Extreme Actions By Incumbent CEOs To Frustrate Hostile Takeover Bids

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Emerging Markets Finance Conference
December 2017

Takeovers

- The threat of a takeover bid represents an important external control mechanism potentially serving to motivate managers to operate their firm "efficiently" – where inefficiencies could arise from agency problems or simply incompetence.

- Successful bids potentially serve to reallocate corporate resources to their highest valued use and provide a means for disciplining errant or incompetent managers.

Preventative Anti-Takeover Measures

- The U.S. allows preventative ex ante steps to deter takeovers:
  - poison pills,
  - antitakeover amendments,
  - staggered boards

- There is extensive research and on going debate on the desirability or efficacy of these measures.

- These measures constitute *ex ante* resistance designed to introduce very significant frictions in the takeover market to deter bids, or prevent them from succeeding.

Takeover Resistance

- This is an empirical study of extreme takeover resistance *after* a bid has taken place in the context of the corporate governance characteristics of the target management and the CEO – specifically, a study of targets that take extreme actions to somehow frustrate takeover bids.

- And, it is a study from the U.K. – a takeover market that does not allow U.S. style “shark-repellents”, and hence, does not have the enormous frictions that characterize the U.S. takeover market.

Takeover Resistance

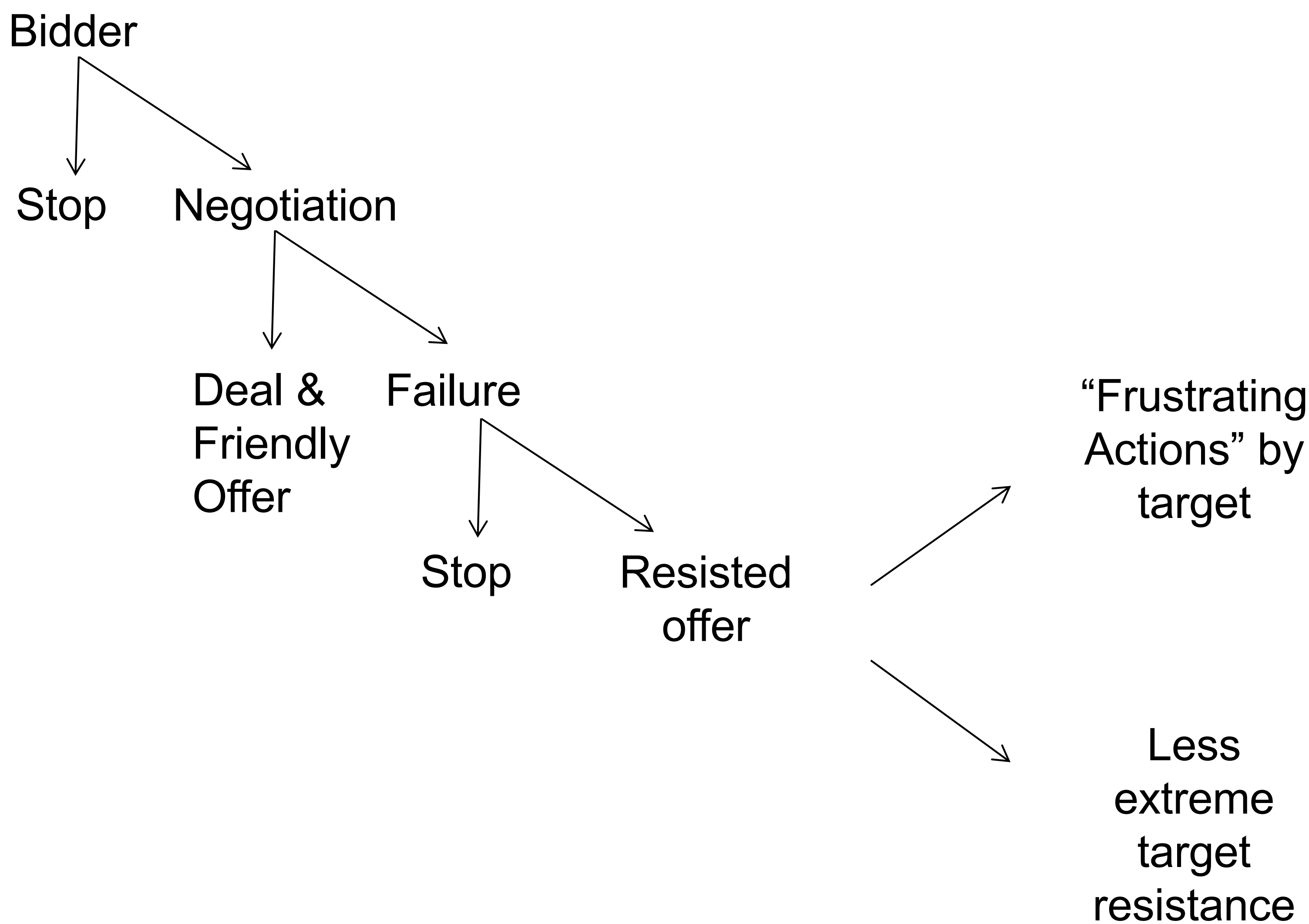
- Resistance after a bid has actually been made is a significant feature of takeover markets.

