THE IMPORTANCE OF BOARD COMPOSITION AND COMMITTEE STRUCTURE: THE CASE OF POISON PILLS

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Abstract

We examine board composition, characteristics, and structure for firms whose boards adopt poison pills. We find that board composition is unrelated to the stock market's perception of poison pill adoption. However, the percentage of shares held by blockholders, the tenure of independent outsiders on the board, and the proportion of outsiders on the executive committee do seem to influence whether a poison pill adoption is perceived as management entrenching or not. We also find that when boards have absolute control of the sample firms, this control is related to board shareholdings, board tenure of outsiders, and the proportion of outsiders on the board committees. It is not related to the market reaction for poison pill adoption.

Keywords: board composition, poison pills, management entrenchment, outsiders

1. Introduction

The board of directors in a corporation is legally bound to monitor management decisions and to set overall corporate objectives and policies. It is the board that must ensure that management does not become entrenched. Critics of boards suggest that management can control board decision making by stacking the board with management-friendly members, by controlling the agenda at board meetings, and by providing board members with biased information. As a result of this criticism, the role of boards and their effectiveness has recently received considerable scrutiny and remains an important empirical question.

In this paper, we examine board of director composition and committee structure in a group of firms that established poison pills, to determine if board and committee composition influence the management entrenchment capability of poison pills. Our work is first a reexamination of the impact of poison pills on shareholder wealth and whether or not the board protects shareholders in this situation. Second, we extend the board analysis to committee structure of the firm to help us understand the role of board structure and organization in firm decision making and in protecting shareholder interests.

Early research found that poison pills appear to support the management entrenchment hypothesis, whereby managers benefit at the expense of shareholders by making firms more difficult to take over (Ryngaert, 1988). By making a takeover more difficult, management can escape or at least lessen the threat of market-based discipline and ensure their own tenure as managers. On the other hand, the adoption of a poison pill may give managers the ability to negotiate for a better price in the event of a takeover attempt. These poison pills would benefit shareholders and would be consistent with shareholder wealth maximization.

Later research (Datta and Iskandar-Datta, 1996) finds insignificant abnormal returns for poison pill adoption. In addition, Brickley, Coles, and Terry (1994) related board composition to the stock market announcement effects of poison pill adoption. They found an overall insignificant market reaction to poison pill announcements. They also found that the market reacted more positively (less negatively) to poison pill announcements when the boards of the companies had a greater proportion of outsiders.

Whether poison-pill adoption hurts or benefits shareholders may be situationally dependent. Board and board committees may play an important role in determining which poison pill adoptions entrench managers or benefit shareholders. By examining boards of directors and the committee structures of these boards that approve them, we can interpret board of director motivation. There is a small but growing body of research indicating the board committees play a significant role in corporate governance (Klein, 1998; Davidson, Pilger & Szakmary, 1998; Xie, Davidson, and DaDalt, 2000.) Based on this body of research, we extend the work of Brickley et al (1994) in the study of boards and poison

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pills by examining the role of board committees in protecting shareholders against management entrenchment. In particular, we find that the composition of the boards' executive committees does influence the stock market's perception of poison pill announcements. Poison pills adopted by firms with greater outside representation on their executive committees are perceived as being associated with less management entrenchment. Thus, our results complement this growing body of research indicating that board committees may be as important in certain instances as is the entire board.

In the next section we first discuss management entrenchment and optimal contracting, the two competing hypotheses and their role in poison pill adoption. In section III we develop our hypotheses on how board composition and board committee structure might influence the stock market's perception of poison pill adoption announcements. Section IV discusses our sample selection, data sources, and methodology. Section V contains our empirical results and Section VI our conclusions.

2. Empirical issues

2.1. Management Entrenchment vs. Optimal Contracting

The management entrenchment hypothesis posits that anything that prevents takeovers protect ineffective incumbent managers from outside competition for control of the firm. By making hostile takeovers more difficult, managers keep control of the firm and shareholders may suffer. Under the optimal contracting hypothesis, anti-takeover devices may allow managers and the board to be in a stronger bargaining position with potential bidders. Here, shareholders benefit more from a takeover because the board can hold out for a better price, and shareholders can benefit from defensive tactics (Jarrell, Brickley, and Netter, 1988).

2.2. Poison Pill Defenses

Poison pills can be used to either entrench an incumbent management team or permit optimal contracting. Whether they serve either purpose is an empirical question. Jarrell, Brickley, and Netter (1988) argue that poison pills are a very effective obstacle to takeover attempts. Poison pills provide target firm shareholders with the right to purchase or sell shares from the target when a triggering event occurs[1]. The adoption of poison pill defenses has been associated with negative abnormal returns in some studies (Ryngaert, 1988; and Malatesta & Walkling, 1988) and with insignificant abnormal returns (Datta and Iskandar-Datta, 1996). The negative abnormal returns imply that poison pills are more consistent with management entrenchment than with optimal recontracting.

