

The Control Risk Premium

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Voting Rights

- Dual Class Shares
 - Firms issue more than one type of share; Super voting rights
 - Observed in the Wild – 1 in 11 listed firms (Hong, 2013)
 - Not disappearing: Alibaba
- Costly Securities
 - Business Press
 - Forbes 2012 – Screw Common Shareholders; Bloomberg 2013 - Buyer Beware!
 - Calpers 2011 – Corruption of the governance system
 - Wall Street Journal 2012 – Undercut outside shareholders
 - Academic Research
 - Gompers et al. (2010) – Low firm values, exploit minority shareholders
 - Masulis et al. (2009) – Value destroying, allow managers extract private benefits
 - Li et al. (2009) – Institutional Investors shun them
 - Regulatory Pressure
 - Restrict inclusion on indexes
 - Add sunset clauses; Add voting rights

Why do the Securities Persist?

- Evolutionary: If all negative - die out due to competition
 - Presumably, there is some reason to develop
 - If costly, who bears it?
 - Rational investors recognize at IPO
 - Initial Owners bear full costs of agency problems through lower price
 - Exploitation Argument
 - Consistently expropriate more than anticipated
 - Investors irrational
 - Exploit unsophisticated retail investors
- Central Issue: Do these structures harm outside shareholders?
 - Where arise – with what organizational structure?
 - What industries arise – randomly or targeted?
 - Revisit - Market Values after observable characteristics
 - *How effect investors – Excess Returns?*
 - Who chooses to own the floatable shares of these firms?

Where Dual Class Firms

- Preliminary Observations about Dual Class
 - 89% occur in family controlled firms (founder or heir)
 - 11% arise in restructurings or founding family initiated and exited firm
 - Industry distribution: 53% occur in just 7 of the 48 Fama-French Industries
- Russell 3000 Industrials (2001 -2015)
 - Single Class Family firms 25.6%
 - Dual Class Family firms **8.4%**
 - Single Class non-family firms 65%
 - Dual Class non-family firm **1.1%**
- What is correct counter-factual?
 - Single Class Family Firms in same industry?
 - Most Analysis: Dual Class Family Firm vs Single Class Atomistic
 - Conflates dual class and family control
 - Results stem from dual class structures or family control?

Dual Class firm examples 7 Ind Codes

Fama French Industry Description (Code)	Companies
Communications (32)	Playboy Enterprises Cox Communications Inc. Spanish Broadcasting Systems Inc. Martha Stewart Living Omnimedia
Retail (42)	Dillards Inc. Sonic Automotive Inc. Ingles Markets Inc.
Business Services (34)	Kelly Services Inc. Grey Global Group Inc. Aaron's Inc.
Print and Publishing (8)	New York Times Co. American Greetings John Wiley & Sons
Electronic Equipment (36)	Method Electronics Molex Inc. Vishay Intertechnology Inc.
Apparel (10)	Oshkosh B Gosh Inc. Timberland Co. Kenneth Cole Productions Inc.
Food Products (2)	Tootsie Roll Industries Inc. Tyson Foods Inc. WM Wrigley Jr. Co.

Descriptive Statistics

Panel A:

	<i>Full Sample</i>				<i>Matched Sample</i>			
	<i>All</i>	<i>Dual Class</i>	<i>Single Class</i>	<i>t-test</i>	<i>All</i>	<i>Dual Class</i>	<i>Single Class</i>	<i>t-test</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>
<i>Observations</i>	24,724	2,333	22,391	-	4,258	1,685	2,573	-
<i>Family Firm</i>	33.97	88.73	28.27	28.68	61.84	88.66	44.27	15.89 ^a
<i>Family Own.</i>	8.63	26.82	6.73	0.28	17.69	27.47	11.28	9.38 ^a
<i>Family Votes</i>	10.97	51.63	6.73	13.94 ^a	27.89	53.30	11.28	18.24 ^a
<i>Total Assets</i>	5,102	5,553	4,918	22.01^a	1,880	1,995	1,805	0.82
<i>Firm Age</i>	45.86	53.46	45.07	3.20^a	46.90	47.93	46.23	0.63
<i>Firm Risk</i>	14.54	14.20	14.58	0.91	14.69	14.85	14.58	0.52
<i>Leverage</i>	19.81	25.10	19.26	3.76^a	21.78	22.59	21.25	0.71
<i>Tobin's Q</i>	1.96	1.71	1.99	4.15^a	1.82	1.72	1.88	1.98 ^b
<i>ROA</i>	8.65	10.33	8.48	2.44^b	10.56	9.96	10.96	0.48
<i>R&D/Sales</i>	23.24	6.23	25.01	6.01 ^a	10.02	7.44	11.71	1.35

