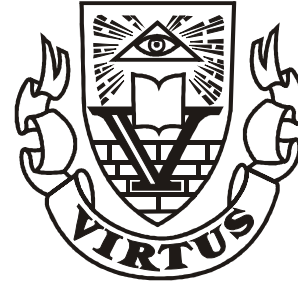

CORPORATE OWNERSHIP & CONTROL

Volume 4, Issue 3, Spring 2007

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Secrecy, Collusion and Coalition Building in Corporate Governance 10

Mick Swartz

This paper studies secrecy in voting and the role of information on coalition building in corporate governance. It finds evidence that supports the coalition building hypothesis and, in part, rejects the agency cost hypothesis. The conditions for insiders and large outsiders to form coalitions are examined. The results are consistent with insiders and large outsiders cooperating and voting as a block to maintain power, this imposes costs on other shareholders. Consistent with the agency theory and the coalition building theory, management initiated amendments have a more negative impact than shareholder initiated amendments. The Vote Your Conscience theory is rejected.

How Toeholds Become Footholds 25

Jean M. Canil, Bruce A. Rosser

We document empirical evidence that bidders tailor their takeover strategy when facing entrenched target managers. Key elements of a takeover strategy comprise the toehold purchase and the initial bid premium. We find that toeholds are acquired in cognizance of the principal outsider and target management block. Bidders' free rider cost savings are measured by the product of the toehold and the initial bid premium. Several relationships are identified. Initial bid premiums for targets characterized by entrenchment are comparatively low and result in low free rider benefits to bidders. To avoid overpayment, bidders do not compensate entrenched managers for lost private benefits. Instead, in entrenchment scenarios toeholds are optimized with respect to the principal outsider as well as the target management block in order to create a foothold that neutralizes entrenchment. At the median toeholds match the spread between the principal outsider and the target management block in entrenchment scenarios, are about double the spread for shareholder-aligned targets and much smaller for owner-managed targets.

Bondholder Wealth Effects from Dividend Changes 42

Mark S. Klock, Katherine I. Gleason

Bhagat and Romano (2002a, 2002b) document the importance of event study analysis of equity returns in corporate governance. We extend their analysis with the argument that analysis of bond returns around important corporate events can provide additional important information. Such information is particularly important in the current active public discussions over corporate governance. We provide an example of event study analysis of bond returns examining the impact of large dividend changes on both stockholders and bondholders in an effort to differentiate between

the information content (transparency) and possible wealth transfers (theft) around dividends. Our study replicates earlier studies on investment grade bonds with ambiguous results using a sample of noninvestment grade bonds. Our results suggest that for ordinary dividend changes, wealth expropriation is a significant explanation in the gain to stockholders.

Ownership Categories and Investment Patterns after Mass Privatization in Bulgaria and the Czech Republic 53

Evgeni Peev

This paper studies the emerging ownership and investment patterns of listed companies during the first years after mass privatization (Bulgaria) and after around ten years after mass privatization (the Czech Republic). It explores firm-level data over the period 1998-2003. We apply accelerator-cash flow model and q-model to cash-flow investment sensitivity. In the Bulgarian sample, contrary to the expectations firms controlled by foreign firms are financially constrained. Firms controlled by state-owned holding company show financial re-allocation investment pattern, while firms under control of privatisation fund have inertial investment behaviour. In the Czech Republic, the estimates of the q-model show that companies controlled by foreign investors are less financially constrained and have profit-maximization behavior, firms controlled by the National Property Fund have insignificant financial re-allocation, and firms under control of other domestic firms are most financially constrained. However, the accelerator model does not confirm these results for the firms under control of other domestic firms.

The Management of Inflation Rate, Interest Rate and Foreign Exchange Rate Risks: A Business Executive Outlook 64

F. J. Mostert, J. H. Mostert

This paper aims at improving financial risk management practices by applying insurance principles to the management of inflation rate, interest rate and foreign exchange rate risks. To achieve this objective, the research paper focuses on the features of finite risk insurance and the perceived importance of these features when South African business executives consider strategies to manage the above risks. The paper closes with recommendations to providers of financial services based on the needs of South African industrial companies to manage the above risks.

SECTION 2. CORPORATE OWNERSHIP

Managerial Hedge (Effort) Incentive, Ownership and Firm Performance: Evidence from Founder-CEOs and Non Founder-CEOs 71

Haksoon Kim

This paper tries to test three different hypotheses for the relationship between firm performance and characteristics of founder-CEOs and non founder-CEOs using three econometric techniques: OLS, feasible GLS and piecewise linear regression. They are risk-averse hypothesis, ownership hypothesis and hedge (effort) incentive hypothesis. Firm performance increases as hedge (effort) incentive increases. Founder-CEOs' ownership has positive effect on firm performance when their ownership is between five percent and twenty percent. This is consistent with ownership hypothesis. The risk-aversion level of founder-CEOs is negatively correlated with firm performance which is consistent with risk-averse hypothesis. The ownership and risk-averse level of non founder-CEOs are not statistically correlated with firm performance.

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Erik Strojer Madsen, Valdemar Smith, Mogens Dilling-Hansen

The paper considers the owners of the firms as normal investors who want to optimise the return from their investments in accordance with their wealth constraint and the risk of their investment in the firm. The paper tests this theory on a representative sample of Danish companies including small

firms. Concerning the wealth constraint for owners, the study finds evidence of more dispersed ownership in larger and more capital-demanding firms. According to the investors' risk aspect, firms operating on foreign markets are more likely to have more than one owner. Concerning the domestic markets the owner structure is more dispersed in industries with a volatile business cycle.

**Accounting Standards For Employee Stock Option Disclosure:
The Current Debate**

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Geoffrey Poitras

The paper examines the implications of recent changes to accounting standards for employee stock based compensation with contingent features. The Dec. 2005 implementation of FAS 123R by the Financial Accounting Standards Board requires the fair value of such expenses to be recorded in net income. The change is now impacting the reported financial statements of firms that have been substantial users of employee stock options. This provides an opportunity to directly assess the actual impact of FAS 123R on such firms. Arguments for and against mandatory expensing are reviewed and an assessment of the contrasting positions provided. Significant limitations of current reporting requirements are identified.

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Ching-Lung Chen, Gili Yen, Chung-Jen Fu, Fu-Hsing Chang

The present study posits that auditors have weaker bargaining power when facing clients with ultimately controlling family members as opposed to clients without. By analyzing clients' magnitude of discretionary accruals in company with audit reports, the present study examines empirically the influence of family-controlled clients on the audit quality. The empirical results, as expected, reveal that the magnitude of discretionary accruals of a family-controlled firm, given receiving a standard unqualified audit report, is significantly larger than a firm that has no ultimately controlling family members. Moreover, family-controlled firms with larger positive discretionary accruals, as expected, are more likely to receive a standard unqualified audit report than clients without ultimately controlling shareholders.

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Mohammed Hossain, Peter J Taylor

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Xiaoyue Chen, Jeong-Bon Kim, Steven Shuye Wang, Xiaodong Xu

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Langnan Chen, Weibin Lin

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Rodolfo Apreda

This paper sets forth that compliance risk and the compliance function are powerful devices to enhance corporate governance. Firstly, it reviews the contribution made to the subject by the Bank for International Settlements (BIS). Next it argues that compliance risk matters not only in financial but in any other organization. Afterwards, it deals with how the compliance function can be shaped so as to grant independence and accountability to such managerial endeavors. Later, it shows some shortcomings in the BIS’ choice of governance principles. Lastly, it brings forth a set of governance principles related to compliance risk and the compliance function on behalf of financial as well as non-financial organizations.

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