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**Foreign takeovers in Britain**

# Small island for sale

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**The takeover of Cadbury by Kraft seems to symbolise a hollowing-out of corporate Britain. The truth is rather more complicated**


THE Thames Valley provides two contrasting examples of what happens when foreign companies buy British ones. Any day now the Scottish & Newcastle (S&N) brewery beside the M4 motorway at Reading will brew its last barrel. It opened only in 1980, the successor of William Blackall Simonds's 18th-century brewhouse in the town centre; its closure was announced two years ago, weeks after S&N was bought by Carlsberg, of Denmark, and Heineken, of the Netherlands, and carved up between them. There's little of Scotland, Newcastle or Berkshire left in what is now Heineken UK, a subsidiary of a Dutch lager-maker. Heads of departments such as marketing and product development are now in Amsterdam.

About 40km (25 miles) to the north, the BMW MINI factory in Oxford makes more than 200,000 cars a year, assembled with engines and body panels from sister factories in Birmingham and Swindon. MINI is a survivor of BMW's otherwise failed attempt to turn around Britain's ailing Rover group in the 1990s. Whereas the original Mini sold in large numbers but was an underpriced lossmaker, foreign ownership and capital have made the new version a global commercial success. Four out of five cars made in Oxford are exported; one in six BMWs sold is a MINI. The other surviving bit of Rover, Jaguar Land Rover, is on its third foreign owner—Tata Motors, of India—after Ford failed to turn it round. Tata's first move was to proclaim a ten-year plan to develop the two British brands; their outlook is at last looking brighter.

Britons these days are more likely to be found crying into their beer than celebrating successes like MINI. Cadbury, a venerable chocolate-maker, is just the latest household name to be swallowed by foreigners after a hostile takeover bid. Its recent purchase by Kraft Foods, an American company, has come to illustrate a complex set of anxieties: that Britain will lose jobs and skills, and that whereas British firms are open to takeover, their foreign predators are often protected against becoming prey themselves. There is something to these worries, but it is far from clear that Britain is a net loser. Purchases go both ways—and many British firms have found new strength under foreign owners.

## An open and open case

For 30 years the consensus has been that Britain has more to gain than to lose from its open embrace of globalisation. It has welcomed the presence of foreign investors, by and large, as a vote of confidence in the country's business climate. British companies have also been eager purchasers abroad: this month Prudential, an insurer, agreed to pay $35.5 billion for the Asian assets of once-mighty American International Group. Repatriated earnings have flowed into British pension funds.

Britain has enjoyed a strong inflow of foreign direct investment. It has consistently attracted more than any other European country. A report on British manufacturing for Policy Exchange, a centre-right think-tank, notes that the openness of the economy "makes Britain a magnet for foreign companies looking for acquisitions on which they can build their manufacturing operations" for Britain and elsewhere. According to Dealogic, a financial-information firm, foreigners have spent $1 trillion on acquiring 5,400 British companies in the past decade. The British have spent less on foreign firms, $750 billion, but have snapped up a larger number, just over 6,000 (see chart 1).


Now Britons aren't so sure that they have got a good deal. Their most basic anxiety is that foreign ownership will mean factory closures and job losses. As head offices close, power shifts abroad and Britain risks becoming a "branch factory" economy. When companies need to cut capacity, they will chop factories far from home first. Renault shut its Belgian factory in the late 1990s, rather than close one in France; Peugeot closed its British one a few years ago for the same reason. Three years after Corus, an Anglo-Dutch steelmaker, was taken over by India's Tata Steel, its complex at Redcar, on Teesside, is being mothballed. Kraft's purchase of Cadbury has also touched this nerve. Cadbury had intended to close its factory at Keynsham, near Bristol; Kraft said during the takeover battle that it would keep the plant open, but then changed its mind.

