Does Mandatory Bid Rule Discourage Acquisitions above the Threshold?

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Extended Abstract

In a study leveraging the staggered adoption of mandatory bid rules (MBRs) across 41 nations spanning five decades (1972-2022), Kim, Kim, and Lee (2023) uncovered that these regulations led to a decrease in control premiums, subsequently reducing the incentive to extract private benefits after gaining control. They employed a series of staggered difference-in-differences (DiD) regressions, treating acquisitions beyond the threshold as treatment groups and the years post the MBR adoption as treatment years. The authors argue that when a mandatory bid rule is in effect, acquirers must work to keep control premiums low to prevent their acquisition costs from becoming prohibitive. This occurs because a higher control premium makes the offering price more attractive and signals a heightened risk of expropriation, leading more minority shareholders to tender their shares.

However, it's worth noting that this finding may potentially be influenced by self-selection bias. Acquirers aiming to secure substantial private benefits may have mostly acquired shares below the specified threshold, whereas those seeking minimal benefits may not have chosen to do so. In other words, the assignment to the treatment group may not be random and could be

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influenced by the acquirer's desire to extract private control benefits. This study seeks to explore the validity of this concern by using takeover deal size as the primary outcome variable.

Several notable findings emerge from our analysis, using the same dataset of acquisition deals as Kim, Kim, and Lee (2023). Firstly, we find that adopting the mandatory bid rule increases the likelihood of a deal falling below the threshold. In our probit regressions, we observe that MBR_{it} (equals to 1 for country-years, where the mandatory bid rule is in effect, and 0 otherwise) increases the likelihood of the deal being below the threshold, even after controlling for an extensive list of firm and deal characteristics. The average marginal effects of MBR_{it} fall within the range of -11 ~ -25 percent and they are statistically significant.

Secondly, we observe that this tendency primarily stems from acquirers' efforts to reduce the deal size slightly below the threshold when the original deal would have been slightly above it in the absence of a mandatory bid rule. The density functions of deal sizes show a discontinuity around the threshold following the implementation of the mandatory bid rule, whereas such discontinuity is not evident prior to its adoption. The McCrary (2008) test rejects the null hypothesis that the density function is continuous during the post-adoption period.

Thirdly, we ascertain that this sorting pattern is not motivated by the acquirer's intent to gain private control benefits. Deals immediately below the threshold do not display significant variations in expropriation risk inferred from the control premium before and after adopting the mandatory bid rule. If the motivation behind this sorting behavior were the acquirers' desire to extract greater private control benefits, we would expect the deals immediately below the threshold during the post-adoption period to demonstrate a higher control premium than similar deals in the pre-adoption period.

Fourthly, as part of our robustness check, we perform the same series of analyses using U.K. deals alone along with their propensity-score matched U.S. deals. This approach offers two advantages: it allows us to employ a control group comprising deals from a country that has never implemented a mandatory bid rule, and it permits us to restrict the control group samples to deals that closely resemble the treatment group samples. The findings from this two-country analysis closely align with those obtained in our multi-country analysis.

This study contributes to the existing literature in two significant ways. First, we provide the first empirical investigation into the impact of the mandatory bid rule on takeover deal sizes.

Previous research has primarily focused on the influence of the mandatory bid rule on block sellers' control premiums (Rossi and Volpin, 2004; Wang and Lahr, 2017), its effects on target firm announcement returns around the time of rule adoption (Humphrey-Jenner, 2012; Wang and Lahr, 2017), and its implications for the risk associated with private benefit extractions (Kim, Kim, and Lee, 2023).

Secondly, our study substantiates the validity of Kim, Kim, and Lee's (2023) conclusions, which propose that the mandatory bid rule prompts acquirers to offer lower control premiums for deals above the threshold. This is supported by the observation that the tendency of acquirers to purchase shares below the threshold is not driven by their intent to offer higher control premiums.

Keywords: mandatory bid rule, equal opportunity rule, private benefits of control, control premium, self-limitation mechanism

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