THE REACTION OF BLOCKHOLDERS TO CHANGES IN MARKET CONDITIONS

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Abstract

In this study, we examine the impact of business conditions and stock market conditions on blockholders' ownership in U.S. firms. We expect that in periods when the general interest in the stock market goes up, blockholders' interest and participation in the market will also increase (i.e. there are more blockholders per firm and the percentage share of blockholder ownership in each corporation is higher). We use the Aruoba-Diebold-Scotti (i.e. ADS) Business Conditions Index and the S&P 500 Index as proxies for business conditions and stock market conditions, respectively. We find that blockholders' investments more closely track stock market conditions than business conditions. Our nonparametric tests show that there are more blockholders per firm when stock market conditions are better.

Keywords: Stock Market Conditions, Blockholders' Investments

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1 Introduction

Do general macroeconomic conditions affect ownership concentration in U.S. firms? This paper is a crossover for two strains of research: the pervasiveness of the blockholder (defined here as *any* shareowner holding more than 5% of a firm's outstanding shares) in corporate governance structures within U.S. firms and the impact of these blockholders on good corporate governance when economic shocks occur to the financial system. Specifically, we seek to identify a pattern in the number of blockholders and the percentage of shares held by blockholders as market conditions improve and decline in the U.S. between 1996 and 2001.

Understanding the incentives that drive managers and owners is at the heart of constructing good corporate governance; forecasting when ownership concentration is likely to change should shed light on one such incentive, that of agency. The potential for damage to a firm's value increases when the decision maker (agent) has too much control but too little ownership stake, or when many owners each have a small stake, especially if transaction costs are high. A blockholder whose stake is large enough to overcome the transaction costs of activism (See Burkhart et al., 1997) may act as an effective monitor for all the shareholders (Shleifer and Vishney, 1986). Under this view, the presence of a blockholder may be an indicator of better corporate governance. At the margin, the blockholders' stake in the company may

signal higher relative share prices, *ceteris paribus*, because the cost of capital has gone down due to the better governance (Black et al., 2006). Being able to understand the influence of good governance measures during economic booms and especially busts may help to anticipate the return to firms impacted by shocks to their economic environment.

This paper documents the empirical relationship between ownership concentration and business conditions as a first step for understanding the circumstances for when ownership concentration is likely to change. We explore the patterns between the two rather than asserting causal direction. Using 1996-2000 as an expansion period and 2001 as a contraction phase in the U.S., our nonparametric tests show that the business cycle, as represented by the ADS Business Conditions Index, is correlated with both the number of blockholders and the percentage owned by blockholders. When we use the S&P 500 Index as a proxy for U.S. stock market conditions, however, we find that the number of blockholders and the percentage owned by blockholders are both correlated in a statistically significant way with the stock market index. When the S&P 500 index is relatively higher during the 1999-2001 period, there are more blockholders and they own a greater percentage of the common shares.

The next section summarizes the relevant academic literature on the frequency and magnitude of blockholder ownership. Very little in the academy juxtaposes the blockholder against a backdrop of the

economic environment. Section 3 outlines the hypotheses considered. Section 4 identifies the data sources used and explains the nonparametric methods of comparison employed. Section 5 provides an exposition of our results and section 6 concludes our findings.

2 Literature review

The ways the academy has classified the various groups within the typical ownership structure and measured their influence varies considerably, from average ownership for the CEO (80% hold less than 1.4%) (Jensen and Murphy, 1988) to the total percentage of common shares owned by all blockholders (Holderness, 2009). Three articles, Jensen and Warner (1988), Holderness (2003), and Holderness (2009), provide surveys of "recent research" findings for evidence of sizeable blocks of share ownership. Jensen and Warner's (1988) contribution divides ownership conentration between the largest shareholder (average holding 15.4%), various combinations of insider holdings (the board of directors average holding 10.6%), and institutional holdings (average 19.1%), and compiles the findings of several different applied articles. Holderness (2003) considers the prevalence of insider holdings to be one of four fundamental questions asked in the corporate governance research. He concludes that insiders hold about 20% of a randomly selected sample set of corporations headquartered in the United States in any given year. Special attention is paid in his survey to the CEO specifically, and he notes that "studies infrequently address the stock ownership of outside blockholders who do not serve on the board of directors" (page 53). In a more recent article, Holderness (2009) addresses the above shortcoming directly by focusing on blockholding in many of its forms (insider, outside, affiliated) to conclude that the prevalence of blockholding in the United States is average, neither diffuse nor concentrated. In his sample, 96% of the firms have a blockholder in their ownership structure. For many, this is a new idea, as ownership structure in the United States is considered to be diffuse, certainly more so than elsewhere (See: Becht and DeLong (2005), Denis and McConnell (2003), Franks et al., (2008), La Porta et al.,(1999)). In these articles, it is considered a "stylized fact" that U.S. ownership is diffuse, with typical statistical comparisons that 50% of European companies have a single shareholder that controls a majority of the voting shares, compared to only 3% of the firms in the United Kingdom and the United States (Franks et al., 2008).

