The Present Status of Takeover Bids (TOB) and Their Effect on Stock Prices

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Introduction

Takeover bids (TOBs, also called tender offers) were introduced in Japan under the Securities and Exchange Act of 1971, with a major revision occurring in 1990. For the first five to six years after their introduction, only two or three takeover bids occurred per year. However, the number has gradually increased since 1996, reaching double digits in 1998 (Figure 1). Since last year, the content of takeover bids has also changed gradually with the unprecedented appearance of several contested TOBs.

In this paper, we give a brief description of TOBs while drawing comparisons with the United States, and examine TOB characteristics in the past decade as well as their impact on stock prices.

Figure 1 Number of Tender Offers by Year

	1990	91	92	93	94	95	96	97	98	99	Total
Listed companies	2	1	4	2	0	1	6	7	14	11	48
Unlisted companies	1	0	0	0	0	2	0	1	2	4	10
Total	3	1	4	2	0	3	6	8	16	15	58

1. Broad Definition of TOB in Japan

The conventional image of a tender offer is where an offer price is presented above the market price, and shares are bought broadly from many unspecified shareholders. While this type of transaction is included, what sets apart Japan’s system is the inclusion of other types of actions as well. In principle, tender offer rules apply whenever shares are acquired outside of the securities markets, with only a few exceptions. Thus the scope of tender offer rules is extremely broad.

There are two main exceptions. First are tender offers that result in an ownership ratio of 5% or less after the transaction is completed. This threshold was reduced from 10% following the adoption of the 5% rule (for disclosure of shareholdings of 5% or more) in the 1990 revision. Second are tender offers made to a very small number of persons. When shares are acquired outside of securities markets from ten or less persons within 60 days, the transactions are treated as negotiated transactions and not subject to tender offer rules. However, a special provision exists in which if the ownership ratio after acquisition exceeds one-third of the issued shares, tender offer rules are applicable even if 10 or fewer persons are involved in the transaction.[1]

These rules differ significantly from tender offer rules in the United States. The Williams Act of 1968, which amended the Securities Exchange Act of 1934 and introduced tender offer rules, does not contain any legal definition of a tender offer. Thus general standards have been developed to define tender offers based on court decisions, the most prominent of which is the eight factor test (Figure 2). The SEC uses this standard to determine whether a particular transaction is a tender offer. However, the eight factor test is not definitive, and final decisions are based on a comprehensive review of other factors as well.

Figure 2 The Eight Factor Test in the U.S.

1. Active and widespread solicitation of shareholders
2. Solicitation of a substantial percentage of issued stock
3. Premium offered over the market price
4. Firm rather than negotiated terms
5. Contingent on the tender of a fixed number of shares
6. Limited duration of offer
7. Shareholders are subject to pressure to sell shares
8. Offer announcement precedes or accompanies rapid and substantial accumulation of shares

There is a major difference in the scope of tender offers between the U.S. approach, which is based on the eight factor test, and the Japanese approach, which in principle designates all acquisitions outside of securities markets as tender offers. For example, when shares are acquired from one major shareholder at below market price, in Japan tender offer rules will apply if the acquisition results in ownership of at least one-third of the issued shares, while in the U.S. tender offer rules would not apply. Other comparisons between the two countries are shown in Figure 3.

Figure 3 Comparison of Tender Offer Rules in Japan and the U.S.

	Japan	U.S.
Definition of tender offer	Clearly defined	Not legally defined
Disclosure to stockholders	Limited to newspaper advertisements and tender offer prospectus	1. Detailed newspaper ads, 2. simple newspaper ads with contact information, 3. direct mailing to stockholders, 4. choice of other methods
Offer duration	20 to 60 days	20 business days (SEC rules)
Disclosure of target company's opinion	None; but if opinion is expressed, report must be submitted.	Must inform SEC of company's opinion within 10 days of start.
Tender offer of 5% or less	Not subject to tender offer rules	
Separate tender offer	Prohibited	
Shareholder's withdrawal right	Valid during tender offer period	
Oversubscription	Must accommodate all subscribers during offer period	
Change in tender conditions	Price increase during offer period applies to all subscribers prior to increase.	

Source: Kondo, Yoshihara, and Kuronuma, *Introduction to the Securities and Exchange Law,* revised edition; P.A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings*; T.H. Hazen, *The Law of Securities Regulation*, 3rd edition.

2. Frequent Occurrence of Tender Offers Below Market Price

Below we look at the characteristics of past tender offers of publicly held companies in Japan.

(1) Tender Offer Period

The Securities and Exchange Law stipulates that the tender offer period last from 20 to 60 days starting from the advertisement date. Our data shows that most tender offers are concentrated at the lower end at 21 to 23 days (Figure 4). These are friendly tender offers that involve agreements between the acquirer and major shareholders and management prior to the announcement, and thus are completed in minimal time. Only once has the offer period been extended — when Avon Beauty Products (ABP) and Avon International Operation Inc. (AIO) acquired Avon Products, the original 22-day period was extended twice, and lasted for 50 days.

