooled funds, and the manager of such pooled funds, to take into account when making investment decision matters other than immediate tangible realised capital gains, without fear of adverse legal consequences to themselves. Trustees, directors and managers all need and deserve what is already possessed by direct individual shareholders: the right to say NO to takeovers on moral, ethical, regional, strategic or other broader grounds, not just on short-term, quantifiable financial grounds.

d) **More stringent Company law to restrain power-hungry tycoons and the 'intermediaries' who aid and abet them.** Should not the costs of the successful defender by borne by the unsuccessful bidder rather than by the defending company's shareholders?

e) **More stringent rules relating to registration of shares held in nominee names** to make it easier to identify the ultimate beneficial owner.

f) **A much wider remit for the Office of Fair Trading,** enabling it to take into account issues other than those of the narrowest "anti-competitive" sort.

g) Proposals for **alternative methods of improving the efficiency of a firm** without a takeover.

h) **A Statement of the Criteria for judging a legitimate takeover.** A Check List against which the bidding company would have to justify its case and the defending company would have to answer. eg:

Does the takeover make industrial logic?

Would it improve the position of the company?

Is the 'mix' compatible?

Is the aim to suppress or to expand?

What will be the effect on the local community?

Is is an "unbundling" exercise, etc. etc.?

Note: We believe that none of the proposals here suggested would adversely affect genuine investors in listed companies. Nor would they interfere to any great extent with the free market in company securities. They would prove awkward only for raiders and short-term speculators.

MEMORANDUM BY DENNIS HENRY

Mr Dennis Henry is Director, Business Performance, Strategy Services of P-E International plc, a Management and Computer Consultancy. The views and opinions expressed in this paper are his own and not necessarily those of P-E International plc.

Background

The early stages of this work were undertaken in 1974 from Scotland on a main frame computer in London using an audio coupler. This proved to be an expensive, slow and complicated process. It was abandoned until the mid-1980s when the first of the reasonable powerful micro-computers became available.

From 1972 until 1989 the author was the Regional Director in Scotland for a leading Management Consultancy practice. He, therefore, has a need to know as much as he could about Scottish companies and their performances. It was this need which stimulated the setting up of a Scottish database covering Industry and Commerce.

Whilst other database information was available from commercial suppliers such as ICC, Dun & Bradstreet and Extel, they suffered from certain weaknesses. These included:-

- A long time lag between the publication of accounts and their inclusion in the database
- Not knowing the specific companies included in the statistics
- A limited range of statistics
- All the available date mixed public and private companies
- The classifications were not always accurate.

A Database was established to meet the identified needs and its basis was;

- Scottish based or operated companies

- Publicly quoted companies, Public companies tend to maximise their profits whilst private companies attempt to minimise theirs. This makes a mixed Database less comparable
- Industrial and Commercial companies only. The three sectors of Finance, Energy and Property companies were excluded. Some of these groups do not publish enough or suitable information for all of the ratios required to be obtained. For example, what is the Turnover of a Bank?
- When a company ceased to meet the above criteria, by being taken over, all of its entries would be eliminated to ensure that all comparisons were on a "like for like" basis over the years to ensure there would be no sampling errors.

As one of the purposes of the Database was to provide a basis for comparison, the sectors mentioned above where incompatible ratios occur were omitted. The Sales, Capital, Employer, Profit and other factors per Employee in the three sectors excluded are quite different from those included. Also, some finance organisations do not provide full information to enable all the required ratios to be calculated.

When the database was established in 1986, 81 companies met the above criteria. By the end of 1987 this had been reduced to 64 companies. Whilst the drop in the number of companies does not look large, it was the scale of the change which prompted a deeper inspection of the impact.

It will be seen that the original intention of the Database was for its internal commercial use and not for any other purpose. The ability to measure the impact of Takeovers and Mergers on Scotland came about as a fortuitous by-product.

This work on measuring the impacts in 1985-6 was undertaken and some of the results published before the Bain Report was published in 1987. Otherwise the criteria used would have

been redefined to enable more direct comparisons to be made.

