

Morgan Stanley

# Journal of Applied Corporate Finance

FALL 1991

VOLUME 4.3

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*by Michael J. Barclay,  
University of Rochester, and  
Clifford G. Holderness,  
Boston College*

# CONTROL OF CORPORATIONS BY ACTIVE BLOCK INVESTORS

by Michael J. Barclay,  
University of Rochester, and  
Clifford G. Holderness,  
Boston College\*

**T**op managers are often suspicious of, if not outright hostile toward, active large-block investors. This attitude is summed up in the words of one chief executive officer who said, "I want a million shareholders, each of whom owns one share." The antagonism between managers and blockholders is reflected in corporate charter provisions such as poison pills that are triggered when a new shareholder accumulates a large block of stock. Managerial resistance to blockholders has also contributed to the passage of recent state legislation that restricts the voting rights of blockholders.

How should minority shareholders react to their large-block brethren? If blockholders use their voting power to extract corporate resources at the expense of minority shareholders, or if well-meaning but incompetent blockholders interfere with effective corporate decision-making, then minority shareholders have good reason to support management's efforts to restrict blockholders. But if large-block shareholders typically use their voting power to increase firm value, either by monitoring management or by assuming a managerial role, then minority shareholders should be skeptical of managers' resistance to blockholders. Finance theorists have long argued that broadly dispersed investors, when confronted with substandard managerial performance, are frustrated by a "free-rider" problem that makes it "rational" for them just to sell their shares rather than try to bring about change. The

large-percentage ownership of blockholders may help overcome this problem.

In this article, we discuss the findings of our recent research that examined 106 trades of large (5% or more) blocks of common stock over the period 1978-1982. Our most notable conclusions are these:

- *The initial public announcements of these 106 negotiated block trades were associated with average, market-adjusted stock price increases of approximately 16%.*
- *The increases tended to be larger when control later passed to the new blockholder, management did not resist the block purchaser's attempts to influence corporate policy, or the block purchaser eventually fully acquired the firm.*
- *When the firm was not later acquired, stock prices increased with the announcement of the trade, declined gradually over the 40 following days, and remained level thereafter. Even after the decline, the market-adjusted returns of such companies were roughly 6% higher one year after the trade.*
- *Turnover among top managers and directors after the trades substantially exceeded what is normal for public corporations. For example, even in the firms that were not later acquired in a merger or tender offer, 33% of the chief executives departed in the year following the trade, and many of their replacements were hired externally.*
- *Finally, we found considerable evidence that block purchasers or their representatives play an active role in firm management.*

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\*This article is a shortened, less technical version of "Negotiated Block Trades and Corporate Control," *Journal of Finance* (August 1991).

**Finance theorists have long argued that broadly dispersed investors, when confronted with substandard managerial performance, are frustrated by a “free-rider” problem that makes it “rational” for them just to sell their shares rather than try to bring about change.**

Taken together, these findings suggest that minority shareholders benefit from laws and corporate policies that facilitate block trades. The increases in firm value associated with these trades suggest that block purchasers tend to be superior managers or, at least, effective monitors of corporate management. The extensive managerial turnover after the trades also suggests that managers know what they are doing in opposing block purchasers. Many stand to lose their jobs if the block purchaser assumes control.

### **SELECTING A SAMPLE OF BLOCK TRADES**

We obtained our sample of block trades by examining each entry of the *Wall Street Journal* company index from 1978 through 1982. We selected all NYSE- or Amex-listed firms in which there was a reported trade of at least 5% of the common stock. (We chose 5% because the SEC mandates public filing once that threshold is reached.) Newspaper reports indicated that virtually all of these trades were negotiated between the buyer and the seller. Most of these block purchases, moreover, were made at significant premiums over the current market value of the stock—although in 15% of our cases, the blocks were purchased at a modest discount from the current stock price.

In order to distinguish negotiated block trades from takeovers and other more conventional control transactions, we excluded all block trades made in response to outstanding merger or tender offers. We did, however, include trades that were announced simultaneously with or as a prelude to offers by the block purchaser to acquire the firm's remaining shares. Our sample of 106 block trades consisted of 41 cases in which the firm was acquired within a year and 65 cases in which the firm remained independent at least one year after the trade.<sup>1</sup>

In 90% of the trades in our sample, the identity of the company's largest shareholder changed as a consequence of the trade. And after *all* the trades, the

block purchaser was the firm's largest shareholder. In 75% of the trades, the block purchaser did not own any stock prior to the trade; and in such cases, the concentration of ownership does not change. In the remaining 25% of the trades, the block purchaser's pre-trade holdings averaged 14% of the firm's stock.<sup>2</sup>

### **The Size of the Companies and the Blocks**

As reported in Table 1, the size of our sample of companies varied widely, with book value of assets ranging from \$2 million to almost \$1.7 billion.<sup>3</sup> The average sample firm had assets of \$247 million (median \$85 million). By comparison, over the same time period, the average exchange-listed company had assets of \$1.8 billion (median \$209 million). Thus, our sample firms were smaller than average, a trait which appears to characterize firms with large-block shareholders in general.<sup>4</sup>

The fraction of the common stock traded in the block averaged 27% (median 21%). In the 41 cases in which the firm was eventually acquired by the block purchaser, the percentage blocks were considerably larger, averaging 37% (with a median of 33%).

