INTERNATIONAL PRIVATE BENEFITS OF CONTROL: CROSS-SECTIONAL AND TIME-SERIES ANALYSIS

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Abstract

The 1998 Asian Financial Crisis and more recent corporate scandals in the U.S. have triggered growing attention of researchers and policy makers on the agency problem between controlling shareholders and minority investors. One respect of this problem is private benefits of control. In this paper, we extend the findings in Dyck and Zingales (2004) and show that the degree of investor protection still matters in curbing private control benefits for the period 1999–2007. More importantly, we find that private benefits of control have decreased significantly over time. Finally, our analyses show weak evidence of differential decreases in the value of control between weak and strong investor protection countries.

Keywords: Private Benefits of Control, Investor Protection, Block Premium, Mergers and Acquisitions

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1. Introduction

In the wake of the 1998 Asian Financial Crisis and a cascade of collapses of U.S. firms (e.g. Enron and WorldCom) in the early 21th century, governments, markets, and researchers have expressed more interests in the corporate governance practices of modern corporations. Private benefits of control, an important indicator of the quality of corporate governance systems, become increasingly noticed. They apparently play a significant role in recent U.S. corporate scandals and in how poorly firms in East Asia fair the crisis (e.g. Mitton, 2002; Lemmon and Lins, 2003).

Introduced by Grossman and Hart (1980), private benefits of control arise when controlling shareholders exert influence on a company and gain at the expense of non-controlling shareholders. Barclay and Holderness (1989) argue that if block holders can use their voting power to secure benefits that do not accrue to minority shareholders, blocks will trade at a premium to the post-announcement exchange price and the control premium will reflect an estimate of private benefits of control.[1] Alternatively, Levy (1982) and Lease et al. (1983) are among the first to use voting premium, the price difference between voting and non-voting shares of dual-class companies, as a proxy for private benefits of control.[2]

The purpose of this research is two-fold. First, we want to extend the results by Dyck and Zingales (2004) for a more recent period of 1999–2007 to see if private benefits of control are still negatively correlated with the degree of investor protection in the cross-section of countries. Secondly and more importantly, we examine the evolution of private benefits of control, and implicitly *de facto* corporate governance, following the 1998 Financial Crisis. We expect that post-crisis increasing attention to private control benefits and corporate governance lessons learnt from the crisis and corporate scandals[3] would result in a

[1] See also Dyck and Zingales (2004), and Albuquerque and Schroth (2010).
[2] See also Nenova (2003), Doidge (2004), and Doidge et al. (2009).
[3] See Mitton (2002), Lemmon and Lins (2003), Jain and Rezaee (2006), and Hutton et al. (2009).

widespread reduction in private control benefits across the globe. We follow Dyck and Zingales (2004) and use block premiums to infer private benefits of control enjoyed by controlling shareholders. Using a sample of 2,814 transactions from 37 countries, we find consistent evidence with Dyck and Zingales (2004) that private benefits of control are more pronounced in countries with weaker investor protection. However, our cross-sectional mean block premium of 6.9% is substantially lower than their reported mean of 14% for the period of 1990–1999. Within our sample period of 1999–2007, we find that on average, private benefits of control decline from 11% of a firm's equity value in 1999 to 2% of a firm's equity value in 2007. In addition, we find weak evidence that the decline in private control benefits is significantly larger for countries with low corporate governance scores.

The rest of the paper proceeds as follows. Section 2 describes sample selection and descriptive statistics. Main results are reported in section 3. Section 4 concludes.

2. Data and Descriptive Statistics

2.1 Data

Our initial sample from Thomson's Mergers and Acquisitions (hereafter, TMA) database includes all completed mergers and acquisitions that are announced between January 1, 1999 and December 31, 2007. The number of deals is increasing from 21,881 in 1999 to 48,275 in 2007. Firstly, as with Dyck and Zingales (2004), we restrict our sample to transactions that result in acquirers moving from a position where they hold less than 20% of the shares to a position where they have more than 20% of the shares. The block involved in the transaction must be 10% or greater. Secondly, we exclude all transactions that are identified by TMA as open market purchase, tender offers, spinoff, recapitalization, self-tenders, exchange offers, repurchases, and acquisitions of remaining interest. Thirdly, we limit our targets to public firms and eliminate any cross-border deals and cross-listing targets. Fourthly, because we wish to measure private benefits of control, we need to restrict our sample to transactions for which we can observe 1) the price paid by the acquirer to target, 2) the market price on the stock exchange two days after the announcement 3) and the percentage of target's equity owned by the acquirer after the deal is completed. Finally, we search the deal synopsis from TMA and exclude problematic transactions that do not involve control transfers, involve the exercise of options, or indicate a tender offer for the remaining interests within six months following the announcement. The qualitative screening substantially increases our confidence that 2,814 observations in our final sample contain transfers of control and their prices are not distorted by potentially compounding information.

