



# Anti-takeover Provisions and Shareholder Wealth: Will Anti-takeover Provisions Destruct Firm Value?

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**Abstract.** This paper reviews the literature on anti-takeover provisions (ATPs), focusing on the relationship between ATPs and shareholder value. The empirical literature review is divided into four categories: 1) short-term event studies, 2) studies on the impact of different ATPs on acquisitions, 3) longitudinal studies on the relationship between ATPs and corporate performance or policies, and 4) studies that investigated how ATPs destruct shareholders' value.

**Keywords:** Anti-takeover provisions · shareholder · firm value

## 1 Introduction

ATPs are company-level or state-level arrangements that taken by the management of a target company to prevent the transfer of control of the company from being acquired by the acquirer. ATPs enable companies to defend their legal rights from hostile takeover bids and insecure acquisitions of control. It can also increase controlling shareholders' bargaining power in negotiating with the acquirer, leading to a higher merger and acquisition (M&A) premium. Previous literature discussed the impact of ATPs on shareholders' value from multiple perspectives, including agency costs, company value, and innovation. This paper reviews empirical studies on the relationship between the anti-takeover clause and shareholder wealth. First, it investigates the value implications of adopting ATPs within a short-term event study. The paper then compares how different ATPs affect shareholder value, followed by a discussion on changes in firm policy and performance after adopting an ATP. Additionally, this paper sheds light on how boards with more ATPs extract private benefits at the expense of shareholders.

## 2 Empirical Evidence

The effects of ATPs on shareholder wealth within a firm can be investigated using an event study, particularly looking at the abnormal returns before and after ATPs were initiated. Previous event studies revealed diverse findings in the field caused by two competing effects coinciding. One of the effects is that adopting ATPs can increase the

possibility of a takeover attempt; the second is that it reduces the likelihood of successful acquisitions. Each effect of ATPs may benefit a particular type of firms and value while being ineffective to others. Such conflicting results may wash out to an average abnormal return insignificantly different from zero after considering a cross-section of firms.

McWilliams found a significant effect of ATPs on firms' market performance in light of various levels of management voting rights. When managers with a voting right under 10 percent announced the use of ATPs, the market responded positively (0.49 percent) [1]. However, comparable negative market performance was discovered for managers whose voting right over is over 10 percent. Similar to Stulz's argument, this finding suggested that with a lower management voting right, the use of ATPs benefits shareholder value [2]. This may be attributed to a potential improvement towards the agency problem. In agency theory, the corporate board is an essential internal governance community responsible for overseeing corporate governance. The power balance between the corporate management and the corporate board is critical. When the corporate board has more power, it is likely to be vigilant in protecting shareholder value. Meanwhile when the management has more power, the board will likely be less effective in corporate governance. This further implies that ATPs require formal approval from shareholders in addition to company managers.

Shareholder approval typically requires dual class recapitalization, classified boards of directors, super-majority requirements, fair price requirements, and elimination of cumulative votes. Four studies evaluated the impact of dual-class recapitalization on stock prices and found mixed effects. Whilst these four studies revealed that the aforementioned provisions had insignificant wealth effects [1, 3–5]. However, other studies supported that the provisions depleted shareholder wealth [6–11].

Notably, exceptions to this requirement are poison pills and golden parachutes, which the board can generally approve at any time. Several studies examined poison pill provisions and found negative effects on firm value [11–15]. Similarly, Datta and Iskander–Datta concluded that adopting poison pills had a net negative effect on firm value—even though poison pills had an insignificant effect on stockholder reactions, these provisions reduced bondholder wealth [16]. Brickley, Coles and Terry argued that poison pills had a negative impact only in firms with fewer outsiders on the board [17]. When the majority of the board are outside directors, investors react positively to the announcement of adopting the poison pill provision (0.94 percent). However, when firm insiders dominate the board, investors react negatively to the announcement (–0.31 percent). This finding suggested that market expectations of the use of poison pills were influenced by the board structure of the firm. Nevertheless, several research studies found that ATPs, such as poison pills and golden parachutes, did not lower takeover possibilities but tended to increase the bid premium. Heron and Lie (2006) denied any relationship between the initiation of poison pills and successful takeover bids [18]. At the same time, the authors (Heron & Lie, 2006) indicated a positive relation between poison pills and increasing bid premiums as well as the total bid premiums.

Studies concerning market reactions to adopting golden parachute agreements also found mixed results. Lambert and Larcker found positive effects after adopting golden parachute agreements [19]. Born, Trahan, and Faria further concluded that the positive impact was limited to golden parachutes used by firms that are not under being adopted

situation during 1979 and 1984 [20]. Machlin, Choe and Miles reported that firms with golden parachutes were more likely to be acquired; they received multiple offers, with an increasing takeover premium (see also Sokolyk) [21]. These research studies simultaneously suggested that certain ATPs were good for shareholders because they did not deter takeovers rather increased takeover premiums.