- For example:
  - Arcelor/Mittal Steel, €27bn, 2006;
  - Yahoo/Microsoft, $45bn, 2008;
  - Cadbury/Kraft, £10bn, 2009;
  - AstraZeneca/ Pfizer, £70bn, 2014.

Post-Bid Takeover Resistance

- Relatively few studies have empirically examined the *nature of target resistance* to a hostile bid.
  - Several studies on hostile bids, but not on the nature of the takeover resistance characterizing the hostile bid.
    - Bates and Becher (2012); Franks and Mayer (1996); Schwert (2000)); Heron and Lie (2006)).
  - A notable exception is the old paper by Dann and DeAngelo (JFE,1988) which focuses on abnormal returns around frustrating actions to thwart takeovers.
  - The focus of this study is on the corporate governance features of the target in resisted bids with frustrating actions vs. other resisted bids.

Takeover Resistance



What is a “Frustrating Action”?

- “*The triggering by incumbent CEOs of any operational and financial transaction that make targets significantly more difficult to acquire, at least for initial would-be acquirers.*”

Frustrating Action: Example 1

- **Spin-offs/sell-offs which are divestments that deny bidders access to assets of value.**
  - Six Continents announced that it was pursuing a spin-off of its hotels and soft drinks businesses from its retail side.
  - This divestment was intended to deny Cap Management & Investment, the bidder, access to assets of value from cash flow or break-up perspectives.
  - Abnormal return = -12%.

Frustrating Action: Example 2

- **Mergers/acquisitions/joint ventures which make target firms more cumbersome to acquire due to size, strategic or antitrust grounds, or which eliminate bidders directly.**

  – Burnfield announced that it was pursuing the acquisition of Ling Dynamic Systems Ltd to be financed by a rights issue.

  – This amalgamation was intended to make it cumbersome for Fairey Group to acquire Burnfield.

  – Abnormal return = -12%.

Frustrating Action: Example 3

- **Stock repurchases/special dividends which involve payouts that effectively eliminate bidders' plans for the utilization of excess cash held by the target, and, in the case of targeted repurchases, that increase the proportion of stock in the hands of friendly stockholders.**
  - British Polythene Industries (BPI) announced that it was pursuing a tender offer to buy back 30% of its issued shares.
  - This pay-out was intended to nullify MacFarlane Group's plans for the efficient utilisation of BPIs excess cash.
  - Abnormal return = -4%.

Frustrating Action: Example 4

- **Going private transactions which use competing management buyouts to create potentially costly bidding contests.**
  - Ward White Group (WWG) announced that it was pursuing a leveraged buyout for all or part of the company.
  - This buyout was intended to create a costly bidding contest for Boots, and to give WWG private control to prevent further unwanted takeover attempts.
  - Abnormal return = -2.35%.

Frustrating Action: Example 5

- **Management changes which make removal of newly appointed officers especially costly because of special contractual payments (‘golden parachutes’) triggered by a takeover.**
  - Blockleys announced that it was pursuing the appointment of a new chairman, resulting in the separation of this role from that of the chief executive.
  - This board change was intended to make removal of the newly appointed director especially costly because of special contractual payments triggered by a successful takeover.
  - Abnormal return = -1.2%.

Frustrating Action: Example 6

- **White squires which involve solicitation of friendly third party participants who acquire a stake that will effectively block the takeover.**
  - Owners Abroad Group announced that, as part of a strategic alliance, it was pursuing a 12.6% placement of new shares with Thomas Cook.
  - This placement was intended to thwart Air tours' takeover attempt by soliciting the friendly third party to acquire a strategic only blocking stake. (Abnormal return = -3.07%).

Examples of “Peaceful” Resistance

- Tilbury Group responded to a takeover bid from Lilley by forecasting significantly increased profits and dividends.

- Wellcome responded to a takeover bid from Glaxo by actively soliciting a third party bidder.

- Allied Colloids Group responded to a takeover bid from Hercules by both forecasting increased profits and dividends, and by actively soliciting a third party bidder.

Frustrating Actions

- When announced, frustrating actions can be value reducing for target stockholders (Ruback, 1987).

- However, Berkovitch and Khanna (1990), in theoretical consensus with Hirshleifer and Titman (1990), predict that frustrating actions can also benefit target stockholders.
  - Although value reducing for initial would-be acquirers, they do not always make targets less valuable for other would-be acquirers.
  - The threat to trigger frustrating action can also be sufficient to generate higher offer premiums from initial would-be acquirers.

Motivations for Resistance

- Both frustrating actions and peaceful resistance can be motivated by the potential for:
  - Price improvements from initial offers.
  - Incumbent managerial entrenchment.

