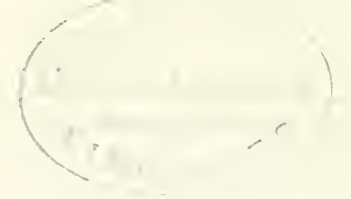


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An Economic View of the
Market for Corporate Control

by

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#1472-83

August 1983

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An Economic View of the Market For Corporate Control

1. Introduction

There is a rapidly growing set of scientific evidence about the effects of various aspects of the market for corporate control on the wealth of shareholders. This scientific evidence does not resolve all of the empirical issues that lie behind the debate about the structure of the market for corporate control. But the evidence does provide an important factual framework for such a debate. In particular, the evidence indicates that:

- Target Shareholders substantially benefit from successful takeovers;
- Shareholders of bidding firms do not, on average, suffer from successful takeovers;
- Completed takeovers increase the combined value of the firms involved and most of these gain accrue to shareholders of the target firms;
- The benefit of takeovers are realized only when control of the target firms assets are transferred to a bidding firm;
- Anti-takeovers corporate charter amendments do not reduce stockholder wealth;
- Opposition to takeovers which eliminates a takeover bid reduces the wealth of the shareholders of the target firm.

Before expanding on this scientific evidence and its implications for public policy, I would like to discuss the economic framework in which the evidence is interpreted. The market for corporate control is the arena in which management teams compete for the right to manage

resources.¹ In this managerial competition model of the market for corporate control, management teams are the activists and, when the market for corporate control functions well, stockholders are relatively passive.

The passivity of stockholders in the market for corporate control evolves from their role in the modern corporation. Jensen and Meckling [1976] define the corporation as a 'nexus of contracts' between independent agents. Stockholders in the modern corporation are the agents that specialize in risk bearing. Fama and Jensen [1983] point out that contracts with other agents in the firm typically involve fixed payouts. This reduces contracting costs and facilitates efficient risk bearing. The risks associated with the differences between the uncertain cash inflows and outflows of the firm are, therefore, borne by the stockholders.

Efficient specialization in risk bearing precludes the active participation of stockholders in the management of the corporation. Modern portfolio theory shows that investors can minimize their risk (for a given level of expected returns) by holding well-diversified portfolios in which only a small fraction of their wealth is invested in an individual firm. For example, in the Standard and Poors 500 less than four percent of the portfolio is invested in any single company. Diversification reduces risk because any changes in the value of any a firm which is not market-wide has a small effect on the value of the portfolio. This diversification virtually eliminates the incentive for stockholders to monitor the firm. Shareholders have a small percentage

¹ Jensen and Ruback (1983) present this definition of the market for corporate control.

of their wealth invested in the firm so that the expected rewards from monitoring the firm are likely to be smaller than the costs. Also, since stockholders hold securities of many firms, they do not have the information or expertise to monitor any single firm. Thus efficient risk bearing results in passive stockholders.

Since stockholders in modern corporations are passive, the management team allocates corporate resources. Control is vested in the board of directors who are elected by the stockholders. The board in turn delegates much of its responsibility to the top management of the corporation. The board of directors formally retains the rights to control the corporation in the sense that they retain the rights to hire, and compensate top managers [Fama and Jensen, 1983]. Fama and Jensen [1983] highlight the different roles of the board and top managers. The top managers control the daily operations of the firm including the initiation and implementation of investment and other decisions. The board of directors approves major decisions and evaluates the managers. These differences in roles are an important element of the internal control system that limits the divergence between the interests of the stockholders and the managers of the corporation. But the allocation of corporate resources and therefore the profitability of the corporation results from the interaction between the board of directors and the top managers.

A change in corporate control occurs when rights to allocate corporate resources are transferred from an incumbent management team of the firm, including the board of directors and top managers, to a new management team. Note that a change in corporate control does not necessarily imply that the top managers are replaced. Corporate control

is transferred when the right to allocate the firm's resources moves from the incumbent management team to another. The new management team may delegate some of the responsibility for the daily operations of the firm to members of the previous management team.

