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The Law and Economics of Hostile Takeovers: Shareholder Wealth vs. Long-Term Corporate Health

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Abstract: Hostile takeovers have long been a controversial topic in the field of corporate governance, reflecting the tension between shareholder wealth maximization and long-term corporate health. With the global integration of capital markets, hostile takeovers have become an important mechanism for restructuring corporate ownership and optimizing resource allocation, but they also trigger fierce debates about their economic effects and legal regulation. This paper systematically explores the legal and economic dimensions of hostile takeovers, focusing on the trade-off between short-term shareholder wealth gains and the sustainability of corporate long-term development. Through analyzing the economic motivation behind hostile takeovers, the impact on shareholder interests and corporate long-term value, as well as the legal regulatory frameworks in different countries, the research finds that hostile takeovers have a dual nature: they can restrain managerial inefficiency and improve resource allocation efficiency, but they may also induce short-termism, damage corporate innovation capacity, and undermine stakeholder interests. Finally, the paper puts forward suggestions for constructing a balanced legal and regulatory system that promotes market efficiency while safeguarding long-term corporate health, so as to realize the coordinated development of shareholder wealth and corporate sustainability.

Keywords: Hostile Takeovers; Shareholder Wealth; Corporate Long-Term Health; Legal Regulation; Corporate Governance.

1. Introduction

In modern corporate governance, hostile takeovers— a board-unapproved corporate control transfer via direct offers to target shareholders— are a key part of the capital market. They spark controversy for their dual impact: proponents view them as an external mechanism to discipline underperforming managers and boost efficiency, while opponents argue acquirers' pursuit of short-term gains harms long-term investment, innovation and stakeholder interests. Tied to capital market development and legal changes, their study matters for enriching corporate governance theory and optimizing regulatory and governance practices. This paper explores their links with shareholder wealth and corporate long-term health to inform relevant legal and governance improvements.

2. Economic Analysis of Hostile Takeovers: Motivation and Impact on Shareholder Wealth

2.1. Economic Motivation Behind Hostile Takeovers

The core motivation for hostile takeovers is acquirers' pursuit of economic benefits. From the agency theory perspective, the separation of ownership and control in modern enterprises causes agency problems, with managers prioritizing their own interests over shareholder wealth and leading to inefficient operations. Hostile takeovers offer a market solution: acquirers spot underperforming companies, gain control via tender offers, replace management and restructure to enhance operational efficiency and profitability [2]. Another major motivation is the pursuit of synergistic effects. Acquirers hold that combining their resources with the target's can create more economic value than separate operations—for instance, a financially robust firm may acquire a tech-intensive target to strengthen core competitiveness, or a mature-industry firm may buy a high-growth one to expand business and market share. Besides, the target's undervalued stock is a key driver; when its market price is below intrinsic value, acquirers can profit by purchasing it cheaply and improving its value through restructuring [7].

2.2. Impact of Hostile Takeovers on Shareholder Wealth

The impact of hostile takeovers on shareholder wealth has long been an academic focus. Empirical studies show target company shareholders often get significant benefits [1]: acquirers generally offer a 20%-50% premium over the market price to attract share tenders, directly increasing target shareholders' short-term wealth. A case in point is Broadcom's 2017 hostile takeover of Qualcomm, where its ~30% premium drove a sharp short-term rise in Qualcomm's stock price. The impact on acquirer shareholders is more complex. In the short term, their stock prices may fluctuate due to high takeover costs and integration uncertainty. Some studies note acquirer shareholders may face short-term negative returns, particularly when the acquirer pays a steep premium or relies heavily on debt for financing [1]. Yet long-term, successful integration and realized synergies are likely to push the stock price to recover and rise, bringing long-term gains to these shareholders [9]. It is worth noting that hostile takeovers' wealth effect is mainly short-term. The acquirer's premium centers on immediate value transfer, while long-term corporate value depends on post-takeover integration and operations. If the acquirer only focuses on short-term asset stripping and cost-cutting instead of long-term investment, it may damage the company's sustainable profitability and ultimately hurt shareholders' long-term wealth [3].

3. The Tension Between Hostile Takeovers and Long-Term Corporate Health

3.1. How Hostile Takeovers May Undermine Long-Term Corporate Health

Corporate long-term health is a company's ability to maintain sustainable profitability, innovation capacity and competitive advantage, dependent on long-term investments in R&D, employee training, brand building and stakeholder relationships. However, hostile takeovers often prioritize short-term financial performance, which may conflict with pursuing long-term corporate health [6]. Firstly, they may trigger short-termism in decisions. Post-acquisition, acquirers focus on boosting short-term financial indicators to meet investor expectations and repay takeover debts, possibly cutting R&D and employee training investments—since these have long payback periods and reduce short-term profits [3]. For instance, some acquirers immediately cut R&D budgets post-takeover to cut costs, undermining the company's innovation capacity and long-term competitiveness [5]. Secondly, they may damage organizational and cultural stability. Management replacement and corporate restructuring often lead to key employee loss, disrupted business processes and cultural conflicts [10]. These changes increase integration costs and hurt employee morale and productivity, hindering long-term development. Additionally, they may harm relationships with suppliers, customers and communities, as stakeholders lose confidence in the company's stability [8].

