

MBO Withdrawals and Determinants of Stockholders' Wealth

Pornsit Jiraporn*
Texas A&M International University

Wallace N. Davidson III
Southern Illinois University, Carbondale

Hong Qian
The Pennsylvania State University

Not all firms that intend to go private do so successfully. Numerous management buyouts are announced but subsequently withdrawn. We document that the stock market reacts negatively to the withdrawal announcement. This adverse effect, however, is alleviated in firms where inside directors hold higher proportions of equity ownership and where boards of directors are dominated by independent directors. The results suggest that higher ownership by inside directors helps align management's and shareholders' interests whereas outsider-dominated boards better monitor management, whose fiduciary duties to shareholders may be compromised by conflicts of interest inherent in management buyouts. Finally, there is evidence that firms that could have taken the offer by another bidder but decided in favor of the MBO, which subsequently fails, suffer more adverse market reactions when the MBO is withdrawn.

Introduction

A management buyout or a leverage buyout is a transaction in which incumbent managers, normally with the assistance of third-party private investors, use debt financing to purchase a corporation or a corporate division. This form of corporate restructuring has led to a great deal of research. It has been a source of controversy; perhaps, because a number of individuals have become very wealthy while others have lost their jobs as a result of MBOs (Opler and Titman, 1993). Although the number of management buyouts (MBOs) decreased in the 1990s, due to the decline of the junk bond market, MergerStat Review (2000) reports that the number of management buyouts has recently risen. The resurgence in MBOs suggests that they continue to be a relevant form of corporate restructuring.

Not all firms that announce their intention to go private do so. Some MBOs are subsequently withdrawn. For instance, in October 1984, Diversifoods Inc., the owner of the Burger King and Godfather Pizza's franchises, announced that its board of directors had agreed to have the firm taken private by an investor group led by Donald Smith, Diversifoods' president and CEO. In November 1984, however, the board of directors reversed its previous decision and canceled the going-private agreement.

A large number of studies have examined stock market reactions to the MBO announcement (DeAngelo, DeAngelo, and Rice, 1984; Marais, Schipper, and Smith, 1989; Lehn and Poulsen 1989; Torabzadeh and Bertin, 1992; Madden, Marples, and Chugh, 1990; Kaplan, 1989, Lee, Rosenstein, Rangan, and Davidson, 1992; Travlos and Cornett, 1993). These studies have generally found MBO announcements to be associated with positive abnormal stock returns. Considerably less attention has been paid, however, to the stock market response when a company backs out of the MBO previously announced. The notable exceptions are DeAngelo, DeAngelo, and Rice (1984) and Lee (1992). Both studies document a negative market reaction to announcements of MBO withdrawal.

In this study we focus on the shareholder wealth effects associated with MBO withdrawals and extend the work of DeAngelo, DeAngelo, and Rice (1984) and Lee (1992) in a number of ways. First, by using a more recent sample that includes failed MBOs in the 1990s, this study reexamines the stock market reactions to MBO withdrawals in a time period when the market for corporate control was much less active. The marked reduction in corporate control activities in the 1990s may influence the stock market reaction to MBO withdrawals. Second, this study extends prior research on cancelled MBOs by examining the role of board of directors, ownership structure, and the presence of outside acquisition attempts around MBO withdrawals.

Reaffirming the results in prior research, we find that the stock market reacts adversely to MBO withdrawal announcements (DeAngelo, DeAngelo, and Rice, 1984 and Lee, 1992). We also find results that ownership characteristics are important determinants of shareholders' wealth when MBOs are withdrawn. Specifically, firms where inside directors hold larger portions of equity ownership sustain less negative market reactions to the withdrawal announcement, suggesting that higher proportions of equity ownership by inside directors help align management's and shareholders' interests. Additionally, the results demonstrate that firms where independent directors constitute the majority on the board experience less negative market reactions.

Finally, there is empirical evidence that firms that received alternative bids from other potential acquirers experience more negative stock market reactions when the MBO is withdrawn. We interpret this wealth reduction as reflecting the opportunity cost of not taking the alternative bid and, instead, deciding in favor of the MBO, which subsequently fails.

Empirical Issues and Prior Research Stock Market Reactions

Numerous studies have documented positive stock market reactions to the announcement of an MBO. For instance, DeAngelo, DeAngelo, and Rice (1984) compute average two-day abnormal returns of 22.27 percent and abnormal returns of 30.40 percent over a 40-day interval surrounding the MBO announcement. Since then, a number of other studies have confirmed their results (Marais, Schipper, and Smith, 1989; Lehn and Poulsen, 1989; Torabzadeh and Bertin, 1992; Madden, Marples, and Chugh, 1990; Kaplan, 1989; Lee, Rosenstein, Rangan, and Davidson, 1992; Travlos and Cornett, 1993).