### **The Block Traders**

Half of our block sellers, and almost 80% of the block buyers, were corporations.<sup>5</sup> Two-thirds of those corporate block buyers, moreover, were in businesses closely related to the firm whose shares they bought.

Among the 54 sellers who were individuals rather than companies, most were active in firm management. In 12 cases, the sellers were either the company founders or members of the founder's family. Twenty-five other sellers held the offices of president, chief executive officer, or chairman of the board. Seven others served as directors. Only ten of the sellers who were individuals did not appear to have held a formal position with the firm before the trade.

1. We lack the data to determine how the frequency of block trades compares with the frequency of more conventional control transactions. What data is available, however, suggests that negotiated block trades are relatively common. For example, W.T. Grimm & Co. (1987) reports ten hostile offers a year for NYSE-listed and ASE-listed firms; DeAngelo and DeAngelo (1989) report five proxy contests annually for the same group of firms. (Harry DeAngelo and Linda DeAngelo, "Proxy Contests and the Governance of Publicly Held Corporations," *Journal of Financial Economics* 23 (1989), 29-59. By comparison, we identify approximately 20 negotiated block trades a year.

2. The results of our study do not change significantly when we exclude those trades in which the purchaser owned stock prior to the trade.

3. All dollar values reported in this article are in GNP-price-deflated 1982 dollars.

4. See Harold Demsetz and Kenneth Lehn, "The Structure of Corporate Ownership: Causes and Consequences," *Journal of Political Economy* 93 (1985), 1155-1177. See also Clifford G. Holderness and Dennis P. Sheehan, "The Role of Majority Shareholders in Publicly Held Corporations: An Exploratory Analysis," *Journal of Financial Economics* 20 (1988), 317-346.

5. Most of the results reported in this article are not sensitive to whether the block trading parties were individuals or corporations.

**TABLE 1**  
DESCRIPTIVE STATISTICS  
FOR 106 NEGOTIATED  
BLOCK TRADES OF AT  
LEAST 5% OF THE  
COMMON STOCK OF  
NYSE- OR AMEX-LISTED  
CORPORATIONS BETWEEN  
1978 AND 1982\*

	Mean	Median	Min.	Max.
<b>■ All firms</b>				
Book value of assets (millions of 1982 dollars)	247	85	2	1680
Percentage of common stock in block	27	21	5	83
<b>■ Firms remaining independent</b>				
Book value of assets (millions of 1982 dollars)	264	86	2	1680
Percentage of common stock in block	21	17	5	63
<b>■ Firms subsequently acquired</b>				
Book value of assets (millions of 1982 dollars)	221	68	9	1131
Percentage of common stock in block	37	33	6	83

\*The sample of firms remaining independent consists of 65 trades in which the firms whose shares are traded are not acquired within a year of the block trade announcement. The sample of firms subsequently acquired consists of 41 trades in which the firms whose shares are traded are acquired within a year of the block trade announcement.  
Source: COMPUSTAT, SEC 13d filings, and the *Wall Street Journal*.

None of the block trading parties were institutions (such as banks or funds), even though institutions hold approximately half of the outstanding common stock of NYSE and Amex corporations. This conspicuous absence of institutional owners apparently reflects legal requirements that institutions diversify their investments, and limitations on their percentage ownership of individual corporations.

### Block Trades and Industry-Wide Declines

In many cases, the reasons for a block trade were apparent. For example, when the block buyer was a corporation in a closely related business, there were likely to be synergies that did not exist with the block seller. In other cases, the potential benefits from the trade were less apparent. Such cases seem to beg the question: Why was the block seller unable to make the changes instituted by the purchaser?

