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HOSTILE TAKEOVERS AND SHAREHOLDER RIGHTS

WHAT IS A HOSTILE TAKEOVER?

A hostile takeover takes place when the acquiring company attempts to take over the target company against the wishes of the company and its management. In this case, the acquiring company must purchase and gain control of at least 51% of the voting shares of the target company. It starts with friendly offers, where the acquiring company makes an offer to the target company to convince their board and management to accept the offer. This offer turns hostile when the target company's board refuses to accept the deal and the acquirer directly approaches the shareholders. Typically, the acquirer uses strategies to replace the target company's board of directors or management. In the case of a hostile takeover, the majority shareholders gain the opportunity to acquire control of the business. Companies with a record of underperformance are usually targeted for hostile takeovers.

HOW IT CAN BE DONE?

Hostile takeovers can be carried out in two ways:

1. Tender Offer- Tender offers, offered for a limited period of time, are usually an offer to buy shares above market value, at a premium. The acquirer would need to accept the tender offer for a majority of the shares in order for the hostile takeover to succeed. This is done to persuade the target company's current shareholders to sell their shares and give the acquiring company ownership of the majority stake.
2. Proxy vote- Another tactic used in hostile takeovers is the proxy vote, in which the acquiring firm tries to persuade current target shareholders to remove the company's board of directors and executive management. The purchasing business would then

appoint people who are receptive to the takeover proposal and will cast votes in favour of it to replace the required management team and board members.

DEFENCES AGAINST A HOSTILE TAKEOVER

To save itself from such a takeover, the company may use certain defences-

1. **Differential Voting Rights (DVRs)**- A business can set up stock with differential voting rights, where some shares have more voting power than others, to guard against hostile takeovers. If management holds an adequate stake in shares with greater voting power, it may be more challenging to get the necessary number of votes for a hostile takeover.
2. **Employee Stock Ownership Plan (ESOP)**- In order to set up an employee stock ownership programme, a tax-qualified plan that gives employees significant ownership in the business must be used. Workers might vote with management more frequently. This makes it a potentially effective defence. These schemes have, however, previously come under investigation. Courts have occasionally declared defensive ESOPs invalid on the grounds that management, not shareholders, was the intended beneficiary of the plan.
3. **Crown Jewel**- The company has to sell its most valuable assets to use this defence if there is a hostile takeover. This will make it less attractive an opportunity for the acquirer. This defence is normally used as the last resort.
4. **Poison Pill**- This defence is also called the shareholder rights plan. If one shareholder purchases more than a predetermined percentage of the newly issued stock, it enables existing shareholders to purchase the stock at a reduced price, diluting the acquiring company's ownership interest. The discount does not apply to the buyer who initiated the defence, which is typically the acquiring company. Poison pill defences come in two different types: flip-in and flip-over. If an individual owns a certain quantity of shares of the target company, they may be eligible to purchase additional stock at a reduced price through a flip-in. The purchasing company's ownership interest is diminished and it is not included in the sale.

If the takeover proceeds, a flip-over strategy enables the target company's shareholders to buy the acquiring company's stock at a steep discount, targeting the acquiring company by reducing its equity.

EFFECT ON SHAREHOLDERS

Hostile takeovers have both a positive and negative effect on shareholders. Some of the positive factors are-

- Hostile takeovers can lead to increase in the share value of the target company which is the key to satisfying shareholders.
- Hostile takeovers lead to an influx in cash which provides the shareholders with a chance to liquidate their investment and earn profits.
- Even the mere possibility of a hostile takeover has the power to stir up management and compel them to make adjustments that will benefit shareholders.

Some of the cons are as follows-

- The future plans of the acquiring company may not align with shareholder interests, leading to uncertainty for them.
- Shareholder rights such as influence over the decision-making process may be lost in the process of a hostile takeover.
- Many lay-offs occur during a hostile takeover as cost-cutting measure which leads to loss of jobs and restructuring of the company.

REAL LIFE

An example of a successful hostile takeover is that of pharmaceutical company Sanofi's acquisition of Genzyme. Sanofi viewed Genzyme as a way to get into a specialised market and increase the range of products it offered, as the company produced medications for treating uncommon genetic diseases. Following the failure of friendly takeover proposals due to Genzyme's resistance, Sanofi proceeded to purchase Genzyme directly from the shareholders, paying a premium for the shares and adding contingent value rights.

CONCLUSION

When someone tries to acquire a majority stake in a company's voting stock or persuades shareholders to vote out the current management team and bring in a new one, it is known as a hostile takeover. These happen for a variety of reasons, including an impression that a business

may be undervalued. A hostile takeover can pose risks or opportunities for investors. Purchasing target company stock at that time is a smart move if an advantage of the premium the acquirer is giving to the shareholders is to be taken. Investors should exercise caution, though, as this type of acquisition has the potential to completely destroy shareholder value if the acquirer is unduly focused on short-term profits or if management dilutes the shares in order to thwart the takeover.