

Institutional Investor Support of Managers: An Investigation of Tender Offers

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This paper examines whether institutional investors such as pension funds, mutual funds, and insurance companies facilitate or impede the corporate control market. One of the most powerful management control mechanisms is firm takeover by tender offer. The success of tender offers in removing ineffective managers depends on whether shareholders sell their shares to bidders. If institutional investors support management by refusing to sell, the threat of removal decreases and agency costs due to shirking and perquisite consumption increase. Results presented here demonstrate that institutions rapidly sell shares during tender offers. Institutions involved in multiple business enterprises are less willing to sell but do not appear to be influenced more by managers than are other institutions. Large blockholders are no more subject to management pressure than are smaller blockholders. Finally, management influence is no more evident in unsuccessful than in successful tender offers.

INTRODUCTION

One of the most powerful corporate control mechanisms is the takeover of one firm by another. Dissatisfied shareholders can dislodge or replace ineffective managers by soliciting or supporting stock tender offers. Managers are controlled not only by actual takeovers, but also by the threat of a takeover.

Some researchers hypothesize that if institutional investors cooperate with outside bidders the tender offer more likely will be successful because bidders only need to contact a relatively few large institutions instead of many diffuse shareholders (Shleifer and Vishny, 1986). Managers, aware of institutional investment in their firm, should be more sensitive to monitoring than are managers of firms with diffuse ownership. This increased sensitivity to monitoring in turn should reduce agency costs and increase firm value.

On the other hand, there is evidence that some institutional investors side with management even on value-reducing issues (Brickley, Lease, and Smith, 1988). If institutional investors cooperate with management, the probability of a tender offer being successful is reduced, as is the threat to managers. Managers may increase opportunistic behavior if they know large institutional shareholders make reprisal by stockholders unlikely.

This paper investigates whether institutions support managers or other shareholders during tender offers. If institutions support managers during control contests, they likely will support them on other controversial issues. This added managerial clout may render other shareholders nearly defenseless.

This research examines statistically the change in stock ownership by institutions in the quarter a tender offer is announced. The data set details the portfolio composition of over 1,000 institutions required to file a quarterly form 13f with the Securities and Exchange Commission (SEC) from January 1985 through December 1988. The sample includes tender offers that are successful and unsuccessful, management opposed and unopposed. The short-term response to the offer is investigated by examining a sub-

sample composed of offers received late one quarter and expiring the next. The results are analyzed by institutional type to determine whether institutions support management or other shareholders. Finally, institutions holding relatively large stakes are compared with other institutions.

The results here imply that institutions rapidly sell shares during tender offers. Some institutional types sell less readily than others, but there is no evidence to suggest they are influenced more by managers. Institutions with large stakes react much the same as do those with smaller stakes. Finally, management reaction can significantly reduce the percentage of shares sold. Whether institutions of all types are more subject to management influence than other shareholders cannot be determined with the current data set.

BACKGROUND

Jensen and Meckling (1976) show that as owner-managers decrease their stake in the firm by selling shares to outside investors they are more likely to act in their own best interests. Agency problems caused by managers acting on their own behalf can cost the firm in terms of undue consumption of perks, suboptimal choices in investment decision making, and information asymmetry between agent-managers and outside shareholders. Shareholder monitoring is required to minimize these costs.

Not all shareholders, however, are equally motivated to monitor managers. Heard and Sherman (1987) argue that institutions tend to follow the Wall Street rule and either vote with managers or sell their stock when policy disagreements occur. Brickley, Lease, and Smith (1988) suggest institutions such as banks and insurance companies that have current or potential business connections with a firm may be particularly sensitive to pressure by firm management. Those who believe institutions are less vigilant in monitoring than are typical shareholders have proposed regulations to require institutions to disclose voting policies or to pass the vote to beneficiaries (Easterbrook and Fischel, 1983).