For the main analysis of the relation between block premiums and the quality of corporate governance across countries in this study, we use investor protection indexes from La Porta et al. (1998). They include accounting standards index (ACCTG), anti-director rights index (AD) and rule of law index (RULE). We also follow Morck et al. (2000) to construct an index representing the quality of government (GOVT). This government index is the simple average of three La Porta et al.'s (1998) indexes: government corruption, the risk of expropriation of private property by the government, and the risk of government repudiating contracts.

2.2 Descriptive Statistics

Table 1 describes some statistics on block premiums for each country over the sample period. After applying the screening criteria as mentioned above, we select a total number of 2,814 deals in our study. The United States, Canada and Japan are countries with the most deals.[4] Countries with the smallest number of deals include Pakistan, Peru, Brazil, Colombia and Ireland.[5]

We follow Dyck and Zingales (2004) to calculate a block premium as the difference between the price per share paid for the block and the target market price two days after the announcement of the block transaction, divided by the target market price after the announcement and multiplied by the proportion of

[4] Our number of deals for the U.S. is significantly higher than Dyck and Zingales (2004) because (1) our period is more recent from 1999 to 2007 meaning better coverage by Thomson's Mergers and Acquisitions database, and (2) Dyck and Zingales (2004) include only the first twenty deals in a year for their analysis.

[5] We do not apply the minimum of two observations per country for the sample period as in Dyck and Zingales (2004). Excluding them, i.e. Pakistan and Peru, does not change our results.

cash flow rights represented in the controlling block. The mean (median) block premium across all our sample countries is 6.9% (6.1%). Compared to Dyck and Zingales's (2004) mean (median) of 14% (11%), our results suggest a significant decrease in private benefits of control across the world. In 7 out of the 37 sample countries, we find that the control premiums exceed 15% of equity value. These high private benefit countries include Peru, South Korea, Colombia, Egypt, Brazil, Pakistan, and the Philippines. In 20 out of the 37 sample countries, the control premiums are less than 5% of equity value with Denmark having the lowest average block premium of -9.6%.

Table 1. Block Premiums by Country

This table presents descriptive statistics on block premium by country. The block premiums are computed as the difference between the price per share paid for the control block and the target market price two days after the announcement of the control transaction, divided by the target market price after the announcement and multiplied by the proportion of cash flow rights represented in the controlling block.

Country	N	Mean	Median	Std. dev.	Min	Max
Australia	81	0.021	0.020	0.142	-0.310	0.468
Belgium	11	0.015	0.015	0.023	-0.019	0.072
Brazil	2	0.190	0.190	0.135	0.095	0.286
Canada	219	0.052	0.022	0.183	-0.511	0.670
Chile	3	0.036	-0.053	0.158	-0.057	0.218
Colombia	2	0.201	0.201	0.234	0.035	0.366
Denmark	4	-0.096	-0.089	0.086	-0.206	0.001
Egypt	4	0.195	0.194	0.212	0.000	0.394
Finland	3	0.096	0.066	0.115	0.000	0.224
France	90	0.079	0.027	0.217	-0.493	0.652
Germany	30	0.002	0.005	0.163	-0.590	0.346
Greece	10	0.121	0.037	0.238	-0.060	0.666
Hong Kong	51	0.000	0.015	0.414	-0.577	0.756
India	12	0.026	0.037	0.297	-0.540	0.573
Indonesia	8	0.056	0.046	0.149	-0.206	0.321
Ireland	2	0.014	0.014	0.002	0.012	0.015
Israel	9	0.057	0.044	0.126	-0.193	0.216
Italy	14	0.098	0.015	0.181	-0.153	0.439
Japan	140	-0.002	-0.008	0.215	-0.518	0.749
Malaysia	15	0.029	0.024	0.122	-0.328	0.190
Mexico	3	0.030	0.031	0.023	0.007	0.052
Netherlands	10	0.025	0.027	0.119	-0.272	0.159
New Zealand	10	0.070	0.030	0.129	-0.036	0.418
Norway	9	0.007	0.027	0.123	-0.154	0.241
Pakistan	1	0.172	0.172	0.000	0.172	0.172
Peru	1	0.350	0.350	0.000	0.350	0.350
Philippines	10	0.162	0.046	0.241	0.000	0.776
Singapore	35	-0.051	0.021	0.203	-0.550	0.161
South Africa	17	0.032	0.040	0.083	-0.171	0.150
South Korea	4	0.277	0.315	0.353	-0.100	0.577
Spain	4	0.127	0.074	0.132	0.039	0.319
Sweden	4	0.000	0.014	0.097	-0.131	0.103
Switzerland	3	0.135	0.158	0.399	-0.275	0.522
Taiwan	11	0.042	0.044	0.179	-0.375	0.238
Thailand	9	-0.003	0.036	0.179	-0.311	0.316
United Kingdom	12	-0.070	0.011	0.176	-0.446	0.083
United States	1961	0.075	0.042	0.128	-0.469	0.862
Number/Average	2814	0.069	0.061	0.162	-0.198	0.355

