Ownership Duration and Firm Performance

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Overview

- Ownership duration.
- Corporate Governance.
- Measuring duration: Problems...
- Facts about ownership duration.
- What determines ownership duration?
- Does duration affect corporate performance?
Focus of this paper: Ownership Duration

Ownership duration:
Ex ante: What horizon does an equity investor have when buying an equity stake?
Ex post: How long did an equity investor hang on to the shares before selling?

Does an equity owner’s horizon’s matter? In a complete and efficient market: No

- If firms are run to maximize value, and this is common knowledge, the value of a firm will reflect the present value of future cash flows.
- But doesn't the owners investment horizon guide her to choose a company with a similar horizon?
  - No. Equities can be sold at any time. What matters is that an equity value correctly reflects the future cash flows.
Opinions about ownership patience

“Everybody” has opinions about ownership patience

• “Ownership patience is good, it allows companies to take a long view.”

• “Short owner horizons forces companies to focus on next quarter’s results.”

• “Impatient owners are good, their focus on the economic results force companies to make optimal decisions.”

• “Patience should be tailored: Some companies need long term owners since they have long investment horizons, others can get by with short term owners.”

Question: How many of these opinions violate the basic notion of market efficiency?
What market imperfections can make ownership patience matter?

- Asymmetric information
  Uncertainty about a company’s value may make it pay for equity owners to become informed.

- Agency problems.
  Large owners can have a monitoring role in disciplining management.
  
  Incentive: With a large stake an owner sees effects immediately on the value of his stake
  
  Problem: All other owners free ride on the large owner’s monitoring of management

Long term horizon on equity investment: Spreads the costs/benefits for a large owner over longer time frame.
Part of the learning by owners “cheap” (osmosis).

→ motivate looking at ownership duration in a corporate governance setting.
Corporate Governance

Broadly: Studies the link between how a corporation is organized and its (economic) results. A very broad area of study.

- The Jensen and Meckling (1976) view of the firm as a nexus of contracts.
- Conflicts of interests between:
  - Shareholders
  - Creditors
  - Management
  - ......
- Agency Problems.
- Asymmetric information.
Corporate Governance – Economic Performance studies

Corporate Governance theories.
Many partial theories, eg.

- Owner – Manager conflict: Incentives, empire building, waste of resources ...
- Debt – Equity conflict.
- Information: Inside / Outside information – Signaling to market.
- Boards: Chosen by whom?

Not really a comprehensive, testable theory.
Testing link governance performance

**Empirical implementations** of test of the link between corporate governance and economic performance.

Crossectional regressions

- Dependent variable: Measure of economic performance
- Independent variables:
  - Governance related (suggested by theory)
  - Non-governance related, but still important for performance.
Governance related variables

- Insider ownership (mitigate shareholder-manager conflicts)
- Ownership concentration
- Owner type
  - State
  - Financial
  - Foreign
  - Industrial (nonfinancial)
  - Private (individual)
- Security design (e.g. nonvoting stock)
- Capital Structure

Typical Controls (non-governance related)

- Product markets / Industry
- Firm size

(Not always obvious what goes where)
Empirical Governance - Performance studies

Well–known examples

• Demsetz and Lehn (1985)
• Morck et al. (1988)
• McConnell and Servaes (1990)
• Agrawal and Knoeber (1996)
• Cho (1998)
• Bøhren and Ødegaard (2003) (Norway)

Look at Norwegian results (typical)
Main Focus of the paper:
Adds ownership duration as a governance mechanism.
But:
Additionally: Generates useful stylized facts about ownership duration.
Ownership duration. Relevant literature

Limited literature concerning ownership duration directly.

Theoretical

• Du (2001) Impatience: Commitment device

Empirical

• Bhagat et al. (2004): Relationship investing
• Gaspar et al. (2005): Link patience of institutional owners and performance in a takeover setting.
Problem: How to measure ownership duration?

• What owners to focus on?
  • Based on rank (largest owner only? averages of the largest owners? weighted average based on rank/duration?)
  • Based on stake (fraction owned?)
• The cutoff problem in measurement. (Only observe a finite number of years)
How to define ownership duration?

Ways of defining individual duration

1. Time until owner lowers ownership stake.
2. Time until owner changes rank.
3. Time until owner lowers rank.

<table>
<thead>
<tr>
<th>Duration definition</th>
<th>Owner A</th>
<th>Owner B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>
Duration definitions

Will focus on the duration definitions:

- Time until owner lowers stake (Information Duration)
- Time until owner changes rank (Governance Duration)
Problems in defining duration, ctd

What owners to focus on:

- The largest only?
- Owners above some threshold stake/rank?
- Only the owner with the longest duration?
- (Averages of) owners satisfying some criteria on size?

Governance effects:
Largest owners most important?
Problems in defining duration, ctd

The cutoff problem

Focus on
- Firms surviving whole period?
- All firms?
→ Check sensitivity of conclusions to this
Data


- **Stock exchange**: (OBI)
  - Stock returns etc
  - Accounts
  - Announcements: Insider trades
- **Securities Registry (VPS)**
  - Annual owner lists, all owners.
    Lists are anonymized, but with an unique ID which allow us to follow each owner over time.
    Data include owner type code, split into
      - State owners
      - Individual (Private) owners
      - Financial owners (Mutual funds etc)
      - Industrial owners (Nonfinancials)
      - Foreign owners
Facts: Ownership Duration at the Oslo Stock Exchange 1989–1999
Determinants of Ownership Duration

- OLS regressions
- Binary choice analysis
Duration Determinants: OLS regressions

Duration measure

Governance variables
Controls
Duration Determinants: OLS regressions

\[ \text{Duration} = f ( \text{Governance variables measure} \text{ Controls} ) \]
Duration Determinants: Binary Choice Analysis


Sell stake

Keep stake

Sell stake

Keep stake

Keep stake

Sell stake

Idea: (long) duration is the result of a sequence of annual decisions.
Duration Determinants: Binary Choice
Analysis ctd

Should you stay or \( = f(\text{Governance variables, Controls}) \) should you go
Does Ownership Duration affect firm performance?

Implementing an empirical test of whether duration and performance is linked.

1. Regressions of averages.
2. Forward-looking regressions
Performance: OLS regressions


Largest Owner

Owner 1 → Owner 2 → Owner 3

Duration measure
Governance variables
Controls

Performance
Performance: OLS regressions

\[
\text{Performance} = f (\text{Duration} \ (\text{average}) \ \text{Governance variables} \ \text{Controls})
\]
Performance: Sequential Regressions

Idea: Performance - result of past owner’s patience.


Largest Owner Q

Duration measure
Governance variables Controls
Conclusions

- Most owners are impatient
- The largest least impatient, but seldom patient
- Financial institutions: Least patient, owned by the least patient
- Duration and performance
  - Indirect ownership has problems
    - Financial institutions: Focus on short term results?
    - Industrial owners: Sleeping?
  - Direct ownership: Works better
    - Patient private owners positive
    - Foreign owners the same

Thus:
Patient ownership not a necessary condition for good governance.
“Good” short term owners are not that bad...


