Changes in governance, the market for corporate control, and the mechanisms for hostile takeovers in Continental Europe: The case of Arcelor's takeover by Mittal Steel

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ABSTRACT

This paper describes the changes in governance, the market for corporate control, and the mechanism for hostile takeovers that have occurred in the last decade in Continental Europe, using the hostile takeover of Arcelor by Mittal Steel to illustrate these changes.

Keywords: governance, market for corporate control, hostile takeovers, Arcelor takeover

Introduction

The hostile takeover of Arcelor by Mittal Steel illustrates the changes in governance, the market for corporate control, and mechanism for hostile takeovers that occurred in the last decade in continental Europe. To explain these changes I begin by describing the differences in governance and corporate control between the United States and Europe, the evolution of the market for corporate control in Europe, and changes in the mechanics for hostile takeovers in Europe. I then then illustrate how these changes enabled and influenced the course of the hostile takeover of Arcelor by Mittal Steel.

Governance and Corporate Control in Continental Europe

In the United States, the ownership of most firms that are listed in stock exchanges is dispersed among small shareowners, and as a consequence corporate control of these firms lies with their managers. Because of this separation of ownership and control, corporate governance in the U.S. has focused primarily on the problem of alleviating the conflict of interest that can occur between shareholders and powerful management (Jensen & Meckling, 1976).

In Continental Europe, in contrast, fewer of the firms that are listed in stock exchanges are widely held by small shareowners (as explained by Enriques and Volpin; 2007). Instead, most of the firms that are listed in stock exchanges in Continental Europe (and indeed around the world) have one dominant shareholder—usually an individual or a family—who controls the majority of votes. Often, this controlling shareholder exercises control without directly owning a large fraction of the firm; they exercise control using pyramidal ownership, shareholder agreements, and dual classes of shares. Pyramidal ownership (or *pyramidal control*) is defined as the ownership structure in which the controlling shareholder exercises control of one listed firm through control in at least one other listed firm (La Porta, Shleifer, & Lopez-de-Silanes, 1999).

A dominant shareholder or *controlling shareholder* is commonly defined as one that owns at least 20% of the voting rights of the listed firm. Such concentrated ownership has two consequences for corporate governance. First, it gives the dominant shareholders the incentive (and the necessary power) to align the interests of management and shareholders. This eliminates the potential for the conflicts of interest between shareholders and managers that are common in firms that are widely held by small shareholders. Secondly, it can create a new conflict of interest between the controlling and minority shareholders (Enriques & Volpin, 2007).

Figure 1. Ownership concentration.

Country	Widely Held %	Family Control %	State Control %	Pyramid Control %
France	60	20	15	15
Germany	50	10	25	20
Italy	20	15	40	20
US	80	20	0	0

Source: Adapted from "Corporate Governance Reforms in Continental Europe," by L. Enriques & P. Volpin, 2007, *Journal of Economic Perspectives, 21*(1), pp. 117–14 and "Corporate Ownership Around the World," R. La Porta, A. Shleifer, & F. Lopez-de-Silanes, 1999, *Journal of Finance, 54*(2), pp. 471–517.

The first column of Figure 1 shows the percentage by which 20 of the largest listed firms in France, Germany, Italy, and the U.S. did not have a controlling shareholder in the mid-90s. Note that widely held ownership (that is, firms held by small stock owners) was common in the U.S. and rare in Italy; and widely held ownership was almost evenly divided from other types of ownership in Germany and France. The second and fourth columns show that family and pyramidal ownership were common for listed firms in Continental Europe. The third column shows that there was also a large percentage of state ownership, especially in Italy (Enriques & Volpin, 2007; La Porta et al., 1999).

Barontini and Caprio (2005) demonstrated that family-controlled firms in continental Europe are, on average, better managed than widely held firms. They concluded the following:

> *We investigate the relation between ownership structure and firm performance in Continental Europe, using data from 675 publicly traded corporations in 11 countries. Our results confirm that families are the type of controlling shareholders that most recur to the control-enhancing devices which are associated with lower valuation and performance. However, even after taking into account that family-controlled corporations exhibit larger separation between control and cash-flow rights, our results do not support the hypothesis that family control hampers firm performance. Valuation and operating performance are significantly higher in founder-controlled corporations, and are at least not worse than average in descendants-controlled corporations. Thus, our results lead to the conclusion that family control is positive for firm value and operating performance in Continental European firms. This is true not only when the founder is still alive, but also when the controlling stake is held by descendants that sit on the board as non-executive directors. When a descendant takes the position of CEO, family-controlled companies are not statistically distinguishable from non-family ones in terms of valuation and performance.*

However, Enriques and Volpin (2007) have argued that these findings do not guarantee that family-controlled firms are always better governed than widely held ones. Family control helps protect shareholders interest against managerial abuse, however families (like managers in widely held firms) can abuse their power and use corporate resources to their own advantage. A common practice is *self-dealing* or *tunneling*: where the family control over the firm is enacted via a pyramidal control structure. By this practice, value is transferred higher up in the pyramid, so that the controlling shareholders own a larger fraction of the firm's cash-flow rights.

The power of controlling shareholders to guarantee the firm's performance (by supervising management on the positive side; and by the use corporate resources for their advantage in the negative side) is probably the most important reason for why the value of a firm is higher for them than for other minority shareholders. The higher value of the controlling shareholders' block of shares is commonly called *control block premium*, and this represents the difference between the price per share in a sale of the control block transaction and the market price of the shares after the transaction. Another measure of the value of corporate control is the *voting premium*, which is the difference between the market price of voting and non-voting shares. Figure 2 shows the control block premium and the voting premium in the early 2000 for France Germany, Italy, and the U.S. (Enriques & Volpin, 2007).

Figure 2. Control premium.

Country	Block Premium %	Voting Premium %
France	2	28
Germany	10	10
Italy	37	29
US	2	2

Source: Adapted from "Corporate Governance Reforms in Continental Europe," by L. Enriques & P. Volpin, 2007, Journal of Economic Perspectives, 21(1), pp. 117–14.

