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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.

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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”).

desirable for the minority shareholders to expend more resources in monitoring his behavior.³ Important for us in accounting, this is clearly one of the reasons for the demand for accounting-related information. In fact, the genesis of accounting was in the “stewardship role” it can play in monitoring agents (see, e.g., Gjesdal, 1981 for a nice discussion). It is only more recently that the “valuation role” of accounting information has gained in prominence (and may well be the dominating role today). Related to the stewardship role (or governance) role of accounting, Jensen and Meckling argue that their theory can explain “why accounting reports would be provided voluntarily to creditors and stockholders, and why independent auditors would be engaged by management to testify to the accuracy and correctness of such reports.”

2.2. More on the role of ownership concentration (or importance of large shareholders)

There are two common approaches to corporate governance throughout most of the world (e.g., Shleifer and Vishny, 1997). First, investors’ rights are protected to varying degrees across the world through the legal process and legal environment. The second major approach, and the focus of this article, is ownership by large investors.

Research provides evidence that managers, when left unmonitored, are more likely to manage earnings, commit fraud, or make suboptimal investment decisions (e.g., Biddle and Hilary, 2006; Hope and Thomas, 2008). Thus, shareholder monitoring is an important mechanism by which agency costs can be reduced. However, while all shareholders have the responsibility to monitor managerial activities, the benefits of doing so by any individual shareholder are proportional to the percentage of shares owned (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). Put another way, when ownership is widely dispersed, it is economically less feasible for any individual shareholder to incur significant monitoring costs, because she will receive only a small portion of benefits. Similarly, when ownership is dispersed, it is harder for shareholders to monitor managerial actions.

Thus, as the percentage of ownership by individual shareholders increases (i.e., concentration increases), the more willing individual shareholders are to incur necessary monitoring costs. That is, when ownership is limited to one or a few individuals, it is easier and more efficient for those individuals to directly monitor managerial actions. This is the typical “vertical agency cost” argument (i.e., conflicts between managers and owners) and leads to the general prediction that agency costs are expected to be lower as ownership concentration increases.⁴

Potential manager–owner conflicts are not the only relevant issues. Horizontal agency costs relate to how large shareholders can decrease a firm’s value through extracting private benefit from the minority shareholders (e.g., La Porta et al., 1999). Morck et al. (1988) argue that increased ownership concentration may entrench managers, as they are increasingly less subject to governance by boards of directors and to discipline by the market for corporate control. Controlling shareholders may either engage in outright expropriation from self-dealing transactions or exercise de facto expropriation through the pursuit of objectives that are not profit-maximizing in return for personal utilities. These controlling shareholders may attempt to hide these activities from other stakeholders (e.g., minority shareholders and creditors) by manipulating reported performance (an issue of obvious interest to accountants). In other words, a controlling owner can increase agency costs via the positive association with private benefits of control (e.g., Hope et al., 2012a).

To summarize the discussion, the presence of a controlling owner represents forces that work in opposite directions. For a researcher, this is both a challenge and an opportunity. It is an opportunity if the researcher is able to specify ex ante which set of agency costs is likely to be most significant. For example, in countries with less legal protection of the minority shareholders the main agency problem often exists between controlling shareholders and minority shareholders.

³ Jensen and Meckling consider the term monitoring to include more than just measuring or observing the behavior of the agent. It includes efforts on the part of the principal to “control” the behavior of the agent through budget restrictions, compensation policies, operating rules, etc.

⁴ Furthermore, controlling shareholders could enable a long investment horizon which allows the building of strong relationships between the firms and outside providers of capital (Ellul et al., 2009). In fact, a controlling shareholder could increase business focus and make contracting negotiations easier.

2.3. The role of the second-largest shareholder

While the previous discussion explains the need for shareholders to monitor managers, the literature also establishes the need for shareholders to monitor one another. For example, controlling shareholders have the ability to exploit minority shareholders in closely-held corporations (e.g., Nagar et al., 2011). Such exploitation can include higher compensation to controlling shareholders, misappropriation of assets, and dilution of minority shareholders' interests through the issuance of stock or dividends (Gogineni et al., 2010). As the ownership stake of a second shareholder increases, so does her ability and willingness to effectively monitor the largest shareholder. The monitoring activities by the second largest shareholder would be similar to those used by the largest shareholder to monitor managers (Hope et al., 2012a).

Pagano and Roell (1998) specify conditions under which large shareholders monitor each other, reducing expropriation and improving firm performance. They predict that expropriation of minority shareholders is likely to be less severe when the ownership stake of non-controlling shareholders is more concentrated, as such concentration makes it easier and more effective to monitor the controlling shareholder. This is the typical "horizontal agency cost" argument (i.e., conflicts between majority and minority shareholders) and leads to the prediction that as ownership by the second largest shareholder increases, agency costs decrease.

2.4. How do large shareholders exercise their monitoring?

Often finance and accounting research is vague on the *mechanisms* through which monitoring happens. In practice monitoring by a large shareholder could take many forms. Perhaps the most commonly discussed means of monitoring discussed in the literature involves a large shareholder having a seat on the board. Several studies show in a variety of contexts the board's role in monitoring managers (e.g., Fama, 1980; Fama and Jensen, 1983; Adams et al., 2010). Other forms of direct monitoring would be a large shareholder actively participating in the firm's operations or having routine meetings with managers. As the proportion of ownership increases, the more beneficial it is for large shareholders to engage in these types of costly direct monitoring activities. Large shareholders can also serve to block business decisions that may be considered suboptimal (e.g., aggressive expansion through negative net present value projects). Doing so involves an investment in time and expertise by the shareholder to understand the consequences of major business decisions. Large shareholders are also likely to have more control over the firm's dividend (or capital distribution) policy, as a way to further discipline managers' actions.

