The motives for takeover bid targets:
"A Study in the Egyptian Context"

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Abstract

This study analyses the characteristics of companies subject to takeover bids in the Egyptian context. The main objective of this paper is to examine the suitability of methodologies that the literature proposes to predict the acquisition targets, in order to explain the motives for takeover bids in Egypt. So, the study, uses a sample of 20 non- financial firms that were subject to takeover bids in Egyptian Stock Exchange during the period 2010-2015, compared with a further 20 firms, selected on an industrial and time basis, that were not taken over. The paper found that firms subject to takeover bid were characterized by having lower profitability than other firms operating in the same sector. However, no difference was found in terms of market valuation and this circumstance not allow to argue that Egyptian takeover have been driven by disciplinary motives. Even imbalance, size and ownership concentration were not significant variables in the distinction between firms that were taken over and firms that were not.

1. Introduction

Literature on merger and acquisition has been paid great attention to the characteristics of companies that are potentially takeover targets. During the last three decades, a number of empirical studies, most of them financial in nature, have attempted to identify those characteristics that distinguish takeover targets from other firms.

Within these studies it is possible to distinguish three subgroups. The first subgroup tries to determine whether targets have any distinguishing features (Ambrose and Megginson 1992)(Powell 1997). The second subgroup analyses characteristics of targets in order to develop takeover probability models to provide the basis for an investment strategy (Palepu 1986, Barnes 1999, Barnes 2000).The third subgroup examines characteristics of targets in order to test whether the Market for Corporate Control (MCC) hypothesis applies or not (Barnes 2000).

The majority of the available evidence on the characteristics of takeover targets refers to the corporate control markets of the USA and the United Kingdom. With respect to the case of the USA, reference can be made to the works of Hasbrouck(Hasbrouck 1985, Palepu 1986, Ambrose and Megginson 1992, Berger and Ofek 1996) whilst the characteristics of target firms in the United Kingdom have been analyzed, among the others, by(Kennedy and Limmack 1996) (Powell 1997)and(Barnes 1999) . Empirical evidence related to no-Anglo-Saxon countries is limited but some studies examined the characteristics of target firms in Spain (Alcalde and Espitia 2003, Tsagkanos, Georgopoulos et al. 2006).

However, regarding to the Egyptian case there is a lack of analysis and, therefore the specific purposes of this paper are divided to two purposes. The first purpose is to provide additional empirical evidence by examining the characteristics of non-financial companies' subjects to takeover bids that have been targets under The Egyptian regulation. The second purpose of the paper is to investigate whether the methodologies that the literature proposes to predict the acquisition targets are strong, in order to explain the motives for takeover bids in Egypt.

2. Institutional background

there are many studies related to takeover bids, for example, In Italy takeover bids have been subject to increasing regulatory interest, since they are considered tools of corporate governance to favour control transfers and minority shareholders protection(Macchiati and Siciliano 1999).

According to the actual rules, who intends to make a takeover bid has to give advance notice thereof to the public authority responsible for regulating the Egyptian securities market through a communication. Notifications of offers to the Egyptian Financial Regulatory Authority have to be accompanied by a copy of the offer document that contains all the information necessary for shareholders to make an assessment of the takeover bid. The offer document has to disclose three elements defined essential such as the quantity of subject financial instruments, the price offered per instrument, the starting date and closing date of the offer.

Within 15 days of notification, Egyptian Financial Regulatory Authority may require bidder to include supplementary information in the offer document and establish special guarantees to be provided. The offer document, supplemented in accordance with any integration demanded by the public authority responsible for regulating the Egyptian securities market, has to be sent to the issuer without delay and disseminated by means of integral publication in newspapers with adequate circulation or by equivalent means.

Egyptian law considers four types of takeover bids as follows.

1) *Full takeover bid*. Any party which, as a result of acquisitions, comes into possession of a shareholding exceeding the 30% threshold has to implement a takeover bid addressed to all holders for the full quota of securities in their possession and admitted to trading on a regulated market. The offer has to be made within 30 days at the highest price granted in the last 12 months by the offer or for the purchase securities of the same category.

