

Origination and Evolution of Ownership and Control

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Corporate Ownership Today

- In Europe, more than 50% of companies have single block of voting shareholders. Mostly families. Many pyramids (Becht and Mayer 2001, Franks and Mayer 2001)
- In UK and US, less than 3% have single majority-voting block. No families and no pyramids.
- Was it always like this?

Foss v Harbottle (1843)

“First, the proper plaintiff in an action in respect of a wrong alleged done to a company... is prima facie the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company.... on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that if a mere majority of the members of the company... is in favour of what has been done then *cadit quaestio* – the matter admits of no further argument”

Absence of Investor Protection

"The emancipation of minority shareholders is a recent event. For most of the first century of company law they were virtually defenceless, kept in cowed submission by a fire-breathing and possibly multiple-headed dragon called *Foss vs. Harbottle*. Only in exceptional cases could they claim protection of the court."

L.H.H. Hoffmann, foreword to Robin Hollington's *Minority Shareholders' Rights*

The Beginning of the 20th Century

- Minority investor protection was exceptionally weak after *Foss v Harbottle*
- At the beginning of the century UK markets were largely unregulated
- The law and finance literature would therefore predict small capital markets and concentrated ownership

Is this the case?

Stock Market Development

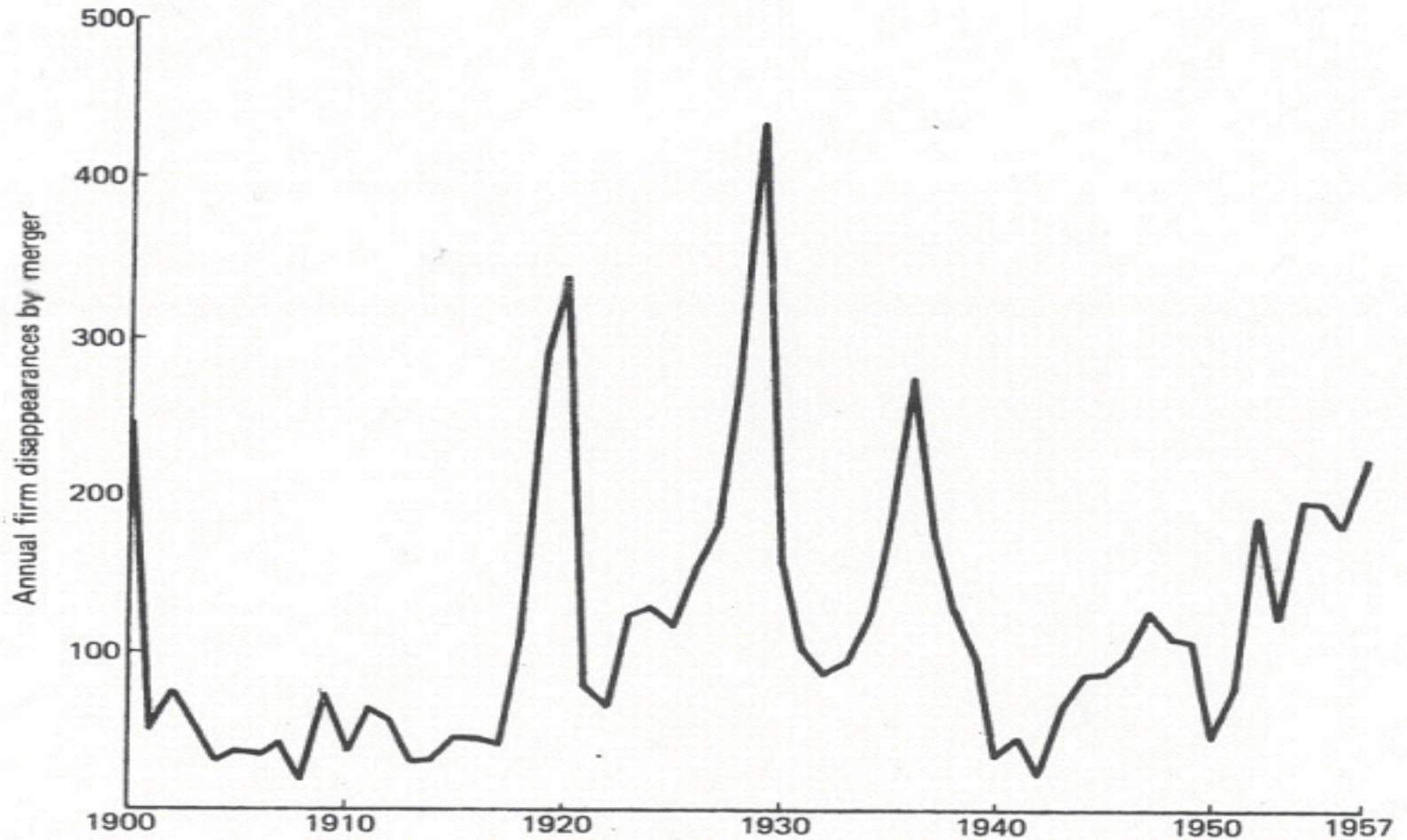
- Consistently among the largest stock markets in the world (Rajan and Zingales 2002)
- Listed companies (industrial, commercial and financial): 200 in 1853, “many thousands” in 1914, 4,409 in 1963, 1,904 in 2000 (Michie 1999)
- Provincial stock markets collectively as large as the London stock exchange