In contrast, Shleifer and Vishny (1986) argue that small shareholders have little incentive to invest in monitoring because any gains go primarily to other shareholders. Blockholders, on the other hand, have economies of scale sufficient to make monitoring profitable and are more likely to exert control over managers than are other shareholders. Demsetz and Lehn (1985) empirically support this blockholder-monitoring hypothesis with evidence that firm ownership balances the benefits of diffuse ownership against the benefits of reduced agency costs.

Brickley, Lease, and Smith (1988) test the hypothesis that ownership concentration among institutional investors increases incentives to invest in firm-specific information and to participate in the voting process. They find a strong positive correlation between the level of institutional ownership and the percentage of no-votes cast in value-reducing antitakeover amendments. Brickley, Lease, and Smith (1988) also find mutual funds and public pension funds are more likely to oppose management than are banks and insurance companies that frequently benefit from other lines of business under management control. This potential conflict of interest may lead these institutions to support managers when outside bidders make higher value offers.

This paper explores institutional willingness to sell shares during tender offers. Tender offers raise firm value by 20 percent on average (Asquith, 1983), yet they fre-

quently are opposed by management. The management entrenchment hypothesis posits that management opposition raises the cost of displacing self-serving incumbent managers and reduces stockholder wealth. The stockholder interests hypothesis holds, however, that management opposition enables stockholders to secure a higher control premium and to increase wealth. Malatesta and Walkling (1987) and Jensen (1986) provide support for the managerial entrenchment hypothesis by finding that managerial opposition reduces shareholder wealth. If institutions support management opposition of tender offers, firm value would decline on average.

DATA

TENDER OFFERS

A sample of 491 public tender offers occurring between January 1, 1985 and December 31, 1988 was obtained from Automatic Data Processing (ADP). For inclusion in the ADP data base, a transaction must be valued at \$1 million or more; partial acquisitions of 5 percent or more of a company's stock are included if the \$1 million threshold is met. To be included in the final sample here, the target firm must have some shares held by institutional investors at the beginning of the quarter a tender offer is received. This screen results in 259 observations. Tender offer summary statistics are reported in Table 1.

ADP designates whether management's position on the tender offer is friendly, hostile, or whether it changed during the tender offer period. ADP defines a friendly offer as one that initially is accepted by management, making the tone of the transaction friendly. A hostile offer is one that management initially opposes, making the tone of the transaction hostile. A changed tender offer is one in which the tone changed from hostile to friendly during the course of the transaction. One hundred forty-six are friendly, 71 are hostile, and 42 changed. In this study hostile and changed tender offers are combined and called *opposed*. ADP also designates whether the tender offer is successful. Although most firms in the sample subsequently were acquired by other bidders, if the first bidder failed to acquire a controlling interest the offer is considered unsuccessful. Only 28 firms had not been acquired by any bidder one year after the expiration date of the initial tender offer.

The mean number of business days between the initial offer and the first expiration date was 30.74 days. Bidders often extended the expiration date of tender offers. The mean number of business days between the initial offer and the last extended expiration date was 64.29 days. Successful tender offers were completed in an average of 55.8 days; unsuccessful tender offers were allowed to expire after an average of 89.4 days.

INSTITUTIONAL OWNERSHIP

Control Data Advisors (CDA) Investment Technologies, Inc. Spectrum 3/4 provides the institutional ownership data, based on information obtained from quarterly institutional form 13f filings with the SEC. All institutions with investment control of over \$100 million must report quarterly to the SEC equity holdings above 10,000 shares and with a market value above \$200,000. The Spectrum data set used in this study contains all filings between January 1985 and December 1988.

Table 1—Sample Summary Statistics

Summary statistics for a sample of 259 tender offers made between 1/1/86 and 12/31/88 where at least some target firm shares are reported held by institutions during the quarter when a tender offer is received. The tender offers are disaggregated by whether the first bidder was successful or unsuccessful and by whether the offer was opposed or unopposed by management.