The Bain Report was commissioned by the Scottish Economic Planning Department, now the Industry Department for Scotland to report on "Economic Effects of the Inward Acquisition of Scottish Manufacturing Companies 1965 to 1980". This study included private companies.

Company Size

Firstly the size of companies whose control went furth of Scotland, is analysed in order to provide a benchmark for comparison.

There are obvious difficulties in measuring the size of companies over a period of more than 20 years. This time scale is required to enable the research done by the author to be compared to the Bain Report. Although there are accepted inflation factors to enable this to be done, the number of people involved provides a suitable basis which required no factoring

TABLE 1: EMPLOYMENT IN COMPANIES ACQUIRED

Period	No of Yrs	No of Cos	Employment in Yrs of Takeover	Avg Emp'ees Takenover/Yr
1965-67	3	5	5,258	1,753
1968-70	3	10	10,677	3,559
1971-73	3	13	3,633	1,211
1974-76	3	12	5,583	1,861
1977-80	4	14	6,841	1,710
Total 1965-80	**16**	**54**	**31,992**	**1,983**
1985-86	2	14	94,960	47,480

Sources: 1965-80, Industry Department for Scotland
1965-86, P-E International

The change in the rate of takeovers in the earlier period of 16 years researched by Bain, from an average of 1,983 employees per annum being involved, to the later period with an average of 47,480 in 1985-86, clearly shows the scale of the change which took place in the takeover scene in the mid-80s. The total of the employees involved in the two years 1985-86 was three times that of the total for the 16 years 1965-80. On an annual basis this is 24 times the rate. Had private companies been included in the 1985-86 data, as they were in the Bain study, then the figures would have been higher still.

This impact could be further illustrated by looking at the average number of employees per company taken over. In the earlier period of 16 years this was 587 which compares with an average of 6,783 in 1985-86; almost 12 times the size. This shows that the earlier period had target companies which were small. A reason for this could be that the earlier period included some private companies. The more robust comparison is the number of employees involved per annum.

Companies Involved

It is useful to record some of the publicly quoted companies which went out of Scottish control between the start of the period covered by Bain and the very beginning of this research in 1974 as well as some of the better known private companies not included in this subsequent study. These included:-

Sir Wm Arroll	since closed
Bruce Peebles	
J H Curruthers	since returned as a MBO
Century Aluminium	
Dennystown Forge	since closed
Lawson of Dyce	
MESL	
Ross Chemical	
John G Stein	
James Scott	
Smith & Wellstood	since closed
Wm Teacher	

Between the start of this study in 1974 and the end of 1984, some significant PLCs went out of Scottish control. Some of these were listed in Bain but others fall into the subsequent period of 1981-5. Amongst the PLCs lost since 1974 were:-

Amalgamated Distilled Projects
Anderson Strathclyde
Barr and Stroud
Culter Guardbridge
Gourock Ropework
Inveresk Paper
F Miller
SUITS
Stenhouse
Wm Teacher

The control of most of these, and others, went quietly South with the minimum of fuss. Two of the above, Culter Guardbridge and Inveresk Paper, went to the USA and the rest to England. Of the 54 companies in the Bain study, 83% went to England, 7% to North America and 4% to Europe; calculated by number of companies with no correction for scale.

Some of these companies were investigated by the Monopolies and Mergers Commission. None was saved. Two of these received particular attention. Scottish and Universal Investments was bid for by Lonrho and a Boardroom split preceded a full investigation. Considerable play was made of the importance of SUITS to the Scottish economy because of its whisky and publishing subsidiaries. Assurances were given that control would remain in Scotland but over the years this level of local control has decayed until all those businesses remaining now report to London without an effective Scottish central management in operation.

It is important to stress that component parts of SUITS have continued to flourish. Whyte & Mackay, which acquired a number of brands as part of the takeover conditions of Distillers, continued to expand and was subsequently sold off. It has

changed hands again after an unsuccessful attempt at a Management Buy Out. This would have been the largest MBO yet in Scotland. George Outram, which owns the Glasgow Herald and the Evening Times, is flourishing.

The importance of the SUITS purchase by Lonrho should not be overlooked as this gave Lonrho a major shareholding in House of Fraser which was then used as the platform for a bid. We subsequently lost House of Fraser out of Scotland.