Contemporary corporate governance in Europe is based on the principles raised in two documents: "The Cadbury Report" (Cadbury, 1992), and "The OECD Principles of Corporate Governance" (Johnston, 2004). These reports present general principals around which businesses are expected to operate to assure proper governance. Based on these principles, France, Germany, and Italy have introduced, in the last 20 years, corporate law reforms to strengthen corporate governance, empower shareholders, and enhance disclosure requirements. Because most continental European firms have controlling shareholders, special emphasis was placed in these reforms on empowering minority shareholders and on disclosure, to curb possible abuses from dominant shareholders (Enriques & Volpin, 2007).

Market for Corporate Control

In the end of the late 70s and early 80s it started to become evident that mergers and acquisitions (particularly hostile deals) were consistently increasing shareholder gains. Based on this evidence, Jensen and Ruback (1983) introduced of a definition for the market for corporate control as "the market in which alternative management teams compete for the right to manage corporate resources." They called it "an important component of the managerial labor market."

Jensen and Ruback (1983) reasoned that if a management team of a listed firm is failing to give the best return to its shareholders (and is consequently undervaluing their shares in the market) it could be replaced by a more competent management team of another firm. The acquiring firm's management team could offer a significant premium for the undervalued shares of the firm that they are acquiring, and then after the acquisition make the necessary improvements in its performance to justify the purchase premium.

Shareholders of both the acquired firm and acquiring firm tend to gain from such an acquisition. The acquired shareholders receive a substantial premium for their shares and the acquiring shareholders benefit from the improved performance of acquired firm plus synergies. These benefits, obviously, only occur if the premium that was paid was not excessive, and did not consume all the potential benefit of the acquisition (Martynova & Renneboog, 2005, 2006, 2011).

Viewing the market for corporate control as being only for underperforming listed firms is a gross simplification. There are many other motives for the acquisition of listed firms by other firms, including: improving the strategic position, acquiring technology, increasing market share, and operational synergies (Trautwein, 1990). However, the basic principle for the premium price paid for the acquired listed firms shares does not change. The premium paid for the shares has to be justified by the increase in value of the acquiring firm.

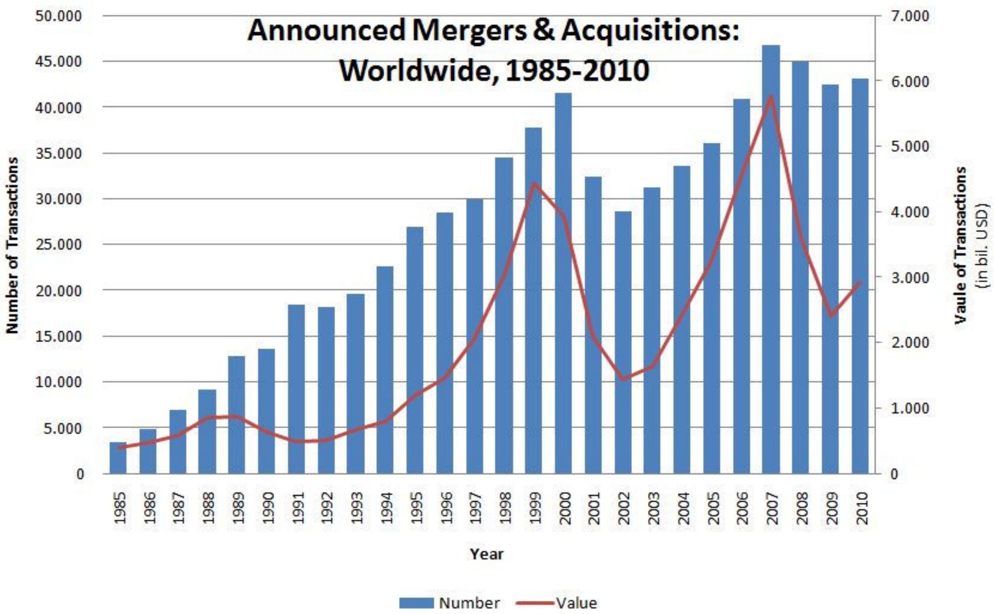
Takeovers in Continental Europe

A takeover is the acquisition of the shares of a target listed firm by another firm, the bidder, or an acquiring firm. In a friendly takeover, the bidder makes a public tender offer at a premium price for the shares of the target firm. The offer is usually initially communicated to, and further negotiated with, the management and board of directors of the target firm before it is made public. When an agreement is reached on the premium price to be paid for the shares, and the board of directors of the target firm concludes that accepting the offer serves its shareholders better than rejecting it, the board recommends, in a formal shareholders' meeting of the target firm, that the offer be accepted by its shareholders.

If the target firm's board of directors rejects the offer, the bidder firm can still make the public tender offer. In this case, the tender offer will be considered hostile, and if successful the acquisition will be considered a hostile takeover of the target firm. Such hostile takeovers may be conducted in several ways. A public tender offer can be made, by the acquiring firm, for the shares of the target firm at premium price (a price above the current market price of the target firm's shares). These tender offers are strictly regulated in the U.S. and Europe (Magnuson, 2008). The acquiring firm may start a proxy fight by persuading enough shareholders (usually a simple majority) to replace those members of the board of directors and management of the target firm who are against the takeover with others who approve the takeover. Another method, known as the *creeping tender offer*, involves quietly purchasing enough shares on the open market of the target firm to force the board of directors and management to accept the takeover. Similar to the tender offer, in the U.S. and Europe there are strict rules for the creeping tender offer: the acquiring firm has to disclose its intentions if purchasing more than a certain percentage of the shares of the target firm.

Takeovers occur all the time, but historically they have occurred unevenly: in cyclical, non-periodic bursts, or waves of activities. Steger and Kummer (2007) have indicated that these waves occur in vicious cycles, from pressure to failure. They have explained that the magnitude of takeover waves, despite their high rate of failure, occurs because of the time lag before the failures are realized. In this model of time lag management, desire and pressure for growth builds up the wave; but when failures are realized on a critical level the wave collapses quickly.

