Question

Introduction

It is a common practice in the arena of companies that mergers and takeovers or acquisitions may take place in the hostile take over the targeted company may put up defensive measures to avoid a take over taking place.

Enumate and elucidate any five defensive mechanisms that the targeted company employs in order to avoid a hostile acquisition

In the context of hostile takeovers, targeted companies may implement several defensive strategies to deter the acquiring company. Here are five commonly used defensive mechanisms:

**Poison Pill (Shareholder Rights Plan)**:

The poison pill strategy allows existing shareholders to purchase additional shares at a discount if any one shareholder acquires a certain percentage of the company. This dilutes the ownership interest of the acquiring company, making the takeover more expensive and less attractive.

**White Knight Defense**

In this strategy, the targeted company seeks out a more favorable company, known as a "white knight," to merge with instead. The white knight offers better terms than the hostile bidder and preserves some control for the target company's management.

**Golden Parachute**:

A golden parachute involves offering lucrative benefits to key executives if the company is taken over and they are terminated. This provision includes large severance payments, stock options, or bonuses. It increases the cost of the acquisition, making the takeover less attractive to the acquirer.

**Pac-Man Defense**:

In a Pac-Man defense, the targeted company turns around and attempts to buy the acquiring company. This aggressive counter-move can force the acquirer to focus on defending itself, diverting resources and making the original takeover less feasible.

**Crown Jewel Defense**:

With this approach, the target company sells off or transfers its most valuable assets, known as "crown jewels," to another company or a friendly third party. This reduces the attractiveness of the target to the hostile acquirer, as the company becomes less valuable without its key assets.

These defensive mechanisms can help a company maintain its independence and deter a hostile acquisition. However, each comes with risks and potential impacts on shareholder value and the company's long-term strategy.

**What are the risks of these defensive mechanisms**

Each defensive mechanism in a hostile takeover scenario has potential risks that can affect the company, its shareholders, and its long-term viability. Here are the key risks associated with each strategy:

**Poison Pill (Shareholder Rights Plan)**:

**Dilution of Share Value**: Issuing additional shares to existing shareholders can dilute the value of shares, impacting all shareholders and potentially reducing overall market confidence.

**Reduced Attractiveness to Other Bidders**: The poison pill may deter not only hostile acquirers but also potential friendly acquirers, limiting the company's strategic options in the future.

**Legal and Regulatory Risks**: The poison pill strategy can attract lawsuits from shareholders or regulatory scrutiny if it's seen as damaging shareholder value.

**White Knight Defense**:

**Loss of Control**: While preferable to a hostile takeover, merging with a "white knight" may still involve significant changes in company control, culture, and operational independence.

**Less Favorable Terms**: The company may have to offer better terms to a white knight than it would have in a straightforward acquisition or merger, impacting financial flexibility and long-term profitability.

**Conflict of Interest**: Management may prioritize its own interests in choosing a white knight rather than the best possible outcome for shareholders.

**Golden Parachute**:

**High Costs**: Large severance packages and bonuses can place a significant financial burden on the company, reducing cash reserves or impacting profitability.

**Shareholder Backlash**: Shareholders may perceive golden parachutes as benefiting executives at their expense, which can lead to dissatisfaction or decreased investor confidence.

**Legal and Governance Issues**: Excessive golden parachute packages can attract regulatory scrutiny or even legal action if seen as excessive or misaligned with shareholder interests.

**Pac-Man Defense**:

**High Financial Cost**: Attempting to acquire the hostile bidder can be extremely costly, requiring significant capital that might strain the company's finances.

**Risk of Escalation**: This strategy can create a cycle of escalating bids, draining both companies’ resources and potentially weakening both financially.

**Management Distraction**: The counter-acquisition attempt can divert management's attention from core operations, which can impact productivity and strategic focus.

**Crown Jewel Defense**:

**Loss of Valuable Assets**: Selling or transferring key assets can weaken the company, reducing its operational strength and long-term competitive advantage.

**Decreased Shareholder Value**: Selling off valuable assets may reduce the overall value of the company, potentially disappointing shareholders and decreasing stock value.

**Legal and Contractual Complications**: Depending on the assets involved, the crown jewel strategy may be legally complex and time-consuming, potentially causing regulatory issues or disputes with buyers.

In summary, while these defensive mechanisms can prevent a hostile takeover, they each come with trade-offs that can impact financial stability, shareholder confidence, and the company's future growth potential.

REFERENCES