Essays on Corporate Governance

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Chapter 5  
Governance Mechanisms and Firm Performance in the Netherlands

1 Introduction

Let us briefly summarize the main findings of the previous two chapters. In Chapter 3, we provided an overview of the Dutch system of corporate governance for firms that are listed on the local stock exchange. We looked at the ownership structures of these firms, reported the different ways in which shareholder control rights are diluted and considered the ties between banks and non-financial firms. We also investigated whether corporate decisions are affected by these governance characteristics by focussing on changes in the composition of the supervisory board. There was no evidence what so ever that large outside shareholders actively replace supervisory board members or appoint new ones. Our analysis did indicate that firms that operated under the governance regime are characterized by lower levels of supervisory supervisory board turnover. However, the presence of the governance regime did not affect the accountability of supervisory board members in the form of a reduction in the probability that supervisory board members leave the firm after poor performance. We also found that the presence of a banker on the supervisory board was related to block ownership by banks/financial conglomerates, which is suggestive of control related motives behind these board memberships.

In Chapter 4, we concentrated on detecting an active role for large shareholders in enforcing management turnover after poor performance. Our results largely failed to support such a role. Our analysis also showed that the dilution of shareholder control rights does not reduce the degree in which management is held accountable for (poor) corporate performance. We did find that banks tend to enforce management turnover as the cash flow coverage of the firm’s debt obligations worsens, and that this effect runs through their credit relations with firms as well as through their presence on the supervisory board.

The evidence in the previous two chapters is therefore not very supportive of an active role of large shareholders in monitoring and controlling corporations in the Netherlands. Also, there is no disruptive evidence that suggests that the governance regime or corporate control over votes leads to the entrenchment of management or supervisory board members. The only evidence for the relevance of governance mechanisms that we found was when we focussed
on banks. In this chapter, we further investigate the implications of the differences in governance characteristics for the behavior of the firm by concentrating on the performance of Dutch listed companies. The main purpose of this chapter is to analyze whether corporate performance is directly affected by the ownership structure of the firm and by the degree to which the control rights of shareholders are diluted. Following Demsetz and Lehn (1985), Morck, Shleifer and Vishny (1989) and McConnell and Servaes (1990), we perform a cross-sectional analysis, where we regress various measures of corporate performance on the size of the stakes held by the different type of blockholders. Managerial ownership or supervisory board ownership potentially aligns the interests of these corporate insiders with those of shareholders. If this improves their incentives, we expect this to show up in the performance of the company. Also, large outside shareholders might monitor the firm, thereby effectively reducing the adverse consequences of agency problems between management and shareholders. Outsider block ownership will then have a positive impact on performance. Through our cross-sectional regressions, we can search for evidence for the relevance of these two conjectures.

Besides studying whether the ownership structure of Dutch listed firms affects their performance, we test whether the different ways in which the control rights of shareholders are transferred to corporate insiders, i.e. management and supervisory board members, have repercussions for the performance of these companies. To make such an analysis meaningful, there should be a sufficient degree of heterogeneity across firms with respect to way in which control rights are allocated over the different stakeholders. In Chapter 3, we argued that this is indeed the case. Although in practically all the firms in our sample the control rights of shareholders are diluted to some degree, the formal control rights of the supervisory board and shareholders differ substantially from each other across Dutch firms. In firms that operate under the governance regime, the formal authority of the supervisory board is large. Most of the control rights of shareholders are then formally transferred to the supervisory board. This is not the case if firms separate the votes from the shares. In those firms, the transfer of control rights from shareholders to corporate insiders is complete, but it does not lead to an increase in the formal power of the supervisory board. These two arrangements therefore potentially lead to different control allocations.

There are many reasons why the governance regime might be important for the performance of companies. First of all, the governance regime explicitly requires supervisory board members to represent all the stakeholders of the firm. These supervisory boards might therefore be more prone to protect the interests of employees, management, suppliers and creditors at the expense of (other) investors. Also, the concentration of power in the hands of the supervisory board may lead to excessive control over management. Managerial initiative
that enhances corporate performance can be discouraged if top-officers anticipate that there is a considerable probability that they will be overruled. Some authors argue that the governance regime leads to an environment where corporate decision making is consensus driven and inert (see for example Boot 1994 and (the contributions in) Wildenkamp and Zwetsloot 1994). According to this view, the governance regime allows the supervisory board to appoint kindred members. This creates an atmosphere of conflict aversion within the supervisory board and a less critical stance towards management. Finally, shareholder monitoring might become ineffective under the governance regime because shareholders lose most of their formal control rights.

In all these scenarios, the governance regime negatively affects corporate performance. A similar negative impact on the performance of companies may result from the use of trusts to control the votes of outside shareholders. However, of the scenarios that we presented above, only the one relating to the reduced effectiveness of shareholder monitoring seems relevant. If the firm strips the votes from the shares, the formal authority of the supervisory board is in principle unaltered.

To test these conjectures, we investigate whether firms that operate under the governance regime or that control a substantial fraction of the votes of the shares held by outside shareholders perform differently. Hence, we measure the differences in performance relative to companies that either do not dilute shareholder control rights at all (other than the option to issue preferred shares) or that use golden shares/binding nominations to ensure control over the company. We believe this is the correct comparison to make within the Dutch setting. Recall that in Chapter 3, we found that firms that do not dilute the rights of shareholders (other than perhaps through the option to issue preferred shares), the largest shareholder on average held 46% of the shares in 1992 (compared to 28.5% for the complete sample). With the presence of such a large single shareholder, whether or not there are golden shares or binding nominations will be rather unimportant. Moreover, if the firm operates

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72 See Burkart, Gromb and Panunzi (1997) for a formalization of this argument and the references in Chapter 6 of this dissertation for some other papers that show that control over management can be excessive. By this same line of reasoning, the governance regime might have a positive impact on performance. Assume that the governance regime insulates the supervisory board from shareholders and that as a result of this, the supervisory board is not primarily focussed on shareholder value. This may provide a credible commitment that intervention in the firm does not always take place when this leads to gains for shareholders. Such a commitment may be good for the incentives of employees and management to invest in firm specific human capital, thereby increasing firm performance.

73 Stated differently, whether or not a firm has golden shares/binding nomination clauses if it doesn’t operate under the governance regime or strips most of the votes of its shares mainly depends on the ownership structure of the firm. Therefore, if we find an empirical relation between performance and an indicator variable for whether not the firm has golden shares binding nominations, the causality will actually run through the ownership structure and not through the indicator variable.
under the governance regime or if it controls most of the votes through an administrative office, the presence of golden shares and binding nominations will become innocuous.

We use four different performance variables in our analysis. These are (1) the market-to-book value of the firm (Tobin's $q$), (2) the market-to-book value of equity, (3) the return on assets and (4) the return on equity. We rely on cross-sectional regressions where for each firm the data are averaged over the years 1992-1996. Our results suggest that corporate performance is both affected by the ownership structure of the firm and by the way in which the control rights of shareholders are diluted. Concentration of shares in the hands of outsiders is positively related to our market-to-book measures as well as to the return on assets. Insider ownership and corporate performance are only related to each other when we use the return on assets as a performance variable. There is no effect of insider ownership on performance when we measure performance through the other variables. Firms that operate under the governance regime perform significantly poorer. This effect is economically large. Our results clearly indicate, however, that whether or not the firm strips the votes from the shares is unimportant for the performance of the company.

We also briefly look whether the relative importance of short-term bank loans in the capital structure of the firm and supervisory board representation by a banker affects corporate performance. Interpreting these variables as proxies for a close tie with a bank, they may affect corporate performance. For example, banks might be able to reduce agency problems or liquidity constraints of firms. Our results indicate that the performance of firms with a banker on the supervisory board is similar to that of other companies. In contrast, the performance measures are negatively related to the relative amount of short-term bank debt of the firm. This effect is especially present when we use the market-to-book value of the firm and the return on equity. It is much milder when we use the return on assets. Such a pattern is consistent with banks extracting rents through their credit relations, while enforcing somewhat conservative policies. Boot (1994) argues that this is indeed one of the potential hazards of the Dutch governance system. We have no direct evidence, however, that supports this view.

The closest related studies for the Netherlands are those of Chirinko, Van Ees, Garretsen and Sterken (1999) and De Jong (1999). The methodology and results of these papers are somewhat different from ours. Chirinko et al (1999) focus on the relation between the fraction of the shares held through block ownership by financial institutions (banks, insurance companies and pension funds) and the return on assets. Their sample consists of 94 industrial firms that were listed on the Dutch stock exchange from 1992 to 1996. When they use a linear specification, there is no relation between block ownership of any of these financial institutions and performance. However, for a separate regression that includes a
quadratic term for the fractions of shares held through blocks by banks, they find a positive relation for lower levels of ownership concentration and a negative effect of bank ownership if it increases beyond 14%. A similar pattern is found when they estimate a regression with a quadratic term for the fraction of shares held through blocks by insurance companies or pension funds. Chirinko et al (1999) interpret this as evidence that banks discipline management while at the same time extracting rents from firms which becomes dominant for high level of bank ownership.

Their results may not be very robust, however. Chirinko et al also find that when they add up the block ownership of banks, insurance companies and pension funds, the coefficients of the two variables that relate to the block ownership of these financial institutions are driven towards zero and become statistically insignificant. This casts some serious doubts on the interpretation mentioned above. One would expect that the non-linear relation would be even more pronounced if we add up these blocks. In our analysis, we also test for the presence of such non-linearities and in accordance with this last result of Chirinko et al (1999), we find no support for a hump-shaped relationship.

De Jong (1999) looks at the relation between Tobin's $q$ (which is the market value of the firm over its replacement value) and governance variables such as managerial block holdings and total ownership concentration. His sample includes all non-financial firms in the Netherlands that are listed on the stock exchange from 1992-1996. De Jong includes a linear and a quadratic term for each of these two different ownership structure variables. He finds an insignificant positive coefficient for the non-quadratic term and a significant negative coefficient for the quadratic term for managerial shareholdings. For total share ownership concentration, he reports a similar but inverse pattern where both coefficients are significant. The inflection points are both roughly at 50% ownership concentration. This suggests that for high level of managerial ownership, the fraction of the shares held by these insiders negatively affect Tobin's $q$. For total ownership concentration, the effect on firm value is first negative, and then turns positive for higher levels.

