STAGGERED BOARDS
RESEARCH SPOTLIGHT
Staggered (or classified) board

• Directors elected to three-year terms, with one-third of board standing for election each year.

• Staggered boards are a formidable antitakeover protection.

• The board cannot be replaced in a single year; two election cycles are required to gain majority control.

• Staggered boards are often adopted in combination with other protections, such as a poison pill, limits on shareholder rights to call a special meeting, and supermajority voting required to remove directors.

• Combining a staggered board and poison pill is practically insurmountable.
• From a theoretical standpoint, it is unclear how staggered boards impact shareholder value:

(-) Management entrenchment.
(+ ) Enhances bargaining power with potential acquirers.
(+ ) Strengthens long-term commitments to strategic partners.
(+ ) Encourages management to take risk / invest in long-term projects.

• Empirical evidence tends to be negative, but is very mixed.

The impact of a staggered board—positive or negative—likely depends on situational factors that are company-specific.
Daines and Klausner (2001) examine whether antitakeover protections are more prevalent in companies where they might be value maximizing:

1. Do they increase bargaining power in industries with lower takeover activity? (less deal competition = lower takeover premiums)

2. Do they allow long-term R&D whose value is not understood by markets? (prevent a raider from purchasing company at a discount)


Find that staggered boards are not correlated with firms that have these characteristics.

Conclusion: staggered boards are not adopted to maximize value.
Johnson, Karpoff, and Yi (2014) examine whether antitakeover protections are implemented to protect long-term business commitments.

Sample: 1,219 companies undergoing an IPO, 1997-2005.

Find that staggered boards are more prevalent if company:
1. Has one or more large customers.
2. Is dependent on one or more key suppliers.
3. Has an important strategic alliance in place.

Also find that long-term operating performance is positively related to the use of takeover defenses among these firms.

Conclusion: staggered boards increase value when they protect long-term business relationships.
Pound (1987) evaluates the impact of staggered boards on merger activity.

Sample:
- 100 companies without these protections (control group).
- Examine merger activity through 1984.

Find that staggered boards:
- Reduce likelihood of takeover bid (28% vs. 38% in control group).
- Do not increase premiums among completed deals (51% vs. 49%).

Conclusion: staggered boards harm deal activity.

“These amendments increase the bargaining power of management… to the detriment of shareholder wealth.”
Bebchuk, Coates, and Subramanian (2002) also study the impact of staggered boards on merger activity.


Companies with staggered boards are significantly more likely to defeat an unsolicited bid (61% vs. 34% single-class board).

Premiums not materially higher among completed deals (54% vs. 50%).

Conclusion: staggered boards harm deal activity.

Staggered boards “do not seem to provide sufficiently large countervailing benefits for shareholders of hostile bid targets, in the form of higher deal premiums, to offset the substantially lower likelihood of being acquired.”
Bebchuk and Cohen (2005) examine whether companies with staggered boards trade at lower market-to-book values (Tobin’s Q) than companies with single-class boards.

- Sample: ~1,600 companies, 1995-2002.
- Find that companies with staggered boards trade at 10.6% lower industry-adjusted Tobin’s Q, on average.

Conclusion: staggered boards are associated with lower firm value.
Faleye (2007) examines the relation between staggered boards and governance quality.


Finds that staggered boards are associated with:
- Lower market-to-book values.
- Lower CEO turnover (16.4% vs. 30.3%).
- Less CEO pay-performance sensitivity.
- Lower likelihood of proxy contests or shareholder proposals.

Conclusion: staggered boards entrench management and reduce value.

“Classified boards significantly insulate management from market discipline, thus suggesting that the observed reduction in value is due to managerial entrenchment and diminished board accountability.”
Guo, Kruse, and Nohel (2008) measure the stock market’s reaction to the decision to destagger a company’s board.


Use matched pairs to compare to similar firms that retain staggered board.

Announcement to destagger is associated with a 1% increase in stock price.

Companies with “good governance” are more likely to destagger (those with higher E-index scores, more independent boards, and those responding to shareholder pressure).

Conclusion: a decision to destagger is beneficial to shareholders.


Findings:
- A decision to stagger is associated with a subsequent increase in value (Tobin’s Q and excess returns).
- A decision to destagger is associated with a subsequent decrease in value.

Conclusion: staggered boards are not harmful to shareholders.

“Overall our findings seem to support the view that staggered boards help to commit shareholders and boards to longer horizons and challenge the managerial entrenchment interpretation that staggered boards are not beneficial to shareholders.”
Ge, Tanlu, and Zhang (2014) also examine the impact of the decision to destagger using time-series analysis.


Find that companies are more likely to destagger if they face pressure from shareholder activists or exhibit poor performance.

Find that the decision to destagger leads to a deterioration in operating performance (ROA) and no improvement in market value (Tobin’s Q).

Conclusion: destaggering is not beneficial to shareholders.

“Our evidence is contrary to the earlier studies that claim that destaggered boards are always optimal and value-increasing.”
Larcker, Ormazabal, and Taylor (2011) examine the market reaction to proposed regulations that would bar staggered boards.

Sample:
- 18 proposed legislative rules / amendments in the years preceding Dodd-Frank.

Firms with staggered boards exhibit negative excess returns in response to proposals that include provisions to eliminate staggered boards.

Conclusion: restrictions on board structure are not value enhancing.

“The evidence suggests the market reaction [to regulation] is increasingly negative for firms with staggered boards. This is consistent with the notion that the presence of a staggered board is a value-maximizing governance choice.”
CONCLUSION

• The evidence on staggered boards is highly mixed.

• Staggered boards decrease merger activity by protecting a company from an unsolicited takeover.

• When combined with other defenses (in particular, a poison pill), the defense is very formidable.

• Whether staggered boards entrench management or empower a board to adopt a long-term horizon is unclear.

• Staggered boards appear to have a positive impact on companies with unrecognized potential resulting from proprietary knowledge, innovation, or business relationships.


