Mergers, Acquisitions and Corporate Restructuring
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Lecture - 07
Takeover Tactics and Anti-Takeover Defenses – 1 (Continued)

Hello friends, we are going to continue the previous session in that we discussed about different takeover tactics by the acquiring company. In this particular session will be focusing more on the defense techniques tactics by the target companies and its management.

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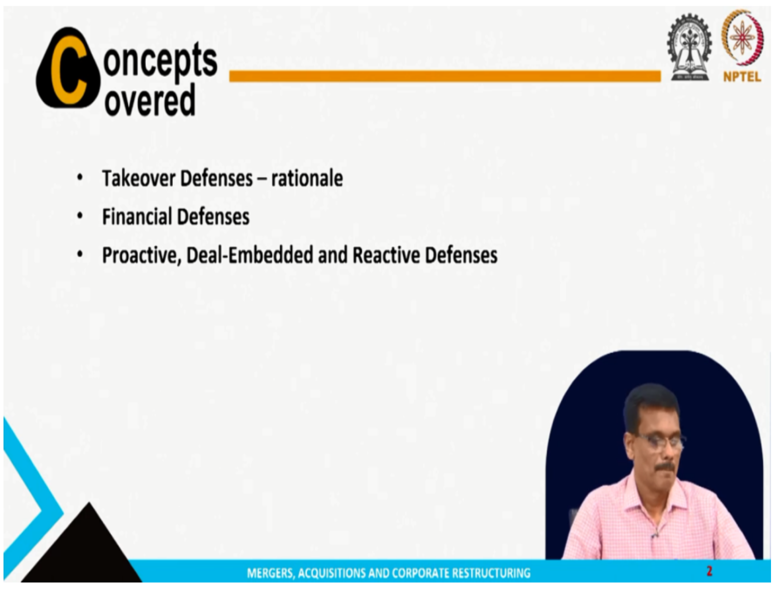

So, this is the way we go we are going to talk about takeover defenses and why defenses can be justified they could rational for that and we will talk about financial defenses, then we will have other defenses which will be talking about proactive and during the deal embedded or reactive defenses by the target company and its management.

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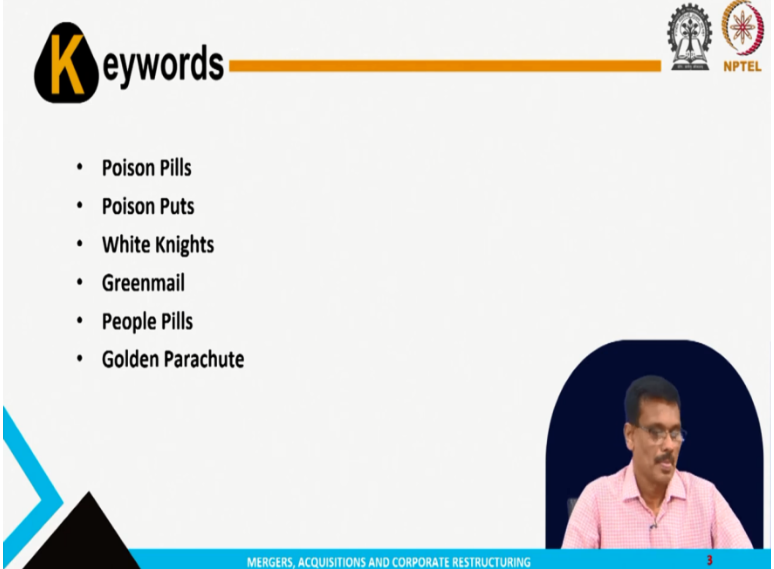

So, coming to the keywords these are the keywords you have poison pills, poison ports, white knights, green mail, people pills, golden parachute, these are only select keywords but we will be talking about different other concepts in as a techniques of defense mechanism by target company.

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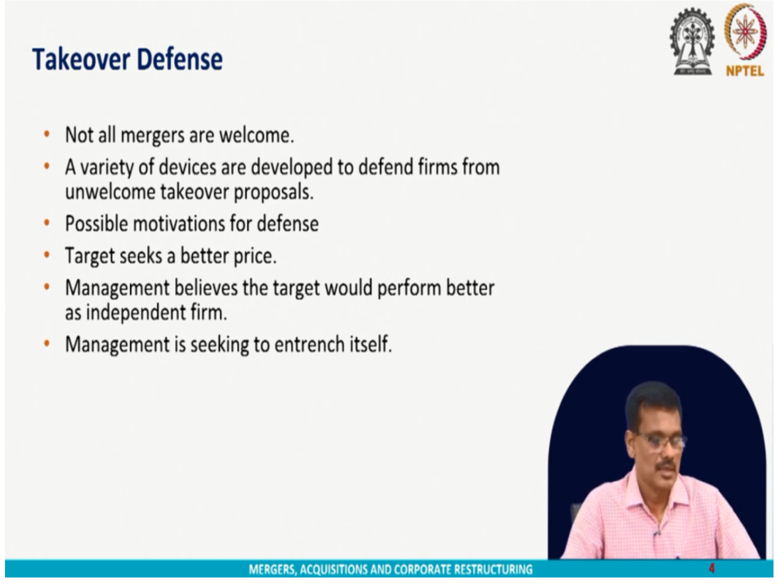

So, coming to the defense see this is a company which is existing maybe the company filled their companies being managed well. So, they may not like the company merge with another company and they like to continue access. So, that is why all mergers and acquisition may not be welcomed by the target company and at the same time to protect their interest variety of devices

techniques are there to define the firms from the on welcome takeover proposals or hostile takeover proposals.