The results of De Jong are potentially biased, however, because he pools all the yearly observations into one data set. If the ownership structure of firms is rather stable over the years, this artificially increases the number of observations. The standard errors will therefore be biased downwards, favoring the analysis towards finding significant coefficients. Our approach avoids this problem because we use firm data that are averaged over the sample period. Contrary to De Jong (1999), we find no support for the relevance such non-linearities.

74 Three other papers worth mentioning in this respect are those of Bosveld and Goedbloed (1996), Kabir, Cantrijn and Jeuniaux (1997) and Van Kampen and Van der Kraats (1995). These studies all focus on the stock
Our results are also somewhat different from the international evidence on the relation between ownership structure and performance. Most authors that use a similar cross-sectional framework find that corporate performance is unaffected by outside block ownership. There is also no strong evidence that suggests that insider ownership is important for corporate performance. The direct comparability of the results of these studies is of course limited because they are derived within governance systems that are quite different from the Dutch system. Nevertheless, we will discuss most of these contributions in the next section. This will provide us with the major background for our own empirical analysis. Section 3 then presents our data and introduces the methodology that we employ in Section 4, which presents the results of the analysis. Section 5 offers some concluding remarks.

2 Literature Overview: Governance Mechanisms and Corporate Performance

In this section we provide a brief overview of the recent empirical literature that analyzes the relation between governance mechanisms and firm performance. The number of papers that concentrate on this relationship is large, and we will only discuss the contributions that are the most relevant to the cross-sectional approach that we apply in this paper. We will split up our discussion in three subsections. In Section 2.1 we will discuss the empirical relation between insider ownership and performance that researchers have documented. We then turn to the evidence with respect to the importance of outside block ownership for corporate performance. Section 2.3 addresses the studies that focus on the role of banks. We are not aware of any papers that look at the effects of the differences in the way control rights are allocated over shareholders and corporate insiders.

The research that we will discuss in this section not only focuses on the 'sign' of these relationships but also on the functional form. More precisely, based on the theory, the relation between the governance variables and performance can be positive as well as negative and
monotone as well as non-monotone. We there start each sub-section with a brief presentation of the theoretical arguments that support these different relations.

2.1 Insider Ownership and Corporate Performance

Most empirical work on the effect of insider ownership on corporate performance has been done within the context of US companies. Insider ownership then represents the stakes held by chief officers and members of the board of directors. These studies recognize that ownership by corporate officers and directors not only aligns the wealth of those in control of the company to the equity value of the firm, it also puts (voting) power in the hands of corporate insiders. Outsiders might then be discouraged outsiders to exercise control over the company. This will especially hold for raiders, whose chances of a successful bid might be reduced when corporate insiders own a significant fraction of the shares.76

The negative effect of high insider ownership on firm value is less obvious within a governance system where the threat of hostile takeovers does not serve as a disciplinary device. Shleifer and Vishny (1997) and Zingales (1994) argue that in those systems, a negative effect of high insider ownership on corporate performance might also prevail. If insiders obtain private benefits of control that compensate for inefficiencies in corporate policies, high insider ownership might insulate the firm from effective governance by other parties. These private benefits may consist of an outright expropriation of other shareholders through self-dealing but also of the benefits that these insiders receive from merely being in control of the company. It may then be hard for other parties to oust an incapable CEO or to redirect inefficient corporate policies if top management (or their families) controls most of the shares.

Concentrated insider ownership can therefore be beneficial as well as costly in terms of firm value. The empirical literature on the relation between insider ownership and corporate performance has provided mixed results concerning this relationship. Morck, Shleifer and Vishny (1988) and McConnell and Servaes (1990) find that insider ownership and Tobin’s q for the US is indeed non-monotonically related. For lower levels of ownership, performance improves with insider ownership. For higher levels, the relation reverses, suggesting that the negative effect of managerial entrenchment on firm value dominates the positive effect of the alignment of interests.77 The ranges for which insider ownership affects performance positively or negatively in both these studies differ quite a bit from each other. Hermelin and Weisbach (1991) report a non-monotone relation between insider ownership

76 See for example the theoretical contributions of Stulz (1988), Israel (1992) and Zingales (1995a).
77 Short and Keasy (1999) also find a non-linear relation for the UK.
and performance for which these ranges are even more different from the ones found by Morck et al (1988) and McConnell and Servaes (1990). These three studies therefore report suggestive but inconsistent evidence that insider ownership affects corporate performance.

There are quite a few studies that fail to support the existence of a direct relation between insider ownership and corporate performance. Mikkelson, Partch and Shah (1997) focus on IPOs and conclude that insider ownership is unimportant for explaining their performance. Denis and Denis (1994) and Holderness and Sheehan (1988) find that firms that are majority-owned by insiders neither perform worse nor better than other firms do. Agrawal and Knoeber (1996) not only concentrate on the ownership structure on the presence of other governance mechanisms, such as the probability of a takeover in the industry, the leverage of the firm and the presence of independent directors on the board. When they use a cross-sectional OLS regression that neglects the interdependency of all these mechanisms, they find some mild evidence that insider ownership and firm performance are positively related. There is no evidence, however, that for higher levels of insider ownership, performance decreases with the stakes held by corporate insiders. Agrawal and Knoeber note that these patterns are also consistent with a reversed causality, namely that performance affects insider ownership. Such a reverse causality for example arises if firms reward their management for good performance with equity. Indeed, using a simultaneous equations framework that accounts for a reversed causality and for the presence of other governance mechanisms, Agrawal and Knoeber show that insider ownership no longer affects performance.

This interpretation of the evidence of Morck et al (1988) and McConnell and Servaes (1990) is also supported by Kole (1996), Loderer and Martin (1997) and Cho (1998). These authors find that the positive relation between insider ownership and corporate performance for lower levels of insider ownership in the US is probably due to the compensation schemes of top-officers. Hence, there seems to be no consistent evidence that insider ownership affects corporate performance.

### 2.2 Outside Ownership and Corporate Performance

From a theoretical perspective, the relation between concentrated ownership in the hands of outsiders and corporate performance can go either way as well. Assuming that monitoring is costly, the monitoring incentives of outside shareholders will be increasing in the sizes of

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78 Their analysis suggests three turning points for this relation, as opposed to one (McConnell and Servaes 1990) or two turning points (Morck et al 1988).

79 Another study that is worth mentioning is the one by Ang, Cole and Lin (1999). They focus on the importance of insider ownership in small, non-listed firms in the US. They find that agency costs, as measured by the expenses-to-sales ratio and the inverse of sales-to-assets ratio, are increasing as managerial ownership declines.
their stakes. The presence of outside block holders then improves performance. On the other hand, several authors have provided a different perspective on this issue and stress that there may be costs associated with the presence of large outside shareholders. These arise from lower liquidity (Bolton and Von Thadden 1998a,b), less informative stock prices (Holmström and Tirole 1993), too much monitoring (Burkart, Gromb and Panunzi 1997) or expropriation of small shareholders (Shleifer and Vishny 1997, Zingales 1994, 1995b). So, just as with insider ownership, the correlation between outsider ownership concentration and corporate performance can be positive or negative, resulting in the possibility of a non-monotone relation.

The empirical studies that focus on concentrated ownership in the hands of outside shareholders generally conclude that there is no direct relation with corporate performance in a cross-sectional regression analysis. Demsetz and Lehn (1985) and Agrawal and Knoeber (1996) look at US data but find no evidence that performance is different in firms that have outside blockholders. Prowse (1992) and Gorton and Schmid (1996) examine whether there exists such a relation in Japan or Germany but fail to find support for this as well. Lichtenberg and Pushner (1992) find some mild evidence that firms in Japan are less likely to become poor performers if financial institutions own a significant fraction of the shares. They do not focus on ownership concentration, however, which makes their results hard to interpret in terms of monitoring by financial institutions. Most of these studies also allow for the possibility of a non-monotone relationship but fail to find any significant results.

We wish to stress that such results do not imply that large outside shareholders are unimportant for corporate governance. Event studies typically find that in the US, increases in ownership concentration lead to positive abnormal returns (see for example Wruck 1989, Holderness and Sheehan 1988, Barclay and Holderness 1989 and Shome and Singh 1995). There is also a large number of papers that suggest that external blockholders monitor the firm and influence corporate decisions. The lack of evidence just implies that in general, one cannot (mechanically) improve firm performance by increasing the stakes of outside blockholders.

See for example Admati, Pfleiderer and Zechner (1994), Huddart (1993) and Shleifer and Vishny (1986).

For example, by enforcing board turnover (see Denis, Denis and Sarin 1997 and Renneboog 1996), by influencing the decision to adopt takeover defenses (Bhagat and Jefferis 1991 and Brickley, Lease and Smith 1988), by influencing expenditure decisions (Yafeh and Yosha 1995), or by setting managerial compensation more efficiently (Core, Holthausen and Larcker 1998).
2.3 The Involvement of Banks and Corporate Performance

As we already noted in the introduction, the relationship of a bank with a firm may affect firm performance in itself, irrespective of the equity stake of the bank. As creditors, they may have incentives to monitor the firm and constrain managerial opportunism or asset substitution incentives, thereby enhancing firm performance (Stiglitz 1985, Ongen and Smith 1998). Also, by producing private information about the firm, banks may overcome adverse selection problems when companies have to finance themselves. This relaxes the liquidity constraints for the firm (Bhattacharya and Thakor 1993, Ongen and Smith 1998). The dependence on banks as capital suppliers can also be costly. Sharpe (1990), Rajan (1992) and Bhattacharya and Chiesa (1995) point out that if banks obtain superior information about the firm, they have bargaining power when refinancing has to take place. The extraction of rents, for example through higher interest rates, can adversely affect the incentives within the firm. According to this view, a strong tie with a bank can have a negative influence on firm value. Weinstein and Yafeh (1998) argue that if a bank has a large amount of debt outstanding to a firm relative to the equity stake in the firm, it has an incentive to direct the corporate policy towards overly conservative policies. These may be optimal for creditors but inefficient from the perspective of total firm value.

