ANALYSIS OF THE ROLE INSTITUTIONAL INVESTORS PLAY IN TAKEOVERS

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Abstract

This article examined the role institutional investors' play in takeovers. Managers of companies are agents of the owners of companies and are expected to carry out their responsibilities for the sole purpose of protecting the interests of owners of companies, in this instance, institutional investors. Due to the fact that managers have access to more information about companies than institutional investors, there is the tendency to pursue their selfish interests as against the interests of the owners of the company. Institutional investors respond by utilising market for corporate control to punish managers of poorly managed companies. This they do by way of takeover. The question worth answering is whether takeovers actually punish managers. This article focused on the United Kingdom and the United States of America due to the active roles institutional investors in these jurisdictions play in market for corporate control. Such active roles to the best knowledge of this article were not found in Nigeria. The article found that takeovers do not really punish managers as they end up making more money by way of huge payout or getting new jobs at the acquiring firm. Acquirer firm managers benefit from increased remuneration linked with firm size. It was also found that takeovers lead to job loss of employees of target firms. It is recommended that the interests of employees of target firms be taken into consideration in negotiating for takeovers.

Key Words: *institutional investors, target firms, acquirer firms, takeovers, managers, employees.*

Introduction.

This article explored the role institutional investors' play in takeovers. The examination of the modus operandi of companies may not be complete without taking cognisance of the agency problem inherent in companies. This agency problem is mostly between managers and company owners, in this instance, institutional investors. Managers are seen as agents of company owners and as such, must perform their duties for the sole purpose of protecting the interests of the owners. Managers are responsible for the day to day management companies. This role puts them in a position where they do not only have more expertise with respect to management of companies than institutional investors, but also gives them access to more information about companies than institutional investors. In other words, there is information asymmetry between managers and institutional investors and this information asymmetry gives managers the incentive to promote their selfish interests at the detriment of the interests of institutional investors. The incentives managers have to satisfy their selfish interests at the detriment of company owners necessitate the need to put some checks and balances in place to checkmate activities of managers. Execution of these checks and balances fall squarely on company owners.

However, share ownership is disperse in nature and as such it may be difficult for the many shareholders to come together to form a common front against managers. The dispersion of share ownership therefore necessitates the need for institutional investors to fill in the gap created by dispersed share ownership. The emphasis on institutional investors is germane as they have large concentration of wealth that puts them in a better position than shareholders to exercise influence on companies.

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To this extent, it is worth examining whether institutional investors have been able to answer this call to duty. In other words, to what extent do institutional investors discipline managers through market for corporate control? This article analyses this issue in four sections. The first section is the introduction. The second section is an analysis of institutional investors and the role they play in takeovers. This section aims at examining whether takeovers discipline managers and the extent to which takeovers enhance the wealth of target shareholders. This section states that institutional investors play significant role in takeovers, however, effectiveness will be more achieved if they act as community of institutional investors rather than individually. This is because of the finding of this article that shareholding of institutional investors both in the United Kingdom (UK) and other European countries has been declining.[1] Thus, declining shareholding may make it impossible for them to achieve any desired result individually. However, this section did not find any conclusive evidence that market for corporate control disciplines managers irrespective of whether the takeover is under the United States of America (USA) approach or the UK approach. The third section is an analysis of the extent to which takeovers affect performance of acquirer firms in order to determine whether takeovers are worth the pains. There is no conclusive evidence on the impact of takeovers on acquirer firms. An extension of the analysis to target company employees indicate that takeovers lead to job loss. The implication of the findings in sections two and three of this article is that takeovers do not really sanitise companies but instead, create avenues for managers to increase their wealth. In this instance, target firm managers benefit by receiving huge payout while acquirer firm managers benefit from increased remuneration linked with firm size. The last section concludes the article.

Institutional Investors and Market for Corporate Control.

