The Voice of Foreign Blockholders: A Corporate Governance perspective

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ABSTRACT

Around the world, more than one third of all publicly listed firms have foreign blockholders and yet very little is known about their motivations and objectives. The current study tries to fill this void by analyzing a large international panel of foreign blockholdings from over 3,600 firms across 26 European countries. At the descriptive level, we observe high between-country variability in the level of foreign blockholdings and show that foreign blocks especially originate from the U.S. and Western Europe. Importantly, foreign blockholding stake is growing as weak firm-level corporate governance increases only in poor institutional quality host countries. The results are driven by those cases in which foreign investors are corporate blockholders. We explain our findings from the fact that foreign blockholders with incentives and opportunities to exert their *voice* via *vote* compensate for the higher expropriation risk in weak institutional countries via larger shareholdings, expecting eventually to take control. Our findings provide important new insights in the literature on the monitoring power of central shareholder categories.

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1 Introduction

Foreign investors have emerged as an important investors' group for financial markets. Recent insights show that 35% of publicly listed firms have at least one foreign blockholder and in emerging markets the proportion of firms with a foreign blockholder rises above 50% (Holderness 2009, Liu et al. 2012). At the same time, foreign blockholders globally own about one third of the listed firms' equity (He et al. 2013). These considerable proportions may not come as a surprise given the large body of evidence highlighting significant benefits of foreign capital on total productivity, investment and growth (e.g., Henry 2000; Bekaert et al. 2005) as well as on firm's cost of capital (Bekaert and Harvey, 2000).

One specific type of foreign investment may be particularly relevant, namely when foreigners are so-called 'Principal Shareholders' of the foreign company, or are *foreign blockholders*. To identify them, it is necessary to first define what we want to mean by the term *blockholder*. Following Denis (2001), Seifert et al. (2005) and Holderness (2009), we define *blockholder* as a shareholder who owns at least 5% of the firm's ownership.[1]

From a governance perspective, blockholders' presence can be seen as a positive ownership feature because blockholders can exert governance through direct intervention in a firm's operations, otherwise known as *voice*, or indirectly via the sell-off of their equity stake, otherwise known as *exit* (see Edmans 2014). Examples of the first case include suggesting a strategic change via a public shareholder proposal or via a private letter to management, or voting against directors. The second governance mechanism is basically trading a firm's shares, if the manager destroys value, pushing down the stock price and thus punishing the manager ex-post. In this sense, we argue that also large foreign investors might play a central role in firm governance. In particular, we recognize that changes in ownership structures and the role of foreign blockholders are likely to arise as endogenous responses to environmental factors, as in the case of poor corporate governance, to enforce governance changes. Large foreign investors, like any other blockholder, can affect the firms' corporate governance, particularly given the capital they control, either through direct intervention or through the sell-off of their equity stake.

[1] Pivotal in the debate on explaining the differences is the discussion whether the foreign ownership should be seen as a percentage of a firm's free float that is held by foreign investors rather than a percentage of the total market capitalization (e.g. Leuz et al. 2009). In our tests, we partly overcome this debate by studying foreign *blockholdings* which inherently are part of the proportion of closely held shares.

With reference to this aspect, the debate on foreign blockholdings in the international arena also comprises another dimension, in that variations in local and institutional quality may shape the way foreign owners decide to invest and under what conditions. There is profuse evidence that when investor protection is weak and the information environment is suffering from poor corporate governance, potential agency problems tend to exacerbate (Denis and McConnell 2003; Shleifer and Vishny 1997), whereas in the presence of strong investor protection and good governance, agency problems are less extant. In particular, the high level of ownership concentration in European firms (Barca and Becht 2001, Becht and Röell 1999, Faccio and Lang 2002, La Porta et al. 1999), generates a strong influence of large shareholders on firm governance, with the possible result of reducing or amplifying problems of opportunism, depending on the institutional context. Specifically, the risk of expropriation is great when there are large shareholders with high equity stakes and when there are weak legal protection of small shareholders, underdeveloped capital markets, and limited monitoring role of banks (La Porta et al. 1999). These factors can, in fact, lead to the expropriation of small shareholders (*type II* agency problems). In particular, if the largest shareholder is an individual or a family, he can have significant incentives to expropriation (Villalonga and Amit 2006). As suggested by Mengoli et al. (2009), citing Roe (1994), the prevailing role of large shareholders leads to a system characterised by "*weak managers, strong blockholders and unprotected minority shareholders*".

However, the fact that a significant presence of foreign investors exists, even in settings that are characterized by relatively weak investor protection, raises important questions about the determinants of foreign blockholdings both at firm-level as well as at country-level. More in particular, the current literature has been unable to document international patterns in firm-level foreign blockholding positions. Indeed, despite a wealth of evidence on country-level ownership concentration (La Porta et al. 1999; Claessens et al. 2000; Faccio and Lang 2002) and on cross-border investment preferences (Kang and Stulz 1997; Chan et al. 2005; Dahlquist and Robertson 2001), prior literature has not yet given a clear answer on the determinants of foreign blockholdings. It is however of fundamental importance to understand the pattern of international blockholdings and to study how foreign blockholdings may act as a mechanism that can compensate for the lack of good governance (Aggarwal et al. 2011) in an international setting.

