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## Private Benefits of Control: An International Comparison

ALEXANDER DYCK and LUIGI ZINGALES\*

### ABSTRACT

We estimate private benefits of control in 39 countries using 393 controlling blocks sales. On average the value of control is 14 percent, but in some countries can be as low as  $-4$  percent, in others as high as  $+65$  percent. As predicted by theory, higher private benefits of control are associated with less developed capital markets, more concentrated ownership, and more privately negotiated privatizations. We also analyze what institutions are most important in curbing private benefits. We find evidence for both legal and extra-legal mechanisms. In a multivariate analysis, however, media pressure and tax enforcement seem to be the dominating factors.

THE BENEFITS OF CONTROL OVER corporate resources play a central role in modern thinking about finance and corporate governance. From a modeling device (Grossman and Hart (1980)) the idea of private benefits of control has become a centerpiece of the recent literature in corporate finance, both theoretical and empirical. In fact, the main focus of the literature on investor protection and its role in the development of financial markets (La Porta, Lopez-de-Salines, and Shleifer (2000)) is on the amount of private benefits that controlling shareholders extract from companies they run.

In spite of the importance of this concept, there are remarkably few estimates of how big these private benefits are, even fewer attempts to document empirically what determines their size, and no *direct* evidence of their impact on financial development. All of the evidence on this latter point is *indirect*, based on the (reasonable) assumption that better protection of minority shareholders is correlated with higher financial development via its curbing of private benefits of control (La Porta et al. (1997)).

The lack of evidence is no accident. By their very nature, private benefits of control are difficult to observe and even more difficult to quantify in a reliable

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way. A controlling party can appropriate value for himself only when this value is not verifiable (i.e., provable in court). If it were, it would be relatively easy for noncontrolling shareholders to stop him from appropriating it. Thus, private benefits of control are intrinsically difficult to measure.

Two methods have been used in attempting to quantify them. The first one, pioneered by Barclay and Holderness (1989), focuses on privately negotiated transfers of controlling blocks in publicly traded companies. The price per share an acquirer pays for the controlling block reflects the cash flow benefits from his fractional ownership and the private benefits stemming from his controlling position in the firm. By contrast, the market price of a share after the change in control is announced reflects only the cash flow benefits noncontrolling shareholders expect to receive under the new management. Hence, as Barclay and Holderness have argued, the difference between the price per share paid by the acquiring party and the price per share prevailing on the market reflects the differential payoff accruing to the controlling shareholder. In fact, after an adjustment, this difference can be used as a measure of the private benefits of control accruing to the controlling shareholder.

The second method relies on the existence of companies with multiple classes of stock with differential voting rights. In this case, one can easily compute the market value of a vote (Lease, McConnell, and Mikkelsen (1983, 1984), DeAngelo and DeAngelo (1985), Rydqvist (1987)). On a normal trading day market transactions take place between noncontrolling parties who will never have direct access to the private benefits of control. Hence, the market value of a vote reflects the expected price a generic shareholder will receive in case of a control contest. This in turn is related to the magnitude of the private benefits of control. Thus, if one is willing to make some assumptions on the probability a control contest will arise, the price of a voting right can be used to estimate the magnitude of the private benefits of control (Zingales (1994, 1995a)).

In this paper we use the Barclay and Holderness (1989) method to infer the value of private benefits of control in a large (39) cross section of countries. Based on 393 control transactions between 1990 and 2000 we find that on average corporate control is worth 14 percent of the equity value of a firm, ranging from a -4 percent in Japan to a +65 percent in Brazil. Interestingly, the premium paid for control is higher when the buyer comes from a country that protects investors less (and thus is more willing or able to extract private benefits). This and other evidence suggest that our estimates capture the effect the institutional environment has on private benefits of control.

Given the large number of transactions from countries with different levels of financial development in our data set, we are able to provide a direct test of several theoretical propositions on the effects private benefits of control have on the development of financial markets. Theory predicts that where private benefits of control are larger, entrepreneurs should be more reluctant to go public (Zingales (1995b)) and more likely to retain control when they do go public (Zingales (1995b) and Bebchuk (1999)). In addition, where private benefits of control are larger a revenue maximizing Government should be more likely

to sell a firm through a private sale than through a share offering (Zingales (1995b) and Dyck (2001)).

We find strong evidence in support of all these predictions. A one standard deviation increase in the size of the private benefits is associated with a 67 percent reduction in the ratio of external market capitalization of equity to GNP, an 11 percent reduction in the percentage of equity held by noncontrolling shareholders, and a 36 percent increase in the number of privatized companies sold in private negotiations rather than through public listings. This evidence gives support to the prominent role private benefits have come to play in corporate finance.

While the existence of private benefits is not necessarily bad, their negative effect on the development of security markets raises the question of what affects their average size across countries. Thus far, the literature has emphasized the law as the primary mechanism to curb private benefits by giving investors leverage over controlling shareholders. The right to sue management, for instance, limits the discretionary power of management and, with it, the ability to extract private benefits (Zingales (1995a)) and so does any right attributed to minority shareholders (La Porta et al. (1997)). A common law legal origin is similarly argued to constrain management by lowering the standard of proof in legal suits and increasing the scope of management decisions subject to judicial review (Johnson et al. (2000)). Consistent with this literature, we analyze the effect the law has on the size of private benefits.

Besides the law, we also consider extra-legal institutions, which have been mentioned in the literature as possible curbs for private benefits: competition, labor pressures, and moral norms. To these well-known mechanisms we add two: public opinion pressure and corporate tax enforcement. Reputation is a powerful source of discipline, and being ashamed in the press might be a powerful deterrent (Zingales (2000)), especially where the press is more diffused. Similarly, effective tax enforcement can prevent some transactions (such as below market transfer prices) that expropriate minority shareholders. We find that a high level of diffusion of the press, a high rate of tax compliance, and a high degree of product market competition are associated with lower private benefits of control.

Given the noisiness of the proxies used and the paucity of degrees of freedom, it is impossible to establish reliably which factor is more important. That in a multivariate analysis newspapers' circulation and tax compliance are most important suggests these extra legal mechanisms deserve further study.

Our paper complements and expands the existing work in this area that focuses on the voting premia such as Zingales (1998), who assembles estimates of the voting premium across seven countries, and Nenova (2001a), who uses the price of differential voting shares in 18 countries. We complement the existing work by providing an alternative estimate of the private benefits of control, available for a broader cross section of countries. While in a few cases our estimates differ from Nenova's (she finds that both Brazil and Australia have a ratio of value of control to value of equity equal to 0.23, while we find only 0.02 for Australia and 0.65 for Brazil), overall our estimates are remarkably

similar. Moreover, we are able to understand the differences between the two sets of estimates in terms of a sample selection bias present in estimates based on differential voting shares. These findings give confidence that the extraction of private benefits is a real phenomenon, which can be consistently estimated.

Our paper also expands the existing work. The estimates for 39 countries allow us to test several theoretical propositions on the effects private benefits of control have on the development of financial markets. Our large sample of countries and their institutional variation enable us to test alternative theories of the major factors driving the magnitude of private benefits of control and to identify some new ones.

The rest of the paper proceeds as follows. Section I discusses how the measure developed by Barclay and Holderness (1989) relates to the magnitude of the private benefits of control. Section II describes the data used and presents our estimates. Section III uses these estimates to test several theoretical predictions regarding the effects private benefits of control have on the development of markets. Section IV analyzes the correlation between the magnitude of the private benefits of control and the various institutional characteristics. Section V discusses our findings and concludes.

## **I. Theoretical Framework**

### *A. What Are Private Benefits of Control?*

The theoretical literature often identifies private benefits of control as the “psychic” value some shareholders attribute simply to being in control (e.g., Harris and Raviv (1988) and Aghion and Bolton (1992)). Although this is certainly a factor in some cases, it is hard to justify multimillion dollar premia with the pure pleasure of command. Another traditional source of private benefits of control is the perquisites enjoyed by top executives (Jensen and Meckling (1976)).

The use of a company’s money to pay for perquisites is the most visible but not the most important way in which corporate resources can be used to the sole (or main) advantage of the controlling party. If the law does not effectively prevent it, corporate resources can be appropriated by the large shareholder through outright theft. Fortunately such activities, while documented in a few cases, are generally rare.

Nevertheless, there are several reasons why more moderate versions of these strategies might be more pervasive. Educated economists can legitimately disagree on what is the “fair” transfer price of a certain asset or product. As a result, small deviations from the “fair” transfer price might be difficult or impossible to prove in court. If these small deviations are applied to large volume trade, however, they can easily generate sizeable private benefits. Similarly, it is easy to disagree over who is the best provider of an asset or product when the relationship might involve considerations of quality and price.

Or consider the value of the information a corporate executive acquires thanks to his or her role in the company. Some of this information pertains directly to

the company's business while some reflects potential opportunities in other more or less related areas. It is fairly easy for a controlling shareholder to choose to exploit these opportunities through another company he or she owns or is associated with, with no advantage for the remaining shareholders. The net present value of these opportunities represents a private benefit of control.

The common feature of all the above examples is that some value, whatever the source, is not shared among all the shareholders in proportion of the shares owned, but it is enjoyed exclusively by the party in control. Hence, the name private benefits of control.

Control does not only confer benefits: sometimes it involves costs as well. Maintaining a controlling block, for instance, forces the largest shareholder to be not well diversified. As a result, it might value the controlling block less. At the same time, a fledging company might inflict a loss in reputation to the controlling party and, in some extreme cases, even some legal liabilities. For this reason we do not necessarily expect all our estimates to be always positive. In particular, we expect a higher frequency of negative value of control for financially distressed companies (see also Barclay and Holderness (1989)).

Note that the existence of private benefits of control is not necessarily inefficient. First of all, private benefits might be the most efficient way for the company to capture some of the value created. Imagine, for instance, that a corporate executive acquires valuable information about investment opportunities in other lines of businesses, which the company cannot or does not want to pursue. The executive could sell this information in the interest of shareholders. But the price she will be able to fetch is probably very low. Thus, it might be efficient that the executive exploits this opportunity on her own. Second, even if the *extraction* of private benefits generates some inefficiency, their *existence* might be socially beneficial, because their presence makes value-enhancing takeovers possible (Grossman and Hart (1980)).

Given the difficulties in distinguishing whether private benefits are socially costly, consistently in this analysis we shy away from any welfare consideration. Even the implications of the effects of private benefits on the development of security markets should be interpreted as a positive statement, not a normative one. In fact, in at least one of the models from where these implications are derived (Zingales (1995b)), the level of private benefits has no efficiency consequences, but only distributional ones.<sup>1</sup>

### *B. How to Measure Private Benefits?*

Unfortunately, it is very difficult to measure the private benefits directly. Psychic values are intrinsically difficult to quantify, as is the amount of resources captured by the controlling shareholder to her own benefit. As argued above, a controlling party will find it possible to extract corporate resources to his or her benefit only when it is difficult or impossible to prove that this is the case. In

<sup>1</sup> Bebchuk and Jolls (1999) discuss additional issues associated with a welfare evaluation of private benefits.

other words, if private benefits of control were easily quantifiable, then those benefits would not be private (accruing only to the control group) any longer because outside shareholders would claim them in court.

Nevertheless, there are two methods to try to assess empirically the magnitude of these private benefits of control. The first one, pioneered by Barclay and Holderness (1989), is simple. Whenever a control block changes hands, they measure the difference between the price per share paid by the acquirer and the price quoted in the market the day after the sale's announcement. As we will show momentarily, this difference (which we shall call the control premium) represents an estimate of private benefits of control enjoyed by the controlling party.

The second method of estimating the value of private benefits of control uses the price difference between two classes of stock, with similar or identical dividend rights, but different voting rights. If control is valuable, then corporate votes, which allocate control, should be valuable as well. How valuable? It depends on how decisive some votes are in allocating control and how valuable control is. If one can find a reasonable proxy for the strategic value of votes in winning control—for example in forming a winning coalition block—then one can infer the value of control from the relationship between the market price of the votes and their strategic role. This is the strategy followed by Rydqvist (1987), Zingales (1994, 1995a), and Nenova (2001a).

Both methods suffer from a common bias: They capture only the common value component of private benefits. If an incumbent enjoys a psychic benefit from running the family company, this value is unlikely to be shared by any other potential buyer and hence is unlikely to be reflected into the value of a controlling block when this changes hands (and hence in the value of a voting right). If, as it is likely, psychic benefits are more idiosyncratic to the controlling shareholder, then companies with large nonmonetary private benefits are less likely to change hands (it is more difficult to find somebody that values control more than the incumbent) and when they do, they are likely to exhibit lower control premia.<sup>2</sup> Hence, both methods tend to underestimate the value of control, and more so in countries where the major source of private benefits is nonpecuniary.<sup>3</sup>

Besides this bias, both methods have pluses and minuses. The estimates obtained using the control premia method are relatively model free (albeit, see Section II.C. below). If we are careful in isolating only the transactions that transfer control, we do not have to worry about the proper model of how private benefits will be shared among different parties and what is the probability of a takeover (e.g., Nicodano and Sembenelli (2001)). On the other hand, sales of controlling blocks are relatively rare and might not occur randomly over time. Furthermore, any systematic overpayment or any delay in incorporating

<sup>2</sup> The reason why a superior voting share trades at a premium is that its holder expects to receive a differential premium (see Zingales (1995b)). Hence, if a potential buyer is not willing to pay any more for control, the premium disappears.

<sup>3</sup> We thank the referee for pointing out this bias.

public information can bias the estimates (a problem we will deal with in Section III.E.).

Estimates obtained using dual class shares are often based on many firms and therefore are less likely to be driven by outliers. On the other hand, dual class shares are not allowed in every country. Hence, the second method limits the number of countries that can be included in the study. More importantly, the proportion of dual class companies differs widely across countries. Hence, the estimates obtained using the second method represent a differently selected universe of companies in each country. In any case, given the importance of private benefits in our understanding of corporate finance, it makes sense to explore both approaches. Nenova (2001a) has followed the voting rights approach while we use control premia.

### C. Theoretical Relation between Control Premium and Size of the Private Benefits of Control

An implicit assumption in the Barclay and Holderness (1989) approach for estimating private benefits is that the sale price reflects the buyers' willingness to pay. However, as Nicodano and Sembenelli (2001) point out, if there is imperfect competition in the market for controlling blocks, the Barclay and Holderness approach can misestimate private benefits. We illustrate this point with a simple bargaining model.

Let  $\lambda$ , on the interval  $[0, 1]$ , be the bargaining power of the controlling shareholder selling out,  $B_{s,b}$  the level of private benefits extracted by the seller (buyer), and  $Y_{s,b}$  the level of security benefits generated by the seller (buyer), then the price  $P$  paid for a controlling block of shares with  $\alpha$  cash flow rights, on the interval  $[0, 1]$ , is

$$P = \lambda(B_b + \alpha Y_b) + (1 - \lambda)(B_s + \alpha Y_s) \quad (1)$$

and the per share price of the controlling block equals

$$\frac{P}{\alpha} = \frac{\lambda B_b + (1 - \lambda)B_s}{\alpha} + \lambda Y_b + (1 - \lambda)Y_s. \quad (2)$$

To compute the control premium, Barclay and Holderness (1989) subtract from equation (2) the price prevailing in the market after the announcement that control has changed hands, which should equal to  $Y_b$ . Thus, they obtain

$$\frac{\lambda B_b + (1 - \lambda)B_s}{\alpha} - (1 - \lambda)(Y_b - Y_s). \quad (3)$$

They then multiply this price difference by the size of the controlling block  $\alpha$ . Hence, their estimate of private benefits of control  $\hat{B}$  is

$$\hat{B} = \lambda B_b + (1 - \lambda)B_s - \alpha(1 - \lambda)(Y_b - Y_s). \quad (4)$$

In a perfectly competitive market ( $\lambda = 1$ ),  $\hat{B}$  collapses to  $B_b$  and thus the control premium is a legitimate estimate of the private benefits of control the buyer expects to enjoy. When the market is not perfectly competitive, but the security value is the same for the buyer and the seller ( $Y_b = Y_s$ ),  $\hat{B}$  is still a legitimate estimate of the private benefits of control, albeit this time it represents a weighted average of the private benefits of the seller and those of the buyer.

The problem arises when the security values are different ( $Y_b \neq Y_s$ ). By subtracting the price after the announcement from the per share price paid for the controlling block (the step from equation (2) to equation (3) above), Barclay and Holderness implicitly assume that the seller is able to capture the full value of the security benefits produced by the buyer. When this is not true,  $\hat{B}$  misestimates the average value of private benefits, where the extent of this bias is represented by the term  $\alpha(1 - \lambda)(Y_b - Y_s)$ .

To understand this bias, consider the other extreme case, where the buyer has all the bargaining power, ( $\lambda = 0$ ). In this case,  $\hat{B}$  collapses to  $B_s - \alpha(Y_b - Y_s)$ . Intuitively, the sale price of the controlling block does not reflect the differential ability of the new buyer to create security benefits, while the price on the exchange does reflect this ability. Hence,  $\hat{B}$  misestimates the value of private benefits by the difference in security value times the amount of security value contained in the controlling block ( $\alpha$ ). Since the magnitude of this bias is zero if  $\lambda = 1$  and  $B - \alpha(Y_b - Y_s)$  when  $\lambda = 0$ , in general it is  $\alpha(1 - \lambda)(Y_b - Y_s)$ . All the terms in this bias, except for the bargaining power of the seller, are observable. Hence, if we can estimate  $\lambda$ , we can adjust our estimates.

## II. Data and Descriptive Statistics

An example motivates our sample selection strategy and definition of our dependent variable. In January 1999 Ofer Brothers Investment Limited, an investment vehicle for Sami and Yuli Ofer of Israel, bought 53 percent of the shares and control of Israel Corporation Limited from the Eisenberg family. The price per share for the control block was reported to be 508 shekels per share while the exchange price after announcement of the transfer was 363 shekels per share. The price premium paid per share for the controlling block over the postannouncement price in this case is 40 percent. A better measure of the value of the private benefits of control is the total premium paid divided by the equity value of the firm. In this example, the Ofer brothers paid a 40 percent premium relative to the postannouncement price for 53 percent of the firms' equity, which produces an estimate of private benefits as a percentage of equity of 21 percent. This example turns out to be fairly typical of Israeli deals where we calculate a mean private benefit as a percentage of equity of 27 percent and a median value of 21 percent.

As suggested by this example, to construct a measure of private benefits, we need to identify transactions that meet at least three criteria. First, the transaction must involve a transfer of a block of shares that convey control rights. Second, we need to observe the price per share for the control block. Third, we have to observe the exchange price after the market has incorporated the

identity of the new acquirer in its expectation of future cash flow. We also add a fourth criterion, implicit in this choice of an Israeli deal—both the control and the postannouncement market prices should not be restricted by regulation. Many countries do not follow the Israeli (and U.S.) approach of allowing buyers and sellers to determine their own prices but impose some link between the exchange and the control price. As we will explain, we will eliminate all these cases from our sample.

### *A. Identifying Transactions*

To identify transactions that convey control rights we use the SDC international mergers and acquisitions database. SDC describes its sources as: “Over 200 English and foreign language news sources, SEC filings and their international counterparts, trade publications, wires and proprietary surveys of investment banks, law firms, and other advisors.” The database provides extensive information on transactions that involve transfers of blocks of shares that may convey control, including details of the parties to the transaction, the value of the transaction, and the date of announcement and conclusion of the transaction. SDC provides extensive international coverage with 7,144 transactions in 1990 (including 396 transactions from non-OECD countries) and steadily increasing numbers over the decade, including 21,881 transactions in 1999 (including 3,300 from non-OECD countries).