2) *Pre-emptive full takeover bid*. Any party, who intends to acquire the control of a listed company, or to acquire over 30% of voting rights, has to launch a pre- emptive tender offer on the entire voting capital.

3) *Partial-acquisitions takeover bid*: the obligation to make a full takeover bid do not have to arise when the shareholding is owned as a result of a public offer to buy or exchange at least 60% of the ordinary shares.

4) *Residual takeover bid*: if as a result of a full takeover bid, the bidder becomes holder of at least ninety-five per cent of the capital represented by securities, squeeze-out of the remaining securities has to be mandatory should any other party so request.

Furthermore, any party becomes holder of a quota exceeding ninety per cent of capital represented by securities admitted to trading on a regulated market has to mandatorily squeeze-out the remaining securities admitted to trading on a regulated market by any holder thereof unless a float sufficient to ensure regular trading performance is not restored within ninety days.

3. Theoretical background and hypotheses development

Following priors researches (Palepu 1986)(Powell, 1997)(Scherer 1988, Alcalde and Espitia 2003), the paper formulate hypotheses referring to the main theories developed in order to explain takeover motives (Market for Corporate Control Theory, search for under-valued assets, growth-resource mismatch, transaction costs).

The Market for corporate control theory (MCC) was introduced by Manne (Manne 1996). According to this theory, special market exists in which control of corporations is exchanged. Such control is considered as an independent valuable asset and many mergers or acquisitions are probably the effect of the successful workings of this market.

The MCC suggests that when a company is managed in an inefficient way, there will be someone that will take control of the company and replace the old management. Thus, the market for corporate control has the fundamental role of disciplining inefficient boards and thereby improving the operational

effectiveness of the acquired enterprise. Many papers have suggested that disciplinary motives are important motors for takeover(Jensen 1993, Barnes 2000).The disciplinary role of MCC is closely related to agency theory (Jensen 1993).

In large listed companies with widespread share ownership and inefficient internal control systems, opportunistic managers may pursue their own objectives rather than in shareholder's best interests(Shivdasani 1993, Song and Walkling 1993). In the context of a separation of management and ownership, managers aim to achieve their own goals, in an attempt to benefit from increased prestige or salaries. These strategies of self-interested managers may lead to excessive diversification, unjustified expansion of the business, short term investments(Shleifer and Vishny 1988), and low market valuation (i.e.: low market to book ratios).

A number of studies, such as those of Palepu, (1986), Song and Walking (1993), Powell (1997) and Barnes (1999), have used different accounting measures of profitability to test this theory. The paper uses return on equity (ROE) of the firm as an indicator of the managerial efficiency in order to develop the first hypothesis:

H1: *the lower firms' return on equity, the higher probability of being subject to a takeover bid than firms belong to the same sector*

One of the main motivations for the merger and acquisition of firms is the search for assets that are undervalued by the market(Barnes 2000, Potito 2016). While (Hasbrouck 1985) points out that firms wishing to expand via takeover would compare the costs of new investment and the cost of acquiring assets already in place and they would consider the acquisition of an undervalued firm as an interesting option from a financial point of view. However, it is possible that the acquirer firm could simply be to take advantage of market bargains, in order to subsequently resell the assets at a higher price.

There are many works found that the valuation ratio has no significant effect on the probability that a firm will be the subject to a takeover bid (Palepu 1986, Barnes 1999).

The under-valuation could be due to two main reasons. Mainly, it might be related to the previous hypothesis (managerial inefficiency). When managers do not perform, the enterprise is not appreciated by the market. The second reason, the capital market systematically undervalues certain firms according to (Scherer 1988).