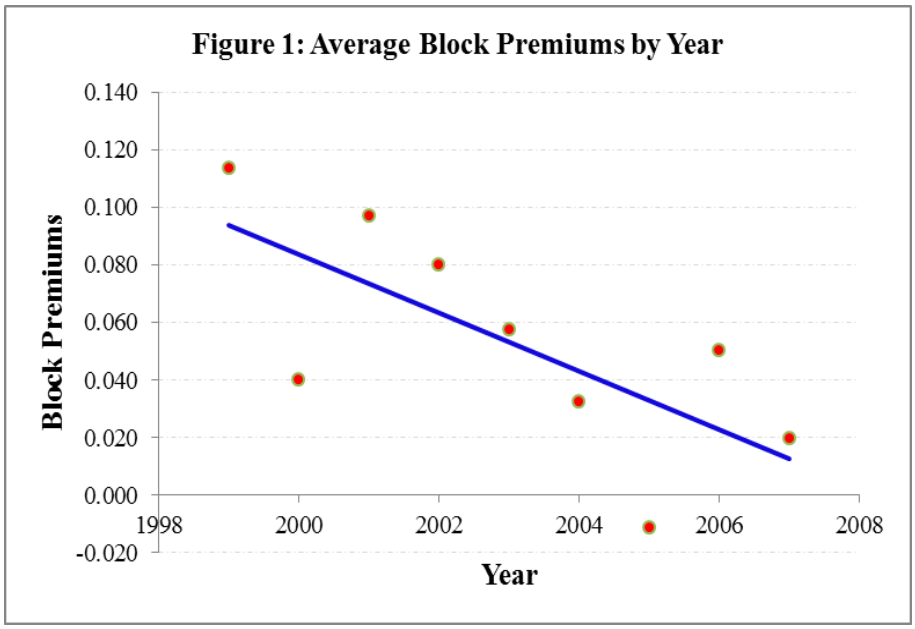
Table 2 provides more insights into the trend of the value of control over the period 1999–2007. First, block premiums are averaged across all transactions in a year for each country. The yearly block premiums are then the simple average across all country observations in a year. Table 2 shows that the average block premium decreases from 11.4% in 1999 to 2% in 2007. Year 2000 and 2005 appear to have relatively low block premiums compared to those of their preceding years. A decreasing pattern of block premiums can also be seen from the yearly medians. Figure 1 plots the yearly means of block premium with a downward sloping trend line. Statistics of the trend line shows that on average, the level of private

benefits across the sample countries decrease by 1.02% a year, statistically significant at the 5% level (*t*-stats = -2.69, *p*-value = 0.031).

Table 2. Block Premiums by Year

This table presents descriptive statistics on block premiums by year. Block premiums are firstly averaged across transactions in a year for each country, and secondly, averaged across all countries to obtain a yearly average. N is the number of countries with block premium data in a year.

year	N	Mean	Median	Std. dev.	Min	Max
1999	22	0.114	0.020	0.264	-0.311	0.756
2000	15	0.040	0.061	0.088	-0.131	0.171
2001	21	0.097	0.082	0.149	-0.272	0.418
2002	21	0.080	0.048	0.122	-0.057	0.522
2003	26	0.057	0.052	0.102	-0.086	0.350
2004	21	0.032	0.024	0.103	-0.102	0.439
2005	21	-0.011	0.024	0.158	-0.590	0.201
2006	23	0.050	0.026	0.179	-0.416	0.577
2007	24	0.020	0.015	0.126	-0.299	0.363



3. Main results

3.1 Univariate Results

In a univariate setting, we split each investor protection proxies into two groups of countries, weak and strong investor protection, using the median score as the reference point. We also divide our sample period into two sub-periods: 1999–2003 and 2004–2007. Block premiums are averaged by country-year before they are used in univariate tests between groups of countries or between sub-periods.