And there could be a lot of motivations for the defense to have and at the same time the target also have may have the defense mechanism so that you can get a better price for the shareholders and also it could be something like this. The management it is a belief that it being staying independent and they will be doing better, they will perform better and instead of being merged with another company and acquired by another group for that matter.

Or at the same time the management even if they are not doing well, they would like to entrance its themselves. They do not want to leave the company even the company is not doing well so it is called entrancement hypothesis. So, these are certain things which say that yes takeover defense could be desirable for that matter.

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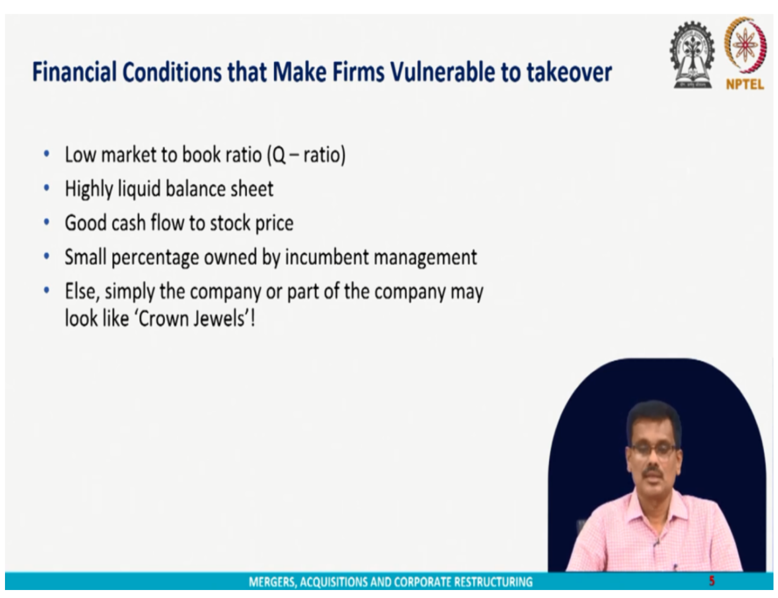

Then certain conditions of the company make the actually company vulnerable. So, in that case forget for that matter a company may have very low market to book ratios known as **(()) (03:13)** Q ratio, where we talk about market to book market value of the company to book value of the company that is low. That means same company the one is available it is cheaper. So, in that case because if your company is doing well in that case market to book ratio would be actually high.

Markets recognize that and even the company doing well is not recognized market may be valuing company less. So, this company may be available cheaper so that is why you become target by another company. The company also may have good balance it liquid balances that means they may have some liquid assets which can be used for different expansion activities furthermore. So, that liquid balance it can mean attraction for the acquiring company.

Company may be generating good cash flow to stock price ratio resident order of cash flow so that is also can be used for growth by the acquiring company. And the incumbent management also may have a small percentage in that case of the company can be easy target because to displace the income and management is not going to very difficult for the acquiring company or the company may be simply a very good company which has a lot of crowns jewels.

Crown jewels means something else every key assets, key capabilities of the company and which actually generates lots of revenue and cash flow for the company. So, the company has lot of crowns jewels in the crown jewels becomes so attractive for the acquiring commercial they will like to take over the company itself.

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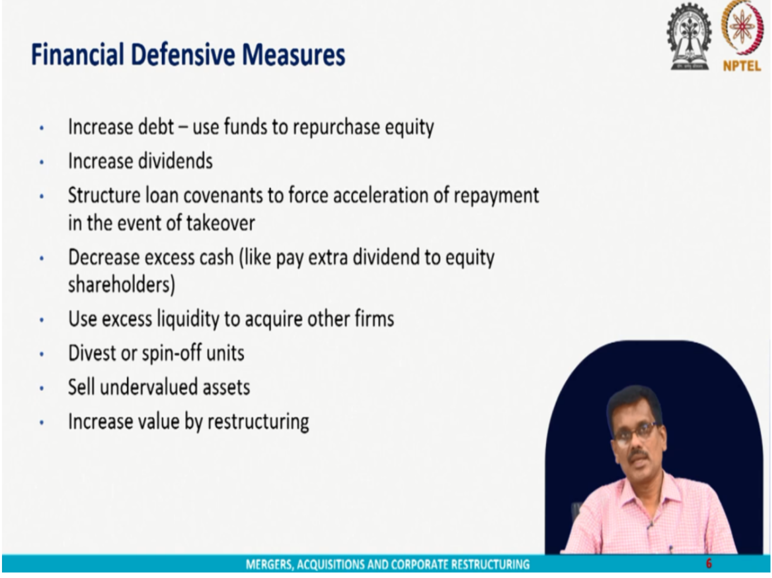

Then in that case if that makes the particular company vulnerable. So, company on its own can plan so that they do not become the takeover target like they can increase the date in that case they leverage themselves their financial risk of the companies go up and take the money also

instead of expanding the assets they may go for repurchase of shares. Of course, subject to the regular rules and regulations; that particular country where other repurchase can be repurchased or buyback of shares can be financed by loan or not.

If it is if there is no constraint like that companies may go for. So, in one way, they are leveraging they are making the more little riskier financial riskier and at the same time they are also buying the shares from the market and that way the existing controlling shareholders have more percentage stake in the company effectively. You can increase dividends so that you do not have the excess gas.

Then you can also the company can also go for loan covenants and which will say that if the lender wants, they can take the money earlier. Then decrease excess cash we talked about that also so you can pay some extra dividend for the shareholders or you can use the excess liquidity to acquire some other companies, then company can also divest and make spin-offs or make multiple units.

And then possibly it becomes little cumbersome for the occurring company to acquire multiple companies for that matter and divesting means the companies maybe a particularly crown jewel is there and they were divested, so the company does not remain attractive. And there could be some assets which are not on valued properly you can sell it and get a better value or the company can also itself go for further restructuring of the business itself.