2.3. Corporate Governance and Poison Pills

The composition of the board of directors could influence whether or not a poison pill is adopted. However, the empirical evidence on this issue does not support this contention (Mallette & Fowler, 1992 and Sundaramurthy, 1996). Loh (1994) finds that 85.9% of firms adopting poison pills have outsider dominated boards. Malatesta and Walkling (1988) also found that takeover defenses that are not submitted to stockholders for approval tend to reduce stockholder wealth, whereas defenses that stockholders must approve have no significant wealth effect on average. Shareholders would not knowingly entrench an ineffective management team, but a board controlled by insiders might have incentives to do so. Brickley, Coles, and Terry (1994), in research closely related to this paper, find a positive stock market reaction to poison pill adoption when the boards have a majority of outside directors, and they find a negative reaction when outsiders are not in the majority. However, the overall market reaction they find is statistically insignificant. Whether or not a poison pill is management entrenching may be case dependent and the evidence in Brickley et al suggests that outsiders on boards do appear to protect shareholders from management entrenching poison pills. Sundaramurthy, Mahoney, and Mahoney (1997) report results that conflict with those in Brickley et al. They find that the market reacts negatively to anti-takeover amendments (75% of the amendments in their study are poison pills) and even more negatively when the percentage of board outsiders is large. Thus, the role of the board in protecting shareholders from managers using poison pills to entrench their own position remains an unanswered question. In addition to reexamining this issue, we also add the role of board committee structure to the debate. Since board committees can influence overall board policy, it may be the committees that help protect shareholders.

3. Hypothesis development

In this paper we examine whether the composition of the board of directors and/or the composition of its committees influences the stock market's perception of whether poison pills allow for optimal contracting

[1] With a "flip-in" poison pill, target shareholders are able to purchase stock at a deep discount when the trigger occurs. In a "flip-over" poison pill, the acquiring firm is obligated to allow right holders (target shareholders) to acquire voting equity of the acquiring firm at a discount. Other poison pill defenses include the creation of a preferred stock issue with an extremely large dividend payout designed to drain the firm of resources. All of these poison pill plans are triggered when a takeover attempt begins.

or entrench managers. We use the integrative model of board attributes and roles developed by Zahra and Pearce (1989) and examine three board attributes: composition; committee structure, and others.

3.1. Board Composition

Some researchers have argued that to ensure adequate monitoring of managers, it is necessary to have a high proportion of outside directors (American Law Institute, 1982; Dunn, 1987). In specific situations such as CEO turnover, mergers, and management buyouts, empirical results have shown that outside directors protect shareholders (Weisbach, 1988; Brickley & James, 1987; Byrd & Hickman, 1992; and Lee, Rosenstein, Rangan & Davidson, 1992). However, the evidence that outside directors improve long run performance is not clear-cut. For example, Bhagat and Black's (2000) results do not support the hypothesis that a large proportion of outside directors improves long-term firm performance. Similarly, Dalton, Daily, Ellstrand and Johnson (1998) and Hermalin and Weisbach (1991) find overall company performance to be unrelated to overall financial performance. Because most studies have shown that outside directors protect shareholders in specific situations when they make major decisions, we argue that the proportion of independent outside directors on boards will be greater for firms that establish poison pills interpreted by the market as optimal contracting than for firms whose poison pills are interpreted as entrenching the incumbent management team. We also argue that if the board chair is an independent outsider, the firm's shareholders will receive greater protection from management entrenchment. The board chair likely has more power on the board than other board members and is in a position to influence company actions. Thus, we argue that firms adopting poison pills consistent with optimal contracting will be more likely to have an independent outsider as chair than firms whose poison pills are interpreted to be management entrenching.

3.2. Board Committee Structure

Recent surveys indicate that the average number of committees among the Fortune 1000 companies is 4.3 (Heidrick and Struggles, Inc., 1987; National Association of Corporate Directors, 1982). The SEC requires all of its registered companies to disclose whether or not they have an audit committee, a compensation committee, and a nominating committee (National Association of Corporate Directors, 1982). Since 1978, the New York Stock Exchange has required listed firms to maintain an audit committee. The American Stock Exchange recommends (but does not require) that all its listed companies have an audit committee. A fourth important committee is the executive committee. Although executive committee disclosures are not required by the SEC, many companies voluntarily report both the existence and membership of this committee.

The executive committee is used as a substitute for the full board when immediate actions are required. Executive committee members also counsel the CEO on proposals prior to disclosure to the board. The executive committee is usually larger than the other three basic committees. However, the composition of this committee differs considerably from the other key committees in that outside directors on average do not have a majority of the membership. The executive committee may also control the agenda for board meetings and may, therefore, heavily influence what the board discusses. If the executive committee acts in place of the whole board and largely determines what the board sees, then its composition may heavily influence the monitoring role of the board.

These four committees are considered to have the greatest influence on corporate activities and financial performance (Vance, 1983). In a study of Fortune 1000 firms: 99.2 percent of the responding companies had audit committees; 92.8 percent had compensation committees; 78.9 percent had executive committees; and 60.4 percent had nominating committees (Heidrick and Struggles, Inc., 1990). Kesner (1988) argues that most important board decisions originate in these committees. Recent evidence has yielded results that committee structure is important for firm performance. Klein (1998) finds that overall board composition is unrelated to firm performance but finds that the percentage of inside directors on finance and accounting committees positively impacts firm performance. Klein argues that this result is consistent with Fama and Jensen's (1983) "assertion that inside directors provide valuable information to boards about the firms' long-term investment decisions" (Klein, 1998: 275).