3. Who are the large shareholders? Does it matter?

Analytical research on large shareholders tends to be rather generic and often does not consider that there may be very different types of large shareholders. There is surprisingly limited extant research on how different groups of large shareholders can affect corporate outcomes (e.g., financial reporting quality).⁵ Here I briefly consider research on the following owner types: families (including the CEO as owner), institutional investors, governments, and employees.

3.1. Family ownership

A large fraction of businesses throughout the world are organized around families and there is a relatively large literature on family ownership (Bertrand and Schoar, 2006). Most of this research is on publicly listed companies. For example, family-controlled firms dominate in East Asia and Latin America. As an indication of the importance of family firms, La Porta et al. (1999) report that 65% of the 20 largest firms in Argentina have at least a 20% family stake; in Hong Kong this fraction is 70%. In contrast, in Japan the corresponding number is 5%.

⁵ An exception is Cronqvist and Fahlenbrach (2009). They examine effects of different types of institutional investors in the US and find that investor type has significant effects on several corporate policies. The only study I'm aware of in accounting is Dou et al. (2012) who follow an approach similar to Cronqvist and Fahlenbrach (2009) and examine the effects of large shareholders on accounting practices for a large sample of US firms over the 2001–2009 period.

If a researcher is really interested in examining the effects of family ownership, it would seem that private (i.e., unlisted) firms offer even more fertile ground for research. Section 4 discusses private firms in more detail.

A stream of research has examined “family firms” included in the S&P 500. This line of research is primarily motivated by the fact that, notwithstanding the oft-cited idea that US publicly firms have widely dispersed ownership, Shleifer and Vishny (1986) (and others) document that large shareholders are common and, in particular, note that founding families continue to hold equity stakes and board seats in nearly 33% of the Fortune 500 firms. In other words, US firms may not be as different from those observed elsewhere in the world as thought by many. These founding families represent a unique class of long-term shareholders that hold poorly diversified portfolios and often control senior management positions. Family owners can thus exert influence and control over the firm, potentially leading to performance differences with nonfamily firms.

In a widely cited study, Anderson and Reeb (2003) investigate the relation between founding-family ownership and firm performance. They find that, contrary to their conjecture, family firms perform better than nonfamily firms. Additional analyses reveal that the relation between family holdings and firm performance is nonlinear and that when family members serve as CEO, performance is better than with outside CEOs. Overall, their results are inconsistent with the hypothesis that minority shareholders are adversely affected by family ownership, suggesting that family ownership may be an effective organizational structure.

Ali et al. (2007) recognize that, compared with nonfamily firms, family firms face less severe agency problems due to the separation of ownership and management. However, they face more severe agency problems that arise between controlling and non-controlling shareholders. These conflicting effects are often referred to as “entrenchment versus alignment.” Thus it is not clear what to predict regarding family firms’ disclosure practices relative to other firms. Using a sample of only S&P 500 firms, Ali et al. (2007) conclude that family firms report better quality earnings, are more likely to warn for a given magnitude of bad news, but make fewer disclosures about their corporate governance practices. Consistent with family firms making better financial disclosures, the authors find that family firms have larger analyst following, more informative analysts’ forecasts, and smaller bid–ask spreads.⁶

It is far from clear that the above findings should be generalized to other settings, even in the United States. First, although the firms classified as “family firms” by definition meet the definition of a family firm for these studies, others may employ a higher threshold for family ownership. Given the nonlinearities documented in the US setting, it is thus highly unclear what to expect in very different environments and with much higher family ownership (e.g., in private firms). Even more importantly, conflicting evidence exists on whether having family ownership increases or decreases a firm’s value, and it seems to be country dependent. Bertrand and Schoar (2006) conclude that there is no strong empirical evidence for the economic superiority of family-controlled businesses. According to Bertrand and Schoar (2006), family firms appear to underperform relative to nonfamily firms in most countries: for example, Claessens et al. (2002) for several Southeast Asian countries; Morck et al. (2000) for Canada; and Cronqvist and Nilsson (2003) for Sweden. Also, Bloom and Van Reenen (2007) find that family firms in France, Germany, the United Kingdom and the United States are systematically associated with worse managerial practices. Bertrand and Schoar (2006) note two important exceptions. Khanna and Palepu (2000) find that business groups in India, which are for the most part family-controlled, perform better than stand-alone firms in matched industries (see more on this below); and Sraer and Thesmar (2007) who find a premium for family firms in France.

3.1.1. The role of the CEO in family firms

There is comparatively limited research on the role of the CEO as part of the dominant family. A dominant belief in the literature is that as CEO ownership increases, her incentives align more with those of other shareholders, reducing the agency problem that arises from separation of ownership and control (e.g., Jensen and Meckling, 1976). This is known as the alignment effect which suggests reduced agency costs.

⁶ In a closely related study, Chen et al. (2008) find that, compared with nonfamily firms, family firms provide fewer earnings forecasts and conference calls, but more earnings warnings. The authors interpret the former to be consistent with family owners having a longer investment horizon, better monitoring of management, and lower information asymmetry between owners and managers, they interpret the higher likelihood of earnings warnings to be consistent with family owners having greater litigation and reputation cost concerns. In another related paper, Wang (2006) finds that founding family ownership is associated with higher earnings quality in S&P 500 firms (but also shows that the relation is non-linear).

Major shareholders are often family members of the CEO for private firms (Hope et al., 2012a). There are interesting competing hypotheses when the CEO is related to the major shareholder. Because of the family relationship, these shareholders no longer act as independent monitors in disciplining CEOs' decisions. In addition, family-controlled firms are likely to suffer from greater horizontal agency costs. It may be easier for major shareholders, who are family members of the CEO, to extract private benefits from minority shareholders or other stakeholders. The reason it may be easier to extract these benefits is that major family owners typically have strong influence over choosing members of the board. Consequently, the monitoring effectiveness of the board may be impaired when its composition is determined primarily by the CEO's family. These arguments would support the idea that agency costs will increase when there is a family relation between the CEO and major shareholder (Hope et al., 2012a).