To understand what happens with blockholder investment over time, researchers have, for the most part, used point comparisons across time rather than a smooth time series. Mikkelson and Partch (1989) document insider ownership percentages for 1973, 1978, and 1983 by examining proxy statements for

240 randomly selected, industrial firms from the Center for Research in Security Prices (CRSP) database. They estimate the mean blockholder voting share for the sample to be 19.6% with a standard deviation of 19.5%. McConnell and Servaes (1990) report that average ownership for officers and directors went from 13.9% in 1976 (1173 firms) to 11.8% in 1986 (1,093 firms) and that average blockholding ownership went from 32.4% to 25.6%. Holderness et al. (1999) analyze how managerial ownership for U.S. firms changes between 1935 and 1995. They discover that with this broader time frame, insiders increased their ownership stakes from a mean 13% (median 7%) in 1935 to a mean 21% (median 14%) in 1995. Franks et al. (2008) look at ownership concentration over a hundred years, in the United Kingdom, but their focus is on the impact of investor protection on ownership structure. The argument made is one of economic history and the power of institutions (Common or Civil law traditions) versus the power of financial capitalism (See also: La Porta et al., (1997, 1998, 1999, 2000, 2002). The range of findings as well as the lack of clear analysis of when blockholder prevalence grows or recedes leaves the empirical question of its magnitude, given the economic environment, still unanswered.

The exception to the static analysis across time comes from Denis and Sarin (1999). They consider equity ownership structure across a ten year period, 1983-1992, for 583 randomly selected, publicly traded firms from the CRSP database. They find that in 12% of the firm-year observations, there was a change in blockholdings that was ususally related to changes in top-executives or to takeover threat dynamics. This was seen as a sizeable portion of the sample; indeed, they discover that 65% of the firms considered experienced either a large change in ownership concentration or board structure and that large changes tended to persist after three years. Typically, the catalyst for each of the big changes in the sample was a fundamental shift in the business conditions for the firm specifically, and the follow-up result was an asset restructuring. The focus is microeconomic in perspective, and considers the relationship between blockholders and management, rather than the prevalence of the blockholder with respect to the macroeconomic environment.

Morch et al. (2005) broaden the economic scope and consider the connections between insider control rights, the functioning of capital markets, and economic growth (Morch, Wolfenzon, & Yeung, 2004). Here, the authors look at the conditions where ownership is *not* diffuse, where pyramidal control structures and cross holdings thrive, leaving a few insiders with far greater control than what would be suggested by their ownership stake (La Porta, et al., 1999). Still, there is recognition in the paper "that economic growth depends on the distribution of control over capital assets" (p.655). Where the agency

problem is acute, economic growth may be sacrificed. Essentially, more diffuse structures, which is what we see in the United States, may help establish a more level playing field which may spur growth.

There is not a great deal in the literature that compares the prevalence of blockholding to general business conditions and nothing for the United States market specfically. In research on financial market development, however, there is some analysis on the relative performance of firms, given several measures of corporate governance, in a financial crisis. In general, firms with good measures of corporate governance maintain more of their firm's value during a financial crisis (Zaharia and Zaharia, 2012). Black et al. (2006) and Baek et al. (2004) each consider firms listed in Korea's market. Johnson et al. (2000) and Mitton (2002) focus their analyses in Asia. Mitton (2002) argues that the stock price for a firm with solid corporate governance measures may fall less during a financial downturn because good governance may mitigate the incentives of a large blockholder to expropriate resources for themselves during the crisis. Also, where there is a lack of transparency in governance, large outside investors may vote with their feet, further exacerbating the push downwards on price during a financial crisis. Jones et al. (2012) talk about the ways that opacity breeds price contagion over the business cycle. They found that merger announcements in the banking industry would lead to a cumulative abnormal return for other firms inside the industry but outside the immediate transaction in question. Further, the firms that were the least transparent, benefitted the most during the 2000-2006 expansion period and also lost the most value with the onset of the 2007 financial crisis.

