INSTITUTIONAL INVESTORS' IMPACT ON THE TERMS AND OUTCOME OF FREEZE-OUT TENDER OFFERS

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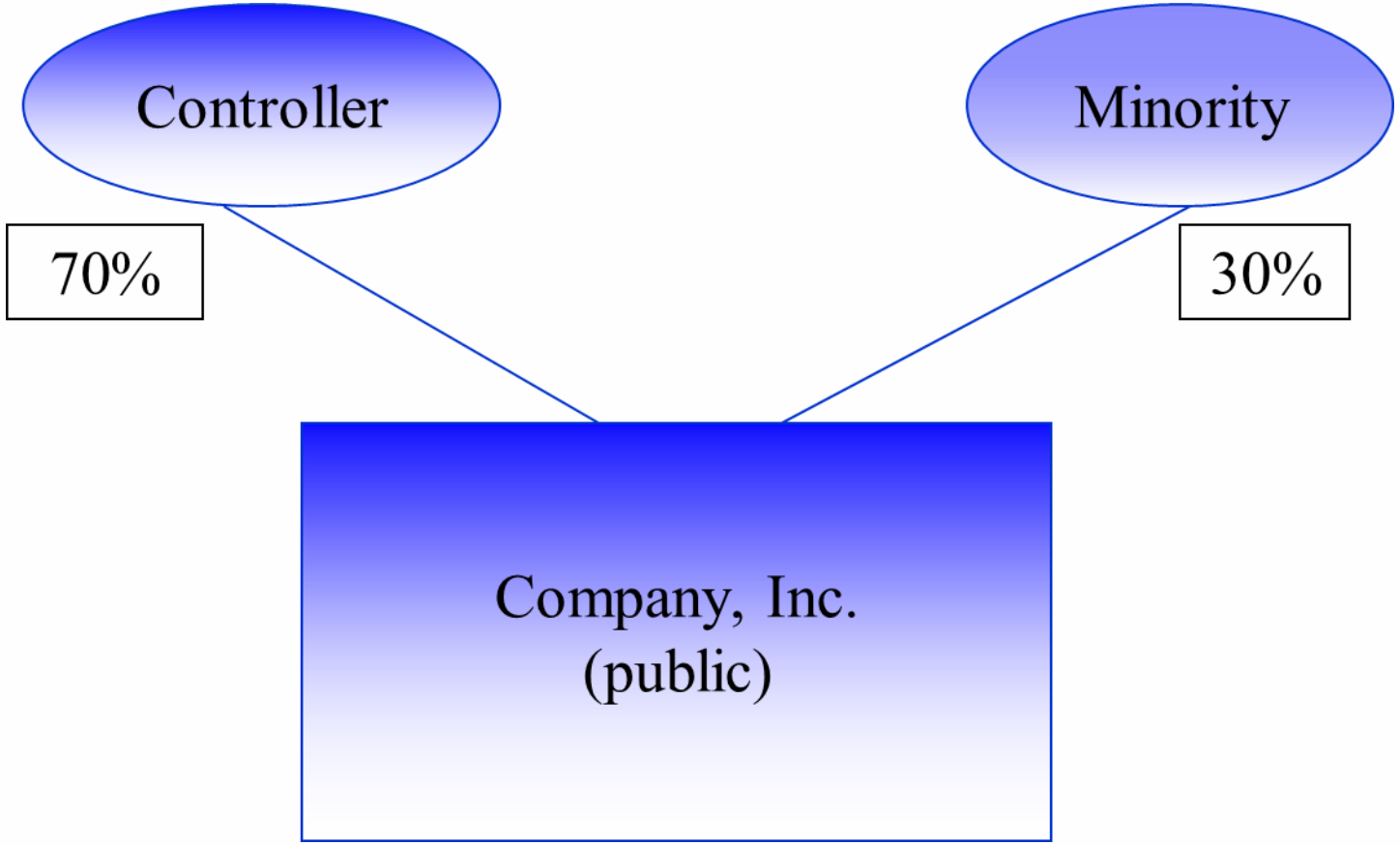
Stock Exchanges' Eclipse

- In the 21st century, many stock exchanges have experienced a drop in the number of listed firms. Doidge, Karolyi and Stulz (2017) document the phenomena is relatively strong in the U.S. (the listing gap). However, it exists also in other markets. For example, the number of listed firms on the Tel Aviv Stock Exchange (the market I study) decreased from 642 at the end of 2008 to 448 at the end of 2018.
- Possible reasons: higher regulatory costs, including tougher standards of minority shareholders protection; availability of alternative financing sources such as private financing (private-equity funds); and the abundance and aggressiveness of activist funds.