An alternative view is that family member CEOs are less likely to act in ways that opportunistically harm other family members. That is, installing a family member as the CEO could be a mechanism through which family-owned companies can increase their monitoring of management and reduce the need for external monitoring. If this effect dominates, the agency costs are smaller when the CEO is a family member because familial ties are likely to create closer alignment of the CEO's preferences with those of family owners.

In conclusion, vertical and horizontal agency costs supply opposite predictions for effects of family firms. In addition, there are strong differences in the degree to which families control business, to what extent the CEO comes from the dominant family, and in other institutional arrangements. In short, there is ample "tension" in terms of predictions and plenty of room for future research!

3.1.2. Hope et al. (2012a) on agency conflicts in (private) family firms

Hope et al. (2012a) are interested in understanding how agency conflicts in private firms arise through ownership structures and family relationships. They analyze auditors' increase of effort and firms' choice of auditors in situations with higher level of agency conflicts. For a large sample of private Norwegian firms, they use data obtained through special permission by the government to measure direct and ultimate ownership for each shareholder as well as extended family relationships. Family relationships are measured based on marriage and blood lines, going back four generations and extending out to fourth cousin, and cover all shareholders, board members, and CEOs.

The authors find that (excess) audit fees, their proxy for audit effort in the face of agency conflicts, vary as hypothesized with firm-level characteristics related to ownership structures and family relationships. Specifically, they show that fees relate negatively to ownership concentration and to the extent of ownership by the second-largest shareholder. Audit fees also relate negatively to the portion of shares held by the CEO, consistent with ownership aligning the incentives of the CEO and other stakeholders. Audit fees are further positively associated with family relationships between the CEO and the major shareholder (a signal of reduced monitoring and a situation in which expropriation by the family/major shareholder is easier).

With respect to board independence, they find that audit fees decline as the number of board members related to the largest shareholder increases, consistent with fewer agency conflicts between owners and the board. In contrast, as the number of board members related to the CEO increases, fees increase, suggesting less board independence and greater agency conflicts.

Hope et al. (2012a) report two interesting sets of results for the demand for Big 4 auditor. First, for agency settings that are *not* CEO family-related, they observe results consistent with those obtained for the auditor effort tests. Specifically, the propensity to hire a Big 4 auditor increases as ownership concentration decreases, ownership of the second largest owner decreases, and the major shareholder's family influence on the board decreases. These results are consistent with the demand for a Big 4 auditor being greater in higher agency cost settings. They do not find significant evidence of a relation between hiring a Big 4 auditor and the fraction of shares owned by the CEO for the main tests but they do in sensitivity tests.

The authors find no association between the choice to hire a Big 4 auditor and CEO family-related agency variables. Specifically, there is no significant evidence that the demand for a Big 4 auditor is affected when a family relationship exists between the CEO and the major shareholder or as the number of board members related to the CEO increases. While some CEOs in family-related agency settings may wish to signal more credible reporting by hiring a Big 4 auditor, other CEOs in these settings may feel a Big 4 auditor is either

unnecessary given close family ties or unwanted because of the gains from extracting private benefits which could be reduced by a Big 4 audit.

3.2. Institutional ownership

Institutional investors such as pension funds and mutual funds are often “large” shareholders. In addition, they are typically viewed as “sophisticated investors” in the literature. The extant theoretical literature generally predicts large institutional investors as an efficient form of corporate governance. However, large institutional holders are not using their own money to make investments. Thus, with regulatory constraints or lack of incentives, Coffee (1991) argues that institutional shareholders tend to be passive.

Prior research has documented that sophisticated investors behave differently from other, less informed investors (e.g., Callen et al., 2005). Sophisticated investors have superior abilities and consequently can learn better from experience (Bonner and Walker, 1994). Economic incentives are potentially important as well. Institutional investors have large investment portfolios and, therefore, have much more to gain or lose in absolute dollar terms from their investment decisions. Furthermore, the costs of engaging in in-depth firm analysis are lower for institutions, in part because of their superior access to databases and analytical tools.

Research documents the existence of distinct groups among institutions that differ in their objectives and information needs. Bushee (1998) classifies institutions into three groups – transient, dedicated, and quasi-indexers. “Transient” institutions have high portfolio turnover and highly diversified portfolio holdings. They focus on the short term and make investments based on the likelihood of short-term trading profits. According to Bushee (2001), the short investment horizons of transient investors create little incentive for them to gather information relevant to long-run value.

In contrast, “dedicated” investors and “quasi-indexers” focus on the long term and provide stable ownership to firms. Dedicated investors hold large stakes in a limited number of firms. Such ownership creates greater incentives to invest in monitoring management and to rely on information beyond current earnings to assess managers’ performance. Quasi-indexers generally follow indexing and buy-and-hold strategies, and are characterized by high diversification. Although quasi-indexers follow a passive investment strategy, these investors may also have strong incentives to monitor management to ensure that it is acting in the best interest of the firm.

Many studies report results that are consistent with a superior ability of sophisticated investors to gather, analyze, and price information. Price (1998) finds that informed investors appear to make greater use of accounting disclosures and non-earnings information to form more precise earnings expectations. Bonner et al. (2003) document that sophisticated investors incorporate the information inherent in the relative accuracy of analyst forecasts to a greater extent than less informed investors. In addition, Bhattacharya et al. (2007) provide evidence that sophisticated investors demonstrate less behavioral bias in the way they process pro forma earnings information relative to more sophisticated investors. Finally, the efficiency of a firm’s stock price is associated with the degree of sophistication of the firm’s marginal investor (e.g., Bartov et al., 2000).

