The Monitoring Effects of Institutions, Outside Directors, and Outside Blockholders on Manager's Decision: The Case of Antitakeover Measures Adoption

Hyuntai Choo*

─────────────────〈ABSTRACT〉─────────────────

This study examines the monitoring effects of institutions, outside directors, and outside blockholders by seeing managers' selection of antitakeover measures. In this paper, we hypothesize that managers use antitakeover techniques to entrench themselves when they are not monitored closely. Consequently, we hypothesize that institutional ownership, outside membership on board of directors, outside directors ownership, and outside blockholder ownership are less in firms which adopt harmful antitakeover measures.

This paper analyzes whether the degree of monitoring by institutions, outside directors, and outside blockholders influences managers' adoption of different types of takeover defenses. We find interesting empirical results. First, aggregate institutional ownership is positively correlated with the likelihood of antitakeover techniques adoption. This result implies that institutional investors are passive. Second, total and active blockholder ownership is higher at firms that do not propose any defensive tactics. passive blockholder ownership is highest at fair price firms but low at poison pills firms. Ownership concentration by outside investors increases monitoring and reduces agency problems. Thirid, outside board monitoring is ineffective.

1. Introduction

The monitoring effects of outside directors, outside blockholders, and institutions have been extensively researched. Shleifer and Vishny (1986) present the active monitoring hypothesis, while Pound (1988) suggests the passive voting hypothesis. Shleifer and Vishny

(1986) state that large outside shareholders, such as institutional investors, effectively monitor manager actions, while Pound (1987) suggests that most large shareholders are passive and support managers actions. Agrawal and Mandelker (1990) support active monitoring hypothesis by finding a significant positive relationship between shareholder wealth effect and institutional ownership during antitakeover amendments adoptions.

Jensen and Meckling (1976) argue that managers are more likely to harm shareholders if their actions are not monitored. As the percentage of outside directors to total directors increases, managers are more likely to be directly monitored in their decision processes. Fama and Jensen (1983) argue that outside board of directors play a critical role in monitoring managerial actions, while Demsetz (1983) suggests that monitoring by outside board members is ineffective. Klein and Rosenfeld (1988) support the view that internal mechanisms monitor top management actions. Outside director ownership in a firm is expected to align outside directors interests and common shareholders interests. According to the active monitoring hypothesis, it is less likely for managers in a firm with higher outside ownership to adopt antitakeover techniques which harm shareholders.

We hypothesize that managers use antitakeover amendments to entrench themselves when they are not monitored closely. Consequently, we hypothesize that institutional ownership, outside membership on boards of directors, outside directors ownership, and outside blockholders ownership are less in firms which adopt harmful antitakeover techniques.

This paper analyzes whether the degree of monitoring by institutions, outside directors, and outside blockholders influences managers' adoption of different types of takeover defenses. The specific anticipatory antitakeover techniques considered are poison pills, classified board amendments, and fair price amendments. Classified board amendments, fair price amendments, and poison pills are usually adopted as anticipatory takeover defenses prior to an explicit hostile tender offer bid. Antitakeover charter amendments require shareholder approval before the adoption while a poison pill can be implemented without shareholder approval. Previous studies show that the direction and the extent of share price reactions varies over the different types of antitakeover techniques. The adoption of anticipatory antitakeover techniques may be related to the degree of monitoring by outside directors or outside blockholders. To our knowledge, no existing study has analyzed the monitoring effects of institutions, ouside directors, or outside blockholders on managers' adopting poison pills instead of antitakeover amendments or taking no action.[1]

Table 1. A summary of previous studies on wealth effects of antitakeover techniques

	Types	%Return	Interval	Size	Period
DeAngelo&Rice (1983)	Antitakeover Amendments	-0.1621	(0,1)	100	1974~1979
Linn&McConnell (1983)	Antitakeover Amendments	+0.075	(0,1)	398	1960~1980
Jarrell&Poulsen (1987)	Antitakeover	-1.25a	(-20,0)	649	1979~1985
	Amendments	-0.04	(-1,1)		
	Fair price	-0.65	(-20,0)		
	Non-pair price	-2.95a	(-20,0)		
	Supermajority	-4.92a	(-20,0)		
	Classified Board	-1.29	(-20,0)		
Agrawal&Mandelker (1990)	Antitakeover	+0.2	(-1,1)	356	1979~1985
	Amendments	-1.3a	(-20,1)		
Office of Chief Economist(1986)	Poison pills	-0.22	(-1,0)	245	1982~1986
Malatesta&Walkling (1988)	Poison pills	-0.915a	(-1,0)	118	1982~1986
Ryngaert(1988)	Poison pills	-0.34a		380	1982~1986

a Significant at the 0.05 level.

