

FIN 423 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

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