



American Finance Association

Negotiated Block Trades and Corporate Control

Author(s): Michael J. Barclay and Clifford G. Holderness

Source: *The Journal of Finance*, Vol. 46, No. 3, Papers and Proceedings, Fiftieth Annual Meeting, American Finance Association, Washington, D. C., December 28-30, 1990 (Jul., 1991), pp. 861-878

Published by: Blackwell Publishing for the American Finance Association

Stable URL: <http://www.jstor.org/stable/2328546>

Accessed: 25/11/2009 12:10

Your use of the JSTOR archive indicates your acceptance of JSTOR's Terms and Conditions of Use, available at <http://www.jstor.org/page/info/about/policies/terms.jsp>. JSTOR's Terms and Conditions of Use provides, in part, that unless you have obtained prior permission, you may not download an entire issue of a journal or multiple copies of articles, and you may use content in the JSTOR archive only for your personal, non-commercial use.

Please contact the publisher regarding any further use of this work. Publisher contact information may be obtained at <http://www.jstor.org/action/showPublisher?publisherCode=black>.

Each copy of any part of a JSTOR transmission must contain the same copyright notice that appears on the screen or printed page of such transmission.

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.



Blackwell Publishing and American Finance Association are collaborating with JSTOR to digitize, preserve and extend access to *The Journal of Finance*.

<http://www.jstor.org>

Negotiated Block Trades and Corporate Control

MICHAEL J. BARCLAY and CLIFFORD G. HOLDERNESS*

ABSTRACT

We identify negotiated trades of large-percentage blocks of stock as corporate control transactions. When a block trades and the firm is not fully acquired, cumulative abnormal returns average 5.6%, and 33% of the chief executives are replaced within a year. Stock-price increases are larger when control passes to the new blockholder, when management does not resist the blockholder's effort to influence corporate policy, and when the block purchaser eventually fully acquires the firm. These findings suggest that the specific skills and expertise of blockholders, and not just the concentration of ownership, are important determinants of firm value.

WE EXAMINE 106 NEGOTIATED trades of at least 5% of the common stock of New York Stock Exchange (NYSE)- and American Stock Exchange (AMEX)-listed corporations. Our primary objective is to assess the impact of these transactions on the firms whose shares are traded. We also investigate the importance of active block investor's specific managerial expertise and incentives for firm value.

The emerging literature on concentrated ownership focuses on how the level of ownership affects a blockholder's incentives to undertake a variety of corporate decisions. Although it has been recognized that a blockholder's identity also can be important, less attention has been paid to this issue. Several recent studies, however, provide evidence that blockholders' incentives and expertise are not homogeneous. For example, Holderness and Sheehan (1985) find that the stock market reacts more favorably to initial block accumulations by six controversial investors, who are often portrayed in the press as "raiders," than to initial accumulations by a random sample of investors. Morck, Shleifer, and Vishny (1988) find that firm value tends to be lower when the firm is run by a member of the founder's family than when it is run by an officer unrelated to the founder. Brickley, Lease, and Smith (1988) document that institutional blockholders are less willing to vote against management on antitakeover amendments when they are likely to have business dealings with the firm. When a block trades, the concentration of ownership typically does not change, but the blockholder's identity does

*University of Rochester, William E. Simon Graduate School of Business Administration and Boston College, Wallace E. Carroll School of Management, respectively. This research has been partially supported by the Managerial Economics Research Center at the Simon School. We would like to thank Hesna Genay and Meeta Kothare for research assistance. We have benefited from the suggestions of Raymond Ball, James Brickley, Robert Comment, Gregg Jarrell, David Mayers, Ronald Schmidt, Dennis Sheehan, Clifford Smith, and Michael Weisbach.

change. Thus, we use our block trades to investigate whether a blockholder's specific expertise and incentives affect firm value.

The initial public announcements of the negotiated block trades in our sample are associated with average abnormal stock-price increases of approximately 16%. The increases tend to be larger when control passes to the new blockholder, when management does not resist the block purchaser's attempts to influence corporate policy, and when the block purchaser eventually fully acquires the firm. When the firm is not acquired, stock prices increase with the announcement of the trade, decline gradually over the 40 following days, and remain level thereafter. Even with the decline, however, cumulative abnormal returns average 5.6% a year after the trade. Turnover among top managers and directors following the trades substantially exceeds what is normal for public corporations. For example, in the firms that remain independent, 33% of the chief executives depart in the year following the trade, and many of their replacements are hired externally. Finally, there are numerous reports in the financial press that block purchasers or their representatives play an active role in firm management.

Two broad conclusions emerge from these findings. First, although block trades sometimes precede more conventional control transactions, in most cases the block trade is the final outcome, with control passing from the block seller to the block purchaser. Thus, we argue that negotiated block trades should be added to the list of corporate control events. Second, the increases in firm value and extensive managerial turnover associated with block trades suggest that the managerial skills and incentives of blockholders are not homogeneous. Firm value, therefore, depends in part on the blockholder's specific skills and not just on his fractional ownership.

1. Negotiated Block Trades and Corporate Control

1.1. Sample of Block Trades

We obtain a sample of block trades by examining each entry of the company index of *The Wall Street Journal* from 1978 through 1982. For inclusion in our sample, there must be a report of a trade of at least 5% of the common stock of a NYSE- or AMEX-listed corporation. We require blocks of at least 5% because the SEC mandates public filing once that threshold is reached. Because we want to focus on negotiated block trades rather than on more conventional control transactions, we exclude trades made in response to outstanding merger or tender offers. We do, however, include trades that are announced simultaneously with offers by the block purchaser to acquire the firm's remaining shares. These steps produce a sample of 106 block trades involving 97 corporations.¹

¹We lack the data to determine how the frequency of block trades compares with the frequency of more conventional control transactions. The available data, however, suggest that negotiated-block trades are relatively common. For example, W. T. Grimm & Co. (1987) reports ten hostile tender offers a year for NYSE- and AMEX-listed firms; DeAngelo and DeAngelo (1989) report five proxy contests annually for the same group of firms. By comparison, we identify approximately 20 negotiated-block trades a year.