Delisting Trend

- Doidge et al. (2017) document that about half of the listing gap is due to delists. The central mechanism in the U.S. is mergers.
- We study Israel where the holding structure of public companies is different than in the U.S. About 90% of the publically-listed companies in Israel are closely held, that is have controlling shareholders with majority holdings.
- In Israel, the central delisting mechanism has been “freezeout” offers, whereby controlling shareholders tender for (and if successful) buy all publically-held shares and the firm goes private.

Freezeout Transactions



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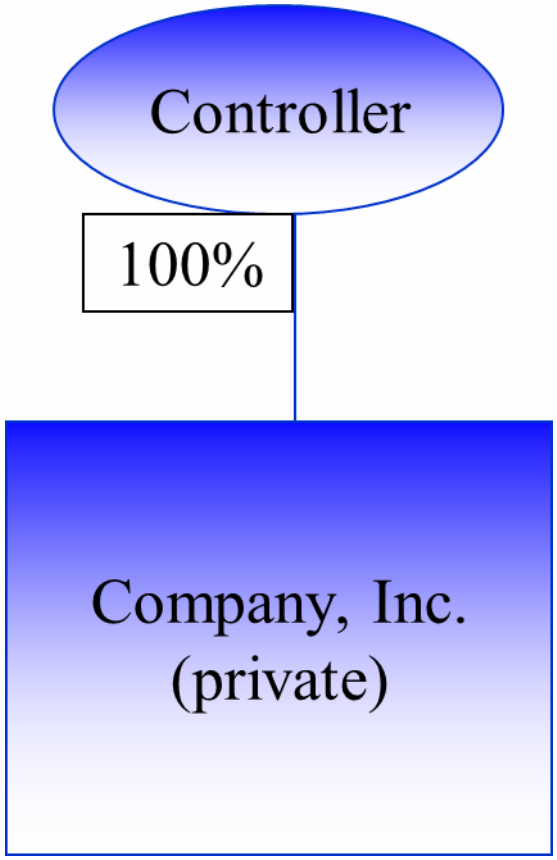

Why are Freezeouts Preferred in Israel?

Transaction Type	Merger (US)	Tender Offer (US)	Tender Offer (Israel)
Majority	Majority of shares outstanding	Get to 90% of outstanding	Get to 95% of outstanding
Board	Approval Required	Opinion	No
SC	Yes	Yes (opine/veto)	No
Fairness Opinion	Yes	Yes	No
Appraisal	Yes	Yes	Depends
Disclosure	Yes	Yes	No

Israeli minority shareholders depend largely on themselves!

Freeze-out Tender Offers

- **Control group offers to buy all public shares.**
- Legitimate reasons
  - Achieve synergies; save regulatory costs; keep information confidential; implement idiosyncratic vision; simplify corporate structure; or see no value in remaining a public company.
- However,
  - A possible primary or secondary motivation is expropriating public shareholders – buying public shares at below their true value. (“Timing”)
  - Such an “equity tunneling” is possible because of asymmetric information (control group’s inside information advantage).

Do Institutional Investors Step in to Defend the Public?

- Regulators and lawmakers trust institutional investors to defend the public, for example, by repelling expropriation attempts by controlling shareholders.
- Is this a wishful belief of naïve regulators?
- Do institutional investors play a positive role in defending small investors?
- There is not much evidence in favor of the hypothesis that institutional investors protect small investors. Institutional investors are often perceived as indifferent and inactive, perhaps because their main focus is on achieving high returns in their highly competitive market.

The Exception: Institutional Investors' Impact on Significant Firm Deals

- Studies on mergers and acquisitions, in general, present a significant value-impact of institutional investors.
- Gaspar, Massa, and Matos (2005) find that target firms held by institutional investors extract on average a 3% higher premium.
- Chen, Harford, and Li (2007) show that concentrated holdings by independent long-term institutions are positively associated with post-merger performance. The presence of these institutions also makes withdrawal of "bad" proposals more likely.