To determine whether the monitoring by institutions, outside directors, or outside blockholders influences managers' choices over different types of antitakeover techniques, we utilize a multinomial logistic regression analysis. The explanatory variables chosen are institutional ownership, the percentage of outside directors, outside director ownership, and outside blockholder ownership.

This paper consists of four sections. The remainder of this paper is organized as follows. Section two of the paper presents the model development and the hypotheses. Data, empirical tests and results are presented in section three. Section four draws conclusions.

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1) Bhagat and Iefferis(1991), Brickley, Lease, and Smith(1988), and Jarrell and Poulsen(1987) focus on antitakeover amendments and variables that proxy agency cost.

Table 2. Independent variables and expected signs in multinomial logistic regression.

Multinomial logistic regression: Type $= g$ (INST/OUTDIR1/OUTDIR2/OUTBLK)

Hypothesis	Independent variables	Relationship between independable variable and the adoption of the most harmful technique
1.	Institutional ownership	negative
2.	Percentage of outside directors	negative
	Outside director ownership	negative
	Outside blockholder ownership	negative

2. Model Development and Hypotheses

2. 1 Model Development

Table 1 shows that the share price response surrounding the announcement of antitakeover techniques is different for various takeover defenses. The differences in the share price responses may result from different effects of various takeover defenses on the probability of a bid or success of the offer, cost to the bidder, or preventing or encouraging an auction. Consequently, ex-post, we can express the share price response (CAR) as a function of the type of antitakeover technique:

$$CAR = f\ (TYPE\ OF\ ANTITAKEOVER\ TECHNIQUE) \tag{1}$$

A negative CAR supports the management entrenchment hypothesis and is consistent with antitakeover techniques that reduce the probability of a successful offer or an auction and increase the cost to the bidder. A positive or zero CAR supports the alignment hypothesis and should be observed with defenses that increase the bid premium without substantially reducing the probability of the success of a tender offer.

The degree of monitoring by institutions, outside directors and outside blockholders may play a role in influencing the manager's selection of the type of antitakeover technique.

$$TYPE\ =\ g\ (degree\ of\ monitoring\ by\ outside\ directors\ or\ outside$$
$$blockholders) \tag{2}$$

Institutional ownership(INST), the percentage of outside directors (OUTDIR1), outside director ownership(OUTDIR2), and outside blockholder ownership(OUTBLK) attempt to capture the degree of direct and indirect monitoring. We can rewrite (2) with the above explanatory variables as follows:

$$TYPE = g \ (INST/OUTDIR1/OUTDIR2/OUTBLK) \qquad (2')$$

The above model (2') is the model used for a multinomial logistic regression in this study to analyze the degree of monitoring by institutions, outside directors and outside blockholders. We examine the effects of above variables on choosing a specific type of antitakeover technique.

2. 2 Hypotheses

Following hypotheses are developed from the above discussion. The hypotheses are concerned with the impact of monitoring by institutional ownership, the number of outside directors to total directors, outside director ownership, and outside blockholders on the type of antitakeover technique:

Hypothesis 1: Managers choose the most harmful antitakeover techniques when institutional ownership is low.

Hypothesis 2: Managers choose the most harmful antitakeover techniques when the number of outside directors to total directors, outside directors ownership, and outside blockholders ownership are low.

Table 2 summarizes the expected relationship between the selection of a specific antitakeover technique and independent variables in our empirical model, based on the above hypotheses.