Thus, there is room in the literature for investigating ownership concentration across time and across market conditions within the United States. The way in which these proportions change across good and bad times adds one more piece to the greater puzzle of what constitutes good corporate governance.

3 Hypotheses

We add to the discussion on the significance of blockholding in the United States stock market by considering its presence and prevalence of blockholding during good and poor business conditions. Here, we seek to understand the pattern and the degree of blockholder ownership—when ownership of over 5% of the common shares in a company is held by an investing unit—as the economic environment changes. When does blockholding become a more important component in ownership structure? We test two hypotheses:

Hypothesis 1: In the United States stock market, the number of blockholders goes up when market conditions improve.

The basic idea is to determine if blockholding increases when business conditions appear to be promising. This is related to whether the big institutional investors are timing the market or not. More interesting, we would like to see if blockholding investors vote with their feet during tougher business conditions, thereby revealing their lack of confidence in management. We expect to see the reaction to business conditions to be lagged. The first step to considering these bigger questions is to understand ownership patterns.

Hypothesis 2: Total ownership by blockholders increases when market conditions improve.

Does the presence of the blockholder become more substantial as confidence in the market grows? If blockholder presence waxes and wanes with business conditions it might suggest a limited general interest in corporate governance. Is the blockholder exiting when its monitoring role is the most beneficial? Alternatively, perhaps the agency problem is the most difficult when times are easy and resources are more readily available. Under that scenario, a larger presence in the ownership structure could signal more active oversight from large shareholders. Seeing how the size and presence of the blockholder changes over the business cycle or across alternative business conditions can provide insight into corporate governance monitoring of the blockholder.

4 Data and methodology

In this study, we use the data set from Dlugosz, *et al.* (2006) to identify patterns in blockholding over the 1996-2001 period. The data set represents a standardized, cleaned version of the information available from *Compact Disclosure*, which tends to contain many mistakes and biases when left on its own. Because widespread blockholding is a fairly recent phenomenon in the United States, good data are available over very limited periods of time. Any conclusions must be considered tentative until additional data are available. Nonetheless, using the clean data that are readily available is a worthy exercise. In total, there were 7,649 blockholder observations during that period for 1,913 individual companies.

Since the National Bureau of Economic Research classifies the March 2001-November 2001 period as a recession and since our data is annual, we designate the year 2001 as a recessionary period and the years 1996-2000 as an expansionary period. First, we compare the number of blockholders and also the sum of the blockholder ownership percentage across these two periods (expansionary versus recessionary). We use several nonparametric tests for our comparisons, but due to space concerns we only report the results of the Wilcoxon tests.

As a second measure of macroeconomic conditions, we consider stock market levels. When the market is high, the general interest in stocks is high. These periods may also be the periods when the blockholders' interest in stock ownership is the

strongest, therefore, our second measure for business conditions is a stock market-related measure. Here, we differentiate between the period that had relatively high stock market levels ("S&P500 High") and the period that had relatively low stock market levels ("S&P500 Low"). We would expect to see a lagged relation between an increasing index and blockholder ownership over time. We classify the 1999-2001 period as "S&P500 High" and the 1996-1998 period as "S&P500 Low". We estimated several variations of what constituted a high stock market period, and found similar results for all variations. Again, we use several nonparametric tests for our comparisons, but we only report the results of the Wilcoxon tests.

Table 1 shows our sample of firms over the 1996-2001 period. Panel A shows the number of observations in each year, while Panel B shows the number of observations across the expansionary (1996-2000) and the recessionary (2001) time periods The first row in each panel (i.e. "All") shows the total number of observations during that year or period. In both panels, we also show the number of observations in each ownership group. The second row shows the number of observations (or blockholders) that own five percent or less of the company (i.e. <5%); the third row shows the number of blockholders that own between five percent and ten percent of the company (i.e. 5%-10%); and so on. The last row shows the number of blockholders that own the majority of the company (i.e. >50%).

