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How do staggered boards affect shareholder value? Evidence from a natural experiment[☆]

Alma Cohen[a,b], Charles C.Y. Wang[c,*]

[a] Tel-Aviv University School of Economics, Harvard Law School, United States
[b] National Bureau of Economic Research, United States
[c] Harvard Business School, United States

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ABSTRACT

The well-established negative correlation between staggered boards (SBs) and firm value could be due to SBs leading to lower value or a reflection of low-value firms' greater propensity to maintain SBs. We analyze the causal question using a natural experiment involving two Delaware court rulings—separated by several weeks and going in opposite directions—that affected the antitakeover force of SBs. We contribute to the long-standing debate on staggered boards by presenting empirical evidence consistent with the market viewing SBs as leading to lower firm value for the affected firms.

1. Introduction

Governance provisions that weaken shareholder rights and insulate directors from removal are now well known to be negatively correlated with firm value (Gompers, Ishii, and Metrick, 2003). This correlation is partly driven by the negative association between firm value and staggered board provisions, which prevent shareholders from removing a majority of directors in any given shareholder meeting (Bebchuk and Cohen, 2005; Bebchuk, Cohen, and Ferrell, 2009). Such correlation, however, might not imply causation but could reflect the greater propensity of low-value firms to

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* Corresponding author.
E-mail address: cwang@hbs.edu (C.C.Y. Wang).

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maintain such provisions. In this paper, we seek to contribute to understanding the causal question by studying two natural experiments: two court rulings that affected, for a subset of Delaware firms, the extent to which staggered boards can impede shareholders seeking to replace a majority of directors. We find evidence consistent with market participants viewing the antitakeover force of staggered boards as bringing about, and not merely reflecting, reduced shareholder value.

Our findings contribute to the long-standing debate on staggered boards by providing causal, not just correlational, empirical evidence on the effect of weakening staggered boards on shareholder value. Certain institutional investors have over time become increasingly opposed to staggered boards. The Council of Institutional Investors; major institutional investors such as American Funds, BlackRock, CalPERS, Fidelity, TIAA-CREF, and Vanguard; and the two leading proxy advisers, ISS and Glass Lewis, all have policies favoring both the annual election of all directors and board de-staggering proposals.[1] As a result, many companies have chosen to eliminate staggered boards in recent years. According to FactSet Research Systems, the number of Standard & Poor's (S&P) 500 companies with staggered boards declined by more than 50% from 2000 to 2012. Still, many companies continue to maintain staggered boards and argue that such provisions enhance rather than reduce shareholder value.[2] As of mid-2013, of the more than three thousand publicly traded companies whose takeover defenses are tracked by FactSet Research Systems, over half still have a staggered board.

The theoretical literature cannot fully resolve the ongoing debate as it identifies both costs and benefits of staggered boards (and of takeover defenses more generally). On the one hand, insulating incumbent directors from the disciplinary threat of removal could enable those directors (as well as the managers they oversee) to deviate from the interests of shareholders by shirking, empire building, and extracting private benefits (Manne, 1965). Moreover, such insulation could allow self-interested directors and managers to block acquisition attempts (Easterbrook and Fischel, 1981) or discourage potential acquirers from making offers (Grossman and Hart, 1980) that would have been beneficial to shareholders.

On the other hand, protecting directors and managers from control contests might enable them to focus on creating long-run shareholder value and avoid inefficient short-termism (Stein, 1988). Furthermore, staggered boards could also improve the bargaining position of target firms during takeover attempts, allowing target firm management to extract greater acquisition premiums (Stulz, 1988). Beyond the takeover contexts, some argue that staggered boards can produce benefits by securing stability and continuity in board composition but, at the same time, can produce costs by preventing shareholders from recording their views on the performance of individual directors each year. Given the ambiguity from a theoretical standpoint, empirical evidence is useful in advancing the debate.

To contribute to the empirical assessment of the value implication of staggered boards, we use a quasi-experimental research design based on two Delaware court rulings. In particular, we focus on the Delaware Court of Chancery and Delaware Supreme Court rulings of October 8, 2010 and November 23, 2010, respectively, in the takeover battle between Airgas Inc. and Air Products and Chemicals, Inc. The rulings focused on the permissibility of shareholder-adopted bylaw amendments that substantially weaken the antitakeover force of staggered boards, arising from Air Products' battle to take over Airgas. The Delaware Chancery Court initially ruled that such shareholder-adopted bylaw amendments are permissible, but the Delaware Supreme Court subsequently reversed and held such measures to be invalid.

We examine the cross section of stock returns surrounding the announcements of the rulings and compare the returns of the set of companies that were most affected by the rulings with the returns of companies that were not impacted. We estimate the average treatment effect for the treated group of firms using standard ordinary least squares (OLS) regressions as well as propensity score matching methods. We also employ placebo tests and simulation methods to rule out alternative explanations and assess the significance of our estimated treatment effects. Overall, our evidence is consistent with the hypothesis that the value of the affected companies was increased by the initial ruling weakening the antitakeover force of staggered boards and was decreased by the ruling's subsequent reversal. We also find that these pairs of relative market responses are unlikely to arise from random sampling variation.

Our findings that the weakening of the antitakeover force of staggered boards, on average, improves firm value are consistent with the support among certain institutional investors for proposals to repeal staggered boards. These findings are also consistent with the view that the continued de-staggering of boards—an ongoing process since the early 2000s—can be expected to produce benefits for shareholders. However, interpretation of our results is subject to the following two caveats. First, because we estimate the average treatment effect of staggered boards for the affected firms in our sample, we cannot rule out the possibility that staggered boards might have heterogeneous effects. Future empirical work might consider how the impact of staggered boards on firm value varies for different types of firm. For example, useful toward understanding the value implications of staggered boards (and of takeover defenses in general) would be to empirically identify some subsets of firms for which the effect is zero or positive. Second, our setting takes as given the current Delaware rules allowing for the unhindered use of defensive tactics such as poison pills to deter unwanted

[1] Council of Institutional Investors, *Corporate Governance Policies*, p. 3; American Funds, *Proxy Voting Procedures and Principles*, p. 3; BlackRock, *Proxy Voting Guidelines for US Securities*, p. 6; California Public Employees' Retirement System, *Global Principles of Accountable Corporate Governance*, p. 17; Fidelity Investments, *Corporate Governance and Proxy Guidelines*, p. 11; TIAA-CREF, *Policy Statement on Corporate Governance*, p. 31; Vanguard, *Vanguard's Proxy Voting Guidelines*, p. 2; and RiskMetrics Group, *2010 US Proxy Voting Guidelines Summary*, p. 18.

[2] For examples of statements of boards of directors in opposition to shareholder proposals in favor of board de-staggering brought to a vote in 2010 annual meetings, see the 2010 proxy statements of Abercrombie & Fitch Co.; Bancorp South, Inc.; and Hospitality Properties Trust.