



DATE DOWNLOADED: Thu Oct 8 21:57:15 2020

SOURCE: Content Downloaded from [HeinOnline](#)

Citations:

Bluebook 21st ed.

John Pound, The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence, 30 J.L. & ECON. 353 (1987).

ALWD 6th ed.

Pound, J. ., The effects of antitakeover amendments on takeover activity: Some direct evidence, 30(2) J.L. & Econ. 353 (1987).

APA 7th ed.

Pound, J. (1987). The effects of antitakeover amendments on takeover activity: Some direct evidence. *Journal of Law & Economics*, 30(2), 353-368.

Chicago 7th ed.

John Pound, "The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence," *Journal of Law & Economics* 30, no. 2 (October 1987): 353-368

McGill Guide 9th ed.

John Pound, "The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence" (1987) 30:2 JL & Econ 353.

MLA 8th ed.

Pound, John. "The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence." *Journal of Law & Economics*, vol. 30, no. 2, October 1987, p. 353-368. HeinOnline.

OSCOLA 4th ed.

John Pound, 'The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence' (1987) 30 JL & Econ 353

-- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at

<https://heinonline.org/HOL/License>

-- The search text of this PDF is generated from uncorrected OCR text.

-- To obtain permission to use this article beyond the scope of your license, please use:

[Copyright Information](#)

# THE EFFECTS OF ANTITAKEOVER AMENDMENTS ON TAKEOVER ACTIVITY: SOME DIRECT EVIDENCE\*

JOHN POUND  
*Harvard University*

## I. INTRODUCTION

ANTITAKEOVER amendments change the structure of the corporate charter and ostensibly increase the bargaining power of management when confronted with a hostile outside contest for control of the corporation. Recent evidence shows that, as of December 1986, over 40 percent of the Fortune 500 had adopted some form of "shark repellent" amendment,<sup>1</sup> that over 700 New York Stock Exchange (NYSE) corporations have adopted one or more such amendments since the NYSE began keeping an informal log in the late 1960s,<sup>2</sup> and that over 650 nationally listed corporations have adopted antitakeover amendments since 1980.<sup>3</sup>

Three types of antitakeover amendments are most prevalent among major corporations. The most common, in terms of the number of recent adoptions, is the so-called fair price amendment, which requires that an equal price be paid for each share in a merger.<sup>4</sup> A second type of amendment is the simple supermajority requirement, which generally sets the

\* I am indebted to Philip Dybvig, James Heard, Roger Ibbotson, Gregg Jarrell, Robert Shiller, and an anonymous referee for comments and suggestions. I am also grateful to the Investor Responsibility Research Center for providing research support.

<sup>1</sup> Antitakeover Charter Amendments: A Directory of Major American Corporations (Investor Responsibility Research Center, Washington, D.C. 1985).

<sup>2</sup> Internal log of corporate charter revisions (New York Stock Exchange, ongoing).

<sup>3</sup> Gregg Jarrell & Annette Poulsen, Shark Repellents and Stock Prices: The Impact of Antitakeover Charter Amendments since 1980, *J. Fin. Econ.* (in press).

<sup>4</sup> Generally, fair price amendments are structured so that violation of the fair price provision invokes a restrictive supermajority condition, which in some cases may be effectively impossible to satisfy. Some fair price amendments also carry extremely restrictive "procedural" requirements that also serve to impose heavy costs on a potential bidder. While the amendments have a general similarity, it is a mistake to assume that all fair price amendments create identical incentives.

[*Journal of Law & Economics*, vol. XXX (October 1987)]

© 1987 by The University of Chicago. All rights reserved. 0022-2186/87/3002-0011\$01.50

number of shares required to approve a merger at between 66 and 80 percent. The third common type of amendment is the so-called classified board provision, which staggers terms of directors so that only a small minority (usually one-third) can be removed by vote at any one time. The staggered board amendment is clearly efficiency enhancing only if the board acts, on average, as an efficient bargaining agent for shareholders. During the late 1970s and early 1980s, it was common for supermajority and classified board amendments to be proposed and adopted together as a package of takeover defenses.

