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Blockholders and Corporate Governance

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BLOCKHOLDERS AND CORPORATE GOVERNANCE

By

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ABSTRACT

BLOCKHOLDERS AND CORPORATE GOVERNANCE

By

Jin-Mo Kim

This study contains two essays. In the first essay, we study the role of foreign investors in the corporate governance of U.S. firms. Using a sample of 257 partial acquisitions of U.S. firms by foreign firms during the period 1981-1999, we show that foreign blockholders from countries with strong shareholder rights play a more active role in disciplining managers of U.S. targets than do those from countries with weak shareholder rights. In particular, the probability of nonroutine top executive turnover and the extent of other governance activities by foreign investors, such as the threat of hostile takeovers and the demand for representatives on the target's board, are positively related to the shareholder rights score of their home countries. This positive relationship, however, is mainly driven by the subsample of acquisitions in which foreign investors do not have any business relationships with U.S. targets (unrelated foreign investors). Abnormal announcement returns for U.S. targets of unrelated foreign investors also display a strong positive association with the level of shareholder rights protection in the acquiring firm country. This result suggests that the stock market takes the increase in the frequency of a foreign acquiring firm's

value-enhancing future governance activities for U.S. targets into account when assessing their market values.

In the second essay, we examine the role of geographic proximity in corporate governance. Using a sample of 698 partial acquisitions in the U.S. during the period of 1990-1999, we find that geographically proximate block acquirers are more likely to be involved in governance activities in target firms than are remote block acquirers. Acquirers located within the same state as targets (in-state acquirers) or those who are located within 250 miles of target firms (local acquirers) are more likely to have their representatives on the target's board and replace target management after block share purchases. In addition, targets of in-state and local acquirers experience higher abnormal announcement returns and post-acquisition operating performance than those of other acquirers. Furthermore, these effects are strongest when target firms are small or have poor past performance and higher insider ownership. Finally, we find that block acquirers have strong preference for local firms. Our results suggest that geographically proximate investors have significant advantages in terms of governance activities over remote investors and such governance activities affect operating performance and the value of firms.

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To my parents, my wife, and my daughter and son
for their unqualified love and support

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ESSAY 1. Foreign Blockholders, Shareholder Rights, and Corporate Governance: Evidence from Partial Acquisitions of U.S. Firms by Foreign Firms

1.1 Introduction

Recent research has demonstrated that legal environments, such as the legal protection of investors and the quality of law enforcement, affect the development of a country's financial markets (La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997), hereafter referred to as LLSV), the acceleration of economic growth (Demirguc-Kunt and Maksimovic (1998)), the extent of ownership concentration (LLSV (1999)), and the difference in financial policy (LLSV (2000b)). In particular, LLSV (1997, 1998, 1999, 2000a) show that differences among countries in the structure of laws and their enforcement explain the differences in financial market development, and that such development is promoted by better protection of investors. Moreover, several studies have established a link between legal environments and agency problems. For example, Dyck and Zingales (2002) show that stronger minority shareholder rights and a higher quality of law enforcement are associated with lower levels of a country's private benefits of control. DeFond and Hung (2003) also document that strong law enforcement institutions significantly improve the sensitivity of top executive turnover to poor performance.

In this paper, we extend this literature by providing evidence on the importance of legal rules and their enforcement in fostering corporate governance activities. Our evidence comes from corporate governance activities of foreign firms who acquire at least 5 percent, but less than 50 percent, of voting shares in U.S. firms. Specifically, we

examine whether the extent of corporate governance activities, such as hostile takeovers, board representation, and nonroutine top executive turnover, of foreign blockholders in U.S. targets is related to shareholder rights and the quality of law enforcement in their home countries. We also investigate whether these legal environments have any explanatory power in regard to the cross-sectional variation in abnormal announcement returns for U.S. targets. If strong protection of investors in the acquiring firm country fosters good corporate governance in targets, and good corporate governance leads to an increase in target value,¹ we should observe a positive relationship between investor protection by the legal system and target returns.

We focus on partial acquisitions since unlike mergers where target firms are subsequently delisted from stock exchanges after the transaction, those involved in partial acquisitions still survive on stock exchanges and therefore detailed public information on post-acquisition governance activities of foreign blockholders is readily available. Further, partial acquisitions represent a setting where block acquirers have strong incentives to monitor target managers, so the governance activities of foreign investors are expected to be magnified in this case.

There are several possible reasons why legal rules protecting minority shareholders and their enforcement in the foreign acquiring firm country might influence corporate governance activities in U.S. firms. First, these legal rules and law enforcement allow shareholders to function actively as governance mechanisms in their home countries. For example, legal rights of shareholders, such as cumulative voting, proportional

¹ Several studies have shown that the legal environment has an effect on corporate valuation. For example, LLSV (2002) show that firms in countries with better shareholder protection have a higher Tobin's q than those where such protection is weaker. Nenova (2003) finds that voting premium is higher in countries with poor shareholder protection.

representation of minorities on the board of directors, and calling for extraordinary shareholders' meetings, facilitate the governance activities of minority shareholders and thus support shareholder activism for corporate governance. Furthermore, the investor protection by legal systems, especially shareholder rights, is an essential element of governance structures and has an important influence on the governance activities of shareholders. The shareholder rights limit the expropriation of minority shareholders by corporate insiders by providing specific governance mechanisms through which shareholders can protect their interests. In this context, shareholder rights foster the governance activities of minority shareholders and even determine the scope and effectiveness of their governance activities (Shleifer and Vishny (1997), LLSV (2000a)). To the extent that foreign firms in strong protective regimes can transfer their corporate governance standards to domestic firms in the host country, they are expected to perform an important governance role in domestic targets.

Second, the high frequency of governance activities by minority shareholders in countries with strong shareholder rights and a high quality of law enforcement allow investors to become acquainted with better governance skills and experience than those in countries with poor shareholder rights and a low quality of law enforcement. DeFond and Hung (2003) also argue that strong law enforcement creates an environment that fosters good corporate governance. These arguments suggest that foreign shareholders from countries with stronger shareholder protection and law enforcement would possess governance skills and expertise that are superior to those from countries with poor shareholder protection.

Finally, as discussed in Shleifer and Vishny (1997), investor protection and governance structure mitigate the agency problem between managers and outside investors, which arises from the separation of ownership and control, and thus affect firm value. For example, protected shareholder rights might provide corporate managers with strong incentives to maximize shareholder wealth. In contrast, weak shareholder protection might allow managers to exploit minority shareholders more easily and thus increase the incentive to carry out expropriation. Therefore, the variation in the degree of shareholder rights protection across countries can create a difference in managerial incentives to maximize firm value, which in turn affects the incentives for managers of foreign firms to perform an active governance role in domestic targets.

Foreign acquisitions in the U.S. provide important advantages that make them particularly well suited to an investigation of the link between the level of shareholder rights protection and the extent of corporate governance activity. First of all, these acquisitions allow us to examine the corporate governance activities of foreign investors at a level of detail and consistency that would be hard to aggregate across countries. Furthermore, unlike in the U.S., where they are strong, the degree of shareholder rights protection and the quality of law enforcement are poor in many countries. These countries sometimes prevent foreign investors from actively participating in governance activities in domestic firms. Focusing on the U.S. market, therefore, allows us to avoid the measurement bias in cross-country analysis that arises from poor protection of legal rights and the severe regulation of the governance activities of foreign firms.

In addition to gaining insight into the link between shareholder rights protection and corporate governance, our research contributes to the literature on large shareholders by

comparing the role of domestic block ownership and foreign block ownership in corporate governance. Although the presence of foreign ownership in the U.S. and other countries has substantially increased over the last three decades,² systematic evidence of its role in corporate governance is scarce. Previous studies show that large domestic shareholders play an important role in corporate governance (Shivdasani (1993), Denis and Serrano (1996), Bethel, Liebeskind, and Opler (1998)). Unlike small shareholders who like to free-ride the corporate governance activities of other shareholders (Grossman and Hart (1980)), large shareholders have strong incentives to monitor managerial performance and take actions that enhance firm value (Shleifer and Vishny (1986)).

However, *a priori*, the role of foreign shareholders in corporate governance is unclear. If foreign investors are less well informed about a domestic firm than are domestic investors and have to pay additional costs to overcome such an information disadvantage (e.g., costs associated with searching for information, costs associated with multinational operations, costs associated with traveling, etc.), their incentives to engage in corporate governance are expected to be smaller than those of domestic investors. In contrast, if foreign multinational firms have firm-specific advantages (e.g., superior management skills, better production technology, and a stronger financial position) over domestic firms in the host country (Hymer (1976), Kindleberger (1960), Caves (1971), Harris and Ravenscraft (1991), Kang (1993)) and can internalize these advantages in their

² According to the NYSE Fact Book, at year-end 1970, foreign investors owned only 3 percent of the total equity in the U.S. firms. Foreign equity ownership, however, had increased to 11 percent by year-end 2001. The growth of foreign ownership is also common in many other countries, possibly due to the ongoing process of globalization. For example, Hiraki, Inoue, Ito, Kuroki, and Masuda (2003) report that foreign ownership for firms on the Tokyo Stock Exchange increased from 7.01 percent to 18.6 percent between 1985 and 1999. Dahlquist and Robertsson (2001) show that equity ownership held by foreigners in Sweden increased from 8.2 percent to 32.4 percent during the period 1991-1997. In addition, the Korean Financial Supervisory Service reports that foreign equity ownership in Korea had increased to 37.5 percent by August 2003 since 1992 when the Korean government opened the stock market to foreign investors.

monitoring function, we would expect foreign blockholders to perform a more active governance role in domestic firms than do domestic blockholders.

To explore the role of foreign ownership in a systematic and comprehensive way, we construct a control sample of domestic partial acquisitions and compare post-acquisition governance activities of foreign blockholders in targets to those of domestic blockholders. Since previous research has shown that potential business relations with firms influence the monitoring incentives of domestic investors (Brickley, Lease, and Smith (1988)),³ we classify large-block acquirers into two groups, related and unrelated ones. Related large-block acquirers are those who have maintained a business relationship with target firms or have announced their intention of establishing such a relationship in the future. Given that the role of foreign investors in corporate governance has not yet been examined, our paper presents the first empirical evidence on such a role.

We find that compared to foreign blockholders from countries with strong shareholder rights, those from countries with weak shareholder rights are less likely to engage in governance activities in U.S. targets. In particular, the probability of nonroutine top executive turnover and the extent of other governance activities by foreign investors, such as the threat of hostile takeovers and the demand for representatives on the target's board, are positively related to the shareholder (anti-director) rights score of their home countries. This positive relationship, however, is mainly driven by the subsample of acquisitions in which foreign investors do not have any business relationships with U.S.

³ Brickley et al. (1988) show that banks and insurance companies that tend to be influenced by existing business relations with firms are more likely to vote for management-proposed anti-takeover amendments than are other institutions such as mutual funds and public pension funds which do not have business relationships with management. While their study focuses on the role of large financial shareholders in corporate governance and classifies them into affiliated and unaffiliated blockholders, we classify all types of acquirers into related and unrelated large blockholders according to their actual business relationship

targets. Thus, related foreign investors are less likely to be involved in governance activities in U.S. targets than are unrelated foreign investors. These results are generally consistent with those of Brickley et al. (1988). Accounting standards and the rule of law that measure the quality of law enforcement, however, do not explain the extent of the governance activities of foreign blockholders.

We also find that the extent of the governance activities of domestic acquiring firms is statistically indistinguishable from that of the subsample of foreign firms from countries with strong shareholder rights, but is significantly greater than that of the subsample of foreign firms from countries with weak shareholder rights. Since the degree of shareholder rights protection in the U.S. is similar to that in foreign countries with strong shareholder rights, these results further confirm that the legal protection of investors plays an important role in predicting the variation in governance activities among large-block shareholders.

We perform several robustness checks on the data, using creditor rights and other shareholder rights in the acquiring firm country as additional control variables and geographic, religious, and cultural differences as alternative explanations, and find that the results are qualitatively unchanged.

Overall, our results suggest that the governance activities of foreign firms in U.S. targets are largely influenced by the structure of legal rules protecting minority shareholder rights in their home countries. The results are also consistent with the view that foreign multinational firms from strong shareholder protection countries are able to carry their strength in governance skills and expertise across national borders, which

with target firms. Hence, our definition of related investors includes corporate and individual blockholders as well as financial blockholders.

allows them to perform an active governance role in disciplining managers in domestic firms.

We also examine the effect of the legal protection of investors and the quality of law enforcement in the acquiring firm country on the value of U.S. targets by analyzing the valuation effect of announcements of block share purchases. We find that the abnormal returns for U.S. targets of unrelated foreign investors are positively related to the shareholder rights score in their home countries. This result suggests that the stock market takes the increase in the frequency of a foreign unrelated firm's value-enhancing future governance activities for U.S. targets into account when assessing their market values.

Our paper is related to a few recent studies on cross-border takeovers. Bris and Cabolis (2002) use a sample of 9,277 cross-border mergers from 1985 to 2000 to examine the changes in corporate governance induced by these mergers. They show that the acquisition of firms in weaker shareholder protection countries by firms in stronger protective regimes significantly increases the Tobin's q of the target industry. Rossi and Volpin (2004) examine the determinants of cross-border mergers and acquisitions by focusing on differences in laws and regulations across countries. They show that the volume of mergers and acquisitions activity is significantly larger in countries with stronger shareholder protection and better accounting standards. Target premiums are also higher in countries with stronger shareholder protection. They also find that the probability that a given deal is a cross-border rather than a domestic merger decreases with the degree of investor protection of the target's country. These results suggest that cross-border mergers and acquisitions represent an important mechanism for the

contractual transfer of corporate governance. Kuipers, Miller, and Patel (2003) examine the link between the legal environment and corporate valuation by examining the cumulative abnormal returns (CARs) to U.S. targets, foreign acquirers, and the portfolio of target and acquirer for a sample of 181 cross-border tender offers from 1982 to 1991. They find that both acquirer and portfolio returns are positively related to the degree of shareholder rights protective mechanisms where the acquiring firm is domiciled but target returns are not.

We extend this literature by providing evidence for an explicit link between shareholder rights protection of the foreign acquiring firm and corporate governance activity in the U.S. target. Unlike the studies listed above, we use partial acquisitions of U.S. firms by foreign firms and focus on the effect of the investor protection of the acquiring firm's country on governance activity in target firms as well as its impact on target market value.

Our paper is also related to recent studies that examine corporate governance convergence in the world, as argued by Coffee (1999). For example, Pagano, Roell, and Zechner (2002) and Reese and Weisbach (2002) show that firms from countries with poor investor rights list their securities in the U.S. market more frequently than do those with strong investor rights. They argue that the dual listing of securities in the U.S. market allows foreign firms to follow the better corporate governance standards of the U.S., such as high transparency in accounting rules, frequent disclosure of financial information, and effective enforcement of U.S. law. In a similar vein, Doidge, Karolyi, and Stulz (2004) argue that a U.S. listing reduces the extent to which controlling shareholders can engage in expropriation and increases firms' ability to take advantage of

growth opportunities. All these arguments suggest that a dual listing can provide foreign firms with an important channel for institutional changes in corporate governance. In contrast, Siegel (2004) shows that the SEC in the U.S. has not been effective in enforcing the law against U.S.-listed Mexican firms and argues that reputational bonding explains the success of their cross-listings better than legal bonding. Bris and Cabolis (2002) and Rossi and Volpin (2004) also argue that cross-border mergers provide foreign firms that have weak legal institutions with a mechanism for the contractual transfer of better corporate governance standards. Although these studies show that the institutional changes or reputational bonding in the governance structures of foreign firms are important determinants of convergence in corporate governance, our paper suggests that foreign block ownership could also be another alternative mechanism for the transfer of corporate governance. To the extent that foreign investors from countries with good governance structures have an ability to carry their superior governance skills and expertise across national borders, they have the potential to play an instrumental role in improving the corporate governance in the host country. Since foreign large-block shareholders have already become an important part of ownership in many large firms around the world, they are expected to serve as an effective mechanism for corporate governance convergence.

This paper proceeds as follows. Section 1.2 describes the data and sample characteristics. In Section 1.3, we show the results of post-acquisition governance activities by large-block shareholders and abnormal target returns. Section 1.4 shows the results of our robustness tests. Section 1.5 summarizes and concludes the paper.

1.2 Sample Selection and Data

Our sample consists of block share acquisitions of U.S. targets by foreign firms between 1981 and 1999. We obtain the initial sample of U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We first identify cross-boarder partial acquisitions in which the foreign firm initially held less than 5 percent of a U.S. target firm's outstanding shares before the acquisition, and then purchases more than 5 percent but less than 50 percent of its outstanding shares. We eliminate cases where foreign acquiring firms come from tax haven countries, such as the Cayman Islands, Bermuda, and the British Virgin Islands. To be included in the final sample, we require that the initial public announcement date of block share purchase be available in *Dow Jones Newswire*. We use as the announcement date the date that a news announcement first appears in this publication. We also require that stock returns and financial data for U.S. targets be available in the CRSP returns and COMPUSTAT tapes, respectively. These restrictions result in the final sample of 270 U.S. targets. However, in 13 cases, the measures of investor protection in the acquiring firm country, such as the level of shareholder rights protection and the quality of law enforcement, are not available in LLSV (1998) from which we collect most of the information on index scores for these measures. Therefore, our tests employing variables measuring the degree of investor protection are conducted over 257 samples, though our results are similar if we use the entire sample instead by assigning the lowest values of shareholder rights protection and law enforcement to these 13 cases. The appendix summarizes the definitions and sources of the variables used in this paper.

We obtain equity ownership and top executive data on U.S. targets from proxy statements and annual reports, respectively. To examine post-acquisition governance activities of foreign acquirers in U.S. targets, we use several sources, including 13D filings (general statement of acquisition of beneficial ownership), *Dow Jones Newswire*, proxy statements, and annual reports of target firms. All sources are examined for stories during the holding period of block shares by foreign firms up to three years after the acquisition. We define the holding period as the period from the date when the foreign firm announces the acquisition of a target firm's block equity to the date when it decreases its holding in the target to less than 5 percent. The sales of block shares by foreign firms are identified by closely following news articles and 13D filings up to three years after the announcement date of acquisition. If we are not able to identify the sale dates of block equity from this process, we search target firms' proxy statements to see whether the foreign firms still hold block equity in the targets. If foreign or other bidders acquire more than 50 percent of outstanding equity in the target firms (18 cases), the date prior to the announcement of the this acquisition is assumed to be the last date of equity holdings in the targets by the foreign firms.

To compare the governance activities of foreign large blockholders with those of domestic ones, we construct a control sample of 270 U.S. targets in domestic partial block acquisitions between 1981 and 1999. A U.S. target involved in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. We determine the relatedness of the two firms by searching *Dow Jones*

Newswire, proxy statements, and annual reports of the target for three years prior to and subsequent to the announcement date of block share purchases. We search for information about whether the two firms involved in the acquisition have strategic agreement, business alliance, joint venture, or other product market partnerships such as supply, marketing/distribution, and technology-sharing relationships. As in Allen and Phillips (2000), we define the related acquisitions as those in which the acquiring firms have maintained at least one of these relationships with target firms before the acquisition, or have announced their intention of establishing such relationships in the future. We classify the remaining acquisitions as unrelated ones. If no firm matches by year of acquisition, a control target matched in the previous or following year is used. Although in 267 of the 270 cases, we are able to identify control samples using these matching criteria, we cannot match three targets of foreign acquisitions with control targets based on the relatedness of acquisition. For these three cases, we obtain matching firms without applying a relatedness criterion.

Panel A of Table 1.1 shows the distributions of the sample of 270 U.S. targets of foreign acquirers by the shareholder rights protection of the acquirer's country and the target's industry. The measure of shareholder rights protection is from LLSV (1998) and ranges from zero to six. Following LLSV (2000b), we classify the country with an index score smaller or equal to three as one with weak shareholder protection and the country with an index score larger than three as one with strong shareholder protection. We find that foreign acquirers from countries with strong (weak) shareholder protection account for about 59.7 (35.5) percent of the total sample. A breakdown of the acquisitions by

target industry shows that most of the U.S. targets are in manufacturing (53 percent), services (14.4 percent), and transportation and public utilities (9.3 percent).

Panel B of Table 1.1 summarizes the frequency distribution of foreign acquisition activity by year. The years 1988 and 1995 are the most active years of acquisition announcements with 30 (11.1 percent) and 28 (10.4 percent) cases, respectively. In contrast, no acquisition announcements are observed in 1981 and 1982.

Although not reported here, 52 of the targets are acquired by U.K. firms, followed by Japanese (33 acquisitions) and Canadian (29 acquisitions) firms. Given the large number of U.K. acquirers in our sample, we examine the robustness of our findings by repeating all analyses below excluding acquisitions involving U.K. firms and obtain results that are qualitatively similar to those reported in the paper.

Table 1.2 presents the summary statistics of a sample of 257 U.S. targets of foreign acquirers for which we are able to find the index score of shareholder rights protection from LLSV (1998), and a sample of 257 U.S. control targets of domestic acquirers. The first three rows of Table 1.2 compare the level of shareholder rights protection and law enforcement in the acquiring firm country across the two groups: U.S. targets of foreign firms from countries with strong shareholder protection and those from countries with weak shareholder protection. We measure the quality of law enforcement by country scores for two variables, accounting standards and the rule of law. Accounting standards measure the disclosure quality of accounting information and the rule of law assesses the law and order tradition in the acquiring firm country. We find that the median score of the shareholder rights index for foreign firms from countries with strong (weak) shareholder protection is 5 (2). The difference in the level of shareholder rights between

the two groups is statistically significant at the 1 percent level. The median score of the accounting standards index for foreign acquirers from countries with strong shareholder protection is again significantly larger than that of the accounting standards index for foreign acquirers from countries with weak shareholder protection (74 compared to 65). In contrast, acquirers from strong shareholder protection countries score lower on the rule-of-law measure than do those from weak shareholder protection countries.

