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Antitakeover Provisions and Shareholder Value Implications: A Review and a Contingency Framework

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This paper reviews literatures on the two competing theoretical views of the antitakeover provisions–shareholder value relationship — managerial entrenchment and shareholder interests — and offers a contingency framework to reconcile these views. This framework, based on a broader agency theory perspective and the organizational literatures on power, incorporates two key moderators: corporate board and shareholder monitoring, and draws attention to when *rather than on* whether *antitakeover provisions enhance or erode shareholder value.*[1]

Managerial responses to an active takeover market of the 1980s sparked considerable controversy (Jennings and Mazzeo 1986; Kesner and Dalton, 1985). A common strategic action taken by managers even prior to a takeover bid was the adoption of antitakeover provisions, which essentially involves a change in a company's corporate charter or operating policy that makes a takeover more expensive. Revival of merger and acquisition activity in the 1990s has reactivated the controversy because additional firms are adopting antitakeover provisions (Blair, 1995; Brickley, 1998; Lipin, 1998; Mergers and Acquisitions, 1996; Myers, 1996; Rouffignac, 1998; Wirth, 1996). Moreover, powerful shareholders such as pension funds are increasingly challenging firms to repeal antitakeover provisions adopted during the takeover wave of the 1980s (Bizjak & Marquette, 1998; Byne, 1999; Lindeman, 1999; McCoy, 1999).

At the heart of the controversy surrounding antitakeover provisions is whether these provisions enhance or detract from shareholder value. Managers believe that these provisions "represent a sound and reasonable means of addressing the complex issues of corporate policy created by the current takeover environment" (Lindeman, 1999: C1), whereas, vocal shareholders argue that these

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provisions "permit lackluster managers to stay on even as shareholders suffer" (Norton, 1998: 17).

Academics from a variety of disciplines — law, economics, finance and management — are also sharply divided in their views about the merits of antitakeover provisions (Easterbrook & Fischel, 1981; Gilson, 1982; Grossman & Hart, 1980; Walsh & Seward, 1990). Some scholars argue that the takeover market serves as a disciplining mechanism and hence managers should not resist the market (Easterbrook & Fischel, 1981; Kesner & Dalton, 1985). Other scholars argue that managerial resistance to takeovers can enable managers to negotiate greater benefits for their shareholders (Grossman & Hart, 1980; Jennings & Mazzeo, 1986). Empirical work examining the impact of antitakeover provisions also has not provided equivocal support for either of the positions. Furthermore, little effort has been devoted to reconciling the opposing viewpoints regarding antitakeover provisions (Turk, 1992). Such an omission is unfortunate since the controversy surrounding this managerial action is likely to continually resurface with the revival of takeover activity (Norton, 1998).

This paper therefore, attempts to fill this gap in the literature by reviewing competing theoretical and empirical work on antitakeover provisions and offering a contingency framework to reconcile these positions. The proposed framework recasts the debate in terms of *when* rather than on *whether* antitakeover provisions enhance or erode shareholder value. Drawing from a broader agency perspective and organizational literatures on power, it is argued that when the degree of board or shareholder monitoring is high antitakeover provisions can enhance shareholder value because these monitoring mechanisms can serve as a superior alternative to the takeover market (Pound, 1993). Alternately, when the degree of monitoring by these mechanisms is low, antitakeover provisions can erode shareholder value because managers are protected from the disciplining effects of the takeover market. The proposed contingency framework therefore embeds the debate on antitakeover provisions within a broader governance context.

Antitakeover Provisions:[2] Protection or Erosion of Shareholder Value?

Theoretical Perspectives

Agency theory motivates the debate regarding the impact of antitakeover provisions. According to agency theory managers are considered agents of stockholders, the owners of the corporation. These agents manage the resources of the corporation, but do not bear the wealth effects of their actions. In such a situation, managers have the opportunity and incentive to make choices and decisions regarding the use of firm resources that benefit them personally at the cost of the firm, giving rise to agency problems (Berle & Means, 1932; Eisenhardt, 1989; Fama, 1980; Jensen & Meckling, 1976). To reduce agency problems, several governance mechanisms exist; one of which is the market for corporate control (Manne, 1965; Moerland, 1995; Williamson, 1975). If managers are inappropriately or inefficiently managing the resources of the firm, an alternative team through the market for corporate control can replace these managers.