Corporate Defence Mechanisms to prevent Hostile Takeovers

Why in news?

Publicly listed companies are most exposed to threats of a hostile takeover. However, with time, they have come up with varied defence mechanisms to prevent such takeovers.

What is the issue?

- Recently, billionaire Elon Musk now has said that he wants to buy Twitter outright, taking it private to restore its commitment to free speech.
- Elon Musk currently owns about 9% of Twitter shares.
- The company's board has resisted this and deployed the “poison pill” mechanism.

What is a ‘Poison Pill’ defence?

- A poison pill is officially known as a shareholder rights plan.
- A poison pill is a defense tactic utilized by a target company to prevent or discourage hostile takeover attempts.
- Poison pills allow existing shareholders the right to purchase additional shares at a discount, effectively diluting the ownership interest of a new, hostile party.
- Poison pills often come in two forms
    - **Flip-in strategy**- Allows the shareholders, except for the acquirer, to purchase additional shares at a discount.
    - **Flip-over strategy**- Allows the stockholders to purchase the shares of the acquiring company at a deeply discounted price if the hostile takeover attempt is successful
- The mechanism protects minority shareholders and avoids the change of control of company management.
- Poison pills also often open the door to further negotiations that can force a bidder to sweeten the deal.
- If a higher price makes sense to the board, a poison pill can simply be cast aside, clearing the way for a sale to complete.
- **Twitter’s mechanism**- Twitter's plan works by imposing a significant penalty on any investor that builds up a stake of at least 15% in the Twitter without the board's approval.
- If Musk were to hit the 15% threshold, the Twitter board can grant shareholders the right to buy one-thousandth of a share of preferred stock for each common share they own, at a price of 210 dollars.
- That option makes it virtually impossible for anyone to buy Twitter.

What are the other corporate defence mechanisms to prevent hostile takeovers?

- **Greenmail Defence-** In this, the target company pays a premium, known as greenmail, to purchase its own shares back at inflated prices from a corporate raider.
- After accepting the greenmail payment, the raider generally agrees to discontinue the takeover and not buy any more shares for a specific time.
- **Crown jewel defence-** Crown jewels are the most profitable or valuable corporate units or assets that belong to the company.
- The Crown Jewel Defense strategy is when the target company of a hostile takeover sells its most valuable assets to reduce its attractiveness to the hostile bidder.
- **Pac-man defence**- It prevents a hostile takeover by initiating a reverse takeover.
- In a Pac-Man defense, the target firm tries to acquire the company that has made a hostile takeover attempt.
- The target company could make use of its ‘war chest’ or securing finances from outside for the reverse takeover bid.
- **White Knight defence-** A white knight is a hostile takeover defense whereby a 'friendly' company acquires a corporation at fair consideration when it is on the verge of being taken over by an 'unfriendly' acquirer.
- The unfriendly bidder is generally known as the "black knight."

References

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