One area that has been mostly neglected by MBO researchers is the valuation effects associated with cancelled MBOs. Because the market reactions are positive for MBO announcements, one may expect the stock market to react negatively to the announcement of a cancelled MBO. From the theoretical perspective, however, this issue may not be as clear as it seems. Managers have a fiduciary responsibility to act in the best interests of shareholders. An MBO may be withdrawn because managers want to pursue other offers that would generate more wealth for shareholders. If this is the case, then the market reactions should be favorable. There is empirical evidence that for firms that are the targets of unsuccessful tender offers, target firm shareholders receive a permanent increase in wealth (Dodd and Ruback, 1977; Bradley, 1980). Dodd (1980) finds that shareholders of firms that are targets of unsuccessful merger proposals also experience a permanent increase in wealth. These wealth gains are attributable to the discovery of favorable information about the targets that is divulged during the acquisition process. Davidson, Dutia, and Cheng (1989), on the other hand, find that this increase in wealth for cancelled mergers is attributed to anticipated subsequent takeover proposals. When these proposals do not occur, stock prices fall over time to pre-merger levels. Similar findings are documented for MBOs in Lee (1992). Consequently, *ex ante*, it is not so obvious how the market would react to an MBO cancellation.

Using a sample of 18 MBO withdrawals, DeAngelo, DeAngelo, and Rice (1984) document negative market reactions to the withdrawal announcement. Their MBO sample is from 1973 to 1980. Lee (1992), using a more recent sample covering a longer period of time, documents similar negative reactions to the MBO withdrawal. We extend the work in these two studies by determining whether the board of directors, the body guarding shareholder interests from managers who want to acquire the firm as cheaply as possible, protects shareholder interests.

Corporate Governance

An MBO creates a complex situation in which agency problems could be particularly acute. In an MBO, management has a fiduciary obligation to act in the best of shareholders' interests and, hence, is expected to obtain the highest price for

the shareholders. In an MBO, however, management along with the aid of third-party investors attempt to take the firm private and, therefore, has a motive to acquire the firm at the lowest possible price for at least two reasons. First, a lower price would reduce the out-of-pocket money that management has to spend in the acquisition. Second, a lower price would allow the company to borrow less. With less debt, the company, after being taken private, has a much higher probability of survival (Lee, Rosenstein, Rangan, and Davidson, 1992). When management is present on both sides of the transaction, conflicts of interest are likely to occur.

One specific area of corporate governance that is particularly relevant to MBOs is the role of independent directors on the board. In an MBO, because the inside directors' objectivity may be compromised by conflicts of interest, independent directors on the board assume a more important role. Lederman and Bryer (1989) point out that in going private transactions independent outside directors are specifically charged with protecting shareholders interests. There is a great deal of empirical evidence indicating that outside independent directors play a critical role in control contests. For instance, Byrd and Hickman (1992), examining 128 acquisition attempts that involved tender offer bids from 1980 to 1987, document that the stock market reacts negatively to the tender offer announcement. The stock market reactions, however, are significantly less negative for bidders whose boards are numerically dominated by independent outside directors than for those that are dominated by insiders. With respect to ownership structure, they find that abnormal returns are positively related to relatively small levels of managerial ownership and relatively large levels of outside ownership. Shivdasani (1991) finds that for companies that are hostile takeover targets (and thus are presumably not being managed efficiently), outside directors hold significantly lower ownership stakes than in firms that are not hostile takeover candidates. Besides, outside directors in hostile takeover targets hold fewer other directorships, indicating that they are less experienced or less effective monitors of management.

More evidence on the role of independent outside directors in situations where agency problems are likely acute can be found in Brickley and James (1987), who find that the proportion of outside directors is significantly lower on boards of banks in states that restrict banking acquisitions than in those that do not, implying that outside directors play a crucial role in evaluating takeover proposals. Their study also notes that, in "non-acquisition" states, where there is no corporate control market to discipline managers, outsider-dominated boards help control managerial consumption of perquisites (as proxied by salary expenses). Weisbach (1988) documents that CEO turnover is more highly correlated with firm performance in corporations that have a majority of outside directors than in those with a majority of insider directors.

Additional evidence is documented that supports the notion that outside directors are crucial in monitoring managerial actions. Cotter, Shivdasani, and Zenner

(1997) find that when a target firm's board is predominantly independent, the initial tender offer premium, bid premium revision, and target shareholder gains are higher with or without the presence of a poison pill provision. Brickley, Coles, and Terry (1994) find that the average stock market reaction to the adoption of a poison pill is positive when the board is numerically dominated by outside directors and negative otherwise. They also find that the likelihood that subsequent control contests will result in an auction is positively related to the proportion of outside directors.

Similar empirical evidence can be found in Hermalin and Weisbach (1988), who find that outsiders are more likely to join a board after the firm performs poorly or leaves an industry. Rosenstein and Wyatt (1990) find that even though most boards are numerically dominated by outsiders, the addition of an outside director is associated with positive abnormal returns. Kosnik (1990) finds that greater diversity in outside directors' principal occupations increases the tendency of corporations to use greenmail, suggesting that diversity fragments the board and provides insiders with a greater degree of control. Both Cochran, Wood, and Jones (1985) and Singh and Harianto (1989) report that firms adopting golden parachutes have a higher proportion of outside directors than those that do not, indicating that the protection afforded by a golden parachute more closely aligns management and shareholder interests.