Our Goal

- To provide further evidence on cases where institutional investors are influential activists and contribute to the public. In our extreme environment (lax law) and decision type (a major and potentially terminal corporate decision) we expect and show that institutional investors do expose an erect spinal cord and do defend small shareholders' interests.
- Finer explorations of the data provide several intriguing observations on institutional investor response to freezeout offers. These observations may enrich our understanding of institutional investors activism.

Database

- Identify freeze-out tender offers (2000-2016): TASE
  - 274 transactions
  - excluded: stocks with no trading volume in the last 20 days; non-cash deals; the offer price is below the recent stock prices.
  - **201 cases; 170 companies**.
- Stock prices, accounting data, institutional holdings: TASE, Super Analyst; Praedicta.
- Comment: We found only 38 going private mergers.

Sample Descriptive Statistics

	Mean	Median	Standard deviation
Company characteristics			
Total assets (in thousands NIS)	1,025,112	221,232	3,066,008
Tobin's Q	1.10	0.99	0.49
ROA	0.011	0.031	0.143
Control group holdings (as a proportion of equity)	0.821	0.853	0.105
Institutional holdings (as a proportion of equity)	0.043	0.019	0.058
Institutional presence (indicator)	0.657	1	0.476
Pre-offer stock returns			
Weekly net of market return in the pre-offer period	-0.0032	-0.0019	0.0110
STD of weekly returns in the pre-offer period	0.0644	0.0565	0.0374

Sample Companies

- Small. Median Assets = 221 million NIS. All belong to Yeter (small stock) Index.
- 132 offers in firms with institutional holdings (69 without).
- Non-representative of TASE:
  - Merchandising (31%) – TASE 14%;
  - Manufacturing (22%) – TASE 15%;
  - Real Estate (21%) – TASE 21%;
  - Investment and Holding (18%) – TASE 11%;
  - Others include : banks, financial services.. ;
  - **Technology (0%) – TASE technology sec – 16%.**

Offer Attributes

	Mean	Median	Standard deviation
Premium	0.239	0.180	0.253
Pre-negotiation indicator (1=yes, 0=no)	0.58	1	0.49
Days from announcement to decision	23	19	10.7
Acceptance rate	0.57	1	0.50

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The Impact of Institutional Investors on Freezeout Offers

Offer Premium

	Mean of all observations	Successful offers	Failed offers
Overall sample premia			
	0.239	0.240	0.238
	(201)	(114)	(87)
Partitioning by institutional presence			
Institutional investor present	0.251	0.270	0.231
	(132)	(69)	(63)
No institutional investors	0.215	0.194	0.255
	(69)	(45)	(24)
Partitioning by institutional holdings			
Institutional holdings above median	0.255	0.273	0.236
	(100)	(51)	(49)
Institutional holdings below median	0.223	0.213	0.240
	(101)	(63)	(38)

Panel A: The effect of institutional presence on the premium

	(1)	(2)	(3)	(4)	(5)
Log total assets	0.007				
	(.017)				
Control group holdings	-0.28	-0.30			
	(0.25)	(0.24)			
STD of pre-offer returns	0.63				
	(0.80)				
Pre-offer abnormal return	-12.8***	-13.3***	-13.2***	-12.9***	-11.8***
	(3.3)	(3.0)	(3.0)	(2.9)	(2.7)
Institutional presence indicator	0.103**	0.109**	0.117**	-0.011	-0.035
	(0.049)	(0.047)	(0.048)	(0.066)	(0.046)
Pre-negotiation indicator	0.065*	0.071*	0.073*	-0.042	-0.011
	(0.038)	(0.038)	(0.038)	(0.057)	(0.045)
Pre-negotiation * Inst. presence				0.217**	0.165**
				(0.090)	(0.065)
Calendar year fixed effects	Yes	Yes	Yes	Yes	No
Industry fixed effects	Yes	Yes	Yes	Yes	No
Number of observations	114	114	114	114	114
Adjusted R^2	0.231	0.243	0.242	0.277	0.281

Panel B: The effect of institutional holdings and institutional holdings' concentration, conditional on institutional presence

	(1)	(2)	(3)
Log total assets	0.058**	0.030	
	(0.028)	(0.031)	
Control group holdings	-0.69	-0.25	
	(0.45)	(0.38)	
STD of pre-offer returns	1.80	2.33	
	(2.02)	(1.89)	
Pre-offer abnormal return	-19.2***	-17.4***	-18.4***
	(4.50)	(4.51)	(3.45)
Institutional holdings	-1.20		
	(0.87)		
HHI		-0.105	
		(0.165)	
Pre-negotiation indicator	0.124	0.073	0.179**
	(0.120)	(0.123)	(0.074)
Calendar year fixed effects	Yes	Yes	Yes
Industry fixed effects	Yes	Yes	Yes
Number of observations	69	69	69
Adjusted R^2	0.323	0.303	0.312