The amendments focus attention on the nature of the principal-agent relationship between management and shareholders<sup>5</sup> and on the efficiency of shareholder oversight. Proponents argue that the amendments can correct a serious collective choice problem affecting target shareholders' tendering decisions in the event of a control offer.<sup>6</sup> The problem occurs because less than all shares—in some cases, a bare 50 percent majority—are needed to transfer control of the corporation.<sup>7</sup> Given this, any individual shareholder attempting to hold out and bargain with target management for the economically competitive takeover premium faces the possibility of being undercut by a majority and thus ending up in the back end of the takeover transaction, which may carry a significantly lower premium. Each of the three types of amendments described above arguably gives target management or target shareholders greater bargaining power, either by making it less likely that control will be transferred without the assent of all shareholders or by making it more expensive for the bidder to replace the board without the complicity of target management.

The case against antitakeover amendments is based on the fact that the amendments serve to increase managerial bargaining power—and hence managerial discretion for self-interested behavior—in the single situation in which such self-interested behavior is most likely to occur if there

<sup>5</sup> The question of managerial accountability arises throughout the literature on tender offer resistance. For example, Frank Easterbrook & Daniel Fishel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 *Harv. L. Rev.* 1161 (1981), have questioned whether lawsuits by target managements are consistent with fiduciary duties.

<sup>6</sup> See Lucian Bebchuck, *A Model of the Outcome of Takeover Bids* (Discussion Paper, Harvard University Law School Program in Law and Economics, November 1985); Harry DeAngelo & Edward Rice, *Antitakeover Amendments and Stockholder Wealth*, 11 *J. Fin. Econ.* 329 (1983).

<sup>7</sup> The majority vote needed to gain control is a function both of existing corporate charter provisions and of the relevant state statutes governing corporate structure, which generally set a default on the necessary majority. State provisions have vacillated over the past decade, as a number of state statutes setting high majority requirements (for example, two-thirds) have been struck down in the federal courts.

exists any imperfection at all in the managerial labor market. In addition, recent evidence suggests that the aforementioned bargaining imperfection may not be a significant distortion in tendering decisions.<sup>8</sup> It has thus been argued that the additional bargaining power conferred by the amendments is actually used by managements to pursue their own interests rather than those of shareholders.

Each of these effects—pro- and antishareholder—implies that anti-takeover amendments systematically affect shareholders' gains from takeover activity. If the amendments are proshareholder, this must be because they increase the expected blended premium accruing in a takeover bid while not significantly diminishing the probability of such a bid occurring. Conversely, if the amendments are antishareholder, the most likely reason is that management uses them to increase bidder costs and hence to decrease the probability of bids. Costs may be increased either through more trenchant resistance, which increases bidders' transactions costs, or through the necessity of increased compensation to target management. It is also possible, though not likely, that, in bids that do occur, shareholders' gains are decreased in order to increase managerial compensation.

To date, evidence on the effects of antitakeover amendments has not centered on estimating their direct effects on takeover activity, but rather has consisted of analyses of the average effects of amendment adoptions on stock prices. At least three such studies exist, which use somewhat conflicting methodologies and end up with inconsistent results. However, the most recent study provides quite strong evidence.<sup>9</sup> By using a large sample, by controlling for confounding events, and by separating amendments by type, the authors show that non-fair price amendments, which are primarily supermajority and classified board amendments, cause significant negative excess returns in the neighborhood of 3 percent.<sup>10</sup> By

<sup>8</sup> For evidence that back ends—even in explicit two-tier tender offers—carry a relatively small penalty compared to front-end premiums, see Robert Comment & Gregg Jarrell, "Two-Tier Tender Offers: The Imprisonment of the Free-riding Shareholder, *J. Fin. Econ.* (in press). Back-end shareholders are compensated at well above preoffer market prices. For evidence that tender offers are rationally rejected—that is, are rejected only when the expected compensation from rejection is nonnegative—see Michael Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 *J. Bus.* 345 (1980). For evidence that the takeover market is competitive in the sense that bidders' expected gains from a higher offer than the successful offer are nonpositive, see Richard Ruback, *Competition in the Market for Corporate Control*, 11 *J. Fin. Econ.* 141 (1983).