3. Data and Empirical Tests

3. 1 Data

Standard sample selection procedures in many previous studies of antitakeover techniques are used. An initial sample of firms adopting antitakeover amendments or poison pills is identified from a directory of major American corporations with antitakeover charter amendments or poison pills which is published by Investor Responsibility Research

Center (1990). Firms adopting poison pills in this preliminary sample are verified in the Wall Street Journal Index (WSJI). A matched sample of nonadopting firms is collected from CRSP tapes by matching the announcement date, three digit SIC code, and firm size. For each firm in the matched sample, we locate the proxy statement closest to the mailing date of the corresponding firm which adopted an antitakeover technique. Firms that adopt classified board amendments, fair price amendments, or take no action are verified by proxy statements. To qualify for inclusion in the final sample, firms have to meet the following selection criteria:

(a) The sample contains industrial public corporations that adopted an anticipatory defense including antitakeover amendments (classified board and fair price amendment) or poison pills during 1980~1989. (b) The date of the initial public announcement is identified in the proxy statements for antitakeover amendments or the WSJI for poison pills. (c) No other extraordinary firm-specific announcement occurs within the period 5 days prior to the announcement date and 5 days afterwards. (d) The firms' daily common stock returns around the public announcement are available in the CRSP Daily Return File. The firm must have been listed on the NYSE or AMEX for at least 3 years prior to the announcement and 1 day afterwards. (e) Institutional ownership data, the percentage of outside directors data, outside director ownership data, and outside blockholder ownership data must be available in either the latest proxy statement, Standard & Poors Stock Guide, or COMPUSTAT tapes before the announcement of the adoption of antitakeover techniques.

The final sample consists of 54 poison pills, 44 classified board amendments, 58 fair price amendments, and 156 nonadopting firms. The classification between fair price amendments and non-fair price amendments follows Jarrell and Poulsen (1987). Hence, the category of fair price amendments in our sample includes the simultaneous adoption of both classified board amendments and fair price amendments.

3. 2 Independent Variables

This paper investigates the relation between the type of antitakeover technique selected by managers and independent variables representing the degree of monitoring by institutions, outside directors, and outside blockholders. In our empirical model for logistic regression analysis, INST(institutional ownership), OUTDIR1(the percentage of outside directors to

total directors), OUTDIR2(the outside director ownership), and OUTBLK(the outside blockholder ownership) are independent variables representing the degree of monitoring by institutions, outside directors and outside blockholders.

Institutional ownership (INST)

Shleifer and Vishny (1986) present the active monitoring hypothesis, while Pound (1988) suggests the passive voting hypothesis. Shleifer and Vishny (1986) state that large outside shareholders, such as institutional investors, effectively monitor manager actions. Share price response to the adoption of antitakeover techniques should then be positively related to institutional shareholdings. Pound (1987) argues that most large shareholders are passive and support managers' self-interest motivated actions. A negative relationship between share price responses and antitakeover techniques adoption would then be expected. Jarrell and Poulsen (1987) report a positive relationship between abnormal returns and institutional holdings. Agrawal and Mandelker (1990) also support active monitoring hypothesis by finding a significant positive relationship between shareholder wealth effect and institutional ownership during antitakeover amendments adoptions. Bhagat and Jefferis (1990) report that ownership by institutional investors does not appear to have a substantial impact on the introduction of antitakeover amendments. Institutional stockholdings are collected from Standard & Poors Stock Guide.

Percentage of outside directors to total directors (OUTDIR1) *and outside director ownership*
   (OUTDIR2)

Jensen and Meckling (1976) also argue that managers are more likely to harm shareholders if their actions are not monitored. As the percentage of outside directors to total directors increases, managers are more likely to be directly monitored in their decision processes. Klein and Rosenfeld (1988) support the view that internal mechanisms monitor top management actions. It is less likely for managers monitored by outside directors to adopt antitakeover techniques which harm shareholders. Thus, the share price response to antitakeover techniques is positively related to the percentage of outside directors. Weisbach (1988) reports that CEO turnover is more highly correlated with firm performance in firms having a majority of outside directors than in those where insiders predominate, implying that outside directors are important in monitoring.

Outside director ownership in a firm is expected to align outside directors interests and common shareholders interests. Thus, it is less likely for managers with higher ownership in a firm to adopt antitakeover techniques which harm shareholders.

Outside director data are collected from the proxy statements of the firms proposing antitakeover techniques and matched sample firms. The percentage of outside directors is calculated by dividing the number of outside directors by total directors.

Outside blockholders ownership (OUTBLK)

Shleifer and Vishny (1986) argue that outside blockholders effectively monitor managers actions, while Pound (1987) suggests that most large shareholders are passive and support managers actions. According to the active monitoring hypothesis, it is less likely for managers in a firm with higher outside ownership to adopt antitakeover techniques which harm shareholders.   Outside blockholder ownership data are collected from the proxy statements of the firms adopting antitakeover techniques and matched sample firms.

