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Abstract

This study examines f the targetfirm. Three categories of competitionreducin increase competition for con ed gains to the target firm during the takeover battle relative to gains obtained when the initial takeover offer is supported. Competition-reducing resistance is shown to have the opposite effect.

1 Though tender offer responses may have important implications for employees, creditors, or other groups, this article focuses only on their implications for shareholders of the target firm.

2 Targeted share repurchases ("greenmail") are premium share repurchases from a potential acquirer, excluding all other shareholders from the offer. Standstill agreements often accompany greenmail transactions. These agreements limit the percentage of voting shares that a substantial stockholder may own (Bradley & Wakeman, 1983).

3 Poison pill securities assume a variety of forms. Generally, they give shareholders of the target firm the right to purchase stock in their firm or the acquiring firm at a substantial discount if an outside investor obtains a major block of stock, usually 20%-30% (Malatesta & Walkling, 1988).

4 Antitakeover charter amendments ("shark repellents") limit the control of the acquirer in partial acquisitions. For example, fair price provisions require the acquirer to pay minority shareholders at

least the tender price in any subsequent mergers. Super-majority provisions require more than 50% control to affect mergers or major asset sales (Jarrell & Poulsen, 1987).

5 Counter tender offers ("Pac Man" strategies) are offers by the target firm to buy the shares of the would-be acquirer.

6 Dissagregation strategies involve selling assets particularly valued by the would-be acquirer ("crown jewel" sales) or granting another firm an option to purchase them in the event of a takeover ("lock-up" agreements).

7 Intrafirm tender offers and large scale open market repurchases are methods for the target firm to buy back their shares. "White squire" arrangements involve issuance of common stock to a firm expected to follow management recommendations toward the tender offer.

8 Several alternative measures of risk-adjusted returns were estimated including mean-adjusted returns (Masulis, 1980); cumulative abnormal residuals; standardized cumulative abnormal residuals (Dodd & Warner, 1983); and market -adjusted returns (Brown & Warner, 1985). The results remained essentially unchanged across risk-adjustment techniques.

9 The market model methodology assumes stationarity of the return process throughout the estimation period and event period. Uncertainty regarding target management response and the outcome of the offer suggests that takeover contests will increase the variance in daily security returns. In fact, for this sample, the average event period return variance is 3.81 times larger than the estimation period variance. This suggests that hypothesis tests based on methods that assume variance stationarity may be misspecified.

A simple cross-sectional regression provides a second test of hypotheses 3 and 5. This involves using ordinary least squares to estimate the following equation:

$TR_j = a + b_1TR_{mj} + b_2D_1TR_{mj} + b_3D_2TR_{mj} + b_4D_1 + b_5D_2 + ej,$

where TR_j = the total unadjusted return of security j during the event period,

Trmj = the total return of the market portfolio during the event period of firm j,

D1 = 1 if the firm responds with auction-inducing resistance, 0 otherwise, and

D2 = I if the firm responds with competition-reducing resistance, 0 otherwise.

The estimates of b_4 and b_5 reflect the effect of management response strategies on shareholder wealth. Estimates of *bl,* b_2, and b_3 reflect the relative sensitivity of returns to passive, aucition-inducing, and competitionreducing firms to market returns. If the estimate of b_4 exceeds 0, auction-inducing firms earn greater risk-adjusted returns during takeover contests than passive firms. An estimate of b_5 less than 0 indicates that competition-reducing firms earn lower risk-adjusted returns during takeover contests than passive firms.

The results indicate that auction-inducing firms earned 19.38% more than passive firms (t = 2.74), on average. Competition-reducing firms earned returns 25.96% lower than passive firms, on average, after controlling for market fluctuations (t = -2.71). These results are consistent with those presented in Table 4 and support hypotheses 3 and 5.

10. Several researchers have argued that related acquisitions offer greater potential gains than unrelated acquisitions (Kusewitt, 1985; Lubatkin, 1983, 1987; Porter, 1980, 1987; Salter & Weinholdt, 1978; Singh & Montgomery, 1987). Similarly, the size or financial resources available to the target firm may influence the gain available from an acquisition (Jemison & Sitkin, 1986). If any of these factors are correlated with response strategy and in fact influence gains to target shareholders during the post-announcement period, the observed relationship between response strategy and target shareholder gains may be spurious.

To address this possibility, the cross-sectional regression test described in footnote 9 was repeated controlling for firm size, liquidity, financial leverage, and various measures of relatedness with the acquiring firms. Controlling for these variables, however, had no material impact on the results.

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