# Antitakeover Amendments and Analysts' Long-Term Earnings Forecasts

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## Abstract

*This paper utilizes the one year changes in analysts' long-term earnings growth forecasts from the I/B/E/S database to provide evidence on whether antitakeover charter amendments promote stockholders' interests or lead to managerial entrenchment. One year changes in analysts' long-term earnings growth forecasts have a number of advantages over previous measures that have been used to study the financial effects of antitakeover amendments. The results for the entire sample show a negative and weakly significant one year change in long-term earnings forecasts following antitakeover charter amendment proposals, providing some support for managerial entrenchment. The findings appear to be driven by firms with amendments that receive high shareholder support. For these firms, the long-term earnings forecasts strongly decrease in the year following the amendment proposal. The high support could indicate a lack of stock held by dissident shareholders who monitor the actions of management, implying that the adoption of antitakeover amendments without sufficient monitoring of management leads to managerial entrenchment.*

*Keywords: Antitakeover charter amendment, analysts' long-term earnings growth forecasts, stockholder voting*

*I acknowledge Thomson Financial for providing analysts' forecasts from the *I/B/E/S* database. Also, I thank Deryl Martin, Joanne Li, Barry Marks, and an anonymous reviewer for helpful comments and suggestions.

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## 1. Introduction

Antitakeover charter amendments (ATCAs) have been a source of controversy over the years. They involve a change in a corporation's charter and make takeovers more difficult. To be implemented, they must be approved by a stockholder vote.[1] Proponents of these amendments argue that since they protect managers from the takeover market, they provide managers with an incentive to invest in firm specific skills and encourage them to invest in projects that are not profitable in the short-run but beneficial in the long-run. Further, according to their supporters, ATCAs can help managers negotiate a better deal for shareholders in the case of a takeover attempt (DeAngelo and Rice, 1983). The view that ATCAs benefit shareholders is known as the "stockholders' interests hypothesis." However, opponents of ATCAs argue that they shield managers from the discipline of the takeover market. This can lead to value decreasing behavior such as excessive risk aversion, excessive consumption of perquisites, and empire building. The perspective that ATCAs are not in the shareholders' interests is known as the "management entrenchment hypothesis." The controversy of these amendments is supported by the negative stock market reactions found in most of the ATCA market reaction studies that primarily use data from a period after the 1970s, implying that investors tend to believe that ATCAs are value-decreasing. In recent years, shareholder activism has lead to a slowing of ATCA adoptions and in a number of cases, the repealing of an ATCA. For example, in 2003, 21 of 22 proposals to eliminate the classified board takeover defense received over 50 percent of shareholder votes (Rosenbaum, 2004).

This study uses the one year changes in financial analysts' mean consensus long-term earnings growth rate forecasts from the *I/B/E/S* database to test the long run performance effects of ATCAs. Following the adoption of an ATCA, beneficial (e.g., a focus on profitable long run projects) or detrimental (e.g., empire building) actions taken by management may not affect performance in the short-run. However, analysts' long-term earnings growth forecasts reflect analysts' expectations of growth in operating earnings over a period of somewhere between three and ten years.[2] Further, analysts are more likely than most stakeholders to recognize in the short run actions taken by management that are expected to enhance or reduce the firm's long-term prospects. This is because financial analysts spend a considerable amount of time studying their target firms and normally have knowledge of the internal workings of particular firms that most other outside parties lack. In addition, prior research has conveyed that analysts' performance is positively related to their reputation and pay (Stickel, 1992) and that analysts' forecasts are revised in a timely manner (Fried and Givoly, 1982; Brown, et al., 1985; Vogel and Lobo, 2002). Therefore, following the adoption of an ATCA, if management is taking actions intended to benefit the firm and its stakeholders over the long run, then analysts are expected to revise their

[1] ATCAs are proposed in the proxy statement and voted on during the shareholder's meeting, which normally takes place in the first half of the fiscal year.

[2] According to Thomson Financial (2004), analysts' long-term earnings growth forecasts on the *I/B/E/S* database represent a period of three to five years. Sharpe (2005) develops a formal model, uses *I/B/E/S* analysts' consensus long-term earnings growth forecasts, and shows that the stock market applies these forecasts to a period of between five and ten years.

long-term earnings forecasts upward. This upward revision is in anticipation of increased earnings once the benefits from management's efforts are realized. On the other hand, if management has become entrenched following the adoption of an ATCA and is taking actions that are harmful to the long-term performance of its firm, then analysts are likely to revise their long-term earnings forecasts downward.

The approach using the one year changes in analysts' long-term earnings growth forecasts has a number of advantages over previous methodologies. First, long-term earnings forecasts should reflect empire building by management. A number of papers have tested the effects of ATCAs on capital expenditures or research and development expenditures and have provided mixed results. The argument is that if ATCAs help managers become less risk averse and more focused on the long-run, then the managers at ATCA adopting firms will increase their expenditures on capital and research and development (Stein, 1988). However, a counter argument is that entrenched managers who do not face the discipline of the market for corporate control could undertake empire building by increasing the size of their companies through spending on negative net present value projects. Growth in size tends to increase management's power by increasing the resources under its control (Jensen, 1986). Indeed, officers of larger firms tend to have more power and prestige and receive higher levels of compensation (Murphy, 1985; Jenson, 1986; Stulz, 1990; Bebchuk and Fried, 2003; O'Byrne and Young, 2006). Therefore, an increase in spending on research and development and capital may not necessarily signal that management is acting in the interests of shareholders. But empire building will reduce long-term earnings. Therefore, if management is empire building, this may cause parties with a thorough knowledge of the firm's operations to lower expected future earnings. Hence, it should lead to a downward revision in financial analysts' long-term earnings forecasts.

Second, the approach in this paper limits survivorship bias. To make inferences regarding ATCAs using actual financial information (e.g., research and development expense, capital expenditures, earnings), one normally needs a number of years of future data, which can lead to a large number of firms dropping out of the sample due to events such as mergers, acquisitions, delistings, and liquidations. But this paper requires analysts' long-term earnings growth forecasts for only the month of the proxy statement that includes the ATCA (the ATCA proposal month) and the same month in the subsequent year. This is because the forecasts pertain to time frames of between three and ten years. Third, by the time one year after the ATCA proposal month has been reached, financial analysts have had a chance to observe the actions of management after the ATCA adoption. [3] Johnson and Rao (1997b) examine analysts' capital expenditure forecasts one quarter after the quarter of the ATCA proposal. One quarter after an ATCA proposal may not give analysts enough opportunity to determine whether there has been a positive or a negative change in management's actions subsequent to the ATCA adoption, especially since the official vote on the ATCA at a shareholders' meeting is normally more than a month following the ATCA proposal in the proxy statement. Therefore, any changes in

[3] The use of say, the two-year change in analysts' long-term earnings growth forecasts, would give financial analysts a longer time frame to observe management's actions after an ATCA adoption. However, it would also lead to more survivorship bias. Thus, the one-year change in analysts' long-term earnings growth forecasts is chosen because the time period is long enough to capture effects of managements' actions following ATCAs and short enough to keep the level of survivorship bias low.

analysts' long-term forecasts the quarter after the proxy statement could primarily reflect analysts' preconceived notions of the firm's ATCA or of ATCAs in general.

