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The role of hostile takeovers in corporate governance

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Abstract

The study makes a distinction between the role of hostile takeovers as a mechanism for downsizing and exit in the process of ‘creative destruction’ and the role of hostile takeovers as a corporate governance mechanism for curbing managerial slack and opportunism. The likelihood that underperforming firms with ineffective internal governance structures are the targets of hostile takeover bids is examined using a panel data for a matched sample of firms in the UK. The study does not find underperformance in firms as a significant factor in the likelihood of a hostile takeover bid. The findings of the literature reporting a significant influence of underperformance in hostile takeovers appear to be the outcome of a mis-specified model. The study also compares the relationship between governance structure and performance for firms subject to a hostile takeover bid with firms that did not receive a tender offer. The

empirical findings do not show that firms with relatively ineffective internal governance structure are the likely targets for hostile takeover bids.

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Notes

‘In most countries, including the United States, control is not contestable. When control is not exerted through control blocks, anti-takeover devices like poison pills, classified boards and anti-takeover laws limit the scope for control challenges through markets. The United Kingdom, where such challenges are possible, is an exception’ (Gugler, 2001).

Only slope dummies have been used. Sector dummies cannot be used. The use of both sector dummies and firm specific dummies as in panel data estimates causes the collapse of the estimation process because of collinearity

The variance inflation factor is computed by regressing each of the independent variables in the regression equation on the remaining repressors. If the value of the ratio $\{1/ (1-R)^2\}$ for any of the repressors exceeds 5 then the independent variable is considered to be significantly correlated with one or more of the remaining variables

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