In that way possibly will convey to the market that your company is doing well it has called multiple businesses and so that the market recognizes that and market price goes up. And it becomes higher market price as you discussed in previous class, a very high market price is the best defense for the company available. So, increasing value also leads to high market to book ratio.

So, these are certain things which the company can adopt so that they become less attractive for the acquiring company.

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Then we have will cover different techniques of defense and the three broad classification you can have one is called the proactive defenses. In fact, the previous level we talked about certain things can be taken as product that means is already there in the companies statute are already there. So, before a bit actually these provisions are always there in the company assess. Then another is when there is a deal embedded during the deal of course it happens when the friendly deal takes place the deal during deal you can have some defense mechanism.

So, that you avoid the some other third party coming and disturbing the bid also disturbing the process. Another is called the reactive differences where once a hostile bid takes place the company may react with different measures so that they can withstand and they can put a pressure on the acquiring company. So, that they do not come further so they are called react they are called reactive defenses we will discuss one by one.

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Coming to proactive defenses it is called chatter amendments. We will talk about charter amendments, in Indian context we something have called articulate versus system memorable system for that matter. So, article association can have certain mechanisms and those things can be changed so that the companies can have proactive defenses. For example, the company's article may have something called a staggered board.

The staggered board means all the board members are not elected at one go for all full term. Rather they are related stagger that means one third of board may be elected this year another next year. That means the board members have got certain continuity in the company, if the company is taken over by another company still the board members will continue because they are still there.

And one third may retire after something another in another one third like that they will come. So, they can in that case what will happen, even if the company is taken over the existing board members can create problems for the acquiring company. Then the company can have a provision subject to the particular country's laws and regulations; company kind of provisioned that any merger acquisition can be approved only with super measured like sets 75 percent of three fourth voting.

So, that guys what happens so many people shareholders have to actually approve the merger assets, otherwise the merger acquisition will not be approved so that can be there. Then called fair price provision in that case if the occurring company is offering X rupees per share to somebody, it has to also offer same price to all. In fact, in our Indian context the law itself protects the interest of shareholders.

If there is a controlling stake change by somebody is some X companies acquiring some stake in Y company buying paying a premium to the existing controlling stakeholders and management then the X company also has to offer those to buy the shares from the retail shareholder. So, that case so that retail sales also get the same price like the controlling shareholders. So, that even if that is law does not provide let us say the company in its own amend in its chatter itself can have the provision.

That no there is going to be any discrimination between on the offer the price to different type of shareholders. Then the companies can have dual class recapitalization that means you can go for different types of shares and of course in India, we do not have you have only two types equity shares like whenever non-voting shares or equity shares. But in certain countries we also have soup both same shareholders having more than one voting right.

So, one may have more certain number of shares issue to some people where they have more than one voting rights as, so that is called dual class a different class of shares. So, those people can actually create an obstruction at the time of takeover attempt. Then the companies can have the poison pills we will discuss that in subsequent side slide poison pills, then you have poison puts.

Then company can have golden parachute, company can also have employees stock option plans labour agreements as far as this employee stock ocean plan are there. In this case what happens the you have an employee stock option plan means the employee will go and get the shares in future the wasting takes place. And so, since employees are in your favour access and also there could be agreement labour so that yes, the labour will continue to support the existing management.

And maybe the management changes the management new management may have to go for new agreement with the existing labour assets. So, that can create some inconvenience in future if the companies eventually taken over. So, you will be discussing further about poison pills, poison puts and golden parachute in the subsequent slides.

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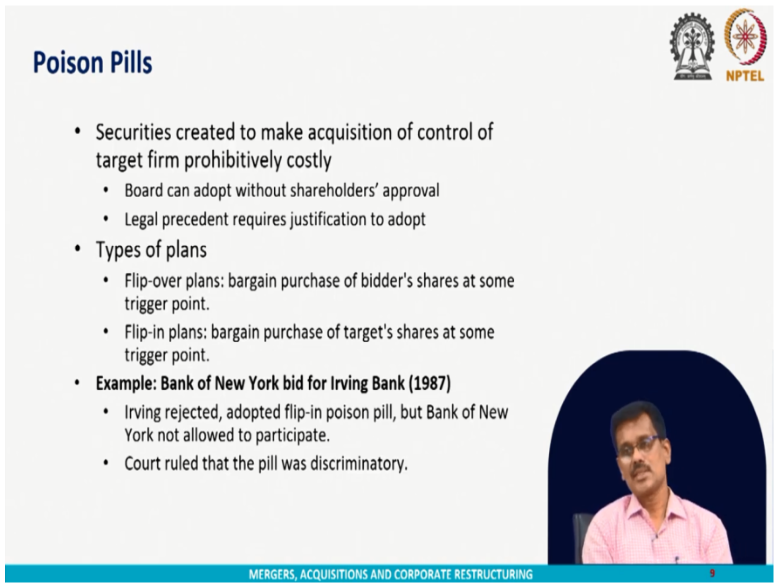

When it comes to poison pills assets what happens in this case and additional securities are actually created to make the acquisition of control of target from little costlier to more costly for that matter. And a board can again all this thing to talking about they are subject to rules or regulations of the particular country. So, it is general concept we are talking about and the board can adopt a poison pill approval and but you have to justify while you have this particular poison pill.

And poison pill what happens the two types of poison pills possible generally, they have flip over and flip in. So, what happens in the flip over plan the bidders shares will be bought by the target company several they will have the right to buy the shares of the bidders company, the targets are also suppose company A is acquiring making an attempt to counter a clear company B, the company B shareholders will have the rights to buy the shares of company A after the measures takes place.