As demonstrated by the studies cited above, independent outside directors' role in monitoring management is crucial. This is particularly relevant in an MBO where management is present on both sides of the transaction, suggesting that acute agency problems are likely to occur. It is hypothesized in this study that a larger proportion of outside independent directors positively contributes to shareholder wealth in an MBO cancellation. We suggest this outcome because if the MBO offer is not in the shareholders' best interest, then an independent board may be more likely to reject the offer. While we expect some of the positive announcement period returns to be reversed, when there is an independent board, we expect the withdrawal abnormal returns to be less negative in these situations.

Byrd and Hickman (1992) find that greater ownership by outsider directors motivates these directors to better monitor management. Consistent with this finding, we hypothesize that in firms where outside independent directors hold larger portions of equity, there will be more positive (less negative) market reactions when their going private attempts are cancelled.

Blockholders and their equity ownership in the firm may also contribute to shareholder wealth around MBO cancellations as illustrated by Shleifer and Vishny (1986), who find that equity ownership by unaffiliated blockholders helps overcome the free-rider problem in takeover bids. The evidence also suggests that unaffiliated blockholders play a critical role in facilitating takeover bids. Given that blockholders influence corporate control contests, we expect that they may play a role when MBOs are cancelled. That is, blockholders monitor management and should help to ensure that an MBO is withdrawn when the withdrawal serves shareholder interests.

Therefore, this study hypothesizes that unaffiliated blockholders who hold large portions of equity help mitigate the adverse market reactions when the MBO is withdrawn.

Market for Corporate Control

When a bidder attempts to acquire a target, target managers may propose an MBO to either negotiate a better price for shareholders or prevent the bidder from acquiring the firm. The presence of a bid from an outside bidder may influence the MBO's outcome and how the market perceives the subsequent withdrawal. Whether the MBO proposal is used to prevent the takeover or just as a bargaining strategy, the stock market reactions to the MBO withdrawal may be different than if the firm did not receive any takeover bids prior to the unsuccessful MBO. For this reason, we explore the effect of the status of the firm in the corporate control market on stockholders' wealth when the MBO is cancelled. In addition, some firms that undergo unsuccessful MBOs are eventually acquired by other bidders. This may affect stockholders' returns around MBO cancellations as well in anticipation of a larger subsequent bid. Therefore, we also control for whether the firm is subsequently acquired or not.

Sample

The sample includes 43 management buyouts that were announced but never consummated between 1984 and 1999. Table 1 summarizes the year distribution of the sample. Most of the observations (67.4 percent) come from the latter half of the 1980s when a wave of corporate restructuring swept through corporate America. Our sample also includes failed MBOs in the 1990s when restructuring activities somewhat subsided. None of the prior research on failed MBOs includes observations as current as the late 1990s. Although the number of MBOs was falling in the 1990s, in recent years it has accelerated rapidly again (Mergerstat Review), renewing interest in this form of corporate restructuring.

The original sample came from the Security Data Corporation Database (SDC). For each observation to be included in the final sample, it has to satisfy two conditions.

- The MBO has to be for the entire firm. Unit management buyouts where only a part of the entire company is taken private are not included in the sample.
- There must be an indication in the MBO announcement or elsewhere that management is involved in the transaction. Cases where firms are taken private but management involvement is questionable are not included. Conflicts of interest are likely to occur in cases where management is involved in the transaction. That is why we impose this restriction on the sample.

Table1—Year Distribution

Year	Frequency	Percent
1984	2	4.65
1985	6	13.95
1986	8	18.6
1987	3	6.98
1988	5	11.63
1989	5	11.63
1990	1	2.33
1992	1	2.33
1993	1	2.33
1994	2	4.65
1995	2	4.65
1996	2	4.65
1997	2	4.65
1998	1	2.33
1999	2	4.65
Total	43	100.00

MBO announcements that may suffer from potential confounding events are not included. Board composition is obtained from each firm's proxy statement on the year prior to the MBO attempt. Directors are classified into three categories as in Baysinger and Butler (1985): inside, independent or outside and affiliated directors.

Methodology

A standard event study methodology (Fama, Fisher, Jensen, and Roll, 1969) is utilized to determine the stock market reactions to MBO withdrawals. We use the market model and we estimate the parameters for it over days -720 to -520 before the cancellation announcement. We set the estimation period so far back in order to avoid the potential confounding effect due to the original announcement of the going-private transaction. Statistical tests used to measure abnormal performance are similar to those in Dodd and Warner (1983). A cross-sectional analysis is conducted to determine the effects of board composition and ownership characteristics on shareholder wealth. The framework for the cross-sectional regression analysis can be expressed as

$$CAR(-1, 0) = f(\text{board composition, ownership characteristics, firm characteristics, corporate control variables})$$

The dependent variable is the two-day cumulative abnormal returns around MBO withdrawals. The independent variables are discussed below.