3.2. The Potential Positive Impact of Hostile Takeovers on Long-Term Corporate Health

Despite the potential negative impacts, hostile takeovers can also have a positive effect on long-term corporate health under certain conditions. As an external governance mechanism, hostile takeovers can restrain the agency problems of managers, forcing them to focus on improving corporate operational efficiency and long-term value to avoid being taken over [2]. This "disciplinary effect" can promote managers to make more rational decisions, increase investment in projects with long-term returns, and improve the company's long-term competitiveness [1].

In addition, hostile takeovers can promote the optimal allocation of resources in the market. Underperforming companies that fail to effectively use their resources are acquired by more efficient acquirers, who can reorganize the resources to realize their maximum value [7]. For example, an acquirer may sell off the target company's non-core assets, focus on its core business, and invest in promising projects, which can improve the overall efficiency of the company and lay a foundation for long-term development. Moreover, hostile takeovers can also promote the improvement of corporate governance structures. After the takeover, the new management team may introduce more scientific governance mechanisms, such as strengthening the supervision of managers, improving the incentive system, and enhancing the transparency of corporate information, which are conducive to the long-term healthy development of the company [5].

4. Legal Regulation of Hostile Takeovers: International Experience and Comparison

4.1. Legal Regulatory Frameworks in Major Countries

Different countries have built diverse legal regulatory frameworks for hostile takeovers based on their market conditions, corporate governance models and policy goals. The US applies a market - oriented approach centered on protecting shareholder rights and market efficiency. The Williams Act is key, regulating tender offers and mandating acquirers' information disclosure for shareholders' informed decisions [3]; state laws also permit targets to adopt defensive measures under specific conditions to balance shareholder and manager interests [4]. The UK relies on a self - regulatory organization - led model. The Takeover Panel's City Code on Takeovers and Mergers regulates both acquirers and targets, stressing "equal shareholder treatment" and banning managers from taking defensive measures without shareholder approval [4], to ensure transaction fairness and protect minority shareholders. Continental European countries, by contrast, focus more on safeguarding stakeholder interests and corporate long - term development, imposing stricter takeover restrictions. Germany's Co - Determination Act requires employee representatives on supervisory boards, granting employees a say in takeovers [6]; France's Commercial Code allows government intervention in hostile takeovers of strategic industries to protect national economic security [6].

4.2. Trade-Offs in Legal Regulation

The legal regulation of hostile takeovers involves a core trade-off: balancing the promotion of market efficiency through takeovers' disciplinary effect and the protection of corporate long-term health by restricting short-termist behaviors [4]. Overly loose regulation may lead to excessive hostile takeovers, triggering short-termism and damaging long-term corporate development; overly strict regulation will weaken takeovers' disciplinary role, enabling underperforming managers to keep their posts and undermining market efficiency [3]. Major countries' experiences prove effective regulatory systems need to balance these two goals. For example, the US's federal-state legal combination not only ensures free market transactions but also permits target companies to adopt reasonable defensive measures against malicious takeovers [4]. The UK's self-regulatory model ensures transaction fairness while avoiding excessive government intervention [4]. Continental European countries focus on stakeholder interests, reflecting their attention to corporate long-term health, yet they must avoid excessive restrictions that impede market competition and resource allocation [6].

5. Conclusions and Policy Suggestions

5.1. Main Conclusions

This paper conducts a systematic analysis of the law and economics of hostile takeovers, focusing on the relationship between hostile takeovers, shareholder wealth, and long-term corporate health. The research finds that hostile takeovers have a dual economic effect: on the one hand, they can act as an external governance mechanism to discipline underperforming managers, improve resource allocation efficiency, and bring short-term wealth gains to target shareholders [1, 2]; on the other hand, they may induce short-termism, reduce long-term investment, and damage corporate innovation capacity and stakeholder relationships, thereby undermining long-term corporate health [3, 6].

The legal regulation of hostile takeovers in different countries reflects different policy orientations, with varying degrees of emphasis on market efficiency and long-term corporate health [4]. An effective regulatory system should balance these two objectives to realize the coordinated development of shareholder wealth and corporate sustainability.

5.2. Policy Suggestions

To build a balanced hostile takeover regulatory framework, key suggestions:

Improve info disclosure: Acquirers disclose takeover purpose, fund sources and post-takeover plans; target firms clarify impacts on long-term development (e.g., R&D, employee welfare).

Standardize defenses: Allow target firms to use measures like poison pills/staggered boards against malicious takeovers, but ban manager abuse (e.g., require shareholder approval).

Protect stakeholders: Cover employees, creditors and communities; acquirers need sound staff resettlement and guaranteed creditor rights.

Boost corporate governance: Encourage sound internal structures, stricter manager supervision and optimized long-term incentives to reduce agency issues and reliance on hostile takeovers.

Enhance international coordination: Strengthen cross-country regulatory alignment to avoid arbitrage and ensure fair, efficient cross-border takeovers.

Summary: Hostile takeovers are a capital market double-edged sword. A scientific regulatory system—balancing market efficiency and corporate long-term health—is key to achieving win-win between shareholder wealth and corporate sustainability.

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