Gorton and Schmid (1996) find no relation between the equity stakes of banks and firm performance in Germany. For Japan, Weinstein and Yafeh (1998) document that firms with a strong bank tie have lower profitability, grow slower, and pay higher interest rates on their debt. These findings suggest that Japanese banks use their power to extract rents and to enforce conservative policies to safeguard their loans. We are unaware of any other studies that directly relate corporate performance to bank ties using a cross-sectional approach like ours.82

2.4 Concluding Remarks

The evidence to date concerning the importance of ownership structure and firm performance has provided mostly evidence in favor of a lack of such a relationship. There is no robust evidence that insider ownership improves performance by aligning the interests of corporate insiders and shareholders, nor that insider ownership can be ‘excessive’ in the sense that it insulates the firm from effective governance. Moreover, all the studies that we cited failed to

82 Some important empirical analyses on the role of banks in influencing corporate decisions are Hoshi, Kashyap and Scharfstein (1990a,b, 1991), Kang and Shivdasani (1995) and Morck and Nakamura (1999) for Japan.
find a direct relation between the performance of companies and outsider block ownership in a (randomly constructed) cross-section of firms. This also applies for concentrated ownership in the hands of banks. In the next few sections, we will present some evidence on these relations for the Netherlands.

3 Data and Methodology

3.1 Sample

Our initial sample consists of all non-financial firms that were listed on the Dutch stock exchange in 1992. We exclude two firms whose ownership structure is opaque\(^{83}\), and two firms that have extreme degrees of ownership concentration\(^{84}\). We also exclude five firms that were delisted at the start of 1993 after two large mergers took place, and four companies that were in financial distress in 1992. We also neglect two large multinationals that are a part of a UK/Dutch conglomerate. The corporate policies in these firms are mainly determined at the conglomerate level. The Dutch governance data of the Dutch subsidiaries are therefore not completely representative. Finally, we exclude one firm that merged with an UK firm during our sample period, which makes its accounting figures incomparable over time. This leaves us with a sample of 132 firms. We follow these firms through 1996.\(^{85}\) The average (median) size of the assets of these firms equaled 1.53 (0.38) billion in Dutch Guilders over the sample period.

3.2 Performance measures

To relate corporate governance channels to performance, we rely on four different performance measures. A commonly used performance variable in the literature is Tobin’s \(q\), which is defined as the market value of the firm over the replacement value of assets. Constructing Tobin’s \(q\) is computationally very intense and requires a large amount of

\(^{83}\) One of these companies doesn’t have to disclose its ownership structure because it is chartered in the Netherlands Antilles. The other company is a small holding company that is controlled by four offshore investment companies. We were unable to track the ultimate owners of these investment companies, but they are probably controlled by the managers of the holding company.

\(^{84}\) The first company is actually a subsidiary of a large listed company and the other one is a small company where the insiders own around 97% of the shares through blocks.

\(^{85}\) Some of these firms were delisted after 1993 because of takeovers or bankruptcy. Our sample is therefore an unbalanced panel over the years 1992-1996.
detailed information at the firm level. Such data are typically not (publicly) available for Dutch firms. One can approximate $q$ using simpler versions that only require readable available information. A simple approximation can be obtained by using the book value of debt plus the market value of equity as a proxy the market value of the firm and by using the book value of the assets for its replacement value. This version is highly correlated with more sophisticated versions of $q$: the correlation coefficients for US data are generally well over .90 (Perfect and Wiles 1994 and Chung and Pruitt 1994). Because our data does not allow us to calculate more sophisticated versions of $q$, we use this simple version of $q$.\footnote{De Jong and Veld (1998) report that the $q$'s for Dutch listed firms that are obtained in this simple manner are highly identical to ones obtained by using the Perfect-Wiles approximation.}

In addition to Tobin's $q$, we rely on the market-to-book value of equity as performance measures. This measure avoids the assumption that the market value of debt equals its book value. Both these performance measures, however, have the disadvantage that they are also proxies for the growth opportunities of a firm. A firm with a low $q$ because of lower growth opportunities is not necessarily a poor performer. Hence, one would like to control for the growth opportunities of the firm that are unrelated to the quality of corporate decisions. One can do this by including additional variables, but this is probably an imperfect solution. We therefore also use performance measures that directly relate to the profitability of the firm. These are the return on assets, calculated as earnings before interest and taxes over the book value of assets and the return on equity, calculated as net income over the book value of equity.

We use the Reach database of Delwel to construct these performance measures. Table 1 at the end of this section provides the summary statistics for these four variables. Observe that the medians for the market-to-book of equity and the return on equity are substantially below their means. This is due to the presence of one extreme (positive) outlier for each of these series. Without these outliers, the means drop to 2.08 and 10.81 respectively. These two equity-based measures are also substantially more volatile than Tobin's $q$ and the return on assets. Even after excluding this outlier, the standard deviation for the return on equity is 3.5 times as high than the standard deviation of the return on assets.

### 3.3 Governance Data

**Ownership Structure.** We obtain ownership data from the disclosures made by shareholders to the STE, the agency that supervises the local stock market. In 1992, all shareholders were required to disclose their stakes if they held more than 5% of the shares of a listed firm. Further disclosures were only required when the block held by the shareholder crossed the
barrier of 5%, 10%, 25%, 50% or 66 2/3%, from below or above. We collected these data up to 1996. Note that we have no information about shareholders that own less than 5% of the shares: all our ownership data relate to blockholders owning more than 5% of the shares. Also, our ownership data on blocks exceeding 10% may be somewhat inaccurate, because the bandwidths that trigger a new disclosure become quite large beyond 10%. For a more precise description on how these ownership data are assembled, we refer to Chapter 3.

In classifying these blockholders, we distinguish six different types of shareholders. Using the “Yearbook of Dutch Listed Enterprises”\(^8\), we check whether the disclosing blockholder is a member of the management board or the supervisory board.\(^9\) These two types of blockholders are considered to be corporate insiders. For outside blockholders, we distinguish four different types:

1. Banks/Insurance Companies/Financial Conglomerates
2. Other Financial Institutions
3. Non-financial Companies
4. Individuals.

‘Other Financial Institutions’ includes the blocks held by pension funds, mutual funds and other investment companies. Table 1 provides the summary statistics for the ownership structure of our sample of firms. We have summed up all the disclosed blocks for each type of blockholder. The data presented are averages for the years 1992 to 1996. Financial conglomerates, other financial institutions and non-financial companies are important blockholders. On average, each of these categories of shareholders owns roughly 10% of the shares of listed firms through blocks. In 81% of the firms, the average blockholdings of outside shareholders exceeds the 10% while in 58% of the firms, outside shareholders on average held more than 25% of the shares through blocks. Insider block ownership is also quite frequent. In 19% (10%) of the firms, the average blockholdings of management (supervisory) board members were at least 5% over the sample period.

**Voting Rights.** As we reported in Section 3, the voting rights of the shareholders of listed firms in the Netherlands are often diluted. Many firms strip the voting rights from the shares and retain them to prevent that outsiders can obtain control over corporate decisions. We can rely on the ownership disclosures to obtain precise information about the distribution of voting rights. The disclosure law requires that shareholders report the blocks of votes that they hold. Hence, for each blockholder we know whether or not the shares carry votes as well. Moreover, when firms strip the votes from the shares, they have to report that they own a

\(8\) In Dutch, ‘Jaarboek van Nederlandse Ondernemingen’.

\(9\) In Dutch, ‘Jaarboek van Nederlandse Ondernemingen’.
large block of votes, just like any other blockholder. This gives us a precise idea about the fraction of the votes that are controlled by the firm.\textsuperscript{88}

We use these disclosures to construct a measure of excessive control over voting rights by the firm by calculating how many votes the firm controls that were initially attached to shares that are held by outsiders. We do this by checking whether the firm holds a block of votes. We then subtract from that the blocks of non-voting equity disclosed by the corporate insiders (i.e. management board members or supervisory board members). This last correction is useful because the votes that are stripped from shares held by corporate insiders do not affect the balance between the number of votes under control of the firm and the number of votes under control of outside shareholders.

Table 1 reports that over the sample period, firms on average controlled 28\% of the votes as a result of stripping the voting rights from the shares of outside shareholders. The median firm does not retain the votes of outside shareholders. In 41\% of the firms, however, the excessive control of voting rights amounts to more than 25\% of the total of votes. Together with the frequent and substantial insider block ownership, corporate insiders controlled on average around 40\% of the votes. In 39\% of the firms, they hold a majority of the votes.

A second source for the dilution of the control rights stems from the requirement to install the governance regime. As we denoted in Section 1 of this chapter, this regime transfers the control rights from shareholders to the supervisory board, thereby strongly reducing the formal control rights of the shareholder meeting. In 1992, 58\% of the firms in our sample had operated under the governance regime.

\textit{Ties with Banks/Financial Conglomerates.} As we already reported when we discussed the ownership data, banks, insurance companies and financial conglomerates are important blockholders. In our analysis, we distinguish two additional channels through which banks/financial conglomerates can influence firm behavior. The first one concerns the degree to which firms rely on bank debt. We were only able to obtain data on the amount of short-term bank debt.\textsuperscript{89} For our sample of firms, the average ratio of short-term bank loans over assets equaled 8.9\%, while the median ratio was 5.6\%.

The second channel through which banks/financial conglomerates may exercise control originates from their positions on the supervisory boards of firms. For each firm and

\textsuperscript{88} To be precise, the definition we used is somewhat broader. We also included the blocks held by the family of the board members and of companies that are owned by the board members or their families.

\textsuperscript{89} As we denoted earlier, some firms cap the maximum number of votes that a single shareholder can have. In our analysis, we do not ignore these caps because they show up in the disclosures of the voting blocks. If a cap is binding for a shareholder, the number of votes he discloses will be equal to that cap.
each year in our sample, we check whether a member of the supervisory board of the firm is also a member of the management board of a bank or of a financial conglomerate with a banking division. In 1992, 14% of the firms in our sample had a banker on their supervisory board.

3.4 Methodology

Our sample consists of a relatively small unbalanced panel. We only have 132 firms in our sample and the performance and governance data are for the years 1992 to 1996. We decided to average these data for each firm so as to construct a sample with one observation for each firm. There are good reasons for doing this. The yearly governance data for each firm are not independent of each other. For example, the ownership structure of a firm typically does not change dramatically from year to year. Also, given that the sample size is rather small, the yearly performance data are quite erratic. By averaging these data, we obtain less noisy measures for corporate performance.

