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- 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.

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  - The board of directors is asleep at the switch. This is a case when internal monitoring fails.

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

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- Major role in the early 1980's

The Target's Options

- Sell Out
- Leveraged Buyouts
- Capital Distribution

Selling Out

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- Often the targeted firm tries to negotiate a higher price or find another buyer who will pay the higher price.
- In some cases, buyouts work well; in other cases they fail

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.

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The agency problem disappears.

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Operating Income Relative to Sales	Two Years Before to One Year Before	One Year Before to One Year After	One Year Before to Three Years After
Percentage Change	-1.7	7.1	19.3
Industry Adjusted Percentage Change	-1.9	12.4	34.8

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- 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.

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- 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

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