The next two rows compare the holding period of block shares and the percent of shares purchased across the two subsamples of U.S. targets in foreign acquisitions and the sample of U.S. control targets in domestic acquisitions. Foreign acquirers with weak shareholder rights on average hold block shares in U.S. targets longer than do both domestic acquirers and foreign acquirers with strong shareholder rights. Although 57 percent of foreign acquirers with weak shareholder rights hold block shares in U.S. targets for longer than three years, the corresponding numbers of domestic acquirers and foreign acquirers with strong shareholder rights are only 35 percent and 43 percent, respectively. These differences in holding periods are significant at the 1 percent and 5 percent levels, respectively. We also find that foreign firms with weak shareholder rights purchase a larger percentage of block shares than do domestic firms and foreign firms with strong shareholder rights (a median of 11.7 percent compared to medians of 9.9 percent and 9.8 percent).

To see whether foreign firms prefer U.S. targets with certain characteristics, Table 1.2 also compares target characteristics across the three groups before the acquisitions. We measure target characteristics at the fiscal year-end that comes immediately before the announcements of the acquisition of block shares.

Several features of the target characteristics are worth noting. Although the median equity ownership by managers (the sum of equity ownership by officers and directors) is not statistically different among the three groups, the median equity ownership by institutional investors is significantly higher for the targets of foreign firms with strong shareholder rights than for those of foreign firms with weak shareholder rights (22 percent compared to 17 percent). The means show a similar pattern.

Following Denis, Denis, and Sarin (1997), we define the CEO as the top executive of the firm. If a firm has no CEO, the chairman (or president if there is no chairman) is assumed to be the top executive of the firm. The mean and median ages of top executives are significantly younger in the targets of foreign firms with weak shareholder rights than they are in the other two types of targets. The mean and median tenures of top executives, however, are not significantly different among the three groups. The fraction of firms in which a chairman (founder) is the top executive is not significantly different among the three groups, except that it is significantly larger for U.S. targets of foreign firms from countries with strong shareholder rights than it is for U.S. targets of domestic firms.

The mean and median sizes (market value of equity) of targets show no statistical difference among the three groups. The median leverage ratio (total debt to total assets) is significantly larger for the targets of foreign firms from countries with strong shareholder rights than it is for those of domestic firms.

When we compare the median past performance for the three groups of targets using the ratio of cash flow (the sum of operating income and depreciation) to total assets, we find that it is lowest for targets of foreign firms with weak shareholder rights (4 percent), followed by targets of domestic firms (7 percent), and then targets of foreign firms with

strong shareholder rights (8 percent). In contrast, the median Tobin's q (the sum of market value of equity and book value of debt / book value of total assets) is highest for the targets of foreign firms with weak shareholder rights (1.24) and lowest for those of foreign firms with strong shareholder rights (0.95). The tests of median differences in past performance and Tobin's q between the targets of foreign firms with strong shareholder rights and those with weak shareholder rights strongly reject the null hypothesis of equality. The means show a similar pattern. These findings suggest that the foreign acquirers with strong shareholder rights prefer U.S. targets with a large cash flow and low growth opportunity, compared to those with weak shareholder rights. To the extent that this type of target has a more severe agency problem than do other types of targets (Jensen (1986a)), our results indirectly indicate that acquirers from strong shareholder protection countries tend to choose U.S. targets for which their disciplinary actions have the potential to induce target managers to take actions that lead to the reallocation of the target resources in an efficient way.

To better understand the differences in the nature of foreign and domestic block ownership in U.S. targets, Table 1.3 summarizes detailed information on holding periods, the purpose of acquisitions, and the activeness of acquirers (whether the intention of acquirers is to influence target policies or not) by the relatedness of the acquirer and the target. We classify our sample according to the relatedness of the two firms since Brickley et al. (1988) show that large financial blockholders in the U.S. who have business relationships with firms are less likely to play an active role in influencing managers. If investors who have maintained business relationships with targets purchase large shares of targets, they would have few incentives to monitor target management

since active intervention can jeopardize such relationships. Furthermore, target management is usually involved in the process of selecting related blockholders. Therefore, related blockholders are expected to be less active in disciplining target managers.⁴

Panel A of Table 1.3 presents summary statistics for holding periods. Although 68 percent of foreign acquirers in related acquisitions hold block shares for longer than three years, the corresponding number of those in unrelated acquisitions is only 27 percent. We find similar patterns for domestic acquisitions (46 percent compared to 24 percent). In contrast, the fraction of foreign acquirers in unrelated (related) acquisitions in which the holding period is less than one year is 34 (12) percent. The corresponding number of domestic acquirers in unrelated (related) acquisitions is 54 (23) percent. These results suggest that both foreign and domestic acquirers in related acquisitions hold block ownership in U.S. targets for longer than do those in unrelated acquisitions. They also indicate that foreign acquirers are more likely to hold block ownership for a long period than are domestic acquirers.

Panel B of Table 1.3 summarizes the fractions of acquirers who indicate that the purchase of shares is for control purpose. It also shows the fractions of acquirers who are classified as active investors. We determine the purpose of acquisitions from 13D filings. We classify the acquisition as control purpose if the acquiring firm discloses in a filing of 13D that it seeks the control of the target. Following Bethel, Liebeskind, and Opler

⁴ Related investors, however, typically possess industry knowledge or operating expertise that is superior to that of unrelated investors. Since the stock prices of acquirers are affected by those of targets via a change in the market value of their equity holdings in targets, related investors might have strong incentives to fully utilize their information advantage and operating expertise in order to maximize target value. In this case, we expect related investors to be more actively involved in governance activities in targets than unrelated investors.

(1998), we define active investors as those who announce their intention of influencing firm policies or who are known for active policies in the past.

The main finding in Panel B is that unrelated investors are more likely to seek the control of firms or to play an active role in influencing target management. Of the 125 unrelated foreign investors, 22 (18 percent) disclose their intentions of control purpose and 25 (20 percent) can be classified as active investors. However, only four (3 percent) of 132 related foreign investors indicate their intention of control purpose and none of them are classified as active investors. We obtain similar patterns for domestic acquirers. These findings suggest that unrelated investors have stronger incentives to influence target managerial behavior than do related investors, which is generally consistent with the findings of Brickley et al. (1988).

To see if our results are sensitive to the degree of shareholder rights protection in the acquiring firm country, Panel C of Table 1.3 further divides related and unrelated foreign acquirers into those from countries with strong shareholder rights and those from countries with weak shareholder rights. Of the 97 (28) unrelated foreign investors from countries with strong (weak) shareholder rights, 23 percent (43 percent) hold block ownership for longer than three years. Twenty percent (11 percent) of these investors also disclose their intention of control purpose and 28 percent (4 percent) can be classified as active investors. Thus, unrelated investors from countries with strong shareholder rights hold block shares in targets for a shorter time than do those with countries with weak shareholder rights, but have stronger incentives to engage in corporate governance activity in targets. Related investors, however, do not show such patterns.

1.3 Empirical Results

1.3.1 Post-Acquisition Governance Activities

Firms that acquire block shares might have strong incentives to monitor managerial performance in targets and take action that enhances target firm value. In this section, we examine various kinds of corporate governance activities that acquiring firms initiate during the holding period of block shares up to three years. We classify the corporate governance activities that acquirers undertake into seven categories: (1) threat of hostile takeovers; (2) proxy contests or threat; (3) expression of opposition to or attempts to amend anti-takeover provisions; (4) seeking representatives on the target's board; (5) threat of top executive turnover or involvement in the selection of a new top executive; (6) asset downsizing; and (7) other governance activities, such as heading an investor alliance, expressing an opinion on a target's major decisions, requesting a meeting with target management to address the potential way to maximize shareholder value, and so forth.

1.3.1.1 Governance Activities of Foreign Acquirers

Post-acquisition governance activities of foreign acquirers are summarized in Table 1.4. While some acquiring firms engage in a single governance activity, several acquiring firms are involved in multiple activities. Thus, the classifications are not mutually exclusive. During the period from 1981 to 1999, 257 foreign acquiring firms announce a total of 84 involvements (33 percent of the total sample) in governance activities. Out of these 84 activities, other governance activities are reported most frequently (21 cases), followed by threat of hostile takeovers (19 cases), seeking board representation (18

cases), and asset downsizing (11 cases). Of the 19 foreign firms that threaten hostile takeovers, three eventually acquire more than 50 percent of target equity. For the 18 foreign acquirers that seek or demand representation on targets' boards, 10 are eventually represented but 8 are not.⁵ Six foreign acquirers are involved in proxy contests and another six demand changes to the top executive. In the remaining three cases, acquirers officially express opposition to or attempt to amend anti-takeover provisions proposed by target management.

A breakdown of the governance activities by the relatedness of the acquirer and the target and the degree of shareholder rights protection in the acquiring firm country shows that these activities are mainly rendered by unrelated investors from countries with strong shareholder rights. This type of investor accounts for 93 percent (78 cases) of the total governance activities. In contrast, unrelated investors from countries with weak shareholder rights engage in only two governance activities. Although related acquirers from countries with weak shareholder rights are involved in four governance activities, surprisingly, those from countries with strong shareholder rights are not involved in any types of governance activities. Therefore, unrelated acquirers from strong protective regimes stand in sharp contrast to other types of acquirers regarding post-acquisition governance activities in target firms. These findings clearly suggest that acquirers that are incorporated in countries with strong shareholder rights, particularly those that do not have any business relationships with targets, have strong incentives to actively intervene in the governance process of target firms.

⁵ We also find that several targets of foreign acquirers, mostly engaged in related acquisitions, exchange board representatives with acquirers. This result suggests that the extent of the board's independence is less

1.3.1.2. Governance Activities of Domestic Acquirers

Table 1.4 also summarizes the governance activities of U.S. blockholders from 1981 to 1999. During this period, 257 domestic acquiring firms announce a total of 134 involvements (52 percent of the total sample) in governance activities. Thus, U.S. acquirers are more than 1.6 times as likely to engage in post-acquisition governance activities as are foreign acquirers. The threat of hostile takeovers is the most frequently observed type of governance activity (34 cases), followed by other governance activities (31 cases), and seeking board representation (27 cases). Thirteen acquirers initiate the threat of proxy contests against target management. U.S. acquirers also frequently demand top executive turnovers (11 cases). Ten firms in the sample oppose or attempt to amend anti-takeover provisions proposed by target management. There are eight cases where U.S. acquirers demand some form of asset downsizing. Overall, in all governance activities except demanding asset downsizing, U.S. acquirers take governance action more frequently than do foreign acquirers.

We also find that of the 134 governance activities, 110 (82 percent of the total activities) are undertaken by unrelated U.S. acquirers, while the remaining 24 (18 percent of the total activities) are undertaken by related ones. Thus, like foreign acquisitions, U.S. acquisitions in the sample display evidence of significantly high levels of governance activities by unrelated investors.

In summary, the analysis of post-acquisition governance activities indicates that foreign firms operating under strong shareholder rights protection perform a more active governance role in their U.S. targets than do those operating under weak shareholder rights protection. This result suggests that strong shareholder rights create an

in related acquisitions than in unrelated acquisitions.

environment that fosters active corporate governance and thus influence managerial incentives to engage in such activities. The frequent governance activities associated with strong shareholder protection, however, are entirely driven by unrelated foreign investors. Therefore, our results show that related foreign investors who have current or potential business relationships with target firms are less likely to take disciplinary actions against target management. We also find that the frequency of governance activities in targets is much higher in domestic acquisitions than in foreign acquisitions. U.S. acquirers are almost twice as likely to engage in threats of hostile takeovers, proxy contests, and top executive turnovers, and at least three times as likely to oppose target management-proposed anti-takeover amendments. Like foreign unrelated acquirers, U.S. acquirers that do not have any business relationships with targets play a more active role in corporate governance.

1.3.2 The likelihood of governance activity

In this section, to clarify the relation between legal rules covering the protection of shareholders and the likelihood of post-acquisition governance activity, we perform multivariate logistic regressions in which the dependent variable is set to one if a particular governance activity occurs and zero otherwise. As a primary measure of legal rules covering the protection of shareholders, we use the shareholder rights index in the acquiring firm country. We also consider the indices for accounting standards and the rule of law in the acquiring firm country as additional explanatory variables for the likelihood of post-acquisition governance activity. LLSV (1998) argue that strong law enforcement institutions can act as a substitute for poor shareholder rights since a well-

functioning court tends to replace the specific legal rules protecting the interests of investors. For example, DeFond and Hung (2003) document that a strong system of law enforcement significantly improves the sensitivity of top executive turnover to poor performance, while strong investor protection does not. These findings suggest that high-quality law enforcement is sometimes more important than strong investor protection in fostering the corporate governance activities of investors.

Since the univariate results in the previous section show that the relatedness of the acquirer and the target is an important determinant of the likelihood of post-acquisition governance activity, we include a dummy variable, which equals one if the two firms are related and zero otherwise.

Large shareholders' incentives to perform governance activities in targets can be influenced by the duration of their block holding period. For example, Demsetz and Lehn (1985) argue that large shareholders as long-term investors have strong incentives to monitor management. In contrast, Butz (1994) views large shareholders as short-term investors who have an incentive to influence the firm to divesture its assets and then leave soon after to obtain a rapid improvement in wealth. These studies suggest that long-term and short-term blockholders have different incentives concerning corporate governance. Therefore, we include an indicator, which equals one if the holding period of block shares acquired by investors is longer than three years and zero otherwise.

We also include the percent of shares acquired. Shleifer and Vishny (1986) show that as the size of equity ownership by large shareholders increases, their optimal choice of monitoring increases. Hence, we expect a positive relationship between the size of equity ownership acquired by large shareholders and their governance activities in targets.

It is shown that the board of directors plays an important role in corporate governance. For instance, Jensen (1986b) argues that the board of directors serves as one of the most important internal governance mechanisms. Weisbach (1988) documents that the sensitivity of top management turnover to firm performance is higher for firms with outsider-dominated boards than for those with insider-dominated boards. Shivdasani (1993) also shows that an effective board structure and hostile takeovers are substitute mechanisms for corporate control. Therefore, we include the ratio of the number of members of the board of directors represented by large blockholders in the target's board during the holding period up to three years after the acquisition.

Equity ownership by target managers can also have an effect on the likelihood of the acquirer's post-acquisition governance activity. According to Jensen and Meckling (1976), concentrated managerial ownership aligns the interests of managers with those of shareholders, thus minimizing the agency problem that arises from the separation of ownership and control. Concentrated managerial ownership, however, can insulate managers from outside influence and thus leave them unconstrained. For example, Stulz (1988) argues that high management ownership effectively precludes takeover threats and thus decreases firm value. These arguments suggest that target management ownership affects the acquirer's incentives to conduct post-acquisition governance activities since it could create a different level of agency problems in targets.

The next variable we consider is equity ownership by other institutional investors before the acquisition of block shares. If acquirers and other institutional shareholders interact with each other to monitor target management and cooperate in governance activities in targets, we expect such institutional ownership to be positively related to the

likelihood of governance action by acquirers. For example, Zwiebel (1995) shows that minority blockholders can exert control through coalitions with other blockholders.

To control for other important target characteristics, we also include firm size (log of the market value of equity), leverage, past performance (the ratio of cash flow to total assets), and Tobin's q .

As shown in Section II.A, the threat of hostile takeovers and the demand for representatives on the target's board are the two governance actions most frequently carried out by both foreign and domestic large-block investors. Furthermore, the previous studies show that the threat of external takeovers and having outside directors on the board play an instrumental role in external and internal governance, respectively.⁶ Therefore, in investigating the role of large-block shareholders in corporate governance below, we focus on hostile takeover and board representation activities as their key governance roles. As a robustness check, we also consider all governance activities that acquirers undertake during the holding period of block shares in the analysis.

1.3.2.1 Threat of Hostile Takeovers

Table 1.5 reports the results from logistic regressions where the dependent variable equals one if large-block acquirers are involved in hostile takeover activity and zero otherwise. In the first two regressions, we report the results for the targets of foreign acquirers. Both shareholder rights and the rule of law are positively and significantly related to the probability that foreign acquirers engage in hostile takeover actions. Thus, controlling for other factors, foreign acquirers are more likely to engage in hostile takeover activities when they come from countries with stronger shareholder rights or

stronger law enforcement. To the extent that strong shareholder rights and strong rule of law allow foreign acquirers to have better skills or experience in performing governance activities in their home countries and thus reflect the effectiveness of their governance structures, our results suggest that foreign investors are able to carry these skills or experience across national borders and transfer their governance standards to domestic targets.

We also find that the coefficient on equity ownership by managers is negative and significant (p -value = 0.04) in the first regression, suggesting that foreign acquirers are less likely to undertake hostile takeover activity for U.S. firms with high management ownership. This observation is consistent with the argument of Stulz (1988) that significant control by managers results in effective opposition to takeovers. The coefficient on the equity ownership by institutional investors is also negative and significant (p -value = 0.06) in the second regression, indicating that the threat of hostile takeovers by new large-block acquirers is less likely to arise when ownership by the firm's other institutional shareholders is high. Therefore, foreign investors have few incentives to take hostile takeover actions if other institutional investors already hold large equity claims in targets before the acquisition of block shares.

The coefficient on Tobin's q is negative and significant at the 5 percent level. If Tobin's q measures either growth opportunities or the managerial ability of the firm (Lang, Stulz, and Walkling (1989), Servaes (1991)), this result suggests that U.S. firms

⁶ See Jensen and Warner (1988) and Black (1992) for a review of this literature.

with low growth opportunities or inefficient management teams are more likely to be the target of hostile takeovers by foreign acquirers.⁷

In the next two regressions, we report the logistic regression estimates for the targets of U.S. acquirers. As with the previous results for the targets of foreign acquirers, the likelihood of hostile takeover activity decreases with equity ownership by managers, equity ownership by existing institutional investors, and Tobin's *q*. Unlike the results for foreign acquirers, however, the coefficient on the dummy variable for the duration of block ownership is negative and significant. Thus, U.S. acquirers are less likely to be involved in hostile takeover activity when they hold block ownership for longer than three years. We also find that the coefficient on the cash flow ratio is positive and significant at the 1 percent level, suggesting that firms with larger cash flows are more likely to be the targets of hostile takeover activity by U.S. acquirers (Jensen (1986a), Lang, Stulz, and Walkling (1991)).

The previous univariate analysis shows that the frequency of hostile takeover activity in targets is much higher in domestic acquisitions than in foreign acquisitions. To investigate this result further, in the last two regressions, we estimate the difference in takeover likelihood between foreign and domestic acquisitions for a pooled sample of 259 targets of foreign acquirers and 259 control targets of U.S. acquirers. The fifth regression includes the dummy variable, which equals one if a large-block acquirer is from the foreign country and zero otherwise. It shows that the coefficient on this dummy is negative and significant at the 5 percent level, suggesting that foreign acquirers are less likely to engage in hostile takeover activity than are domestic acquirers, even after

⁷ We do not include the dummy for the relatedness of the acquirer and the target in these regressions since there is only one case of hostile takeover activity for related acquisitions.

controlling for other explanatory variables. In the sixth regression, we separate the foreign country dummy into two dummies according to the level of shareholder rights protection in the acquiring firm country: the dummy for a foreign country with strong shareholder rights and the dummy for a foreign country with weak shareholder rights. In other words, we use the domestic acquisitions as the reference group for comparison. The coefficient on the first country dummy is negative but insignificant. Thus, the probability of hostile takeover activity occurring in the targets of foreign acquirers from countries with strong shareholder rights is similar to that occurring in the targets of U.S. acquirers. Since the shareholder rights score in the U.S. belongs to the category of countries with strong shareholder rights used in this paper, our result further indicates that the shareholder rights protection of the acquirer's country is an important factor that determines corporate governance activity in targets. The coefficient on the second country dummy, however, is negative and significant at the 1 percent level, suggesting that U.S. targets are less likely to experience the threat of hostile takeovers when their acquirers are from weak shareholder protection countries than when they are from the U.S.

1.3.2.2 Demand for Representatives on the Target's Board

In Table 1.4, we examine the effect of the legal protection of investors and the quality of law enforcement on the likelihood of acquirers' demanding board representation. The dependent variable equals one if large-block acquirers announce that they seek or demand representatives on the target's board and zero otherwise. In the first two regressions, we report the logistic regression estimates for the targets of foreign acquirers. In these

regressions, the estimated coefficients on shareholder rights are positive with p -values of 0.03 and 0.04, respectively, while none of the law enforcement variables are significant. These findings suggest that although the likelihood of acquirers' demanding board representation is not affected by strong law enforcement institutions in foreign home countries, it increases with the degree of their shareholder rights protection.

Consistent with the results of the univariate tests, in the first regression, the coefficient on the dummy for related investors is negative and statistically significant at the 5 percent level. Tobin's q is also negative and significant, suggesting that foreign acquirers are more likely to demand board representation when the target firms have poor growth opportunities or inefficient management teams.

In regressions (3) and (4), we report the results for the targets of U.S. acquirers. As in the results for those of foreign acquirers, the coefficients on the dummy for related investors are negative and significant.

In regressions (5) and (6), we use a pooled sample of the targets of foreign acquirers and those of domestic acquirers. We find that the coefficients on the foreign country dummy and the dummy for a foreign country with strong shareholder rights are not significant, while the coefficient on the dummy for a foreign country with weak shareholder rights is negative and significant. These results are generally consistent with those in Table 1.5 and further suggest that investor protection of the acquirer's country is an important determinant of corporate governance activity in U.S. targets.

1.3.2.3 All Types of Governance Activity

To further examine the effect of legal environments in the acquirer's country on the likelihood of undertaking governance activities in targets, Panel A of Table 1.7 reports the results from logistic regressions that consider all types of governance activity undertaken by acquirers. The dependent variable equals one if acquirers are involved in at least one of the seven governance activities categorized in Table 1.6.

The results in regressions (1) and (2) show that, as in the regressions for hostile takeover and board representation activities, the probability that foreign acquirers take any type of governance action is positively and significantly related to shareholder rights at the 1 percent level. It is also positively related to the percent of shares acquired (p -value = 0.00). However, this probability is negatively and significantly related to the dummy for relatedness between the acquirer and the target, to equity ownership by managers, to equity ownership by institutional investors, and to Tobin's q . The positive coefficient on the percent of shares acquired and the negative coefficient on equity ownership by institutional investors suggest that the existence of other shareholders in targets before the acquisition of block shares adversely affects the incentives for foreign blockholders to take an active role in post-acquisition governance activities.