Figure 4 Distribution of Tender Offer Periods

Offer period	No of. cases
21 days	30
22 days	8
23 days	2
24 – 30 days	4
31 – 40 days	2
41 – 50 days	2
Mean duration	23.6 (days)
Median duration	21
Maximum duration	50
Minimum duration	21

Note: The 50-day case was extended from an initial 22 days.

(2) Tender Offer Price

Since the purpose of a tender offer is to buy shares from many unspecified shareholders, the general conception is that the announced offer price must exceed the market price. Otherwise, shareholders would be better off selling shares in the market.

However, only about half of the tender offers have exceeded the market price (Figure 5). And only in five cases has the premium over market price reached 50%. Even in a contested takeover such as Boehringer Ingelheim’s bid for SS Pharmaceutical, the premium was 41.9%, while MAC Inc. offered only a 13.6% premium in its bid for Shoei Co.

On the other hand, half of the cases are transacted at an offer price below the market price. Out of the total sample, one-third have a tender price at least 20% below the market price, one-fourth are at least 30% off the market price, and 17% are at least 50% off the market price; the largest discount is 80% off the market price. Despite the deep discounts, virtually 100% of the planned number of shares were acquired in all of the cases.

Figure 5 Distribution of Tender Offer Prices

Tender price relative to market price	No. of cases
Over -50%	8
–50% to –30%	4
–30% to –20%	4
–20% to –10%	4
–10% to 0%	5
0% to +10%	7
+10% to +20%	6
+20% to +30%	2
+30% to +50%	3
More than +50%	5
Mean divergence	–5.4%
Median divergence	–2.2%
Maximum divergence	95.2%
Minimum divergence	–77.6%

Note: Divergence = (Tender price – Market price) / Market price * 100
Note: Percentage divergence is (Offer price – Market price) / Market price * 100

The success of these tender offers despite the steep discounts is explained by the fact that the acquirers had made the necessary arrangements with large shareholders prior to the announcement. Large shareholders agree to sell at discounted prices for several reasons.

The first reason involves the liquidity of the stock market. If a shareholder tries to liquidate a substantial position in a short period of time, the stock price is almost certain to drop at least temporarily. He thus accepts the discounted price as a reflection of the market's illiquidity. Moreover, by accepting the discounted price, the shareholder is guaranteed the sale of his entire position.

Second, the market for corporate acquisitions is immature. Companies tend to be oriented toward internal growth, and are unfamiliar with aggressive acquisition practices. Since motivated sellers — be they major shareholders or management — thus have difficulty finding buyers, they forced to accept deeply discounted prices.

Third, the possibility exists that a company's actual value is not accurately reflected in its stock price. Major shareholders with access to internal information may find that the company is grossly overvalued, and sell their shares at a discount before the market has a chance to adjust the company's valuation.

(3) Number of Shares Tendered

We next look at the number of shares tendered as a proportion of the shares bid for (Figure 6). In all, 83.3% of the tender offers were over-subscribed; 89.6% had a subscription rate of at least 90%. However, among the over-subscribed offers, only 30% are over-subscribed by 5% or more. The majority of over-subscribed offers are in the 100% to 105% range.

These results show that in the vast majority of cases, the number of shares tendered is roughly equal to the desired amount. This is because, as we mentioned earlier, the transactions have already been arranged at discount prices prior to the tender offer.

Figure 6 Subscription Rate of Tender Offers

Tendered / solicited shares	No. of cases
Less than 30%	1
30% to 49%	2
50% to 69%	1
70% to 79%	1
80% to 89%	0
90% to 99%	3
100% to 104%	28
105% to 109%	4
110% to 119%	1
120% to 129%	2
130% to 149%	2
150% or more	3
Mean	104.5%
Median	100.0%
Maximum	233.3%
Minimum	6.5%

(4) Total Acquisition Cost

From the tender offer prices and share counts, we calculated the mean average acquisition cost at ¥11.8 billion. However, the median cost is only ¥2.7 billion because 31 acquisitions are valued at ¥5 billion or less, indicating the relatively small scale of most acquisitions (Figure 7). The largest acquisition to date is to ¥100 billion acquisition of Chujitsuya by Daiei and Maruetsu.

Figure 7 Distribution of Acquisition Cost

Total acquisition cost	No. of cases
Less than ¥1 billion	11
¥1 billion up to ¥2 billion	9
¥2 billion up to ¥5 billion	11
¥5 billion up to ¥10 billion	5
¥10 billion up to ¥30 billion	4
¥30 billion up to ¥50 billion	6
¥50 billion or more	2
Mean	¥11.8 billion
Median	¥2.7 billion
Maximum	¥102.3 billion
Minimum	¥0.1 billion

(5) Ownership Ratio of Acquirer

Upon completion of the tender offer, the mean ownership ratio is 52.9% and the median ratio is 50.9%, with the distribution concentrated in the 40-60% range (Figure 8). Thus most acquisitions result in ownership of approximately half of the issued shares. In fact, due partly to the scarcity of contested acquisitions, the ownership ratio fails to reach 30% in only two cases.