Table 1. Sample firms over time

				Panel A				
	1996	1997	1998	1999	2000	2001	All
All	1,130	1,046	1,510	1,387	1,336	1,240	7,649
<5%	161	160	185	158	147	152	963
5%-10%	166	154	172	175	147	138	952
10%-15%	147	122	165	151	136	133	854
15%-25%	244	237	332	284	289	254	1,640
25%-50%	322	303	511	478	473	431	2,518
>50%	90	70	145	141	144	132	722

	Panel B		
	Expansion	Recession	All
All	6,409	1,240	7,649
<5%	811	152	963
5%-10%	814	138	952
10%-15%	721	133	854
15%-25%	1,386	254	1,640
25%-50%	2,087	431	2,518
>50%	590	132	722

In the next section, we show the number of blockholders and total percentage ownership for blockholders over time. First, we show the trend in the number of blockholders and the percentage ownership of blockholders in tabular form. Then, we show these trends in graphical form and compare them to the stock market levels and the business conditions during the same period (1996-2001). Are the trends in the number of blockholders and the percentage sum of blockholder ownership similar to the trends in the stock market levels and the business condition levels? Finally, we run nonparametric tests to see if the differences are statistically significant.

5 Empirical results

Table 2 summarizes the prevalence of the number of blockholders per firm over the 1996-2001 period.

Here, instead of presenting the total number of blockholders, we present the mean and the median values of the number of blockholders per firm over our sample period. Panel A shows the average number of blockholders per firm over time, while Panel B shows the number of observations per firm across the expansionary (1996-2000) and the recessionary (2001) periods. Panel A shows that, after 1997, the mean value of the number of blockholders per firm started to go up. In 1997, there were 2.10 blockholders per firm; in 1998, this number climbed to 2.41; in 1999, it further climbed to 2.44; and in 2000, it reached 2.53. In other words, during the 1997-2000 period, the number of blockholders, on average, went up for our sample firms. In 2001, there was a slight drop in the average number of blockholders to 2.50.

Table 2. Number of Blockholders over time

	Panel A											
	1996		1997		1998		1999		2000		2001	
	Mean	Med.	Mean	Med.	Mean	Med.	Mean	Med.	Mean	Med.	Mean	Med.
All	2.12	2.00	2.10	2.00	2.41	2.00	2.44	2.00	2.53	2.00	2.50	2.00

	Panel B					
	Expansion		Recession		All	
	Mean	Med.	Mean	Med.	Mean	Med.
All	2.34	2.00	2.50	2.00	2.37	2.00
<5%	0.00	0.00	0.00	0.00	0.00	0.00
5-10%	1.00	1.00	1.00	1.00	1.00	1.00
10-15%	1.65	2.00	1.68	2.00	1.65	2.00
15-25%	2.36	2.00	2.39	2.00	2.37	2.00
25-50%	3.50	4.00	3.61	4.00	3.52	4.00
>50%	4.11	4.00	4.39	4.00	4.16	4.00

The same trend can be seen in the blockholders' overall ownership in our sample firms. Panel A in Table 3 shows that the sum of blockholdings (%) went up during the 1997-2000 period before dropping in 2001. In 1997, blockholders owned, on average, 21.35% of their respective firms (meaning that the average share of all blockholders invested in a firm was 21.35%). In 1998, this number was 24.51%; in 1999, it was 24.95; and in 2000, it was 25.47%. In 2001, the total percentage ownership of blockholders in a typical firm dropped to 25.02%.

Table 3. Sum of Blockholdings (%) over time

	Panel A											
	1996		1997		1998		1999		2000		2001	
	Mean	Med.	Mean	Med.	Mean	Med.	Mean	Med.	Mean	Med.	Mean	Med.
All	21.66	18.16	21.35	18.64	24.51	21.80	24.95	22.18	25.47	23.15	25.02	22.26

	Panel B					
	Expansion		Recession		All	
	Mean	Med.	Mean	Med.	Mean	Med.
All	23.79	20.90	25.02	22.26	23.99	21.10
<5%	0.00	0.00	0.00	0.00	0.00	0.00
5-10%	7.00	6.71	7.00	6.72	7.00	6.71
10-15%	12.62	12.60	12.84	13.00	12.65	12.70
15-25%	19.83	19.80	19.96	20.21	19.85	19.90
25-50%	35.15	34.34	35.10	34.28	35.14	34.30
>50%	62.39	59.52	61.74	59.10	62.27	59.40

Figure 1 shows the number of blockholders per firm and Figure 2 shows the sum of blockholdings (%) over our sample period. These are just the graphical representations of Table 2-Panel A and Table 3-Panel A numbers. The two graphs are largely similar. Both the number of blockholders per firm and the sum of blockholdings (%) increase through the 1997-2000 period, and then decrease in 2001. There was a slight drop from 1996-1997 in Figures 1 and 2 while we see an increase in the ADS Index and the stock market index for the same period.

