

Does the Toehold Influence the Success of an M&A Transaction?

Radu CIOBANU

Bucharest University of Economic Studies, Department of Finance, Romana Square no. 6, sector 1, Bucharest, Romania,
E-mail: radu_ciobanu_86@yahoo.com (Corresponding author)

Abstract This study analyses whether the toehold (the target shares owned by the acquirer prior to launching a takeover bid) have a decisive role in the success of mergers and acquisition (M&A) transaction. It is well known that in any bidding process having a toehold is a significant competitive advantage over the rival bidders. This study is based on the takeover bids occurred on the Romanian capital market from 2000 to 2012. Our database includes both successful and unsuccessful transaction in terms of the change of control and companies operating in every industry. Other results suggest that the toehold can play an important role in a successful M&A transaction, but also that the toehold is influenced by other factors and by the industry of the acquired company.

Key words Toehold, takeover bid, mergers and acquisition, competitive advantage, control

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1. Introduction

Nowadays, the corporate finance theory often shows us that, through mergers and acquisition, companies can gain rapidly more market share and reach synergetic gains. So, in every economy and even at a global scale there is a permanent race to acquire the most profitable companies. As we live in a highly competitive market where only the powerful companies will survive in the end, it is well known that the both the financial capital and information can play a key role in successful M&A transactions.

In common knowledge, a toehold represents a purchase of less than 5% of a target company's share by an acquiring company or person. A toehold under 5% does not represent a significant percentage of shares of a company's equity, but it allows the shareholders to have a grip on the company financial status and its decision making.

The aim of this study is to analyze if there is a higher change for a successful takeover bid in case the acquirer has a toehold of the target company. From my point of view this study is different from others in the literature because its main focus is the connection between the toehold and the result of a takeover bid and also that these characteristics are analyzed on a post communist East European country.

The paper is organized as follows. Section 2 presents the literature review and the hypotheses tested. In section 3 describes the database and methodology. Section 4 presents and discusses the main empirical results. The final section concludes.

2. Literature review and tested hypotheses

In the financial literature, the success in mergers and acquisition and the factors that can increase this chance is a frequently discussed matter. Moreover, several studies including a probit model were realized in order to show important elements that are connected with the mergers and acquisition process or with the takeover-bid offer.

The toehold owned by an acquirer or the shares owned by him before the transaction can be one important factor when we discuss about takeover bids (Dragotă *et al.*, 2013). In the same study the toehold (that quantifies the bargain power of the acquirer) is related to the control premium and the results show that for a higher toehold there is a lower premium.

Other studies show that the toehold can be a key issue when we speak about mergers and acquisition (Walkling and Edmister, 1985; Dyck and Zingales, 2004). Also if the acquirer already owns some

of the target shares there is a high chance that the correct information about the firm’s physical assets, leverage, the value of the total sales and profit is transmitted prior to the M&A decision (Ragozzino and Reuer, 2011; Cassiman *et al.*, 2005). Moreover, since the toehold means knowledge about the target value, it can lead to more aggressive bidding which can deter competition from rivals and overcome many auction problems.

Jennings and Mazzeo (1993), and Betton and Eckbo (2000) report that toehold can increase the probability of winning the target. Moreover, Eckbo and Langohr (1989) and Betton and Eckbo (2000) report that toeholds are associated with lower offer premiums in winning bids, which is consistent with a negative effect of toeholds on bidder competition. Also the industry can have an effect on the success of the M&As (Dyck and Zingales, 2004).

According to these considerations, the hypotheses tested are:

H1. The toehold has a positive influence on the chance of a successful takeover bid

H2. The toehold is more important in some industries than others

3. Database and methodology

The database contains all the transactions that took place on the BSE (Bucharest Stock Exchange) and RASDAQ (the Romanian equivalent for US NASDAQ) during the period 2000-2012. In the data sample were included all takeover bids so not only those where the buyer succeeded in taking the control of the target company but also the ones where the buyer tried to obtain a control position. I considered a successful transaction if there has been a change in the company’s controlling shareholder. The cases where the buyer did not target to gain the control of the company were eliminated from the database.

Between 2000 and 2012 on BSE and RASDAQ I recorded over more than 470 takeover bids where the buyer tried to gain the controlling position. The sample for this study consists of 431 transactions. I did not include all 470 because I had some cases where I could not find information about the ownership before the transaction. I found that more than 42 percents of the takeover bids were successful and the buyer became the controlling shareholder.

The aim of this study is the analysis of toeholds in the takeover transactions. Our hypothesis states that if an acquirer has a toehold of the target company share, he has a better chance to acquire that specific company. I divided our sample of takeover bids in successful and unsuccessful takeover bids and I correlated these values with the average value of the toehold (see Table 1).

Table 1. The average toehold and ownership concentration index of the takeover bids

	Toehold	Ownership concentration index
Successful takeover bids	20.71%	0.3100
Unsuccessful takeover bids	9.02%	0.3376

In this table we present the average toehold and ownership concentration index value for the successful and unsuccessful takeover bids on the Romanian capital market between 2000 and 2012.

According to the data from Table 1, I can conclude that there is a higher probability to have a successful takeover bid if the acquirer owns more of the target company equity at the beginning of the transaction. In the case of the ownership concentration I cannot find a specific trend. The values for the successful and unsuccessful cases are very close, so I can conclude that, for the moment, there is no influence from this point of view. The ownership concentration index was determined using the Herfindahl-Hirschman index (HHI) applied for the shareholders that held more than 5% of shares. The value of the index is the sum of the squared values of the percentage of equity owned by the shareholders of the target company.

I conducted another analysis of the toehold and I divided the database by industries (see Table 2). The aim for this was to see in which of the industries the potential buyers are engaging in takeovers having a higher toehold.