Although there are likely to be a variety of answers, it appears that some block trades occur because a new blockholder is better able to deal with the challenges associated with a declining industry. The firms in our sample, whether they remained independent or were later acquired, tended to be marginal performers in poorly performing industries. In the three years before the trade, our sample firms underperformed broad market aver-

ages by over 40%; they also underperformed companies in their industry by about 8.4%.<sup>6</sup>

In this sense, block trades play a function similar to that often performed by hostile takeovers. As shown by a recent study, the targets of hostile takeover attempts also tend to be marginal players in troubled industries. Existing management, as the authors of this study suggest, may well have difficulty dealing with industry-wide declines; and, in such cases, outsiders may find it easier to make the extensive changes necessary to restore profitability.<sup>7</sup>

### THE MARKET REACTION TO BLOCK TRADES

To measure the market's reaction to negotiated-block trades, we used the widely accepted "event study" method. In brief, this research technique begins with the firm's stock price change over a brief time period surrounding announcement of the block trade and adjusts it for market-wide movements and for the risk of the individual stock. The result of this process is a "cumulative abnormal stock return," or "CAR," which is the financial economist's best measure of the market's reaction to a particular event.

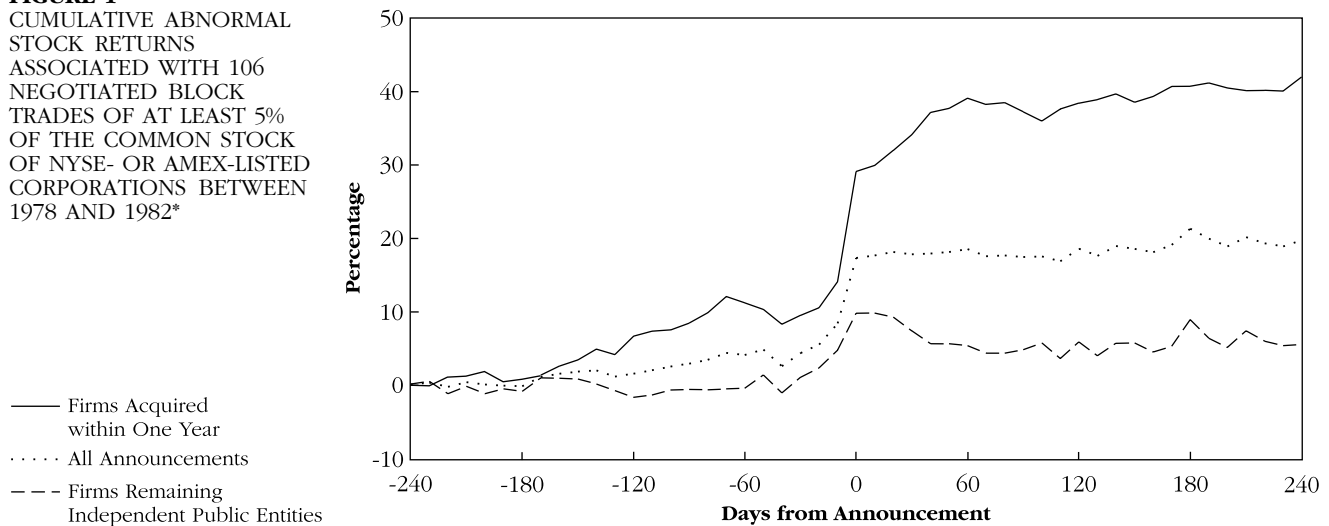
Figure 1 plots the abnormal stock returns from 240 days before through 240 days after the initial public announcements of a block trade, with day 0 indicating the initial public announcement day.

6. In technical language, they experienced cumulative abnormal stock returns of -41.5% (p-value = .001) and -8.4% industry abnormal returns when compared to other firms in the same two-digit SIC industry classification.

7. See Randall Morck, Andrei Shleifer, and Robert W. Vishny, "Alternative Mechanisms for Corporate Control," *American Economic Review* 79 (1989), 842-852.

**In the three years before the trade, our sample firms underperformed broad market averages by over 40%; they also underperformed companies in their industry by about 8.4%. In this sense, block trades play a function similar to that performed by hostile takeovers.**

**FIGURE 1**  
CUMULATIVE ABNORMAL STOCK RETURNS ASSOCIATED WITH 106 NEGOTIATED BLOCK TRADES OF AT LEAST 5% OF THE COMMON STOCK OF NYSE- OR AMEX-LISTED CORPORATIONS BETWEEN 1978 AND 1982\*



\*Day 0 is the initial public announcement of the block trade. The sample of firms remaining independent consists of 65 trades in which the firms whose shares are traded are not acquired within a year of the block-trade announcement. The sample of firms subsequently acquired consists of 41 trades in which the firms whose shares are traded are acquired within a year of the block-trade announcement.