Figure 8 Distribution of Ownership Ratios after Tender Offer

Shareholding ratio	No. of cases
Less than 20%	1
20% to 29%	1
30% to 39%	7
40% to 49%	12
50% to 59%	16
60% to 69%	4
70% to 79%	2
80% to 89%	2
90% or more	3
Mean	52.9%
Median	50.9%
Maximum	97.60%
Minimum	6.50%

3. Increase in Stock Price of Acquired Company

To examine the effect of tender offers on the share prices of the companies involved, we use the event study approach.

Stock prices often surge when a tender offer is reported in the newspapers. The event study approach extracts such irregular stock price movements caused by media reports. To isolate this effect, we remove the effect of overall market fluctuations by using the statistical relationship between the market and individual stock prices extrapolated from pre-tender offer data. This is necessary because a rise in the stock market generally lifts individual stock prices.

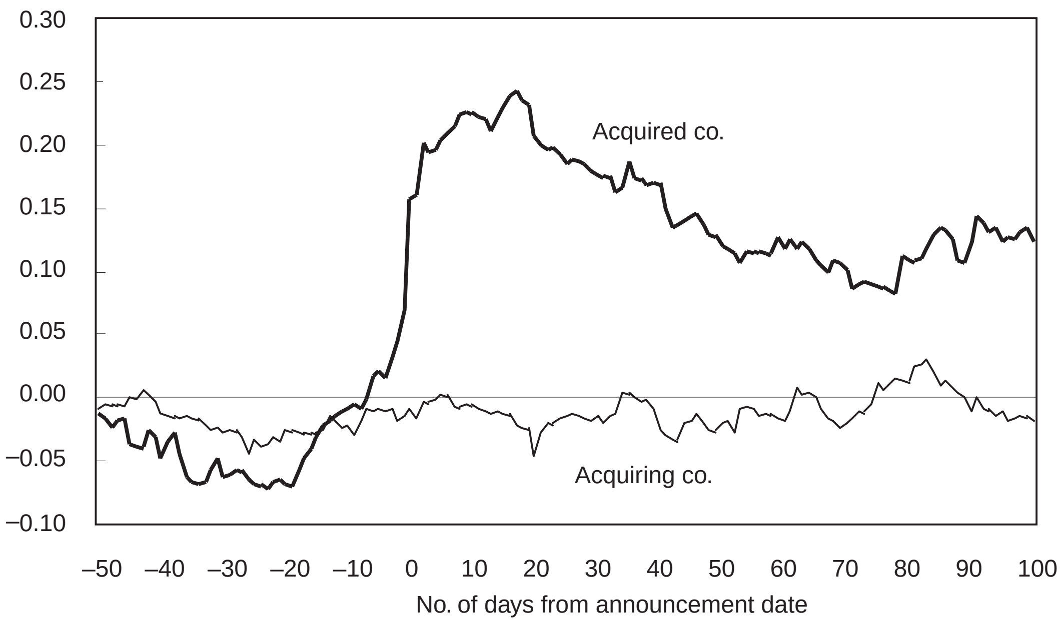
Below we use the term abnormal return (AR) to refer to the deviation from normal stock price fluctuations — that is, the stock price fluctuation rate excluding the overall market's effect — and the cumulative abnormal return (CAR) to measure AR over a fixed duration.

Our sample consists of tender offers for public companies from 1990 to 1999. Because we exclude cases in which sufficient stock price data is unavailable, and in which the acquirer is either an individual or foreign company, the final sample size consists of 40 acquired companies and 24 acquirers.

The tender offer announcement date is defined as the date a story appears in the *Nihon Keizai Shimbun* newspaper. If no story appears prior to the tender offer advertisement, the announcement date is taken to be the first day of the tender offer. The announcement date is designated as day zero, and the number of days is counted forward or backward in time. Daily stock price data is obtained from *Nikkei Quick*.

The results are shown in Figure 9. For acquired companies, the CAR begins rising from around day -20, and reaches approximately 25% at announcement day. It then declines gradually, but sustains at 15% even after day 80.

Figure 9 Cumulative Abnormal Returns of Acquired and Acquiring Companies



On the other hand, for acquiring companies, no significant fluctuations are observed either before or after the announcement day, and the CAR fluctuates around zero. The stock price increase of acquired companies can be attributed to several factors.

When the market price is below the tender price, the market price tends to approach the tender price during the offer period. In addition, even after the offer period is completed, a higher tender price can often cause the market to revise its valuation of the company upward, thereby pushing the market price upward.

On the other hand, when the market price exceeds the tender price, if the acquirer is considered a better credit risk that the current major shareholders, the market will react favorably and push the stock price upward.

Judging from CAR trends, the stock price movements of acquirers appear neutral. This is due to the positive and negative cases canceling each other out. A positive effect occurs primarily when the tender price exceeds the market price, and the market reacts favorably to the synergy created with the acquired company. On the other hand, if the acquired company is a poor performer, the market tends to view the acquisition negatively.

Since the effect of tender offers is positive for acquired companies and negative for acquiring companies, we can surmise that the overall impact of tender offers on the economy is positive.

Note

1. However, tender offer rules do not apply in transactions where the acquired company is already a subsidiary.