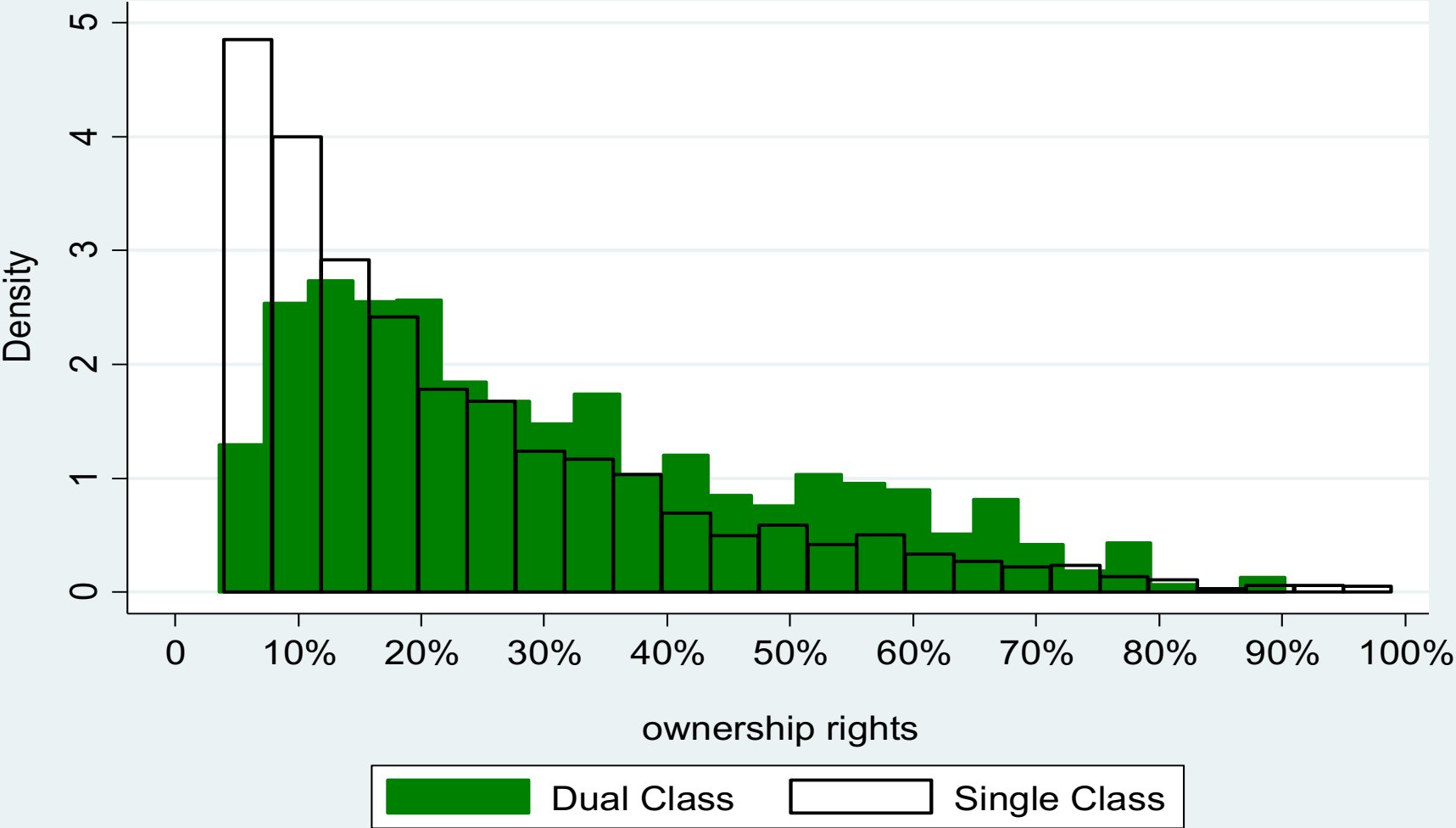
Descriptive Statistics

Panel B:

	<i>Family Dual</i>	<i>Nonfam Dual</i>	<i>Family Single</i>	<i>Nonfam Single</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<i>Observations</i>	2,070	263	6,329	16,062
<i>Family Own.</i>	31.30	0.41***	22.93***	0.35***
<i>Family Votes</i>	58.12	0.59***	22.93***	0.35***
<i>Total Assets</i>	5,554	5,547	2,751	5,963
<i>Firm Age</i>	53.88	50.11	36.37***	48.49**
<i>Firm Risk</i>	13.83	17.14**	15.90***	14.06
<i>Leverage</i>	24.89	26.75	15.97***	20.55**
<i>Tobin's Q</i>	1.639	2.27***	1.99***	1.99***
<i>ROA</i>	10.84	6.32	8.25***	8.57***

Cash Flow Rights: Dual and Single Class

Cash Flow Rights



The Cash Flow Wedge

- Difference between cash and control rights
 - Viewed as Agency Issue
 - Substitute cash rights for voting rights
 - Cash Flow Ownership in Family Firms
 - Dual Class: Cash Flow = **31%**
 - Single Class: Cash Flow = **23%**
 - Wedge: About Control rights – not minimizing cash rights
 - Usually, see Wedge related to firm value
- Alternative: Mechanism to facilitate governance
- Dual Class shares encourages founders to hold larger cash flow stakes