Corporate Governance Variables¹

Proportion of Inside Directors: Inside directors are managers that are on the board of directors. In an MBO, inside directors are exposed to conflicts of interests as they have a fiduciary duty to shareholders and they are also involved in the transaction as purchasers. The presence of managers on both sides of the transaction creates a complex situation where agency problems are likely to occur. Due to this complex situation, how the proportion of insiders on the board affects the valuation effects around MBO withdrawals is an empirical question. This variable is computed as the number of insiders on the board divided by the total number of board members. As shown in Table 2, on average, 34.37 percent of the directors are inside directors. This proportion is similar to the proportion of inside directors documented by Lee, Rosenstein, Rangan, and Davidson (1992).

Table 2—Summary Statistics for the Independent Variables

All of the corporate governance variables are in percentage except the number of board meetings. Total assets are in millions. The debt ratio is defined as long-term debt divided by total assets

Variable	Mean	Median	Std Dev
Corporate Governance			
Proportion of Independent Boards (Outsiders>50%)	47.73		
Percent of Inside Directors	34.37	30.00	17.42
Percent of Outside Directors	50.23	50.00	19.34
Percent of Shares Owned by Inside Directors	17.01	9.16	19.95
Percent of Shares Owned by Outside Directors	2.07	0.38	4.91
Percent of Shares owned by Unaffiliated Blockholders	16.56	6.71	27.94
Number of Meetings	6.34	6.00	2.62
Firm Characteristics			
Total Assets	788.14	204.00	1,599.19
Debt Ratio	26.33	23.14	0.20
Corporate Control Variables*			
Pre-MBO Alternative Bids	23.00	-	-
Successful Subsequent Takeover	16.00	-	-

*These two corporate control variables are dichotomous variables that are equal to one if there is a pre-MBO alternative bid or a successful subsequent takeover and zero otherwise. Hence, the mean for the first variable is simply the percentage of firms that received pre-MBO alternative bids. Likewise, the mean for the second variable is just the percentage of firms that are subsequently taken over

Proportion of Independent Outside Directors: There is a great deal of empirical evidence that indicates that the presence of outside independent directors on the

¹Recently, several studies that examine board composition have treated board variables as endogenous (Agrawal and Knoeber, 1996 and Hermalin and Weisbach, 1998, among others). The majority of these studies look at the relationship between firm performance and board composition. In these studies, it is not entirely clear what the direction of causality is. Therefore, board variables are treated as endogenous. In our study, however, we examine the relationship between the stock market reactions and board composition. There is no particular reason to assume endogeneity.

board benefits shareholders (Lederman and Bryer, 1989; Byrd and Hickman, 1992; Cotter, Shivdasani, and Zenner, 1997; Brickley, Coles, and Terry, 1994; Brickley and James, 1987; Shivdasani, 1991; Weisbach, 1988; Hermalin and Weisbach, 1988; Rosenstein and Wyatt, 1990; Kosnik, 1990; Cochran, Wood, and Jones, 1985; and Singh and Harianto, 1989). In accordance with the empirical evidence, it is hypothesized that firms with more outside independent directors on the board experience more positive (less negative) stock market reactions around MBO cancellations. This variable is calculated as the number of independent directors divided by the total number of directors on the board. The sign of this variable is expected to be positive. As shown in Table 2, on average, 50.23 percent of the directors are independent outside directors.

Proportion of Equity Ownership Held by Inside Directors: A large proportion of ownership held by inside directors should help align their interests with those of shareholders. Therefore, the variable is expected to have a positive effect on the abnormal returns around MBO cancellations. This variable is calculated as the number of shares owned by inside directors divided by the number of total shares outstanding. As shown in Table 2, the inside directors in the sample, on average, hold 17.01 percent of equity ownership. Examining takeover and non-takeover targets, Shivdasani (1993) finds that the percentage of ownership held by the inside directors in his control group of non-takeover targets is only 1.77 percent. His non-takeover control group includes firms that have not experienced tender offers, leveraged buy-outs, or proxy fights. So, it appears that the inside directors of firms that attempt to go private hold substantially larger portions of equity ownership, a finding consistent with Maupin and Label (1987).

Equity Ownership Held by Independent Outside Directors: As reported by Byrd and Hickman (1992), outsiders who hold more ownership of the firm should have stronger incentives to monitor managers and protect shareholder interests. Hence, it is predicted that a larger percentage of equity ownership held by outside directors contributes positively to the abnormal returns. This variable is computed as the number of shares owned by independent directors divided by the number of total shares outstanding. As shown in Table 2, the independent outside directors, on average, hold 2.07 percent of equity ownership.

Equity Ownership Held by Outside (unaffiliated) Blockholders: Shleifer and Vishny (1986) report that equity ownership held by unaffiliated blockholders, who have more incentives to monitor management, helps overcome the free-rider problem in takeover bids. Similarly, blockholders should play a monitoring role in MBOs, where there exists an inherent conflict of interest. As a result, it is hypothesized that larger equity ownership held by unaffiliated blockholders positively contributes to the abnormal returns. The sign of this variable is expected to be positive. This variable is represented by the number of shares owned by unaffiliated blockholders divided by the number of total shares outstanding. As shown in Table 2, on average,

the unaffiliated blockholders hold 16.56 percent of equity ownership, a percentage comparable to the proportion of ownership held by blockholders in Shivdasani's (1993) control group of non-takeover targets.

