How Much Shareholder Voting Do we Really Need? Evidence from UK Class 1 Transactions

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Shareholder Involvement in “Corporate Government”

- Strong delegation model (US, Germany)
  - Shareholders delegate most decisions to the board of directors/supervisory board
- Moderate delegation model (UK)
  - Shareholders retain veto right over important decisions (“referendum”)

Less or More Shareholder Voting?

- Common to all systems
  - Appoint the board / supervisory board
  - Approve fundamental changes to articles
  - Dissolve the company
- Not voted under strong delegation
  - Executive remuneration (policy and/or packages)
  - Seasoned equity offers
  - Voluntary delisting
  - Related party transactions
  - **Large transactions** (acquisitions, divestitures)

Does Mandatory Shareholder Voting Prevent Bad Acquisitions?

Becht, Marco and Polo, Andrea and Rossi, Stefano, Does Mandatory Shareholder Voting Prevent Bad Acquisitions? (October 21, 2015). European Corporate Governance Institute (ECGI) - Finance Working Paper No. 422/2014 (forthcoming, Review of Financial Studies)

Corporate Acquisitions in Finance

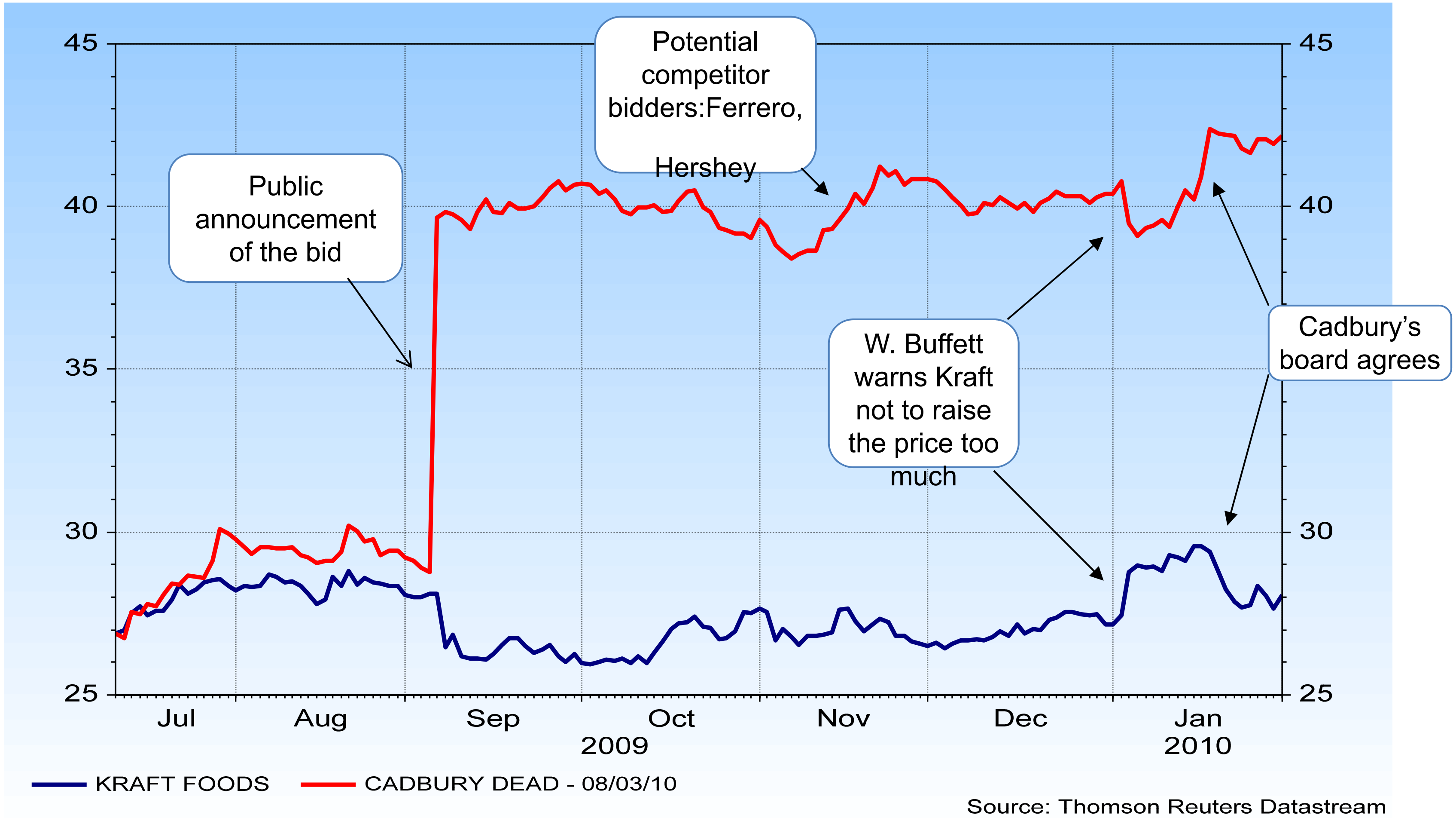
- Large percentage of U.S. acquisitions have negative announcement abnormal returns
  (Andrade, Mitchell and Stafford (2001), Bouwman, Fuller and Nain (2009), Harford et al (2012))
- Losses for worst performing U.S. deals very large
  (Moeller, Schlingemann, and Stulz (2005))
- Why?
  – Agency theory: conflicted managers
    (Jensen (1986), Morck, Shleifer, and Vishny (1990))
  – Behavioural finance: overconfident managers ("hubris")
    (Roll (1986), Malmendier and Tate (2008))