Voting Rights

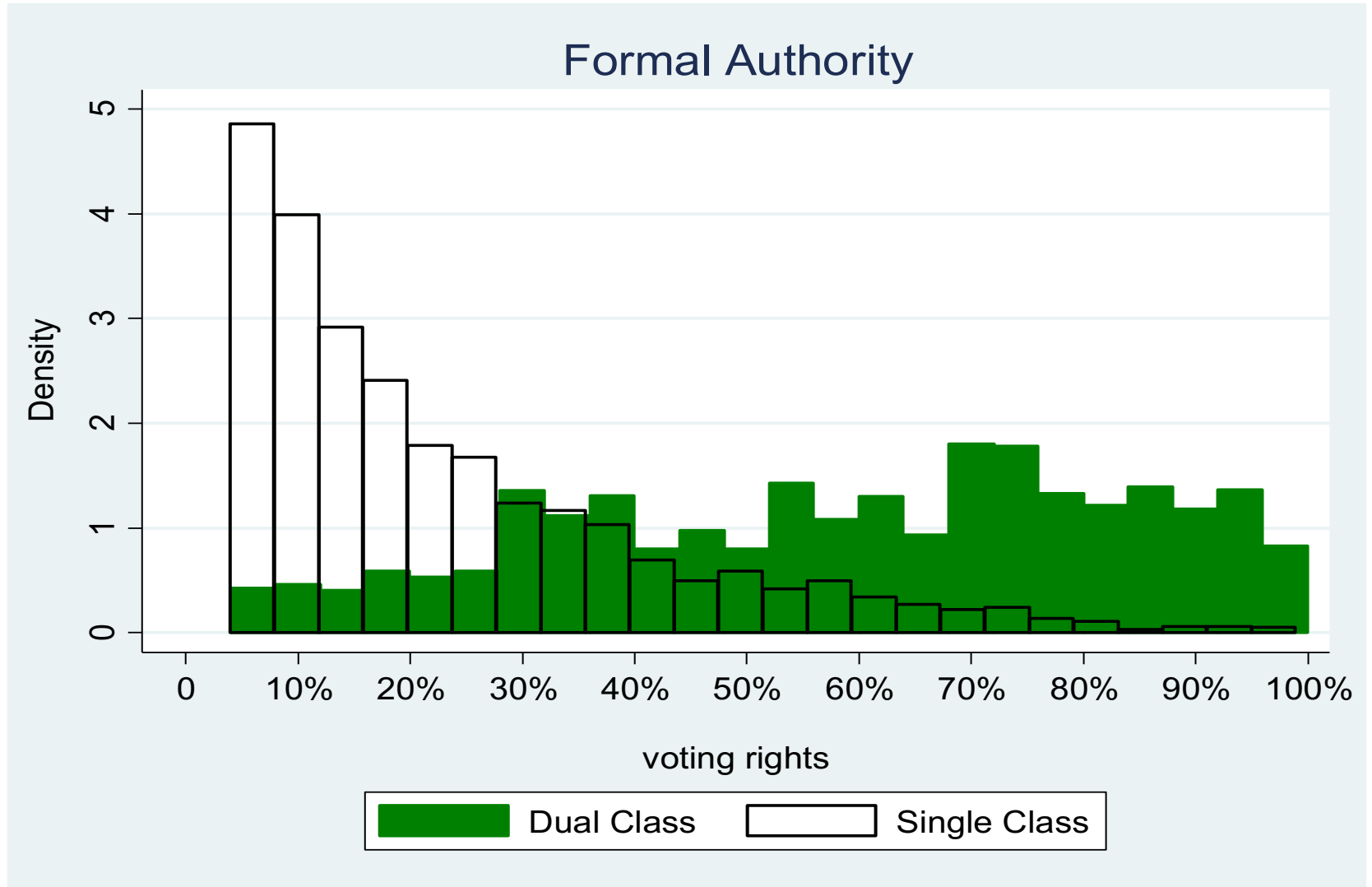


Figure 2: Relative Tobin's Q