In both cases the under-valuation hypothesis indicates that firms whose market value is lower than their real value will become takeover targets, given that the price demanded by the market for their control is lower than their true value. In addition to a lower ROE, the study expects that the under-valuation may be also measured by a valuation ratio lower than that of other firms in the sector. Typically, these variables are used as proxies of management inefficiency. The second hypothesis can be developed as follows:

H2: *The lower firms' valuation ratio, the higher probability of being subject to a takeover bid than firms operating in the same sector.*

Another reason behind the takeover of a firm is the bidder's intention to take advantage of an imbalance between the expectations of growth and the amount of available resources within the target firm. Thus, firms with a mismatch between their growth and the financial resources at their disposal are likely targets. (Palepu 1986) points out two dimensions of such an imbalance: low-growth, resource-rich firms and high-growth, resource-poor firms.

(Jensen 1986) summaries an agency cost of free cash flow theory of takeover between shareholders and management. Free cash flow is the cash flow in excess of that required to fund all projects that have positive net present value when discounted at the relevant cost of capital. He explained that managers have incentives to cause their firms to grow, even if it means investing in negative net present value project. Firms whose free cash flow is high will tend to waste the money rather than repay it to shareholders. Such free cash flow should ideally be

paid out to shareholders if the firms is to be efficient and to maximize value for shareholders. Retaining excess cash flow internally reduces the ongoing need for firms to raise finance in the capital markets. Financing projects from retained funds avoids the monitoring by the capital market when additional funds are needed. The theory predicts that firms with resources that are in excess of that required to fund their investment projects with a positive net present value are the most likely targets.

Other studies belong to the financial literature such as (Myers and Majluf 1984) analyze investment and financing decisions under the hypothesis of asymmetric information. They find that firms with a mismatch in the opposite direction (many growth opportunities associated with limited available resources), also have a higher likelihood of being acquired.

This mismatch involves financial characteristics of target firms such as growth, liquidity and leverage, and there is no possibility to predict a prior which imbalance will predominate.

This study tested the imbalance through the differences observed among the two sub-groups (target and non-target) using Price Earnings ratio as a proxy to measure the imbalance. Thus, hypothesis three can be developed as follows:

H3: *The greater the mismatch between firms' available resources and growth opportunities, the higher probability of being subject to a takeover bid.*

Previous studies such as Powell (1997)(Mikkelson and Partch 1989, Ambrose and Megginson 1992, Barnes 1999, Barnes 2000) found a relationship between the transaction costs and the size of the acquired company. The costs associated with the integration of the target into the acquirer's organization as well as the costs generated by a prolonged battle that a target may carry out to defend itself tend to increase with the target size.

Accordingly, the study expects that there is a negative influence to be exerted by size on the probability that the firm would be a takeover target. Another factor influencing the transaction costs is the ownership concentration. (Grossman and Hart 1980) point out that when a company is characterized by widespread ownership structure is necessary to offer a high premium for the shares to incentive the bid. This is due to the free rider problem, in consideration of which each shareholder, given the limited possession in the capital of the firm, considers that his decision (to accept or to refuse the offer) will not affect the result of the takeover, consequently the bidder is forced to offer an high price in order to incentive shareholders.

Theoretically, when the ownership structure is more concentrated the free-rider problem is alleviated, because shareholders consider their decision relevant to the outcome of takeover and the bidder has the possibility to negotiate in an individual way with each of the most important shareholders. So, hypothesis four can be developed as follows:

H4: *The firms with a smaller size and concentrated ownership structure have a higher probability of being subject to a takeover bid than companies operating in the same sector.*

4. Research Methodology

4.1. Selected firms

The sample uses in this study contains annual reports for non-financial 20 companies listed in Egyptian stock exchange and subject to takeover bid during the period 2010-2015. The financial information corresponding to the last accounting year end prior to the date of the announcement of the bid is retrieved by annual reports held by Egyptian Stock Exchange.

