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

Beni Lauterbach and Yevgeny Mugerman

Discussion
Janis Berzins
BI Norwegian Business School
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 (DeAngelo 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?