EMERA'S TAKEOVER OF LIGHT & POWER HOLDINGS LTD: A CASE STUDY IN CORPORATE GOVERNANCE AND TAKEOVERS IN THE CARIBBEAN

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Abstract

Corporate governance and takeovers are fundamental areas in the field of finance and, given their importance, the way each influences the other merits investigation. A takeover scenario presents circumstances that are conducive to the observation of this symbiosis at work. The effectiveness of the participant's corporate governance practices is brought into sharp focus since it may ultimately determine the outcome of the takeover attempt. The obverse case is covered extensively in the literature; that is, the threat of takeovers is thought to act as a corporate governance mechanism by inducing managers to focus on maximising their company's performance. In this paper corporate governance, takeovers and the relationship between them are explored in the Caribbean context by using a Caribbean takeover scenario: Emera's takeover of Barbadian public utility, Light & Power Holdings Ltd. We discover that the business environment in the Caribbean holds implications for the effectiveness of corporate governance and the nature of takeovers in the region. Important findings for the Caribbean include: the presence of large shareholders may determine the effectiveness of corporate governance, a potential acquirer may complete a de facto takeover of a public company without securing an ownership stake, there is an increasing trend of foreign takeovers of indigenous companies, conditions for the threat of takeovers being effective as a preventative corporate governance mechanism do not generally exist and takeovers may induce a change in corporate strategy.

Keywords: Corporate Governance; Takeovers; Mergers and Acquisitions

SECTION 1 - Introduction:

Light and Power Holdings Company (LPH) is the sole supplier of electricity in Barbados. The country's economic performance, attractiveness to investors and even its citizens' standard of living depend on the utility providing a reliable and cost-effective service. In December, 2010 Emera Inc. (Emera), a Canadian energy services company and the largest shareholder in Light and Power Holdings Company (LPH), made an offer to acquire any and all outstanding common shares of LPH. Subsequently, the LPH board publicly notified shareholders of Emera's bid and also advised shareholders against taking any action unless advised by the board. Shortly after, the board advised that the shareholders sell to Emera at their bidding price. The response from shareholders was overwhelming and by March, 2011 Emera had gained a controlling interest in LPH after successfully acquiring 79.6% of the company's shares. With that transaction, ownership of LPH was transferred outside of Barbados for the first time in its century long existence.

Even though LPH is regulated by the local Fair Trading Commission and a government institution, the National Insurance Scheme (NIS), is still a large shareholder, though in a diminished capacity after divesting half of its shares to Emera, the change in ownership may yet have national implications for Barbados and warrants an evaluation. This study assesses Emera's takeover from a corporate governance perspective and considers the implications of the local

business environment for conducting takeovers in Barbados and the Caribbean. In this regard, the role of the board of LPH in the transaction will be rigorously evaluated.

The remainder of the paper is organised as follows: Section 2 reviews the development of LPH and its link with Barbados; section 3 follows with a review of the literature on corporate governance and takeovers; the discussion and analysis of the Emera's takeover of LPH is the focus of section 4, while section 5 provides a concluding summary

SECTION 2: The History of Light & Power Holdings

The Barbados Electric Supply Corporation (BESC), the predecessor of Light & Power Holdings, was founded in 1909 after the passage of the Electric Light & Power Act by the Barbados House of Assembly in 1899 and its enactment in 1907. From 1908, underground mains were laid from the capital Bridgetown along Barbados's south coast and on June 17, 1911 the Electric Light Works was officially opened. The electrification of the island proceeded slowly. The new power source needed to prove itself and the newly-formed company had to work hard to attract customers. Nonetheless, throughout the 1920's demand grew and the BESC acquired more equipment to increase its power capacity. As was common in other countries at the time, the growth of the electricity industry in Barbados depended mainly on the middle and upper economic classes.

The 1930's brought social unrest whose effect was to set Barbados on a path to reducing social and economic inequality. By 1940, the total capacity of the BESC was 2,000 kW, but by 1955 it had tripled to 7,044 kW, with peak demand on the system totalling 4,200 kW. Since the adoption rates for comparable periods pre- and post- disturbance for the BESC were starkly different, the rapid expansion in the customer base suggests that the service grew beyond the domain of the

social elite. It is conceivable that electricity's transition from a privilege to a widely accessed utility was one of the consequences of the unrest. Indeed, the accessibility of some amenities like electricity to a nation's people is a socio-economic development indicator. As Barbados continued to develop, the country's progress brought with it the availability of electricity for its citizens. In 1955, The Barbados Light & Power Company Ltd. (BLPC) was formed to take over the local assets of the BESC, which remained as a holding company in London. Half a million shares were offered to Barbadians and the share issue was oversubscribed. That year Hurricane Janet devastated the island, causing severe dislocation to the operations of the company. The company not only recovered but also needed to grapple with growing demand.

In 1960, the BLPC sold its shares in the company to the Mitchell Engineering Group, also of the UK. Three years later control passed to the Canadian International Power Company. In 1965, the Barbados Light & Power Company served 29,238 customers and, in the following year, it purchased a 5 1/2 acre site at Spring Garden which would become its main generating station. Once again, the BLPC's advancement seemed to parallel that of Barbados since it was in that year, 1966, that Barbados gained its independence from Britain. The Spring Garden Generating Plant went into operation in 1967 with five GM diesel generator sets and a peak capacity of 11,500 kW. Two further diesel sets were added to Spring Garden at a cost of Bds. $4 million. The extension added another 9,000 kW of power to meet the demand of a rapidly growing customer base, which had swollen to 40,249; an increase of 10,000 customers in just four years, a staggering 33% in growth.

The decades of the 1970s and 1980s saw continued adoption of the company's service with local shareholders also increasing in number, from 1,300 in 1970 to 2,265 by 1983. Indeed, by 1980, Barbadians owned 52% of the company, or some three million shares. Although the BLPC had

already written itself into the story of Barbados's development, increasing Barbadian investment in the company served to further intertwine its interests with those of the country. The company once again needed to expand but faced cash constraints. It successfully applied to the Public Utilities Board (PUB) for rate increases on May 16, 1980 bringing financial relief to the cash-strapped company, and allowing ongoing loan negotiations to be finalized.

At a special meeting of the shareholders in November, 1997 the company's shareholders voted to have all of the company's shares exchanged for shares in a new parent company, Light & Power Holdings Ltd. (LPH). Thus, on January 2, 1998 The Barbados Light & Power Company became a wholly owned subsidiary of Light & Power Holdings, which could then seek out new business opportunities in and outside of the region. There was, however, no consequential change in the share ownership, with some 63% of the shares owned by approximately 2,800 Barbadian investors, of which the National Insurance Board was the largest, with 28% of the company's shares. The remaining 37% of Light & Power Holdings shares were owned by Canadian International Power Co. Ltd., whose parent company is the Leucadia National Corporation of the USA. For the financial year ended December 31, 1999, the LPH earned a net profit of $12.8 million on gross revenues of $191.5 million after just completing a project to boost its production. With profitability intact, capacity expanded, wide public participation (in a notoriously anaemic stock market no less) and a holding company in place to diversify interests, Barbados Light and Power Holdings Limited seemed extremely well-positioned to meet the new millennium.

The company continued to show strong financial performance and has remained consistently profitable. This has seemingly augured well for its shareholders since LPH has been able to provide a constant dividend stream, measured in nominal terms (Table 1).

The signal being sent by the board through its dividend policy is that the company is stable and that the board is dedicated to providing predictable returns to the investors.

