Research in International Business and Finance xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Research in International Business and Finance

journal homepage: www.elsevier.com/locate/ribaf

Full length Article

Do shareholder coalitions affect agency costs? Evidence from Italian-listed companies☆

Fabrizio Rossi[a,*], James R. Barth[b], Richard J. Cebula[c]

[a] PhD in Management Engineering, Adjunct Professor of Economics and Business Organisation, University of Cassino and Southern Lazio, Via G. Di Biasio 43, Cassino, FR, 03043, Italy

[b] Lowder Eminent Scholar in Finance at Auburn University, AL, USA

[c] Walker/Wells Fargo Endowed Chair in Finance at Jacksonville University, FL, 32211, USA

ARTICLE INFO

JEL classification:
G32
G34

Keywords:
Agency theory
Debt
Ownership structure
Multiple blockholders
Family-controlled firms
GMM estimation

ABSTRACT

This study investigates the relationship between agency costs and ownership structure for a sample of listed Italian companies to determine the impact of shareholder coalitions on agency costs. Using a balanced panel dataset of 1956 firm-year observations for the period 2002–2013, the results provide evidence that ownership concentration and debt play a limited role in monitoring agency costs, whereas the type of shareholder plays an important role in either mitigating or exacerbating agency costs. Family-controlled firms and coalitions among non-controlling shareholders seem helpful in reducing agency costs. The results suggest that coalitions among non-controlling shareholders both in family and non-family firms reduce agency costs. The findings also indicate that multiple blockholders play a key role as mediators. The paper provides a new perspective on assessing the role of agency costs in a bank-based, civil law country. The results enable one to better understand the impact of blockholders on agency costs and their interactions within family-controlled firms. The results also provide support for both the entrenchment effect and the alignment-of-interests hypothesis.

1. Introduction

The classic work by Jensen and Meckling (1976) has long served as the general framework for analyzing the issue of agency costs and ownership structure of firms. More recent studies, including those by Prowse (1990), Ang et al. (2000), Singh and Davidson (2003), and McKnight and Weir (2009), tend to probe deeper into the relationships between ownership structure and agency costs. However, these studies all share a limitation: they address the issue only within the context of common law countries, and not civil law countries, of which there are nearly twice as many countries. Civil law offers less overall shareholder protection and fewer creditor rights (La Porta et al., 1999; World Bank Group, 2015) than common law. Ownership structures in civil law systems tend to differ as well from common law systems. For Italy, in particular, firms show a high ownership concentration, a high degree of separation between ownership and control, a large presence of family firms, and a prevalence of pyramidal groups (Bianchi et al., 2002). Thus, the types of agency costs in civil law nations differ from those in common law countries. The latter generally contend with conflicts of interest between owners and managers, which is the classic "vertical"agency problems or Agency Problem I (Jensen and Meckling, 1976). Yet in Italy and other civil law countries, conflicting interests commonly arise between majority (family) shareholders and minority shareholders, a phenomenon known as a "horizontal"agency problem or Agency Problem II (Villalonga

☆ The authors wish to thank the Editor-in-Chief John W. Goodell and an anonymous reviewer for helpful suggestions and comments that have improved this study.

* Corresponding author.
E-mail addresses: f.rossi@unicas.it (F. Rossi), barthjr@auburn.edu (J.R. Barth), rcebula@ju.edu (R.J. Cebula).

https://doi.org/10.1016/j.ribaf.2018.02.002
Received 1 December 2017; Received in revised form 15 February 2018; Accepted 19 February 2018
0275-5319/

Please cite this article as: Rossi, F., Research in International Business and Finance (2018), https://doi.org/10.1016/j.ribaf.2018.02.002

and Amit, 2006; Villalonga et al., 2015). This conflict framework leads to an increase in the extraction of private benefits of control by majority shareholders to the detriment of minority shareholders (Bigelli and Mengoli, 2004).

Using a balanced panel dataset of 1956 firm-year observations for the period 2002–2013, this study empirically investigates the relationships between ownership structure and agency costs on the one hand and between debt and agency costs on the other hand. The results provide empirical evidence that family-controlled firms reduce agency costs, while debt plays a limited role in the monitoring and control of agency problems. The research also addresses the impacts of blockholders—individuals or groups owning large numbers of shares—on agency costs, and provides strong evidence that coalitions of non-controlling shareholders and/or the size of multiple blockholders significantly contribute to a reduction of agency costs. By contrast, the dispersion of control from minority shareholders to the largest shareholders increases agency costs. The study also finds that coalitions of non-controlling shareholders serve to strengthen the impacts of family-controlled firms on reducing agency costs.