The results for the overall sample in this paper show that when firm size and change in financial performance are controlled, the change in analysts' long-term earnings growth forecasts for ATCA adopters relative to a matched set of control firms is negative and weakly significant, providing some support that ATCAs lead to management entrenchment. However, no significant difference in the change in long-term earnings forecasts is found between fair price amendments and non-fair price amendments. On the other hand, for amendments that receive high shareholder support, long-term earnings forecasts strongly decrease in the year following the ATCA proposal. This implies that a lack of voting stock held by dissident shareholders who vote against such controversial amendments may convey a lack of oversight of management after the adoption of an ATCA. A lack of oversight combined with protection from a takeover encourages management to put less focus on the firm's interests. Thus, current or potential stakeholders in firms can examine shareholder support of controversial management-initiated proposals along with other factors to gain insight into the level of oversight of management. Interestingly, results from additional tests show that although the levels of pressure sensitive and pressure resistant institutional ownership influence the amount of support for ATCAs, they do not affect the change in long-term earnings forecasts.

The paper proceeds as follows. The next section gives a brief background on ATCAs and prior research. Following this, the hypotheses are developed and expected findings are discussed. Next, the methodology is explained. Subsequently, the results are discussed. This is followed by additional tests that utilize institutional ownership, examine the presence of state antitakeover laws, and study actual future earnings. Finally, the conclusions are presented.

## 2. Background

According to the stockholders' interests hypothesis, ATCAs benefit firms because they enable management to have a long-run orientation. Since managers are protected from the takeover market and feel secure about their long-run employment, they invest in firm-specific skills which are important for the long-run success of the firm (Sundaramurthy, 2000). Also, without the protection of an ATCA, a takeover may occur before the benefits of managers' long-term projects are realized. Management would not reap the rewards of its long-term investments and shareholders may receive a price below the true value of the firm. As a result, without an ATCA, management would be encouraged to take actions that increase the firm's current earnings at the expense of its long-term earnings (Stein, 1988). Additionally, a fair price ATCA can prevent a two-tier tender offer from a bidder and enable target managers to hold out for one higher uniform bid (DeAngelo and Rice, 1983).

Proponents of the management entrenchment hypothesis with respect to ATCAs argue that protection from the discipline of the market for corporate control can lead to managers shirking their duties and consuming excessive amounts of perquisites. Moreover, supporters of this view indicate that protection from the threat of a takeover encourages excessive aversion to risk (Sundaramurthy, 2000). In addition, managers who are protected from the market for corporate control may have the incentive to empire build through investing in negative net present value

projects. Jensen (1986) argues that managers have incentives to grow their firms to exceed their optimal size.[4] Jensen and Meckling (1976) convey that stockholders are often unable to force value maximization by managers due to factors such as the cost of monitoring and replacing managers and the lack of suitable outside firms available to take over an ineffectively managed firm. Also, unprofitable projects can be 'mixed in' with profitable projects to obscure the impact on firm profit.[5] Indeed, officers of larger firms tend to have more power and prestige and receive higher levels of compensation (Murphy, 1985; Jenson, 1986; Stulz, 1990; Bebchuk and Fried, 2003; O'Byrne and Young, 2006). Therefore, an increase in expenditures such as research and development and capital may not necessarily signal that management is acting in the interests of shareholders.[6]

Stein (1988) does propose the use of capital or research and development expenditures to test whether managers focus on the long-term after the adoption of ATCAs. Not considering the possibility of empire building, an increase in those expenditures may imply a long-run orientation and support the stockholders' interests hypothesis whereas a decrease in those expenditures may signal a short-run focus and support the management entrenchment hypothesis. Therefore, there have been a number of papers that have tested research and development and capital expenditures following ATCA adoptions (e.g., Meulbrock, et al., 1990; Mallette, 1991; Page, et al., 1992; Akhigbe and Madura, 1996; Mahoney, et al., 1997; Johnson and Rao, 1997a; Johnson and Rao, 1997b). Overall, the findings from these studies have been mixed. Johnson and Rao (1997a) also study the financial statement measures of operating costs, overhead costs, and earnings after ATCA adoptions and conclude that, all in all, ATCAs do not influence financial performance.

Interestingly, Johnson and Rao (1997b) use analysts' capital expenditure forecasts from *ValueLine* instead of actual results to examine the influence of ATCAs but find that ATCAs have no effect on the forecasts. However, since Johnson and Rao (1997b) examine capital expenditure forecasts made the quarter following the ATCA proposal quarter, it is questionable whether the financial analysts had enough time after the ATCA adoptions to draw conclusions on whether the ATCA adopting firms' managers were taking actions beneficial or detrimental to shareholders. Additionally, the use of capital expenditure forecasts does not take into consideration the possibility of empire building. In non-ATCA related research, Vogel and Lobo (2002) study the changes in financial analysts' earnings, capital expenditure, and cash flow forecasts for a one-year period following the adoption of long-term performance plans for management.

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[4] Jensen (1986) uses the oil industry in the late 1970s and early 1980s to provide evidence of companies growing beyond their optimal sizes and investing in negative net present value projects. Jensen (1986) mentions that the oil industry was spending heavily on exploration and development even though the net present values were on average negative. Further, a number of oil companies made ill advised forays into other industries through purchase of retailing, office equipment, manufacturing, and mining firms.

[5] Hope and Thomas (2008) document that after Statement of Financial Accounting Standards (SFAS) 131, US multinational firms that no longer disclose earnings by geographic location have experienced an expansion in foreign sales combined with lower foreign profit margins and lower firm value. The authors attribute their results to empire building by managers due to nondisclosure reducing the ability of investors to monitor managers' actions with respect to foreign operations.

[6] McConnell and Muscarella (1985) find that announcements of increases (decreases) in exploration and development expenditures by oil companies from the period 1975-1981 were associated with a decrease (increase) in the announcing firm's stock price.

Research using samples containing ATCAs from years prior to 1981 has shown positive (Linn and McConnell, 1983) and weak negative (DeAngelo and Rice, 1983) stock market reactions around the adoption of ATCAs. On the contrary, most of the researchers who have analyzed fair price, classified board, and supermajority amendments (the amendments studied in this paper) primarily from the time period after the 1970s have found negative stock market reactions (e.g., Jarrell and Poulson, 1987; Agrawal and Mandelker, 1990, 1992; Mahoney and Mahoney, 1993; Mahoney, et al., 1996). This supports the management entrenchment view of ATCAs and documents their controversy among investors. On the other hand, a smaller number of studies that have used samples predominantly from the 1980s have found insignificant reactions (e.g., McWilliams, 1990; Lauterback, et al., 1991). Further, Dann and DeAngelo (1988) show that shareholder wealth significantly declines at the announcement of management's defensive restructuring plans in response to hostile takeovers. This implies that shareholders view the resistance to hostile takeovers to be entrenching. However, unlike ATCAs, shareholders are rarely able to vote on defensive restructuring plans (Dann and DeAngelo, 1988).