Table 1: Barbados Light & Power Financial Measures

Year	Revenues ($Bds 000's)	Net Profit ($Bds 000's)	Dividends/Share ($Bds)	Total Dividends Paid ($Bds 000's)
2002	241,904	15,308	.40	5,357
2003	272,490	10,736	.40	5,800
2004	301,593	26,816	.40	5,811
2005	339,231	15,389	.40	5,818
2006	361,653	30,366	.40	6,119
2007	397,636	58,350	.40	7,001
2008	473,310	31,716	.40	6,856
2009	415,392	27,455	.40	6,872
2010	508,139	45,646	.40	6,865

Source: Barbados Light and Power Holdings, Annual Reports

The LPH also continues to accommodate increasing demand and to expand its customer base, creating a strong trend for increased sales in the foreseeable future (Table 2).

Table 2: Growth of Barbados Light and Power Capacity & Demand

Year	Peak Demand (Megawatts)	Sales (GWh's)	Domestic Customers	Commercial Customers	Total Customers	Number of Streetlights
2001	130.4	735.0	90,194	12,938	103,132	23,600
2002	134.7	763.9	91,641	13,554	105,195	24,600
2003	141.6	805.9	92,809	14,423	107,232	25,417
2004	143.0	831.3	94,045	15,443	109,488	25,962
2005	154.2	992.8	95,223	16,520	111,743	26,666
2006	157.0	1,020.4	96,486	17,775	114,261	27,308
2007	162.4	1,049.2	97,801	18,857	116,658	27,846
2008	164.0	1,053.7	99,000	19,798	118,798	28,101
2009	165.7	1,068.4	99,748	20,874	120622	28,425
2010	167.5	1,078.3	102,407	19,699	122,106	29,046

Source: Barbados Light and Power Holdings, Annual Reports

On May 8, 2009 Barbados Light and Power Company Limited submitted an application to the Fair Trading Commission (FTC) for a review of its electricity rates. In January, 2010 the Commission approved a 10% rate of return with the requested capital structure of 35% debt and 65% equity. The newly guaranteed rate of return and the strong indicators pointing to continued growth made the company extremely attractive to potential investors, or for that fact, acquirers. Almost immediately after the FTC's decision, Leucadia sold its interests in LPH to Emera in May, 2010 affording Emera 37% ownership of the company and making them the largest shareholder.

The Company is headed by a Managing Director who is ultimately responsible for the operations of eight departments: Accounts, Administration, Customer Services, Distribution, Generation, Human Resources, Information & Communication Technology, and Marketing and Corporate Communications. LPH's departments are currently staffed by approximately 525 persons. Like shareholders, these employees can be viewed as stakeholders in the firm to whom corporate governance is highly important. Indeed, through the company's employee share purchase plan, many of the workers wear both hats.

The LPH's place as a cornerstone in the foundation of Barbados's development cannot be disputed. As Barbados has grown, the company has grown with it. Like other small economies in the age of globalisation, Barbados finds itself competing fiercely to attract foreign direct investment. In considering possible destinations for investment, multinational companies look not only at a country's human capital and political stability, but the degree of infrastructural support a country can offer its enterprises. For many industries, the ready and reliable availability

of power is an extremely important factor in determining a location to do business. The Global Competitiveness Report 2009-2010 rated Barbados 24th worldwide with respect to the quality of electricity transmission. The quality of service provided by the LPH allowed Barbados to be ranked above countries such as Ireland and Australia, and higher than any other Caribbean country. In fact, among Barbados's neighbours, the highest ranked was Trinidad and Tobago in 49th position. The LPH is therefore more than a utility; it can be considered a source of competitive advantage for Barbados in the global marketplace. Hence, in a reversal to what obtained in the period immediately following the 1930's, the availability of electricity could be a driver for Barbados's development rather than one of its consequences.

SECTION 3: Literature Review

Corporate Governance

Clarifying the Concept

Against the backdrop of numerous corporate scandals in recent years, corporate governance has become a focal point in the arena of corporate finance. Though heavily discussed and increasingly important in a global corporate environment growing in complexity, corporate governance is still an ill-defined concept for many. Typically, the concept of corporate governance is framed within the paradigm of principal-agent conflict and the reduction of agency costs caused by the separation of ownership and control. Agency costs were first identified in Berle and Means' (1932) seminal work which highlighted problems arising from the principal-agent relationship. In their model, agency costs result from the tendency of a firm's shareholders (the principals) to expend little or no effort in monitoring the activities of the firm's management (the agents) when share ownership is widely dispersed. The distributed nature of the share ownership implies that each shareholder has a relatively minor stake in firm ownership and is thus less likely to expend the effort required to closely monitor the firm's activities. Thus, although the firm's management is employed to act in the best interests of the owners, to the extent that monitoring is reduced, the managers are free to act with discretion in pursuit of their own interests. This can lead to sub-optimal performance of the firm and therefore be seen as a cost. The degree of discretion afforded to management may therefore be a determinant of the level of agency costs incurred by a firm. Thus, corporate governance focuses on effective

mechanisms to deal with the principal-agent conflict, thereby reducing the level and impact of agency problems.

Jensen and Meckling (1976) define agency costs as the sum of the monitoring expenditures of the principals when there is separation of ownership and control, the bonding costs expended by the agent to guarantee that his actions will not harm the principal or ensure that the principal is compensated if he does, and residual loss attributed to divergence in the interests of the agents and principals. Effective corporate governance aims to reduce the residual loss due to disparate interests. Tirole (2006) provides a means through which to define and categorise agency costs. He attributes agency costs to insufficient effort, extravagant investments, the practice of entrenchment strategies and self-dealing.

Hart (1995) extends the framework for corporate governance by explaining the separation of ownership and control though contracting costs. He asserts that the only way for business owners to completely control the actions of their management is via a contract that explicitly outlines the management's course of action for all possible decisions that need to be made in the business's day-to-day operations. Since this is not only extremely costly but impractical, some degree of residual control will lie outside of the contractual arrangement between the principals and the agents. Corporate governance focuses on managing that residual control. Therefore, a governance mechanism can also be viewed as a structure for decision-making where management's response is not contractually defined. This perspective of corporate governance is applicable not only in widely held public companies, but also in private corporations managed by their owners where there is no separation of ownership and control. Even in these companies, a means by which decisions are made in the best interests of the corporation and its owners must still exist.

Shleifer and Vishny (1997) define corporate governance as the process through which the suppliers of finance to corporations assure themselves of a return on their investment. They argue that some effective corporate governance systems exist since there are capital markets where large amounts of capital flow freely to business and the profits are repatriated to the financiers. Shleifer and Vishny point out that effective corporate governance systems are supported by, if not shaped by, the legal framework in which they develop. The converse also applies; where there is little legal enforcement of stakeholder rights, corporate governance tends not to be effective. This perspective coincides with Hart's view in that contractual arrangements are only effective to the extent that they can be enforced. Even though Hart emphasizes that contracts cannot be complete, they still remain the starting point for defining the relationship between principal and agent, and are therefore integral to establishing a governance arrangement.

A fundamental tenet of corporate governance involves safeguarding the interests of those who have a stake in the company's operation, primarily through incorporating their perspectives in the company's decision-making and strategy. The definition of "stakeholders" has expanded from solely involving "shareholders"; employees, suppliers, consumers and the society in which the firm operates are increasingly thought to be among a firm's stakeholders (Freeman 1984). It is increasingly being recognised that without the committed participation of such stakeholders, the performance of the company would be jeopardized, thereby impacting negatively on the return on invested capital (Wallace 2003, Martin et al. 2009). In subscribing to the stakeholder paradigm, a firm's corporate governance needs to accommodate the expanded body of stakeholders in order to be considered effective. A company's commitment to corporate social responsibility should therefore factor into an assessment of its corporate governance practice (Dick-Forde 2006)

A broader definition of corporate governance is also provided by the OECD Glossary of Statistical Terms website (2010) which refers to corporate governance as the procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making. Also, the Financial Times Lexicon website (2010) views corporate governance as the way a company is managed, in terms of the institutional systems and protocols meant to ensure accountability and sound ethics. The concept embraces a number of issues including disclosure of information to shareholders and board members, remuneration of senior executives, potential conflicts of interest among managers and directors, supervisory structures, etc.