As an example of my own work that includes institutional investors, Chen et al. (2012) shows that the difference between closed-end country funds’ net asset values and their trading prices (i.e., the fund discount) is positively associated with the earnings opacity of the underlying companies. In conditional analyses they further find that the positive relation between earnings opacity and fund discounts is weaker for those funds with a higher level of institutional ownership. In other words, investors who are better equipped at information acquisition than other investors are able to overcome some of the information disadvantage of being “non-local.” In an earlier study, Callen et al. (2005) find that the variance contribution of foreign earnings increases with the level of investment by long-term (but not short-term) institutional investors.

To sum, there is strong evidence that institutional investors are an important class of large shareholders, in part because of their greater expertise in analyzing accounting information. There is also extensive evidence that there is important variation among the different classes of institutional investors. Thus, yet again we conclude that there is significant diversity among even subgroups of large shareholders.

3.3. State ownership⁷

3.3.1. History/background

State ownership of enterprises is far from new and is not solely confined to Continental Europe or Asia. In practice most states have relied on the state to kick start growth or at least to protect fragile industries. More recently, Singapore is often viewed as starting the new kind of state capitalism. Lee Kuan Yew, its founding father, was a tireless advocate of “Asian values,” by which he meant a mixture of family values and state control. However, state ownership is far from confined to quasi-authoritative states. In particular, many governments have found it desirable to have a tight control over their natural resources such as oil and gas. In China Deng Xiaoping transformed the economy by embracing globalization through creating special economic zones and inviting foreign companies in. He forced state enterprises to model themselves on Western companies and concentrated resources on national champions.⁸

3.3.2. Scale and importance of state ownership

State ownership is prevalent around the world. The rich world still has a large number of state-owned or state-dominated companies. For example, France owns 85% of EDF, Japan owns 50% of Japan Tobacco, and Germany owns 32% of Deutsche Telekom. In total OECD state-owned enterprises have a combined value of almost \$2 trillion and employ 6 m people. However, state-owned enterprises are even more important in the emerging world. They make up most of the market capitalization of China's and Russia's stock markets and account for 28 of the emerging world's 100 biggest companies. Finally, in terms of industry focus, state ownership is especially noticeable in the energy sector, with the 13 biggest oil firms in the world all being state-backed (as is the world's biggest natural-gas company, Russia's Gazprom).⁹ These are also the companies in which governments tend to have the highest ownership stakes and the most direct control.

3.3.3. Types of state ownership and quality of management

Property rights theory argues that ownership and control rights should be given to the parties that make ex-ante specific investments (e.g., Hart and Moore, 1996). According to the property rights theory SOE managers lack incentives to maximize corporate profitability, as the majority of the firm is owned by the state. Building on property rights theory, Hart et al. (1997) argue that privatized firms have a better incentive to minimize costs, but the systematic pursuit of profits may lead to poorer service quality. For example, following the privatization of railways in the UK and the Netherlands the quality of service visibly deteriorated. Schmidt (1996) argues that a trade-off exists for state-ownership. The benefit is that under state ownership the government has better information about the firm's management. The cost is that the government tends to interfere too much for political reasons.

In practice not all SOEs are created equal and there is evidence that governments are becoming more sophisticated owners. Only a handful of SOEs are still reporting directly to government ministries.¹⁰ In contrast most governments prefer to exercise control through their ownership of shares. Sometimes they hold all the shares, but increasingly they prefer to dilute their shareholdings.¹¹ There is also evidence that SOEs have become more productive as a result of restructuring. For example, in China their return on assets increased from 0.7% in 1998 to 6.3% in 2006 (although accounting figures obviously can be manipulated – which should provide a promising area for future research). I discuss more China-related issues in Section 5.2.

⁷ The primary source for this subsection is The Economist Special Report “The Visible Hand” January 31, 2012.

⁸ Similarly, the post-Soviet disaster created a craving for order and the Russian government reasserted direct state control over “strategic” industries.

⁹ However, state firms can be found in almost any industry. China Mobile has 600 million customers. Saudi Basic Industries Corporation is a huge chemical company. Russia's Sberbank is Europe's third-largest bank. Dubai Ports is the world's third-largest ports operator. In addition to having ownership stakes in companies, governments are also important large owners through sovereign wealth funds.

¹⁰ Statoil of Norway is the world's 13th-biggest oil company by revenue. Norway also has the third-biggest sovereign-wealth fund, the Government Pension Fund. Both are required to behave like regular companies.

¹¹ The United Nations Conference on Trade and Development defines a state-owned company as one in which the state owns more than 10% of the shares.

3.4. Employee ownership

Compared with the other groups discussed in this section, employees are typically less significant as owners. However, there is also significantly less research on employee ownership and there are interesting cross-country variations in how firms are structured and hence in the importance of employees in the governance of the firms, both of which create opportunities for future studies. Although clearly a generalization, it is probably fair to state that employees, including labor unions, have a relatively stronger say in Continental Europe than elsewhere.

The pros and cons of employee ownership have inspired much debate in recent years (Bova et al., 2012). On the one hand, advocates of employee ownership cite evidence which suggests that employee ownership leads to increasing employee–manager goal alignment and productivity gains that are ultimately reflected in higher shareholder returns (Kruse, Blasi, and Park, 2009). On the other hand, contrasting empirical evidence suggests that giving non-manager employees too much ownership in the company can erode shareholder value (La Porta et al., 1997).¹²

What is perhaps especially interesting about employees as an owner group is that there are three very different groups: managers, non-manager employees, and unions. There has been a fair amount of research on managerial ownership but much less on other employees and unions. Focusing on top managers' stock-based incentives, Nagar et al. (2003) find that stock-based incentives (and thus ownership) can reduce agency problems between managers and shareholders, and thus increase the incentives for managers to disclose information.