That means and that to at a very low price for that matter. So, that is a condition they are assessed unless the condition is revoked. Flip in plans means one triggering event like that controlling stack changes takes place the target company shareholders will have the right to buy the targets shares at a very low price. So, that case what happens the existing share holders target will have more shares at a very low prices.

So, that it becomes now their stake also has to be bought by the acquiring companies. That way the acquisition becomes more costly for the management for that matter. So, for example in 2018 old example Irving was there is a hostile beat by Bank of New York to acquire Irving bank Irving but Irving actually rejected and then adopted a flipping poison pill but Bank of New York was not allowed to participate in that and court also.

But in that case even if you have a poison pill can of the acquiring company can also go to court of law and but this particular poison pill is actually found to be discriminatory against certain shareholders because it was actually cancelled by the court but there is actually the Irving bank took this particular measure to protect or protest the takeover attend for that matter.

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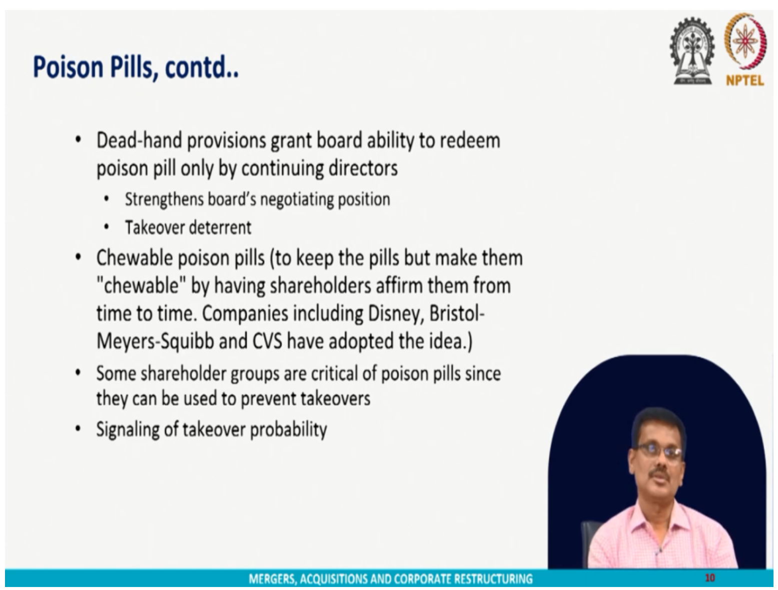

Then you have other provisions in that there could be some provision in the poison pill because it is not the idea is to make it more costly, I just make that this does not go for a get a very this size air or a very cheaper price, the shareholders will get a good deal that is the actually possible the

major idea I would have poison pill. In that case the board can also redeem this poison pill with that I can be there with the board that and but the containing directors can actually redeem that assets.

So, in that case what happened? The boards negotiation position is strengthened and is also acts as a takeover debtor and assets. At the same time, you can have chewable poison pills in that case the board can decide that yes if the offer is certain very high for that matter. In that case like say godfather offer for that matter discuss in the previous session that the price is so high it is attractive to go for this particular takeover attempt and you can always give the shares in favour the acquiring company.

So, in that case there can be automatically it will be the appeals will be chewable and the people should actually vanish and the takeover can actually take place because the sellers are going to get a very good price for that matter. And at the same time some people are some cellular groups like proxy firms object to this because poison pills is there means, they are actually possibly they are trying to prevent a healthy takeover by some good company.

And the existing company may not be doing well and they are actually unnecessary protesting they take over attempt. And at the same similarly also people say if the company is actually adopting a poison pills in its chatter possibly they are thinking the takeover attempt is there. So, there is a probably take over that is why they ah are going for it, so there is a signal to the market that there is a attempt to there is could be a takeover attend for this particular company for that matter.

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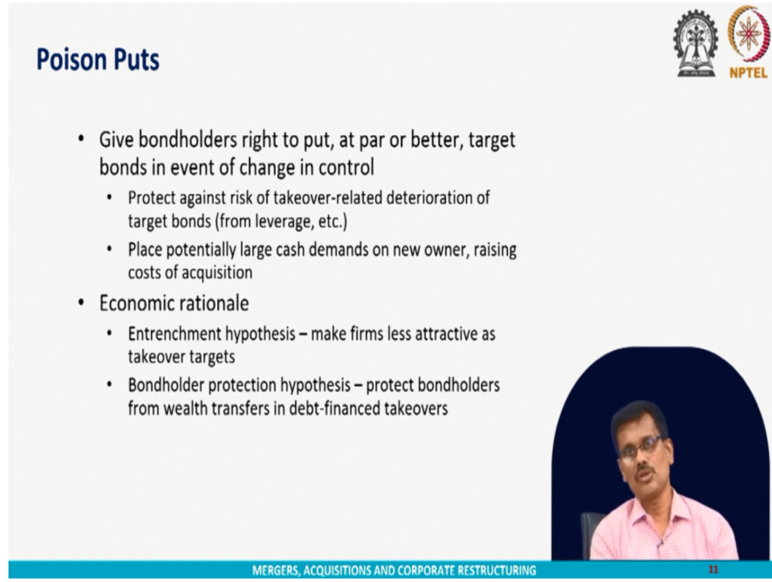

Then we have another called poison puts. In the poison puts what happens, it is for the bondholders or the lenders, so if there is a there is a condition that if there is a change in control in the management in that case the bondholders will have the right to take back the money from the like they can access as a put option and they will take back the money from the borrower may be the same value or at a premium for that matter.