To identify candidates for control sales, we began with the complete set of control transactions in publicly traded companies during the period 1990 to 2000. We then restricted our attention to completed purchases of blocks larger than or equal to 10 percent of the stock.<sup>4</sup> Since we wanted transactions that conveyed control, we further restricted our attention to transactions that result in the acquirers moving from a position where they hold less than 20 percent of the shares to a position where they have assembled more than 20 percent of the shares. We exclude all transactions that were conducted through open market purchases and were identified by SDC as tender offers, spinoffs, recapitalizations, self-tenders, exchange offers, repurchases, and acquisitions of remaining interest. We further restricted ourselves to transactions where there was a reported transaction value or price per share in the control block.

We refined our sample by exploiting additional available qualitative data to screen out transactions that do not involve control transfers (e.g., transfer of shares among subsidiaries of common parent, where acquirer is not the largest shareholder) or were problematic for other reasons (e.g., involved related parties, reported price per share based on securities that could not be valued objectively, transfer involved the exercise of options). This step involved reading multiple news stories for every transaction resulting from searches of Lexis-Nexis and Dow-Jones Interactive to confirm the details of the transaction

<sup>4</sup> We have also explored the robustness of our results if we were to further restrict this criterion and exclude deals where block is less than 15 percent. The results are unchanged although we lose some countries as a result of a lack of observations.

collected by SDC and collecting ownership information through use of company annual reports and other sources. This process significantly increased our confidence in the observations included in the data set, but inevitably involved greater use of discretion in determining whether an observation was included in our data set.

To ensure the availability of exchange prices, we restricted ourselves to transactions involving companies available in the Datastream International database. To implement the criterion that the difference between the control price and the exchange price not be driven by legal requirements, we excluded observations driven by legal requirements. We first excluded all instances where the controlling block was purchased as part of a public offer, as in this circumstance there are usually laws that require all shareholders be treated equally. We researched rules regarding mandatory tender offers across different countries and only include transactions where there is no forced linkage between prices for the control block and prices on the exchange. For example, in Britain where the city code on takeovers requires that those who purchase a stake greater than or equal to 30 percent of the shares make an equal offer to all remaining shareholders on the same terms as the block sale, we restrict our attention to block sales less than 30 percent. As an illustration of the importance of this legal threshold, more than one quarter of our observations in Britain are between 29 and 30 percent, with a median block size of 25 percent.

Finally, we eliminated all transactions where there are ex ante or ex post indications (in SDC synopsis, news stories, or Datastream) of a tender offer for the remaining stock in the six months following the announcement. This criterion, also used by Barclay and Holderness (1989), is meant to eliminate events where the expectation of a tender offer distorts the value of minority shares.

Table I summarizes our variable definitions and sources. The data appendix provides a more complete description of the construction of our sample. Appendix Table AI lists countries and rules regarding control transactions. Appendix Table AII lists the number of equities available for Datastream in each sample year from each of our countries.

### *B. Descriptive Statistics of the Raw Control Premium*

Table II presents descriptive statistics of the block premia from our sample by country in which the acquired firm is located. After imposing our criteria, we have an unbalanced panel of 393 observations from 39 countries for the time period 1990 to 2000.<sup>5</sup> The sample includes more than 40 observations from active equity markets such as the United Kingdom and the United States. For

<sup>5</sup> We only include countries in our analysis if there were two or more transactions over our sample period. The final sample is based on all of the data available over the 10-year sample period for every country aside from the U.S. For the U.S., there were many more potential observations and we limited ourselves to an initial sample based on the first 20 transactions for each calendar year over our 10-year sample period that met our sample selection criteria.

**Table I**  
**Description of Variables**

| Variable                                            | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|-----------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Block premia as a percentage of the value of equity | The block premia are computed as the difference between the price per share paid for the control block and the price on the Exchange two days after the announcement of the control transaction, divided by the price on the Exchange after the announcement and multiplied by the proportion of cash flow rights represented in the controlling block. Securities Data Corporation, Datastream International, 20-Fs, Company annual reports, Lexis-Nexis, Dow-Jones interactive, various country sources including ISI Emerging markets and country company yearbooks. |
| The change in security value                        | The difference between the security value of the buyer (market price at $t + 2$ ) and of the seller (market price at $t - 30$ ) normalized by the market price at $t + 2$ . We subtract from this amount the percentage difference in the level of the market index over the same time period (between date $t + 2$ and $t - 30$ normalized by the level of the index at date $t + 2$ ). Datastream International.                                                                                                                                                      |
| Majority block                                      | A dummy variable that takes the value one if the control block includes 50 percent of all shares or 50 percent of all voting shares. Securities Data Corporation, 20-Fs, Company annual reports, Lexis-Nexis, Dow-Jones interactive, various country sources including ISI Emerging markets and country company yearbooks.                                                                                                                                                                                                                                              |
| Another large shareholder                           | A dummy variable that takes the value one if there is another shareholder with a stake in excess of 20 percent after the block sale. Securities Data Corporation, Company annual reports, Lexis-Nexis, Dow-Jones interactive, various country sources including ISI Emerging markets and country company yearbooks.                                                                                                                                                                                                                                                     |
| Financial distress                                  | A dummy variable that takes the value one if earnings per share in the target are zero or negative in the year of the block trade or the year preceding the block trade. Datastream International.                                                                                                                                                                                                                                                                                                                                                                      |
| Seller identity                                     | Dummy variables to identify seller identity. Includes dummies for individual seller, the company itself (through new share issues), a corporate entity, or unknown. A corporate entity is the most prevalent category and is the excluded category. Securities Data Corporation, Company annual reports, Lexis-Nexis, Dow-Jones interactive, various country sources including ISI Emerging markets and country company yearbooks.                                                                                                                                      |
| Foreign acquirer                                    | A dummy variable that takes the value one if the acquirer is from a different country than the target. Where acquirer is unknown, assume acquirer is from same country as target. Securities Data Corporation.                                                                                                                                                                                                                                                                                                                                                          |
| Acquirer identity                                   | Dummy variables to identify if the acquirer is a public company, subsidiary, the government, or a private company. A public company is the most prevalent group and is the excluded category. Securities Data Corporation.                                                                                                                                                                                                                                                                                                                                              |
| Cross listed                                        | Dummy variable that takes the value one if the company's stock is listed in the United States either on an exchange, on Portal under rule 144A, or as an over-the-counter listing. Data provided by Andrew Karolyi based on Citibank Universal Issuance Guide.                                                                                                                                                                                                                                                                                                          |

**Table I—Continued**

| Variable                                        | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|-------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Industry type                                   | Dummy variables that indicate the acquired companies industrial type (two digit SIC). Manufacturing is the most prevalent group and is the excluded category. Securities Data Corporation, Global Access.<br>Agriculture, forestry, & fishing (01–09)<br>Mining (10–14)<br>Construction (15–17)<br>Manufacturing (20–39)<br>Transportation & pub. utilities (40–49)<br>Wholesale trade (50–51)<br>Retail trade (52–59)<br>Finance, insurance, & real estate (60–67)<br>Services (70–89)                                                                                                                                                                         |
| Tangibility of assets                           | The median value of the percentage of total assets that are fixed for U.S. firms in the same three digit SIC code as the acquired firm. Securities Data Corporation, Standard and Poor's Research Insight (COMPUSTAT)                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| Stock market synchronicity                      | As a measure of valuation uncertainty we use the average $R^2$ of firm-level regressions of bi-weekly stock returns on local and U.S. market indexes in each country in 1995. Returns include dividends and are trimmed at 25 percent. Higher levels indicate that stocks are more likely to move together. Morck et al. (2000).                                                                                                                                                                                                                                                                                                                                |
| Control premia based on voting/nonvoting shares | "Control benefits based on a sample of 661 dual-class firms in 18 countries using data for 1997. Control benefits are extracted from the total value of the votes in the control block, based on a baseline control contest model in the case of a dual class firm," Nenova (2001a). Nenova (2001a).                                                                                                                                                                                                                                                                                                                                                            |
| Log GDP per capita                              | Average log GDP per capita 1970 to 1995. World Bank.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| Ownership concentration                         | "The average percentage of common shares owned by the three largest shareholders in the 10 largest nonfinancial, privately owned domestic firms in a given country. A firm is considered privately owned if the state is not a known shareholder in it." La Porta et al. (1998). La Porta et al. (1998), derived from: Moodys International, CIFAR, EXTEL, Worldscope, 20-F's, Price-Waterhouse, and various country sources.                                                                                                                                                                                                                                   |
| Initial public offerings/population             | "Ratio of the number of initial public offerings of equity in a given country to its population (in millions) for the period 1995:7–1996:6." La Porta et al. (1997). La Porta et al. (1997), derived from: Securities Data Corporation, AsiaMoney, LatinFinance, GT Guide to World Equity Markets, and World Development Report, 1996.                                                                                                                                                                                                                                                                                                                          |
| Number of listed firms/population               | "Ratio of the number of domestic firms listed in a given country to its population (in millions) in 1994." La Porta et al. (1997). La Porta et al. (1997) derived from: Emerging Market Factbook and World Development Report, 1996.                                                                                                                                                                                                                                                                                                                                                                                                                            |
| External market capitalization/GNP              | "The ratio of the stock market capitalization held by minorities to gross national product for 1994. The stock market capitalization held by minorities is computed as the product of the aggregate stock market capitalization and the average percentage of common shares not owned by the top three shareholders in the ten largest nonfinancial, privately owned domestic firms in a given country. A firm is considered privately owned if the State is not a known shareholder in it." La Porta et al. (1997). La Porta et al. (1997), derived from Moodys International, CIFAR, EXTEL, Worldscope, 20-F's, Price-Waterhouse, and various country sources |

Table I—Continued

| Variable                         | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|----------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Takeover laws                    | A dummy variable that takes the value one if the transaction takes place in the presence of a legal requirement to make a mandatory offer if the shareholding after acquisition exceeds a threshold, yet the transaction lies below the threshold. Data presented in Appendix Table I. ISSA Handbook, 6 <sup>th</sup> and 7 <sup>th</sup> editions, EIU country commerce guides, exchange web sites, country company handbooks.                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Accounting standards             | "Index created by examining and rating companies' 1990 annual reports on their inclusion or omission of 90 items. These items fall into seven categories (general information, income statements, balance sheets, funds flow statement, accounting standards, stock data, and special items). A minimum of three companies in each country were studied. The companies represent a cross section of various industry groups; industrial companies represented 70 percent, and financial companies represented the remaining 30 percent." La Porta et al. (1998). La Porta et al. (1998) derived from: International accounting and auditing trends, Center for International Financial Analysis and Research.                                                                                                                                                                  |
| Antidirector rights              | "An index aggregating shareholder rights formed by adding one when (1) the country allows shareholders to mail their proxy vote to the firm, (2) shareholders are not required to deposit their shares prior to the general shareholder's meeting, (3) cumulative voting or proportional representation of minorities in the board of directors is allowed, (4) an oppressed minorities mechanism is in place, (5) the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholder's meeting is less than or equal to 10 percent (the sample median), or (6) shareholders have preemptive rights that can be waived only by a shareholders' vote. The index ranges from zero to six." La Porta et al. (1998). La Porta et al. (1998) based on company law or commercial code. Pistor et al. (2000) for Czech Republic and Poland. |
| Rule of law                      | "Assessment of the law and order tradition in the country produced by the country risk rating agency International Country Risk (ICR). Average of the months of April and October of the monthly index between 1982 and 1995. Scale from zero to 10, with lower scores for less tradition for law and order (we changed the scale from its original range going from zero to six)." La Porta et al. (1998). La Porta et al. (1998), derived from: International Country Risk guide. Pistor et al. (2000) for Czech Republic and Poland.                                                                                                                                                                                                                                                                                                                                        |
| Competition laws                 | Response to survey question, "competition laws prevent unfair competition in your country?" Higher scores suggest agreement that competition laws are effective. World Competitiveness Yearbook, 1996.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| Newspaper circulation/population | Circulation of daily newspapers/population. UNESCO Statistical yearbook 1996, as reported in World Competitiveness Report, for Taiwan based on Editors and Publishers' Association Year Book and AC Nielsen, Hong Kong, as reported in "Asian Top Media—Taiwan" <a href="http://www.business.vu.edu">www.business.vu.edu</a>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| Violent crime                    | This is a proxy for moral norms suggested by Coffee (2001). It is the reported number of murders, violent crimes, or armed robberies per 100,000 population. Interpol and country data for 1993 as reported in World Competitiveness Yearbook, 1995.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |

**Table I—Continued**

| Variable          | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Catholic          | This is another proxy for moral norms suggested by Stulz and Williamson (2001). The indicator variable takes the value one if the country's primary religion is Catholic. 2000 CIA World Factbook as reported in Stulz and Williamson (2001).                                                                                                                                                                                                                                                                                                                                          |
| Labor power       | We use as an index of labor power the extent of statutory employee protections based on the average of indicators on regular contracts (procedural inconveniences, notice and severance pay for no-fault-dismissals, difficulty of dismissal) and short-term contract (fixed-term and temporary) as derived in Pagano and Volpin (2000). An alternate index is the weighted average of indicators on regular contracts, short-term contract and collective dismissals as derived by Pagano and Volpin (2000). The index is from Pagano and Volpin (2000) based on data from OECD 1999. |
| Tax compliance    | "Assessment of the level of tax compliance. Scale from 0 to 6 where higher scores indicate higher compliance. Data is for 1995." La Porta et al. (1999). The Global Competitiveness Report 1996 as reported in La Porta et al. (1999).                                                                                                                                                                                                                                                                                                                                                 |
| Cheating on taxes | Response to survey question "cheating on taxes if you have a chance is justified?" Scaled from one to 10 where one is never justified and 10 is always justified. World Values Survey, 1996.                                                                                                                                                                                                                                                                                                                                                                                           |
| Legal origin      | Identifies the legal origin of the company law or commercial code of each country. Categories include English common law, French commercial code, German commercial code, Scandinavian civil law, and former Soviet bloc country. La Porta et al. (1998), derived from Reynolds and Flores (1989).                                                                                                                                                                                                                                                                                     |

some countries despite looking at the full population of control transactions available in SDC, we have relatively few observations as a result of the combination of weak coverage by Datastream, few reported prices for control sales, and limited observability of control premia as a result of laws regarding tender offers in case of control sales. The rank ordering of countries by control premia is very similar using mean and median values suggesting that our results are not driven by a few outliers.

The first column of Table III presents the average control premium by country, computed as the coefficient of fixed country effects in a regression where the dependent variable is  $\hat{B}$  (calculated as in (4)) normalized by  $Y_b$ . Overall, the average control premium is 14 percent if each country has an equal weight and 10 percent if each observation receives equal weight. In 10 of our 39 sample countries, we find that the control premia exceeds 25 percent of equity value. These high private benefit countries include Argentina, Austria, Colombia, Czech Republic, Israel, Italy, Mexico, Turkey, and Venezuela (of these Brazil has the highest estimated value of 65 percent. At the other extreme, we have 14 countries where private benefits are 3 percent of the value of equity or less.) These low private benefit countries include Australia, Canada, Finland, France, Hong Kong, Japan, Netherlands, New Zealand, Norway, Singapore, South Africa, Taiwan, United Kingdom, and United States.

**Table II**  
**Block Premium as Percent of Firm Equity**

This table presents descriptive statistics by country on the block premia in the 393 control block transactions we study. The block premia are computed as the difference between the price per share paid for the control block and the price on the Exchange two days after the announcement of the control transaction, divided by the price on the Exchange after the announcement and multiplied by the proportion of cash flow rights represented in the controlling block. Securities Data Corporation, Datastream International, 20-Fs, Company annual reports, Lexis-Nexis, Dow-Jones interactive, various country sources including ISI Emerging markets and country company yearbooks.

| Country        | Mean  | Median | Standard<br>Deviation | Minimum | Maximum | Number of<br>Observations | Number of<br>Positive<br>Observations |
|----------------|-------|--------|-----------------------|---------|---------|---------------------------|---------------------------------------|
| Argentina      | 0.27  | 0.12   | 0.26                  | 0.05    | 0.66    | 5                         | 5                                     |
| Australia      | 0.02  | 0.01   | 0.04                  | -0.03   | 0.11    | 12                        | 8                                     |
| Austria        | 0.38  | 0.38   | 0.19                  | 0.25    | 0.52    | 2                         | 2                                     |
| Brazil         | 0.65  | 0.49   | 0.83                  | 0.06    | 2.99    | 11                        | 11                                    |
| Canada         | 0.01  | 0.01   | 0.04                  | -0.02   | 0.06    | 4                         | 2                                     |
| Chile          | 0.18  | 0.15   | 0.19                  | -0.08   | 0.51    | 7                         | 6                                     |
| Colombia       | 0.27  | 0.15   | 0.34                  | 0.06    | 0.87    | 5                         | 5                                     |
| Czech Republic | 0.58  | 0.35   | 0.80                  | 0.01    | 2.17    | 6                         | 6                                     |
| Denmark        | 0.08  | 0.04   | 0.11                  | -0.01   | 0.26    | 5                         | 3                                     |
| Egypt          | 0.04  | 0.04   | 0.05                  | 0.01    | 0.07    | 2                         | 2                                     |
| Finland        | 0.02  | 0.01   | 0.06                  | -0.07   | 0.13    | 14                        | 9                                     |
| France         | 0.02  | 0.01   | 0.11                  | -0.10   | 0.17    | 4                         | 2                                     |
| Germany        | 0.10  | 0.11   | 0.14                  | -0.24   | 0.32    | 17                        | 14                                    |
| Hong Kong      | 0.00  | 0.02   | 0.05                  | -0.12   | 0.05    | 8                         | 6                                     |
| Indonesia      | 0.07  | 0.07   | 0.03                  | 0.05    | 0.09    | 2                         | 2                                     |
| Israel         | 0.27  | 0.21   | 0.32                  | -0.01   | 0.89    | 9                         | 8                                     |
| Italy          | 0.37  | 0.16   | 0.57                  | -0.09   | 1.64    | 8                         | 7                                     |
| Japan          | -0.04 | -0.01  | 0.09                  | -0.34   | 0.09    | 21                        | 5                                     |
| Malaysia       | 0.07  | 0.05   | 0.10                  | -0.08   | 0.39    | 40                        | 30                                    |
| Mexico         | 0.34  | 0.47   | 0.35                  | -0.04   | 0.77    | 5                         | 4                                     |
| Netherlands    | 0.02  | 0.03   | 0.05                  | -0.07   | 0.06    | 5                         | 4                                     |
| New Zealand    | 0.03  | 0.04   | 0.09                  | -0.17   | 0.18    | 16                        | 12                                    |
| Norway         | 0.01  | 0.01   | 0.05                  | -0.05   | 0.13    | 12                        | 8                                     |
| Peru           | 0.14  | 0.17   | 0.11                  | 0.03    | 0.23    | 3                         | 3                                     |
| Philippines    | 0.13  | 0.08   | 0.32                  | -0.40   | 0.82    | 15                        | 11                                    |
| Poland         | 0.13  | 0.12   | 0.11                  | 0.02    | 0.28    | 4                         | 4                                     |
| Portugal       | 0.20  | 0.20   | 0.14                  | 0.11    | 0.30    | 2                         | 2                                     |
| Singapore      | 0.03  | 0.03   | 0.03                  | -0.01   | 0.06    | 4                         | 3                                     |
| South Africa   | 0.02  | 0.00   | 0.03                  | 0.00    | 0.07    | 4                         | 2                                     |
| South Korea    | 0.16  | 0.17   | 0.07                  | 0.04    | 0.22    | 6                         | 6                                     |
| Spain          | 0.04  | 0.02   | 0.06                  | -0.03   | 0.13    | 5                         | 4                                     |
| Sweden         | 0.07  | 0.03   | 0.09                  | -0.01   | 0.22    | 11                        | 10                                    |
| Switzerland    | 0.06  | 0.07   | 0.04                  | 0.01    | 0.15    | 8                         | 8                                     |
| Taiwan         | 0.00  | 0.00   | 0.01                  | -0.01   | 0.00    | 3                         | 2                                     |
| Thailand       | 0.12  | 0.07   | 0.19                  | -0.08   | 0.64    | 12                        | 11                                    |
| Turkey         | 0.37  | 0.11   | 0.58                  | 0.05    | 1.41    | 5                         | 5                                     |
| United Kingdom | 0.01  | 0.00   | 0.04                  | -0.06   | 0.17    | 41                        | 21                                    |
| United States  | 0.01  | 0.02   | 0.09                  | -0.20   | 0.25    | 46                        | 27                                    |
| Venezuela      | 0.27  | 0.28   | 0.21                  | 0.04    | 0.47    | 4                         | 4                                     |
| Average/Number | 0.14  | 0.11   | 0.18                  | -0.04   | 0.48    | 393                       | 284                                   |

These estimates assume the seller has all the bargaining power. If this assumption is not valid, these estimates would be downward biased on average, since the bias is proportional to  $-(Y_b - Y_s)$ , which on average is negative six percentage points.<sup>6</sup> More importantly, the bias can differ across deals and countries, since both the improvement in security value,  $(Y_b - Y_s)$ , and the percentage of voting rights contained in the controlling block,  $\alpha$ , differ across deals (and thus a fortiori across countries). All the terms of this bias,  $\alpha(1 - \lambda)(Y_b - Y_s)$ , are observable, except for the seller's bargaining power ( $\lambda$ ). Unfortunately, we do not have enough degrees of freedom to estimate reliably a country-specific  $\lambda$ . Therefore, we initially restrict it to be equal across all transactions, and we estimate  $(1 - \lambda)$  as a coefficient of the term  $\alpha(Y_b - Y_s)$  inserted in our previous regression (column 1 of Table III), where the dependent variable is  $\frac{B}{Y_b}$  and the other explanatory variables are the country fixed effects. The estimate of  $\lambda$  so obtained equals 0.655 and is statistically different from zero at the 10 percent level. Not only does this estimate lie in the  $[0, 1]$  interval, as predicted by the model, but it is also very reasonable. It suggests that on average the seller captures two-thirds of the gains from trade.