## 3. Hypotheses

If financial analysts believe that management is taking actions that are in the firm's best interests for the long term, then the analysts should revise their long-term earnings growth forecasts upward. On the other hand, if analysts think that management is entrenched and not looking out for the firm's best long-term interests, then they are expected to revise their long-term earnings forecasts downward. Therefore, an overall positive (negative) change in analysts' long-term earnings growth forecasts between the ATCA proposal month and one year later supports the shareholders' interests (management entrenchment) view of ATCAs. However, this study makes no prediction whether shareholders' interests or management entrenchment prevails. Therefore, Hypothesis 1 (H1), stated in its null form, is as follows:

*H1: Analysts' long-term earnings growth forecasts do not change between the ATCA proposal month and one year later.*

In addition to the full sample of ATCA adopting firms, various sub-samples are tested. One sub-grouping is based on amendment type, namely fair price amendments and non-fair price amendments (supermajority amendments and classified boards).[7] Fair price amendments are arguably more likely to be in the shareholders' interests whereas classified board and supermajority amendments are more likely to be motivated by management's incentives to reduce the scrutiny of the corporate control market, enabling management to become entrenched (Jarrell and Poulson, 1987). As a result, firms proposing fair price amendments are expected to exhibit higher changes in analysts' long-term earnings growth forecasts than are firms which propose non-fair price amendments. Hypothesis 2 (H2), stated in its null form, is as follows:

[7] The supermajority amendment requires a minimum affirmative vote ranging from 66 percent to 90 percent of voting stock for a takeover to occur (Johnson and Rao, 1997a). The classified board amendment staggers the election of the board of directors so that only a proportion of the board of directors can be elected at a point in time. Fair price amendments require a bidder to pay the same 'fair' price for *all* shares it acquires. The failure to offer a fair price often initiates a supermajority requirement.

*H2: There is no difference in the change in analysts' long-term earnings growth forecasts between firms proposing fair price ATCAs and firms proposing non-fair price ATCAs.*

Further, the sample firms are classified based on the percentage of shareholder votes supporting their ATCAs. High support for an ATCA could mean that shareholders believe that the proposal is in the firm's best interests. On the other hand, high support for an ATCA could convey a lack of shareholder oversight of management as only a small percentage of shareholders are willing to vote against or abstain from voting on a controversial management-initiated proposal. This lack of oversight would promote managerial entrenchment following an ATCA. Due to different potential causes of high support for ATCAs, no prediction is made on the relationship between the levels of support for ATCAs and the changes in analysts' long-term earnings growth forecasts. Hypothesis 3 (H3), stated in its null form, is as follows:

*H3: There is no association between the changes in analysts' long-term earnings growth forecasts and the levels of shareholder support for ATCAs.*

If the findings for the entire sample show a positive change in analysts' long-term earnings growth forecasts, then the association between shareholder support for ATCAs and changes in long-term earnings forecasts is expected to be positive and not negative. In this case, a positive relationship would imply that stockholders provide more support for ATCAs that are more in their interests and less support for amendments that are not as much in their interests. Hence, there are subsequent positive changes in long-term earnings forecasts when ATCAs receive higher support and less positive, zero, or negative changes when ATCAs receive lower support, with positive changes dominating. On the other hand, since an overall positive change in long-term earnings forecasts implies that ATCAs are on-average in the stockholders' interests, one would not expect to find lower shareholder support corresponding to higher changes in analysts' long-term earnings forecasts. This is because such a relationship would convey that stockholders give less support to ATCAs that are more in their interests.

However, if the results for the entire sample show a negative change in analysts' long-term earnings growth forecasts, the association between the levels of stockholder support for the ATCAs and the changes in long-term earnings forecasts can be positive or negative. A positive relationship would convey that stockholders give more support for amendments that they think are less entrenching or in their interests but provide less support for amendments they feel will lead to more entrenchment. Therefore, there are subsequent positive, zero, or smaller negative changes in long-term earnings forecasts when ATCAs receive higher support and negative changes in long-term earnings forecasts when ATCAs receive lower support, with negative changes dominating. On the other hand, a finding of negative changes in long-term earnings forecasts for ATCAs that receive higher support along with weaker negative or zero changes in long-term earnings forecasts for ATCAs that receive lower support would indicate that ATCAs are entrenching. Higher support would indicate a lower proportion of holdings by dissident shareholders. These dissident shareholders vote against those controversial management proposals and thereafter monitor management.

## 4. Methodology

### *4.1. Sample Selection*

Investor Responsibility Research Center (IRRC) voting records and SEC proxy statements are used to identify firms that proposed ATCAs between October 1984 and December 1990 that were thereafter adopted.[8] The high amount of takeover activity during the 1980s makes it an interesting period to examine (Jarrell and Poulsen, 1987). Also, firms tended to have fewer takeover barriers (including ATCAs) during this period of time relative to more recent years. Therefore, the adoption of an ATCA was likely seen as a bigger event during this time period, which means that using ATCAs implemented during this period should lead to more powerful tests than the use of ATCAs initiated during more recent years.[9] The sample section process is shown in Table 1. The initial sample includes 211 firms. Nineteen firms are eliminated because they lack the necessary data from *Research Insight Compustat* and two firms are dropped because they changed their fiscal year-end during the year of ATCA adoption. Four firms are eliminated because there are no available matched control firms (to be discussed). Also, due to a lack of available control firms, twelve of the thirteen sample firms with SIC code number 60 have the same matched control firm. Therefore, all thirteen sample firms with SIC code 60 are dropped. A total of 26 sample firms are eliminated because they lack the necessary *I/B/E/S* analysts' consensus long-term earnings growth rate forecasts. Further, thirteen of the sample firms are dropped because a matched control firm with the necessary *I/B/E/S* forecasts could not be found after two attempts (to be discussed). Thus, we are left with a sample of 134 ATCA adopting firms, each of which is matched with a control firm.

**TABLE 1**
**Sample Selection**

| | |
|---|---|
| Initial sample | 211 |
| Missing the necessary *Compustat* information | -19 |
| Changed year-end during ATCA adoption year | -2 |
| No available control firms | -4 |
| Too few available control firms (SIC code 60) | -13 |
| Missing necessary *I/B/E/S* information | -26 |
| Could not find matching control firm with necessary *I/B/E/S* information after two attempts | -13 |
| Revised sample | 134 |

[8] This sample has also been used in Hoi, Lacina, and Wollan (2008).
[9] This is not to say that ATCAs are no longer important. On average, the *incremental* effect of an additional ATCA may be less in more recent times relative to the sample period. For example, assume a firm had no ATCAs in its corporate charter at the beginning of 1987 and two ATCAs at the start of 2008. Ceteris paribus, the addition of the first ATCA in 1987 would likely have had more influence than the inclusion of a third ATCA in 2008.

