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Takeovers under Asymmetric Information: Block Trades and Tender Offers in Equilibrium

Abstract

I study transfers of control in a firm having atomistic shareholders and one dominant minority blockholder (incumbent). A potential acquirer can try to negotiate a block trade with the incumbent. If the negotiations are successful, the control changes hands via a block trade. If the negotiations fail, the acquirer can launch a public tender o¤er. According to empirical evidence, both types of transactions occur in the market. However, the existing models that allow for both types of control transfer ultimately obtain that the incumbent and the acquirer always negotiate a block trade in equilibrium. By introducing asymmetry of information about the acquirer's ability to generate value, I bring imperfections into the bargaining between the acquirer and the incumbent, which allows me to generate either a block trade or a tender o¤er as the game outcome. In equilibrium, high ability acquirers take over the firm by means of a tender offer, intermediate ability acquirers negotiate a block trade, and low ability acquirers do not attempt any transaction. This result provides an immediate explanation for a generally higher target's stock price reaction to tender offers as compared to block trade announcements. The model also explains why takeover premiums are generally higher in countries with stronger legal protection of shareholders and predicts that better shareholder protection should result in a higher stock price reaction to block trade announcements as well. Finally, the model predicts how, for a given incumbent's share, the choice between a tender offer and a block trade is affected by the legal shareholder protection.

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