Number of Board Meetings: The number of annual board meetings is a proxy for how active the board is before the MBO. It could be argued that more active boards are more likely to act in shareholder interests (Vafas, 1999). *Ceteris paribus*, firms with more active boards should experience higher abnormal returns. The sign of this variable is expected to be positive.

Firm Characteristic Variables

Size: The logarithm of total assets is used as a proxy for size.

Debt Ratio: As in Travlos and Cornett (1993), Torabzadeh and Bertin (1992), and Singh (1990), we control for the degree of leverage. This ratio is computed as long-term debt divided by total assets.²

Corporate Control Variables

In addition to the variables mentioned above, two corporate control variables are included as well.

Pre-MBO Alternative Bidders: This dichotomous dummy variable is equal to one if there are alternative bidders to the MBO before the MBO announcement and zero otherwise. This variable is constructed as a result of searching many news publications on Lexis-Nexis in the period one year prior to the announcement. In several cases, a number of other bidders try to acquire the target company before the MBO. Perhaps, a MBO that is announced and subsequently withdrawn is used strategically as a takeover defense mechanism. Once the firm announces a MBO, it is less likely to receive more takeover bids. To explore this possible strategic maneuver, this variable is included in the analysis. As shown in Table 2, 23 percent of firms in the sample received alternative bids before the MBO announcement.

Successful Subsequent Takeover: There are cases in which the firm is taken over after a thwarted attempt to go private. This dummy variable is set to one if the company is eventually taken over. Many news publications on Lexis-Nexis are examined in the period one year after the withdrawal announcement to determine if each firm with a thwarted MBO is eventually acquired. As shown in Table 2, 16 percent of the firms are eventually acquired after their attempts to go private failed.

²An alternative debt ratio, which includes current liabilities, was used and produced similar results but with a lower degree of significance. Because MBOs are typically financed by long-term debt, the long-term debt ratio is believed to be more relevant.

Empirical Results

Table 3 presents the stock market reactions to the withdrawal announcement. The stock market responds negatively when an MBO that was announced earlier is cancelled. The two-day cumulative abnormal return over the day before and the day of the announcement is -2.41 percent and statistically significant at the 1 percent level, suggesting that shareholders, on average, lose 2.41 percent of their wealth over the two-day period. The evidence shows that canceling an MBO is viewed as detrimental to shareholders. This evidence is consistent with DeAngelo, DeAngelo, and Rice (1984). Using a sample of 18 withdrawn MBOs from 1973 to 1980, DeAngelo, DeAngelo, and Rice (1984) document adverse stock market reactions to the withdrawal announcement. Lee (1992) and Marais, Schipper, and Smith (1989) also report similar negative reactions for their samples of MBO withdrawals. Our study uses a more recent sample and produces similar results.

Table 3—Stock Market Reactions to the Withdrawal Announcement

Days	Cumulative Average Abnormal Return	Median Cumulative Abnormal Return	t-statistic s	Z-statistics
(-10,+6)	-0.68%	-0.58%	-0.33	0.45
(-2,+2)	-2.62%	-0.98%	-2.37***	0.12
(-1,+1)	-2.46%	-0.84%	-2.87***	0.12
(-1,0)	-2.41%	-0.55%	-3.45***	-0.84
(0,+1)	-2.35%	-1.06%	-3.36***	-0.2
(-5,+5)	-1.44%	-2.89%	-0.88	0.12
(+6,+10)	-1.41%	-0.70%	-1.28	-1.16

* Statistically significant at the 10 percent level

** Statistically significant at the 5 percent level

*** Statistically significant at the 1 percent level

Table 4 displays the results of the cross-sectional regression analysis. The dependent variable is the two-day cumulative abnormal returns, CAR (-1,0). In model 1, all the independent variables are included. Surprisingly, neither the percentage of insider directors nor that of outside independent directors is statistically significant, although their coefficient signs are positive as expected. The percentage of shares owned by inside directors appears to contribute positively to shareholders' wealth around the withdrawal announcement, as the coefficient of this variable is positive and statistically significant at the 5 percent level. The evidence suggests that when inside directors hold larger portions of equity ownership, their interests and those of shareholders are more aligned. The results are consistent with Lee, Rosenstein, Rangan, and Davidson (1992), who find that higher share ownership by inside directors is positively related to the abnormal returns associated with the initial MBO announcement. There is no evidence that blockholders' ownership impacts shareholders' wealth, as the coefficient for the blockholder ownership variable is not statistically significant (although it is positive as expected).