### *4.2. Matching Procedure*

Sample and matched control firms' *I/B/E/S* analysts' mean consensus long-term earnings growth rate forecasts are found for the ATCA proposal month (forecast in Year t) and for the same month in the following year (forecast in Year t+1). A sample firm is matched with a corresponding control firm based on two-digit SIC code, fiscal year of the ATCA proposal, and return-on-assets (ROA) the year before the ATCA proposal (in Year t-1).[10] [11] Matching based on lagged ROA controls for earnings momentum and mean reversion in earnings (Kothari, Leone, and Wasley, 2005). Analysts have been known to overemphasize past earnings momentum in formulating earnings forecasts. Additionally, a matched control firm must have a fiscal year-end month that is not after the fiscal year-end month of the sample firm and not more than three months earlier. The requirement that the control firm's fiscal year-end month not follow the sample firm's fiscal year-end month prevents a situation in which, by the ATCA proposal month, prior year's actual earnings have been announced for the sample firm but not the control firm.

In finding matched control firms for the sample firms, non-sample firms with available ROA in Year t-1 from *Research Insight Compustat* and with analysts' consensus long-term earnings growth rate forecasts included on the *I/B/E/S* database some time between 1983 and 1992 are considered. Then a sample firm is matched with a non-sample firm based on lagged ROA. Following this, the corresponding non-sample firm's *I/B/E/S* analysts' mean consensus long-term earnings growth rate forecasts are retrieved for the ATCA proposal month (in Year t) and the same month in the following year (in Year t+1). If one or both of the non-sample firm's forecasts are missing, then a second attempt is made to find a control firm for the sample firm. If a non-sample firm with the necessary data is still not found after the second attempt, then the sample firm is dropped so as not to risk a sample and control firm having much different lagged ROA.

### *4.3. Statistical Tests*

The primary measure used is the change in analysts' long-term earnings growth forecast made between Year t and Year t+1. This change is found for the sample firms and their corresponding control firms and statistical tests of significance are performed. However, a firm's change in performance is likely to affect the change in its analysts' long-term earnings growth forecast made between Year t and Year t+1. Thus, since actual earnings for Year t are normally announced before the date of the Year t+1 long-term earnings forecast, it is important to control for the Year t change in earnings. Further, although it is important to match sample and control firms based on lagged ROA, doing so may lead to some of the sample firms being much larger or smaller than their corresponding control firm. Therefore, it is important to control for firm size. Hence, the following regression is run:

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[10] Year t-1 return-on-assets is calculated as (*Compustat* numbers in parentheses): Income before extraordinary items and discontinued operations $(18)_{t-1}$ / Total assets $(6)_{t-2}$.

[11] Assume that, for an ATCA adopting firm with a December fiscal year-end, its ATCA proposal month is March 1988. This ATCA adopting sample firm would be matched with a control firm based on ROA for 1987 (Year t-1). Also, analysts' mean consensus long-term earnings growth rate forecasts for March 1988 (in Year t) and March 1989 (in Year t+1) would be retrieved for the sample firm and the control firm.

$$CHLTG_{i,t+1} = \alpha_0 + \alpha_1 SAM_i + \alpha_2 CHROA_{i,t} + \alpha_3 LNASSET_{i,t} + \varepsilon, \quad (1)$$

where:

$CHLTG_{i,t+1}$ is the change in analysts' mean consensus long-term earnings growth rate forecast between the ATCA proposal month (in Year t) and the same month in the following year (in Year t+1);
$SAM_i$ = 1 if a sample firm and 0 if a control firm;
$CHROA_{i,t}$ is the change in return on assets between Year t-1 and Year t; and
$LNASSET_{i,t}$ = natural log of total assets as of the end of year t.

CHROA is the proxy for change in firm performance whereas LNASSET measures firm size.[12] If the coefficient $\alpha_1$ is positive (negative), then the shareholders' interests (management entrenchment) hypothesis with respect to ATCAs is supported. The coefficient $\alpha_2$ is expected to be positive.

### *4.4. Tests on Sub-Samples*

To test H2 and H3, sub-samples are formed. For the tests based on amendment type, firms are classified into three categories: Firms that adopted only a fair price amendment (fair price firms), firms that adopted both fair price and non-fair price amendments at the same time (mixed firms), and firms that adopted only non-fair price amendment(s) (non-fair price firms). Also, as previously discussed, the sample firms are separately classified based on the percentages of shareholder votes supporting their ATCAs. Shareholder voting for twelve sample firms is based on a percentage of total votes cast. These firms are dropped when classifying firms based on shareholder support because the percentages of votes in favor of their ATCAs are not comparable to the percentages from the remaining sample firms, which are based on shares outstanding.[13] If more than one ATCA is adopted by a firm at the same time, the average of the percentages supporting the different amendments is used. Nevertheless, the percentages supporting different ATCAs proposed by the same firm are normally similar. The median (mean) percentage of outstanding shares the sample ATCA adopting firms received in support of their amendments was 59.6 (61.2) percent, with a minimum of 50.4 percent and a maximum of 82.1 percent. Firms are equally divided into three portfolios based on the level of support.

## 5. Results

### *5.1. Changes in Performance*

Untabulated results show that the mean (median) ROA for Year t-1 is 7.36 (6.45) percent and 7.40 (6.40) percent for sample and control firms, respectively. These similar percentages are due to matching on Year t-1 ROA. Table 2 shows the means and the medians of the changes in ROA between Year t-1 and Year t for the sample firms and the control firms. Also, the means and the medians of the differences in the ROA changes between the sample firms and the control firms

[12] The regressions in this paper are also run with net sales in place of total assets and the results are similar.
[13] When voting is based on a percentage of shares outstanding, not voting and an official abstention are in essence the same as a vote against the amendment.

are shown. The median change for the sample firms less the median change for the control firms is not the same as the median of the differences. Therefore, the control firm median subtracted from the sample firm median will not normally equal the 'Difference' column.

**Table 2**
**Percentage One Year Changes in Return-on-Assets**

| | | N | Sample Firms | Control Firms | Difference |
|---|---|---|---|---|---|
| *Full Sample* | | | | | |
| Mean Change | | 134 | -1.10** | -1.58*** | 0.48 |
| Median Change | | 134 | -0.35*** | -0.70*** | 0.40 |
| *Amendment Type* | | | | | |
| Fair price - | Mean change | 39 | -1.99** | -0.95 | -1.04 |
| | Median change | 39 | -0.90*** | -0.40* | -0.90 |
| Mixed - | Mean change | 40 | 0.12 | -1.18* | 1.30* |
| | Median change | 40 | -0.15 | -0.45** | 0.60** |
| Non-Fair Price - | Mean change | 55 | -1.37* | -2.31*** | 0.94 |
| | Median change | 55 | -0.40* | -2.00*** | 1.00 |
| *Level of Support* | | | | | |
| High - | Mean change | 40 | -0.69 | -1.23** | 0.54 |
| | Median change | 40 | -0.30 | -0.35 | 0.30 |
| Medium - | Mean change | 42 | -1.48** | -1.83** | 0.35 |
| | Median change | 42 | -0.45* | -1.25*** | 0.40 |
| Low - | Mean change | 40 | -1.19* | -2.63*** | 1.44 |
| | Median change | 40 | -0.50* | -1.20*** | 0.70 |

This table shows the means and the medians of the one year changes in return-on-assets (ROA). ROA is measured as income before extraordinary items and discontinued operations divided by beginning of year total assets. The ROA change is measured as ROA for the year of the antitakeover charter amendment (ATCA) proposal less ROA for the previous year. For each sample-control firm combination, the difference in ROA change is found. The *Difference* column shows mean and median values of those differences. Therefore, the control firm median subtracted from the sample firm median will not normally equal the *Difference* value.