- *Does shareholder voting impose a constraint?*

U.S. Voting on Acquisitions Studies

- U.S. studies inconclusive because shareholder voting is discretionary
  (Kamar (2006), Hsieh and Wang (2008))
- No legal requirement under company law
- NYSE listing rules: voting only if deal financed through share issue > 20%
- Example
  – "Warren Buffett's Lost Vote" (Kraft Inc's bid for Cadbury; Steven Davidoff 2010 NYT)

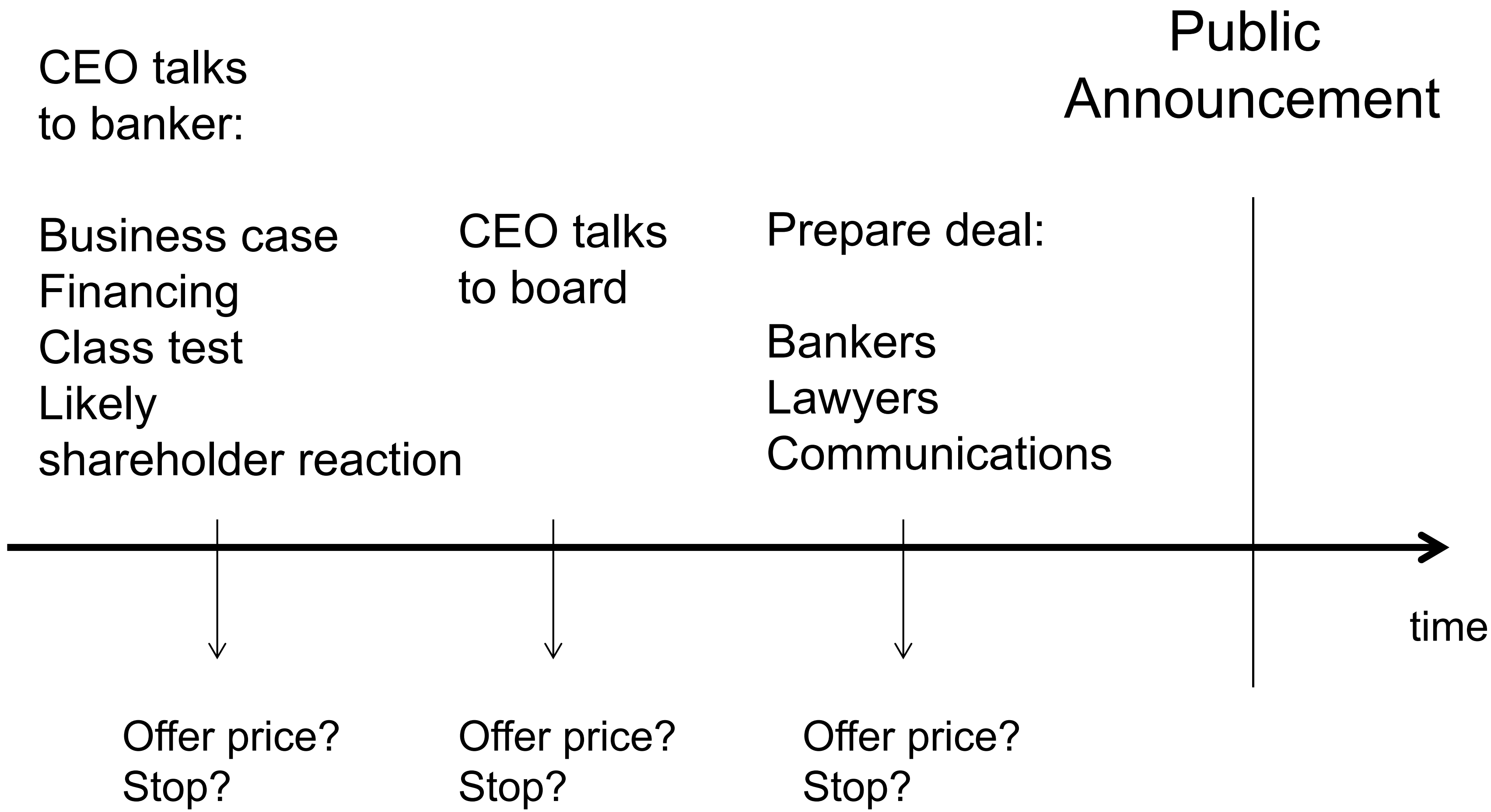
Kraft Inc's Acquisition of Cadbury Plc



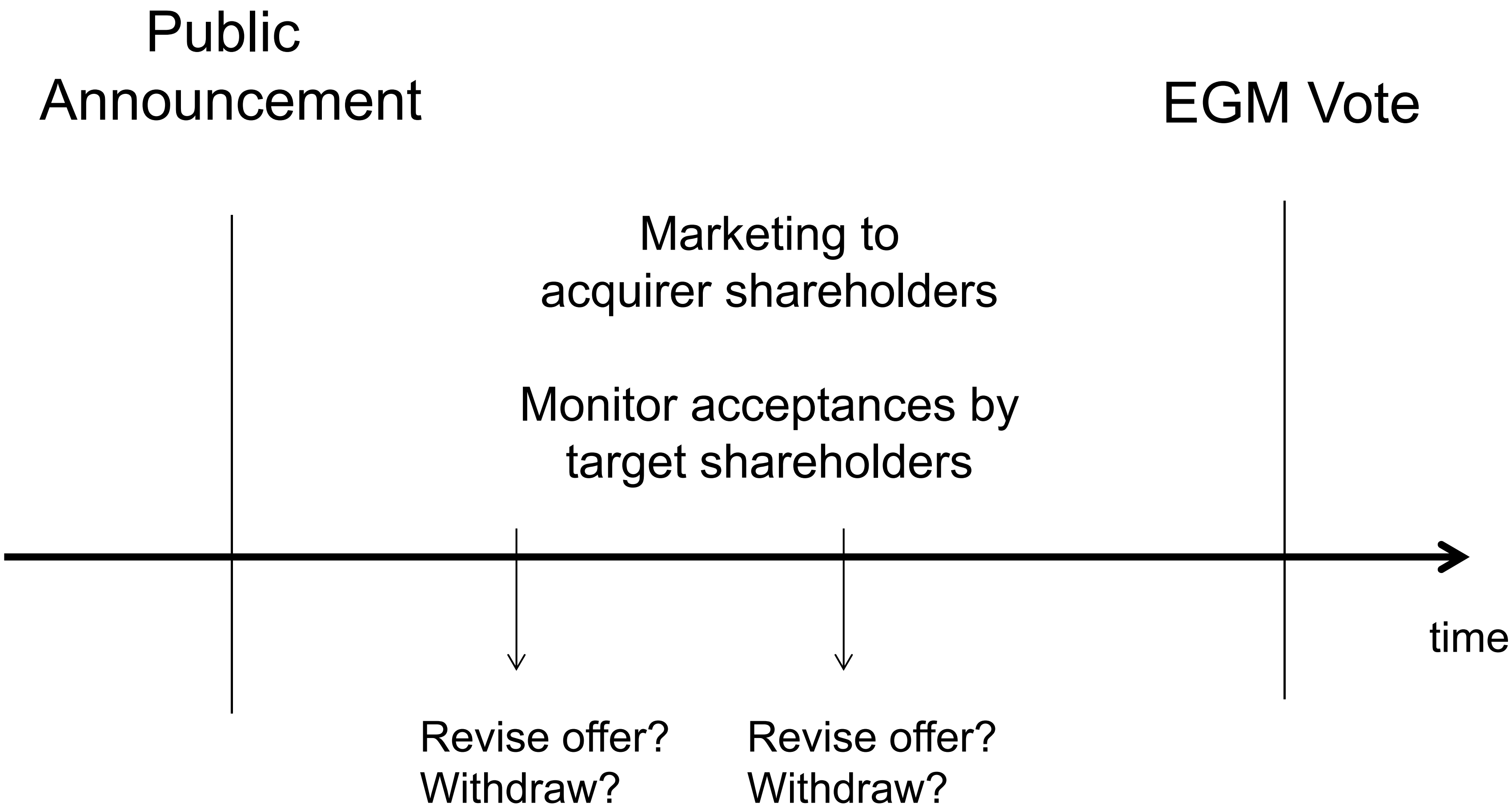
U.K. Mandatory Voting

- Mandatory voting if target is **relatively** large compared to the acquirer
- Relative size "Class tests"
  - Class 1 (voting) : at least one ratio > 25%
  - Class 2 (no voting) : all ratios < 25%
- Ratios