Table III (column 2) presents the estimates of the country fixed effects obtained in this way. A few countries see the estimated private benefits of control increase after this adjustment. For example, the estimate for the United States goes from 1.0 to 2.7 percent. The overall ranking, however, remains substantially unchanged.<sup>7</sup>

Of course, the seller's bargaining power is unlikely to be constant across all deals. The question is how potential differences in bargaining power can affect our estimates. If differences in the bargaining power have large effects on our private benefits estimates, then our estimates should be correlated with proxies for the buyer's bargaining power. A proxy for the buyer's bargaining power is the announcement return experienced by the buyer of the controlling block. In our sample, we have 203 observations where the acquirer is a publicly traded company and the stock price is reported in Datastream for 115 of those. As we show later (in Table IV, panel B), we regress the acquirers' cumulative abnormal returns around the transaction on our estimates of private benefits. We find no significant correlation between the two, thus potential biases do not seem to be of the first order. Nevertheless, to address this problem in the next section, we introduce additional control variables, which will proxy for deal-specific differences in the relative bargaining power of the parties involved.

Our major concern, however, is not variability across deals, but systematic variability across countries, which might bias our cross-country comparison. In particular, if competition for control is stronger in some countries than others, imposing an equal  $\lambda$  will artificially inflate the estimates of private benefits in countries with strong competition and reduce them in others. To exclude this

<sup>6</sup> With an average controlling block size of 37 percent, the maximum downward bias, on average, in our sample of 2.2 percent if the seller has no bargaining power and there is no bias if sellers have all the bargaining power.

<sup>7</sup> While  $\lambda$  is constrained to be fixed across countries, the term  $\alpha(Y_b - Y_s)$  does differ across deals (and a fortiori across countries). Thus, the adjustment introduced in column 2 could alter the relative ranking across countries.

possibility, we divide countries in quartiles according to our estimates of private benefits and we re-estimate  $\lambda$ , imposing it to be equal only within each quartile. We find that countries with higher levels of private benefits have lower estimated lambdas than countries with lower levels of private benefits. These results suggest that our assumption of equal  $\lambda$  across countries tends, if anything, to dampen the cross-country differences in the level of private benefits.

### *C. Differences in Deal and Firm Characteristics*

Cross-country differences in the level of private benefits could be driven by systematic differences in deal characteristics and firm characteristics, which affect the amount of control transferred, the size of the private benefits, and the relative bargaining power of the parties involved. To increase confidence that our estimates of block premia reflect country differences rather than other characteristics, we generate revised estimates based on a regression of our raw data against firm and deal characteristics.<sup>8</sup>

#### *C.1. Differences in the Extent the Block Carries Control*

First of all, we assume that all transactions transfer absolute control. This is probably incorrect. The transfer of a 20 percent block does not carry the same amount of control as the transfer of a 51 percent block. Similarly, the transfer of a 30 percent block when there is another shareholder controlling 20 percent carries less control than the transfer of the same block when the rest of the shares are dispersed. Thus, per given size of private benefits control blocks above 50 percent are likely to fetch a higher price. Similarly, the presence of another large shareholder (a stake in excess of 20 percent) should reduce the premium.<sup>9</sup>

In our sample, 27 percent of the transactions involve sales that exceed 50 percent of the votes, and in 16 percent of the cases the acquirer has to deal with another large shareholder with more than a 20 percent stake.<sup>10</sup> As shown in Table III, *ceteris paribus* an absolute majority of votes increases the value of a controlling block by 9.5 percent of the total value of equity, significant at the 5 percent level. Contrary to expectations, the presence of another large shareholder has a positive effect on the premium, but this is not statistically significant.

#### *C.2. Differences in the Extent of the Seller's Bargaining Power*

In estimating the private benefits of control, we assumed that the seller's bargaining power is constant across deals. As we just discussed, variations in

<sup>8</sup> Summary statistics for the characteristics of the deals that we use later in our empirical analysis are provided in our earlier working paper, Dyck and Zingales (2002a).

<sup>9</sup> In Canada and Australia we used 15 percent since exceeding 20 percent would trigger a mandatory offer for remaining shares.

<sup>10</sup> An alternative approach to identify the likelihood that a stake brings control is to calculate a Shapley value associated with control. Unfortunately, we were not able to collect information on a consistent basis on the ownership status of other shareholders. For example, some countries might report the presence of all shareholders with stakes that exceed 5 percent while other countries might only report holdings that exceed 10 percent or higher.

Table III  
Estimated Block Premia by Country

The dependent variable is the block premia as a percent of firm equity. Each regression includes country fixed effects. In addition, in column (2) we introduce the buyer's proportion of the difference in security value between the buyer and seller. In column (3) we introduce several deal characteristics: whether it is a majority block, whether there is another large shareholder, whether the firm is in financial distress, whether the block was created by issuing new shares, whether the buyer is foreign, and if the firms' shares are cross listed in the United States. In column (4) we introduce several industry and seller/buyer characteristics: identity of the buyer (individual, government, subsidiary, dispersed), identity of the seller (individual, government, unknown), two-SIC code industry dummies, and the proportion of fixed to total assets. Definitions for each of the variables can be found in Table I. All regressions are estimated by OLS. Robust standard errors are in parentheses.

| Independent Variables                          | Dependent Variable: Block Premium |        |         |         |
|------------------------------------------------|-----------------------------------|--------|---------|---------|
|                                                | (1)                               | (2)    | (3)     | (4)     |
| Buyer's proportion of change in security value |                                   |        |         |         |
| Stake greater than 50%                         |                                   | -0.345 | -0.323  | -0.319  |
| Another large shareholder                      |                                   |        | 0.095** | 0.095** |
| Financial distress in selling firm             |                                   |        | 0.041   | 0.018   |
| Sold through new share issue                   |                                   |        | -0.054* | -0.043  |
| Buyer is foreign                               |                                   |        | 0.041   | 0.034   |
| Cross-listed in the US                         |                                   |        | 0.069** | 0.065*  |
| Buyer individual or private                    |                                   |        | -0.062  | -0.067* |
| Buyer government                               |                                   |        |         | -0.042  |
| Buyer subsidiary                               |                                   |        |         | 0.008   |
| Buyer dispersed or unknown                     |                                   |        |         | -0.001  |
| Seller individual                              |                                   |        |         | -0.039  |
| Seller government                              |                                   |        |         | 0.021   |
| Seller unknown                                 |                                   |        |         | 0.008   |
| Fixed assets as percent of total               |                                   |        |         | 0.028   |
| Industry—Agriculture, Forestry, Fishing        |                                   |        |         | -0.097  |
| Industry—Mining                                |                                   |        |         | -0.03   |
| Industry—Construction                          |                                   |        |         | -0.071  |
| Industry—Transportation & utilities            |                                   |        |         | -0.027  |
| Industry—Wholesale Trade                       |                                   |        |         | 0.066*  |
| Industry—Retail Trade                          |                                   |        |         | 0.046   |
| Industry—Finance, Insurance, Real Est.         |                                   |        |         | -0.057  |
| Industry—Services                              |                                   |        |         | 0.055   |
|                                                |                                   |        |         | -0.024  |

|                |          |         |          |         |          |         |          |         |
|----------------|----------|---------|----------|---------|----------|---------|----------|---------|
| Argentina      | 0.268**  | (0.111) | 0.268**  | (0.112) | 0.158    | (0.131) | 0.197    | (0.123) |
| Australia      | 0.020    | (0.013) | 0.029    | (0.018) | -0.001   | (0.034) | 0.051    | (0.052) |
| Austria        | 0.383*** | (0.099) | 0.364*** | (0.082) | 0.318*** | (0.054) | 0.309*** | (0.050) |
| Brazil         | 0.650*** | (0.252) | 0.653*** | (0.249) | 0.606*** | (0.229) | 0.652*** | (0.245) |
| Canada         | 0.013    | (0.017) | 0.016*   | (0.009) | -0.06    | (0.056) | -0.055   | (0.075) |
| Chile          | 0.183*** | (0.069) | 0.213*** | (0.070) | 0.149**  | (0.065) | 0.165**  | (0.067) |
| Colombia       | 0.273*   | (0.142) | 0.274**  | (0.129) | 0.197    | (0.137) | 0.242*   | (0.132) |
| Czech Republic | 0.578*   | (0.312) | 0.600*   | (0.320) | 0.462    | (0.297) | 0.555*   | (0.325) |
| Denmark        | 0.077    | (0.048) | 0.076*   | (0.045) | 0.039    | (0.050) | 0.036    | (0.070) |
| Egypt          | 0.038    | (0.024) | 0.035**  | (0.015) | -0.050   | (0.061) | 0.025    | (0.082) |
| Finland        | 0.025    | (0.016) | 0.028    | (0.018) | -0.016   | (0.027) | -0.010   | (0.036) |
| France         | 0.019    | (0.052) | 0.035    | (0.049) | 0.040    | (0.059) | 0.080    | (0.077) |
| Germany        | 0.095*** | (0.034) | 0.090*** | (0.033) | -0.020   | (0.052) | 0.016    | (0.059) |
| Hong Kong      | 0.003    | (0.019) | 0.026    | (0.021) | 0.045    | (0.033) | 0.040    | (0.044) |
| Indonesia      | 0.072*** | (0.017) | 0.032    | (0.025) | -0.034   | (0.040) | 0.043    | (0.047) |
| Israel         | 0.270**  | (0.107) | 0.284**  | (0.113) | 0.238**  | (0.108) | 0.259**  | (0.114) |
| Italy          | 0.369*   | (0.199) | 0.378*   | (0.201) | 0.323*   | (0.191) | 0.311    | (0.192) |
| Japan          | -0.043** | (0.021) | -0.041** | (0.020) | -0.070   | (0.044) | -0.038   | (0.054) |
| Malaysia       | 0.072*** | (0.017) | 0.072*** | (0.014) | 0.063*** | (0.018) | 0.093*** | (0.032) |
| Mexico         | 0.345**  | (0.146) | 0.381**  | (0.150) | 0.296**  | (0.143) | 0.322**  | (0.144) |
| Netherlands    | 0.016    | (0.020) | -0.031   | (0.047) | -0.054   | (0.068) | -0.015   | (0.060) |
| New Zealand    | 0.027    | (0.024) | 0.044    | (0.027) | -0.028   | (0.042) | 0.026    | (0.046) |

Table III—Continued

| Country Fixed Effects  | Dependent Variable: Block Premium |                     |                     |                     |
|------------------------|-----------------------------------|---------------------|---------------------|---------------------|
|                        | (1)                               | (2)                 | (3)                 | (4)                 |
| Norway                 | 0.015<br>(0.014)                  | 0.019<br>(0.019)    | 0.007<br>(0.026)    | 0.052<br>(0.041)    |
| Peru                   | 0.142***<br>(0.053)               | 0.121<br>(0.075)    | 0.067<br>(0.080)    | 0.060<br>(0.082)    |
| Philippines            | 0.129<br>(0.083)                  | 0.169**<br>(0.085)  | 0.115<br>(0.081)    | 0.142*<br>(0.079)   |
| Poland                 | 0.133***<br>(0.052)               | 0.134***<br>(0.041) | 0.003<br>(0.081)    | 0.041<br>(0.092)    |
| Portugal               | 0.203***<br>(0.073)               | 0.215***<br>(0.075) | 0.159***<br>(0.052) | 0.197***<br>(0.059) |
| Singapore              | 0.030*<br>(0.016)                 | 0.027<br>(0.019)    | 0.024<br>(0.035)    | 0.042<br>(0.069)    |
| South Africa           | 0.017<br>(0.015)                  | 0.035*<br>(0.019)   | -0.045<br>(0.061)   | 0.005<br>(0.072)    |
| South Korea            | 0.157***<br>(0.027)               | 0.146***<br>(0.036) | 0.086<br>(0.066)    | 0.088<br>(0.086)    |
| Spain                  | 0.041<br>(0.027)                  | 0.049*<br>(0.026)   | 0.021<br>(0.042)    | 0.047<br>(0.058)    |
| Sweden                 | 0.074***<br>(0.027)               | 0.083***<br>(0.029) | 0.033<br>(0.047)    | 0.041<br>(0.057)    |
| Switzerland            | 0.063***<br>(0.015)               | 0.061***<br>(0.016) | -0.073<br>(0.056)   | -0.067<br>(0.074)   |
| Taiwan                 | -0.004<br>(0.004)                 | -0.011**<br>(0.005) | -0.047<br>(0.039)   | -0.040<br>(0.074)   |
| Thailand               | 0.125**<br>(0.054)                | 0.142**<br>(0.057)  | 0.073<br>(0.080)    | 0.121<br>(0.084)    |
| Turkey                 | 0.371<br>(0.246)                  | 0.362<br>(0.226)    | 0.276<br>(0.232)    | 0.346<br>(0.249)    |
| United Kingdom         | 0.014*<br>(0.007)                 | 0.016*<br>(0.009)   | 0.000<br>(0.019)    | 0.040<br>(0.033)    |
| United States          | 0.01<br>(0.013)                   | 0.027<br>(0.016)    | 0.002<br>(0.031)    | 0.044<br>(0.038)    |
| Venezuela              | 0.270***<br>(0.094)               | 0.305***<br>(0.103) | 0.256**<br>(0.105)  | 0.221**<br>(0.112)  |
| Number of observations | 393                               | 393                 | 393                 | 393                 |
| R-squared              | 0.389                             | 0.399               | 0.431               | 0.459               |

\* significant at 10% level; \*\* significant at 5% level; \*\*\* significant at 1% level.

the seller's bargaining power can affect our estimates of the private benefits of control: Per given size of private benefits of control, the lower the seller's bargaining power, the lower our estimates. We try to control for these differences with three proxies.

First, if the company is in financial distress, the seller is more likely to be forced to sell. Hence, her bargaining power is smaller. As a proxy for financial distress, we create a dummy variable that takes value one if earnings per share are zero or negative in the year of the block trade or the year preceding the block trade.<sup>11</sup> In our sample, 27 percent of the firms are in financial distress in the year of the block trade and 23 percent in the year preceding the block trade. As expected, firms in financial distress exhibit a control premium that is 5.4 percentage points lower. This effect is statistically significant at the 10 percent level.

Similarly, that the acquisition of a controlling block takes the form of an equity infusion probably indicates that a company needs to raise equity, a sign of a weak bargaining position. We insert a dummy if the block was formed by newly issued equity (16 percent). This method is particularly diffused in Japan where in a majority of cases control is transferred by a financially distressed company via a private placement of newly issued equity. This clustering underscores the importance of controlling for industry firms' and deals' characteristics, to avoid attributing to the Japan institutional framework a feature due to the particular economic phase Japan has been going through during our sample period. Contrary to expectations, the fact a block was created through a new equity offering has a positive effect on the premium, but this is not statistically significant.

Finally, companies that can be acquired by foreigners are likely to face more competition. We attempt to capture this possibility by introducing a dummy variable equal to one if the acquirer is foreign. As a result of the increased competition, the bargaining power of the seller in these transactions is likely to be bigger. We find that foreign buyers pay a premium of 6.9 percent that is statistically significant at the 5 percent level.

### *C.3. Cross Listing in the United States*

Coffee (1999), Reese and Weisbach (2001), and Doidge, Karolyi, and Stulz (2001) argue that foreign companies list in the United States to submit themselves to tougher governance rules and precommit to extract less private benefits of control. Since we want to measure the country-specific value of private benefits, we want to control for companies that might have lower than average private benefits due to their borrowing of foreign institutions. To this purpose we insert a dummy variable equal to one for any company that is cross listed in the United States as well as in its home market.<sup>12</sup> As expected, cross-listed companies enjoy lower private benefits, although given the paucity of cross

<sup>11</sup> While other measures of cash flow are preferable, earnings per share is one of the few data items consistently reported in Datastream for the companies in our database.

<sup>12</sup> We obtained the list of cross listing from Doidge, Karolyi, and Stulz (2001). We thank Andrew Karolyi for kindly providing us with the data.

listed companies in our sample (23), the statistical significance of this effect is just below conventional levels ( $p$ -value = 12 percent).

#### *C.4. Estimates of Private Benefits Controlling for Differences in Deal and Firm Characteristics*

After inserting all these deals' and firms' characteristics into our basic regression, we re-estimate the country fixed effects. The results are reported at the bottom of column 3 in Table III. Since many of the control variables included capture part of the value of control, the country fixed effects cannot any longer be interpreted as the estimates of the average value of private benefits in that country, but only as relative rankings. Including these controls dramatically lowers the ranking for countries characterized by higher than average incidence of foreign acquirers and sales of majority stakes like Germany, Switzerland, Egypt, and Poland.

On the one hand, these estimates represent an improvement over our raw data, for they keep constant deal characteristics. On the other hand, they suffer from an econometric problem. To estimate the impact of these deal and firm characteristics, we had to assume that this impact is constant across countries. In some cases this assumption might be untenable. The difference between acquiring a 51 percent stake rather than a 30 percent one might be huge in a country where private benefits of control are large, but it might be small or even irrelevant in a country where the private benefits of control are very tiny.<sup>13</sup> The regression, however, imposes the same effect on all the countries, underestimating differences across countries.

In the rest of the paper, where we explore the effects and causes of these cross-country differences, we focus on this refined measure that controls for deal (and other) characteristics. But recognizing that this procedure may bias the results because deal characteristics may not be constant across countries, we also test results without controls.

#### *D. Differences in Industry and Buyer/Seller Characteristics*

Cross-country differences could also arise because of other differences in industry and deal characteristics. Private benefits might differ across industry. The media industry, for instance, is often mentioned (Demsetz and Lehn (1985)) as an industry where private benefits are larger. Similarly, individuals might value opportunities to consume prerequisites more highly than corporate blockholders (see e.g., Barclay and Holderness (1989)). We want to make sure our cross-country comparison is not affected by any systematic difference in the industry characteristics of the deals or the nature of the seller and the buyer.