*Fair price* firms propose only a fair price ATCA. *Mixed* firms propose both 1) a fair price ATCA and 2) a supermajority and/or a classified board ATCA. *Non-fair price* firms propose a supermajority and/or a classified board ATCA but no fair price ATCA. For *Level of Support*, sample firms with a percentage of outstanding stock voting rule are divided into three portfolios based on the levels of support for the ATCAs.

A t-test (Wilcoxon signed rank test) is used to determine whether a mean (median) is significantly different than zero.

*** Significant at the 1 percent level (two-tail test)
** Significant at the 5 percent level (two-tail test)
* Significant at the 10 percent level (two-tail test)

For the full sample, the financial performance of the sample and control firms as measured by ROA significantly decreased. However, the mean and the median of the differences are not

significant at conventional levels. Similar findings usually hold when the sample is partitioned by amendment type or by level of support, the main exception being mixed amendment firms.

**Table 3**
**Percentage One Year Changes in Analysts' Long-Term Earnings Growth Forecasts**

| | | N | Sample Firms | Control Firms | Difference |
|---|---|---|---|---|---|
| *Full Sample* | | | | | |
| Mean Change | | 134 | -1.03*** | -0.81*** | -0.22 |
| Median Change | | 134 | -0.51*** | -0.60*** | 0.16 |
| *Amendment Type* | | | | | |
| Fair Price - | Mean change | 39 | -1.02*** | -0.80 | -0.22 |
| | Median change | 39 | -1.03*** | -0.94** | 0.51 |
| Mixed - | Mean change | 40 | -0.87* | -0.56 | -0.31 |
| | Median change | 40 | -0.26* | -0.35 | -0.10 |
| Non-Fair Price - | Mean change | 55 | -1.14*** | -1.00** | -0.14 |
| | Median change | 55 | -0.51** | -0.36*** | 0.24 |
| *Level of Support* | | | | | |
| High - | Mean change | 40 | -1.34** | 0.45 | -1.79** |
| | Median change | 40 | -0.76** | 0.05 | -0.34** |
| Medium - | Mean change | 42 | -1.09*** | -1.05** | -0.04 |
| | Median change | 42 | -0.81*** | -0.96*** | 0.49 |
| Low - | Mean change | 40 | -0.72** | -1.73*** | 1.01* |
| | Median change | 40 | -0.24 | -1.13*** | 0.87* |

This table shows the means and the medians of the one year changes in analysts' mean consensus long-term earnings growth rate forecasts from the *I/B/E/S* database for the sample and matched control firms. The change is measured as the analysts' long-term earnings growth forecast made one year after the antitakeover charter amendment (ATCA) proposal month less the long-term earnings forecast made during the ATCA proposal month. For each sample-control firm combination, the difference in the changes in long-term earnings forecasts is found. The *Difference* column shows mean and median values of those differences. Therefore, the control firm median subtracted from the sample firm median will not normally equal the *Difference* median value.

*Fair price* firms propose only a fair price ATCA. *Mixed* firms propose both 1) a fair price ATCA and 2) a supermajority and/or a classified board ATCA. *Non-fair price* firms propose a supermajority and/or a classified board ATCA but no fair price ATCA. For *Level of Support*, sample firms with a percentage of outstanding stock voting rule are divided into three portfolios based on the levels of support for the ATCAs.

A t-test (Wilcoxon signed rank test) is used to determine whether a mean (median) is significantly different than zero.

*** Significant at the 1 percent level (two-tail test)
** Significant at the 5 percent level (two-tail test)
* Significant at the 10 percent level (two-tail test)

### *5.2. Changes in Long-Term Growth Forecasts*

Untabulated results show that the means (medians) of the analysts' long-term earnings growth forecasts for the ATCA proposal month are 12.75 (11.92) percent and 13.77 (12.39) percent for the sample and the control firms, respectively. Table 3 shows the means and the medians of the changes in analysts' long-term earnings growth forecasts between Year t and Year t+1 for the sample firms and the control firms. Also, the means and the medians of the differences in changes in long-term earnings forecasts between the sample firms and the control firms are shown. As in Table 2, the median for the control firms cannot be subtracted from the median for the sample firms to get the median of the differences. The results for the full sample show that the long-term earnings forecasts decrease for the sample firms and the control firms. However, the mean and the median of the differences in the changes are not significant at conventional levels. When the sample is divided by amendment type, there is no evidence that the changes in long-term earnings forecasts are different between the sample firms and the control firms.

When the sample is partitioned by levels of support for ATCAs, interesting results emerge. For ATCAs with low levels of support, the average decrease in the sample firms' analysts' long-term earnings growth forecasts is not as large as the average decrease in the control firms' long-term earnings forecasts and the mean and the median of the differences are significant at the ten percent level. Results from further tests will show that this is caused by firm size effects. On the other hand, for high support firms, the mean and the median of the changes in long-term earnings forecasts for sample firms are clearly lower than those for the control firms. The mean (median) of the differences in the changes in long-term earnings forecasts is -1.79 percent (-0.34 percent) and significant at the five percent level. This is consistent with management becoming entrenched due to a lack of stock held by dissident shareholders who monitor its actions, where the small amount of dissident shareholdings is documented by high support for the ATCA. Note that unlike low support firms, the changes in long-term earnings forecasts for high support firms do not follow the corresponding changes in ROA shown in Table 2. For instance, Table 2 shows that the change in financial performance is insignificantly higher for sample firms that receive high support relative to their matched control firms.

### *5.3. Regression Analysis*

Table 4 shows the results from regression equation (1). The number of observations N includes both the sample and the matched control firms. The coefficient on CHROA is positive and significant at the 1 percent level for the full sample. Therefore, as expected, change in profitability is positively associated with change in analysts' long-term earnings growth forecasts. Moreover, the coefficient on LNASSET is positive and significant at the 1 percent level, which documents the importance of controlling for firm size. Further, for the full sample, the coefficient on the dummy variable SAM is negative and significant at the 10 percent level. Thus, holding change in profitability and firm size constant, there is a negative and weakly significant change in the long-term earnings forecasts following the adoption of ATCAs. Hence, some support is provided for ATCAs leading to management entrenchment. On the other hand, for each sub-sample based on amendment type, the variable SAM is negative but not significant. Therefore, H2 cannot be rejected since the findings give little indication that the changes in long-term earnings forecasts are different across amendment types.

