

Topics in Financial Economics Lecture 7: Takeovers and the Collective Action Problem

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The Objectives

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- Key: the collective action problem
- Based on Grossman and Hart (1980) "takeover bids, the free rider problem, and the theory of the corporation".

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- Insider Trader Mr Malcolm Calvert.

The Collective Action Problem in General

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- However, the idea is not so correct. Takeover is also plagued with the collective action problem, as is shareholder monitoring.

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- The takeover, if succeeding, costs the entrepreneur c million dollars.

The Impossibility of Efficient Takeover - 2

- For a single shareholder: If I say yes, then I gets p if the takeover succeeds and q if it fails; if I say no, then I keep my share which is worth v if the takeover succeeds (so the new management is installed) and q if it fails.

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- How is this related to the collective action problem?

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- So $v_s = v - \phi$. Then $\pi = \phi - c$. If $\phi \geq c$, the efficient takeover happens.
- The optimal dilution. If there is uncertainty of c , then the optimal $\phi = c$. What if there is uncertainty?

- Possible ways of dilution: a salary to the raider; a number of news issued to the raider; sell the target firm's asset at below its true value to another company owned by the raider; sell the target firm's products at below market price to the company, etc.

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- The latter two kinds of transactions are generally prohibited. But Grossman and Hart (1980) argue that they can improve the ex ante efficiency.

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- This is one reason why share concentration benefits the value of the firm.

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- The final exam.