Before delving into the crux of this section, it is apposite to define certain concepts that feature prominently in this article. Institutional investor refers to company or organisation with employees who invest on behalf of others.[2] Institutional investors are organizations with large concentration of wealth and they invest this wealth in companies. They include such institutions as insurance companies, hedge funds, pension funds and mutual funds. The size of institutional investors gives them access to large share concentration and more incentives to monitor managers more than shareholders.[3] Market for corporate control disciplines managers of corporation with public traded stock to act in the best interests of shareholders.[4] Here, poorly managed companies are targets for takeovers and once the firm is taken over, the bidder can replace the inefficient management team.[5]

It is argued that firms with high levels of institutional ownership are more likely to be acquired than firms that do not have high levels of institutional ownership.[6] The implication of this may be that the more institutional investors there are in a company, the more discipline managers in that company would be. This is because institutional investors may opt for exit as a way of punishing management for its reckless behaviour. This exit normally comes in the form of takeover and thus, necessitates the need for this article to examine the extent of the role institutional investors' play in takeovers.

[1]This article focused on the United Kingdom and the United States of America due to the active roles institutional investors play in these two jurisdictions. This article, to the best of its knowledge, did not find such roles played by institutional investors in Nigeria.

[2] Investopedia, 'Institutional Investors vs Retail Investors: What's the Difference?', Investopedia, April 11, 2023, https://www.investopedia.com/ask/answers/06/institutionalinvestor.asp#:~:text=Institutional%20investors%20are%20large%20entities,of%20their%20clients%20or%20members, accessed on 18/07/2023.

[3]Duggal, Rakesh and Miller, James, 'Institutional Investors, Antitakeover Defenses and Success of Hostile Takeover Bids', (1994), 34 (4), *The Quarterly Review of Economics*, 387-402.

[4]Jonathan N. Macey, 'Market for Corporate Control', The Library of Economics and Liberty, 2023, https://www.econlib.org/library/Enc/MarketforCorporateControl.html, accessed on 30/07/2023.

[5]*Ibid.*

[6]Qiu, Lily and Wan, Hong, 'Selection or Influence? Institutional Investors and Acquisition Targets', (2006), 2-27, http://www.brown.edu/Departments/Economics/Papers/2006/2006-25_paper.pdf, accessed on 28/03/2012.

It is argued that large concentration of shares put institutional investors in a better position to make takeover become a reality.[7] Nevertheless, it may be said that the ability of institutional investors to play any significant role in takeovers may depend on the powers they have. Some jurisdictions encourage managers to adopt any defence within their power to frustrate takeovers while others allow market for corporate control to take its full force without any interference. For instance, the UK's self-regulatory approach gives institutional investors unfettered power in takeovers.[8] The implication of this is that managers in the UK firms are barred from adopting defensive tactics to prevent takeovers unless the institutional investors consent to it. On the other hand, the USA approach gives managers the power to adopt any anti-takeover defences of their choice to frustrate takeovers. To this extent, it is argued that institutional investors in the UK play more significant role in takeovers than their counterparts in the USA.[9] Also, it is argued that foreign institutional investors in both target and acquirer firms play more significant role in cross-border mergers and acquisitions than domestic institutional investors because foreign institutions have less business ties to target firms.[10] However, the question is: are the roles institutional investors' plays in takeovers more effective when they act individually or when they act communally?

In answering this question, it is worth knowing that one of the reasons shareholders may be unable to discipline managers through market for corporate control is because of the disperse nature of their shareholdings. Dispersed shareholding may make it impossible for shareholders all over the world to come together to form a common front against managers. Thus, for institutional investors to be able to effectively checkmate the excesses of managers there may be need for them to act not individually but communally. The need to act communally becomes more necessary because different interests institutional investors pursue may make it impossible for them to play a homogeneous role in market for corporate control.[11] Also, evidence indicates that shareholding of institutional investors like pension funds and insurance companies has been declining since 1997.[12] This article is not arguing that institutional investors cannot influence companies individually[13] , but that effectiveness would be more achieved if they act communally. Thus, the question is: what are the qualities that put institutional investors and not shareholders in the position to play significant role in takeovers?