In regressions (3) and (4), we re-estimate the full regression separately for the subsample of U.S. targets of unrelated foreign acquirers and for the subsample of U.S. targets of related foreign acquirers. The results indicate that our findings for the full sample mirror those for the subsample of unrelated targets. In contrast, none of the variables in the subsample of related targets are significant. Along with the negative coefficients on the dummy for relatedness between the acquirer and the target in

regressions (1) and (2), these findings suggest that when share ownerships are in the hands of related investors, these ownerships prevent them from effectively monitoring their targets.

In regressions (5) through (8), we estimate logistic regressions similar to those in regressions (1) through (4) for governance actions by U.S. acquirers. As in the results for foreign acquisitions, the coefficients on the dummy for relatedness between the acquirer and the target and equity ownership by managers are negative and significant. However, the coefficients on the percent of shares acquired and equity ownership by other institutional investors are not significant.

In regressions (9) and (10), we report the regression estimates for a pooled sample of the targets of foreign acquirers and those of U.S. acquirers. The coefficients on the foreign country dummy and the dummy for a foreign country with weak shareholder rights are again negative and significant. The likelihood that acquirers undertake any type of governance action is also inversely related to relatedness between the acquirer and the target.

To check the robustness of the results, in Panel B of Table 1.7, we perform the ordinary least squares (OLS) regressions using the governance activity index as the dependent variable. We construct an index aggregating governance activities by adding one when large-block acquirers undertake one of the seven governance activities described in Table 1.6. Therefore, the score of this index ranges from zero to seven, with a higher score meaning the acquirer undertakes governance activities more frequently. We find that the results in Panel B of Table 1.7 are similar to those in Panel A of Table 1.7.

In summary, the analysis of post-acquisition governance activities of foreign acquirers indicates that the probability of these activities being undertaken increases when the acquirers come from countries with strong shareholder rights protection. Although the likelihood of undertaking governance activities is similar for foreign acquirers from countries with strong shareholder rights and domestic acquirers, foreign acquirers from countries with weak shareholder rights are less likely to engage in governance activities than are domestic acquirers. These results suggest that the extent of post-acquisition governance activities by large-block acquirers is a function of the legal protection of investors in their home countries. We also find some similarities in factors that determine the governance activities of foreign and domestic acquirers. For both foreign and domestic acquirers, the probability of undertaking governance activities decreases when they have business relationships with targets and when institutional shareholders or managers in targets hold large equity claims.

1.3.3 Top Executive Turnover

One potential problem in our previous analysis is that to identify post-acquisition governance activities initiated by acquirers, we have used reports from newspapers, SEC filings, and other public information sources. To the extent that some companies decided not to reveal such information to the public, several governance activities we have examined from these sources might be biased downward and thus we may have underestimated the extent of such activities. Therefore, to show that our results are not driven by this bias, having collected complete information on nonroutine top executive turnover events for targets that took place during our sample period, we examine whether

the likelihood of such events is related to the variables we have considered in the previous regressions.⁸

We focus on nonroutine top executive turnover since the removal of the top executive is one of the most aggressive actions taken by governance mechanisms. Furthermore, several studies show that blockholders play an important role in the process of top executive turnover. For example, Denis, Denis, and Sarin (1997) document that the probability of top executive turnover occurring is positively related to the presence of large outside shareholders. Bethel, Liebesind, and Opler (1998) show that such a probability is high for firms experiencing activist block purchases. Kang and Shivdasani (1995) also show that for large Japanese firms, nonroutine turnover is more likely when ownership by the top 10 shareholders is high.

We obtain the sample of top executive turnover events from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for changes of presidents, chairmen, and CEOs. For each turnover, we also collect data on the background of the departing top executive, such as age and tenure, from proxy statements and annual reports. Since our objective is to evaluate the effect of disciplinary actions by large blockholders on the likelihood of top management turnover, we focus on turnover events that are most likely to be disciplinary and thus exclude those that are likely to represent normal succession. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. Following Denis, Denis, and Sarin (1997), we refer to turnover events where the top executive is

⁸ One disadvantage of using this approach is that it overestimates the extent of governance activities of foreign and domestic acquirers since some turnovers we consider might be initiated by other investors.

removed due to death, illness, or other normal reasons as routine turnover. We classify a management change as normal if the stated reason for the change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover.⁹ This procedure yields a final sample of 57 nonroutine turnovers (22 percent of the total sample) for U.S. targets of foreign acquirers and a final sample of 55 nonroutine turnovers (21 percent of the total sample) for U.S. targets of domestic acquirers (Panel A of Table 1.8). Forty-three (27 percent) out of 159 targets of foreign firms from countries with strong shareholder rights experience top executive turnovers, while only 14 (14 percent) out of 98 targets of foreign firms from countries with weak shareholder rights experience top executive turnovers. Thus, acquirers from countries with strong shareholder rights are over three times as likely to be involved in removals of the top executive as are those from countries with weak shareholder rights.

Panel B of Table 1.8 further divides 57 nonroutine turnovers for U.S. targets of foreign acquirers into four subgroups according to shareholder rights and the relatedness of the acquirer and the target. The main finding is that the targets of unrelated acquirers from countries with strong shareholder rights experience the highest frequency of top management turnover. Twenty-seven (28 percent) out of 68 targets of unrelated acquirers from countries with strong shareholder rights experience nonroutine top executive turnovers. This result is consistent with that of Table 1.4, which shows that the frequency of all governance activities obtained from public information sources is highest for the subsample of targets of unrelated foreign investors from strong shareholder protective regimes.

⁹ We also experiment with an alternative definition of nonroutine turnover assuming that normal retirement takes place at any age above 60 or 64. Our results are qualitatively similar with this approach.

Table 1.9 shows the results from the logistic regressions where the dependent variable is one if nonroutine turnover occurs and zero otherwise. In addition to including all explanatory variables used in the previous regressions, we also control for other variables that may affect top executive turnover. Specifically, the regressions control for the age and tenure of the top executive, and also include a chairman dummy, which equals one if the top executive is the chairman of the board, as well as a founder dummy, which equals one if the top executive is the founder of the firm. We define founders as those who are described as founders in the proxy statement or the annual statement, or those who have held the position of top executive since the inception of the firm.

Although we incorporate the age of the top executive in classifying nonroutine turnover, the age and tenure of the top executive can still affect turnover likelihood, either positively or negatively. For example, if they are an indicator that the top executive is close to retirement or to being removed due to normal management changes, the turnover probability is expected to be positively related to them (Weisbach (1988)). In contrast, if the age and tenure of the top executive represent the extent of control that he or she has over firms, the turnover probability is likely to decrease with these variables.

The status of the top executive either as chairman or founder may also affect the process of top executive turnover. For example, Fama and Jensen (1983) argue that the concentration of decision management and decision control in an individual reduces the effectiveness of the internal governance system in monitoring top management. Denis, Denis, and Sarin (1997) also show that the probability of top executive turnover is significantly smaller when the top executive is the founder or a member of the founding family. These results suggest that top executives who are also founders or who have

chairmanship have more control over firms than other types of top executives and thus there will tend to be a low probability of top executive turnover.

The first two regressions report the logistic regression estimates for the targets of foreign acquirers. The coefficients on shareholder rights are again positive and significant at the 5 percent level, indicating that foreign acquirers from countries with strong shareholder rights are more likely to replace target management subsequent to an acquisition of large minority ownership. This finding suggests that the shareholder rights protection of the acquirer's country has a significant influence on the acquirer's managerial incentives to perform an active role in disciplining target managers. The board representation ratio by foreign acquirers is also positively and significantly related to turnover likelihood. Given that the board members represented by large-block acquirers are independent outside directors, this result suggests that outside directors play an important governance role during the process of top management turnover (Weisbach (1988)). Nonroutine turnover is significantly more likely when the percent of shares purchased by acquirers is high. This finding is consistent with the monitoring role of large shareholders argued by Shleifer and Vishny (1986). The coefficients on the dummy variable for the duration of block ownership are positive and significant at the 5 percent level, indicating that acquiring firms that hold target equity for a long period are more likely to replace target management. The coefficients on the age of top management are positive and significant, while those on the tenure of top management are negative and significant.

In regressions (3) and (4), we examine the results for the targets of unrelated foreign investors and those of related foreign investors, respectively. As in the results shown in

Table 1.7, all of the significance in the total sample is driven by the subsample of acquisitions in which foreign investors do not have any business relationships with U.S. targets.

In regressions (5) through (8), we report the results for the targets of U.S. acquirers. We find that most of the results for U.S. acquirers are similar to those for foreign acquirers. The main exception is that for targets of related acquirers, the coefficients on the percent of shares acquired and the dummy variable for the duration of block ownership by acquirers are positive and significant at the 5 percent level. These findings suggest that unlike foreign related acquirers, domestic related acquirers who have significant equity claims on targets or maintain a long-term equity relationship with them play an important role in the decision to remove target management.

Regressions (9) and (10), which use a pooled sample of targets of foreign acquirers and those of domestic acquirers, show that the coefficients on the dummy for foreign acquirers from weak protective regimes are negative and significant at the 1 percent level. The coefficients on the dummy for related investors are also negative and significant at the 5 percent level in both regressions.

Overall, the results from the analysis of nonroutine top executive turnover confirm those of the previous analysis for various governance activities and further show that shareholder rights protection of the acquirer's country influences its corporate governance activities in the host country. Our results also suggest that relation-specific or deal-specific characteristics, such as the business relationship between the acquirer and the target, the holding period of block ownership, and the percent of shares purchased,

create different incentives for foreign and domestic acquirers to undertake various governance activities in targets.

1.3.4 The Announcement Effects

In this section, we examine the effect of differences in the legal protection of investors and law enforcement in the acquiring firm country on the value of U.S. targets by analyzing the valuation effect of announcements of block share purchases. To assess the valuation effect of acquisition events, we compute abnormal returns using a standard event-study methodology. We obtain our estimates of the market model by using 200 trading days of return data, beginning 220 days before and ending 21 days before the announcement of the block share purchase. We use as the market return the CRSP equally weighted return. We sum the daily abnormal returns to get the cumulative abnormal return (CAR) from day t_1 before the announcement date of the block share purchase to day t_2 after the announcement date of the block share purchase. We use the t -statistics to test the hypothesis that the average CARs are equal to zero, and the sign-rank test statistic to test the hypothesis that the CARs are distributed symmetrically around zero.

Panel A of Table 10 reports the CARs for the targets of foreign and domestic acquirers for different event windows. Shareholders of U.S. target firms earn, on average, statistically significant positive gains. The average CAR (-1, 0), CAR (-1, 1), and CAR (-5, 5) for the targets of foreign acquirers are 4.8 percent, 6.0 percent, and 7.4 percent, respectively, all of which are statistically significant at the 1 percent level. The corresponding CARs for the targets of domestic acquirers are 6.9 percent, 8.2 percent,

and 9.4 percent, respectively. They are also significant at the 1 percent level. These findings are consistent with those of Mikkelsen and Ruback (1985), who document positive announcement returns for target firms who sell 5 percent or more of their equity stakes to other companies. Tests of differences in mean CAR (-1, 0) and CAR (-1, 1) between the targets of foreign acquirers and those of domestic acquirers are rejected at the 5 percent level. The medians show a similar pattern.

In Panel B of Table 10, we examine the variation in valuation effects for targets of foreign acquirers by stratifying the sample firms into four subgroups according to the degree of shareholder rights protection and the relatedness of the acquirer and the target. U.S. targets of unrelated foreign investors from weak shareholder protection countries realize small and insignificant returns, while the other three subgroups realize large and significant returns. In particular, the differences in mean and median CARs (-1, 1) between unrelated investors from weak shareholder protection countries and those from strong shareholder protection countries are significant at the 5 percent and 1 percent levels, respectively. Related investors, however, do not show such differences. These findings suggest that for unrelated acquisitions, strong shareholder rights of the acquirer's country are more likely to be perceived positively by U.S. investors than are weak shareholder rights.

In sum, our results suggest that managers of unrelated foreign firms that come from countries with strong shareholder rights have different objectives from those that come from countries with weak shareholder rights when they acquire firms in the U.S., and that the stock market clearly differentiates these differences in managerial incentives.

To understand better the cross-sectional variation in target returns, we present the estimates from multivariate regressions. All regressions are estimated using OLS. The regression results are presented in Table 1.9. In the first regression, we regress the CAR (-1, 1) for targets of foreign acquirers on shareholder rights and the quality of law enforcement in the acquiring firm countries, the relatedness of the acquirer and the target, the percent of shares acquired, the extent of board representation by acquirers, and other target-specific characteristics. The coefficient on shareholder rights is insignificant. However, the coefficient on the board representation ratio by acquirers is positive and significant at the 10 percent level, indicating that shareholders of target firms realize a greater wealth gain when foreign investors actively seek representatives on the target's board.

In regressions (2) and (3), we report the regression estimates for the subsample of targets acquired by unrelated foreign investors. In regression (3), the shareholder rights score is positively and significantly related to CAR (-1, 1) at the 1 percent level. A regression coefficient of 0.026 indicates that an increase of the shareholder rights score by one point in the acquiring firm country is associated with a 2.6 percent increase in abnormal returns for U.S. targets. Therefore, the effect of shareholder rights protection in the acquiring firm country on target value seems to be both statistically and economically significant. The percent of shares acquired by foreign investors also has a positive and significant effect on the CAR (-1, 1) for targets. This finding is consistent with theoretical work on the role of large shareholders by Shleifer and Vishny (1986). We also find that the coefficient on the board representation ratio by foreign investors is positive and significant at the 5 percent level in regression (2). The positive significance of these

variables are generally consistent with that in the previous analysis of logistic regressions and confirms the importance of investor protection and board structure as a determinant of the effectiveness of corporate governance. Consistent with the results from the previous logistic regressions, none of the regression coefficients on explanatory variables are significant when we use the subsample of targets of related foreign investors (regressions (4) and (5)).

For comparison, regressions (6) through (8) show the estimates for the total sample of targets of domestic acquirers, the subsample of targets of unrelated domestic acquirers, and the subsample of targets of related domestic acquirers, respectively. Unlike the regressions for targets of foreign acquirers, the coefficients on most of the explanatory variables are not significant and the adjusted R-square of the regressions are relatively low, suggesting that the regression specifications used for targets of foreign acquirers do not fit well for targets of domestic acquirers.

1.4 Alternative Explanations

To rule out alternative explanations that are also consistent with our findings, we conduct several additional tests. Below, we briefly summarize the results of these tests.

1.4.1 Information Asymmetry

If foreign investors are less well informed about firms in the host country than are domestic investors, they will have fewer incentives to undertake an active governance role in these firms because the costs of overcoming information asymmetry are higher. Since the information asymmetry that foreign investors face in the host country varies

depending on their language barrier, geographical difference, and experience in the U.S. prior to the acquisition, one would expect these measures of information asymmetry to have a significant effect on the likelihood of their post-acquisition governance activities in targets. To see whether our results are sensitive to considering the effect of information asymmetry, we re-estimate the previous logistic regression in Table 1.7 by including additional variables that act as a proxy for the extent of information asymmetry faced by foreign acquirers: the language (English) dummy, which equals one if the primary language of foreign acquirers is English; the geography dummy, which equals one if foreign acquirers are from the same geographical region as the U.S. targets (i.e., the Americas); and the U.S. operation dummy, which equals one if the foreign acquirers have U.S. operations prior to the acquisitions. The results are reported in regression (1) of Table 1.12. It turns out that the coefficients on these dummy variables are not significant. Controlling for information asymmetry does not change the significance of the coefficients on other explanatory variables, including the shareholder rights of the acquirer's country.

1.4.2 Creditor Rights and Other Shareholder Rights

Although we have shown that shareholder rights protection is an important determinant of the governance activities of foreign acquirers in the U.S., other legal rules covering the protection of shareholders can also affect the likelihood that such activities occur. For example, LLSV (1998) argue that investors are better protected when dividend rights are closely tied to voting rights such as the one share–one vote rule. They also argue that the mandatory dividend right can serve as a legal substitute for the weakness of

other protections of minority shareholders. Therefore, we check the robustness of our results by including the dummy for the one share–one vote rule and the dummy for the mandatory dividend right. We also include the creditor rights index of the acquirer’s country as an additional explanatory variable. To the extent that stronger creditor rights protection provides lenders with more incentives to monitor managerial performance and to take more actions that preserve or enhance firm value, we expect it to be positively related to the likelihood of post-acquisition governance activities in targets. None of these three variables in regression (2), however, are significant. Including these variables does not change the main results we document.

1.4.3 Cultures and Religions

Stulz and Williamson (2003) document that investor protection, particularly creditor rights protection, is related to culture. They show that a country’s primary religion explains the cross-sectional variation in creditor rights better than do legal origins, language, and country’s openness to international trade. Since foreign investors’ incentives to undertake post-acquisition governance activities also tend to be affected by their cultural backgrounds, we include a proxy that measures the cultural difference between the acquirer and the target as an additional explanatory variable. Specifically, following Stulz and Williamson, we include in the regression a Catholic dummy, which equals one if the primary religion of a country that the foreign acquirer comes from is Catholic, and a Protestant dummy, which equals one if it is Protestant. The third regression of Table 1.12 shows that the coefficients on these two dummy variables are

not statistically significant. The sign and significance of the coefficients on other explanatory variables remain about the same.

1.4.4 Legal Origin

LLSV (1998) show that legal rules pertaining to investor protection differ substantially across legal origins and that countries with a common law origin tend to have the strongest legal protection of shareholder rights. Therefore, as a further robustness check, in the last regression, we use a legal origin variable (a dummy for common law countries) as a broad indicator of shareholder rights protection. However, in our sample, the correlation coefficient between the common law origin dummy and shareholder rights index variables is 79 percent. Since including such highly correlated variables in the same regression causes severe collinearity problems, we do not include the shareholder rights index variable in the regression. The results show that the coefficient on the common law origin dummy variable is positive and statistically significant at the 1 percent level. This result further confirms our previous finding that investor protection by the legal system in the acquiring firm country is an important factor in determining the likelihood of governance activities in U.S. targets.

1.5 Summary and Conclusions

In this paper, we have studied the role of legal rules and law enforcement for foreign acquiring firms in fostering their corporate governance activities in U.S. targets. We find that foreign firms that purchase block shares of U.S. targets undertake several governance activities after the acquisition, such as the threat of hostile takeovers, the demand for

appointment of their representatives to the target's board, nonroutine top executive turnover, proxy contests, the expression of opposition to and attempts to amend anti-takeover provisions, and so forth. These post-acquisition governance activities are less likely to occur when acquirers are from foreign countries with weak shareholder rights than when they are either from countries with strong shareholder rights or from the U.S. In particular, the likelihood of governance activities including the threat of hostile takeovers, the demand for representatives on the target's board, and nonroutine top executive turnover increases with the level of the shareholder rights score of the acquirer's country. The analysis of the abnormal returns for U.S. targets at the announcement of block share purchases also indicates that they are positively related to the shareholder rights score of the acquirer's country.

Taken together, these results are consistent with the view that the legal protection of investors, especially shareholder rights, is an essential element of corporate governance and has an important influence on governance activities. They also suggest that foreign investors from countries with good governance structures have an ability to carry their superior governance skills and expertise across national borders and perform an instrumental role in improving the corporate governance standards of U.S. targets. However, these results are mainly driven by the subsample of acquisitions in which foreign investors do not have any business relationships with U.S. targets, suggesting that the relatedness of the acquirer and the target is a key determinant of the likelihood of post-acquisition governance activities and the valuation effect of announcements of such activities. We obtain similar results for U.S. targets of domestic acquirers.

Overall, our results show that the likelihood of governance activity of foreign acquirers in U.S. targets is a function of the legal protection of investors in their home countries and that the relatedness of the acquirer and the target plays a critical role in this process. Therefore, our study sheds light on the issue regarding a link between investor protection and corporate governance and extends the literature on the law and finance.

APPENDIX 1
TABLES OF ESSAY 1

Table 1.1

Distribution of Foreign Acquisition Activity in the U.S. by the Level of Shareholder Rights Protection in the Acquiring Firm Country, Target Industry, and Year

The sample consists of 270 U.S. targets in foreign block share acquisitions between 1981 and 1999. We obtain the sample of partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. The measure of shareholder rights protection for the foreign acquiring firm is from LLSV (1998). See the Appendix for a detailed definition of the variable. The number in parentheses is the percentage of observations.

Panel A: Distribution of Foreign Acquisition Activity in the U.S. by the Level of Shareholder Rights Protection in the Acquiring Firm Country and Target Industry																				
Target industry (first two digits of the SIC code)		Countries with weak shareholder rights (0-3)					Countries with strong shareholder rights (4-6)					Total								
		Unknown	0	1	2	3	4	5	6											
Agriculture, forestry, and fishing (01-09)	0	0	0	0	0	0	1	0	0	0	1 (0.4)									
Mining and construction (10-17)	0	0	0	0	3	2	6	7	0	0	18 (6.7)									
Manufacturing (20-39)	6	1	21	19	13	13	35	48	0	0	143 (53.0)									
Transportation and public utilities (40-49)	1	0	0	3	4	4	4	13	0	0	25 (9.3)									
Wholesale and retail trade (50-59)	1	0	1	3	3	2	2	11	0	0	20 (7.4)									
Finance, insurance, and real estate (60-67)	3	0	3	4	0	0	4	10	0	0	24 (8.9)									
Services (70-89)	2	0	3	6	6	8	7	13	0	0	39 (14.4)									
Total	13 (4.8)	1 (0.4)	28 (10.4)	38 (14.1)	29 (10.7)	59 (21.9)	102 (37.8)	0 (0.0)	270 (100.0)											
Panel B: Distribution of Foreign Acquisition Activity in the U.S. by Year																				
Year	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	To- tal
Frequency	0	0	2	2	20	11	25	30	21	13	16	15	8	14	28	20	20	14	11	270

Table 1.2
Descriptive Statistics for U.S. Targets in Foreign and Domestic Acquisitions

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. The numbers in the difference columns denote p -values for the two-tailed test.