And so the rationale for this is that, yes it creates an entrancement so that farm because less attractive. Because the immediately acquiring company has to arrange for chaos pay to the lenders and in that way, it becomes little more costly besides paying the shareholder they also pay to the lender they have to arrange the cash for that. Also, another thing is that yes with this you are also protecting the bondholders with lenders also have to protect it.

Because this management changes when the bonds were actually issued it was with existing management, they are style of functioning. If the management is changing, we do not know whether the bondholders interest will protected or not so that is why the bondholders may have a right to exercise the put option and take the money in the event of change in the control. So, these are the certain economy rational for having a poison puts.

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Golden Parachute

- Change in control benefits for top level management
- Severance package in employee's contract
- Key personnel's are protected by this clause whenever there is change in control of the firm
- If there is a loss of job then severance package is paid to them
- The benefits can be paid to them in cash, bonuses or stock options too
- It is paid if the employment is severed prematurely
- Protects interest of employees during hostile or unfavorable environment
- Existing employees can be dominated by the new employers

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Then we have another takeover defense that is called the golden parachute. In golden parachute what happens if there is a change in control then it benefits of management and top managements actually are given a severance packaging there is a change of control, change of control takes place then the top management will get some money or some consideration and they can actually lead the company.

Or even if they are asked to leave the company, they will be entitled to get those extra incentives for that matter. So, that way you are protecting the key persons with this clause in this engine control and so that they are continuing in the company there is an incentive for them or if they leave, they have to get the money assessed. So, that there is a loss of job then the severance package is paid to them.

And these benefits can in the form of cash or it can be some extra bonuses can be taken or can be stock options can be there, they can have the right to buy the shares of the company. And yes, it is of course given to the employment which is prematurely they are actually leave the company and it protects the interest of the employees. And so that otherwise existing employees can be dominated by the new employees that is a possibility.

So, why to take the access dominance, it is better that one can actually lead the company and take the severance packages. So, these are the justification for having golden parachute.

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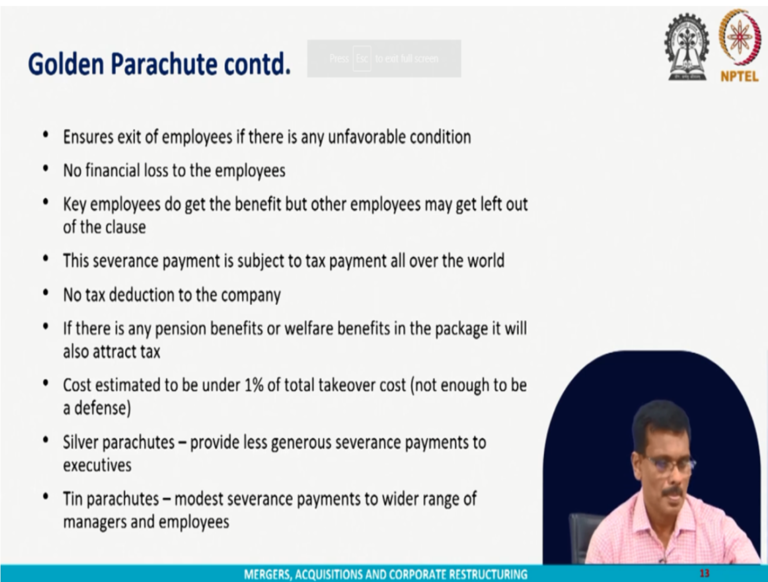

And so that if the one favourable condition is there people can leave and so that the employees do not have any financial loss and but one problem is that if this golden parachute may be given to certain key employees not to all the employees of the company for that matter. So, in that case some people may be left out. And yes, this severance payment can be subject to tax that is all like any other salary or incentive package.

And it is given that surround total whatever you look at general takeover market around 1% total takeover cost goes towards this golden parachute. And the parachute is extended a little lower middle level management for that matter beside the key then in that case they will be getting some amounts which is actually lesser than the golden parachute that is known as silver parachute.

And if it is given to several people of the company that they can also live in the event of change in control and there this given to wider range of employees in that case it is called tin parachute. Of course, that amount is going to be substantial lower compared to golden parachutes for that matter.

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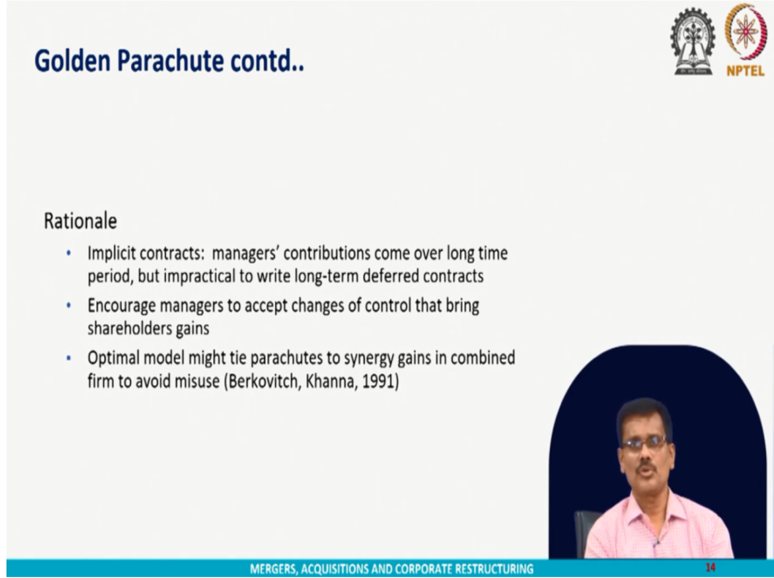

And rational yes, it is implicit contracts because the managers are there with the company for long. So, there interested protected and they should not be changed just like that and yes in the otherwise management is also accepting changes in the control that bring shareholder gains for that matter. And then optimum model can be that you can do a golden parachute those are you have synergy gains in the combined firm to avoid the misuse itself.