Davidson, Pilger, and Szakmary (1998) find that firms react negatively to announcements of golden parachute adoptions when insiders and affiliated outsiders have majority control of the compensation committee. Xie, Davidson, and DaDalt (2000) find the proportion of independent outside directors on the audit committee and the executive committee influence the likelihood of earnings management. Firstenberg and Malkiel (1980) find that the key to greater director independence lies in the board control of the nomination process. If committees influence corporate activities and decisions, then committees dominated by independent outside directors should protect shareholders from management entrenchment. We hypothesize that the membership of standing board committees (audit committees, compensation committees, nominating committees, and executive committees) will have a greater average proportion of outside members for those firms adopting poison pills that are optimal contracting than those adopted to entrench management.

3.3. Other Characteristics

Other characteristics may also influence market perception of a poison pill adoption. These include board characteristics such as directors' experience (e.g., tenure) on the board, the stock ownership of directors, and the number of meetings per year held by the board. In addition, market forces, such as analyst coverage and blockholder ownership, may also protect shareholder interest.

a. Tenure of Directors

Effective performance as an outside director requires some period of time as a member of a board to learn about the company (Bacon & Brown, 1973 and Alderfer, 1986). The longer directors stay on the board, the more knowledgeable they are about the firm and longer tenures of outside directors may provide them with greater stature on the board. Empirical research to date suggests that senior outside directors are more likely to resist management's proposal to pay greenmail (Kosnik, 1990). Thus outside directors with greater tenure may be in a stronger position to prevent management from using poison pills as an entrenchment device.

b. Stock Ownership of Directors.

Outside directors owning a large block of stock will benefit more by promoting shareholders' interest and by being independent of management control. In contrast, directors who own small amounts of stock may have more of an incentive to free ride in the monitoring of management which may lead to greater entrenchment of the top executives of the firm. Patton and Baker (1987) find that there are only a few outside directors that own large amounts of stock in the company on whose board they serve. Most outside directors in their study owned fewer than 500 shares of stock. This level of ownership of the host firm's stock represents a small proportion of the director's net worth. This leads to the common notion that unless outside directors of a company own stock, individuals have no real incentives to make the organization a success (Heidrick and Struggles, Inc., 1990).

Empirical evidence on equity ownership by directors has led to mixed conclusions. Morch, Shliefer, and Vishny (1988) found that outside directors with large stockholdings were more likely to support management entrenchment, and Kosnik (1987) finds large holdings by directors weakens board resistance to greenmail.

In contrast, Brickley, Lease, and Smith (1988) found greater shareholdings increases the incentives to monitor managers. Bacon, Cornett, and Davidson (1997) found that stock ownership by inside and affiliated directors appears to align the interests of management and shareholders in dual-class recapitalizations. McConnell and Servaes (1990) find a non-linear relation between managerial stock ownership and firm performance, as measured by Tobin's Q in U. S. Firms. Short and Keasey (1999) find that although management entrenchment occurs at higher levels of ownership in U. K. firms than in U. S. firms, there appears to be a non-linear relation between managerial stock ownership and firm performance. We argue that the stock holdings of both inside directors and of outside directors will be proportionately greater for firms adopting poison pills that are optimal contracting than for those interpreted to be management entrenching.

c. Number of Meetings

If a board of directors actively monitors the company and its managers, more regular meetings should be required than if the board simply rubber stamps management decisions.

Vafeas (1999) finds that the number of board meetings is inversely related to firm value. Board activity increases when firm performance declines which is consistent with contracting and agency theory. Thus, regular meetings should help a board to prevent management entrenchment.

If poison pills are the result of and help to perpetuate management entrenchment, we would expect that these boards would meet infrequently. If, on the other hand, a board actively participates in company affairs and the poison pill is interpreted to be optimal contracting, then we would expect such boards to meet more regularly than the boards which approve poison pills to perpetuate management entrenchment.

d. Analyst Coverage

Market forces may protect shareholder interests. Firms followed by a large number of analysts may be unable to behave in a manner that entrenches managers. Analysts and other market forces could keep managers in line with shareholder interests through their buy and sell recommendations. We, therefore, argue that the number of analysts following a firm will be positively related to the market's reaction to poison pill adoption announcements.

e. Blockholder Ownership

We also include the percentage of shares held by blockholders and the number of blockholders since they may serve as monitors of the firm. We define blockholders as any non-executive shareholder with a 5% or larger equity stake in the firm. We expect that blockholders will protect their own interests. Given their large holdings, they may strongly resist management entrenching poison pills. Therefore, we expect that blockholder ownership will be positively related to poison pill announcement period abnormal returns.

4. Sample and method

4.1. Sample Selection

We identified firms that adopted poison pill amendments from two data sources. The first source was Market Control Alert which is a monthly report on current changes in corporate control. The second data set was the 1991 edition of Corporate Anti-Takeover Defenses: The Poison Pill Device. We compiled the initial sample by identifying only those firms which were listed in both sources and had the same board approval date.

