

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**