<sup>9</sup> See Jarrell & Poulsen, *supra* note 3.

<sup>10</sup> The evidence on straight supermajority amendments is surprising, as these amendments appear to carry no adverse implications for management's ability to impose arbitrary costs on the takeover process. Rather, they seem to be a relatively pure approach to vesting more power with target shareholders.

contrast, the more prevalent fair price amendments appear to have no significant effect on shareholder wealth. In addition, the authors find that the incidence of fair price amendments is growing while the incidence of harmful amendments appear to be declining. Furthermore, they find that fair price amendments are associated with higher institutional ownership and lower insider ownership than are other types of amendments. They argue, on the basis of these trends, that informed shareholder-voters weed out malodorous amendments, albeit imperfectly and with considerable delay.

Even with careful methodology and strong results, however, it cannot be reliably concluded from the stock price evidence that the amendments themselves significantly alter the management-shareholder contract as it pertains to the market for corporate control. It is possible, indeed probable, that the decision to adopt an antitakeover amendment itself conveys information to the market and that it is this information and not the structural effects of the amendment that drive the adoption-period market reaction. With such signaling effects, the announcement- and adoption-period behavior of security returns will reflect not only the amendments' direct effects but also the additional information conveyed by the firm's decision to pursue the adoption of an amendment. This sort of problem is a growing difficulty throughout the corporate control literature, rendering precise valuations of certain corporate policies extremely difficult.

The most important confounding information potentially conveyed by amendment announcements is management's assessment of the probability that the firm in question is likely to become a takeover target. Because the commitment to an amendment is costly and, measured in terms of expected takeover-related gains, less costly the more a takeover attempt is likely, amendment adoption might be expected to signal an increased firm-specific probability of takeover, relative both to other firms in the market and to the preceding, preamendment regime.<sup>11</sup> This effect, if present, would militate toward setting some (unknown) positive average excess return as the null hypothesis for event studies of amendment adoptions.<sup>12</sup>

A second possible signaling effect militates in the opposite direction. If managements invoke antitakeover amendments as an attempt to protect

<sup>11</sup> This case is less clear when the amendment is undertaken in reaction to an alteration of the state laws setting default merger guidelines. However, it is still relevant if the control is defined properly—which, in this case, would mean comparing adopting firms to nonadopting firms from the same state and in the same time period.

<sup>12</sup> Such results are reported in Scott Linn & John McConnell, *An Empirical Investigation of the Effects of "Antitakeover" Amendments on Common Stock Prices*, 11 *J. Fin. Econ.* 383 (1983).

themselves from unwanted bids, the mere adoption of an amendment may send a negative signal about managerial quality. If this is the case, an observed negative excess return in response to amendment adoption may be caused not solely by a change in expected shareholder gains from takeovers but also by a change in expected returns in the absence of takeover activity.

To address these problems, this paper offers empirical evidence on the direct effect of antitakeover amendments on takeover activity. The evidence determines the structural effects of the amendments, exploring how they affect management, target shareholders, and potential and actual bidding firms. This evidence is used to generate a direct test of the power of the event-study evidence, asking whether the expected value change greeting amendment adoptions appears, *ex post*, to constitute a correct prediction. The results thus provide perspective on the magnitude of the potential signaling problems discussed above (which cloud the results of a number of important studies of the market for corporate control) as well as providing a more complete picture of the actual effects of antitakeover amendments on takeover bids.

## II. ANTITAKEOVER AMENDMENTS AND SHAREHOLDER GAINS FROM TAKEOVER ACTIVITY

This section presents tests of the effects of antitakeover amendments on shareholder's expected gains from takeover activity. The tests focus on firms adopting supermajority and classified board amendments in combination, which, recent evidence suggests, has a negative effect on shareholder wealth. The tests examine the amendments' effect on the frequency of, and gains accruing from, takeover activity. These two factors together determine expected gains to shareholders from takeover bids.

