Undoing the Powerful Anti-Takeover Force of Staggered Boards

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Abstract

In this paper we examine cases where managers announce an intention to de-stagger their boards via either proxy proposals or board action. The literature has now established the staggered board as arguably the most consequential of all available takeover defenses. Thus, the dismantling of this structure in favor of annual director elections has important implications for shareholder rights and wealth. We study the wealth effects and motives behind this change in governance. Our results are consistent with the view that forcing directors to face annual election is good for shareholders. Moreover, it is firms with better governance and more active shareholders that are more likely to act in the interest of shareholders.

1.   Introduction

The many financial scandals arising out of the recent stock market bubble have refocused investors' attention on the importance of good governance practices. One aspect receiving considerable scrutiny of late is the prevalence of staggered boards: a structure whereby only one third of the directors stand for election in a given year. Bebchuk, Coates, and Subramanium (2002a) report that the existence of a staggered board is associated with an erosion of 8%-10% of shareholder value relative to firms that hold annual director elections. Furthermore, they find no evidence that an effective staggered board increases the premium paid in a hostile takeover.[1]   In this paper we examine cases where managers announce an intention to de-stagger their boards via either proxy proposals or board action. We document the wealth effects and explore the motives behind this decision.

Why might staggered boards destroy value? It is not a staggered board in isolation but rather the combination of a staggered board and a poison pill that creates a veritable fortress for the incumbent board. But since a board can install a pill at any time without shareholder approval, the staggered board becomes the crucial cog in this defense.[2] Control the board and you control the fate of the poison pill. The poison pill is such an effective defense that no pill has ever been triggered. How does a potential suitor gain control of a staggered board? It requires a minimum of two proxy fights separated by a minimum of one year (i.e., two annual shareholder meetings) to win a majority of

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[1] A companion paper, Bebchuk et al (2002b), extends this finding to negotiated transactions. More recent papers by Bebchuk and Cohen (2005) and Daines (2005) find additional evidence that staggered boards destroy value.

[2] An exception is the "dead hand" poison pill that can only be redeemed by the incumbent board, however, dead hand pills are routinely struck down by the courts, for example by the New York courts in the 1980s and the Delaware courts in the 1990s.

the seats on a staggered board, an arduous task. In fact, Bebchuk et al. (2002a) state that not a single potential suitor won a ballot box victory over an effective staggered board in the period studied (1996-2000). But how common are staggered boards?

As of the year 2000 approximately 60% of the boards of companies in the Investor Responsibility Research Center (IRRC) governance database were staggered (see Bebchuk and Cohen, 2005). Many firms adopted staggered boards in the 1980s in the midst of an explosion of hostile takeover activity and before the power of the staggered board as a defense had been well established. Since 1990 few firms have been able to convince shareholders to approve the adoption of staggered terms, but many firms adopt a staggered board prior to going public (see Daines and Klausner, 2001). Commensurate with the refusal to adopt staggered boards, shareholder proposals calling for the removal of the staggered structure are routinely the most common and the most popular, often receiving majority support (see Georgeson Shareholder Services, 2004). In spite of this shift in shareholder sentiment, few firms considered abandoning the staggered structure prior to 2003: though our events date back to 1987, two-thirds of our sample is from 2003 and 2004.

In this paper, we compile a dataset of 187 firms whose management has stated an intention to put a binding resolution to remove the staggered structure to a shareholder vote or simply removed the staggered structure with a board vote. We conduct an event analysis that is supportive of the idea that de-staggering the board is in the interest of shareholders. The cumulative abnormal returns (CARs) of those firms that intend to immediately switch to a policy of annual election of directors is about 1% and significant at the 5% level, while the CARs for firms that are slowly phasing in the annual election

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of directors are an insignificant -0.66%. Moreover, the difference in these CARs is about 1.7% and significant at the 1% level. The CARs are significantly related in the cross section to various firm and industry characteristics.

We also conduct a Probit analysis of the determinants of the decision to drop the staggered board structure. We find that it is generally those firms that would be considered to have good governance that are more inclined to drop the staggered structure. Firms with more debt, operating in an industry with more M&A activity, and better governance index scores are more likely to eliminate the staggered structure, while firms with poison pills in place are less likely to drop the staggered structure. Finally, shareholder proposals play a pivotal role in this process with shareholder proposals to de-stagger the board at sample firms outnumbering those at control firms by more than 6-to-1.

Our results are thus consistent with the view that forcing directors to face annual election is good for shareholders. Moreover, it is firms with good governance and/or active shareholders that are more likely to drop the staggered board structure in favor of annual elections, i.e., to act in the interest of shareholders.

This paper makes several contributions to the literature on corporate governance. Staggered boards are now recognized as the most potent takeover defense (see Bebchuk et al., 2002a, b; Bebchuk and Cohen (2005); and others). Ours is the first paper to examine firms' decisions to drop the staggered board in favor of annual elections – a decision that has become fairly common post Sarbanes-Oxley but was previously rare. We document that shareholder activism in the form of shareholder proposals is an important catalyst in pushing firms to make this change. Furthermore, our paper

contributes to the literature linking governance practices and firm value. Our results support the idea that better governance (in this case dropping the staggered board) is value-enhancing. Moreover, an event study framework, as we use here, is not plagued by endogeneity concerns of the type raised by Lehn, Patro, and Zhao (2005). Finally, we show that the level of takeover activity in a firm's industry (see Schlingemann. Stulz, and Walkling, 2002) affects their decision to adopt annual director elections and it is positively related to the CARs of our sample firms, suggesting that a significant portion of the wealth effects we document are related to a perceived enhanced probability of takeover upon switching to annual director elections.