The defence of Anderson Strathclyde was vehement and well presented. Its importance to the Scottish economy was again well emphasised, especially in the defensive work of Professor Donald Mackay. Any subsequent adverse impact of this takeover by Charter Consolidated on the Scottish economy is hard to measure because of two subsequent major events; the miners' strike and the later cut back by British Coal.

The case of Gourock Ropework is interesting as it illustrates the gangrene which can affect companies taken over by ones with similar products and manufacturing facilities. Bits were chopped off one by one. It had been a successful company for over 200 years through many varied and difficult times. The one situation it did not survive was a takeover. It seems that key operations were sequentially removed to British Ropes' English plants until those left in Port Glasgow were not viable on their own. The operations were then finally closed down as what was then left could no longer survive on its own.

Turning now to more recent times, the companies which had to be deleted from the Database during 1985-6 were:-

Arthur Bell	Gelfer
Bremner	House of Fraser
Brownlee	P & W Maclellan
Brunton	Scottish Agricultural Ind
Coats Patons	United Wire
Distillers	Uniroyal
Don Bros, Buist	Yarrow

This reads like a First World War Role of Honour, but that war lasted four years and these companies were lost in two years.

Scale of Losses

The number of companies lost does not indicate the full scale of these losses. The real impact is much greater, as is shown by the following figures:-

TABLE 2: SCALE OF LOSSES

£M	Before	After	Lost	%Lost
Turnover	10,963	6,924	4,039	37
Added Value	3,447	2,156	1,291	37
PBT	927	477	450	49
Cap Employed	4,762	2,278	2,484	53

Source: P-E International

This gives a much more realistic scale to the impact of takeovers on the Scottish business economy, especially the last figure of 53% of the Capital Employed in publicly quoted industrial and commercial companies going out of Scottish control in just two years. It was the capital intensive rather than labour intensive companies which were taken.

In the IDS study covering 1966-80, the average size of company taken over was very much smaller than those lost in 1985-6. The largest company in the 16 years of the IDS study was Scottish & Universal Investments which then had Capital Employed of £29M, at 1975 prices. In the two years of 1985-6, 5 of the companies taken over had Capital Employed of over £50M, of which, 1 was over £500M, 1 over £600M and 1 over £1,000M. These are significantly greater than the £29M maximum in the earlier period, even after inflation.

Quality

The above figures have shown the scale of the companies lost. It is also important to look at the Quality of those now gone outside Scottish control and to see how they compared to those remaining.

TABLE 3: QUALITY

	Before	After	Lost	Lost% After
Profit Margin %	8.46	6.87	11.14	162
Avg. Remuneration £	6,450	6,282	6,796	108
Emp'ee Cost/Sale%	19.79	20.51	18.54	92
Sales/Employee £	36,670	35,350	42,530	120
Added Value/£ Pay	1.59	1.52	1.72	113

Source: P-E International

This shows that not only, as was shown earlier, were the companies lost to Scotland the larger ones, but they were those with the better performances. The gap of 62% in Profit Margin between those which were lost and those which were left shows that it was the much more profitable ones which were lost. Also, they paid their employees higher average earnings but, in spite of this, they made more productive use of their labour as they had 8% less Employee Cost as a percentage of Turnover than those remaining. Perhaps most significantly, the effective use of the Human Resource to create wealth is shown in the Added Value/Pay ratio where those lost were 13% more effective in creating wealth for each £ spent on pay, even after paying higher average earnings. In other studies involving well over 2,000 companies, the Added Value/Pay ratio has been found to be the most sensitive ratio in measuring company performance.

We have now shown that Scotland has lost the bigger and the better companies.

Growth

A further factor to be considered is the rate of growth between those lost and those remaining.

TABLE 4: GROWTH

	Before	After	Lost	Lost% After
Turnover %	13.00	11.60	15.90	137
Cashflow %	43.72	24.31	87.23	359
Sales/Employee %	13.06	10.17	18.63	183

Source: P-E International

This makes a further key point; not only was it the bigger and better companies which were lost, they were also the faster growing ones.