Figure 3. The worldwide takeover waves of the 1990s and of the 2000s

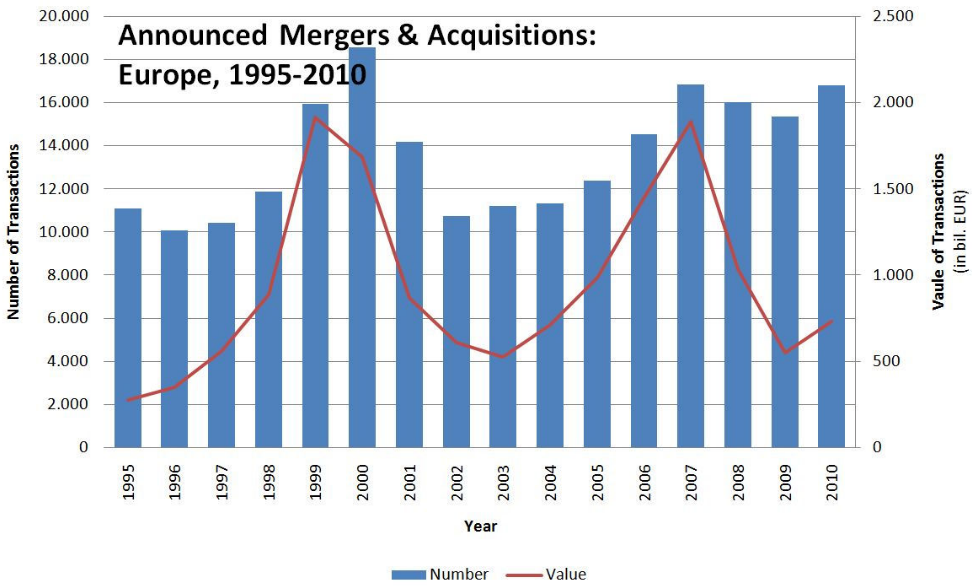


Source: Institute of Mergers, Acquisitions, and Alliances

There are six documented takeover waves: the early 1900s, the 1920s, the 1960s, the 1980s, the 1990s, and (more recently) the 2000s (Martynova & Renneboog, 2005, 2006, 2011; Lipton, 2006). Martynova and Renneboog (2005, 2006, 2011) explained that the wave that occurred in the 1990s was remarkable compared with the past waves, in terms of size and geographical dispersion. Lipton (2006) has noted that this trend continued in the wave of the 2000s (see Figure 3).

Takeovers in Continental Europe had grown from a negligible number of transactions in the early 1980s to a significant number of transactions by the end of the fourth takeover wave later in that decade. However, only in the fifth and sixth waves did continental European firms begin to participate aggressively in takeovers (see Figure 4). Factors that are commonly attributed to the intensive participation of Continental European firms in the takeover waves of the 1990s and the 2000s include: the introduction of the euro, the globalization process, technological innovation, deregulation and privatization, shareholder activism, the boom in the financial markets (particularly the availability of low cost financing), and the growth of private equity and hedge funds (Martynova & Renneboog, 2005, 2006, 2011; Lipton, 2006).

Figure 4. The European takeover waves of the 1990s and of the 2000s.



Source: Institute of Mergers, Acquisitions, and Alliances

Most of the takeovers in Continental Europe (both horizontal and vertical ones) involved firms in related industries (Martynova & Renneboog, 2005, 2006, 2011). This trend of consolidating industries started in the 1980s, during the fourth wave, and became predominant in the fourth and fifth waves as firms focused on promoting the growth of their core business.

Martynova and Renneboog (2005, 2006, 2011) have noted that the considerable financial resources required for growth via takeovers has forced many cash-constrained firms to finance their acquisitions with equity or a combination of equity and debt. Martynova and Renneboog suggested that the boom in the stock market that began in the second half of the 1990s increased the attractiveness of equity as a means of payment for acquisitions. At the same time, the European market for corporate bonds grew rapidly and provided another accessible source of funds for acquiring firms. Additionally, the banks' growing appetite for more risky loans and the low interest rates also fueled the takeover activities in the fifth and sixth takeover waves.

Politics and Hostile Takeovers in Continental Europe

Hostile takeovers are considered to be a standard business practice in the United States and in the United Kingdom. In these two counties, firms can freely change control without any restriction (except for antitrust laws): they have what is commonly known as an *active market for corporate control*. In this context, the assets of acquired firms can be exploited, reorganized, sold, or liquidated with no special considerations for past compromises or for the social impact on employees and communities (Culpepper, 2011).

In these two economies, corporate raiders such as Carl Icahn are often celebrated as heroes. Icahn developed his reputation as a ruthless corporate raider after his hostile takeover of TWA in 1985, where he systematically sold off the firm's assets to repay the debt he used to purchase it (Kiviat, 2007). This practice of systematically selling the assets of an acquired firm to repay debt is known as *asset stripping*.

In contrast, Continental Europe is designated as a *passive market for corporate control*. In most continental European countries political and business leaders collude to prevent large firms from being treated as disposable assets (Culpepper, 2011). This approach is based on an argument that hostile takeovers are a negative aspect of poorly regulated capitalism and that the conquered firms are open to being ransacked, reorganized, or even liquidated, with grim consequences for employees and communities. Awareness of this argument has often allowed the management of target firms in Continental Europe to mobilize enough political support to neutralize any attempt of hostile takeover.

As a consequence of these political barriers, hostile takeovers were rare in Continental Europe prior to the 1980s. With the deregulation of the capital markets in the fourth wave, however, these institutional arrangements that had formerly impeded hostile takeovers began to be dismantled. With the deregulation of the capital markets, Anglo-American pension and hedge funds with cheap and abundant capital began raising their ownership stakes in many continental European firms. In exchange, they demanded political and firm-level reforms to improve governance and consequently corporate performance (Culpepper, 2011).

