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)

(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

(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

- 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)

(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

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