Competition between management teams is most transparent in proxy contests. In such contests an insurgent management team proposes an alternative operating strategy for the corporation and shareholders choose among the competing management teams. Proxy contests are not, however, the most frequent device used to transfer corporate control. This lack of popularity occurs because proxy contest inherently conflict with the passivity of stockholders. In a proxy contest stockholders are required to evaluate the plans of the competing management teams. Shareholders vote for the team whose plan is expected to result in the highest stock price. But passive stockholders that hold well diversified portfolios are unlikely to be rewarded for such an evaluation. Furthermore, stockholders do not have the information or expertise required to estimate the effects of competing management teams on the equity value of the firm. In other words, efficient risk bearing by stockholders in the modern corporation tends to preclude their careful evaluation of alternative management teams upon which proxy contests depend.

Competing management teams could provide stockholders with forecasts of the future stock prices of the firm under their plans. However, the competing teams have ample incentives to overstate the benefits of their plans. Furthermore, these forecasts are not amenable to third party verification because they often involve different assumptions about the future. Thus stockholders in proxy contests would have to verify the forecasts of the competing management teams. This verification process,

of course, conflicts with the passive role of stockholders.

Management teams can compete and the passive role of stockholders can be preserved if the competing teams guarantee a lower bound on the equity value of the firm by offering to purchase the target's stock. Stockholders can thereby avoid expending resources to verify the claims of the competing management teams. Stockholders only have to compare the offer prices of the alternative proposals to a forecast of the stock price of the firm without a change in the management team. This form of competition between management teams occurs in the most frequent transactions in the market for corporate control: mergers and tender offers.

The popularity of mergers and tender offers is consistent with the management competition model of the market for corporate control. These forms of competition are more efficient than proxy fights since they preserve the passivity of stockholders. However, mergers and tender offers require that the insurgent management team has resources to purchase the shares of the target firm. This suggests that proxy contests are likely to occur when the insurgent management team lacks such resources.² Consistent with this implication, Dodd and Warner [1983] find that 83% of proxy contests for firms listed on the New York Stock Exchange and American Stock Exchange that occurred between 1962 and 1978 were led by individuals.

The managerial competition model suggests that tender offers are less efficient than mergers. In a tender offer, the bidder offers to purchase

² There are, of course, other reasons why mergers and tender offers occur. For example, some forms of synergy such as realization of economies of scale, are likely to require the formal combination of the bidding and target firms.

the common stock at a fixed price. The target shareholders cannot, however, remain completely passive. The decision to tender is determined by comparing the offer price with the shareholder's assessment of the future price of the target firm. Such an assessment is likely to be complex since it involves evaluating the potential of higher competing bids and any new information released during the offer which would alter behavior or profitability of the incumbent management team. The costs of this assessment are mitigated by the fact that target shareholders can sell their stock in the market during a tender offer to anonymous arbitraguers. The arbitraguers perform an important role by specializing in valuing competing offers and providing a market that allows investors to delegate both the valuation and risk bearing function during a tender offer. This specialization reduces the costs and increases the rewards from evaluating the competing management teams. Nevertheless, it is unlikely that the arbitraguers will have complete information about various management teams. Furthermore, for arbitraguers to survive, their gross profits (on average) must at least equal the costs of evaluating the competing management teams. Thus, the arbitraguers reduce, but do not eliminate, the costs of evaluating the competing management teams in a tender offer.

Merger proposals are negotiated and approved by the target's incumbent management team. The evaluation of the merger proposal and its comparison with the value of the firm without a change in corporate control is done by the incumbent management team. Ignoring conflict of interest problems, the evaluation by the incumbent management team is most efficient since they are likely to have the best information set. Since the incumbent management team typically wants to retain its

position, it is unlikely that it would approve a merger at less than the full value of the target firm.³ The incentives of the incumbent management team ensure that an increase in value will occur as result of the change in corporate control when a merger proposal is forwarded to target stockholders. Target stockholders can therefore rely on the incumbent management's appraisal of such mergers proposals and remain completely passive.