In contrast, Bova et al. (2012) investigate the role of non-manager employee ownership on voluntary disclosure. Specifically, they focus on the firm's employees as a group of stakeholders that have the potential to extract above-market rents from the firm and on employee ownership as a tool to mitigate this potential to extract rents. This provides for an interesting contrast between these two roles ("alignment" versus "rent extraction"). The literature provides evidence that managers have an incentive to keep information asymmetric with the market if employees can extract above-market rents from the firm – for example, in cases where the employee base is highly unionized. The benefit to the strategy of disclosing less is that reduced transparency should weaken the employees' bargaining position. However, an opaque disclosure policy keeps information asymmetric with not only employees, but also investors and other stakeholders. Employee ownership can thus potentially play an important role in mitigating this tension. Cramton et al. (2008) provides analytical and empirical evidence that employee stock ownership leads to a greater propensity for employees to internalize the costs of labor disputes, which in turn reduces employees' incentive to extract rents through costly strikes, which are deadweight losses. The decrease in the incentive arises as employee compensation becomes more closely linked to the stock returns of the firm, leading to any costly negotiation frictions (e.g., extended negotiations or strikes) impacting employee compensation to a greater extent.

Bova et al. (2012) employ a number of proxies for voluntary disclosure and find that firms whose non-manager employees have strong bargaining power provide less voluntary disclosure whereas firms whose employees have larger equity stakes in the firm provide greater voluntary disclosure. Furthermore, the effect of employee ownership in generating better disclosure is particularly strong, the greater employees' negotiation leverage. In other words, employee ownership appears to benefit the firm by not only aligning goals between the firm and its employees, but by also increasing disclosure from the firm to *all* of its stakeholders by mitigating the firm's need to keep information opaque.

In conclusion, there is limited research on employee ownership and great potential for future research to take advantage of cross-country variation in such ownership.

¹² For example, in 1995, United Airlines awarded employees 55% of the firm's equity in exchange for concessions on salaries and benefits. While the plan at the time was applauded by the US Federal government as an innovative way to heal the fractious nature of the union–management relationship, others remained skeptical of allowing a stakeholder that already contracted with the firm enough power to essentially control the firm's decision making (Bova et al., 2012).

4. Private (i.e., unlisted) firms

4.1. Importance of private firms

Private firms provide an important vehicle for economic growth around the world. More than 99% of limited liability companies, in most countries, are not listed on a stock exchange (e.g., Pacter, 2004; Chen et al., 2011). In the aggregate, non-listed firms have about four times more employees, three times higher revenues, and twice the amount of assets than do listed firms (Berzins et al., 2008). In 2008, *Forbes* reported that the 441 largest private companies in the United States accounted for \$1.8 trillion in revenues and employed 6.2 million people. Furthermore, according to the US Census Bureau, there are 29 million privately held companies in the United States, 7.6 million of which have paid employees, representing one-half of the nation's GDP (Hope et al., 2012b). Despite their obvious importance to the economy, there is limited extant research on private firms in general and in particular very little research related to accounting and auditing of such firms.

4.2. How are private firms different?

Private firms are different from publicly traded firms in several respects. Private firms are more closely held, have different governance, and have greater managerial ownership. Moreover, their major capital providers often have insider access to corporate information and typically take a more active role in management. With greater ownership concentration than in public corporations, large shareholders have a greater potential to take advantage of their controlling positions and direct private benefits for personal consumption, which is the typical problem of expropriation of minority shareholders and creditors (e.g., Morck et al., 1988).

4.3. The role of accounting and auditing in private firms

Some researchers take a strong position on whether accounting and auditing plays a lesser or stronger role in private compared with public firms. Personally I have no strong priors and I frankly believe there is not much evidence comparing the relative usefulness of accounting in these two sets of firms. In addition, I am not certain that it is fruitful to pursue such a line of inquiry per se.

The arguments in favor of reduced importance of accounting in private firms include the following. Most importantly, researchers often argue that there is lower demand for public accounting information in private firms as stakeholders may have access to private information. Furthermore, given the stronger ownership concentration, shareholder turnover is lower, and shareholders take a more active role in management, which some claim would reduce their reliance on financial statements for monitoring managers compared with public firms.

However, there are competing arguments also. Private firms typically have a weaker overall information environment compared with the relatively stronger disclosure environment of public firms. This suggests that, even if say the financial reporting quality (FRQ) is lower for private firms, accounting information could still play an important role since there are fewer competing sources of information.¹³ For example, McNichols and Stubben (2008) emphasize the role that accounting information plays in internal decision making. Small firms are unlikely to have management accounting systems that are separate from financial accounting, potentially enhancing the role of accounting in internal decision making (Chen et al., 2011). Finally, it is possible that the lack of analyst coverage and lower media coverage makes accounting information a relatively greater component of the overall information set used for decision making by insiders or outsiders (Chen et al., 2011).

With respect to the role of auditing, it is not obvious whether external auditors play a lesser or a stronger role in private firms than in public firms (Hope and Langli, 2010; Hope et al., 2011, 2012). On the one hand, Coffee (2005) discusses how the existence of controlling (i.e., especially large) shareholders can affect auditor independence. That is, Coffee (2005) argues that it is difficult for the auditor to escape the control of the party that she is expected to monitor. On the other hand, it is possible that the monitoring value of auditing is higher

¹³ For example, Indjejikian and Matejka (2009) highlight the importance of accounting information for private firms in compensation contracts.

in private firms because they are less vulnerable to takeovers and because they are required to disclose less accounting and non-accounting information than public firms (e.g., [Lennox, 2005](#)).