**Table 4**
**Results from Regressions with Change in Analysts' Long-term Earnings Growth Forecast on a Sample/Control Firm Dummy Variable and Control Variables, for Full Sample and Sample Partitions**

| | N | Intercept | SAM | CHROA | LNASSET | Adj. $R^2$ |
|---|---|---|---|---|---|---|
| *Full Sample* | 268 | -3.631 | -0.630 | 14.729 | 0.468 | 0.122 |
| | | -4.41*** | -1.76* | 4.48*** | 3.92*** | |
| *Amendment Type* | | | | | | |
| Fair price | 78 | -2.503 | -0.203 | 18.210 | 0.294 | 0.150 |
| | | -1.69* | -0.32 | 3.93*** | 1.33 | |
| Mixed | 80 | -5.127 | -0.799 | 0.250 | 0.674 | 0.070 |
| | | -3.15*** | -1.23 | 0.02 | 2.94*** | |
| Non-fair price | 110 | -3.917 | -0.703 | 13.806 | 0.503 | 0.118 |
| | | -2.92*** | -1.18 | 2.47** | 2.62** | |
| *Level of Support* | | | | | | |
| High | 80 | -2.515 | -2.100 | 7.332 | 0.473 | 0.066 |
| | | -1.41 | -2.82*** | 0.97 | 1.81* | |
| Medium | 84 | -1.972 | -0.159 | 7.545 | 0.153 | -0.008 |
| | | -1.31 | -0.27 | 1.17 | 0.74 | |
| Low | 80 | -7.202 | 0.177 | 9.910 | 0.889 | 0.268 |
| | | -5.58*** | 0.30 | 1.51 | 4.82*** | |

This table shows the results from the following regression (parameter estimates and t-values are shown above):

$$CHLTG_{i,t+1} = \alpha_0 + \alpha_1 SAM_i + \alpha_2 CHROA_{i,t} + \alpha_3 LNASSET_{i,t} + \varepsilon,$$

where:
$CHLTG_{i,t+1}$ is the change in analysts' mean consensus long-term earnings growth rate forecast between the ATCA proposal month (in Year t) and the same month in the following year (in Year t+1);
$SAM_i$ equals 1 if a sample firm and 0 if a control firm;
$CHROA_{i,t}$ is the change in return on assets between Year t-1 and Year t; and
$LNASSET_{i,t}$ is the natural log of total assets as of the end of year t.

Analysts' mean consensus long-term earnings growth rate forecasts from the I/B/E/S database are used. Return on assets is calculated as the value of income before extraordinary items and discontinued operations divided by beginning of year total assets.

*Fair price* firms propose only a fair price ATCA. *Mixed* firms propose both 1) a fair price ATCA and 2) a supermajority and/or a classified board ATCA. *Non-fair price* firms propose a supermajority and/or a classified board ATCA but no fair price ATCA. For *Level of Support*, sample firms with a percentage of outstanding stock voting rule are equally divided into three portfolios based on the levels of support for the ATCAs. N is the sum of the number of sample firms and the number of control firms and equals the number of observations used in the regressions.

*** Significant at the 1 percent level (two-tail test)
** Significant at the 5 percent level (two-tail test)
* Significant at the 10 percent level (two-tail test)

However, when the sample is partitioned according to levels of shareholder support for the ATCAs, a different story emerges. For firms with ATCAs that receive a high level of support, the coefficient on SAM is negative and significant at the 1 percent level. On the contrary, no significant coefficient on SAM is found for firms with ATCAs that receive a low or a medium level of shareholder support. Therefore, the results reject H3. For low support firms, Table 3 does show a higher change in long-term earnings forecasts for the sample firms than for the matched control firms. But the regression results in Table 4 document that this is due to firm size, as the coefficient on LNASSET is positive and significant at the 1 percent level. Overall, the findings in Table 4 indicate that a high level of support for an ATCA suggests there are fewer shares of voting stock held by dissident shareholders who are willing to go against management's wishes and not support a controversial proposal. This implies that in high support firms, there is less monitoring of management's actions. This in turn leads these managers, who are protected by ATCAs, to take actions that are not in their firms' best interests in the long run. Financial analysts accordingly revise their long-term earnings forecasts downward. In essence, management becomes entrenched if it is not monitored.

## 6. Additional Tests: Institutional Shareholdings

### *6.1. Overview*

This paper has yet to address what could help cause a high shareholder vote in support of an ATCA and also lead to less monitoring by shareholders. Therefore, one possible determinant, the level of institutional shareholdings, is examined. Agrawal and Mandelker (1990) find a positive association between the level of institutional holdings and the stock market reaction to management's proposals of ATCAs, lending support to the hypothesis that institutional shareholders actively monitor management instead of passively voting with management on its proposals. However, the type of institutional shareholder may matter with respect to the monitoring of management. Banks and insurance companies that own large amounts of stock in a firm are considered to be pressure sensitive institutional shareholders. They tend to have incentives to vote for management proposals due to current or potential relationships with the firm. Likewise, they may be less likely than other institutional shareholders to monitor management so as not to upset current or potential customers. On the contrary, pressure resistant institutional shareholders, including public pension funds, mutual funds, endowments, and foundations owning large amounts of a firm's stock, tend to be more likely to vote against management proposals that are expected to be value decreasing (Brickley, et al., 1988). Further, these shareholders have the incentive and the power to monitor management. Indeed, Brickley, el al. (1988, 1994) find that pressure sensitive institutions are more likely to vote for ATCAs whereas pressure resistant institutions are less likely to support ATCAs.

### *6.2. Research Design*

Institutional shareholdings are retrieved from Thomson Financial's CDA/Spectrum s34 database, which contains information on 13f institutional holding filings with the SEC. Since institutional shareholdings are reported on the s34 database on a quarterly basis, the percentage of institutional shareholdings for the closest month equal or prior to the month of the ATCA

proposal are retrieved and used in the upcoming tests.[14] Pressure sensitive institutional shareholders are defined to be those that hold at least one percent of the firm's outstanding common stock and have a type code of 1 (bank) or 2 (insurance company) in the s34 database. Pressure resistant institutional shareholders are designated to be those that own at least one percent of the firm's outstanding common stock and have a type code of 3 (investment companies and their managers), 4 (independent investment advisors), or 5 (all others, including pension funds, endowments, and foundations). The one percent threshold follows Brickley, et al. (1988, 1994).[15] The 122 sample firms with shareholder voting based on percentage of outstanding shares are utilized in these tests. Untabulated results show a mean (median) percentage of total outstanding common shares of 8.9 percent (7.2 percent) and 15.0 percent (14.3 percent) owned by pressure sensitive and pressure resistant shareholders, respectively.

First, the following regression is run to show the relationship between the change in analysts' long-term earnings growth forecasts and the stockholder vote, controlling for change in financial performance and firm size:

$$\mathrm{DCHLTG}_{i,t+1} = \lambda_0 + \lambda_1 \mathrm{FOR}_{i,t} + \lambda_2 \mathrm{DCHROA}_{i,t} + \lambda_3 \mathrm{LNDASSET}_{i,t} + \varepsilon ; \quad (2)$$

where:
$\mathrm{DCHLTG}_{i,t+1}$ is the change in analysts' mean consensus long-term earnings growth rate forecast between the ATCA proposal month (in Year t) and the same month in the following year (in Year t+1), for a sample firm less its corresponding control firm;
$\mathrm{FOR}_i$ is the percentage of votes in favor of the ATCA;
$\mathrm{DCHROA}_{i,t}$ is the change in return on assets between Year t-1 and Year t, for a sample firm less its corresponding control firm; and
$\mathrm{LNDASSET}_{i,t}$ is the natural log of end of year t total assets for a sample firm less the corresponding measure for its matched control firm.