The worry is not just about the quantity of jobs but also about their quality. The moan is that high-value head-office jobs and R&D skills will drift abroad. Cadbury's true expertise, for example, is not in making chocolate but in running a fast-moving consumer-goods company in global markets. As its head office in Uxbridge yields to Kraft's in Illinois, that British knowledge will be dissipated. Talented Britons may have to search for work abroad if there are fewer outlets for their skills at home. As the pool of know-how dries up, Britain will in turn become less attractive to foreign businesses seeking to do anything more complicated than basic work or serving the local market.

From time to time other countries are gripped by panic about foreigners taking over: in the 1950s Japan put in place barriers to stop American multinationals taking over its emerging industries; in the 1980s America worried that Japanese corporations were taking over Hollywood and prime Manhattan property. More recently Germany fretted that a swarm of (largely American) "locusts" was devouring its *Mittelstand*, the private companies behind its export success. A French prime minister even declared that Danone, a yogurt-maker, was in a strategic industry when an American rival came sniffing.

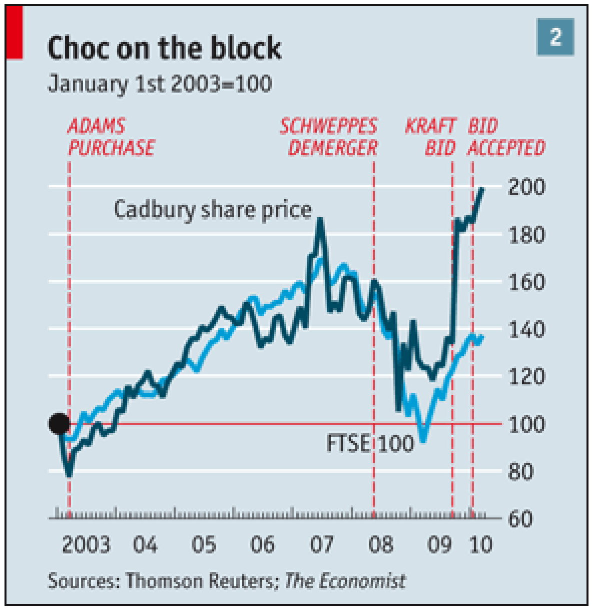
Britain has hitherto been more relaxed. This shows above all in its open market for corporate control. In America "poison pill" defences are still legal, and many states have laws that prevent local companies being bought by foreigners. In addition, points out Colin Mayer, the dean of Saïd Business School at Oxford University, "staggered" boards with fixed, differing terms mean it can take five years for a predator company to purge the board. By comparison, he notes that 90% of directors of purchased British firms are out of office within a year, leaving the new owners a free hand. Both the chairman and the chief executive of Cadbury were out within a few days of Kraft's takeover.

Most of the continental European companies that buy British firms are themselves protected from hostile takeover. Listed firms frequently have big, stable family shareholdings, bolstered by enhanced voting rights that enable families to retain control even when they are in a minority. The use of foundations and trusts of various types also helps shelter companies from hostile bids, as do state holdings, notably in France. All the more galling, then, for Britons to see such stalwart names as Cadbury, Rowntree and Terry's—to name only the chocolate-makers—fall to foreigners once the families were no longer in control. British business families can be eclipsed rapidly because shareholdings can quickly become widely dispersed. Mr Mayer believes that somehow the British have lost the secret of keeping family firms going as such for more than two generations. The biggest loss to the business, he believes, is the disappearance of a long-term vision, with the emphasis switching to short-term financial results.

Britain's imperial heritage left it with a disproportionate number of international companies and brands. These firms seem to have run out of energy to play the game of worldwide consolidation that accompanies globalisation of markets. Perhaps this timidity stems from the intense scrutiny of their widely held shares, making them leery about paying too much for foreign acquisitions. At the same time, in a globalised world, British firms with broad international reach are attractive partners to foreigners with money to spend.