Shareholder Activism in Continental Europe

Shareholder activism pioneered by institutional investors and hedge funds in the United States used the proxy process and other approaches to pressure management to change (Gillan & Starks, 1998; Brav, Jiang, Partnoy, & Thomas, 2008; Ferreira, Massa, & Matos, 2010). Shareholder activism primarily focuses on increasing shareholders value through changes in corporate policy, financial structure, cost-cutting or divestment, and adopting more aggressive environmental policies. When institutional investors and hedge funds entered the Continental European market during the fourth takeover wave in the 1980s, they introduced U.S. style shareholder activism to continental Europe.

Brav, Jiang, Partnoy, and Thomas (2008) found that hedge funds have had more success than institutional investors in increasing shareholders' value in firms, particularly in the contexts of mutual funds and pension funds that follow activist agendas. They suggested that hedge funds are better able to influence corporate boards and management because of their highly incentivized managers, and because they are not subject to regulations that govern mutual funds and pension funds. Hedge funds can hold highly concentrated positions in small numbers of companies, and use leverage and derivatives to extend their reach. Hedge fund managers also suffer few conflicts of interest, because they are not beholden to the management of the firms whose shares they hold. In summary, hedge funds are better positioned to act as informed monitors than other institutional investors.

Enriques and Volpin (2007) have identified that lawmakers in Continental Europe have responded to shareholder activism and have taken various steps to increase the powers of minority shareholders vis-à-vis managers and dominant shareholders. Minority shareholders now have the power to authorize or ratify some transactions and resolutions in potential conflicts of interest. To limit the power of controlling shareholders, special majorities for non-routine shareholders resolutions have been put in place and the regulatory framework for disclosure has been improved. Additionally, the cost of voting has been reduced and firms can now allow remote voting (via the internet).

Successful Takeover of Arcelor by Mittal Steel

The successful takeover bid by Mittal Steel (a company that had overtaken in 2005 Arcelor to become the number one steel producer in the world) for Arcelor in 2006 is a landmark in many respects (see Figure 5). The takeover illustrates the changes in governance, market for corporate control, and the mechanisms for hostile takeovers that have occurred in the last decade in Continental Europe, motivated by strong shareholder activism. Arcelor was a typical Central European firm with strong ties to local government, which supported management in detriment to the shareholders' return. The excuse given for this was that the economic and social importance of the company as employer and its contribution to the country's economy was more important that increasing value for shareholders. To contextualize these ties to the Luxemburg government, I will give a brief description of Arcelor's history.

Figure 5. Top steel-producing firms in 2004 and 2005 in million metric tons crude steel output

Firm	2004		2005	
	Position	Production	Position	Production
Mittal Steel	2	42.8	1	63.0
Arcelor	1	46.9	2	46.7
Nippon Steel	3	32.4	3	32.0
POSCO	5	30.2	4	30.5
JEE Steel	4	31.6	5	29.9
Shanghai BoaSteel	6	21.4	6	22.7
US Steel	7	20.8	7	19.3

Source: *The Steel War: Mittal vs. Arcelor* (Case) by I, Walter & A. M. Carrick, 2007. Copyright 2007 by INSEAD

Arcelor's Ties to Luxemburg

After the discovery in 1843 of rich local iron ore deposits in Luxemburg, the steel industry became the major force in the country's development, until the 1974 the steel industry crisis. The steel industry in Luxemburg was the main contributor for the country's GDP and its larger employer. After a series of mergers at the beginning of the 20^{th} century, the steel firm Arbed was formed (Walter & Carrick, 2007; Goralski, 2009).

The firm was restructured after oil crisis in the 1970s and some of its underperforming plants were closed and others were modernized. The number of employees was gradually reduced: from almost 30,000 in 1974 to just 5000 in 1998. Due to the importance of Arbed to Luxemburg's economy, the government saved it from bankruptcy in 1982 by becoming a 30% shareholder in a recapitalization. To cover the cost of the bailout, Luxemburg's taxpayers were subject to a 10% income tax rise, as well as an increase in value-added tax (Walter & Carrick, 2007).

In 2002 Arbed merged with France´s Usinor and Spanish Acerlisa, and created Arcelor (with its headquarters in Luxemburg). The new firm employed a total of 104,000 employees and produced 5% of the world's steel. The Luxemburg government remained an active shareholder of the new firm. Arcelor was responsible for one third of the country's production and more that 12% of its energy consumption in the year of the merger. By the end of 2004, Arcelor's contribution to Luxemburg´s GDP had declined to 10%, and the total number of employees to 94,000 and in Luxemburg to 5,000 (Walter & Carrick, 2007).

In a CNN interview on May 30, 2005 (Benjamin, 2005), the CEO of Arcelor, Guy Dollé, stated his visions for firm: (1) To become one of the leaders in the steel industry by producing 80 to 100 million tons (double what Arcelor was producing at the time of the interview), (2) to deliver continuous value to its shareholders, and (3) to grow to be one of the four major leaders in the industry for the future.

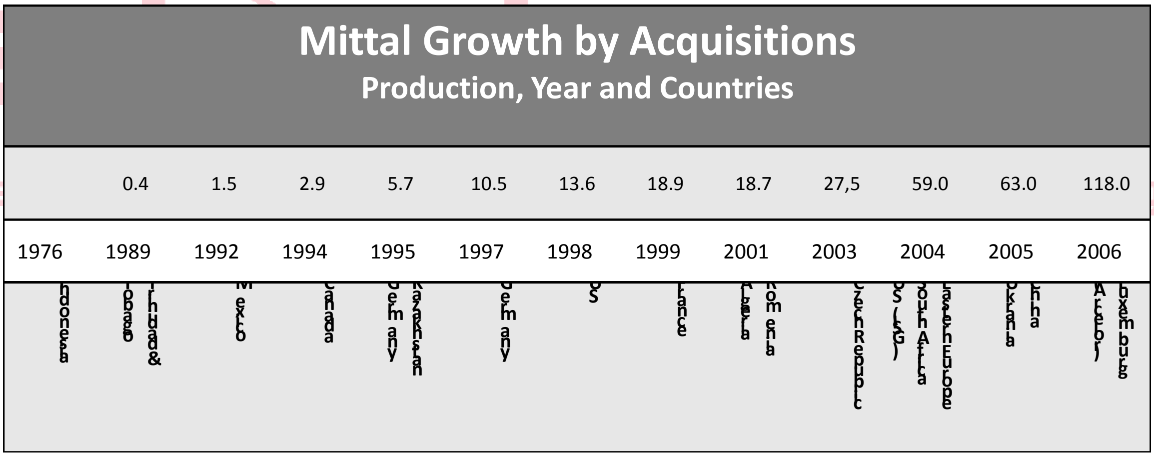
In January of 2006, Arcelor outbid Germany´s ThyssenKrupp in a hostile takeover and acquired Canada's largest steel producer Dofasco for 5.6 billion Canadian dollars. This increased Arcelor's presence in the North

