

The Study of Takeover Defences and Firm Values Moderated by Firm's Ownership Structure in Malaysia

Teoh Siau Teng *

Abstract: By utilising agency theory as an underlying theory, this paper proposes a conceptual framework based on the current corporate governance literatures. The objectives of this paper are twofold - firstly, to study the relationship between the firm's takeover defences and firm value as previous research have exhibited inconsistent results and secondly, to propose the moderating effect of firm's ownership structure (management shareholder and outside investor shareholders) that may have an impact on the takeover defences-firm value relationship. A conceptual framework and four propositions are developed based on a comprehensive literature review for future research direction.

Keywords: Takeover defences, firm values, ownership structure, Malaysia

INTRODUCTION

Merger and acquisition activities have come in waves. 76,000 deals were completed globally during the period of 1990 – 2007, with a recorded value of US\$ 4.1 trillion. According to Rahman and Lambkin (2015), data cited from Thomson Reuters, the most recent merger and acquisition wave came in 2010 after the world financial crisis with a total value of US\$2.4 trillion with 37,000 transactions completed in 2012. This active market has drawn a large attention from academicians for widespread research in various disciplines. One of the most common discussions in the merger and acquisition issue is the takeover defence

*Teoh Siau Teng, School of Business and Management, Han Chiang University College of Communication. Email: teohst@hju.edu.my

strategy. Takeover defences may present itself as a positive mechanism when the target firm uses it during the negotiating stage against the bidder in order to gain more advantages. On the other hand, it can also be a form of resistance strategy from being acquired.

In general, takeover defences can refer to the manager's action in resisting the takeover proposals suggested by external forces to acquire a company. Takeover motives can be classified as hostile takeovers or friendly takeovers (Morck et al., 1988). However, the intensity of the defences can range from mild to severe, which may cause the takeover process to be complicated (Ruback, 1987). Previously, scholars believed that no companies will adopt takeover defences prior to IPOs due to agency cost incurred between the owner-managers and shareholders, which subsequently decreases the IPOs proceeds. This thought remained until the 1990s when there were adequate research evidence showing that many companies adopted takeover defences prior to IPOs (Coates, 2001). In fact, the recent paper published by Mazouz and Zhao (2019), revealed that the risk-averse managers are more likely to adopt takeover defences to protect one's compensation portfolios and avoid the firm's stock price uncertainty as the market is often myopic.

LITERATURE REVIEW AND PROPOSITION DEVELOPMENT

2.1 TAKEOVER DEFENCES

Takeover defences can be distinguished into pre-bid defences and post-bid defences. Pre-bid defences are the defences deployed prior the bid, such as staggered board/ classified board, poison pills, non-voting and/or multiple voting shares and others. Whereas, post-bid defences are the defences adopted once the bid starts, litigation and white squire are the most common measure used (Iannotta, 2010). Poison pills and classified boards are the most popular and effective approaches in takeover defences. Both of these approaches are positively related to the target's share of merger gains, target announcement returns and target premiums when the target firm hires a top-tier advisor. The top-tier advisor is treated as a bargaining tool in utilising takeover defences in the negotiation process by strengthening the target firm's bargaining position,

which helps the firm to seize higher premium and merger gains (Ertugrul, 2015).

Humphery-Jenner, (2014) focused on the "hard-to-value" (HTV) companies by putting the lens to the firm's takeover defences and its impact of managerial entrenchment decision making. The results suggest that takeover defences are beneficial to HTV firms by increased shareholder wealth and firm's innovation intensity. Nevertheless, there are mixed results in market reaction to a takeover defence proposal in managerial share ownership and efficiency. There are indications that although takeover defences will increase the firm's bargaining power, however, it does not apply to those firms with inefficient managers, regardless of the level of the managerial share ownership. The importance of the firm to have effective managers can determine the firm's bargaining advantage position (Malezadeh & McWilliams, 2011).

Another perspective from the bonding hypothesis argued that takeover defences can help to bond the IPO's firm intrinsic and extrinsic commitments to the firm's stakeholders, namely customers, suppliers and strategic partner. On the other hand, it will also facilitate the firm's counterparties to engage in a business relationship, and benefits the IPO firms in the long run (Johnson et al., 2015). Cremers et al. (2008) asserted that the long-term relationship of the firm to the customers and suppliers will lead to greater incentives for the stakeholders to monitor and take takeover defences, especially in product market competitive industries. Ryngaert and Scholten (2010) focused on the shareholder wealth outcome and managerial turnover to those defeated takeover bids firms. The result suggested that for those firms which were successful in their defence from being acquired, the shareholders generally exhibited a better wealth outcome. Conversely, the successful defence from hostile takeover bids do not result in management entrenchment, instead it increases the managerial turnover rate.

By using the US as a sample to study the correlation between religion piety and takeover defence effects on the firm, it is suggested that a stronger religious firm can substitute corporate governance, particularly in the lens of takeover defences. The firm with stronger religious piety is more likely to have takeover defences. However, this course of action will lead to managerial consolidation, subsequently destructing shareholders' interest (Chintrakarn et al., 2015).