Table 4—Multivariate Regression Analysis

The dependent variable is the two-day cumulative abnormal returns between the day before and the day of the withdrawal announcement, CAR (-1,0)

Variable	Model 1	t-statistic s (p-value)	Model 2	t-statistic s (p-value)
Intercept	-0.498	-3.63*** (0.00)	-0.483	-5.29*** (0.00)
Corporate Governance				
Independent Board (Outsiders>50%)			0.067	1.89* (0.08)
Percent of Inside Directors	0.000	0.45 (0.68)		
Percent of Outside Directors	0.001	0.85 (0.41)		
Percent of Shares Owned by Inside Directors	0.003	2.63** (0.02)	0.004	4.31*** (0.00)
Percent of Shares Owned by Outside Directors	0.005	0.99	0.003	0.61 (0.54)
Percent of Shares Owned by Unaffiliated Blockholders	0.001	1.09 (0.30)	0.001	1.03 (0.32)
Number of Board Meetings	0.010	1.40 (0.19)	0.011	1.81* (0.09)
Firm Characteristics				
log (Total Assets)	0.13	3.61*** (0.00)	0.150	4.78*** (0.00)
Debt Ratio	-0.12	-1.16 (0.27)	-0.161	-1.81* (0.09)
Corporate Control Variables				
Pre-MBO Alternative Bids	-0.100	-1.96* (0.07)	-0.108	-2.69** (0.02)
Successful Subsequent Takeover	-0.030	-0.43 (0.68)	0.064	-1.00 (0.34)
Adjusted R ²		0.32		0.47
F-statistics		2.01		3.20**

We replace CAR (-1, 0) with CAR (-1, 1) and obtain qualitatively similar results. We also run two alternative regressions where only the percentage of inside directors and the percentage of outside directors are included at a time. The results remain qualitatively similar

* Statistically significant at the 10 percent level

** Statistically significant at the 5 percent level

*** Statistically significant at the 1 percent level

In the regression we control for firm size. Size as proxied by total assets appears to affect shareholders' wealth around the MBO withdrawal for the estimated coefficient of the size variable is positive and statistically significant at the 1 percent level. The evidence suggests that larger firms suffer less adverse market reactions when the MBO is withdrawn. There are a number of possible reasons for the sign of the size

variable's estimated coefficient. The market may have more information for large firms and thus the withdrawal announcement may be less of a surprise. The market may, alternately, assume that large firms are less likely to go private and the cancellation would, therefore, be less of a surprise. Finally, there may be some sort of small firm effect causing greater market reactions for the smaller firms.

As far as the corporate control variables, there is evidence that firms that received alternative bids prior to the MBO experience more adverse market reactions when the MBO turns out to be unsuccessful. This makes sense as the firm could have been taken over by another bidder had it not been for the MBO that turns out to be unsuccessful. The more severe negative stock market reactions probably reflect the opportunity cost of rejecting the offer by another bidder. The subsequent successful takeover variable is not statistically significant at the conventional levels, suggesting that whether the firm is eventually acquired or not does not affect stockholders' returns around the MBO withdrawal.

In model 2, an additional independent variable is created that takes the value of 1 if the board of directors is dominated by outsiders and 0 otherwise. Although the percentages of inside and outside independent directors do not appear to affect shareholder's wealth as implied in model 1, it is conceivable that outside directors do not contribute to shareholder's wealth unless they constitute a majority on the board. To explore this possibility, in model 2, the percentages of inside and outside directors are replaced by the independent board variable. A board of directors is classified as independent when the outside independent directors constitute more than a half of the directors on the board. The independent board variable does produce a positive and statistically significant coefficient at the 10 percent level. The results imply that firms that withdraw from the previously announced MBO suffer less adverse market reactions when they have independent boards of directors.

In model 2, the coefficient of the percentage of shares owned by inside directors remains positive and significant (at 1 percent), confirming the results in model 1. The number of board meetings, which is not significant in model 1, turns significant in model 2. Because the coefficient for board meetings is positive, the evidence suggests that firms where the board of directors meets more often (implying more active boards) experience less negative market reactions. Consistent with Vafaes (1999), more active boards appear to enhance shareholders' wealth.

The size variable also remains positive and significant (at 1 percent). The estimated coefficient for the debt ratio, which is not significant in model 1, turns significant in model 2 and has a negative sign. This evidence suggests that a higher debt ratio before going private exacerbates the negative market response when the MBO is cancelled. We have included this variable only as a control because many MBOs are financed with debt. We would have expected a positive sign because debtholders can serve a monitoring function. The negative sign is a puzzle that we cannot explain. The pre-MBO alternative bids variable remains negative and signifi-

cant, reinforcing the results in model 1. The results on the number of board meetings and the debt ratio in model 2 should be interpreted with caution, as the results seem to be influenced by model specification.

Due to the nature of the more active corporate control market in the 1980s, a time dummy variable is created that differentiates between the MBOs in the 1980s and those in the 1990s to determine if the withdrawal effect differs across the two decades. In an alternative model (results not shown), this variable is included in the regression but produces an insignificant coefficient, suggesting that the market reactions do not differ significantly across the two decades. This time dummy variable is also combined with a number of other independent variables to create interaction terms, none of which turn out statistically significant (results omitted).

Taken together, the results indicate that the proportion of inside and outside directors on the board does not affect shareholders' wealth. Only in cases where the board is dominated by outsiders is there evidence that the adverse market reactions are mitigated. As far as ownership characteristics, higher ownership held by inside directors seems to reduce the negative impact of the withdrawal. The dynamics in the corporate control market surrounding the unsuccessful MBOs also help explain the stock market reactions. Firms that could have been taken over by another bidder but were not due to the unsuccessful MBO suffer more severe adverse market reactions.