In Table I we report the size of the firms whose shares are traded and the percentage of the firm's common stock in the block. We also report this information after partitioning our sample into trades in which the firm continues as an independent public corporation for at least a year after the trade and trades that are followed within a year by an acquisition of the firm (typically by the block purchaser).² We make this partition throughout the paper, for three reasons. First, several effects of a block trade, including the stock-price reaction to its public announcement, differ significantly when the minority's shares are acquired. Second, when a firm continues to be publicly held, more information is available and thus more analyses are possible on post-trade changes, including managerial turnover. Third, a block trade leading to the acquisition of the minority's interest is a fundamentally different organizational change from the continuation of the firm as an independent public entity.

As reported in Table I, the size of our firms varies widely, with book value of assets from \$2 million to almost \$1.7 billion.³ The average sample firm has

Table I
Descriptive Statistics for 106 Negotiated Block Trades of at
Least 5% of the Common Stock of NYSE- or AMEX-Listed
Corporations between 1978 and 1982

The sample of firms remaining independent consists of 65 trades in which the firms whose shares are traded are not acquired within a year of the block trade announcement. The sample of firms subsequently acquired consists of 41 trades in which the firms whose shares are traded are acquired within a year of the block trade announcement. Data from COMPUSTAT, SEC 13d filings, and *The Wall Street Journal*.

	Mean	Median	Minimum	Maximum
All firms				
Book value of assets (millions of 1982 dollars)	247	85	2	1680
Percentage of common stock in block	27	21	5	83
Firms remaining independent				
Book value of assets (millions of 1982 dollars)	264	86	2	1680
Percentage of common stock in block	21	17	5	63
Firms subsequently acquired				
Book value of assets (millions of 1982 dollars)	221	68	9	1131
Percentage of common stock in block	37	33	6	83

²Fourteen of our trades involve simultaneous tender offers by the block purchaser. In six additional cases, an offer occurs within 30 days. Thereafter, tender offers become less frequent and appear to occur randomly.

³All dollar values in this paper are in GNP price-deflated 1982 dollars.

assets of \$247 million (median \$85 million). In contrast, over the same time period, the average exchange-listed firm had assets of \$1.8 billion (median \$209 million). Thus, our sample firms tend to be smaller than the average exchange-listed firm, a trait which apparently characterizes firms with large-block shareholders in general.⁴ The fraction of the common stock traded in the block averages 27% (median 21%). This differentiates our research from previous studies that examine trades that are large in relation to normal trading volume yet small in relation to the total number of shares outstanding. For example, of the 358,000 trades examined by Holthausen, Leftwich, and Mayers (1987), only 256 exceed 2% of the issuing firm's common stock. In addition, large dollar but small percentage trades are usually conducted over the exchange, whereas press reports indicate that virtually all of our trades were negotiated between the buyer and the seller.

Most of our trades represent a change in the firm's largest blockholder, not an increase in the concentration of ownership. The firm has a new largest blockholder after 96 (90%) of the trades; after all trades, the block purchaser is the firm's largest shareholder. In 79 trades (75%), the concentration of ownership does not change as the block purchasers did not own any stock prior to the trade. In the 27 other trades, the block purchaser's average pretrade holdings were 14% (median 9%). Our qualitative findings do not change when we exclude those trades in which the purchaser owned stock prior to the trade.

1.2. Stock-Price Reaction to Initial Public Announcements of Block Trades

To ascertain the abnormal stock-price reaction associated with initial public announcements of our block trades, we use the market model to adjust for general movements in stock prices. The model is estimated with a linear regression of our firms' continuously compounded rate of return on the return for the Center for Research in Security Prices (CRSP) equally weighted index. The estimation period includes day -720 through day -241 (approximately 2 calendar years), with day 0 being initial public announcement of the trade.⁵ Prediction errors are calculated for each event day from -240 through +240, and cumulative abnormal returns are formed by summing and then averaging the daily prediction errors over various event periods. The statistical significance of the cumulative abnormal returns is calculated using standardized prediction errors.

Figure 1 plots the abnormal stock returns from 240 days before through 240 days after the initial public announcements of our block trades. Table II summarizes these returns and their significance levels for various parts of the 480-day event period. For the full sample of 106 trades, abnormal returns from day -1 to 0 average 5.1% (p -value = 0.001). Seventy percent of these returns are positive (p -value of the binomial probability test = 0.001). Fig-

⁴See Demsetz and Lehn (1985) and Holderness and Sheehan (1988).

⁵The initial announcement of our trades is either *The Wall Street Journal* announcement or the 13d filing, which is the first filing required by the SEC for block trades.