In fact, the stock price reaction reflects not only the direct impact of ATPs on shareholder value, but also responses to unrelated information, i.e., management quality or private information of managers about upcoming takeover bid [13, 22, 23]. In this sense, market responses may not fully reflect the value of adopted provisions [24, 25].

Research studies on the relationship between ATPs and long-term performance or firm policies largely supported the argument that ATPs harmed shareholder value by limiting their rights and strengthening corporate managers. Several empirical studies reported that ATPs were associated with an economically meaningful reduction in firm value. Bhagat and Jefferis examined the market reaction to the proposals to adopt various ATPs [24]. By employing a two-stage method, Bhagat and Jefferis obtained wealth effect estimates and estimated a negative value impact of adopting the provision [24]. Cunat et al. further used a regression discontinuity design to estimate market response [25]. They concluded that the average value of the adoption proposal would increase by 2.8% after the anti-takeover clause was removed. These studies suggested that anti-takeover clauses erode shareholder wealth on balance.

Bebchuk and Cohen argued that a staggered board is an efficient way to protect incumbents from removal [26]. They found that an effective staggered board can negatively affect shareholder returns after a hostile bid is conducted. However, such a finding neglected the impact of an effective staggered board on firm value.

In 2003, Gompers, Ishii, and Metrick set a GIM index based on 24 management-favoring provisions followed by IRRC [27]. Gompers et al.'s study found that increasing provisions led to declining firm value. Their study was followed by extensive empirical research, examining the channels through which G-index provisions affected shareholder wealth and testing the robustness of the initial results. Core, Guay, and Rusticus extended Gompers et al.'s research [28]. They concluded that weak shareholder rights were unlikely to lead to lower abnormal stock returns; instead, the abnormal return differences between high and low G index firms resulted from market model misspecification or other context-specified factors. Johnson, Moorman, and Sorescu reached a similar conclusion [29]. These authors critically contended that the asset pricing model used in Gompers et al.'s study was misspecified. They further reported that firms with high G index scores and firms with low G index scores differed from firm populations and how they clustered across industries. After adjusting for this industry clustering, the result became insignificant.

Furthermore, based on these previous studies, Bebchuk et al. identified different ATPs that were mainly responsible for the declining firm value [30]. The study divided GIM index into two components: 1) the staggered board and all other rules, and 2) using the firm's Tobin's Q to reflect the impact of removal protections on shareholder value. Bebchuk et al. disclosed that, comparing with other governance provisions, staggered boards had a more substantial adverse effect on firm value. The authors also emphasized

that the correlation with reduced firm value was stronger for staggered boards established in the corporate charter than for staggered boards established in the company's bylaws.

Another set of studies investigated how boards extract personal benefits at the expense of shareholders when protected from removal [31]. In 2002, Bebchuk identified several ways in which ATPs influenced company value, including the aspects of management behavior and incentives, acquisition possibilities, and acquisition premium.

Masulis et al. employed the ratio and wedge measure to capture the voting-cash flow rights divergence and/or the extent of management protection from removal [32]. The authors found that corporate cash holdings were more likely to be misused as managers were protected from removal (more ATPs). These further resulted in CEOs getting higher compensation levels, managers making more shareholder value-destroying acquisitions in their favor and capital expenditure contributing less to shareholders. It also explains why high-voting stocks a higher premium in the marketplace has than low-voting stocks, which is not considered in this article.

Firms with more ATPs are more likely to perform worse than those with fewer ATPs. In Masulis et al.'s theory, the four possible reflections of poor performance include,

1. a dollar to a firm may not be worth a dollar to shareholders,
2. Managers may increase CEO compensation to pursue their interest,
3. Managers are more likely to make poor acquisition decisions, and.
4. Less attractive capital expenditures.

The worse case would be when the board has too much power and use ATPs to prevent adoptions that could increase shareholders' wealth and generate private benefit at the same time.

### 3 Conclusions

This paper reviewed and analyzed previous literature on ATPs and firm value. Previous short-term event studies explored how ATPs influenced shareholder wealth and found that different ATPs had different effects on firm value, depending on their effectiveness of board oversight. Additionally, most studies on the long-term relationship between ATPs and firm performance showed that, in general, anti-takeover rules increased agency costs and decreased shareholder value. This paper also found that firms with more ATPs got a lower firm value through misusing corporate cash holding, making value-destroying acquisitions, or less attractive capital expenditures.

Although the current research study discussed the economic consequences of ATP setting from many aspects, few scholars focused on its impact on the risk-taking level of listed companies. Additionally, a large body of literature studied the factors affecting risk-taking from the perspective of internal governance, with more attention paid to traditional internal governance mechanisms. A lack of studies was found on the topic of risk-taking factors from the perspective of ATPs. Also, previous literature rarely investigated the impact of anti-takeover clauses on enterprises' innovation capability. Therefore, these are the recommendations for future research.

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