Within this sample of averaged data, we cross-sectionally regress the performance of the companies on the governance variables that we presented above, where we include all governance variables simultaneously in the regressions. In addition to the governance variables we described above, we use several control variables in our regressions. As a proxy for the size of the firm, we use the log of sales of the company. We expect the size of the firm to be negatively related to growth opportunities, because firm size increases as companies exploit their growth opportunities. We also include tangible fixed assets (scaled by assets) and investment in tangible fixed assets (scaled by last year's tangible fixed assets) in the regression. Firms with higher levels of tangible fixed assets are more likely to operate in capital intensive industries, which are generally characterized by lower growth opportunities. Likewise, firms with higher growth opportunities will probably invest relatively more than other firms. By including the investment term in the regressions, we try to capture these growth opportunities that affect our 'market-to-book' measures in a way that is less directly related to the quality of corporate policy. We also include eight industry dummies using one digit SIC codes.  

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* Source: 'Jaarboek van Nederlandse Ondernemingen'
* Ideally, we would like to control for investment opportunities by including R&D expenditures and advertisement expenditures in the analysis, as is common in the literature. These items are not available, however, in the Netherlands because firms are not required to report them in their annual accounts.
Table 1: Summary Statistics of the Performance and Governance Data.
Summary statistics are constructed using firm averages over the years 1992-1996, unless indicated otherwise. Tobin's $q$ is calculated as the market value of equity plus the book value of debt over book value of the assets. Ownership structure data relate to the total sum of disclosed blocks. Blocks are only disclosed in the Netherlands if they exceed 5% of the total of shares. 'Other Financial Companies' includes pension funds, mutual funds and other investment companies. For a description of the 'Governance Regime', we refer to the text. The assets of the firms are in Dutch Guilders. Two Dutch guilders roughly equal one US Dollar.

<table>
<thead>
<tr>
<th>Performance Data</th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin's $q$</td>
<td>1.36</td>
<td>1.18</td>
<td>0.79</td>
<td>4.52</td>
</tr>
<tr>
<td>Market-to-book of Equity</td>
<td>2.38</td>
<td>1.53</td>
<td>0.50</td>
<td>42.00</td>
</tr>
<tr>
<td>Return on Assets (%)</td>
<td>7.95</td>
<td>7.56</td>
<td>-15.70</td>
<td>29.74</td>
</tr>
<tr>
<td>Return on Equity (%)</td>
<td>15.62</td>
<td>12.05</td>
<td>-76.89</td>
<td>645.74</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Governance Data</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership Structure: (in %)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks, Insurance Companies and Fin. Conglomerates</td>
<td>9.50</td>
<td>7.18</td>
<td>0.00</td>
<td>42.72</td>
</tr>
<tr>
<td>Other Financial Companies</td>
<td>12.34</td>
<td>5.31</td>
<td>0.00</td>
<td>70.47</td>
</tr>
<tr>
<td>Non-financial Companies</td>
<td>10.95</td>
<td>0.00</td>
<td>0.00</td>
<td>82.50</td>
</tr>
<tr>
<td>Individuals</td>
<td>3.73</td>
<td>0.00</td>
<td>0.00</td>
<td>49.06</td>
</tr>
<tr>
<td>Management Board</td>
<td>7.38</td>
<td>0.00</td>
<td>0.00</td>
<td>88.22</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td>3.46</td>
<td>0.00</td>
<td>0.00</td>
<td>77.56</td>
</tr>
<tr>
<td>Fraction of firms with Outside Shareholders Owning:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 10% through Blocks</td>
<td>0.81</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 25% through Blocks</td>
<td>0.58</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fraction of firms with Management Board Owning</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 5% through Blocks</td>
<td>0.20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fraction of firms with Supervisory Board Owning</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 5% through Blocks</td>
<td>0.10</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Largest Block</td>
<td>28.39</td>
<td>22.02</td>
<td>0.00</td>
<td>88.22</td>
</tr>
<tr>
<td>All Blocks (Total Ownership Concentration)</td>
<td>48.92</td>
<td>50.48</td>
<td>0.00</td>
<td>90.73</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Voting Rights</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Votes of Outside Shareholders Retained by the Firm</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(as a % of all Shares)</td>
<td>28.17</td>
<td>0.00</td>
<td>0.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Fraction of Firms Controlling more than 25% of all the Votes as a Result of Retaining the Votes of Outside Shareholders (in 1992)</td>
<td>0.40</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fraction of Firms with the Governance Regime in 1992</td>
<td>0.58</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ties with Banks:</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term Bank Loans over Assets (%)</td>
<td>8.91</td>
<td>5.62</td>
<td>0.00</td>
<td>56.96</td>
</tr>
<tr>
<td>Fraction of Firms with a Banker on the Supervisory Board in 1992</td>
<td>0.14</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other Data</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Firms</td>
<td>132</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets (Billions of Dutch Guilders)</td>
<td>1.53</td>
<td>38</td>
<td>0.008</td>
<td>48.87</td>
</tr>
</tbody>
</table>
4 Results

This section presents the results of our regressions. Following the literature we reviewed in Section 2, we would like to explore various specifications (linear as well as non-linear) for the relation between block ownership and corporate performance. We start off with what we denote as the base case regression. The specification of this regression presumes a monotonic linear relation between block ownership and corporate performance. In Section 4.2 and 4.3, we then discuss the regression results using several other specifications.

4.1 Corporate Governance Channels and Corporate Performance: Base Case Regressions

For each firm in our sample, we use the ownership data as presented in Table 1. The averages of the total of the blocks disclosed by the different types of shareholders are included simultaneously as independent variables in the regressions. Using this specification implies that we test whether there is a linear relation between corporate performance and the total amount of shares held through blocks by different shareholders. We maximally exploit our information about the identity of the large shareholders this way. In Section 4.2 we will analyze different specifications regarding the relation between concentrated ownership and performance.

In addition to these ownership variables, we include two measures for the dilution of the voting rights of shareholders in the base case regressions. The first one is a dummy for whether or not the firm operated under the governance regime in 1992. The second one is a dummy variable for excessive control over voting rights by the firm. This dummy equals one if in 1992, the firm controlled at least 25% of the votes as a direct result of stripping the votes of the shares held by outside shareholders.

To capture the relations between firms and banks beyond the block ownership of shares by banks, we include the amount of short-term bank loans over assets in the regressions and a dummy variable for whether or not in 1992 the firm had a banker on its supervisory board. We also use the average debt ratio of the firm in the regressions. This allows us to measure the effect of short-term bank loans on firm performance controlling for the overall debt ratio of the firm. The debt ratio should pick up the tax shield associated with debt and the effect of leverage on the required return on equity. Also, this ratio may vary with Tobin’s \( q \) and market-to-book of equity if the firm bases its debt ratio on market values in stead of book values. For both these reasons, Tobin’s \( q \) and market-to-book of equity might
be positively related to the debt-ratio for reasons that have nothing to do with corporate governance.

Jensen (1986) has argued that debt may positively affect firm performance because it reduces the opportunities of management to inefficiently invest free cash flows. Debt forces management to pay out these cash flows, after which they might have to turn to the market for additional financing. If the proposed investments are inferior, management might be unable to obtain these funds. This argument is only indirectly related to corporate governance. If debt is indeed useful because it reduces the cash flows that are at the discretion of management, one still needs forces that induce management to take on a debt level that restricts them. The positive effect of debt on firm performance therefore does not run directly through the debt level but through the governance of the company. For these reasons, we do not consider the debt ratio itself as a governance channel.\footnote{Admittedly, this argument is not complete. Other debt holders than banks may exercise control over the company as well. This effect will then be captured by the debt ratio. Moreover, because we only have data on the amount of short-term bank debt in the capital structure of the firm, the debt ratio will reflect the control aspects of long-term bank debt as well.}

We include all these governance variables simultaneously in the regressions, using our four different performance variables as independent variables. We exclude one observation in both the regression for the market-to-book value of equity and the regression for the return on equity, because they are clearly outliers.\footnote{The market-to-book value of equity and the return on equity of this firm ('Management Share') are more than three times as high as the second highest values in the sample and they are both more than ten standard deviations above the mean.} We also exclude one firm because of an extreme value for their investment in tangible assets and one option trading company that doesn’t report any sales data. Our sample is therefore reduced to 130 or 129 firms, depending on the performance variable that we use. Table 2 reports the regression results using the specification that we just outlined. We discuss these results in the next three sub-sections.

4.1.1 Ownership Structure and Corporate Performance

The regressions for Tobin’s $q$ and the market-to-book of equity show no evidence in favor of a positive relation between corporate performance and ownership by different types of blockholders. None of the coefficients for the total fraction of shares held by the different blockholders is significant. The regressions for the profitability measures paint a different picture. The return on assets of the firm is positively related with the amount of shares held through blocks by banks/insurance companies, other financial institutions, individuals and management. The coefficients for the stakes held by non-financial companies and supervisory board members are also positive and borderline significant at the 10% level. Overall, there
seems to be a rather strong positive relation between return on assets and ownership concentration. When using the return on equity of the firm, this relation largely disappears. Only the coefficient for the amount of shares held through blocks by other financial institutions comes out significant.

The change in results from using the return on equity in stead of the return on assets is somewhat puzzling. The return on equity is more closely related to shareholder wealth than the firm’s return on assets. If the relation between return on assets and ownership concentration originates from monitoring by large outside shareholders or from a positive incentive effect associated with managerial ownership, we expect this to show up even stronger when we use the return on equity of firms.

In Section 4.2, we will further investigate whether there is a relationship between ownership structure and performance by looking at various alternative specifications for the shape of this relationship.