Provincial Exchanges

- “The number of commercial and industrial companies quoted in the Manchester list increased from seventy in 1885 to nearly 220 in 1906. Most of these were small companies with capitals ranging from £50,000 to £200,000” (Thomas)
- “By the mid 1880s Sheffield, along with Oldham, was one of the two most important centres of joint stock in the country, with 44 companies, with a paid up capital of £ 12 million” (Thomas)

Merger Waves

72 Concentration in Modern Industry



Source: Hannah (1976), appendix 1.

Fig. 5.1. Merger activity in U.K. manufacturing industry, 1900-57

The Companies

- All companies incorporated or reincorporated over the period 1897 to 1903 and 1958 to 1962 that are still in existence today (40 companies)
- All companies that died and for which data have been retained by companies house (10 companies)

The Data

- Individual firm data on insider/outsider ownership
- Names of shareholders and their holdings (outside > 1%) from share registers
- Equity issuance - rights issues, private placements
- Acquisitions - dates and shares issued
- Boards - names of directors and their shareholdings

Analysis

- Evolution over 100 years at 10 year intervals
- Compute insider/outsider, family ownership
- Contribution to growth and ownership changes of rights issues, placings, IPOs and acquisitions
- Board representation, chairmanship of families
- Compute measures of dispersion, mutation and separation of family ownership/control

Measures of Dispersion and Mutation

- Dispersion t to $t+T = \{Y(t+T)/Y(t)\}^{1/T} - 1$ where Y is the minimum number of shareholders required to pass control threshold (eg 25%) of voting rights – coalition control group
- Mutation t to $t+T = 1 - \{Z(t+T)/Z(t)\}^{1/T}$ where $Z(t+T)$ is the number of members of the coalition control group in year $t+T$ who were present in year t . It measures *stability* of the coalition control group

Average Annual Growth in Equity

1900 Sample, 1900-2000

- Number of Observations: 25
- Mean Annual Growth: 6.6%
- Contributions to Growth:
 - IPOs 1.9%
 - Acquisitions 67.3%
 - Rights issues 25.6%
 - Placings 5.3%