3. 3 Methodology

In this study, multinomial logit analysis is used to examine whether systematic relations exist between the explanatory variables and the type of takeover defenses selected before a takeover bid.

Multinomial logistic analysis is used to examine the impact of explanatory variables on the probability that a firm selects each of different types of antitakeover defenses before a takeover attempt. Our sample is classified into four categories which consists of poison pills, classified board amendments, fair price amendments, and nonadopting firms.

A multinomial logit regression is conducted to estimate coefficients of our logistic model for the sample. The dependent variable in this analysis is 1, 2, 3, and 4 indicating poison pills, classified board amendments, fair price amendments, and non-adopting firms respectively. All firms will select one of $J = 4$ categories. Each firm's selection is predicted by each explanatory variable, designated by INST/OUTDIR1/OUTDIR2/OUTBLK. Defining P_j as the probability that a given firm will eventually select category J, the multinomial logit model postulates that the P_j's of the firm can be estimated as follows:

Table 3. Summary statistics by type of antitakeover technique

Panel I The mean and median value of variables for sample firms proposing antitakeover techniques and nonproposing firms, in the period 1/1/1980 to 12/31 1989. All data are from the Proxy Statement, Standard & Poors Stock Guide, or CRSP file. All firms in the proposing sample adopted only one of the three techniques listed in the proxy statement over the sample period.

Type	Variable							
	INST (%)		OUTDIR1 (%)		OUTDIR2 (%)		OUTBLK (%)	
	MEAN	MED	MEAN	MED	MEAN	MED	MEAN	MED
Poison pills	51.48	55.38	73.70	75.00	2.98	0.53	7.33	2.55
Classified-board amendments	39.56	40.30	71.91	71.01	5.26	0.74	7.49	0.00
Fair-price amendments	47.13	47.41	72.66	74.17	4.11	0.84	11.51	5.80
Nonadopting	30.70	27.00	66.05	66.67	3.93	0.71	16.37	11.56

a INST = Institutional ownership
   OUTDIR1 = Percentage of number of outside directors to total directors
   OUTDIR2 = Outside directors ownership
   OUTBLK = Outside blockholders ownership excluding outside directors
b Significant at the 0.05 level.

Panel II. Difference between means and pairwise parametric tests indicating whether the mean are different at 5% level or better[b].

	INST (%)	OUTDIR1 (%)	OUTDIR2 (%)	OUTBLK (%)
Poison Pill - Classified Board	11.93[b]	1.789[b]	-2.2804	-0.157
Poison Pill - Fair Price	4.35	1.042	-1.1257	-4.185
Poison Pill - Nonadopting	20.78[b]	7.647[b]	-0.9455	-0.9042[b]
Classified Board - Fair Price	-7.57[b]	-0.747	1.1547	-4.029
Classified Board - Nonadopting	8.85[b]	5.858[b]	1.3350	-8.885[b]
Fair Price - Nonadopting	16.43[b] ·	6.605[b]	0.1803	4.185

$$Z_j = b_{j1}(INST_i / OUTDIR1_i / OUTDIR2_i / OUTBLK_i)$$
$$for\ each\ type\ j = 1, 2, 3, 4$$
$$P_j = exp(Z_j) / \sum_{j=1}^{4} exp(Z_j)$$

where

INST$_i$ = the percentage of stock owned by institutional investors on firm i,

OUTDIR1$_i$ = the percentage of outside directors to total directors on firm i,

OUTDIR2$_i$ = the outside directors ownership on firm i,

OUTBLK$_i$ = the outside blockholders ownership on firm i,

Z_j is the log ($P_j/P4$) and P_j is a firm's probability of selecting type j where j=1,2, or 3. The coefficients b_{j1} can be considered as the effect of each explanatory variable on a firm's probability of selecting type j. In this paper, we determine the effect of each explanatory variable on choosing different antitakeover techniques by examining the coefficient of each variable in our model.

3. 4 Summary Statistics

Table 3 summarizes the difference in percentage of institutional ownership, outside directors to total directors, outside directors ownership, and outside blockholder ownership for the proposing and nonproposing samples and reports the results of pairwise tests.