American market significantly (Walter & Carrick, 2007). The Mittal Steel initial hostile bid for Arcelor in January 27 was made just one day after Arcelor officially announced the takeover of Dofasco (Goralski, 2009).

Mittal Steel Becomes the Number One Steel Producer in the World

Mittal Steel was formed in 2004 by the India born industrialist Lakshmi N. Mittal. At that time, the Holland-based and publicly owned Ispat (of which the Mittal family held a 70% shareholding) purchased LNM Holding (which was wholly owned by the Mittal family) for 13.3 billion U.S. dollars, and so became the second largest steel producer in the world. The acquired LNM Group was formed in 1976, when Mittal purchased an Indonesian rod mill from his father and started acquiring steel assets all over the world (although primarily in developing countries, including Eastern Europe; see Figure 6). The LNM Group was one of the leaders in the consolidation of the global steel industry, with their clear strategy to emphasize size and scale (Reed, 2007; Walter & Carrick, 2007; Singh, 2008).

Figure 6. Mittal growth by acquisitions (production in million metric tons crude steel output)



Source: "Mittal & Son: An Inside Look at the Dynasty that Dominates Steel," S. Reed, 2007, Businessweek, 44–52.

The LNM Group specialized in producing flat and long steel products from direct-reduced-iron, also called *sponge iron*. The direct-reduced-iron is produced by the direct reduction of iron ore using a reducing gas produced from natural gas or coal. This process is less capital intensive, uses less energy, and is overall less expensive than the conventional process (which requires sintering plants, coke ovens, blast furnaces, basic oxygen furnaces, and raw materials of stringent specifications). Also, conventional steel plants of less than one million tons annual capacity are generally considered to be economically unviable. This high breakeven point is probably the main reason that so many firms using the conventional iron production process to make steel had economic troubles in the cyclical downturns of the steel market and were shut down or sold (Ashrafian, Rashidian, Amiri, Urazgaliyeva, & Khatibi, 2011; Sawada & Myamoto, 2010).

In 2005, Mittal Steel (based in Rotterdam) acquired, for 4.5 billion U.S. dollars, the U.S.-based International Steel Group (ISG) and so became the first truly global number one steel producer in the world with operations in 16 countries (Reed, 2007; Walter & Carrick, 2007; Singh, 2008).

Lakshmi Mittal's Takeover Strategy

In January 2006, Lakshmi Mittal was aware that Guy Dollé (the CEO of Arcelor) and his management team were completely focused on the hostile takeover bid of 5.6 billion Canadian dollars for Dofasco, Canada's largest steel producer (4.4 tons). He was also aware that Arcelor's defenses against a hostile takeover were limited due to unusual movement in its share price during the months before the bid for Dofasco. Walter and Carrick (2007) described this situation:

> *The French Prime Minister's office and the Direction de Surveillance de Territoire (DST) had informed Arcelor's management that 20 percent of its shares had changed hands in November 2005, and the company was in a vulnerable position for a takeover bid.*

Also, the Arcelor's shares were rated lower than Mittal's (at a P/E ratio of 4 against 5), and both companies were rated lower than Japanese and U.S. steel firms, which had P/E's in the range of 7–9 (Walter & Carrick, 2007). These created the ideal situation for Mittal Steel to initiate a hostile takeover of Arcelor.

On January 13, 2006, Lakshmi Mittal invited Guy Dollé for dinner at his house in London and surprised him during pre-dinner drinks by proposing the merger between Arcelor and Mittal Steel. The outcome of this dinner is not clear, as Gumbel (2006) explained:

> *Exactly what happened next is a matter of dispute. Dollé says he gave a noncommittal reply, and the two moved on to dinner and other business, leaving discussion about a possible merger open. "I said neither yes nor no," he recalled last week. "I just said 75% to 80% of mergers fail because of cultural differences." For his part, Mittal says Dollé immediately ruled out a deal. "He gave several reasons why he wasn't interested," he told Time. "I told him I'd get in touch again, and called a few days later to say there was an urgent need to meet." The men never did re-establish contact and on Jan. 26 —less than two weeks later—Mittal called Dollé on his mobile phone at Frankfurt airport while he was checking in for a flight to Toronto. The message: Rotterdam-based Mittal Steel would be announcing the following day a formal $22.6 billion takeover bid for Arcelor, one of the largest hostile bids in European history.*

It is clear that Guy Dollé underestimated Lakshmi Mittal's determination to takeover Arcelor. Goralski (2009) further explained:

> *It is my opinion that Guy Dollé did not know enough about the culture of business in India to win this bidding war between Arcelor and Mittal Steel. As an Indian student, Lakshmi Mittal would have learned about logic, patience in business, and strategizing. Indian students are taught from rote with mathematical calculation. No decision is taken lightly. All decisions are calculated from all perspectives before a decision is made, regardless of the time necessary for the calculations to occur. Mittal knew Dollé, as both were board members of the steel industry's international trade group. They had discussed industry-wide issues. As a strategist, Mittal would have listened and taken the measure of Dollé during those conversations to use to his benefit in future negotiations. When Dollé mounted a personal attack on Lakshmi Mittal, claiming that he "did not want his shareholders to be paid with the Indian-born Mr. Mittal's 'monkey money'," Mittal would have recognized that Dollé was becoming emotional, which in India is viewed as a*

weakness. Mittal would have known that this assault was the beginning of the end.