<sup>13</sup> Since we have enough observations for the U.S. (46), we can assess the realism of our assumption by estimating the same specification restricted to U.S. data. While the other coefficients are very similar to the ones reported in Table IV, the coefficient of the majority block dummy is small and insignificant. "Imposing" to the U.S. the same majority dummy effect as other countries, thus, will distort its average level of private benefits upward.

For this reason, we re-estimate the country averages, controlling for differences in industry characteristics and identity of the controlling party.

To capture industry differences, we introduce an industry dummy based on the two-digit SIC code of the acquired firm. About three quarters of our transactions are accounted for by manufacturing (39 percent); finance, insurance, and real estate (24 percent); and services (10 percent). In a crude way these controls capture differences in private benefits linked to product market competition. Second, we construct a measure of tangibility of assets (percentage of total assets that are fixed) based on the three-digit SIC code the acquired firm belongs to. The argument for this control is that insiders will have more difficulty diverting resources if assets are tied down and easily observable, as is the case with tangible assets. To avoid potential endogeneity problems, we use U.S. averages (see Rajan and Zingales (1998)).<sup>14</sup>

Table III column 4 shows that firms with more tangible assets have lower private benefits, and firms in wholesale trade, finance (financial, insurance, and real estate sector), and transportation and utilities have a higher level of private benefits than firms in manufacturing, although these differences are not statistically significant. We also collected information on the identity of the acquirer and the seller. To identify characteristics of the seller, we focus exclusively on the news stories, identifying whether the seller is an individual, the company itself (through new share issues), a corporate entity, or unknown. Here we find the most common seller to be a corporation, followed next by individuals (18 percent), new share issues (16 percent), unidentified (8 percent) and the government (3 percent). We use SDC data to identify whether the acquirer is a public company, subsidiary, the government, or a private company. The typical transaction in our sample involves a public acquirer (41 percent), although private acquirers are also very common (41 percent). We provide a further classification using news stories and the SDC synopsis field. We identify 13 percent of our transactions involving an individual acquirer, using as our criteria whether the stories mention the name of an individual or if the private company involved is identified with a particular individual. We also identify 4 percent of transactions involving a financial intermediary who purchases the shares and then resells the shares to institutional investors. We interpret these acquisitions as the dispersal of the controlling stake. None of these buyer or seller characteristics turns out to be significant.

At the bottom of column 4 of Table III, we report the estimates of the country average level of private benefits after we control for the above differences in level of private benefits across industries. The relative ranking, however, does not seem to be affected very much by these industry controls.

Finally, the level of private benefits extracted might be endogenous to the size of the controlling block. Large shareholders who retain a larger block of

<sup>14</sup> We derive U.S. measures in a two-step procedure. First, we computed the average ratio of fixed assets (property plant and equipment) to total assets for all companies that in each three-digit SIC-code for the period 1990 to 1999. Then we took the median value across all companies. We then impute this value for all of the companies in our sample.

equity have less of an incentive to dilute minority shareholders, because they internalize more the inefficiency they generate (see Burkart, Gromb and Panunzi (1998)). For this reason, in an unreported regression, we also inserted the size of the controlling block  $\alpha$ . Since it has no effect on the value of control, we dropped it.

### *E. Alternative Interpretations*

Thus far, we have interpreted block premia as indicative of private benefits. Yet, there are alternative interpretations that we need to consider. The most important alternative interpretation, already considered and rejected by Barclay and Holderness (1989) in their U.S. sample, is that control premia arise from a systematic overpayment, possibly due to a winner's curse problem.

As in Barclay and Holderness (1989), we check for this possibility by looking at the announcement effect on the stock price of the acquiring company. If these premia reflect overpayments, acquiring firms should experience negative returns at the announcement of the transaction. In our sample, we have 203 observations where the acquirer is a publicly traded company and the stock price is reported in Datastream for 115 of those. Table IV presents the results of our analysis. Inconsistent with the overpayment hypothesis, the mean value of the announcement effect is slightly positive (0.5 percent) and not statistically different from zero.

Another implication of the overpayment hypothesis is that the buyer's announcement return should be negatively related to the size of the control premium. In Table IV, panel B, we regress the acquirers' cumulative abnormal returns around the transaction on the raw control premium. We focus on a 16-day event window ( $t - 8$  to  $t + 7$ ) to allow for information about the transaction to be leaked in advance or to be communicated slowly to the market although results are not significantly affected by the choice of window. The coefficient is indeed negative, but is neither economically nor statistically significant (coefficient of  $-0.018$ ,  $p$ -value of  $0.64$ ).

The results above reject the hypothesis that on average the control premium is due to overpayment. It is still possible, thus, that this might be true in some countries. In particular, we are concerned that in less developed countries, where there is more uncertainty about the value of a company, the winner's curse is more severe leading to a higher apparent premium and distorting our international comparisons. While such behavior is inconsistent with a rational bidding process (Milgrom and Weber (1982)), we still want to ensure it is not present in the data.<sup>15</sup> As a measure of the degree of company-specific information available we use the synchronicity measure developed by Morck, Yeung, and Yu (2000). This is a measure of how much stock prices move together. The more they move together, the less company-specific information is revealed. If there is more overpayment in less developed markets, we should observe that the control premium is more negatively correlated with the acquirer's return in

<sup>15</sup> A rational bidder knows that if he bids his valuation he will overpay, the more so the more uncertainty there is about the fundamental value of the asset. Thus, the more uncertainty there is, the more he will shade his bid.

**Table IV**  
**Does the Control Premium Come from Overpayment?**

Panel A reports the summary statistics of the cumulative abnormal returns (CAR) of the stock price of the acquiring company around the date the acquisition of the controlling block is announced. We use a window from eight days prior to the announcement to seven days after the announcement. We have 203 transactions involving publicly traded acquirers, of which 115 have stock prices reported in Datastream. Panel B reports the OLS estimates of two regressions, where the dependent variable is the acquirer's CAR from  $t - 8$  and  $t + 7$  and the independent variables are: (1) the raw block premia (Table III column 1); (2) the raw block premia (Table III column 1) interacted with a measure of how much stock prices move together at the country level (see Morck et al. (2000)). Definitions for each of the variables can be found in Table I. Robust standard errors are in parentheses.

| Panel A: Cumulative Abnormal Returns of the Acquirer |                         |
|------------------------------------------------------|-------------------------|
|                                                      | from $t - 8$ to $t + 7$ |
| Mean                                                 | 0.005                   |
| Median                                               | 0.000                   |
| Maximum                                              | 0.333                   |
| Minimum                                              | -0.408                  |
| Standard deviation                                   | 0.110                   |
| Number of observations                               | 115                     |

  

| Panel B: Systematic Differences in Cumulative Abnormal Returns |                                                                                             |                |
|----------------------------------------------------------------|---------------------------------------------------------------------------------------------|----------------|
| Independent Variables                                          | Dependent Variable:<br>Cumulative Abnormal Return<br>of Acquirer (from $t - 8$ to $t + 7$ ) |                |
|                                                                | (1)                                                                                         | (2)            |
| Block premia                                                   | -0.018 (0.040)                                                                              | -0.106 (0.156) |
| Block premia $\times$ synchronicity in target nation           |                                                                                             | 0.419 (0.835)  |
| Constant                                                       | 0.007 (0.011)                                                                               | 0.007 (0.012)  |
| Number of observations                                         | 115                                                                                         | 105            |
| R-squared                                                      | 0.001                                                                                       | 0.008          |

a country with a high level of synchronicity. In fact, the interaction coefficient is positive and not statistically significant.

A second alternative interpretation that could potentially explain a larger premia in underdeveloped markets is that the buyer has superior information and there is a delay in incorporating new information. On average, delays in adjusting will spuriously inflate our estimates of private benefits. To test for this possibility we re-estimated the private benefits using the market price 30 days after the announcement rather than two days after. The results (not reported) are virtually identical. If anything, the average premium in developing countries, like Brazil, goes up rather than down. We also examined the cumulative abnormal returns to shareholders in target firms from two days to 30 days after the announcement and tested whether the initial level of private benefits was related to the subsequent cumulative abnormal returns. We found no such effect with an insignificant relationship between control premia and postannouncement returns (coefficient = 0.009,  $p$ -value = 0.80).

Another alternative interpretation focuses on liquidity differences between developed and less developed markets. Differences in liquidity cannot explain our findings either. While a lack of liquidity reduces the willingness to pay for shares on the exchange and this effect is more pervasive in less developed markets, the lack of liquidity also impacts the price that is paid for large blocks. Large noncontrolling blocks generally sell at a discount to the exchange price (Holthausen, Leftwich, and Mayers (1990)) and the more so the more illiquid is the market for the underlying stock. Thus, if the control value were zero there would be a bigger discount in less liquid markets for large blocks. Therefore liquidity differences suggest that, if anything, more underdeveloped countries should have smaller block premia, not larger ones.

We are also concerned about a possible distortion due to selective nondisclosure. In fact, one of the criteria we had to impose to obtain our estimates was the observability of the price paid for the controlling block. A worrisome possibility is that in countries with better protection of investors, controlling parties are more fearful to disclose large premia. In such a case, we would estimate lower private benefits in the United States, not because they are indeed lower, but because large premia are less likely to be disclosed.

To check for this possibility, we compute the percentage of deals we have to drop because the terms are not disclosed. On average, 33 percent of the deals do not disclose the terms, going from 0 percent in Taiwan and other countries to 70 percent in Austria and 82 percent in the Czech Republic. Contrary to the selective nondisclosure argument, we find that countries with higher premium tend to have a higher percentage of deals that are not disclosed (correlation 0.2, not statistically significant). Similarly, if we use as a proxy of shareholders' protection the antidirector rights index constructed by La Porta et al. (1997), we find (not surprisingly) that in countries that protect shareholders a greater percentage of deals are disclosed. In sum, if selective nondisclosure biases our results it biases them in the direction of attenuating the cross-country differences rather than amplifying them.

Finally, if the acquirers of the controlling block, for instance, already owned a large stake in the company beforehand, they might be willing to pay a premium only because they internalize a fraction of the increase in the security value via their toeholds (Grossman and Hart (1980) and Shleifer and Vishny (1986)). Toeholds, however, are unusual in our sample. The average shareholding prior to purchasing the control stake is just 1 percent, in 76 percent of the cases the acquirer has no prior shareholding, and in 86 percent of the cases the prior shareholding is less than 1 percent. Nevertheless, to examine the impact of a toehold we re-estimate the regressions in Table III (not reported) introducing the initial toehold as an additional regressor. The initial toehold has a negative and statistical insignificant impact ( $p$ -value of 0.20 to 0.32) on our private benefits' estimates. All of our results are unaffected by the inclusion of this additional regressor.

#### *F. Are We Really Estimating Private Benefits?*

Therefore, we can reject all these alternative interpretations, but what evidence do we have that our estimates indeed capture private benefits of control?

At the anecdotal level, we have papers documenting the pervasiveness of self-dealing transactions in countries like Italy (Zingales (1994)) and the Czech Republic (Glaeser, Johnson, and Shleifer (2001)). It is reassuring, thus, that our estimated private benefits for these two countries are very high (respectively, 37 percent and 58 percent). It is particularly interesting to stress the difference between Poland and the Czech Republic. Both are former socialist countries, with a similar level of GDP per capita. Nevertheless, our estimates are very different (11 percent for Poland and 58 percent for the Czech Republic).

At a more systematic level, if our measures reflect the different ability to extract private benefits in different countries, they should be affected in predictable ways by country-specific institutions that restrict the ability to extract private benefits. We will explore these implications in Section IV. One limitation with this approach, however, is that it is difficult to separate specific institutions from a broad institutional context. More subtle tests of whether these estimates really reflect the ability to extract private benefits are whether our estimated private benefits depend not only upon the institutional variables of the country of the company whose control has been acquired, but also on institutions of the country of the acquiring company (when this is different) and on institutions of the country where a company's shares are listed (when a company cross lists in the United States).

An acquirer coming from a country with less investor protection is better able to siphon out corporate resources from a subsidiary than an acquirer coming from a country with very rigid rules. This should result in a higher willingness to pay and, in a nonperfectly competitive market, at a higher price. Thus, we should observe higher estimated private benefits when the foreign acquirer comes from a country with poor protection of investors.

For this reason, in Table V column 1, we re-estimate our basic specification (see Table III) inserting as an additional explanatory variable the interaction between the foreign acquirer's dummy (equal to one if the acquirer comes from a country different from the target) and a measure of the difference in legal protection between the two countries. This measure is the difference between the La Porta et al. (1998) measure of antidirector rights for the country of the acquiring company and the one for the country of the acquired company. As Table V shows, companies coming from more investor friendly countries pay, on average, a control premia that is 2.7 percent less, and this effect is statistically significant. In the bottom of Table V, we present country fixed effects with this control.

The finding is interesting per se within the context of the debate on corporate governance convergence. Coffee (1999) predicts that companies from countries with better protection of investors will end up buying companies from countries with weaker protection. Our result suggests that in the presence of controlling blocks this might not be the case. Companies from countries with better investor protection are more limited in their ability to extract private benefits and thus *ceteris paribus* are able to bid less for the controlling block. This engenders the risk that controlling blocks may end up in the hands of companies from the countries with the worst rules, not the best ones.

**Table V**  
**Does Legal Protection in the Investor's Country of Origin Affect the Acquirer's Willingness to Pay for Control?**

The dependent variable is the block premia as a percent of firm equity. The explanatory variables include all of the variables introduced in Table II column (4). In column 1, we include the interaction between the foreign acquirer's dummy (equal to one if the acquirer comes from a country different from the target) and a measure of the difference in legal protection between the two countries. This measure is the difference between the La Porta et al. (1998) measure of antidirector rights for the country of the acquiring company and the one for the country of the acquired company. In column 2, we include the interaction between the dummy for cross listing in the U.S. and a measure of the difference in investor protection between the U.S. and the country where the target firm is located. Robust standard errors are in parentheses.

| Independent Variables                                                                                   | Dependent Variable: Block Premium |         |          |         |
|---------------------------------------------------------------------------------------------------------|-----------------------------------|---------|----------|---------|
|                                                                                                         | (1)                               |         | (2)      |         |
| Foreign acquirer dummy                                                                                  | 0.063*                            | (0.035) | 0.060*   | (0.036) |
| Cross listed in the US                                                                                  | -0.060                            | (0.039) | 0.113    | (0.083) |
| Interaction of relative strength of antidirector rights (home—target nation) and foreign acquirer       | -0.027**                          | (0.011) | -0.028** | (0.011) |
| Interaction of relative strength of antidirector rights (home—target nation) and cross listed in the US |                                   |         | -0.070** | (0.034) |
| Variables Controlled for:                                                                               |                                   |         |          |         |
| Buyer's proportion of change in security value                                                          | y                                 |         | y        |         |
| Ownership variables                                                                                     | y                                 |         | y        |         |
| Financial distress                                                                                      | y                                 |         | y        |         |
| Buyer identity                                                                                          | y                                 |         | y        |         |
| Seller identity                                                                                         | y                                 |         | y        |         |
| Industry group                                                                                          | y                                 |         | y        |         |
| Tangibility of assets                                                                                   | y                                 |         | y        |         |
| Country fixed effects                                                                                   |                                   |         |          |         |
| Argentina                                                                                               | 0.183                             | (0.114) | 0.183    | (0.113) |
| Australia                                                                                               | 0.054                             | (0.051) | 0.052    | (0.051) |
| Austria                                                                                                 | 0.309***                          | (0.048) | 0.319*** | (0.051) |
| Brazil                                                                                                  | 0.655***                          | (0.245) | 0.653*** | (0.245) |
| Canada                                                                                                  | -0.059                            | (0.083) | -0.052   | (0.083) |
| Chile                                                                                                   | 0.160**                           | (0.065) | 0.16**   | (0.065) |
| Colombia                                                                                                | 0.282**                           | (0.131) | 0.325**  | (0.128) |
| Czech Republic                                                                                          | 0.563*                            | (0.328) | 0.563*   | (0.330) |
| Denmark                                                                                                 | 0.028                             | (0.065) | 0.027    | (0.065) |
| Egypt                                                                                                   | 0.077                             | (0.085) | 0.112    | (0.093) |
| Finland                                                                                                 | -0.002                            | (0.037) | 0.002    | (0.037) |
| France                                                                                                  | 0.076                             | (0.077) | 0.084    | (0.078) |
| Germany                                                                                                 | 0.038                             | (0.058) | 0.041    | (0.058) |
| Hong Kong                                                                                               | 0.039                             | (0.043) | 0.008    | (0.048) |
| Indonesia                                                                                               | 0.042                             | (0.046) | 0.043    | (0.045) |
| Israel                                                                                                  | 0.254**                           | (0.116) | 0.252**  | (0.116) |
| Italy                                                                                                   | 0.323*                            | (0.193) | 0.349*   | (0.199) |
| Japan                                                                                                   | -0.032                            | (0.052) | -0.039   | (0.051) |
| Malaysia                                                                                                | 0.090***                          | (0.033) | 0.089*** | (0.033) |

Table V—Continued

| Independent Variables  | Dependent Variable: Block Premium |         |          |         |
|------------------------|-----------------------------------|---------|----------|---------|
|                        | (1)                               |         | (2)      |         |
| Mexico                 | 0.348***                          | (0.129) | 0.396*** | (0.133) |
| Netherlands            | −0.025                            | (0.062) | −0.015   | (0.062) |
| New Zealand            | 0.027                             | (0.046) | 0.028    | (0.045) |
| Norway                 | 0.06                              | (0.042) | 0.061    | (0.043) |
| Peru                   | 0.076                             | (0.075) | 0.08     | (0.075) |
| Phillipines            | 0.147*                            | (0.079) | 0.148*   | (0.080) |
| Poland                 | 0.045                             | (0.092) | 0.039    | (0.092) |
| Portugal               | 0.204***                          | (0.060) | 0.207*** | (0.059) |
| Singapore              | 0.046                             | (0.064) | 0.038    | (0.062) |
| South Africa           | −0.014                            | (0.075) | −0.014   | (0.074) |
| South Korea            | 0.128                             | (0.080) | 0.137*   | (0.081) |
| Spain                  | 0.058                             | (0.053) | 0.058    | (0.052) |
| Sweden                 | 0.044                             | (0.057) | 0.047    | (0.056) |
| Switzerland            | −0.054                            | (0.073) | −0.051   | (0.073) |
| Taiwan                 | −0.038                            | (0.074) | −0.038   | (0.073) |
| Thailand               | 0.111                             | (0.080) | 0.107    | (0.080) |
| Turkey                 | 0.364                             | (0.246) | 0.363    | (0.246) |
| United Kingdom         | 0.029                             | (0.034) | 0.02     | (0.033) |
| United States          | 0.037                             | (0.038) | 0.035    | (0.038) |
| Venezuela              | 0.234**                           | (0.107) | 0.268**  | (0.119) |
| Number of observations | 393                               |         | 393      |         |
| R-squared              | 0.466                             |         | 0.470    |         |

\*significant at 10% level; \*\*significant at 5% level; \*\*\*significant at 1% level.

This finding that the owners' identity (as reflected in the home country of the acquirer) is associated with the extent of private benefits also provides one rationale for the approach in many privatizations of not simply selling to the highest bidder and for the consistent finding in central and eastern Europe (Djankov and Murrell (2000)) of superior returns for firms sold to foreigners (most from countries with higher levels of antidirector rights than in the transition countries) after controlling for possible selection issues.

Cross-listed companies provide another test of whether these estimates reflect the ability to extract private benefits. A subtler prediction of the argument that cross-listing in the United States acts as a precommitment is that the effect of this cross listing should be a function of the difference between the corporate governance rules in the United States and the rules facing the company in its home market.<sup>16</sup> To test this hypothesis, we measure the superiority in governance as the difference between antidirector rights in the United States and antidirector rights in the target country. In Table V specification 2,

<sup>16</sup> This is the prediction that Doidge (2002) tests using companies with differential voting stock. He finds that the voting premium of companies cross listed in the United States is significantly lower. This is consistent with our findings and an additional confirmation that different methods lead to the same answer: private benefits exist and are important.

we again re-estimate our basic specification (see Table III) and include an interaction term that is the product of the cross-listing dummy and the measure of the superiority of governance rules. We find a statistically significant negative effect of the superiority of governance rules on the control premia. This means that the reduction in private benefits with cross listing is greater for firms from countries that have weaker investor protections. These results provide direct support for the contention of Coffee (1999), Reese and Weisbach (2001), and Doidge et al. (2001) of a link between cross listing and private benefits.