The Effect of Institutional Investors on Successful Offers' Premium

- The central explanatory variable is institutional investors' presence and not institutional holding percentage.
- Why isn't the institutional % holdings significant? It is possible that 1) It is enough that there is one trouble-making institutional investor that leaks his opposition to the public.., or 2) Pre-offer price precision is higher as institutional investors' % holdings increase. Thus, as % holdings by institutions increase, on one hand institutional bargaining power is stronger, yet on the other hand market prices are less distorted.

The Effect of Institutional Investors on Successful Offers' Premium

- It appears that accepted offers premia are about 11% higher when there is at least one institutional investor that holds the company shares. Given that the mean premium without institutional investors is about 19%, the increase in premium is 11/19 (=58%), economically significant.
- Institutional investors increase accepted offer premium only when there are indications of "behind the scene negotiations". In such cases the mean increase in offer premium is 17%. Offer premium almost doubles.

Methodological Comment

- The comparison of firms with and without institutional investors may be improper if firms with institutional investors differ materially from firms without institutional ownership, and if this difference might affect the results.
- For example, it can be argued that institutional investors elect better firms, and in such better firms, the premium controlling shareholders have to pay in order to take the firm private is higher.

Methodological Comment

- On the other hand, if part of the premium is intended to overcome disbelief and asymmetric information problems, then in firms with relatively large information asymmetry (firms without any institutional investor), controlling shareholders must offer higher premia.
- In addition, firms with institutional investors are presumably less mispriced, as institutional investors monitor them. The more precise stock prices of firms with institutional investors present should have reduced the premium (all other things equal).
- In sum, a clear link between the selection bias and the results cannot be established.

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The Impact of Institutional Investors on Freezeout Offers

Offer Acceptance Likelihood

$$Success_i = \alpha + \beta inst_i + O'_i\gamma + T'_i\delta + \tau_t + \varphi_s + \varepsilon_i$$

where $Success_i$ is the freezeout tender offer outcome (binary, success or failure); $inst_i$ is the institutional investors' presence indicator (or cumulative holdings) in the firm; O'_i is a vector of offer characteristics; T'_i is a vector of firm and stock characteristics; τ_t is a year fixed effect; φ_s is an industry fixed effect; and ε_i is an error term clustered at the firm level. Our main interest is in the effect of $inst_i$ on $Success_i$.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Log total assets	0.17**	0.19***	0.18**	0.20***	0.17**	0.19***	0.13**
	(0.07)	(0.07)	(0.08)	(0.08)	(0.08)	(0.07)	(0.06)
Control group holdings	4.98***	5.13***	4.51***	4.80***	5.00***	5.32***	4.03***
	(1.29)	(1.33)	(1.40)	(1.45)	(1.42)	(1.35)	(1.32)
Offer premium	0.25		0.14		0.25		
	(0.53)		(0.52)		(0.54)		
STD of pre-offer returns	-5.06		-4.63		-5.05		
	(3.46)		(3.31)		(3.46)		
Pre-offer abnormal return	-0.88		-1.02		-0.86		
	(13.16)		(12.90)		(13.16)		
Institutional holdings			-2.13	-1.77	0.08		
			(2.77)	(2.77)	(2.99)		
Institutional presence indicator	-0.60**	-0.56**			-0.61**	-0.78**	-0.60**
	(0.27)	(0.27)			(0.29)	(0.36)	(0.30)
Pre-negotiation indicator	0.83***	0.82***	0.80***	0.79***	0.82***	0.53	0.49
	(0.22)	(0.22)	(0.22)	(0.21)	(0.23)	(0.34)	(0.32)
Pre-negotiation * Inst. presence						0.47	0.18
						(0.47)	(0.40)
Calendar year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	No
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	No
Number of observations	188	188	188	188	188	188	188
Pseudo R^2	0.227	0.219	0.212	0.205	0.227	0.223	0.119

Factors Affecting Offer Acceptance

- The larger the firm, the higher the probability of offer acceptance. (More information, less suspicion).
- The larger are controlling shareholders' pre-tender holdings, the higher are acceptance rates. (Shorter distance to 95%)
- Pre-negotiations increase offer acceptance rate.
- Offer premium has a positive yet statistically insignificant effect.

