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Price differences between equity classes. Corporate control, foreign ownership or liquidity?

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Abstract

This paper is the first comprehensive study of price differences for dual class equity at the Oslo Stock Exchange. It analyzes the relative importance of corporate control, foreign ownership restrictions and stock market liquidity for the price differences. The Norwegian market has the peculiar feature that in part of the sample period non-voting shares were trading at a premium to voting shares, i.e., what is usually termed the "voting premium" was negative. This result can be rationalized by restrictions on foreign ownership. In the later part of the period, with no regulatory restrictions on foreign ownership, the voting premium is positive, and related to corporate governance and liquidity.

JEL classification: G10; G30

Keywords: Dual class equity; Corporate governance; Foreign ownership restrictions; Stock market liquidity

1. Introduction

Recent years have seen a resurgence of research interest in "dual class" stocks, equity issued by the same corporation with equal cash flow rights, but differing along some other dimension, such as voting rights. A prime reason for this resurgence is the increased interest in corporate governance, and the potential for dual class shares to measure corporate governance variables, in particular private benefits of control.

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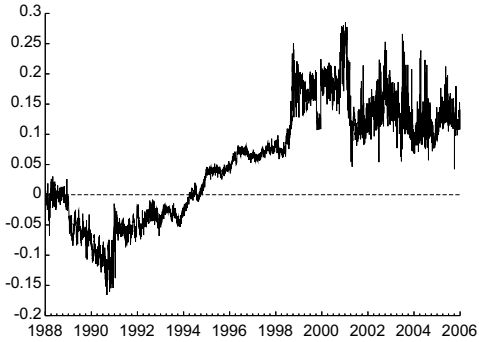

Fig. 1. The "Voting Premium" at the Oslo Stock Exchange. Value weighted average percentage price differentials between voting and non-voting shares. The price differential is defined as $(P_{A,it} - P_{B,it})/P_{A,it}$, where $P_{A,it}$ is the price of the voting (A) share for stock i at time t, and $P_{B,it}$ the corresponding price of the non-voting (B) shares. At each date t the relative price differential is calculated only for those companies in which both classes actually traded. A value weighted average is calculated of these observations, using total firm capitalization as weights. The figure uses data for all dual class stocks at the Oslo Stock Exchange in the period 1988–2005.

Much of the recent empirical literature takes the broad view, analyzing the topic of interest using a multi-country crossection.[1] Such multi-country studies have the benefit of a relatively large sample, but run the risk of only imperfectly controlling for country specificity. Many of the effects studied in this literature are results of country specific regulation. Using broad measures of country specificity, such as the Law and Finance variables of LaPorta et al. (1998), may only imperfectly control for differences across countries in the effects of regulation. It is therefore important to complement these multi-country studies with single-country studies, in which the regulatory environment is held constant.

The present paper is the first to take a close look at dual class equity at the Oslo Stock Exchange (OSE). The Norwegian case has some unique features that contradict prior research. In particular, for part of the period analyzed, non-voting stock were trading at a premium to voting stock, making the "voting premium" negative!

As a preview and summary of the paper, Fig. 1 shows the evolution of what is usually called the "voting premium" in this literature, the relative price difference between voting and non-voting shares, for the Oslo Stock Exchange in the period 1988–2005. Financial theory would argue that the voting premium should be positive or zero, since the voting shares have additional options relative to the non-voting shares. However, this intuition does not seem to hold in the Norwegian market, at least for the 1988–1994 period. Note also the sudden shift in the time series for the relation. There seems to be a structural change around 1994. The early period is characterized by a negative "voting premium," which changes to the positive premium observed in almost every other market. As will be shown later, this result can be rationalized by a change in regulation in 1995, at which date a restriction on foreign ownership of voting stock was lifted.

The most important contribution of the paper is that I document the existence of a negative voting rights premium, contradicting both intuition and observations from other

[1] See for example Bailey et al. (1999), Faccio and Lang (2002), Nenova (2003), Doidge (2004) and Pajuste (2004).