### *F.1. Comparing Control Premia Measures*

Another check that our estimates measure the value of control comes from comparing them with estimates of the value of control obtained using different methods. Nenova (2001a) provided the largest set of alternative estimates. By using the prices of shares with different voting rights, she estimates the value of control across 18 countries. Table VI (panel A) reports both her numbers and our numbers. The first two columns report the raw measure of private benefits (both Nenova's and ours) and the second two the adjusted measures, after controlling for extraneous factors, which might bias the estimates.

In spite of the different method used, there is a remarkable similarity in findings. Our estimates for countries like Mexico and Germany are identical, and the overall correlation between our measures is 0.59 for the raw measure and 0.62 for the refined measure (statistically different from zero at the 2 percent level).<sup>17</sup> There are, however, notable exceptions. Nenova finds that both Australia and Brazil have a ratio of value of control to value of equity equal to 0.23, while we find only 0.02 for Australia and 0.65 for Brazil. What can explain these differences?

As we discussed, both sets of measures can have pluses and minuses. One possible sample selection story that could account for these differences goes as follows. Companies are more likely to issue dual class shares when private benefits of control are large (Grossman and Hart (1988) and Zingales (1995b)). Hence, a measure of private benefits of control based on the voting premium of companies that issued dual-class shares tends to overestimate the value of control. Most importantly, this upward bias is not homogeneous across countries, but it is more severe the fewer the percentage of dual class companies in the population of traded companies in a country. And this percentage varies widely across countries.

The final column in Table VI reports the percentage of dual-class firms with prices available by Datastream as a percentage of the total population of Datastream firms in the country in that year. In countries that allow dual-class shares, on average only 14 percent of the firms have two classes of shares traded. There is a wide cross-sectional variation: Brazil has 59 percent of such firms, while Australia and the United Kingdom have only 1 percent.

<sup>17</sup> If we exclude Brazil, as we should for reasons to be discussed in Section III.G., the correlation increases to 0.69 using the raw data and 0.86 using the refined data.

**Table VI**  
**Comparing Control Premia Measures**

Panel A reports Nenova's (2001a) estimates of the value of control based on the price difference between classes of shares with differential voting rights and ours, based on control block transactions. The first column reports Nenova's raw voting premium, defined as total vote value (value of a vote times number of votes) as a share of firm's market value. The second column reproduces our raw block premium (Table III column (1)). The third column reports Nenova's fixed effect estimates of the value of control, where she controls for differences in the dividend rights between the two classes of stock, differences in liquidity, and the presence of a conversion option (Nenova, Table VI, Col. 4). The fourth column reports our fixed effect estimates of the value of control (Table V). The fifth column reports the percentage of firms in Datastream sample that have multiple share classes with available price data, where the number of firms with multiple share classes is taken from Nenova and the number of firms with equity prices in Datastream for 1997 is reported in Appendix Table AII. Panel B reports OLS regressions of the difference between Nenova's control premia and ours. In column 1 there is the difference between the raw estimates, in column 2 the difference between the fixed effect estimates. The explanatory variable is the percentage of firms that have dual-class shares and price data available in each country (column 5 of Panel A). Robust standard errors are in parentheses.

| Country        | Panel A: Data Comparisons                                              |                                    |                                                                                |                                  |                                                                                 |
|----------------|------------------------------------------------------------------------|------------------------------------|--------------------------------------------------------------------------------|----------------------------------|---------------------------------------------------------------------------------|
|                | Raw Data                                                               |                                    | Estimated Country Fixed Effects                                                |                                  |                                                                                 |
|                | Premia Using<br>Voting/Nonvoting<br>Shares (Nenova,<br>Table V (2000)) | Block Premia<br>(Table III, Col 1) | Premia Using<br>Voting/Nonvoting<br>Shares (Nenova,<br>Table V, Col. 4 (2000)) | Block Premia<br>(Table V, Col 2) | Percentage of Equities<br>with Dual-Class<br>Shares and Available<br>Price Data |
| Australia      | 0.232                                                                  | 0.020                              | 0.185                                                                          | 0.052                            | 0.01                                                                            |
| Brazil         | 0.232                                                                  | 0.650                              | 0.180                                                                          | 0.653                            | 0.59                                                                            |
| Canada         | 0.028                                                                  | 0.013                              | 0.035                                                                          | -0.052                           | 0.04                                                                            |
| Switzerland    | 0.054                                                                  | 0.063                              | 0.054                                                                          | -0.051                           | 0.19                                                                            |
| Chile          | 0.231                                                                  | 0.183                              | 0.231                                                                          | 0.16                             | 0.07                                                                            |
| Germany        | 0.095                                                                  | 0.095                              | 0.148                                                                          | 0.041                            | 0.14                                                                            |
| Denmark        | 0.008                                                                  | 0.077                              | 0.009                                                                          | 0.027                            | 0.20                                                                            |
| Finland        | -0.050                                                                 | 0.025                              | 0.058                                                                          | 0.002                            | 0.24                                                                            |
| France         | 0.281                                                                  | 0.019                              | 0.282                                                                          | 0.084                            | 0.02                                                                            |
| United Kingdom | 0.096                                                                  | 0.014                              | 0.090                                                                          | 0.02                             | 0.02                                                                            |

Table VI—Continued

| Panel A: Data Comparisons                                                                                               |                                                               |                                 |                                                                       |                               |                                                                        |
|-------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------|---------------------------------|-----------------------------------------------------------------------|-------------------------------|------------------------------------------------------------------------|
| Country                                                                                                                 | Raw Data                                                      |                                 | Estimated Country Fixed Effects                                       |                               | Percentage of Equities with Dual-Class Shares and Available Price Data |
|                                                                                                                         | Premia Using Voting/Nonvoting Shares (Nenova, Table V (2000)) | Block Premia (Table III, Col 1) | Premia Using Voting/Nonvoting Shares (Nenova, Table V, Col. 4 (2000)) | Block Premia (Table V, Col 2) |                                                                        |
| Hong Kong                                                                                                               | −0.029                                                        | 0.003                           | −0.029                                                                | 0.008                         | 0.01                                                                   |
| Italy                                                                                                                   | 0.294                                                         | 0.369                           | 0.345                                                                 | 0.349                         | 0.31                                                                   |
| South Korea                                                                                                             | 0.289                                                         | 0.157                           | 0.338                                                                 | 0.137                         | 0.11                                                                   |
| Mexico                                                                                                                  | 0.364                                                         | 0.345                           | 0.460                                                                 | 0.396                         | 0.06                                                                   |
| Norway                                                                                                                  | 0.058                                                         | 0.015                           | 0.058                                                                 | 0.061                         | 0.11                                                                   |
| Sweden                                                                                                                  | 0.010                                                         | 0.074                           | 0.010                                                                 | 0.047                         | 0.19                                                                   |
| United States                                                                                                           | 0.020                                                         | 0.010                           | 0.016                                                                 | 0.035                         | 0.08                                                                   |
| South Africa                                                                                                            | 0.067                                                         | 0.017                           | 0.063                                                                 | −0.014                        | 0.07                                                                   |
| Panel B: Can Differences between Benefits-Estimates Be Explained by Potential Selection Bias in Voting Rights Approach? |                                                               |                                 |                                                                       |                               |                                                                        |
|                                                                                                                         | Dependent Variable                                            |                                 |                                                                       |                               |                                                                        |
|                                                                                                                         | Nenova Measure – Our Measure                                  |                                 | Refined Nenova Measure – Our Refined Measure                          |                               |                                                                        |
| Percentage of dual-class firms in country                                                                               | −0.873***                                                     | (0.109)                         | −0.816***                                                             | (0.218)                       |                                                                        |
| Constant                                                                                                                | 0.127***                                                      | (0.029)                         | 0.144***                                                              | (0.032)                       |                                                                        |
| Number of observations                                                                                                  | 18                                                            |                                 | 18                                                                    |                               |                                                                        |
| Adjusted <i>R</i> -squared                                                                                              | 0.76                                                          |                                 | 0.63                                                                  |                               |                                                                        |
| *** significant at 1% level.                                                                                            |                                                               |                                 |                                                                       |                               |                                                                        |

We test the possible effects of the sample selection described above by regressing the difference between Nenova's estimates and our estimates against the percentage of companies with dual class shares. If there exists a bias, we expect Nenova's estimates to exceed ours in countries with few dual-class stocks like Australia and the United Kingdom (i.e., a negative coefficient in the regression). This is indeed what we find. In countries where dual class shares are more rare Nenova's number significantly exceeds ours. The effect is economically very important. A one standard deviation increase in the percentage of dual class shares leads Nenova's estimates to exceed ours by 22 percentage points.<sup>18</sup> This variable alone explains 76 percent of the difference in raw estimates and 63 percent of the difference in refined estimates.

Overall, these results give confidence that the Barclay and Holderness method to estimate private benefits indeed measures private benefits (and not overpayment) and it does so introducing smaller biases than the alternative method. That the two sets of estimates differ in the way predicted by theory is also a strong indication these estimates are indeed measuring the value of private benefits of control.

### *F.2. An Analysis of Outliers*

Another way to verify that we are indeed measuring private benefits of control is an in-depth analysis of the outliers. In Brazil, we estimate private benefits to be 65 percent of the value of equity. Could private benefits really be this large, or is this finding the result of some problem in the way we infer private benefits? Nenova (2001b), as part of a study of the impact of legal reform on private benefits in Brazil, independently collected information on control sales in Brazil between 1995 and 2000, identifying eight transactions that meet our initial sample selection criteria, including six transactions not in our database.<sup>19</sup> In the sample of eight transactions (Nenova (2001b), Table III) she reports an average value of private benefits of 42 percent, not too dissimilar from our estimate. In addition, we asked a Brazilian investment bank to give us all the privatization data where the Government sold a controlling block of a firm already listed.<sup>20</sup> Their search produced 23 privatization transactions with the requisite data, including 21 transactions that were not

<sup>18</sup> Using differential voting shares to estimate the value of control can induce also another bias. When ownership is highly concentrated, the price of voting shares tends to underestimate the value of votes, because control is securely held in the hands of the largest shareholder. There is some weak evidence this might be the case if we use Nenova's (2001a) raw estimates. Nenova, however, is aware of this problem and in her regressions she controls for ownership concentration. Consistently, her refined measure seems completely unaffected by this bias.

<sup>19</sup> Her approach, albeit very similar, is not strictly comparable with our own, as she uses the price on the date of sale and compares the sale price with the price of voting shares on the exchange.

<sup>20</sup> This sample only includes transaction where sale price is cash. That is, we excluded privatizations where sale price could include so-called "privatization currencies" that included government debt that was trading at a discount.

included in our original data set.<sup>21</sup> The average control premia in this sample is 129 percent.

In sum, independent estimates lead to a very similar conclusion: Private benefits of control in Brazil are extremely high.

### *F.3. Within-country Variation in Private Benefits*

Another check to verify whether our method captures private benefits is to see whether our estimates change when external conditions, which affect the ability to extract private benefits, change. While the fact that we have relatively few transactions from many countries limits our ability to systematically explore time series variation, at least for three events, we have this possibility.

The first event we explore is the passage in Italy of a corporate governance reform in 1998, also known as the Draghi reform. Among other things, this reform made it easier for minority shareholders to sue management appointed by the controlling shareholder. Such reform should limit the ability to extract private benefits. When we segment our data into those observations before and after July 1998, we find that before the reform the average value of private benefits is 47 percent, while after the reform it is only 6 percent.<sup>22</sup>

The second event we explore focuses on Brazil in the 1990s where, as Nenova (2001b) reports, there were two important changes in the legal environment. The first change occurred on May 5, 1997 when Law 9457 was adopted. This law, designed to enhance government revenues from selling State-owned controlling blocks, eliminated several protections of minority investors: the right to be bought out at book value in case of major transactions, such as mergers and spinoffs, the requirement for acquirers to make a mandatory offer to other holders of voting shares at the same price as the control block, etc. The elimination of these protections makes control more valuable. The second change was the passage of Instruction 299 by the Brazilian securities and exchange commission (CVM), reinstating these rights and adding new disclosure requirements.

These legal changes suggest that private benefits will differ depending on which legal regime is in effect, with private benefits expected to be greatest in the period when Law 9457 was in effect, and lower both before and after. This is in fact what we find in our sample of transactions: the premia are highest during the period of law 9457 at 119 percent, with lower levels in the pre-9457 period at 53 percent, and in the postinstruction 299 period of 37 percent. Similar findings are found using our methods in the Nenova sample (27 percent for the pre-9457 period to 61 percent in the 9457 period to 37 percent in the postinstruction 299 period). A similar trend is revealed in our privatization

<sup>21</sup> They identified 12 transactions where the stake sold was 19.26 percent, which we excluded because this level was below our selection criteria, but in Brazil accounted for 50.1 percent of the voting shares in the company. In addition, they were able to identify stock market prices for a number of firms that we were not able to collect using Datastream or were not identified by SDC.

<sup>22</sup> The *p*-value for the equality of the two means is only 21 percent, but this is not surprising given we have only six observations before and two afterward.

sample where we just have data for the first two periods (with values of 109 percent in the pre-9457 period increasing to 131 percent in the 9457 period).

The third event we explore focuses on changes in the economic environment rather than changes in the legal regime to protect investors. It has been suggested that stealing will increase when the expected return on investment declines and that the Asian crisis presents such an event (Johnson et al. (2000)). We test for this, examining whether the levels of private benefits are different for emerging markets in Asia during the Asian crisis, where following Johnson et al. we define the crisis to be 1997 and 1998.<sup>23</sup> Based on a regression of private benefits with country fixed effects we find that the Asian crisis period is indeed associated with higher private benefits (coefficient of 0.068), although this is not significant at conventional significance levels ( $p$ -value = 0.162).

In sum, in all three instances, our estimates move as theory predicts private benefits should move. Having established some degree of confidence in our estimates, we now move to use them in international comparisons.

### III. Effects of Private Benefits on Financial Development

#### A. Theoretical Predictions

We have shown that the magnitude of private benefits of control varies greatly across countries. We have not shown, however, that larger private benefits are necessarily more inefficient. Can we derive any implication on the effects of larger private benefits of control on the development of financial markets that is independent of their characterization as efficient or inefficient?

The answer is yes. In countries where a controlling party can appropriate a larger share of the value of a company, entrepreneurs will be more reluctant to take their companies public. If they sell a minority position, outside investors will be willing to pay less for it than what it is currently worth to the entrepreneur, because they factor in the possibility a new acquirer will dilute the value of the company in the future. As a result, entrepreneurs are reluctant to sell (Zingales (1995b)). At the same time, when control value is high they do not want to sell a majority of votes in the market because they will not receive an adequate compensation for it. Atomistic shareholders will pay for the voting rights they expect to receive in a future tender offer. If, as it is likely to be the case, the market for corporate control is not perfectly competitive, atomistic shareholders will receive less in a tender offer than what a controlling shareholder would have obtained in a private negotiation (Zingales (1995b)). Hence, three implications follow:

- (1) Since fewer companies will list in countries with high private benefits of control, the importance of the equity market relative to GDP should be smaller;

<sup>23</sup> Specifically, countries included in this test include Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand.

- (2) Since incumbents are more likely to retain control after they take their company public in countries with high private benefits of control, the percentage of companies widely held should be smaller;
- (3) Since it is more profitable to sell control in a private negotiation in countries with high private benefits of control, a revenue maximizing government should prefer to sell control in private transactions rather than in public offerings.

All these predictions are independent of the direct welfare implications of private benefits of control. In fact, they are derived from Zingales (1995b), where private benefits of control have no efficiency consequences, but only distributional ones.

### *B. Test*

In Table VII we test these three predictions using our private benefits measure as an independent variable. We focus on our estimated country fixed effects from Table V. Since our explanatory variable is estimated, OLS estimates are biased and inconsistent. Thus, we also report instrumental variable (IV) estimates, where we use the family of origin of a country's legal system as an instrument for the extent of private benefits. As we show below in Table XI, legal origin is highly correlated with our private benefit measure. All of the reported results are robust to using the raw measure of private benefits from Table II in place of the estimated country fixed effects from Table V.

We begin by focusing on the relation between the size of private benefits and ownership concentration (specification 1). As a measure of ownership concentration that is available for almost all of the countries in our data set we use the percentage of equity controlled by the three largest shareholders in the 10 largest nonfinancial firms where the state is not a shareholder (La Porta et al. (1998)). To control for other possible factors, we insert in all the regressions the log GDP per capita.

As predicted, countries with higher private benefits have more concentrated ownership. A one standard deviation increase in the size of private benefits translates into 11 percent more of the equity held by the largest three shareholders in the instrumental variables specification. This simple specification seems to also have a very high explanatory power ( $r$ -squared = 0.45).

In specification 2, we test the effect of private benefits on the way firms are privatized. Our dependent variable is the percentage of privatizations that took place as a private asset sale, rather than as a share offering from Megginson et al. (2000). Asset sales almost always involve the sale of a majority (or 100 percent) of the shares to a controlling shareholder or group. Share offerings disperse ownership to a greater extent. To control for other factors, we include not only the per capita GDP, but also the importance of the equity market, on the basis that governments are more likely to sell shares in public offerings if the market is more developed.<sup>24</sup>

<sup>24</sup> The results are robust to excluding this variable.

**Table VII**  
**Testing the Theoretical Predictions on the Effects of Private Benefits on Financial Market Development**  
In specification 1 of Panel A the dependent variable is the average concentration of ownership as measured by the combined stakes of the three largest shareholders in the 10 largest nonfinancial, nonforeign corporations where the state is not a shareholder (see La Porta et al. (1997)). In specification 2 the dependent variable is the percentage of privatization transactions that took the form of an asset sale rather than a share offering (Megginson et al. (2000)). In Panel B the dependent variables are: (1) the number of initial public equity offerings in 1995 to 1996; (2) the number of listed domestic firms; (3) the ratio of the stock market capitalization held by minority investors to GNP (all from La Porta et al. (1997)). The explanatory variables are the average log GDP per capita 1970 to 1995 (World Bank) and our fixed effect estimates of the country average level of value of control from Table V. More complete variable descriptions and sources are provided in Table I. The instruments are the families of origin of a country's legal system (English, French, German, Scandinavian, and Soviet). Robust standard errors are in parentheses.

| Independent Variables  | Panel A: Dependent Variables: Ownership Structure |                           |                                                                             |                           |
|------------------------|---------------------------------------------------|---------------------------|-----------------------------------------------------------------------------|---------------------------|
|                        | Dependent Variables                               |                           |                                                                             |                           |
|                        | (1)<br>Ownership Concentration<br>(3 largest)     |                           | (2)<br>Percentage of Privatizations as Asset Sales<br>(not share offerings) |                           |
|                        | OLS                                               | Instrumental<br>Variables | OLS                                                                         | Instrumental<br>Variables |
| Country control premia | 0.365** (0.124)                                   | 0.591** (0.261)           | 0.999*** (0.240)                                                            | 2.005** (0.797)           |
| Log per capita income  | -0.047*** (0.015)                                 | -0.033 (0.021)            | -0.024 (0.057)                                                              | 0.022 (0.061)             |
| Constant               | 0.807*** (0.127)                                  | 0.659*** (0.207)          | 0.554 (0.505)                                                               | 0.037 (0.583)             |
| Number of obs.         | 36                                                | 36                        | 36                                                                          | 36                        |
| R-squared              | 0.445                                             |                           | 0.276                                                                       |                           |

Table VII—Continued  
Panel B. Dependent Variable: Capital Market Structure Based on Aggregate Data

| Independent Variables  | Dependent Variables                            |                           |                                               |                           |                                     |                           |
|------------------------|------------------------------------------------|---------------------------|-----------------------------------------------|---------------------------|-------------------------------------|---------------------------|
|                        | (1)                                            |                           | (2)                                           |                           | (3)                                 |                           |
|                        | Initial Public Offerings<br>in 1996/Population |                           | Number of Listed Domestic<br>Firms/Population |                           | Equity Market<br>Capitalization/GNP |                           |
|                        | OLS                                            | Instrumental<br>Variables | OLS                                           | Instrumental<br>Variables | OLS                                 | Instrumental<br>Variables |
| Country control premia | -2.753** (1.263)                               | -12.66** (5.609)          | -24.03 (26.74)                                | -199.3* (94.21)           | -1.265*** (0.413)                   | -3.747** (1.307)          |
| Log per capita income  | 0.451** (0.195)                                | -0.082 (0.419)            | 8.643*** (3.079)                              | -0.327 (5.711)            | -0.041 (0.065)                      | -0.168 (0.103)            |
| Constant               | -2.315 (1.543)                                 | 3.472 (4.064)             | -45.60** (24.69)                              | 51.57 (57.79)             | 0.943 (0.614)                       | 2.319** (0.988)           |
| Number of obs.         | 34                                             | 34                        | 37                                            | 37                        | 37                                  | 37                        |
| R-squared              | 0.203                                          |                           | 0.168                                         |                           | 0.213                               |                           |

\*significant at 10% level; \*\*significant at 5%; \*\*\*significant at 1% level.

