

So, what next? When the cat is idle, the mice will play

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- When managers do not fear stockholders, they will often put their interests over stockholder interests
 - Greenmail: The (managers of) target of a hostile takeover buy out the potential acquirer's existing stake, at a price much greater than the price paid by the raider, in return for the signing of a 'standstill' agreement.
 - Golden Parachutes: Provisions in employment contracts, that allows for the payment of a lump-sum or cash flows over a period, if managers covered by these contracts lose their jobs in a takeover.
 - Poison Pills: A security, the rights or cashflows on which are triggered by an outside event, generally a hostile takeover, is called a poison pill.
 - Shark Repellents: Anti-takeover amendments are also aimed at dissuading hostile takeovers, but differ on one very important count. They require the assent of stockholders to be instituted.
 - Overpaying on takeovers: Acquisitions often are driven by management interests rather than stockholder interests.

No stockholder approval needed.....Stockholder Approval needed

Managerial Self Interest or Stockholder Wealth? Overpaying on takeovers!

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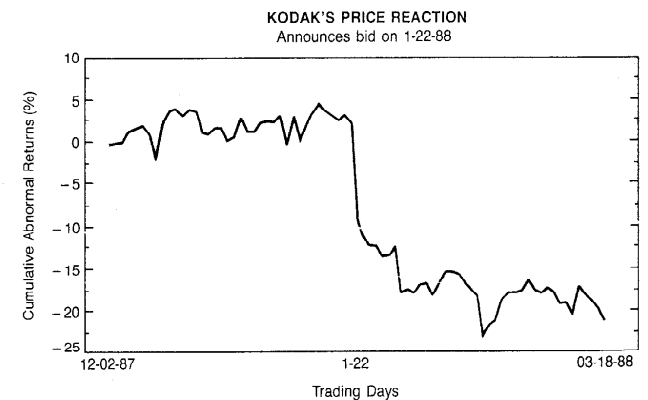
- The quickest and perhaps the most decisive way to impoverish stockholders is to overpay on a takeover.
- The stockholders in acquiring firms do not seem to share the enthusiasm of the managers in these firms. Stock prices of bidding firms decline on the takeover announcements a significant proportion of the time.
- Many mergers do not work, as evidenced by a number of measures.
 - The profitability of merged firms relative to their peer groups, does not increase significantly after mergers.
 - An even more damning indictment is that a large number of mergers are reversed within a few years, which is a clear admission that the acquisitions did not work.

A case study in value destruction: Eastman Kodak & Sterling Drugs

Kodak enters bidding war

- In late 1987, Eastman Kodak entered into a bidding war with Hoffman La Roche for Sterling Drugs, a pharmaceutical company.
- The bidding war started with Sterling Drugs trading at about \$40/share.
- At \$72/share, Hoffman dropped out of the bidding war, but Kodak kept bidding.
- At \$89.50/share, Kodak won and claimed potential synergies explained the premium.

Kodak wins!!!!



Kodak's market reaction indicates that investors expected no synergies:

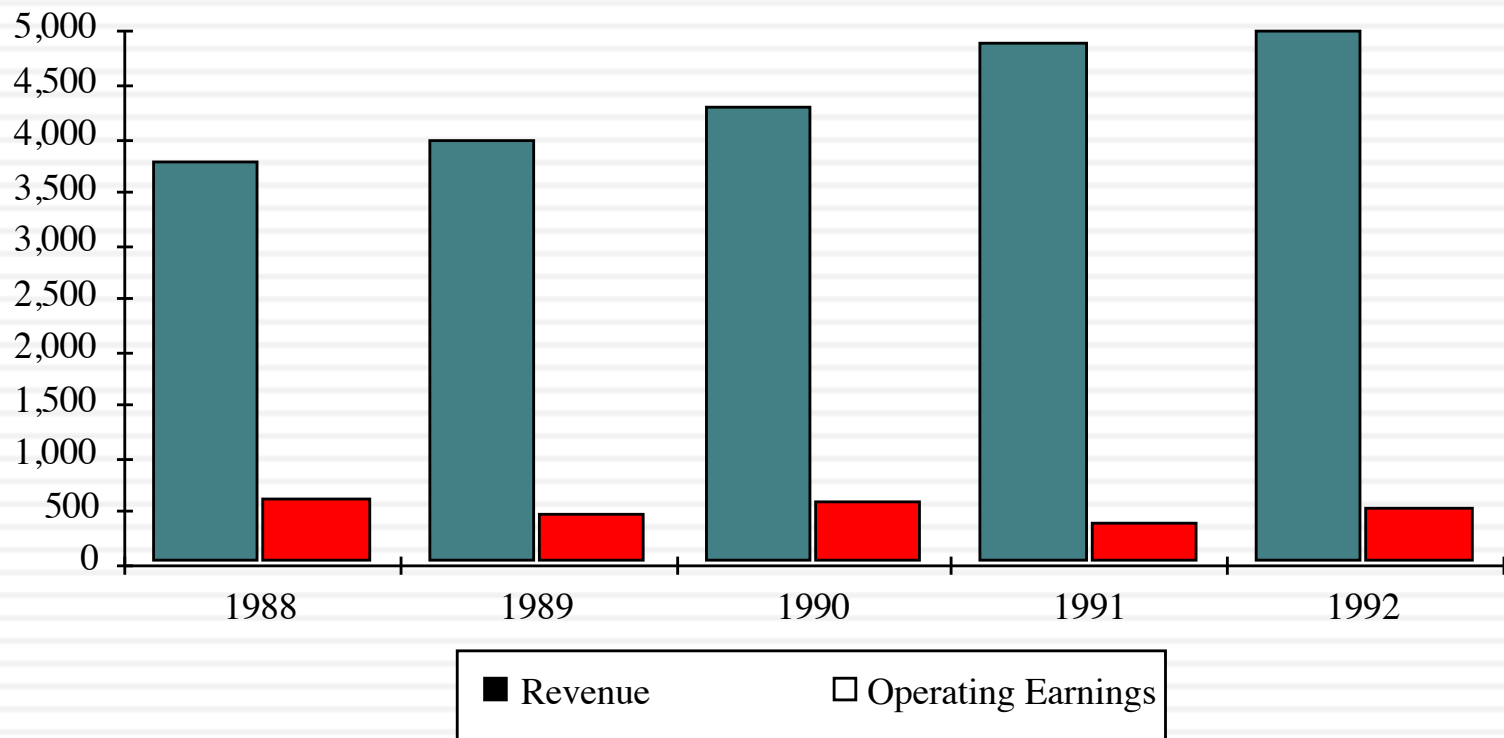
Kodak's bid =	\$5.1 billion
Sterling's market value 30 days prior to announcement =	<u>3.0 billion</u>
Premium bid	\$2.1 billion
Decrease in Kodak's market value =	\$2.2 billion

