

Corporate Defence Mechanisms to prevent Hostile Takeovers

Why in news?

Publicly listed companies are most exposed to threats of a hostile takeover. However, with time, they have come up with varied defence mechanisms to prevent such takeovers.

What is the issue?

- Recently, billionaire Elon Musk now has said that he wants to buy Twitter outright, taking it private to restore its commitment to free speech.
- Elon Musk currently owns about 9% of Twitter shares.
- The company's board has resisted this and deployed the “poison pill” mechanism.

What is a ‘Poison Pill’ defence?

- A poison pill is officially known as a shareholder rights plan.
- A poison pill is a defense tactic utilized by a target company to prevent or discourage hostile takeover attempts.
- Poison pills allow existing shareholders the right to purchase additional shares at a discount, effectively diluting the ownership interest of a new, hostile party.
- Poison pills often come in two forms
 - **Flip-in strategy**- Allows the shareholders, except for the acquirer, to purchase additional shares at a discount.
 - **Flip-over strategy**- Allows the stockholders to purchase the shares of the acquiring company at a deeply discounted price if the hostile takeover attempt is successful
- The mechanism protects minority shareholders and avoids the change of control of company management.
- Poison pills also often open the door to further negotiations that can force a bidder to sweeten the deal.
- If a higher price makes sense to the board, a poison pill can simply be cast aside, clearing the way for a sale to complete.
- **Twitter’s mechanism**- Twitter's plan works by imposing a significant penalty on any investor that builds up a stake of at least 15% in the Twitter without the board's approval.
- If Musk were to hit the 15% threshold, the Twitter board can grant shareholders the right to buy one-thousandth of a share of preferred stock for each common share they own, at a price of 210 dollars.
- That option makes it virtually impossible for anyone to buy Twitter.

POISON PILL

POISON PILL is strategy used by Target Company to avoid hostile takeovers completely or at least slow down acquiring process, by making it costly or unattractive.

ADVANTAGES

- Saves company against hostile takeover
- Interest of minority shareholders
- Opens door for better acquiring prospects
- Allows stakeholders to make decisions
- It helps acquisition process to slow down

DISADVANTAGES

- Value of company falls down.
- Discourages FDI's and FII's investments
- Encourages managers to halt growth.
- It halts change & efficient use of resources.
- It may have negatively impact target.

TYPES

- Flip-In Poison Pills
- Flip-Over Poison Pills
- Voting Rights
- High Leverage
- Preferred Stock Option and Employee Stock Options
- Golden Parachute or Staggered Board

What are the other corporate defence mechanisms to prevent hostile takeovers?

- **Greenmail Defence-** In this, the target company pays a premium, known as greenmail, to purchase its own shares back at inflated prices from a corporate raider.
- After accepting the greenmail payment, the raider generally agrees to discontinue the takeover and not buy any more shares for a specific time.
- **Crown jewel defence-** Crown jewels are the most profitable or valuable corporate units or assets that belong to the company.
- The Crown Jewel Defense strategy is when the target company of a hostile takeover sells its most valuable assets to reduce its attractiveness to the hostile bidder.
- **Pac-man defence-** It prevents a hostile takeover by initiating a reverse takeover.
- In a Pac-Man defense, the target firm tries to acquire the company that has made a hostile takeover attempt.
- The target company could make use of its 'war chest' or securing finances from outside for the reverse takeover bid.
- **White Knight defence-** A white knight is a hostile takeover defense whereby a 'friendly' company acquires a corporation at fair consideration when it is on the verge of being taken over by an 'unfriendly' acquirer.
- The unfriendly bidder is generally known as the "black knight."

References

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