The Control Risk Premium

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Summary

- Controlling family shareholders hold substantial economic stakes (cash flow rights) in dual class firms
- Family control is associated with a risk premium (abnormal returns of 350 basis points per year)
- Part of this risk premium is associated with liquidity constraints attached to super voting shares
- There is no evidence of higher compensation levels or headquarter spending (exploitation hypothesis)
- Institutional investors hold over 87% of free float (non-family control) shares
- Dual class shares incentivize large shareholder monitoring – a costly solution to contracting problem (selling discounted shares)

Theoretical Framework: Why Risk Premium on Family Ownership?

- What exactly creates the risk associated with family ownership? Why do we need a risk premium for holding firms with more than 5% of shares in founding family hands?
- Previous literature emphasizes the negative aspects of separation between ownership and control (the wedge). This paper does not find any significant relationship between stock returns and the wedge.
- Managerial entrenchment, higher salaries, self-dealing. No evidence, either.
  - E.g, Smart, Thirumalai, Zutter (JAE, 2008) find that CEO turnover is not sensitive to performance in dual-class firms.

Theoretical Framework: Why Risk Premium on Family Ownership?

- Behavioral biases against dual class shares leading to excessive discounts and eventual abnormal returns. The paper briefly mentions the behavioral story as a plausible explanation (footnote 3), but does not elaborate on it.
- The risk premium result is confined to firms in which high vote shares are not publicly traded (liquidity restricted)
  - Is this because of sample size (as majority of dual class firms have only one publicly traded share class)?
  - Through which channel the liquidity restriction affects the risk level of outside investors?
  - The liquidity argument should be explained better.
- In sum, I would like to see stronger argumentation for the reasons behind the risk premium associated with family ownership and how this risk differs from other forms of concentrated ownership.

Data and sample

- Family firm definition: "the founder or founder's descendants own more than 5% of the firm's outstanding shares"
  - 89% of dual class firms are family firms
  - 7% of dual class firms have diversified shareholder bases (usually short-lived)
  - In 4% of dual class firms the dual class shares are kept after the founder exited the firm
- Please show average assets and age in each matched sample.
- Questions:
  - What is the role of other large shareholders? Do results differ if family owns 10% and institutional investors 50% or family owns 50% and institutional investors 10%?
  - Why should those 11% of dual class firms without family ownership be *systematically* less risky and actually trade at a premium to single class firms?
  - Are unifying firms excluded from the sample after unification or added to the single class category? As a robustness check, I would like to see the results with unifying firms excluded from the sample.

Results

- Why do the stock return results differ from e.g. Smart, Thirumalai, Zutter (2008) and Cremers, Lauterbach, Pajuste (2018) that find no abnormal returns on dual class shares, using Fama-French-Carhart four factor model?
  - Is it model specific? How can we interpret the differences?
- What is the reason for comparing the adjusted institutional ownership in dual class and single class firms? By construction, the measure is higher in dual class firms because of lower denominator (higher family control).
  - It would be interesting to have a more elaborate overweight/ underweight measure. For example, excluding index trackers or exploring the differences in institutional investor patterns in dual and single class firms.
- It would be interesting to see the stock return analysis upon ownership change from family to non-family
  - How frequent are ownership changes in your sample?

To conclude

- Impressive study exploring family ownership in a broad sample of single and dual class companies
- Intriguing findings that family firms generate higher abnormal stock returns
- Do we have a new “family factor” to be used by the asset management industry and academics?

Thank you!