4.1.2 Voting Rights and Corporate Performance

The coefficients for the two voting rights variables indicate that firms that operated under the governance regime in 1992, displayed poorer performance over the years 1992-1996 than those firms that did not. The dummy variable is significant at the 5% level in the return on assets regression, and slightly less significant when using the other three performance variables. The economic significance of these coefficients is very large. The return on assets for firms that operated under the governance regime was 2.4 percentage points lower than the return on assets of other firms. This is quite a lot, considering that the mean return on assets for the firms in our sample was 7.9%. For the return on equity regression, the size of the coefficient suggests an even more dramatic impact of the governance regime of −7.1 percentage points. Note that despite the large size of this coefficient, the governance regime dummy is less significant in this regression than its counterpart in the regression for the return on assets. This suggests that the return on equity a more noisy performance measure than the return on assets.
Table 2: OLS Estimates from Regressing Corporate Performance on Various Governance Mechanisms: Different Types of Blockholders.

The regressions are based on averaged data for the years 1992-1996, unless indicated otherwise. Tobin’s $q$ is calculated as the market value of equity plus the book value of debt over book value of the assets. ‘M-B’ is market-to-book of equity. ‘ROA’ is Earnings Before Interest and Taxes over book value of assets. ‘ROE’ is Net Income over book value of equity. Ownership structure data relate to the total sum of disclosed blocks. Blocks are only disclosed in the Netherlands if they exceed 5% of the total of shares. ‘Other Financial Companies’ includes pension funds, mutual funds and other investment companies. ‘Fixed Assets’ and ‘Investment in Fixed Assets’ are based on tangible assets. ‘Assets’ always relate to the book value of assets. ‘Banker on the Board (1992)’ is a dummy variable that equals one if the firm has a member of the management board of a bank/financial conglomerate with a banking division on the supervisory board in 1992. For a description of the ‘Governance Regime’, we refer to the text. ‘Excessive Control over Votes’ refers to a dummy variable that equals one if the firm controls at least 25% of the votes as a direct result of stripping the votes of the shares of outside equityholders. All regressions include industry dummies.

<table>
<thead>
<tr>
<th>Blockholder</th>
<th>Tobin’s $q$</th>
<th>M-B</th>
<th>ROA</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Coeff.</strong></td>
<td><strong>Coeff.</strong></td>
<td><strong>Coeff.</strong></td>
<td><strong>Coeff.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>[S.E.]</strong></td>
<td><strong>[S.E.]</strong></td>
<td><strong>[S.E.]</strong></td>
<td><strong>[S.E.]</strong></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>0.129</td>
<td>*-2.911</td>
<td>**-1.05</td>
<td>-2.70</td>
</tr>
<tr>
<td></td>
<td>[0.505]</td>
<td>[1.677]</td>
<td>[0.052]</td>
<td>[1.180]</td>
</tr>
<tr>
<td>Banks/Insurance Companies</td>
<td>0.388</td>
<td>1.017</td>
<td>**1.132</td>
<td>0.200</td>
</tr>
<tr>
<td></td>
<td>[0.508]</td>
<td>[1.682]</td>
<td>[0.053]</td>
<td>[1.180]</td>
</tr>
<tr>
<td>Other Financial Companies</td>
<td>0.009</td>
<td>0.097</td>
<td>**0.079</td>
<td>**2.56</td>
</tr>
<tr>
<td></td>
<td>[0.323]</td>
<td>[1.070]</td>
<td>[0.034]</td>
<td>[1.140]</td>
</tr>
<tr>
<td>Non-financial Companies</td>
<td>0.231</td>
<td>0.570</td>
<td>0.038</td>
<td>0.023</td>
</tr>
<tr>
<td></td>
<td>[0.255]</td>
<td>[0.853]</td>
<td>[0.027]</td>
<td>[0.091]</td>
</tr>
<tr>
<td>Individuals</td>
<td>0.555</td>
<td>2.519</td>
<td>**1.186</td>
<td>-1.04</td>
</tr>
<tr>
<td></td>
<td>[0.607]</td>
<td>[2.046]</td>
<td>[0.063]</td>
<td>[2.190]</td>
</tr>
<tr>
<td>Management Board</td>
<td>0.206</td>
<td>0.368</td>
<td>**0.093</td>
<td>0.141</td>
</tr>
<tr>
<td></td>
<td>[0.310]</td>
<td>[1.033]</td>
<td>[0.032]</td>
<td>[1.110]</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td>0.238</td>
<td>0.941</td>
<td>0.056</td>
<td>0.090</td>
</tr>
<tr>
<td></td>
<td>[0.412]</td>
<td>[1.362]</td>
<td>[0.043]</td>
<td>[1.146]</td>
</tr>
<tr>
<td>Governance Regime (1992)</td>
<td>*-0.200</td>
<td>*-0.611</td>
<td>**0.024</td>
<td>*-0.071</td>
</tr>
<tr>
<td></td>
<td>[0.105]</td>
<td>[0.347]</td>
<td>[0.011]</td>
<td>[0.037]</td>
</tr>
<tr>
<td>Excessive Control over Votes (1992)</td>
<td>0.107</td>
<td>0.372</td>
<td>0.004</td>
<td>0.041</td>
</tr>
<tr>
<td></td>
<td>[0.095]</td>
<td>[0.315]</td>
<td>[0.019]</td>
<td>[0.037]</td>
</tr>
<tr>
<td>Debt/Assets</td>
<td>**0.735</td>
<td>**3.955</td>
<td>**0.073</td>
<td>**2.23</td>
</tr>
<tr>
<td></td>
<td>[0.399]</td>
<td>[1.357]</td>
<td>[0.041]</td>
<td>[1.145]</td>
</tr>
<tr>
<td>Short-term Bank Loans/Assets</td>
<td>**-1.300</td>
<td>**-4.508</td>
<td>**0.096</td>
<td>**-4.477</td>
</tr>
<tr>
<td>Banker on the Board (1992)</td>
<td>-.121</td>
<td>-.372</td>
<td>-.003</td>
<td>-.049</td>
</tr>
<tr>
<td></td>
<td>[.144]</td>
<td>[.476]</td>
<td>[.015]</td>
<td>[.051]</td>
</tr>
<tr>
<td>Log Sales</td>
<td>**0.067</td>
<td>**0.236</td>
<td>**0.016</td>
<td>**0.042</td>
</tr>
<tr>
<td></td>
<td>[.034]</td>
<td>[.115]</td>
<td>[.004]</td>
<td>[.012]</td>
</tr>
<tr>
<td>Fixed Assets/Assets</td>
<td>-.437</td>
<td>-.230</td>
<td>**0.071</td>
<td>**-2.28</td>
</tr>
<tr>
<td></td>
<td>[.278]</td>
<td>[.0920]</td>
<td>[.029]</td>
<td>[.098]</td>
</tr>
<tr>
<td>Inv. In Fixed Assets/Fixed Assets Previous Year</td>
<td>*-0.642</td>
<td>**2.27</td>
<td>*.066</td>
<td>.098</td>
</tr>
<tr>
<td></td>
<td>[.338]</td>
<td>[.1118]</td>
<td>[.035]</td>
<td>[.120]</td>
</tr>
</tbody>
</table>

Prob. F-statistic 0.00
Adjusted R-squared 0.28 0.28 0.24
Number of Observations 130 129 130 130

* significantly different from zero at the 10% level
** significantly different from zero at the 5% level
*** significantly different from zero at the 1% level
Our results strongly suggest that the governance regime has adverse consequences for the performance of companies. In the introduction, we have offered several explanations for such a negative impact. Perhaps these supervisory boards are relatively focused towards the interests of stakeholders such as employees, suppliers and creditors. Alternatively, because the supervisory board has complete control over its own composition, they might be consensus driven in their tasks. Our analysis doesn’t allow us to discriminate between these different scenarios, however.

There is no evidence that companies that controlled at least 25% of the votes in of outside shareholders in 1992 perform differently. The dummy that captures such excessive control over votes by the firm is never significant in the regressions. We also used 50% as a threshold for this dummy. This variable then separates the firms that controlled a majority of the votes in 1992 by stripping these from the shares of outside shareholders from those that did not. If we replace the old dummy by its new version, there is still no evidence that firms that control most of the votes of the firm by stripping these from the shares of outside equity holders perform less well. The regressions even indicate that there is some mild evidence that those companies perform better. For Tobin’s \( q \), market-to-book of equity and return on assets, the coefficient of this dummy shows up positively and significant at the 10% level (but not at the 5%).

The two voting rights dummies that we used in the regressions reported in Table 2 are constructed with data for the year 1992. The performance date related to the year 1992-1996. This specification makes sense because if these two governance variables are relevant for corporate decisions, we expect that the consequences will be materialized over the following few years (as well the contemporaneous year). Moreover, whether or not a firm operates under the governance regime or controls the votes of the shares held by outsiders does not vary strongly from year to year. To check whether the previous results are sensitive to fact that we used the year 1992 to construct the two dummies, we reran the regressions using the years 1992-1996 to base the dummies on. The results are almost identical to the ones reported above. Interestingly, the pattern that we observed above when using 50% as the cutoff value to measure excessive control over voting rights by the firm, still persists.

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94 The inclusion of this dummy is somewhat tricky, though, because we saw in Chapter 3 that ownership structure and the incidence that a firm controls more than 50% of the votes of outside shareholders are closely related to each other. The dummy variable is therefore correlated with the ownership variables in our regression. This also applies for the dummy that uses 25% as the threshold, although the data show that the differences in the ownership structures of these two groups of firms are then less extreme.

95 More precisely, if the firm operates under the governance regime in any of the years 1992-1996, we coded the dummy variable as equaling one. To capture excessive control over votes, we constructed a dummy variable that equals one if on average the firm controlled more than 25% of the votes of outside shareholders over the years 1992-1996.
Our analysis clearly indicates that the concentration of voting rights in the hands of companies that results from a separation of cash flow rights and voting rights has no direct adverse consequences for the performance of these companies. In Section 4.3 we will investigate whether stripping the votes of the shares of outside blockholders is innocuous as well. This aspect was neglected in the current analysis because we did not consider whether the votes under control of the firm were stripped from the shares of blockholders or from the shares of small equity holders.

4.1.3 Ties with Banks and Corporate Performance

Table 2 reveals that there is a strong negative relation between corporate performance and the amount of short-term bank loans over assets. This is particularly true if we use Tobin’s $q$, the market-to-book ratio of equity and the return on equity. It is weaker, however, when we measure performance by the overall profitability of the firm. The coefficient of the bank loans variable in the return on assets regression is five times as low its counterpart in the return on equity regression.