Mittal Steel's Bids for Arcelor

On January 27, 2006, Mittal Steel made its hostile takeover bid for Arcelor with a 18.6 billion euro (equivalent to 22.6 billion U.S. dollars) cash-and-share offer for Arcelor. The offer proposed payment of a maximum of 4.7 billion euros in cash for Arcelor, with the rest financed through a stock offering of four new shares in Mittal Steel for every five held in Arcelor. The offer valued Arcelor's shares at 28.21 euros per share, a 27% premium on its close the night before the bid. The Mittal family shares in Mittal Steel would be reduced from 88% to 50.7%. Citigroup and Goldman Sachs were mandated to arrange a loan of 5 billion euros to support the cash portion of the bid (Marsh, 2006a; Walter & Carrick, 2007).

Two days later, on January 29, 2006, Arcelor's board rejected the offer. However, Arcelor's Chairman, Joseph Kinsch, stated in mid-February 2006 that the board of directors would reconsider the deal if Mittal Steel made an all-cash bid. This implied that the Arcelor board was considering the offer more closely, but that it was also aware that an all-cash offer would be a challenge for Mittal Steel, since it would have to raise almost all the funds through the loan market (Walter & Carrick, 2007).

On May 10, 2006, Mittal Steel raised its offer from 18.6 billion euros to 20.7 billion euros, but Guy Dollé still refused to meet Lakshmi Mittal. Despite Dollé's position, Arcelor's Chairman, Joseph Kinsch, commented that he would be prepared to talk with Lakshmi Mittal as long that he provided (in advance) detailed information, including Mittal Steel's business plan and a financial forecast. Lakshmi Mittal refused this offer. Meanwhile, the U.S. and individual European States approved the deal on antitrust grounds. The only outstanding approval was from the European regulatory authority, although this was considered a mere formality (Walter & Carrick, 2007).

On May 17, 2006, Mittal Steel raised the offer again by 34% to 25.8 billion euros, with a 57% increase in the cash component. The new offer relinquished the Mittal family's control of the combined group, as the family's share would be reduced from 88% to just 43.5%. Despite the revised offer, Guy Dollé and Joseph Kinsch, were determined to avoid the Mittal Steel takeover (Walter & Carrick, 2007).

Arcelor's Ineffectual Defenses and Shareholder Activism

The Economist, on June 15, 2006 summarized the ineffectual defenses used by Arcelor against the hostile takeover by Mittal Steel and the disrespect of management for its shareholders:

> *"MONKEY money" is how Guy Dollé, chief executive of Arcelor, charmingly dismissed a hostile bid earlier this year from Indian-born Lakshmi Mittal, who runs (and largely owns) Mittal Steel. That was the high point of his defense of Europe's biggest steelmaker. Since then Mr. Dollé and Arcelor's chairman, Joseph Kinsch, have twisted and turned to escape Mr. Mittal. None of their scheming would count as more than two old men's efforts to cling to their jobs, except that shareholders everywhere also have a stake in this fight. For the sake of investors in Europe, what matters is not just who wins Arcelor, but how the battle is resolved.*
>
> *The steel industry is consolidating. Mr. Mittal's €25.8 billion ($32.3 billion) bid would create a huge producer nearly four times the size of its nearest rival. The match, steel men judged, was a good one. Mittal could expand into Arcelor's high-margin markets, Arcelor could gain from Mittal's low-cost production. But Mr. Dollé would have none of it. The offer was "150% hostile," priced too low and strategically misguided. Through management and ownership, the untrustworthy Mittal family would dominate. Although Mittal Steel is registered in the Netherlands and run out of London, it did not in some mysterious way share Arcelor's European "cultural values."*
>
> *Before long, that nasty little piece of Euro-nationalism was supplemented by opportunism and hypocrisy. First Messrs. Dollé and Kinsch bundled Dofasco, a recently acquired Canadian steelmaker, into a holding structure designed to frustrate Mittal's plans to sell it on—a poison pill, if ever there was one. Next they*

proposed to scotch Mittal by merging with Severstal, an opaque metals firm controlled by a Russian tycoon who, without launching a bid, was to become the dominant shareholder of the combined group. So much for Mr. Dollé's superior standards of corporate governance.

The victims in all this are Arcelor's own shareholders—something that should worry investors in Europe. All along, Messrs. Kirsch and Dollé have denied their own shareholders a proper shout. Investors had no say over Dofasco and they can stall the Severstal deal only if at least half of the shareholder register rejects the merger at a meeting in Luxembourg at the end of this month (see article). The threshold for such votes is usually a simple majority of those present: Arcelor's hurdle looks as if it was erected to be insurmountable.

Arcelor insists it has done nothing wrong. Its articles of association and the law of Luxembourg, where it is incorporated, would allow the Severstal deal without any shareholder vote at all. Mittal has already raised its offer once and Mr. Dollé says he is open to further offers that are higher still. That is disingenuous. Whether Mittal or Severstal would most benefit Arcelor shareholders is open to argument. Most analysts favor Mittal's improved offer, but Arcelor's board this weekend judged, as it is entitled to, the Russian deal to be better. The way to decide between the two is for Arcelor's shareholders to have a fair vote. It is their company, after all.

That is the principle at stake here—and a good reason to hope that Arcelor investors now rush to sell their shares in the market to Mr. Mittal, giving him the majority he needs. Managers are entitled to use the rules to push up a bidder's price and protect their company. But if they exploit the rules against their own shareholders' interests, by seeking to deprive investors of a choice, then the essential covenant between owner and manager is broken, whatever the small print. If Arcelor's managers get away with flouting that principle, shareholders everywhere in Europe will be the losers.