The selection of the sample that operates as the control group was made on an industrial and time basis. For each target firm, the paper selected a firm that had not been subject of a takeover bid during a period of four years before the date of announcement, that belong to the same sector, that was quoted on the Egyptian Stock Exchange in the year in which the bid was launched and whose annual accounts were also reflected in the above-mentioned database.

The composition of the sample by year and sector is presented in panels A and B of Table I. The sector classification issued by the Egyptian Stock Exchange has been adopted.

Tale I. Composition of examined firms

A – Temporal composition

Year	Target firms	Non-target firms
2011	6	6
2012	3	3
2013	6	6
2014	3	3
2015	2	2
Total	**20**	**20**

B – Sector composition

Sector	Target firms	Non-target firms
Food	1	1
Utility	6	6
Machinery	1	1
Electronic	2	2
Textiles	1	1
Logistic	1	1
Publishing	2	2
Transport/Tourism	2	2
Other services	4	4
Total	**20**	**20**

4.2. The variables

The construction of the variables referred to the last accounting year end prior to the date of announcement of the bid, retrieved by annual reports held by Egyptian Stock Exchange. With respect to the valuation ratio, the paper uses the last quote of the year immediately prior to that of the announcement of the bid.

The financial variable uses to test the hypothesis related to the transaction costs has been calculated as natural logarithm of total net assets as used by previous studies such as (Powell, 1997).

For each firm the paper selected the data on significant shareholdings that is provided on a six-monthly, corresponding to a date between six and twelve months prior to the date of the announcement of the bid. In this way, the paper has tried to avoid the situation whereby the data related to the ownership structure of the target firms could be affected by taking of prior positions on the part of the bidding firm during the period close to the launching of the bid.

For the construction of the dummy variable uses to test the hypothesis that those firms with an imbalance between growth opportunities and available resources have a higher probability of being a takeover target, the paper has used the price earnings ratio.

The independent variables used in the study, together with the form of calculation and the predictable sign in function of the hypothesis formulated in the previous Section, are showed in Table II.

Table II. Variables measurement and hypotheses expectations

Variables	Calculation	Hypotheses	Expected sign
Return on Equity (ROE)	Net Profit/Equity	Replacement of inefficient management	-
Valuation Ratio (VR)	(Capital market value + Book value of the debt) / (Book value of equity + Book value of the debt)	Replacement of inefficient management /Undervaluation	-
Imbalance	Price/Earning per share	Growth-resource imbalance	+
Size	Natural logarithm of total net assets	Cost of the transaction	-
Ownership concentration (OC)	% of capital in the ownership of the two most important shareholders	Cost of the transaction	+

4.3. Univariate Analysis

In this section the study is presented a univariate analysis. To that end table III contains the mean and the median values for each variable observed in the two sub-samples (target and non-target).

Observation of abnormal values suggests the use of trimmed mean. In contrast to the arithmetic mean, the trimmed mean is a robust measure of central tendency. For example, a small fraction of irregular measurements with abnormally large deviation from the center may change the mean value substantially. At the same time, the trimmed mean is stable in respect to presence of such abnormal extreme values, which get "trimmed" away.

The value of the T-statistic to test the existence of significant differences in estimated mean values between both types of firms appears in the last column of the table IV. T-test is used to verify if the null hypothesis likelihood is lesser or higher than 0.05.

Table III. Descriptive statistics

A – Target

Variables	Mean	Standard deviation	Max	Min
Net profit	-15.121.649	227.631.745	528.037.000	- 773.000.000
Equity	1.670.867.146	4.674.705.180	20.624.000.000	20.155.147
Number of shares	1.176.710.659	2.668.867.785	8.845.239.632	1.772.152
Capital market Value	3.327.856.378	8.159.762.970	35.557.863.321	19.801.500
Indebtedness	840.468.737	1.935.253.062	6.857.000.000	9.000
Total net assets	5.929.948.303	18.609.547.970	83.384.000.000	24.805.989
% of capital owned by the two most important shareholders	52,17%	18,96%	93,10%	20,30%
Price / Earning	27	126	458	- 193