SOURCE: The Alcar Group, Inc.

Earnings and Revenues at Sterling Drugs

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Sterling Drug under Eastman Kodak: Where is the synergy?



Kodak Says Drug Unit Is Not for Sale ... but...

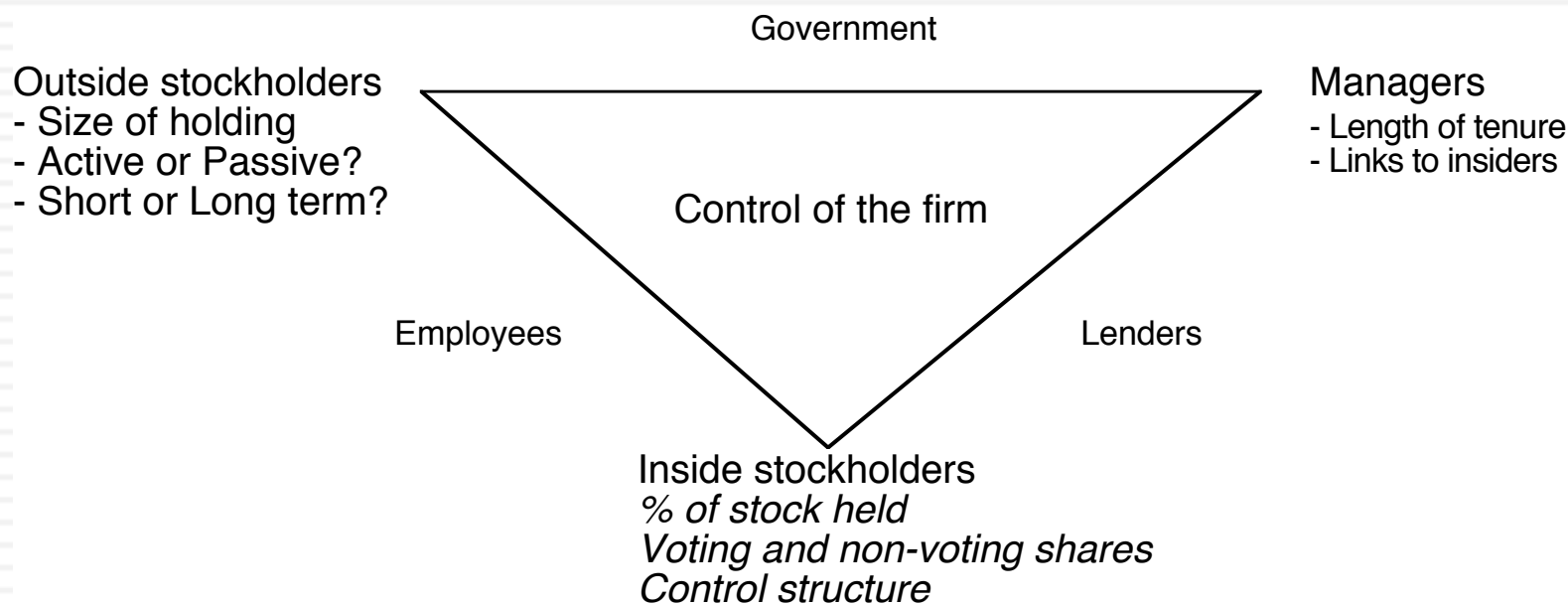
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- An article in the NY Times in August of 1993 suggested that Kodak was eager to shed its drug unit.
 - ▣ In response, Eastman Kodak officials say they have no plans to sell Kodak's Sterling Winthrop drug unit.
 - ▣ Louis Mattis, Chairman of Sterling Winthrop, dismissed the rumors as “massive speculation, which flies in the face of the stated intent of Kodak that it is committed to be in the health business.”
- A few months later...Taking a stride out of the drug business, Eastman Kodak said that the Sanofi Group, a French pharmaceutical company, agreed to buy the prescription drug business of Sterling Winthrop for \$1.68 billion.
 - ▣ Shares of Eastman Kodak rose 75 cents yesterday, closing at \$47.50 on the New York Stock Exchange.
 - ▣ Samuel D. Isaly an analyst , said the announcement was “very good for Sanofi and very good for Kodak.”
 - ▣ “When the divestitures are complete, Kodak will be entirely focused on imaging,” said George M. C. Fisher, the company's chief executive.
 - ▣ The rest of the Sterling Winthrop was sold to Smithkline for \$2.9 billion.