Monitoring is proxied by aggregate institutional ownership, outside blockholder owner-ship, composition of the board of directors, and outside director ownership. Aggregate in-stitutional ownership is smaller at non-proposing firms than all proposing firms. Surprisingly, aggregate institutional ownership is highest for poison pill firms. This result suggests that non-blockholder institutions do not have incentives to monitor managers. Next, we examine whether outside blockholders monitor managers and whether the type of block ownership varies across categories.

The statistics support the view that outside blockholders are effective monitors. Non-pro-posing and fair price firms have appreciable mean (median) outside blockholder ownership of 16. 37% (11.56) and 11.51% (5. 8) respectively. Alternatively, the mean (median) outside blockholder ownership is 7.48% (0%) and 7.33% (2.55%) for classified board and poison pill firms respectively. Table 3 shows that poison pill and classified board firms have sig-

nificantly lower outside blockholder ownership than non-proposing firms.

To determine whether outside block ownership reflects monitoring, Table 4 analyzes the frequency and type of blockholder for each category. The type of blockholder is categorized as passive, active, or indeterminant.[2] The passive category includes banks, trusts, and insurance firms. ESOP ownership is not included in the outside blockholder category but is considered passive. The active category represents investment firms, pension plans, and unaffiliated companies that have a controlling interest (greater than 20%). Individuals and firms that could not be classified are considered indeterminant.

Several interesting trends emerge. First, nonproposing firms have the highest active (8. 66%) and indeterminant (4.25%) block ownership. Table 5 shows that unaffiliated company ownership (at least 20%) is much higher at nonproposing firms than all proposing firms. Furthermore, investment company ownership is significantly higher at nonproposing firms than fair price firms or classified board firms. Moreover, N4 in Table 4 shows that a large number of nonadopting firms had investment companies (49/156), control companies (16/156), unaffiliated individuals (31/156), or unaffiliated non-controlling firms (23/156).[3]

Fair price firms have the highest amount of total passive shareholders (6.07%) compared to 3.6% for non-adopting firms. Table 4 also shows that bank, trust, insurance, and ESOP ownership combined are significantly higher at fair price firms than at poison pill (1.45%) and classified board (1.9%) firms. Therefore, pressure-sensitive institutions seem to influence the type of anticipatory technique selected. A particularly interesting result is that poison pill and classified board firms have few ESOP blockholders. ESOP ownership, however, is not significantly different across categories in Table 5.

To summarize, all types of blockholders appear to influence managers' decisions. Nonproposing firms are primarily monitored by active blockholders. Passive blockholders appear to support fair price amendments but not classified board amendments or poison pills. Although outside blockholder ownerships of 7.48% and 7.33% for poison pills and classified board firms respectively is low, the composition is different. Active shareholder ownership is significantly higher at poison pill firms than at classified board firms. Consequently, the poison pill firms may attempt to offset monitoring by outside blockholders by

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2) See Fischel(1983) and Brickley, Lease, and Smith(1988).

3) Some firms have more than one type of blockholders.

Table 4. Classification of outside blockholders for the sample firms adopting antitakeover techniques and nonadopting firms during the period 01/01/80 through 12/31/89.

Panel I. Ownersip by the type of outside blockholders. (t statistics are in parentheses)

Classification		Ownership (%)							
		Percentage of common stock owned by outside blockholders							
		PP[d]		CB		FP		NON	
		Mean	N_1[e]	Mean	N_2	Mean	N_3	Mean	N_4
Passive	Bank	0.63[a]	3	0.95a	4	1.82c	12	1.06c	15
		(1.76)		(1.95)		(3.34)		(3.72)	
	Trust	0.10	1	0.00	0	2.59[a]	6	1.16[c]	8
		(1.00)		(−)		(1.78)		(2.48)	
	Insurance	0.55[a]	3	0.22	1	0.21	2	0.50[c]	9
		(1.73)		(1.00)		(1.41)		(2.75)	
	ESOP	0.17	1	0.73	2	1.45[b]	5	0.97[c]	10
		(1.00)		(1.21)		(2.07)		(2.66)	
	Total	1.45[c]		1.90[b]		6.07[c]		3.68[c]	
		(2.94)		(2.45)		(3.61)		(5.60)	
Active	Investment Co.	2.73[c]	16	1.78[c]	10	1.79[c]	10	3.93[c]	49
		(4.17)		(3.37)		(2.77)		(6. 10)	
	Pension	0.25	2	0.00	0	0.00	0	0.05	1
		(1.39)		(−)		(−)		(1.00)	
	Control Co.	1.13	2	0.00	0	1.33	3	4.69[c]	16
		(1.14)		(−)		(1.47)		(3.99)	
	Total	4.12[c]		1.78[c]		3.12[c]		8.66[c]	
		(3.77)		(3.37)		(3.11)		(6.85)	
Indeterminate	Individual	0.59[a]	5	0.99[b]	5	0.59	3	2.19[c]	31
		(1.90)		(2.26)		(1.47)		(4.87)	
	Company	0.98[c]	7	2.79[b]	9	1.07[b]	5	2.06[c]	23
		(2.73)		(2.62)		(2.07)		(4.48)	
	Total	1.57[c]		3.78[c]		1.66[b]		4.26[c]	
		(2.90)		(3.17)		(2.60)		(6.53)	