4.4. Some findings from the private firm setting¹⁴

Not surprisingly, accounting research has focused primarily on properties of earnings and in particular on comparing financial reporting quality between private and public firms. There is clearly some tension in this question – whereas the “demand” perspective predicts higher FRQ for public firms, the “opportunism” perspective lead to the opposite prediction. While some research that has focused on specialized samples and industries have found higher FRQ in private firms, the large-sample investigations to date suggest that the demand hypothesis dominates and that FRQ is higher on average in public firms (e.g., [Burgstahler et al., 2006](#) for European firms; [Ball and Shivakumar, 2005](#) for UK firms; [Hope et al., 2012b](#) for US firms).

4.4.1. *Hope et al. (2012b)*

There is very limited research to date on within-private firm variation in accounting. [Hope et al. \(2012b\)](#) provide the first exploration of cross-sectional variations in the FRQ of US private firms. They show that private firms with greater external financing needs and a greater presence of long-term debt have higher FRQ and greater conservatism.

More directly related to the topic of large shareholders, [Hope et al. \(2012\)](#) also investigate the expected impact of organizational form on FRQ from two perspectives – owner–manager separation and ownership dispersion. Because managers understand that their actions are not perfectly observable by the owner, managers have the ability to hide unfavorable performance by manipulating reported performance. Thus, firms which are more likely to suffer from agency costs (i.e., owner–manager separation) would be expected to have lower FRQ.

Owners are expected to take action by monitoring the activities of the manager. However, monitoring is costly, and owners are willing to incur monitoring costs only to the extent that the benefits outweigh the costs. These arguments suggest that when ownership dispersion is high, managers’ activities are less likely to be closely monitored and therefore manipulation of reported performance is more likely to occur. Based on these arguments, firms with owner–manager separation and higher ownership dispersion should have lower FRQ.

However, [Hope et al. \(2012\)](#) also discuss competing arguments which suggest that separated ownership may positively affect private firms’ FRQ. A controlling shareholder may have the ability to extract resources from the firm for personal consumption. These controlling shareholders may attempt to hide these activities from other stakeholders by manipulating reported performance. Such activities would lead to a positive relation between owner–manager separation and FRQ. In addition, the demand perspective would also predict a positive relation. In particular, when agency costs are higher, those contracting with the firm may demand more reliable financial information.

[Hope et al.](#)’s empirical findings indicate that private firms with more dispersed ownership (i.e., C corporations) have lower FRQ than other organizational structures as measured by three widely used FRQ proxies. These results are in line with the agency cost arguments (but not the demand arguments) described above.¹⁵

4.4.2. *Hope et al. (2011)*

[Hope et al. \(2011\)](#) use a sample of private firms from 68 countries (mostly from emerging markets) obtained from the World Bank. They first show that firms with greater financial reporting credibility, operationalized as financial statements reviewed by an external auditor, experience significantly lower perceived problems in gaining access to external finance. More relevant to our topic, they additionally examine how this relation varies with ownership concentration and with cross-country institutional factors.

¹⁴ Recall that the findings of [Hope et al. \(2011\)](#) are summarized in Section 3.1.

¹⁵ They further find that C corporations exhibit higher conditional conservatism, which might be explained by the higher information asymmetry associated with C corporations creating the demand by investors, creditors, and others for more timely loss recognition. An alternative explanation for this finding relates to tax effects.

In their sample of private firms, the largest shareholder owns on average 74% of the shares and 69% of the firms have a controlling owner. Thus, their cross-country sample provides a rich setting for testing the effect of large shareholders.

Hope et al. (2011) are primarily interested in the effect of financial reporting credibility on financing constraints in the presence of a controlling owner. When there is a controlling shareholder, financial reporting credibility can play a greater role in reducing *costs* associated with agency and information problems. In other words, financial credibility matters more when there is a stronger need for it (i.e., high agency cost setting such as a controlling shareholder). In addition, there is no reason to expect increased financial credibility to reduce the *benefits* associated with a controlling owner. In fact, financial credibility may further improve monitoring and incentive alignment when a controlling owner exists. Therefore, regardless of whether the agency costs of a controlling owner outweigh the benefits, the authors unambiguously predict that financial credibility will have a greater effect on reducing financing constraints when a controlling owner exists. Their empirical results support this hypothesis – the effect of financial credibility on reducing perceived financing constraints is increasingly important in the presence of a controlling shareholder.

The study further examines the effect of cross-country variations in institutional factors. Recent cross-country literature places considerable emphasis on the adverse effects of private benefits of control (e.g., Dyck and Zingales, 2004). Countries which have better institutional properties (e.g., investor protection, legal enforcement, creditor rights, etc.) are better equipped to curb costs associated with private benefits of control. Hence, if agency costs related to private benefits of control are considered important by providers of external finance, then the mitigating role of financial credibility would likely be more pronounced in regimes with weaker institutions. In other words, financial credibility matters more when agency problems are more severe. Because private benefits of a controlling shareholder are less severe in countries with stronger institutions, there is less concern for these agency costs, and financial credibility is expected to have less of an effect. Consistent with these ideas, Hope et al. (2011) find that the impact of financial credibility in reducing financing constraints in the presence of a controlling owner is more pronounced in countries with weaker creditor rights.¹⁶

My conclusion from the limited extant research on private firms is that there is a wealth of opportunities for future research. For example, there are interesting data sources available for private firms in China, and such data bases could potentially be combined with data on political connections or other interesting issues relevant for the Chinese setting.

5. Country variations in the roles of large shareholders

5.1. Introduction

Although it is primarily the more general agency cost arguments from Jensen and Meckling (1976) that have been cited by subsequent literature, it is also highly relevant for our discussion that Jensen and Meckling discuss the important *role which the legal system and the law play* in social organizations, especially, the organization of economic activity. In other words, we should not necessarily expect the same organizational structures or the same economic outcomes across different environments. As Jensen and Meckling (1976) explain, statutory laws sets bounds on the kinds of contracts into which individuals and organizations may enter without risking criminal prosecution. They focus on how the police and related powers of the state are used to enforce performance of contracts or to enforce the collection of damages for non-performance. The courts adjudicate conflicts between contracting parties and establish precedents. Such government activities affect both the kinds of contracts executed and the extent to which contracting is relied upon.