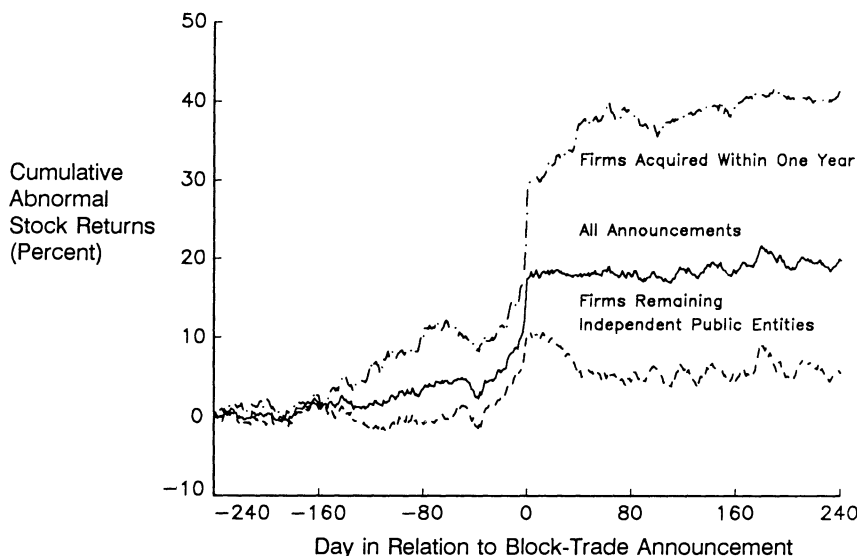


Figure 1. Cumulative abnormal stock returns associated with 106 negotiated block trades of at least 5% of the common stock of NYSE- or AMEX-listed corporations between 1978 and 1982. Day 0 is the initial public announcement of the block trade. The sample of firms remaining independent consists of 65 trades in which the firms whose shares are traded are not acquired within a year of the block-trade announcement. The sample of firms subsequently acquired consists of 41 trades in which the firms whose shares are traded are acquired within a year of the block-trade announcement.

ure 1 also documents an increase in stock prices in the 40 days preceding the announcement. This increase possibly reflects leakage of information about the trade, suggesting that the event-day returns understate the impact of a block trade on firm value. Analysis of stock prices over the 40 days immediately preceding the announcement (days -40 through 0) shows average abnormal returns of 14.0% (p -value = 0.001). From day -40 through day $+240$, stock prices increase by 16.5% (p -value = 0.001).

Figure 1 and Table II also report abnormal returns when the sample is partitioned into those firms that remain independent following a trade and those that are acquired within a year. Notwithstanding notable differences between the two subsamples, in particular, returns are considerably larger when a trade leads to an acquisition; both are associated with stock-price increases.⁶ When a firm remains independent, the average abnormal return increases from day -40 through day 0 , declines from day 1 through day 40 , and remains approximately level thereafter. This pattern suggests that the initial increase partially reflects an increased expectation that the minority's shares will be acquired. As that expectation is not realized, stock prices drift

⁶The pretrade run-up in stock prices is statistically indistinguishable between those firms that are subsequently acquired and those remaining independent.

Table II
Cumulative Abnormal Stock Returns over Various Event-Time
Intervals Associated with 106 Negotiated Block Trades of at
Least 5% of the Common Stock of NYSE- or AMEX-Listed
Corporations between 1978 and 1982

Day 0 is initial public announcement of the block trade. The sample of firms remaining independent consists of 65 trades in which the firms whose shares are traded are not acquired within a year of the block-trade announcement. The sample of firms subsequently acquired consists of 41 trades in which the firms whose shares are traded are acquired within a year of the block-trade announcement.

	Days In Relation To Block-Trade Announcement				
	- 1 to 0	- 10 to 0	- 40 to 0	- 40 to 40	- 40 to 240
All firms					
Cumulative abnormal return (%)	5.1	9.2	14.0	14.6	16.5
<i>p</i> -value ^a	0.001	0.001	0.001	0.001	0.001
Firms remaining independent					
Cumulative abnormal return (%)	2.1	5.5	9.9	5.7	5.6
<i>p</i> -value ^a	0.020	0.001	0.001	0.034	0.322
Firms subsequently acquired					
Cumulative abnormal return (%)	9.8	14.9	20.5	28.6	33.4
<i>p</i> -value ^a	0.001	0.001	0.001	0.001	0.001

^a*p*-value for the two-tailed test of the hypothesis that the cumulative abnormal returns are equal to zero.

down. Because this subsample excludes firms that are acquired within a year and because stock prices are approximately level from day 40 on, we conclude that the remaining abnormal returns of approximately 5.6% do not reflect anticipated acquisitions.⁷

1.3. Management and Board Turnover following Block Trades

Table III tracks changes in the composition of the top management team for those firms that remain independent public corporations after a trade. The table reveals that 33% of the chief executive officers depart in the first year following a trade; an additional 19% depart in the subsequent year. This significantly exceeds the normal turnover for public corporations not involved in control transactions. For example, Comment (1985) studies 2731 NYSE- or AMEX-listed corporations between 1975 and 1980 and finds that

⁷Abnormal returns calculated by simply subtracting the equally weighted market return are somewhat larger than the market-model adjusted returns in Figure 1 and Table II. For example, for those firms that remain independent public entities after a trade, the abnormal returns from day -40 through day 240 are 7% with the simple market adjustment, versus 5.6% with the market-model adjustment.

Table III
Turnover among the Top Three Corporate Officers and the
Board of Directors following 65 Negotiated Trades of at Least
5% of the Common Stock of NYSE- or AMEX-Listed
Corporations between 1978 and 1982

All firms remain independent for at least a year following the block trade. Data from Standard and Poor's Register of Corporations, Directors and Officers.

	Year Following Block-Trade Announcement			
	1	2	3	4
Top officers				
CEO turnover (%)	33	19	14	7
Percentage outsiders	50	55	50	0
# 2 turnover (%)	43	25	36	18
Percentage outsiders	35	40	50	38
# 3 turnover (%)	43	34	43	30
Percentage outsiders	35	55	29	31
Board of directors				
Turnover of chairmen (%)	37	16	15	21
Average number of arriving board members	2.13	1.05	1.02	0.97
Average number of departing board members	1.78	1.17	1.16	1.09
Number of firms	65	59	54	51

approximately 5% of the chief executives turn over annually. Warner, Watts, and Wruck (1988), who focus on larger firms which generally have higher turnover than smaller firms, report annual top management turnover of 18%.

