"Has the Threat of a Takeover Improved the Management of the Target Firm? Case of the First Hostile Bidder, M&A Consulting"

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Summary

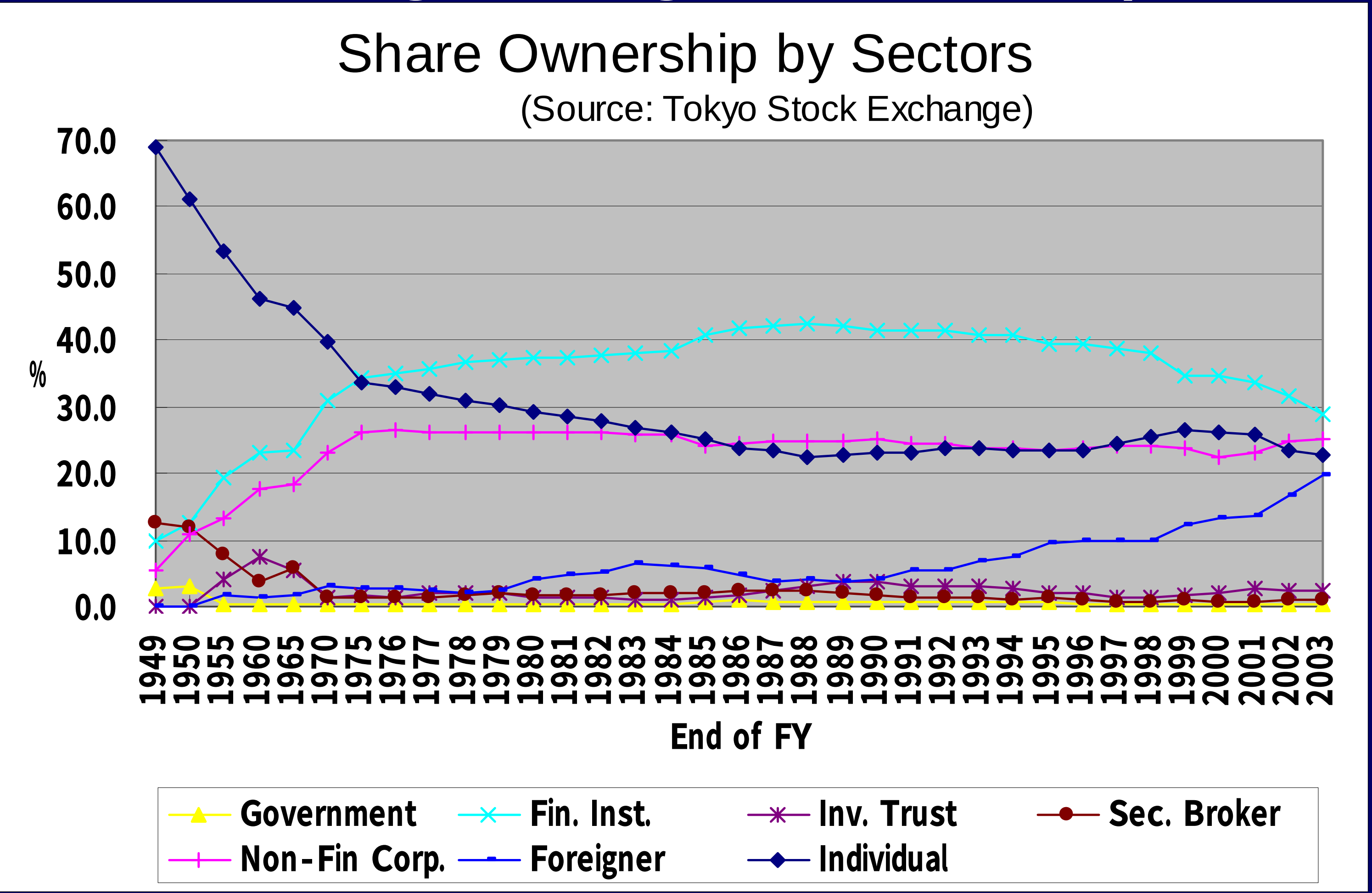
- Background
- Pros and Cons of Hostile Takeovers
- The First Hostile TOB: MAC vs. Shoei
- Our Research
- Sample
- Findings
- Conclusion & Future Research

Our research is still very preliminary. Please do not quote the contents of this presentation without the authors' permission.

