

FIN 514

Takeover Defenses

Successful takeovers:

- target stockholders gain 20-35% or more

Unsuccessful takeovers:

- target stockholders gain little if not eventually taken over

Question: Why would target management resist a premium offer?

- Is entrenchment the only answer?

Types of Takeover Defenses

(1) Charter amendments

- must be approved by stockholders
- supermajority: 67% or more of votes necessary to approve control change
 - can be avoided by board ("board out")
- fair-price: supermajority clause can be avoided if price is high enough (P/E or P/B)

Types of Takeover Defenses

(1) Charter amendments

- staggered board: Senate vs. House
 - only 1/K of board is elected each year, so it takes K years to turnover board completely
- poison pills: something to kill sharks that are eager to eat
 - rights to buy cheap shares if a control event occurs (only hostile deals)

Types of Takeover Defenses

(2) Legal/Regulatory/Antitrust Defenses

- state corporation/anti-takeover laws impose rules that are similar to stringent charter amendments for all corporations chartered in that state
 - changing state of incorporation can improve defense

Types of Takeover Defenses

(2) Legal/Regulatory/Antitrust Defenses

- if some activities of target (or bidder) firm are regulated, that may slow down successful bid
 - CBS used FCC regulation of broadcast licenses to ward off Ted Turner

Types of Takeover Defenses

(2) Legal/Regulatory/Antitrust Defenses

- Antitrust investigation can slow down bid
 - cases frequently start from someone in the industry (e.g., the target)
 - Security Trust tried to ward off Norstar by buying some branches near Albany
 - Norstar promised to divest those branches if the takeover succeeded

Types of Takeover Defenses

(2) Legal/Regulatory/Antitrust Defenses

- Mobil's bid for Conoco failed, even though it had the highest nominal price
 - ignored by the market because the probability of a successful takeover was small for Antitrust reasons

Types of Takeover Defenses

(2) Legal/Regulatory/Antitrust Defenses

- **interfirm litigation can be effective**
 - **e.g., target charges that bidder failed to disclose something material in SEC filings**
- **ask a judge to enjoin bidder**
 - **stall tactic**
 - **Kaufman's bought McCurdy's, and was challenged by BonTon**

Types of Takeover Defenses

(3) Asset Restructuring

- "Crown Jewel" defense: contract to sell attractive assets to a third bidder contingent on hostile bid
 - e.g., Revlon
- "Pac Man" defense: make competing tender offer for shares of bidder
 - Bendix/Martin Marietta (eventually acquired by United Tech)

Types of Takeover Defenses

(4) Leveraged Recapitalizations

- partial LBO leaving equity holders with much riskier claims
 - Phillips Petroleum after Pickens/Mesa bid, followed by Icahn interest
- generally increase stock value

(5) ESOPs

- employees get equity claim in the firm, but management votes the shares of the stock in the ESOP
 - Polaroid after Shamrock attack

Types of Takeover Defenses

(6) Golden Parachutes

- **lump sum payments to target management if fired due to takeover**
 - usually small relative to size of deal, so probably not much deterrence effect
- **aligns the interests of target management with shareholders**
 - but you don't want them taking just any bid

Types of Takeover Defenses

(7) "Greenmail" (targeted share repurchases, usually at a premium)

- often linked with "standstill agreements" -- bidder will go away
- Bradley & Wakeman find that share repurchases ending takeover attempts have negative announcement returns
 - reducing the probability of a control premium is bad news
- Should greenmail be outlawed?

Types of Takeover Defenses: Summary

Defenses where stockholders get to approve do not have large negative effects

- management may not try anything too aggressive if shareholders have veto power

Defenses where target management has sole discretion have larger negative effects

- "Crown Jewel", early pills

Uses of Takeover Defenses

Target management has to try to get a higher bid from bidder

- **like buying cars or appliances -- negotiation is assumed to be important**
- **if target saw a good bid and took it without resisting at all they are likely to be sued by stockholders because they should have gotten an even better deal**

Uses of Takeover Defenses

Benefits from using defenses are:

- (1) stall for more time to find a "White Knight"
- (2) directly compete with bidder (LBO, leveraged recap, Pac Man)
- (3) threaten high transaction costs (litigation, etc.) as part of bargaining strategy

Uses of Takeover Defenses

Costs of using defenses are:

- (1) transaction costs (lawyers, investment bankers, etc.)
- (2) may deter some deals that would have been profitable with weaker defenses, but aren't now
 - entrenchment is easier
 - hard (impossible) to measure deals that never get tried

Return to FIN 514 Home Page

<http://schwert.ssb.rochester.edu/f514/>