Application Test: Who owns/runs your firm?

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- Look at: Bloomberg printout HDS for your firm
- Who are the top stockholders in your firm?
- What are the potential conflicts of interests that you see emerging from this stockholding structure?



Case 1: Splintering of Stockholders

Disney's top stockholders in 2003

<HELP> for explanation.
Enter #<GO> to select aggregate portfolio and see detailed information

dgp Equity HDS

001189650224-000 **HOLDINGS SEARCH** CUSIP 25468710
DIS **US** **DISNEY (WALT) CO** Page 1 / 100

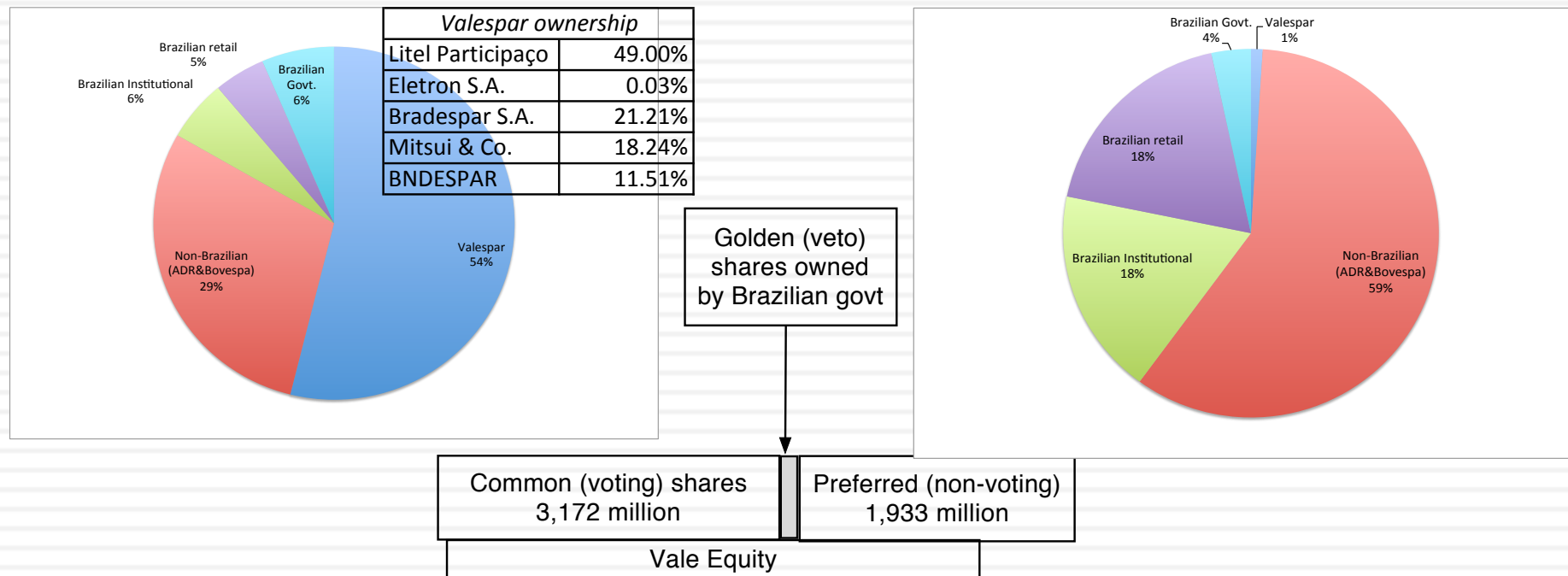
Holder name	Portfolio Name	Source	Held	Outstd	Change	Latest Filing Date
1BARCLAYS GLOBAL	BARCLAYS BANK PLC	13F	83,630M	4.095	1,750M	09/02
* 2CITIGROUP INC	CITIGROUP INCORPORAT	13F	62,857M	3.078	4,811M	09/02
* 3FIDELITY MANAGEM	FIDELITY MANAGEMENT	13F	56,125M	2.748	5,992M	09/02
4STATE STREET	STATE STREET CORPORA	13F	54,635M	2.675	2,239M	09/02
* 5SOUTHEASTERN ASST	SOUTHEASTERN ASSET M	13F	47,333M	2.318	14,604M	09/02
6ST FARM MU AUTO	STATE FARM MUTUAL AU	13F	41,938M	2.054	120,599	09/02
7VANGUARD GROUP	VANGUARD GROUP INC	13F	34,721M	1.700	-83,839	09/02
8MELLON BANK N A	MELLON BANK CORP	13F	32,693M	1.601	957,489	09/02
9PUTNAM INVEST	PUTNAM INVESTMENT MA	13F	28,153M	1.379	-11,468M	09/02
10LORD ABBETT & CO	LORD ABBETT & CO	13F	24,541M	1.202	5,385M	09/02
11MONTAG CALDWELL	MONTAG & CALDWELL IN	13F	24,466M	1.198	-11,373M	09/02
12DEUTSCHE BANK AK	DEUTSCHE BANK AG	13F	23,239M	1.138	-5,002M	09/02
13MORGAN STANLEY	MORGAN STANLEY	13F	19,655M	0.962	3,482M	09/02
14PRICE T ROWE	T ROWE PRICE ASSOCIA	13F	19,133M	0.937	2,925M	09/02
15ROY EDWARD DISNE	n/a	PROXY	17,547M	0.859	-126,710	12/01
16AXA FINANCIAL	ALLIANCE CAPITAL MAN	13F	14,283M	0.699	69,353	09/02
17JP MORGAN CHASE	JP MORGAN CHASE & CO	13F	14,209M	0.696	-462,791	09/02
Sub-totals for current page:			599,159M	29.340		