Background

- Declining ICSH in the 1990s
- More vocal foreign/institutional shareholders
- More focus on shareholders' value
- "Selection & Concentration"
- M&A as a positive strategic option

Increasing foreign ownership



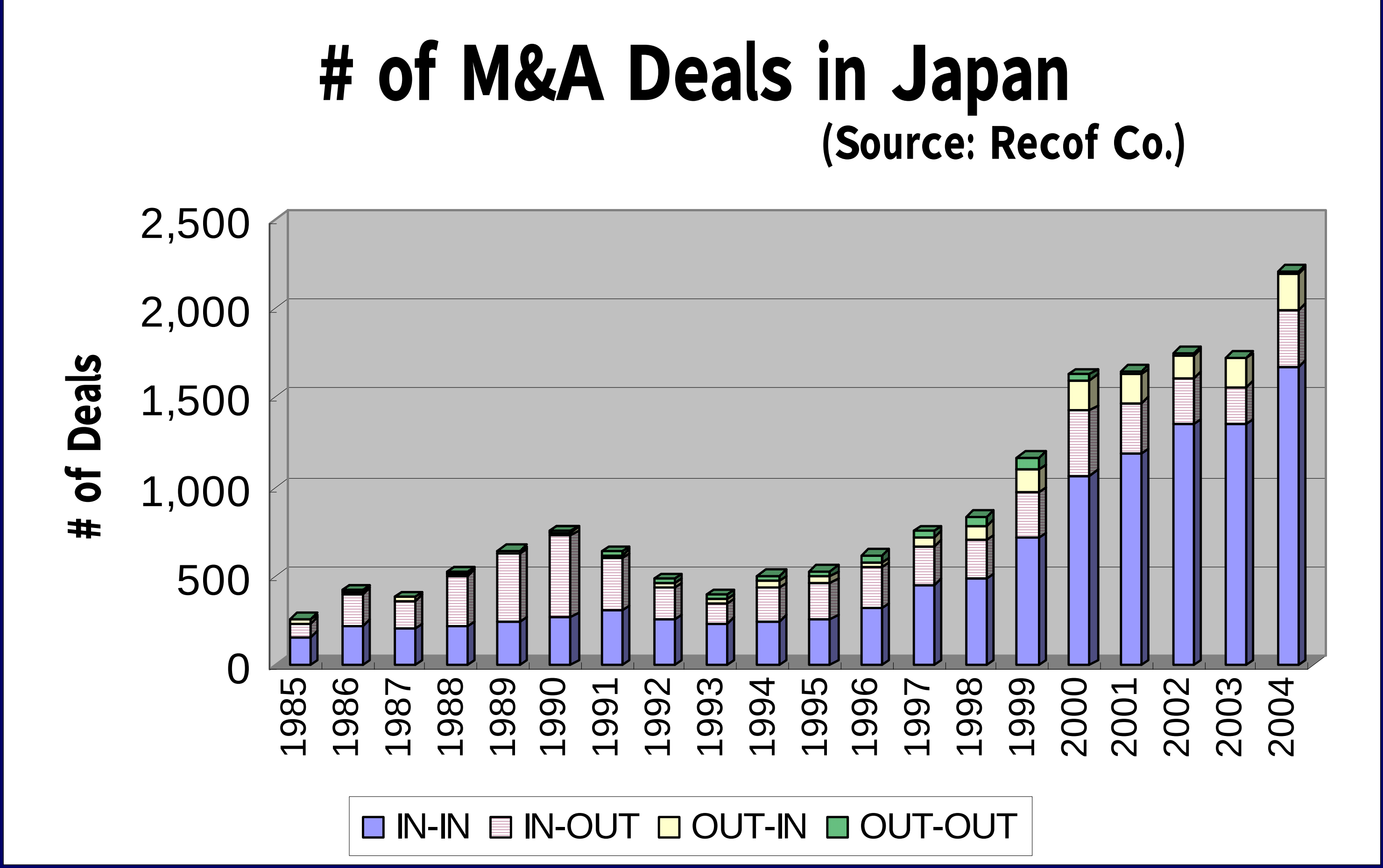
More vocal shareholders

- Increasing ownership of institutional investors (esp. foreign institutions)
- Shareholder activism as a means to improve Japanese corporate performance