Following this introduction, we review the literature on governance and firm value in Section 2. Section 3 describes our sample and data sources. Section 4 presents estimates of the Probit model of the decision to de-stagger. Section 5 shows the wealth effects associated with the decision to de-stagger and their determinants. Section 6 concludes.

2. Staggered Boards, Corporate Governance, and Firm Value

The notion of what constitutes good governance and the growing emphasis on the need for it are nothing new. While shareholders have campaigned for better governance for some time, the movement accelerated rapidly in the wake of oversight and conflicts of interest scandals at the likes of Enron, Worldcom, and Tyco International. Perhaps the penultimate step in this movement was the passing of the Sarbanes-Oxley legislation (hereafter, SARBOX) in 2002.[3] The academic contribution to this movement is more

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[3] In addition to SARBOX, many institutions have embraced the push towards better governance. These include the NYSE and NASD, who have developed minimum governance standards for listed companies,

recent, having largely begun with the paper of Gompers, Ishii, and Metrick (2003). This seminal paper spawned a new literature on the relationship between firm value and measures of the quality of corporate governance (see, for example, Bebchuk, Cohen, and Ferrell, 2004, Core, Guay, and Rusticus, 2005, and Dittmar and Mahrt-Smith, 2005 to name a few).[4]

The events of the 1980s revealed the power of the market for corporate control as a tool for enforcing good corporate governance. The hostile takeover became the modus operandi for a band of corporate raiders who saw others' excesses as an opportunity for a quick buck. In 1979, when the hostile takeover market was in its infancy, Marty Lipton developed the modern day poison pill (see Lipton, 1979). Thus began a huge push towards the use of various anti-takeover amendments or shark repellents to fend off the aforementioned raiders. It was unclear how these devices would be treated by the courts until the landmark case of Time vs. Paramount in 1989, which gave boards the right to "just say no" to an offer for the firm even if it appeared superior to any other offer on the table.

The academic literature on the use of anti-takeover amendments (ATAs) dates back some 25 years.[5] This literature is rather inconclusive in many respects with few papers showing significant wealth effects. Moreover, those that do find significant effects

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activist public pension funds like CalPERS that have published guidelines for good governance, and even, somewhat reluctantly, the mutual fund industry that has in place new rules for governance structures as well as new disclosure rules for voting on shareholder proposals (see Davis and Kim, 2005).

[4] Prior to these studies there were numerous studies that looked at the effect of certain governance features in isolation (e.g., board independence) on firm value, but no earlier studies tried to develop a comprehensive measure of what constitutes good governance.

[5] See, for instance, De Angelo and Rice (1983), Linn and McConnell (1983), Jarrell and Poulsen (1987), Karpoff and Malatesta (1989), Agarwal and Mandelker (1990), McWilliams (1990), Bhagat and Jeffries (1991), Mahoney (1996), and McWilliams and Sen (1997) all look at the wealth effects stemming from the adoption of ATAs by firms. Note that none of these studies has significant coverage of the 1990s in their dataset.

are unable to reach a consensus on the question of whether ATAs are good or bad for shareholders. There are many possible explanations for the lack of consistency in these studies: ATA adoption dates are imprecise with few firms actually making formal announcements (this is no doubt weakening our results as well); there was little consensus as to which ATAs were the most important so different studies examined varying subsets of ATAs; and differing time periods across studies rendered the results non-comparable given the dynamic nature of case law on the subject, not to mention that none of the studies in this literature included significant sample sizes that post-dated the landmark Time-Paramount case. Also underlying this is a theoretical debate over whether ATAs help or hurt shareholders. On the one hand, ATAs are clearly a way for poorly performing managers to entrench themselves, but, on the other hand, ATAs can enhance the bargaining position of the incumbent board, leading ultimately to a higher premium on deals that eventually go through.[6]

Recent work shows that of all the potential adoptions of ATAs, it is the staggered board that is the most important. Control of the board means control over the decision to redeem many ATAs, e.g., a poison pill. Of all the ATAs that firms might adopt, it is the staggered board that erects the greatest obstacle to controlling the board. For instance, Bebchuk and Cohen (2005) argue that since the staggered board/poison pill combination is so effective other ATAs like fair price provisions are largely irrelevant in modern takeover contests. Daines (2005) makes a similar argument. Moreover, shareholders seem to be getting the impression that the staggered board structure is not value-maximizing.

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[6] Though limited in scope, the recent work of Bebchuk et al. (2002a, b) raises serious questions about the ability of staggered boards to increase premia in either negotiated or hostile transactions.

Klausner (2002) reports that the number of shareholder proposals to institute the annual election of directors, as well as the percentage of shareholders voting for said proposals, steadily increased over the period 1986-2000. These observations are reinforced by Georgeson Shareholder Services (2004). Moreover, the number of management proposals to stagger the board has fallen from 88 in 1986 to 10 in 2000 and these proposals now rarely if ever receive majority support.[7] One exception to this trend is that firms going public often adopt a staggered board prior to the IPO. In fact from 1988 to 1999, the proportion of firms going public with staggered boards has increased from 36.2% to 82.0% (Field and Karpoff, 2002, Daines and Klausner, 2001, Coates, 2001). Another exception is that some states have adopted laws meant to shield local firms from potential hostile offers.

In 1990, the state of Massachusetts, in response to a hostile bid for a Massachusetts-chartered company by a British firm, adopted a law requiring all Massachusetts firms to have staggered boards.[8] There were some provisions allowing firms to opt out of this law under certain circumstances but many firms were affected. In a recent paper, Daines (2005) studies the impact of the adoption of this legislation on the 134 Massachusetts-domiciled companies that could be identified. He finds that the portfolio of MA firms that did not already have a staggered board at the time this legislation was introduced lost 1% to 1.5% of their value over the period of introduction and passage of the law, significant at the 5% to 10% level depending on how returns were

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[7] According to Klausner (2002), of the 10 proposals to introduce staggered boards made in 2000, 6 were made by firms where insider holdings exceeded 35% of outstanding shares. Of the remaining 4 only 1 passed.