Change in takeover target selection

Many of the companies lost in the years 1966-80 researched by Bain were low performing and small. Being low performing, a good proportion of them were probably the better for having new management, with the exception of the like of Gourock Ropework which was closed down shortly afterwards.

As has been shown above, the scene changed dramatically in 1985-86 to the bigger, more profitable and faster growing companies being the takeover targets. This shows a much more selective approach to takeovers on the part of the predators and their advisors. The change from the small and the weak being the target to the strong, the fit and the faster growing is significant. From the predators' and their professional advisors' point of view, a much more effective assault has been seen.

Jobs

Whilst control has gone out of Scotland for the companies identified above, what impact has this had on jobs? The answer

is probably not a lot. The problem is the type of jobs which have been lost.

Most of the companies taken over have continued in production. Therefore, the weekly paid and junior management are mainly still in their jobs and the fact that they are now working for a new employer will not be too obvious to many of them.

It is the Directors and senior managers who have felt the draught. The first positions to go have been usually the Chairman and Managing Directors. As soon as the accounting systems have been integrated, the Financial Director could be next to go, an incumbent at that level and cost being no longer required. The job is then down graded as the key services previously provided locally are now handled by the new Head Office. Whilst Sales will likely to be integrated into the new owner's team, there will probably be no room for the Sales Director. This pattern has been illustrated by the unsolicited mail received by the author from those affected in this way and from their redundancy counsellors.

This means that the lower levels in a business can be reasonably safe. It is the senior and high quality jobs which go. Not only have they gone for those who have recently held them but the opportunities have gone for the next generations. Hence fewer junior positions with good prospects exist for the young engineers, accountants, marketing men, etc. coming on the job market. Hence, even more have to go South, or further afield, to advance their careers.

As it is usually the more enterprising who move away, Scotland then loses even more of those with skills, drive and vision who could become the next generation of entrepreneurs. Once they have gone away they are unlikely to return. Such people are needed as the seed for the future wealth creation.

Secondary Impact

Not only are those employed in the companies at risk from takeovers, those who supply professional and other services also suffer. Such organisations include:-

Accountants
Advertising Agents
Banks
Insurance Brokers
Lawyers
Stockbrokers
Travel Agents
Printers

The local offices of such organisations lose a substantial proportion of their business and it is usually their biggest single account which is lost. Bain listed the impact on a range of organisations which showed:-

TABLE 5: NET CHANGE

	%
Materials	-24
Services, of which	-72
Auditors	-52
Banks	-40
Lawyers	-24

Source: Industry Department for Scotland

One item which could be quantified accurately was that of audit fees. Those PLCs lost in 1985-86 had total audit fees of £3.5million. This compares with Bain's estimate of only £825,000, at 1984 prices, for all of the 54 companies lost in the 16 years from 1965-80. Thus, the impact on the auditing profession was 4 times more severe in the two years than it had been in the 16 year period, a factor of 34 times greater per year.

Of this £3.5M lost, one accounting practice lost £1.5M and another lost £1.1M. Even after allowing that not all of that work would have been done in their Scottish offices, this must have had a major impact. In addition, most of the special services on investigation, taxation, etc. would have been provided by the Scottish practices to the Head Offices lost. This sum cannot be quantified as its value is not published. Nevertheless, it is likely to be substantial.

The loss in number employed cannot be estimated from the above but it can be seen that the losses must have been significant both in numbers and the quality of jobs lost or reduced in value.

Since 1986

At the beginning of 1987, it was decided to cease the routine updating of the Scottish Database as so many of the major companies were no longer included and the outputs were, therefore, less reliable as indicators. However, from this experience of analysing Scottish companies, attention was then given to developing a broader based Database covering the largest 250 UK owned PLCs. Subsequently, a European Database has been developed. Extracts from these are regularly published in the Sunday Times.

However, for this paper an effort has been made to bring the Scottish data as up-to-date as possible from limited records. It has been found to be impossible to gather information on some of the companies no longer trading.

The impact of takeovers in the years 1987-90 (Oct) has been very much reduced. Whilst 23 companies have been traced as being taken over, they are small by the standard of the two earlier years. However, these recent years saw the attempted takeover of Scottish & Newcastle Breweries. The above data were used extensively in the defence of S&N.