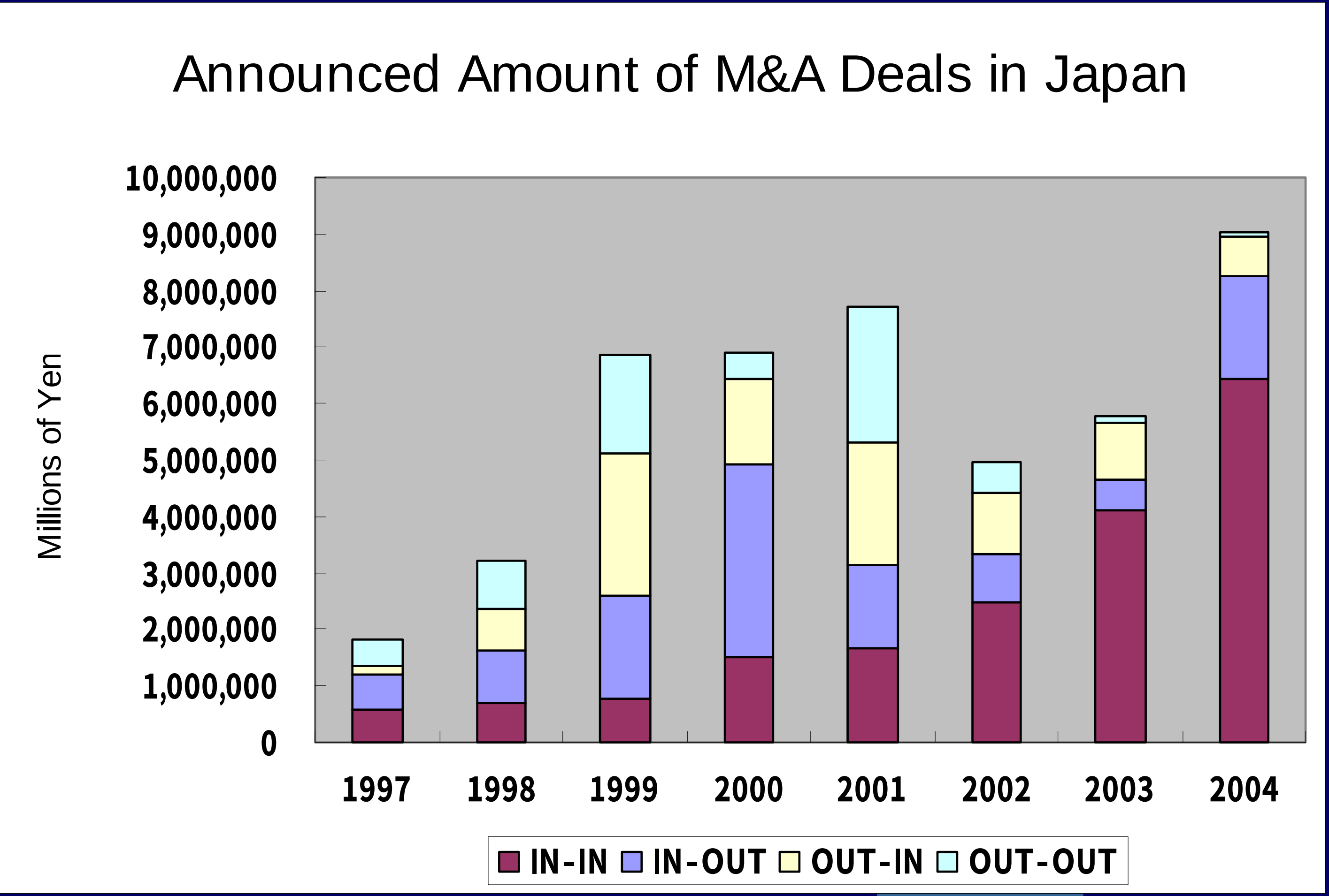
More emphasis on shareholders' value

- Emphasis on cash flow (e.g., FCF and EVA®)
- Selection and concentration of a company's business portfolio
- Increasing M&As & Market for corporate control
- New mechanism to improve shareholders' value: Hostile TOB, MBOs, private equity funds, etc.

