THE MARKET FOR CORPORATE CONTROL
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• The price of a stock reflects not only the value of corporate assets but also the performance of management in realizing that value.

• The board of an underperforming company has the choice:
  – Replace management, or
  – Sell entire company to new owners who can manage its assets more profitability (e.g., change strategy, cost structure, capital structure, etc.).

• The market for corporate control puts pressure on CEO to perform or risk sale of the company.

“The lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently.”

Manne (1965)
The market for corporate control consists of all mergers, acquisitions, and reorganizations—including those by a competitor, a conglomerate, or a private equity buyer.

The company making the offer is the acquirer (or bidder); the subject of the offer is the target.

When the target is open to receiving an offer the acquisition is said to be friendly. Otherwise, it is hostile.

In a tender offer, the acquirer makes an offer directly to the target shareholders to purchase their shares at a stated price.

In a proxy contest, the acquirer asks target shareholders to elect a dissident slate of directors to approve the deal.
• **Financial synergies.** The acquiring firm believes it can increase profits through revenue improvements, cost reduction, or vertical integration. This is the logic behind a strategic buyer.

• **Diversification.** Two companies whose earnings are uncorrelated might benefit by relying on the capital generated when one business is thriving to help the other when it is struggling. This is the logic behind a conglomerate structure.

• **Change in ownership.** New owner group might have superior access to capital, managerial expertise, or other resources. This is the logic behind a private equity buyer.

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*Countries that enact laws to facilitate takeover activity see an improvement in governance quality.*
NONSTRATEGIC REASONS FOR AN ACQUISITION

• **Empire building.** The acquirer purchases a target primarily for the sake of managing a larger enterprise.

• **Hubris.** Overconfidence on the part of management that it can more efficiently manage a target than current owners can.

• **Herding behavior.** The senior management of one company pursues an acquisition because its competitors have recently completed acquisitions.

• **Compensation incentives.** The management of the target company agrees to an acquisition primarily because it stands to receive a large payment upon change in control.

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The average CEO of a large U.S. company stands to receive $28 million in cash and accelerated equity grants following a change in control.

Equilar (2017-2018)
Research has routinely shown that markets expect the incremental value of an acquisition to flow to the target rather than to the acquirer.

The target:
- Receives double-digit takeover premium offer.
- Experiences greater excess returns in hostile deals.
- Experiences greater excess returns in all-cash deals.

The acquirer:
- Experiences no excess returns following bid.
- Experiences negative excess returns for hostile bid.
- Experiences greater declines if equity-financed bid.

Research has also shown that acquirers realize less value following a merger than originally expected.

The acquirer:
- Underperforms peers on a one- to three-year basis.
- Performs worse if acquisition is financed with equity.
- Decreases investment in working capital and cap ex.

Acquisitions are highly disruptive:
- Require significant management attention.
- Lead to elevated turnover up to 10 years following the deal.

Martynova and Renneboog (2008); Krug and Shill (2008)
A company that does not want to become the target of an unsolicited takeover might adopt defense mechanisms to discourage or prevent a bid.

Antitakeover protections might give a company time to pursue long-term value creation without threat of takeover; or to enhance bargaining power to secure a higher bid.

Common antitakeover protections include:
- Poison pill (2% of companies currently have in place)
- Dual-class shares (10%)
- Staggered board (42%)
- Restricted rights to call a special meeting (51%)
- Shareholders cannot vote by written consent (74%)

SharkRepellent (2019)
A poison pill grants current shareholders the right to acquire additional shares at a deep discount to market (e.g., $0.01 per share).

The poison pill is triggered if a shareholder accumulates an ownership position above a threshold (e.g., 15 to 20 percent).

If the threshold is exceeded, the market is flooded with new shares, making it prohibitively expensive to gain control.

Companies that adopt a plan are twice as likely to defeat an unsolicited offer. If deal is accepted, premium is 5% to 10% higher. But, if deal is defeated, the target’s stock price declines by 14%.

Market reaction to adoption of plan is mixed. Negative, if company is perceived to be a takeover candidate. Positive or neutral otherwise.

Brickley, Coles, and Terry (1994); Ryngaert (1988)
STAGGERED BOARDS

• In a staggered board, directors are grouped into three classes, each of which is elected to a three-year term. Only one class stands for election in a given year.

• An activist must win two elections, one year apart, to gain majority control.

• A staggered board brings greater stability to the board; however, it is a formidable obstacle (particularly when coupled with a poison pill).

• Companies with a staggered board are significantly more likely to defeat a bid.

• Companies with a staggered board that get acquired do not receive a materially higher takeover premium (54% v. 50%).

• Market reaction to decision to stagger (or destagger) board is mixed.

• Forced destaggering leads to a deterioration in performance.

Bebchuk, Coates, and Subramanian (2002); Guo, Kruse, and Nohel (2008); Cremers, Litov, and Sepe (2017); Ge, Tanlu, and Zhang (2016)
A company’s state of incorporation is important because state law dictates most governing rights. A company might reincorporate to a state with more protective laws.

Example of restrictive state law (Pennsylvania):
- Directors can consider impact of deal on stakeholders.
- Voting rights are curtailed for shareholders owning > 20%.
- Short-term profits must be disgorged.
- Severance must be provided to employees terminated in a deal; labor contracts cannot be terminated.

Shareholders have a negative reaction to restrictive state laws.
Companies that opt out of restrictive provisions experience positive returns.

Szewczyk and Tsetsekos (1992); Subramanian (2003)
DUAL-CLASS SHARES

• A company with dual-class shares has more than one class of common shares; each class typically has proportional ownership interests but disproportionate voting rights.

• The difference between economic interest and voting interest is known as the “wedge”.

• The class with favorable voting rights typically does not trade in the market but is instead held by insiders, founders, or another shareholder friendly to management.

Companies with dual-class shares:
• Might have lower governance quality
• Trade at lower values
• Evidence on long-term performance, however, is mixed

SUMMARY OF ANTITAKEOVER PROTECTIONS

Summary of defenses, from most protective to least protective.

1. Companies that have either dual-class shares or staggered boards and prohibitions on shareholder rights to call special meetings or act by written consent.

2. Companies with staggered boards but no limitations on shareholder rights to call special meetings or act by written consent.

3. Companies with annually elected boards but prohibitions on shareholder rights to call special meetings or act by written consent.

4. Companies with annually elected boards and full shareholder rights to call a special meeting or act by written consent.

5. Companies with no antitakeover provisions.

Daines and Klausner (2001)
Antitakeover protections generally reduce governance quality and shareholder value.

In evaluating antitakeover measures, shareholders and the board might consider the following:

1. Does the company require exposure to the capital markets to keep management “in check”? Or, are other governance features sufficient?

2. What are the motives of potential acquirers? Are they consistent with the long-term objectives of the company?

3. Are antitakeover defenses adopted for shareholder protection or to entrench management?


Martijn Cremers, Beni Lauterbach, and Anete Pajuste. The Life-Cycle of Dual Class Firms. 2018. Social Science Research Network.