Furthermore, we included only original poison pill amendment adoptions and not revisions of an earlier version of the pill. We considered only those firms that approved poison pill amendments between June, 1984 and December, 1989 in the initial sample. We selected this time period for two reasons. Most prior studies of poison pills use this time period (approximately), and it allows our results to be more comparable.

Second, as pointed out by Brickley et al. (1994), this time period seems to be associated with the most negative returns around poison pill adoption. Using this time period lets us determine if the negative returns are related to board composition and structure.

The initial sample for this data set included 610 firms whose board of directors had approved a poison pill plan. We eliminated 353 firms for various reasons (e.g., no proxy statements, confounding information, or no announcement of the amendment in the proxy statement). The year the board approved each of the final 257 poison pill plans appears in Table 1.

Table 1. Poison Pill Amendments, Listed by Announcement Date, And Exchange, 1984 to 1990

	Firms Listed		
	On New York	*Firms Traded*	
Year	American Stock Exchange	Over-the-Counter	Total
1984	0	1	1
1985	8	1	9
1986	66	16	82
1987	24	6	30
1988	46	28	74
1989	36	25	61
Total	*180*	*77*	*257*

4.2 Data Collection

We collected sample statistics on the three board attributes: composition, characteristics, and structure from the firm's most recent proxy statement which was released prior to the time of the adoption of the poison pill amendment.

4.3. Director Classification

The method used for classifying the directors in this study is based on the format implemented by Baysinger and Butler (1985), Hermalin and Weisbach (1988), Weisbach (1988), Gilson (1990), Byrd and Hickman (1992) and Lee, Rosenstein, Rangan, and Davidson (1992). We classified directors into three general categories: inside directors, affiliated outside directors, and independent outside directors. The exact guideline for classifying directors is similar to that in Baysinger and Butler (1985) and appears in Table 2.

Table 2. The Classification of Directors into Insiders, Affiliated Outsiders and Independent Outsiders

Inside Directors:

Senior Management
Junior Management
Former manager of company
Employee of common stock ownership plan (ESOP)
Relative of current manager

Affiliated Outside Directors:

Lawyer affiliated with the firm

Table 2 continued

Investment banker
Bank or insurance company lender of firm
Employee of another firm doing business with firm
Director noted as having any transaction with firm
Director having an interlock directorship with an inside director

Independent Outside Directors:

Manager in an unaffiliated nonfinancial firm
Manager of unaffiliated bank or insurance company
Retired manager of another company
Major blockholder in firm
Lawyer unaffiliated with firm
Academic unaffiliated with firm
Other

4.4. Committee Structure Classification

We obtained board committee information from each firm's proxy statement and classified committee members in the same three categories as for the boards and as shown in Table 2. We classified committees by function and not by title[2].

Some firms did not have one or more of the committees, others had one committee serving two functions, and in these instances we recorded them in both categories. We did not record committee membership for members that were rotated on and off a committee throughout the year.

Table 3 contains summary statistics on the sample firms' boards and committees. The table also contains statistics on director tenure, director stock ownership, board committee size, and number of board meetings per year. As shown in the table, board chairs are independent outsiders in 5.06% of the firms and outside directors average 43.98% of the total board.

Denis and Sarin (1999) report that independent outsiders as a percent of the total board have a mean of 40% and median of 43%. Our sample statistics are very similar. On average, inside and affiliated directors control 9.07% of the firms' stock while outsiders control 1.21%. Insiders and affiliated directors average 7.05 years of tenure while outsiders average 7.44 years. The table also shows other board characteristics and the average composition of the four board committees.Table 3 also shows the same information for the 195 firms with no takeover activity and the 62 firms with. We define takeover activity as any announcement or rumor reported in the Wall Street Journal in the 12 months prior to the announcement that the firm is "in play." There is one variable that is significantly different between the two groups. Boards average 7.32 meetings per year for the no-takeover sample and 8.29 meetings for the takeover sample. This difference is significant at 0.05 and may be due to board meetings caused by the takeover attempts. Otherwise, there are no significant differences between the takeover and no-takeover samples.

4.5. Procedure – Event Study

We computed cumulative abnormal returns for our sample firms using the procedure pioneered by Fama, Fisher, Jensen, and Roll (1969). We estimated market model parameters over the 200 day period –210 to –11 where day 0 is the day the poison pill announcement occurred. Abnormal returns are considered to be the difference between the actual return and those predicted by the market model. To determine if the abnormal returns and cumulative abnormal returns (CARs) are significantly different from zero, we use the z-statistic as described in Dodd and Warner (1983).

[2] The following general functions, which were used to classify the committees, are listed for each of the four committees. The functions of the audit committee typically include consulting with the company's independent auditors, with personnel from the financial department or corporate accounting, and reporting practices. The compensation committee's function is to administer several compensation plans, such as the company's management incentive plan, stock option plan, and the employee stock purchase plan. Another function of this committee is to make recommendations to the Board of Directors for salary increases and any changes in the compensation policies for executive officers. The nomination committee's functions consist of making recommendations to the Board of persons to be nominated for election as directors by the stockholders, and also of those to be elected by the Board to fill vacancies that arise between annual meetings. The function of the executive committee involves the authority, between meetings of the Board of Directors, to take all actions with respect to the management of the company's business that required the action of the Board of Directors, except with respect to matters that by law must be approved by the entire Board.