Conclusion

In addition to confirming the negative market reaction associated with MBO withdrawals documented in prior research (DeAngelo, DeAngelo, and Rice, 1984 and Lee, 1992) and using a more recent sample, this study makes two contributions to the finance literature. First, we demonstrate that, consistent with the predictions of agency theory, firms where inside directors hold larger portions of equity and where boards of directors are dominated by independent directors suffer less adverse market reactions to the MBO withdrawal. The second contribution of this study to the literature is on the role of the market for corporate control in determining stockholders' wealth around the MBO withdrawal. We document that firms that could have taken an alternative offer but decided in favor of the MBO instead experience more severe stock market reactions when the MBO is withdrawn. Therefore, this study contributes to the literature not only on agency theory but also on corporate restructuring. Given the rapidly increasing interest in corporate governance introduced by the Enron and WorldCom debacles and by the debate surrounding the Sarbanes-Oxley Act, the results of this study aptly contribute to the on-going discussion on corporate governance.

Due to the decline in the junk bond market, the market for MBOs subsided in the mid-1990s. Mergerstat Review (2002) reports that the number of MBOs has recently increased from only ten transactions in 1995 to 77 in 2001, indicating that the market for MBOs has become more active in recent years. For this reason, the

finance literature should continue to explore MBOs, as they remain a relevant form of corporate restructuring in the U.S.

Not all firms that intend to go private do so successfully. This study examines the effects on shareholders' wealth of management buyouts that were withdrawn after previous announcement. The evidence demonstrates that there is a decline in shareholders' wealth, as evidenced by the negative stock market reactions to the withdrawal announcement. The overall results are in agreement with the empirical evidence documented earlier by DeAngelo, DeAngelo, and Rice (1984), Lee (1992) and Marais, Schipper, and Smith (1989).

We extend this literature by examining governance factors that influence how the market reacts to the withdrawal announcements. The empirical evidence suggests that firms where boards of directors are dominated by independent directors experience less severe adverse market reactions when the MBO is withdrawn.

In management buyouts, agency problems are likely acute as management is present on both sides of the transaction. Consistent with the predictions of the agency theory, this study shows that when management holds higher ratios of equity ownership, the withdrawal announcement period abnormal returns are less negative, implying that higher proportions of ownership help align management's and shareholders' interests. Lee, Rosenstein, Rangan, and Davidson (1992) document similar findings in their study of shareholders' wealth around the initial MBO announcement.

Finally, the status of the firm in the corporate control market is also found to explain stockholders' wealth around the MBO withdrawal. Specifically, firms that could have taken an alternative offer before the MBO, which subsequently fails, suffer more severe negative market reactions. We interpret the more adverse effect as reflecting the opportunity cost of not taking the alternative offer presented before the unsuccessful MBO.

References

1. Agrawal, Anup, and Charles R. Knoeber, "Firm Performance and Mechanisms to Control Agency Problems between Managers and Shareholders," *Journal of Financial and Quantitative Analysis*, 31 (1996), pp. 377-398.
2. Baysinger, B.D., and H.N. Butler "Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition," *Journal of Law, Economics, and Organization*, 1 (1985), pp. 101-124.
3. Bradley, Michael, "Interfirm Tender Offers and the Market for Corporate Control," *Journal of Business*, 53 (1980), pp. 345-376.
4. Brickley, James, and C.M. James, "The Takeover Market, Corporate Board Composition, and Ownership Structure: The Case of Banking," *Journal of Law and Economics*, April (1987), pp. 161-180.
5. Brickley, James, Jeffrey Coles, and Rory Terry, "Outside Directors and the Adoption of Poison Pills," *Journal of Financial Economics*, 35 (1994), pp. 371-390.
6. Brigham, Eugene, and Joel Houston, *Fundamental of Financial Management* (Mason, Ohio: Harcourt Inc., 2000)