  - x1, Ratio of consideration offered and market cap of acquirer
  - x2, Ratio of gross assets (target/acquirer)
  - x3, Ratio of profits (target/acquirer)
  - x4, Ratio of gross capital (target/acquirer)
  - Additional ratios can be imposed by regulator in special cases

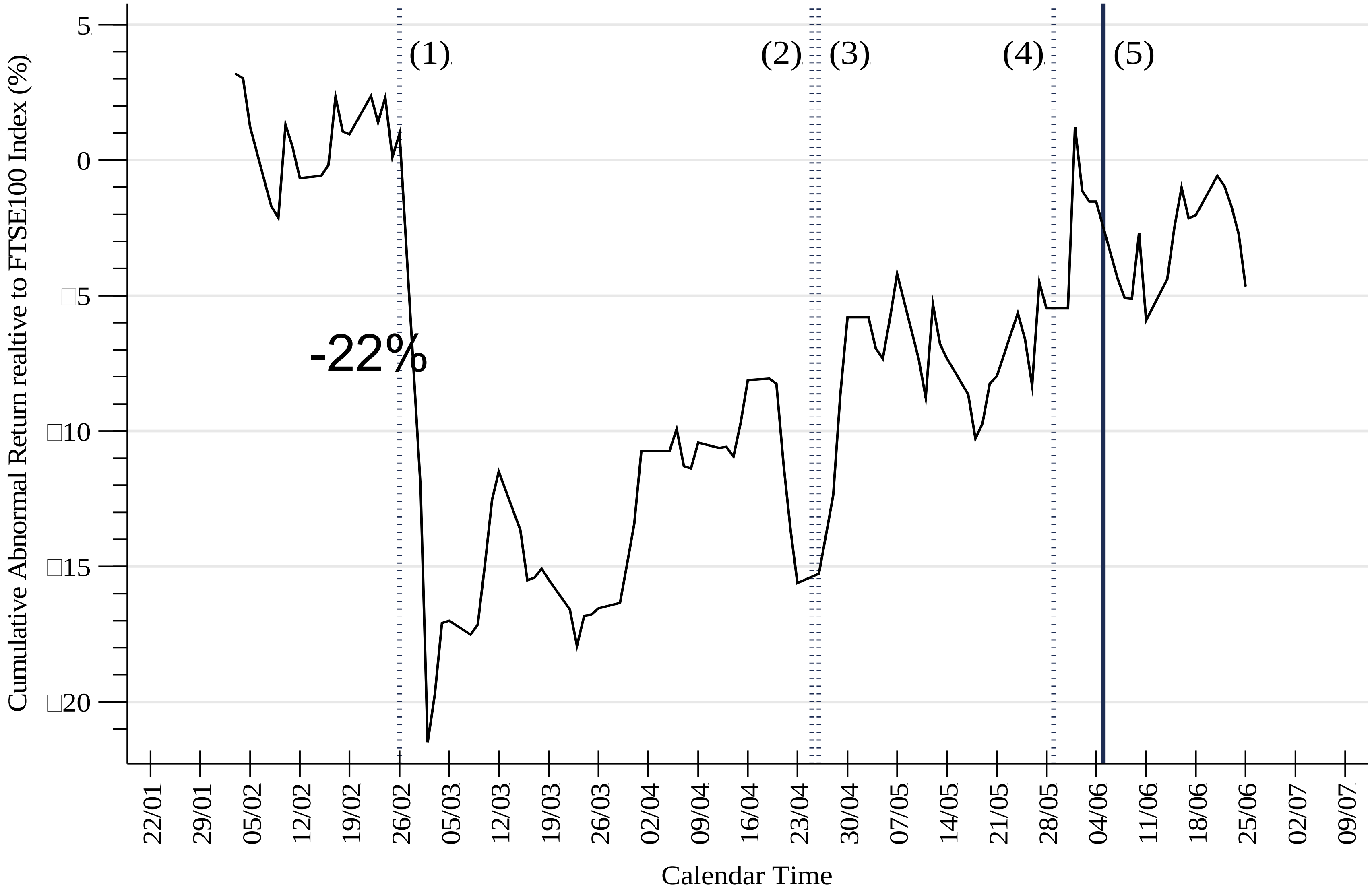
Stylized Acquisitions by a UK Acquirer : Pre-Announcement Period