	Opposed	Unopposed	Total
Successful	78	116	194
Unsuccessful	35	30	65
Total	113	146	259

Because not all institutions may react the same to controversial issues, institutions are classified by type according to the designations assigned by the 1988 *Money Market Directory*. Those designations are: bank trusts, insurance companies, corporate pension funds, investment advisors (including mutual funds), endowment funds, foundations, and government pension plans. A conflict-of-interest subgroup is formed by aggregating the shares held by bank trusts, insurance companies, and corporate pension plans. A no-conflict subgroup is formed by aggregating investment advisors and government pension plans. Other institutional types and those institutions not reported in the directory are classified as *other*. This closely parallels the classification schedule employed by Brickley, Lease, and Smith (1988).

Summary institutional ownership data are presented in Table 2. Institutional investors owned 41.42 percent of the shares of the average firm before successful tender offers were announced. During the quarter the tender offer was announced, average institutional ownership dropped by 59.05 percent $((16.96 - 41.42)/41.42)$. By the time the tender offer expired, average institutional ownership dropped by 77.8 percent (to 9.16 percent). The no-conflict subsample owned more than twice the percentage of shares as the conflict subsample; however, the change across quarters was about the same.

Institutional ownership of the 65 firms subject to initially unsuccessful tender offers is summarized in Panel B of Table 2. Although these firms had lower initial institutional ownership than successful tender offers, the shares held at the end of the tender offer quarter were similar. The unsuccessful tender offer group had somewhat greater institutional ownership at the final expiration.

The statistics in Table 2 Panel B illustrate the difficulty in identifying successful versus unsuccessful tender offers. While one bidder fails to capture control, another may be concurrently successful. End-of-quarter institutional ownership was much the same for both groups. To isolate a sample of unsuccessful tender offers, 28 firms are identified that were still trading one year following the expiration of the final tender offer. Tender offer trading data for these firms are summarized in Panel C. As expected, the change in shares held by institutions during the tender offer event is much smaller for this subgroup.

ANALYSIS

To investigate whether institutions facilitate takeovers, the percentage of shares sold by institutions immediately following the date of the tender offer should be examined. Because institutions only are required to report portfolio composition quarterly, however,

Table 2—Percentage Shares Held by Institutional Investors at the End of the Given Quarter

Panel A reports the mean and (standard deviation) of shares held by institutions at the end of the quarter before successful tender offers, at the end of the quarter when the tender offer is made, and at the end of the quarter when the tender offer expires. The percentage ownership is disaggregated by type of institution where conflict-of-interest institutions include banks, insurance companies, and corporate pension funds. No-conflict institutions include mutual funds and government pension funds. Unclassified and other types of institutions are reported as Other. Panel B reports the same information for tender offers where the first bidder is unsuccessful. Panel C reports on tender offers where no bidder is successful within one year of the last tender offer expiration.

Type of Institution	Percentage Shares Held by Institutions Quarter Before Tender Offer	Quarter of Tender Offer	Quarter Tender Offer Expires
Panel A			
Successful Tender Offers (n=194)			
All Institutions	41.42 (24.57)	16.96 (19.71)	9.16 (15.49)
Conflict-of-Interest Institutions	11.59 (8.76)	4.97 (7.56)	2.65 (6.16)
No-Conflict Institutions	24.89 (16.44)	9.88 (11.54)	5.56 (9.40)
Other Institutions	4.94 (4.93)	2.11 (3.77)	.95 (2.29)
Panel B			
Unsuccessful Tender Offers (n=65)			
All Institutions	33.72 (32.06)	16.65 (21.27)	11.88 (19.68)
Conflict-of-Interest Institutions	8.79 (9.59)	4.71 (7.64)	3.60 (7.56)
No-Conflict Institutions	20.74 (20.13)	9.97 (12.94)	7.01 (11.70)
Other Institutions	4.19 (5.35)	1.97 (3.38)	1.27 (2.52)
Panel C			
Ultimately Unsuccessful Tender Offers (n=28)			
All Institutions	39.58 (29.44)	34.18 (24.73)	31.61 (21.27)
Conflict-of-Interest Institutions	11.84 (11.95)	10.17 (11.60)	9.09 (11.32)
No-Conflict Institutions	23.10 (15.61)	19.92 (12.86)	19.21 (13.52)
Other Institutions	4.63 (5.91)	4.08 (5.23)	3.31 (3.32)