The turnover among chief executive officers following block trades is similar to the turnover following more conventional control transactions. For example, Martin and McConnell (1989) find chief executive turnover of 38% in the first year following a successful tender offer and 19% in the subsequent year. DeAngelo and DeAngelo (1989) find that in 20 of 39 firms (51%) in which dissidents fail to win a majority of the Board seats in proxy contests, the chief executive, president, or chairman resigns within 3 years. Finally, Comment (1985) confirms such turnover following both successful and unsuccessful proxy contests and finds higher-than-normal annual turnover among chief executives following successful mergers (38%) and successful tender offers (46%).

Table III further reports that 50% of the chief executives hired in the first year after a trade and 55% of those hired in the following year are brought in from the outside. Similarly, Martin and McConnell (1989) find that 57% of the chief executives hired in the first year following a successful tender offer and 54% of those hired in the succeeding year are outsiders. In contrast, Warner, Watts, and Wruck (1988) and Reinganum (1985) document that when public corporations are not involved in control transactions, only 15% of new chief executives are hired from the outside.

We also document extensive turnover among subordinate members of the top management team (as classified by Standard and Poor's Register) and among directors. For example, Table III reports that 43% of the number two and number three executives leave in the year following a block trade. Although the turnover in this group drops somewhat in the succeeding years, it nevertheless exceeds the extensive turnover among chief executives. Turnover among chairmen of the board is almost as pronounced, as 37% leave in the year following a trade. Turnover among directors in general is abnormally high only in the first year after a trade.⁸

Only 6 of 65 firms (9%) experience no turnover among their top three executives in the 2 years following a trade. On the other hand, 26 firms (40%) experience turnover in all three positions. This complete turnover, however, seldom occurs within a year, and it seldom involves the wholesale introduction of outsiders. Indeed, in only three cases (5%) does it appear possible that all three new members of the top management team are outsiders. Thus, although block trades typically lead to significant management turnover, seldom do we observe the simultaneous replacement of one management team with another. A likely reason is that current executives have valuable firm-specific information or skills that the block purchaser cannot easily duplicate.

When we look at our entire sample, including those firms that are subsequently acquired, survival among chief executives and board chairmen following a block trade becomes even less common. In Table IV, a chief executive or chairman is treated as surviving if he retains his position and the firm remains independent and publicly traded. Only 26% of the firms retain both their chief executive and chairman for 2 years following a block trade. This confirms that management change at the highest level is likely to follow a block trade. Moreover, whether this change simply involves replacing the chief executive or chairman of the board, or whether it means changing the organizational form through a merger or tender offer, press reports suggest that it is the block purchaser who typically initiates the changes.

1.4. Negotiated Block Trades: Corporate Control Transactions

The empirical regularities presented in this section suggest that negotiated trades of large-percentage blocks of stock are corporate control transactions,

⁸Hermalin and Weisbach (1988) report that for a sample of 142 NYSE corporations director turnover averages approximately one per year per firm.

Table IV
Cumulative Survival Rate for Chief Executive Officers and Board Chairmen following Negotiated Trades of at Least 5% of the Common Stock of NYSE- or AMEX-Listed Corporations between 1978 and 1982

A chief executive or chairman is treated as surviving if he retains his position with the firm and the firm remains independent and publicly traded. Data from Standard and Poor's Register of Corporations, Directors and Executives.

	Year Following Block-Trade Announcement			
	1	2	3	4
Survival rate of both chief executive officer and chairman of the board (%)	36	26	24	21
Survival rate of chief executive officer (%)	41	30	29	27
Survival rate of chairman of the board (%)	44	35	32	25

even when the firm is not fully acquired following the trade. The abnormal stock-price increases, combined with the extensive post-trade managerial and board turnover, suggest that most of these blocks convey sufficient votes for the block purchaser to influence, if not determine, the composition of the top management team. Such power is seen as the essence of corporate control. Furthermore, although the literature often assumes that corporate control is predicated on majority ownership, our evidence suggests that blocks as small as 10–15% often convey significant corporate control.

Block trades are fundamentally different from the control transactions that have been the focus of most previous research. Jensen and Ruback (1983, p. 6) distinguish between control transactions in which relatively passive shareholders choose among offers for control of the corporation by competing management teams and control transactions in which “activist stockholders are the parties who (alone or in coalition with others) buy control of a company and hire and fire management to achieve a better resource utilization.” They point out that many control transactions—mergers, tender offers, going-private transactions, and proxy contests—are best viewed within the paradigm of competing management teams. Negotiated block trades, in contrast, are best viewed within the paradigm of the active investor.

2. Changes in Firm Value from Changing Blockholders

2.1. The Importance of a Blockholder's Expertise and Incentives

Researchers have begun to investigate the impact of concentrated stock ownership on firm value, focusing on how the fraction of stock held by top

managers affects their incentives to expend effort, resist takeover attempts, or consume perquisites. This focus reflects the influence of the agency literature and its emphasis on the incentive problems that arise when managers do not own the firm. The existing evidence suggests that the concentration of ownership has an important effect on corporate decisions and firm value [Jensen and Warner (1988)].