Increasing Japanese M&A deals



Increasing Japanese M&A deals



Increasing Japanese M&As

- The biggest merger wave since 1980s
- More domestic (IN-IN) mergers than ever
- "Selection and concentration" rather than size expansion
- Several attempts of hostile TOB
- Active involvement of financial buyers (equity funds)

Cases of hostile takeover

- Minebea vs. Sankyo Seiki vs. Trafalgar Glenn (1985)
- Koito Manufacturing vs. T. Boone Pickens (1989)
- Shoei vs. MAC (Murakami) (2000)
- SSP Co. vs. Boehringer Ingelheim (2000)
- Steel Partners vs. Sotoh Company and Yushiro Chemical Industries (2003)
- Live Door Inc. vs. Nippon Broadcasting Inc. and Fuji Television Network (2005)
- Yumeshin Holdings Co. vs. Japan Engineering Consultants (2005)

Pros and cons of a hostile takeover

Pros:

- Removal of the inefficient management
- Value creation for shareholders

Cons:

- Dissolving company assets in the name of shareholders' interest
- Myopia of the management at the cost of long-term growth
- Demoralization of the employees (Shleifer and Summers 1988)

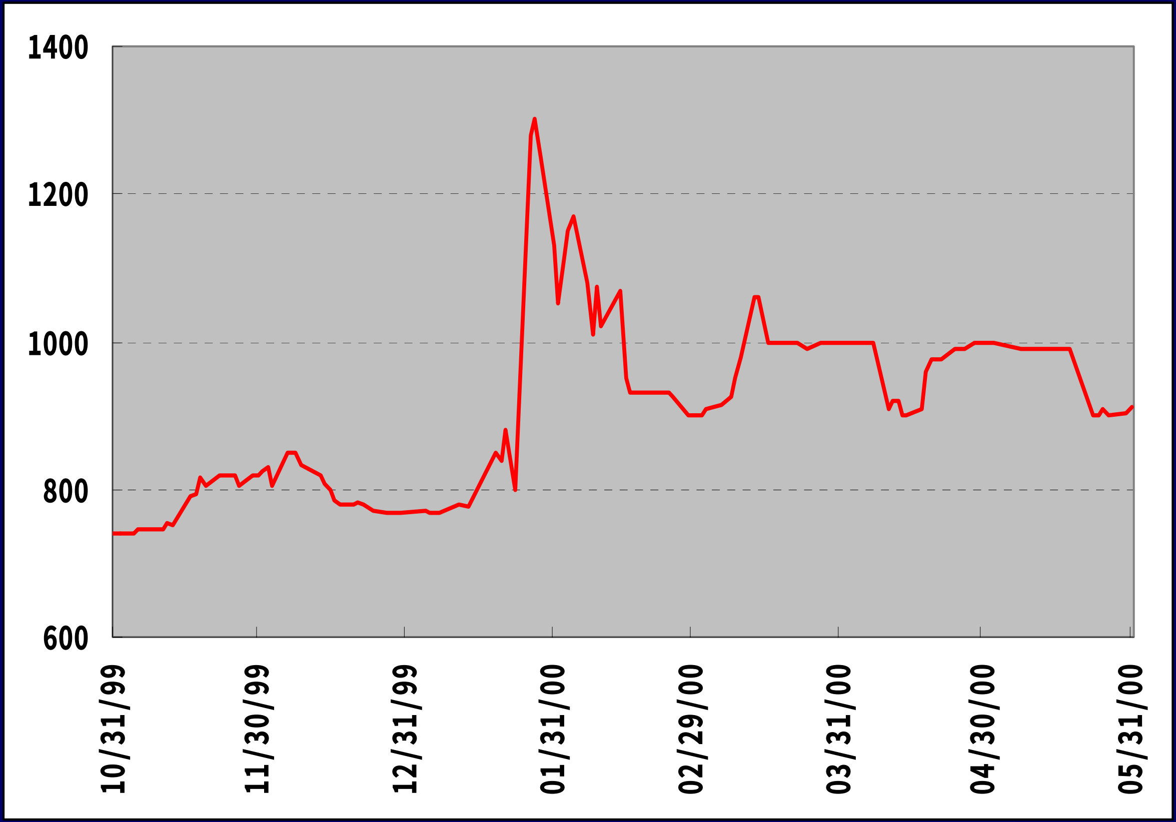
* Even in the US, out of about 35,000 M&As between 1976 and 1990, <u>only 364 are hostile.</u> (Jensen 1993).