As stated above, one of the advantages institutional investors enjoy is their access to large concentration of shares. To this extent, institutional investors fill in the gap created by individual shareholders especially when they act in unity since they have more percentage of shareholding in firms, which also translates to more voting power. The large concentration of shares at the disposal of institutional investors helps in the reduction of “the bargaining and transaction costs associated with takeover bids”.[14] Another factor that contributes to the role institutional investors' play in takeovers is

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[7]Kobayashi, Mami, 'Ownership Structure, Shareholder intervention, and success in takeovers', Japan and World Economy, (2007), 19 (4), *Japan and World Economy*, 425-440, at 429. & Useem, Micheal, *et al*, 'US Institutional Investors look at Corporate Governance in the 1990s', (1993), 11 (2), *European Management Journal*, 175-189 at 176.

[8]Eaglesham, Jean and Burgess, Kate, 'Mandelson's plea to investors on bids', Financial Times, January 14, 2010, http://www.ft.com/cms/s/0/758d3098-00ad-11df-ae8d-00144feabdc0.html#axzz1qLCpB3dU, accessed on 27/03/2012.

[9]Armour, John and Skeel, David, 'The Divergence of US and UK Takeover Regulation', (2007), 50-59, at 50, http://www.cato.org/pubs/regulation/regv30n3/v30n3-8.pdf, accessed on 28/03/2012 & Payne, Jennifer, 'Minority shareholder protection in takeovers: A UK perspective', (2011), 8 (2), *European Company and Financial Law Review*, 145-173, at 146.

[10]Ferreira, A. Miguel, *et al*, 'Shareholders at the gate? Cross-Country evidence on the role of institutional investors in mergers and acquisitions', (2007), 1-46, at 16, http://128.122.130.4/cons/groups/content/documents/course_description/uat_025795.pdf, accessed on 22/03/2012

[11]Duggal, Rakesh and Miller, James, *supra*, n.3, 593 & Qiu and Wan, *supra*, n.6, 12 &13.

[12]Office of National Statistics, 'Ownership of UK Quoted Shares: 2022', https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2022, accessed on 11/09/2024.

[13]Useem, Micheal, *et al*, *supra*, n.7, 176.

[14]Ferreira, A. Miguel, *et al, supra*, n.10, 2.

the cost of monitoring the activities of managers. It is argued that institutional investors sell their stakes in order to avoid the high cost of monitoring management.[15] This is despite the fact that their large stakes put them in a better position bear monitoring cost.[16] However, it can be said that pursuit of profit maximization gives institutional investors the incentive to do anything within their power to minimise cost no matter how minute the cost may be. Following from this, it is worth examining whether the role institutional investors play in takeovers yield any positive result.

Effectiveness of the activities of institutional investors in takeovers can be said to depend on the extent to which such activities punish managers and the wealth that accrues to institutional investors to compensate them for the role they play in takeovers. As stated above, information asymmetry problems between managers and institutional investors compel institutional investors to resort to takeovers to checkmate the activities of managers. As a result, managers have the incentives to manage firms at their control in a prudent way in order not to incur the wrath of institutional investors. Thus, it can rightly be argued that managers are supposed to suffer loss whenever a firm within their control is taken over. Nevertheless, takeovers trigger off such anti-takeover defences as poison pills, white knight, greenmail and stock buyouts in managers.[17] The essence of these anti-takeover defences is to enable managers frustrate every move by institutional investors to allow their firms to be taken over. Thus, the reaction of managers at the announcement of a takeover bid can be likened to a cow that goes on rampage on becoming aware of its imminent death. This makes the takeover hostile and expensive in nature and necessitates the need for bidder firms to negotiate with managers in order to succeed in the takeover. To this extent, it is argued that managers resist takeovers in order to create room to negotiate their interests with the bidder company.[18] The end result of this is that managers benefit from takeovers either by way of increase in financial wealth, a better job in the bidder firm or both.[19]

However, there is a contrary view that managers do not benefit from hostile takeovers, but instead benefit from friendly takeover.[20] This article supports the argument that managers benefit from takeovers irrespective of whether it is friendly or hostile in nature. For instance, the takeover of Cadbury by Kraft was hostile in nature but it did not prevent Roger Carr and Todd Stitzer, Cadbury's Chairman and Chief Executive respectively from leaving the Company with huge financial benefits.[21] Following from this, it can be argued that takeovers do not discipline managers,[22] but instead give them the incentives to maximise profits. Thus, if takeovers do not discipline managers, then how do institutional investors benefit from them?