Common Corporate Governance Mechanisms

Several mechanisms exist to implement corporate governance. Perhaps the most ubiquitous and important of these is the board of directors. Conceptually, the board comprises parties that represent key stakeholders, ensuring the stakeholders' perspectives are considered in important strategic decisions for the firm. Decision-making aside, what makes the board particularly important is that it is the mechanism through which management is directly governed and monitored by those for whom the outcomes of management's decisions matter most. It is, so to speak, where the rubber meets the road. A board's effectiveness can however be affected, if not determined, by the number, composition and motivation of its members as well as the dynamic at play among them.

What boards do and what boards should do are not necessarily one and the same. This disparity is explored by Adams et al (2010) in their survey of the literature on the roles of boards and directors in corporate governance. What directors and boards should do are contractually defined and may vary from firm to firm. However, based on descriptive studies covered in the survey, there are some functions that seem to be considered commonplace for directors that sit on boards.

Firstly, directors provide “advice and counsel” for executive management in the firm. Although it is unclear what “advice and counsel” constitute, the implication is that directors generally act as sounding boards for the ideas of the chief executive officer (CEO) and senior management. Additionally, there are some cases where directors can provide expertise in areas where they are qualified. The activity that most directors agreed was involved in their role on the board was to assist with developing the strategy of the company. It is noteworthy that despite the board being designed as an instrument of corporate governance, in the minds of the directors strategic planning superseded providing monitoring and discipline. To the extent that boards do provide discipline, the survey suggests that the mechanism for doing so is unclear. Apart from dismissing errant managers, there is also an assertion that discipline stems from the firm’s management knowing that they must periodically appear before the board to justify their performance.

There have been cases where boards are captured by management, rendering them ineffective in not only monitoring management, but also in acting to discipline management when necessary. Indeed, the fact that the studies indicate that monitoring and discipline were secondary activities for board members suggests that a certain level of passivity can be ascribed to the board’s members. When management controls the board, rather than vice versa, the situation leads to the famous question: *“Quis custodiet ipsos custodes?”* ("Who watches the watchmen?"). Adams et

al (2010) however suggest that this passivity may be a thing of the past. This is evidenced by CEO dismissal probabilities trending upwards in some of the studies covered in their survey.

The size of the board has been identified as a determining factor in its effectiveness. In a study of board of directors in five European countries, Conyon and Peck (1998) found an inverse relationship between board size and the returns to shareholders. Indeed, it has been argued that large boards increase behavioural problems (Lipton and Lorsch 1992), negatively impacts organisation, cohesion and communication (Forbes and Milliken 1999) and create large coordination and process problems (Jensen 1993). Conversely, others have contended that larger boards provide greater diversity of skills and thus can better restrict the opportunistic behavioural tendencies of management (Forbes and Milliken 1999, Smith et al. 1994) and opportunities for adequate representation of stakeholder groups (Van den Berghe and De Ridder 2002). For example, in Germany direct representation by employees in the governance of corporations is enshrined in the law as part of the German social governance model. In the two-tier board model of Germany, 50% membership of a supervisory board must come from the ranks of ordinary workers through trade union representation (Kerr 2004).

The issue of CEO-Chairman duality has also been the subject of some discussion in the literature. Such a dual role is viewed by many as affording CEOs too much control at the expense of other parties, including non-executive or outside directors (Goyal and Park 2002, Adams et. al. 2005). To mitigate the consequent agency and related problems, some authors have recommended a cessation of this practice (for example, Jensen 1993). Considering the variety of factors contributing to a board’s function, evaluating a board’s effectiveness in ensuring corporate governance is a complex endeavour.

The Audit Committee has been identified as another internal control mechanism which can reduce agency problems in companies. Typically, such a committee comprises board members, external auditor and internal auditor, and it plays an important role in ensuring the veracity and completeness of financial information. The success of the Audit Committee depends crucially on the expertise and knowledge of the board members sitting on the committee. According to Rittenburg and Nair (1993) and the Blue Ribbon Committee (1999), members should possess expertise in the important areas of accounting, auditing and law. The board will therefore be better able to interpret the information provided by management and provide more effective monitoring.

Proxy fights are another form of corporate governance. Despite agency problems being at the heart of the theory surrounding governance, there are instances where small shareholders take a more active role in enforcing their control of the business. If the board's performance is inadequate shareholders can move to replace its members, typically by a proxy fight. An aggrieved or dissident shareholder or shareholder group can seek either election to the board directly or through preferred candidates and try to persuade a majority of shareholders to support them. Their ultimate goal would be to remove the management which they view to be unsatisfactory. The success of proxy fights depends not only on whether the dissident shareholders are trusted by other shareholders but also on costs and feasibility. To aid in a proxy fight, shareholders should have good channels of communication and the fight between shareholders and management must be fair.

Another mechanism to alleviate the agency problem in corporations is management compensation. The aim here is to achieve an alignment of shareholder and management interest through the offer of appropriately designed incentive contracts to management. Typically,

management compensation, including salary and bonuses, should be significantly related to the performance of the company or shareholder returns (Coughlan and Schmidt 1985). Other writers, for example (Holmstrom 1979), went further suggesting that CEOs compensation should not only be based on changes in shareholder wealth but on other factors that provide insights into the choices made by the CEOs. Such factors may include accounting measures of firm’s performance and measures of relative performance based on other executives in the industry or market. Though the practice is to use various accounting measures to assess the stewardship of managers, such an approach might be counter-productive since it may provide managers with incentives to manipulate the accounting system and also to reject projects with favourable Net Present Values for those of lesser values but with larger immediate accounting profits (Gibbons and Murphy 1990); that is, managers may have an inordinate focus on elevating the share price rather than creating long-term value for the company. Others have noted that managers have a disconcerting level of influence in determining their remuneration (Bebchuk and Fried 2004), rendering management compensation a largely ineffective corporate governance mechanism.

The presence of large shareholders in a firm can also serve as a corporate governance mechanism. Shareholders with large stakes in a firm are much more likely to monitor the firm’s management and performance than highly dispersed minority shareholders. Thus, to the extent that large shareholdings serve to concentrate the share ownership, dispersion in share ownership is reduced and the propensity to monitor management is increased, suggesting a reduction in the likelihood of agency costs. Owning a large proportion of the firm allows these shareholders significant voting representation in the boardroom. In theory, all owners of the firm should have common interests, particularly maximising the firm’s value. Thus, having management closely monitored by large shareholders should redound to the benefit of minority shareholders as well.

Unfortunately, this is not always the case. There are cases where the interests of large shareholders do not coincide with those of other shareholders. For example, where large shareholders have interests in other businesses, they may influence management to pursue arrangements with those businesses on preferential terms that are suboptimal for the firm. The disenfranchisement of minority shareholders and other stakeholders is always a concern when large shareholders exert significant influence on a firm's operations.