* Money market directory info available. Select portfolio, then hit IP<GO>.

Australia 61 2 8777 8600 Brazil 55 11 2048 4506 Europe 44 20 7330 7500 Germany 49 69 928410
 Hong Kong 852 2577 6800 Japan 81 3 3281 0900 Singapore 65 212 1890 U.S. 1 212 338 2000 Copyright 2002 Bloomberg L.P.
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Case 2: Voting versus Non-voting Shares & Golden Shares: Vale



Vale has eleven members on its board of directors, ten of whom were nominated by Valepar and the board was chaired by Don Conrado, the CEO of Valepar.

Case 3: Cross and Pyramid Holdings

Tata Motor's top stockholders in 2013

TTMT IN Equity

25) Settings

99) Feedback

Holdings: Current

Tata Motors Ltd

ISIN INE155A01022

1) Current

2) Historical

3) Matrix

4) Ownership

5) Transactions

6) Options

Search Name --

21) Save

22) Delete

3) Saved Search

24) Refine Search

Text Search

Holder Group

All Holders

20) Export

Holder Name	Portfolio Name	Source	Opt	Amt Held	% Out	Latest Chg	File Dt
		All Sources	All				
1. TATA SONS LTD	n/a	Co File		702,333,345	26.07	0	09/30/13
2. CITIBANK NA	n/a	20F		446,246,135	16.56	0	06/30/12
3. LIFE INSURANCE CORP OF I	n/a	Co File		168,754,477	6.26	-119,728,333	09/30/13
4. TATA STEEL LTD	n/a	Co File		147,810,695	5.49	0	09/30/13
5. CAPITAL GROUP COMPANIES	n/a	ULT-AGG		97,689,911	3.63	-877,871	09/30/13
6. TATA INDUSTRIES LTD	n/a	Co File		68,436,485	2.54	0	09/30/13
7. VANGUARD GROUP INC	n/a	ULT-AGG		41,285,983	1.53	4,535,434	09/30/13
8. PRUDENTIAL PLC	n/a	ULT-AGG		34,080,063	1.26	147,814	09/30/13
9. GIC PRIVATE LIMITED	n/a	ULT-AGG		30,428,428	1.13	0	09/30/13
10. WILLIAM BLAIR & COMPANY	WILLIAM BLAIR & COMP	13F		30,093,943	1.12	3,997,149	06/30/13
11. JPMORGAN CHASE & CO	n/a	ULT-AGG		24,918,852	0.92	-2,157,750	08/31/13
12. SCHRODER INVESTMENT MGMT	Multiple Portfolios	MF-AGG		19,136,665	0.71	2,578,904	06/30/13
13. BLACKROCK	n/a	ULT-AGG		14,100,725	0.52	-265,173	10/31/13
14. NORGES BANK	Multiple Portfolios	MF-AGG		10,762,579	0.40	0	12/31/12
15. T ROWE PRICE ASSOCIATES	Multiple Portfolios	MF-AGG		10,056,366	0.37	324,353	09/30/13
16. TATA INVESTMENT CORP LTD	n/a	Co File		10,025,000	0.37	0	09/30/13
17. SBI LIFE INSURANCE CO LTD	Multiple Portfolios	MF-AGG		9,256,170	0.34	-151,323	09/30/13
18. ALLIANZ ASSET MANAGEMENT	n/a	ULT-AGG		8,129,923	0.30	2,071,551	09/30/13

% Out 76.19

Zoom

100%

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2013 Bloomberg Finance L.P.
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Case 4: Legal rights and Corporate Structures: Baidu

- The Board: The company has six directors, one of whom is Robin Li, who is the founder/CEO of Baidu. Mr. Li also owns a majority stake of Class B shares, which have ten times the voting rights of Class A shares, granting him effective control of the company.
- The structure: Baidu is a Chinese company, but it is incorporated in the Cayman Islands, its primary stock listing is on the NASDAQ and the listed company is structured as a shell company, to get around Chinese government restrictions of foreign investors holding shares in Chinese corporations.
- The legal system: Baidu's operating counterpart in China is structured as a Variable Interest Entity (VIE), and it is unclear how much legal power the shareholders in the shell company have to enforce changes at the VIE.