Figure 1. Number of Blockholders over time
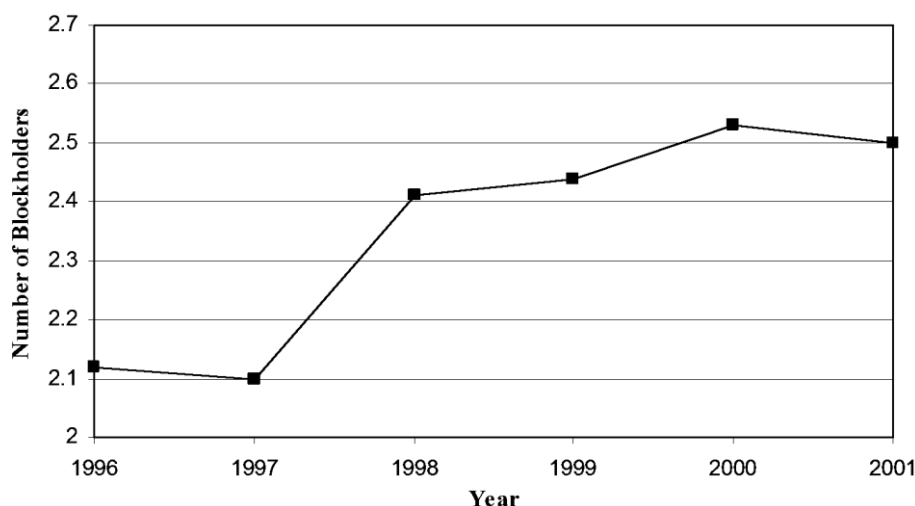
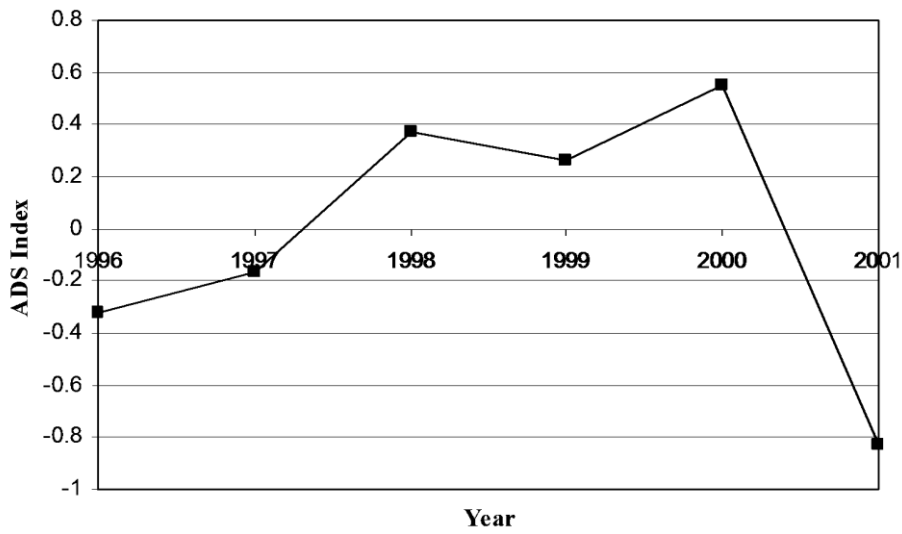**Figure 2.** Sum of Blockholders (%) over time
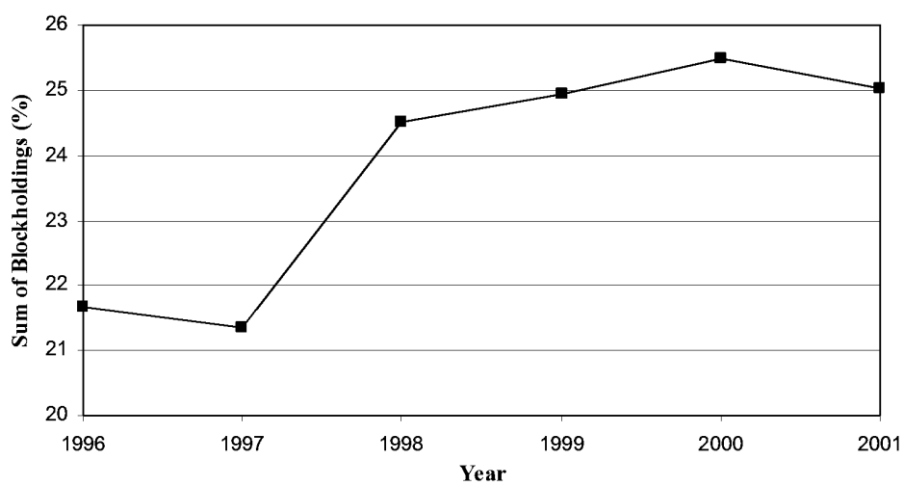
Our main question in this paper is whether blockholder demand for firms' shares increases within good economic environments. As a proxy for macroeconomic (and market) conditions, we use two measures. The first one is the Aruoba-Diebold-Scotti (i.e. ADS) Business Conditions Index. This index takes into account several factors including weekly initial jobless claims, monthly payroll employment, industrial production, personal income less transfer payments, manufacturing and trade sales, and quarterly real GDP. The daily values of the index are calculated and posted on the Philadelphia Fed's website (http://www.philadelphiafed.org/research-and-data/real-time-center/business-conditions-index/). Figure 3 shows the beginning-of-the-year values of the ADS Index. In general the index is improving until 2000 and takes a sharp turn downwards in 2001. Our second measure for macroeconomic conditions is the S&P 500 Index. It reflects the stock market's conditions. The beginning-of-the-year values of this index are shown in Figure 4. When we compare

