

The brouhaha over the Hershey Trust's investigation of selling its controlling interest in Hershey Foods was striking for numerous reasons. From the ambiguities inherent in extrapolating the wishes of Mr. Hershey to the dynamics of a company town trying to come to terms with the realities of a global economy, this single case captured dozens of interesting questions for scholars of law and economics. Individuals on both sides of the potential sale raised almost every conceivable argument for and against the deal, except perhaps the most important one. Is it a good thing financially to have corporate control vested in a trust?

In a path-breaking article in the April 1965 issue of *The Journal of Political Economy*, Henry Manne described how the "Market for Corporate Control" induced executives to make efficient decisions that are in the best interests of corporate shareholders. Effectively, Manne described how inefficiently run companies will become attractive targets for takeover by those believing they can manage the firm better. Inefficient managers generate relatively low stock prices which make a firm cheaper to buy and provide an excellent profit opportunity for the purchaser. In such a setting, inefficient executives have the incentive to improve their performance to save their jobs, or else they will be displaced by those who can do better.

However, Manne's argument presupposes that those who stand to gain from improved management, the shareholders, have the incentive and ability to put their capital to its highest and best use. In Hershey's case, however, those making the decisions, the trustees, have essentially no financial incentive to make sure the best executives are at the helm. If Hershey underperforms relative to the market, they do not suffer the loss, and if it performs relatively well, they do not stand to gain. Manne's conditions guaranteeing efficient management do not hold because Hershey's executives do not face the incentives that the prospects of takeover and removal provide. It hardly seems surprising then that Hershey's management opposed the sale.

Opponents of the Hershey sale used the example of Enron to illustrate the dangers of corporate greed. If Hershey is taken over by some faceless, "foreign" corporation, they said, Hershey faces the potential of being devastated the way Houston was, perhaps even more so given the role of Hershey Foods in the town's economy and identity. The Enron example may be salient, but it's more than likely wrong. As Manne, now dean emeritus of the George Mason University School of Law, pointed out in a June 26, 2002 commentary in *The Wall Street Journal*, it was insulation from takeovers that allowed executives at Enron, Tyco, and WorldCom to injure, irreparably in some cases, the value that rightfully belonged to shareholders.

This insulation from takeovers takes the form of state regulations and statutes that disfavor hostile takeovers, as well as a host of other mechanisms by which outsiders can police corporate executives. State legislatures passed many such measures during the 1980s when the anti-takeover sentiment among the public looked much like the current fear-mongering going on in Hershey. As Yale Law School professor Roberta Romano, perhaps the nation's foremost expert on corporate law, has demonstrated, most of these anti-takeover measures, enacted at the behest of sitting corporate executives, have hurt shareholder value and social welfare. The insulation provided by anti-takeover statutes pales in comparison to the protection provided to Hershey executives by virtue of having corporate control vested in the Milton Hershey School Trust.

The citizens of Hershey were led to believe that life as they know it would be in peril if "outsiders" gained control over Hershey Foods. Perhaps some things would have changed, though visions of evil Philip Morris (or some other likely buyer) executives coming to town, menacingly puffing their cigarettes, to lock up the Hershey factories and put half the city out of work seemed a bit overstated. However, one thing's certain, forcing Hershey executives to face market discipline, would have led to a better-run company. If one suspects this is simply the idle speculation of some ivory-tower academic, take a look at how Wall Street valued the prospect of corporate control going to individuals who actually have something at stake. When talk of the sale began this summer, the stock price simply exploded in the middle of a bear market. Obviously, the market knows Professor Manne's lesson well.

Jonathan Klick, Robert A. Levy Fellow in Law and Liberty at George Mason University School of Law, holds a Ph.D. in economics.