Variables	Foreign Acquisitions				Domestic Acquisitions				Test of Difference			
	Total	Strong shareholder rights (A)	Weak shareholder rights (B)	Total (C)	(A-C)	(B-C)	(A-B)					
	N=257	N=161	N=96	N=257								
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	t-test	Wil- Coxon Z-test	Wil- Coxon Z-test
Investor Protection, Law Enforcement, and Deal Characteristics												
<i>Shareholder (anti-director) rights</i>	3.62	4.00	4.63	5.00	2.00	2.00	2.00	-	-	-	0.00	0.00
<i>Accounting standards</i>	70.02	69.00	72.50	74.00	66.06	65.00	-	-	-	-	0.00	0.00
<i>Rule of law</i>	8.90	8.98	8.89	8.57	8.92	9.23	-	-	-	-	0.82	0.00
<i>Fraction of acquiring firms whose holding period is longer than three years</i>	0.48	-	0.43	-	0.57	-	0.35	-	0.13	-	0.03	-
<i>Percent of shares acquired</i>	13.92	10.00	13.50	9.80	14.64	11.70	12.72	9.90	0.42	0.09	0.08	0.08

Target Characteristics															
<i>Equity ownership by managers (officers and directors)</i>	0.20	0.13	0.21	0.13	0.20	0.14	0.19	0.15	0.47	0.97	0.85	0.96	0.70	0.91	
<i>Equity ownership by institutional investors</i>	0.25	0.20	0.27	0.22	0.22	0.17	0.26	0.22	0.85	0.79	0.85	0.79	0.10	0.07	
<i>Age of top executive</i>	51.95	52.00	53.23	53.00	49.79	50.00	52.07	52.00	0.19	0.25	0.02	0.01	0.00	0.00	
<i>Tenure of top executive</i>	7.55	5.00	7.75	5.00	7.21	5.00	6.61	5.00	0.12	0.26	0.46	0.62	0.60	0.69	
<i>Fraction of firms with a chairman as the top executive</i>	0.63	-	0.65	-	0.59	-	0.57	-	0.09	-	0.67	-	0.34	-	
<i>Fraction of firms with a founder as the top executive</i>	0.25	-	0.25	-	0.26	-	0.24	-	0.76	-	0.76	-	0.92	-	
<i>Market value of equity (in millions of dollar)</i>	513.77	74.66	573.62	75.51	413.40	59.71	379.38	69.22	0.22	0.36	0.83	0.91	0.41	0.47	
<i>Leverage (total debt / total assets)</i>	0.28	0.27	0.29	0.29	0.30	0.22	0.25	0.22	0.13	0.03	0.47	0.42	0.57	0.35	
<i>Cash flow (operating income plus depreciation / total assets)</i>	-0.03	0.07	0.01	0.08	-0.08	0.04	-0.02	0.07	0.36	0.46	0.10	0.07	0.04	0.02	
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	1.82	1.05	1.51	0.95	2.36	1.24	1.88	1.11	0.11	0.12	0.30	0.13	0.06	0.01	

Table 1.3

Frequency of Holding Periods, Acquisitions with Control Purpose, and Active Investors by the Relatedness of the Acquirer and the Target

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. The number in parentheses is the percentage of observations.

Panel A: Holding Periods of Block Ownership by the Relatedness of the Acquirer and the Target				
	Foreign Acquisitions		Domestic Acquisitions	
Holding period	Unrelated: N=125	Related: N=132	Unrelated: N=125	Related: N=132
Less than one year	42 (34 %)	16 (12 %)	68 (54 %)	31 (23 %)
Longer than one but less than two years	26 (21 %)	12 (9 %)	25 (20 %)	23 (17 %)
Longer than two but less than three years	23 (18 %)	14 (11 %)	2 (2 %)	17 (13 %)
Longer than three years	34 (27 %)	90 (68 %)	30 (24 %)	61 (46 %)
Panel B: Control Purpose and Active Investor by the Relatedness of the Acquirer and the Target				
	Foreign Acquisitions		Domestic Acquisitions	
	Unrelated: N=125	Related: N=132	Unrelated: N=125	Related: N=132
Control purpose	22 (18 %)	4 (3 %)	18 (14 %)	9 (7 %)
Active investor	25 (20 %)	0 (0 %)	34 (27 %)	3 (2 %)
Panel C: Holding Period, Control Purpose, and Active Investor by the Relatedness of the Acquirer and the Target, and the Degree of Shareholder Rights in the Acquiring Firm Country: Foreign Acquisitions Only				
	Unrelated		Related	
	Strong shareholder rights: N=97	Weak shareholder rights: N=28	Strong shareholder rights: N=64	Weak shareholder rights: N=68
Holding period is longer than three years	22 (23 %)	12 (43 %)	47 (73 %)	43 (63 %)
Control purpose	19 (20 %)	3 (11 %)	1 (2 %)	3 (4 %)
Active investor	24 (28 %)	1 (4 %)	0 (0 %)	0 (0 %)

Table 1.4

Post-Acquisition Governance Activities Initiated by Acquirers during the Holding Period of Block Shares

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Post-acquisition governance activities are identified from several sources, including 13D filings, *Dow Jones Newswire*, proxy statements, and annual reports of target firms. All sources are examined for stories during the holding period of block shares by acquiring firms up to three years after the acquisition. Other governance activities include heading an investor alliance, expressing an opinion on a target's major decisions, requesting that the meeting with target management address the potential way to maximize shareholder value, and so forth. The classification of governance activities is not mutually exclusive, so acquirers that are involved in multiple governance activities are indicated more than once in the table. The numbers in parentheses are the percentages of observations.

	Foreign Acquisitions					Domestic Acquisitions		
	Total	Unrelated		Related		Total	Unrelated	Related
		Strong shareholder rights N=97	Weak shareholder rights N=28	Strong shareholder rights N=64	Weak shareholder rights N=68			
Governance activities	N=257					N=257	N=125	N=132
Threat of hostile takeovers	19 (22.6)	18	0	0	1	34 (25.4)	26	8
Proxy contests or threats	6 (7.1)	6	0	0	0	13 (9.7)	11	2
Expression of opposition to or attempt to amend anti-takeover provisions	3 (3.6)	3	0	0	0	10 (7.5)	9	1
Seeking representatives on the target's board	18 (21.4)	16	0	0	2	27 (20.2)	21	6
Threat of top executive turnover or involvement in the selection of a new top executive	6 (7.1)	5	1	0	0	11 (8.2)	9	2
Demand for asset downsizing	11 (13.1)	11	0	0	0	8 (6.0)	7	1
Other governance activities	21 (25.0)	19	1	0	1	31 (23.1)	27	4
Total	84 (100.0)	78 (92.9)	2 (2.4)	0 (0.0)	4 (4.8)	134 (100.0)	110 (82.1)	24 (17.9)

Table 1.5
Logit Regression Estimates of the Likelihood of Hostile Takeover Activity
by Large-Block Acquirers

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Post-acquisition hostile takeover activities are identified from several sources, including 13D filings, *Dow Jones Newswire*, proxy statements, and annual reports of target firms. All sources are examined for stories during the holding period of block shares by acquiring firms up to three years after the acquisition. The dependent variable equals one if large-block acquirers are involved in hostile takeover activity and zero otherwise. *P*-values are in parentheses.

Independent variables	Foreign Acquisitions (A)		Domestic Acquisitions (B)		Pooled Sample (A + B)	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Intercept</i>	-15.242 (0.01)	-14.146 (0.02)	-0.543 (0.28)	-0.0172 (0.98)	-0.805 (0.24)	-0.775 (0.26)
Investor Protection /						
Transaction Characteristics						
<i>Shareholder rights</i>	0.985 (0.02)	0.891 (0.05)				
<i>Accounting standards</i>	0.031 (0.65)	0.035 (0.64)				
<i>Rule of law</i>	0.743 (0.04)	0.629 (0.10)				

Table 1.6

Logit Regression Estimates of the Likelihood of Large-Block Acquirers' Demanding Board Representation

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Post-acquisition hostile takeover activities are identified from several sources, including 13D filings, *Dow Jones Newswire*, proxy statements, and annual reports of target firms. All sources are examined for stories during the holding period of block shares by acquiring firms up to three years after the acquisition. The dependent variable equals one if large-block acquirers announce that they seek or demand representatives on the target's board and zero otherwise. *P*-values are in parentheses.

Independent variables	Foreign Acquisitions (A)		Domestic Acquisitions (B)		Pooled Sample (A + B)	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Intercept</i>	-2.159 (0.58)	-1.798 (0.65)	-1.214 (0.04)	-0.490 (0.59)	-0.953 (0.17)	-0.954 (0.17)
Investor Protection /						
Transaction Characteristics						
<i>Shareholder rights</i>	0.987 (0.03)	0.904 (0.04)				
<i>Accounting standards</i>	-0.082 (0.18)	-0.068 (0.30)				
<i>Rule of law</i>	0.157 (0.62)	0.117 (0.72)				

Table 1.7

Logit Regression Estimates of the Likelihood of Governance Activities by Large-Block Acquirers and OLS Regression Estimates of the Governance Activity Index

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Post-acquisition hostile takeover activities are identified from several sources, including 13D filings, *Dow Jones Newswire*, proxy statements, and annual reports of target firms. All sources are examined for stories during the holding period of block shares by acquiring firms up to three years after the acquisition. In Panel A, the dependent variable equals one if acquirers undertake at least one of the seven governance activities categorized in Table IV. In Panel B, the dependent variable is the governance activity index. An index aggregating governance activities is created by adding one when large-block acquirers undertake one of these seven activities. *P*-values are in parentheses.

Panel A: Logit Regression Estimates of the Likelihood of Governance Activities

	Foreign Acquisitions (A)				Domestic Acquisitions (B)				Pooled Sample (A + B)	
	Total	Unrelated	Related	Total	Unrelated	Related	Total	Unrelated	Related	Total
Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>Intercept</i>	-1.856 (0.55)	-1.474 (0.65)	-1.217 (0.76)	-12.212 (0.44)	-0.009 (0.98)	0.725 (0.32)	0.647 (0.46)	0.687 (0.63)	-0.030 (0.59)	0.305 (0.58)
Investor Protection /										
Transaction Characteristics										
<i>Shareholder rights</i>	0.749 (0.00)	0.751 (0.01)	1.193 (0.00)	-0.1267 (0.88)						
<i>Accounting standards</i>	-0.070 (0.15)	-0.075 (0.17)	-0.106 (0.10)	-0.152 (0.48)						

Panel B: OLS Regression Estimates of the Governance Activity Index									
Independent variables	Foreign Acquisitions (A)			Domestic Acquisitions (B)			Pooled Sample (A) + (B)		
	Total		Unrelated Related		Total		Unrelated Related		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<i>Intercept</i>	0.281 (0.73)	0.154 (0.85)	-0.401 (0.81)	-0.025 (0.93)	1.077 (0.00)	1.025 (0.00)	1.119 (0.07)	0.599 (0.02)	0.866 (0.00)
Investor Protection / Transaction Characteristics									
<i>Shareholder rights</i>	0.145 (0.01)	0.141 (0.01)	0.309 (0.01)	-0.008 (0.67)					
<i>Accounting standards</i>	-0.011 (0.40)	-0.011 (0.40)	-0.015 (0.58)	-0.003 (0.54)					
<i>Rule of law</i>	0.075 (0.21)	0.072 (0.22)	0.049 (0.69)	0.030 (0.15)					
<i>Acquirer is from a foreign country (dummy)</i>								-0.216 (0.02)	
<i>Acquirer is from a foreign country with strong shareholder rights (dummy)</i>									-0.132 (0.22)
<i>Acquirer is from a foreign country with weak shareholder rights (dummy)</i>									-0.359 (0.01)
<i>Acquirer is a related investor (dummy)</i>	-0.478 (0.00)	-0.468 (0.00)			-0.690 (0.00)	-0.549 (0.00)		-0.611 (0.00)	-0.582 (0.00)
<i>Holding period of block shares is longer than three years (dummy)</i>	-0.125 (0.32)	-0.131 (0.30)	-0.224 (0.41)	-0.022 (0.61)	0.063 (0.70)	0.078 (0.63)	0.358 (0.30)	-0.133 (0.23)	-0.026 (0.80)
<i>Percent of shares acquired</i>	0.008 (0.16)	0.009 (0.14)	0.022 (0.09)	0.002 (0.28)	0.004 (0.64)	0.002 (0.82)	0.013 (0.51)	-0.011 (0.12)	0.007 (0.20)
Target Characteristics									

<i>Equity ownership by managers (officers and directors)</i>	-0.763 (0.01)	-0.670 (0.03)	-1.117 (0.07)	0.018 (0.87)	-0.892 (0.06)	-1.049 (0.03)	-1.695 (0.07)	-0.539 (0.14)	-0.743 (0.01)	-0.771 (0.00)
<i>Equity ownership by institutional investors</i>	-0.121 (0.68)	-0.628 (0.11)	-1.250 (0.10)	-0.239 (0.12)	-0.388 (0.33)	-0.659 (0.18)	-1.177 (0.17)	0.109 (0.79)	-0.559 (0.07)	-0.581 (0.06)
<i>Log of market value of equity</i>		0.083 (0.08)	0.185 (0.07)	0.022 (0.19)		-0.004 (0.94)	-0.015 (0.90)	-0.042 (0.35)	0.048 (0.20)	0.047 (0.22)
<i>Leverage (total debt / total assets)</i>		-0.165 (0.54)	-0.208 (0.70)	-0.081 (0.43)		0.391 (0.25)	0.196 (0.77)	0.473 (0.07)	0.075 (0.73)	0.081 (0.71)
<i>Cash flow (operating income plus depreciation / total assets)</i>		-0.003 (0.99)	0.217 (0.58)	-0.073 (0.38)		0.629 (0.04)	1.969 (0.03)	0.303 (0.10)	0.234 (0.17)	0.230 (0.17)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>		-0.026 (0.26)	-0.020 (0.57)	-0.021 (0.18)		-0.001 (0.97)	0.013 (0.91)	-0.003 (0.88)	-0.018 (0.34)	-0.016 (0.39)
Adjusted R^2	0.1274	0.1296	0.0815	-0.0232	0.0774	0.0879	0.0279	0.0248	0.1147	0.1111
F-value	5.56	4.10	1.98	0.74	5.26	3.72	1.44	1.51	7.60	6.78
No. of observations	251	251	123	128	255	255	124	131	510	510

Table 1.8

Frequency of Nonroutine Top Executive Turnover by Shareholder Rights in the Acquiring Firm Country and the Relatedness of the Acquirer and the Target

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Nonroutine top executive turnover events are identified from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for changes of presidents, chairmen, and CEOs. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. We refer to turnover events where the top executive is removed due to death, illness, or other normal reasons as routine turnover. We classify a management change as normal if the stated reason for the management change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover. The number in parentheses is the percentage of observations. The number in brackets is the corresponding number of total observations in each cell. The numbers in the test-of-difference columns and rows denote p -values for the two-tailed test.

Panel A: The Frequency of Targets Experiencing Nonroutine Top Executive Turnover				
	Foreign Acquisitions		Domestic Acquisitions	
	Total	Strong shareholder rights	Weak shareholder rights	Total
	N=257	N=159	N=98	N=257
Firms experiencing nonroutine top executive turnover	57 (22.2)	43 (27.0)	14 (14.3)	55 (21.4)
Panel B: The Frequency of Targets Experiencing Nonroutine Top Executive Turnover by Shareholder Rights in the Acquiring Firm Country and the Relatedness of the Acquirer and the Target				
	Unrelated (A)	Related (B)	Test of difference (A-B) Chi-squared test	
Total	29 (23.2) [125]	28 (21.2) [132]	0.70	
Strong shareholder rights (C)	27 (28.4) [97]	16 (25.0) [64]	0.60	
Weak shareholder rights (D)	2 (6.7) [28]	12 (17.6) [68]	0.15	
Test of difference (C - D)				
Chi-squared test	0.00***	0.31		

Table 1.9

Logit Regression Estimates of the Likelihood of Nonroutine Top Executive Turnover

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Nonroutine top executive turnover events are identified from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for changes of presidents, chairmen, and CEOs. We define the top executive as the CEO. If a firm does not have any CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. We refer to turnover events where the president is removed due to death, illness, or other normal reasons as routine turnover. We classify a management change as normal if the stated reason for the management change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover. The dependent variable is one if nonroutine turnover occurs and zero otherwise. *P*-values are in parentheses.

	Foreign Acquisitions (A)				Domestic Acquisitions (B)				Pooled Sample (A) + (B)	
	Total	Unrelated	Related		Total	Unrelated	Related			
Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Intercept	-4.853 (0.11)	-4.537 (0.14)	-9.046 (0.07)	-2.970 (0.53)	-4.189 (0.00)	-4.300 (0.00)	-5.895 (0.02)	-4.976 (0.02)	-5.154 (0.00)	-4.994 (0.00)
Investor Protection / Transaction Characteristics										
Shareholder rights	0.443 (0.02)	0.446 (0.02)	0.759 (0.04)	0.368 (0.18)						
Accounting standards	-0.041 (0.33)	-0.040 (0.34)	-0.040 (0.56)	-0.027 (0.67)						
Rule of law	-0.040 (0.83)	-0.033 (0.86)	-0.051 (0.87)	-0.064 (0.67)						
Acquirer is from a foreign country (dummy)								-0.194 (0.44)		
Acquirer is from a foreign country with strong shareholder rights (dummy)									0.187 (0.50)	
Acquirer is from a foreign country with weak shareholder rights (dummy)									-1.022 (0.01)	
Acquirer is a related investor (dummy)	-0.397 (0.34)	-0.444 (0.30)			-0.850 (0.05)	-0.655 (0.16)		-0.693 (0.02)	-0.596 (0.04)	
Holding period of block shares is longer than three years (dummy)	0.985 (0.02)	1.070 (0.01)	1.525 (0.03)	0.860 (0.20)	1.717 (0.00)	1.756 (0.00)	2.683 (0.00)	1.213 (0.02)	1.324 (0.00)	1.374 (0.00)

<i>Percent of shares acquired</i>	0.039 (0.04)	0.040 (0.03)	0.060 (0.04)	0.019 (0.52)	0.062 (0.01)	0.059 (0.02)	0.068 (0.21)	0.061 (0.04)	0.044 (0.00)	0.042 (0.00)
<i>Number of members of the board of directors represented by acquirers / total number of members of the board of directors in target</i>	3.406 (0.01)	3.253 (0.02)	2.458 (0.22)	3.758 (0.11)	5.082 (0.00)	4.981 (0.01)	7.214 (0.01)	2.771 (0.17)	3.906 (0.00)	4.215 (0.00)
Target Characteristics										
<i>Equity ownership by managers (officers and directors)</i>	0.924 (0.35)	0.797 (0.43)	2.370 (0.15)	-0.243 (0.87)	-0.109 (0.92)	-0.649 (0.59)	-2.160 (0.32)	0.254 (0.88)	0.464 (0.53)	0.308 (0.63)
<i>Equity ownership by institutional shareholders</i>	-1.485 (0.14)	-0.647 (0.62)	-1.018 (0.57)	-0.198 (0.93)	-2.142 (0.07)	-2.405 (0.10)	-4.629 (0.06)	-0.831 (0.68)	-1.375 (0.13)	-1.502 (0.11)
<i>Age of top executive</i>	0.089 (0.00)	0.089 (0.00)	0.127 (0.00)	0.059 (0.21)	0.039 (0.09)	0.034 (0.15)	0.040 (0.35)	0.049 (0.13)	0.062 (0.00)	0.061 (0.00)
<i>Tenure of top executive</i>	-0.066 (0.02)	-0.065 (0.03)	-0.090 (0.05)	-0.063 (0.20)	-0.065 (0.09)	-0.064 (0.10)	-0.063 (0.32)	-0.055 (0.27)	-0.059 (0.01)	-0.060 (0.01)
<i>Top executive is a chairman (dummy)</i>	-0.247 (0.53)	-0.166 (0.68)	-0.381 (0.57)	-0.268 (0.64)	0.234 (0.55)	0.257 (0.53)	0.949 (0.20)	0.108 (0.84)	0.159 (0.56)	0.127 (0.64)
<i>Top executive is a founder (dummy)</i>	-0.517 (0.25)	-0.624 (0.18)	-0.270 (0.74)	-0.994 (0.14)	-0.371 (0.42)	-0.426 (0.38)	-1.940 (0.08)	-0.003 (0.99)	-0.513 (0.11)	-0.539 (0.09)
<i>Log of market value of equity</i>		-0.139 (0.37)	-0.067 (0.78)	-0.367 (0.17)		0.007 (0.96)	0.162 (0.55)	-0.121 (0.57)	-0.063 (0.55)	-0.060 (0.57)
<i>Leverage (total debt / total assets)</i>		-0.006 (0.99)	-0.524 (0.71)	2.255 (0.11)		1.281 (0.11)	2.640 (0.09)	0.439 (0.69)	0.401 (0.47)	0.468 (0.41)
<i>Cash flow (operating income plus depreciation / total assets)</i>		-0.434 (0.40)	0.299 (0.80)	-0.633 (0.55)		0.587 (0.44)	-0.708 (0.79)	0.693 (0.41)	-0.184 (0.65)	-0.191 (0.64)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>		-0.011 (0.87)	-0.015 (0.86)	0.083 (0.68)		0.041 (0.50)	0.162 (0.57)	0.041 (0.53)	0.007 (0.87)	0.018 (0.69)
Pseudo R ²	0.2235	0.2307	0.3113	0.2523	0.2851	0.2965	0.4568	0.1991	0.2213	0.2382
No. of observations	251	251	123	128	255	255	124	131	510	510

Table 1.10

Cumulative Abnormal Returns (CARs) for Targets around the Announcement Date

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. We obtain the initial public announcement date of the acquisition from the *Dow Jones Newswire*. We compute abnormal returns using the market model. We estimate the market model by using 200 trading days of return data ending 21 days before the acquisition announcement. We use as the market return the CRSP equally weighted return. The number in brackets is the corresponding number of target firms in each cell. The numbers in the test-of-difference columns and rows denote p -values for the two-tailed test.