the percentage change in institutional share ownership over the entire tender offer quarter must be used.

For each firm the percentage change (PERCH) in the sum of shares held by no-conflict, conflict, and other institutions during the quarter the tender offer is announced is calculated:

$$(1) \text{PERCH}_{jt} = \frac{\sum_{i=1}^I \text{SHEND}_{ijt} - \sum_{i=1}^I \text{SHBEG}_{ijt}}{\sum_{i=1}^I \text{SHBEG}_{ijt}}$$

where:

PERCH_{jt} = Percentage change in shares held by institutions of type t (conflict, no-conflict, other) in firm j ;

SHEND_{ijt} = Shares held by institution i of type t in firm j at the end of the quarter during which a tender offer is announced; and

SHBEG_{ijt} = Shares held by institution i of type t in firm j at the beginning of the quarter during which a tender offer is announced.

An analysis of variance model is used to determine the significance of the type of institution and the reaction of management to tender offers:

$$(2) \text{PERCH}_{jt} = \alpha_0 + \alpha_1 (\text{TYPEDUM}_{jt}) + \alpha_2 (\text{REACTDUM}_j)$$

where:

TYPEDUM_{jt} = A dummy variable equal to 1 if the institution is not expected to be subject to conflicts of interest and 0 otherwise; and

REACTDUM_j = A dummy variable equal to 1 if the tender offer is opposed by management and 0 otherwise.

Separate regressions are computed for firms where aggregate institutional ownership exceeds various threshold levels. Results are reported in Table 3.

In this model the intercept reflects the percentage shares sold by no-conflict institutions during friendly tender offers. If management does not oppose the tender offer, 66 percent of the shares held by these institutions are sold during the quarter the initial tender offer is announced ($t = -20.80$). If management opposes the offer, 54 percent of the shares are sold ($-.66 + .12$). Conflict-of-interest institutions sell significantly fewer shares than do no-conflict institutions.

Table 3—Regression Results by Level of Institutional Ownership

The percentage change in institutional ownership ($PERCH_{jt}$)^a during the quarter a tender offer is received is regressed on $TYPEDUM$ ^b and $REACTDUM$.^c Panel A includes all tender offers in the sample. Panel B includes only those tender offers where the initial announcement and the expiration date are in different quarters. Separate regressions are reported for firms with different initial aggregate institutional ownership. The t-statistics are in parentheses. The analysis of variance model is:^d

$$PERCH_{jt} = \alpha_0 + \alpha_1 (TYPEDUM_{jt}) + \alpha_2 (REACTDUM_{jt})$$

Institutional Ownership	α_0	α_1	α_2	N	F	R ²
Panel A						
All Tender Offers						
Full Sample	-.66** (-20.80)	.07* (1.85)	.12** (3.14)	259	6.79**	.03
Institution Shares Held > 10%	-.72* (-20.54)	.04 (.76)	.16** (3.60)	259	6.99**	.05
Institution Shares Held > 20%	-.73** (-15.97)	.14* (1.81)	.11* (1.87)	259	3.42**	.04
Panel B						
Tender Offers Beginning and Ending in Different Quarters						
Full Sample	-.54** (-10.29)	10.10* (1.83)	.006 (.10)	99	1.68	.01
Institution Shares Held > 10%	-.61** (-10.18)	.05 (.70)	.06 (.84)	99	.68	-.005
Institution Shares Held > 20%	-.60** (-6.80)	.11 (.89)	.01 (.08)	99	.40	-.02

a. $PERCH_{jt}$ = The sum of the percentage change in institutional ownership of firm j during the quarter a tender offer is announced;

b. $TYPEDUM$ = 1 if the institution is suspected of conflicts of interest and zero otherwise;

c. $REACTDUM$ = 1 if management opposes the tender offer and zero otherwise;

d. The analysis of variance model is interpreted as follows:

- $E(Y|TYPEDUM = 0, REACTDUM = 0) = \alpha_0$
- $E(Y|TYPEDUM = 1, REACTDUM = 0) = \alpha_0 + \alpha_1$
- $E(Y|TYPEDUM = 0, REACTDUM = 1) = \alpha_0 + \alpha_2$
- $E(Y|TYPEDUM = 1, REACTDUM = 1) = \alpha_0 + \alpha_1 + \alpha_2$

* Significant at the 5 percent level in one-tailed t-test

** Significant at the 1 percent level in one-tailed t-test

Regressions are performed for firms where institutions in aggregate hold greater than 10 percent and 20 percent of the outstanding shares to test whether the coefficients change when institutions are more likely to influence the outcome of the tender offer. In general, conflict institutions sell more shares and no-conflict institutions sell fewer shares as aggregate institutional ownership increases.

To examine the short-term reaction of institutions to tender offers, a subsample of tender offers is compiled where the announcement and expiration of the tender offer are in different quarters. Of the 259 tender offers, 99 began and ended in different quarters. Because the end of quarter institutional change observation typically is available in this subsample much sooner after the tender offer is made, it is possible that management's reaction and the probable success of the tender offer are more uncertain. The percentage change in shares held by no-conflict institutions is smaller for this subsample than for the total sample. Management reaction is generally not significant (Panel B of Table 3).

The evidence presented in this table suggests institutional investors of all types sell large portions of their holdings during tender offers. Only the results reported for the overall sample in Panel A, however, are consistent with the hypothesis that conflict-of-interest institutions are influenced more easily by managers. As reflected in Panel B, the short-term reaction by conflict institutions is unchanged when management reaction is either unknown or unimportant. This may indicate that these types of institutions simply react more slowly than do other institutions to certain events, such as tender offers as reported here or antitakeover amendments as reported by Brickley, Lease, and Smith (1988).

A more sensitive test of management influence over institutions may be to examine institutions holding relatively large blocks of stock. Managers are more likely to attempt to influence large blockholders because these institutions are most likely to affect the final outcome of a tender offer. In Table 4 the percentage change in shares held by institutions initially holding greater than .01 percent, .1 percent, and 1 percent of the outstanding shares is regressed on management reaction and institutional type.

Management reaction remains significant across all regressions. Institutional type, although quantitatively similar to the coefficients for the full sample, becomes insignificant as institutional ownership increases. These findings fail to support the hypothesis that conflict-of-interest institutions are influenced greatly by managers.

Another possibility is that conflict institutions quickly estimate the likely outcome of a tender offer and side with the expected winner. If this is the case, they should sell more shares during successful tender offers than during unsuccessful tender offers. This hypothesis is examined in Table 5.

During the quarter the successful tender offer is announced, no-conflict institutions sell 67 percent of their holdings when managers do not oppose the offer and 55 percent of their holdings when managers oppose the offer. Conflict institutions sell 48 percent of their holdings when managers oppose the offer. When the offer is unsuccessful, no-conflict institutions sell only 24 percent of their holdings. This figure is not significantly changed by either management reaction or institutional type. As the institutional type is not significant, these results do not support management entrenchment by conflict-of-interest institutions.