To test whether supermajority and classified board amendments decrease the probability of takeover bids, I collected an experimental sample of 100 NYSE-listed firms that adopted as a package both a supermajority and a classified board amendment in the period 1973–79 and that showed no confounding events around the adoption period. I selected these firms using the informal log kept by the NYSE of changes in voting rights for listed firms.<sup>13</sup> For each firm, sufficient information had to be available in relevant news sources and in the NYSE log to determine the exact type of amendment, the date of adoption, and the relevant control-related events occurring in the period surrounding adoption and in the subsequent test period.

<sup>13</sup> Many thanks to the exchange for providing this log for the sampling exercise.

I then assembled a complementary control group, consisting of 100 NYSE firms that, for the period examined, could reliably be determined to have adopted neither supermajority nor classified board amendments. Again, the NYSE log confirmed that candidate firms were free from amendment adoption during the period in question, and relevant news sources had to be sufficient to ensure full reporting of control-oriented activity involving the firm. These firms were stratified over the 1973–79 period in the same distribution as the experimental group. That is, the two samples contain temporarily matched pairs of adopting and nonadopting firms.

To determine the effects of the amendments on takeover frequency, I followed each firm in these two groups from the adoption date forward to December 1984 and utilized the *Wall Street Journal Index*, the *Business Index*, *Predicasts/Findex*, the *Business Periodicals Index*, and the *News Bulletin of the Securities and Exchange Commission* (SEC) (the latter lists tender offer filings with the agency). For each firm, these sources were scanned for evidence of control-oriented activity against the firm; activity defined as, at a minimum, a formal offer to purchase by an outside entity. For each sample this protocol resulted in 817 firm years of market exposure.

Given the potential informational effects of the amendments, described in the previous section, and the documented unpredictability of takeover activity, the use of a control group that is equivalent only in rough size and exchange listing (as opposed, for example, to industry matching) suggests a one-tailed test for the deterrent effects of amendments. If the amendments do not serve as a takeover barrier, the experimental group of firms should be expected to show at least as high a frequency of takeover offers as the control group because, by incurring the costs of amendment adoption, they have signaled a higher-than-average takeover susceptibility.<sup>14</sup> Thus, the hypothesis tested was that

$$P'_a \geq P'_c, \quad (1)$$

where  $P'_a$  is the frequency of takeover for firms with antitakeover amendments, and  $P'_c$  is the frequency of takeover for firms in the control group.

The results of this frequency test are displayed in Table 1. They are

<sup>14</sup> The argument is only strengthened if takeover activity is somewhat predictable on an industry-specific basis. In this case, amendment adoptions (because of their cost) should come in industries experiencing significant takeover activity. Thus, a comparison of takeover frequency between adopting firms and random nonadopting firms (the latter presumably in less takeover prone industries) should show at least as high a takeover frequency for adopting firms. By contrast, the effect would be less strong if the control group were industry matched.

TABLE 1  
THE EFFECT OF ANTITAKEOVER AMENDMENTS ON THE FREQUENCY OF  
TAKEOVER BIDS

Sample	Offer Frequency
With antitakeover amendments	.28
Control sample (no amendments)	.38

NOTE.—Table measures the frequency of takeover attempts against 100 NYSE firms with and 100 NYSE firms without supermajority and classified board amendments, measured from 1974–84. Frequency is percentage of firms in each sample receiving at least one formal acquisition offer over the period.  $z$ -statistic for null hypothesis of no differences between the samples = 2.54.  $p < .25$ .

quite striking, confirming a significant deterrent effect for antitakeover amendments at the .01 level. Firms with antitakeover amendments show a 26 percent lower frequency of takeover attempts over the period examined. In economic terms, this represents a substantial divergence.

To examine differences in takeover-bid-induced target firms returns, I adopted a portfolio comparison approach. I measured premiums across contests with and without target antitakeover amendments and inferred that differences stem from the amendments' presence. Power problems obtain with this test if it is found that the amendments cause a change in the expected takeover premium because, without a fully specified model of takeover premiums, antitakeover amendments may proxy for other variables. However, because of the bias introduced by omitted variables, it is also true that rejection of any relation between antitakeover amendments and premiums is of high power.