The Effect of Institutional Investors on Offer Acceptance Rates

- Last and most relevant to our research goal, the presence of institutional investors in a company decreases the probability of freeze-out offer acceptance.
- The coefficient of institutional investor implies that acceptance (rejection) frequency decreases (increases) by 17% when institutional investors hold the firm. Given that in firms without institutional presence, offer rejection rate is about 35%, the increase in rejection rate is 17/35 (=almost 50%).
- However, pre-negotiations with institutional investors nullify their negative effect on offer acceptance.

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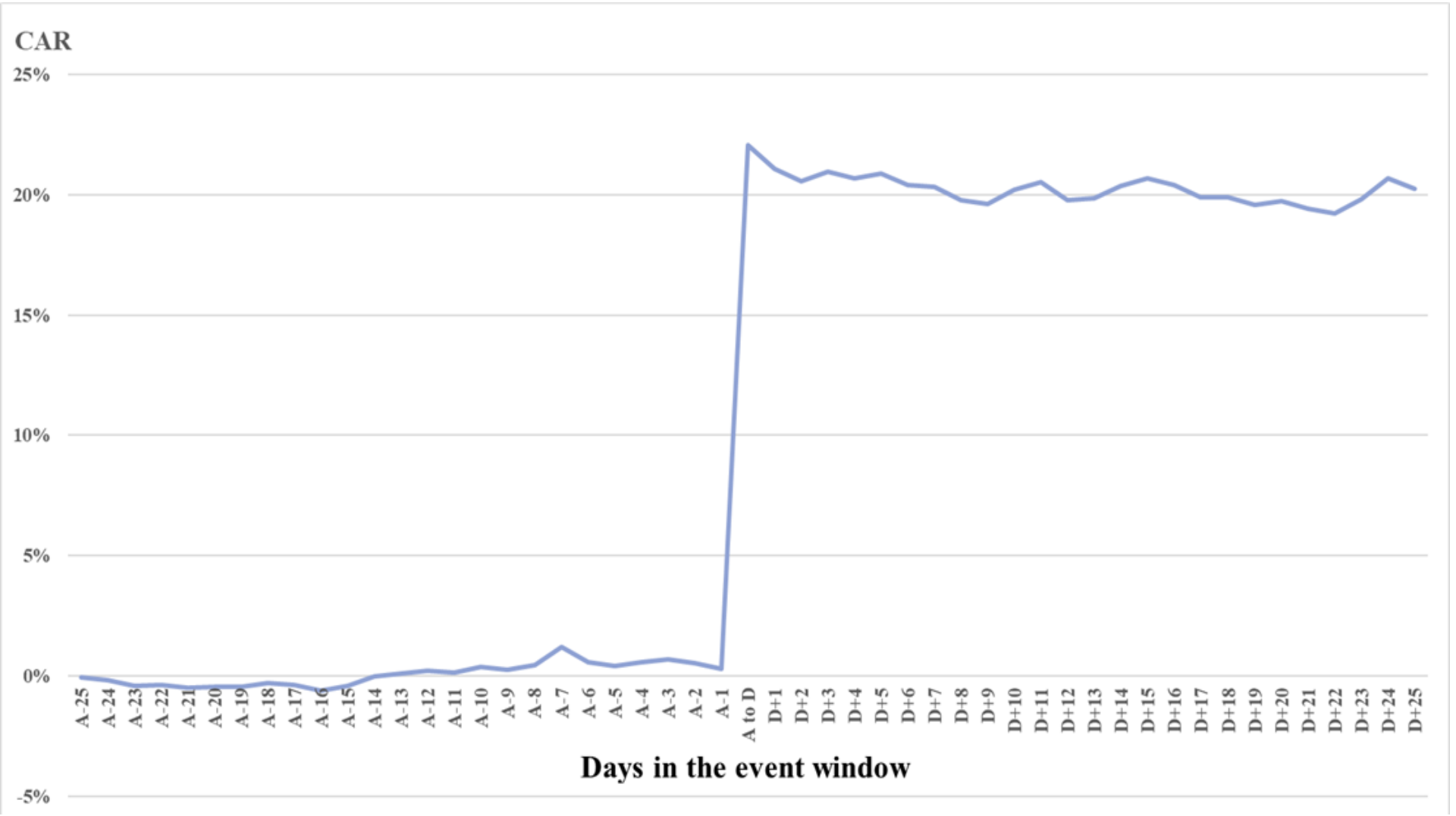
The Impact of Institutional Investors on Freeze-out Offers

