Corporate governance and ownership structure of target companies and the outcome of takeovers

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Abstract

This paper examines the influence of the corporate governance and ownership attributes of target companies on the outcome of takeovers in Australia between 1991 and 2000. The findings suggest that board composition and chairperson identity of target companies and director, institutional investor and external share ownership in targets have minimal effects on the likelihood of takeover success. The nature of the recommendations of target directors is found to be the most significant determinant of takeover success or failure, and bid premium levels and offer price revisions are also shown to be important in discriminating between successful and failed takeovers. The results bring into question the likely effectiveness of the introduction of formal corporate governance requirements in Australia and advocate a modification to existing corporate legislation to encourage takeover activity.

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1. Introduction

A takeover represents, in its crudest form, a power struggle between two, or more, adversaries fighting for control of a corporation and its resources. In most circumstances, this is not an equally matched fight, with the bidding company typically in a stronger
bargaining position. Possible reasons for this are many, including a substantial toehold shareholding position, a relative size advantage or the offer of a sizeable takeover premium to target shareholders. Target companies themselves are not defenceless, however, and have means available to defend and thwart takeover bids.¹ As all takeover attempts do not succeed, there are likely to be certain factors or determinants which have a more pronounced influence on the outcome of takeovers.

This paper addresses the issue of the outcome of takeover actions and develops a model of share ownership, corporate governance and takeover offer characteristics thought to influence the likelihood of takeover bid success or failure in Australia. This is very much an unresolved issue in the Australian market for corporate control, with little prior empirical research evaluating the factors relevant and influential in determining takeover outcome. Previous Australian studies by Eddey and Casey (1989) and Eddey (1991, 1993) evaluated limited variables and their relationship to takeover outcome determination. Findings from early international research (including Hoffmeister and Dyl, 1981; Walkling, 1985; Brown and Raymond, 1986; Hirshleifer and Titman, 1990; Duggal and Miller, 1994) hypothesized a number of factors consistently identified as being determinants of whether takeovers² in the United States succeed or fail. These factors include target management resistance to takeover bids, target-company and relative bidder/target-company size, toehold shareholding levels of bidder companies, the existence of competing bidder parties and the level of bid premiums offered in takeovers.

More recent work, and particularly Raad and Ryan (1995), Holl and Kyriazis (1996), Sudarsanam (1995, 1996), Cotter et al. (1997), Weir (1997) and O’Sullivan and Wong (1998a, 1999), has emphasized the relevance of management and ownership structure in influencing the outcome of takeovers. This relates directly to the separation of ownership and control evident with modern listed corporations, and the agency structure under which companies operate. Traditional agency theory ideals posit that company shareholders contract with a management body (the Board of Directors) to operate the company on their behalf and these directors are given day-to-day decision-making authority. It is initially assumed that this management body will make decisions consistent with maximizing the wealth of the principal shareholders’ claims, although the autonomy of such decision-making and the potential benefits accruing from self-interest motives renders doubt as to the certainty of such assumptions. The occurrence of agency problems resulting from self-serving decisions (conflicts of interest) made by managements creates various costs and losses borne by shareholders, and there are mechanisms in place by which both parties can minimise the degree of non-convergence.

¹ The defensive tactics available to target companies in Australia are not as diverse as those open to companies in the United States and other countries, and involve more fundamental defensive strategies, as opposed to the structural devices such as anti-takeover charter amendments, poison pills and the like, available to US companies.

² The term takeovers is used here, and throughout the paper, in a generic form. Prior studies in the United States have focused primarily on tender offers, which are the predominant acquisition method employed in that country. This is in contrast to the Australian market for corporate control where the formal takeover offer method is most employed, with the tender (on-market) offer process sparingly adopted in Australia.
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