The evaluation of competing management teams by the incumbent management team does present a potentially serious conflict of interest. Incumbent managers may oppose takeover bids for reasons other than their desire to retain their positions. Such opposition may occur when the incumbent managers anticipate higher competing offers or when they possess other information that indicates that the compensation offered by the competing management team is inadequate. However, the desire to retain their positions, as well as the natural belief that they are the best management team for the firm, will cause the incumbent management team to reject some value increasing proposals by competing management teams. In such cases the competing management team can make a tender offer if the merger proposal is rejected. Also, while members of the old management team may be retained by a successful insurgent management team, such retention of the old management is unlikely in a tender offer. The model also implies systematic differences between the motives for friendly and hostile takeover bids. If the plans of the insurgent management team require the replacement of the incumbent management team,

³ Barron (1983) constructs a model of managerial resistance in which opposition occurs unless the premium compensates the incumbent managers for the value of their positions.

TABLE 1

ABNORMAL PERCENTAGE STOCK PRICE CHANGES ASSOCIATED WITH
* SUCCESSFUL CORPORATE TAKEOVERS*

Takeover Technique	Targets	Bidders
	%	%
Tender Offers	30	4
Mergers	20	0
Proxy Contests	8	na

* Abnormal price changes are price changes adjusted to eliminate the effects of marketwide price changes.

na: Not applicable

SOURCE: Michael C. Jensen and Richard S. Ruback, "The Market for Corporate Control: The Scientific Evidence," Journal of Financial Economics, 11, (1983), pp.

TABLE 2

ABNORMAL PERCENTAGE STOCK PRICE CHANGES ASSOCIATED WITH
UNSUCCESSFUL CORPORATE TAKEOVER BIDS*

Takeover Technique	Targets	Bidders
	%	%
Tender Offers	-3	-1
Mergers	-3	-5
Proxy Contests	8	na

* Abnormal price changes are price changes adjusted to eliminate the effects of marketwide price changes.

na: Not applicable

SOURCE: Michael C. Jensen and Richard S. Ruback,
"The Market for Corporate Control: The
Scientific Evidence," Journal of Financial
Economics, 11, (1983), pp.

the managers of the target firm have little incentive to approve a merger proposal. Approving such a merger proposal would guarantee that the incumbent managers would lose the power, prestige and value of organization-specific human capital associated with their positions. Opposition to such an offer may be successful; if successful, the incumbent management team would retain their positions. This implies that hostile takeovers are likely to occur when the insurgent management team's strategy involves replacement of the incumbent management team. Therefore, takeovers in which the gains are realized by replacing inefficient target managers or adopting a radically different business plan for the target are likely to occur through tender offers. However, other motives for takeovers, such as synergy and tax shield utilization, do not require the replacement of the incumbent management team and thus are likely to occur through mergers.

II. The Scientific Evidence

The effect of takeovers on the stock prices of participating firms has been studied extensively. Each of the empirical studies focus on a different aspect of the takeover market, and use slightly different techniques and data. A synthesis of the results of these studies, which was recently compiled by Michael C. Jensen and me, is presented in table 1 for successful takeovers and in table 2 for unsuccessful takeovers. Table 1 shows that the stockholders of target firms realize substantial and statistically significant stock price gains of 30% in tender offers and 20% in mergers. Successful bidders realize abnormal returns of 4% in tender offers and zero in mergers. These data indicate that target shareholders are not harmed by takeovers. Instead, target shareholders appear, on average, to capture most of the percentage gains in tender

offers and all of the gains in mergers.

The ratio of percentage gains are not, however, the appropriate measure of the relative gains of bidding and target firms because bidding firms tend to be larger than target firms; an equal splitting of the dollar gains would result in a smaller percentage change in the equity value of bidding firms. Unfortunately, most studies of the wealth effect of takeovers do not report the dollar value of gains to bidding and target firms. There is, however, some evidence. Malatesta (1983) examines a matched sample of 30 bidding and target firms in mergers and finds that the dollar gains are split roughly equally. Similarly, Asquith, Brunner, and Mullins (1983) find that the percentage gain for the bidders are larger when the market value of the target firms is larger. The relative percentage gains in table 1 may, therefore, overstate the fraction of the gains that accrue to target firms. Nevertheless, the data indicate that the stockholders of target firms benefit substantially in successful takeovers.