a Significant at the 0.10 level.
b Significant at the 0.05 level.
c Significant at the 0.01 level.
d PP : Poison pill (N=54) CB : Classified board amendment (N=44)
  FP : Fair price amendment (N=58) NON : Nonadopting (N=156)
e N_1, N_2, N_3, N_4 : the number of firms in each category (PP, CB, FP, NON) that had each type of blockholder.

Table 4. — Continued

Panel II. Differences between means by type of outside blockholder ownership and pairwise parametric statistics indicating whether the means are different at the 5% level or better.

	Bank	Trust	Passive Insurance	ESOP	Total Passive	Active Investment Co.	Pension	Control Co.	Total Active	Indeterminant Individual	Company	Total Indeterminant
1 - 2	- 0.32	0.10	0.33	- 0.57	- 0.45	0.96	0.25	1.13	2.34	- 0.40	- 1.80	- 2.21
1 - 3	- 1.19	- 2.49[b]	0.34	- 1.28	- 4.62[b]	0.95	0.25	- 0.20	1.00	- 0.00	- 0.09	- 0.09
1 - 4	- 0.43	- 1.06	0.06	- 0.80	- 2.23	- 1.20	0.20	- 3.55[b]	- 4.55[b]	- 1.60[b]	- 1.08	- 2.69[b]
2 - 3	- 0.87	- 2.59[b]	0.01	- 0.72	- 4.16[b]	- 0.01	0.00	- 1.33	- 1.34	0.40	1.72	2.12
2 - 4	- 0.11	- 1.16	- 0.28	- 0.23	- 1.78	- 2.15	- 0.05	- 4.69[b]	- 6.89[b]	- 1.20	0.72	- 0.48
3 - 4	0.76	1.43	- 0.29	0.48	2.39	- 2.14[b]	- 0.05	- 3.35[b]	5.54[b]	- 1.60[b]	- 1.00	- 2.60[b]

a1 : Poison pill 2 : Classified board amendment 3 : Fair price 4 : Nonadopting.
b : significant at the 0.05 level.

choosing a technique that does not require shareholder approval. These finding are consistent with the conjecture that all types of outside blockholders monitor the actions of managers.

The number of outside directors to total directors is significantly higher at all proposing firms than at nonproposing firms. Outside director ownership, however, is not significantly different across categories. These findings suggest that monitoring by outside directors is ineffective.

3. 5 Empirical Evidence

Institutional Ownership

In Table 6, we find that the impact of institutional investors on fair price amendments and poison pills is strong. Institutional presence is positively related to adoption. The firms with higher institutional ownership are more likely to adopt poison pills. The result supports Pound's (1987) assertion that institutions are passive. Thus, institutional investors in aggregate have little incentive to monitor managers' actions.

Table 5. *Announcement returns realized by sample firms offering antitakeover techniques during the period 01/01/80 through 12/31/89 and nonadopting firms. Day 0 is the proxy mailing date for classified board or fair price amendments and the announcement date in the Wall Street Journal for poison pills. The CRSP equally weighted index is the market index. Each firm adopted one type of antitakeover technique. Nonproposing firms do not propose any technique during the sample period and are selected on the basis of size and industry. Z statistics are constructed using standardized returns (see Dodd and Warner, 1983).*

| Portfolio | Announcement returns for days [-1,1] | | | | | |
	Mean	Median	Standard deviation	z-statistic	Sample size	Number positive
Poison pill	- 0.0078	- 0.0075	0.0259	- 1.5084[a]	54	23[b]
Classified board amendment	0.0019	- 0.0008	0.0226	- 0.4728	44	10
Fair price amendment	0.0042	0.0022	0.0253	0.4916	58	31
Nonproposing	- 0.0006	- 0.0032	0.0727	0.5055	156	69

[a] significant at the 0.10 level.
[b] significant at the 0.05 level by using a sign test.