There does not seem to be any relation between firm performance and the presence of a banker on the supervisory board of the firm. The debt ratio shows up significantly positive in our market-to-book regressions but negative and almost insignificant in the profitability regressions. This suggests that firms set their debt levels on the basis of the market value of the firm, so that higher book to market increases their perceived debt capacity.

The strong negative impact of bank loans on firm performance requires some additional analysis. It may be that companies that perform poorly increase the amount of short-term bank loans to overcome liquidity problems. To check this, we calculated for each firm, the average increase in short term bank loans over assets over the sample years. Including this term in the regressions does not affect the coefficient on the short-term bank loan variable. Moreover, the coefficient for the increase in bank loans is highly insignificant, implying that firms that increased the amount of short-term bank loans that they borrowed over the sample period were not performing particularly poorly. We also calculated the difference between the average ratio of short-term bank loans and assets and the 1992 value. Including this term in the regressions does not alter the results either. Hence, there is no evidence that the negative relation between performance and the relative amount of short-term bank debt is due to increases in bank borrowing after poor performance.

The correlation between the debt ratio and the relative amount of short-term bank loans in the capital structure is 0.43, which is quite high. It is unlikely, however, that our results are driven by multi-collinearity of these variables. Excluding the debt ratio from the
regression decreases the coefficient for the bank loans term in the regression for Tobin's q somewhat, but it is still significant at the 10% level. Moreover, the significance of the bank loan term in the profitability regressions only goes up after excluding the debt ratio.

We find the strong relation that we document between firm performance and the use of short-term bank loans intriguing. The evidence with respect to this relation is consistent with the view that banks are potentially powerful through their lending relations with firms and that this enables them to enforce conservative, low profitability corporate policies as well as to extract rents. If banks are indeed using their power this way, we expect this to show up in lower market-to-book type performance measures. Our findings that profitability decreases with short-term bank lending suggests that these policies are to some extent value reducing. In addition, the overall profitability of the firm seems to suffer less from the influence of banks than the return on equity does; the absolute value of the coefficient is almost five times as small. This is what we would expect to find if at the expense of shareholders, banks are able to extract a larger part of the profits through their credit relations.

We are unwilling to adopt this view, however, solely on the basis of the current analysis. We haven't tested directly for the adoption of more conservative corporate policies as companies rely more on short-term bank financing nor do we have direct evidence that banks extract rents through interest charges as they increase their short-term lending to a company. Also, conversations with some practitioners about the possibility of banks squeezing firms that extensively rely on bank debt cast some doubts on this interpretation. One consultant argued that he has analyzed the loan pricing process several times and that he consistently came to the conclusion that banks provide loans at too favorable terms, which they try to make up for by earning additional fees from other services. Our results therefore point at an interesting topic for future research.

4.2 Ownership Structure and Corporate Performance: Other Specifications

The base case regression in Table 2 searches for a monotonic linear relation between the sum of the blocks held by the different type of shareholders. There is no reason to assume that this is the best way to capture the relation between ownership structure and performance. Studies that are similar to ours have used different specifications and we will try some other functional forms that are reasonable as well. We start with a specification that classifies the different types of blockholders as either outside blockholder or inside blockholder (management board or supervisory board). Such a specification may be useful because if all types of outside blockholders improve corporate performance through monitoring, classifying
outside shareholders in four different categories as we have done is not necessary. Distinguishing between different shareholders will then reduce the regression power to detect a relationship between concentrated ownership and performance.

We therefore rerun the regressions using the total sum of the blocks held by outsiders and the total sum of the blocks held by insider as independent variables. The results, reported in Table 3, are largely similar to the ones we obtained before. Block ownership of outsiders and insiders improves the return on assets, but there is no relation between ownership concentration and the other three performance measures. Note however that the ownership coefficients in the return on equity regressions are quite large. They are more than 1.5 times as large as their counterparts in the return on assets regression. Apparently, the return on equity regression lacks the statistical power to produce significant results regarding the relationship between ownership structure and firm performance.

The change in the specification of the regression equations slightly affects the significance pattern of the other variables. Most notably, the negative coefficient of the short-term bank loans term in the return on assets regression is now no longer significant at the 10% level while the results of the return on equity regression are unaffected. This further supports the interpretation we gave earlier about rent extraction by banks. Also, the negative effect of the governance regime in the regression with the return on equity becomes insignificant although its size is still economically very large.96

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96 Observe also that based on the adjusted R-squared of the regressions, the fits of both specifications are quite similar.
Table 3: OLS Estimates from Regressing Corporate Performance on Various Governance Mechanisms: Inside and Outside Blockholders.

The regressions are based on averaged data for the years 1992-1996, unless indicated otherwise. Tobin's $q$ is calculated as the market value of equity plus the book value of debt over book value of the assets. 'M-B' is market-to-book of equity. 'ROA' is Earnings Before Interest and Taxes over book value of assets. 'ROE' is Net Income over book value of equity. Ownership structure data relate to the total sum of disclosed blocks. Blocks are only disclosed in the Netherlands if they exceed 5% of the total of shares. 'Outsider Blockholdings' is the sum of the blocks held by banks/insurance companies, other financial companies, non-financial companies and individuals. 'Insider Blockholdings' is the sum of the blocks held by the members of the management board and supervisory board. 'Fixed Assets' and 'Investment in Fixed Assets' are based on tangible assets. 'Assets' always relates to the book value of assets. 'Banker on the Board (1992)' is a dummy variable that equals one if the firm has a member of the management board of a bank financial conglomerate with a banking division on the supervisory board in 1992. For a description of the 'Governance Regime', we refer to the text. 'Excessive control over votes' refers to a dummy variable that equals one if the firm controls at least 25% of the votes as a direct result of stripping the votes of the shares of outside equityholders. All regressions include industry dummies.

<table>
<thead>
<tr>
<th></th>
<th>Tobin's $q$</th>
<th>M-B</th>
<th>ROA</th>
<th>ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coeff</td>
<td>Coeff</td>
<td>Coeff</td>
<td>Coeff</td>
</tr>
<tr>
<td></td>
<td>[S.E.]</td>
<td>[S.E.]</td>
<td>[S.E.]</td>
<td>[S.E.]</td>
</tr>
<tr>
<td>Blockholder</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
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<td>-0.076</td>
<td>-2.254</td>
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<td>[1.601]</td>
<td>[.052]</td>
<td>[.174]</td>
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<td>Outsider Blockholdings</td>
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<td>.600</td>
<td>***-.072</td>
<td>.110</td>
</tr>
<tr>
<td>Insider Blockholdings</td>
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<td>500</td>
<td>**-.079</td>
<td>.130</td>
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<td></td>
<td>[.270]</td>
<td>[.900]</td>
<td>[.029]</td>
<td>[.098]</td>
</tr>
<tr>
<td>Governance Regime (1992)</td>
<td>**-.201</td>
<td>*-.606</td>
<td>*-.019</td>
<td>-.056</td>
</tr>
<tr>
<td></td>
<td>[.100]</td>
<td>[.331]</td>
<td>[.011]</td>
<td>[.036]</td>
</tr>
<tr>
<td>Excessive Control over</td>
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<td>.363</td>
<td>.004</td>
<td>-.026</td>
</tr>
<tr>
<td>Debt/Assets</td>
<td>*-.722</td>
<td>***4.052</td>
<td>-.060</td>
<td>-.224</td>
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<td>[.382]</td>
<td>[1.288]</td>
<td>[.041]</td>
<td>[.140]</td>
</tr>
<tr>
<td>Short-term Bank Loans/Assets</td>
<td>**-1.294</td>
<td>**-4.422</td>
<td>-.082</td>
<td>**-.450</td>
</tr>
<tr>
<td></td>
<td>[.544]</td>
<td>[1.805]</td>
<td>[.058]</td>
<td>[.197]</td>
</tr>
<tr>
<td>Banker on the Board (1992)</td>
<td>-.110</td>
<td>-.350</td>
<td>-.002</td>
<td>-.045</td>
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<tr>
<td></td>
<td>[.140]</td>
<td>[.463]</td>
<td>[.015]</td>
<td>[.051]</td>
</tr>
<tr>
<td>Log Sales</td>
<td>***.064</td>
<td>*.204</td>
<td>***.013</td>
<td>***.041</td>
</tr>
<tr>
<td></td>
<td>[.032]</td>
<td>[.105]</td>
<td>[.003]</td>
<td>[.015]</td>
</tr>
<tr>
<td>Fixed Assets/Assets</td>
<td>-.430</td>
<td>-1.125</td>
<td>**-.065</td>
<td>**-.243</td>
</tr>
<tr>
<td></td>
<td>[.268]</td>
<td>[.891]</td>
<td>[.029]</td>
<td>[.098]</td>
</tr>
<tr>
<td>Inv. in Fixed Asset/Fixed</td>
<td>**.657</td>
<td>**2.262</td>
<td>*.061</td>
<td>0.062</td>
</tr>
<tr>
<td>Assets Previous Year</td>
<td>[.328]</td>
<td>[1.087]</td>
<td>[.035]</td>
<td>[.118]</td>
</tr>
<tr>
<td>Prob. F-statistic</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
</tr>
<tr>
<td>Adjusted R-squared</td>
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<td>.24</td>
<td>.25</td>
<td>.24</td>
</tr>
<tr>
<td>Number of Observations</td>
<td>130</td>
<td>129</td>
<td>130</td>
<td>129</td>
</tr>
</tbody>
</table>

*** significantly different from zero at the 1% level
** significantly different from zero at the 5% level
* significantly different from zero at the 10% level
One may argue that some minimal degree of outsider ownership concentration might be sufficient to ensure shareholder monitoring, so that once outsider ownership concentration reaches this minimal level, increasing ownership concentration does not affect corporate performance beyond this critical level. Clearly this is not the case when we measure performance by the return on assets, but perhaps such a relation exists for our other performance measures. Similarly, it may be that once insiders own a significant fraction of the shares, the interests of insiders and shareholders are largely aligned so that their decisions are no longer affected very much by the exact size of their stake.