B – Non-target

Variables	Mean	Standard deviation	Max	Min
Net profit	58.855.392	115.389.174	431.000.000	- 72.579.458
Equity	884.087.706	1.448.271.548	5.451.000.000	16.853.899
Number of shares	484.585.282	836.693.287	3.078.185.264	11.333.500
Capital market value	1.419.769.588	1.849.365.087	6.353.750.000	34.285.116
Indebtedness	635.476.871	1.111.696.392	3.530.000.000	-
Total net assets	2.244.732.051	3.568.663.142	13.094.000.000	32.194.108
% of capital owned by the two most important shareholders	51,75%	14,78%	72,50%	19,50%
Price / Earning	315	1.287	5.781	- 31

Table IV. T-test

Variables	Target		Non-target		T-test
	Mean*	Median	Mean*	Median	
ROE	-3,7%	0,8%	5,7%	8,0%	$p < 0.05$
Valuation ratio	2,1	1,4	1,8	1,50	$p > 0.05$
P/E	14,9	-2,7	27,1	17,97	$p > 0.05$
Size	19,9	19,1	20,3	20,30	$p > 0.05$
OC	51,7%	50,3%	51,7%	55,1%	$p > 0.05$

* Trimmed mean of 5%

As we can note from Table IV, there is only one variable for which the difference in mean is statistically significant. On average, the ROE is lower amongst target firms than amongst non-targets ones. The same relevance is not verified regarding to the second variable of managerial performance, that is to say valuation ratio.

Even imbalance, size and ownership concentration are not significant variables in the distinction between target and non-target firms.

4.4. Multivariate analysis

In this section the study completes a multivariate analysis to analyze the motives of takeover bids in Egypt. Following priors researches(Palepu 1986, Alcalde and Espitia 2003), the study uses a logistic model to specify the functional relationship between the characteristics of companies and the probability of being a target.

The logistic model represents a particular specification of the binary choice models: the dependent variable (Y_{it}) can only take two values (*1* or *0*). If the company has been subject to takeover bid, assign value *1* and *0* otherwise. Thus, the probability that the firm *z* is a takeover target in the period *t* can be expressed as:

$$\text{Prob}(Y=1) = \frac{\exp(B_0+B_1.ROE+B_2.VR+B_3.P/E+B_4.LnASS+B_5.OC)}{1+\exp(B_0+B_1.ROE+B_2.VR+B_3.P/E+B_4.LnASS+B_5.OC)} +e$$

where *Y* is equal to *1* if the firm belongs to the target sample, and *0* in the opposite case.

The quantitative variables have been transformed in dummy variables that are dichotomy in nature and assume *1* for values inferior to the trimmed mean of the sample and *0* in the contrary case.

The regression coefficient represents the net effect exercised by a single variable on the logarithm of the probability of being a target firm. The interpretation of the β parameter estimates has a multiplicative effect on the probabilities ratio (the probability divided by one minus the probability). The parameters are usually estimated by maximum probability. It is provided the stepwise method to select the most relevant explicative variables.

In the case of positive *β*, an increase in the related variable means an increase of the probability of being subject to takeover bid. Contrary, in case of a negative *β* an increase in the related variable means a decrease of the probability of being subject to takeover bid. The statistical significance is verified by the coefficient Wald. The results of the logistic model show in the Table V.

Table V. Results

Variables	Wald*	Exp(ß)	p-value
ROE	6,06	5,57	$p < 0.05$
Valuation Ratio	0,16	1,35	$p > 0.05$
P/E	0,001	0,98	$p > 0.05$
Ln Total net Assets	0,10	0,79	$p > 0.05$
OC	1,28	2,32	$p > 0.05$

* Indicates significance at a level of confidence of 95%.

The results indicate that only one variable (ROE) has a significant effect on the probability that a firm will be a takeover target. It seems to confirm the first hypothesis, related to the inefficiency of the management, according to firms which have a lower return of equity than firms belong to the same sector have a higher probability of being subject of a takeover bid.