Utilizing several large tender offer data bases,<sup>15</sup> I developed a sample containing sixty-five takeover contests in which the target firm had both a supermajority amendment and a classified board amendment in place at the time of the initial takeover bid. These contests were stratified over the period 1974–84. I developed a control sample of ninety-eight bids, in which the target firm did not have supermajority or classified board amendments in place. The sample was stratified over time in the same proportion as the experimental group of bids. Each of these firms had to have been the subject of a tender offer for control; the relevant bid announcement dates had to be available in the *Wall Street Journal* or other

<sup>15</sup> Included were the tender offer data bases maintained by the Managerial Economics Research Center at the University of Rochester and an internal SEC list of all tender offer registrations filed with the agency since 1976.



equivalent news sources; and stock returns data had to be contained on the CRSP tapes.<sup>16</sup>

For each of the two samples of firms, I created an excess returns portfolio, defined as the cumulative average of the excess returns from the market model. I estimated a market model on the basis of daily returns for each target firm for the period from 190 days to forty days prior to the announcement date for the first acquisition offer, deriving

$$R_{it} = \hat{\alpha}_i + \hat{\beta}_i(R_{mt}) + \epsilon_{it}, \quad (2)$$

where  $R_{it}$  is the observed return on firm  $i$  in month  $t$ , and  $R_{mt}$  is the observed return on the market portfolio for month  $t$ .

These equations were then forecast forward from day  $-40$  to the announcement day for the highest offer made for the target,<sup>17</sup> deriving

$$\hat{E}R_{it} = R_{it} - \hat{\beta}R_{mt} - \hat{\alpha}_i, \quad (3)$$

where  $E R_{it}$  is the estimated excess return for firm  $i$  on day  $t$ , and  $\hat{\phantom{x}}$  denotes an estimated value.

For each firm, I then summed excess returns from day  $-40$  to the day of the highest offer to yield cumulative excess returns, by

$$\hat{C}ER_i = \sum_{t=-40}^N \hat{E}R_{it}. \quad (4)$$

By incorporating not just the first but also the highest bid made for the target firm, the window used captures any significant additional returns facilitated by the presence of antitakeover amendments. The CERs were then averaged across firms in each portfolio to derive portfolio excess returns.

The appropriate test for a difference in premium between these two samples is two tailed, as it is possible that the amendments serve to decrease shareholder gains from takeovers (if some portion of a fixed level of gains is transferred from target shareholders to management) as well as to increase gains if the shareholder interests hypothesis holds. Table 2 presents the mean return and the standard error of the mean return for each portfolio, along with a test of the null hypothesis that mean

<sup>16</sup> The CRSP tapes are compiled by the Center for Research in Securities Prices, University of Chicago.

<sup>17</sup> One methodological problem occurs in measuring returns on the basis of the highest offer date. Firms exhibiting trenchant takeover resistance may show little share price reaction to increased offers because the market may by then heavily discount the probability of the offer's success. This was corrected for in both samples simply by calculating the blended per-share value of final offers directly for those targets ultimately defeating all outstanding offers to remain separate.

TABLE 2  
THE EFFECT OF ANTITAKEOVER AMENDMENTS ON TAKEOVER PREMIUMS

Sample	Average Bid Premium (SE)
With antitakeover amendments ( $N = 65$ )	.514 (.039)
Control sample (no amendments) ( $N = 98$ )	.488 (.029)

NOTE.—Table measures takeover bid premiums for sample of sixty-five targets with supermajority and classified board amendments and ninety-eight targets with no antitakeover amendments, measured as excess returns from the market model over a period from forty days before the first bid announcement to the date of the highest bid announcement.  $t$ -statistic for no difference between sample means = 1.35.  $p$  (two-tailed test) > .25.

returns are equal across the two portfolios. As can be seen, the null of equal portfolio CERs cannot be rejected. Indeed, returns across the two portfolios are very close in economic terms, differing by less than 10 percent, despite the considerable variance of firm-specific returns within each portfolio. Returns in both portfolios, moreover, are in line with other broad evidence on average takeover premiums already contained in the literature.<sup>18</sup>

It thus appears that supermajority and classified board amendments do not serve to increase takeover-related gains to shareholders in takeover contests that do occur while concurrently acting as a significant deterrent to the instigation of control contests. These results stand in support of the managerial interests hypothesis and confirm the recent stock returns-based findings specific to these two types of amendments.<sup>19</sup>