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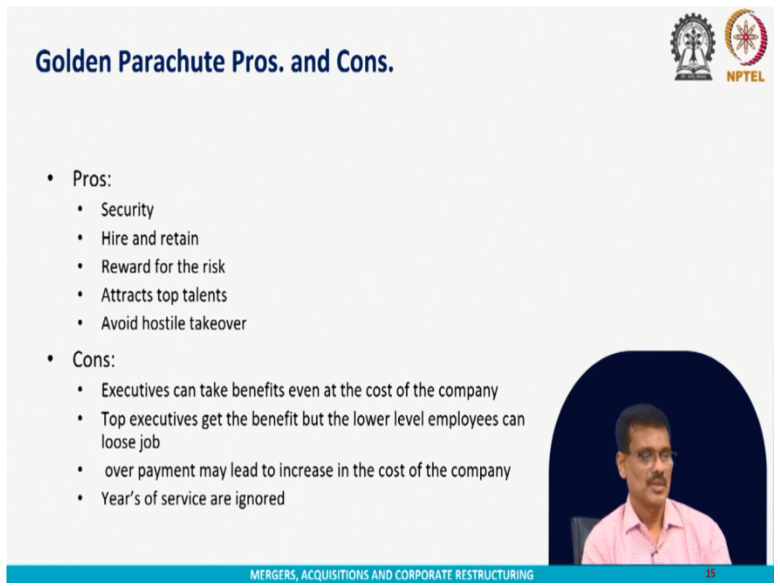

So, the pros and cons, yes there is a security and you hire and retain the employee, then your reward for the risk taken by the people and it also attract the top talents. It also possible avoids any hostile takeover. And what the consequence is that if the company has been taken over these

people will have lot of money, they will take away take leave the company with them so that it will be the company becomes less attractive and the top level actually get the benefit but not the lower level people.

And in that case in its release over payment also cost of the company goes up and how many years of service you have put that may be actually ignored and that benefits actually goes from the knowledge itself goes from the company itself.

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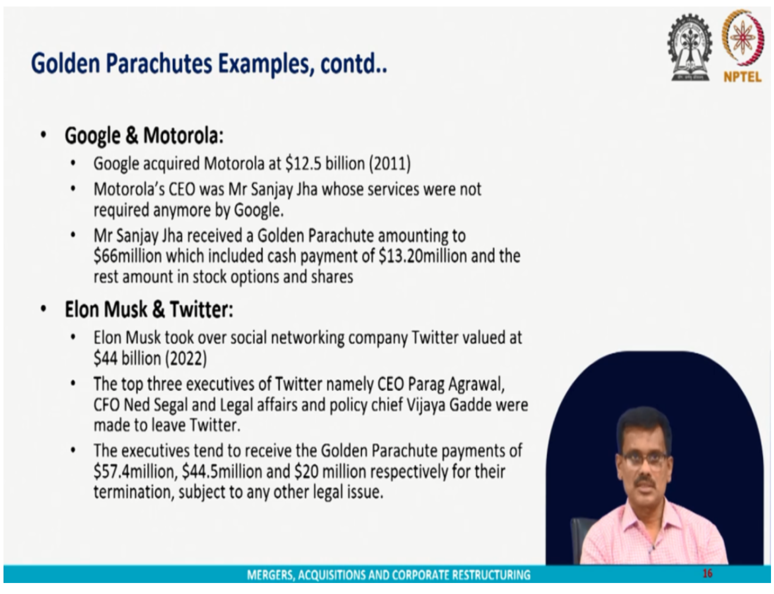

So, there are certain examples recent in 2011 when the Google acquired proposed to acquire material and acquire eventual 12.5 billion dollar the Motorola CEO that Mr Sanjay Jha then his services are not required by Google. So, Mr Sanjay Jha as a agreement of in which is there existing in the company with Motorola their golden parachute because of that he got 66 million dollar severance packages which included some 13.20 million in cash and rest of the amount in the stock options and shares in the company.

Similarly, recently we had Elon Musk taking over Twitter in that case Twitter is taken away 44 billion dollar and the top three executives Parag Agarwal, Ned Segal and Vijaya so they were actually made to leave Twitter. And there is an agreement in the existing twitters condition with these people that if there is a franchise in control, they will be getting some 57.4 million cash for the termination subject to 57.4 million for Mr Parag Agarwal.

44.5 for the second person and 20 million for the third person Mr Vijaya Gadde. And they will be getting those terminations be subject to any other legal issues for that matter.

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Then when the deal is actually going on between is a friendly deals going on two different companies acquiring in our company so there could be some defense mechanism so that there is no flick this it controls **(()) (23:20)**. We discuss partly those things in our also in the takeover attempt takeover techniques for that matter. So, there could be a breakup or topping fees for that matter breakup fees can be there if there is suppose the target company goes to solicit the bid of some other company.

Then the company can always ah the target has to pay a breakup into the acquiring company which is sitting in the table and negotiating. There could be some assets which would be there and if this finally deal does not take place the acquiring company may have the right to buy those key assets for that matter. Similarly, the acquiring company can have some equity hold some share some 20 percent, 5 percent or something like so that they will have the right to buy the shares and they can create particle.