We find that in countries with large private benefits, governments are more likely to divest companies through private sales. A one standard deviation increase in the size of private benefits translates into 36 percent more firms being privatized through private negotiations in the instrumental variables specification. These results are consistent with evidence from privatizations in specific countries. In Brazil, for example, government interest in receiving the control premia at the time of privatization led them to weaken existing protections for minority investors so that minority holders of voting shares no longer had the right to an equal offer at the same price as the control block. In Mexico, Lopez-de-Silanes (1997) reports that the price per share for sales that did not involve control were just one quarter of the prices for sales of control blocks, helping to explain the fact that 87 percent of all sales in his sample of Mexican firms involved sales of control.

In Table VII, panel B, we test the link between private benefits and capital market development, beginning with the various aggregate indicators of financial development introduced by La Porta et al. (1997): number of IPOs/population, the number of listed firms/population, and the external market capitalization relative to GDP. Private benefits also explain a significant fraction of the cross-sectional variation in these measures. Our measure of private benefits is significant in all regressions with the exception of the OLS specification with the number of listed firms, where the single data point of Israel, with an unusually high level number of firms, reduces our level of significance. All the regressions include log per capita GDP as a regressor, to control for other possible factors.<sup>25</sup> A one standard deviation increase in private benefits translates into a 67 percent decline in the percent of external equity capitalization/GNP.

#### IV. What Curbs Private Benefits of Control?

##### A. Theoretical Predictions

Since the extent of private benefits of control seems to matter for security market development, the question of what curbs them becomes of central importance for any attempt to foster security market development.

The evidence of systematic differences in legal rules and the correlation between these rules and features of financial development La Porta et al. (1997, 1998, 1999) has focused the attention on the importance of the legal system. To capture the effect of the legal framework, we use three empirical proxies: (1) the formal rights of minority shareholders, (2) the degree of accounting disclosure (which allows minority shareholders to identify abuses), and (3) the quality of legal enforcement.

<sup>25</sup> Similar results obtain if we follow La Porta et al. (1997) and include GDP growth to capture future growth prospects and log GDP to capture any economies of scale in financial development.

*A.1. Legal Institutions*

(i) *The legal environment.* The ability of a controlling shareholder to appropriate some of the value generated is limited by the possibility of being sued. Thus, a greater ability to sue should translate into smaller private benefits of control (Zingales (1995a)). The same reasoning applies to any legal right attributed to noncontrolling shareholders (La Porta et al. (1997)). Accordingly, we examine the explanatory power of legal rights that give minority investors leverage over insiders in firms focusing on the so-called antidirector rights index developed by La Porta et al. (1997) and used by Pistor, Raiser, and Gelfer (2000) for the transition countries. We focus our attention on the level of shareholder rights in the country of the target firm. As seen above, we also examine the impact of shareholder rights in the acquirer's country based on the hypothesis that these might also constrain private benefits (Dyck (2000)).

(ii) *Disclosure standards.* Disclosure standards regulate the information available to noncontrolling shareholders. The more accurate this information is, the more difficult it is for a controlling shareholder to appropriate value without incurring legal penalties or, at least, reputational costs. Thus, measures of quality of disclosure should be negatively correlated with the size of private benefits of control.

(iii) *Enforcement.* The strength of legal protections depends upon the expectations of speedy and predictable enforcement. Thus, we include as one of our contractual variables a measure of the strength of a country's law and order tradition as measured by the country risk rating agency, International Country Risk. This rule of law index is scaled from zero to 10.

*A.2. Extra-legal Institutions*

The possibility of extracting private benefits is intrinsically related to managerial discretion, a discretion that courts cannot easily restrict. As a result, extra-legal institutions may play an important role in constraining private benefits (Dyck (2000)), both in settings with legal protections as well as in settings where legal protections are nonexistent or not enforced.

The potential constraints imposed by extra-legal institutions have not been prominent in current debates, at least in part because of a lack of empirical examination. We focus our attention on five institutional factors that, at least in theory, have the potential to raise expectations of penalties for activities that produce private benefits for controlling shareholders. Some of these factors that can raise the costs to the controlling shareholder for diverting activities (such as the penalties produced by product market competition and by public opinion pressure) are constraints external to the firm. Other factors (such as the sanctions that can be introduced by moral norms, labor, and the government as tax collector) are more "internal" to the firm.

(iv) *Product market competition.* The degree of product market competition affects the opportunity to appropriate private benefits in two dimensions. First, the more competitive markets are, the more verifiable prices become. When prices are more "objective," it is more difficult for a controlling shareholder to

tunnel out resources through manipulated transfer prices without incurring legal and/or reputational costs. Second, in a competitive market the distortions produced by the extraction of private benefits are more likely to jeopardize the survival of the firm. Hence, competition represents a natural constraint to the extraction of private benefits.

The extent of product market competition is based both on industry and on country characteristics. In our regressions we include controls for industry characteristics, which we constrain to be constant across countries. The extent of product market competition is also influenced by country level characteristics, particularly government policies regarding entry and competition. We use as our proxy for the extent of product market competition at the national level the response to the survey question, "competition laws prevent unfair competition in your country?" as reported by the World Competitiveness Yearbook for 1996. This variable, which is available for all of our countries, captures cross-country differences in the extent to which national policy makers allow for barriers to competition over and above those constraints associated with industry.

(v) *Public opinion pressure.* Controlling shareholders might limit their efforts to divert firm resources not out of fear of legal sanction but rather out of concern for their reputation. As Dyck and Zingales (2002b) argue, reputation to reduce diversion, the information about improper behavior must be publicized. For example, shareholders' activist Robert Monks succeeded in initiating some major changes at Sears, not by means of the norms of the corporate code (his proxy fight failed miserably), but through the pressure of public opinion. He paid for a full-page announcement in the *Wall Street Journal* where he exposed the identities of Sears' directors, labeling them the "non-performing assets" of Sears (Monks and Minnow (1995)). The embarrassment for the directors was so great that they implemented all the changes proposed by Monks. Similarly, recent efforts to stem diversionary practices by the powerful Korean Chaebol have also come not from court cases but through the public identification and dissemination of behavior through the media by shareholder activists. Public humiliation is not only a tool of activists, but is also viewed as an important tool of regulators. In Hong Kong, for example, the main sanction available to securities regulators was not financial penalties but the threat and use of publishing those who violate listing requirements through the press.<sup>26</sup>

Critically, for reputation to work, though, it is necessary to have a "public opinion: that is, a combination of an independent press that publicizes the facts and of a large set of educated investors, who read the newspapers and sanction improper behavior" (Zingales (2000)). We try to capture this idea with an indicator of newspapers' diffusion, measured as the circulation of daily newspapers normalized by population.

(vi) *Internal policing through moral norms.* Regardless of the reputational cost and/or the legal punishment the appropriation of private benefits trigger,

<sup>26</sup> While public opinion pressure is likely to act as a restraint in the extraction of private benefits, it does not necessarily push managers in the direction of shareholders' value maximization. In fact, in Dyck and Zingales (2002b) we show that media pressure also induces companies to be more environmentally conscious even if this does not necessarily benefit shareholders.

a controlling shareholder might choose not to appropriate value for moral considerations. But what constitutes a measure of the strength of such an internal policeman? Coffee (2001) proposes the violent crime rate as a proxy for these moral norms, noting that this at least captures an important difference between Scandinavian and other countries. Stulz and Williamson (2001) focus on culture as an indicator of norms. They use religion as their proxy for cultural norms and hypothesize that certain religious traditions will be more antagonistic to investor rights, such as the historical antagonism Catholics and Muslims had toward the payment of interest. To test for an impact of moral norms we use both proposed measures: (1) the number of violent crimes reported by the World Competitiveness Yearbook based on Interpol data for 1993 and (2) Stulz and Williamson's classification of countries by their primary religious orientation.

(vii) *Labor as monitor*. Additional constraints on controlling shareholders might come from the presence of economic entities with a direct interest in firm decisions that could penalize efforts to extract private benefits directly without having to turn to the courts. From this perspective, it is clear that labor has the potential to monitor controlling shareholders and the ability to penalize diversions without resorting to legal sanctions. Labor is privy to inside information on customers and suppliers and can hold up the controlling shareholder by threatening to withhold services and in some cases, through their position on the board of directors. Stiglitz (1985), for example, suggests that unions have both the potential for low cost monitoring and have a strong incentive to monitor. "Labor is also motivated to take actions that protect the long-term survival of the firm, and particularly where employees are also owners through the investment of their pension funds in company stock, their interests are not narrowly focused on wages," (Stiglitz (1985)). At the same time, it is theoretically ambiguous how labor might act for it does not necessarily have the incentive to constrain private benefits, possibly aligning itself with the controlling shareholder against outside investors and labor's information access might not include critical information that is the source of private benefits. We test for the effect of labor on private benefits using as a cross-country measure of the extent of potential labor power the degree of employee protection. This measure is available for all OECD countries.

(viii) *Government as monitor through tax enforcement*. There is one de facto minority shareholder that is common to all companies: the Government. As for minority shareholders, the Government has an interest in ascertaining the value produced by a company and getting a share of it. Transfer pricing, for instance, is disciplined by the tax code. In the United States, intracorporate transfers should take place at the price the two units would have charged in a competitive market. Hence, how tax authorities enforce their rules on transfer pricing affects the incentives to transfer profits to related companies. The stricter the enforcement, the less controlling shareholders will use transfer prices to siphon out value at the expense of minority shareholders.<sup>27</sup>

<sup>27</sup> Tax authorities should be particularly concerned about diversions of revenues from taxed to nontaxed entities, be those entities domestic or foreign.

Unlike noncontrolling shareholders, however, the tax authority does not face any free-rider problem in monitoring and enforcing its right. On the contrary, by aggressively prosecuting a company the Government sets an example that induces all others to behave. Thus, it has an incentive to prosecute cases even when the cost of prosecution is higher than the money recoverable. Furthermore, the Government has the benefit of disciplinary powers that are simply not available to dispersed shareholders. Therefore, better tax enforcement can have an important role in reducing the private benefits of control.

Note that this effect is true only for the quality of the enforcement not for the level of the tax rates. In fact, a higher tax rate increases a company's benefit from hiding income. In so doing, it subsidizes the siphoning out activity of the largest shareholder. For any dollar siphoned out by the majority shareholder, minority shareholders lose only  $(1-t)$  dollars, where  $t$  is the corporate tax rate. Hence, the higher the  $t$ , the lower the incentives of minority shareholders to stop this activity.

For this reason we want a measure of tax compliance, not of tax revenues. To this purpose, we use an index developed by the World Competitiveness Report, which assesses the level of tax compliance. The index goes from zero to six where higher scores indicate higher compliance.

That an effective corporate taxation system might have this positive externality has not been emphasized in the corporate finance literature, or, to our knowledge, in the public finance literature.<sup>28</sup> Any evidence in this direction would be an important element in the debate on the costs and benefits of corporate income taxation, particularly in countries with high private benefits.

### B. Test

The large panel data set of 393 transactions from 39 countries provides a unique sample to try and identify the main institutional curbs of private benefits of control discussed above. In what follows, we describe the empirical proxies used and their effect on the private benefits of control. The definition for all these proxies is reported in Table I. Table VIII reports their actual values. In Table IX we test the impact of each institution in isolation and in Table X we try to test them one against the other. For these regressions, we include all of the control variables used in Table V as well as an indicator variable that identifies countries that have any form of tender offer requirement.

We start with the impact of "legal" factors, that is, factors that directly or indirectly rely on the court enforcement of certain rights. Information disclosure is the prerequisite for any legal action. Thus, we start (column 1) with the quality of the accounting standards, as measured by the CIFAR index. Firms in countries with better accounting standards have lower private benefits of control. This effect is both statistically and economically significant.

<sup>28</sup> For example, Gresik's (2001) recent review of the literature on rationales for and effects of corporate income taxation in the context of transnationals does not mention any spillovers between government actions and agency costs.

Table VIII  
Institutional Variables

This table presents summary statistics of the institutional variables used in Tables IX to XI. Variable definitions and sources can be found in Table I.

| Panel A            |              |                             |                           |                                     |                          |                            |                                   |                          |                      |                                           |                  |
|--------------------|--------------|-----------------------------|---------------------------|-------------------------------------|--------------------------|----------------------------|-----------------------------------|--------------------------|----------------------|-------------------------------------------|------------------|
| Legal Institutions |              |                             |                           |                                     | Extra Legal Institutions |                            |                                   |                          |                      |                                           |                  |
| Country            | Legal Origin | Accounting Standards (0-90) | Antidirector Rights (0-6) | Rule of Law at Country Level (1-10) | Competition Laws         | Newspaper Circulation/ Pop | Serious Crime/ 100,000 Population | Labor Protection Measure | Tax Compliance (1-6) | Acceptability of Cheating on Taxes (1-10) | Primary Religion |
| Argentina          | French       | 45                          | 4                         | 5.35                                | 4.85                     | 1.2                        | 8.2                               |                          | 2.41                 | 1.97                                      | Catholic         |
| Australia          | English      | 75                          | 4                         | 10                                  | 5.52                     | 3.0                        | 57.5                              | 0.9                      | 4.58                 | 2.16                                      | Protestant       |
| Austria            | German       | 54                          | 2                         | 10                                  | 5.29                     | 2.9                        | 57.3                              | 2.2                      | 3.6                  | 1.97                                      | Catholic         |
| Brazil             | French       | 54                          | 3                         | 6.32                                | 4.9                      | 0.4                        |                                   |                          | 2.14                 | 3.11                                      | Catholic         |
| Canada             | English      | 74                          | 5                         | 10                                  | 5.37                     | 1.6                        | 122.3                             | 0.6                      | 3.77                 | 2.34                                      | Catholic         |
| Chile              | French       | 52                          | 5                         | 7.02                                | 5.4                      | 1.0                        | 53.7                              |                          | 4.2                  | 1.98                                      | Catholic         |
| Colombia           | French       | 50                          | 3                         | 2.08                                | 4.71                     | 0.5                        | 129.1                             |                          | 2.11                 | 1.92                                      | Catholic         |
| Czech Republic     | Soviet       |                             | 2                         | 8.3                                 | 4.89                     | 2.5                        | 177.2                             |                          | 2.54                 |                                           | Atheist          |
| Denmark            | Scand.       | 62                          | 2                         | 10                                  | 5.16                     | 3.1                        | 46.1                              |                          | 3.7                  | 2.48                                      | Protestant       |
| Egypt              | French       | 24                          | 2                         | 4.17                                | 4.6                      | 0.4                        |                                   |                          | 3.57                 |                                           | Muslim           |
| Finland            | Scand.       | 77                          | 3                         | 10                                  | 5.26                     | 4.6                        | 47.1                              | 2.0                      | 3.53                 | 2.63                                      | Protestant       |
| France             | French       | 69                          | 3                         | 8.98                                | 5.83                     | 2.2                        | 126.8                             | 3.0                      | 3.86                 | 3.28                                      | Catholic         |
| Germany            | German       | 62                          | 1                         | 9.23                                | 5.91                     | 3.1                        | 74.1                              | 2.5                      | 3.41                 | 2.94                                      | Protestant       |
| Hong Kong          | English      | 69                          | 5                         | 8.22                                | 5.85                     | 8.0                        | 190.8                             |                          | 4.56                 |                                           | Local beliefs    |
| Indonesia          | French       |                             | 2                         | 3.98                                | 4.42                     | 0.2                        | 4.6                               |                          | 2.53                 |                                           | Muslim           |
| Israel             | English      | 64                          | 3                         | 4.82                                | 5.11                     | 2.9                        | 68.9                              |                          | 3.69                 |                                           | Judaism          |
| Italy              | French       | 62                          | 1                         | 8.33                                | 5.14                     | 1.0                        | 61.7                              | 3.3                      | 1.77                 | 2.28                                      | Catholic         |
| Japan              | German       | 65                          | 4                         | 8.98                                | 5.64                     | 5.8                        | 2.7                               | 2.4                      | 4.41                 | 1.49                                      | Buddhist         |
| Malaysia           | English      | 76                          | 4                         | 6.78                                | 4.84                     | 1.6                        | 34.5                              |                          | 4.34                 |                                           | Muslim           |
| Mexico             | French       | 60                          | 1                         | 5.35                                | 4.93                     | 1.0                        | 100.8                             |                          | 2.46                 | 3.35                                      | Catholic         |
| Netherlands        | French       | 64                          | 2                         | 10                                  | 5.53                     | 3.1                        | 122.8                             | 2.1                      | 3.4                  | 3.08                                      | Catholic         |

| Panel B: Correlation Matrix |                      |                             |                           |                                     |                  |                           |                                  |                          |                      |                                           |
|-----------------------------|----------------------|-----------------------------|---------------------------|-------------------------------------|------------------|---------------------------|----------------------------------|--------------------------|----------------------|-------------------------------------------|
|                             |                      | Accounting Standards (0-90) | Antidirector Rights (0-6) | Rule of Law at Country Level (1-10) | Competition Laws | Newspaper Circulation/Pop | Serious Crime/100,000 Population | Labor Protection Measure | Tax Compliance (1-6) | Acceptability of Cheating on Taxes (1-10) |
| Accounting standards        | English New Zealand  | 1.00                        |                           |                                     |                  |                           |                                  |                          |                      |                                           |
| Antidirector rights         | Scand. Norway        | 0.32                        | 1.00                      |                                     |                  |                           |                                  |                          |                      |                                           |
| Rule of law                 | French Peru          | 0.53                        | 0.06                      | 1.00                                |                  |                           |                                  |                          |                      |                                           |
| Competition laws            | French Philippines   | 0.49                        | 0.26                      | 0.59                                | 1.00             |                           |                                  |                          |                      |                                           |
| Newspaper circulation       | Poland               | 0.54                        | -0.01                     | 0.62                                | 0.35             | 1.00                      |                                  |                          |                      |                                           |
| Serious crime               | Portugal             | 0.19                        | 0.33                      | -0.09                               | 0.26             | -0.13                     | 1.00                             |                          |                      |                                           |
| Labor protection            | English Singapore    | -0.57                       | -0.55                     | -0.54                               | -0.46            | -0.10                     | -0.35                            | 1.00                     |                      |                                           |
| Tax compliance              | English South Africa | 0.58                        | 0.40                      | 0.65                                | 0.74             | 0.65                      | -0.08                            | -0.78                    | 1.00                 |                                           |
| Cheat                       | German South Korea   | 0.08                        | -0.11                     | 0.17                                | -0.03            | -0.11                     | 0.07                             | 0.46                     | -0.10                | 1.00                                      |

A one standard deviation increase in accounting standards reduces the value of control by 9.0 percentage points. Together with the other control variables, accounting standards explain 21 percent of the variation in private benefits of control (the firm-specific control variables alone explain just 15 percent).