Panel A: CAR (%) for U.S. Targets by Nationality of Acquirers						
Foreign Acquisitions (A) N=257			Domestic Acquisitions (B) N=257		Test of Difference (A - B)	
	Mean	Median	Mean	Median	Mean	Median
CAR (-1, 0)	0.048***	0.032***	0.069***	0.039***	0.03**	0.08*
CAR (-1, 1)	0.060***	0.043***	0.082***	0.061***	0.04**	0.03**
CAR (-5, 5)	0.074***	0.047***	0.094***	0.062***	0.20	0.17
CAR (-20, 20)	0.083***	0.063***	0.133***	0.101***	0.11	0.08*
Panel B: CAR (%) for U.S. Targets by Shareholder Rights in the Acquiring Firm Country and the Relatedness of the Acquirer and the Target						
	Unrelated (C)		Related (D)		Test of Difference (C - D)	
	Mean	Median	Mean	Median	t-test	Wilcoxon Z-test
Total	0.0516*** [125]	0.0335***	0.0661*** [132]	0.0546***	0.36	0.24
Strong shareholder rights (E)	0.064*** [97]	0.043***	0.053*** [64]	0.046***	0.66	0.62
Weak shareholder rights (F)	0.010 [28]	0.003	0.078*** [68]	0.064***	0.00***	0.01***
Test of Difference (E - F) t-test	0.02**	0.01***	0.33	0.22		

Table 1.11

Regression of Cumulative Abnormal Returns (-1, 1) for Targets on the Degree of Shareholder Rights Protection and the Quality of Law Enforcement in the Acquiring Firm Country and Other Target Characteristics

The sample consists of 257 U.S. targets in foreign block share acquisitions and 257 U.S. control targets in domestic block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). A U.S. target in the domestic acquisition is matched to that in the foreign acquisition by acquirer industry (financial or nonfinancial), target industry (at least to the first two digits of the SIC code), target size (the closest in book value of assets), year of acquisition, and relatedness of the acquirer and the target. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. We obtain the initial public announcement date of the acquisition from the *Dow Jones Newswire*. We compute abnormal returns using the market model. We estimate the market model by using 200 trading days of return data ending 21 days before the acquisition announcement. We use as the market return the CRSP equally weighted return. *P*-values are in parentheses.

	Foreign Acquisitions				Domestic Acquisitions			
	Total	Unrelated	Related	Total	Unrelated	Related	Total	
Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Intercept</i>	0.052 (0.22)	-0.017 (0.76)	0.301 (0.03)	0.097 (0.09)	0.231 (0.22)	0.064 (0.06)	0.1026 (0.02)	0.079 (0.16)
Investor Protection / Transaction Characteristics								
<i>Shareholder rights</i>	0.001 (0.89)	0.015 (0.05)	0.026 (0.01)	-0.009 (0.35)	-0.013 (0.32)			
<i>Accounting standards</i>			-0.003 (0.13)		0.001 (0.79)			
<i>Rule of law</i>			-0.014 (0.19)		-0.022 (0.12)			
<i>Acquirer is a related investor (dummy)</i>	0.007 (0.72)					0.016 (0.37)		

<i>Percent of shares acquired</i>	0.001 (0.33)	0.002 (0.03)	0.003 (0.02)	-0.001 (0.70)	-0.000 (0.86)	0.016 (0.37)	0.001 (0.44)	0.000 (0.93)
<i>Number of members of the board of directors represented by acquirers / total number of members of the board of directors in target</i>	0.145 (0.06)	0.206 (0.05)	0.145 (0.18)	0.099 (0.38)	0.109 (0.35)	0.015 (0.50)	0.162 (0.16)	0.078 (0.56)
Target Characteristics								
<i>Equity ownership by managers (officers and directors)</i>	-0.031 (0.48)	-0.067 (0.21)	-0.066 (0.21)	-0.006 (0.93)	0.020 (0.80)	0.041 (0.43)	0.075 (0.24)	0.021 (0.80)
<i>Equity ownership by institutional shareholders</i>	0.064 (0.27)	0.018 (0.78)	0.028 (0.65)	0.056 (0.59)	0.092 (0.38)	0.058 (0.27)	0.004 (0.94)	0.138 (0.13)
<i>Log of market value of equity</i>	-0.009 (0.17)	-0.003 (0.71)	-0.003 (0.73)	-0.009 (0.38)	-0.011 (0.33)	-0.009 (0.14)	-0.005 (0.50)	-0.016 (0.13)
<i>Leverage (total debt / total assets)</i>	0.011 (0.77)	-0.058 (0.21)	-0.052 (0.26)	0.100 (0.13)	0.085 (0.22)	0.032 (0.38)	-0.080 (0.08)	0.134 (0.03)
<i>Cash flow (operating income plus depreciation / total assets)</i>	0.006 (0.82)	0.020 (0.54)	0.024 (0.47)	-0.029 (0.60)	-0.014 (0.80)	-0.046 (0.17)	-0.091 (0.15)	-0.028 (0.51)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	0.005 (0.11)	0.006 (0.04)	0.006 (0.03)	0.002 (0.85)	0.005 (0.66)	-0.000 (0.99)	-0.010 (0.21)	0.003 (0.50)
Adjusted R ²	0.0093	0.1189	0.1614	-0.0209	-0.0236	0.0220	0.0404	0.0047
F-value	1.24	2.84	3.13	0.70	0.73	1.64	1.65	1.07
No. of observations	255	124	123	131	128	255	124	131

Table 1.12

Logit Regression Estimates of the Likelihood of Governance Activities by Foreign Large-Block Acquirers

The sample consists of 257 U.S. targets in foreign block share acquisitions between 1981 and 1999. We obtain the sample of foreign partial acquisitions in which the foreign firms acquire more than 5 percent but less than 50 percent of the outstanding shares in U.S. targets from the Security Data Corporation (SDC) Platinum of Thomson Financial. We eliminate cases where the measures of investor protection are not available from LLSV (1998). We determine the relatedness of the acquirer and the target by searching *Dow Jones Newswire*, proxy statements, and annual reports of the target for three years prior to and subsequent to the announcement date of block share purchases. We define the related acquisitions as those in which the two firms engaged in the acquisitions have maintained strategic agreement, business alliance, joint venture, or other product market partnerships such as supply, marketing/distribution, and technology-sharing relationships before the acquisition, or have announced their intention of establishing such relationships in the future. The measure of shareholder rights protection and the quality of law enforcement for the foreign acquiring firm are from LLSV (1998). See the Appendix for a detailed definition of these variables. Post-acquisition governance activities are identified from several sources, including 13D filings, *Dow Jones Newswire*, proxy statements, and annual reports of target firms. All sources are examined for stories during the holding period of block shares by acquiring firms up to three years after the acquisition. The dependent variable equals one if acquirers undertake at least one of the seven governance activities categorized in Table 1.3. *P*-values are in parentheses.

Independent variables	(1)	(2)	(3)	(4)
<i>Intercept</i>	-0.222 (0.97)	-2.066 (0.10)	-5.410 (0.26)	-1.332 (0.21)
Investor Protection / Transaction Characteristics				
<i>Shareholder rights</i>	0.838 (0.00)	0.389 (0.07)	0.556 (0.06)	
<i>Accounting standards</i>	-0.091 (0.26)		0.003 (0.97)	
<i>Rule of law</i>	0.323 (0.30)		0.338 (0.36)	
<i>Acquirer has an operation in the U.S. (dummy)</i>	0.221 (0.76)			
<i>Acquirer's primary language is English (dummy)</i>	-0.247 (0.76)			
<i>Acquirer is from the same geographical region (i.e., the Americas) (dummy)</i>	-15.486 (0.99)			
<i>Acquirer's primary religion is Catholic (dummy)</i>			-0.645 (0.41)	
<i>Acquirer's primary religion is Protestant (dummy)</i>			-1.167 (0.16)	
<i>One share-one vote (dummy)</i>		-12.033 (0.96)		
<i>Mandatory dividend (dummy)</i>		-0.950 (0.99)		
<i>Creditor rights (dummy)</i>		0.033 (0.84)		
<i>Common law origin (dummy)</i>				1.409 (0.01)
<i>Acquirer is a related investor (dummy)</i>	-2.528 (0.00)	-2.246 (0.00)	-2.445 (0.00)	-0.231 (0.00)
<i>Holding period of block shares is longer than three years (dummy)</i>	-0.610 (0.26)	-0.445 (0.40)	-0.610 (0.27)	-0.409 (0.45)

<i>Percent of shares acquired</i>	0.053 (0.03)	0.046 (0.05)	0.055 (0.03)	0.044 (0.06)
Target Characteristics				
<i>Equity ownership by managers (officers and directors)</i>	-2.891 (0.04)	-2.668 (0.05)	-2.927 (0.04)	-2.723 (0.04)
<i>Equity ownership by institutional shareholders</i>	-2.892 (0.06)	-2.542 (0.09)	-3.335 (0.04)	-2.799 (0.06)
<i>Log of market value of equity</i>	0.286 (0.14)	0.302 (0.11)	0.313 (0.11)	0.282 (0.14)
<i>Leverage (total debt / total assets)</i>	0.214 (0.85)	-0.305 (0.78)	0.164 (0.88)	-0.335 (0.75)
<i>Cash flow (operating income plus depreciation / total assets)</i>	1.408 (0.61)	1.537 (0.56)	1.252 (0.65)	1.155 (0.66)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	-1.204 (0.01)	-1.086 (0.02)	-1.245 (0.01)	-1.127 (0.01)
Pseudo R ²	0.3419	0.3458	0.3428	0.3305
No. of observations	249	251	251	255

Appendix A

Description of Variables

Variable	Description	Source
Shareholder (anti-director) rights index	It is created by adding one when (1) shareholders are allowed to mail their proxy vote; (2) shareholders are not required to deposit their shares prior to the general shareholders' meeting; (3) cumulative voting or proportional representation of minorities on the board of directors is allowed in the law; (4) an oppressed minorities mechanism is in place; (5) the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholders' meeting is less than or equal to 10 percent (the sample median); or (6) when shareholders have preemptive rights that can only be waived by a shareholders' vote. The range for the index is from zero to six and a higher score indicates better protection.	La Porta et al. (1998)
Accounting standards index	It is created by the <i>Center for International Financial Analysis and Research</i> by examining the contents of 1990 annual reports on their inclusion or omission of 90 disclosure items. These items fall into seven categories (general information, income statements, balance sheets, funds flow statement, accounting standards, stock data, and special items).	La Porta et al. (1998)
Rule of law index	Assessment of the law and order tradition in the country produced by the country risk-rating agency <i>International Country Risk</i> . Average of the months of April and October of the monthly index between 1982 and 1995. The range for the index is from zero to ten and a higher score indicates a greater tradition of law and order.	La Porta et al. (1998)
Creditor rights index	It is created by adding one when (1) the country imposes restrictions, such as creditors' consent, to file for reorganization; (2) secured creditors are able to gain possession of their security once the reorganization petition has been approved (no automatic stay); (3) secured creditors are ranked first in the distribution of the proceeds that result from the disposition of assets of a bankrupt firm; and (4) the debtor does not retain the administration of its property pending the resolution of the reorganization. The range for the index is from zero to four and a higher score indicates better protection.	La Porta et al. (1998)

Common law dummy	A dummy variable that takes the value of one if the legal origin of the company law or the commercial code of the country is English common law and zero otherwise.	La Porta et al. (1998)
One share–one vote dummy	A dummy variable that takes the value of one if the company law or the commercial code of the country requires that ordinary shares carry one vote per share and zero otherwise.	La Porta et al. (1998)
Mandatory dividend dummy	A dummy variable that takes the value of one if the company law or the commercial code requires firms to distribute a certain percentage of their net income as dividend among stockholders and zero otherwise.	La Porta et al. (1998)
Related acquirer dummy	A dummy variable that takes the value of one if the large-block acquirer is classified as a related investor and zero otherwise. We determine the relatedness of the acquirer and the target by searching several sources for three years prior to and subsequent to the announcement date of block share purchases. We define the related acquisitions as those in which the two firms engaged in the acquisitions have maintained strategic agreement, business alliance, joint venture, or other product market partnerships such as supply, marketing/ distribution, and technology-sharing relationships before the acquisition, or have announced their intention of establishing such relationships in the future.	13D, proxy statement, annual statement, <i>Dow Jones Newswire</i>
Strong shareholder rights dummy	A dummy variable that takes the value of one if the shareholder rights index is greater than three and zero otherwise.	La Porta et al. (1998)
Weak shareholder rights dummy	A dummy variable that takes the value of one if the shareholder rights index is smaller or equal to three and zero otherwise.	La Porta et al. (1998)
Active investor	Following Bethel, Liebeskind, and Opler (1998), we define active investors as those who announce their intention of influencing firm policies or who are known for active policies in the past.	13D, <i>Dow Jones Newswire</i>
Nonroutine top executive turnover	We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. Following Denis, Denis, and Sarin (1997), we refer to turnover	Proxy statement, annual statement

events where the top executive is removed due to death, illness, or other normal reasons as routine turnover. We classify a management change as normal if the stated reason for the management change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover.

Top executive founder dummy	A dummy variable that takes the value of one if the top executive is the founder of the firm. We define founders as those who are described as founders in the proxy statement or annual statement, or those who have held the position of top executive since the inception of the firm.	Proxy statement, annual statement
Governance activity index	The index is formed by adding one when acquirers undertake at least one of the following seven governance activities: (1) threat of hostile takeovers; (2) proxy contests or threat; (3) expression of opposition to or attempts to amend anti-takeover provisions; (4) seeking representatives on the target's board; (5) threat of top executive turnover or involvement in the selection of a new top executive; (6) asset downsizing; (7) other governance activities, such as heading an investor alliance, expressing an opinion on a target's major decisions, requesting that the meeting with target management address the potential way to maximize shareholder value, and so forth. The range for the index is from zero to seven and a higher score indicates more frequent activities.	13D, proxy statement, annual statement, <i>Dow Jones Newswire</i>
Governance activity dummy	A dummy variable that takes the value of one if acquirers undertake at least one of the seven governance activities listed above and zero otherwise.	13D, proxy statement, annual statement, <i>Dow Jones Newswire</i>
Foreign investor dummy	A dummy variable that takes the value of one if the ultimate parent country of the acquirer is not the U.S. and zero otherwise.	Securities Data Corporation

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ESSAY 2. Geography and Corporate Governance: Evidence from Partial Acquisitions

2.1 Introduction

Recent empirical evidence suggests that geography plays an important role in financial economics. Professional money managers and individual investors exhibit a strong preference for geographically proximate equities (Coval and Moskowitz (1999), Huberman (2001), Zhu (2002)). Furthermore, their local investments outperform their remote investments, suggesting that geographically proximate investors have significant information advantages over distant investors (Coval and Moskowitz (2001), Ivkovic and Weisbenner (2003), Bodnaruk (2003)).

While these studies have focused on the effect of geography on investor portfolio choice, Coval and Moskowitz (2001) argue that the governance activities of geographically proximate investors facilitate their information advantage over remote investors: “This information may be the result of improved monitoring capabilities or access to private information of geographically proximate firms.” (pp. 812, 838) This observation suggests that geographically proximate investors may be better monitors than other investors. Investors located near the firm may be more likely to engage in governance activities than distant investors, since they would bear lower transaction costs involved in their governance activities such as costs of acquiring information, traveling, and communication, compared to distant investors.

In this paper, we investigate the effect of geography on the corporate governance activities of large-block acquirers. Examining the post-acquisition governance activities of large-block acquirers who acquire at least 5 percent, but less than 50 percent of voting

shares in target firms, we find that geographically proximate acquirers are more actively involved in governance activities in target firms than are remote block acquirers¹⁰. Specifically, acquirers who are located within the same state as targets (hereafter referred to as in-state acquirers) or who are located within 250 miles of target firms (hereafter referred to as local acquirers) are more likely to have their representatives on the target's board and replace target management after block share purchases. In addition, targets of in-state and local acquirers experience higher abnormal announcement returns and post-acquisition operating performance than those of other acquirers. Moreover, these effects are more pronounced when target firms are smaller, have worse past performance, or have higher insider ownership.

Our findings suggest that geography has an important influence on large-block acquirers' incentives to engage in governance activities in target firms. In-state acquirers and local acquirers who are expected to possess advantages in terms of information acquisition and lower monitoring costs are more likely to be involved in governance activities in targets and the stock market anticipates the increase in governance activity of these acquirers and views it positively. Therefore, our results suggest that an information advantage and lower monitoring costs of geographically proximate blockholders foster their active corporate governance activities, and impact the operating performance and firm value. The further analysis shows that the effect of geographic proximity on firm value is concentrated in small firms, firms with higher insider ownership, and firms with

¹⁰ We focus on large-block acquirers since detailed information on their ownership changes and post-acquisition governance activities is publicly available. More importantly, unlike small shareholders who like to free-ride the corporate governance activities of other shareholders (Grossman and Hart (1980)), large shareholders have strong incentives to monitor managerial performance and take actions that enhance firm value (Shleifer and Vishny (1986)). For instance, Shivdasani (1993), Denis and Serrano (1996), and Bethel, Liebeskind, and Opler (1998) document that blockholders play an important role in corporate governance.

poor past performance, where local acquirers may have superior access to information about the firm since information about these companies gets out more slowly and is likely to be communicated through private channels (Hong, Lim, and Stein (2000), Ball, Kothari, and Robin (2000)). These findings also suggest that firm-specific characteristics, such as firm size, insider ownership, and past performance, have an effect on information asymmetry between local and nonlocal shareholders.

In addition, the fraction of board representation by blockholders and the probability of nonroutine top executive turnover are negatively related to the physical distance from the target. If investors' monitoring costs increase with physical distance from the target because of extra communication costs and transportation costs (Sussman and Zeira (1995), Peterson and Rajan (2002), Degryse and Steven Ongena (2004)), this finding suggests that monitoring costs associated with geography may be an important determinant of their governance activities. Furthermore, the stock market appears to anticipate value-enhancing governance activities of geographically proximate acquirers. We find that targets of in-state acquirers earn higher abnormal returns at the formation of block ownership when the acquirer is appointed to the target's board or their top executives are replaced following the block share purchase.

We also examine whether large shareholders exhibit a bias toward locally headquartered firms as mutual fund managers do. We find that on average, large-block acquirers are 1,603 kilometers away from target firms, which is similar to the 1,654 kilometers from holding stocks for fund managers (Coval and Moskowitz (1999)). Hence, large-block acquirers appear to have a strong preference for locally located firms. Given that geographic proximity is related to that information asymmetry and monitoring

costs of investors, our results suggest such information asymmetry and monitoring costs are important determinants of investment decisions of large shareholders.

Several studies have documented that the information asymmetry between domestic and foreign investors or local and nonlocal investors may drive their preference for domestic and local stocks that are geographically proximate to them (Kang and Stultz (1997), Coval and Moskowitz (1999), Ivkovic and Weisbenner (2003)). This paper shows that geography has an important influence on investors' incentives concerning their corporate governance activities. We argue that corporate governance factors associated with geographic proximity are another important determinants of home or local bias and therefore, investors choose domestic or local firms because they can be better monitors in those firms than remote investors.

Finally, by providing a link between geography and corporate governance, this paper provides an additional dimension to the role of geography in economics. Previous literature has focused on information-based explanations of the role of geography in terms of portfolio decision. For example, Coval and Moskowitz (2001) and Ivkovic and Weisbenner (2003) examine investor portfolio returns and document that investors earn substantial excess returns from their investment in local stocks. They argue that such excess returns are due to an information advantage of local investors. This paper, however, examines the effect of geography on the value and operating performance of the firm and shows that firms acquired by local investors are more subject to active governance activities and outperform those acquired by nonlocal investors. Therefore, our findings suggest that geographic proximity may have real effects on the value and operating performance of firms through the governance activities of local investors.

This paper is organized as follows. We discuss our hypotheses and review previous studies in Section 2.2. In Section 2.3, we describe our data and methodology. The empirical results are in Section 2.4 and 2.5. Section 2.6 concludes this paper.

2.2 Hypotheses and Literature Review

2.2.1 Geographic Proximity and Information Advantage

It is well documented that despite the substantial gains from international diversification, investors exhibit a strong preference for domestic stocks (French and Poterba (1991), Kang and Stultz (1997)). Furthermore, such a bias in international portfolio selection (the so-called home bias) extends to regions within the same country and investors prefer to hold geographically proximate stocks (the so-called local bias). Recent studies also document the geographic link between investor portfolio choice and investment performance. For example, Coval and Moskowitz (1999) analyze the role of geographic proximity in the context of U.S. mutual fund managers and show that U.S. fund managers exhibit a bias toward locally headquartered firms, particularly with small, highly leveraged firms that produce nontraded goods. Coval and Moskowitz (2001) also show that on average fund managers generate an additional return of 2.65 percent per year from their local investments compared to their nonlocal investments. They argue that fund managers earn such abnormal returns in their local holdings as compensation for information they acquire about local companies. Ivkovic and Weisbenner (2003) examine the stock investments of U.S. households and show that individual investors exhibit a local bias to an even larger degree than professional money managers do. They also find that the average household generates an additional return of 3.7 percent per year

from its local holdings relative to its nonlocal holdings. Moreover, Malloy (2004) shows that geographically proximate analysts provide more accurate earnings forecasts, update their forecasts more frequently and impact stock prices more than nonlocal analysts. In the context of acquisitions, Kedia, Panchapagesan, and Uysal (2005) show that acquirers have a strong preference for local firms. They also show that bidder returns in local transactions are higher than those in nonlocal transactions.

Overall, these findings suggest that investors can access to information more easily for local firms than nonlocal firms, which translates into better investment performance. Specifically, local investors could acquire information about the firm with lower costs than nonlocal investors. Local investors may use less time and face lower costs associated with traveling and searching for information about a particular firm. They may follow the firm through local media reports or even place a local call directly to the firm for instance. In addition to lower costs associated with obtaining such information, investors may have informal sources of information about local companies, such as conversations with employees, managers, suppliers of the firm, and customers. In particular, large shareholders located near the firm can visit the firm and meet CEOs face-to-face more often to obtain information.