A more quantitative, if stylized, comparison is possible between the recent stock price evidence on the amendments and the data contained in Tables 1 and 2. The stock price data show a net decrease in expected wealth of between 3 and 5 percent as a consequence of amendment adoption. The results in Tables 1 and 2 show that, on average, a firm taken at random from the market has approximately a 4.9 percent chance of becoming a takeover target in a given year<sup>20</sup> and that, if such a bid should occur, the expected premium is approximately 45 percent over previous market value. This means that, for a random NYSE firm, the possibility of takeover bids generates a component of expected annual returns with a

<sup>18</sup> See, for example, Comment & Jarrell, *supra* note 8.

<sup>19</sup> Jarrell & Poulsen, *supra* note 3.

<sup>20</sup> This is calculated by taking the number of bids (thirty-eight) occurring in the sample and dividing by the total number of firm years of exposure (817).

value of about 2.2 percent. By contrast, for a firm with antitakeover amendments, the annual probability of takeover drops to 3.6 percent, and the expected takeover premium is 48 percent. This implies that the annual expected takeover premium drops to approximately 1.7 percent.

Given a total expected annual return in the 7–10 percent range, and, for simplicity, ignoring changes in risk, the amendment-caused loss in expected returns as measured by Tables 1 and 2 thus constitutes about 5–7 percent of annual expected returns. Assuming stability in the returns-generating process over time, this evidence implies that the amendments' adoption should be associated with a 5–7 percent capitalized loss in the adoption period, in the absence of significant signaling effects stemming from the adoption decision. This obviously squares very closely with the returns behavior that is shown to exist around adoption. The evidence thus lends support to the conjecture that the market is rational in assessing the amendments' effect on future returns. However, the slightly lower value of the actual stock price reaction to amendment adoption may suggest that something about the firm caused the possibility of the antitakeover amendment adoption to be partially anticipated by the market.

A final question about antitakeover amendments' effects on expected shareholder gains is whether they tilt bidders' incentives away from partial and two-tier offers and toward any-or-all offers. Such an effect, protecting the rights of shareholders in the back ends of deals, is the benefit alleged to derive from the amendments by those suggesting that in their absence there is a collective choice problem in shareholders' tendering decisions. Such an effect may exist even given the results shown in Table 2, which indicates no difference in average premiums in the presence of the amendments, because these premiums constitute blended measures that average front-end offers with the market's estimate of back-end payoffs. If the takeover market is competitive, the presence of supermajority amendments might encourage more equal treatment while leaving total blended premiums unchanged, although this would involve reductions of the front-end offer to offset increases in back-end compensation.

This question can be examined by comparing the relative frequency of different types of offers occurring in the antitakeover amendment sample with existing data on the relative frequency of different types of offers across all recent takeover bids.<sup>21</sup> Antitakeover amendments can be inferred to have some positive effect on minority shareholders if they result in a higher proportion of any-or-all offers than obtains across the market in their absence.

Table 3 presents this comparison. It shows that the proportion of any-

<sup>21</sup> The latter, aggregate data have been compiled by Comment & Jarrell, *supra* note 8.

TABLE 3  
THE EFFECT OF ANTITAKEOVER AMENDMENTS ON MINORITY SHAREHOLDER WEALTH

Type of Bid	Frequency Antitakeover Sample	Frequency SEC Master Sample
Any or all	.65	.80
Two tier	.15	.17
Partial	.20	.13

NOTE.—Table measures the frequency of any-or-all, partial, and two-tier takeover bids in sample of sixty-five bids in which target had supermajority and classified board amendments, compared to equivalent frequencies in SEC master sample of all bids from 1980 to 1984.

or-all offers is in fact lower in the antitakeover amendment sample than across the market as a whole. This is a surprising result and argues that the amendments do not have a significant positive effect on minority shareholder wealth. A possible reason is that, if antitakeover amendments make takeover bids more costly—as they must if they are to have significant deterrent effects—and if the takeover market is competitive in their absence, then the amendments may make some any-or-all bids too costly to carry out. In this case, the bidder's alternatives will be to abandon a control attempt altogether or to attempt to gain control through the use of a more coercive, partial bid. The latter alternative is obviously the very strategy that antitakeover amendments militate against, according to their proponents.