7. Byrd, J., and K. Hickman, "Do Outside Directors Monitor Managers? Evidence from Tender Offer Bids," *Journal of Financial Economics*, 32 (1992), pp. 195-222.
8. Cochran, P.L., R.A. Wood, and T.B. Jones, "The Composition of Boards of Directors and Incidence of Golden Parachutes," *Academy of Management Journal* (September 1985), pp. 664-671.
9. Cotter, James, Anil Shivdasani, and Marc Zenner, "Do Independent Directors Enhance Target Shareholder Wealth During Tender Offers?" *Journal of Financial Economics*, 43 (1997), pp. 195-218.
10. DeAngelo, Harry, Linda DeAngelo, and Edward Rice, "Going Private: Minority Freezeouts and Stockholder Wealth," *Journal of Law and Economics*, 27 (1987), pp. 367-402.
11. Dodd, Peter, "Merger Proposals, Management Discretion and Stockholder Wealth," *Journal of Financial Economics*, 8 (1980), pp. 105-138.
12. Dodd, Peter, and Richard Ruback, "Tender Offers and Stockholder Returns: An Empirical Analysis," *Journal of Financial Economics*, 5 (1977), pp. 351-373.
13. Fama, E., Fisher, L., Jensen, M. and Roll, R., "The Adjustment of Stock Prices to New Information," *International Economic Review* 10 (1969), pp. 1-21.
14. Hermalin, Benjamin, and Michael Weisbach, "The Determinants of Board Composition," *Rand Journal of Economics*, 19 (1988), pp. 589-606.
15. Hermalin, Benjamin, and Michael Weisbach, "Endogenously Chosen Boards of Directors and their Monitoring of the CEO," *American Economic Review*, 88 (1998), pp. 96-119.
16. Jensen, Michael, "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers," *American Economic Review*, 76 (1986), pp. 323-339.
17. Kaplan, Steven, "Management Buyouts: Evidence of Taxes as a Source of Value," *Journal of Finance*, 44 (1989), pp. 611-632.
18. Kosnik, R.H., "Effects of Board Demography and Directors' Incentives on Corporate Greenmail Decisions," *Academy of Management Journal* (March 1990), pp. 129-150.
19. Lederman, L., and B.A. Bryer, "Representing a Public Company in a Leveraged Buyout Transaction," in *Leverage Management Buyouts: Causes and Consequences* (Homewood, IL: Dow Jones-Irwin, 1989)
20. Lee, Chun I., Stuart Rosenstein, Nanda Rangan, and Wallace N. Davidson III, "Board Composition and Shareholder Wealth: The Case of Management Buyouts," *Financial Management*, 21 (1992), pp. 58-72.
21. Lee, Scott, "Management Buyout Proposals and Insider Information," *Journal of Finance*, 47 (1992), pp. 1061-1079.
22. Lehn, Kenneth, and Annette Poulsen, "Free Cash Flow and Stockholder Gains in Going Private Transactions," *Journal of Finance*, 44 (1989), pp. 771-788.
23. Lehn, Kenneth, Jeffrey Netter, and Annette Poulsen, "Consolidating Corporate Control," *Journal of Financial Economics*, 27 (1990), pp. 557-580.
24. Madden, Gerald, Lynn Marples, and Lal Chugh, "A Stock Market Evaluation of Management Buyouts," *Journal of Business, Finance and Accounting*, 17 (1990), pp. 351-358.
25. Marais, Laurentius, Katherine Schipper, and Abbie Smith, "Wealth Effects of Going Private for Senior Securities," *Journal of Financial Economics*, 23 (1989), pp. 155-191.
26. Maupin, R.J., "Financial and Stock Market Variables as Predictors of Management Buyouts," *Strategic Management Journal* (March-April 1987), pp. 39-57.
27. Maupin, Rebekah J. and Wayne A. Label, "Profiting from a Management Buyout," *Management Accounting*, 68 (1987), pp. 32-34.

28. *MergerStat Review*, MergerStat Global Mergers & Acquisition Information (Los Angeles, CA., 2000).
29. Opler, Tim, and Sheridan Titman, "The Determinants of Leverage Buyout Activity: Free Cash Flow Versus Financial Distress Costs," *Journal of Finance*, 48 (1993), pp. 1985-1999.
30. Peck, Sarah, "The Influence of Professional Investors on the Failure of Management Buyout Attempts," *Journal of Financial Economics*, 40 (1996), pp. 267-294.
31. Rosenstein, Stuart and Jeffrey Wyatt, "Outside Directors, Board Independence and Shareholder Wealth," *Journal of Financial Economics*, 26 (1990), pp. 175-192.
32. Shivdasani, Anil, "Board Composition, Ownership Structure, and Hostile Takeovers," *Journal of Accounting & Economics*, 16 (1993), pp. 167-198.
33. Shleifer, Andrei and Robert Vishny, "Large Shareholders and Corporate Control," *Journal of Political Economy*, 94 (1986), pp. 461-488.
34. Singh, Harbir, "Management Buyouts: Distinguishing Characteristics and Operating Changes Prior to Public Offering," *Academy of Management Journal*, 11 (1990), pp. 111-129.
35. Singh, H. and F. Harianto, "Management-Board Relationships, Takeover Risk, and the Adoption of Golden Parachutes," *Academy of Management Journal*, (March 1989), pp. 7-24.
36. Torabzadeh, Khalil, and William Bertin, "Abnormal Returns to Stockholders of Firms Acquired in Business Combinations and Leverage Buyouts," *Journal of Accounting, Auditing, and Finance*, 7 (1992), pp. 231-239.
37. Travlos, Nickholaos and Marcia Million Cornett, "Going Private Buyouts and Determinants of Shareholders' Returns," *Journal of Accounting, Auditing, and Finance*, 8 (1993), pp. 1-25.
38. Vafaes, N., "Board Meeting Frequency and Firm Performance," *Journal of Financial Economics*, 53 (1999), pp. 113-142.
39. Weisbach, Michael, "Outside Directors and CEO Turnover," *Journal of Financial Economics*, 20 (1988), pp. 431-460.

Copyright of Quarterly Journal of Business & Economics is the property of College of Business Administration/Nebraska and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.