When a block trades, however, the concentration of ownership typically does not change. What changes is the identity of the blockholder and thus the specific expertise and incentives of a potentially important corporate-decision maker. Such a change can affect firm value in several ways. First, blockholders can have different managerial or monitoring skills. This will be important when blockholders are active managers or monitors, and the available evidence suggests they are.⁹ Second, corporate block purchasers can provide synergies in research and development and in production. Finally, different blockholders can have different incentives to increase firm value. For example, corporate blockholders can face different incentives than individual blockholders, and government or nonprofit blockholders can face different incentives than private-sector blockholders. In this section we investigate the proposition that the identity of blockholders, in addition to the concentration of ownership, affects firm value.

2.2. The Block-Trading Parties

Half of our block sellers and 79% of our block buyers are corporations.¹⁰ Approximately two-thirds of the corporate block buyers are in closely related businesses. Thus, synergies in production provide a potential explanation for the abnormal returns associated with some trades.

Among the 54 block sellers who are individuals, most were active in firm management. Twelve sellers were the company founder or members of the founder's family. Twenty-five additional sellers held the office of president, chief executive officer, or chairman of the board; seven others served as directors. Only ten of the sellers who were individuals do not appear to have held a formal position with the firm before the trade.

Even though institutions (such as banks and pension funds) hold approximately half of the outstanding common stock of NYSE and AMEX corporations, none of our block trading parties are institutions. This apparently reflects legal requirements that institutions diversify their investments and limit their percentage ownership of individual corporations.

Block purchasers tend to be active in corporate management. Their activities are summarized in Table V which represents a lower bound on such

⁹See, for example, Holderness and Sheehan (1988).

¹⁰Most of the results in this paper are not sensitive to whether the block trading parties are individuals or corporations. In contrast, Barclay and Holderness (1989) report that the pricing of large-percentage blocks is affected by whether block-trading partners are individuals or corporations.

Table V

**Summary of Corporate Activities of Block Purchasers and
Managerial Resistance to the Blockholders Associated with 106
Negotiated Block Trades of at Least 5% of the Common Stock of
NYSE- or AMEX-Listed Corporations between 1978 and 1982**

Information from *The Wall Street Journal*, Moodys, and Standard and Poor's Register of Corporations, Directors and Officers. Percentages in parentheses.

	Individual Block Purchasers (N = 22)	Corporate Block Purchasers (N = 84)	Entire Sample (N = 106)
Individual block purchaser becomes officer or director	15 (68)	NA	NA
Corporate block purchaser in related business	NA	55 (65)	NA
Block purchaser buys additional stock	5 (23)	25 (30)	30 (28)
Reports of managerial resistance to blockholder	5 (23)	29 (35)	34 (32)
Reorganization of firm			
Number of attempted reorganizations by block purchaser	6 (27)	45 (54)	51 (48)
Number successful	5 (23)	36 (43)	41 (39)
Number of attempted reorganizations by third party	5 (23)	9 (11)	14 (13)
Number successful	2 (9)	5 (6)	7 (7)
Firms with no indication of block purchaser activity or managerial resistance ^a	4	10	14

^aAn individual block purchaser does not become a director or an officer, a corporate block purchaser is not in a related business, the blockholder does not purchase additional stock after acquiring the block, management does not resist the block seller or the block purchaser, and there are no attempts to reorganize the firm.

activity because it incorporates only reports from *The Wall Street Journal*, Moody's, and Standard and Poor's Register of Corporations, Directors and Officers ("Standard and Poor's Register"). We expect a further downward bias because *The Wall Street Journal* follows large firms more closely than small firms, and many of our firms are small. Nevertheless, only 14 firms (13%) show no evidence of block purchaser involvement in corporate activity.

Fifteen of the individual blockholders (68%) become directors or officers.¹¹ Because Moody's and Standard and Poor's Register do not list the affiliations of directors and officers, we are unable to determine how often corporate block purchasers place their representatives on the board and in top managerial positions. None of the 106 purchasers sell any of their stock (other than selling the block intact), but 30 (28%) purchase additional shares. These 30 blockholders on average add 12% (median 8%) to their block purchases (which themselves average 21%, median 18%, with a maximum of 49%). Almost half of the block purchasers attempt to take over the firm within 2 years, and they succeed in 80% of these attempts. Takeover attempts by third parties succeed less often.

2.3. Block Purchasers' Role in Improving Management

Table V indicates that block purchasers are active in firm management. We now investigate the importance of these activities for firm value.

The Transfer of Control

To determine whether the increases in firm value generally associated with block trades depend on the block purchasers' efforts to improve management, we first partition our firms into two categories: those for which there is evidence that the block purchaser achieves control of the corporation, and those for which there is no evidence that the block purchaser achieves control, either because he does not seek it or because he is rebuffed by management. Thus, for example, if the block purchaser becomes an officer or if a corporate block purchaser announces a joint venture with the firm, we classify the blockholder as achieving control. If there is no mention in *The Wall Street Journal* of any blockholder activity, or if the blockholder attempts to replace management but is unsuccessful, we classify the blockholder as not achieving control. We limit our analysis to firms that are not taken over within a year of the trade.

Using this classification, Figure 2 reports the average cumulative abnormal returns from 240 days before through 240 days after the block-trade announcement. The stock returns are larger when the block purchaser achieves control. From day -40 through day +40, the 45 firms in which the block purchaser achieves control have average abnormal returns of 8.1% (p -value = 0.01), whereas the returns over the same interval for the 20 firms in which the block purchaser does not achieve control are only 0.4% (p -value = 0.97). From day -40 through day +240, the abnormal returns for the respective subsamples are 11.2% (p -value = 0.08) and -6.6% (p -value = 0.44). The p -values for the one-tailed test that the returns are

¹¹The seven individual block purchasers who do not become directors or officers either hold their blocks briefly or make their investment through a private foreign firm. In the latter case, it is difficult to identify a block purchaser's representative who may be serving as a director or an officer.

