Take-over Bids: Theory, Reality and the Free-Rider Problem

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ABSTRACT

Takeover bids occur frequently. A theoretical and experimental literature starting with Grossman and Hart (1980) focuses on the free-rider problem that may be created by such bids. Minority shareholders who hold back their shares when facing a tender offer can make substantial gains if the post-takeover value of the shares is higher than the bid. If this forces the bidder to offer to buy the shares at the expected post-takeover value, the bidder will not be able to make any profit through gaining control of the firm. This will leave no incentive to make a takeover bid, even if a potential bidder is confident that it could increase the value of a target firm if it gained control. This paper assembles a database of all Canadian takeover bids for publicly traded companies and provides a general overview of the outcome of those bids from Jan 2008 to Jun 2013. I use these data to show that the vast majority of takeovers do not result in incentives for minority shareholders to free ride. This is because in most takeovers minority shareholders who do not tender are forced to sell their shares on the same terms as the shareholders who choose to tender. Thus, they are unable to profit from the post-takeover value of the target firm. Very few cases permit the possibility of free-riding. This paper illustrates in detail, including all the cases in which minority shareholders remain after the takeover, and two representative cases of the more common scenario in which the bidder acquires all the shares of the target.