Toehold Strategy in Negotiated Transfer of Corporate Control under a Disclosure Rule

Mami Kobayashi
Faculty of Economics, Kinki University

Abstract

A toehold is a block of shares in a target firm accumulated by an acquirer before launching a takeover. Establishing a toehold makes it easier for the acquirer to take control, but is also costly if a disclosure rule is taken into consideration, because the stock price incorporates the post-takeover value of the target firm if the toehold size rises above the threshold given by the rule. Following a standard two-stage takeover model, we focus on the condition under which ownership affects the equilibrium. The equilibrium is either the acquirer succeeding in the negotiated merger or the insider retaining control rights by going private. Classifying the acquirers into high and low types according to the post-takeover value achieved through the negotiated merger, we show that the higher the inside ownership concentration, the more likely is the equilibrium to be pooling, where both the high- and the low-type acquirers succeed in the negotiated merger. In contrast, the lower the inside ownership concentration, the more likely is the equilibrium to be separating, where only the high-type acquirer succeeds in the negotiation. In a pooling equilibrium, the high-type acquirer establishes a smaller toehold than the low-type one, whereas in a separating equilibrium, the former establishes a larger toehold than the latter. We also show that the block premium is decreasing in the inside ownership concentration, and the marginal effect of the inside ownership concentration is decomposed into the direct effect and the toehold effect. We provide a possible explanation of the change in corporate governance in the 1990s and empirical predictions on the distribution of the toehold sizes in negotiated mergers.