Figures 1 and 2 to Figure 4, we can easily say that the number of blockholders per firm and the percentage ownership of blockholdings trend lines (Figures 1 and 2) are very similar to the business condition proxies, especially the S&P 500 Index trend line (Figure 4). In all three graphs, there is a positive trend until 2000 and then a drop in 2001. Figure 3 (i.e. the ADS Index) is slightly different because there is a drop in 1999 rather than an increase before a significant drop in 2001.

By looking at these graphs, we can argue that the S&P 500 Index (the proxy for the stock market) is correlated with blockholders' investments in the stock market. When the market advances, there are more blockholders per firm and also the share of blockholding in each firm is much higher. In other words, when general interest in the stock market goes up (therefore the S&P 500 Index goes up), blockholder interest in the market also goes up (i.e. there are more blockholders per firm and the share of blockholders in each firm is higher).

Figure 3. ADS Business Conditions Index over time

Figure 4. S&P 500 Index over time
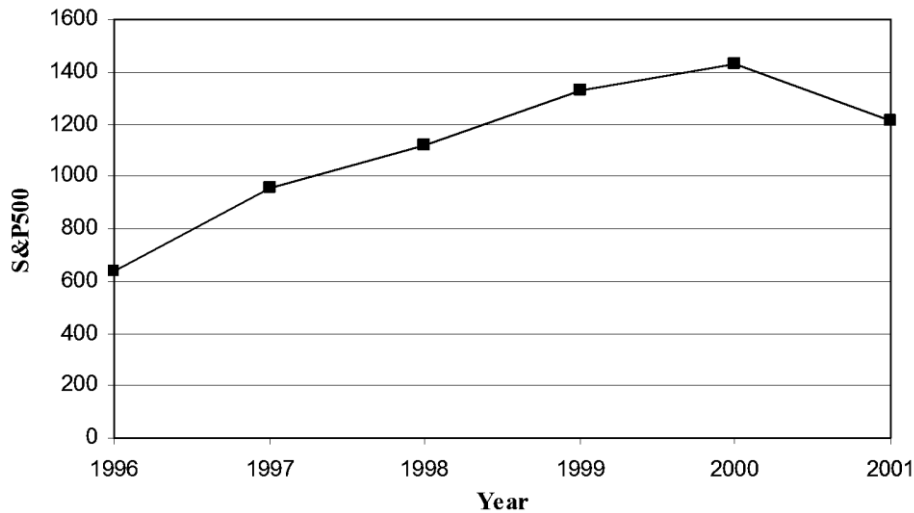
In Table 4, we run Wilcoxon tests in order to compare the number of blockholders across the expansionary and the recessionary periods. Our tests show that, for the whole sample (i.e. row 1), there were more (at 0.2% level) blockholders per firm during the recessionary period (i.e. 2001) compared to the expansionary period (1996-2000). This is not what we hypothesized. There were 2.50 blockholders per firm in the recessionary period versus 2.34 blockholders per firm in the expansionary period. Of course it is worth noting that, since in each ownership category (i.e. 0%-5%, etc.) we limit the total ownership by blockholders to that specified range, within each ownership group, the result is not statistically significant.