Jensen (1986) proposes that capital structure can also be an effective corporate governance mechanism. He posits that managerial discretion is facilitated by large amounts free cash-flow within an organisation. The more free cash that managers have at their disposal, the greater the opportunity they have to allocate the firm's funds injudiciously. Jensen asserts that having debt obligations focuses management on generating a revenue stream to honour the firm's obligations. The greater the proportion of debt in a firm's capital structure, the greater this influence is exerted and the more focused management should be on making the firm perform. There is a threshold beyond which the dangers of debt, such as bankruptcy costs, can outweigh its benefit. Thus, although debt may serve to focus the efforts of management, it should not be over-utilised. Another downfall of using capital structure as a corporate governance mechanism is that debt incurs its own agency costs (Jensen and Meckling (1976)).

Large creditors can also play a role in ensuring corporate governance. Their effect is almost tantamount to the combination of large shareholders, in terms of the influence they can exert on management, and debt overhang in reducing free cash flow and focusing management on the firm's performance. However, the interests of creditors and owners do not necessarily align and the influence of large creditors may in fact harm rather than help the firm's owners. Where creditors of the firm take equity positions in the company that allow them access to the

boardroom, they may influence the firm to pursue strategies that secure cash flow for repayment rather than strategies that are riskier but result in more value accruing to the firm's owners.

Leveraged buyouts (LBO's) are another debt-dependent form of corporate governance mechanism. LBO's occur when all of the public stock in a company is purchased and the firm goes private. Usually this transaction involves the firm's management, a specialised buyout firm, and other investors. The buyouts are regarded as leveraged since the share purchase is usually financed by debt. One effect of this transaction is that the managers, now with an equity stake in the company, have a higher incentive to ensure that the company performs. The debt incurred as a result of the buyout also serves as an incentive to goad managers into maximising company performance. Although highly incentivised, management's performance is no longer exposed to the scrutiny of the market. However, this does not mean that the firm's performance is no longer closely monitored. The buyout firm that finances the going private transaction is typically heavily involved in the monitoring of the firm's activities in order to safeguard its returns.

Another corporate control mechanism gaining considerable attention in the literature is takeovers. The term "takeovers" is sometimes used in a collective manner and subsumes hostile takeovers, mergers and acquisitions. Within the context of corporate governance, takeovers are associated with the imposition of market discipline on underperforming firms. Typically, the threat of a takeover should serve as an incentive for incumbent management to pursue policies to improve the financial performance of the company, while an actual takeover will result in a new controlling shareholder, a newly constructed board of directors, a change in management and a change in strategic direction of the company. In this regard, Jensen (1986, 1988) remarks that takeovers occur because incumbent managers are incompetent and because changing technology or market conditions necessitate a major restructuring of corporate assets. He also credits the

external market with motivating the efficient utilisation of resources and protecting shareholders when the corporation's internal controls and board level control mechanisms are slow, clumsy or break down entirely.

However, there may be other reasons for takeovers. Indeed, Jenkinson and Mayer (1994), Franks and Mayer (1996), and Argawal and Jaffee (2003) found little evidence that takeovers were motivated by managerial failures on the part of target firms. DePamphilis (2003) contends that other compelling reasons for takeovers include the search for economies of scale and scope, to achieve synergies, to diversify, to achieve market power, to realign company strategy with the dynamic environment, out of managerial hubris, to achieve cheap assets, to get tax advantages, to improve on monopoly power or simply because of misevaluation of the target firm.

Other writers have questioned the effectiveness of the threat of hostile takeovers as a corporate governance mechanism since several defences have been established to thwart hostile takeover attempts. For example, Hellwig (2004) noted that after 1989 it was almost impossible to execute a takeover without the complicity of the target board. Implicit in this trend is the fact that the signals that once triggered hostile takeovers may actually now result in seemingly amiable mergers and acquisitions since potential raiders that monitor the market for underperforming firms can no longer easily move to forcibly acquire them. Furthermore, takeovers tend to be successful only through bribing managerial consent through the provision large severance payments. Hence, not only has the threat of hostile takeovers more or less ceased being a credible source of market discipline in the enforcement of corporate governance, like share-based incentive pay, it may even incite agency conflicts rather than eliminate them. Thus, takeovers may be more corrective than preventative and therefore allow for losses in shareholder value before becoming effective.

Corporate Governance in the Caribbean

Like other areas in the world, the Caribbean has reason to be concerned about failures of corporate governance. This is not only because the Caribbean financial systems have been marred by failures in corporate governance, such as the financial crisis in Jamaica in the 1990's, the demise of the Stanford International Bank and failure of CL Financial Limited and its subsidiaries. In the age of globalisation, increasing financial liberalisation has resulted in fewer restrictions on international flows of capital. Effective corporate governance can be a differentiator that allows Caribbean firms to compete globally for investment. Caribbean countries are small, comprise small communities and have open economies that are generally heavily reliant on either agriculture or tourism. Therefore, aspects of corporate governance that relate to corporate social responsibility are extremely important to Caribbean societies, especially as it relates to the countries' natural environment. The exploration of LPH's corporate governance is best undertaken by establishing the prevailing corporate governance climate in LPH's business environment, that of Barbados.

Unfortunately, the literature on the corporate governance of Barbadian companies is quite sparse. Not much work has been done to contribute to insight on the Caribbean corporate governance situation either but the available literature on the Caribbean may serve as a good proxy for the nature of corporate governance in Barbados.

In the literature there is consensus that there is room for improvement. The Caribbean Trade and Investment Report (2005) states:

"*Up until recently there was no formal mandatory framework of corporate governance in any of the territories with often poorly administered Companies Acts being the major drivers……...The*

weakness is both at the self-regulatory and governmental levels and with respect to all aspects of the business relationship between shareholder and management; between management and the board of directors; and between the firm and consumers and the general public"

Typically, the stock markets in the Caribbean are thinly traded and shareholders tend to be very passive in their approach to the market (Kerr 2004, Kerr 2007). There seems to be little focus placed on share price and, unlike the Anglo-Saxon corporate governance system, the market for corporate control is not powerful and takeovers are infrequent. Khan and Russell (1996) also note that corporate governance in the Anglo-Saxon system depends on shareholders being able to easily exit their investments in underperforming firms, allowing them to "vote with their feet". The absence of liquidity in regional stock exchanges further undermines the development of any governance mechanisms that constitute a market for corporate control.

Additionally, since there is a significant concentration of share ownership, it would be expected that the separation of ownership and control resulting in agency problems and characterised by agency costs are less. These circumstances lend themselves to at least one corporate governance mechanism, the influence of large shareholders. However, in the Caribbean the effectiveness of this mechanism seems questionable. Kerr (2007) suggests that the concentration in ownership has not reduced the level of management control exhibited in Caribbean firms and that together, ownership concentration and significant management control remain the most significant impediments to corporate governance in the Caribbean. Indeed, he goes on to state that safeguarding the rights of minority shareholders is a major concern in the Caribbean. Thus, regular shareholders in the Caribbean seem to be restricted in exerting control on the firms they own by either raised hands or moving feet.

The board of directors is another corporate governance mechanism explored in the literature on corporate governance in the Caribbean. Apart from the aforementioned issues suggesting that the boards are unduly influenced by large shareholders and/or management, a little work has been done to explore the impact of other factors relating to the efficacy of Caribbean boards. Kerr (2004) considers Jamaica's corporate governance environment as the most advanced one in the region and uses it as a representative model for the Caribbean. He identifies the topics in corporate governance that are the most highly discussed globally and relates them to the Caribbean context. Some of the topics that refer to the board of directors include:

Board Size - Smaller boards are thought to be more focused and efficient. However, fewer members may mean less control exerted over management and the absence of some stakeholders' perspectives. Kerr indicates that Caribbean boards are getting smaller, in line with global corporate governance trends.

CEO-Chairman duality– Such a scenario represents an intersection of the leadership of the board and management and suggests a lack of independence between the two. Kerr finds that over 90% of the companies he surveyed for his study exhibited separation in these roles, implying independence between the boards and executive management.