[8] Interestingly, the firm whose targeting prompted this response in the first place (Norton) was acquired by a French firm only two weeks after the passage of this law. Apparently the French were more generous, especially to Norton's management than were the British.

computed and over which interval. Based on these and related results Daines (2005) concludes that staggered boards destroy value, presumably implying that dismantling a staggered board in favor of annual director elections will create value.

In summary, most of the research on the adoption of ATAs is rather dated with samples largely if not completely pre-dating the landmark Time-Paramount case that firmly established the "just say no" defense in Delaware case law. Moreover, the early studies on ATAs did not consistently distinguish between different types of ATAs, nor did any of them focus on the staggered board as an especially strong defense. More recent papers have paid considerable attention to staggered boards (i.e., Bebchuk et al, 2002a, b; Bechuk and Cohen, 2005; Bebchuk, Cohen, and Ferrell, 2005; Daines, 2005; and Faleye, 2004). These papers make it much harder to make the case that staggered boards are good for shareholders. Shareholders themselves seem to recognize this based on voting and proposal patterns over the last 15 years, and institutions like the California Public Employees Retirement System (CalPERS), Institutional Shareholder Services (ISS) and TIAA/CREF specifically make the case against staggered boards in their corporate governance guidelines. In spite of this, many still try to make the case in favor of staggered boards.

In 2002 the *Stanford Law Review* organized a symposium around the paper of Bebchuk et al. (2002a). Five symposium participants wrote detailed critiques of the Bebchuk et al. study (Bainbridge, 2002; Gordon, 2002; McGurn, 2002; Strihe, 2002; and Stout, 2002) and several seem to retain in some way the view that staggered boards can be good for shareholders. They rely on the standard arguments that staggered boards can induce a long-term perspective from directors, improve continuity among the company's

leaders, and increase the board's negotiating power in the event a bidder makes an offer for the firm. They also rely on anecdotal evidence, which as it turns out doesn't necessarily support their position anyway (see Bebchuk et al., 2002b). It is important to note that none of these critiques cites any statistical evidence suggesting that staggered boards are good for shareholders (because it doesn't exist). Finally, none other than John Wilcox, the head of Georgeson Shareholder Services tries to make similar arguments (see Wilcox, 2002), but again not backed up by any hard evidence.

We believe that the evidence we provide in this paper makes the case against staggered boards even stronger. Our event analysis shows that shareholders benefit when firms immediately drop the staggered structure in favor of annual election of directors. Moreover, our Probit analysis suggests that it is firms with good governance and more active shareholders that are more inclined to drop the staggered structure, i.e., do what's best for shareholders.

3.   Sample Selection and Data Sources

Our sample consists of firms that choose to de-stagger their boards in the period of 1987-2004. We collect data on the incidence of staggered boards from the governance database available from the Investor Responsibility Research Center (IRRC). The sample firms are first identified from firms that change their staggered board status in the IRRC governance data. We supplement the sample by searching the Dow Jones Newswire (Factiva) and Lexis-Nexis with the key words "declassification," "de-staggering," "declassify," "de-stagger," and "annual election of directors." Our final sample consists of

187 firms and is heavily skewed towards the last two years: more than 65% of the sample comes from 2003 and 2004. We present a time breakdown of the sample in Table 1.

We gather proxy statements filed with the Securities and Exchange Commission (SEC) in the year of the decision to de-stagger for each sample firm. We collect information such as the implementation of the board de-staggering (immediate vs. phased-in), the minimum votes required to de-stagger, changes via bylaw or charter, other concurrent shareholder proposals, and information concerning share ownership and the board of directors.

For the sample firms that are covered by the IRRC corporate governance data, we collect governance data such as the governance index of Gompers, Ishii, and Metrick (2003) (hereafter, GIM Index), as well as indicator variables for poison pill, golden parachutes, whether the company is incorporated in Delaware, whether there exist limits to shareholder bylaw amendments, whether there is a supermajority requirement for mergers, and whether there is a supermajority requirement for charter amendments. Currently, there are six years of data (1990, 1993, 1995, 2000, 2002, and 2004) covered in the IRRC corporate governance data. If IRRC data in a particular year is not available, we use data from the most recent prior year. We supplement the IRRC data by examining bylaws and charters and by using Proxy Research Reports from ISS. As a result, for firms announcing the decision to de-stagger in the years of 2002 and 2003, the governance variables are extracted from the 2002 IRRC data. Note that IRRC data from year t is actually from the end of year t-1.

We further merge our sample with the directors' data available from IRRC. The IRRC directors dataset has an annual frequency, and covers information on the board of

directors of companies included in the S&P 500, S&P MidCap, and S&P SmallCap indices for the eight-year period of 1996 to 2003. We gather information such as (1) dual role of CEO as the chairman, (2) board size, (3) percentage of independent directors, and (5) the percentage of shares held by directors.

We construct a sample of one-to-one matching firms by identifying firms from the IRRC database that retain their staggered boards and are closest in total asset value (Compustat item #6) to each of the firms in our original sample. We also gather return information from CRSP, and financial statement information from the annual Compustat database.