Dispersion of Ownership

1900 sample

	All shareholders	Directors	Outsiders	n. obs
1900-1910	7.86	21.30	6.57	25
1910-1920	2.28	9.99	12.32	25
1920-1930	4.79	16.77	11.95	25
1930-1940	1.81	20.03	-2.91	25
1940-1950	2.59	0.66	10.01	24
1950-1960	1.86	4.47	1.85	24
1960-1970	0.42	-7.47	10.04	23
1970-1980	0.07	8.81	-0.02	22
1980-1990	-5.65	13.82	-7.82	22
1990-2000	0.24	5.00	-0.14	20
mean	1.77	9.58	4.42	

Mutation of Ownership

1900 Sample

	All shareholders	Directors	Outsiders	n. obs
1900-1910	4.89	0.54	19.04	25
1910-1920	10.60	9.95	24.73	25
1920-1930	19.71	14.46	25.03	25
1930-1940	18.45	21.01	25.01	25
1940-1950	30.25	32.36	26.10	24
1950-1960	24.59	8.12	25.29	23
1960-1970	21.86	23.17	40.62	22
1970-1980	33.97	26.56	25.42	21
1980-1990	55.03	26.84	64.80	21
1990-2000	42.03	30.74	42.09	20
mean	25.21	18.87	31.10	

Decline in Directors' Ownership

	mean	median
1900	91.61	100
1910	57.97	57.50
1920	53.58	38.51
1930	40.86	24.24
1940	35.70	17.91
1950	28.65	11.99
1960	23.75	9.22
1970	17.80	9.43
1980	14.10	0
1990	8.30	0
2000	9.85	0

Sources of Decline in Directors' Shareholdings

	Decline	IPO	Acquisitions	Rights Issues	Placings	Total	Residual
1900-1950	12.6	0	36.2	4.6	20.8	61.6	38.4
1950-2000	3.8	11.7	14	11.7	-2.3	35.1	64.9

Example - GKN

- Guest Keen and Company founded in 1900 to take over two iron and steel companies
- Acquired Nettlefold in 1902 by issuing 315,000 ordinary shares to form GKN
- In 1920 quoted on Birmingham, Bristol, Cardiff, Edinburgh, Glasgow, Liverpool, Manchester and Sheffield exchanges

Growth Through Acquisition

- Acquired:
 - John Lysaght in 1920 by issuing 2,000,000 ordinary shares,
 - D Davis and Sons in 1923 by issuing 1 GKN shares for each 5 shares in Davis and Sons, and
 - Consolidated Cambrian in 1923 by issuing 2 GKN shares for every 5 shares in Consolidated Cambrian
- Between 1920 and 1924 number of shareholders increased from 1,000 to 20,000

Founding Family Ownership

	Mean	Median	n. obs
1900	53.92	34.78	24
1910	48.82	31.86	24
1920	44.62	29.01	24
1930	28.85	5.82	24
1940	25.57	4.25	25
1950	19.79	0.02	23
1960	14.87	0	23
1970	8.28	0	22
1980	2.08	0	21
1990	0.61	0	20
2000	0.80	0	20
Mean	22.56		

Board composition: Influence of Founding Family

	Board size		Family CEO	Board members outside founding family (%)		n. obs
	Mean	Median		Mean	Median	
190	5.92	5.00	20	48.63	41.45	25
191	6.74	5.00	20	45.92	52.75	25
192	7.00	5.00	16	60.13	66.60	25
193	7.40	6.00	14	63.03	72.35	25
194	7.16	6.00	14	61.63	71.55	25
195	7.63	6.50	12	68.40	87.50	24
196	8.04	7.00	7	72.69	100	23
197	9.00	8.00	4	79.12	100	22
198	8.24	7.00	4	86.78	100	21
199	8.24	8.00	2	90.68	100	20
200	7.90	7.00	2	92.51	100	20
Mean	7.53		10.92	69.96		

Separation of Ownership and Control: Percentage of Family Board Representation – Ownership

	Mean	Median	n. obs
1900	-4.58	0	24
1910	3.53	0	24
1920	-7.25	0	24
1930	6.33	0	24
1940	12.79	8.21	25
1950	10.41	7.40	23
1960	12.45	0	23
1970	12.60	0	22
1980	11.13	0	21
1990	8.71	0	20
2000	6.69	0	20
Mean	6.62		

