Comments on Cremers & Ferrell

Bernard Black
Northwestern University
Law School and Kellogg School of Mgmt
Lots to Like

• Extend Gompers, Ishii Metrick (2003)
• Fix most of the problems
• Address problems with prior studies of takeover defenses
  – Compare critique in Coates (2000)
• Core question:
  – What matters in US governance?
  – Maybe only poison pills
    • mediated by delay from other antitakeover rules
Start with GIM (2003)

• 1990s: G predicts higher q, share price gains
  – Bebchuk, Cohen Ferrell (2009): subindex (“E”) contains all value-relevant information

• Influential, but lots to dislike

• Some problems with GIM
  – G is takeover defenses, not overall governance
  – Econometric concerns
    • No firm fixed effects (limited time variation in governance)
    • Use Fama-MacBeth to combine results across years
      – Appropriate for stock returns
      – Not appropriate for Tobin’s q
  – Alternate explanations for results
Is GIM an equilibrium story?

• In equilibrium, governance (takeover defenses) should **not** predict returns
  – If anything, better governance ➔ lower returns

• **What should** predict returns (if anything)?
  – shock to governance of **some** firms (others as controls)
    • Black & Khanna (JELS 2007, India)
    • Black & Kim (JFE 2011, Korea)
    • Litvak (JCF, 2007, impact of SOX on cross-listed firms)
  – shock to world (holding governance fixed)
    • returns (given shock) could depend on governance

• GIM: no shock to governance
Is there a shock to world?

• Takeover activity low in 1990, hi in 1999
  – takeover defenses should matter more in 1999 than 1990
  – consistent with reversal in 2000s (Core, Guay, Rusticus, 2006)

• This story: natural for a takeovers scholar
  – Yet not part of GIM

• Cremers & Ferrell: support this story
  – Nice when new results support my prior surmise 😊
Cremers and Ferrell use:
- firm fixed effects
- firm clusters

⇒ much more reliable results

Plus plausibly exogenous shock:
- judicial approval of poison pill, 1985
- affects value of “delay” defenses
  - especially staggered board
  - but delay for how long was unclear for years . . .
Does US governance matter?

• All firms have a “shadow pill”
  – Can adopt when needed
  – So pill is merely a signal of management attitude
  – Is that governance!?

• I was driven out of US governance research by weak results
  – Bhagat and Black (2002); Bhagat, Black & Blair (2004)
  – This paper doesn’t persuade me I was wrong 😊

*Governance matters more in emerging markets*
What Predicts Takeover Defenses?

• G (or E) associated with q in cross-section
• But only weakly in time series
• $\Rightarrow$ fixed characteristics predict G

What else predicts takeover defenses?

• Test predictors of governance from emerging markets:
  – size (Durnev and Kim, JF, 2005)
  – share price volatility (Black, Jang and Kim, JCF, 2006)
  – capital intensity (Klapper and Love, 2004)
  – long-term profitability, need for equity finance (BJK, 2006)
Coates’ delay measure

• Coates (1999?) proposes:
  – all firms have a shadow pill
  – bidder who offers premium can win proxy fight
  – therefore key defenses are about delay before bidder can replace majority of target board
  – offers measure of delay

• You should try that measure
  – I bet it will predict $q$
  – Possible that nothing else will matter
## Some puzzles in cross-section?

<table>
<thead>
<tr>
<th>Year (end?)</th>
<th>coeff on G</th>
<th>comments</th>
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<tbody>
<tr>
<td>1987</td>
<td>-1.60**</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>-1.25**</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>-1.22</td>
<td>takeover market crashed in fall 1989</td>
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<tr>
<td>1990</td>
<td>-2.21***</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>-3.27***</td>
<td>why larger results in weak takeover market</td>
</tr>
<tr>
<td>1992</td>
<td>-3.18***</td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>-2.80***</td>
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<tr>
<td>...</td>
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<tr>
<td>1999</td>
<td>-2.71**</td>
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<tr>
<td>2000</td>
<td>-2.62**</td>
<td>tech bubble burst in March 2000</td>
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<td>2001</td>
<td>-2.26*</td>
<td>takeovers were near-dead in 2001</td>
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<tr>
<td>2002</td>
<td>-0.68</td>
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</tr>
<tr>
<td>...</td>
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<tr>
<td>2006</td>
<td>-0.46</td>
<td>takeover market revives, but results weak from 2002 on</td>
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</table>
Is there a control group?

• What results for firms with locked-in control
  – controlling shareholder or group
  – dual class shares

• Hate to ask for more data but . . .
  – inside ownership could really matter here

• Can you run DiD using Moran as a shock?
  – firms with locked-in control as control group
  – not perfect, but worth trying
Methodology suggestion: Arellano-Bond

  - board independence predicts:
    - lower $q$ in cross section
    - higher $q$ with firm fixed effects
    - nothing with Arellano-Bond internal instruments
  
- Non-results w. A-bond due to weak instruments?
  - Or (as authors believe) because of dynamic endogeneity, not captured by fixed effects
  - Same question for you: you might try A-bond, have a view on what it can tell you