Based on previous results, the coefficient $\lambda_1$ is expected to be negative.

Second, the following regression is run to test the relation between the support for an ATCA and the levels of pressure resistant and pressure sensitive institutional shareholdings:

$$\mathrm{FOR}_i = \delta_0 + \delta_1 \mathrm{NP}_{i,t} + \delta_2 \mathrm{PRES}_{i,t} + \delta_3 \mathrm{LNDASSET}_{i,t} + \varepsilon ; \quad (3)$$

where:
$\mathrm{NP}_{i,t}$ is the percentage of total outstanding shares of common stock held by pressure resistant institutional shareholders; and
$\mathrm{PRES}_{i,t}$ is the percentage of total outstanding shares of common stock held by pressure sensitive institutional shareholders.

The coefficient $\delta_1$ is predicted to be negative and $\delta_2$ is expected to be positive.

[14] The upcoming tests are also run using institutional holdings retrieved (approximately) one year following the ATCA proposal month and the results are similar.
[15] The upcoming tests are also run by defining pressure sensitive and pressure resistant institutional shareholders without a minimum one percent shareholding requirement and the results are similar.

Finally, the following regression is run to examine the influence of pressure resistant and pressure sensitive institutional shareholdings on the changes in analysts' long-term earnings growth forecasts:

$$\text{DCHLTG}_{i,t+1} = \omega_0 + \omega_1 \text{NP}_{i,t} + \omega_2 \text{PRES}_{i,t} + \omega_3 \text{DCHROA}_{i,t} + \omega_4 \text{LNDASSET}_{i,t} + \varepsilon . \quad (4)$$

A positive $\omega_1$ coefficient is consistent with pressure resistant institutional shareholders monitoring managers following an ATCA so that they refrain from actions detrimental to the long-run interests of the firm. A negative $\omega_2$ coefficient would suggest that pressure sensitive institutional shareholders provide less monitoring for fear of damaging current or potential relationships.

### *6.3. Results*

Table 5 shows the results of the additional tests. For regression (2), the coefficient on FOR is significantly negative at the 1 percent level. Therefore, in accordance with prior results, the level of support for an ATCA is negatively associated with the change in analysts' long-term earnings growth forecast. Also, as predicted, the coefficients from regression equation (3) indicate a strong negative (positive) association between the level of pressure resistant (sensitive) institutional shareholdings and the percentage of outstanding shares supporting an ATCA. The coefficient on NP is significant at the 1 percent level and the coefficient on PRES is significant at the 5 percent level.

The results from regression equation (4) do not support a relationship between the level of institutional shareholdings and the change in analysts' long-term earnings growth forecasts. Although the coefficients on NP and PRES are the expected signs, they are insignificant. Therefore, despite that institutional shareholdings are found to affect the support for ATCAs, these results do not provide evidence that the level of monitoring by institutional shareholders is a cause of the change in long-term earnings forecasts. The association between the levels of support for ATCAs and changes in long-term earnings forecasts is likely due to other causes (e.g., the amount of large individual and corporate shareholdings).

### *6.4. State Antitakeover Laws*

Beginning in 1982, a number of states enacted 'second generation' state antitakeover laws after the U.S. Supreme Court struck down the 'first generation' state antitakeover laws. In April 1987, these 'second generation' laws were presumed to be valid when the U.S. Supreme court upheld Indiana's 'second generation' law. Therefore, the possibility that the presence of state antitakeover laws is influencing the results is examined. Pugh and Jahera (1990) examine the market reactions to state antitakeover legislation in four states that passed 'second generation' laws and find weak negative market reactions. Pugh and Jahera (1997) find that, after the enactment of 'second generation' state antitakeover laws, firms protected by these laws increase expenditures on capital and R&D relative to other firms. Further, these expenditure increases are found to be higher for firms that have no ATCA relative to those that already have ATCAs.

**TABLE 5**
**Results from Regressions with Control Firm Adjusted Change in Analysts' Long-Term Earnings Growth Forecast or Percentage of Votes in Favor of the ATCA on Percentage of Votes in Favor of the ATCA or Measures of Institutional Holdings, with Control Variables**

| | | Independent Variables | | | | | |
|---|---|---|---|---|---|---|---|
| | | Intercept | $FOR_i$ | $DCHROA_{i,t}$ | $LNDASSET_{i,t}$ | | |
| | | $(\lambda_0)$ | $(\lambda_1)$ | $(\lambda_2)$ | $(\lambda_3)$ | | Adj. $R^2$ |
| Model (2) | Coeff. Est. | 8.839 | -15.068 | -0.500 | 0.186 | | |
| | t-statistic | 2.84*** | -2.99*** | -0.09 | 0.88 | | 0.054 |

$$DCHLTG_{i,t+1} = \lambda_0 + \lambda_1 FOR_i + \lambda_2 DCHROA_{i,t} + \lambda_3 LNDASSET_{i,t} + \varepsilon$$

| | | Intercept | $NP_{i,t}$ | $PRES_{i,t}$ | $LNDASSET_{i,t}$ | | |
|---|---|---|---|---|---|---|---|
| | | $(\delta_0)$ | $(\delta_1)$ | $(\delta_2)$ | $(\delta_3)$ | | Adj. $R^2$ |
| Model (3) | Coeff. Est. | 0.634 | -0.262 | 0.199 | -0.001 | | |
| | t-statistic | 48.68*** | -4.19*** | 2.44** | -0.33 | | 0.133 |

$$FOR_i = \delta_0 + \delta_1 NP_{i,t} + \delta_2 PRES_{i,t} + \delta_3 LNDASSET_{i,t} + \varepsilon$$

| | | Intercept | $NP_{i,t}$ | $PRES_{i,t}$ | $DCHROA_{i,t}$ | $LNDASSET_{i,t}$ | |
|---|---|---|---|---|---|---|---|
| | | $(\omega_0)$ | $(\omega_1)$ | $(\omega_2)$ | $(\omega_3)$ | $(\omega_4)$ | Adj. $R^2$ |
| Model (4) | Coeff. Est. | -0.119 | 0.614 | -4.180 | 0.523 | 0.190 | |
| | t-statistic | -0.15 | 0.16 | -0.83 | 0.09 | 0.87 | -0.021 |

$$DCHLTG_{i,t+1} = \omega_0 + \omega_1 NP_{i,t} + \omega_2 PRES_{i,t} + \omega_3 DCHROA_{i,t} + \omega_4 LNDASSET_{i,t} + \varepsilon$$

$DCHLTG_{i,t+1}$ is the change in analysts' mean consensus long-term earnings growth rate forecast between the ATCA proposal month (in Year t) and the same month in the following year (in Year t+1), for a sample firm less its corresponding control firm;
$FOR_i$ is the percentage of votes in favor of the ATCA;
$NP_{i,t}$ is the percentage of total outstanding shares of common stock held by pressure resistant institutional shareholders;
$PRES_{i,t}$ is the percentage of total outstanding shares of common stock held by pressure sensitive institutional shareholders;
$DCHROA_{i,t}$ is the change in return on assets between Year t-1 and Year t, for a sample firm less its corresponding control firm; and
$LNDASSET_{i,t}$ is the natural log of end of year t total assets for a sample firm less the corresponding measure for its matched control firm.