Stylized Class 1 Acquisitions by a UK Acquirer
Post-Announcement



Prudential's (failed) bid for AIG Asia



Study Design

- Compare UK Class 1 to Class 2 deals
  - Announcement abnormal returns (% and value)
  - Control for relative size (and other things)
    - Linear regression
    - Propensity score matching
    - Around the threshold (“naïve RDD” & MRDD)

- Compare similar transactions in the U.K. and U.S.

Data

- Acquisitions by companies listed on the London main market 1992-2010
- Data from SDC Platinum
  - Corrected dates by hand in 10% of cases
  - Check for confounding information on Factiva
- Match with stock returns from Datastream
- Take a 50% random sample : 5400 deals
- Exclude
  - Relative size smaller 5%
  - Deal value less than $1 million
- Final sample: 1264 transactions

Class 1 or Class 2?

- Classify deals “by hand” looking at Factiva
- For Class 1 record EGM date

Sample Distribution

Total number of announced deals = 1264

	Number	Within Group %
Class 1 Transactions	383	
“Withdrawn” deals	20	5%
Other	31	8%
Voted at EGM	**332**	**87%**
Completed deals	**332**	**87%**
Class 2 Transactions	881	
“Withdrawn” deals	9	1%
Other (acquired by another bidder etc.)	95	11%
Completed deals	777	88%

Evidence on Returns

Announcement Abnormal Returns (%) Class 1 vs. Class 2

		Class 1 transactions (1)	Class 2 transactions (2)	Difference (1)-(2)	t/z statistic tests of difference
CAR (-1,+1)	Mean	2.5	0.8	1.7	4.9***
	Median	1.6	0.5	1.1	4.0***
	No of observations	332	777		

Announcement Abnormal Dollar Returns
Class 1 vs. Class 2

		Class 1 transactions (1)	Class 2 transactions (2)
Dollar Returns in $ Millions	Mean	$41	-$4
	Total	$13,632	-$2,958
	No of observations	332	777

Announcement Abnormal Returns (%) Class 1 vs. Class 2 - Robustness

- Similar results if we:
  - Look at (-2,+2) window
  - Remove cases where there is confunding info in the event window
  - Winsorize returns

Multivariate Analysis of Acquirer Returns

	Dependent variable: CAR		
	(1)	(2)	(3)
Class 1	1.8***	2.4***	2.5***
Relative size		-0.01	-0.01
Deal characteristics	No	Yes	Yes
Acquirer characteristics	No	No	Yes
Industry dummies	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes
N	1109	971	941
R^2	0.066	0.100	0.110

Multivariate analysis of acquirer returns- robustness

- Similar results if we look at subsamples:
  - Acquirer bottom size quartile
  - Acquirer top size quartile
  - Private targets
  - All cash deals