Shoei vs. MAC's Murakami

- TOB Price @¥1,000 for 100% ownership
01/23/00 close ¥800, BVAPS ¥546 (MVAPS ¥4,000)
- Major shareholders of Shoei
Canon: 11.3%, Yasuda Fire & Marine:10.0%, Chase: 8.2%, Yasuda Life: 6.0%, Fuji Bank: 5.0%, Yasuda Trust: 5.0% (total 45.5% with 6 SHs)
- Murakami said he would be able to turn the company more profitable if he ran it.

Shoei vs. MAC's Murakami

Share price soared at the announcement…



Shoei vs. MAC's Murakami

- Major shareholders rejected the offer.
- Murakami collected only 6.5%.
- Shoei replaced its CEO in March 2001 with Mr. Kenji Watanabe, another former Fuji Bank employee.
- Shoei repurchased Mr. Murakami's shares in July and August 2002.
- Murakami came to be known as a proponent of shareholders' value and portrayed himself as a "corporate reformer."

Shoei vs. MAC's Murakami

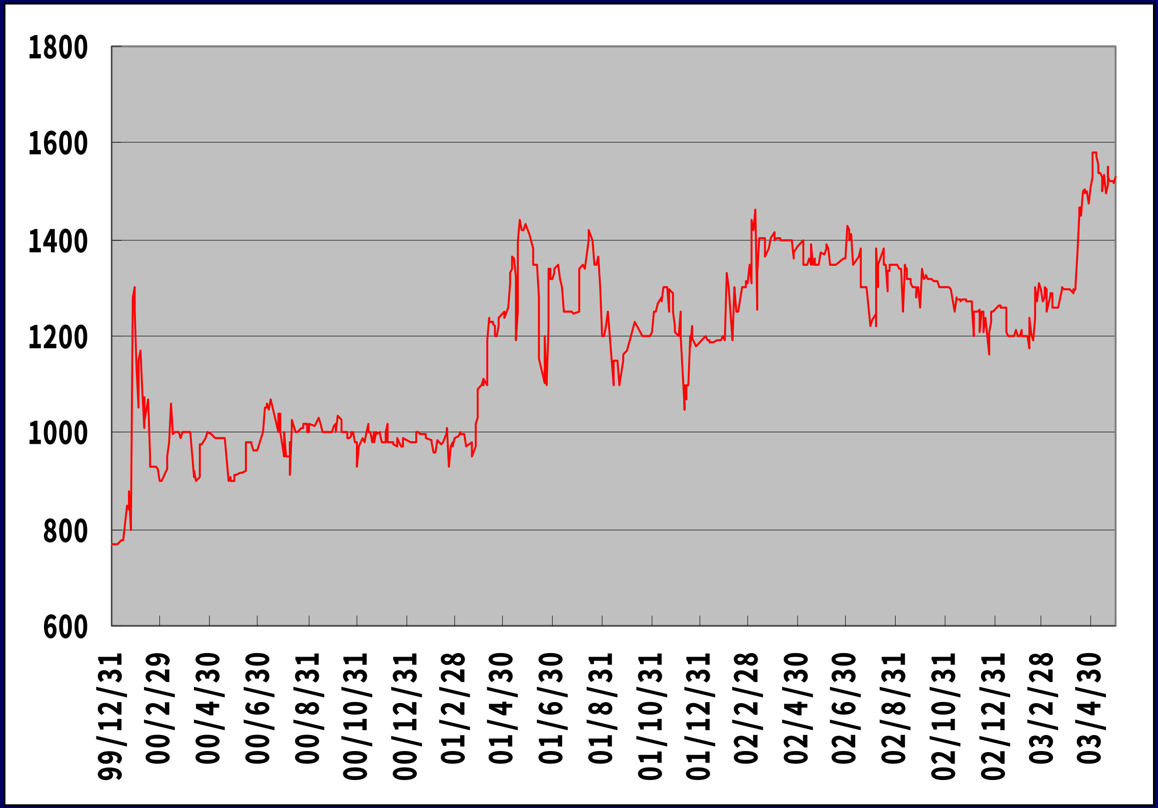
Puzzles of the case

- Insufficient TOB premium (25%) & no increase of premium
- Why chose knowingly heavily cross-held company?
- Murakami's no previous corporate restructuring experience

=> Was he really willing to win the TOB?