For a recent example of accounting research on how cross-country variations in the extent to which contracts are enforced matter to accounting outcomes, Dou et al. (2013) predict (based on incomplete contracting

¹⁶ Creditor rights are presumably one of the most important measures of legal protection associated with private firms.

theory) and find that firms that both reside in countries with weak contract enforceability and operate in industries with a greater need for relationship-specific investments tend to smooth reported earnings more.^{17,18}

Perhaps even more interesting than how certain institutional factors vary across countries is what I will call “country peculiarities.” These are differences across countries that are due to a multitude of factors that are difficult to summarize for researchers. Hence it may make sense to separately analyze certain issues related to large shareholders in specific countries. In the following I briefly mention some examples from China, India, and Japan/Korea.

5.2. China: the role of state-owned enterprises

In China, the government plays a central role in corporate governance. In fact, the most obvious difference between China and many other countries is likely in the extent of state ownership of large companies. According to Li and Zhang (2010), China has by far the highest percentage of state-controlled firms in the countries they survey. Specifically, in their study the state is the “ultimate controller” for 63.15% of Chinese firms. In contrast, the corresponding figures for their other sample countries are: Singapore 23.5%, Germany 6.3%, France 5.11%, Hong Kong (included as a separate country in their study) 1.40%, Japan 0.80%, and the United Kingdom 0.08%. This huge difference in reliance on state ownership in China versus other countries suggests that the notion of large shareholders is likely quite different in China.

There are two types of state-owned listed companies in China: either the company is controlled by a parent (holding) company or the majority shares of the listed company are held by a state asset management (operational) company (Tomasic and Andrews, 2007). Tian (2001) finds that the government is the majority shareholder of 31.4% of the Chinese public listed companies. Thus, the state is often the largest shareholder for publicly traded companies resulting in many state-owned enterprises in the market. However, contradicting theoretical and empirical evidence exist on whether the state ownership is beneficial in creating market value.

Property rights theory argues that ownership and control rights should be given to the parties that make ex-ante specific investments (e.g., Hart and Moore, 1996). According to the property rights theory SOE managers lack incentives to maximize corporate profitability, as the majority of the firm is owned by the state. However, given the unique government structure in China, it is difficult to draw any solid predictions through just examining the theoretical literature.

Official statistics suggest that about one third of Chinese SOEs are loss makers, another third either break even or making losses and the remaining one third are marginally profitable (Bai, Liu, Lu, Song, and Zhang, 2003). Bai, Liu, Lu, Song, and Zhang (2003) empirically show that a firm’s performance is negatively affected when the largest shareholder is the government. Tomasic and Andrews (2007) conducted interviews with various corporate participants and outline how there is a lack of minority shareholder protection in the presence of state ownership in China.

However, state ownership can also be beneficiary. For example, state ownership can provide long-term and stable ownership and ensure financing is available also during crisis periods. Both Tian (2001) and Hess et al. (2010) conclude that there is a U-shaped relation between government shareholding and market value. The detected U-shape implies that firms dominated by the state players continue to maintain a greater respect by the market and outperform those with lower levels of state ownership. However, the effects of state ownership in mitigating minority shareholder expropriation or manipulation of the market at lower levels of state ownership are limited.

Whether state ownership is “good or bad” is not as relevant to accounting researchers as how it can affect interesting outcomes. In the following I very briefly review some recent studies that focus on ownership issues (and state ownership in particular) in China.

You and Du (2012) employ both agency and resource dependency theory to predict involuntary CEO dismissal and subsequent firm performance in Chinese firms. They find that board monitoring mechanisms

¹⁷ Dou et al. (2012) further decompose income smoothing into “garbled” and “informational” components and find that results are driven by the informational component of income smoothing.

¹⁸ Although not the focus of this article, I would recommend authors to look beyond the standard La Porta et al. measures when looking for country-level variations. This is not a criticism of the La Porta et al. measures; however there are many other interesting variables and new websites available.

explain very little of the outcomes, but political ties with government officials at the state, provincial, county, and city levels are highly predictive of CEO turnover and ultimately firm performance. In other words, they conclude that political ties overrule economic norms in China, lending stronger support for the resource dependency perspective and challenging the agency cost perspective in the Chinese context.

Li and Zhang (2010) use Shanghai National Accounting Institute's Chinese Firms' social responsibility ranking and observe a negative relation between corporate ownership dispersion and corporate social responsibility for a state-owned firm; whereas a positive relation exists for non-state-owned firms. The authors attribute their finding to the large degree of political interference in state-owned firms.¹⁹

Pi and Lowe (2011) find no association between Chinese CEO turnover and the percentage of shares held by CEOs. They interpret the finding to mean that CEOs do not derive significant power from their shareholder status in China. Furthermore, they find that CEOs in state-owned firms are significantly less likely to be replaced involuntarily and conclude that CEOs in state-owned firms are likely enjoying more discretion because state-owned firms have weaker corporate governance mechanisms and strong political connections.²⁰

5.3. India: the role of business groups

Transaction cost theory suggests that the optimal structure of a firm depends on its institutional context. Khanna and Palepu (2000) discuss how diversified business groups dominate private sector activity in many emerging markets and in particular in India.²¹ The typical Indian business groups are collections of publicly traded firms in a wide variety of industries, with a significant amount of common ownership and control, usually by a family. Prior US literature has documented that businesses affiliated with diversified firms underperform their focused competitors. Among the reasons cited for the underperformance of diversified corporations are inappropriate allocation of decision rights, inefficient allocation of capital, and poor internal governance.