Paper Objectives

- First, we examine the relative importance of initial offer and target characteristics for predicting frustrating actions in hostile takeover bids to shed light on the motivational implications for this type of resistance.

- Second, we examine whether the motivational implications for frustrating actions are reflected in the target stockholder wealth effects of hostile takeover bids and in the rate of incumbent CEO turnover after hostile takeover bids.

Sample of Target Companies

- Hostile offers for firms domiciled in the U.K.
  - 1989-03, UK (Acquisitions Monthly, SDC, LSE- Regulatory News Svc.); Only fully listed firms; Exclude firms in highly regulated industries
- There were finally 121 cases that were formally resisted by the target - all the others were “friendly" offers that were accompanied by concomitant recommendations of the Board.
  - We examined each and every one of the 121 cases individually to determine if the resistance was motivated by a desire to get more for shareholders, or by the desire to destructively thwart the bid in whatever way that was feasible.

Post-Bid Takeover Resistance

- In particular, we looked for resistance strategies that mounted a counter-offensive designed explicitly to thwart the bid from a negative perspective rather than get a better deal for the shareholders.
- These were cases in which realization of the target's end-goal was difficult to see as increasing shareholder value - only managerial entrenchment.
- There were 53 such cases of concrete negatively oriented counter-offensives being launched.
- The other 68 were cases in which the resistance actions were in the form of a variety of positively oriented defensive measures rather than a concrete offensive negatively oriented action.

Frustrating Actions

Characteristics of target board resistance for a sample of 121 publicly resisted U.K. takeover bids 1989-03: Percentage of frustrating actions				
Resistance tactics	1989-03 (50 bids)	Average abnormal return at announcement of action (%)	1989-96 (24 bids)	1997-03 (26 bids)
Spin-off/sell-off	46.0	-2.7	58.3	34.6
Merger/acquisition/joint venture	30.0	-3.5	25.0	34.6
Stock repurchase/special dividend	16.0	-1.2	8.3	23.1
Going-private transaction	10.0	-1.4	4.2	15.4
Management change	10.0	-0.8	12.5	7.7
White squire	8.0	-1.4	8.3	7.7

50 cases are classified as having engaged in frustrating actions, defined as having employed at least 1 of the above tactics and to which the market responded negatively.

Range of number of tactics employed: 1 to 3; 41 used 1, 8 used 2, and 1 used 3

Controls

- We account for the effects of censoring other takeover bids and treating the type of bid resistance as being exogenous.
  - For these tests, we differentiate between target fiscal year-ends before and after incorporation of the corporate governance recommendations of the Cadbury Report into the listing requirements of the main London market in 1993.
  - The post-Cadbury environment makes it mandatory for incumbent boards to state the extent of their compliance with recommendations intended to lessen CEO control. and is associated with a wholesale lessening of incumbent CEO control.

Research Questions and Findings

- **Q1: Is the choice to engage in frustrating actions influenced by target firm ownership and governance characteristics?**
  - Yes
- **Q2: Is stockholder wealth influenced by frustrating actions?**
  - Yes, and negatively
- **Q3: Is the probability of takeover success influenced by frustrating actions?**
  - Yes (in the absence of a third party bid)
- **Q4: Are CEOs who engage in frustrating actions negatively impacted in the ex post employment market?**
  - Yes

Findings

- Frustrating actions are motivated less by the potential for price improvements from initial offers than other types of bid resistance.

- Frustrating actions are motivated more by incumbent CEO inefficiency and control and, hence, the potential for entrenchment than other types of bid resistance.

- The relationships between initial offer and target characteristics and the probability of general hostility in takeover bids has much clearer motivational implications when it comes to frustrating actions than is the case with other types of resistance in hostile takeover bids.

Findings

- The motivational implications for frustrating actions are reflected in smaller target stockholder wealth effects of hostile takeover bids, and in a higher rate of incumbent CEO turnover after hostile takeover bids, than for other types of resistance.

- It would seem that investors, successful acquirers, and surviving incumbent boards come to the conclusion that incumbent CEOs are more likely to have triggered frustrating actions as a ploy for their own ends than for the advantage of target stockholders.

Findings

- Hostile takeover bids with frustrating actions are associated more with middle-aged incumbent CEOs and with larger incumbent CEO stockholdings, but smaller other incumbent directors stockholdings, than other hostile takeover bids.
- Hostile takeover bids with frustrating actions are also associated less with independent incumbent chairpersons and with smaller target outside blockholdings than other hostile takeover bids.
- All in all, our findings for incumbent CEO control indicate that frustrating action is motivated more by the potential for entrenchment than other types of bid resistance.

Findings

- Our findings add to the ongoing debate about the legitimacy of hostility in takeover bids by suggesting that there should be limitations on the ability of incumbent CEOs to trigger frustrating actions in response to takeover bids.