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Large shareholders and accounting research☆

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ABSTRACT

Large shareholders are a potentially very important element of firms' corporate governance system. Whereas analytical research is typically vague on who these large shareholders are, in practice there are important variations in the types of large owners (and the different types of large owners could play very different governance roles). After briefly reviewing the standard agency cost arguments, in this article I emphasize the heterogeneity of concentrated ownership and in particular focus on the roles of families, institutions, governments, and employee ownership. I also discuss the role of large shareholders in private (i.e., unlisted) firms, where ownership tends to be more concentrated than in publicly traded firms. Finally, I briefly discuss variations in ownership structures across selected countries.

1. Introduction

This article is based on my keynote address at the 2012 *CJAR* Special Issue Symposium at CEIBS in Shanghai. The topic of the conference was "large shareholders" and I was honored to be given the opportunity to

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make some comments on how large shareholders are important for (accounting) research. I should hasten to say that there are several well-cited survey studies on corporate governance in accounting, economics, finance, and management. Thus, in this paper I will not attempt a complete survey on the literature on large shareholders. Instead, I have decided to focus on one particular aspect – the *heterogeneity* of large shareholders.

We tell our PhD students that they should base their research on theory to the extent possible. At least in financial accounting the "theory" that is referred to is often analytical economics-based research. At the Rotman School we have the same emphasis on theory and I am personally a strong believer in anchoring your work in theory. However, most analytical models are vague (to put it mildly) when describing exactly who the large shareholders are and how they act. As this article will highlight, there is in fact rather considerable diversity in the *types of large shareholders* we observe, and it is very likely that these may have different effects on outcomes of interest to accounting researchers. Hence the reader can consider this article also as a call for "attention to the context" in which the study is conducted. For example, I would encourage "case-based" type studies that delve deeper into one particular form of large shareholder, such as state-owned enterprises in China.

I would like to offer three brief caveats. First, as already mentioned there are other, more comprehensive surveys on corporate governance issues and I would recommend that readers consult these if relevant. Second, although I consider several different types of large shareholders I could clearly have included additional types (e.g., the effect of foreign shareholders). Finally, there are important measurement issues in defining large shareholders (using cut-offs; multiple large owners; concentration ratios; ownership percentage versus voting rights; considering potential nonlinearities; organizational form; etc.).

Section 2 provides a brief review of the classic Jensen and Meckling (1976) arguments and discusses both vertical and horizontal agency costs. It also discusses the role of the second-largest shareholders and examines how large shareholders exercise their monitoring in practice. Section 3 focuses on who the large shareholders are. The chapter considers the roles of families, institutions, governments, and employee ownership. Large shareholders are particularly prominent in private (i.e., unlisted) firms, and Section 4 summarizes relevant research on these economically very important firms. Section 5 contains a discussion of variations across selected countries in the types of dominating ownership, and Section 6 concludes.

2. Overview of large shareholders and agency costs

2.1. Brief review of Jensen and Meckling (1976)

As this conference is motivated to a large extent by Jensen and Meckling (1976), it is worthwhile to first briefly revisit and review their seminal study.[1] Jensen and Meckling define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties are utility maximizers there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the value-reducing activities of the agent.[2]

If a wholly owned firm is managed by the owner, he will make decisions which maximize his utility. This situation is of course unusual other than for the smallest private firms and by definition not observed in publicly traded companies. In such cases, Jensen and Meckling argue that agency costs will be generated by the divergence between his interest and those of the outside shareholders, as he will then bear only a fraction of the costs of any non-pecuniary benefits he takes out in maximizing his own utility. Put differently, as the owner–manager's fraction of the equity falls, his fractional claim on the outcomes falls and this will tend to encourage him to appropriate larger amounts of the corporate resources in the form of perquisites. This also makes it

[1] Jensen and Meckling's article was in part motivated by the observation by Adam Smith (1776) that "The directors of such [joint-stock] companies, however, being the managers rather of other people's money than of their own, it cannot be well expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own… Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."

[2] In some situations it will pay the agent to expend resources to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions (referred to as "bonding").