Table 3 presents the results. Panel A of Table 3 shows that private control benefits in weak accounting quality (ACCTG) countries, on average, have reduced from 9.4% in the period 1999–2003 to 2.6% in the period 2004–2007. This decrease of 6.8% is statistically significant at the 5% level. A similar, albeit slightly smaller, decrease in block premium is also recorded for countries with high quality of accounting standards. This decrease of 6.1% is highly significant at the 1% level. Panel A also shows that the value of control is generally higher for weak ACCTG countries than those with strong ACCTG (9.4% vs. 7.3% for the period 1999-2003, and 2.6% vs. 1.2% for the period 2004–2007). The differences, however, are not statistically significant.

Table 3. Univariate Tests of Block Premiums

This table presents univariate tests of the mean block premiums between strong and weak investor protection countries, and between the 1999-2003 and 2004-2007 periods. All the univariate tests in this table are based on block premiums that are averaged across transactions in a country-year. Investor protection variables from La Porta et al. (1998) are divided into two groups, strong and weak, using the median as the splitting point. ACCTG is the accounting standards; AD is the anti-director rights index; GOVT is the proxy for government quality; and RULE is the rule of law index. N represents the total number of country-year observations for a group of countries. ***, ** and * represent respective significance levels of 1%, 5% and 10% based on the Wilcoxon signed-rank tests.

Panel A:	N	1999-2003 (1)	2004-2007 (2)	(2) - (1)	
(a) Weak ACCTG	74	0.094	0.026	-0.068	**
(b) Strong ACCTG	112	0.073	0.012	-0.061	***
(a) - (b)		0.021	0.014		

Panel B:	N	1999-2003 (1)	2004-2007 (2)	(2) - (1)	
(a) Weak AD	94	0.088	0.050	-0.038	
(b) Strong AD	100	0.071	-0.004	-0.075	***
(a) - (b)		0.017	0.054		**

Panel C:		1999-2003 (1)	2004-2007 (2)	(2) - (1)	
(a) Weak GOVT	78	0.125	0.063	-0.062	*
(b) Strong GOVT	116	0.056	-0.014	-0.070	***
(a) - (b)		0.069	0.077		**

Panel D:	N	1999-2003 (1)	2004-2007 (2)	(2) - (1)	
(a) Weak RULE	73	0.128	0.056	-0.072	**
(b) Strong RULE	121	0.058	-0.005	-0.063	***
(a) - (b)		0.070	0.061		**

Panel B of Table 3 shows a significant decrease of 7.5% in the mean block premium for countries with high scores for anti-director rights index (AD) whereas the decrease of 3.8% in the mean block premium for the country group of low AD is not significant. The results from Panel B exhibit a significant 5.4% difference in private control benefits between weak and strong AD countries for the period 2004–2007. Panels C and D of Table 3 present the results for different country groups based on government quality (GOVT) and rule of law (RULE) indexes. The decreases in mean block premium are all statistically significant and range from 6.2% to 7.2% across all groups of countries. The comparisons between weak and strong investor protection countries show that the mean block premium in the former group of countries is between 6.1% and 7.7% significantly higher than the mean block premium in the latter group of countries.

Overall, the univariate results in Table 3 confirms Dyck and Zingales (2004) that investor protection does matter in curbing private benefits of control. The results also show strong reductions in the value of being in control. Private benefits of control are apparently wiped out entirely in countries with strong anti-director rights index, good government, and effective rule of law. Despite large reductions, private benefits of control in weak corporate governance countries are still around 5% of target firm values.