Our second variable (column 2) is the extent of legal protections for minority investors, measured using La Porta et al. (1998) index of antidirector rights. Countries with more antidirector rights have lower private benefits of control. A one standard deviation increase in antidirector rights reduces the value of control by 4.4 percentage points. Together with the firm-specific variables, antidirector rights explain 17 percent of the variation in private benefits of control.

Finally, we use the quality of law enforcement, which we measure using the IBR index of the quality of the law enforcement in a country. Countries with better law enforcement have lower private benefits of control. A one standard deviation increase in our law enforcement measure reduces the value of control by 7.0 percentage points. Together with the firm-specific variables, rule of law explains 20 percent of the variation in private benefits of control.

In sum, we find that legal institutions are strongly associated with lower levels of private benefits. When we combine the two legal variables that are available for our full sample in one regression (Table X, column 1), both are statistically significant and the *R*-squared is 21 percent.

We also test the explanatory power provided by extra-legal institutions, which are suggested by a functional rather than an institutional perspective. Here we focus on crude country-wide measures of product market competition, scope of reputational penalties, moral norms, employee protections, and diligence of tax authorities.

Table IX, columns 4 to 9, explores the explanatory power of these factors one at a time. In column 4 we test the effect of competition. After having controlled for industry type, we find that countries with more competitive product markets, at least as measured by this survey of the World Competitiveness Report, have lower private benefits of control. A one standard deviation increase in our measure of competition reduces the value of control by 6.0 percentage points. Together with the firm specific variables, competition explains 20 percent of the variation in private benefits of control.

In column 5 of Table IX, we explore the idea that public opinion pressure might curb the amount of private benefits extracted. We measure the importance of this pressure with the diffusion of newspapers (number of copies sold per 100,000 inhabitants). Diffusion captures both the importance of public opinion and the credibility of newspapers (less credible newspapers sell less).<sup>29</sup> Countries where newspapers are more diffused have lower private benefits

<sup>29</sup> In Dyck and Zingales (2002b), we study the determinants of newspapers' diffusion. We find that the type of dominant religion and the degree of ethnolinguistic fractionalization explain 41 percent of the variation in press diffusion. When we use these as instruments for press diffusion, the results are unchanged.

**Table IX**  
**Institutional Determinants of Private Benefits of Control—Univariate Analysis**

The dependent variable is the block premia as a percent of firm equity. The explanatory variables include all of variables introduced in Table V except the country fixed effects, but including a dummy to indicate the presence of a mandatory tender offer law. In place of the country fixed effects, we introduce one at a time several institutional variables: (1) accounting standards index; (2) antidirector rights index; (3) rule of law index; (4) tax compliance index; (5) diffusion of the press as measured by the newspaper circulation/population; (6) an index of the extent of competition laws; (7) incidence of violent crimes; (8) extent of legal protections for labor; (9) a dummy variable if primary religion is Catholicism. More complete descriptions of variables are provided in Table I. Standard errors, which are reported in parentheses, are robust and clustered by country.

[illegible]

Table IX—Continued

| Independent Variables                                   | Dependent Variable: Block Premium |       |       |                          |       |       |       |       |       |
|---------------------------------------------------------|-----------------------------------|-------|-------|--------------------------|-------|-------|-------|-------|-------|
|                                                         | Legal Institutions                |       |       | Extra Legal Institutions |       |       |       |       |       |
|                                                         | (1)                               | (2)   | (3)   | (4)                      | (5)   | (6)   | (7)   | (8)   | (9)   |
| Variables Controlled for:                               |                                   |       |       |                          |       |       |       |       |       |
| Buyer bargaining power                                  | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Ownership variables                                     | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Financial distress                                      | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Foreign acquirer                                        | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Crosslisted in the U.S.                                 | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Buyer identity                                          | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Seller identity                                         | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Industry group                                          | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Tangibility of assets                                   | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Interaction of relative strength of antidirector rights | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| (home—target nation) and foreign acquiror dummy         |                                   |       |       |                          |       |       |       |       |       |
| Interaction of relative strength of antidirector rights | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| (US—target nation) and crosslisted in the US dummy      |                                   |       |       |                          |       |       |       |       |       |
| Presence of takeover law                                | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Constant                                                | y                                 | y     | y     | y                        | y     | y     | y     | y     | y     |
| Number of observations                                  | 381                               | 393   | 393   | 393                      | 393   | 377   | 233   | 393   | 393   |
| Countries included                                      | 36                                | 39    | 39    | 39                       | 39    | 36    | 18    | 39    | 39    |
| R-squared                                               | 0.213                             | 0.174 | 0.203 | 0.203                    | 0.200 | 0.175 | 0.208 | 0.184 | 0.230 |

\*significant at 5% level; \*\* significant at 1% level.

**Table X**  
**Institutional Determinants of Private Benefits**  
**of Control—Multivariate Analysis**

The dependent variable is the block premia as a percent of firm equity. The explanatory variables include all of the variables introduced in Table V except the country fixed effects, but including a dummy to indicate the presence of a mandatory tender offer law. As institutional variables in specification (1), we use antidirector rights index and rule of law index. In specification (2), a dummy variable if primary religion is Catholicism, a tax compliance index, the diffusion of the press as measured by the newspaper circulation/population and the index of the extent of competition laws. The independent variables in specification (3) are antidirector rights index, rule of law index, tax compliance index, diffusion of the press as measured by the newspaper circulation/population. More complete descriptions of variables are provided in Table I. Standard errors, which are reported in parentheses, are robust and clustered by country.

| Independent Variables                                                                                       | Dependent Variable: Block Premium |                   |                 |
|-------------------------------------------------------------------------------------------------------------|-----------------------------------|-------------------|-----------------|
|                                                                                                             | (1)                               | (2)               | (3)             |
| Antidirector rights                                                                                         | -0.026** (0.012)                  |                   | -0.003 (0.019)  |
| Rule of law                                                                                                 | -0.026*** (0.010)                 |                   | -0.006 (0.011)  |
| Catholic                                                                                                    |                                   | 0.019 (0.056)     |                 |
| Tax compliance                                                                                              |                                   | -0.064*** (0.021) | -0.061* (0.033) |
| Newspaper circulation/ population                                                                           |                                   | -0.020** (0.009)  | -0.018* (0.010) |
| Competition laws                                                                                            |                                   | -0.042 (0.036)    |                 |
| Variables Controlled for:                                                                                   |                                   |                   |                 |
| Buyer bargaining power                                                                                      | y                                 | y                 | y               |
| Ownership variables                                                                                         | y                                 | y                 | y               |
| Financial distress                                                                                          | y                                 | y                 | y               |
| Buyer characteristics                                                                                       | y                                 | y                 | y               |
| Seller characteristics                                                                                      | y                                 | y                 | y               |
| Foreign acquirer                                                                                            | y                                 | y                 | y               |
| Crosslisted in the U.S.                                                                                     | y                                 | y                 | y               |
| Industry type                                                                                               | y                                 | y                 | y               |
| Tangibility of assets                                                                                       | y                                 | y                 | y               |
| Interaction of relative strength of antidirector rights (home—target nation) and foreign acquirer dummy     |                                   | y                 | y               |
| Interaction of relative strength of antidirector rights (US—target nation) and cross listed in the US dummy | y                                 | y                 | y               |
| Presence of takeover law                                                                                    | y                                 | y                 | y               |
| Constant                                                                                                    | y                                 | y                 | y               |
| Number of observations                                                                                      | 393                               | 393               | 393             |
| Countries included                                                                                          | 39                                | 39                | 39              |
| R-squared                                                                                                   | 0.213                             | 0.245             | 0.243           |

\*significant at 10% level; \*\*significant at 5%; \*\*\*significant at 1% level.

of control. A one standard deviation increase in newspapers' diffusion reduces the value of control by 6.4 percentage points. Together with the firm-specific variables, newspapers' diffusion explains 20 percent of the variation in private benefits of control. Columns 4 and 5 suggest that institutions external to the firm are associated with private benefits.

In columns 6 and 8, we test the idea that countries with higher moral norms have lower private benefits. Consistent with Coffee's prediction, countries with worse norms as proxied by a higher violent crime rate have higher private benefits of control, but the effect is economically and statistically insignificant. To investigate moral norms, we introduce indicator variables for the four main religions (Buddhist, Catholic, Muslim, and Protestant), which differ in their impact on moral attitudes (Guiso, Sapienza, and Zingales (2003)). As a country religion we use the dominant one (see Stulz and Williamson (2001)). We find that Catholic countries have significantly higher private benefits, and Protestant ones significantly lower (estimate not reported). The effect of the Muslim and Buddhist religion is not significant.

In columns 7 and 9, we test whether the strength of other entities that have a direct economic interest in firm decision making is associated with lower levels of private benefits. In column 7 we examine the impact of labor as a monitor of private benefits. As an index of potential labor strength, we use both an unweighted and a weighted (not reported) index of employee protections based on average indicators on regular contracts and short-term contracts from OECD data compiled in Pagano and Volpin (2000). The restriction to OECD countries unfortunately limits our number of countries and observations, but is perhaps a purer test of the contention that labor can work as monitors, since this literature has focused on organized labor in developed economies. Inconsistent with the hypothesis that labor is an effective monitor, and consistent with Pagano and Volpin's counter contention that entrepreneurs and workers will align themselves against the interests of minority investors, we find that increased labor power is associated with higher private benefits, although this result is not statistically significant ( $p$ -value of 0.204 for employee protections, 0.13 for weighted employee protections).

In column 9 we investigate the possibility that a government interested in enforcing tax rules can reduce private benefits. This column shows that those countries with a higher degree of tax compliance, as measured by the World Competitiveness Report, have lower private benefits of control. A one standard deviation increase in our measure of tax compliance reduces the value of control by 8.6 percentage points, a significant amount. Together with the firm specific variables, tax compliance explains 23 percent of the variation in private benefits of control.

Tax compliance is an equilibrium outcome, affected both by tax enforcement and by the attitude of citizens toward cheating on their taxes. To try to identify the impact of tax enforcement in an unreported regression, we include a measure of willingness to cheat on taxes as measured in the World Value Survey.

In this survey people are asked to rate from one to 10 the statement “cheating on taxes if you have a chance is . . .,” where one is never justifiable and 10 is always justifiable. We find this variable to be insignificant, and the coefficient on tax compliance to remain significant, suggesting the effect of tax compliance comes from tax enforcement and not from differences in moral values across countries. We also examine the robustness of this result to the inclusion of the marginal tax rate and our results are unchanged.

In Table X (column 2), we combine the four extra-legal institutions that individually had a statistically significant effect. All four variables retain the predicted sign, but the magnitudes of their coefficients drop and only tax compliance and newspaper diffusion remain statistically significant at the 5 percent level. Together these four variables are able to explain 24 percent of the variation in private benefits.

The evidence, thus far, is consistent with both the legal and the extra-legal institutions playing a role in constraining private benefits. In fact, a crude *R*-squared test suggests they have roughly the same explanatory power. Can we distinguish which one is more important?

There are two obstacles to doing so. First, many of these institutional variables are highly correlated, as panel B of Table VIII shows. Shareholder’s protection, though, is not correlated with newspapers’ circulation and has a correlation of only 0.4 with tax compliance. Second, and most important, all these proxies are measured with error. Hence, their statistical significance in a multivariate analysis might be more related to the level of noise in these measures than to their actual importance.

Nevertheless, we think it is interesting to try and put all these variables in one regression. This is what we do in column 3 of Table X. When all the institutional variables we found to be significant in the previous regressions are simultaneously included, only newspapers’ diffusion and tax compliance remain significant. The paucity of observations and the high degree of multicollinearity caution us against drawing any strong conclusion from this comparison. We can say, however, that the results are inconsistent with an exclusive focus on legal variables as institutional curbs to private benefits.

### *C. The Effect of Legal Families*

Since LLSV’s (1998) seminal paper, the origin of a country’s legal system has played an important role in all the institutional explanations of cross-country differences. LLSV claim that legal traditions differ in their respect for property rights and, hence, in their ability to protect minority shareholders. We should have already accounted for this effect by inserting the LLSV index of antidirector rights. Nevertheless, it is possible that the origin of a country’s legal system is a better indicator of the degree of protection of outside investors than the antidirector index. For this reason, we repeat some of the previous

estimates substituting the country of origin of the legal system for the antidi-rector rights variable.

As Table XI, panel A shows, the average level of private benefits differs substantially across different legal families. Private benefits are highest in former communist countries (36 percent), then countries with a French code (21 percent), and countries with a German, English, and Scandinavian code seem to have the lowest level of private benefits (respectively, 11, 5.5, and 4.8 percent). Panel B, column 1, shows that the levels of private benefits are significantly lower in countries with German, English, and Scandinavian legal origins than in French legal origin countries. Thus, the distinction is not in terms of civil law versus common law, but it is more complex.

In Table XI, panel B, we report how these results are changed after we control for the most significant extra-legal institutions (diffusion of readership and tax enforcement). Any distinction between English-based legal systems and the others disappears. If anything, common law countries have *higher* (not lower) private benefits of control once these extra-legal institutions are taken into consideration, but this effect is not statistically significant. Only Scandinavian countries have lower private benefits of control even after controlling for extra-legal institutions.

Overall, these results confirm the previous ones: Extra-legal institutions are important and they should be controlled for in any cross-country analysis.

Table XI  
Private Benefits of Control and Legal Origin

Panel A presents descriptive statistics of block premia by legal origin, first presenting averages at the country level and second presenting averages based on the full set of 393 transactions. Panel B provides OLS regressions of block premia on legal origin and our other explanatory variables. The independent variables examined are those included in Table IX with (1) legal origin; (2) tax compliance and newspaper circulation; (3) English origin to capture the difference between common and civil law origin, tax compliance and newspaper circulation; (4) all legal origin dummies, tax compliance, and newspaper circulation. More complete descriptions of variables are provided in Table I. Robust standard errors clustered by country are in parentheses.

| Panel A: Block Premium by Legal Origin |                        |                    |                     |                  |                    |                        |
|----------------------------------------|------------------------|--------------------|---------------------|------------------|--------------------|------------------------|
| Law Origin                             | Groups of Legal Origin |                    |                     | All Transactions |                    |                        |
|                                        | Mean                   | Standard Deviation | Number of Countries | Mean             | Standard Deviation | Number of Observations |
| Scandinavian origin                    | 0.048                  | 0.033              | 4                   | 0.041            | 0.075              | 42                     |
| English origin                         | 0.055                  | 0.080              | 11                  | 0.045            | 0.123              | 196                    |
| German origin                          | 0.109                  | 0.152              | 6                   | 0.051            | 0.138              | 57                     |
| French origin                          | 0.212                  | 0.171              | 16                  | 0.251            | 0.439              | 88                     |
| Soviet origin                          | 0.356                  | 0.314              | 2                   | 0.400            | 0.639              | 10                     |

Table XI—Continued

| Panel B: Investigating Explanatory Power of Legal Origin                                                            |                                   |                      |                      |                      |
|---------------------------------------------------------------------------------------------------------------------|-----------------------------------|----------------------|----------------------|----------------------|
| Independent Variables                                                                                               | Dependent Variable: Block Premium |                      |                      |                      |
|                                                                                                                     | (1)                               | (2)                  | (3)                  | (4)                  |
| English origin                                                                                                      | −0.155**<br>(0.067)               |                      | 0.043<br>(0.044)     | −0.024<br>(0.062)    |
| Soviet origin                                                                                                       | 0.128<br>(0.201)                  |                      |                      | 0.141<br>(0.207)     |
| German origin                                                                                                       | −0.228**<br>(0.097)               |                      |                      | (−0.121)<br>(0.084)  |
| Scandinavian origin                                                                                                 | −0.189***<br>(0.058)              |                      |                      | −0.098*<br>(0.053)   |
| Tax compliance                                                                                                      |                                   | −0.070***<br>(0.021) | −0.087***<br>(0.027) | −0.066***<br>(0.022) |
| Newspaper circulation                                                                                               |                                   | −0.021**<br>(0.010)  | −0.015<br>(0.011)    | −0.003<br>(0.008)    |
| Variables controlled for:                                                                                           |                                   |                      |                      |                      |
| Buyer bargaining power                                                                                              | y                                 | y                    | y                    | y                    |
| Ownership variables                                                                                                 | y                                 | y                    | y                    | y                    |
| Financial distress                                                                                                  | y                                 | y                    | y                    | y                    |
| Buyer identity                                                                                                      | y                                 | y                    | y                    | y                    |
| Seller identity                                                                                                     | y                                 | y                    | y                    | y                    |
| Industry group                                                                                                      | y                                 | y                    | y                    | y                    |
| Tangibility of assets                                                                                               | y                                 | y                    | y                    | y                    |
| Foreign acquirer                                                                                                    | y                                 | y                    | y                    | y                    |
| Crosslisted in the U.S.                                                                                             |                                   |                      |                      |                      |
| Interaction of relative strength of<br>antidirector rights (home—target<br>nation) and foreign acquirer dummy       | y                                 | y                    | y                    | y                    |
| Interaction of relative strength of<br>antidirector rights (US—target<br>nation) and crosslisted in the US<br>dummy | y                                 | y                    | y                    | y                    |
| Constant                                                                                                            | y                                 | y                    | y                    | y                    |
| Number of observations                                                                                              | 393                               | 393                  | 393                  | 393                  |
| Number of countries (clusters)                                                                                      | 39                                | 39                   | 39                   | 39                   |
| R-squared                                                                                                           | 0.243                             | 0.242                | 0.244                | 0.260                |

\*significant at 10% level; \*\*significant at 5%; \*\*\*significant at 1% level.

## V. Conclusions

In this paper we apply the Barclay and Holderness (1989) approach to measure the magnitude of private benefits of control across countries. That we obtain estimates very consistent with previous studies, using different approaches, indicates that the extraction of private benefits is a very real phenomenon that can be consistently measured.

We then use these estimates to test several theoretical predictions from the corporate finance literature on the negative effects that large private benefits have on financial development. In countries where private benefits of control are large, ownership is more concentrated, privatizations are less likely to take

place as public offerings, and capital markets are less developed by several measures. These results vindicate the emphasis that, since Shleifer and Vishny (1997), corporate finance research has put on the importance of protecting outside investors against expropriation by insiders. They also suggest the importance of gaining a better understanding of what are the institutions that help curb private benefits.

We find that many institutional variables, taken in isolation, seem to be associated with a lower level of private benefits of control: better accounting standards, better legal protection of minority shareholders, better law enforcement, more intense product market competition, a high level of diffusion of the press, and a high rate of tax compliance.

The possible role of tax enforcement in reducing private benefits, and thus indirectly enhancing financial development, is probably the most important new fact that emerges from our analysis. Improving the corporate taxation system is well within the range of feasible reforms. If this is indeed a primary mechanism by which private benefits of control can be curbed and financial markets fostered, the benefits of financial development might be within reach for many more countries. Before jumping to any conclusion, though, more research is needed. In particular, it would be useful to show that within a country changes in the level of tax enforcement lead to changes in the size of private benefits.

Our results suggest also other avenues for future research. We find that public opinion pressure helps to curb private benefits of control. A strong pressure from the media on corporate managers, however, will not always increase shareholders value. In fact, in Dyck and Zingales (2002b) we find that strong media also induce corporate managers to bow to environmental pressures, which are not necessarily in the shareholders' interest. The broader question, then, which awaits future research, is how media pressure interacts with social norms in shaping corporate policy. We also do not discuss, in this context, what are the incentives of the media to expose bad corporate practices and how these incentives may vary over the business cycle. We address this in a separate paper (Dyck and Zingales (2003)).