**TABLE 2**  
CUMULATIVE ABNORMAL STOCK RETURNS OVER VARIOUS EVENT-TIME INTERVALS ASSOCIATED WITH 106 NEGOTIATED BLOCK TRADES OF AT LEAST 5% OF THE COMMON STOCK OF NYSE- OR AMEX-LISTED CORPORATIONS BETWEEN 1978 AND 1982<sup>1</sup>

	<b>Days In Relation To Block-Trade Announcement</b>				
	<b>-1 to 0</b>	<b>-10 to 0</b>	<b>-40 to 0</b>	<b>-40 to 40</b>	<b>-40 to 240</b>
<b>■ All Firms</b>					
Cumulative abnormal return (%)	5.1	9.2	14.0	14.6	16.5
p-value <sup>2</sup>	.001	.001	.001	.001	.001
<b>■ Firms remaining independent</b>					
Cumulative abnormal return (%)	2.1	5.5	9.9	5.7	5.6
p-value <sup>2</sup>	.020	.001	.001	.034	.322
<b>■ Firms subsequently acquired</b>					
Cumulative abnormal return (%)	9.8	14.9	20.5	28.6	33.4
p-value <sup>2</sup>	.001	.001	.001	.001	.001

1. Day 0 is initial public announcement of the block trade. The sample of firms remaining independent consists of 65 trades in which the firms whose shares are traded are not acquired within a year of the block-trade announcement. The sample of firms subsequently acquired consists of 41 trades in which the firms whose shares are traded are acquired within a year of the block-trade announcement.

2. p-value for the two-tailed test of the hypothesis that the cumulative abnormal returns are equal to zero.

Table 2 summarizes these returns (and their levels of statistical significance) for various parts of the 480-day event period.

Although the returns were considerably larger when a trade led to a merger or tender offer, shareholder value increased significantly even when the company was not subsequently acquired. In cases where the firm was not acquired within a year, the abnormal stock returns increased from day -40

through day 0, declined from day 1 through day 40, and remained approximately level thereafter. This pattern suggests that the initial increase partly reflected the increased expectation that the minority's shares would later be acquired through a merger or tender offer. As that expectation was not realized, stock prices drifted down, but not without leaving minority stockholders about 5% better off as a consequence. Because this subsample excluded

**TABLE 3**  
SUMMARY OF CORPORATE  
ACTIVITIES OF BLOCK  
PURCHASERS AND  
MANAGERIAL RESISTANCE  
TO THE BLOCKHOLDERS  
ASSOCIATED WITH 106  
NEGOTIATED BLOCK  
TRADES OF AT LEAST 5%  
OF THE COMMON STOCK  
OF NYSE- OR AMEX-LISTED  
CORPORATIONS BETWEEN  
1978 AND 1982<sup>1,2</sup>

	Individual Block Purchasers (N = 22)	Corporate Block Purchasers (N = 84)	Entire Sample (N = 106)
<b>■ Individual block purchaser becomes officer or director</b>			
	15 (68)	NA	NA
<b>■ Corporate block purchaser in related business</b>			
	NA	55 (65)	NA
<b>■ Block purchaser buys additional stock</b>			
	5 (23)	25 (30)	30 (28)
<b>■ Reports of managerial resistance to blockholder</b>			
	5 (23)	29 (35)	34 (32)
<b>■ Reorganization of firm</b>			
<b>Number of attempted reorganizations by block purchaser</b>			
	6 (27)	45 (54)	51 (48)
<b>Number successful</b>			
	5 (23)	36 (43)	41 (39)
<b>Number of attempted reorganizations by third party</b>			
	5 (23)	9 (11)	14 (13)
<b>Number successful</b>			
	2 (9)	5 (6)	7 (7)
<b>■ Firms with no indication of block purchaser activity or managerial resistance<sup>3</sup></b>			
	4 (18)	10 (12)	14 (13)

1. Source: *Wall Street Journal*, Moodys, and Standard and Poor's Register of Corporations, Directors and Officers.

2. Percentages in parentheses.

3. An individual block purchaser does not become a director or an officer, a corporate block purchaser is not in a related business, the blockholder does not purchase additional stock after acquiring the block, management does not resist the block seller or the block purchaser, and there are no attempts to reorganize the firm.

firms that were acquired within a year of the trade, we are inclined to view this 5% gain as conveying not the market's lingering expectation of future takeover, but rather its anticipation of management improvements initiated by the block purchaser.