Stout (2002) explained that many of the studies focused on ex-post analysis on how anti-takeover defences affect shareholder's wealth after the firms were successfully acquired. Though the firm encouraged non-shareholders to make extra-contractual investment in corporate team production, the takeover defences might increase the shareholder's wealth ex ante. The results suggested that shareholders indeed perceive takeover defences as beneficial ex ante. Yeh, (2014) conducted a post-adoption examination of operating performance to verify the robustness for the managerial entrenchment hypothesis. This empirical study showed there was no significant difference in a firm's performance after adopting takeover defences for two years. Yeh explained that these anti-takeover attributes did not intrinsically alter the manager's behaviour, where the adoption of takeover defences basically was to deter hostile takeovers.

2.2 TAKEOVER DEFENCES WITH FIRM VALUE

Takeover defences are often associated with wealth effects to the shareholders. The resistance from the management will lower the possibility of being acquired, and the shareholders will less likely to receive the takeover premium. Furthermore, the defences might also benefit the shareholders through the takeover bid, which may increase the offer price. Additionally, the firm value will also be affected even though the takeover did not succeed (Ruback, 1987; Ryngaert & Scholten, 2010). This causality was further validated by Johnson et al. (2015) and Andres et al. (2019) that there is a significant positive relationship between IPO firm value and the use of takeover defences.

In contrast, Gompers et al. (2003) pointed out that the takeover defence approach will cause fatal effects to the firm. Through the anti-takeover process, the inefficient or opportunistic managers will be segregated from the firm's control. As a result, the takeover defences will cause a managerial entrenchment that will worsen the agency conflict, subsequently lowering the firm's value. By using a large sample in the U.S firms during 1990 to 2006, Hwang and Lee (2012) denoted that the anti-takeover provision exhibited a lower value relevance of earnings. From the investors' perspective, the firm value will be discounted to the firm that adopted a defensive approach as the investors perceive such firms will less likely to generate a satisfying return of investment. Therefore, the firms with takeover defences will deteriorate the investor's

perception of current earnings, and cause the managerial entrenchment rather than increase the firm value.

Based on above discussion, previous research showed a significant yet mixed results between the relationship of takeover defences and firm value. Hence,

Proposition 1: The firm's takeover defences are significantly associated with the firm value.

2.3 TAKEOVER DEFENCES WITH OWNERSHIP STRUCTURE

According to a study from O'Sullivan and Wong (1999), by using UK as a sample, it showed that the firm's ownership structure and board composition are closely related to the firm's likelihood to becoming hostile takeover targets. Results showed that executive share ownership has a significantly lower probability in becoming hostile takeover targets as compared to the firms that separates its ownership and executive roles. Hostile takeovers are more likely to target firms that possess insufficient equity to defeat the bid, or the bid is too costly for the bidders.

A study in Japan using 130 Japanese firms by examining the relationship of Cumulative Abnormal Return (CARs) and the ownership structure is closely related. Managers with intermediate shareholdings are prone to use takeover defences to attain a better deal from the bidder, and they are more closely aligned with the firm's interest. While managers with less or greater shareholding are more likely to manage entrenchment, likewise they tend to prevent hostile takeovers to maintain their power and control. It can be concluded that the firms with greater outside shareholdings are associated with lower CARs and higher outside shareholding ownership structure implying higher tendency to engage in takeover defences from hostile takeover threats (Yeh, 2014).

There are many literature exploring the consistent result on takeover defences in different types of ownership structure. As previous literatures suggested, the management shareholder will have a higher tendency prone to anti-takeover provisions. Therefore the propositions are formulated as below:

Proposition 2: Takeover defences are significantly associated to the firm's ownership structure, a) management shareholder, and b) outside investor shareholding ownership.

2.4 OWNERSHIP STRUCTURE WITH FIRM VALUE

The relation of ownership structure to the firm value has been studied by numerous scholars. The core of this analysis is usually to explain the conflict of interest between internal and external shareholder, as per agency theory proposition (Wei et al., 2005). A comprehensive paper by Lins (2003) covered 1,433 firms across 18 emerging markets in studying the relationship of firm ownership structure to firm value. Those companies with outside investor shareholdings as the blockholders are positively related to firm value and this is noticeable in the countries with lower shareholder protection. Lins has interpreted this result and suggested that outside investor shareholdings play a role as a substitute institutional governance mechanism to restrain the agency cost. Besides that, an empirical research conducted in China with 5,284 private firms that were formerly state-owned firms also demonstrated that ownership structure and firm value are significantly correlated. Wei et al. (2005) noticed when the government retained significant ownership after privatisation, the firm values decreased. When other block shareholders become the dominant shareholder than the government, the firm value increased.