Things change.. Disney's top stockholders in 2009

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DIS US \$ ↑ **24.2422** +.7422 D 2s EquityHDS
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DIS US Equity 95) Saved Searches 96) Default Settings Page 1/150 Holdings Search
Walt Disney Co/The CUSIP 25468710

21) Sources 22) Types 23) Countries 24) Metro Areas 25) Advanced Filters
Name Filter Sort By **Mkt Val**

	Holder Name	Portfolio Name	Source	Mkt Val	% Out	Mkt Val Chg	File Dt
1)	JOBS STEVEN PAUL	n/a	Form 4	3.34BLN	7.46	0	5/5/06
2)	FIDELITY MANAGEMENT &	FIDELITY MANAGEMEN	13F	2.05BLN	4.58	-36.12MLN	9/30/08
3)	STATE STREET CORP	STATE STREET CORPO	13F	1.7BLN	3.79	-18.6MLN	9/30/08
4)	BARCLAYS GLOBAL INVES	BARCLAYS GLOBAL IN	13F	1.66BLN	3.70	-160.12MLN	9/30/08
5)	VANGUARD GROUP INC	VANGUARD GROUP IN	13F	1.38BLN	3.08	-6.82MLN	9/30/08
6)	SOUTHEASTERN ASSET M	SOUTHEASTERN ASSE	13F	1.12BLN	2.50	-14.03MLN	9/30/08
7)	STATE FARM MUTUAL AU	STATE FARM MUTUAL	13F	1.02BLN	2.28	0	9/30/08
8)	WELLINGTON MANAGEMEN	WELLINGTON MANAGE	13F	939.38MLN	2.09	110.6MLN	9/30/08
9)	CLEARBRIDGE ADVISORS	CLEARBRIDGE ADVISO	13F	815.91MLN	1.82	-47.04MLN	9/30/08
10)	JP MORGAN CHASE & CO	JP MORGAN CHASE &	13F	693.31MLN	1.55	-18.89MLN	9/30/08
11)	MASSACHUSETTS FINANCI	MASSACHUSETTS FINA	13F	682.16MLN	1.52	112.29MLN	9/30/08
12)	BANK OF NEW YORK MELL	BANK OF NEW YORK	13F	681.68MLN	1.52	-57.13MLN	9/30/08
13)	NORTHERN TRUST CORP	NORTHERN TRUST CO	13F	610.26MLN	1.36	-4.81MLN	9/30/08
14)	AXA	AXA	13F	486.28MLN	1.08	47.05MLN	9/30/08
15)	BLACKROCK INVESTMENT	BLACKROCK INVESTME	13F	476.12MLN	1.06	-47.11MLN	9/30/08
16)	JENNISON ASSOCIATES L	JENNISON ASSOCIATE	13F	428.85MLN	0.96	-102.77MLN	9/30/08
17)	T ROWE PRICE ASSOCIAT	T ROWE PRICE ASSOC	13F	351.61MLN	0.78	-9.94MLN	9/30/08

26) Latest Chg 27) Hist Held % Out on Page **41.12**
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II. Stockholders' objectives vs. Bondholders' objectives

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- *In theory*: there is no conflict of interests between stockholders and bondholders.
- *In practice*: Stockholder and bondholders have different objectives. Bondholders are concerned most about safety and ensuring that they get paid their claims. Stockholders are more likely to think about upside potential

Examples of the conflict..