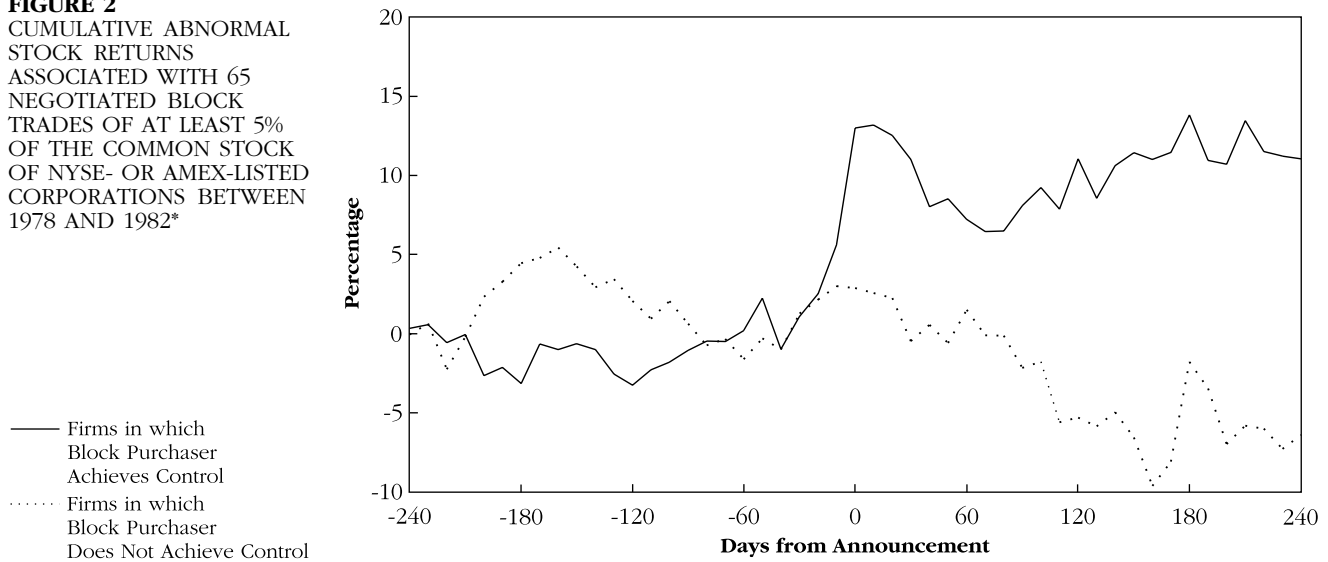
**Information Revealed by the Trade.** An alternative explanation for the stock price increases associated with block trades is that the trades revealed information that the firms were undervalued. If this were the case, the information revealed by the trade would cause the stock price to increase even if the block purchaser were not expected to influence the quality of the firm's management.

The reality, however, is that the block purchasers in our sample had extensive involvement in the firm's management. Such activities, as summarized

in Table 3, would suggest that block traders accomplish far more than identifying undervalued securities. Moreover, if the revelation of new information were the principal factor responsible for the stock price increases, and if the block-trading parties were assumed to have better information about firm value than other market participants, then those blocks that are priced at a discount to the exchange price should cause stock prices to fall, and those blocks priced at a premium to the exchange price should cause prices to rise. But that is not the pattern we found. Instead, the average announcement-period stock returns were positive regardless whether the block trades were transacted at a premium or a discount; and, indeed, the returns for the two subsamples were statistically indistinguishable.

**Although the returns were considerably larger when a trade led to a merger or tender offer, shareholder value increased significantly even when the company was not subsequently acquired.**

**FIGURE 2**  
CUMULATIVE ABNORMAL STOCK RETURNS ASSOCIATED WITH 65 NEGOTIATED BLOCK TRADES OF AT LEAST 5% OF THE COMMON STOCK OF NYSE- OR AMEX-LISTED CORPORATIONS BETWEEN 1978 AND 1982\*



\*Day 0 is the initial public announcement of the block trade. There are 45 firms in which the blockholder achieves control and 20 firms in which the blockholder does not achieve control. All firms remain independent and publicly traded for at least a year after the trade.

### ACTIVE BUYERS, MANAGERIAL RESISTANCE, AND MANAGERIAL TURNOVER

Although it is not possible to determine conclusively why stock prices increase when blocks are traded, activities within the firm after the trades offer some useful insights. In some cases, the block purchaser eventually acquired the minority shareholders' stock. This was almost always the best outcome for minority shareholders. When companies were not acquired, however, there were still signs of considerable activity by the block purchasers and top management. We now turn to these activities.

#### Active Block Buyers

Soon after acquiring their blocks, most block purchasers became active in management. As reported in Table 3, 68% of the individual blockholders became directors or officers. None of the purchasers sold any of their stock (other than selling the block intact), and 28% of the blockholders purchased additional shares. Almost half of the block purchasers attempted to take over the firm within two years, and they succeeded in 80% of those attempts. The success rate for takeover attempts by third parties was considerably lower.