The proportion of non-executive directors- The higher the proportion of non-executive directors, the less influence management is thought to have on the board's operations. Kerr indicates that there is a shift in the Caribbean towards a larger proportion of non-executive directors on corporate boards, ostensibly reducing managerial discretion.

Nonetheless, even though these aspects of Caribbean boards seem to be moving towards internationally accepted best practices, the literature is clear that the board's effectiveness in the

face of the influence of large shareholders and elevated management powers continues to be the issue central to Caribbean corporate governance.

Takeovers in the Caribbean

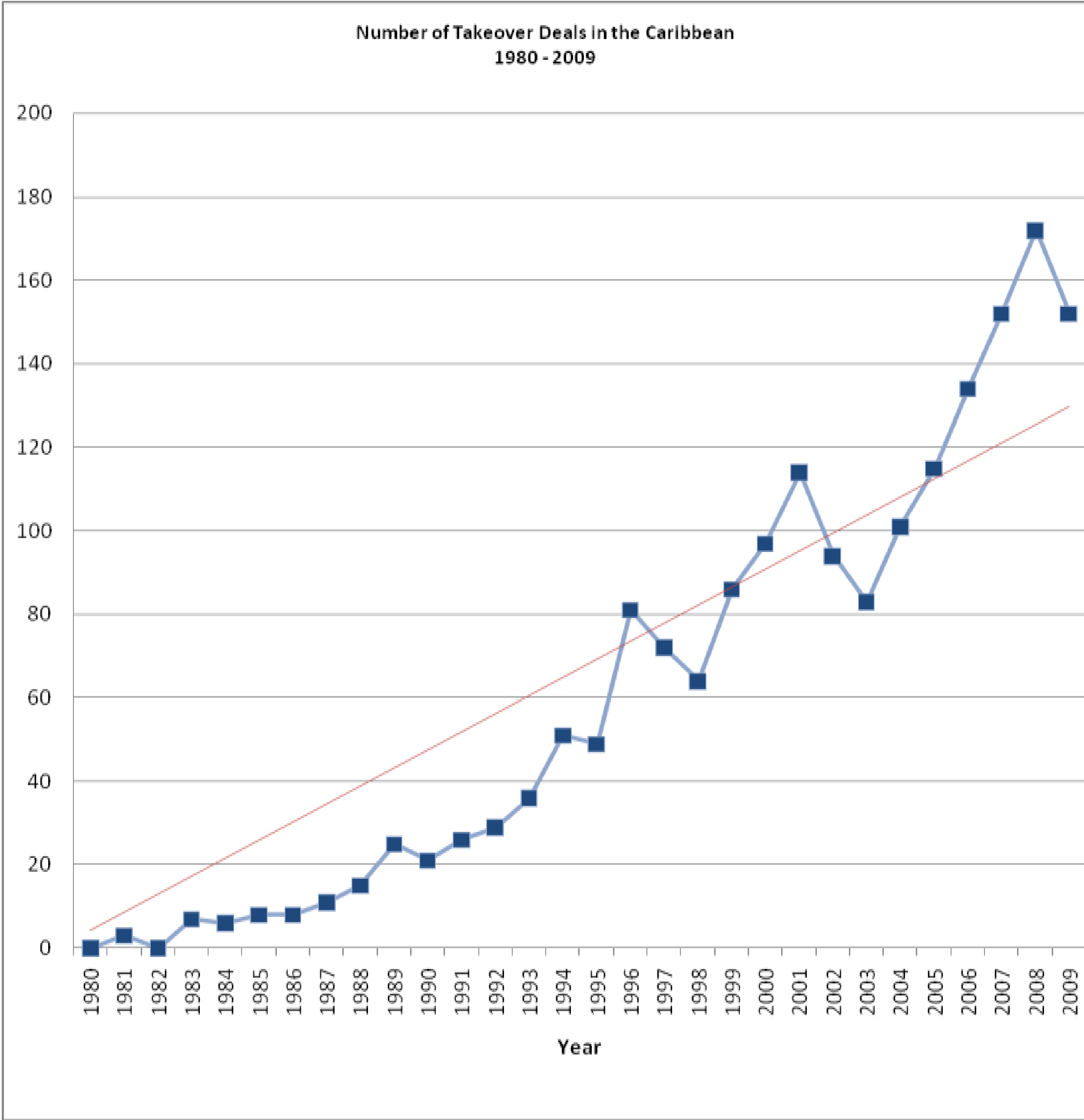
Similar to the studies on Caribbean corporate governance, the literature on takeovers in the Caribbean is far from voluminous. A possible contributory factor to this situation is the infrequency of takeovers in the Caribbean. Russell and Khan (1998) at the time of their study noted that no mergers whatsoever had taken place in Barbados even though it was one of the four Caribbean countries where active share trading was practiced. Acquisitions are the dominant form of takeovers in the Caribbean, mergers are few and hostile takeovers are practically non-existent (Elebourne and Rambarran 2004). Caribbean equity markets are nascent at best when compared with those of developed countries and there is not an effective market for corporate control to facilitate hostile takeovers. Takeovers in the Caribbean may also be characterised by the frequency of acquisitions initiated by local, regional or international bidders, respectively.

Globally, two of the many economic factors that impacted the environment for takeovers and helped to spur activity were increased global competition for domestic and international markets, and deregulation. Kahn and Russell (1996) specify the breaking up of the Soviet Union as the source of increased competition among small economies, such as those in the Caribbean, for scarce investment resources from the international financial community.

Historically, the evolution of takeovers in the Caribbean began with intense acquisition activity during the 1970's when regional governments undertook a process of nationalisation of what they believed to be the critical sectors of their economies. However, following the debt crisis of the 1980s and the resultant economic difficulties of many of the Caribbean economies, a reversal

of strategy ensued at the behest of multilateral financial institutions. Russell and Khan (1998) are of the view that the liberalisation of Caribbean economies opened up the possibility to mergers and acquisitions. They refer to the takeover activities which commenced around the early 1990's as the first wave of Caricom mergers and acquisitions. Their assessment of the upsurge in takeover activity as well as its root cause has some merit. From 1980 to 1989 there were only 83 mergers and acquisitions in the Caribbean. In fact 1980 and 1982 were completely bereft of takeover activity. In the 1990's there was a marked increase in activity, with 515 takeovers. In the years 2000 through 2009 the Caribbean witnessed 1,214 mergers and acquisitions (**s**ee **Figure 1**).

Figure 1 – Number and Trend of Takeover Deals in the Caribbean (1980-2009)



Source – Salina (2010)

As a Caribbean country having one of the more active takeover markets, the nature of Trinidad's experience with takeovers may be instructive for the experience of the wider Caribbean. From 1985 to 2009, Trinidadian companies were involved in 75 takeovers. However, 39 of those takeovers resulted in Trinidadian firms being acquired by foreign companies, with the first of these acquisitions occurring in 1990. This strongly supports the assertion that financial liberalisation beginning in the early 1990's paved the way for an increase in takeover activity across the Caribbean, characterised by foreign companies acquiring domestic ones.

SECTION 4: Discussion and Analysis

Corporate Governance and the Case of Light & Power Holdings

There is a growing emphasis on a stakeholder view of corporate governance worldwide, causing companies to exhibit a greater sense of corporate social responsibility. The stakeholder view differs from the long-held shareholder view in that it not only incorporates the considerations of the firm's owners, but also its employees, suppliers and customers, as well as the firm's impact on the environment and society in which it operates. LPH's clearest demonstration that it subscribes to this perspective of corporate governance would be to employ alternate sources of energy to produce electricity.