Table 3. Sample Characteristics for the 257 Firms in the Sample that Announced the Adoption of a Poison Pill Amendment

	Total Sample	*Firms With No Takeover* Announcements	*Firms With Takeover* Announcements	t
Board Composition				
Percent with Outside Chair n=257	5.06	4.62	6.45	-0.53
Percent Affiliated & Inside Directors n=257	56.02	55.77	56.81	-0.37
Percent Outside Directors n=257	43.98	44.33	42.89	0.37
Board Shareholdings				
Percent Shares Inside & Affiliated Directors n=248	9.07	9.48	7.78	0.13
Percent Shares Outside Directors n=248	1.21	1.16	1.37	0.54
Board Tenure (Years)				
Average Tenure Inside & Affiliated Directors n=255	7.05	7.18	6.65	1.09
Average Tenure Outside Directors n=255	7.44	7.73	6.52	1.94
Other Characteristics				
Number of Board Meetings n=257	7.55	7.32	8.29	-2.07*
Number of Analysts Following the Firm n=214	15.28	15.22	15.55	-0.15
Percent Shares Held by Blockholders	*12.98%*	*12.97%*	*12.98%*	*-0.01*
Number of Blockholders	1.49	1.48	1.52	0.22
Executive Committee				
Percent Outside Directors n=136	23.92	24.06	19.74	1.02
Audit Committee				
Percent Outside Directors n=246	63.57	62.39	56.16	1.38
Compensation Committee				
Percent Outside Directors n=239	61.14	59.09	59.08	0.00
Nomination Committee				
Percent Outside Directors n=146	51.37	48.36	49.70	-0.23

* Significant at 0.05 or better

4.6. Procedure – Relating Management Entrenchment to Board Variables

We regressed the CAR_{-1to0} against the various board measures.

$$CAR_{-1to0} = \gamma_0 + \sum_{i=1}^{n} \gamma_i (i^{th} \text{ variable})$$

where

γ = regression parameters

i = represents the i^{th} board of directors characteristic

5. Results

5.1. Abnormal Returns

Table 4 contains the abnormal returns for the interval –1 to 0 relative to poison pill announcements. For the total sample the CAR is 0.58% but is statistically insignificant. The results for firms in-play the prior year and those not in-play also have statistically insignificant CARs. Seventy-three firms' poison pills were announced in the Wall Street Journal. The CARs for these announcements are also insignificant. Whether the poison pill was announced in the Wall Street Journal, or the adopting firm subject to a takeover attempt, does not significantly impact the market's response to the announcements. These findings are consistent with those of Brickley et al (1994) and Datta and Iskandar-Datta (1996), but they are inconsistent with studies using samples from earlier time periods (Malatesta & Walking, 1988; and Ryngaert, 1988) that find negative abnormal returns. The inconsistencies among the studies suggest that an individual firm's reaction to the announcement may be influenced by company and board specific factors.

Table 4. Abnormal Returns Computed Around the 257 Announcements Of Poison Pill Adoptions

	Interval		*Total* Sample	*Takeover* Firms	*No-Takeover* Firms	t-statistic *for difference* in means
Total Sample	-1 to 0	CAR	0.058%	0.056%	0.059%	-0.04
		Z	(1.48)	(1.39)	(0.92)	
Reported in *WSJ*	-1 to 0	CAR	0.075%	0.057%	0.083%	-0.21
		Z	(1.22)	(0.94)	(1.03)	

5.2. Cross Sectional Regressions

Table 5 contains the cross sectional regression results. Regression 1 uses the total sample and six variables. Here, the coefficients for percent of outside directors, tenure of the directors and their stock ownership are statistically insignificant[3].

The only significant variable is the percentage of shares held by outside blockholders. All other variables are statistically insignificant. Regression 2 includes only the percentage shares held by blockholders. This variable remains significant.

We, therefore, have not found a relationship between board variables and poison pill announcement period returns. In our sample, blockholder ownership seems to be the only variable association with monitoring.

Regression 3 repeats 1 using only the no-takeover sample. The results are, again, largely insignificant, however, the coefficient for the percent of shares held by blockholders remains significant. Regression 4 uses only the takeover sample. Here all coefficients are statistically insignificant.

Table 6 contains regression results for the board committees. There are 231 firms with audit committees, 223 firms with compensation committees, 137 firms with nomination committees and only 126 firms with executive committees. There are only 88 firms with all four committees.

Regressions 5-9 separately regresses the CAR_{1to0} against the percent of outsiders on each committee. The results in all four regressions are statistically insignificant. Regression 9 includes board composition of all four committees but is for a reduced sample of firms with all committees[4].

Here, as hypothesized the coefficient for percent of outsiders on the executive committee is significant and positively related to the announcement period returns. Executive committee composition is related to the market's interpretation of poison pill adoption, and the sign of this relationship suggests that the executive committee composition can influence the perception of the poison pill. This relationship, however, is only statistically significant in firms with all four committees.