To determine whether the increases in firm value generally associated with block trades depended on the efforts of block purchasers to improve management, we divided our firms into two categories: (1) those where there was evidence that block purchasers achieved control of the corporation; and (2) those where there was no such evidence, either because the purchasers did not seek control or because they were rebuffed by management. For example, if the block purchaser became an officer, or if a corporate block purchaser announced a joint venture with the firm, we classified the blockholder as "achieving control." But if there was no mention in the *Wall Street Journal* of any blockholder activity, or if the blockholder attempted to replace management but was unsuccessful, we classified the blockholder in the second category. We limited this analysis to the 65 cases in which the firm was not taken over within a year of the trade.

Using this classification, Figure 2 reports the cumulative abnormal stock returns from 240 days before through 240 days after the block-trade announcement. Stock returns were significantly larger when the block purchaser achieved some measure of control. From day -40 through day +40, the 45 firms in which the block purchaser achieved control had an average abnormal return of 8.1%. The return over the same interval for the 20 firms in which the

block purchaser did not achieve control was only 0.4%. From day -40 through day +240, the abnormal returns for the respective subsamples were 11.2% and -6.6%.<sup>8</sup>

### Managerial Resistance

Although Figure 2 is consistent with the hypothesis that much of the value created by block trades was related to the block purchasers' activities, incomplete news reports on post-trade corporate activities make it difficult in some cases to conclude that control has in fact passed to the block purchaser. Accordingly, we also analyzed the impact on share values of managerial resistance to blockholders. We reasoned that if blockholders typically improve management, then resistance to them will reduce firm value. But if blockholders use their voting power primarily to extract private benefits to the detriment of minority shareholders, then managerial resistance will increase firm value.

We identified managerial resistance to blockholders in 32% of our cases. Five of these cases involved block sales to white knights following press reports of managerial resistance to changes proposed by the block seller. In 20 cases, lawsuits were filed by management against a block purchaser. In other instances, management either publicly questioned the block purchaser's ability to manage the firm or initiated a defensive restructuring. Five of the blocks were ultimately repurchased by the firm at a premium to the exchange price ("greenmail").

We isolated the 19 firms in our sample where there was overt management resistance to the blockholder and no announced attempts to take over the firm in the year following the trade. The two-day average abnormal stock return following the *Wall Street Journal* announcement of this resistance was -1.5% (p-value = .06). These firms had average abnormal returns of 2.3% from day -40 through day +40, and -3.1% from day -40 through day +240 (neither is significantly different from zero). In contrast, the 46 firms for which there were no reports of managerial resistance had average abnormal returns of 7.1% from day -40 through +40 (p-value = .04) and 9.4% from day -40 through day +240 (p-value = .19).<sup>9</sup>

### A Case of Resistance

The events following a block trade at Treadway Corporation serve to illustrate both the efforts by block purchasers to influence firm management and the extent of managerial resistance. In November 1978 Care Corporation purchased a block that, together with stock previously acquired, gave it a 24% interest in Treadway. Initially, Care claimed the block "was for investment purposes only. We're both in the bowling business. We like [Treadway]."

Several months later, however, Treadway announced that it had retained a New York City law firm "to protect the interests of our stockholders to the fullest" in connection with the block purchase by Care. Two weeks later Treadway filed suit against Care, alleging a "conspiracy to seize control of [Treadway]." The judge in the case issued, but shortly thereafter lifted, a temporary restraining order blocking Care from acquiring more stock in Treadway.

During the following year, there was extensive maneuvering by both sides over a slate of directors Care wanted to offer in a proxy contest. Among the steps taken by Treadway's management to resist Care was the private placement of a 25% block of stock (slightly larger than Care's 24%). Care narrowly lost the proxy contest, although initially a federal court awarded it the victory by invalidating the votes cast from the private placement. Finally, two years after the block trade, Treadway repurchased Care's block at a 38% premium to the exchange price.

As the case of Treadway confirms, block purchases do not necessarily convey control. But the fact that none of the blocks in our sample was broken up (at least, in the five year-period after their purchase) suggests that, even when block purchasers fail to influence management initially, they deem it profitable to maintain the block intact. By so doing, blockholders presumably preserve their option to wait for a change in circumstances that will make it easier to replace management, to sell the block to someone more skilled in achieving corporate control, or to sell the block back to the firm at a premium.

For minority shareholders, of course, the last outcome is by far the least desirable. In the five cases in which the insurgent's block was repurchased by

8. The p-values for the one-tailed test that the returns are larger for the firms in which the block purchaser achieves control are .13 for day -40 through day +40 and .07 for day -40 through day +240.

9. The p-values for the one-tailed test that the returns are larger for the firms in which there is no management resistance to the blockholder are .25 for day -40 through day +40 and .14 for day -40 through day +240.