The data in Table 1 indicate that there are no abnormal returns to bidding firms in successful mergers. This suggests, in the language of financial economics, that mergers are zero net present value investments from the perspective of the bidding firm. However, the summary table masks the substantial variation across studies in the estimated abnormal returns for successful bidders in mergers. For example, Dodd (1980) reports an abnormal return of -7% whereas Asquith, Brunner, and Mullins (1983) report an abnormal return of 3.5%. Thus, while zero is my best estimate of abnormal returns for bidding firms in mergers, I have less confidence in this estimate than in any other of the empirical results reported in this talk. There are several reasons for the

difficulties in measuring the abnormal returns for bidders. First, as noted previously, bidders tend to be much larger than targets. This tends to reduce the estimated percentage abnormal returns for bidders and their statistical significance. Second, the acquisition may have been anticipated. This anticipation could occur through the announcement of an acquisition program. Schipper and Thompson (1983) report that bidding firms realize average abnormal returns of 13.5% in the year in which they announce acquisition programs. Also, some of the gains associated with acquisitions may have been impounded into the stock price of the bidding firm when it invested in a "toehold" position in the target prior to announcing the merger.

The stock price changes associated with unsuccessful takeover attempts are presented in table 2. Both targets and bidders in unsuccessful mergers and tender offers suffer small negative returns, although only the -5% return for unsuccessful bidders is statistically significant. Stockholders in firms that experience proxy contests realize statistically significant abnormal returns of about 8%. Somewhat surprisingly, these returns are about the same whether the insurgent group wins or loses the contest.

The contrast between the large stock price increases for successful targets and the insignificant stock price changes for unsuccessful targets indicates that the benefits of mergers and tender offers are realized only when control of the target firm's assets are transferred to a bidding firm. The stock prices of unsuccessful merger targets seem to revert to their pre-offer level by the time failure of the offer becomes known. The stock prices of unsuccessful tender offer targets exhibit a different pattern. The stock prices of unsuccessful targets rise in

response to the announcement and remain substantially above their pre-offer level after the failure of the offer is announced. However, Bradley, Desai, and Kim (1983) report that the stock prices of unsuccessful target firms that do not receive subsequent takeover offers in the next two years revert to their pre-offer level. In contrast, the targets that receive subsequent offers realize a further increase of about 28% in their stock price. This evidence suggests that the stock prices of unsuccessful tender offer targets remain above their pre-offer level in anticipation of a future takeover bid, and that an eventual takeover is required to realize the stock price increases associated with the announcement of a tender offer.

Comparing the stock price changes for unsuccessful mergers and tender offers with the corresponding data for successful takeovers indicates that both bidding and target firms are better off when takeovers are successful. This suggests that stockholders of target firms are harmed when the target management teams oppose takeover bids or take other actions that reduce the probability of a successful acquisition. However, opposition by the incumbent management team to a takeover proposal may benefit stockholders if it leads to a higher takeover offer or otherwise increased stock price. Also, since the incumbent management team typically has more detailed inside information about the firm, their evaluation and active opposition may provide stockholders with important information that they could not otherwise obtain. I now turn to a more detailed examination of the issue of managerial opposition to takeovers.

III. Managerial Opposition to Takeovers

The incumbent management team of the target firm can take a variety of actions to increase the costs and reduce the probability of success

for competing management teams. The incumbent management team can oppose potential competing management teams prior to the actual takeover bid by instituting anti-takeover charter amendments, repurchasing large blocks of its common stock held by potential bidders, and by entering into standstill agreements with potential bidders. The target's management team can oppose actual takeover bids by rejecting merger proposals. If the bidder elects to make a tender offer, the incumbent management team can continue to oppose the competing management team by filing antitrust suits or by seeking objectives from government regulatory agencies, by divesting key assets, or by soliciting a competing bid from a "white knight."