To test these relations, we run our regressions using dummy variables for the ownership structure of the firm in stead of the sum of the stakes of the blockholders. Given that 94% of the firms in our sample have at least one outside blockholder, we decided to create a dummy that equals one if the average sum of the stakes of outside blockholders exceeded 10%.17 For 81% of the firms in our sample this is the case. We also create separate dummies for whether or not the management board or supervisory board owns a block. To capture the effects of higher degrees of ownership concentration, we include a dummy in the regression that equals one if on average more than 25% of the shares of the firm were in the hands of outside blockholders.

Table 4 displays the results of these regressions. Tobin’s \( q \) and market-to-book of equity are positively related to the 10% outside block ownership dummy. Observe that the coefficients of the dummies are quite large (0.29 and 0.93), given that the sample averages for these two performance measures are 1.36 and 2.08 respectively. The insider block ownership dummies, however, are clearly insignificant. For the return on equity, all the dummy variables are insignificant. Again, the coefficients are generally quite high but the regression seems to lack the statistical power that the other regressions tend to have.

In comparison with our previous results, the change in the specification hardly affects the coefficients of the other variables. Note however that for the regression where we use the return on equity as the performance variable, the dummy for the governance regime still has a large coefficient but it is no longer significant (t-value -1.59, Prob. = .11). Also, compared to Table 2, the significance for the short-term bank loans variable in the return on assets regression now disappears.

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17 There is another good reason for setting the threshold for the dummy above the 5% level. Corporate blockholders that own 5% of a firm obtain a tax reduction on the dividends they receive from their blockholdings. This provides firms, especially financial ones, with an incentive to acquire a block just above the 5% independent of whether or not they plan to exercise control.
Table 4: OLS Estimates from Regressing Corporate Performance on Various Governance Mechanisms: Dummies for Blockholders.

Regression coefficients are based on average data for the years 1992-1996, unless indicated otherwise. Tobin’s q is calculated as the market value of equity plus the book value of debt over book value of the assets. ‘M-B’ is market-to-book of equity. ‘ROA’ is Earnings Before Interest and Taxes over book value of assets. ‘ROE’ is Net Income over book value of equity. Ownership structure data relate to the total sum of disclosed blocks. Blocks are only disclosed in the Netherlands if they exceed 5% of the total of shares. ‘Outsider Blocks > 10%’ and ‘Outsider Blocks > 25%’ are dummy variables equaling one if the sum of the blocks of outside shareholders is larger than 10% and 25% respectively. ‘Management Board > 5%’ and ‘Supervisory Board > 5%’ are dummies equaling one if the firm has a blockholder that is a member of the management board and supervisory board respectively. ‘Fixed Assets’ and ‘Investment in Fixed Assets’ are based on tangible assets. ‘Assets’ always relates to the book value of assets. ‘Banker on the Board (1992)’ is a dummy variable that equals one if the firm has a member of the management board of a bank/financial conglomerate with a banking division on the supervisory board in 1992. For a description of the ‘Governance Regime’, we refer to the text. ‘Excessive control over votes’ refers to a dummy variable that equals one if the firm controls at least 25% of the votes as a direct result of stripping the votes of the shares of outside equityholders. All regressions include industry dummies.

<table>
<thead>
<tr>
<th></th>
<th>Tobin’s q</th>
<th>M-B</th>
<th>ROA</th>
<th>ROE</th>
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<tr>
<td>Blockholder</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>.062</td>
<td><strong>-3.113</strong></td>
<td>-.072</td>
<td><strong>-.289</strong></td>
</tr>
<tr>
<td>Outsider Blocks &gt; 10%</td>
<td><strong>.315</strong></td>
<td><strong>.963</strong></td>
<td><strong>.029</strong></td>
<td>.079</td>
</tr>
<tr>
<td>Outsider Blocks &gt; 25%</td>
<td>-.129</td>
<td>-2.76</td>
<td>.016</td>
<td>.002</td>
</tr>
<tr>
<td>Management Board &gt; 5%</td>
<td>-.060</td>
<td>-2.87</td>
<td><strong>.022</strong></td>
<td>.055</td>
</tr>
<tr>
<td>Supervisory Board &gt; 5%</td>
<td>.132</td>
<td>5.58</td>
<td><strong>.028</strong></td>
<td>.044</td>
</tr>
<tr>
<td>Governance Regime (1992)</td>
<td><strong>-.198</strong></td>
<td><strong>-.605</strong></td>
<td><strong>-.024</strong></td>
<td>-.056</td>
</tr>
<tr>
<td>Excessive Control over</td>
<td>.044</td>
<td>1.71</td>
<td>.006</td>
<td>-.054</td>
</tr>
<tr>
<td>Debt/Assets</td>
<td><strong>.874</strong></td>
<td><strong>.589</strong></td>
<td>-.048</td>
<td>-.201</td>
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<td>Short-term Bank Loans/Assets</td>
<td><strong>-1.310</strong></td>
<td><strong>-.612</strong></td>
<td>-.093</td>
<td><strong>-.458</strong></td>
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<tr>
<td>Banker on the Board (1992)</td>
<td>-.056</td>
<td>-.120</td>
<td>.007</td>
<td>-.033</td>
</tr>
<tr>
<td>Log Sales</td>
<td>*.058</td>
<td>*.197</td>
<td><strong>.012</strong></td>
<td><strong>.040</strong></td>
</tr>
<tr>
<td>[S.E.]</td>
<td>[.030]</td>
<td>[.100]</td>
<td>[.003]</td>
<td>[.010]</td>
</tr>
<tr>
<td>Fixed Assets/Assets</td>
<td>-.398</td>
<td>-1.087</td>
<td><strong>-.052</strong></td>
<td><strong>-.221</strong></td>
</tr>
<tr>
<td>Inv. in Fixed Asset/Fixed</td>
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<td><strong>.2309</strong></td>
<td>.051</td>
<td>.050</td>
</tr>
<tr>
<td>Assets Previous Year</td>
<td>[.325]</td>
<td>[1.076]</td>
<td>[.036]</td>
<td>[.119]</td>
</tr>
<tr>
<td>Prob. F-statistic</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>.32</td>
<td>.26</td>
<td>.24</td>
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</tr>
<tr>
<td>Number of Observations</td>
<td>130</td>
<td>129</td>
<td>130</td>
<td>129</td>
</tr>
</tbody>
</table>

** significantly different from zero at the 1% level
*** significantly different from zero at the 5% level
* significantly different from zero at the 10% level
We reran the regressions including additional dummies for insider block ownership higher than 25%. The results are similar to the ones reported in Table 4. We also included a dummy for (average) majority insider ownership in the regressions but this dummy came out insignificant. Hence, there is no evidence that firms with high level of insider ownership perform different. In addition, we tested whether performance was related to the average stake size of the largest shareholder and the largest three shareholders. We found no evidence that there are such relations.

Finally, it may be that ownership concentration is good for performance up till a certain level but detrimental for performance beyond that point. This last effect may be the result of an expropriation of minority shareholders, the entrenchment of insiders at high levels of insider ownership, lower liquidity of the stocks, or of the risk aversion of the large shareholders who control the company. To test for such a non-linear relation between ownership and corporate performance, we reran our regressions using a specification with average total outsider block ownership, average total insider block ownership and two separate terms for the squares of these variables. None of these four terms however came out significantly. We also estimated a quadratic specification where we distinguished between the management board block ownership and supervisory board block ownership. The coefficients for these four variables were clearly insignificant. This result contrasts with the findings of De Jong (1999) that we discussed in the introduction of this chapter. Searching for non-linear effects of block ownership by banks/financial institutions, we fail to find support for their relevance.

In conclusion, our analysis suggests that both the positive effects monitoring by blockholders and positive incentive effects from insider block ownership are relevant for the performance of Dutch firms. Table 3 indicates that the return on assets is increasing in the fraction of the shares held through blocks of outsiders and insiders. We fail to find such a positive effect of insider ownership when we focus on Tobin’s q or market-to-book of equity as performance variables. These two indicators are positively affected by the presence of

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98 Our evidence is consistent with the results of Denis and Denis (1994) and Holderness and Sheehan (1988) that also indicate that the performance of majority owned firms is no different from other firms.

99 To be more precise, we estimated three different versions of the specification presented in Table 3. Using Tobin’s q as a performance variable, we included the total fraction of shares held by outside blockholders, the squared terms of these variables, and (A) the non-quadratic and quadratic term for management board and supervisory board block ownership or (B) the non-quadratic and quadratic term of only management board ownership or (C) the non-quadratic and quadratic term for total insider ownership. In none of the specifications, any of the coefficients of these variables came out significant.

100 This is in line with the results in Chirinko et al (1999). Although they report evidence in favor of a non-linear relation between block ownership by three largest Dutch banks and the performance of companies, this pattern disappears when the block of banks, insurance companies and pension funds are taken together. In our data, we do not distinguish between banks and insurance companies because the large banks in the Netherlands are all extensively active in the insurance market while in turn insurance companies are also active as lenders.
outside blockholders that own at least 10% of the shares, but do not increase further after outside block ownership has reached this level. The results are therefore not completely consistent with each other. In the concluding remarks of this chapter, we will offer a possible explanation for this lack of consistency.

The direct relevance of the ownership structure of the firm and their performance that we find is quite different from the international evidence. As far as we are aware of, most studies that use a similar cross-sectional framework find that corporate performance is unaffected by outside block ownership. There is also no strong evidence that suggests that insider ownership is important for corporate performance. The direct comparability of the results of these studies is of course limited because they are derived within governance systems that are quite different from the Dutch system. Moreover, most of these studies focus on a single country: the US.

4.3 Voting Blocks and Corporate Performance

So far, we have accounted for the dilution of voting rights by including dummy variables for the presence of the governance regime and for excessive control over votes that are stripped from shares held by outside equity holders. At the same time, we have used the blocks of large shareholders to capture their monitoring incentives. However, if votes are essential for effective control by outside shareholders, neglecting whether or not the blocks carry votes is inappropriate. Because we have precise data on whether or not the shares of the blockholders carry votes as well, we can investigate this issue by rerunning the regressions using only the blocks that actually carry votes.

