Do anti-takeover provisions inhibit disciplinary takeovers and `cause' poor investments? Evidence from the market for corporate control

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This article posits that anti-takeover provisions (ATPs) do not cause managers to make value-destroying investments and that this is because ATPs do not protect managers from disciplinary takeovers.

The literature suggests that firms with more ATPs have lower firm-value and make worse takeovers. The `entrenchment' hypothesis holds that this is because (a) ATPs cause managers to make worse investments, and (b) this is because ATPs cause protection from disciplinary takeovers. The alternative `agency' hypothesis is that latent agency conflicts cause managers to make worse investments, and this causes managers to adopt ATPs for protection from disciplinary takeovers. Prior tests of limb (a) have focused on long-term value, which is problematic since ATPs are not new news; and thus, an efficient market should already have priced the impact of ATPs into long-term performance Prior tests of limb (b) have focused on whether ATPs reduce the likelihood of takeovers in general, not whether they reduce the likelihood of a `disciplinary takeover', in specific. Thus, this paper re-examines the causality underlying the entrenchment theory using takeover decisions, about which ATPs may convey information. The results indicate that ATPs do not cause firms to make worse takeovers, and that this is because ATPs do not shield managers from disciplinary takeovers. This suggests that ATPs may not destroy value.

The paper is available here