**Almost half of the block purchasers attempted to take over the firm within two years, and they succeeded in 80% of those attempts. The success rate for takeover attempts by third parties was considerably lower.**

**TABLE 4**  
TURNOVER AMONG THE TOP THREE CORPORATE OFFICERS AND THE BOARD OF DIRECTORS FOLLOWING 65 NEGOTIATED TRADES OF AT LEAST 5% OF THE COMMON STOCK OF NYSE- OR AMEX-LISTED CORPORATIONS BETWEEN 1978 AND 1982\*

	<b>Year Following Block-Trade Announcement</b>			
	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
<b>■ Top Officers</b>				
CEO turnover (%)	33	19	14	7
Percentage outsiders	50	55	50	0
#2 turnover (%)	43	25	36	18
Percentage outsiders	35	40	50	38
#3 turnover (%)	43	34	43	30
Percentage outsiders	35	55	29	31
<b>■ Board of Directors</b>				
Turnover of chairmen (%)	37	16	15	21
Average number of arriving board members	2.13	1.05	1.02	.97
Average number of departing board members	1.78	1.17	1.16	1.09
<b>■ Number of Firms</b>				
	65	59	54	51

\*All firms remain independent for at least a year following the block trade.  
Source: Standard and Poor's Register of Corporations, Directors and Executives.

the firm, the cumulative abnormal returns from the announcement of the trade to the announcement of the repurchase averaged -12.4% (p-value = .23). The returns were negative in all five of these cases.

### Managerial Turnover

It is not difficult to understand why managers are less than friendly toward block purchasers. Our research reveals that a change in the company's largest blockholder often results in significant turnover in the top management team. As shown in Table 4, 33% of the chief executive officers in companies *not* acquired one year after a block trade departed in the first year after the trade, and another 19% left in the following year. This turnover rate significantly exceeds the normal rate of turnover among CEOs in publicly traded corporations.<sup>10</sup>

In fact, the turnover among chief executive officers following block trades is similar to that which follows takeovers and more conventional control transactions. One study found that 38% of the CEOs were replaced in the first year after a successful tender offer and another 19% departed in the following year.<sup>11</sup> Another study found that in 20 of 39 firms (51%) in which dissidents failed to win a majority of the board seats in proxy contests, the CEO, president, or chairman resigned within three years.<sup>12</sup>

As also reported in Table 4, 50% of the chief executives hired in the first year after a trade and 55% of those hired in the following year are brought in from the outside. Again, this is similar to what has been documented for other corporate control transactions.<sup>13</sup> By contrast, when public corporations are not involved in control transactions, only 15% of new chief executives are hired externally.<sup>14</sup>

10. For example, Robert Comment (1985) studied 2731 NYSE and Amex-listed corporations between 1975 and 1980 and found that approximately 5% of the chief executives turn over annually. (Robert Comment, "The Effects of Firm-Specific Human Capital on Management Equity Investment and Turnover, Unpublished manuscript (University of Michigan, 1985). Warner, Watts, and Wruck (1988), who focus on larger firms which generally have higher turnover than smaller firms, report top management turnover of 18%. (Jerold B. Warner, Ross L. Watts, and Karen H. Wruck, "Stock prices and Top Management Changes," *Journal of Financial Economics* 20 (1988), 461-492.

11. Kenneth J. Martin and John J. McConnell, "Corporate Performance, Corporate Takeovers, and Management Turnover," Unpublished manuscript (Purdue University) 1989.

12. DeAngelo and DeAngelo (1989).

13. Martin and McConnell (1989) found that 57% of the chief executives hired in the first year following a successful tender offer and 54% of those hired in the succeeding year were outsiders.

14. Warner, Watts, and Wruck (1988). See also Mark Reinganum, "The Effect of Executive Succession on Stockholder Wealth," *Administrative Science Quarterly* 30, (1985) 46-60.

**TABLE 5**  
 CUMULATIVE SURVIVAL  
 RATE FOR CHIEF  
 EXECUTIVE OFFICERS AND  
 BOARD CHAIRMEN  
 FOLLOWING NEGOTIATED  
 TRADES OF AT LEAST 5%  
 OF THE COMMON STOCK  
 OF NYSE- OR AMEX-LISTED  
 CORPORATIONS BETWEEN  
 1978 AND 1982\*

Year Following Block-Trade	1	2	3	4
<b>Survival rate of both chief executive officer and chairman of the board (%)</b>	36	26	24	21
<b>Survival rate of chief executive officer (%)</b>	41	30	29	27
<b>Survival rate of chairman of the board (%)</b>	44	35	32	25

\*A chief executive or chairman is treated as surviving if he retains his position with the firm and the firm remains independent and publicly traded.

