Anti-Takeover Provisions Backfire

By Maria Guadalupe , INSEAD Associate Professor of Economics and Political Science

The more protected the firm, the less takeover premium it can command.

For many years, CEOs, consultants and even business school textbooks have argued that anti-takeover provisions fend off takeover advances and allow firms to bargain for a higher price in the event of a hostile takeover. Much of the literature says such provisions lower the likelihood of takeover advances, presenting managers with a trade-off: make your firm less likely to be taken over for a high price or more likely to be taken over for a low price.

But while much has been written on the issue there has been surprisingly little causal evidence on the effects of either on takeover probability. Firms can decide to defend themselves from a takeover offer in a variety of ways, such as a "poison pill", which dilutes shares or gives investors the right to buy discounted shares in the acquiring firm, or with staggered boards, where multiple classes of directors sit on the board, serving for different time periods. This makes a hostile takeover particularly tricky, with acquirers forced to wait for annual shareholder elections before they can gain control.

Don't build walls

In a new paper, **“Price and Probability: Decomposing the Takeover Effects of Anti-Takeover Provisions”**, Vicente Cuñat, Mireia Giné and I sought to find evidence of the effects of anti-takeover provisions by examining shareholder proposals to remove them and how the firms fare afterwards. Looking at shareholder voting behaviour in S&P1500 firms over a 20 year period, we find that contrary to the prevailing view, removing an anti-takeover provision garners a 2.8 percent higher takeover premium and increases takeover probability by 4.5 percent.

This is because there is increased competition for unprotected firms, which collect more bidders, improving the overall bargaining power of targets. Previous literature on auctions has also shown that the number of bidders is more important in determining the price the seller can command than the individual bargaining power of each of them.

Removing anti-takeover provisions also improves matching between bidders and targets, as better potential suitors are able to bid for their desired targets more easily, increasing the chance of a strong fit between related businesses with a higher potential for synergies.

When a firm is more protected, the deals that do take place are worse in multiple ways. They involve smaller acquirers and are more likely to be between firms in unrelated business, yet less likely to create value as they find fewer synergies in the deal.

Overall, we find that anti-takeover provisions reduce both takeover probabilities and premiums. This harms firms as well as shareholders, but also the economy as a whole. We find evidence that higher takeover premiums create net value in the market, with the gains from dropping anti-takeover provisions accruing almost exclusively to target shareholders.

There are no trade-offs

Therefore, we find that the trade-off typically offered by managers to defend anti-takeover provisions doesn’t stand up to scrutiny. In our study, both premium and probability of a takeover are significantly lower when there is an anti-takeover provision in place. Our results suggest that target shareholders already know this to a certain extent. The fact that this issue makes it to shareholder votes shows that there is already a degree of strife between management and shareholders over this issue, otherwise management would have accepted the idea earlier without letting it get to a vote.

Similar to my last paper on **why boards should give investors a say on CEO pay**, we demonstrate that there is firm value to be had for companies that at least hear out their shareholders on matters related to the market and compensation.

One argument we don’t address, however, is that firms erect anti-takeover provisions to complete long-term investments and projects that could be value creating over the longer term and want to protect themselves in the interim to see them through. Although there may indeed be cases where this makes sense, our research shows that for a large number of firms there is a clear negative effect of adopting anti-takeover provisions.

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