### III. MANAGERIAL GAINS AND THE NATURE OF THE TAKEOVER DETERRENT

Define the total cost to a bidder of a takeover transaction as consisting of three components: direct compensation to target shareholders ( $C_s$ ), direct compensation to target management ( $C_m$ ), and transactions costs associated with the bid ( $C_t$ ). The total cost of a bid (TC) is expressed as

$$TC = C_s + C_m + C_t. \quad (5)$$

Table 2 demonstrates that  $C_s$  is unchanged in the presence of supermajority and classified board amendments. Therefore, the deterrent effect of the amendments must spring from the ability of an empowered target management to impose higher costs on potential bidders than would occur in the amendments' absence—in the form of an increase in  $C_m$ , an increase in  $C_t$ , or both. Either by elevating transactions costs or by increasing direct compensation, antitakeover amendments shift the expected gains from some takeover bids from positive to negative.

It is difficult to measure either changes in direct managerial compensa-

TABLE 4  
 ANTITAKEOVER AMENDMENTS AND THE FREQUENCY OF  
 TAKEOVER RESISTANCE

Sample	Resistance Frequency
With antitakeover amendments ( $N = 65$ )	.68
Control sample (no amendments) ( $N = 98$ )	.38

NOTE.—Table measures the frequency of managerial resistance to initial takeover bids for sixty-five targets with supermajority and classified board amendments and ninety-eight targets with no antitakeover amendments. Resistance was coded only if target management undertook costly action, such as litigation, in opposition to the initial bid.  $z$ -statistic for hypothesis of no difference between sample frequencies = 2.89.  $p < .01$ .

tion or transactions costs directly, but several inferential measures are again possible using the two samples of takeover targets developed for measuring takeover premiums. The first, simpler task is to test for a higher average level of transactions costs in the sample of contests in which targets had antitakeover amendments in place. One proxy for transactions costs is the frequency of trenchant managerial resistance across bids with and without antitakeover amendments, which is likely to engender higher fees for investment banking and legal services, higher SEC filing fees, and the like. If trenchant resistance is higher in those contests with the amendments in place, an inference can be drawn that this resistance is indicative of a higher average level of bidder transactions costs in these cases.

To measure trenchant resistance, I examined the two samples of takeover contests for several managerial activities that have generally been concluded to constitute significant, costly tender offer resistance. These included lawsuits by targets; appeals to regulatory agencies—such as antitrust—for blocking action; and various market-based actions designed to introduce delay and inflate bidder costs.<sup>22</sup> The frequency of significant takeover resistance across the two samples was then tabulated and compared.

The results are contained in Table 4 and once again are surprisingly strong. Significant takeover resistance appears to be approximately twice as likely among targets containing supermajority and classified board amendments as it is for targets without antitakeover provisions. The frequency of resistance in the control sample, moreover, is in line with other authors' findings for larger samples of takeover activity. This evidence suggests that the amendments' deterrent effects come in part from a sig-

<sup>22</sup> Further examples are the creation of new preferred stock, asset purchase or sale over bidder objections, and the placing of a block of stock with a friendly third-party corporation.

TABLE 5  
ANTITAKEOVER AMENDMENTS AND THE SUCCESS OF  
MANAGERIAL RESISTANCE

Sample	Frequency of Control Transfer
With antitakeover amendments ( $N = 32$ )	.00
Control sample (no amendments) ( $N = 36$ )	.39

NOTE.—Table measures the frequency of control transfer over continued opposition by target management for sixty-five targets with classified board and supermajority amendments and ninety-eight targets with no antitakeover amendments.  $z$ -statistic for hypothesis of no difference between the frequencies = 4.02.  $p < .01$ .

nificant increase in the expected level of transactions costs that bidders estimate to be associated with a takeover bid.