Conclusion from 1900 Sample

- UK at the beginning of the century looked like UK not Germany today
- Chandlerian view that family control persisted is correct
- But rapid dispersal of ownership
- Main driver for dispersal was growth through acquisition
- Occurred in the absence of formal investor protection

Introduction of Investor Protection

- 1947: LSE eliminated differences between formal and informal listing requirements
- 1948: Companies Act:
 - Minimum of 5 years of earnings history
 - Anti-director rules
- 1960's: takeover panel rules
- 1980: minority investor protection in statute

The Rise of Investor Protection

“A statutory remedy was provided for the first time in 1948 but this proved relatively ineffectual. It was not until 1980 that Parliament forged the sword which is now section 459 of the Companies Act 1985 and which enables the unfairly treated minority shareholder to slay the dragon.”

L.H.H. Hoffmann, foreword to Robin Hollington's *Minority Shareholders' Rights*

Founding Family Ownership

	Mean	Median	n. obs
1960	52.17	51.25	25
1970	27.83	19.45	25
1980	16.69	4.75	22
1990	6.32	0	22
2000	4.44	0	20
Mean	21.49		

The 1960 Sample

Dispersion of Ownership

- Mean: 3.80% (All shareholders)
- 1900 minus 1960 – t-tests of differences in means

	First decade	Second decade	Third decade	Fourth decade	Overall
All shareholders	-0.82	2.06 ^b	-0.40	-1.60	0.21
Directors	-1.89 ^c	-0.71	-1.15	0.14	-1.19
Outsiders	-4.94 ^a	-0.34	0.20	-0.78	-2.87 ^a

Mutation of Ownership

- Mean: 40.01% (All shareholders)
- 1900 minus 1960 – t-tests of differences in means

	First decade	Second decade	Third decade	Fourth decade	Overall
All shareholders	-1.08	-2.23 ^b	-3.09 ^a	-2.72 ^a	-4.40 ^a
Directors	-2.25 ^b	-2.30 ^b	-3.54 ^a	-1.71 ^c	-4.41 ^a
Outsiders	-3.38 ^a	-2.60 ^b	-3.14 ^a	-2.45 ^b	-6.05 ^a
Directors (board)	-2.47 ^b	-1.92 ^c	-1.96 ^c	-0.83	-3.59 ^a

Board composition:

Influence of Founding Family

	Board Size		Family CEO	Board members outside founding family (%)		n. obs
	Mean	Median		Mean	Median	
1960	3.16	3.00	21	46.69	41.65	25
1970	5.72	5.00	15	67.94	77.50	25
1980	6.64	6.00	9	77.12	86.65	23
1990	7.09	7.00	4	84.14	100	22
2000	7.00	6.00	3	83.62	100	20
Mean	5.83		10.90	71.90		

Separation of Ownership and Control: Percentage of Family Board Representation – Ownership

	Mean	Median	n. obs
1960	1.15	0	25
1970	4.23	0	25
1980	6.09	0	22
1990	9.55	0	22
2000	11.94	0	20
Mean	6.59		

Conclusions from Comparison

- Pronounced change in investor protection in second half of century
- Associated with similar rate of dispersion of ownership and control but faster mutation
- Family board control retained even in the presence of dispersed ownership
- How did dispersion occur in absence of investor protection?

Prospectuses and Listing Rules

- Early 20th century, shares often sold without prospectuses, e.g. 1911-1913, 596 public companies formed without prospectus and 378 with
- Many shares were traded without listing requirements – 5,000 officially quoted, 400 actively traded, many more traded but not quoted

Monitoring by Trust

- Ownership was dispersed, but *geographically* concentrated
- Provincial stock markets accessed local investors:
Lavington (1921): “Local knowledge on the part of the investor... of the vendor... and his undertaking would ensure fair prices.... The securities are rarely sold by means of a prospectus... they are placed among local people.”