## Cadbury's soft centre

The takeover of Cadbury is a good example of Britain's open capital market in action. Cadbury was the world's second-largest confectionery company, behind Mars/Wrigley, an American group. It was a foreign shopper itself, having bought the Adams gum business in America from Warner Lambert, a pharmaceutical firm, in 2003. The confectionery market consists of chocolate, candy and gum, of which gum is the biggest part—still with huge growth potential as products become more varied. Although Cadbury's sales growth rose to 6% a year with that purchase, investors seemed unconvinced of its merits. The share-price performance was unexceptional (see chart 2). A salmonella scare in 2006 led to a widespread product recall in Britain. Cadbury demerged its Schweppes drinks business, but shareholders were unsettled by the time it took. It was completed in May 2008, in the teeth of the rising financial-market storm.




By late 2008 Cadbury shares were trading at less than £5 ($8.50) and most of the big institutional shareholders had bailed out. American investors showed more warmth than British ones towards Cadbury and the demerger. When Kraft launched its bid in September last year 49% of the shares were in the hands of North American investors, with British funds holding only 28%. This compares with an average British-held stake of 47% and a North American one of 23% for companies in the FTSE 100. As Roger Carr, Cadbury's chairman from 2008 until the sale to Kraft, points out, "Cadbury was unloved and unwanted by the UK investment community." Nor was it a particularly British firm. About 80% of Cadbury's business and over 85% of its employees were already outside Britain.

Even before the actual bid, when Kraft was first signalling its interest, Cadbury shares started to rise markedly. This changed the share register: North American investors went down from 49% to 27% as funds cashed in. Meanwhile, short-term traders such as hedge funds went from holding 5% (about average for a leading British company) to 31%. The battle became a matter only of the price that the Cadbury board could squeeze out of Kraft. It eventually recommended acceptance to its shareholders when Kraft offered £8.50 a share—50% more than the price when the first offer was made on September 4th.

In a lecture at the Saïd school in February, Mr Carr voiced his concern about the unfairness of Britain's open system. Mr Carr—who made his name building Williams, a conglomerate, through aggressive takeovers—focused on the way the war of words over a first approach and before a formal hostile bid (a "bear hug") served to destabilise the share register.

Mr Mayer is blunter. With short-term funds piling in, he notes, there is a risk of a self-fulfilling prophecy leading to a successful bid once the right price is struck to tempt the funds to cash in their gambling chips. Mr Carr suggests some changes that might protect British companies. One is greater disclosure of stakes, forcing them to be declared at 0.5% of shares, instead of 1% as at present. Another would be raising the barrier for acceptance of a bid from 50% plus one vote to 60%. More radically, he also floats the idea of removing the vote from shares bought opportunistically during a bid. But such changes risk being either ineffectual or interfering with the liquidity of stockmarkets.

## Complex consequences

Drawing broader lessons from the Cadbury episode is difficult, however—not least because the full effects of the takeover have not yet been seen. A trawl through foreign purchases of British firms in recent years suggests that the balance is by no means all negative. There are costs, to be sure: some jobs are lost and some activities move abroad. But by and large foreign takeovers have probably done the economy more good than harm.

First, several have been utilities and infrastructure companies. French, German and Spanish utilities have bought British electricity and water firms and sometimes sold them to each other. This week both the French and German state railways were said to be interested in Arriva, a transport firm. If foreigners think they can run such basic services in Britain better than their previous management, good luck to them: the Spanish firm Ferrovial can hardly do a worse job of running London's Heathrow airport than did BAA, the British firm it took over—although if Ferrovial were to buckle under the huge debt it assumed for the deal, that view might change. With utilities, there is no risk of jobs or skills being switched abroad.