The possible merger of Arcelor with Severstal (the largest Russian steel producer) enraged Arcelor's shareholders, as portrayed by the Economist in July 1, 2006:

> *"This is the Chernobyl of corporate governance," says Bernard Oppetit at Centaurus, a hedge fund in London. Like many investors in Arcelor, the biggest European steelmaker, Mr. Oppetit is upset about the shabby treatment of shareholders by Arcelor bosses, as they attempt to fend off a hostile bid for their company by India's Mittal Steel. He and others are not prepared to continue to suffer in silence. They are rallying to force Arcelor bosses to give them more of a say in the decision over the company's future.*

Taking advantage of the discontent felt by Arcelor's shareholders, Goldman Sachs (as Mittal Steel's advisor) launched an Arcelor shareholders campaign to force a vote on the merger with Severstal. More than one third of Arcelor's shareholders signed a letter demanding the right to vote on the proposed merger at a board meeting scheduled for June 30. The Arcelor board of directors summarily rejected this proposal, fearful that the deal would be turned down; under Luxemburg law, the deal could only be rejected if 50% of the shareholders attending a shareholders meeting voted against it. However, also under Luxembourg law, the board is obliged to meet with shareholders if more than 20% request a meeting. So, the board was forced to agree to an extraordinary board meeting to consider the voting rules on the Severstal deal for the shareholders meeting of June 30. On June 18, Arcelor announced the cancelation of the crucial June 30 shareholder's meeting, giving no clear reason (Walter & Carrick, 2007).

After additional shareholder protests and calls to destitute the board members and management, the Arcelor board finally ceded to shareholder's pressure and accepted the Mittal Steel offer of 26.9 billion euros. The deal was scheduled to be closed by the end of 2006 (Walter & Carrick, 2007). During this crucial phase of the takeover battle for Arcelor the European shareholders finally realized their true potential and established that they could impose their views on the management (Chabert, 2006).

Mittal Steel Governance Issues

In The Economist on April 27, 2006, another article outlined what it considered the only valid argument used by Guy Dollé against the takeover:

> *Mr. Dollé had one good argument to wield against the Mittal bid. The steel giant's corporate governance is not fair to minority shareholders. The Mittal family controls 88% of the firm's shares and each of their shares carries ten votes. Three members of the clan—Mr. Mittal, Aditya, his son who is also the company's chief financial officer, and Vanisha, his daughter—sit on the company' s nine-member board. Mr. Mittal says he will rethink multiple voting-rights for shares—after the merger.*

The Financial Times (Plender, 2006) also raised serious questions about the independence of Mittal Steel's outside directors:

> *The Financial Times has established that three of the five directors described by Mittal Steel as independent have such links. The news could come at a sensitive time for the company, which is in the middle of a hostile takeover bid for Arcelor.*

These questions about Mittal Steel's governance forced Lakshmi Mittal to make considerable governance concessions in the new firm (renamed Arcelor-Mittal) after the takeover of Arcelor by Mittal Steel (Financial Times, 2006). He had to give up the majority ownership of the firm that he founded (as the Mittal family had reduced its shares from 88% to 43.5%), he lost control over the board (he could appoint only six of the 18 board members), and he had to accept Joseph Kinsch (ex-Arcelor's Chairman) as the chairman of Arcelor-Mittal, and Roland Junck (ex-Arcelor) as its CEO. He remained as president and his son Aditya Mittal remained as the CFO (Schwartz, 2006).

Politicians in France and Luxemburg were also Hostile to the Takeover

Negative comments against Mittal Steel's hostile takeover bid for Arcelor were by no means restricted to Arcelor's management. Key politicians in France and Luxemburg were also against the takeover. Jen-Claude Juncker, Luxembourg's prime minister, travelled to Paris for meetings with French president Jacques Chirac and the prime minister Dominique de Villepin. Afterwards, Juncker declared: "The hostile bid by Mittal Steel calls for reaction that is at least as hostile." He explained that the two countries had agreed on an approach, but gave no detail of the possible action they may undertake (Hollinger et al., 2006).

The hostility of Luxemburg's prime minister can be attributed to the historical importance of steel industry for Luxemburg, and the fact that in 1982 Luxemburg's government had saved Arbed (now Arcelor) from bankruptcy with the help of its taxpayers (and from that, the state still owned 5.6% of Arcelor shares). He was also concerned about the 6,000 people who worked for Arcelor in Luxemburg (Hollinger, Marsh, & Laitner, 2006; Walter & Carrick, 2007).

The French government was concerned for the 28,000 people who worked for Arcelor, but the French state did not hold any Arcelor shares, so its influence over the firm was limited. In addition, the state of Wallonia (the French speaking region of Belgium) owned 3.2% of Arcelor shares, and was equally concerned about the possible consequences of the takeover (Walter & Carrick, 2007).

After the initial reaction, politicians realized that they were powerless to prevent the hostile takeover bid of Mittal Steel (a Dutch firm) against Arcelor (a Luxemburg firm). Prior to this, Charlie McGreevy (the internal market commissioner of the European Union) had send a letter to Thierry Breton (France's finance minister) demanding justification for provisions of new legislation that gave the government rights to impose conditions or veto takeovers, threatening legal action if not satisfied with the answer. This legislation was part of France's increasingly mood of protectionism that had become a sensitive issue in Europe (as outlined in The Economist, 2006, February 2).

At that time, the French government was finding it difficult to justify, on an intellectual level, its support for hostile takeovers by large French firms of foreign firms, while at the same time protecting local firms from being taken over by foreign ones (Betts, 2006). Besides, Arcelor shareholders (like Gérard Augustin-Normand, president of Richelieu Finances) were calling for politicians not to meddle and suggesting that fund managers needed to consider the offer only based on the merit of price (Hollinger et al., 2006).