It is said that "the returns associated with activism are largely explained by the ability of activists to force target firms into a takeover, thereby collecting a takeover premium".[23]

[15] Kobayashi, Mami, *supra*, n.7, 426 & Moeller, Thomas, 'Let's make a deal! How Shareholder Control Impacts Merger Payoffs', (2005), 76 (1), *Journal of Financial Economics*, 167-190, at 169.

[16] Duggal, Rakesh and Miller, James, *supra*, n.3, 389 & Greenwood, Robin and Schor, Michael, 'Investors Activism and Takeovers', (2009), 92 (3), *Journal of Financial Economics*, 362-375 at 362.

[17] Bradley Caroline, 'Corporate Control: Markets and Rules', (1990), 53 (2), *The Modern Law Review*, 170-186, at 173.

[18] Hartzell Jay, Ofek, Eli and Yermack, David, 'What's in it for me? Personal benefits obtained by CEOs whose firms are acquired', (2000), 1-22, at 11 & 12, http://ssrn.com/abstract=236094, accessed on 28/03/2012.

[19] Global Finance , 'Corporate Finance: US Cross-Border Merger and Acquisition Outflow Sets Record', 2007, http://www.gfmag.com/archives/44-44-january-2007/1239-corporate-finance.html, accessed on 9/03/2010 & Hartzell *et al*, *ibid*.

[20] Morck, Randall, Shleifer, Andrei and Vishny, Robert, 'Characteristics of Hostile and Friendly Takeover Targets', 1987, *NBER Working Paper Series No. 2295*, 1-44, at 18, www.nber.org/paper/w2295.pdf, accessed on 18/03/2010.

[21] London Evening Standard, 'Cadbury Bosses Todd Stitzer and Roger Carr leave after Takeover', 3rd February, 2010, available at: www.thisislondon.co.uk/standard-business/article-23802087-cadbury-bosses-todd-stitzer-and- roger-carr-leave-after-kraft-takeover.do, accessed on 19/03/2010.

[22] Franks, Julian and Colin, Mayer, 'Hostile Takeovers and the Correction of Managerial Failure', (1996), 40 (1), *Journal of Financial Economics*, 163-181, at 177.

[23] Greenwood, Robin and Schor, Michael, *supra*, n.16, 363.

Thus, it is argued that takeover increases the share value of shareholders.[24] This is further illustrated in Table One below using ten takeover samples in the US in 2005.

Table 1: Ten takeover samples in the US demonstrating the extent to which shareholders profit from takeovers.

		IDDER	JUMPER	RICE ER HARE $	RICE ER HARE $	NCREAS	QUITY ALUE($M)
	UIDANT	&J	OSTON CIENTIF C	4.00	0.00	5%	, 308.8
	CI	ERIZON	WEST	0.75	6.00	5.3%	, 705.0
	AYTAG	IPPLEWO D	HIRLPO L	4.00	1.00	0.0%	57.9
	NOCAL	HEVRON	NOOC	0.83	2.43	.6%	32.9
	AMED	EDICIS	LLERGA	5.00	4.00	2.0%	40.8
	OLLYW OD	EONARD REEN	OVIE ALLERY	0.25	3.25	9.3%	82.7
	ETEK	AP	RACLE	50	1.25	2.4%	54.3
	HOPKO	OLDNER AWN	UN APITAL	4.00	9.00	0.8%	51.2
	OODY'S	UN APITAL	RENTIC APITAL			0.0%	

This data is obtained from the Riskmetrics Group, Financial Research and Analysis, available at: www.riskmetrics.com/sites/default/files/RA5-MA_Edge.pdf, accessed on 16/03/2010.

Table One contains the names of the target firm, the initial bidder firm and the firm that finally acquired the target firm known as the deal jumper. From the Table, the highest increase in share price is the takeover of Maytag by Whirlpool, while the least percentage increase in share price is the takeover of Unocal by Cnooc. None of the takeovers in Table One recorded any decrease in share value and this goes to show that shareholders and institutional investors in particular are better off after takeovers. Having established the extent to which managers and institutional investors benefit from takeovers, it is apposite to examine the extent to which takeovers affect the acquirer firms and employees.