In the last decade, oil prices have not only risen sharply but have also tended to undergo periods of volatility. Importing large amounts of expensive oil would have a severe adverse impact on a small open economy such as Barbados's, particularly in recessionary times. With LPH being the sole supplier of electricity on the island, it becomes a matter of national significance that LPH is able to diversify its means of generating power. LPH is currently able to pass any increased fuel costs to its consumers so its operational costs remain relatively unaffected by escalations in fuel costs in the short term. However, there have been societal consequences; its customers have been severely battered by rising electricity costs. In response the government has established a fund specifically to provide financial relief for those struggling to cope with the cost of electricity. Any endeavour by LPH to reduce its reliance on oil would have a desirable impact on the natural environment as well.

A strategy embracing alternative energy sources would also benefit LPH since rising prices will only serve to curb demand and dampen the company's prospects for growth. In fact, a Senior Company Executive indicated in October, 2011 that demand for electricity year-on-year had receded by 4%, the first decline for 37 years. In the past, initiatives to realise diversification included a project to build a wind farm in the north of the island. To date, the project has still not been completed despite beginning in 2007. Emera has indicated its desire to continue, if not intensify, the work to find cost effective alternative energy solutions for LPH. In this regard, LPH has embarked on a pilot programme that allows customers who generate their own electricity to sell any excess back to LPH at a rate 1.8 times the fuel clause adjustment or 31.5 cents/kWh, whichever is greater. It is hoped that LPH will adhere to the modern view of corporate governance since customers, company and country all stand to benefit.

Leucadia, formerly the largest shareholder in LPH, is a holding company engaged in diversified businesses in the United States. The company is involved in manufacturing, health care services, telecommunications, real estate, winery, residual banking and lending activities. At the time of Emera's tender offer, the companies comprising LPH were The Barbados Light & Power Company, LPH Telecom Ltd and LPH Real Estate Inc. The change in the profile of LPH's largest shareholder from a diversified holding company, Leucadia, to a specialised energy industry player, Emera, was quickly mirrored by LPH's strategy. Indeed, in July, 2010 shortly after Emera assumed the mantle of largest shareholder (not to be confused with *majority* shareholder since they only held 38.44% of LPH's shares at this point, not a controlling interest), LPH divested its 25% interest in Caribbean Fiber Holdings LP (CFH), a Delaware Limited Partnership in the U.S.A., at a cost of BDS$21.6 million. The divestiture was facilitated through LPH Telecom, a subsidiary of Light and Power Holdings, entering an agreement to restructure

the partnership with CFH. According to LPH's 2010 annual report, under the terms of the restructuring:

"LPH Telecom was paid a special distribution for the original cost of Bds$21.6 million in exchange for its 25% economic interest in the partnership. As a result, LPH Telecom was left with a sharing ratio of 0% in the partnership and ceased to have any right to future distributions or any obligations to make any further capital contributions to the partnership."

In the 2010 annual report, the board also indicated that the focus of LPH would now be narrowed to the energy industry, its core competency and that of its new largest shareholder Emera. Notably, shareholders were required to vote to form a holding company in support of the previous strategy, but minority shareholders were not involved when there was a fundamental change in the company's strategy. Another consequence of Emera's ascendance to largest shareholder was to end a situation where LPH was incurring losses based on its involvement in a company of which LPH's former largest shareholder owned 75%. Whether Emera's change of strategy represents an affront or an advantage to minority shareholders, the scenario alludes to the pervasive influence of large shareholders in the corporate governance framework, consistent with observations made in previous studies on Caribbean corporate governance.

Frequently, issues surrounding governance in takeover scenarios are associated with the board's response to the takeover bid. Acquisitions tend to work in favour of incumbent shareholders since bids generally exceed existing share prices to induce shareholders to sell (Jensen 1984, Mulherin and Boone 2000, Georgen and Renneboog 2004). Even though in most takeover offers shareholders may enjoy a default premium by selling shares, it can be argued that the board's remit as a function of profit maximisation is to ensure that the firm's owners receive the best

offer and that they are prevented from selling otherwise. Consequently, there will be cases where the board will correctly advise owners to resist takeover attempts. The board can also embark on an active takeover defence strategy to deter the bidder and avoid being forcefully acquired. As previously discussed, management may also be motivated to thwart takeover attempts for reasons other than preserving the interests of the firm's owners.

Pursuant to Emera's public bid on December 10, 2010 the board issued a communication to shareholders on December 12 advising them that they would evaluate the bid independent of Emera's representatives on the board and return with a recommendation within days of the bid's expiration. The LPH board did not initially resist Emera's bid but commissioned KPMG to conduct a valuation of the business so that it, and presumably the shareholders, could place the bidding price in context. They urged shareholders not to act until they received the board's recommendation. On January 5, 2011 the board once again wrote to its shareholders with a recommendation to accept the bid. The board also provided a report by KPMG outlining details of an independent valuation that the board had engaged them to complete. KPMG arrived at a valuation $33 per share, $8 per share in excess of the bid presented by Emera, yet they found Emera's offer fair. Nonetheless, KPMG offered no opinion on whether it should be accepted, that was solely the board's responsibility. The LPH board subsequently recommended that shareholders accept the price offered, despite it falling significantly short of the share price that was determined by the independent valuation. Though price is not the only consideration when contemplating accepting a takeover bid, it certainly is an important one. Did accepting an apparently sub-optimal price necessarily represent a failure of governance on the part of the board of LPH?

Not necessarily. First of all, KPMG was engaged not only to conduct a valuation of LPH's shares, but to determine whether the offer price was a fair one after juxtaposing it with the price from their valuation. Regardless of the price coming out of the valuation, after the offer was adjudged a fair one the board would have been obligated to advise shareholders to act accordingly. This assumes that the independent opinion was not influenced by the board and raises the question of why the offer would be found to be fair despite of the large disparity between the bid price and the valuation price.

The board's communication with shareholders is another aspect of the governance considerations in a takeover scenario. The separation of ownership and control that underpins agency problems represents asymmetry in the availability of information to owners and managers. Thus, the flow of information from management and board to shareholders is an important facet of corporate governance, even in a takeover scenario. Depending on the mode of the acquisition, strong communication from board to shareholders is also integral to eliminating free rider problems that could hamper a favourable acquisition. The board seemed to be at pains to portray transparency and thoroughness in the process that would lead to their decision, even in its first communication before any recommendation was made on its part. It was also extremely proactive in ensuring that shareholders were apprised of the bid shortly after it had been made. However, despite its efforts the board's communication in the context of its corporate governance implications merits further exploration. From the perspective of Levit (2011), freely disclosing information to shareholders can be an indication that the board is a biased one, depending on the extent of shareholder dispersion, if that information leads to shareholders accepting a sub-optimal bid. Such an assertion complicates the analysis of the corporate governance aspects of LPH's board's

communication efforts during the takeover bid since they may have been caused by either a dutiful or a biased board.

An examination of the market's response to developments at LPH is indicative of the ineffectiveness of market-based corporate governance, a view previously expressed by writers on corporate governance and takeovers in the Caribbean. The market's reaction to the news that LPH was granted a significant increase in its guaranteed rate of return from 6.7% to 10% was very minimal ($11.52 start of January 2011, $11.53 end of January 2011). It was also characteristically unresponsive to the news that Emera took over from Leucadia as LPH's primary shareholder ($11.60 unchanged for the month of May 2010).