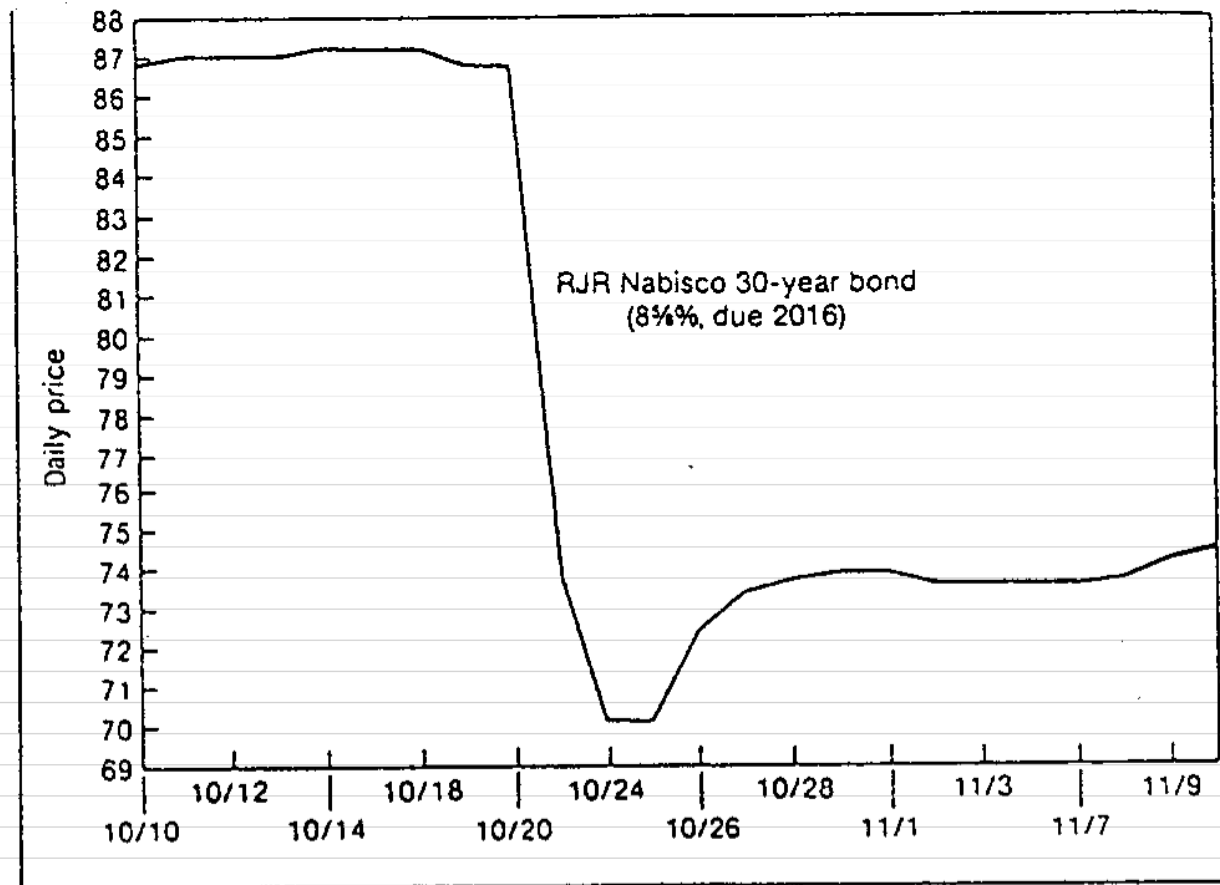
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- A dividend/buyback surge: When firms pay cash out as dividends, lenders to the firm are hurt and stockholders may be helped. This is because the firm becomes riskier without the cash.
- Risk shifting: When a firm takes riskier projects than those agreed to at the outset, lenders are hurt. Lenders base interest rates on their perceptions of how risky a firm's investments are. If stockholders then take on riskier investments, lenders will be hurt.
- Borrowing more on the same assets: If lenders do not protect themselves, a firm can borrow more money and make all existing lenders worse off.

An Extreme Example: Unprotected Lenders?

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RJR Nabisco's
Bonds Sink Follow-
ing Announcement
of the Leveraged
Buyout



III. Firms and Financial Markets

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- In theory: Financial markets are efficient. Managers convey information honestly and in a timely manner to financial markets, and financial markets make reasoned judgments of the effects of this information on 'true value'. As a consequence-
 - ▣ A company that invests in good long term projects will be rewarded.
 - ▣ Short term accounting gimmicks will not lead to increases in market value.
 - ▣ Stock price performance is a good measure of company performance.
- In practice: There are some holes in the 'Efficient Markets' assumption.