4. The Decision to De-stagger

4.1 Descriptive Statistics on Sample and Control Sub-samples

We investigate the motive behind a firm's decision to de-stagger its board by examining the difference of various firm characteristics between our sample firms and a set of control firms. The control firms are similar in size to our sample firms in the given year, but choose to maintain their staggered boards. We investigate three categories of firm characteristics: (1) governance variables, (2) board characteristics, and (3) prior firm performance. Table 2 reports the mean of each variable for de-staggering firms and control firms, as well as t-statistics of the null hypothesis that the mean of each variable is the same for both sub-samples.

The set of governance variables includes a measure of the sample firms' vulnerability to takeover using a modified version of the Bebchuk, Cohen, and Ferrell (2005) entrenchment index (BCF). The Index can take on a score from 0 to 5 and is the

sum of five dummy variables equaling one if the sample firm has a poison pill, requires supermajority approval of mergers, has a golden parachute, has limits to amend its bylaws, and has limits to amend its charter.[9] Other governance variables include indicators of poison pill (Pill), Delaware incorporation (Del), and whether the firm received any shareholder proposals to de-stagger the board in years -3 through -1 (Prop). We hypothesize that firms with better corporate governance, less entrenched managers, and more active shareholders (with low BCF Index, no poison pill adoption, prior shareholder proposals) are more likely to de-stagger the board. Our results indicate that firms that choose to de-stagger the board have lower BCF Index (better governance), are less likely to have a poison pill in place, and are much more likely to have prior shareholder proposals to de-stagger the board.

Smaller and independent boards are reported to be more effective (Yermack, 1996). We hypothesize that firms with such board structures are more likely to open board seats to annual election. Less entrenched managers are also less likely to maintain a staggered board under investor pressure. We hypothesize that firms are more likely to de-stagger the board when the CEO does not take on the added responsibility of chairman. However, our univariate statistics indicate that there are no significant differences in these board characteristics between the de-staggering firms and the control sample.

Firms may be pressured to de-stagger their boards. This pressure may be more effective when firms are suffering from inferior performance. We use the change in return on assets (the change in net income from the end of year -2 to the end of year -1 divided by the average assets at the end of years -2 and -1) and the preannouncement

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[9] The entrenchment index consists of six variables Bebchuk et al, (2005) report as having the greatest explanatory power of the 24 variables in the Gompers et al. (2003) GIM index. The six variables are the five listed above and a dummy variable equaling one if the sample firm has a staggered board.

return (the market-adjusted buy and hold return over days -110 to -11) to capture firm performance prior to the announcement of the decision to de-stagger. We also consider the debt ratio (the ratio of long-term debt over total assets as of year -1 in book value terms) as an explanatory variable. Our univariate statistics indicate that the de-staggering firms exhibit significantly better operating performance prior to the decision to de-stagger their boards, while at the same time use more leverage than the control firms.

Finally, we investigate the impact of industry-specific M&A activity on a firm's decision to dismantle its staggered board. We adapt a merger and acquisition volume measure from Schlingemann, Stulz, and Walkling (2002). Using Thomson Financial's SDC Platinum and Compustat, we calculate the merger and acquisition volume as the average aggregate industry value of mergers and acquisitions activity scaled by aggregate industry assets for year -1 (MAVol). Industries are defined using two-digit SIC codes. Overall, the sample firms appear to be in industries with more active M&A markets than the control firms.

4.2   *Probit Analysis*

The univariate statistics above are suggestive of factors that influence a firm's decision to dismantle its staggered board. We conduct a more thorough analysis of these determinants by estimating a probit model with the board structured (staggered vs. annual elections) as the dependent variable. Specifically, we estimate a probit model of a firm's decision to de-stagger its board with the specification given in Equation (1):

$$\Pr ob(I_i = 1) = \Phi(\alpha_0 + \alpha_1 BCF + \alpha_2 \text{Del} + \alpha_3 \text{Golden} + \alpha_4 \text{Pill} + \alpha_5 MAVol$$
$$+ \alpha_6 \text{Charter} + \alpha_7 \Pr op + \alpha_8 \text{BdSize} + \alpha_9 \text{CEOChair} + \alpha_{10} \text{Indep} \tag{1}$$
$$+ \alpha_{11} \text{PreReturn} + \alpha_{12} \text{DROA} + \alpha_{13} \text{Debt})$$

where I_i is a binary variable that takes the value of one for firms that elect to de-stagger their boards, and zero for control firms whose boards remain staggered. Φ is the cumulative normal distribution function. BCF is the BCF Index adapted from Bebchuk et al (2005). High values of the BCF Index correspond to poor corporate governance. Del, Pill, and CEOChair are all indicator variables that take on the value of 1 for firms that are domiciled in Delaware, have a poison pill in place, and where the CEO and Chairman of the Board are the same person, respectively, and zero otherwise. BdSize is equal to the number of board members, Indep refers to the percentage of directors that are considered independent. We also include the pre-event stock return (PreReturn), the change in ROA over years -2 to -1 (DROA), and the debt-to-asset ratio (Debt). Finally, we examine the effect of prior shareholder proposals (Prop), as well as the M&A activities (MAVol) in the probit model. Prop is an indicator variable that is set to 1 if a firm had a shareholder proposal(s) to de-stagger the board in years -3 through -1, and 0 otherwise, while MAVol is equal to the $-value of M&A transactions in the firm's 2-digit SIC code in year -1 divided by total industry assets in year -1.

The estimation results are presented in Table 3. Model 1 reports the estimated coefficients of all the independent variables identified above except the poison pill indicator. As the poison pill indicator is one component of our constructed BCF Index, we investigate the effect of such variable separately in Model 2. Among the governance variables, the BCF Index has a negative and significant coefficient, consistent with the argument that firms with more democratic governance practices are more likely to improve their governance further and force directors to face annual elections.