3.2 Mutivariate Results

In this section we employ the following regression model to address the relationship between private control benefits and investor protection.

$$APBC_{c,t} = \alpha + \beta_1 Trend_t + \beta_2 CG_{c,t} + \beta_3 CG_{c,t} * Trend_t + \beta_4 Ownership_{c,t} + \varepsilon \quad (1)$$

$APBC_{c,t}$ represents the mean block premium in year t for country c. *Trend* is a time variable with values ranging from 0 (for 1999) and 8 (for 2007). $CG_{c,t}$ represents investor protection variables including accounting standards (ACCTG), anti-director rights index (*AD*), government quality (GOVT), and rule of law (RULE) from La Porta et al. (1998). The interaction between *Trend* and *CG* is to differentiate the evolution of control premiums between groups of countries. Dyck and Zingales (2004) show that ownership concentration is positively correlated with the magnitude of private benefits of control. To separate the effect of ownership concentration from the effects of external legal rules on private benefits of control we use the average concentration of ownership reported in La Porta et al. (1998) as a control variable in all regression specifications.

Table 4 presents the results of 12 different OLS regressions. All significance levels are based on White-corrected standard errors. The first four specifications are for individual investor protection proxies and

trend without the interaction terms between them. The results are consistent with the univariate tests in Table 3. The trend variable is always negative and highly significant at the 1% level. Its value of -0.014 in specification (1), for example, indicates that block premiums, i.e. private benefits of control, decrease over the period of 1999–2007 by an average of 1.4% per year. This average reduction occurs across the sample countries after controlling for their accounting quality. The trend coefficient has a similar magnitude when we use different investor protection proxies in specifications 2–4.

The first four regression results are also consistent with Dyck and Zingales (2004) that stronger investor protection curbs private benefits better than weaker investor protection. The coefficients of accounting standards, government quality and rule of law are all negative and significant at the 5% level or higher while the coefficient of anti-director rights index is positive but not statistically significant. The -0.003 value for accounting quality in specification 1 means that a 10-point difference in the quality of accounting reports between two countries with same ownership structure and in the same year is associated with a 3% block premium difference between them. Specifically, acquirers in the lower accounting quality are willing to pay 3% of target firm values higher for control than acquirers in the higher accounting quality. Similarly, the -0.023 value for government quality in specification 3 means that 2% of target firm values is the marginal value of control that acquirers in country A are willing to pay compared to acquirers in country B if the government quality index for A is one point lower than the index for country B. If the index for rule of law in country A is one point lower than country B, the marginal value of control is 1.4% for acquirers in country A as shown in specification 4.

As a control variable, ownership has positive coefficients across specifications 1-4 and is statistically significant in specifications 1 and 2. The results for ownership concentration are consistent with Dyck and Zingales (2004) that higher ownership concentration is associated with larger private benefits; hence, the value of a controlling block is higher.

Table 4. Country-Level Block Premium Regression Analysis

This table presents the regression results to investigate the evolution of block premiums and its interactions with different proxies for investor protection. The dependent variable of block premiums is the mean block premiums by country-year. Independent variables from La Porta et al. (1998) include accounting standards (ACCTG), anti-director rights index (AD), government quality (GOVT), and rule of law index (RULE). Trend is a time variable with values ranging from 0 (for 1999) to 8 (for 2007). All regression specifications have a control variable, ownership, from La Porta et al. (1998). ***, **, and * indicate respective significance levels of 1%, 5% and 10% based on White-corrected standard errors.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Trend	-0.014	-0.012	-0.013	-0.013	-0.060	-0.003	-0.046	-0.034	-0.057	-0.041	-0.060	-0.006
	(-3.15)***	(-2.78)***	(-3.18)***	(-3.09)***	(-2.22)**	(-0.31)	(-2.11)**	(-2.40)**	(-2.41)**	(-2.73)***	(-2.22)**	(-0.52)
ACCTG	-0.003				-0.006				-0.002	-0.003	-0.005	
	(-2.35)**				(-2.78)***				(-1.89)*	(-1.75)*	(-2.25)**	
AD		0.003				0.014			0.004	0.003		0.009
		(0.40)				(0.91)			(0.42)	(0.36)		(0.57)
GOVT			-0.023				-0.041		-0.037		-0.013	-0.018
			(-2.79)***				(-2.85)***		(-2.39)**		(-0.74)	(-1.06)
RULE				-0.014				-0.026		-0.024	-0.003	-0.004
				(-2.55)**				(-2.74)***		(-2.31)**	(-0.25)	(-0.31)
Trend*ACCTG					0.001						0.001	
					(1.78)*						(1.78)*	
Trend*AD						-0.003						-0.002
						(-0.83)						(-0.77)
Trend*GOVT							0.004		0.005			
							(1.53)		(1.85)*			
Trend*RULE								0.003		0.004		
								(1.56)		(1.89)*		
Ownership	0.165	0.168	0.028	0.036	0.231	0.164	0.025	0.033	0.023	0.020	0.001	0.014
	(2.08)**	(1.97)*	(0.32)	(0.41)	(2.17)**	(1.91)*	(0.28)	(0.38)	(0.23)	(0.20)	(0.01)	(0.14)
Intercept	0.283	0.020	0.287	0.201	0.498	-0.016	0.440	0.299	0.562	0.452	0.591	0.251
	(2.59)**	(0.35)	(2.98)***	(2.74)***	(3.02)***	(-0.22)	(3.17)***	(3.10)***	(3.40)***	(3.34)***	(3.34)***	(2.03)**
Adj. R2	0.070	0.038	0.075	0.069	0.080	0.036	0.081	0.076	0.089	0.088	0.086	0.063
N	186	194	194	194	186	194	194	194	186	186	186	194