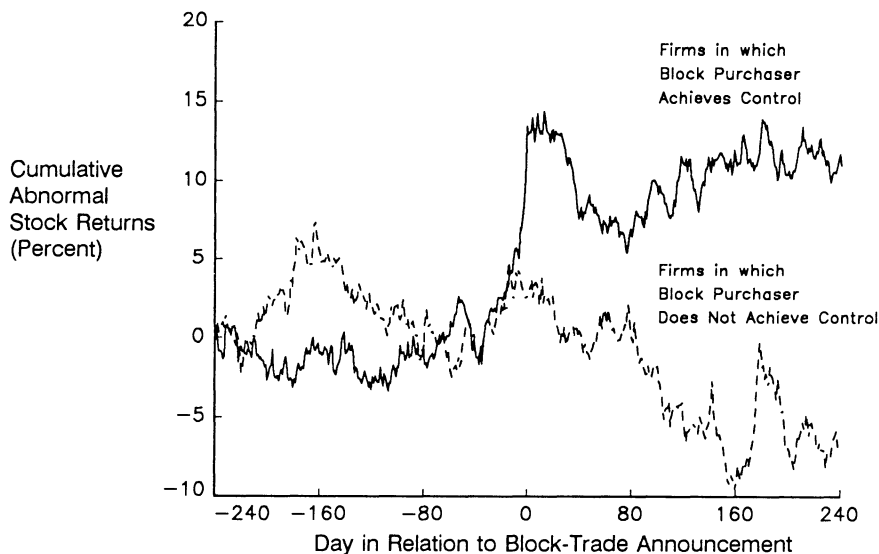


Figure 2. Cumulative abnormal stock returns associated with 65 negotiated block trades of at least 5% of the common stock of NYSE- or AMEX-listed corporations between 1978 and 1982. Day 0 is the initial public announcement of the block trade. There are 45 firms in which the blockholder achieves control and 20 firms in which the blockholder does not achieve control. All firms remain independent and publicly traded for at least a year after the trade.

larger for the firms in which the block purchaser achieves control are 0.13 for day -40 through day $+40$ and 0.07 for day -40 through day $+240$.¹²

Management Resistance

Although the results in Figure 2 are consistent with the hypothesis that much of the value created by block trades is related to the block purchasers' activities, incomplete news reports on post-trade corporate activities make it difficult in some cases to state conclusively that control has passed to the block purchaser. Accordingly, we also analyze the impact of managerial resistance to blockholders. If blockholders typically improve management, then resistance to them will reduce firm value. Conversely, if blockholders use their voting power primarily to extract corporate benefits to the exclusion of other shareholders, or if they are well-intended but incompetent monitors or managers, then resistance will increase firm value.

We identify managerial resistance to blockholders in 34 firms (32%). Five of these cases involve block sales to white knights following press reports of

¹²To control for other variables that might affect announcement-period returns, we regress the returns from day -40 through $+240$ on the percentage of the firm's common stock in the block and a dummy variable that indicates whether the block purchaser achieves control. The coefficient on the control dummy is 11.4%, although it is not statistically significant.

managerial resistance to changes proposed by the block seller. Twenty lawsuits are filed by management against a block purchaser. In other instances, management questions the block purchaser's ability or undertakes defensive restructurings. Five of the blocks are ultimately repurchased by the firm at a premium to the exchange price ("greenmail").

Because others have studied managerial resistance to takeovers, we limit our analysis to the 19 firms with management resistance to the blockholder and no announced takeover attempts in the year following a block trade.¹³ The 2-day average abnormal return at *The Wall Street Journal* announcement of this resistance is -1.5% (p -value = 0.06). These firms have average abnormal returns of 2.3% from day -40 through day $+40$ and -3.1% from day -40 through day $+240$ (neither is significantly different from zero). In contrast, the 46 firms for which there are no reports of managerial resistance have average abnormal returns of 7.1% from day -40 through $+40$ (p -value = 0.04) and 9.4% from day -40 through day $+240$ (p -value = 0.19). The p -values for the one-tailed test that the returns are larger for the firms in which there is no management resistance to the blockholder are 0.25 for day -40 through day $+40$ and 0.14 for day -40 through day $+240$.¹⁴

Events at Treadway Corporation following one of our block trades illustrate the efforts by block purchasers to influence firm management and the extent of management resistance. In November 1978 Care Corporation purchased a block that, together with stock previously acquired, gave it a 24% interest in Treadway. Initially, Care claimed the block "was for investment purposes only. We're both in the bowling business. We like [Treadway]."¹⁵ Several months later, however, Treadway announced that it had retained a New York City law firm "to protect the interests of our stockholders to the fullest" in connection with the block purchase by Care.¹⁶ Two weeks later Treadway filed suit against Care, alleging a "conspiracy to seize control of [Treadway]."¹⁷ The judge in the case issued, but shortly thereafter lifted, a temporary restraining order blocking Care from acquiring additional stock in

¹³Our evidence on managerial resistance to block purchasers' takeover attempts is similar to what has been documented for managerial resistance to takeovers in general: such resistance tends to harm shareholders. The 12 firms in which there is managerial resistance to an ultimately successful takeover have average abnormal returns of 16.5% from day -40 through day $+40$ and average abnormal returns of 23.6% from a day -40 through day $+240$. In contrast, the 36 firms for which there are no reports of managerial resistance to an ultimately successful takeover have average abnormal returns of 28.2% from day -40 through day $+40$ and 34.2% from day -40 through day $+240$. The four firms with managerial resistance and unsuccessful takeovers have average abnormal returns of 20.7% from day -40 through day $+40$ and 12.5% from day -40 through day $+240$.