On the other hand, the results show that other variables (VR, P/E, LnASS and OC) have a no significant effect on the probability that a firm will be a takeover target.

Although the study expects that the valuation ratio should be related to the inefficiency of the management, there is not any significance relation to the probability of being subject to takeover. Thus, it is not possible to confirm that in Egypt takeover bids are an effect of the inefficiency of management.

5. Conclusion

This paper has analyzed the characteristics of Egyptian firms that have been subject to takeover-bid. It has tested a sample of 20 non- financial firms listed in the Egyptian Stock Exchange that were target companies during the period 2010-2015.

The aim is to verify the suitability of methodologies that the literature proposes to predict the acquisition target and explain the motivations for takeover bids in Egypt. According to previous researches, a number of hypotheses have been formulated on the basis of the main theories used to explain takeover reasons.

The results of the analysis point out those disciplinary motives are not conclusively demonstrated in the Egyptian market. Even though ROE is the only significant variable to distinguish target and non-target, and there is a negative relationship between return on equity (ROE) and the probability that the firm would be subject to a takeover bid. Thus, the statistical results support the first hypothesis (H1) that the lower firms' return on equity (ROE), the higher probability of being subject to a takeover bid.

While the study shows that the valuation ratio (VR) is no significant variable with a negative relationship. The valuation ratio that is traditionally used as a proxy of managerial performance shows that target firms are not undervalued with respect to the non-target operating in the same sector.

So, the statistical results not support the second hypothesis (H2) that the lower valuation ratio (VR), the higher probability of being subject of a takeover

bid. This result related to the second hypothesis (H2) was supported by many studies such as (Palepu 1986, Barnes 1999, Barnes 2000).

Furthermore, valuation ratio presents a sign that is contrary to that which might be expected in the case of inefficient management of target firms. In order to confirm the market for corporate control theory and the role of replacement of inefficient management played by takeover activity, both ROE and Valuation ratio would be useful feature to distinguish the two sub-groups.

In respect to third hypothesis (H3), the study shows that the imbalance between growth and resources measured by price/earnings per share is no significant variable with a positive relationship.

So, the statistical results not support the third hypothesis (H3) that the greater the mismatch between available resources and growth opportunities, the higher probability of being subject of a takeover bid.

The statistical results related to the fourth hypothesis (H4) find that first, no significant variable with a negative relationship between size of firms and the probability of being subject to a takeover bid. Second, the same relationship but with a positive sign between ownership concentration (OC) and probability of being subject to a takeover bid

The previous results related to the fourth hypothesis (H4) was supported by many studies such as(Mikkelson and Partch 1989) (Ambrose and Megginson 1992, Barnes 1999, Barnes 2000).

Such a result is not surprising, given that the characteristics of the ownership structure and capital markets of firms in Egypt differ substantially from those of the USA and the UK.

Generally, the ROE is lower amongst target firms than amongst non-targets ones. The same relevance is not verified regarding to the second variable of managerial performance, that is to say valuation ratio.

Even imbalance, size and ownership concentration are not significant variables in the distinction between target and non-target firms.

A logistic model (when the study applies Multivariate analysis) has been used to test the influence that financial and ownership structure variables may exert on the probability that a firm is subject to a takeover bid.

Applying Multivariate analysis indicate that only one variable (ROE) has a significant effect on the probability that a firm will be a takeover target. It seems to confirm the first hypothesis (H1), related to the inefficiency of the management, according to firms which have a lower return of equity than firms belong to the same sector have a higher probability of being subject of a takeover bid.

While the results show that other variables (VR, P/E, LnASS and OC) have a no significant effect on the probability that a firm will be a takeover target. It seems does not confirm the other hypothesizes (H2, H3 and H4).

As regard the Egyptian stock market, we should note that it is characterized by a limited number of quoted companies if compared with developed capital markets such as United States(Pagano, Panetta et al. 1998).

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