Second, several takeovers fit into a broader picture of global consolidation. Part of the attraction of Arriva is that it owns rail franchises in several European countries. There is little cause to bemoan the takeover in 2007 of Hanson, an aggregates company, by Heidelberg, a German company and a world leader in cement. As with the takeover of RMC by Mexico's Cemex, or Blue Circle by France's Lafarge, or BPB, a plasterboard-maker, by Saint-Gobain, another French group, the Hanson deal was part of a consolidation of building-materials groups: pure cement firms are trying to move downstream and others are seeking to widen their interests. These are basic industries in which closeness to raw materials and markets for their bulky products is paramount. So no British factories will close in the face of imports from Germany, France or Mexico.

Third, a foreign takeover does not necessarily mean a loss of technical expertise. The sale of Smiths Aerospace to General Electric (GE) may also have looked like an example of British emasculation. But Smiths Aerospace was a hotch-potch of businesses put together from the break-up of two other companies, TI and Dowty. The avionics and engine-components firm belongs more logically under the wing of the powerful GE Aviation Systems business, which, with this deal, acquired a foothold in Europe. Meanwhile, the detection equipment, medical systems and industrial seals and hoses arms of Smiths seem to be faring better away from aviation. In the six months to January operating profit was up by 12% on a year before.

In 2006 Pilkington, a world leader in glass, was bought by Nippon Sheet Glass (NSG), a smaller Japanese producer. NSG had previously acquired a 20% stake in the British company; Pilkington had bought some American firms in which NSG had a stake. The agreed merger converted NSG from an Asian regional firm to a global one. Pilkington's head office disappeared from St Helens in Lancashire, its home since 1826, but a research centre survives. For a couple of years the Pilkington boss ran the combined group from Tokyo.

Fourth, head offices often stay. Some have even been shifted to Britain. TUI and Thomas Cook are both firms formed by mergers of essentially German travel companies. TUI is now based in Crawley, a Sussex town near Gatwick airport, and Thomas Cook is back in the West End of London. Petrofac, an oil-services company with its origins in Texas and the United Arab Emirates, also has its headquarters in the West End. GE provides another example: after it bought Amersham, a British nuclear medical systems company, it moved the head office of GE Medical from Milwaukee to Buckinghamshire.


Moreover, some international companies have sought to base themselves in Britain even if their deepest roots are elsewhere. The mining industry is a case in point: Anglo-American, BHP Billiton and Rio Tinto all have head offices in London (although the last two also have them in Melbourne). South African Breweries moved its head office and its stock-exchange listing to London as it prepared to develop internationally. Having bought Miller, an American brewer, it is now known as SABMiller.

Fifth, there is evidence that being bought by a foreign multinational is good for productivity. Nick Bloom, an economist at Stanford, and John Van Reenen, of the London School of Economics, have studied the adoption of good management practices by thousands of companies in several countries. Multinational companies tend to be well managed everywhere; and when they buy firms abroad, they take their practices with them.

Being owned by an American multinational can be especially good for you in one particular respect: Mr Bloom and Mr Van Reenen found that companies bought by American firms increased the productivity of their information technology, whereas those taken over by non-American firms did not. But non-American investors can improve productivity too. The Sunderland factory of Nissan, a Japanese carmaker, is the most efficient in Europe and exports 80% of its output. A Hanson insider explains that the company is being better run now it is owned by Germans, despite the hammering it has taken in the recession. Had it not been for Heidelberg's takeover, he says, Hanson might have struggled to survive on its own.

That is not to say that foreign takeovers are always for the best. But blocking takeovers in order to protect British jobs would undermine the country's long-standing support for an open market for corporate control and open markets more generally, which would make Britain a less attractive place to do business. Subsidies to encourage foreign buyers to keep open British factories and offices impose a cost on the rest of the economy. Ultimately the most important thing the government can do is ensure that British workers are competitive with those overseas. As companies like Rolls-Royce, an engineering firm, GSK, a drugs giant, and ARM, a chipmaker, demonstrate, British companies can prosper in high-skill, high-value industries. Education and skills, rather than protectionism, are still the best way to safeguard British jobs when foreign buyers come calling.