Impact on Acquirer Firms and Employees.

It is worth noting that takeovers do not come cheap as acquirer firms sometimes borrow and even sell some of their assets in order to foot takeover bills. For instance, Kraft sold its Pizza business to Nestle in order to raise money to takeover Cadbury while its shares fell by 2.2% as a result of scepticism on the profitability of the Cadbury deal.[25] Thus, it is argued that high rate of assets disposal in order to finance takeovers worsen the financial position of bidder companies.[26] To this extent, it is argued that acquirer firms perform poorly after takeovers.[27]

[24]Haan, Marco and Yohanes, Riyanto, 'The Effects of Takeover Threats on Shareholders and Firm Value', (2006), 59 (1), *Journal of Economic Behaviour and Organisation*, 45-68, at 47 & Shahrur, Husayn, 'Industry Structure and Horizontal Takeovers: Analysis of Wealth Effects on Rivals, Suppliers, and Corporate Customers', (2005), 76 (1), *Journal of Economic Finance*, 61-98, at 74.

[25]Maliha, Sadiq, 'Kraft's Merger with Cadbury is a "Bumpy but Upward Road', Medill Reports Chicago, February 10, 2010, www.news.medill.northwestern.edu/chicago/news.aspx?id=156181, accessed on March 10, 2010 & Wearden, Graeme, 'Warren Buffet blasts Kraft's takeover of Cardbury', The Guardian, Wednesday 20the January, 2010, http://www.guardian.co.uk/business/2010/jan/20/warren-buffett-blasts-kraft-cadbury, accessed on 26/03/2012.

[26]Franks, Julian and Colin, Mayer, *supra*, n.22, 168 & 169.

[27]Agrawal Anup, Jaffe, Jeffrey and Mandelker, Gershon, 'The Post-Merger Performance of Acquisition Firms: A Re-examination of an Anomaly', (1992), XLVII (4), *The Journal of Finance*, 1605-1621, at 1611.

An analysis on the effects of cross-border acquisitions of private firms on bidder returns in different target markets indicates significant positive cumulative average abnormal returns in announcements of acquisitions in the US and China.[28] The analysis also indicates that "private acquisitions generate positive results irrespective of the target market" and the "bidder market".[29] It is also argued that "acquirers in Australia generate positive returns" in takeovers financed with stocks than those financed with cash or both cash and stock.[30] Small acquirers in Australia are said to "generate higher returns with any method-of-payment in private deals (while) large acquirers perform better in stock financed public deals".[31] To this extent, it can be argued that there is no conclusive evidence on performance of acquirer firms after takeover. Though, it is worth knowing that incurring too much debt in order to finance a takeover deal may be sufficient to make the acquirer firm go bankrupt or even be taken over by another firm.[32] However, there is a contrary view that debt spurs managers into action to service the debt obligation and even maximise profit for acquirer firm owners.[33]

Nevertheless, acquirer firm shareholders are not the only group left worse off after takeovers. The fact that firms do not operate in a vacuum means there are other groups that contribute directly or indirectly to the realisation of the firms' objectives. This necessitates an analysis of the extent to which takeovers impact of the wider stake. It is worth noting that the first group of people that suffer the negative impact of takeovers can be said to be target firm employees. For instance, an analysis on the effects of full and partial acquisitions on employees indicates that "worker turnovers rates are lower for partial acquisitions".[34] It is also argued that mergers and acquisitions lead to decline in earnings.[35] An analysis on the impact of takeovers on employment in the UK from 1967 to 1996 shows reduction in the demand for labour after takeovers both in the short term and the long term.[36] Thus, in as much as there is no conclusive evidence on the effect of takeovers on employees, the fact that some employees loose their jobs after takeovers justifies the need for the interests of employees to be taken into consideration in takeover decisions. For instance, Kraft reneged on its promise to save UK jobs after its takeover of Cadbury.[37] Furthermore, Kraft also reneged on its promise not to close Cadbury branches by going ahead with the closure of the Somerdale Factory despite opposition to such move by employees and members of the community.[38] To this extent, it is argued that takeovers are just an excuse for managers to increase firm size and by implication increase their pay.[39] This is because of the finding of this article that takeovers do more harm than good.