Growth and Mistrust

- Stock acquisitions led to geographical dispersion
- Local implicit contracts were weakened
- 1920's and 1930's several scandals and failures (e.G. Hatry, Royal Mail Steam) led to pressure for regulatory change
- Investor protection resulted

Regulation, Private Benefits and Trust

Regulation Hypothesis

- Stock market regulation increases the incentives to go public and disperse ownership

Private Benefits Hypothesis

- Large family board representation reduces rates of dispersion of ownership

Acquisition Hypothesis

- Takeovers and equity issued outside the city associated with greater dispersion of outside ownership

Determinants of Dispersion of Ownership

	(1)	(2)	(3)	(4)	(5)	(6)
1900 Sample	0.004 (.019)	0.040 (.026)	0.003 (.019)	0.049 ^c (.027)	0.018 (.017)	-0.020 (.043)
Directors' ownership			0.104 ^a (.035)	0.051 (.032)	0.081 ^a (.029)	0.045 (.031)
Family representation on boards			-0.084 ^a (.031)	-0.077 ^a (.029)	-0.087 ^a (.029)	-0.082 ^a (.027)
No. of acquisitions					0.029 ^b (.012)	0.030 ^b (.013)
Geo					-0.008 (.007)	0.021 ^b (.009)
Company Ownership (i.e. no. people > 25%)			-0.004 ^c (.002)	-0.005 ^c (.002)	-0.009 ^b (.004)	-0.009 ^a (.003)
Constant	0.038 ^b (.015)	-0.022 (.021)	0.015 (.016)	-0.014 (.019)	0.013 (.017)	0.079 ^b (.040)
Decade fixed effects?	NO	YES	NO	YES	NO	YES
R ²	0.001	0.131	0.103	0.117	0.190	0.262
N obs	188	188	183	183	181	181

Determinants of Mutation of Ownership

	(1)	(2)	(3)	(4)	(5)	(6)
1900 Sample	-0.256 ^a (.059)	-0.392 ^a (.125)	-0.220 ^a (.058)	-0.017 (.117)	-0.203 ^a (.059)	-0.318 ^b (.134)
Directors' ownership			-0.233 ^b (.099)	-0.065 (.126)	-0.253 ^b (.099)	-0.095 (.125)
Family representation on boards			-0.038 (.113)	-0.055 (.115)	-0.023 (.114)	-0.043 (.115)
No. of acquisitions					0.007 (.016)	0.022 (.016)
Geo					-0.056 (.048)	-0.064 (.069)
Company Ownership (i.e. no. people > 25%)			0.014 ^b (.006)	0.017 ^a (.006)	0.013 ^c (.007)	0.014 ^b (.006)
Constant	0.400 ^a (.050)	0.577 ^a (.102)	0.519 ^a (.070)	0.224 ^c (.123)	0.506 ^a (.071)	0.537 ^a (.108)
Decade fixed effects?	NO	YES	NO	YES	NO	YES
R ²	0.094	0.189	0.174	0.213	0.175	0.212
N obs	190	190	184	184	182	182

Conclusions:1

No support for investor protection thesis:

- Dispersed ownership, large capital markets and merger waves in absence of investor protection
- Evolution of ownership and control did not alter with substantial changes in regulation in middle of the century

Conclusions: 2

- Trust and local implicit contracts played an important role in facilitating ownership dispersion
- Takeovers primary cause of dispersal of ownership
- But geographical dispersion undermined relations based on trust
- Formal investor protection was the response

Conclusions: 3

- Increased investor protection associated with greater liquidity
- Slower evolution of corporate control
- Family retention of board control
- Corporation as legal entity provides basis for distinct evolutionary processes

Conclusions: 4

- Striking contrast between UK and German evolution
- In UK, families relinquish ownership but retain board control
- In Germany, families retain large share blocks but accept separation between supervisory and managerial board control