So, this particular equity has to be given or the company can also itself have a two-hole stakes in the company. So, that even there is acquisition takes place this take of the acquiring company

who are supposed to acquire initially they can they have to be now paid some amount, so that they go from the table and because they have already some stake in there. So, they can create some inconvenience in the event of future acquisition by some other company for that matter.
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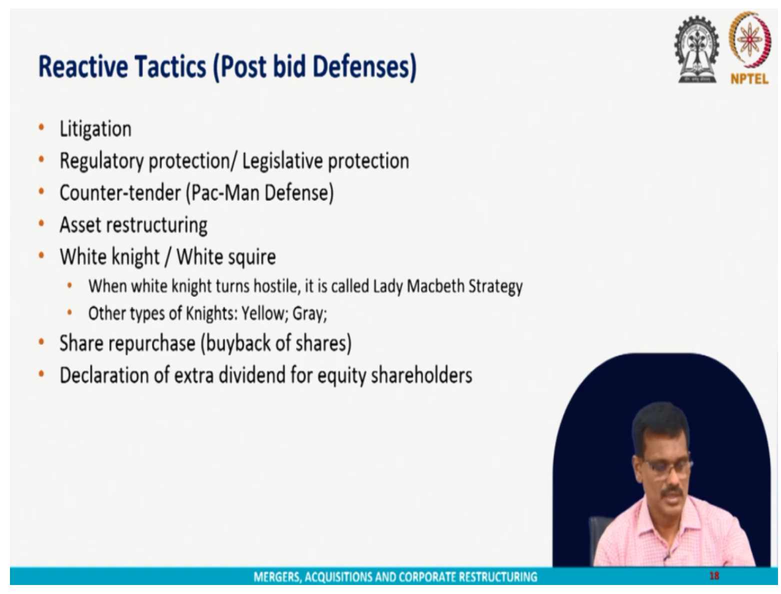

So, another thing is a reactive defense, so actually take over item has been made and now the is hostile the target does not welcome this particular proposal. What they can do? So, they can go for certain reactive differences one of them is called litigation. So, there could be some laws or rules they the occurring government might have violated and they can go to the court of law and say that these things are actually not correct by the company for that matter.

Then there could be some regularly the resistance protection in the some of the countries can favour lifestyle protection can be there. Another thing could be that the target company gives offer to buy the acquiring companies is called counter tender which calls known as Pac-man defenses typical game through the packman. So, each of them will like to acquire the other one assets.

This is called Pac-Man defense or the counter tender by the target company to the acquiring by the tax query compressors. The company can also immediately go from the asset restructuring sell of their shares so accuracy assets. Restructure the company also. Company also can go for

another bidder so they say will not like to go for go with this particular acquiring company rather we like to go for someone else.

So, in that case that is called a third party comes here is called white knight. And white knight means a third party comes at a we will like to go for these particular companies to be acquired so say there the change in control management takes place. But not with the company a which is possibly making an attempt to take over they could go for personal company B they may be more friendly for the existing management or they may get a better terms and condition with the B assets.

So, that means that another party comes to play and then it all depends on the shareholders with particular which offer or the target company A's offer or company B's actually accepted. And sometimes what happens the white knight may look friendly. And subsequently white knight may also go for take over attend with the white knight may come and take the share but the management may not have displaced.

Then they try to displace the existing management like hostile method and this is called borrowing the turn from **(()) (26:42)** one of the **(()) (26:43)** place is called Lady Macbeth strategy further. So, that means initially they whiten it on to be friend but they actually to be hostile access. There are different types of knights also two more nights we can talk about yellow knight means actually.

Yellow knights means, yes somebody tries to take over the company hostile then they come and sit together and say we will now merge they become friendly asses. And grey knight means there is a white knight trying to help others another one company coming and some other company also give me without any solitary solicitation trying to offer to buy the shares in target. And so that they can benefit the troubled water and so third party.

Third party comes they want to create more uncertainty they want to gain so that yes, we will also like to buy the shares in this particular company when actually the fight is going with going on between one hostile takeover acquiring company and on the target company for that matter.

The company can also as a reaction can company go for share represent buyback of shares. And in that case what happens if the shareholders get a better deal from the buyback compared to the deal that is given by the acquiring company.

They may go for buyback for the tender shares in the company's favour and then the takeover attend can be foiled. Or if continuous for somehow, we discussed in the earlier case like how to come when you have good company is more vulnerable to make the company more less attractive. So, company may have lot of cash for that but liquidity was an attraction the company can go for high dividend payment extra dividend payment.

And in that case if the acquiring company is thinking that some cash balance free gas is there with the target company which can be used for some activities future but by when the target company is declaring this particular dividend then those cash is actually not available for the acquiring company, eventually the company gets acquired. So, you are creating a future inconvenience for the acquiring company for that matter.

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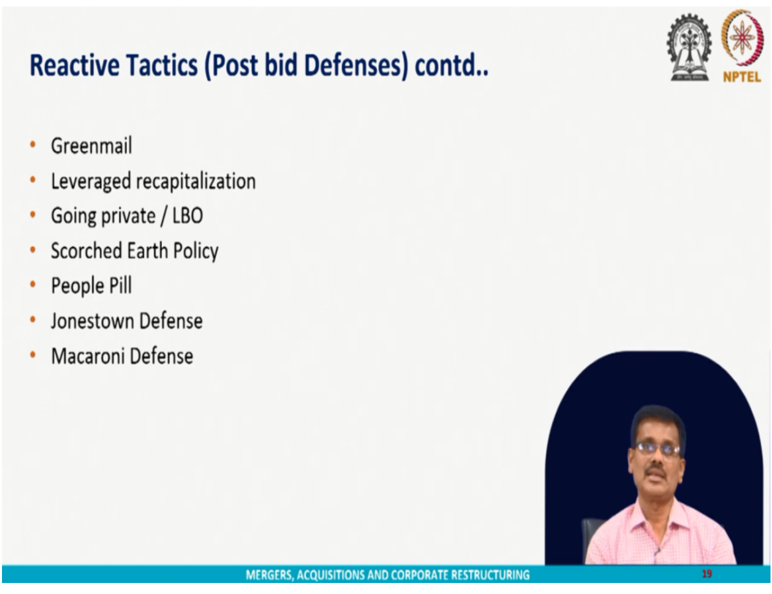

Then we have another other defense mechanism called green mail. Green mail means yes acquiring company has come and they would like to make an attempt they are making it may be hostile, then the target may go for negotiations you have come but will not like to change the

management. Then you have already bought some share, so we like to buy the shares from you and that is called a blackmail becomes something like green mail for that matter.
So, the acquiring company which was attempting they get some money for the shares they have go ahead in the company and they go back. Then company can also go for leverage, leveraging itself they can go for a lot of loan and so that it creates the financial risk is higher for the company. And company can also turn it to be private company or the leverage buyer will discuss in the subsequent session.