Finally, in this paper we do not try to distinguish between the three potential sources of private benefits: psychic value, perquisites, and dilution. That private benefits are smaller in a country with better protection of investors, better tax enforcement, and more media pressure suggests that not all private benefits are psychic. Further work, however, is needed to establish the importance of dilution and its welfare implications.

## **Appendix**

### *A.1. Steps to Identify Transactions*

We used the following approach to implement the first criterion that a transaction be a control transaction between unrelated parties: (1) The transaction had to be identified in the SDC database and through the transaction the

acquirer had to move from a shareholding position of less than 20 percent to shareholding of more than 20 percent shareholding.<sup>30</sup> (2) The block involved in the transaction had to be 10 percent or greater. (3) The block had to be the largest block in the company. (4) News stories surrounding the transaction had to confirm a transfer of control from the seller to the acquirer, with news stories identified by using the company name and transaction date in Nexis-Lexis and Dow-Jones Interactive search engines, often with the use of both English and foreign language media.

Illustrative of the steps we took to identify control transactions is our exclusion of related party transactions. With related parties it is questionable whether control is transferred and the price of the deal is unlikely to reflect the value of control. Systematically, we excluded transactions where SDC reported that the acquirer involved management, as management already has control rights prior to sale. Using qualitative data we identified further related party transactions excluding transfers of shares between subsidiaries and parents of the same company and other deals that don't transfer control. For example, we excluded the sale of 36 percent of the shares of Shin Corp in Thailand in September 2000. News stories reported that "Telecoms Tycoon turned politician Thaksin Shinawatra and his wife have sold their 35.4 percent stake in their flagship Shin Corporation at a deep discount, in what appears to be an attempt to comply with the laws on ministers' ownership of companies. The stake was sold to their son and relatives at just 10 baht a share, less than 6 percent of the stocks closing price yesterday of 177 baht. . . . Analysts said the move was purely political and would have no impact on shareholders or on the company."<sup>31</sup>

To implement the second criterion, that a control price be available and reflect the value of control, we restricted our attention to SDC transactions that met three additional criteria:

- (1) There had to be data in SDC to identify a control price. In many cases SDC reports a price per share in a separate data field where they value cash offers at face value and offers of shares at the exchange price on the day prior to the announcement of the transaction. In other instances, the price per share is not reported in the data field but can be derived by combining information in available data fields and information from other data sources on the number of shares outstanding. For example, SDC would report the total price paid and the percentage of shares sold and we would construct an estimate of the per share price involved in the offer by collecting information on the number of shares outstanding at the time of the transaction. For many transactions, SDC reported that no

<sup>30</sup> For Australia and Canada we used a 15 percent cutoff due to the presence of takeover rules for stakes exceeding 20 percent.

<sup>31</sup> "Thaksin, wife sell entire stake in flagship," Harish Mehta, *Business Times* Singapore, September 7, 2000.

terms were disclosed or that the reported price was only one component of the compensation. We are unable to use such transactions.

- (2) The form of sale had to involve purchases where assets used to establish a per share sale price include securities that could be priced objectively (we exclude transactions that involve warrants, convertible bonds, notes, liabilities, debt-equity swaps, etc.), and where the terms of sale were not determined by exercising an option or included an option to buy additional shares in addition to the shares purchased.
- (3) The synopsis field and news stories had to confirm the price per share and to ensure that the reported price was not misleading. We excluded observations where news stories identified other considerations, and adjusted the price per share from the SDC reported price if two news stories reported a price that deviated from the SDC price.

To implement the third criterion that an exchange price be available we begin by restricting our attention to those transactions where the company whose shares are being acquired is covered by Datastream international, the data provider with the most extensive coverage of international firms.<sup>32</sup> We also are interested in identifying the exchange price after the market is aware of the purchase of shares by the new controlling shareholder. A traditional approach in the finance literature of focusing on the share price on the day of announcement is not warranted with our database. In many cases, the transfer of control leads to a suspension of trading of the company shares either because there is a need for time for the information about the control transfer to be communicated broadly or there are limits to movement of the exchange price per day. While the suspension is of limited duration in established markets like the United States and the United Kingdom, the suspension can last for a day or more in other settings. Consequently, we use as a standard approach the control price two days after announcement. Where news stories indicated a longer delay, we used the first date after restrictions on trading or pricing of securities. This produced modifications in 17 cases where we use a later date for all of our calculations.

### *A.2. The Special Case of Dispersions of Control Blocks*

In 17 transactions we identify through reading news stories that the controlling block is not sold intact but rather sold to a financial intermediary that then sells the block to a variety of institutional investors. We elected to include these deals in our data set. In the Barclay and Holderness (1989) data set such transactions were excluded by construction of their sample, but as they argued, such

<sup>32</sup> We attempted to access additional information sources for price information for local stocks not covered during our time period by Datastream through direct contacts with country stock exchanges and through appealing to news reports that often reported share price information for large local companies. These efforts produced 26 additional observations.

transactions should be included if a private benefit measure is to reflect the general benefits and costs of control. Such transactions are only likely if there is a limited benefit to control of enterprises and costs to control. Our data set includes nine transactions from the United Kingdom, three from Germany, and one from Finland, Japan, New Zealand, Norway, and Taiwan. Our results are robust to the exclusion of these transactions, with small increases in our raw measures of private benefits for the United Kingdom (from 1.6 to 2.4 percent), Germany (from 9.5 to 11.8 percent) and New Zealand (2.6 to 3.6 percent).

#### *A.3. The Special Case of Companies with Dual Class Shares*

We identify all transactions that involve firms with multiple classes of shares. When this is the case we measure the control premium for the shares with voting power relative to the shares that lack voting power, where Datastream provides price information for both classes. For example, we have 11 observations from Brazil that involve firms with dual class shares and Datastream has price series for both classes for 10 of these 11 observations. In Brazil, the principle difference between the two classes is the voting right with largely equal rights to cash flow. Our data set includes 38 dual class firms altogether, including companies from Canada, Denmark, Finland, Germany, Italy, Mexico, Norway, Sweden, and the United States.

#### *A.4. Biases from Not Reporting Terms of Sale*

We made some steps to investigate this bias. When the SDC field reported other considerations we made efforts using stories from local media to see if subsequent to the announcement the other considerations became known. For almost all cases we were unsuccessful. However, for Malaysia, a country with an active business press, we were able to identify additional information. For the years 1995 and 1996, we identified all stories regardless of whether SDC included a transaction price or not. Using this technique we identified nine transactions not identified in our original sample and we were able to identify prices reported in the local press for eight of these transactions. Comparing the estimated private benefits from these transactions and from our reported transactions is revealing. The average control premia is similar between the initial sample used and this new SDC sample with unreported prices with a control premia as a percentage of equity of 6.9 percent for our core sample and 4.5 percent for our sample of “unreported prices.”

Table AI  
Laws Regarding Control Transactions

| Country          | Law Requiring<br>Mandatory<br>Purchase of<br>Additional<br>Shares | Voluntary Code<br>Requiring<br>Purchase of<br>Additional<br>Shares | Shareholding<br>that Triggers<br>Mandatory<br>Purchase of<br>Shares | Year of<br>Passage of<br>Dominant<br>Legal<br>Statute | Legal and Regulatory Bases on Takeovers                        |
|------------------|-------------------------------------------------------------------|--------------------------------------------------------------------|---------------------------------------------------------------------|-------------------------------------------------------|----------------------------------------------------------------|
| Argentina        | N                                                                 |                                                                    | —                                                                   | —                                                     | Resolution 227, National Securities Commission                 |
| Australia        | Y                                                                 |                                                                    | 20                                                                  | 1989                                                  | Corporations Law                                               |
| Austria*         | Y                                                                 |                                                                    | 30                                                                  | 1999                                                  | Council of Vienna Stock Exchange, State Commissioner           |
| Brazil (1)       | Y                                                                 |                                                                    | 50                                                                  | 1976                                                  | Law 6404, law 9457, CVM rule #299                              |
| Canada           | Y                                                                 |                                                                    | 20                                                                  | 1975                                                  | Canada Business Corporations Act, Provincial legislation       |
| Chile (2)        | N                                                                 |                                                                    | —                                                                   | 1994                                                  | Law 18.045                                                     |
| Colombia         | N                                                                 |                                                                    | —                                                                   | 1979                                                  | Act No. 32                                                     |
| Czech Republic   | Y                                                                 |                                                                    | 50                                                                  | 1991                                                  | Czech Commercial Code                                          |
| Denmark          | Y                                                                 |                                                                    | 50                                                                  | n/a                                                   | Danish Securities Trading Act, Stock Exchange Ethics Rules     |
| Egypt            |                                                                   |                                                                    | ?                                                                   |                                                       |                                                                |
| Finland          | Y                                                                 |                                                                    | 67                                                                  | 1989                                                  | Securities Market Act                                          |
| France           | Y                                                                 |                                                                    | 33                                                                  | 1992                                                  | COB regulations, Stock Exchange Council                        |
| Germany* (3)     | N                                                                 | Y                                                                  | 50                                                                  | 1995                                                  | Voluntary takeover code (Übernahmekodex)                       |
| Hong Kong        | N                                                                 | Y                                                                  | 35                                                                  | 1975                                                  | Hong Kong code on Takeovers and Mergers                        |
| Indonesia        | Y                                                                 |                                                                    | 20                                                                  | 1995                                                  | Decree of Capital Market Supervisory Agency No. 22/PM/1        |
| Israel           | N                                                                 |                                                                    | —                                                                   |                                                       |                                                                |
| Italy            | Y                                                                 |                                                                    | 30                                                                  | 1998                                                  | Law no. 149                                                    |
| Japan            | N                                                                 |                                                                    | —                                                                   | —                                                     | Securities and Exchange Law Ch. II.2                           |
| Kenya            | N                                                                 |                                                                    | —                                                                   | 1985                                                  | Company Act, Capital Markets Authority Act                     |
| Malaysia         | Y                                                                 |                                                                    | 33                                                                  | 1993                                                  | Malaysian Code on takeovers and mergers, Companies Act         |
| Mexico           | N                                                                 |                                                                    | —                                                                   | —                                                     | Corporation Law, Credit Law, other regulatory acts             |
| Netherlands      | N                                                                 |                                                                    | —                                                                   | 1970                                                  | Merger Code of the Social Economic Council                     |
| New Zealand      | N                                                                 |                                                                    | —                                                                   | 1986                                                  | Companies Act 1986                                             |
| Norway           | Y                                                                 |                                                                    | 45                                                                  | 1985                                                  | Securities Trading Act                                         |
| Peru             | N                                                                 |                                                                    | —                                                                   | —                                                     | Stock Market Law                                               |
| Philippines* (4) | Y                                                                 |                                                                    | —                                                                   | 1998                                                  | Revised tender-offer rules, Securities and exchange commission |
| Poland           | Y                                                                 |                                                                    | 33                                                                  | 1991                                                  | Act on Public Trading in Securities and Trust Funds            |

|                |   |    |      |                                                       |
|----------------|---|----|------|-------------------------------------------------------|
| Portugal       | Y | 50 | 1986 | Securities Act                                        |
| Singapore      | N | 25 | 1985 | Singapore Code on Takeovers and Mergers               |
| South Africa   | Y | 30 | 1991 | Securities Regulation Code on Takeovers and Mergers   |
| South Korea    | Y | 25 | ?    | Securities and Exchange Law                           |
| Spain          | Y | 25 | 1991 | Law No. 24, Royal Decree 1197                         |
| Sweden         | N | —  | 1991 | Financial Instruments Trading Act                     |
| Switzerland*   | Y | 33 | 1998 | Federal Act on Stock Exchanges and Securities Trading |
| Taiwan         | N | —  | 1988 | Securities and exchange Law, company law 1983         |
| Thailand       | Y | 25 | 1992 | Securities and Exchange Act                           |
| Turkey*        | Y | 25 | 1986 | Capital Market Law                                    |
| United Kingdom | N | 30 | 1968 | City code on Takeovers and Mergers                    |
| United States  | N | —  | 1934 | Securities and Exchange Act                           |
| Venezuela      | N | —  | —    | Capital Markets Law                                   |

Sources: ISSA All data from ISSA Handbook, 6<sup>th</sup> and 7<sup>th</sup> edition.

(1) Prior to 1997, Brazil law 6404 required equal offer to minority investors with voting shares (but not nonvoting preferred shares). This protection eliminated in May 1997 (Law 9457) with reform to enhance privatization proceeds. In 1999, CVM rule #299 reintroduces protections for minorities, now extending to voting and nonvoting class an equal price offer.

(2) In December 2000 (after our observations) Chile has a new law, ley de OPSAS, governing control transactions.

(3) Germany has a voluntary takeover code (Übernahmekodex) in place since 1995. This code "was deemed a failure in early 2000, when both stock market supervisors and the takeover commission appointed by Mr. Schroder demanded a mandatory law." EIE Country Commerce, section 2.2. 2000.

(4) The Securities and Exchange Commission "issued tender-offer rules in October 1998 outlining the requirements for acquiring majority control in existing companies through open-market purchases or private negotiations. The new rules implement Section 33 of the Revised Securities Code and require bidders for majority control of listed companies to make the same offer of purchase to minority share holders. (EIU March 1999). The SEC generally failed to enforce tender-offer rules in major deals involving mergers and acquisitions from 1998 to 2000 because of loop holes in the old regulations (EIU March 2001).

Securities Regulation Code (RA 8799 effective August 2000, implementing rules January 2001) requires those assembling > 15% to make offer.

Note: Canada has both federal and provincial legislation, where Ontario is most important. Rules require mandatory offer if > 20% of voting shares, whereby at least a pro-rata offer for % bought although usually either for 2/3 or 90% of voting rights.

Table AII  
Number of Firms with Equities Priced in Datastream, by Year

| Country Code | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 1990–2000 |
|--------------|------|------|------|------|------|------|------|------|------|------|------|------|-----------|
| AR           | 12   | 13   | 14   | 23   | 61   | 66   | 70   | 73   | 78   | 80   | 84   | 93   | 655       |
| AU           | 452  | 474  | 487  | 515  | 594  | 697  | 741  | 1095 | 1176 | 1178 | 1287 | 1506 | 9750      |
| BD           | 618  | 700  | 735  | 742  | 777  | 800  | 835  | 893  | 926  | 1015 | 1188 | 1348 | 9959      |
| BR           |      | 75   | 143  | 234  | 314  | 371  | 371  | 456  | 481  | 500  | 540  | 557  | 4042      |
| CB           |      |      |      | 104  | 109  | 133  | 122  | 113  | 108  | 98   | 85   | 72   | 944       |
| CL           | 115  | 127  | 134  | 151  | 164  | 170  | 177  | 196  | 209  | 220  | 219  | 221  | 1988      |
| CN           | 1502 | 1971 | 1976 | 2024 | 2195 | 2353 | 2473 | 2653 | 2981 | 3222 | 3352 | 3759 | 28959     |
| CZ           |      |      |      |      | 38   | 57   | 91   | 114  | 129  | 128  | 131  | 126  | 814       |
| DK           | 205  | 210  | 249  | 252  | 261  | 267  | 277  | 296  | 295  | 303  | 291  | 304  | 3005      |
| ES           | 110  | 125  | 133  | 138  | 149  | 152  | 154  | 165  | 184  | 211  | 234  | 264  | 1909      |
| EY           |      |      |      |      |      | 10   | 12   | 65   | 72   | 82   | 101  | 103  | 445       |
| FN           | 58   | 67   | 70   | 71   | 76   | 123  | 128  | 153  | 178  | 198  | 228  | 258  | 1550      |
| FR           | 508  | 628  | 640  | 663  | 693  | 793  | 859  | 1084 | 1143 | 1287 | 1229 | 1416 | 10435     |
| HK           | 251  | 266  | 322  | 371  | 429  | 494  | 518  | 567  | 676  | 723  | 756  | 1072 | 6194      |
| ID           |      | 107  | 120  | 133  | 150  | 192  | 213  | 225  | 259  | 261  | 292  | 313  | 2265      |
| IS           | 196  | 202  | 201  | 267  | 475  | 542  | 558  | 567  | 569  | 593  | 667  | 710  | 5351      |
| IT           | 283  | 309  | 319  | 323  | 325  | 348  | 366  | 388  | 406  | 419  | 443  | 535  | 4181      |
| JP           | 2011 | 2321 | 2520 | 2592 | 2677 | 2954 | 3136 | 3347 | 3552 | 3582 | 3829 | 4304 | 34814     |

|             |        |        |        |        |        |        |        |        |        |        |        |        |         |
|-------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| KN          | 1      | 1      | 43     | 42     | 45     | 45     | 47     | 51     | 52     | 53     | 50     | 47     | 476     |
| KO          | 604    | 660    | 678    | 685    | 694    | 739    | 796    | 1017   | 1135   | 1140   | 1299   | 1569   | 10412   |
| MX          | 46     | 52     | 75     | 99     | 132    | 151    | 145    | 152    | 172    | 163    | 170    | 160    | 1471    |
| MY          | 346    | 404    | 447    | 493    | 544    | 607    | 663    | 757    | 847    | 872    | 738    | 776    | 7148    |
| NL          | 237    | 260    | 271    | 273    | 277    | 288    | 303    | 326    | 361    | 408    | 437    | 482    | 3686    |
| NW          | 80     | 97     | 100    | 114    | 128    | 160    | 182    | 217    | 273    | 287    | 269    | 274    | 2101    |
| NZ          | 68     | 74     | 80     | 91     | 111    | 126    | 130    | 145    | 154    | 153    | 157    | 176    | 1397    |
| PE          |        |        | 22     | 48     | 76     | 98     | 100    | 105    | 102    | 99     | 104    | 96     | 850     |
| PH          | 64     | 96     | 103    | 114    | 137    | 160    | 187    | 212    | 231    | 229    | 222    | 225    | 1916    |
| PO          |        |        | 6      | 11     | 12     | 22     | 27     | 51     | 103    | 167    | 200    | 221    | 820     |
| PT          | 101    | 110    | 116    | 135    | 140    | 149    | 144    | 148    | 155    | 152    | 143    | 148    | 1540    |
| SA          | 161    | 458    | 454    | 469    | 483    | 526    | 535    | 606    | 641    | 724    | 770    | 736    | 6402    |
| SD          | 177    | 197    | 202    | 213    | 232    | 296    | 318    | 362    | 442    | 484    | 532    | 633    | 3911    |
| SG          | 142    | 172    | 176    | 195    | 222    | 255    | 273    | 293    | 337    | 348    | 409    | 534    | 3214    |
| SW          | 259    | 295    | 295    | 290    | 309    | 325    | 343    | 375    | 390    | 401    | 426    | 459    | 3908    |
| TA          | 161    | 178    | 199    | 240    | 271    | 305    | 340    | 451    | 515    | 620    | 738    | 856    | 4713    |
| TH          | 244    | 291    | 350    | 410    | 441    | 521    | 537    | 576    | 602    | 579    | 546    | 531    | 5384    |
| TK          | 70     | 100    | 125    | 135    | 152    | 178    | 209    | 236    | 270    | 298    | 302    | 387    | 2392    |
| UK          | 1812   | 1872   | 1749   | 1713   | 1782   | 1841   | 1932   | 2084   | 2222   | 2272   | 2301   | 2625   | 22393   |
| US          | 274    | 393    | 415    | 419    | 427    | 438    | 462    | 662    | 929    | 1235   | 2671   | 4743   | 12794   |
| VE          |        | 10     | 10     | 11     | 14     | 19     | 21     | 22     | 23     | 25     | 29     | 53     | 237     |
| Grand Total | 11,168 | 13,315 | 13,979 | 14,803 | 16,116 | 17,771 | 18,795 | 21,298 | 23,378 | 24,809 | 27,469 | 32,692 | 224,425 |

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