¹⁴To control for other variables that might affect announcement-period returns, we regress the returns from day -40 through $+240$ on the percentage of the firm's common stock in the block and a dummy variable that indicates whether the management resisted the block purchaser. The coefficient on the resistance dummy is -8.2% , although it is not statistically significant.

¹⁵*The Wall Street Journal*, November 14, 1978, p. 3.

¹⁶*The Wall Street Journal*, September 13, 1979, p. 4.

¹⁷*The Wall Street Journal*, September 26, 1979, p. 21.

Treadway. For the following year there was extensive maneuvering by both sides over a slate of directors Care wanted to offer in a proxy contest. Among the steps taken by Treadway's management to resist Care was the private placement of a 25% block of stock (slightly larger than Care's 24%). Care narrowly lost the proxy contest, although initially a federal court awarded it the victory by invalidating the votes cast from the private placement. Finally, 2 years after the block trade, Treadway repurchased Care's block at a 38% premium to the exchange price.

Such resistance, some of which (as in Treadway) apparently prevents the blockholder from achieving control, confirms that some of our blocks do not convey control. Nevertheless, none of our blocks are broken up in the 5 years following a trade. This suggests that even when block purchasers fail to influence management initially, they deem it profitable to maintain the block intact and either wait for a change in circumstances that will make it easier to replace management, sell the block to someone more skilled in achieving corporate control, or sell the block back to the firm at a premium. In the five cases in which the insurgent's block is repurchased by the firm, and thus in a sense broken up, cumulative abnormal returns from the announcement of the trade to the announcement of the repurchase average -12.4% (p -value = 0.23).¹⁸ All five of these abnormal returns are negative.

Information Effects as an Alternative Explanation

An alternative to the hypothesis that a blockholder's identity has an important affect on firm value is that blockholders either are homogenous or have little impact on firm value. In either case, a change in blockholders per se would not affect firm value. The trade of a block, however, could lead to the positive abnormal returns documented in Section 1 if the trade reveals information that the firm is undervalued.

The block purchasers' extensive involvement in management (Table V) appears inconsistent with such a pure information hypothesis. Moreover, if the revelation of information were driving the stock-price changes and if the block-trading parties have better information about firm value than other market participants, then blocks that are priced at a discount to the exchange price should cause stock-price decreases, and blocks that are priced at a premium to the exchange price should cause stock-price increases. We do not find such patterns. Instead, the average announcement-period returns are positive whether the block trades at a premium or a discount, and the returns for the two subsamples are statistically indistinguishable.¹⁹ Thus, we

¹⁸The average number of trading days from the announcement of the block trade to the repurchase announcement is 219.

¹⁹Blocks that are priced at discounts to the exchange price (measured 2 trading days before the initial announcement of the trade) are associated with stock-price increases from day -10 to day 0 of 5.0% ($N = 16$, p -value = 0.33). Blocks that are priced at premiums are associated with stock-price increases from day -10 to day 0 of 10.5% ($N = 76$, p -value = 0.01). The number of observations in the two groups is less than the full sample size because the block-trade price is unavailable for 14 trades.

reject a pure information hypothesis as an explanation for the stock-price increases associated with block trades.

2.4. Block Trades and Dealing with Industry-Wide Declines

In many cases, the reasons for a block trade are apparent. For example, when the block buyer is a corporation in a closely related business, there can be synergies that did not exist with the block seller. In other cases, the potential benefits from changing blockholders are less apparent. Why, in particular, did the block seller not make the changes instituted by the block buyer? Although there are likely to be a variety of answers to this question, it appears that some of our trades occur because a new blockholder is better able to deal with the challenges of a declining industry.

The firms in our sample, whether they remain independent or are subsequently acquired, tend to be marginal performers in poorly performing industries. In the 3 years before the trade (event days -760 through -40), our sample firms have average cumulative abnormal returns of -41.5% (p -value = 0.001) when measured against the market,²⁰ and -8.4% (p -value = 0.18) when measured against the other firms within the same two-digit SIC industry classification.²¹ A similar pattern emerges when the sample is partitioned into those firms that remain independent following a trade and those that are acquired within a year. The firms that remain independent have pretrade market-adjusted returns of -44.1% (p -value = 0.001) and industry-adjusted returns of -7.6% (p -value = 0.347); the firms that are subsequently acquired have pre-trade market-adjusted returns of -37.5% (p -value = 0.001) and industry-adjusted returns of -9.6% (p -value = 0.332).²² Accounting-based returns paint a similar picture. For example, firms that are not acquired have an industry-adjusted average return on assets of -11.4% in the 3 years before the trade; those firms that are subsequently acquired have industry-adjusted average returns of -19.9% .²³

Morck, Shleifer, and Vishny (1989) similarly find that targets of hostile takeover attempts tend to be marginal performers in poorly performing industries. They speculate that existing management has difficulty dealing with industry-wide declines and that outsiders find it easier to make the extensive changes often called for in troubled industries. Our evidence suggests that the same rationale may also explain a number of block trades.

²⁰This is the firm's return minus the equally weighted return of all NYSE- and AMEX-listed firms.

²¹Seventy-one percent of the firms have negative market-adjusted returns over this period (p -value of the binomial probability test = 0.001); 57% have negative industry-adjusted returns (p -value of the binomial probability test = 0.16).

²²Differences between the samples are not statistically significant.

²³Accounting returns are measured as earnings before interest and taxes (not including extraordinary items) divided by the book value of total assets. We then subtract the median return for all firms in the same two-digit SIC industry classification to adjust for industry wide effects.