Yermack (1996) documents a higher Tobin's Q for companies with small boards and suggests that large boards are ineffective due to poor communication and decision-making. Presumably, small boards could be more effective in instituting action to improve corporate governance practices. On the other hand, if directors of large boards need to exert greater effort to be effective, the incremental benefit of de-staggering the board is larger by placing those directors under the active investor monitoring of annual elections. As a result, we do not have a pre-determined sign prediction on the effect of board size on firm's decision to drop de-staggered board. Extant prior literature and positions advocated by regulators call for an independent board as well as separation of roles between CEO and chairman as effective board composition. In our analysis, however, the variables of board characteristics such as board size, whether the CEO serves a dual role as board chairman, and the proportion of independent directors are not significant determinants of a firm's decision to dismantle its staggered board.

Among variables measuring prior firm performance, the change in profitability (ROA) and the debt-to-asset ratio have positive and significant coefficients in the Probit regressions. Our results indicate that firms with better operating performance and higher leverage are more likely to de-stagger. Firms that are more highly-levered and/or exhibiting better operating performance are less likely to be takeover candidates, suggesting that directors are more confident to face annual elections.

Existence of prior shareholder proposals to de-stagger board, as well as an active M&A market emerge as two important determinants in a firm's decision to change to annual election of its directors in Model 1.   Apparently at some point firms feel compelled to submit to shareholder pressure.   This is consistent with Bizjak and

Marquette (1998) who find that firms are more likely to rescind poison pill provisions if shareholders have submitted proposals to have the pill rescinded or put to a vote. Taken together, our results and theirs provide evidence that active shareholders can successfully push for improvements in corporate governance. Moreover, we contribute to the recent focus on the importance of shareholder activism in the corporate governance literature (see Del Guercio and Hawkins, 1999; Gillan and Starks, 2000; among others).

Bebchuk et al (2002a) argue that the combination of a staggered board and a poison pill creates a virtually impenetrable defense against potential raiders. To investigate whether the presence of a poison pill has a separate and dominant effect over those of the other four ATA components in the BCF score, we include the poison pill indicator in Model 2 in addition to all other aforementioned variables. Our results indicate that firms with a poison pill in place are less willing to unwind the staggered board. In Model 2, the effect of BCF is no longer significant, while inference of other variables remains mostly similar to that in Model 1.

In Model 3 of Table 4, we exclude all the insignificant variables and include only the poison pill indicator, change in ROA, the leverage ratio, prior shareholder proposal, and M&A volume. The results are similar to those of Model 1 and 2.

5. Regressions of announcement effects

We investigate the wealth effects surrounding announcements of firms' intentions to de-stagger their boards and insist that their directors face annual shareholder elections. We estimate cumulative abnormal returns (CARs) for firms choosing to de-stagger their boards. CARs are defined in Equation (2) below:

$$CAR_i = (1 + AR_{i,-1}) \times (1 + AR_{i,0}) \times (1 + AR_{i,+1}) \tag{2}$$

Where $AR_{i,t}$ is the abnormal return for firm i on event day t defined in Equation (3) below:

$$AR_{i,t} = r_{i,t} - (\alpha_i + \beta_i r_{m,t}) \tag{3}$$

The coefficients α_i and β_i in Equation (3) are estimated over the period from event day -110 through event day -11. We use the earliest of three dates as event dates. These dates are the day the decision to de-stagger was announced in the press and the date of the release of the preliminary and definitive proxy statements containing a proposal to de-stagger or information to the effect that the board has de-staggered itself without the necessity of a shareholder vote. Note that not all companies have all three dates. We report results of the event study in Table 4. Overall, the abnormal returns are positive but not significantly different from zero.

We also divide the sample according to the time the decision to de-stagger was made, whether the implementation of the annual election of directors was to be immediate or phased in as directors' terms concluded, whether the staggered board was bylaw- or charter-based, and whether the company received a shareholder proposal calling for a de-staggered board in the three years prior to the decision to de-stagger. In most cases, there were no significant differences between the sub-samples. The one exception was the immediate vs. phased implementation. In this case, announcements of immediate implementation have mean (median) positive and significant announcement effects of 1.06% (0.57%), while the announcement of phased implementation generates a negative though insignificant return. These abnormal returns for immediate

implementation are significantly greater than those greeting announcements of phased implementation.

To conduct a more thorough analysis of the wealth effects associated with the dismantling of a staggered board, we run regressions with announcement period CARs as the dependent variable and a wide array of variables as regressors. The explanatory variables fall into several broad categories.

The first set of explanatory variables has to do with the type of staggered board and how the proposals are structured. Charter is a dummy variable equaling one if the provision staggering the board is charter-based. In this situation, both the board and the shareholders have to approve the decision to de-stagger. Immediate equals one if the board will immediately begin having annual election of directors. Immediate should have a stronger relation to the announcement effects as the firm will become more quickly and credibly accountable to shareholders and also more vulnerable to a potential takeover. We note though, that many firms include a disclaimer stating that they are unaware of any takeover offers at the time of the announcement.

We consider several typical board and ownership variables. Board variables include the number of directors (BdSize), the proportion of the board composed of independent outsiders (Indep), and a dummy variable equaling one if the CEO and chair are the same person (CEOChair). McWilliams and Sen (1997) report some evidence that announcements of anti-takeover proposals are significantly negative when the CEO and chair are the same person. We also include the proportion of shares held by officers and directors. Presumably firms with greater managerial ownership will be less vulnerable to

takeover (OffShare). Therefore, the decision to de-stagger should have less of an announcement effect.