Some features of the composition of LPH's board of directors bear mention in the discussion of corporate governance at LPH. In line with international and regional trends, the board's size has decreased from 12 members in 2003 to 9 members in 2010. However, this has been as a result of a net reduction in local, non-executive membership. There is no Chairman-CEO duality but another type of duality exists. In the period 2003–2010, a representative of the largest shareholder has assumed chairmanship of LPH's board of directors. Having a representative of the largest shareholder at the board's helm can represent good governance. Conversely, it could undermine corporate governance due to difficulties associated with divergent objectives of large shareholders, in LPH's case foreign companies, and minority shareholders, in LPH's case local citizens. Collectively, these attributes of the board's composition point to increased control by management and the majority shareholder, conjuring up the spectre of the dark side of Caribbean corporate governance.

Takeovers and the Case of Light & Power Holdings

There is extensive yet inconclusive work on the effect of takeovers on bidder firms. In general, it is thought that shareholder value is particularly difficult to materialise for bidding firms particularly in hostile takeovers (Kaplan and Weisbach 1992, Georgen and Renneboog 2004, Sundaram and Inkpen 2004). However, the focus of this case study is not a bidding firm, but an acquired one.

The typical post-acquisition changes did not occur at LPH when Emera officially acquired controlling interest in LPH through purchasing most of the company's shares. There was no change of the board's composition, the company's existing strategy or in the company's management. This was all done previously when Emera became the largest shareholder in May, 2010 many months prior to succeeding in their takeover bid. Emera's representatives assumed positions on the board, one as chairman. Both LPH's management and its strategy changed shortly after. A new managing director was appointed in July, 2010. LPH quickly divested its shares in its telecoms investment after Emera assumed control of the company, signalling a significant change in LPH's strategy and alignment with Emera's. It is telling that the outcomes of a firm acquiring a 38% stake in LPH are indistinguishable from those expected of a successful takeover. *De facto*, the two appear to be one and the same.

Considering that Emera assumed a significant amount of control without actually having the number of shares that should confer the degree of control they enjoyed, the question has to be asked: how would Emera benefit from purchasing more shares in LPH? The answer to this may lie in examining how they benefitted from their position as largest shareholder. Indeed, although most acquiring firms can only hope to realise the benefits that drive them to make a takeover bid,

Emera's pre-existing position allowed them a degree of certainty in the benefits they would realise after successfully acquiring LPH. Ironically then, the extent of the takeover's success might be evaluated by aspects of the firm's performance that took place before the takeover bid was even raised.

Barbados is the home of the third-highest number of Canadian offshore companies because of its double-taxation agreement with Canada. One advantage of this agreement is lower withholding tax rates and lower tax rates on dividends when repatriating funds from the offshore entity compared with a country where no such agreement exists. The advantage of having a holding company in Barbados is even greater since any of its subsidiaries in countries also having a double-taxation agreement with Barbados can repatriate the profits to the parent through the holding company at a much lower rate than doing so directly to the parent in the absence of preferential tax rates. In order for a company to be eligible for the terms of the agreement, it must have residential status in Barbados which is determined by the degree of ownership and control. Emera may not have been able to access the benefits of the agreement with a 38% stake in LPH, but can more easily demonstrate ownership and control after increasing their holdings to approximately 80%.

On October 4, 2011 LPH announced that it had acquired Emera's shares in LUCELEC, the St. Lucian electricity company in which Emera formerly held a 19.1% stake. LPH's Managing Director indicated that this equity stake in LUCELEC would allow for sharing of skills and efficiencies which would benefit customers in both countries. It should be expected that the equity stake would achieve this by allowing LPH a representative seat on the board, thereby facilitating the free flow of ideas, input and strategy between the two entities. However, the Managing Director of LPH had already been appointed to represent Emera on LUCELEC's

board approximately 8 months prior on February 7, 2011 obviating the need for an equity investment by LPH to achieve the stated results. It is therefore unclear how the transfer of shares from Emera to its Barbadian subsidiary LPH would accomplish the desired objectives. It is noteworthy that St. Lucia does not have a double-taxation agreement with Canada but, through Caricom, has one with Barbados.

Emera's acquisition of LPH can be classified using the frameworks from the takeover literature. One of the major drivers and measures of takeover success is the realisation of synergy. Synergy is the positive incremental net gain through a merger or acquisition of two firms, and may be operational or financial (Damodaran 2009). Operational synergy allows firms to increase their operating income, increase growth, or both; while with financial synergy, the payoff can take the form of higher cash flows or a lower cost of capital (discount rate). Enough time may not have elapsed since Emera acquired majority interest in LPH to judge if any synergies have been achieved subsequently. However, since acquiring the role of largest shareholder seems for all practical purposes to represent a virtual acquisition of LPH, synergies may have been manifested from that point onwards. Those synergies may have been one of factors inducing Emera to make a formal bid to acquire LPH.

Much of the literature on takeovers is devoted to the premise that they can remedy, if not prevent, agency costs due to mismanagement. Underperformance does not seem to be the motivation for Emera's takeover since LPH's operations were already being significantly influenced by Emera. Ostensibly, Emera would not have attempted to acquire the company because they believed they were not running it well. In keeping with the established parallel between Emera's initial incursion into LPH as a large shareholder and an actual acquisition, on the point of management it is perhaps notable that a new managing director was appointed

shortly after Emera assumed their position on the board. In the classical literature on takeovers, underperformance is detected by the market through a company's share price. However, given the inactivity on the local exchange, share price would not be a good indicator of a domestic firm's performance. It is therefore difficult to establish that LPH was underperforming using its share price as a reference.

The transaction can be classified as a strategic one and there is the potential for operational synergies to accrue to Emera, since the acquisition presents them with opportunities for both increased income and growth, and reduced costs. LPH shows strong indicators for constant growth given its steadily increasing demand year-on-year for the past decade. The successful application to increase LPH's rate of return to 10% just prior to Emera's buyout of Leucadia's shares and subsequent tender offer represent an opportunity for LPH to increase its operating income. The financial results for 2010 would have confirmed for Emera that these benefits could be realised. LPH's net operating income rose to Bds $45.6million in 2010, up from $27.5 million in 2009. Although there was a one-time boost to the company's income by divesting its interest in LPH Telecom, this accounted for only $7.5 million of the increased income. The remaining $10.6 million increase over the previous year's $27.5 million profit represents a significant boost in the company's financial performance. Even though an increased shareholding could not conceivably afford Emera significantly greater control over LPH's operations, it would definitely give them a greater share of the dividends. Thus, one synergy that would be realised post-acquisition would be an enhanced revenue stream.

The acquisition can be considered a horizontal one since both companies share an identical core business, that of generating electricity. Thanks to the change that Emera's influence brought

about in LPH's strategy, the link between the modes of operation and the objectives of the two companies has been strengthened.

Emera's acquisition of the LPH was an acquisition by stock which occurs when the shares of the target firm are acquired in an act of mutual exchange with the owners of the target firm accepting cash and/or securities for their shares. Emera publicly announced their bid to acquire any and all shares in LPH in December, 2010. The board of LPH duly requested that shareholders refrain from responding to the bid until they could make a recommendation on the offer but did not mount a takeover defence. Given that Emera was already the largest shareholder possessing 38% of LPH's shares, assuming controlling interest of the company would not have been a particularly difficult task.

