RESEARCH NEWS STORY

March 08, 2022

How Companies Use Negative Disclosures to Escape a Hostile Takeover

Research reveals that companies use a negative disclosure strategy to emphasize bad news when faced with a corporate control threat in the industry

A recent study investigated the voluntary disclosure response of firms during corporate control contests in industries. It was found that peer firms of hostile takeover targets voluntarily emphasize bad news as a means to cast uncertainty about their firm's value and prevent potential acquirers from attempting a takeover. The likelihood of this behavior increased among vulnerable firms and firms whose managers were incentivized to resist a takeover.

Corporate control contests, such as mergers and acquisitions, are major events that influence how companies make voluntary disclosures. Firms targeted in such control contests and hostile takeovers may use voluntary disclosures highlighting positive forecasts about themselves, to negotiate a better exit outcome. In contrast, competitors and peers of these hostile takeover targets—which are not direct targets but still feel threatened during a control event—would try to minimize the control threat through asymmetric voluntary disclosures.

Studies suggest that acquirers target firms with good performance records. Therefore, peer firms that want to discourage potential acquirers could use voluntary disclosures to emphasize bad news forecasts about their firms. Such negative news can create uncertainty about the firm, making it difficult to assess the advantage of acquiring it. This would typically deter potential acquirers from choosing that firm as a takeover target. A recent study aimed to find out if this is true.

Researchers from the University of Texas at Austin, the Chinese University of Hong Kong, and University of Georgia, explored whether peer firms under control threat *actually* resort to more voluntary disclosures of bad news. *"We hypothesized that when one firm becomes a takeover target, other firms in the same industry strategically promote negative news about themselves to avoid becoming the next target,"* says Prof. Shuping Chen from the University of Texas, co-author of the study, which was published in *The Accounting Review* in January 2022.

The researchers identified two types of sample firms—treatment firms (or peer firms that face control threat due to a hostile takeover in the industry) and control firms (that are neither direct takeover targets nor immediate peers of target firms). The study analyzed these firms' response to 112 hostile takeover announcements made between 1997 and 2014. The nature of their voluntary disclosures, announcements of management earnings forecasts, and transcripts of their earnings conference calls held during the period surrounding the announcements were scrutinized. The research was designed using a difference-in-differences (DID) design, which is a statistical technique that attempts to mimic an experimental research design using observational study data. "*DID studies how two different groups react to a common variable. It compares the average outcome over time between the two groups*," explains Prof. Bin Miao, co-author, and Associate Professor of Accounting at The Chinese University of Hong Kong.Results of the DID regressions revealed that in comparison to control firms, treatment firms did, in fact, make significantly more negative voluntary disclosures, which they coupled with earnings announcements to heighten their visibility. Managers in these firms used a more negative tone in presentations during conference calls and tended to distribute negative tonal words more evenly across their presentations, thereby highlighting bad news. There were no significant changes in the frequency or bundling of good news or positive forecasts in both types of firms.

Dr. Kristen Valentine, co-author, from the University of Georgia, also tells us that "*Firm-level takeover defenses and managers' self-interests impact the disclosure behavior of managers at peer firms*." Managers who have their careers at stake or those who stand to lose personal wealth in the event of a takeover are more incentivized to try to quash takeover attempts. Among the sampled peer firms, those with less resilient takeover defense mechanisms and younger or highly compensated CEOs exhibited more bad news disclosures. Additionally, managers of peer firms feel more threatened during merger waves and accordingly manage earnings downwards (essentially using discretion in accounting rules to report lower earnings), along with promoting bad news disclosures to mitigate the threat. Several validation tests reinforced these findings, adding to their credibility.

"*Previous research suggested that career concerns motivate managers to promote good news or withhold the release of bad news. However, our findings highlight how managerial career concerns and behavior change during a control event."* Prof. Valentine and Prof. Chen say.

The study therefore highlights how control threat influences the strategies used by peer firms—including voluntary bad new disclosures and accounting actions—to avoid takeover attempts. Talking about their study's effect on finance and accounting research, Prof. Miao concludes, *"Our research contributes to the dearth of literature discussing how corporate control contests affect voluntary disclosure behavior of firms, especially those threatened by an imminent takeover."*

Reference

Authors	Shuping Chen[1], Bin Miao[2], Kristen Valentine[3]
Title of original paper	Corporate Control Contests and the Asymmetric Disclosure of Bad News: Evidence from Peer Firm Disclosure Response to Takeover Threat
Journal	*The Accounting Review*
DOI	https://doi.org/10.2308/TAR-2018-0619
Affiliations	[1]McCombs School of Business, Department of Accounting, The University of Texas at Austin; [2]Department of Accounting, The Chinese University of Hong Kong;

[3]Terry College of Business, J. M. Tull School of Accounting, University of Georgia

Managers of companies under corporate control threat use voluntary disclosures to emphasize bad earnings forecast to deter potential acquirers and prevent takeover attempts.
Image courtesy: Shutterstock

About Professor Shuping Chen
Prof. Shuping Chen is a Wilton E. and Catherine A. Thomas Professor of Accounting at the McCombs School of Business, University of Texas at Austin. She has a Ph.D. in Accounting from the University of Southern California. Throughout her career she has received several accolades, including the McCombs School of Business Research Excellence Grant, the Arthur Anderson Doctoral Dissertation Fellowship, the American Accounting Association Doctoral Consortium Fellow, and the Deloitte & Touche Doctoral Fellowship. Her research interests include corporate voluntary and mandatory disclosures, information quality of social media investment platforms, factors affecting analysts' research output, ownership structure, and bank financial reporting.

About Professor Bin Miao
Prof. Bin Miao is an Associate Professor of Accounting at The Chinese University of Hong Kong, Shenzhen. He has previously taught at The Hong Kong Polytechnic University and National University of Singapore, and was the Director of Research at Institute of Singapore Chartered Accountants. Dr. Miao obtained his Ph.D. in accounting from Nanyang Technological University in 2007. He is also a CFA Charter holder. His research—which has been published in leading academic accounting journals—include corporate disclosure, empirical asset pricing, and market microstructure with a focus on the mechanisms through which accounting information is incorporated into stock prices.

About Professor Kristen Valentine

Prof. Valentine is an Assistant Professor at the J.M. Tull School of Accounting, University of Georgia. She was awarded her Ph.D. in Accounting in May 2019 from University of Texas at Austin. Her research has been widely published, and she is a reviewer for multiple accounting journals. She conducts regular workshops and has spoken at many conferences. She has been a recipient of several prestigious awards, like the Terry College of Business Outstanding Teacher, and the FARS Excellence in Reviewing Award.