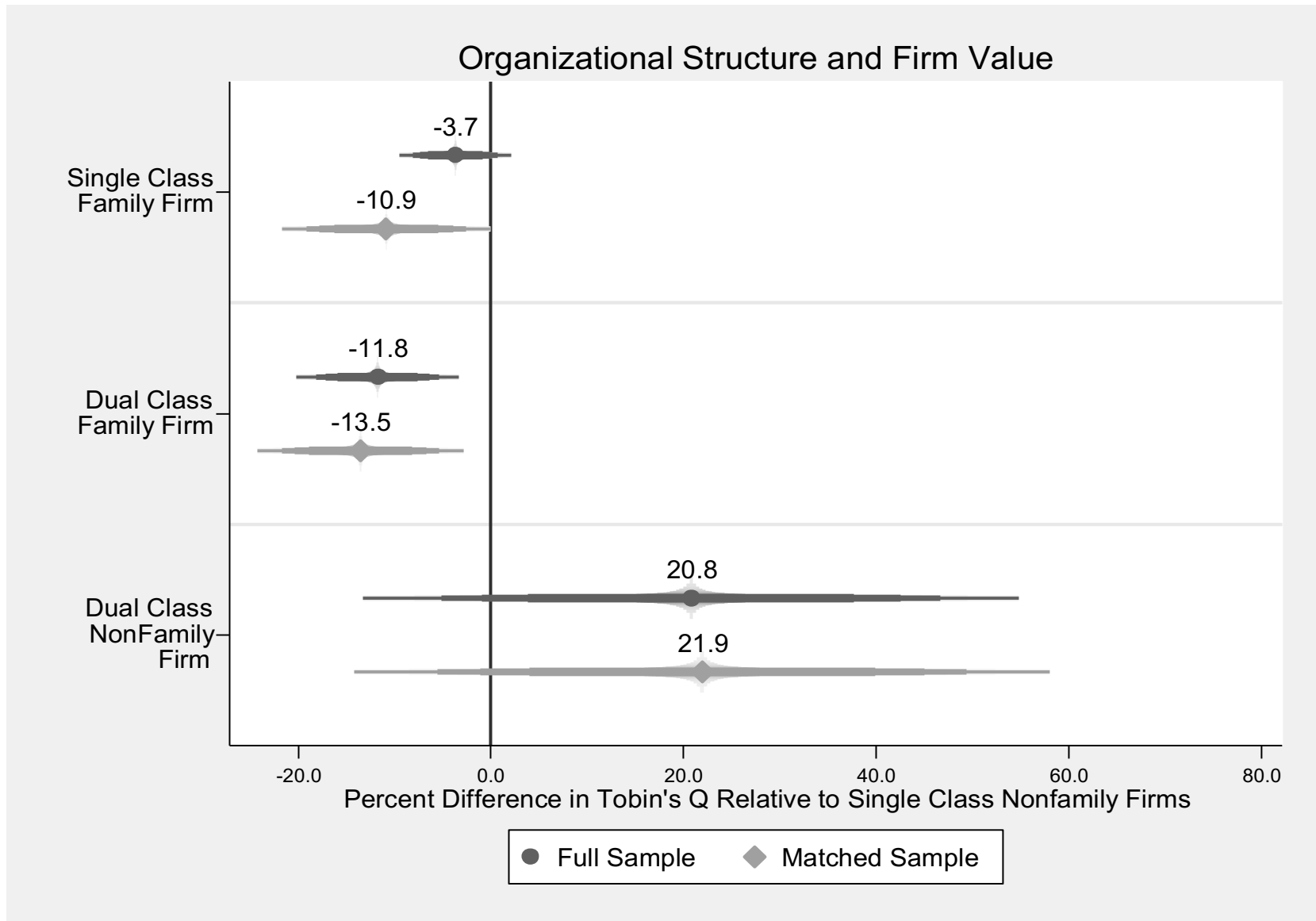
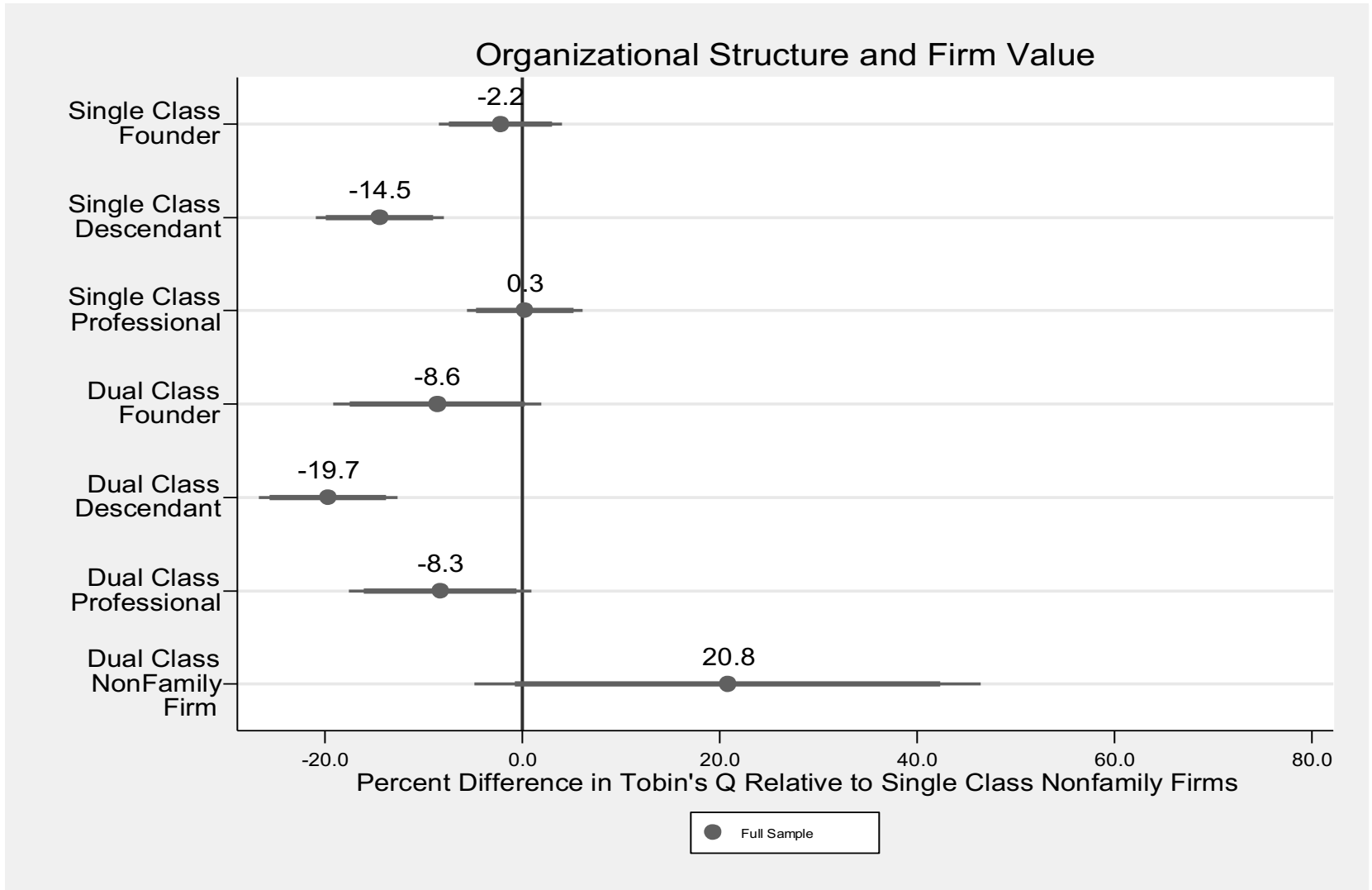


