Take overs

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- Moral hazard problem. How to align shareholders and managers interests

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- The raider can install a management team which acts his/her interest

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- Should foreign companies be allowed to take over domestic firms?

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- Very rare in continental Europe and Japan.

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- Takeovers allowed the creation of interstate banking without causing excess capacity.

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- In contrast the raider makes losses or barely breaks even.
- Are raiders just irrationally optimistic?
- Do they indeed run firms more profitably but competition between potential raiders reduces profits to a normal level?

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  - If left to private provision, too few public goods will be produced.

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- Success of the takeover is a public good for shareholders.

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- If shareholders expect the bid to succeed they will not tender their shares.

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- UK law says an offer must be made when 29.9% of the target is acquired, the price cannot be less than the highest price in the previous 3 months.

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  - UK company law gives little protection.

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- They will sell if

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- Two tier bids are common in the USA but are illegal in the UK.

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- It is better to return free cash flow to shareholders and let them decide where to invest it.

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- High debt may weaken organisational opposition to change.

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- Management continued high exploration and development expenditures.
- Also firms diversified into other industries such as retailing, office equipment mining and manufacturing.
- In 1980's takeover wave, many of the targets were in the oil industry.
- As a result free cash flow was paid out to shareholders, expenditure on refining and exploration was cut.

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- Hence $X = E_i - 10$.

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- This illustrates how the market can aggregate information

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Hubris Hypothesis

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- If the raider's valuation of the target exceeds the current market value the raider makes a bid.
- Those valuations which are greater than the market value on average overestimate the value of the firm.
- The winnerís curse.
- The raider fails to correct for this. (Hubris) He/she pays too much for the target.

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- Also many states have passed laws restricting takeovers.

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- Implementing the raider's policies, e.g. Increasing the debt-equity ratio.