Investment Banks were Supportive of the Hostile Takeover

The investment banks that were active in Europe were also supportive of the hostile takeover of Arcelor by Mittal Steel. They provided both advice, and financing and political lobbying. By the end of March 2006, Citigroup and Goldman Sachs (joined by Société Général, Commerzbank, Crédit Suisse, and HSBC) secured 8 billion euros in loan commitments to back Mittal Steel's 18.6 billion Euros hostile offer for Arcelor. The investment banking advisory fees were estimated to be between 90 and 100 million dollars U.S. (Walter & Carrick, 2007).

The French investment bank Société Générale in particular helped convince the French government to react kindly towards the hostile takeover. This came as a surprise, because Société Générale had a traditional relationship with Arcelor. Société Générale either concluded that the takeover was better a better deal for Arcelor's investors or was simply motivated by the prospect of obtaining million dollar investment-banking fees (Goralski, 2009).

Convincing Société Générale to switch sides and support Mittal Steel was a brilliant tactical strategy by Lakshmi Mittal, according to Goralski (2009). However, this also demonstrated that modern investment banking relationships could swing from a potential target firm to a hostile takeover bidder if the fees were attractive enough, without constraints of loyalty or nationalism.

Conclusion

The hostile takeover of Arcelor by Mittal Steel reflects the changes in terms of governance, market for corporate control, and the mechanism for hostile takeovers, that had occurred in Europe throughout the last decade. These changes were mainly motivated by growing shareholder activism, led by institutional investors and hedge funds that entered the Continental European market during the 1980s and introduced this market to U.S. style shareholder activism. Lawmakers responded, and took various steps to reduce protectionism of local firms and increase shareholder's power vis-à-vis management and dominant shareholders.

Also, it became evident that mergers and acquisitions (particularly hostile deals) were consistently increasing shareholder gains. This created a market for corporate control, where firms that did not give the best return to their shareholders could replace their management with more competent management from another firm. This was the case of Arcelor's management (with a poor performance that reflected in P/E of 4), who was replaced by Mittal Steel's management (which had a better performance that reflected in a P/E of 5). The decisive factor for analysts and investors, in all likelihood, was that Mittal Steel´s management could better take advantage of the synergies of the combined firm and eventually reach the same P/E level of other steel firms (which were in the 8–9 P/E range). This was a huge windfall for Arcelor shareholders, who received a 43% price increase for their shares out of the deal (Financial Times, 2006).

The potential of the combined firms, the financial market boom, the availability of low cost financing, and the substantial fees, were probably the decisive factors that motivated the investment banks to promote the hostile takeover of Arcelor by Mittal Steel.

Mittal Steel's Success is Responsible for its Recent Predicament

The availability of cheap financing allowed Mittal Steel to grow and be successful in its takeover of Arcelor. However, the new firm, ArcelorMittal, is now heavily indebted after years of deal-making and is vulnerable to the economic downturn started after the 2007 financial crisis. In a recent article in BusinessWeek, Reed and Biesheuvel (2011) explained the predicament of ArcelorMittal:

> *The Arcelor acquisition was to have been the achievement of Mittal's career. The new company, combining Mittal's proven ability to wring efficiencies from aging steelworks with Arcelor's state-of-the-art European technology, seemed poised to profit handsomely from a booming world economy.*
>
> *Three years of weak steel demand have put downward pressure on earnings and profits at ArcelorMittal, which is heavily indebted after*

years of dealmaking. The company also has to contend with a steel glut: Chinese mills have more than doubled production since 2005 to a projected 733 million metric tons this year, according to U.K. steel consultant MEPS. ArcelorMittal has trimmed back output some 20 percent from the 116 million metric tons it produced in 2007. Its share of the global market has fallen from 9.5 percent in 2006 to 6.4 percent in 2010, according to data compiled by Bloomberg.

The stock is down some 50 percent from its 52-week high in February. And Mittal's 40.9 percent stake in the company is now worth about $12 billion, down from $55 billion in 2008. Says Rochus Brauneiser, an analyst at Frankfurt brokerage Kepler Capital Markets: "We're in a very dark market environment right now."

Mittal, 61, one of the globe's most prolific dealmakers over the past three decades, seems ever the cool hand. Wearing a blue suit with no tie at his office on London's tree-filled Berkeley Square, Mittal shrugs off any notion that the marriage with Luxembourg-based Arcelor has been anything less than a success. "There has been no surprise or disappointment in the merger," he says. "It has been a very positive experience."

ArcelorMittal is forecast to report a profit of $3.7 billion this year, the highest in three years. Still, that's far less than the company's $10.4 billion profit in 2007. Analysts wonder if that record can ever be reprised. "Those days may be gone forever," says Tony Taccone, a co-founder of First River Consulting in Pittsburgh. "The only way we return is if the economies of all major countries and regions fire on all cylinders at the same time."

Just about everyone, including Chief Financial Officer Aditya Mittal, agrees with that assessment. "Prices have moved down in the fourth quarter," Mittal's 35 year-old son told reporters on Nov. 3. "Customers are not keen to build inventories."

An anemic economy is exposing the weak links in Mittal's empire. The plants acquired through the merger with Arcelor are concentrated in Western Europe, where operating costs are high. To *keep steel prices from collapsing, Mittal is putting some of those plants on ice. Rather than cutting production across the board, the goal is to keep the best facilities such as those at Ghent in Belgium and at Dunkirk in France running at near full capacity while closing less competitive mills, reducing costs by $1 billion.*

In the last two months, ArcelorMittal has announced it is idling plants in France, Germany, Luxembourg, Poland, and Spain. On Oct. 14 the company said it would permanently shut down its blast furnaces in Liège, Belgium, which employs 581 workers. Employees responded by barricading six Arcelor managers in their offices for 24 hours. The company says it will try to find new jobs for them. "What is happening now is not a surprise," says former Arcelor Chief Executive Officer Guy Dollé. "Continental Europe plants have no future."

The problems of the euro and the need of global firms such as ArcelorMittal to adapt to new market realities threaten to reverse the advances in the market for corporate control and the mechanism for hostile takeovers in Continental Europe; however they may also motivate new protective and nationalistic policies from governments.

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