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RE : Adoption of Poison Pills and Impact on Shareholder Wealth

Over the last two years, 15 firms have adopted "poison pills" as takeover defenses. In a poison pill defense, holders of the company's common stock are issued rights to purchase a newly issued class of preferred stock or other security. However, these rights may be exercised only when a triggering event occurs. Triggering events may include a tender offer for the firm's shares or the acquisition by an outside party of a large block of the company's stock.

Rights issued in the poison pill defense take many forms. They may allow the target firm's shareholders to purchase common stock of the acquiring firm at a substantial discount (as in the Household International case) or they may allow the target firm's shareholders to swap their shares of common stock for other securities, such as the one-year notes valued significantly above the existing share price in the Phillips Petroleum defense. Poison pills are effective as a takeover defense because the target company becomes prohibitively expensive to any potential acquirer not approved by the board of directors.

OCE has studied the impact on shareholder wealth of the adoption of these poison pills. Because poison pills are often adopted in the midst of takeover rumors and contests, it is difficult to sort out the impact of the adoption of a poison pill as separate from other events affecting the stock price. However, by concentrating on share price changes (adjusted for changes in the overall market) during a very small window around the announcement day of a proposed poison pill, we have tried to isolate the poison pill effect.

Table 1 presents results from our study of share prices of 15 firms which announced poison pills from June 1983 (Lenox International) through April 1985 (Unocal). (Table 2 lists the firms in our sample.) We find that, on average, firms suffered a 1.98% share price loss on the day before and the day the poison pill is announced in the Wall Street Journal. This loss is significantly different from zero at the 95% probability level. On the day of the Wall Street Journal announcement, firms lose an average of 1.03%, significantly different from zero at the 85% probability level. On the announcement day, 73.3% of the returns were negative.

Over the longer event periods (days (-10, +5) and days (-10, +10)), returns remain negative but are no longer significantly different from zero. This result is not surprising due to the increased noise in the returns over the longer time period.

The evidence indicates that poison pills cause a small but significant wealth loss to shareholders of adopting firms. This loss probably results from the lowered probability of a successful tender offer and the loss of the substantial premiums paid for shares in these offers. However, managers of adopting firms argue that there is a real benefit to shareholders from these provisions. If the poison pill forces a potential acquiror to pay a higher premium for the firm, then shareholders do gain. The risk is that the poison pill will prevent a takeover bid from being made.

Table 1
 Net-of-Market Stock Returns Around the
Wall Street Journal Announcement Date
 For 15 Firms Proposing Poison Pill Defenses

<u>Trading Day Interval Around Announcement Date</u>	<u>Mean Net-of-Market Return (%)</u>	<u>T-Statistic</u>
Day (0)	-1.03	-1.71*
Day (-1) to Day (0)	-1.98	-2.25**
Day (-10) to Day (+5)	-1.18	-0.49
Day (-10) to Day (+10)	-1.48	-0.53

NOTES:

- * Significantly different from zero at the 85% probability level.
- ** Significantly different from zero at the 95% probability level.

Table 2
 Company Names and Announcement Dates of
 Firms Proposing Poison Pill Defenses

<u>Company</u>	<u>Date</u>
Lenox Inc.	6-16-83
Bell & Howell Co.	7-18-83
Enstar Corp.	8-16-83
Superior Oil Co.	11-25-83
Warner, Communication Inc.	1-13-84
Crown Zellerbach Corp.	7-20-84
Owens-Illinois Inc.	9-12-84
Household International Corp.	9-13-84
Colgate Palmolive Co.	10-15-84
Southwest Forest Industries, Inc.	10-23-84
Johnson Controls Inc.	11-21-84
Rorer Group Inc.	2-8-85
Phillips Petroleum	2-11-85
Morton-Thiokol Inc.	3-29-85
Unocal Corp.	4-17-85