In specifications 4–8 of Table 4, we include interactions between investor protection proxies and the trend variable. If the Asian Financial Crisis in 1998 leads to a more prevalent corporate governance reform in countries with poor protection of investor rights, we should expect larger decreases in control premium in

those countries. Generally, we find weak evidence that the decrease in block premium is stronger for countries with weak protection of investors. The interaction coefficient is positive for specifications 5, 7, and 8 while it is negative for specification 6. The interaction between trend and accounting standards in specification 5 is 0.001 and marginally significant at the 10% level. This result indicates that the yearly reduction in private control benefits is approximately 1% larger for country A than for country B if the difference in accounting quality scores between them is 10 points.

The last 4 specifications of Table 4 present some multivariate results for different combinations of investor protection proxies and their interactions with trend. The results in specifications 9 and 10 indicate that after controlling for ownership concentration, accounting quality and anti-director rights, countries with relatively low quality of government and legal rules exhibit larger reductions in private control benefits over the period 1999–2007 compared to countries with relatively high scores in those measures. The results in specifications 11 and 12 show that after controlling for ownership structure, the quality of government and rule of law, the differential decrease is significant between countries with low and high financial reporting quality and insignificant between strong and weak anti-director rights countries.

Overall, the results in Table 4 firstly are consistent with Dyck and Zingales (2004) that there is a positive correlation between private benefits of control and the stringency of corporate governance. Secondly, Table 4 shows strong evidence that the value of control has reduced over the period 1999–2007 across 37 countries in our sample. Finally, the results, albeit weak, also indicate that the reductions are stronger for countries with poor protection of investor rights.

3.3 Robustness Tests

While country-level analysis would reduce the effect from countries with large proportion of deals in the sample such as the U.S., Canada and Japan, firm-level analysis would allow us to control for some firm- and deal-level characteristics as argued in Dyck and Zingales (2004). We estimate equation (1) using firm-level data. The unreported results are qualitatively similar as in Table 4. These firm-level results are also robust after excluding U.S. transactions. Another robustness check of our results is to use alternative institutional factors such as product market competition, newspapers' diffusion, number of violent crimes and the level of tax compliance (see Dyck and Zingales, 2004). The unreported results for these alternative factors are also consistent with those in Table 4.

4. Conclusion

In this paper we aim to address the following. First, we want to see if the relationship between private benefits of control and the degree of investor protection reported in Dyck and Zingales (2004) extends to a more recent period 1999–2007. Second, we investigate how private control benefits evolve over time. Finally, if there is a trend in the value of control and the relationship between private control benefits and investor protection still holds, we study if the trend interacts with the degree of investor protection. These issues are of interest in the wake of the 1998 Asian Financial Crisis and U.S. corporate scandals that apparently trigger more attention and corporate governance reform across the world.

We find evidence that the level of private benefits is negatively correlated with the degree of investor protection at both country-level and firm-level analyses. Our evidence is consistent with Dyck and Zingales (2004). However, our estimate of the mean private benefits of control across country-years shows a remarkable decrease between their period 1990–1999 and our period 1999–2007. Specifically, they report an average value of control of 14% compared with our average of 6.9%. Within our sample period, we find evidence of a significant decrease in the level of private benefits from an average value of 11.4% in 1999 to 2% in 2007. However, the decline in the value of control is relatively larger for countries with low investor protection at the start of the period 1999–2007. This result implies that *de facto* corporate governance might have been improving more strongly in countries with poor *de jure* investor protection.

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