Disclosure Behavior of Peer Firms and Managers under Corporate Control Threat

Corporate control contests like mergers and acquisitions can strongly influence an industry, prompting varying responses from different companies. Firms targeted in a takeover may try to negotiate a better exit outcome by forecasting positive disclosures. On the other hand, peer firms from the same industry—those that are not direct targets but face the threat of imminent takeover attempts—may use different strategies to fend off a potential acquisition.

What are these strategies? A new study attempted to find out.

Using a difference-in-differences (DID) research design, the study team compared two types of firms—treatment firms, or peer firms facing control threat; and control firms, that were neither takeover targets nor peers of target firms. The team also analyzed the nature of voluntary disclosures made by these firms during 112 hostile takeover announcements from 1997 to 2014.

The researchers found that treatment firms highlight bad news. As compared to control firms, treatment firms disclosed significantly more negative news and bundled these disclosures with earnings announcements. Their managers used a more negative tone in presentations during conference calls, while evenly spreading negative tonal words across the presentation to increase their visibility. Furthermore, peer-firm managers often managed earnings downwards to support their bad news disclosures and anticipated high control threat during merger waves. In contrast, none of the firms showed any significant changes in their good news disclosures.

What could possibly cause these treatment firms to *voluntarily* disclose negative news? Empirical evidence indicates that acquiring firms look for potential takeover targets having good performance records. Bad earnings and negative news forecasts generate uncertainty, make it difficult for acquirers to accurately assess the firm's value and discourage them from targeting these firms in a takeover attempt. Hence, such voluntary disclosures safeguard peer firms from control threats.

Understandably, this behavior is more common among managers in vulnerable firms, such as those with weaker takeover defense mechanisms, or in firms whose managers are more incentivized to resist takeover attempts, like those with CEOs younger than 60 years of age with greater career concerns, or CEOs with higher compensation, which would be at stake if the firm were taken over.

The findings of this study add to the growing database of knowledge on corporate control threats and how firms may use voluntary disclosures to avoid them.

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