[3] We were intrigued by the negative sign of the coefficient on the dummy variable for an outside chair. We ran a logit regression where the dependent variable is one if an outsider is board chair and zero otherwise. The probability of an independent outsider as board chair is positively related to the percent of shares held by outside directors, the tenure of outside directors and the shares held by inside and affiliated directors.

[4] The sample here is truncated toward larger firms. There are 17.66 analysts, on average, following these firms and only 15.28 in the total sample. There is also a slightly larger number of duality firms; 79.78% in this sample. The percentage of outsiders on the board is 45.8% for this group, versus 43.98% for the entire sample.

Table 5. Cross Section Regression Analysis – Dependent Variable is CAR_{-1to0} – Regressed Against Board of Director and Other Corporate Control Variables for Firms that Adopt Poison Pills[a]

Regression Number Total Sample	Inter-cept	Percent Blockholder Shares	Percent Outside Directors	Tenure Outside Direc-tors	Percent Shares Outside Directors	Tenure Inside & Affiliated Directors	Percent Shares Inside & Affiliated Directors	Number of Board Meetings	Adjusted R^2 (F)
1	-0.318	1.2600	0.1671	0.0289	-1.1611	-0.0027	-0.4222	-0.0172	0.008
	(-1.02)	(2.17)*	(0.35)	(1.49)	(-0.55)	(-0.18)	(-0.44)	(-0.68)	(1.31)
2	-0.0660	1.3003	-----	-----	-----	-----	-----	-----	0.016
	(-0.61)	(2.28)*	-----	-----	-----	-----	-----	-----	(5.18)*
No Takeover Sample									
3	0.1295	1.4204	-0.1833	0.0285	-1.1361	-0.0094	-0.8282	-0.0229	0.009
	(0.32)	(2.27)*	(-0.36)	(1.39)	(-0.53)	(-0.59)	(-0.81)	(-0.83)	(1.23)
Takeover Sample									
4	-1.1565	0.7172	1.7222	0.0125	-3.6421	0.0161	0.5722	0.0014	0.000
	(-1.36)	(0.44)	(1.25)	(0.22)	(-0.46)	(0.37)	(0.21)	(0.02)	(0.36)

Note: figures in parenthesis below coefficients are t-statistics.
* Significant at 0.05 or better.

Table 6. Cross Sectional Regression Analysis – Dependent Variable is CAR_{-1to0} – Regressed Against Board Committee Structure Variables for Firms Announcing Poison Pill Adoption

			Percentage of Outside Directors				Adjusted
	Regression #	Intercept	Audit Committee	Compensation Committee	Nominating Committee	Executive Committee	R^2 (F)
Total Sample							
	5	0.0009	-0.0005				-0.004
		(0.93)	(-0.36)				(0.13)
	6	0.0016	-	-0.0017			0.002
		(1.71)†		(-1.22)			(1.48)
	7	0.0008	-	-	-0.0006		-0.006
		(0.98)			(-0.42)		(0.18)
	8	0.0001	-	-	-	0.0023	0.005
		(0.18)				(1.30)	(1.70)
	9	0.0009	-0.0012	-0.0001	-0.0026	0.0065	0.025
		(0.66)	(-0.53)	(-0.05)	(-1.03)	(2.42)*	(1.56)
No Takeover Sample							
	10	0.0002	0.0007				-0.004
		(0.15)	(0.42)				(0.18)
	11	0.0010	-	-0.0007			-0.005
		(0.89)		(-0.40)			(0.16)
	12	0.0005	-	-	0.0007		-0.007
		(0.65)			(0.47)		(0.22)
	13	0.0003	-	-	-	0.0025	0.021
		(0.54)				(1.47)	(2.15)
	14	0.0007	-0.0002	-0.0008	-0.0022	0.0069	0.028
		(0.56)	(-0.09)	(-0.34)	(-0.82)	(2.39)*	(1.46)

Table 6 continued

Takeover Sample						
	15	0.0028 (1.61)	-0.0042 (-1.52)			0.023 (2.300)
	16	0.0035 (1.98)†	-	-0.0049 (-1.86)		0.041 (3.469)
	17	0.0011 (0.57)	-	-	-0.0033 (-1.04)	0.002 (1.09)
	18	-0.0003 (-0.24)	-	-	-	0.0003 (0.07)	-0.031 (0.00)
	19	0.0033 (0.77)	-0.0057 (-0.96)	0.0006 (0.09)	-0.0039 (-0.58)	0.0040 (0.61)	-0.101 (0.47)

Note: figures in parenthesis below coefficient estimates are t-statistics.
* Significant at 0.05 or better.

In regressions 10-14, we repeat these tests for the no-takeover sample and in regression 15-19 for the takeover sample. The results suggest that the no-takeover sample behaves qualitatively similar to the total sample. The board committee composition variables in the takeover sample are insignificant at conventional cutoffs. The overall composition of the board does not appear to influence shareholder wealth when poison pills are adopted, although there is some limited evidence that the composition of the executive committee may have some influence. One explanation is that since poison pills seem to help target firm shareholders in a takeover attempt (Comment & Schwert, 1995), poison pills are not really an agency problem. This may particularly be true in our sample which includes poison pills up to 1989; most other samples stopped in 1986 or earlier. Since poison pills were a 1980's phenomenon, it may have taken the market awhile to gain sufficient experience to determine them not to be an agency problem.

