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Multiple large shareholders and firm value

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Abstract

This paper investigates the effects of having multiple large shareholders on the valuation of firms. Using data on Finnish listed firms, we show, consistent with our model, that a more equal distribution of votes among large blockholders has a positive effect on firm value. This result is particularly strong in family-controlled firms suggesting that families (which typically have managerial or board representation) are more prone to private benefit extraction if they are not monitored by another strong blockholder. We also show that the relation between multiple blockholders and firm value is significantly affected by the identity of these blockholders.

JEL classification: G3; G32
Keywords: Corporate governance; Ownership structure; Multiple blockholders; Firm value

1. Introduction

Recent empirical work has shown that ownership is typically concentrated in the hands of a small number of large shareholders (e.g., La Porta et al., 1999; Barca and Becht, 2001). This evidence has shifted the focus from the traditional conflict of

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interest between managers and dispersed shareholders (Berle and Means, 1932) towards an equally important agency conflict between large controlling shareholders and minority shareholders. On the one hand, large shareholders can benefit minority shareholders by monitoring managers (Shleifer and Vishny, 1986, 1997). On the other hand, large shareholders can be harmful if they pursue private goals that differ from profit maximization or if they reduce valuable managerial incentives (Shleifer and Vishny, 1997; Burkart et al., 1997). In this paper, we address a different question: In which way do multiple large shareholders, as opposed to just one large shareholder, benefit or harm minority shareholders?

Outside the United States, the presence of several large shareholders [1] with substantial blocks of shares is common (Barca and Becht, 2001). Data on 5232 European companies collected by Faccio and Lang (2002) show that 39% of firms have at least two blockholders that hold at least 10% of the voting rights, and 16% of firms have at least three blockholders. Therefore, it is important to study the allocation of control between multiple large shareholders, as well as its impact on firm performance. The theoretical literature provides models in which multiple blockholders compete for control (Bloch and Hege, 2001), monitor the controlling shareholder (Winton, 1993; Pagano and Röell, 1998; Bolton and Von Thaden, 1998), and form controlling coalitions to share private benefits (Zwiebel, 1995; Pagano and Röell, 1998; Bennedsen and Wolfenzon, 2000; Gomes and Novaes, 2001).

Empirical evidence on the effect of multiple large shareholders on firm performance has been limited. For Italy, Volpin (2002) provides evidence that valuation is higher when control is to some extent contestable as in the case in which a voting syndicate controls the firm. Lehman and Weigand (2000) report that the presence of a strong second largest shareholder enhances profitability in German listed companies. Faccio et al. (2001) test the effect of multiple large shareholders on dividends. They find that the presence of multiple large shareholders dampens expropriation in Europe (due to monitoring), but exacerbates it in Asia (due to collusion). Most of these empirical studies focus on the simple presence of multiple blockholders, and not on the characteristics of individual blockholders.

We present a simple model in which multiple blockholders can have two different roles in firms. On the one hand, by holding a substantial voting block, a blockholder has the power and the incentives to monitor the largest shareholder and therefore the ability to reduce profit diversion. On the other hand, the blockholder can form a controlling coalition with other blockholders and share the diverted profit. One of the key contributions of this paper is the derivation of conditions under which the diversion of profits can be higher in firms with multiple blockholders than in firms with a single blockholder. Related to the first role, we hypothesize that firm value is positively affected by the ability to challenge the largest block, i.e., by contestability. Related to the second role, we hypothesize that firm value is negatively affected by the presence of blockholders, who, by colluding, can increase the efficiency of private benefit extraction.

[1] In this paper, terms *large shareholder* and *blockholder* are used interchangeably as synonyms.