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Is it time to bid adieu to ‘poison pills’?

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IS there anything common between McKesson, Caterpillar, Motorola, General Electric, Intel and Hewlett-Packard? Yes, these are the names of few Fortune 100 companies which have, during the past 5 years, either scrapped their poison pills or have adopted board pill policy to make the poison pills more shareholder-friendly, if adopted in the future.

Poison pills have for long been one of the most lethal anti-takeover strategies, adopted by companies world over to prevent unsolicited acquisitions. Its origin can be traced to 1982, with the US Supreme Court invalidating a few anti-takeover provisions of the Illinois Business Take-Over Act in their landmark ruling in Edgar vs MITE Corp. Subsequent to this ruling and pursuant to increasing trend of hostile takeovers, a number of companies started adopting poison pills to frustrate hostile takeover bids.

Despite being one of the most effective anti-takeover devices of recent times, we are witnessing an increase in shareholders’ activism against poison pills and an increasing trend by large companies to shed their poison pills. The number of Fortune 100 companies with poison pill declined from 33 in 2004 to a mere 17 by 2007 (a study by Shearman & Sterling, a New York City law firm). The adoption of poison pills during 2007 stood at 42, supposedly the lowest since early 1980s. Further, a dozen Japanese companies have scrapped poison pills during the last two years with Shiseido and e-Access being the latest to follow the trend in 2008.

Does this trend exists because poison pills don’t offer any benefits to shareholders? The answer would be in negative. It is a fact that poison pills protect shareholders from coercive takeovers. Further, it has been used as a powerful tool by the management to bargain better premium at the time of takeovers. A study by Georgeson Shareholder Communications in 1997 found companies with poison pills received 8% higher takeover premiums, on an average, compared to companies without poison pills.

The growing apathy of shareholders towards poison pills may be attributed to its potential to block all hostile takeovers, irrespective of its merits. Further, they have been used by the management to shield their inefficiencies and deny an opportunity to the shareholders to evaluate genuine open offers. This, in turn, has raised serious doubts on whether poison pills really enhance shareholders’ wealth. Further, leading companies are also shedding their poison pills to enhance their corporate governance ratings.

In response to above, though there are companies which have altogether scrapped their poison pills, there are many more which have adopted favourable policies to get around its negative effects. These include periodic review of poison pills by an independent board; making the poison pills “chewable”, whereby they would be redeemed upon the hostile takeover; meeting certain favourable criteria; and adopting a board pill policy to the effect that the board would not adopt poison pills without shareholders’ prior approval or, if done without such approval, the plan would be ratified or terminated within a certain period.

So, will the corporates soon bid adieu to one of the most powerful antitakeover devices? The answer to this is obviously not so simple. Though the statistics suggest lesser adoption of poison pills by the top corporates, other antitakeover devices have not been powerful enough to replace them. The need today, obviously, seems not to do away with poison pills, but a change in the attitude of the management towards the poison pills. Not all hostile takeovers are bad; so long as the shareholders reserve the power to exercise the poison pills and take an informed decision, the pills and hostile takeovers can do more good than harm. **(The authors work for law firm Nishith Desai Associates)**

Popular poison pills:

- Shareholders’ Rights Plan - ‘Flip in’ - This plan will give the shareholders of the target company, other than the acquirer, a right to acquire new shares in the target company at a significant discount (generally up to 50%) from the market price. This would dilute the stake of the acquirer substantially and would make the takeover expensive
- Rights Plan - ‘Flip over’ - A variant from the ‘Flip in’, ‘Flip over’ provides a right to the shareholders to buy the acquirer’s shares at a bargain price in the event of an unwelcome merger
- Poison Debt - Under this, the target company issues debt securities with few onerous terms and conditions in order to discourage the takeover bid, which may include accelerated maturity of the debt, hike in interest rate, etc, upon a takeover