Much of the recent legal literature on the market for corporate control focuses on the opposition of the incumbent management team to takeover attempts. This highlights what may be the weak link in the current institutional framework of the market for corporate control. The managerial competition model describes the market for corporate control as the arena in which management teams compete for the right to allocate corporate resources. This competition is an important feature of the modern corporation since it provides a mechanism by which the internal control system of the corporation can be replaced when it fails to maximize the value of the firm. However, opposition by the incumbent management team can raise the costs of a takeover and thereby reduce the efficiency of the external control system. Of course resistance by the incumbent management team does not eliminate the external controls. But such resistance will eliminate some competing management teams and force others to use costlier techniques to obtain control of the target firm.

The incumbent management team of the target firm may oppose a

takeover in order to elicit a higher price. Such opposition can take the form of press releases and mailings that present the incumbent management team's position, the initiation of various delaying tactics, and the encouragement of competing bids. For example, the solicitation of a higher bid from a white knight would benefit target shareholders. Furthermore, resistance to takeovers that eliminates takeover bids may benefit target stockholders. Suppose the incumbent management team has reliable inside information that its equity is underpriced and that the takeover proposal does not adequately compensate shareholders. If this information cannot be made public without reducing the value of the target, the management team will, in the best interest of its stockholders, attempt to defeat the takeover. If such resistance successfully blocks the competing management team, stockholders benefit through higher expected future prices. Furthermore, even if the managerial resistance does not eliminate the competing management team, such resistance will provide stockholders with information about managements' assessment of the takeover bid. While this information is clouded by the possibility that the opposition is due to self interest by the incumbent management team, it nevertheless provides important information to target shareholders that would not be available in the absence of managerial resistance.

The summary of the abnormal stock price changes indicates that stockholders of completed mergers realize gains of about 20% and stockholders of successful tender offers realize larger gains of about 30%. While these percentage stock price changes are not directly comparable and the difference may not be statistically significant, it is nevertheless tempting to conclude that hostile tender offers are more

rewarding to target shareholders than friendly, negotiated mergers.⁴ This suggests that instead of being costly, the opposition of the incumbent management team to the takeover benefits the shareholders of the target firm by raising premiums. However, the data also indicate that bidders in tender offers realize abnormal returns of 4% whereas bidders in mergers realize zero abnormal returns. The larger gains by both bidding and target firms suggests the total gains are larger in tender offers than in mergers. Furthermore, assuming that bidders in tender offers and mergers are about equal size, target firms seem to realize, on average, a smaller fraction of the total gains in tender offers.

Interpreted within the framework of the managerial competition model of the market for corporate control, these results suggest that the opposition to takeovers by the incumbent management team does not benefit target shareholders. According to the model, mergers are a more efficient means of transferring corporate control than tender offers because shareholders retain more passivity in mergers. Insurgent management teams, therefore, prefer to acquire control of the target firm through a merger. Tender offers occur when resistance by the target's incumbent management team precludes a merger. But not all rejected merger proposals become tender offers. The required assessment of alternatives in a tender offer and the signal implicit in the incumbent

⁴ Of course not all mergers are friendly and not all tender offers are hostile. Also, there are other systematic differences between mergers and tender offers; for example, tender offers typically involve cash compensation for target shareholders whereas mergers typically involve the exchange of securities.

managers' rejection of the merger proposal means that premiums will, on average, be higher in tender offers. Therefore, some rejected mergers will not become tender offers because the gains from shifting corporate control are insufficient. Thus the higher average total gains in tender offers may result from truncation of less profitable offers; that is, the average gain in tender offers are higher because the low premium rejected mergers are eliminated from the population and this raises the average measured premium. The evidence, interpreted in this way, indicates that the rejection of merger proposals does not necessarily benefit target shareholders.

Other data on the effects of takeover opposition are available. Kummer and Hoffmeister (1978) examine the abnormal returns associated with tender offers that are opposed and unopposed by target management. The average abnormal return is about 20% for 21 targets that opposed the offer and about 16% for the 44 successful targets in which managers did not oppose the offer. Thus managerial resistance is associated with higher abnormal returns. However, these data are insufficient to conclude that managerial opposition benefits target shareholders. If resistance to the tender offers is anticipated by the bidding firms, then comparison of the abnormal stock price changes in opposed and unopposed tender offers suffers from the same truncation bias that is involved in the comparison between mergers and tender offers: The larger abnormal stock price increases in opposed tender offers may be due to the elimination from the average of those lower valued offers which would have occurred in the absence of managerial opposition.