We also investigate the impact of the amount of merger and acquisition activity in the sample firms' industries and the sample firms' susceptibility to takeover. Therefore, we include the MAVol adopted from Schlingemann et al. (2002). As mentioned earlier, governance has received increased scrutiny in the wake of the post-bubble scandals. As such, the importance of the takeover deterrence aspect of a staggered board might be different in recent years. Therefore, we include a dummy variable equaling one if the company announced the decision to de-stagger during 2003 or 2004 (SARBOX). We then inter-act MAVol with this dummy variable.

We also include the performance measures discussed in Section 4.1. In this case, firms exhibiting worse performance might be expected to have greater announcement effects as the market is happy the firm is doing anything/something to improve shareholder value.

We include several additional control variables. These are the logarithm of total assets at the end of year -1, a dummy equaling one if the sample firm received a shareholder proposal calling for a de-staggered board over years -3 to -1, a dummy variable equaling one if the sample firm is incorporated in Delaware, and a dummy variable equaling one if the sample firm is a real estate investment trust (REIT). Twenty-two (11.8%) of the sample firms are REITs. Finally, we include the BCF entrenchment index adapted from Bebchuk et al. (2005) (BCF)

Based on these variables, we estimate cross-sectional regressions of the form given in Equation (4) using ordinary least squares (OLS):

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$$CAR_i = b_0 + b_1 Charter + b_2 Immediate + b_3 SARBOX + b_4 MAVol + b_5 MAVol * SARBOX$$
$$+ b_6 OffShare + b_7 CEOChair + b_8 Indep + b_9 BdSize + b_{10} DROA + b_{11} Assets \qquad (4)$$
$$+ b_{12} REIT + b_{13} DEL + b_{14} BCF + b_{15} \Pr op + \varepsilon_i$$

Table 5 presents the results of regressions of the three-day CARs. Firms going immediately to the annual election of directors experience greater announcement effects, consistent with the idea that these firms are more quickly accountable to shareholders and/or more vulnerable to a takeover. This difference is approximately 2% and significant at the 5% level, similar to, or slightly larger than, the effects documented in Daines (2005) around the adoption of the Massachusetts staggered board law.

Somewhat surprisingly, firms with greater officer and director ownership have greater announcement effects. Perhaps these firms are seen as signaling their willingness to be acquired. This idea is also consistent with the positive relation between industry M&A activity and the decision to de-stagger documented in section 4.2. Also, firms with larger boards have lower announcement effects. However, the proportion of the board consisting of independent outsiders and the dummy variable indicating the CEO and chair are the same person are not significantly related to the abnormal returns.

The announcement effects are positively related to the scaled volume of mergers and acquisitions activity. However, the coefficient on the interactive term is significantly negative and of a similar magnitude to the coefficient on the scaled mergers and acquisitions activity indicating the positive relation is limited to firms de-staggering their boards prior to 2003. Taken together this is consistent with the idea that initially the market viewed the announcement of an intention to de-stagger as a signal of a greater likelihood of acquisition. With the increased emphasis on governance during the post-

scandal era, the strength of the signal has disappeared. However, neither BCF nor Prop is related to the announcement effects.

Firms experiencing inferior pre-announcement equity returns also experience greater announcement returns. This is consistent with the idea that investors are especially relieved that firms that are struggling are finally doing something to turn themselves around. Also, both REITs and firms incorporated in Delaware have lower announcement returns.

We consider, but do not report several other variables. These are the proportion of the shares outstanding required for the proposal to pass and the proportion of shares held by affiliated and unaffiliated 5% blockholders. Excluding these variables does not have an effect on the reported results.

Overall, the results of this section support the idea that the de-staggering announcement is signaling an increased willingness to be acquired. In particular, the positive relation between the announcement returns and the immediate implementation dummy, the shares held by officers and directors, the volume of mergers and acquisitions activity all support this conclusion.

6.   Conclusion

In this paper, we compile a dataset of 187 firms with staggered boards whose management has stated an intention to put a binding resolution to remove the staggered structure to a shareholder vote or simply remove the staggered structure with a board vote. The literature has now established the staggered board as arguably the most consequential of all available takeover defenses (see Bebchuk et al., 2002a,b; Bebchuk

and Cohen, 2005; Bebchuk et al., 2005; and Daines, 2005; among others). Thus, the dismantling of this structure in favor of annual director elections has important implications for shareholder rights and wealth.

We conduct an event analysis that is supportive of the idea that de-staggering the board is in the interest of shareholders. The cumulative abnormal returns (CARs) of those firms that intend to immediately switch to a policy of annual election of directors is about 1% and significant at the 5% level, while the CARs for firms that are slowly phasing in the annual election of directors are an insignificant -0.66%. Moreover, the difference in these CARs is about 1.7% and significant at the 1% level. The CARs are significantly related in the cross section to various firm and industry characteristics.

We also conduct a Probit analysis of the determinants of the decision to drop the staggered board structure. We find that it is generally those firms that would be considered to have good governance that are more inclined to drop the staggered structure. Firms with more debt, operating in an industry with more M&A activity, and better governance index scores are more likely to eliminate the staggered structure, while firms with poison pills in place are less likely to drop the staggered structure. Finally, shareholder proposals play a pivotal role in this process since fully 35% of our sample firms face shareholder proposals to de-stagger the board in the three years leading up to the event date while only 5% of control firms face such pressure.

Our results are consistent with the view that forcing directors to face annual election is good for shareholders. Moreover, it is firms with good governance and/or activist shareholders that are more likely to act in the interest of shareholders. Finally, we show that the level of takeover activity in a firm's industry affects their decision to

de-stagger the board and the level of M&A activity is positively related to the CARs of our sample firms, suggesting that a significant portion of the wealth effects we document are related to a perceived enhanced probability of takeover upon switching to annual director elections.