This analysis of Italian firms contributes to the literature in several ways. First, this study extends knowledge of blockholders, about whom there is only limited published empirical research. Indeed, relatively little is known about the role and the real impact that blockholders may have on the value of companies. Coalitions between minority shareholders could mitigate agency costs, particularly in civil law countries. This study therefore examines agency costs in the relatively unexplored context of a single civil law country (Italy) that is characterized by a high concentration of ownership, including family ownership, and high debt levels. High ownership concentration along with high debt could produce an expropriation effect (rather than a monitoring of agency costs) at the expense of minority shareholders, especially in an institutional setting where corporate governance mechanisms are weaker. Thus, the presence of blockholders could balance the excess power of the single largest shareholder who could use debt to extract the private benefits of control. Unlike common law countries, in civil law countries, firms may use debt to expropriate resources to the detriment of minority shareholders without risking loss of control over the company.

Second, this study examines the role of blockholders, also considering family businesses, a type of company that is widespread in the world and which is still not adequately understood. Family businesses, compared to non-family-controlled firms, may have totally different *modus operandi*. Typically, most of the founder's financial resources are invested in the company and this implies a more limited opportunity for a diversified portfolio and hence greater risk. Such a situation could reinforce a hypothesis involving a business and financial strategy aimed at limiting risk-taking, although alternatively intended to make sub-optimal investments rather than increase a company's value in the interest of minority shareholders. The goal of preserving wealth could be placed ahead of a company’s growth, exposing family businesses to more serious agency problems. Such companies may abuse debt to increase their power without jeopardizing a dilution of control. Alternatively, they may constrain the level of debt to limit the risk of financial distress and market scrutiny but without sacrificing growth and maximization of value in the long run. In such companies, multiple blockholders could serve as a counterweight to the largest shareholder and thereby better serve the interests of minority shareholders.

Third, unlike other studies, this study employs several metrics for the measurement of ownership structure and not only investigates the size of blockholders but also considers the nature of shareholders and their impact on agency costs. The type of shareholders could have a non-negligible influence when interacting with the controlling shareholder and the other blockholders both in terms of objectives and preferences that blockholders wish to pursue (Pedersen and Thomsen, 2003). In addition, this study also considers the interaction between family ownership and blockholders to measure the impact thereof on agency costs. Due to limited knowledge as to the actual strength of multiple blockholders in mitigating agency costs, especially in family businesses, this study provides useful insights regarding directions that can be pursued in future research. The results, in fact, provide strong evidence that coalitions between minority shareholders and family-controlled firms have a positive impact on reducing agency costs.The effect is not only statistically significant, but also economically large. A one standard deviation increase in family-controlled firms results in an increase of 8.21% in the sales-to-asset ratio, whereas for a one standard deviation increase in the coalition the results indicate a decrease of 0.80% in the asset liquidity ratio, which is about 7.32% of the mean of cash holdings.

The remainder of this study is organized, as follows: Section 2 discusses related literature and develops the hypotheses; Section 3 describes the sample and survey methodology; Section 4 provides the estimation results and a discussion of the findings, while Section 5 provides a summary of the results and their importance.

2. Literature review and hypothesis development

A well-documented body of literature has addressed issues arising from the separation of ownership and control, and the agency costs that arise from conflicts between either principal and agent or between principal and principal (Berle and Means, 1932; Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983; Demsetz and Lehn, 1985; Morck et al., 1988; McConnell and Servaes, 1990; Cho, 1998; La Porta et al., 1999; Demsetz and Villalonga, 2001; Claessens et al., 2002; Faccio and Lang, 2002; Villalonga and Amit, 2006; and Coles et al., 2012). According to Jensen and Meckling (1976), in companies where a sole owner holds 100% of the shares, agency costs are nonexistent. However, when the largest shareholder holds less than 100% of a firm’s stock, agency costs tend to arise and the company’s value consequently decreases. Of note, Morck et al. (1988) find that when management ownership of the firm’s equity exceeds a certain threshold, the entrenchment effect tends to prevail over the aligned-interests effect. Jensen (1986) argues that the firm’s debt can be a good tool for monitoring agency costs in the presence of separation between ownership and control, which is a worldwide phenomenon (Claessens et al., 2000; Faccio and Lang, 2002). The presence of a positive relationship between firm performance and ownership structure in Europe and in Asia is confirmed in various empirical studies, such as Nowak et al. (2003); Hu and Izumida (2008); and Ng et al. (2009).

Prowse (1990) investigates the relationship between agency costs and ownership structure for firms in Japan and finds that bank shareholdings appear to be useful in mitigating their agency costs. Bartholdy et al. (1997) examine data from six OECD countries and