In countries such as India there are a variety of market failures, caused by information and agency problems. For example, firms often provide limited financial disclosure and often have weak corporate governance and control. In addition, intermediaries such as financial analysts or the financial press are not fully evolved and securities regulations and related enforcement are weaker than in Western countries. There is thus a potential for diversified business groups that can act as an intermediary between individual entrepreneurs and imperfect markets.

Khanna and Palepu (2000) analyze the performance of affiliates of diversified Indian business groups relative to unaffiliated firms. They find that accounting and stock market measures of firm performance initially decline with group diversification and subsequently increase once group diversification exceeds a certain level. Interestingly, unlike US conglomerates' lines of business, affiliates of the most diversified business groups outperform unaffiliated firms. Of the potential sources of performance effects of group affiliation, Khanna and Palepu (2000) find the strongest effect related to group-affiliated firms' access to international capital markets (presumably due to the track record of the group as a whole).²²

5.4. Japan and Korea: the role of keiretsus and chaebols

The ownership structure of Japanese (and also many Korean) firms is typically highly concentrated among corporate stockholders with financial institutions occupying a majority of the stock holdings (e.g., Douthett

¹⁹ Bai et al. (2004) use a panel data of 32 two-digit industries in 29 Chinese regions over the period of 1985–1997 and find that the degree of regional specialization is low for firms with larger shares of state ownership. The finding indicates that local governments have strong incentives to protect their industries.

²⁰ Chang and Wong (2004) examine local party committees' role in China's economic reform and suggest publicly listed Chinese firms can improve firm performance through decreasing local political party members' existing control level, supporting the grabbing hand theory. In addition, Yang et al. (2011) also support the idea of decreasing state-ownership in China to improve corporate governance. Huang and Xu (2009) study large blocks of share transfer in China and find a positive correlation between private benefit of control and block price but a negative relation between trading restrictions and block price. Moreover, private institutions offer a higher price than state-owned institutions.

²¹ Almeida and Wolfenzon (2006) provide a theoretical analysis of family business groups and in particular provide a new rationale for pyramidal ownership. A pyramid allows a family to access all retained earnings of a firm it already controls to set up a new firm, and to share the new firm's no diverted payoff with share-holders of the original firm.

²² Rather surprisingly, there is very limited accounting research using Indian data, which suggests opportunities for future work.

and Jung, 2001). A significant portion of Japanese industrial firms' ownership is represented by small groups of enterprises – *keiretsus* – composed of firms in different industries. These firms are interrelated through cross holdings of equity ownership and generally rely on a large commercial bank for their primary banking needs. The *keiretsu* firms maintain close financial and personal ties through cross-shareholding, credit holding, interlocking corporate directorates within the group, and a variety of business transactions.

On the one hand, the *keiretsu* relationship has the potential to increase the monitoring of managerial performance. On the other hand, the *keiretsu* relationship may decrease the effectiveness of monitoring. Managers may entrench in an inefficient, low-effort arrangement in which managers protect each other in the market for corporate control, resulting in an anti-competitive and exclusionary environment.

As but one example from Japan, Douthett and Jung's (2001) find that Japanese *keiretsu* firms have higher earnings response coefficients (their proxy for informativeness of earnings) than those of non-*keiretsu* firms. In addition, the ERC increases as the strength of the *keiretsu* relationship increases. Finally, discretionary accruals by *keiretsu* firms are smaller than discretionary accruals of non-*keiretsu* firms. Douthett and Jung (2001) conclude that the monitoring ability of the *keiretsu* improves the informativeness of earnings.

Business practices in Korea are similar although not identical to Japan. There is widespread use of pyramid ownership structures and cross-holdings among firms that belong to a business group. This type of corporate structure allows controlling shareholders to exercise full control over a firm despite holding a relatively small portion of its cash flow rights (e.g., Baek et al., 2006). Such a divergence between ownership and control raises concerns about the degree to which the controlling shareholders siphon resources out of firms to increase their wealth, that is, the degree to which the controlling shareholders engage in tunneling.

Baek et al. (2006) find that Korean chaebol issuers involved in intragroup deals set the private securities offering prices to benefit their controlling shareholders. They also find that chaebol issuers realize an 8.8% higher announcement return than do other types of issuers if they sell private securities at a premium to other member firms, and if the controlling shareholders receive positive net gains from equity ownership in issuers and acquirers. These results are consistent with tunneling within business groups.²³

The overall conclusion from this section is that standard agency cost theory predictions do not necessarily apply to all countries around the world. The legal, cultural, and other contexts in which ownership operates will likely influence the governance impact of large shareholders. It is incumbent upon us as researchers to both understand the environment that we are studying and to make use of such variations in the environment to come up with interesting new research questions to pursue. The good news is that there should be plenty of opportunities for future research!

6. Brief concluding remarks

This article has focused on highlighting the heterogeneity of large shareholders. Specifically, I discuss the importance of families, institutions, governments, and employees as shareholders. The roles of each of these is likely different and thus it is prudent to go beyond overly general notions of “large shareholders” and instead consider exactly who the owners are, and also suggests that further research on specific shareholder type effects on accounting outcomes would be welcome. I also emphasize that if researchers are really interested in researching ownership concentration, private firms may be the most fertile ground, both because these firms tend to have more concentrated ownership and because there is considerably less prior research on these economically important firms compared with publicly traded companies.

But perhaps most importantly, I would encourage readers to use their imagination and not just “follow the bandwagon” in terms of choosing research topics. I would recommend reading outside of accounting (both to find interesting topics and to bring methodological advances into accounting) and to follow closely what is happening in practice. There are many exciting research opportunities in China and I very much look forward to future issues of *CJAR* and to attending future conferences in China.

²³ Bae et al. (2008) examine intragroup propping within Korean chaebols. They find that the announcement of increased (decreased) earnings by a chaebol-affiliated firm has a positive (negative) effect on the market value of other non-announcing affiliates. This finding is consistent with the market's *ex ante* valuation of intragroup.

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