Source: Standard and Poor's Register of Corporations, Directors and Executives.

There is also extensive turnover among subordinate members of the top management team (as classified by Standard and Poor's Register) and among directors. As reported in Table 4, 43% of the second- and third-ranking executives left in the year following a block trade. Although the turnover in this group dropped somewhat in succeeding years, it nevertheless exceeded the extensive turnover among chief executives. Turnover among chairmen of the board was almost as pronounced, with 37% leaving in the year following a trade. Turnover among directors in general was abnormally high only in the first year after a trade.

When we look at our entire sample—that is, including those firms that were subsequently acquired as well as those that were not—survival among chief executives and board chairmen became even less likely. As reported in Table 5, a chief executive or chairman was treated as “surviving” if he retained his position and his firm remained independent and publicly traded. In only 26% of the firms in our sample did both the chief executive officer and the chairman of the board “survive” for two years following the block trade.

In sum, management changes at the highest level typically follow many block trades. Moreover, whether this change is simply replacing the chief executive or chairman of the board, or whether it means changing the organizational form through a merger or tender offer, press reports suggest that the block purchaser typically initiates the changes.

## CONCLUSION

Negotiated trades of large-percentage blocks of stock are significant events for corporate shareholders and managers. Our analysis of 106 negotiated

trades of at least 5% of the common stock of NYSE- and Amex-listed corporations found that these trades were associated with average abnormal stock-price increases of 16.5%. The stock price increases were larger when the block purchaser eventually acquired the minority's interest. But even when companies remained independent, cumulative abnormal stock returns averaged 5.6% a year after the trade. As in the case of hostile takeovers, block trades tend to be concentrated among poorly performing companies and, often, in troubled industries.

Even if they don't lead eventually to acquisition, such block trades are generally followed by significant change within the corporation. Most strikingly, turnover among top managers is far higher than normal for public corporations. One third of the companies in our sample that were not acquired in a merger or tender offer replaced their chief executives within a year after the trade; turnover among other members of the top management team was even more pronounced. Although we found evidence that corporate control increased with percentage ownership, blocks as small as 10% to 15% of the common stock were often associated with stock price increases as well as extensive managerial turnover. Thus, in some firms at least, such fractional ownership can be viewed as conferring effective voting control.

Most block purchasers are active in firm management, sometimes directly, through service as officers and directors, sometimes less directly, through negotiations with management. The stock price increases among our sample of trades were larger when control passed to the block purchaser. Conversely, when the blockholder failed to achieve control or encountered resistance by management, firm value declined.

**The turnover among chief executive officers following block trades is similar to that which follows takeovers and more conventional control transactions.**

To the extent potential blockholders bring valuable managerial and monitoring skills to public companies, recent antitakeover laws and corporate charter amendments that restrict block purchasers from exercising their management rights take on added importance. During the mid-1980s, most states and many corporations enacted provisions that prevent purchasers of large-percentage blocks from voting their shares until approved by other shareholders. If block purchasers are not so approved, it is unlikely that firm value will increase, as such increases seem to depend on block purchasers using their voting power to institute management changes.

Large gains from block trades, and certainly the largest on average for minority shareholders, come

when a block purchaser acquires the remaining shares. Some of the recent antitakeover laws and charter amendments dictate that an individual or corporation can accumulate or purchase a large-percentage block of stock but cannot acquire the remaining shares for a specified period (three years under Delaware law). Our research suggests that resistance to acquisitions by blockholders is likely to reduce the wealth of minority shareholders.

Our results also suggest that top managers often have strong motives for resisting block trades since they risk being fired by the block purchaser. Minority shareholders, however, should oppose this resistance and promote a legal and regulatory environment in which blockholders can effectively monitor management.

■ MICHAEL BARCLAY

is Associate Professor of Finance at the University of Rochester's William E. Simon Graduate School of Business Administration.

■ CLIFFORD HOLDERNESS

is Assistant Professor of Finance at the Wallace E. Carroll School of Management at Boston College.

**Journal of Applied Corporate Finance** (ISSN 1078-1196 [print], ISSN 1745-6622 [online]) is published quarterly on behalf of Morgan Stanley by Blackwell Publishing, with offices at 350 Main Street, Malden, MA 02148, USA, and PO Box 1354, 9600 Garsington Road, Oxford OX4 2XG, UK. Call US: (800) 835-6770, UK: +44 1865 778315; fax US: (781) 388-8232, UK: +44 1865 471775, or e-mail: [subscrip@bos.blackwellpublishing.com](mailto:subscrip@bos.blackwellpublishing.com).

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