Table 5 reports the results from the specifications that we used earlier for constructing Table 2 and Table 4. We only display the regressions where we used Tobin’s $q$ and the return on assets as the performance variables. The table shows that corporate performance is not strongly related to the voting blocks in the hands of outside shareholders. In fact, treating the blocks of shares without votes as ‘zero ownership concentration’ generally breaks down the relation between performance and ownership concentration that we found before. The positive relation between return on assets and ownership concentration is much weaker and the dummy for outside block ownership exceeding 10% is now no longer significant in the regression for Tobin’s $q$. The results in Table 5 thus imply that the relation between

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101 The regressions that we report in Table 5 include the blocks of votes held by corporate insiders as well. Whether or not their blocks of shares carry votes is largely immaterial in this context because the votes that are separated from the shares reside with the company itself. For sake of comparability between the regressions, we include these blocks as well. Excluding them leads to similar results.
performance and ownership concentration that we documented in Table 2 and 4 holds irrespective of whether or not the blocks of large shareholder carry votes as well.

Our analysis clearly indicates that corporate control over votes does not insulate the firm from disciplinary forces that enhance their performance. The dummy variable for the incidence that the firm controls a high fraction of the votes is never significantly negative. The fact that the results of Table 2 and 4 are largely broken down if we concentrate on blockholders with votes suggests that large shareholder can improve the performance of companies irrespective of whether or not they hold votes. It seems therefore that shareholder monitoring does not become ineffective when the firm controls the votes of blockholders.

5 Concluding Remarks

In this chapter, we have analyzed whether the governance characteristics of Dutch firms have implications for their performance. The main focus was on establishing whether the ownership structure of companies is important in this respect. Block ownership gives shareholders an incentive to improve firm performance through monitoring. Also, insider ownership ties the wealth corporate insiders to the value of the equity of the firm, which might be good for their incentives to maximize firm value. To investigate the relevance of these two hypotheses for the Netherlands, we tested whether the presence of large shareholders, such as inside blockholders (management and supervisory board members) and outside blockholders (companies, financial institutions, investment companies, individuals) influences corporate performance. We used four different performance measures: Tobin’s $q$, the market-to-book ratio of equity, the return on assets and the return on equity. Our cross-sectional regressions revealed that the return on assets of a firm is increasing in the fraction of shares held through blocks by both inside and outside shareholders. For the other three performance measures, we failed to find the same pattern. Tobin’s $q$ and market-to-book of equity however are higher in firms where outside blockholders own more than 10% of the shares than in firms that are characterized by a lower degree of outside ownership concentration.

When using the return on equity as a performance measure, none of these relations were statistically significant. Nevertheless, these regressions did produce results that were largely consistent. The coefficients for the ownership structure variables are generally larger and of equal sign as their counterparts in the return on assets regressions. It seems that despite reducing the noise in the performance data by averaging them over a large number of years, our regressions still lack the statistical power for this performance variable.
### Table 5: OLS Estimates from Regressions of Corporate Performance on Various Governance Mechanisms: Votes of Blockholders.

The regressions are based on averaged data for the years 1992-1996, unless indicated otherwise. Ownership structure data relate to the total sum of disclosed blocks of votes. For a description of the variables, see Table 2 and Table 4. All regressions include industry dummies.

<table>
<thead>
<tr>
<th></th>
<th>Tobin’s $q$</th>
<th>ROA</th>
<th>Tobin’s $q$</th>
<th>ROA</th>
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<td>Coeff.</td>
<td>S.E.</td>
<td>Coeff.</td>
<td>S.E.</td>
</tr>
<tr>
<td><strong>Constant</strong></td>
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<td>.448</td>
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<td><strong>Banks / Insurance Companies</strong></td>
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<td>.627</td>
<td>.099</td>
<td>.067</td>
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<tr>
<td><strong>Other Financial Companies</strong></td>
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<td>.337</td>
<td>.055</td>
<td>.036</td>
</tr>
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<td><strong>Non-financial Companies</strong></td>
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<td>.251</td>
<td>.011</td>
<td>.027</td>
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<tr>
<td><strong>Individuals</strong></td>
<td>.609</td>
<td>.653</td>
<td><strong>.178</strong></td>
<td>.070</td>
</tr>
<tr>
<td><strong>Management Board</strong></td>
<td>-.089</td>
<td>.315</td>
<td><strong>.068</strong></td>
<td>.034</td>
</tr>
<tr>
<td><strong>Supervisory Board</strong></td>
<td>-.040</td>
<td>.432</td>
<td>.003</td>
<td>.046</td>
</tr>
<tr>
<td><strong>Outsider Blocks &gt; 10%</strong></td>
<td>.000</td>
<td>.130</td>
<td>-.011</td>
<td>.015</td>
</tr>
<tr>
<td><strong>Outsider Blocks &gt; 25%</strong></td>
<td>-.030</td>
<td>.147</td>
<td>.022</td>
<td>.016</td>
</tr>
<tr>
<td><strong>Management Board &gt; 5%</strong></td>
<td>-.119</td>
<td>.139</td>
<td>.021</td>
<td>.016</td>
</tr>
<tr>
<td><strong>Supervisory Board &gt; 5%</strong></td>
<td>.063</td>
<td>.182</td>
<td>.007</td>
<td>.020</td>
</tr>
<tr>
<td><strong>Governance Regime (1992)</strong></td>
<td><strong>-.213</strong></td>
<td>.107</td>
<td><strong>.223</strong></td>
<td>.098</td>
</tr>
<tr>
<td><strong>Excessive Control over Votes (1992)</strong></td>
<td>.133</td>
<td>.012</td>
<td>.064</td>
<td>.013</td>
</tr>
<tr>
<td><strong>Debt/Assets</strong></td>
<td><strong>.707</strong></td>
<td>.396</td>
<td><strong>.754</strong></td>
<td>.389</td>
</tr>
<tr>
<td><strong>Short-term Bank Loans/Assets</strong></td>
<td><strong>1.268</strong></td>
<td>.553</td>
<td><strong>.123</strong></td>
<td>.551</td>
</tr>
<tr>
<td><strong>Banker on the Board (1992)</strong></td>
<td>-.119</td>
<td>.148</td>
<td>-.086</td>
<td>.142</td>
</tr>
<tr>
<td><strong>Log Sales</strong></td>
<td><strong>.060</strong></td>
<td>.033</td>
<td><strong>.013</strong></td>
<td>.004</td>
</tr>
<tr>
<td><strong>Fixed Assets/Assets</strong></td>
<td>-.424</td>
<td>.276</td>
<td>-.058</td>
<td>.030</td>
</tr>
<tr>
<td><strong>Inv. in Fixed Asset/Fixed Assets Previous Year</strong></td>
<td><strong>.610</strong></td>
<td>.340</td>
<td><strong>.687</strong></td>
<td>.338</td>
</tr>
<tr>
<td><strong>Prob. F-statistic</strong></td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
<td>.00</td>
</tr>
<tr>
<td><strong>Adjusted R-squared</strong></td>
<td>.28</td>
<td>.23</td>
<td>.29</td>
<td>.17</td>
</tr>
<tr>
<td><strong>Number of Observations</strong></td>
<td>130</td>
<td>130</td>
<td>130</td>
<td>130</td>
</tr>
</tbody>
</table>

*** significantly different from zero at the 1% level
** significantly different from zero at the 5% level
* significantly different from zero at the 10% level
The positive relation between outsider block ownership and corporate performance that we find suggests that value enhancing monitoring takes place in the Netherlands. The regressions provide somewhat ambiguous results, however, with respect to the nature of this relationship. The market-to-book regressions indicate that after a minimum degree of ownership concentration, the positive effect disappears. The return on assets of the firm, however, is increasing in the total amount of shares held by outside blockholders. For the effect of insider ownership on corporate performance, the ambiguity is even larger. In the regressions where we used market-to-book variables, insider ownership and performance seem to be unrelated. This contrasts with our findings for the return on assets regressions, which revealed that the higher insider ownership, the higher the profitability of the firm. If insider block ownership indeed improves the return on assets because of positive incentive effects, we expect this to show up in the market-to-book variables as well.

An explanation for this lack of consistency might be that market-to-book measures are also affected by the growth opportunities of the firm. Such growth opportunities are not necessarily related to quality of managerial decisions. The standard way to control for this is to include R&D investments and sales expenses (such as marketing costs) in the regressions. These data are not publicly available in the Netherlands, however.

In all, our results do not paint a clear-cut picture about the precise relation between the ownership structure of the firm and its performance. In this respect, they fit in with the inconclusive evidence produced by Chirinko et al (1999) and De Jong (1999) that we discussed in the introduction of this chapter. The sensitivity of the results to the research approach that is being used suggests that more work is needed to firmly establish this delicate issue.

We also tested whether firms that operate under the governance regime perform differently. We found that these firms are characterized by poorer performance compared to firms that do not operate under the governance regime. The economic significance of this effect is quite large. Controlling for the ownership structure as well as other characteristics of the firm, the return on assets of these firms is around 2 percentage points lower. Apparently, the concentration of power in the hands of supervisory board members in these firms adversely affects performance. There are several explanations that are consistent with this result. For example, it may be that control over management by the supervisory board in these companies is excessive in reducing managerial discretion over corporate policies. Alternatively, these supervisory board members might use their formal authority to protect the interests of other stakeholders of the firm at the expense of investors. The negative effect is also consistent with the argument that the governance regime leads to consensus driven
supervision and to a lack of alertness within the supervisory board. Our analysis doesn’t allow us to discriminate between these explanations.

We found no evidence that firms that control a significant fraction of the votes after stripping these from the shares of outside equity holders performance worse. Moreover, when we neglected those blockholders whose shares do not carry voting rights, the relation between performance and block ownership that we documented before largely broke down. Taken together, these results clearly indicate that corporate control over its own votes does not insulate the firm from disciplinary forces such as shareholder monitoring.

Finally, we briefly looked at whether the presence of a banker on the supervisory board of a firm or its reliance on short-term bank debt financing was related to corporate performance. For the relative amount of short-term bank debt, we indeed found that this is the case. The effect was particularly present for Tobin’s $q$, market-to-book of equity and return on equity. It was much milder when we analyzed the return on assets of firms. This pattern is consistent with banks enforcing conservative policies and extracting rents through the interest payments. However, we have no direct evidence in support of this story. Whether or not credit relations between banks and firms lead to rent extraction and conservative corporate policies is an interesting topic for future research.