Takeover Bids

- Another corporation offers $60 a share for Acme, whose shares are currently selling for $40 a share.
- Often, the board of directors will oppose the takeover bid, as “not in the best interest of the shareholders”. The board may be motivated by self interest.

Take-Over Bids

- Why takeover bids?
  - The business is not properly managed. Shares are selling for $40. With proper management, shares would be worth $80.
  - The board of directors is asleep at the switch. This is a case when internal monitoring fails.
Take-Over Bids

• Why takeover bids?
  – The solution is a takeover bid. Some outside group makes an offer for the company for (say) $60 a share.

Are Takeovers a good thing?

• Many people criticize takeover bids as wasteful speculation

• But they play an extremely useful role; making sure that companies are efficiently managed.

The Target’s Options

• Sell Out
• Leveraged Buyouts
• Capital Distribution

Selling Out

• One option is simply to allow the firm to be acquired.
Selling Out

• One option is simply to allow the firm to be acquired.
• Often the targeted firm tries to negotiate a higher price or find another buyer who will pay the higher price.

Leveraged Buy-outs

• The business is bought by the managers with the aid of a bank loan.

Putting all your eggs in one Basket

• An LBO almost always requires that
  • The senior managers make a significant capital investment in the new business, contributing the equity in their homes as well as their pension rights.
  The agency problem disappears.

Do LBO’s make a difference?

<table>
<thead>
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Takeover Bids

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Industry Adjusted Percentage Change

Takeover Bids

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Capital Restructuring

• Here a company will buy back much of its stock, using borrowed money.

• A firm with stock worth $100 million and no debt might borrow $75 million, buy back 75% of the outstanding shares, and end up with stock worth $25 million and debt of $75 million.
Advantages of the Deal

• Tax advantages to the deal.

• There is nothing like having one’s back to the wall.

• Banks act as external monitors

External Monitors

• It doesn't pay for me to monitor a company in which I have a few dollars invested.

• But a bank has a greater expertise in monitoring than does an ordinary shareholder, and has enough money at stake that it is well motivated.

End