CONCLUSIONS

This paper examines whether certain institutional investors impede monitoring by aligning with management during corporate control contests. If management can influence large shareholders, the threat from outside investors decreases and management entrenchment increases. On the other hand, if institutional investors willingly tender shares,

Table 4—Regression Results by Minimum Level of Institutional Ownership

The percentage change in institutional ownership ($PERCH_{jt}$)^a during the quarter a tender offer is received is regressed on $TYPEDUM$ ^b and $REACTDUM$.^c Separate regressions are reported where $PERCH$ is computed including only institutions initially holding the given minimum percentage firm shares. The t-statistics are in parentheses. The analysis of variance model is:^d

$$PERCH_{jt} = \alpha_0 + \alpha_1 (TYPEDUM_{jt}) + \alpha_2 (REACTDUM_{jt})$$

Institutional Ownership	α_0	α_1	α_2	N	F	R ²
No screen	-.66** (-20.80)	.07* (1.85)	.12** (3.14)	259	6.79**	.03
Greater than 00.01%	-.68** (-18.61)	.05 (1.23)	.14** (3.16)	259	5.74**	.03
Greater than 00.1%	-.67** (-18.46)	.06 (1.32)	.14** (3.11)	259	5.68**	.02
Greater than 01.1%	-.69** (-18.84)	.06 (1.26)	.14** (3.21)	259	6.025**	.03

See Table 3 notes

Table 5—Regression Results by Whether Tender Offer was Successful or Unsuccessful

The percentage change in institutional ownership ($PERCH_{jt}$)^a during the quarter a tender offer is received is regressed on $TYPEDUM$ ^b and $REACTDUM$.^c The results are disaggregated by whether the tender offer was successful, unsuccessful by the first bidder, or unsuccessful by any bidders within one year of the expiration of the initial offer. The t-statistics are in parentheses. The analysis of variance model is:^d

$$PERCH_{jt} = \alpha_0 + \alpha_1 (TYPEDUM_{jt}) + \alpha_2 (REACTDUM_{jt})$$

Institutional Ownership	α_0	α_1	α_2	N	F	R ²
Successful	-.67** (-20.80)	.07* (1.85)	.12** (3.14)	194	6.64**	.03
Unsuccessful by 1st bidder	-.59** (-8.09)	.07 (.93)	.09 (1.20)	65	1.14	.003
Unsuccessful	-.24** (2.67)	.11 (1.14)	-.03 (-.31)	28	.71	-.02

See Table 3 notes

bidders may be more likely to attempt a takeover because they can gain control by soliciting a few large shareholders.

A sample of 259 tender offers occurring between 1985 and 1988 is collected where each target firm had at least one institutional investor reporting ownership during the quarter preceding the offer announcement. The change in institutional ownership over the

tender offer quarter is computed for each firm and the results are disaggregated by type of institution.

The results suggest institutions not subject to conflicts of interest sell more than 66 percent of their holdings during the quarter the tender offer is announced. Institutions subject to conflicts of interest sell 54 percent of their shares. When management opposes the tender offer, 12 percent fewer shares are sold by both types of institutions.

Further analysis suggests that although all institutions are influenced by management in their decision to tender shares, conflict-of-interest institutions are not unusually sensitive to this pressure. Specifically, the difference between the number of shares tendered by no-conflict and conflict institutions is unchanged when management attitude is either unknown or unimportant. In addition, conflict institutions that have larger holdings and are more likely the target of management influence sell a similar percentage of shares as do smaller institutional investors. Finally, the effect of institutional type is insignificant in unsuccessful offers although theory suggests it should be more significant.

The implications of this paper are especially important when coupled with the results of Brickley, Lease, and Smith (1988). They find that institutions oppose management-initiated antitakeover proposals more frequently and vote more often than other shareholders. The current paper suggests institutions rapidly sell shares during tender offers despite management opposition and potential conflicts of interest. The finding that institutions willingly oppose managers during at least two important events lends credence to the hypothesis that institutional ownership may reduce opportunistic behavior by corporate managers.

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