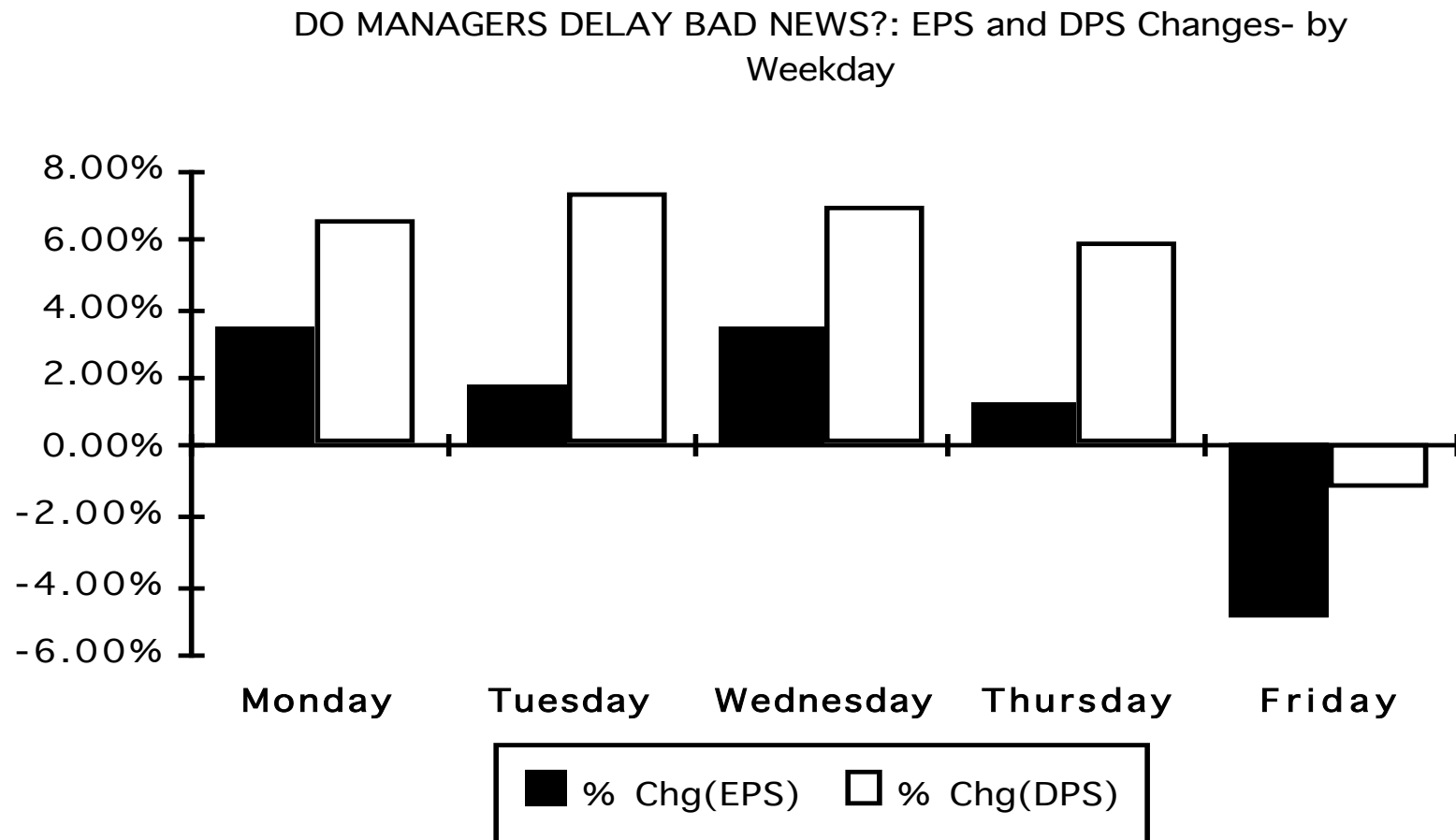
Managers control the release of information to the general public

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- Information management (timing and spin): Information (especially negative) is sometimes suppressed or delayed by managers seeking a better time to release it. When the information is released, firms find ways to “spin” or “frame” it to put themselves in the best possible light.
- Outright fraud: In some cases, firms release intentionally misleading information about their current conditions and future prospects to financial markets.

Evidence that managers delay bad news?

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Some critiques of market efficiency..

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- Investor irrationality: The base argument is that investors are irrational and prices often move for no reason at all. As a consequence, prices are much more volatile than justified by the underlying fundamentals. Earnings and dividends are much less volatile than stock prices.
- Manifestations of irrationality
 - Reaction to news: Some believe that investors overreact to news, both good and bad. Others believe that investors sometimes under react to big news stories.
 - An insider conspiracy: Financial markets are manipulated by insiders; Prices do not have any relationship to value.
 - Short termism: Investors are short-sighted, and do not consider the long-term implications of actions taken by the firm

Are markets short sighted and too focused on the near term? What do you think?

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- Focusing on market prices will lead companies towards short term decisions at the expense of long term value.
 - a. I agree with the statement
 - b. I do not agree with this statement
- Allowing managers to make decisions without having to worry about the effect on market prices will lead to better long term decisions.
 - a. I agree with this statement
 - b. I do not agree with this statement
- Neither managers nor markets are trustworthy. Regulations/laws should be written that force firms to make long term decisions.
 - a. I agree with this statement
 - b. I do not agree with this statement

Are markets short term? Some counter (albeit not conclusive) evidence that they are not..

