



**University of
Zurich** ^{UZH}

Department of Banking and Finance

Master Thesis

The Efficiency of Takeover Defense Tactics The Use of Poison Pills

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Executive Summary

Problem

Takeovers provide a popular and useful means of achieving corporate growth and new business respectively market entry. The last decades have seen extraordinary levels of merger and acquisition activity globally. Not all approaches are conducted in a friendly manner, a significant proportion of all takeovers are hostile or unsolicited. This was especially the case during the 1980s, the era of the fourth merger wave. This era of the fourth merger wave was according to DePamphilis (2012) “a decade that saw the rise of corporate raider”, and was “characterized by the breakup of many major conglomerates and a proliferation of the hostile takeover and the leveraged buyout (LBO) as raider’s primary acquisition strategy”. In response to the active market for corporate control and attack of corporate raiders, companies have invented a wide range of takeover defense tactics including poison pills to contend against unfriendly takeover attempts.

Although the number of unsolicited and hostile takeover attempts dropped immensely after the era of the fourth merger wave, the motives behind the use of takeover defense tactics and the effectiveness of them have been questioned for a long time and the discussion about it is still ongoing. Supporters of the pill argue that the installment of such a defensive device is mainly for the benefit of the shareholders. It gives the managers an instrument which helps them to avoid distractions in order to fulfill their job and maximize the shareholder value of the firm. And if a takeover is inevitable, the adoption of poison pills allows the target managers to negotiate a larger premium in the bargaining process and therefore maximize benefits for the shareholders. Critics however argue that poison pills and other takeover defense tactics hinder or even eliminate the market for corporate control which according to Manne (1965) serves as a disciplinary mechanism for inefficient managers by replacing them with more efficient ones. Critics therefore claim that antitakeover devices entrench managers and consequently harm shareholders.

Research Objective

The present thesis focuses on one main research objective, namely on the impact of poison pills and whether this impact is beneficial to shareholders or not. Empirical studies conducted on this topic show evidence supporting both supporters and critics of takeover defense tactics and especially poison pills. Therefore, the effect of existing poison pills and morning after pills on premiums in unsolicited takeover attempts is examined. Moreover, the analysis answers

the question whether the empirical evidence supports rather the shareholder interests hypothesis or the management entrenchment hypothesis. While a positive impact on premiums would indicate evidence for the first hypothesis, a negative impact would suggest the later one. Despite the possible principal-agent problem in companies, results supporting the beneficial aim of poison pills are expected.

Proceeding

At first, after a brief discussion on basic characteristics of poison pills, a survey of academic literature assessing empirically determined impacts of poison pills on takeover attempts in regard to likelihood of deterrence and effect on premiums is provided. These insights should provide a theoretical and empirical background for the following main part which derives a model based on target characteristics, acquirer characteristics and deal characteristics to interfere in the discussion about the efficiency of poison pills to bargain larger premiums. In a next step, the framework of the models with its underlying variables and the data are described. Finally, the effect of poison pill adoption on premiums in unsolicited takeover attempts is estimated by multiple ordinary least squares regressions. The empirical analyses conducted include effects of poison pills on premium increases and total premiums as well as the effect of the combination of poison pills and staggered boards on these premiums.

Results

The solely investigation of the data reveals interesting facts. Comparing target firms of unsuccessful bids and successful offers, a substantial discrepancy is observed for the existing poison pill variable. Target firms of unsuccessful bids have a considerable higher occurrence of existing poison pills prior to the takeover attempt. The comparison of firms targeted for takeover that employ poison pill plans with the remainder of sample target firms reveals a clear distinction regarding premiums, namely that firms with poison pills get larger takeover premiums – initial premiums, premium increases and consequently final premiums. Another interesting observation is that firms with poison pills on average have lower ROEs in the year prior to the takeover announcement than companies without such defense tactics. The same discrepancy is observed between firms with poison pills in place before the bid and firms adopting morning after pills. Also, in contrast to companies with existing poison pills, firms which adopt morning after pills experience on average lower initial premiums, but converge to nearly

the same terms in final premiums because of larger premium increases during the bargaining process.

In order to determine which of the hypotheses – the shareholder interests hypothesis or the management entrenchment hypothesis – rather holds true, an additional investigation of unsolicited takeover attempts is carried out in a more refined multivariate setting. The regressions on total premiums estimated in this thesis provide evidence for a bargaining power effect of both existing poison pills and morning after pills. Firms with poison pills already in place before the takeover attempt feature on average a 19.66% larger total premium *ceteris paribus* than firms that do not have such a defensive device, whereas firms adopting morning after pills feature on average even a 22.54% larger final takeover premium other things being equal. This both findings are verified at 1% statistical significance (p-value 0.0096) and at 5% statistical significance (p-value 0.0392), respectively. In contrast, regressions on premium increases estimated in this thesis provide only evidence for a bargaining power effect of morning after pills. The adoption of poison pills as a response to an unsolicited bid affects premium increases nearly at a 5% significance level (p-value 0.0573), suggesting a 4.05% higher premium increase *ceteris paribus*. Further, regressions on premium increases and on total premiums (using a modified data sample with only US public targets) reveal that the combination of poison pills and staggered boards has no statistically significant effect on takeover premiums.

Summing all up, it can be concluded that poison pills are indeed beneficial to the shareholders and therefore the shareholder interests hypothesis holds true. But, there are still some indicators supporting the management entrenchment hypothesis and thus this hypothesis cannot be ruled out completely. And lastly, while the combination of poison pills and staggered boards is an extensively effective defense tactic to deter takeover attempts, it has no impact on premiums whatsoever.