

INSTITUTIONAL SHAREHOLDERS' COMMITTEE

Management Buy-Outs

1 INTRODUCTION

- 1.1 With the increase in offers from company managements to purchase entire listed companies, all the major institutional groups have worked together, through the reconstituted Institutional Shareholders' Committee (ISC), to prepare guidance to all those involved in such management buy-outs.
- 1.2 No suggestion is made that there is any opposition in principle to a management buy-out for a quoted company but events over recent months have stimulated thought and discussion on the ways in which the inevitable conflicts of interest that arise might be reduced and how the provision of sufficient advice and information to shareholders, to enable them to make a considered decision might be ensured.
- 1.3 Where a management buy-out involves an offer for a subsidiary company, the ISC is satisfied that the Companies Act responsibilities of directors provide appropriate protection for shareholders.

2 CO-OPERATION WITH THE PANEL ON TAKEOVERS AND MERGERS

- 2.1 In examining this issue, the ISC has worked closely with the Panel on Takeovers and Mergers.
- 2.2 The ISC, representing the interests of pension funds, insurance offices, unit trusts, investment trust companies and the asset management arms of merchant banks and securities houses, welcomes the amendments to the rules of the Takeover Code announced by the Panel on Takeovers and Mergers.
- 2.3 In particular, the ISC welcomes:-
 - 2.3.1 The amendment to Note 1 to Rule 3.1, stressing the importance to shareholders of competent independent advice when in receipt of a management buy-out offer;
 - 2.3.2 The addition of Note 4 to Rule 25.1, recognising the confusion of loyalty inherent in cases where a director of the offeree company is to have a role in the offeror company;
 - 2.3.3 The clarification in Note 2 to Rule 20.2 of the kind of information which an offeree company should be required to furnish to an offeror, or potential offeror, competing with a buy-out;
 - 2.3.4 The addition of Rule 20.3 which will ensure that independent directors and their advisors will be given all the information which has been given to possible providers of finance.

3 ISC GUIDANCE

3.1 In all circumstances, institutional investors favour the presence on boards of quoted companies of independent non-executive directors, as described by ProNed, of which the ISC is a founder sponsor and a strong supporter¹. In the event of a management buy-out the ISC believes that the interests of all shareholders, large and small, are best protected by the presence on the board of the offeree company of such independent non-executive directors, as they will be in a position to mitigate the conflicts of interests which must arise for executive directors involved in a management buy-out.

3.1.1 A management buy-out proposal is unlikely to be favourably received unless it is made by the executives of a company on the board of which there is, and has been for some time, a strong independent, non-executive presence.

3.2 Advisors to companies are employed to give advice to boards on behalf of shareholders and they are paid from shareholders' funds. In most circumstances, the continuation of the indirect relationship between a company's advisors and its shareholders would be to the benefit of shareholders faced with a management buy-out proposal.

3.2.1 In the event of such a proposal, it would not be appropriate for the offeror to employ as advisors those who have previously been employed as such by the offeree company unless independent non-executive directors advise that the interests of shareholders would not be adversely affected by such an arrangement between the offeror and those advisors or, indeed might be better protected by the appointment of new advisors.

3.3 The third guidance note assumes the appropriate presence on boards of independent non-executive directors and the provision to these directors of independent financial advice.

3.3.1 It is most unlikely that such proposals would receive a sympathetic response unless they were supported and recommended by those independent non-executive directors.

3.4 The concerns of holders of any debentures, loan stocks and other bonds should be covered in management buy-out proposals. Institutional investors may frequently prefer an immediate "redemption or roll-over" provision.

3.4.1 Offerors at least should state, at the same time as the announcement of the terms of the offer, their intentions with regard to such stocks and clarify any consequential changes in asset or income cover if the stocks are to remain in issue.

4 OTHER OBSERVATIONS

¹ Subsequently, also advocated by the ISC in "The Role and Duties of Directors" and by the Cadbury Committee in its draft report.

- 4.1 In preparing this guidance, much thought was given to the merits of supplementary payments being made to shareholders if the performance subsequent to a successful management buy-out substantially exceeds that anticipated at the time of the transaction.
- 4.2 The ISC has chosen not to give any specific guidance with respect to the structuring of any management buy-out offer although substantial support was indicated to the ISC with respect to a variety of post acquisition performance payments. Such arrangements are a matter for individual offerors and the ISC believes specific guidance in this area would not be helpful.
- 4.3 Many thoughtful observations were made by a wide variety of companies and organisation to assist the ISC. The ISC thanks all those who made such useful contributions to the general debate in this area.

5 CONCLUSION

- 5.1 This is the first occasion that all the major institutional investing groups have co-operated in such a manner through the ISC.
- 5.2 By confining itself to 4 key areas, together with those incorporated in the amendments to the Panel on Takeover and Mergers' rules, the ISC hopes that greater certainty will be offered to those involved in such activities, without preventing management buy-outs in appropriate circumstances.

Enquiries to:

Michael McKersie (020) 7216 7659
John Hale (020) 7216 7674

Issued December 1989