The type of institutions may differ between firms that adopt poison pills and fair price amendments (Brickley, Lease, and Smith).[4] This conjecture cannot be tested but the next section analyzes the difference between types of blockholders.

Outside Blockholder Ownership

We record ownership by 5% blockholders as recorded in the proxy statement that are not employees (including ESOPs) or board of directors. A blockholder is unaffiliated if the firm does not have any type of relationship or is not an individual related to an officer. The results show that total ownership by outside blockholders discourages managers from adopting poison pills, classified board amendments, and fair price amendments. Thus, the

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4) Ideally, we would like to examine the type of institutional ownership. Brickley, Lease, and Smith(1988) show that institutions that are independent of management respond differently to antitakeover amendments from institutions that are aligned with management. Since the majority of individual institutional ownership is less than five percent and Standard & Poors only provides total institutional ownership, we will not be able to examine this issue. We will, however, examine the type of blockholder ownership across categories.

Table 6.

Estimated coefficients from multinomial logit regressions relating the choice of antitakeover techniques and variables in the period 01/01/80 through 12/31/89 (number of observations = 312).

Regressions		Estimated Coefficient (chi-squared statistic in parentheses)	Intercept
$Y^d = a + b(INST)$	Log(P1/P4)	0.0674c	- 3.8639
		(39.04)	(52.99)
	Log(P2/P4)	0.0265c	- 2.1977
		(7.72)	(30.43)
	Log(P3/P4)	0.0509c	- 3.8639
		(28.47)	(45.89)
	Model chi-squared statistic = 51.08		
$Y = a + b(OUTDIR1)$	Log(P1/P4)	0.0440c	- 4.1498
		(11.10)	(18.42)
	Log(P2/P4)	0.0319b	- 3.4733
		(5.59)	(12.76)
	Log(P3/P4)	0.0368b	- 3.5512
		(3.16)	(15.61)
	Model chi-squared statistic = 17. 64		
$Y = a + b(OUTDIR2)$	Log(P1/P4)	- 0.0211	- 0.9889
		(0.69)	(31.14)
	Log(P2/P4)	0.0188	- 1.3511
		(0.94)	(47.90)
	Log(P3/P4)	0.0031	- 1.0018
		(0.02)	(33.23)
	Model chi-squared statistic = 2.10		

Table 6. — Continued

Regressions		Estimated Coefficient (chi-squared statistic in parentheses)	Intercept
Y = a + b(OUTBLK)	Log(P1/P4)	- 0.0432c	- 0.5828
		(10.11)	(8.57)
	Log(P2/P4)	- 0.0419c	- 0.7972
		(8.21)	(13.87)
	Log(P3/P4)	- 0.0176a	- 0.7465
		(3.13)	(14.10)
		Model chi-squared statistic = 16.82	

a Significant at the 0. 10 level
b Significant at the 0. 05 level
c significant at the 0. 01 level
dY = 1 if a firm adopts Poison pills;
   2 if a firm adopts Classified-board amendments;
   3 if a firm adopts fair-price amendments;
   4 if a firm adopts no antitakeover technique.

creation of block ownership increases the incentives to monitor managers' actions. Table 6 shows that outside blockholder ownership is significantly related to the adoption of poison pills and classified board amendments, but less significantly related to the adoption of fair price amendments. The firms with higher outside blockholder ownership are less likely to adopt poison pills or classified board amendments.

To further examine this point, Table 4 compares the type of blockholders for each antitakeover technique to the type of blockholders in the non-proposing sample. Fischel (1983) and Brickley, Lease, and Smith (1988) argue that certain types of blockholders are sensitive to managerial pressure and thus are less effective monitors. For example, banks, insurance companies, non-bank trusts and ESOPs are current or potential stakeholders that provide services to the firm. Therefore, their outlook concerning managers' actions may not be objective. The adoption of antitakeover amendments should be more prevalent if these types of institutions are passive and pressure sensitive. Alternatively, pension funds, investment companies, takeover specialists, and firms with a controlling interest are argued to be monitoring specialists — pressure insensitive. Thus, firms with high ownership by these blockholders should be less likely to adopt antitakeover amendments. Miscellaneous institutions and individuals that could not be categorized are considered pressure indeterminant.