Companies included in the Database at the end of 1986 which were subsequently lost from the Scottish scene were:-

Aberdeen Construction	
Alexander, Walter	the group was broken up rather than acquired as a whole
Belhaven Brewery	
A Caird	
Collins, William	
Dickie, James	
LDH Group	
North British Steel	
Somerville, Wm	now owned by USA co.
Thomson T-Line	

In addition one company, Caledonian Associated Cinemas, reverted to being a private company and two companies ceased trading:-

Goldberg, A
Lyle Shipping

William Somerville was recently acquired by James River Corporation of the USA. This is their second purchase in Scotland having previously bought Culter Guardbridge. One of the Culter Guardbridge subsidiaries, Smith & McLaurin, has grown from a turnover of £6.7M to £24.2M in the 6 years it has been American-owned. Part of this increase came from a £2.2M investment in a new clean room film coating plant. This helps to show that not all takeovers have an adverse impact on Scotland.

Although Coats Patons lost its position of being a Group Head Office, Coats Viyella is still using the Glasgow office for a number of Group services. All the Group pension schemes are now being administered from Glasgow as are the Group Pension Investments, which exceed £600M. Group Insurance, Group Personnel, 2 Divisional HQ's and the International Operations HQ are all also based in Glasgow. The net effect on employment has been neutral.

Whilst not bringing its much publicised Head Office to Edinburgh, Guinness has established a substantial operation in Scotland to manage its distilled products. Previously much of this work was undertaken at a variety of locations in London.

Inveresk Paper has just announced (Oct 1990) that it is being bought by its management through a MBO and so will return to Scottish control.

Invergordon Distilleries would have been included as a lost company as it became wholly owned by its major shareholder Hawker Siddeley. However, it returned to Scottish control and is now a quoted PLC.

Two other companies, Prestwick Holdings and Shanks & McEwan, have become PLCs since the Database was established. The first of these has had a chequered career but the second has progressed well and consistently.

The small impact of the takeovers in 1987-90 (Oct) is shown in the following table. So that the effect of any changes to the businesses and inflation are eliminated, the following comparisons have been made using data as at the end of 1986.

TABLE 6: IMPACT OF RECENT TAKEOVERS

	As at Dec 86	Lost since Jan 87	Lost % Dec 86
Capital Employed £K	2,277,787	134,726	5.91
Turnover £K	6,924,333	331,853	4.79
PBT £K	477,058	24,641	5.17
Added Value £K	2,156,412	35,875	5.46
Employees	196,083	9,068	4.62
ROCE%	20.94	18.29	-2.65
Profit Margin %	6.89	7.43	0.54
Added Value/Pay	1.52	1.44	-0.08
Sales/Employee £	35.313	36.597	1,284
Remun'n/Employee £	6,282	7,881	1,599

Source: P-E International

Again, it is the more capital intensive companies with higher Sales per Employee, better Profit Margin, and paying higher wages which have gone. However, these are not as significant or serious as in the earlier two years of 1985-86.

Avoiding takeovers

In the years studied by Bain, it could be said that it was the weaker and poor performing companies which were taken over and so the logical conclusion would be to improve performance to avoid being a target.

In the two years of 1985-86, it has been shown that it was the better performing and growing companies which were the target. One conclusion, however erroneous, could be to worsen the performance to avoid takeover. But this is hardly sound advice and would probably result in even more attention being paid.

Most takeovers are the result of the predator believing that it can get a better return than present management. If there is little or no potential left for them to get from the application of their techniques then predators will go off looking for easier prey, unless there are special market factors. It also makes the opportunity for asset stripping to be much less.

"Making the Assets Sweat" seems to be the only effective defence. If you don't get it from the assets then someone else will. This will not only ensure that the defence is sound, but if it is unsuccessful, the shareholders will at least get full value for their business.

A comparison of the performance of the Scottish companies still locally controlled with that for the P-E International Database of the 250 largest UK owned industrial and commercial companies shows that the Scottish companies are under-performing. This means that they are likely to remain targets for the companies which are expanding by acquisition. The following table compares the current performance (Oct

1990) of the Scottish companies with that for the current figures in the UK Database.