3. Conclusion

This paper offers two primary contributions. First, we identify negotiated trades of large-percentage blocks of stock as corporate control events, even when the trades do not lead to the full acquisition of the firm. Second, we document that the specific skills and incentives of large-block shareholders, and not just the concentration of ownership, affect firm value. Firm value typically increases with a block trade even though in most instances the block purchaser has the same fractional ownership as the block seller. We attribute this increase in firm value at least in part to the specific skills and incentives of the block purchaser.

Negotiated trades of large-percentage blocks of stock are significant control events for the firms whose shares are traded. Our analysis of 106 negotiated trades involving at least 5% of the common stock of NYSE- and AMEX-listed corporations shows that these trades are associated with average abnormal stock-price increases of 16.5%. The stock-price increases are larger when the block purchaser eventually acquires the minority's interest; but, even when a firm remains independent, cumulative abnormal stock returns average 5.6% a year after the trade. The trades are generally followed by significant change within the corporation. Most strikingly, in the firms that remain public (60% of our sample), turnover among top managers is far higher than normal for public corporations: 33% of the firms replace their chief executives within a year. Turnover among other members of the top management team is even more pronounced. Although we find that corporate control increases with fractional ownership, trades of blocks as small as 10–15% are often associated with abnormal stock-price increases and extensive managerial turnover.

Most block purchasers are active in firm management, sometimes directly, through service as officers and directors, sometimes less directly, through negotiations with management. Stock-price increases are larger when control passes to the block purchaser. In contrast, when the blockholder fails to achieve control or is resisted by management, firm value declines. These findings suggest the possibility that the block investor is often the key manager, and other members of the top management team play a different, and perhaps less important, role than in diffusely held firms.

Because potential blockholders have different managerial and monitoring skills, recent antitakeover laws and corporate charter amendments that impede block purchasers from exercising their management rights take on added importance. Following our sampling period, most states and many corporations have enacted provisions that prevent acquirers of large-percentage blocks from voting their shares until approved by other shareholders. If block purchasers are not approved, it is unlikely that firm value will increase, as such increases seem to depend on block purchasers using their voting power to institute management changes.

Large gains from block trades, and certainly the largest on average for minority shareholders, come when a block purchaser acquires the remaining

shares. Some of the recent antitakeover laws and charter amendments dictate that an individual or corporation can accumulate or purchase a large-percentage block of stock but cannot acquire the remaining shares for a specified period (3 years under Delaware law). Our results indicate that delaying the acquisition of a firm by a blockholder is likely to reduce the wealth of minority shareholders.

In summary, our evidence on negotiated block trades confirms a growing body of evidence that firm value is not independent of who owns the firm. Firm value increases when large-block ownership is transferred, apparently to those with more valuable managerial and monitoring skills. Thus, the modern public corporation is like any other asset in that its value depends in part on the skills of its owners.

REFERENCES

- Barclay, Michael J. and Clifford G. Holderness, 1989, Private benefits from control of public corporations, *Journal of Financial Economics* 25, 371–395.
- Brickley, James A., Ronald C. Lease, and Clifford W. Smith, Jr., 1988, Ownership structure and voting on antitakeover amendments, *Journal of Financial Economics* 20, 267–291.
- Comment, Robert, 1985, The effects of firm-specific human capital on management equity investment and turnover, Unpublished manuscript, University of Michigan, Ann Arbor, MI.
- DeAngelo, Harry and Linda DeAngelo, 1989, Proxy contests and the governance of publicly held corporations, *Journal of Financial Economics* 23, 29–59.
- Demsetz, Harold and Kenneth Lehn, 1985, The structure of corporate ownership: Causes and consequences, *Journal of Political Economy* 93, 1155–1177.
- Hermalin, Benjamin and Michael Weisbach, 1988, The determinants of board composition, *Rand Journal of Economics* 19, 589–606.
- Holderness, Clifford G. and Dennis P. Sheehan, 1985, Raiders or saviors? The evidence on six controversial investors, *Journal of Financial Economics* 14, 555–579.
- and Dennis P. Sheehan, 1988, The role of majority shareholders in publicly held corporations: An exploratory analysis, *Journal of Financial Economics* 20, 317–346.
- Holthausen, Robert W., Richard Leftwich, and David Mayers, 1987, The effect of large block transactions on security prices: A cross-sectional analysis, *Journal of Financial Economics* 19, 237–268.
- Jensen, Michael C. and Richard S. Ruback, 1983, The market for corporate control: The scientific evidence, *Journal of Financial Economics* 11, 5–50.
- and Jerold B. Warner, 1988, The distribution of power among corporate managers, shareholders, and directors, *Journal of Financial Economics* 20, 3–24.
- Martin, Kenneth J. and John J. McConnell, 1989, Corporate performance, corporate takeovers, and management turnover, Unpublished manuscript, Purdue University, West Lafayette, IN.
- Morck, Randall, Andrei Shleifer, and Robert W. Vishny, 1988, Management ownership and market valuation: An empirical analysis, *Journal of Financial Economics* 20, 293–315.
- , Andrei Shleifer, and Robert W. Vishny, 1989, Alternative mechanisms for corporate control, *American Economic Review* 79, 842–852.
- Reinganum, Marc R., 1985, The effect of executive succession on stockholder wealth, *Administrative Science Quarterly* 30, 46–60.
- Warner, Jerold B., Ross L. Watts, and Karen H. Wruck, 1988, Stock prices and top management changes, *Journal of Financial Economics* 20, 461–492.
- W. T. Grimm & Company, 1987, *Mergerstat Review* (W. T. Grimm & Co., Chicago, IL).