Figure 3: Family Type and Relative Q



Stock Return Analysis

- Are outside shareholders worse off for investing in dual class family firms versus other organizational forms?
- $Stock\ Returns_{it} = \alpha + \beta_1(\text{Single Class Family Firm}) + \beta_2(\text{Dual Class Family Firm}) + \beta_3(\text{Dual Class Nonfamily Firm}) + \beta_X X + \varepsilon_t$
- Stock returns: Buy and Hold annual returns adjusted by:
 - industry returns (FF industry benchmark)
 - market adjusted returns (CRSP value weighted)
 - size and B/M adjusted returns

Stock Return Analysis

	Full Sample			Matched Sample		
	<i>Industry</i>	<i>Market</i>	<i>Fama-French</i>	<i>Industry</i>	<i>Market</i>	<i>Fama-French</i>
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>
Intercept	0.061 ^b (2.08)	0.158 ^a (5.53)	-0.085 ^a (2.86)	0.052 (0.56)	0.171 ^c (1.85)	-0.115 (1.23)
β_1 (Single-Class Family)	0.014 ^b (2.06)	0.012 (1.63)	0.006 (0.81)	0.021 (1.07)	0.019 (0.99)	0.018 (0.93)
β_2(Dual-Class Family)	0.037^a (3.28)	0.035^a (3.06)	0.029^b (2.56)	0.057^a (3.40)	0.059^a (3.47)	0.059^a (3.43)
β_3(Dual-Class Nonfamily)	-0.002 (0.06)	-0.001 (0.04)	0.017 (0.53)	-0.004 (0.09)	0.002 (0.05)	0.025 (0.52)
Ln(Total Assets)	-0.007 ^a (3.29)	-0.012 ^a (5.12)	-0.005 ^b (2.28)	-0.011 (1.49)	-0.014 ^c (1.73)	-0.007 (0.88)
Ln(Firm Age)	0.004 (0.80)	0.004 (0.96)	0.006 (1.19)	0.019 (1.42)	0.022 ^c (1.65)	0.023 ^c (1.73)
Leverage	0.029 (1.58)	0.039 ^b (2.10)	0.029 (1.54)	0.010 (0.22)	0.022 (0.45)	0.010 (0.21)
Return on Assets	0.566 ^a (17.78)	0.584 ^a (18.03)	0.613 ^a (17.85)	0.410 ^a (4.54)	0.425 ^a (4.68)	0.510 ^a (5.43)
Firm Risk	0.621 ^a (9.07)	0.484 ^a (6.93)	0.463 ^a (6.57)	0.528 ^a (3.40)	0.344 ^b (2.18)	0.368 ^b (2.32)
R&D/Sales	0.010 ^b (2.13)	0.010 ^b (2.09)	0.012 ^b (2.45)	0.013 (0.72)	0.007 (0.38)	0.015 (0.81)

The Wedge

- Wedge: Cash Flow vs Control Rights usually emphasized
- Earlier Showed: Wedge occurs because family wants formal control when have really cash flow stake in the firm
- How impact outside investors -returns?

