2 New Outside Blockholders, Performance, and Governance in Germany

2.1 Introduction

Many theoretical analyses argue that the involvement of large shareholders in monitoring or control activities has the potential to limit agency problems (Shleifer and Vishny (1986), Maug (1998), and Noe (2002)). Empirical support for this argument has been provided by a number of studies (e.g. Agrawal and Mandelker (1990), Hartzell and Starks (2003), Holderness (2003)). Results are, however, still ambiguous.

Most of the studies are static in nature, examining the impact of already existing large blockholders on firm performance or monitoring related variables such as management turnover. In contrast, the body of empirical research on the dynamic effects of changes in ownership structure is considerably smaller. This strand of literature investigates acquisitions of 5% or more, that is, the emergence of new blocks. These “partial acquisitions” are typically greeted by positive abnormal returns. This reaction has been ascribed to factors such as the anticipation of an increased takeover probability and enhanced monitoring (e.g. Choi (1991), Barclay and Holderness (1991)). Recent studies further document a strong influence of block- and target-specific characteristics on the realized wealth effects (e.g. Bethel et al. (1998), Allen and Phillips (2000), Park et al. (2008)). So far, block purchases appear fairly well explored. However, the research discussed above focuses entirely on the U.S. In contrast, evidence on the role and effect of large blockholders in Europe is surprisingly scarce. We want to fill this gap by empirically examining the effect of block purchases in Germany. The German system of corporate control and governance has several unique characteristics that motivate us to specifically focus on block purchases in Germany.

First, Germany in particular is characterized by a substantially higher ownership concentration than the U.S. (La Porta et al. (1999), Faccio and Lang (2002)). Becht and

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1 A large shareholder (blockholder) is generally defined as an entity that owns at least 5% of a firm’s outstanding shares.
Boehmer (2003) document that over 80% of officially exchange listed German corporations have a blockholder controlling over 25% of the votes and that 65% are majority controlled. A considerable power can be associated with blocking minority stakes (larger than 25%), even in cases where a controlling shareholder or coalition of controlling shareholders exists (Jenkinson and Ljungqvist (2001)). Conversely, this raises the question if the capital market also values incremental monitoring by an additional large blockholder. For example, activist investors that are often associated with superior monitoring abilities (Bethel et al. (1998), Park et al. (2008)) may not be able to undergo substantial corporate restructurings in the presence of blocking minorities. Second, in the light of substantial ownership concentration, a relative active market exists in stakes. In contrast to the U.S., acquisitions of large stakes are regarded as a substitute for the traditional market of corporate control (Franks and Mayer (2001), Köke (2004)), leading to both friendly and hostile control changes (Jenkinson and Ljungqvist (2001)).

Given the above considerations, we will shed light on the economic implications of block purchases in Germany by studying a new set of data with 85 block purchases with German targets between 1997 and 2006. We focus on de-facto minority block purchases between 5% and 49.9% of target voting stock to separate the wealth effects of implicit majority control transfers from block- and target-specific effects such as acquirers’ intention (e.g. activist investor) or target firms’ incumbent ownership structure.

Our results show that block purchases in German companies lead to positive abnormal returns on average, regardless of the identity of the buyer. In addition, we find block purchases by activist investors to be accompanied with significantly higher abnormal returns than purely financial block purchases. This finding leads us to the conclusion that activist acquirers either have superior monitoring or target selection abilities. With regard to the influence of the ownership structure, we find that incumbent large shareholders have at most a marginal effect on the market reaction, despite the con-

\[\text{Faccio and Stolin (2006) show that bidding firms may use partial acquisitions (acquisitions of majority control but not of 100% control) to expropriate the target firms’ minority shareholders. Accordingly, Martynova and Renneboog (2006) document that the abnormal returns to the announcements of partial acquisitions to target shareholders are substantially lower than for full acquisitions.}\]