Another company is that Scorched earth policy what happens, let anything happen we do not want to be taken over. So, the company tries to sell the crown jewels that company tries to does do some damage to its itself key assets for the company. So, the company becomes less attractive, it becomes a you know actually suicide pill for that matter subsequently because without this good condition the company will be vulnerable in future.

The target will continue but will become vulnerable assets. Then people feel that all the people come together and they say that will lead the company the management is changed. Then the new management thing how to replace these people new controlling stakeholder will how to replace this management you have to get also more people for that matter to manage this company. So, that could be another threatened by the people of the company.

Jonestown defenses likes Scorched earth policy but its more severe that means if they will sell everything, they will create law the existing management will do lot of damage with no more attractive for the acquiring company. And it is like a suicidal attempt but come what may we do not want to be taken over by some other company. And they will create lot of damages to the company so that nothing happens.

But is very weak hardly come these are given certain there could be some cases earlier which you is not documented as of now but yes these are very rarely used by the companies and like this Scorched earth policy, Jonestown defense and last one we in this slide you are going to Macaroni defense in that to happen**.** The bondholders the lenders will have the right to get more money.

That means it will actually inflate the amount that is going to pay to the bondholders or lenders is going to increase because of the change in control. So, that is also going to create can convince for the acquiring company further but they had also arrange cash to make the payment to the bondholders that to more than what the existing value of the existing borrowing amount for that matter.

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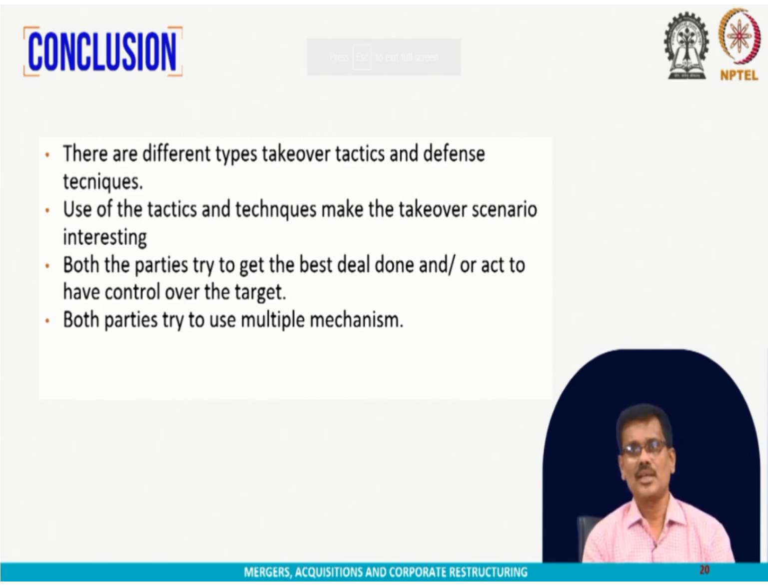
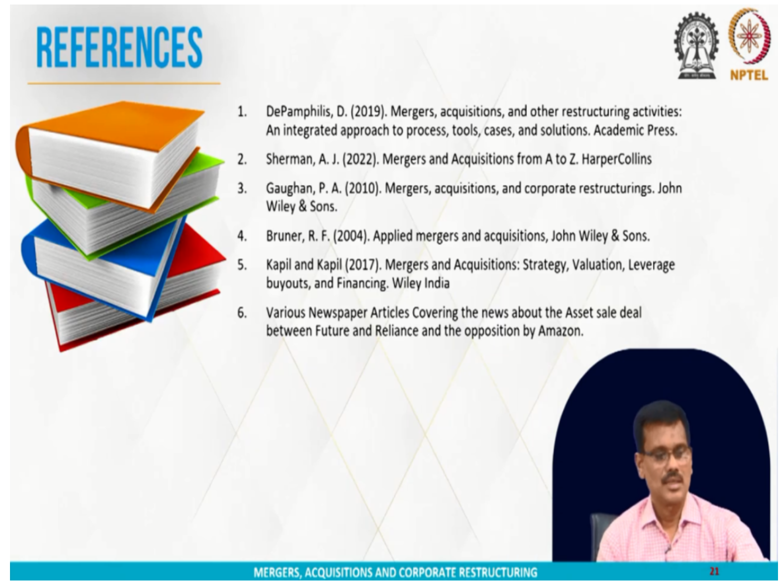


So, in conclusion yes we have discussed about different defense techniques and if you look at different takeover tactics and defense techniques make this scenario very interesting, both the tri parties will try to get the best deal done and they will so that they can have the control over the target and both the **(()) (32:06)** will try to use multiple mechanism. We will continue this particular session in the subsequent session will some other takeover mechanism.

Also, will take up certain cases where multiple takeover attempt take defense take over and different techniques have been discussed.

(Refer Slide Time: 32:26)



So, these are the references for these slides and thank you and happy learning.