Analysts' mean consensus long-term earnings growth rate forecasts from the *I/B/E/S* database are used. Return on assets is calculated as the value of income before extraordinary items and discontinued operations divided by beginning of year total assets.
A total of 122 sample firms with a percentage of outstanding stock voting rule are used in these tests.
*** Significant at the 1 percent level (two-tail test)
** Significant at the 5 percent level (two-tail test)
* Significant at the 10 percent level (two-tail test)

The date of the ATCA proposal is compared with the signing dates of state antitakeover laws, which are drawn from information in Karpoff and Malatesta (1989) and Pugh and Jahera (1997).[16] If the date of the ATCA proposal follows or is less than six months before the date a firm's state of incorporation first signed a 'second generation' antitakeover law, a dummy variable is set equal to one in regression equation (1). This is done for both sample and corresponding control firms. Therefore, two dummy variables are added to equation (1); one for sample firms' state antitakeover laws and one for control firms' state antitakeover laws.[17]

The untabulated results show that the sample and control firms' dummy variables for state antitakeover laws are not significant for the entire sample or any partitions (i.e., type of ATCA amendment, level of support). Further, the coefficients on the other variables in equation (1) are very similar to those shown in Table 4 and the conclusions remain unaltered. Hence, further tests are conducted with the dummy variables for state antitakeover laws defined in three other ways: 1) dummy variable not set to one (set to zero) for states that had only fair price or registration and disclosure laws, which are arguably more benign; 2) dummy variable set equal to one if the firm's state of incorporation had an antitakeover law and the ATCA proposal was April 1987 or later (when the Indiana law was upheld); and 3) a combination of 1) and 2). Again, none of the dummy variables is significant and the findings with respect to the other coefficients in Table 4 remain unaltered. Therefore, it is safe to say that state antitakeover laws do not influence the findings.

### *6.5. Actual Future Earnings*

Regression equations (1), (2), and (4) are also run using actual future ROA in place of the one-year change in analysts' long-term earnings growth forecasts for the dependent variables. Specifically, average ROA over five years (the ATCA proposal year and the following four years) is measured for each sample firm and control firm.[18] Thus, for equation (1), the dependent variable is average five-year ROA whereas in equations (2) and (4), the dependent variable is the difference in average ROA between a sample firm and a matched control firm. As mentioned previously, the sample and control firms are matched on prior year ROA and thus had approximately equal earnings performance the year before the ATCA. For obvious reasons, the ROA independent control variables are eliminated for these tests.

For the entire sample and almost all sample partitions, the coefficients on the test variables ($\alpha_1$ in equation (1), $\lambda_1$ in equation (2), $\omega_1$ and $\omega_2$ in equation (4)) are insignificant.[19] Therefore, the adoption of ATCAs is found to have no association with future actual earnings performance. This is not surprising since Johnson and Rao (1997a) find that ATCAs have little effect on actual

[16] Rosenbaum (2004) and SEC filings on the *LexisNexis* database are examined to determine the firm's state of incorporation around the ATCA proposal date.

[17] In some cases, only the year of the state antitakeover law was found. In these cases, the dummy variable is set equal to one if the calendar year of the ATCA proposal follows or is the same as the year the state antitakeover law is signed.

[18] ROA is calculated as Income before extraordinary items and discontinued operations$_{i,t}$/Total assets$_{i,t-1}$.

[19] The lone exception is that the coefficient $\alpha_1$ is positive and significant at the five percent level for the mixed subsample. The author(s) have no explanation why the mixed firm ATCAs would be positively associated with future ROA whereas the fair-price only and non-fair price only firm ATCAs would have no relationship with future ROA. Thus, this result may be coincidental.

future earnings. The use of actual future earnings has its drawbacks relative to the use of analysts' forecasts. There is a problem with survivorship bias. Only 101 out of 134 sets of sample and control firms could be used in these tests due to missing future ROA information for the remaining sets of firms. Also, one-time items are not included in *I/B/E/S* analysts' forecasts whereas actual earnings can be affected by one-time items, such as a restructuring charge, a weather related loss that is not extraordinary, and additional income taxes due to a LIFO liquidation. In addition, actual earnings are subject to management manipulation. For instance, an entrenched management could manipulate earnings upward to cover a shortfall from investors' expectations.

## 7. Conclusions

This research studies the effects of ATCAs on the one-year changes in analysts' long-term earnings growth forecasts from the *I/B/E/S* database. The use of the one-year changes in analysts' long-term earnings growth forecasts is in a number of ways an improvement over previous methodologies used to test the influence of ATCAs on firms. Additionally, the sample firms are matched with control firms based on financial performance prior to ATCA adoption while adoption year financial performance and firm size are control variables. The findings for the entire sample show a negative and weakly significant change in analysts' long-term earnings growth forecasts following ATCA adoptions, providing some support for management entrenchment following ATCAs. However, strong decreases in analysts' long-term earnings growth forecasts following the adoptions of ATCAs are documented for firms which receive high levels of support for their ATCAs. A lack of dissident shareholders willing to withhold support for controversial management-initiated amendments may imply a lack of monitoring of management, encouraging managers who are shielded from the takeover market to take actions not beneficial to the firm. Hence, this study supports the argument of Sundaramurthy (2000) in that when the degree of monitoring is low, ATCAs can decrease shareholder value.

However, although further tests show that the levels of pressure sensitive and pressure resistant shareholdings strongly influence the support levels for ATCAs, they do not provide evidence of an association between the levels of institutional shareholdings and the changes in analysts' long-term earnings growth forecasts. Therefore, future research can examine other influences on the support for ATCAs that may be associated with the level of monitoring as conveyed by long-term earnings forecasts. Brickley, Lease, and Smith (1994) study ATCAs and find that factors that constrain managers in the voting process include less management ownership, large outside blockholders that own at least five percent of outstanding shares, and small firm size with less dispersed ownership. A lack of those characteristics attributable to a firm's stockholders not only signals a higher probability of amendment passage but may also signal less shareholder monitoring. For instance, if management holds a higher percentage of the firm's voting stock, its proposals will get more support and it has more power against monitoring by other shareholders.[20] Further, smaller individual shareholders are less likely to find it beneficial to spend the time and effort to research management-initiated proposals and therefore may be more

[20] However, if management's proportionate shareholdings reach very high levels, it may be less likely to take actions detrimental to the firm because a large amount of its wealth is tied up in the firm (Jensen and Meckling, 1976). In effect, management may become its own monitor. Other the other hand, those types of managements may feel less need for an ATCA.

willing to hand the authority to vote over to management. Similarly, they are less likely to find it beneficial to monitor management. However, coalitions of voters face lower information gathering costs per voter and have stronger incentives to gather information (Downs, 1957; Brickley, et al., 1994). If shareholdings are more dispersed, which is more likely to be the case in large firms, there may be a lower proportion of shares that are associated with strong coalitions, which are more apt to vote against controversial management proposals and monitor managers' actions.

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