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?

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

Public announcement of the bid

Potential competitor bidders: Ferrero, Hershey

W. Buffett warns Kraft not to raise the price too much

Cadbury’s board agrees

Source: Thomson Reuters Datastream
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
  – $x_1$, Ratio of consideration offered and market cap of acquirer
  – $x_2$, Ratio of gross assets (target/acquirer)
  – $x_3$, Ratio of profits (target/acquirer)
  – $x_4$, 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

CEO talks to banker:
- Business case
- Financing
- Class test
- Likely shareholder reaction

CEO talks to board

Prepare deal:
- Bankers
- Lawyers
- Communications

Public Announcement

Offer price? Stop?

Offer price? Stop?

Offer price? Stop?

time
Stylized Class 1 Acquisitions by a UK Acquirer
Post-Announcement

Public Announcement

Marketing to acquirer shareholders

Monitor acceptances by target shareholders

Revise offer? Withdraw?

EGM Vote

Revise offer? Withdraw?

time
Prudential’s (failed) bid for AIG Asia

Cumulative Abnormal Return relative to FTSE100 Index (%)
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

<table>
<thead>
<tr>
<th>Class 1 Transactions</th>
<th>Number</th>
<th>Within Group %</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Withdrawn” deals</td>
<td>20</td>
<td>5%</td>
</tr>
<tr>
<td>Other</td>
<td>31</td>
<td>8%</td>
</tr>
<tr>
<td>Voted at EGM</td>
<td>332</td>
<td>87%</td>
</tr>
<tr>
<td>Completed deals</td>
<td>332</td>
<td>87%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Class 2 Transactions</th>
<th>Number</th>
<th>Within Group %</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Withdrawn” deals</td>
<td>9</td>
<td>1%</td>
</tr>
<tr>
<td>Other (acquired by another bidder etc.)</td>
<td>95</td>
<td>11%</td>
</tr>
<tr>
<td>Completed deals</td>
<td>777</td>
<td>88%</td>
</tr>
</tbody>
</table>
Evidence on Returns
## Announcement Abnormal Returns (%)

### Class 1 vs. Class 2

<table>
<thead>
<tr>
<th></th>
<th>Class 1 transactions (1)</th>
<th>Class 2 transactions (2)</th>
<th>Difference (1)-(2)</th>
<th>t/z statistic tests of difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mean</strong></td>
<td>2.5</td>
<td>0.8</td>
<td>1.7</td>
<td>4.9***</td>
</tr>
<tr>
<td><strong>Median</strong></td>
<td>1.6</td>
<td>0.5</td>
<td>1.1</td>
<td>4.0***</td>
</tr>
<tr>
<td><strong>No of observations</strong></td>
<td>332</td>
<td>777</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Announcement Abnormal Dollar Returns

**Class 1 vs. Class 2**

<table>
<thead>
<tr>
<th>Dollar Returns in $ Millions</th>
<th>Class 1 transactions (1)</th>
<th>Class 2 transactions (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>$41</td>
<td>-$4</td>
</tr>
<tr>
<td>Total</td>
<td>$13,632</td>
<td>-$2,958</td>
</tr>
<tr>
<td>No of observations</td>
<td>332</td>
<td>777</td>
</tr>
</tbody>
</table>
Announcement Abnormal Returns (%)
Class 1 vs. Class 2 - Robustness

- Similar results if we:
  - Look at (-2,+2) window
  - Remove cases where there is confounding info in the event window
  - Winsorize returns
## Multivariate Analysis of Acquirer Returns

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Class 1</strong></td>
<td>1.8***</td>
<td>2.4***</td>
<td>2.5***</td>
</tr>
<tr>
<td><strong>Relative size</strong></td>
<td>-0.01</td>
<td>-0.01</td>
<td>-0.01</td>
</tr>
<tr>
<td><strong>Deal characteristics</strong></td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Acquirer characteristics</strong></td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Industry dummies</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Year dummies</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>1109</td>
<td>971</td>
<td>941</td>
</tr>
<tr>
<td><strong>R²</strong></td>
<td>0.066</td>
<td>0.100</td>
<td>0.110</td>
</tr>
</tbody>
</table>

Dependent variable: CAR
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 $\leq 35\%$ vs. Class 2 with relative size $\geq 15\%$

<table>
<thead>
<tr>
<th>Differences in Announcement Abnormal Returns in Small Bands</th>
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<tbody>
<tr>
<td></td>
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<tr>
<td>----------------</td>
</tr>
<tr>
<td>CAR (-1,+1)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Dollar Returns in Millions</td>
</tr>
<tr>
<td></td>
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<td></td>
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</tbody>
</table>
Differences-in-Differences
U.K. and U.S.
Acquirer Average Abnormal $M Returns by Relative Size and Country

Economic Mechanism

• Pre-Announcement
  – Not directly observable
  – RDD result suggests constraint on payment

• Post-Announcement
  – Most Class 1 “withdrawn” deal lost to unconstrained bidders

  – Consistent with deterrence effect of mandatory voting
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