There were some factors in Emera's favour at the time of the bid. In Barbados, challenging economic conditions were prevalent and the price offered was more than twice the market price available on the stock exchange. As mentioned earlier, in contrast to Emera's bid of $25.70 Barbados dollars, a shareholder could only receive $12.00 per share by selling on the local exchange at the time the bid was made. The economic conditions not only affected minority shareholders but institutional ones as well. In their most recent report for Barbados, Standard and Poor's had downgraded the country's credit rating to the brink of junk bond status because of concerns over its economic performance and outlook. The National Insurance Scheme (NIS), a government institution and LPH's second largest shareholder sold half of its shares to Emera. Although it is generally accepted that investments in a thriving local utility providing a steady revenue stream would be ideal for a national body charged with preserving pension income for its country's citizens, it is thought that economic circumstances, particularly the country's need for an injection of foreign exchange, led to the NIS disposing of the shares. By selling half its

shares and retaining the remainder that were now worth over twice their pre-bid value, the NIS made a substantial profit and technically without reducing the value of its LPH holdings in its portfolio. Coincidentally, the 13% sold by NIS was the exact amount for Emera to be able to demonstrate ownership and control of LPH. These factors suggested that shareholders large and small were likely to view Emera's bid favourably and pointed to a high probability that Emera would assume controlling interest in the company.

Emera's position on the board, particularly having a representative as the board's chairman, suggests that the remainder of the board would have had difficulty advising shareholders to reject the bid, let alone mount a takeover defence. Any takeover defence would require cohesive action by the target firm's board in the face of possible dissent by shareholders and intensified efforts by the bidder. Even though Emera's representatives took no part in the recommendation put forward by the remainder of LPH's board, their presence on the board may certainly have limited options available to the board in its response to the takeover.

Apart from potentially influencing the board and, being a large shareholder, requiring less shares to assume control of the company than an outsider would, there may be other economic reasons why large shareholders would have implicit advantages in launching a takeover.

If all shareholders had equal shares and equal information then presumably no one shareholder would be able to sell to the others because none of them would buy. All things being equal, there would always be equilibrium since they would all act identically based on the information they have. One can conclude that a shareholder being able to get his counterparts to sell means that he has a size and/or information advantage. Equal size means that the cost of monitoring relative to the share of control of the company and dividend revenue would be equal for all shareholders.

Size is a factor because smaller shareholders would have relatively higher costs due to monitoring for their share of control or revenue, and may therefore be more inclined to dispose of their shares relative to large shareholders because of their relatively higher costs of ownership. An information advantage speaks not only about costs but also potential gains. Thus, a shareholder with an information advantage is able to expend the premium required to buy from other shareholders since he knows he can receive returns whereas the other shareholders do not have this knowledge. There is a positive feedback loop in that large shareholders tend to know more through higher levels of monitoring, influence and availability of information. The Emera acquisition exhibits both sides of this disequilibrium. Emera was LPH's largest shareholder and was actively involved on the board and had significant access to information on LPH's operations.

There are characteristics of takeovers in the Caribbean that were replicated in Emera's acquisition of LPH. For instance, extrapolating the Trinidadian case to the wider Caribbean, this takeover contributes to the upsurge in the acquisition of domestic companies by foreign firms that began in the 1990's. For publicly traded Caribbean companies, persistent under-pricing of their shares due to an absence of liquidity on regional exchanges leaves them vulnerable to acquisition, particularly when the shareholding is widely dispersed. To the extent that shares are under-priced when traded, foreign firms are able to offer bids that smaller shareholders find attractive and are likely to accept. Rather than strengthening businesses by providing a source of capital and encouraging strong performance to stimulate commensurate share pricing, regional exchanges may actually be exposing publicly held companies to predation by making them vulnerable for takeovers. Ironically, it is the larger shareholders who are unwilling to part with their shares that may limit the frequency with which these acquisitions may occur.

The Convergence of Takeovers and Corporate Governance in the Case of Light & Power Holdings

Emera's acquisition of LPH allows for an exploration of the convergence of two essential topics in finance against a Caribbean backdrop: corporate governance and takeovers. Table **3** summarises the inter-relationships between the two topics based on the analysis of the case study.

Table 3: Inter-Relationship of Corporate Governance and Takeovers

How:	Influence(s)	Corporate Governance	Takeovers
Corporate Governance	→	*Not Applicable*	*Governance environment suggests that achieving large shareholding is tantamount to a successful takeover.*
Takeovers	→	*Takeovers can be corrective corporate governance mechanisms, even if not preventative ones.*	*Not Applicable*

Although strong corporate governance may be one of the features that attract international firms to potential acquisitions in emerging markets (Damodaran 2009), there may be cases where lapses in corporate governance can also work in their favour. The influence exerted by large shareholders in the Caribbean's corporate governance environment can lower the *de facto* cost of a takeover by affording comparable control to investors that manage to acquire a significant, though not majority, interest in a corporation.

The threat of hostile takeovers is no longer an effective corporate governance mechanism in mature capital markets because of sophisticated takeover defences. In the context of the Caribbean, though recent trends suggest that takeovers are increasingly affecting businesses, the threat of them is also an ineffective mechanism of corporate governance primarily because Caribbean markets do not sufficiently reflect a firm's performance in its share price. Although an inadequate share price may still be a trigger for takeover activity, a market's inability to influence that price will undermine the market's effectiveness as a performance incentive and by extension, a corporate governance mechanism that prevents losses attributable to agency costs.

However, takeovers often change management, strategy, and the composition and effectiveness of the board, thereby altering the level of a firm's corporate governance effectiveness. In doing so, takeovers can implement corrective measures that improve a firm's performance and shareholder value. LPH's divestment of LPH Telecom immediately after Emera's *de facto* takeover illustrates this.

SECTION 5: **Conclusion**

This paper assessed the recent Emera's takeover of the Barbadian Public utility, Light and Power Holdings Ltd. The analysis supports the findings of previous studies that large shareholders and

powerful management are among the main issues with Caribbean corporate governance. Indeed, that the benefits of control normally associated with a successful takeover are afforded to a firm's large shareholders suggests that control of a Caribbean company may be secured at a discount instead of a premium. For example, Emera was able to exert significant control over LPH by paying for only 38% of its shares.

The LPH acquisition adds to the trend of increasing takeover activity in the Caribbean, particularly by foreign firms. Despite this phenomenon, the threat of takeovers is not viable as a preventative corporate governance mechanism in the Caribbean because share prices are not likely to indicate the companies' value and are unlikely to be a yardstick by which managerial effort is reflected or evaluated. However, takeovers can improve company performance through a change in strategy, hence acting in a corrective fashion.

There is an implication that widely held Caribbean companies may be pre-disposed to be acquisition targets because their shareholders are unable to otherwise receive adequate compensation for disposing of their shares. Undervalued shares prices serve as a catalyst for takeovers. Systemic mispricing of public Caribbean companies may predispose the region to takeovers by external entities. Ironically, it may be the prevalence and influence of large shareholders that could counteract the undermining effects of weak Caribbean capital markets.

There are ways in which the study could have been improved. An examination of LPH by-laws may have yielded more insight into the extent to which Emera may have furthered their control in LPH by acquiring additional shares. Perhaps the most puzzling part of the acquisition was KPMG's adjudication of Emera's bid as fair after determining that their client's firm was significantly more valuable than the offer price suggested.

The study also raises some questions that further research may be able to address. Emera's decision to attempt a takeover of LPH while already owning a significant portion of the company evokes the question of whether it is cheaper for an existing shareholder to purchase x shares as part of a takeover event than it would for an outsider to purchase an equivalent number as part of a takeover. The frequency of takeovers of Caribbean companies by a large shareholder may also be instructive, as well as the synergies to the acquirers. Although suggested by this study, it would be beneficial to better understand the role of Caribbean stock markets in facilitating takeovers of widely held Caribbean companies. Given the trend of increasing takeover activity in the Caribbean, a study into the drivers of this activity would assist in understanding this phenomenon. Based on areas covered in this study, suggested determinants of takeover activity in the Caribbean may include dividend policy and payout, macroeconomic conditions, country of operation, firm size, concentration in shareholding, type of industry and degree of corporate governance effectiveness.

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