2.2.2 Geographic Proximity, Monitoring Costs, and Governance Activities

Monitoring of management involves substantial costs to investors and such monitoring costs may be related to the distance between investors and the firm. Monitoring costs tend to increase with the distance from the firm because of extra communication costs or transportation costs incurred by investors. For example, Sussman

and Zeira (1995) present a model in which banks face monitoring costs that increase in distance. Empirically, Peterson and Rajan (2002) and Degryse and Ongena (2005) show that transportation costs cause price discrimination in bank lending. In the context of U.S. venture capital, Lerner (1995) finds that the board membership of VCs in private biotechnology firms is partly determined by the distance between the firms and the venture capitalist. Lerner argues that the monitoring costs associated with frequent visits and intensive involvement can be reduced if the venture capitalist is located near a company's headquarters.

Furthermore, Coval and Moskowitz (2001) argue that fund managers' information advantages may be the result of improved monitoring capabilities over local firms, which suggests that the governance activities of investors may enhance their information advantage. For instance, shareholders who have their representatives on the board of directors are expected to have superior access to information about the firm.

Given that local investors face lower transaction costs associated with their governance activities, they may be more likely to monitor managerial performance and pursue active governance strategies compared to nonlocal investors. Moreover, the governance activities of local investors may be more effective than those of nonlocal investors since investors located near the firm can closely monitor management and take governance actions quickly in respond to management decisions.

2.3. Data and Descriptive Statistics

2.3.1 Data

Our sample consists of domestic block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5 percent of a target firm's outstanding shares, and then purchased more than 5 percent but less than 50 percent of its outstanding shares.

We exclude cases where either the acquirer or target firm is foreign. We also exclude the cases where targets are financial or regulated firms (SIC 6000-6999, 4000-4099, 4500-4599, and 4800-4899). We eliminated the cases where acquirers are investors groups in SDC since we cannot determine their location. Since we study the role of outside shareholders in corporate governance, we exclude all Employee Stock Ownership Plan and Employee Benefits Trust. Finally, to avoid the effect of outlier, we exclude cases in which target firms or acquirers are located in Alaska, Hawaii and Puerto Rico.

We require that the initial public announcement date of block share purchase be available in *Factiva* and use as the announcement date the date that a news announcement first appears in this publication. We also require that stock returns and financial data for target firms be available in the CRSP returns and COMPUSTAT tapes, respectively. These restrictions result in a final sample of 698 targets.

We obtain data on top executive, board of director, and managerial ownership of target firms from proxy statements and annual reports. These sources are examined during the holding period of block ownership up to three years after the acquisition. We

define the holding period as the period from the date when investors announces the acquisition of a target firm's block equity to the date when it decreases its holding in the target to less than 5 percent.

2.3.2 Descriptive Statistics

Figure1 shows the geographic distribution of our sample acquirers and targets across the continental United States. It shows that the distribution of our sample acquirers and targets resembles a plot of population by locations. Appendix I also shows the distribution of our sample acquirers and targets by states. New York has the highest frequency of acquirers (25.64 percent), followed by California (16.19 percent) and Texas (7.59 percent). Given the large number of acquirers from New York State in our sample, our main findings may be driven by these samples. Hence, we examine the robustness of our findings by replicating the key analyses excluding these samples and obtain results that are qualitatively similar to those reported in the paper.

Table 2.1 shows the distributions of the sample of 698 block acquisitions by target industry, year, and geographic proximity. In this paper, we use two spatial units of observation to capture the effect of geographic proximity on information asymmetry and monitoring costs of investors. First, as in the previous literature, we use physical distance between the investor and the firm as a measure of geographic proximity. Ivkovic and Weisbenner (2003) argue that the distance of 250 miles is a plausible upper bound on the span of local information since the distance of 250 miles is reachable with a daily round trip by car and local media coverage. Hence, we set the perimeter of locality at a distance

of 250 miles and regard all block acquisitions where the block acquirer and the target are within 250 miles of each other as local.

Second, we adopt the state as our primary measure of geographic proximity. The state may be a geographic boundary to information flows since investors located in the same state as the firm may have significant information advantages over investors located out of the state. Investors may derive some of their information about local firms from statewide information sources. For instance, local media, such as newspaper, radio, and TV stations, occasionally provide coverage of the local events within the state. In addition, investors within the same state as the firm are expected to have more information about state regulations that can influence corporate policy, performance, and even their governance activities¹¹. In this context, the state may capture an important information advantage of local investors and can be a measure of informational distance. In-state acquisitions are the cases in which the acquirer and the target are located in the same state. By contrast, out-of-state acquisitions are the cases in which the acquirer and the target are located in different states. Most of the targets are in manufacturing (53.4 percent), services (25.2 percent), and wholesale and retail trade (11.9 percent). The years 1996 and 1995 are the most active years of acquisition announcements with 113 (16.2 percent) and 100 (14.3 percent) cases, respectively.

We use SDC data to obtain the location of acquirer and target firms. We match this location data with the data from the U.S. Census Bureau's Gazetteers and Zip Code

¹¹ Audretsch and Feldman (1996) emphasize that the most relevant unit of policy-making is at the level of the state. In addition, Coffee (2004) argues that in the U.S., the regulatory energy for investor protection came from the state level rather than from the Security and Exchange Commission (SEC) (Federal Securities Law Reports). Therefore, state government and legal system, such as state courts and state legislature, may have an important influence on firms' operation and governance activities of investors.

Database to get latitude and longitude for acquirer and target firms. We use the standard formula for calculating the distance, $d_{i,j}$, between the acquirer and the target as follows:

$$d_{i,j} = \text{arc cos} \{ \cos(lat_i) \cos(lon_i) \cos(lat_j) \cos(lon_j) + \cos(lat_i) \sin(lon_i) \cos(lat_j) \sin(lon_j) + \sin(lat_i) \sin(lat_j) \} 2\pi/360,$$

where lat and lon are latitudes and longitudes of the acquirer and the target locations, respectively, and r denote the radius of the earth (approximately 6,378 kilometers).

Coval and Moskowitz (1999) gauge a bias toward to local stocks in terms of physical distance and show that on average, U.S. fund managers are located 1,654 kilometers from the company they hold while they are located 1,814 kilometers from potential holdings. They use the cross section of 1995 holdings data. Since their sample period overlaps with our sample period, we can compare the level of local bias of fund managers with that of large-block acquires. Table 2.2 shows that on average, large-block acquirers are 1,603 kilometers away from their target firms. If the large-block acquirers' distance from potential holdings is similar to that of fund managers, this result suggests that large-block acquirers may have a similar level of local bias as fund managers¹².

Following Kedia, Panchapagesan, and Uysal (2005), we estimate the expected probability that the target will be acquired by a firm within the same state. We assume that all public firms located within the same state as a target could be a potential acquirer. Hence, the fraction of all public firms that reside in a certain state relative to all public firms in the U.S. will be the target's expected probability of being acquired by firms in the same state. Specifically, for every transaction of block acquisition, we estimate this

¹² Our sample includes the cases where large-block acquirers are mutual fund managers. The total number of fund manager acquirers in our sample, however, is only 57. Four of them are in-state acquisitions and 53 of them are out-of-state acquisitions. Furthermore, our main findings are not affected when we exclude such cases from our analyses.

fraction of block acquisition in the year prior to the announcement. We obtain company headquarter data from COMPUSTAT. As shown in Table 2.2, the mean and median expected probability of being acquired by a firm located in the same state is 7.04 and 5.53 percent, respectively. The actual fraction of targets purchased by in-state acquirers in our sample, however, is 18.34 percent. Large shareholders are expected to have stronger incentives to acquire information about the firm and monitor managerial performance, relative to small individual shareholders. Therefore, our findings show that even such large shareholders exhibit a strong preference for geographically proximate companies.

Table 2.3 presents the summary statistics of target firms. We measure target characteristics at the fiscal year-end that comes immediately before the announcement of the acquisition of block shares. The mean and median sizes of the targets show statistical differences between the two groups: in-state and out-of-state acquisition. The mean (median) asset value of the targets of in-state acquisition is \$163.45 (\$29.35) million in comparison to \$345.98 (\$64.61) million for the targets of out-of-state acquisition. The mean and median equity ownership by managers (the sum of equity ownership by officers and directors) are significantly higher for the targets of in-state acquisition than for those of out-of-state acquisition. Therefore, large-block acquirers are likely to acquire target firms that are small and have high insider ownership when they choose local firms.

Leverage, operating income to asset, and Tobin's q , however, show no statistical difference between the two groups. Following Denis, Denis, and Sarin (1997), we define the CEO as the top executive of the firm. If a firm has no CEO, the chairman (or president if there is no chairman) is assumed to be the top executive of the firm. The mean and median ages of top executives are significantly younger in the targets of in-

state acquisition than out-of-state acquisition. The mean tenure of top executives is also significantly shorter in the targets of in-state acquisition than out-of-state acquisition, while the median of the two groups is not significantly different. The fraction of firms in which a chairman (founder) is the top executive is not significantly different between the two groups. We also find that in-state acquirers purchase a larger percentage of block shares than out-of-state acquirers (a median of 9.35 percent compared to 7.70 for out-of-state).

The difference in percent of shares acquired is significant at the 1 percent level. If firms with smaller size, higher insider ownership and top executive with younger age and shorter tenure have greater information asymmetry between local and nonlocal investors than other firms, these findings suggest that local investors choose the sorts of firms in which they may have significant information advantages and such information advantages would be most valuable (Coval and Moskowitz (1999), Malloy (2004), Ball, Kothari, and Robin (2000)).

In Table 2.4, we compare important transaction characteristics of in-state acquisition and those of out-of-state acquisition. Panel A of Table 2.4 presents summary statistics for holding periods of block ownership. Forty-four percent of in-state acquirers hold block shares for longer than three years in comparison to 30 percent for out-of-state acquirers. Although 43 percent of out-of-state acquirers hold block shares for less than one year, the corresponding number for in-state acquirers is only 27 percent. These differences in holding periods are significant at the 1 percent level, indicating that in-state acquirers tend to hold block ownership for a long period than out-of-state acquirers. These results are consistent with Coval and Moskowitz (2001), who show that fund managers trade far

more frequently in their remote holdings than in their local holdings. Bushee (1988) also shows that “dedicated” institutional investors have a long investment horizon while “transient” institutional investors have a short-term time horizon. In this context, our findings suggest that in-state acquirers may be “dedicated” investors, who adopt longer-term strategies and actively monitor management, while out-of-state acquirers may be “transient” investors, who have a short-term strategy and are therefore less likely to engage in governance activities in the firm.

Panel B of Table 2.4 summarizes the fractions of acquirers who indicate that the purchase of shares is for control purpose. It also shows the fraction of block-acquires who choose targets in the same industry and the fraction of those who are financial institutions or individual investors. We classify the acquisition as control purpose if the acquiring firm discloses in a filing of 13D that it seeks the control of the target. Five percent of all deals in both in-state and out-of-state acquisitions are with control purpose. In addition, 14 percent of in-state acquisitions and 15 percent of out-of-state acquisitions take place in the same industry. In addition, 66 percent of in-state acquirers are financial blockholders, while 60 percent of out-of-state acquirers are financial blockholders. These differences in the investment purpose and the type of investor are not significant between in-state and out-of-state acquisitions.

2.4. Geographic Proximity and Governance Activities

In this section, we examine the relation between geographic proximity and governance activities of large-block acquirers.

To explore a link between geographic proximity and corporate governance, we examine the effects of distance on the extent of governance activities of large-block acquirers. Specifically, we examine two important governance activities of large-block acquirers: board representation by large-block acquirers and nonroutine top executive turnover in target firms. Previous studies show that having outside directors on the board plays an instrumental role in improving internal governance systems in monitoring top management. Brickley and James (1987), Weisbach (1988), and Byrd and Hickman (1992), for example, show that independent outside directors protect the interests of shareholders when there are agency problems. Given that the board members represented by large-block acquirers are independent outside directors, they may play an important monitoring role in target firms.

In addition, we examine nonroutine top executive turnover since the removal of the top executive is considered to be one of the most aggressive governance actions taken by shareholders. For example, Denis, Denis, and Sarin (1997), Bethel, Liebesind, and Opler (1998), and Kang and Shivdasani (1995) document that outside blockholders play an important role in the process of top executive turnover.

We obtain the information about board representation and top executive turnover events from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for board representation by large-block acquirers and changes of top executives in target firms. Following Denis, Denis, and Sarin (1997), we refer to turnover events where the top executive is removed due to death, illness, or other non-governance related as routine turnover. We classify a management change as normal if the stated reason for the change is retirement and the

retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover.¹³

Table 2.5 summarizes director appointments by large-block acquirers and nonroutine top executive turnover during holding periods of block equity ownership. It shows that 46.1 percent (59 out of 128) of in-state block acquires are appointed as directors or have their representatives on the target's board, while only 27.5 percent (157 out of 570) of out-of-state acquirers do. Additionally, the fraction of new blockholder director on target's board for in-state acquisitions is 14.53 percent in comparison to only 6.80 percent for out-of-state acquisitions. The differences in the frequency of board representation by block acquirers between the two groups are significant at the 1 percent level. These findings indicate that in-state block acquires are more likely to intervene in the internal governance process of target firms than are out-of-state acquires.

Table 2.5 also shows that 43 percent (55 out of 128) of targets of in-state acquisition experience top executive turnover during the holding periods of block ownership up to three years after the initial purchase. By contrast, only 21.8 percent (123 out of 570) of targets of out-of-state acquisition experience top executive turnover. Thus, in-state acquirers are about two times as likely to be involved in removals of the top executive as are out-of-state large-block acquirers. When we estimate top executive turnover for three years regardless of their holding periods, 46 percent of targets of in-state large-block acquirers experience top executive turnovers while 32 percent of those of out-of-state acquirers experience top executive turnover.

¹³ We also employ an alternative definition of nonroutine turnover assuming that normal retirement takes place at any age above 60 or 64. Our results, however, are not sensitive to the definition of normal

2.4.1 Likelihood of Board Representation

In order to better understand the relation between geographic proximity and the likelihood of director appointment of block acquirers, we perform multivariate Tobit regressions.

As discussed above, we use the state and the local boundary as measures of geographic proximity. We include an indicator, which equals one if the acquirer and the target are located within the same state. We also include another indicator, which equals one if the acquirers and the target are within 250 miles of each other. To the extent that in-state or local acquirers bear lower transaction costs associated with their governance activities compared to remote acquirers, they will be more likely to engage in governance activities in target firms.

We control for important target characteristics that might affect the likelihood of the acquirer's governance activity.

Firm size is widely argued to be a useful measure of the rate of information diffusion. For example, Hong, Lim, and Stein (2000) argue that information about small firms gets out more slowly because investors who face fixed costs of information acquisition are willing to spend more resources to learn about a firm in which they can take large positions. Coval and Moskowitz (1999) find that investment managers exhibit a strong preference for locally headquartered firms, particularly small firms. In addition, Malloy (2004) shows that local analysts covering small stocks are significantly more accurate than other analysts. These findings suggest that the information advantage arising from geographic proximity is concentrated in small firms.

retirement.

Equity ownership by target managers can have an effect on the extent of information asymmetry between local and nonlocal investors. For instance, Ball, Kothari, and Robin (2000) show that information is likely to be communicated through private channels when ownership is concentrated. Thus, local acquirers' information advantages over remote acquirers are expected to be particularly significant when the target has higher managerial ownership because they have superior access to private information of the firm. On the other hand, managerial ownership can have an effect on the likelihood of the acquirer's governance activities because it could create a different level of agency problems in targets. For example, Jensen and Meckling (1976) argue that concentrated managerial ownership aligns the interests of managers with those of shareholders, thus minimizing the agency problem that arises from the separation of ownership and control. Stulz (1988), however, argues that concentrated managerial ownership can insulate managers from outside influence and thus leave them unconstrained.

Past performance can be related to the rate of information diffusion. Hong, Lim, and Stein (2000) show that negative information about the firm diffuses slowly across investors. Hence, firms with poor performance may have more information asymmetry than other firms and the effect of an information advantage of local investors is more likely to be pronounced in those firms. In addition, if operating performance is an indicator of managerial ability, governance activities of investors could be more valuable when the target has an inefficient management team.

To control for other important target characteristics, we also include leverage (total debt / market value of equity plus book value of debt), and Tobin's q (market value of equity plus book value of debt / book value of total assets).

The duration of block ownership may have an affect on the extent of information that investors can access to the firm. Investors with a long investment horizon can accumulate information about the firm over their holding periods and thus may have significant information advantages over those with a short investment horizon. Moreover, the holding periods can influence large shareholders' incentives to perform governance activities. For example, Demsetz and Lehn (1985) argue that large shareholders with long-term horizon have strong incentives to monitor management. Therefore, we include an indicator, which equals one if the holding period of block shares acquired by investors is longer than three years and zero otherwise.

We also include the percent of shares acquired. In their theoretical work, Shleifer and Vishny (1986) show that the optimal level of monitoring by large-block acquirers increases with the size of their equity ownership. Hence, we expect a positive relationship between the size of equity ownership acquired by large-block acquirers and the extent of their governance activities in target firms.

Audretsch and Feldman (1996a), Audretsch and Stephan (1996b), and Jaffe, Trajtenberg, and Henderson (1993) show that geographic proximity has an effect on innovative activity and knowledge spillovers in various industries. Further, Ellison and Glaeser (1997) show that industries tend to be concentrated because of cost advantages and industry-specific spillovers. These findings suggest that block acquirers who choose target firms in the same industry may have different investment incentives from other block acquirers, which can affect their governance activities in target firms. Thus, we include an indicator, which equals one if large-block acquirers purchase targets in the same industry (two-digit SIC codes) and zero otherwise.

Table 2.6 reports the results from Tobit regressions where the dependent variable is the fraction of directors affiliated with block acquirers on the target's board¹⁴. In the first three regressions, we use the state as a measure of geographic proximity and include a dummy for the same state. The coefficient on the same state dummy is positive and statistically significant at 1 percent level, indicating that the extent of board representation is greater for in-state block acquirers than out-of-state block acquirers.

In the second regression, we include target characteristics and in the third regression, we add transaction characteristics. The estimated coefficients on same state dummy are positive with *p*-values of 0.00. Thus, controlling for other factors, large-block acquirers are more likely to have board representation on target's board when they are located within the same state as targets. These findings suggest that the geographic proximity has a significant influence on large shareholders' incentives to perform an active role in the board of directors. The coefficients on the size of target firm are negative and significant at the 1 percent level. To the extent that firm size is positively related to the rate of information diffusion, this result suggests that large-block acquirers are more likely to have their representative on target's board when target firms have more information asymmetry. The percent of shares acquired is positive and significant at 1 percent level. This finding is consistent with theoretical work on the role of large shareholders by Shleifer and Vishny (1986)¹⁵. The coefficient on the dummy variable for the duration of block ownership is positive and statistically significant at 1 percent level, suggesting that large-block acquirers who hold target equity for a long period are more likely to provide board members to target firms. This finding is consistent with Demsetz and Lehn (1985),

who argue that blockholders with a long-term investment horizon have strong incentives to monitor management. The coefficient on Tobin's q is positive and significant at the 1 percent level. If Tobin's q is a proxy for growth opportunities, this result suggests that large-block acquirers are more likely to have their representatives on target's board when targets have higher growth opportunities.

In regressions (4) through (6), we use the dummy for local transaction as an alternative measure of geographic proximity. The estimated coefficients on this local dummy are positive and significant at least at the 5 percent level. These results are generally consistent with those of Lerner (1995), who finds that the distance between a venture capitalist and the firm is an important determinant of the board membership of venture capitalists in private biotechnology firms¹⁵. Our results, however, show that even for large shareholders in public firms, distance plays an important role in board representation decisions. The coefficients for other control variables are qualitatively similar to those in previous regressions using the same state dummy variable.

In the last regression, we include physical distance between the target and the acquirer. We find that the fraction of board representation by large-block acquirers is negatively related to their physical distance from the targets. The estimated coefficient on the log of distance between the acquirer and the target is negative and significant at the 1 percent level. To the extent that blockholders' monitoring costs increase with physical distance from the target, our findings suggest that monitoring costs and information

¹⁵ Kaplan and Minton (1994) also document that in the Japanese public firms, the probability of corporate director appointments increases with blockholder ownership.

¹⁶ Lerner (1995) shows that venture capital organizations located within five miles from a firm's headquarters are twice as likely to provide board members to the firm as those more than 500 miles away. Lerner argues that the transaction costs associated with frequent visits and intensive involvement prevent remote venture capitalist from actively participating in the governance activity in the firm.

asymmetry from geography are important determinants of their director appointment decisions.

2.4.2. Likelihood of Top Executive Turnover

Table 2.7 shows the results from logistic regressions where the dependent variable is one if nonroutine turnover occurs and zero otherwise. In addition to including all explanatory variables used in the previous regressions, we also control for other variables that may affect top executive turnover. Specifically, the regressions control for the age and tenure of the top executive, and also include a chairman dummy, which equals one if the top executive is the chairman of the board, as well as a founder dummy, which equals one if the top executive is the founder of the firm. We define founders as those who are described as founders in the proxy statement or the annual statement, or those who have held the position of top executive since the inception of the firm.

In the first three regressions, the coefficients on the same state dummy are again positive and significant at the 1 percent level, which suggests that in-state block acquirers play a more active role in the process of top management turnover compared to out-of-state acquirers. This result is also consistent with the view that investors located near the firm are more likely to engage in corporate governance activities in targets since they have significant advantages over distant investors because of an information advantage and lower monitoring costs.

In the second and third regressions, both operating income to total assets and Tobin's q of targets are negatively related to the probability of top executive turnover occurring, indicating that block acquirers are more likely to replace target management when targets

show bad operating performance or they have poor growth opportunities or inefficient management teams. The coefficient on the age of top management is positive and significant, suggesting that age may be an indicator that the top executive is close to retirement or to being removed due to normal management changes (Weisbach (1988)). The coefficient on the tenure of top management, however, is negative and insignificant. The dummy for the chairmanship of top management is negative and significant. This finding is consistent with Fama and Jensen (1983), who argue that the concentration of decision management and decision control in an individual reduces the effectiveness of the internal governance system in monitoring top management.