Returns and the Wedge

	Dependent Variable = Excess Industry Return			
	Full Sample			Matched Sample
	1	2	3	4
Intercept	0.075 ^b (2.58)	0.075 ^b (2.58)	0.063 ^b (2.15)	0.129 (1.38)
β_1 ("Wedge")	0.084^b (2.69)	-	-	-
β_2 ("Family Wedge")	-	0.085^a (2.72)	0.053 (1.57)	0.019 (0.36)
β_4 (Family Cash Flow Rights)	-	-	0.057 ^a (2.80)	0.118^a (2.88)
β_3 (Nonfamily Wedge)	-	-1.961 (1.38)	-1.492 (0.99)	0.857 (0.27)
β_5 (Nonfamily Cash Flow Rights)	-	-	-0.545 (1.43)	-0.028 (0.03)

Institutional vs Atomistic Ownership

- So Far: Lower Values but higher Returns (from smaller firms)
- Who buys shares in Dual Class Firms
 - Institutional usually considered sophisticated
 - Concerns about retail investor exploitation
- Viacom: A Family Firm
 - Redstone family: 79% of shares
 - 79% Not available for purchase
 - Key issue in Viacom: How much of the 21% floated held by retail investors vs institutions
- Comparing Institutional and Retail Shareholdings
 - Total Shares
 - Floated Shares

Institutional Investors

Fraction of Institutional Shareholdings =

Total Number of Shares held by Institutions

Total Shares – Total Shares held by the Family

Institutional Ownership

	Dual-Class Family	Single-Class Family	Single-Class Nonfamily
Total Shares			
Family Ownership	31%	26%	0%
Inst. Ownership Total	68%	54%	74%
Atomistic Total	2%	20%	26%
Floated Shares			
Institutional Ownership	97.5%	73%	74%
Atomistic Ownership	2.5%	27%	26%

Institutional Investors

<i>Dependent Variable = Fraction of Institutional Shareholdings</i>		
	<i>Full Sample</i>	<i>Matched Sample</i>
	<i>1</i>	<i>2</i>
Intercept	0.600 ^a (13.88)	0.437 ^a (3.04)
β_1 (Single-Class Family)	0.023^c (1.79)	0.043 (1.43)
β_2 (Dual-Class Family)	0.274^a (9.00)	0.257^a (7.90)
β_3 (Dual-Class Nonfamily)	-0.07 (1.47)	-0.024 (0.38)
Ln(Total Assets)	0.009 ^b (2.04)	0.011 (0.94)
Ln(Firm Age)	-0.027 ^a (2.84)	-0.011 (0.45)
Leverage	-0.036 (1.34)	-0.152 ^b (2.42)
Return on Assets	0.510 ^a (15.57)	0.555 ^a (6.16)
Firm Risk	-0.695 ^a (10.71)	-0.535 ^a (3.40)
R&D/Sales	0.021 ^a (3.97)	0.016 (1.36)

Risk Factor?

- Low Price & High Returns
 - Risk Factor?
 - Most pronounced in smaller firms
- Dual Class Price/Returns
 - Differ in family and nonfamily firms
 - Suggests Risk Factor associated with family control
- Succession Risk
 - Concerns in family firms about descendent control
 - How limit if family has formal control?
- Liquidation Penalty
 - Sell dual class shares by family – convert to low votes
 - Excess Returns arises in the ones with this liquidation penalty
 - Referred to others as a sunset provision

Summary

- Dual Class are a long lived and common security
 - Arise with founding family control
 - Bulk in 7 Industries
 - Current evidence conflates dual class and family control
- Family holds poorly diversified portfolio
 - Wedge evidence misleading
 - Not used to minimize cash flow rights
 - Dual class induces family to hold large cash flow rights
 - Arise in specific industries
 - Perhaps ones that need controlling shareholder (monitor)
 - Clearly one where family wants to protect their large cash flow stake
- Institutional owners
 - Bought discounted low vote shares
 - Receive high returns on these shares
 - Benefit from regulatory curtailment at expense of family stakeholder

Conclusions and Implications

- Tobins Q Evidence
 - Without conflating family control: High Q firms
 - Family Control
 - Without dual class shares: low Q
 - With dual class shares: low Q
- How Effect Investors
 - Without family control no impact on returns
 - Family firms
 - With dual class shares – high excess returns
 - Without dual class shares – high excess returns ow price but high excess returns
 - Risk factor with family control
- Are Retail Investors Exploited
 - Risk is priced with family control
 - Low price, high return, and 2.5% of shares held by retail investors
- Case for regulation?
 - Usually depends on some impediment to market solution
 - Excess return evidence suggests low q (high returns) is the solution