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Hostile Takeover

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What Is a Hostile Takeover?

A hostile takeover is the acquisition of one company (called the target company) by another (called the acquirer) that is accomplished by going directly to the company's shareholders or fighting to replace management to get the acquisition approved. A hostile takeover can be accomplished through either a tender offer or a proxy fight.

The key characteristic of a hostile takeover is that the target company's management does not want the deal to go through. Sometimes a company's management will defend against unwanted hostile takeovers by using several controversial strategies, such as the poison pill, the crown-jewel defense, a golden parachute, or the Pac-Man defense.

Key Takeaways

- A hostile takeover is when an acquiring company attempts to takeover a target company against the wishes of the target company's management.
- An acquiring company can achieve a hostile takeover by going

directly to the target company's shareholders or fighting to replace its management.

- A tender offer and a proxy fight are two methods in achieving a hostile takeover.
- Target companies can use certain defenses, such as the poison pill or a golden parachute, to ward off hostile takeovers.

Understanding a Hostile Takeover

A hostile takeover bid occurs when an entity attempts to take control of a firm without the consent or cooperation of the target company's board of directors. In lieu of the target company's board approval, the would-be acquirer may then issue a tender offer, employ a proxy fight, or attempt to buy the necessary company stock in the open market. To deter the unwanted takeover, the target company's management may have preemptive defenses in place, or it may employ reactive defenses to fight back.

Factors playing into a hostile takeover from the acquisition side often coincide with those of any other takeover, such as believing that a company may be significantly undervalued or wanting access to a company's brand, operations, technology, or industry foothold. Hostile takeovers may also be strategic moves by activist investors looking to effect change on a company's operations.

Hostile Takeovers Through Tender Offers and Proxy Fights

When a company, an investor, or a group of investors makes a tender offer to purchase the shares of another company at a premium above the current market value, the board of directors might reject the offer. The acquiring company can take that offer directly to the shareholders, who may choose to accept it if it is at a sufficient premium to market value or if they are unhappy with current management. The sale of the stock only takes place if a sufficient number of stockholders, usually a majority, agree to accept the offer. The Williams Act of 1968 regulates tender offers and requires the disclosure of all-cash tender offers.1

In a proxy fight, opposing groups of stockholders persuade other stockholders to allow them to use their shares' proxy votes. If a company that makes a hostile takeover bid acquires enough proxies, it can use them to vote to accept the offer.

Preemptive Offenses

To protect against hostile takeovers, a company can establish stocks with differential voting rights (DVR), where a stock with less voting rights pays a higher dividend. This makes shares with a lower voting power an attractive investment while making it more difficult to generate the votes needed for a hostile takeover if management owns a large enough portion of shares with more voting power. Another defense is to establish an employee stock ownership program (ESOP), which is a tax-qualified plan in which employees own a substantial interest in the company. Employees may be more likely to vote with management, which is why this can be a successful defense. In a crown jewel defense, a provision of the company's bylaws requires the sale of the most valuable assets if there is a hostile takeover, thereby making it less attractive as a takeover opportunity.

Reactive Defenses

Officially known as a shareholder rights plan, a poison pill defense allows existing shareholders to buy newly issued stock at a discount, if one shareholder has bought more than a stipulated percentage of the stock, resulting in a dilution of the ownership interest of the acquiring company. The buyer who triggered the defense, usually the acquiring company, is excluded from the discount. The term is often used broadly to include a range of defenses, including issuing both additional debt to make the target less attractive and stock options to employees that vest upon a merger.

A people poison pill provides for the resignation of key personnel in the case of a hostile takeover, while the Pac-Man defense has the target company aggressively buy stock in the company attempting the takeover.

Real World Examples

A hostile takeover can be a difficult and lengthy process and attempts often end up unsuccessful. In 2011, for example, billionaire activist investor Carl Icahn attempted three separate bids to acquire household goods giant, Clorox, which rejected each one and introduced a new shareholder rights plan in its defense.2 The Clorox board even sidelined Icahn's proxy fight efforts, and the attempt ultimately ended in a few months with no takeover.

An example of a successful hostile takeover is that of pharmaceutical company Sanofi-Aventis's (SNY) acquisition of Genzyme Corp. Genzyme produced drugs for the treatment of rare genetic disorders and Sanofi-Aventis saw the company as a means to expand into a niche industry and broaden its product offering. After friendly takeover offers were unsuccessful as Genzyme rebuffed Sanofi-Aventis's advances, Sanofi-Aventis went directly to the shareholders, paid a premium for the shares, added in contingent value rights, and ended up acquiring Genzyme.