As in the result from board representation, the coefficients on the percent of shares purchased by acquirers and the duration of block ownership are positive and significant, indicating that nonroutine turnover is significantly more likely when the percent of shares purchased by acquirers is high and block acquirers hold target equity for a long period. Those acquirers who have large equity ownership with a long-term investment horizon may be better able to replace inefficient management because of their strong voting rights and accumulated information over holding periods. The dummy for board representation by the block acquirer is also positive and significant at the 1 percent level. Since the board members represented by large-block acquirers are independent outside directors, this result suggests that outside directors play an important governance role in the process of top management turnover (Weisbach (1988)). Finally, consistent with Stulz (1988), equity ownership by managers is negative and significant, which suggests that significant control by managers may prevent governance mechanisms from removing inefficient management teams.

In regressions (4) through (6), we use the dummy variable for local transaction instead of the same state dummy to estimate the effect of geographic distance on top management turnover. The estimated coefficients on the dummy for the local transaction are again all positive and statistically significant at the 1 percent level, indicating that block acquirers are more likely to replace target management when target firms are geographically proximate to them. These findings suggest that distance is an important determinant of the governance activities of large shareholders. The results for our other control variables are qualitatively similar to these from board representation

In regression (7), which uses the actual distance between the acquirer and the target, the probability of top management turnover is negatively and significantly related to this distance. If block acquirers' monitoring costs increase with the physical distance from targets, this finding supports the hypothesis that monitoring costs from geographic proximity are important determinants of the governance activities of large shareholders.

Overall, these results confirm those of the previous analysis for board representation and further suggest that information asymmetry and monitoring costs associated with geographic proximity affect incentives for large shareholders to undertake governance activities in target firms. Our results also suggest that deal-specific characteristics, such as chairmanship of top management, the holding period of block ownership, and the percent of shares purchased, have an effect on the extent of governance activities of large shareholders.

2.4.3. Marginal effects of geographic proximity

In order to gauge economic significance of geographic proximity, we calculate marginal effect of the same state and local dummy variable on the probability of governance activities. Table 2.8 presents the marginal effect of the same state and local dummy variable and other key variables from logistic regressions. The marginal effect of state or local dummy variables indicates the difference in the probability of governance activities between in-state or local block acquirers versus out-of-state or nonlocal block acquirers.

In Panel A of Table 2.8, we report marginal effect of the key variables on the likelihood of board representation by new block acquirers. The marginal effect of the same state dummy is 0.134, indicating that, after controlling target and transaction characteristics, the probability of director appointment is 13.4 percent higher when a new block acquirer comes from the same state as the target than when they comes from outside of the target's state. In comparison, the marginal effect of the dummy variable for block acquirers who are located within 205 miles of targets is 0.074, which indicates that probability of board representation by block acquirers increases by 7.4 percent when they are located within 250 miles of target firms. The marginal effect of the dummy variable for block acquirers who are located within 100 kilometers of targets, however, is statistically insignificant.

Panel B of Table 2.8 shows the marginal effect of the geographic proximity on the probability of nonroutine management turnover. The marginal effect of the same state dummy variable is 0.187, indicating that the probability of top management turnover in targets is about 18.7 percent greater for in-state acquirers compared to out-of-state

acquirers, which is greater than those of dummy variables for 250 miles and 100 kilometers, 11.8 and 14.9 percent. The results also show that those acquires serving as a director in target firms play an important role in the process of top management turnover. In the first regression, the marginal effect for the dummy of director appointment of block acquirers is 0.174, indicating that the probability of top management turnover increased by 17.4 percent when new block acquirers are appointed to target's board. There is also negative relationship between the likelihood of nonroutine management turnover and operating performance. Fifty percent drop in operating performance is associated with about 6 percent increase in the probability of nonroutine management turnover in target firms.

In sum, the effect of geographic proximity on the likelihood of governance activities in target firms seems to be both statistically and economically significant. Furthermore, the effect of state boundary appears to be more important than those of local boundary of 250 miles and 100 kilometers.

2.5 Geographic Proximity and Target performance

2.5.1 Announcement Effects

In this section, we examine the effect of geographic proximity on the value of target firms by analyzing the valuation effect of block ownership formation.

2.5.1.1 The Relation between Distance and Target Returns

To assess the valuation effect of block share formation, we compute abnormal returns using a standard event-study methodology. We obtain our estimates of the market model

by using 200 trading days of return data, beginning 220 days before and ending 21 days before the announcement of the block share purchase. We use as the market return the CRSP equally weighted return. We sum the daily abnormal returns to get the cumulative abnormal return (CAR) from day t_1 before the announcement date of the block share purchase to day t_2 after the announcement date of the block share purchase. We use the t -statistics to test the hypothesis that the average CARs are equal to zero, and the sign-rank test statistic to test the hypothesis that the CARs are distributed symmetrically around zero.

Table 2.9 reports the CARs for the targets of in-state and out-of-state block acquisitions for different event windows. Target firms earn, on average, statistically significant positive gains. This finding is consistent with that of Mikkelson and Ruback (1985), who document positive announcement returns for target firms who sell 5 percent or more of their equity stakes to other companies. The average CAR (-1, 1), CAR (-5, 5), and CAR (-10, 10) for the targets of in-state acquisitions are 9.3 percent, 13.3 percent, and 19.1 percent, respectively, and are significant at the 1 percent level. The corresponding CARs for the targets of out-of-state acquisitions are 7.3 percent, 8.7 percent, and 9.2 percent, respectively. They are also significant at the 1 percent level. The differences in mean CAR (-5, 5) and CAR (-10, 10) are statistically significant at the 5 percent level and 1 percent level, respectively, indicating that there are significant differences in the stock market reactions to announcements of block purchases. The difference in mean CAR (-1, 1), however, is not significant. The medians show a similar pattern. Following Allen and Phillips (2000), we use a 21-day (-10 to +10) interval

centered on the announcement dates of block acquisition in our analyses of announcement effects¹⁷.

Panel A of Table 2.10 reports CAR (-10, 10) for targets for subsamples categorized by distance between targets and block acquirers. The average (median) CAR (-10, 10) for targets located within 100 kilometers of block acquirers is 16.0 (11.2) percent. The average (median) CAR (-10, 10) decrease to 11.24 (8.54) percent when the target is located between 100 kilometers and 200 kilometers of the acquirer. They drop to 8.04 (7.03) percent when the distance is between 200 kilometers and 300 kilometers. The median CAR (-10, 10) for targets decrease to 6.86 percent when the distance is longer than 300 kilometers, while the average CAR (-10, 10) slightly increase to 9.85 percent. These average and median CARs for targets of block acquisitions located over 300 kilometers from the target are significantly different from those for the targets of block acquirers located within 100 kilometers of the target.

Coval and Moskowitz (1999, 2001) and Malloy (2002) define local investors as those who are located less than 100 kilometers from a firm's headquarters. Panel B of Table 2.10 summarizes CARs (-10, 10) for targets for subsamples categorized by the distance of 100 kilometers. It shows that the average (median) CAR (-10, 10) for targets of acquirers located within 100 kilometers of targets is 16.0 (10.95) percent in comparison to 9.87 (6.97) percent for those of acquirers located out of 100 kilometers of

¹⁷ Allen and Phillips (2000) focus on the case of corporate block acquirers. They argue that the stock market could know about the pending stake before it is announced and an announcement of this type event may not be reported until several days after the actual purchase. They report that CAR (-10, 10) for the targets of block acquisition is 9.1 percent, which is similar to the corresponding number of 9.2 percent for the targets of out-of-state acquisition in our sample.

targets. These differences in average and median CAR (-10, 10) are statistically significant at the 5 percent and 10 percent levels respectively.

Ivkovic and Weisbenner (2003) argue that the distance of 250 miles is a plausible thread of locality since the distance of 250 miles is reachable with a daily round trip by car and through local media coverage. Therefore, we classify CAR (-10, 10) by the distance of 250 miles (Panel C of Table 2.10). According to this classification of local transaction, the average (median) CAR (-10, 10) of local acquisitions is 14.91 (10.75) percent, while those of non-local acquisitions is 9.39 (5.33). In particular, the median CAR (-10, 10) for targets of local acquirers is about twice as large as that of nonlocal acquirers. The differences in mean and median CAR (-10, 10) between local and nonlocal acquisitions are significant at the 5 percent and 1 percent levels respectively.

Finally, we classify CAR (-10, 10) for targets by sample median distance. Panel D of Table 2.10 shows that the average (median) CAR (-10, 10) for targets of acquirers that reside shorter than the sample median distance from them is 13.30 (8.68) percent. The corresponding CAR for the targets of acquirers located longer than the sample median distance is 9.46 (5.73) percent. The differences between the two groups are statistically significant.

In sum, these findings indicate that target returns on average decrease as the distance between the target and the acquirer increase. They suggest that local investors have different abilities and objectives concerning corporate governance from nonlocal investors when they purchase large block ownership, which translates into different valuation effects in the stock market.

2.5.1.2 Cross-sectional Variation in Target Returns

Table 2.11 presents the estimates from multivariate regressions. All regressions are estimated using ordinary least squares (OLS). In the first regression, after controlling for important target and transaction characteristics, the coefficient on the dummy for the same state is positive and statistically significant at the 1 percent level, showing a coefficient of 0.079. Evaluating the estimated coefficient indicates that, all else constant, abnormal returns for the targets of in-state acquisitions are greater than those of out-of-state acquisitions by 7.9 percent. Therefore, the effect of geographic proximity on target returns is both statistically and economically significant. This result suggests that geographic proximity has an important effect on corporate valuation.

To more closely examine the role of geographic proximity on the value of target firms, we include interaction terms between the same state dummy and firm-specific variables that can gauge the extent of information asymmetry in target firms. In the second regression, the interaction between the dummy if the target's size is in the bottom 25 percent for the sample and the same state dummy is positive and statistically significant at the 1 percent level. This finding indicates that the firm size effect on the value of target firms is different between in-state and out-of-state acquisitions. To the extent that firm size is negatively related to the rate of information diffusion (Hong, Lim, and Stein (2000)), this result suggests that the effect of geographic proximity on firm value is concentrated in small firms for which local investors can exploit their information advantage.

In the third regression, the interaction between the dummy if target's equity ownership by managers is above the sample median and the same state dummy is positive

and statistically significant at the 1 percent level, with a coefficient of 0.165. If information is likely be communicated through private channels when ownership is concentrated (Ball, Kothari, and Robin (2000)), this finding suggests that in-state acquirers' information advantages would be magnified among target firms that have high insider ownership since they may have informal sources of information about local firms. Alternatively, if concentrated managerial ownership can insulate managers from outside, this result suggests that the stock market anticipates the increase in monitoring by new block acquirers in those firms.

In the fourth regression, the interaction between the dummy if target's operating income to total assets is in the bottom 25 percent for the sample and the same state dummy is positive and significant at the 10 percent level. There are two possibilities for this result. First, if negative information about the firm diffuses slowly across investors and thus firms with poor performance have more information asymmetry (Hong, Lim, and Stein (2000)), the effect of an information advantage of in-state acquirers is most likely to be pronounced in those firms. Second, if operating performance is an indicator of managerial ability, the result suggests that monitoring of in-state acquirers could be more valuable when the target has inefficient management teams.

If the stock market takes acquirers' value-enhancing governance activities for target firms into account when assessing the market values of targets, we would expect the returns to targets to be related to these activities. In the fifth regression, we include the interaction between the same state and the dummy indicating that the acquirer is appointed to the target's board or the top executive of the target is replaced following block share purchases. The coefficient on the interaction variables is positive and

statistically significant at the 10 percent level. This finding, coupled with the positive relation between the same state dummy and the likelihood of governance activity in the previous analyses, supports the hypothesis that in-state acquirers who have advantages in terms of information acquisition and monitoring costs are more likely to engage in governance activities in target firms and the stock market anticipates the increase in the governance activities of in-state acquirers and views it favorably.

In the sixth regression, the coefficient on the interaction between the same state dummy, small size dummy and the governance activity dummy is positive and significant. The coefficient of 0.260 indicates that small target firms acquired by firms located in the same state realize 26 percent higher returns than other targets when governance activities of in-state acquirers are expected in target firms. This finding suggests that the stock market anticipates that in-state block acquirers play an important governance role in target firms for which information asymmetry between in-state and out-of-state acquirers may be largest.

In the seventh and eighth regressions, we use the local transaction dummy as an alternative measure of geographic proximity. In the seventh regression, the coefficient on the local transaction dummy is positively related to the target returns. In the last regression, the interaction between the dummy if target's size is in the bottom 25 percent for the sample and the local dummy is positive and statistically significant. These results confirm those of the previous analysis using the state as a measure of geographic proximity and further suggest that geographic proximity is an important determinant of target returns.

In the last regression, the interaction between the same industry dummy and the same state dummy is negative and statistically insignificant, indicating that the effect of geographic proximity is not different between same industry and different industry block acquisitions. To the extent that same industry transactions are likely to have more geographic synergies such as cost saving and industry-specific spillovers than different industry transactions (Audretsch and Feldman (1996a,b), Trajtenberg, and Henderson (1993)), this finding suggests that positive abnormal returns for the targets of in-state acquisitions are unlikely to be explained by synergies associated with geographic proximity.

Overall, our results show that geographically proximate target firms realize higher announcement returns particularly when they are small, have poor past performance, or have higher insider ownership. These findings are consistent with those of previous studies. For example, Coval and Moskowitz (2001) and Malloy (2002) document that the effect of geographic proximity is concentrated in small stocks and stocks with poor past returns. Therefore, to the extent that small firms, firms with concentrated ownership structures and firms with poor performance are those where geographically proximate shareholders have superior access to information and where such information would be most valuable, our results show that the effect of geographic proximity on corporate valuation is magnified in those firms.

2.5.1.3 Changes in Operating Performance

In this section, we examine the change in operating performance of target firms following the acquisition of block ownership. Table 2.12 reports industry-adjusted

percentage changes in operation income to total assets by the geographic proximity. It shows that the targets of in-state acquisitions exhibit insignificant increases in mean and median industry-adjusted operating income to total assets during the (-1,+3), (-1,+4), and (-1,+5) years. By contrast, targets of out-of-state acquisitions show statistically significant decreases in mean industry-adjusted operating income to total assets during the (-1,+3) and (-1,+4) years. The differences between the two groups, however, are insignificant. In the last two rows of the table 2.11, we calculate average performance of targets for three years and five years following the acquisition of block ownership. We examine whether these average operating performance improve relative to one year before the block purchase. The targets of out-of-state acquisitions exhibit significant decreases in the average of industry-adjusted operating performance for three and four years following block share purchases, while the targets of in-state acquisitions do not show significant changes.

Table 2.13 reports the regression estimates. The dependent variable is the change in average of post-acquisition operating performance for three years following the block purchase relative to one year before ($\text{Mean (Years } +1, +2, +3) - (\text{Year } -1)$). Allen and Phillips (2000) document that target firms forming an alliance or joint venture with block acquirers experience subsequent increases in operating performance and investment. Therefore, we include an indicator, which equals one if the block acquirer forms an alliance or joint venture with the target and zero otherwise¹⁸.

In the first regression, the coefficient on the dummy for the same state is positive and statistically significant at the 10 percent level. The coefficient on the dummy for the same

state is 0.079, indicating that industry-adjusted changes in operation performance for the targets of in-state acquisition is greater than that of out-of-state acquisition by 7.9 percent. Target size is positively related to the change in post-acquisition operating performance, which suggests that in general large firms improve their operating performance after a block share purchase. The coefficients on operating income to total assets, and Tobin's q are positive and significant at the 5 percent level. These results indicate that firms with good past performance and high growth opportunities or efficient management teams improve their operating performance following the block share purchases of outside investors.

In the second regression, the interaction between the dummy if target's size is in the bottom 25 percent for the sample and the same state dummy is positive and statistically significant at the 5 percent level, suggesting that the effect of geography on operating performance is more pronounced in small firms. In the third regression, the interaction between the dummy if the target's operating income to total assets is in the bottom 25 percent for the sample and the same state dummy is positive and significant at the 10 percent level. These findings suggest that there may be a significant interaction between the effect of geographic proximity and the extent of information asymmetry in the firm. When we include above two interactions in the model, the interaction between small size and the state is still positive and significant while the interaction between low operating performance and the same state is not statistically significant any more.

In sum, our results show that compared to targets of out-of-state acquisitions, those of in-state acquisitions realize higher post-acquisition operating performance and these

¹⁸ We search *Factiva* for information whether they make any type of formal alliance such as strategic agreement, business alliance, or joint venture for three years prior to and subsequent to the announcement

effects are strong among target firms that are smaller and have worse past performance. These results confirm those from the announcement effects and further suggests that the effect of geographic proximity on operating performance is concentrated in small firms and firms with bad past performance.

2.6 Summary and Conclusion

This paper documents a link between geographic proximity and corporate governance. Using a sample of 698 partial acquisitions in the U.S. during the period of 1990-1999, we find that geographically proximate acquirers are more likely to be involved in governance activities in target firms than are remote acquirers. Large-block acquirers are more likely to be appointed to the target's board and replace target management following block share purchases when they are located within the same state as targets and the acquirer and the target are within 250 miles of each other. In addition, targets of such acquirers experience higher abnormal announcement returns and post-acquisition operating performance than those of other acquirers. Furthermore, these effects are particularly strong when target firms are small, have poor past performance, or have higher insider ownership. We also find that block shareholders have strong preference for locally located firms. The fraction of targets acquired by a firm located in the same state is 18.34 percent. By contrast, the mean and median expected probability of being acquired by a firm located in the same state is only 7.04 and 5.53 percent, respectively.

Our findings suggest that geographically proximate investors may have significant advantages in terms of their governance activities over remote investors and their

date of block share purchases.

governance activities affect the value of the firm. Specifically, local investors may acquire information about the firm with lower costs and bear lower monitoring costs compared to distant investors. These comparative advantages allow local investors to perform more active governance activities in targets. Consistent with this view, the effect of geographic proximity on firm value is particularly strong among the firms that are small, have high insider ownership, or have poor past performance for which the information asymmetry between local and nonlocal investors may be largest and thus information advantage of local investors would be most pronounced. In addition, the likelihood of governance activities of block acquirers is negatively related to the physical distance from the target, supporting the view that monitoring costs associated with distance is an important determinant of their governance activities.

Our results provide an important dimension to the role of geography in facilitating governance activities. Previous literature has focused on the role of geography in determining portfolio selection from the perspective of investors. This paper, however, shows that geography may have real effects on the value and operating performance of the firm through the governance activities of local investors.

APPENDIX 2
TABLES AND FIGURES OF ESSAY 2

Figure 2.1

Distribution of Block-Acquirers and Target Firms Across the U.S.

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico.

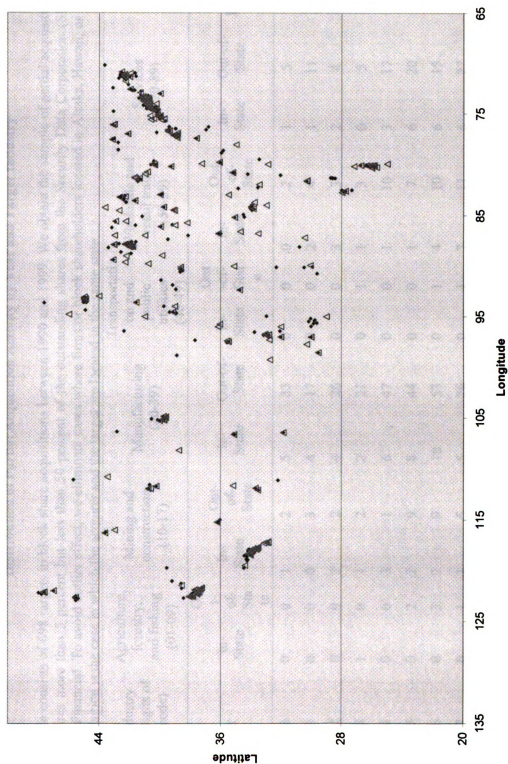


Table 2.1
Distribution of Partial Acquisition Activity by Year and Target Industry

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. In-state acquisition is the case in which the acquirer and the target are located in the same state.

Target industry (first two digits of the SIC code)	Agriculture, forestry, and fishing (01-09)		Mining and construction (10-17)		Manufacturing (20-39)		Transportation and public utilities (40-49)		Wholesale and retail trade (50-59)		Services (70-89)		Total
	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	
Year	Out of State		Out of State		Out of State		Out of State		Out of State		Out of State		Out of State
	In-State	Out of State	In-State	Out of State	In-State	Out of State	In-State	Out of State	In-State	Out of State	In-State	Out of State	
1990	0	0	1	2	5	33	0	0	0	2	1	5	42
1991	0	0	0	3	4	17	0	0	2	4	1	11	35
1992	0	0	2	2	4	26	0	0	3	3	2	4	35
1993	1	0	1	2	2	21	0	1	1	3	0	5	35
1994	0	0	3	1	6	47	0	0	1	10	3	17	77
1995	0	2	2	9	8	44	0	0	1	7	6	20	83
1996	0	3	2	9	10	53	0	1	4	10	6	15	91
1997	0	1	1	5	5	26	0	1	7	11	6	27	72
1998	0	0	2	2	5	22	0	0	2	6	5	16	46
1999	0	1	2	2	5	23	0	2	2	7	4	19	54
Total	1	7	16	37	54	319	0	5	23	60	37	139	570

Table 2.2
Extent of Local Bias

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. The expected probability of being acquired by a firm located in the same state is the fraction of all public firms that reside in a certain state relative to all public firms in the U.S. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. In-state acquisition is the case in which the acquirer and the target are located in the same state.

Distance	
Total sample	
Mean	1603.28
Median	1322.04
Sample of in-state block acquisition	
Mean	139.50
Median	36.57
Sample of out-of-state acquisition	
Mean	1937.80
Median	1708.95
The fraction of targets acquired by a firm located in the same state (%)	18.34
Expected probability of being acquired by a firm in the same state (%)	
Mean	7.04
Median	5.53

Table 2.3
Descriptive Statistics for Target Firms

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. In-state acquisition is the case in which the acquirer and the target are located in the same state. The numbers in the test-of-difference columns denote *p*-values for the two-tailed test.