In an attempt to provide preliminary insights into this matter, we analyze a sample of 3,628 listed firms from 26 European countries for which we compiled comprehensive

ownership data on global foreign equity blockholdings for the period 2002-2009. The EU context is interesting to analyze because of several reasons. First, over the last decades, the European economy went through a significant economic harmonization process, resulting in increased intra-community (foreign) direct investments and resulting in a strong growth in foreign ownership levels (FESE 2007). Second, despite this harmonization process, European countries still have substantial disparities in foreign ownership levels and corporate governance characteristics, both at the firm- and country-level. [2]

At the descriptive level, we show that the large majority of foreign blockholdings come from respectively the U.S. (48.48%) and Western Europe (44.34%). Also, we find large between-country variations in foreign blockholdings in our sample. Further, we observe that foreign blockholders own more than 10% percent of the *total* share capital and that in those firms where foreign blockholders are present, they own more than 25% of the share capital.

In terms of our research hypotheses, we demonstrate that foreign blockholdings are positively related to poor internal corporate governance, but only in countries characterized by weak institutional quality. This finding is consistent with the *voice* argument of blockholdings presence and suggests that foreign blockholders may wish to compensate for the increased possibility of expropriation in weak institutional quality settings by engaging in sufficiently high equity stakes to exert their *voice* through direct intervention in a firm's operations, expecting eventually to take control. In addition, we show that results are driven by *corporate* foreign blockholdings and not by *financial* foreign blockholdings. Our results hold for various interpretations of institutional quality, and persist considering different robustness tests on the definition and interpretation of internal corporate governance, controls for endogeneity problems and applying propensity-score matching technique.

We contribute to the existing literature in several ways. First, we add to the literature on the effects of country- and firm-level governance regimes on foreign investment and ownership structures (La Porta et al. 1999; Leuz et al. 2009), and more in particular on the widespread phenomenon of international blockholdings. Second, our empirical investigation is one of the first that is able to observe cross-country time-series patterns in international foreign blockholding categories in response to *type II* agency problems. Prior empirical work

[2] An extensive range of studies have identified national variations across corporate governance arrangements in Europe. Despite the trend towards convergence, across Europe significant differences remain in terms of corporate governance at institutional-level that are rather difficult to reconcile. In addition, decision-making at EU level is poorly equipped to advance a coherent model based on 'best practices'. Therefore, at least in the short term, the future of corporate governance in Europe is likely to remain multiple peaked with large differences in key aspects among EU members (Cernat 2004).

on foreign blockholdings has typically been hampered by data limitations because sufficiently long time-series on foreign shareholdings are difficult to collect. Third, we provide evidence that foreign blockholders follow investment strategies in line with the *voice* argument of blockholder activism to minimize potential governance problems in target firms.

The remainder of the study goes as follows. Section 2 presents the research question of the work and the hypotheses. The third section describes the empirical model and the variables' definitions. In section 4, we continue with a description of the sample selection and summary statistics. In Section 5, we present our empirical findings. The final section concludes with the discussion of results and policy implications.

2 Research hypotheses

The debate about foreign investor decisions and international capital allocation is substantial. On the one hand, the literature has focused on the well-demonstrated home-bias in individual investment preferences, and finds support for the claim that non-domestic investment opportunities are less favored compared to local investments (French and Poterba 1991; Kang and Stulz 1997). Coval and Moskovitz (1999) illustrate a potential rationale for this preference for local stocks and show that both mutual funds and individuals earn significant abnormal returns on geographically proximate stocks. Park and Chung (2007), however, show that returns of Korean stocks with high foreign institutional ownership lead returns of stocks with low foreign institutional ownership and interpret this finding as that foreign institutional investors have faster processing power of new information compared to local institutional investors.

Studies on the determinants of non-domestic (i.e., foreign) investments comprise, for instance, Dahlquist and Robertson (2001). They show that foreign investors of Swedish firms have a preference for large firms, with significant international operations and without a dominant owner. Focusing on the combined foreign investments of all U.S. investors in 1997, Leuz et al. (2009) show that U.S. investors shy away from foreign firms with higher internal governance problems. Looking at the foreign investment decisions in more than one target market, Dahlquist et al. (2003) find that government expropriation risk is the single country-level characteristic that foreign investors try to flee. Orthogonal to this finding are the results by Chan et al. (2005), who show that foreign mutual funds avoid investments in countries with better scores on government expropriation risk. In another study on foreign mutual

funds, Aggarwal et al. (2005) demonstrate that U.S. mutual funds favor foreign investments in emerging markets that operate in less opaque countries and where there is a better legal enforcement and investor protection. Further, Giannetti and Koskinen (2010) show that in an attempt to avoid potential expropriation in weak investor protection domestic markets, local investors hold relatively more foreign stocks compared to investors from strong investor protection countries.