Table 2. The number of successful and unsuccessful takeover bids displayed by industry and the average value of the toehold

Industry	No. Firms	Percent	Number of successful takeovers	Number of unsuccessful takeovers	Average value of the toehold
Agriculture	10	2.32%	8	2	11.52%
Clothing	28	6.50%	12	16	9.22%
Commerce	66	15.31%	28	38	15.11%
Construction	39	9.05%	9	30	11.46%
Real Estate	33	7.66%	15	18	20.31%
Food industry	42	9.74%	22	20	11.42%
Chemical industry	22	5.10%	8	14	13.47%
Machinery and equipment	23	5.34%	7	16	12.60%
Manufacturing	43	9.98%	24	19	20.88%
Services	106	24.59%	45	61	14.63%
Transport	19	4.41%	6	13	9.77%
Total market	431		184	247	

In this table we present the number of successful and unsuccessful takeover bids and the average toehold before the transaction on the Romanian capital market between 2000 and 2012 by industry of the target firm.

Our analysis shows that, on the industries where the successful takeover bids exceed the number of the unsuccessful takeover bids, there is a higher value of the average toehold before the transaction.

The aim of this study was to determine if the probability of a takeover bid to be successful is determined by the toehold owned by the acquirer in the target company. In order to do that, we used a Probit model and we based on the assumption that the probability of an event to occur is linearly related to a set of explanatory variables. To determine these variables, we conducted several regression models by using variables that characterize the target companies involved in the takeover bid. The variables used are documented in Table 3.

Table 3. Explanatory variables used in the model

Indicator	Explanation
TOEHOLD	Stake owned by the acquirer before the takeover
CAP	The total capitalization (million RON) of the target-company before the transaction
HHI	Ownership concentration index
DPERS	The acquirer type - dummy variable (1 - if it is a legal person, 0 – otherwise)
DINDUSTRY	The industry tyoe - dummy variable (1 - if the target company is in a specific industry, 0 – otherwise)

4. Results

In this section we tested the hypotheses presented in Section 2. As presented in Section 3, we used the probit model to analyze whether the toehold can influence the probability of success for a takeover bid. The study is made on the Romanian capital market between 2000 and 2012. As we stated in the previous section, we used a binary dependent variable that takes the value 1 if the takeover bid is successful and 0 otherwise. A successful takeover bid is the one where, at the end of the transaction, we have a change in the target's controlling ownership. In order to estimate we have conducted 2 probit model regressions including all 431 observations. The results are presented in Table 4.

Table 4. The model estimated results

Variable	(1)	(2)
TOEHOLD	2.12*** (5.69)	0.76*** (5.83)
L_CAP	-0.11*** (-3.33)	-0.04*** (-3.31)
HHI	0.11 (0.34)	0.03 (0.34)
DPERS	0.32** (2.27)	0.11** (2.21)
DAGR	1.29*** (2.59)	0.53*** (2.91)
DFOOD	0.41* (1.72)	0.25* (1.92)
DCLOTH	0.07 (0.27)	0.12 (0.92)
DCOM	-0.05 (-0.26)	-0.08 (-0.71)
DCONST	-0.46 (-1.75)	-0.03 (-0.27)
DREAL	0.01 (0.06)	0.11 (0.82)
DCHIM	-0.11 (-0.34)	-0.06 (-0.44)
DMACH	-0.24 (-0.76)	0.02 (0.18)
DMAN	0.31 (1.29)	0.21* (1.66)
DSERV		0.11 (0.91)
DTRANS	-0.28 (-0.86)	
Intercept	0.73* (1.65)	0.64*** (3.61)
Pseudo R-squared	42.69%	13.43%
Number of observations	431	431

To estimate the influence of the toehold on the probability of a successful takeover bid we used the probit regression model. The regression uses 431 observations of takeover bids on the Romanian capital market between 2000 and 2012. We consider a takeover bid successful if there is a change in the target's controlling ownership. We did not consider in the same regression the variables correlated at a higher level than 0.3. Z-statistics are in parentheses. The symbols *, **, *** represent significance levels of 10%, 5% and 1%.

The results confirm the hypotheses from Section 2. First of all the results show that the toehold is an important factor that can influence the probability of success for a takeover bid. If the acquirer has a toehold in the target company there is a higher chance that the takeover will end with a change of the controlling shareholder. The results are in concordance with Jennings and Mazzeo (1993) and Betton and Eckbo (2000).

Further more, our results also suggest that if the acquirer who has the toehold is a legal person the chance of a successful transaction is even higher. We cannot say the same thing about the capitalization of the company. A larger company tends to be harder to sell and this means a less chance for a successful transaction.

We found something interesting when we analyzed the industries of the target companies. If a company is acting in agriculture, food industry or the manufactory industry there is a higher chance for the

acquirer to take the control of the target. This could mean that, a toehold in a company acting in these industries can increase even more the chance for a successful takeover bid.

5. Conclusions

In this study I analysed if the probability of a successful takeover bid is related to the toehold of the acquirer in the target company. Our sample consists of 431 transactions on the Romanian capital market between 2000 and 2012. Our results were similar to those that can be found in the literature, but it is important to remind that this study analyzes a post communist East European country.

The toehold is an important factor that increases the chance for a successful takeover bid. If an acquirer owns a larger number of shares of the target company, he has a good chance to be successful and overpass the competition in case of a takeover. Another finding is that the toehold is important in agriculture, manufacturing or food industry, where the chance to be successful in a takeover transaction is even higher.

This can be only a part of a large research. Some questions still remain. Having a toehold means that you have access to a lot of inside information about the target company. When is the right moment to engage in a takeover or is the toehold related to the control premium of the takeover?

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