5.3. Absolute Outsider Control

Brickley et al. (1994) show that the absolute control of the board by outsiders is a determining factor in measuring a board's power. Specifically, their results suggest when outside board members occupy 50% or more of the board seats, poison pills produce positive returns that are negative otherwise. Denis and Sarin (1999) show that only 40% of firms have boards with numerical domination by independent outside directors. Since absolute control by outsiders would occur at 50% outsider composition and since prior research has used this as a cutoff for absolute board control, we examine our data using this measure of board power.

Table 7. Comparison of Characteristics and Boards of Poison Pill Firms Based Upon Whether Independent Outside Directors have Numerical Superiority on the Board

	Outside Directors Less than 50%	Outside Directors Greater than or Equal to 50%	t
Abnormal Returns – Percent			
CAR_{-1to0}	0.750	0.200	0.58
Board Composition			
Percent With Outside Chair	3.55	6.90	-1.06
Percent With Takeover Activity	***43.97***	***36.78***	***0.64***
Board Shareholdings			
Percent Shares of Insiders & Affiliated Directors	11.75	4.15	5.42***
Percent Shares of Outsider Directors	0.60	2.17	-2.36***

Table 7 continued

Board Tenure			
Average Tenure of Insider & Affiliated Directors	8.45	5.19	6.46***
Average Tenure of Outsider Directors	7.42	7.71	-0.51
Other Characteristics			
Number of Board Meetings	7.09	8.08	-2.23*
Number of Analysts Following Firm	13.35	18.21	-2.42*
Percent Shares Held by Blockholders	14.93	10.51	-2.72**
Number of Blockholders	1.53	1.42	-0.71
Executive Committee			
Percent Outsiders	12.47	42.04	-6.97***
Audit Committee			
Percent Outsiders	47.69	82.47	-11.08***
Compensation Committee			
Percent Outsiders	41.68	82.69	-12.87***
Nomination Committee			
Percent Outsiders	30.04	68.62	-9.81***

*** Significant at 0.001 or better
** Significant at 0.01 or better
* Significant at 0.05 or better

Table 7 examines our abnormal return results and other board characteristics when the sample has been divided into those firms whose boards have less than 50% independent outsiders and those with at least 50% independent outsiders. Here we are determining whether there are differences in other variables based on outsider control of the boards. The first row of the table shows that the announcement period returns are not significantly different between the two groups. Absolute board control does not influence the outcome in our sample. However, when we compare the characteristics of the two groups of firms, there are several interesting findings. In insider-dominated boards, inside and affiliated board members own 11.75% of the firm's shares, but they own only 4.15% in outsider-dominated boards which is similar to the results in Denis, Denis, and Sarin (1997). In insider-dominated boards, outside board members own 0.6% of the firm's stock but own 2.17% in outside-dominated boards. In insider-dominated boards, insiders and affiliated directors average 8.45 years of tenure and only 5.19 in outsider-dominated boards. All of these differences are significant at 0.001 or better. Outsider-dominated boards meet more often and are covered by more analysts than insider-dominated boards. Outsider dominated boards occur in firms with fewer shares owned by blockholders. Thus, while outsider dominated boards do not seem to protect shareholders from the management entrenching potential of poison pills, outsider dominated boards are more active.

Board composition is also related to board committee composition. In outsider-dominated boards, outsiders make up a significantly larger proportion of committee membership and these differences are significant at better than 0.001.

The overall conclusion from these results is that in the sample of poison pill firms, the various measures of board-power for outsiders are related. That is, outsider dominated boards also have outsiders controlling (or in more control of) the board committees, meet more often and have outsiders that own more shares. Yet, most of these variables do not impact the announcement period returns for the poison pill adoption announcements.

5.4. Comparison With Prior Research

Counting this research project, there have been at least six papers studying the wealth effects of poison pill adoption. These papers, their sample size, sample period, and a brief summary of their findings appears in Table 8.

Table 8. Comparison of Our Findings to Prior Research

Summary of the Study	*Sample Size*	*Sample Period*	*Stock Market Reaction Findings of the Research*
Davidson, Pilger & Szakmary	257 poison pills	1984-89	Statistically insignificant stock market reaction.

Table 8 continued

			Reaction related to composition of executive committee but not overall board
Brickley, Coles, & Terry (1994)	247 poison pills	1984-86	Statistically insignificant stock market reaction over all. Positive market reaction when outsiders control board, negative otherwise.
Datta & Iskandar-Datta (1996)	91 poison pills	1985-89	Statistically insignificant stock market reaction. Board holders have sig Nificantly negative re turns.
Malatesta & Walkling (1988)	113 poison pills	1982-March 1986	Statistically significant negative overall stock market reaction.
Ryngaert (1988)	325 poison pills	1982-86	Stock market reaction is significantly negative particularly with most restrictive poison pills. Finds wealth effect is "modest."
Sundaramurthy, Mahoney & Mahoney (1977)	261 anti-takeover amendments (196) poison pills	1984-	Statistically significant and negative market reaction which is nega tively related to the per centage of outsiders on board.