Opposition to takeover bids by the incumbent target management team may also reduce the welfare of target stockholders by reducing the

frequency of takeover bids. Easterbrook and Fischel (1981) argue that such opposition raises the costs of hostile takeovers and thus reduces the reward since competing bidders share the benefits of the first bidder's identification of the target as a takeover candidate. The opposition to takeover bids, therefore, reduce the incentives of bidders to search for potential targets. The costs of the reduced frequency of takeovers is difficult to quantify. Nevertheless, the larger gains in tender offers are consistent with a reduction in the frequency of takeover proposals when opposition is likely. Further, my study of 48 competing tender offers [Ruback (1983)] indicates that the first bidder was successful in only 25% of the offers.

Some information about the costs of the reduced frequency of takeover proposals can be obtained by examining the effect on stock prices of anti-takeover or "shark repellent" corporate charter amendments. While these amendments take a variety of forms, each is designed to increase the costs of hostile takeovers. Gilson (1982) argues that these amendments may not be effective. However, the amendment may signal managements' intention to oppose hostile takeover bids. The effects of the adoption of anti-takeover amendments on stock prices is examined in DeAngelo and Rice (1983) and Linn and McConnell (1983). DeAngelo and Rice report that no abnormal returns are associated with the adoption of anti-takeover amendments, whereas Linn and McConnell provide weak evidence of a small increase in stock prices. Both studies, therefore, provide no evidence that stockholders are harmed by the adoption of anti-takeover amendments. This evidence suggests that general opposition to takeover proposals does not reduce the wealth of stockholders.

Currently available evidence suggests that managerial opposition to takeovers does reduce stockholder wealth if the resistance eliminates takeover bids by competing management teams. Dodd (1980) provides some direct evidence which indicates that managerial opposition to takeovers harms target stockholders. He examines 25 mergers that appear to be terminated by targets and 54 mergers that are terminated either by bidders or an unidentified party. The average abnormal percentage stock price change on the day before and day of termination announcement is about -6% for cancellations by targets and -10% for cancellations by bidders. If targets cancel mergers to benefit their stockholders, for example, in anticipation of higher priced future takeover bids, the abnormal returns to targets on the announcement of the cancellation would be positive rather than negative. The returns suggest that incumbent management teams that cancel such mergers are not acting in the stockholders' interest.

Resistance to takeover proposals can occur prior to the public announcement of a takeover. The incumbent management team can eliminate a potential competing management team by repurchasing a block of its common stock held by the potential bidder. Generally such targeted repurchases occur at a premium which can be interpreted as payment to potential bidders to cease takeover activity. The evidence indicates that repurchases that occur at a premium are associated with significant negative abnormal returns for the repurchasing firm. Dann and DeAngelo (1983) report that a significant average abnormal return of about -2% is associated with targeted repurchases that involved a premium. Similarly, Bradley and Wakeman (1983) find a significant abnormal return of about -3%. They also present evidence that the total value of non-

participating shareholders' stock declines dollar for dollar with increases in the premiums.

The evidence therefore suggests that targeted repurchases that eliminate potential takeover bidders reduce stockholder wealth. Bradley and Wakeman reinforce this interpretation by examining 21 firms whose targeted repurchases were associated with takeover cancellations. For these firms, the average abnormal return associated with the repurchase is -5.5%. In contrast the abnormal returns for the 40 firms whose targeted repurchases were not associated with takeover cancellation is -1.4%. Thus, targeted repurchases are more costly to non-participating shareholders when they are used to thwart takeover attempts.

Standstill agreements are voluntary agreements in which a firm agrees to limit its holdings in another firm. Dann and DeAngelo (1983) report that significant abnormal returns of -4.5% are associated with standstill agreements. Since standstill agreements may terminate the takeover plans of a competing management team, this evidence further supports the hypothesis that actions by the incumbent target managements that eliminate potential or actual bidders reduces the wealth of target stockholders.