Rejection Decision Ex-post Rationality

Cumulative Abnormal Returns Surrounding Failed Offers



Testing the Ex-Post Rationality of the Offer Rejection Decision

Panel A: The effect of institutional presence on the rationality of the rejection decision

	Mean CAR (A, D+125) (in %)	Mean offer premium relative to day A-1 price (in %)	Mean difference between CAR and the premium (%)	t-statistic of the difference	Median difference between CAR and the premium (%)	% positive differences (z-value – it's not random)	Number of offers
All failed offers	31.88	22.65	9.23	1.62	-1.25	45.4 (-0.85)	86
No institutional investors	49.11	26.12	22.99	1.40	-3.07	39.1 (-1.05)	23
Institutional investors present	25.59	21.38	4.21	0.85	-0.76	46.0 (-0.63)	63

Interpretation

- Public shareholders do not lose when they reject the offer as CAR from offer announcement to half a year after offer rejection exceeds on average the offer premium.
- Institutional investors' presence does not improve public investors' gains in rejected freeze-out offers.
- Thus, the hypothesis proposing significant beneficial effects of institutional investors in the subsample of offer rejections, cannot be supported.
- Why does the hypothesis fail? Perhaps a glimpse at the answer can be obtained by splitting the sample by the pre-negotiation indicator.

Testing the Ex-Post Rationality of the Offer Rejection Decision

Panel B: Further analysis of the rationality of rejections based on "pre-negotiations"

	Mean CAR (A, D+125) (in %)	Mean offer premium relative to day A-1 price (in %)	Mean difference between CAR and the premium (%)	t-statistic of the difference	Median difference between CAR and the premium (%)	% positive differences (z-value – it's not random)	Number of offers
No institutions + pre-negotiation	40.74	30.31	10.43	0.55	-8.80	40.0 (-0.63)	10
No institutions + no pre-negotiation	55.56	22.89	32.67	1.28	-0.08	46.2 (-0.27)	13
Institutional investors present + pre-negotiation	10.48	24.29	-13.81	-3.07	-15.02	29.0 (-2.34)	31
Institutional investors present + no pre-negotiation	40.22	18.56	21.66	2.86	11.46	62.5 (1.41)	32

Interpretation

- We document statistically significant public loss after offer rejection in firms with institutional investors and "pre-negotiations". This is perhaps the most intriguing result of the study.
- Why are these freezeout offers, that are decent on average, and that follow pre-negotiations, rejected?
- Could it be that despite the fact that the institutional investors know that the offer is decent they elect to reject it?

Interpretation

- Institutional investors might act strategically. Their decision about freeze-out offers is just part of their continuous repeated game contest with controlling shareholders. They might want to show off their power. DAVKA approach.
- The institutional investors' long-term reputational concerns and stance against controlling shareholders may override the simple concrete rational decision on a specific offer.

Summary and Conclusions

- Freeze-out offers represent extreme "terminal" decisions, where institutional investors' actions might be more decisive and evident.
- In addition, the choice of Israel, where freeze-out offers are rejected relatively frequently (close to 50% of the times), affords wider latitude of actions by institutional investors.
- A third distinctive feature of our sample is the fair proportion (about 35%) of firms without any institutional investor holdings.

Summary and Conclusions

- The study documents three major findings.
- First, freeze-out offers are rejected more frequently when institutional investors hold the firm.
- Second, in accepted offers, the offer premium is higher when institutional investors hold the firm and where there appear to be pre-negotiations between controlling and public shareholders.
- Interestingly, in these findings the effect is mainly due to the mere presence of institutional investors.

Summary and Conclusions

- Our third major result is that public investors do not lose on average by rejecting freeze-out offers.
- On average, the cumulative net of market stock returns of firms with rejected offers from offer announcement to half a year after offer rejection exceeds the offer premium, irrespective of whether or not institutional investors hold the firm shares.
- We examine why institutional investor presence does not appear to have a beneficial effect in offer rejections, and find that when institutional investors are present and there are pre-negotiations between controlling and public shareholders, offer rejection hurts public shareholders.

THANK YOU

Comments Welcome!