Maltesta and Walkling (1988), Ryngaert (1988), and Sundaramurthy et al. (1997) find that the market reacts negatively to poison pill adoption. The first two of these studies' samples stop in 1986. The differences between these results and ours may be time period dependent. The third paper combines poison pills in their sample with other anti-takeover provisions. Our study is restricted to poison pills.

Brickley et al. (1994) and Datta and Iskandar-Datta (1996) find an overall insignificant market reaction. This is the same as our findings. The Brickley et al. study conflicts with Malatesta and Walkling (1988) and Ryngaert (1988). The Brickley et al. sample period ends at roughly the same time as these but starts in 1984 instead of 1982. The sample period may be a partial explanation for these differences. Comment and Schwert (1995) show that poison pills and other anti-takeover amendments increase the bargaining position of target firms but do not seem to prevent bids. Since poison pill adoption is primarily a 1980's phenomenon, the stock market may have initially interpreted them as protection for incumbent management teams against takeovers. As the market's experience with them grew through the 1980s (1986 seems to be the peak year of poison pill adoption), and the market learned that they increased the bargaining position of target firms, the reaction may have become less negative.

While the purpose of our paper is not to formally examine time period differences, the samples' time period differences are one possible explanation for differences in our findings and those of other papers. We offer no specific hypotheses but analyze time differences as a post-hoc explanation for the differences in our findings from others. Accordingly we divided our sample into two time periods 1984-86 and 1987-89. This break is our sample period's midpoint and follows year 1986, the year with the largest number of poison pill announcements.

We find no significant differences in the CPEs between the time periods. We do find that in the later period more of the poison pill announcements occurred within one month of a takeover attempt

(13.94% compared to 5.43% in the early period, t = 2.36).

Board structure varies between the time periods. We find 41.21% of the boards are independent outsiders after 1986 while 47.12% are independent outsiders in the early time period.[5] This difference is significant at 0.05 (t = 2.38).

We also find that the percent blockholder is larger in the later time period, 14.29% compared to 10.60%. This difference is significant at the 5% level (t = 2.21).

Finally, Brickley et al. show that the market reaction depends on board composition. Our results suggest that it is the composition of the executive committee which is a somewhat complimentary finding particularly given the difference in sample periods.

As we mentioned above, the percent of independent outsiders is larger in the earlier time period and the percentage of blockholders is larger in the later time period. Given these differences, the role of blockholders perhaps increases in the later period while the role of outside directors may have declined.

We also did not find a significant difference in the composition of the executive committee across time. On average, independent outsiders constitute 22.04% of the executive committee in the early period and 22.63% later (t = 0.16). While the executive committees' composition remains the same, the board composition becomes less independent. Perhaps the executive committee as well as blockholders assumes the monitoring role for the companies in the later time period.

We do report (in Table 7) that committee composition is related to board composition. When outside directors dominate boards, executive committees have considerably more outside representation. Since these variables are highly related our results appear to complement those in Brickley et al (1994).

6. Conclusions

We examine the composition, characteristics and structure of boards and their committees that adopted poison pills to determine if they can lessen the potential of poison pills to entrench an incumbent management team. We find no evidence that boards comprised of more outsiders protect shareholder interests when poison pills are adopted.

We do find some limited evidence that board characteristics influence the market's perception of the management entrenching potential of poison pill adoption. Longer tenure of outsiders on the board positively influences the market's reaction to the announcement in univariate tests but has no impact in multivariate tests. We do not find that more active boards which meet more often improve their monitoring. Thus, our results are not consistent with the spirit of those in Vafeas (1999).

Blockholders appear to serve as effective monitors. When their proportion of shares is large, the market responds more positively to the poison pill announcements. Thus, blockholders do serve shareholders in reducing management entrenchment.

Board committee structure also has some limited influence on the perception of the management entrenching potential of poison pill adoption. The proportion of outsiders on executive committees is positively related to announcement period returns (but only in firms with audit, compensation, executive and nomination committees). Our results qualitatively support those in Klein (1998). That is, we find composition of board committees to have an influence on the perceived monitoring ability of the board. This finding is important because an executive committee can influence the agenda for the entire board. When outsiders have greater control of this committee, shareholder wealth is protected in our sample.

Future research on boards should consider committee composition in determining a board's willingness and ability to protect shareholders and in particular address the roles played by the committees in various decisions. For example, we find that the executive committee influences the market's perception of poison pills while Klein (1998) and Xie et al (2000) find the composition of audit committees influence reported results.

A review of the poison pill literature reveals that early studies found them associated with negative abnormal returns but later studies using more recent sample periods document insignificant abnormal returns. Future research should be directed at this phenomenon to explore why poison pill adoptions in later years are viewed differently by the market.

Finally, after dividing our sample into those firms with 50% or more independent outsiders on the board (defined to be absolute control) and those with less than 50%, we find that outside domination influences or is related to other board characteristics such as board shareholdings, board tenure, number of board meetings and to board committee composition. The proportion of shares held by outside blockholders also positively influences this result. Yet with the exceptions noted above, most of these board variables are unrelated to the market's perception of poison pill adoption.

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