Regression Discontinuity Design (RDD) Class 1 and Class 2

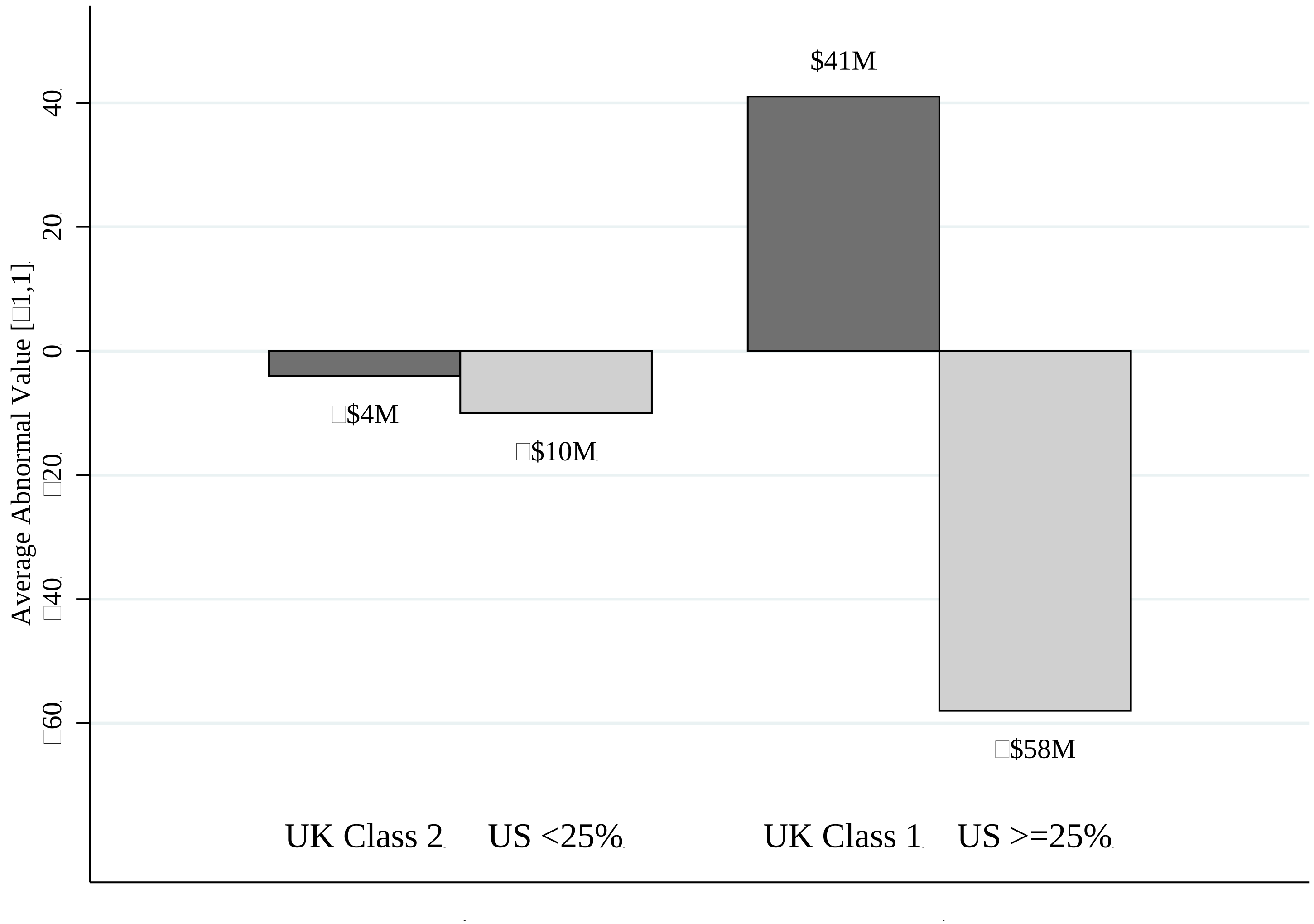
“Naïve RDD”

Class 1 with relative size ≤ 35% vs. Class 2 with relative size ≥15%

Differences in Announcement Abnormal Returns in Small Bands					
		Small Class 1 (1)	Large Class 2 (2)	Difference (1)-(2)	t/z statistic tests of difference
CAR (-1,+1)	Mean	3.0	0.8	2.1	3.3***
	Median	2.6	0.5	2.1	2.8***
Dollar Returns in Millions	Mean	$33	-$10		
	Sum	$5,858	-$1,164		
	No of observations	175	120		

Differences-in-Differences
U.K. and U.S.

Acquirer Average Abnormal $M Returns by Relative Size and Country



Source: Becht, Marco and Polo, Andrea and Rossi, Stefano (2014) Does Mandatory Shareholder Voting Prevent Bad Acquisitions? ECGI Finance Working Paper No. 422

Economic Mechanism

- Pre-Announcement
  - Not directly observable
  - RDD result suggests constraint on payment
- Post-Announcement
  - Most Class 1 ”withdrawn” deal lost to unconstrained bidders
  - <u>Consistent with deterrence effect of mandatory voting</u>

Policy Implications

- Mandatory mandatory voting?
- Opt-in to mandatory voting?
- Opt-out from mandatory voting?
  - Relevant in family controlled markets like Hong Kong
- Advisory voting?
  - Mandatory advisory vote for minority (free float) in family controlled companies?

Conclusion

- Evidence suggests that Class 1 vote imposes a constraint on acquirer management and boards
- It is hard to think of arguments against providing companies with the possibility to opt into mandatory voting on large acquisitions
- The arguments fielded against Coffee in the US debate of the 1990s do not stand up to the empirical UK evidence