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Table 1
Distribution of Sample Firms by Year of the Decision to De-stagger

Year	Number of firms De-staggering	Percent of total	Frequency of shareholder proposals among de-staggering firms (w/in 3 years)		
			n	Number	Percent
1987	1	0.5	0	na	na
1988	2	1.1	0	na	na
1989	2	1.1	0	na	na
1990	0	0.0	na	na	na
1991	0	0.0	na	na	na
1992	3	1.6	2	1	50.0
1993	3	1.6	3	0	0.0
1994	3	1.6	3	1	33.3
1995	2	1.1	2	1	50.0
1996	7	3.7	7	5	71.4
1997	7	3.7	7	1	14.3
1998	3	1.6	3	1	33.3
1999	11	5.9	11	4	36.4
2000	3	1.6	3	2	66.7
2001	9	4.8	9	2	22.2
2002	5	2.7	5	1	20.0
2003	52	27.8	49	15	30.6
2004	74	39.6	72	29	40.3
Total	187	100.0	173	63	35.8

Table 2
Summary Statistics of Sample and Control Firms

BCF score equals the sum of five dummy variables indicating that the sample firm has a poison pill, requires supermajority approval of any merger, has a golden parachute, has limits to amend its charter, and has limits to amend its bylaws. Delaware, Poison Pill, and CEO/Chairman are all indicator variables. Board Size is equal to the number of directors. Board independence refers to the percentage of independent directors. Pre-event stock return is the return on the firm's stock net of the market return in the 100-day period through event day -11. Change in ROA is defined as change in the variable net income divided by assets. Debt is the firm's debt-to-asset ratio in book value terms. Prior shareholder proposal is a dummy variable equaling one if the sample firm received a shareholder proposal calling for a de-stagger board over the three years prior to the announcement year. Mergers and acquisitions volume is the average aggregate industry value of mergers and acquisitions activity scaled by aggregate industry assets for years -1 and 0. Industries are defined using two-digit SIC codes. 1, 2 and 3 asterisks indicate significance at the 10, 5, and 1 percent levels, respectively.

Independent variable	Sample of De-staggering Firms	Control Firms	t-statistics
Governance:			
BCF Index	1.76	2.00	-2.30**
Delaware indicator	0.54	0.56	-0.38
Poison pill indicator	0.46	0.67	-4.07***
Prior shareholder proposal indicator	0.36	0.05	7.56***
Board characteristics:			
Board size	9.73	9.58	0.46
Chair/CEO same person	0.65	0.69	-0.80
Independent Directors	0.70	0.68	1.11
Performance:			
Pre-event stock return	0.03	0.04	-0.27
Change in ROA	0.03	-0.00	1.68*
Other:			
Debt ratio	0.26	0.18	3.84**
Mergers and acquisitions volume	0.06	0.04	2.13**

Table 3
Probit Analysis of Decision to Declassify Board

The dependent variable is 1 for our sample firms which elect to declassify their boards, and 0 for the control firms. BCF equals the sum of five dummy variables indicating that the sample firm has a poison pill, requires supermajority approval of any merger, has a golden parachute, has limits to amend its charter, and has limits to amend its bylaws. Delaware, Poison Pill, and CEO/Chairman, are all indicator variables. Board Size is equal to the number of directors. Board independence refers to the percentage of independent directors. Pre-event stock return is the return on the firm's stock net of the market return in the 100-day period through event day -11. Change in ROA is defined as change in the variable net income divided by assets. Debt is the firm's debt-to-asset ratio in book value terms. Prior shareholder proposal is a dummy variable equaling one if the sample firm received a shareholder proposal calling for a de-stagger board over the three years prior to the announcement year. Mergers and acquisitions volume is the average aggregate industry value of mergers and acquisitions activity scaled by aggregate industry assets for years -1 and 0. Industries are defined using two-digit SIC codes. The MLE estimates are presented in the table with χ^2 statistics in the parenthesis. The χ^2 and p-values of the test that all coefficients are jointly zero are also reported. 1, 2 and 3 asterisks indicate significance at the 10, 5, and 1 percent levels, respectively.

Independent variable	Model One	Model Two	Model Three
Intercept	-0.47	-0.67	-0.26*
	(1.27)	(2.39)	(2.96)
Governance:			
BCF	-0.18**	0.02	-
	(5.78)	(0.37)	
Delaware	-0.11	-0.10	-
	(0.48)	(0.40)	
Poison Pill	-	-0.83***	-0.66***
		(18.57)	(19.24)
Prior shareholder proposal indicator	1.64***	1.88***	1.49***
	(15.41)	(19.82)	(52.75)
Prior shareholder proposal indicator	-0.36	-0.53	-
* announcement in 2003 or 2004	(0.60)	(1.26)	
Board characteristics:			
Board size	0.01	0.02	-
	(0.05)	(0.37)	
Chair/CEO same person	-0.20	-0.20	-
	(1.53)	(1.34)	
Independent Directors	0.39	0.68	-
	(0.64)	(1.82)	
Performance:			
Pre-event stock return	0.06	0.21	-
	(0.05)	(0.48)	
Change in ROA	1.23**	1.33**	0.94*
	(4.01)	(4.27)	(3.49)
Other:			
Debt ratio	1.01**	0.87**	0.96**
	(5.57)	(3.97)	(5.89)
Mergers and acquisitions volume	2.25**	2.31**	1.93**
	(5.11)	(5.08)	(4.41)
Mergers and acquisitions volume	0.93	0.14	-
* announcement in 2003 or 2004	(0.15)	(0.00)	
Model χ^2	147.02	166.26	126.38
(*p*-value)	(0.00)	(0.00)	(0.00)