Nevertheless, Shapiro and Gomez (2014) conducted a research in Spanish firms that showed otherwise; where there was a quadratic relationship between firm value to ownership concentration, and also the majority shareholders managed to expropriate the wealth of minority shareholders which differs from the results obtained from UK, US and Japan. The argument of the difference in value-ownership relations needs to be explained in the various corporate governance systems across countries. The variance effect of ownership structure-firm value relationship between the countries was further confirmed by the research of Morck et al. (2000). As the equity ownership structure in Japan is different from the limited equity ownership practice in US, results show that the firm value increases drastically when there is an increase in the managerial ownership. Equity ownership by corporation blockholders is positively correlated with the firm value.

Ownership structure is often seen as the main determinants of firm value. Most of the literature findings showed inconsistent results in the relationship between ownership structure and firm value, especially in different country settings, hence the propositions below:

Proposition 3: Ownership structure (management shareholder and outside investor shareholding ownership) is significantly associated to the firm value.

2.5 OWNERSHIP STRUCTURE AS MODERATING VARIABLE

Over the years, the perspectives of anti-takeover provisions have polarised into two different ideologies. Some authors (Cohen & Wang, 2013; Field & Karpoff, 2002; Sokolyk, 2011) perceived takeover defences as inefficient firm performance with lower accounting performance and reinvestment rates; where the takeover defences and staggered board's approach do not have any impact on the firm premium during acquisition. Conversely, some authors argue that this provision will cause a managerial entrenchment, subsequently to protect managers from the disciplinary effect of takeover which, in turn, prevents opportunistic bidders by strengthening the firm's bargaining power (Ertugrul, 2015). Andres et al. (2019), Bhojraj et al. (2017) and Ge & Kim (2014) also supports this notion as they found that the manager will be less likely inclined to short-term pressures and manage earnings as takeover defences can mitigate the myopic behaviour by displaying higher commitment to long-term performance to prevent being acquired. This is identified by the higher returns per unit of earnings by surprise in equity market of the firms that inaugurate the takeover defences. There are many determinants for a firm to launch takeover defences as a protection shield from being acquired. However, the advantages of takeover defences to the firm is under great dispute as many literature found there is an inconsistent result to the firm value (Bhojraj et al., 2017; Cohen & Wang, 2013; Ertugrul, 2015; Field & Karpoff, 2002; Ge & Kim, 2014; Sokolyk, 2011).

One of the most widespread determinants in the studies of takeover defences is the firm's ownership structure. Generally, the anti-takeover provision is positively associated with management shareholder type of ownership structure (O'Sullivan & Wong, 1999; Yeh, 2014). Additionally, the relationship of ownership structure also showed a

significant but mixed correlation with firm value (Lins, 2003; Miguel et al., 2001; Morck et al., 2000; Wei et al., 2005).

Based on above arguments and discussion, this paper conceptualises that ownership structure has a moderating effect over takeover defences and firm value relationship.

Proposition 4: The firm's ownership structure, a) management shareholder, and b) outside investor shareholdings significantly moderate the takeover defences and firm value relationship.

CONCEPTUAL FRAMEWORK

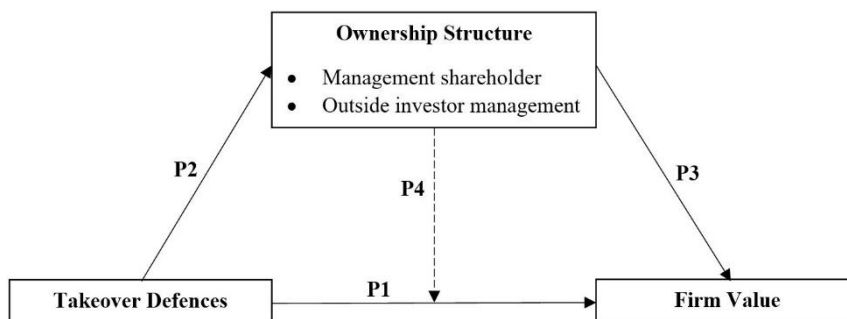


Figure 1: Proposed Conceptual Framework

CONCLUSION AND RECOMMENDATIONS

This paper intends to make a few contributions to the literature on merger and acquisition studies. Firstly, to fill the research gap on current literature by considering the moderating effect of ownership structure to the takeover defences and firm values to academia dedication. Previous study results on takeover defences to firm values differ and are rather inconsistent; takeover defences are closely related to firm's ownership structure, while the ownership structure was seen as one of the most crucial deciding factors to the firm's value. While there have been significant literature linking takeover defences to firm value, takeover defences to ownership structure, and ownership structure to firm value,

there has been little literature evidence relating these three variables. Secondly, the author recognises the significant effect of the ownership structure to the takeover defences and firm's value by proposing the ownership structure as the moderating factor. Many literature discussed takeover defences and ownership structure from diverse perspectives, though it does not examine it as a proposed framework in this paper, but somehow the correlation to firm performance or firm value is significant. Hence, the author suggests that this framework is relevant to be used for future research framework that intends to enrich the body of knowledge in merger and acquisition.

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