TABLE 7: PERFORMANCE COMPARISON - MEDIANS

	Scot'd	UK250	Diff
Return on Tot. Assets %	9.65	11.18	-1.53
Return of Cap. Empl'd %	21.28	26.64	-5.36
Profit Margin %	7.89	8.30	-0.41
Sales/Tot. Assets	131.21	133.67	-2.46
Stockturn, times	5.88	7.00	-1.12
Profit/Employee £	4,375	5,457	-1,082
Sales/Employee £	58,276	70,889	-12,613
Cap Emp/Employee £	19,158	20,387	-1,229
Added Value/£ Pay	1.65	1.66	-0.01

Source: P-E International

The Median figures have been selected for the above comparison to eliminate the effect of extreme data. Similar adverse comparisons exist at the Lower and Upper Quartile Levels.

Table 7 gives considerable cause for concern as it shows how Scottish companies are failing to meet the National standards. This means that it is probable that predators with a history of "Making Assets Sweat" could improve the performance of many Scottish companies and so they must still remain vulnerable to acquisition. It cannot be said that the lower performance is because of the lack of capital backing as the Capital Employed per Employee is reasonably similar in both groupings.

It could be that the Scottish sample is different from that for all the UK and that this is partly the reason for the difference, but it is the best sample we have got, as it includes all of the industrial and commercial companies which are publicly quoted and so must be robust. If this is the reason then it is fortuitous. It would be foolhardy to relax in the belief that sampling errors

are solely the reason for the difference. The UK Database contains companies with a total turnover exceeding £400 billion and employing just under 6 million. The Scottish companies have a turnover of £10.02 billion and employ over 225,000. These figures are all at current value (1990).

As stated above, if present management does not "Make the Assets Sweat" then someone else will do it for them. An example is one which had major Scottish connections, Babcock. It was stated by FKI that after it acquired Bancock it took £50M out of Babcock's costs. Had Babcock previously done this to itself then the Earning per Share would have been 137% greater, making the share value almost 2 ½ times what it then was, assuming a constant P/E. This would, no doubt, have put it beyond the reach of FKI.

Whilst better results can be difficult to achieve, the reward from comparatively small improvements can be substantial. Improving each of 7 key business areas by only 1% each would increase the overall PBT of these Scottish companies by 33%. This would bring the overall performance of the Scottish companies, whose figures are included in Table 7, up to and exceeding UK standards and thus make them less likely to be targetted.

One further aspect of defence is that of legislation. We must ensure that when takeovers do occur the assurances given are honoured. Also, the impact on the Scottish economy should be a factor which is a statutory requirement of the MMC. This should not be the sole criterion, but it should play its part in the overall decision.

Perhaps we need our own panel of "Great and Good" which should be charged with two responsibilities:-

1. Reporting to the MMC on the impact on Scotland of proposed takeovers;
2. Reviewing the performance of assurances given during bids, for some years after a takeover is concluded.

Conclusion

It has been shown that the impact of takeovers in the two years 1985-86 was severe. We are unlikely to see such a rate of loss again, as these two years saw the loss of companies in the industrial and commercial sectors responsible for 53% of the Capital Employed at the start of that period. There are no longer sufficient large companies left for this scale of acquisition to be repeated. This is the natural result of the years 1985-86 when it was the larger and better companies which were acquired.

However, not all takeovers are bad. Many Scottish companies would not have survived under their previous management. This was especially the case during the 16 years reviewed by Bain when it was mainly the small, the weak and the sick which were acquired.

The author, in a letter to the Financial Times (1.11.88), at the height of the Scottish & Newcastle defence, wrote:-

> "While we cannot put a ring fence around Scottish industry, it seems that our grouse, salmon and deer are more effectively protected from human predators than our industries.
>
> Surely some controls are justified, along the lines of the laws which enable game to be taken, but ensuring that this is done in a manner appropriate to the long term preservation of the species. Cannot the Mergers and Monopolies Commission develop and use similar "gamekeeping" laws? Perhaps we should take advice from the Countryside Commission".

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