Shoei vs. MAC's Murakami

Share price of Shoei over longer term



Shoei vs. MAC's Murakami

Operating performance of Shoei

FY	SALES	OP. PROFIT	OP. P/SALES
1995/12	10,104	1,046	10.4%
1996/12	8,072	671	8.3%
1997/12	8,812	850	9.6%
1998/12	7,280	1,029	14.1%
1999/12	5,880	801	13.6%
2000/12	7,475	953	12.7%
2001/12	4,908	585	11.9%
2002/12	7,702	820	10.6%
2003/12	8,100	898	11.1%
2004/12	9,101	2,014	22.1%

Our research

- Examine the consequence of MACs share purchase on (1) share prices and (2) operating performance.
- Assumption: The companies whose shares were purchased by MAC felt the threat of hostile takeover.
- Sample: 22 companies whose shares were purchased by the MAC between 2000 and 2002
- Event date: earliest of the announcement, large shareholdings report, newspaper article or submission of annual report.
- (1) BHAR over TOPIX (2) Relative ROA over industry peer (Barber and Lyon 1996)

Our sample

Event Year	# of Firms	Avg. Mkt Cap. (Million Ye	Avg. Hldg. % by MAC	Avg. % of Cash Hldg
2000	6	15,084	6.44%	4.02%
2001	15	37,693	5.94%	17.76%
2002	1	10,150	1.73%	27.57%
TOTAL	22	30,275	5.86%	14.46%

Industry composition

Industries	
Textile	2
Pharmaceuticals	1
Non-Iron Material	3
Transportation Machinery	1
Other Manufacturing	1
Engineering	4
Trading (Wholesale)	5
Retailing	1
Service	4
TOTAL	22

Our sample

Post-event dividend changes (between Years –1 and +3)

	# of Firms	Average Change	Median Change
Increase	12	62.82%	32.23%
No Change	9	#N/A	#N/A
Decrease	1	-12.35%	-12.35%

Share price performance

Panel A: Average BHAR Including Shoei's TOB

Period	Average BHAR(t –stats.)		# of Positive BHAR
-20~-2	6.895%	(3.46) *	19*
-1~+1	3.386%	(2.39) *	12
+2~+20	-0.241%	(-0.14)	10
+2~+200	11.978%	(2.70) *	15*
+2~+400	12.121%	(2.00)	14
+2~+600	28.950%	(2.93)*	18*

Share price performance

Panel B: Average BHAR Excluding Shoei's TOB

Period	Average BHAR	(t –stats.)	# of Positive BHAR
-20~-2	6.207%	(3.15)*	18*
-1~+1	1.189%	(1.30)	11
+2~+20	0.607%	(0.37)	10
+2~+200	12.750%	(2.77)*	15*
+2~+400	10.999%	(1.75)	13
+2~+600	28.187%	(2.72)*	17*

Operating performance

Panel A – ROA for year relative to event:

–5	6.05%	3.39%	2.14%	-0.14%
–4	6.05	3.15	1.74	0.07
–3	4.26	2.67	0.52	0.74
–2	1.68	2.32	-0.53	0.26
–1	1.04	2.08	-0.16	-0.01
0	1.26	1.25	-1.30	-0.73
+1	2.34	1.45	-1.24	-0.22
+2	1.79	1.79	-2.58*	-1.99*
+3	1.98	1.39	-2.23*	-1.20*

Operating performance

Panel B – Mean ROA for years:				
–5 to –1	4.15%	2.95%	0.95%	0.43%
–3 to –1	2.85	2.36	-0.08	0.21
+1 to +3	1.81%	1.55%	-2.37%*	-0.76%*
Panel C – Change in ROA between:				
-5 to +3	-2.54*	-1.64*	-2.23*	-3.00*
-3 to +3	-1.15	-0.99	-1.13	-2.03

Findings

- BHAR around announcement date is not significant (1.2%) excepting Shoei.
- However, BHAR started to cumulate one month before the event (+6.2% and significant).
- Post-event BHAR +2 Day~+3 Years significantly positive at +28% (raw BHAR +24%).
- Both raw and control firm adjusted ROA significantly declined Year –5 ~ Year +3.
- The average control firm adjusted ROA in Year +3 significantly negative at –2.23%.

Conclusion & Future Research

- The threat of a potential hostile takeover benefited the hostile bidder and the shareholders of the targets.
- However, we cannot find the improvement in operating performance of the target companies.
- Regression analysis to find factors that drive the results, particularly of ROA, is necessary.
- Larger sample size + longer time series required. Particularly, the hostile takeover attempt by Steel Partners in 2003 and their subsequent share purchases in many other Japanese companies.