It is more difficult to determine whether the direct takeover-related compensation paid to managers is also increased by the presence of the amendments. Data on target managements' compensation in takeover contests are difficult to assemble. The approach used here is inferential, using the success of managerial resistance as a proxy for relative managerial gains. Unsuccessful resistance is defined as occurring when a control transfer takes place over the continued objections of target management. Successful resistance takes place when the final transaction (which involves target acquisition in all but two cases, in each subsample) takes place on terms that target management has specifically endorsed. Given Table 2's evidence that expected shareholder compensation is unchanged in the presence of the amendments, and given the higher frequency of managerial resistance in the presence of antitakeover amendments, if it is found that the amendments render managerial resistance more successful, it can be inferred that the total cost of takeover bids has been increased by increasing managerial compensation.

Table 5 shows the proportion of all initially resisting target managements who continued to express opposition through the transfer of control. When combined with the data in Table 4, these results once again are suggestive. Although a considerably higher proportion of managements in the antitakeover amendment sample expressed initial opposition to takeover bids, in none of these cases was control ultimately transferred over managements' continued objections. By contrast, in the control sample, although a lower proportion of all managements expressed initial opposition to the takeover bid, over one-third of those that did ultimately lost control of their firm while still opposed to the acquisition. These results suggest that the amendments confer sufficient additional bargaining

TABLE 6  
 ANTITAKEOVER AMENDMENTS AND TAKEOVER PREMIUMS  
 FOR RESISTING TARGETS

Sample	Average Bid Premium (SE)
With antitakeover amendments ( $N = 32$ )	.589 (.057)
Control sample (no amendments) ( $N = 36$ )	.594 (.047)

NOTE.—Table measures takeover bid premiums for thirty-two initially resisting firms with classified board and supermajority amendments and thirty-six resisting firms without antitakeover amendments. Premiums are measured as excess returns from the market model from forty days prior to the initial bid announcement to the date of the highest offer.  $t$ -statistic for hypothesis of no difference between sample means = .11.  $p > .25$ .

power to target managements to ensure that bidders will be forced to secure managements' approval of the deal. Given that average premiums are no higher in the antitakeover amendment sample, the implication is that part of the increased costs imposed by antitakeover amendments comes in the form of higher direct compensation paid to target managements to purchase their support for control transfer.<sup>23</sup>

This conclusion is supported by comparing the ultimate premium paid to target shareholders, across the two takeover samples, in the cases involving successful acquisitions that were characterized by initial managerial resistance. Table 6 presents these results.<sup>24</sup> As can be seen, there is no change in premiums in the antitakeover amendment sample, despite the fact that almost twice as many of these acquisitions ultimately occurred with managerial approval. Once again, this result implies that bidder costs may be elevated in the presence of antitakeover amendments by the need to pay a higher level of managerial compensation rather than by increases in direct shareholder compensation.

#### IV. CONCLUSIONS

This paper presents new tests of the effects of antitakeover amendments by examining the amendments' direct effects on takeover activity.

<sup>23</sup> Note that the increased managerial satisfaction in the antitakeover amendment sample does not come from a higher frequency of success in retaining independence. In each sample, two firms were successful in preserving autonomy by defeating all outstanding bids.

<sup>24</sup> Premiums were again measured using the market model. The measurement window was from forty days prior to the initial takeover bid announcement to the announcement day for the highest offer for the target.

The focus is on supermajority and classified board amendments whose adoption appears to have significant deleterious effects on stock prices. Taken in sum, the evidence tends to support the view that these amendments increase the bargaining power of management in the event of a control bid, to the detriment of shareholder wealth. The amendments appear to reduce the frequency of takeover bids significantly while not improving the expected value of shareholder gains in those takeover contests that do occur.

It remains for further research to determine whether, as some have argued, the shareholder oversight process works to militate against abusive managerial initiatives over time. It is true that the frequency of both supermajority and classified board amendments has declined in recent years and that the frequency of so-called fair price amendments, which do not appear to carry adverse stock price consequences, has increased. Yet the former types of amendments continue to be proposed and passed. Furthermore, on close inspection it appears that not all recent fair price amendments are alike; some contain strictures that are very unlikely to be met in the event of a hostile bid. Thus it may be that some proportion of these apparently harmless amendments are abusive as well. Overall, these considerations suggest that the shareholders' ability to police management through the enforcement of contracts is imperfect, although far from nonexistent.



