Mergers, Acquisitions and Hostile Takeovers

Introduction:

The business of mergers and acquisitions (M&A) is replete with a number of interesting and often times amusing metaphors. The term "shark repellant", for example, refers to any number of measures taken by a corporation to discourage an unwanted takeover attempt. Other terms include white knight, golden parachute and poison pill. This essay will define those terms, will provide an example of each, and will demonstrate how the process represented by each of those metaphors benefits one or more of the stakeholders during a merger, acquisition or takeover.

White Knight

There are essentially two types of "White Knights". The first type refers to the friendly acquirer of a firm which is the target of a hostile takeover attempt by another firm. The intent of the white knight acquisition is to prevent the takeover by the third entity, whose takeover is perceived to be less favorable. The knight might defeat the undesirable entity by offering a higher and more enticing bid, or strike a favorable deal with the management of the target firm. The second type refers to the acquirer of a struggling firm that may not necessarily be under threat by a hostile firm. The financial standing of the struggling firm could prevent any other entity being interested in an acquisition. In such a case, the knight, under huge risk, acquires the firm that is in crisis. After acquisition, the knight then rebuilds or absorbs the acquisition.

Example of White Knight: In 1997, H.F Ahmanson sought to take over Great Western Financial (GWF) Corp., an acquisition not favored by GWF, as it was considered unfavorable to Great Western's employees, many of whom would have been laid-off during a merger with Ahmanson. Washington Mutual Inc. stepped in and negotiated a stock swap with GWF valued at $6.6 billion, effectively eliminating the threat of a hostile takeover by H.F. Ahmanson. Thus, Washington Mutual is referred to as a "white knight." (Wall Street Journal, 1997)

The target firm benefits from the intercession of a white knight, as it has either been acquired or received an infusion of money to help them remain viable. The white knight benefits if the firm remains solvent, as will the firm and the shareholders. The white knight is essentially a venture capitalist, and thereby stands to make or lose substantially from any such transaction.

Golden Parachute

A "golden parachute" is a clause in the contract of a CEO or other executive officers of a corporation, that will provide money or stock options, in the event the company is acquired. This payment is designed to counter the tendency for a CEO, who might be subject to termination by an acquiring firm, not to negotiate an acquisition which may acqually be beneficial for the company and for the shareholders. The golden parachute, therefore, is supposed to render the CEO impartial.

Often, the terminated CEO will greatly benefit from a golden parachute. Such compensation plans at Fortune 1000 companies increased from 35 percent in 1987 to 81 percent in 2001, according to a survey by Executive Compensation Advisory Services (Oct 2001). Increasingly, shareholders have become concerned over excessive severance and retirement payments. Notable examples include ex-Mattel CEO Jill Barad's $50 million departure payment, and Citigroup Inc. John Reed's $30 million in severance and $5 million per year for life. Michael Ovitz's $140 million exit package at Walt Disney Co. led to a shareholder lawsuit that seeks to recoup that sum, plus interest, from the company's directors. (Zemen, 2005)

In response, more companies -- including Corning, CSX**,** Delta Air Lines**,** Verizon Communications**,** Norfolk Southern Corp. and McKesson Corp. -- have agreed to seek shareholder approval for future parachute payments that exceed IRS standards, *Compliance Week* reported (Zemen, 2005).

These payments cause controversy for several reasons. One being that often a company is a target for being acquired because it is performing poorly and that poor performance causes the market capitalization, or cost to purchase the company, to be lower. If purchased, the CEO would receive a large sum of money even though he had arguably done a bad job of running the company previously.

Conversely, a golden parachute may actually benefit the target shareholders' net return by partially shifting the managerial compensation burden to the buyer through a higher acquisition price, contingent on a change-of-control rather than solely on the manager's layoff (Golden Parachute as a Compensation-Shifting Mechanism, 2004).

Poison Pill

The term “Poison Pill” was coined as a reference to a business takeover process invented by M&A lawyer Martin Lipton of Wachtell, Lipton, Rosen & Katz, in 1982 (Partnership for New York City , 2005), as a response to tender-based hostile takeovers. Poison pills usually take the form of issuing preferred stock below market value, making it unfeasible for a potential acquirer to purchase sufficient stock to become a major shareholder. Poison pills became popular during the early 1980s, in response to the increasing trend of corporate raids.

The value of employing a poison pill strategy is problematic. It was reported in 2001 that since 1997, for every company with a poison pill that successfully resisted a hostile takeover, there were 20 companies with poison pills that accepted takeover offers (Frieswick, 2001). The trend since the early 2000s has been for shareholders to vote against poison pill authorization, since, despite the above statistic, poison pills are designed to resist takeovers, whereas from the point of view of a shareholder, takeovers can be financially rewarding.

The tactic, however, does pose significant risks to the interests of existing shareholders unless it is used correctly. Because of the risk, U.S. authorities allow a target company to use the step only as a bargaining tool to adjust terms of a buyout proposal in favor of the target shareholders' interest. Companies are prohibited from using the measure to foil takeover bids (Federal Trade Commission, 2006).

Conclusion:

As the essay demonstrates, mergers & acquisitions, like all financial transactions, offer both risks and rewards to all involved stakeholders, including corporate officers, shareholders and employees of both the target and acquiring firms. Often, however, the board and officers – and sometimes even the shareholders – of target firm decide that a takeover is not in their best interests, in which case a number of different “shark repellant” stratagems may be employed, including poison pill or white knight. The CEO of a target firm will often benefit from a takeover, regardless of the impact to other stakeholders, by means of a contract clause termed “golden parachute.”

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