Variables	Total N=698			In-State Acquisition (A) N=128			Out-of-State Acquisition (B) N=570			Test of Difference	
	Mean	Median		Mean	Median		Mean	Median		t-test	Wil- Coxon Z-test
<i>Book value of asset (in millions of dollar)</i>	312.51	57.21		163.45	29.35		345.98	64.61		0.01	0.00
<i>Equity ownership by managers (officers and directors)</i>	0.23	0.17		0.27	0.25		0.22	0.16		0.00	0.00
<i>Leverage (total debt / market value of equity plus book value of debt)</i>	0.24	0.17		0.23	0.15		0.24	0.17		0.55	0.60
<i>Operating income / total assets</i>	-0.09	0.02		-0.14	0.00		-0.08	0.03		0.24	0.17
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	1.922	1.16		2.21	1.31		1.86	1.15		0.16	0.15
<i>Age of top executive</i>	51.53	51.00		49.83	49.00		51.91	52.00		0.02	0.02
<i>Tenure of top executive</i>	6.13	4.00		5.21	4.00		6.34	4.00		0.05	0.18
<i>Fraction of firms with a chairman as the top executive</i>	0.61	-		0.59	-		0.61	-		0.65	-
<i>Fraction of firms with a founder as the top executive</i>	0.20	-		0.23	-		0.20	-		0.45	-
<i>Percent of shares acquired</i>	12.52	8.00		14.85	9.35		12.00	7.70		0.01	0.00

Table 2.4
Frequency of Holding Periods and Acquisitions with Control Purpose

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. In-state acquisition is the case in which the acquirer and the target are located in the same state. We classify the acquisition as control purpose if the acquiring firm discloses in a filing of 13D that it seeks the control of the target. The numbers in parentheses are the percentages of observations.

Panel A: Holding Periods of Block Ownership by the Location of Acquirer and the Target				
Holding period	In-State Acquisition (A)	Out-of-State Acquisition (B)	Test of Difference (A-B)	
Less than one year	N=128 35 (27)	N=570 246 (43)	0.00	
Longer than one but less than two years	24 (19)	92 (16)	0.47	
Longer than two but less than three years	13 (10)	60 (11)	0.90	
Longer than three years	56 (44)	170 (30)	0.00	
Panel B: Acquisitions with Control Purpose, Same Industry, Financial Investors by the Location of Acquirer and the Target				
	In-State Acquisition (A)	Out-of-State Acquisition (B)	Test of Difference (A-B)	
Acquiring firms who announce control purpose	N=128 7 (5)	N=570 26 (5)	0.66	
Acquiring firms who are in the same industry (two digit SIC)	18 (14)	84 (15)	0.85	
Acquiring firms who are financial institutions or individual investors (SIC 600-700)	85 (66)	341 (60)	0.17	

Table 2.5

Frequency of Board Representation and Nonroutine Top Executive Turnover by Distance between Acquirer and Target

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. In-state acquisition is the case in which the acquirer and the target are located in the same state. Board representation of acquirers and nonroutine top executive turnover events are identified from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for board representation by large-block acquirers and changes of presidents, chairmen, and CEOs. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. We refer to turnover events where the top executive is removed due to death, illness, or other normal reasons as routine turnover. We classify a management change as normal if the stated reason for the management change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover. The number in parentheses is the percentage of observations. The numbers in the test-of-difference columns denote p -values for the two-tailed test.

	Total	In-State Acquisition (A)	Out-of-State Acquisition (B)	Test of Difference (A-B)
	N=698	N=128	N=570	
Acquirer firms having board representation on the board of target during holding period of block ownership	216 (30.9)	59 (46.1)	157 (27.5)	0.00
Board representation ratio on the board of target by block acquirer during holding period of block ownership	(8.23)	(14.53)	(6.80)	0.00
Target firms experiencing nonroutine top executive turnover during holding period of block ownership up to three years after block share purchase	178 (25.8)	55 (43.0)	123 (21.8)	0.00
Target firms experiencing nonroutine top executive turnover for three years after block shares purchase regardless of their holding periods	244 (35.3)	59 (46.1)	180 (32.0)	0.00

Table 2.6

Tobit Regression Estimates of the Fraction of Board Representation by Block Acquirers

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. Board representation by acquirers is identified from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for board representation by large-block acquirers. The dependent variable is the fraction of directors affiliated with block acquirers on the target's board. *P*-values are in parentheses.

Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>Acquirer and target are in a same state (dummy)</i>	0.197 (0.00)	0.161 (0.00)	0.088 (0.00)				
<i>Acquirer is located within 250 miles of target (dummy)</i>				0.114 (0.00)	0.082 (0.03)	0.063 (0.03)	
<i>Log of distance between acquirer and target</i>							-0.015 (0.00)
Target Characteristics							
<i>Log of book value of asset</i>		-0.042 (0.00)	-0.024 (0.00)		-0.045 (0.00)	-0.025 (0.01)	-0.025 (0.01)
<i>Equity ownership by managers (officers and directors)</i>		0.199 (0.04)	-0.039 (0.58)		0.206 (0.03)	-0.041 (0.57)	-0.044 (0.54)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>		0.295 (0.00)	0.057 (0.36)		0.295 (0.00)	0.051 (0.40)	0.050 (0.41)
<i>Operating income / total assets</i>		-0.011 (0.77)	0.055 (0.11)		-0.0184 (0.64)	0.050 (0.19)	0.050 (0.20)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>		0.012 (0.06)	0.018 (0.00)		0.012 (0.08)	0.018 (0.00)	0.018 (0.00)
Transaction Characteristics							
<i>Holding period of block shares is longer than three years (dummy)</i>			0.158 (0.00)			0.161 (0.00)	0.156 (0.00)
<i>Percent of shares acquired</i>			0.017 (0.00)			0.017 (0.00)	0.017 (0.00)
<i>Acquirer and target are in the same industry (dummy)</i>			-0.001 (0.99)			-0.003 (0.94)	-0.004 (0.91)
<i>Intercept</i>	-0.213 (0.03)	-0.173 (0.01)	-0.357 (0.00)	-0.211 (0.00)	-0.162 (0.03)	-0.362 (0.00)	-0.238 (0.00)
Pseudo R ²	0.0355	0.0822	0.3743	0.0144	0.0633	0.3689	0.3733
No. of observations	698	697	697	698	697	697	697

Table 2.7
Logit Regression Estimates of the Likelihood of Nonroutine Top Executive Turnover

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. In-state acquisition is the case in which the acquirer and the target are located in the same state. Nonroutine top executive turnover events are identified from proxy statements and annual reports. For the holding period up to three years after the formation of block shares, we search these sources for changes of presidents, chairmen, and CEOs. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. We refer to turnover events where the top executive is removed due to death, illness, or other normal reasons as routine turnover. We classify a management change as normal if the stated reason for the management change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover. The dependent variable is one if nonroutine turnover occurs and zero otherwise. *P*-values are in parentheses.

Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>Acquirer and target are in a same state</i> (dummy)	0.992 (0.00)	1.050 (0.00)	0.888 (0.00)				
<i>Acquirer is located within 250 miles of target</i> (dummy)				0.569 (0.00)	0.605 (0.00)	0.586 (0.01)	
<i>Log of distance between acquirer and target</i>							-0.097 (0.02)
Target Characteristics							
<i>Log of book value of asset</i>		-0.027 (0.69)	0.033 (0.66)		-0.042 (0.54)	0.032 (0.67)	0.020 (0.79)
<i>Equity ownership by managers (officers and directors)</i>		0.054 (0.92)	-1.032 (0.08)		0.070 (0.89)	-1.035 (0.09)	-1.026 (0.09)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>		0.306 (0.48)	-0.669 (0.18)		0.319 (0.45)	-0.705 (0.16)	-0.691 (0.16)
<i>Operating income / total assets</i>		-0.883 (0.00)	-0.788 (0.02)		-0.839 (0.00)	-0.752 (0.03)	-0.758 (0.03)

<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	-0.128 (0.03)	-0.141 (0.02)	-0.117 (0.04)	-0.133 (0.03)	-0.131 (0.03)
<i>Age of top executive</i>	0.026 (0.02)	0.031 (0.01)	0.024 (0.03)	0.029 (0.01)	0.029 (0.02)
Tenure of top executive	-0.010 (0.52)	-0.017 (0.34)	-0.013 (0.39)	-0.018 (0.30)	-0.018 (0.30)
<i>Top executive is a chairman (dummy)</i>	-0.399 (0.04)	-0.412 (0.06)	-0.407 (0.03)	-0.432 (0.04)	-0.425 (0.05)
<i>Top executive is a founder (dummy)</i>	0.087 (0.72)	0.221 (0.41)	0.088 (0.72)	0.229 (0.39)	0.225 (0.40)
Transaction Characteristics					
Holding period of block shares is longer than three years (dummy)		0.907 (0.00)		0.912 (0.00)	0.899 (0.00)
Percent of shares acquired		0.064 (0.00)		0.064 (0.00)	0.063 (0.00)
Acquirer and target are in the same industry (dummy)		0.214 (0.44)		0.200 (0.46)	0.180 (0.51)
<i>Acquirer is appointed to the target's board (dummy)</i>		0.700 (0.00)		0.689 (0.00)	0.715 (0.00)
<i>Intercept</i>	-1.274 (0.00)	-2.194 (0.00)	-1.239 (0.00)	-2.007 (0.00)	-2.709 (0.00)
Pseudo R ²	0.0285	0.0592	0.0119	0.1994	0.1973
No. of observations	691	690	691	690	690

Table 2.8
Marginal Effects of Key Variables on the Likelihood of Governance Activities

This table reports the marginal effects of key variables from the logit analyses of board representation by block acquirers and nonroutine top management turnover in target firms. For the dummy variables the marginal effect indicates the difference between having the characteristic versus not having the characteristic. For the continuous variables the marginal effect is evaluated at the mean of the explanatory variables and indicated the change in the probability when each independent variable changes by one unit from its sample mean. In Panel A, the logit regressions include an intercept, log of book value of asset, equity ownership by managers, leverage, Tobin's q, and same industry (dummy) in addition to the variables reported in the table. In Panel B, the logit regressions include an intercept, log of book value of asset, equity ownership by managers, leverage, Tobin's q, and same industry (dummy), tenure of top executive, chairmanship and founder (dummy) in addition to the variables reported in the table.

Panel A: The Likelihood of Board Representation by Block Acquirers			
Independent variables	(1)	(2)	(3)
<i>Acquirer and target are in a same state (dummy)</i>	0.134		
<i>Acquirer is located within 250 miles of target (dummy)</i>		0.074	
<i>Acquirer is located within 100 kilometers of target (dummy)</i>			0.076
Percent of shares acquired	0.024	-0.025	-0.025
<i>Operating income / total assets</i>	0.026	0.023	0.023
Mean dependent variable	0.308	0.308	0.308
No. of observations	697	697	697

Panel B: The Likelihood of Nonroutine Top Executive Turnover			
Independent variables	(1)	(2)	(3)
<i>Acquirer and target are in a same state (dummy)</i>	0.187		
<i>Acquirer is located within 250 miles of target (dummy)</i>		0.118	
<i>Acquirer is located within 100 kilometers of target (dummy)</i>			0.149
Percent of shares acquired	0.010	0.010	0.010
<i>Operating income / total assets</i>	-0.128	-0.123	-0.123
<i>Acquirer is appointed to the target's board (dummy)</i>	0.174	0.182	0.182
Mean dependent variable	0.257	0.257	0.257
No. of observations	690	690	690

Table 2.9
Cumulative Abnormal Returns (CARs) for Targets around the Announcement Date

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. We obtain the initial public announcement date of the acquisition from the *Dow Jones Newswire*. We compute abnormal returns using the market model. We estimate the market model by using 200 trading days of return data ending 21 days before the acquisition announcement. We use as the market return the CRSP equally weighted return. In-state acquisition is the case in which the acquirer and the target are located in the same state. The numbers in the test-of-difference columns denote *p*-values for the two-tailed test.

Event windows	In-State Acquisition N=128		Out-of-State Acquisition N=570		Test of Difference (A - B)	
	Mean	Median	Mean	Median	Mean	Median
CAR (-1, 0)	0.060	0.022	0.051	0.020	0.49	0.45
CAR (-1, 1)	0.093	0.057	0.073	0.040	0.19	0.22
CAR (-5, 5)	0.133	0.103	0.087	0.051	0.03	0.01
CAR (-10, 10)	0.191	0.119	0.0918	0.069	0.00	0.01
CAR (-20, -2)	0.070	0.022	0.050	0.030	0.42	0.98
CAR (2, 20)	0.024	-0.004	-0.018	-0.017	0.05	0.22
CAR (-20, 20)	0.186	0.109	0.104	0.080	0.05	0.28

Table 2.10

Mean and Median Cumulative Abnormal Returns [CAR (-10, 10)] for Targets for Subsamples Categorized by Distance Between Targets and Block Acquirers

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. The numbers in parentheses are the percentages of observations. The numbers in the test-of-difference rows denote *p*-values for the two-tailed test.

Panel A: CAR (-10.10) by Classification of Sample by Distance Range

Distance Range	No. of Firms	Mean CAR (-10,10):	Median CAR (-10,10):
0 - 100 km (I)	128 (18.3)	16.00	10.95
100 km - 200 km	25 (3.6)	11.24	8.54
200 km - 300 km	14 (2.0)	8.04	7.03
> 300 km (II)	531 (76.1)	9.85	6.86
Test of Difference (I-II)			
t-test		0.04	0.07
Wilcoxon z-test			

Panel B: CAR (-10.10) by Classification of Sample by 100 km

Shorter (<100 Kilometers)	128 (18.3)	16.00	10.95
Longer (>100 Kilometers)	570 (81.7)	9.87	6.97
Test of Difference			
t-test		0.04	0.08
Wilcoxon z-test			

Panel C: CAR (-10.10) by Classification of Sample by 250 mile				
Shorter (<250 Miles)	202 (28.9)	14.91	10.75	
Longer (>250 Miles)	496 (71.1)	9.39	5.33	
Test of Difference				
t-test				
	Wilcoxon z-test	0.03	0.01	
Panel D: CAR (-10.10) by Classification of Sample by sample median distance				
Below sample median	349 (50.0)	13.30	8.68	
Above sample median	349 (50.0)	9.46	5.73	
Test of Difference				
t-test				
	Wilcoxon z-test	0.04	0.10	

Table 2.11
OLS Regression of Cumulative Abnormal Returns (-10, 10) for Targets

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. We obtain the initial public announcement date of the acquisition from the *Dow Jones Newswire*. We compute abnormal returns using the market model. We estimate the market model by using 200 trading days of return data ending 21 days before the acquisition announcement. We use as the market return the CRSP equally weighted return. *P*-values are in parentheses.

Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<i>Acquirer and target are in the same state (dummy): a</i>	0.079 (0.01)	0.020 (0.58)	-0.011 (0.80)	0.046 (0.18)	0.049 (0.14)	0.018 (0.63)			0.083 (0.01)
<i>Target size (log of book value of asset)</i>	-0.005 (0.53)		-0.006 (0.45)	-0.015 (0.07)	-0.005 (0.51)		-0.006 (0.48)		-0.005 (0.53)
<i>Target's sizes is in the bottom 25 percent (dummy): b</i>		-0.033 (0.31)				-0.014 (0.68)		-0.024 (0.49)	
<i>a*b</i>		0.189 (0.00)				0.118 (0.11)			
<i>Target's equity ownership by managers is above median (dummy): c</i>			0.005 (0.84)						
<i>a*c</i>			0.165 (0.00)						
<i>Target's operating income / total assets is in the bottom 25 percent (dummy): d</i>				-0.034 (0.31)					
<i>a*d</i>				0.118 (0.07)					
<i>Acquirer is appointed to the target's board or top executive of target is replaced during holding period of block ownership (dummy): e</i>					-0.029 (0.51)	0.008 (0.88)			
<i>a*e</i>					0.124 (0.08)	0.002 (0.99)			
<i>b*e</i>						-0.118 (0.18)			

Table 2.12
Change in Industry-adjusted Ratio of Operating Income to Assets Following Block Share Purchase

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. The changes are percentage changes in operation income to total assets by the geographic proximity. In-state acquisition is the case in which the acquirer and the target are located in the same state. The numbers in parentheses are the percentages of observations. The numbers in the test-of-difference columns denote *p*-values for the two-tailed test.

	In-State Acquisition				Out-of-State Acquisition				Test of Difference (A-B)	
	N=128				N=570					
	Raw Change		Industry-Adjusted Change (A)		Raw Change		Industry-Adjusted Change (B)		t-test	Wil-Coxon Z-test
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Change (year-1, year +1)	-0.015	-0.027	-0.005	-0.032	-0.059	-0.016	-0.045	-0.007	0.37	0.63
Change (year -1, year +2)	-0.004	-0.010	0.011	-0.014	-0.052	-0.015	-0.034	-0.005	0.46	0.93
Change (year -1, year +3)	0.017	0.001	0.044	0.023	-0.097	-0.017	-0.072	0.005	0.11	0.20
Change (year -1, year +4)	0.027	0.002	0.053	0.026	-0.092	-0.030	-0.063	0.003	0.11	0.29
Change (year -1, year +5)	0.071	0.008	0.094	0.0185	-0.116	-0.018	-0.041	0.009	0.14	0.42
Mean (years +1, +2, +3) – Year (-1)	-0.012	-0.021	0.008	-0.020	-0.077	-0.028	-0.058	-0.009	0.16	0.98
Mean (years +1, +2, +3, +4, +5) – Year (year -1)	-0.007	-0.016	0.014	-0.018	-0.087	-0.028	-0.059	-0.011	0.16	0.88

Table 2.13
OLS Regression of Operating Performance Changes

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico. The changes are industry-adjusted percentage changes in operation income to total assets by the geographic proximity. In-state acquisition is the case in which the acquirer and the target are located in the same state. The dependent variable is Mean (Years +1, +2, +3) - (Year -1).

Independent variables	(1)	(2)	(3)	(4)
<i>Acquirer and target are in the same state (dummy): a</i>	0.079 (0.10)	0.008 (0.88)	0.027 (0.62)	-0.017 (0.78)
<i>Target's sizes is in the bottom 25 percent (dummy): b</i>		-0.218 (0.00)		-0.218 (0.00)
<i>a* b</i>		0.216 (0.04)		0.178 (0.09)
<i>Target's operating income / total assets is in the bottom 25 percent (dummy): c</i>			-0.124 (0.03)	-0.101 (0.07)
<i>a* c</i>			0.186 (0.09)	0.137 (0.22)
Target Characteristics				
<i>Target Size (log of book value of asset)</i>	0.032 (0.02)		0.033 (0.02)	
<i>Equity ownership by managers (officers and directors)</i>	0.103 (0.34)	0.099 (0.33)	0.116 (0.28)	0.112 (0.27)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>	0.090 (0.32)	0.115 (0.19)	0.078 (0.40)	0.103 (0.24)
<i>Operating income / total assets</i>	0.140 (0.02)	0.117 (0.05)		
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	0.021 (0.02)	0.022 (0.01)	0.019 (0.03)	0.020 (0.02)

Transaction Characteristics

Percent of shares acquired

Acquirer and target are in the same industry (dummy)

Acquirer makes formal alliance with target (dummy)

Intercept

	0.001 (0.63)	0.001 (0.67)	0.001 (0.83)	0.001 (0.79)
	-0.008 (0.88)	-0.020 (0.72)	-0.001 (0.97)	-0.015 (0.78)
	0.078 (0.17)	0.080 (0.16)	0.083 (0.15)	0.082 (0.15)
	-0.288 (0.00)	-0.107 (0.02)	-0.264 (0.00)	-0.085 (0.07)
Adjusted R^2	0.0254	0.0405	0.0241	0.0385
F-value	2.79	3.62	2.53	3.25
No. of observations	620	620	620	620

APPENDIX B

Appendix B
Distribution of Block-Acquirers and Target Firms by States

The sample consists of 698 targets in block share acquisitions between 1990 and 1999. We obtain the sample of partial acquisitions in which the firm acquires more than 5 percent but less than 50 percent of the outstanding shares from the Security Data Corporation (SDC) Platinum of Thomson Financial. To avoid outlier effect, we eliminate cases where firms or block shareholders located in Alaska, Hawaii, or Puerto Rico.

State of Block-Acquirer	No. of block purchases (A)	No. of In-State block purchases (B)	Actual Probability of being acquired locally (B/A)	Expected Probability of being acquired locally
Alabama	3	0	0.00	0.64
Arizona	7	2	28.57	1.40
Arkansas	1	0	0.00	0.40
California	113	37	32.74	15.69
Colorado	14	2	14.29	2.92
Connecticut	26	1	3.85	2.62
Delaware	6	0	0.00	0.41
D. of Columbia	11	0	0.00	0.33
Florida	25	4	16.00	5.29
Georgia	10	1	10.00	2.51
Idaho	4	0	0.00	0.22
Illinois	38	3	7.90	4.12
Indiana	6	0	0.00	1.35
Iowa	2	0	0.00	0.54
Kentucky	3	0	0.00	0.60
Louisiana	2	1	50.00	0.68
Maryland	11	1	9.09	1.80
Massachusetts	25	5	20.00	4.66
Michigan	6	1	16.67	2.00
Minnesota	18	7	38.89	2.98
Missouri	12	4	33.33	1.52
Nebraska	2	0	0.00	0.29
Nevada	6	1	16.67	0.95
New Jersey	29	4	13.79	5.11
New Mexico	1	0	0.00	0.22
New York	179	21	11.73	9.76
North Carolina	5	1	20.00	1.65
Ohio	15	3	20.00	3.51
Oklahoma	6	2	33.33	0.91
Oregon	4	0	0.00	0.90
Pennsylvania	13	1	7.69	4.14

South Carolina	1	0	0.00	0.60
Tennessee	4	1	25.00	1.16
Texas	53	16	30.19	8.92
Utah	3	1	33.33	0.99
Virginia	8	2	25.00	2.32
Washington	15	4	26.67	1.56
West Virginia	1	1	100.00	0.21
Wisconsin	9	1	11.11	1.28
Wyoming	1	0	0.00	0.10
Total	698	128	18.34	7.04

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