Holdings by all types of blockholders is high at non-adopting firms. Moreover, pressure-resistant ownership is significantly higher at non-adopting firms than all adopting firms. This evidence is consistent with the "active monitoring" hypothesis. The "passive voter" hypothesis concerning bank ownership is not reflected in the data. Pressure-sensitive ownership is significantly higher at nonadopting and fair price firms. Non the less, nonadopting firms have higher pressure-sensitive ownership than classified board and poison pill firms. Thus, pressure-sensitive firms do not provide blanket acceptance of the most harmful antitakeover techniques. Consequently, we provide evidence consistent with Brickley, Lease, and Smith (1988) that monitoring effectiveness is greatest for pressure-resistant blockholders. However, pressure-sensitive blockholders appear to invest in firms that do not have severe agency problems.

Outside Directors

We examine whether the percentage of outside board of directors influence

management's decision to adopt amendments or poison pills. Fama and Jensen (1983) argue that outside board of directors play a critical role in monitoring managerial actions. Thus, if defensive mechanisms are harmful to shareholders the likelihood of adoption should decrease with the percentage of outside directors. Alternatively, Demsetz (1983) suggests that monitoring by outside board members is ineffective. Then, outside board of directors passively accept managerial decisions. Our results show that outside board membership is positively related to poison pill adoption and charter amendments adoption. The firms with a higher percentage of outside directors are more likely to adopt poison pills. Therefore, outside board monitoring is ineffective.

Recently, a number of companies have encouraged outside directors to own stock in the firm. The stated goal is to align outside directors and common stockholders interests. The results show that outside board ownership is insignificantly positively associated with the adoption of classified board amendmentsand fair price amendments but insignificantly negatively related to poison pills adoption. Alternatively, Bhagat and Jefferis (1991) find that votes controlled by outside directors is a deterrent to antitakeover amendments adoption.

4. Conclusion

Managers' incentive to misuse defensive techniques depends on the degree of monitoring and personal gain/loss in the event of a successful bid. We hypothesize that managerial entrenchment occurs when managers are not monitored closely. Recent studies that address this issue restrict attention to the adoption of fair price or classified board amendments.[5] Yet, a poison pill is a frequently utilized alternative. Bidders frequently challenge the legal validity of and managerial intention for poison pills. The argument is that poison pills entrench managers by dramatically increase the cost of a successful bid.

The purpose of this paper is to examine whether the degree of monitoring by institutions, outside directors, outside blockholders influences managers' selection of the type of antitakeover technique. Are firms that unilaterally adopt poison pills systematically different from firms that seek shareholder approval for classified board and fair price amendments? Firms that have motives consistent with entrenchment should have less moni-

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5) See Agrawal and Mandelker(1990), Bhagat and Jefferis(1992), Brickley. Lease, and Smith (1988), and Jarrell and Poulsen(1987).

toring by outside board of directors, outside blockholders, and institutions. Moreover, the choice of antitakeover techniques will depend upon the type of blockholder. Pound (1987) argues that passive blockholders align themselves with management or sell their shares. Thus, firms that adopt the most harmful techniques may have more passive investors. Alternatively, Demsetz (1983) and Shleifer and Vishny (1986) suggest that blockholders that actively monitor can constrain managers' from choosing defensive tactics that reduce shareholders' wealth. Therefore, firms that do not propose takeover defenses should have more active block ownership.

Several interesting results emerge. First, aggregate institutional ownership is positively correlated with the likelihood of poison pills adoption, the adoption of classified board or fair price amendments. This result is consistent with Pound' (1987) assertion that institutional investors are passive. Second, we examine whether some outside blockholders are better monitors than others. Blockholders are categorized as active, passive, or indeterminant following Brickley, Lease, and Smith's (1988) definitions. Total and active block ownership is higher at firms that do not propose any defensive tactics. Passive block ownership is highest at fair price firms but low at poison pill firms. Consistent with Pound (1988), passive stockholders appear to only invest in firms with minimal agency problems but do not support managerial actions that harm shareholders. As expected, total block ownership is lowest at poison pill firms. Thus, we contend that ownership concentration by outside investors increases monitoring and reduces agency problems.

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