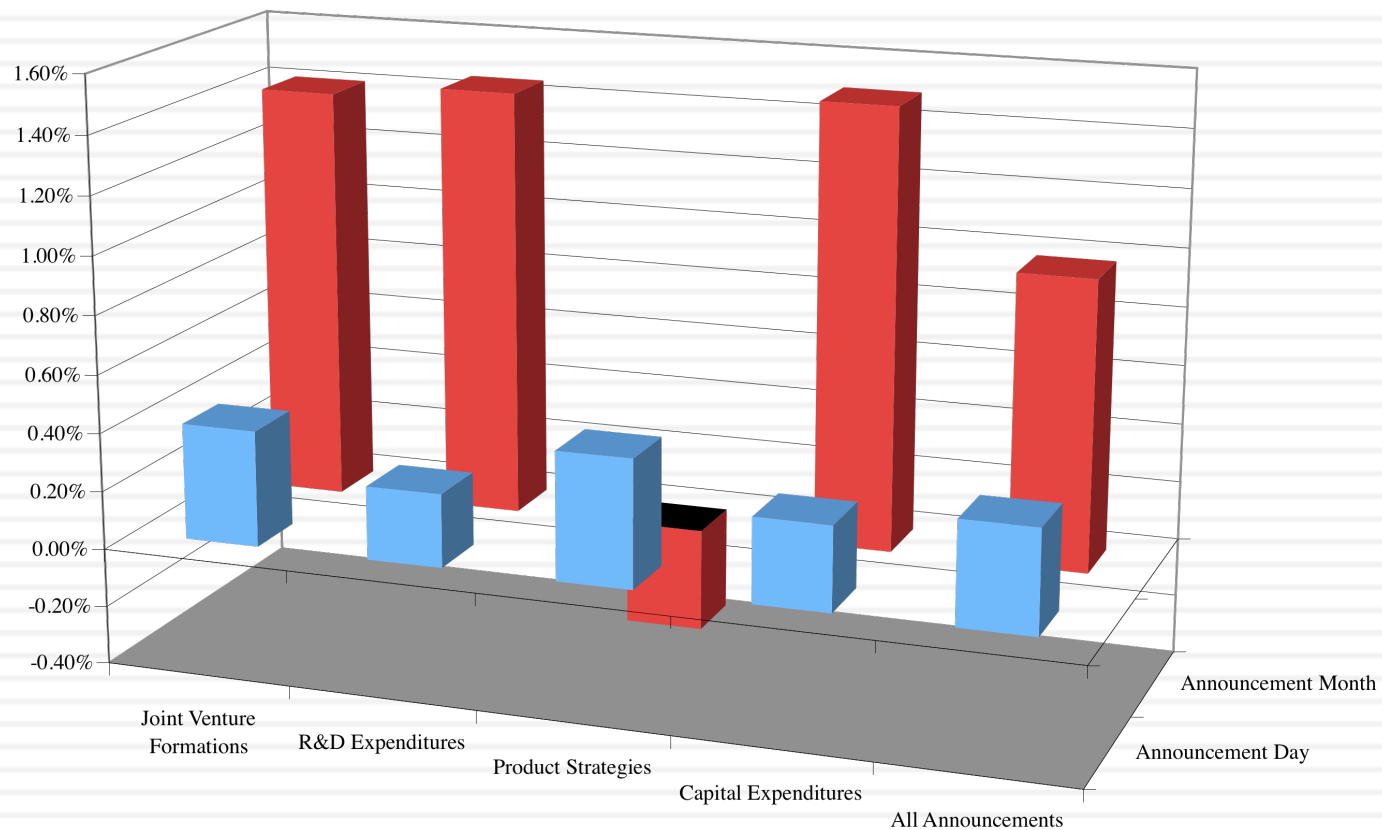
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- Value of young firms: There are hundreds of start-up and small firms, with no earnings expected in the near future, that raise money on financial markets. Why would a myopic market that cares only about short term earnings attach high prices to these firms?
- Current earnings vs Future growth: If the evidence suggests anything, it is that markets do not value current earnings and cashflows enough and value future earnings and cashflows too much. After all, studies suggest that low PE stocks are under priced relative to high PE stocks
- Market reaction to investments: The market response to research and development and investment expenditures is generally positive.

If markets are so short term, why do they react to big investments (that potentially lower short term earnings) so positively?

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Market Reaction to Investment Announcements



But what about market crises?

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- Markets are the problem: Many critics of markets point to market bubbles and crises as evidence that markets do not work. For instance, the market turmoil between September and December 2008 is pointed to as backing for the statement that free markets are the source of the problem and not the solution.
- The counter: There are two counter arguments that can be offered:
 - The events of the last quarter of 2008 illustrate that we are more dependent on functioning, liquid markets, with risk taking investors, than ever before in history. As we saw, no government or other entity (bank, Buffett) is big enough to step in and save the day.
 - The firms that caused the market collapse (banks, investment banks) were among the most regulated businesses in the market place. If anything, their failures can be traced to their attempts to take advantage of regulatory loopholes (badly designed insurance programs... capital measurements that miss risky assets, especially derivatives)

IV. Firms and Society

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- In theory: All costs and benefits associated with a firm's decisions can be traced back to the firm.
- In practice: Financial decisions can create social costs and benefits.
 - A social cost or benefit is a cost or benefit that accrues to society as a whole and not to the firm making the decision.
 - Environmental costs (pollution, health costs, etc..)
 - Quality of Life' costs (traffic, housing, safety, etc.)
 - Examples of social benefits include:
 - creating employment in areas with high unemployment
 - supporting development in inner cities
 - creating access to goods in areas where such access does not exist

Social Costs and Benefits are difficult to quantify because ..

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- Cannot know the unknown: They might not be known at the time of the decision. In other words, a firm may think that it is delivering a product that enhances society, at the time it delivers the product but discover afterwards that there are very large costs. (Asbestos was a wonderful product, when it was devised, light and easy to work with... It is only after decades that the health consequences came to light)
- Eyes of the beholder: They are 'person-specific', since different decision makers can look at the same social cost and weight them very differently.
- Decision paralysis: They can be paralyzing if carried to extremes.