Table 4
Distribution of Three-Day Abnormal Returns by Sub-samples

	n	Mean (%)	Median (%)
Entire sample	168	0.45	0.14
Post-scandal (2003 or later)	109	0.05	0.00
Pre-scandal	59	1.17	0.39
Phased implementation	60	-0.66	-0.36
Immediate implementation	103	1.06**,###	0.57**,##
Bylaw based staggered board	21	0.65	0.15
Charter based staggered board	143	0.40	0.13
Prior shareholder proposals	56	-0.16	-0.04
No prior shareholder proposals	103	0.58	0.22

*, **, *** indicates the value is significantly from zero at the 0.10, 0.05, 0.01 levels respectively.
#, ##, ### indicates the means or medians are significantly different at the 0.10, 0.05, 0.01 levels respectively.

Table 5
Regression of Three-Day Abnormal Returns

This table presents results of regressions of the three day abnormal return at announcement of the decision to de-stagger the board or put the matter to a shareholder vote. Charter is a dummy variable equaling one if the provision staggering the board is charter based. Immediate is a dummy variable that equals one if the board will immediately begin holding annual election of directors. Prop is a dummy variable equaling one if the sample firm received a shareholder proposal calling for a de-stagger board over the three years prior to the announcement year. MAVol is the average aggregate industry value of mergers and acquisitions activity scaled by aggregate industry assets for years -1 and 0. Industries are defined using two-digit SIC codes. Delaware is a dummy variable equaling one if the sample firm is incorporated in Delaware. BCF equals the sum of five dummy variables indicating that the sample firm has a poison pill, requires supermajority approval of any merger, has a golden parachute, has limits to amend its charter, and has limits to amend its bylaws. CEOChair one if the same individual holds the positions of CEO and chair of the board. REIT is a dummy variable equaling one if the sample firm is a Real Estate Investment Trust. Indep is the percentage of independent outside directors on the board. BdSize is the number of directors. ODShares is the fraction of shares owned by the officers and directors. The DROA is the change in net income from the end of year -2 to the end of year -1 divided by the average assets at the end of years -2 and -1. The PreReturn is the market-adjusted buy and hold return over days -110 to -11. Size is the logarithm of total assets is as of the end of year -1. The sample consists of 187 firms announcing they will de-stagger their board or that they will put the matter to a shareholder vote. Absolute values of t-statistics in parentheses. *, **, *** indicates significance at the 10%, 5%, and 1% levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	-0.039	-0.078	-0.029	-0.067	-0.034	-0.077
	(0.83)	(1.55)	(0.62)	(1.32)	(0.75)	(1.57)
Charter	0.000	0.001	-0.001	0.001	0.002	0.004
	(0.03)	(0.13)	(0.09)	(0.06)	(0.19)	(0.35)
Immediate	0.019^{**}	0.021^{***}	0.018^{**}	0.019^{**}	0.019^{**}	0.020^{**}
	(2.42)	(2.58)	(2.18)	(2.34)	(2.36)	(2.53)
Dummy indicating Event in 2003 or 2004 (SARBOX)	0.004	0.002	0.006	0.003	0.005	0.003
	(0.42)	(0.19)	(0.56)	(0.36)	(0.55)	(0.28)
Prop	0.002	0.001	0.000	0.000	0.000	-0.001
	(0.21)	(0.14)	(0.05)	(0.00)	(0.02)	(0.13)
MAVol	0.094^{**}	0.085^{**}	0.090^{**}	0.082^{**}	0.084^{**}	0.076^{*}
	(2.26)	(2.07)	(2.18)	(1.98)	(2.05)	(1.85)
MAVol*SARBOX	-0.251^{**}	-0.233^{**}	-0.249^{**}	-0.230^{**}	-0.244^{**}	-0.226^{**}
	(2.49)	(2.32)	(2.47)	(2.30)	(2.46)	(2.30)
Delaware	-0.019^{**}	-0.019^{**}	-0.018^{**}	-0.017^{**}	-0.016^{**}	-0.015^{*}
	(2.38)	(2.36)	(2.16)	(2.16)	(1.93)	(1.86)
BCF	0.002	0.002	0.001	0.001	0.001	0.000
	(0.48)	(0.51)	(0.28)	(0.34)	(0.18)	(0.14)

ODShares	0.053**	0.060***	0.051**	0.057***	0.046**	0.055***
	(2.38)	(2.81)	(2.28)	(2.65)	(2.09)	(2.59)
CEOChair	-0.007	-0.006	-0.008	-0.007	-0.010	-0.009
	(0.81)	(0.67)	(0.94)	(0.79)	(1.15)	(1.04)
REIT	-0.028**	-0.028**	-0.028**	-0.029**	-0.027**	-0.026**
	(2.12)	(2.19)	(2.17)	(2.27)	(2.11)	(2.13)
Indep	0.000		0.004		-0.005	
	(0.02)		(0.17)		(0.19)	
BDSize		-0.003*		-0.003*		-0.003*
		(1.75)		(1.77)		(1.86)
DROA		-0.019	-0.019			
		(1.28)	(1.29)			
PreReturn					-0.025**	-0.026**
					(2.34)	(2.42)
Size	0.002	0.005**	0.001	0.004	0.002	0.005*
	(0.82)	(1.78)	(0.61)	(1.64)	(0.86)	(1.87)
R^2	0.18	0.20	0.19	0.21	0.22	0.24
Adj-R^2	0.11	0.13	0.11	0.13	0.13	0.16
F-statistic	2.33	2.63	2.30	2.57	2.63	2.95