Hostile Takeovers

Definition

- Hostile takeovers are transactions that do not meet the approval of the target *management*

- To prevent hostile takeovers defence mechanism have been developed

Examples of hostile takeovers

- Vodafone takeover of Mannesmann
- Morrison takeover of Safeway (initially)

- In many cases political issues in international (hostile) takeovers

Shareholder interest hypothesis

- Preventing control changes increases shareholder wealth as managers focus more on daily business

- Bidding becomes more aggressive and increases the price offered

Management entrenchment hypothesis

- Any actions to prevent a takeover reduces wealth
- Aim is for the management to maintain control
- Interests of shareholders are not priority

Empirical results

- Little evidence in favour of shareholder interest hypothesis
- Most evidence in favour of management entrenchment hypothesis.
- If management holds either very small (< 5%) or large (>25%) stakes, entrenchment dominates

Preventing takeovers

- The best takeover defence is a high share price
- Observing market movements
- Public filings of acquirers

Types of takeover defences

- *Preventative measures*: reduce the likelihood of a takeover attempt
- *Active measures*: actions once a hostile bid has been made

Preventative measures

- Poison pills
- Corporate charter amendments
- Golden parachutes

Poison pills

- *Preferred stock plan*
  Issue dividend in preferred shares, convertible into common shares in case of takeover
- *Flip-over rights*
  Rights offer to shareholder to buy stock at low price in the acquiring company after a takeover
- *Flip-in Poison pills*
  Rights offer to shareholder to buy stock at low price in the target company if trigger event happens

Issuing poison pills

- Usually no shareholder approval required
- Rights go with shares until exercisable
- Rights can usually be redeemed for a small amount by the company
- Board can usually deactivate poison pills
- Poison pills can be issued even after a bid is received

Effect on shareholders

- Stock prices reduce slightly on adoption
- Companies with poison pills underperform

- Poison pills require larger takeover premium

Corporate charter amendments

- Staggered boards
- Supermajority rules
- Fair price provisions
- Dual capitalization

Staggered boards

- Terms of directors such that they may not be replaced all at once
- Prevents the complete control of the company by new owners
- Not very successful as a defence
- Share price is not significantly affected

Supermajority rules

- Corporate charter requires a higher approval of mergers, e.g. 2/3, 80%
- Can be waived if board approves merger
- Share prices reduced by 5% upon adoption if escape clause provided

Fair price provisions

- Acquirer has to pay minority shareholders at least a fair market price
- Fair price usually based on price-earning ratio
- Mostly included in takeover regulation
- Prevents lower offer in two-tier tender offers
- Share prices not significantly affected

Dual Capitalization

- Two classes of equity are generated
- Certain groups of voters have greater voting power, e.g. “Golden Shares” of governments after privatizations
- Small negative effect on share prices

Golden parachutes

- Agreement to pay special compensation to senior managers if they leave on change of control or the build-up of significant stakes

- Positive effect on share price and takeover premium

Preventative measures and stock performance

- If managers hold large fraction of shares, negative effect on share price
- Makes takeover less likely
- Shareholders cannot realize gains from takeover

Common preventative measures

- Poison pills
- Staggered board
- Golden parachutes

Active measures

- Greenmail
- Standstill agreement
- White knight
- White squire
- Capital structure adjustments
- Corporate restructuring
- Litigation
- Pac-Man defence

Greenmail

- Company repurchases shares from large shareholder at a premium
- Aims to prevent the takeover by a raider
- Evidence on the share price impact mixed

Standstill agreement

- Agreement with acquirer not to increase its holding further/beyond a threshold for a certain period of time

- Negative impact on share prices

White knight

- A company more acceptable to the management makes an offer
- Offer usually includes a higher price, an agreement on strategy and management, many times combined with break-up fees
- Can lead to a bidding war
- Mostly not beneficial for acquirer

White squire

- A company buys large block of shares, often convertible preferred shares
- In another version agreement to sell certain assets to this company in case of a takeover
- Prevents other bidders from gaining control

Capital structure adjustments

- Recapitalization
- Increasing debt
- Increasing equity
- Share repurchases

Recapitalization

- High dividend paid from increasing debt
- High leverage makes the company less attractive to bidder
- Managers may use their payments to buy shares cheaply

Increasing debt

- Assume a large amount of debt
- Borrowing capacity reduced and hence less attractive to bidder
- Increases the risk to shareholders
- Significant decline in share prices

Increasing equity

- More costly to acquire a majority of shares
- Dilutes shareholder equity and price reduces
- New shares issued to friendly investors, e.g. ESOP

Share repurchases

- Company buys back its own shares
- Uses cash or requires additional debt, making the target less attractive
- Reduces the number of shares available to hostile bidder

Corporate restructuring

- Used only as a measure of last resort
- Sale of assets the acquirer wants
- Make unattractive investments
- Usually very negative impact on share price

Litigation

- Very common strategy in more than 30% of cases

- Violation of antitrust regulation
- Incomplete disclosure of information to shareholders

- No net effect on share prices

Pac-Man defence

- The target tries to take over the bidder
- Not commonly used

Resistance to bidders

- Generally a resistance is viewed negative by the market
- A bidder in itself is not good news