The evidence on managerial opposition to takeover bids indicates that such actions which eliminate competition from insurgent management teams reduce stockholder welfare. However, the data focus entirely on the adverse effects of managerial opposition. They do not examine the favorable consequences of managerial opposition such as solicitation of higher bids, or the signal that inside information warrants a higher offer price. Unfortunately, these data are not yet available. Nevertheless, there is a sound logical basis for the hypothesis that

managerial opposition can be consistent with the interests of stockholders. However, the assessment of the net impact of managerial opposition to takeovers must await a systematic study of such behavior which measures both the costs and benefits of managerial resistance to competing management teams.

IV. Public Policy Implications

As an economist, I am hesitant to recommend changes to a system that works fairly well. The market for corporate control is complex. It involves the interactions between the internal control system of corporations embodied in the managerial labor market and the structure of corporate governance, and the external control system, which occurs through competition between managerial teams. Changes in any aspect of the institutional framework may have unexpected effects through their interactions with other elements of the market.

The scientific evidence indicates that target firms capture a large share of the total gains in takeovers. There is no basis, therefore, to add constraints on bidding firms that are designed to "protect" target shareholders from competing management teams. Such protection is not required because there is no evidence that the shareholders of target firms are exploited in any manner.

There is some scientific evidence and a logical basis for adapting the institutional and legal framework to protect target shareholders from its incumbent management team. The logical basis is that the incumbent management has incentives to oppose some takeovers bids that would increase the value of their stockholders' claims. The current institutional and legal framework allows managers to pursue their self

interest by using corporate resources to oppose takeover bids. This raises the costs and reduces the probability that competing management teams will be able to successfully acquire control of the target resources. In addition to defeating actual bids, potential opposition by the incumbent management team reduces the expected benefits to potential bidders. This may reduce the frequency of hostile takeover bids.

The analysis, therefore, suggests that hostile takeover attempts should not be made more costly. Such changes to the institutional framework, for example, lengthening the time tender offers are outstanding, have been advanced to protect target shareholders from bidding firms. However, no such protection is required. Raising the costs of hostile takeovers would increase the veto power of incumbent target managers and further isolate them from the competition with other management teams.

Easterbrook and Fischel (1981) and Gilson (1981) have recommended changes to the institutional framework which would reduce the ability of the incumbent management team to oppose takeovers. Easterbrook and Fischel propose a passivity rule which prohibits all opposition by incumbent managers. Gilson argues that incumbent management should be allowed to solicit higher competing bids, but in all cases the proposals by the competing management teams should be forwarded to stockholders. While I am somewhat sympathetic to these proposals, I suspect that they would not improve the efficiency of the market for corporate control. Both proposals force stockholders to evaluate the proposals by competing management teams. According to the managerial competition model, this shifts too much responsibility to shareholders. The role of stockholders in a modern corporation is one of passive risk bearing. By forcing shareholders to evaluate competing managerial teams, the proposals

conflict with the stockholders' passivity. Furthermore, while some of this evaluation will occur by takeover specialists such as arbitraguers, the incumbent management is likely to have the best information to make such an evaluation.

The evaluation of competing management teams by the incumbent managers will be affected by their desire to retain their positions. However, the effects of this conflict of interest can be mitigated by compensation agreements which guarantee that the top managers of the target firm do not suffer financially from a change in corporate control. Such compensation agreements, often called "Golden Parachutes," are a private and relatively inexpensive solution to the conflict of interest problem that arises in takeovers. Golden parachutes make it less likely that incumbent managers would oppose takeovers because of their self interest. These compensation agreements, therefore, reduce the instances in which opposition eliminates takeover bids and improves the information content of managerial resistance which is designed to thwart inadequate takeover bids. I believe that private solutions to the conflict of interest problem such as golden parachutes dominate the proposals to eliminate managerial opposition to takeovers because the proposals require shareholders to become active and deny shareholders the information contained in the incumbent management's appraisal of the takeover bid. However, no costless solution to the conflict of interest problem inherent in the market for corporate control exists.

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