Table 4. Number of Blockholders

	Expansion	Recession	Wilcoxon
All	2.34	2.50	0.002
0%-5%	0.00	0.00	1.000
5-10%	1.00	1.00	1.000
10-15%	1.65	1.68	0.539
15-25%	2.36	2.39	0.391
25-50%	3.50	3.61	0.126
>50%	4.11	4.39	0.129

In Table 5, we do similar tests for the stock market cycle. Here, we are comparing the 1996-1998 period when the stock market was relatively low to the 1999-2001 period when the market was relatively high. As can be seen from the table, for the whole sample, there were significantly more (at 0.01% level) blockholders per firm during the 1999-2001 period (i.e. S&P 500 High) compared to the 1996-1998 period. There were 2.49 blockholders per firm in the 1999-2001 period versus 2.23 blockholders per firm in the 1996-1998 period.

Table 5. Number of Blockholders

	S&P500 Low	S&P500 High	Wilcoxon
All	2.23	2.49	<0.0001
0%-5%	0.00	0.00	1.000
5-10%	1.00	1.00	1.000
10-15%	1.65	1.66	0.608
15-25%	2.37	2.36	0.636
25-50%	3.43	3.58	0.001
>50%	3.91	4.34	0.003

Notice that the test results become statistically significant as ownership concentration grows and becomes a factor for firm governance. The difference in the number of blockholders over the low and high stock market is statistically significant once ownership concentration becomes greater than 25%.

In Table 6, we run Wilcoxon tests in order to compare the total percentage blockholder ownership across the expansionary and the recessionary periods. Our tests show that, for the whole sample, blockholders owned a significantly larger portion (at 2.4% level) of their respective companies during the recessionary period (i.e. 2001) compared to the expansionary period (1996-2000). The blockholders, in total, owned 25.02% of their respective firms in the recessionary period versus 23.79% in the expansionary period. The only range where the change in ownership was statistically significant, however, was the 10-15% ownership range.

Table 6. Sum of Blockholdings (%)

	Expansion	Recession	Wilcoxon
All	23.79	25.02	0.024
0%-5%	0.00	0.00	1.000
5%-10%	7.00	7.00	0.859
10-15%	12.62	12.84	0.092
15-25%	19.83	19.96	0.489
25-50%	35.15	35.10	0.723
>50%	62.39	61.74	0.384

In Table 7, we run similar tests for the stock market cycle. Here, for the whole sample, we find that blockholders owned a significantly larger portion (at 0.01% level) of their respective companies during the 1999-2001 period compared to the 1996-1998 period. The blockholders, in total, owned 25.14% of their respective firms in the 1999-2001 period versus 22.74% in the 1996-1998 period.

Table 7. Sum of Blockholdings (%)

	S&P500 Low	S&P500 High	Wilcoxon
All	22.74	25.14	<0.0001
0%-5%	0.00	0.00	1.000
5%-10%	6.98	7.03	0.480
10-15%	12.58	12.73	0.106
15-25%	19.80	19.90	0.515
25-50%	35.02	35.23	0.495
>50%	62.41	62.17	0.993

6 Conclusion

There are statistically significant correlations between blockholders and general business conditions in the United States stock markets between 1996 and 2001. Our tests show that the number of blockholders and the percentage owned by blockholders is higher when the ADS Business Conditions index indicates a

recession (we designate 2001 as recession and 1996-2000 as expansion periods).

We get clearer results when we use the S&P 500 high versus low proxy for stock market conditions in the economy. We find that the number of blockholders and the percentage owned by blockholders are both explained by the stock market index at a statistically significant level. When the S&P 500 index is running relatively higher (1999-2001 period), there are more blockholders and they own a greater portion of the shares outstanding.

The different findings for the different macroeconomic proxies are reflected in the graphical results. When we look at figures 1-4 above, it is clear that the S&P 500 Index more closely tracks with the number of blockholders and the percentage ownership by blockholders than does the Business Conditions Index, which dips downwards in 2000 to become negative. Although both business cycles and the index seem to explain the ownership concentration, we believe that the stock market index explains it better. When the stock market is doing well, the ownership structure shifts more towards the blockholder.

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