[28]Eije, Von, Henk and Wiegerinck, Helene, 'Shareholders' Reaction to Announcements of Acquisitions of Private Firms: Do Target and Bidder Markets make a Difference?', (2010), 19 (4), *International Business Review*, 360-377, at 368 & 369.
[29]*Ibid*, 369.
[30]Humphery-Jenner, Mark and Powell, Ronan, 'Firm size, takeover profitability, and the effectiveness of the market for corporate control: Does the absence of anti-takeover provisions make a difference?' (2011), 17 (3), *Journal of Corporate Finance*, 418-437, at 423.
[31] *Ibid.*
[32]Bradley Caroline, *supra*, n. 17, at 176.
[33]Gillan, Stuart, 'Recent Development in Corporate Governance: An Overview', (2006), 12 (3), *Journal of Corporate Finance*, 381-402, at 388.
[34]Siegel, Donald and Simmons, Kenneth, 'Evaluating the Effects of Mergers and acquisitions on Employees: Evidence from Matched Employer-Employee Data', 2008, 1-32, at 15, http://www.accf.nl/Conference%20papers%20RoF/Siegel-Simons.pdf, accessed: 27/03/2012.
[35]*Ibid.*
[36]Conyon, M, *et al*, 'The Impact of Mergers and Acquisitions on Company Employment in the United Kingdom', 2009, 1-25, at 11 & 12, http://dspace.cigilibrary.org/jspui/bitstream/123456789/19296/1/The%20Impact%20of%20Mergers%20and%20Acquisitions%20on%20Company%20Employment%20in%20the%20United%20Kingdom.pdf? Accessed on 27/03/2012.
[37]Wood, Zoe, 'Kraft to Shed 200 British Jobs but Denies Breaching No-cuts Pledge to MPs', The Guardian, Tuesday 6th December, 2011, http://www.guardian.co.uk/business/2011/dec/06/kraft-axes-200-uk-jobs, accessed on 27/03/2012.
[38]BBC News, 'Cadbury factory closure by Kraft 'despicable'', Wednesday, 10th February, 2010, http://news.bbc.co.uk/1/hi/8507780.stm, accessed on 27/03/2012.
[39]Zhou, Xianming, 'CEO Pay, Firm Size, and Corporate Performance: Evidence from Canada', (2000), 33 (1), *The Canadian Journal of Economics*, 213-251, at 224 & 226.

Conclusion.

This article examined the role institutional investors' play in takeovers. It found that institutional investors play significant roles in takeovers, however, effectiveness may be better achieved if they act communally. This is because the article found that shareholding of institutional investors has been declining both in the UK and other European countries. As such, the percentage of shares institutional investors hold individually may not be sufficient to discipline managers. However, analyses on the extent to which takeovers discipline managers indicate that takeovers do not actually discipline managers. Instead, target firm managers are better off with financial benefits and sometimes, employment in acquirer firms or both. Acquirer firm managers' benefit from increased remuneration linked with firm size. Target firm institutional investors benefit financially from takeovers as can be seen in the sample of ten takeovers in the US in Table One.

Furthermore, since managers and target firm institutional investors benefit from takeovers, this article examined the extent to which takeovers may affect acquirer firms and target employees. This analysis is based on the fact that acquirer firms laden themselves and even sell some of their assets in order to finance takeover deals. The article did not find any conclusive evidence of the impact of takeovers on performance of acquirer firms. However, as stated by Bradley, high debt may drag acquirer firms to bankruptcy or even subsequent takeover by other firms. On the other hand, target employees suffer immensely from takeovers. Thus, the fact that firms do not always perform well after takeovers, and the untold hardship takeovers subject target employees to, question the essence of takeovers. It is therefore recommended that the interests of target firm employees should be taken into consideration in negotiating for takeovers. However, the method of this negotiation and its possible outcomes can be the topic of another research.

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