

# Institutional Investors' Impact on the Terms and Outcome of Freeze-out Tender Offers

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Discussion

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# Freeze-outs: minority protection and going private

- Mechanism:
  - An interested party makes a tender offer to the rest of shareholders alternative to M&A
    - No-toehold bids: often control,
    - Minority toehold bids <50% ownership: often control, control premium, MBOs,
    - Majority or freeze-out bids [50%; threshold%]: most often the main sample, MBOs,
    - Short form >Threshold %: often second step in freeze-out.
  - The tender offer can be accepted or rejected, litigated.
  - If a threshold is reached during the tender period, the company can be taken private in a second step.
  - Negotiation is typical.
  - Typical threshold is 90% (95% in Israel).
    - Non-tendering minority may reject the tender price,
      - involve courts in some jurisdictions (Norway, US) to determine or opine on fair value,
    - Non-tendering minority loses voting rights act as debtors.
  - Relatively rare in overall M&A context (5%-6% US Bates et al).

# Freeze-outs: minority protection and going private, *contd.*

- Purpose
  - Genuine strategy-related decisions to take the company private,
  - Manifestation of horizontal agency conflict (majority-minority):
    - Majority tries to obtain company at a significant discount, especially during downturn,
    - Minority blocks majority to extract disproportionate surplus.
- Outcome
  - One of the mechanism how companies go private,
  - Law set up in '70s, 80s to protect both minority investors and majority investors.
  - In US:
    - Tougher entire fairness standard (EFS): burden on controlling shareholders,
    - The business judgment rule (BJR): transaction is in minority interest, requirements:
      - special committee of non-interested and independent directors,
      - majority vote of the disinterested minority.

# Literature

- Minority receives a fair deal in US freeze-outs (**Bates et al JFE 2006**).
  - Has right to legal review of negotiated price,
  - US 5% of M&A deals are freeze-outs.
- Freeze-outs timed during industry downturns and undervaluation (**Harford JFE 2019**).
  - Consistent with exploitation of target shareholders,
  - 57% of MBOs and freeze-outs litigated (2003–2014),
  - Whole industry undervalued and peer based-benchmarks inaccurate to establish exploitation.
- Literature on exploitation of outside shareholders in non arms length transactions (**DeAngeo et al JLE 1984**).
- Premia are negatively associated with manager holdings in MBOs (**Chen et al IRA 2011**).
- Review of legal setup for freeze-outs.
  - US (**Cain et al Delaware J. Corp. Law 2011**),
  - US vs. Germany (**Krebs GJL 2012**),
  - Germany (**Croci et al MF 2017**): post-deal litigation almost always.

## Literature, *contd.*

- If threshold reached, 10% go to court in Norway to find fair value (Bohren IRLE 2013).
  - Anecdotally: large owners (state) instrumental in extracting fair value for minority,
  - Court fees paid by losing party, almost never minority,
  - Court revalues (Minority has the right to court valuation),
    - Slow freeze-out deal,
    - To higher values than offer,
    - In presence of majority,
    - Private firms deals,
    - Apply to both private and listed firms,
    - 3 years to complete.
- Targets of HF activism more often acquired (**Boyson et al JFE 2017**).
  - Prior Activism influences premium: the activist is or is not acquirer.
- International study: better minority protection law ensures: (**Wenjing IRFA 2016**).
  - Higher premium,
  - More rejections,
  - More cash deals in freeze-out M&As,
  - Ex-post law enforcement important.

# Setup and main result

- Israel, 95% threshold, tender offers (vs mergers (negotiated)), listed firms.
- Mean premium is 19% in regression setting (offer price to before offer).
  - Institution presence increases premium by 11% (7% univariate),
  - Presence and pre-negotiation by 17%.
- Pre-negotiation x Institutional investor interaction significantly positive.
  - Perhaps not surprising if negotiations are prevalent especially with institutional investors?
- Probability of acceptance.
  - Lower with institutional investor,
  - Higher with pre-negotiation.
- Rejected deal CAR to ½ year after same as the premium,
  - Institutional investors do not improve,
  - Failed pre-negotiation with institutional investor very costly.
    - Could these just be very bad deals?
- Pre-offer period shows negative return- consistent with Harford et al 2019.
- Consistent with
  - Gaspar et al 2005: institutional investor positions in targets and premium,
  - Boyson et al 2017: HF activism in targets.

# Uniqueness

- Contribute to the literature identifying relationship between legal environment and minority protection: underscores issues important in the mechanism.
- Setting: Relaxed regulation.
  - no SC, disclosure, independent fairness requirement.
- Observe the early part of the process (50% rejection).
- Institutional bidder participation (35% of cases).
- Medium size companies with concentrated owners:
  - Bridge our knowledge about private and listed companies.
- Document premium of going private transactions.

# Suggestions

- Add back the low liquidity transactions:
  - interesting as they are probably “slow” freeze-outs.
- Shorten the tunneling discussion, focus on freeze-outs, comment on MBOs.
- Expand discussion on institutional setting:
  - (when, scope, litigation, protections in place).
- Control for length of ownership by majority:
  - influence probability of rejection, negotiations, premium (Bohren et al 2013).
- Why institutional dummy and not share is significant:
  - Cross-sectional distribution of institutional share would be informative. Perhaps simply variation is low?
  - Control for the type: passive vs. active (Boyson et al 2017)
    - Do inst. investors participate in the freeze-out as buyers
  - May have selected better companies before despite qualitative argument?