As evidenced, this set of results from the law and finance literature provides mixed results on foreign investment determinants, both at the firm- and country-level. In fact, the only clear conclusion is that the investment patterns in foreign stocks are affected by potential expropriation risk and additionally depend on foreign investor type, risk preferences and deal type. However, a potentially surfacing explanation relates to the *level* of foreign ownership a particular investor holds. This may be particularly relevant since related studies suggest that *large* foreign investors (i.e., blockholders) are not necessarily deterred by weak corporate governance (Liu et al. 2012) and that in cases of control acquisitions, like in M&A transactions, acquirers can overcome governance issues by monitoring the investor protection within target firms (Rossi and Volpin 2004). A likely explanation is that in settings of high potential shareholder expropriation, foreign blockholders may only be willing to bear the investment risk if they can protect themselves via obtaining a higher amount of shares (directly or indirectly), which is *de facto* a higher control.

While the information disadvantage that foreigners face increases the potential risk for expropriation by local insiders – especially so in poor corporate governance settings where insiders have a higher ability and incentive to divert firm sources into their own pocket – foreign blockholders might pursue a larger equity stake in firms to compensate for this type of risk (Liu et al. 2012), expecting eventually to take control, substituting for previous controlling shareholder. Therefore, in cases where there is a greater risk that local dominant shareholders can expropriate large foreign investors, the latter may only be willing to invest in combination with a larger ownership stake to prevent or reduce such a potential expropriation. This reasoning is consistent with the argument that foreign blockholdings may arise in response to concerns about insider misbehavior and weak investor protection. The rationale is also consistent with the *voice* argument in the blockholder literature which is facilitated at larger equity stakes or a de facto larger control.

Combined, these arguments suggest a positive association between foreign blockholdings and high expropriation risk (i.e., weak firm-level corporate governance combined with poor institutional quality) and result into our first hypothesis (H1):

H1: Foreign blockholdings are positively related to weak internal corporate governance in poor institutional environments.

Blockholders can differ substantially in terms of their activism role. The activism through *voice* rather than through *exit* is likely dependent upon the investment preferences from different types of blockholder. Also, monitoring skills of the investor type may impact on the ex post observed changes in firm policies (e.g., Velury and Jenkins 2006).

One particular type of blockholder that prefers a more active participation in firms' governance is the corporate investor. Douma et al. (2006), for instance, suggest that the higher commitment, combined with the industry-specific expertise and private information by corporate investors, may well explain the observed positive corporate blockholdings effect on firm performance. In an attempt to investigate the impact of blockholder type other than on firm performance, Dou et al. (2014) study the association between blockholder heterogeneity and the quality of a firm's information environment (proxied by financial reporting quality). The authors find, however, no discernible effects in the type of blockholder. While the non-result from Dou et al. (2014) may suggest that blockholder type potentially does not matter for a firm's information environment, their findings do not necessarily suggest that blockholders' expectations – and hence also their investment decisions – are homogenous across investor types. Chan et al. (2005) and Ferreira and Matos (2008), for instance, show that financial investors particularly favor investment opportunities in settings with greater transparency and are less actively involved in corporate governance designs compared to corporate blockholders (Douma et al. 2006). Indeed, foreign financial investors' preferences and decisions might be guided much more by short-term security return objectives than those of foreign corporate investors, which typically take on a *strategic* equity stake. Kang et al. (2012) empirically observe this rationale in a study on blockholder stakes by corporate value chain investors.

We argue, as the previous literature suggests, that foreign financial blockholders are predominantly passive blockholders. This is also consistent with the legal and structural

constraints they generally face.[3] As a result, financial blockholders may find exiting or remaining passive more attractive than trying to acquire a large enough stake in the firm to cover the costs of *voice* mechanism. Conversely, corporate blockholders have a higher degree of activism, since they are unique in that they can create synergies through cross-ownership with the target company that other blockholders may not be able to realize (Gerken 2014).

Combined, this leads to the expectation that, in an attempt to mitigate potential expropriation risk in foreign investments, the positive association between foreign blockholdings and high expropriation risk (i.e., weak firm-level corporate governance combined with poor institutional quality) is especially driven by blockholders with a preference of *voice* over *exit*, namely in the case when blockholders are foreign corporations. This results in the second hypothesis (H2).

H2: Foreign blockholdings are positively related to weak internal corporate governance in poor institutional environments more in the case of corporate compared to financial foreign blockholdings.

3 Empirical model and variable definition

3.1 Empirical model

Our base model takes the following form:

Foreign Blockholdings = f (Firm-Level Corporate Governance, Control Variables)

To capture the interplay between firm- and country-level governance effects, we estimate our model partitioning the sample based on our country-level governance proxies.[4]

[3] Certain institutional investors face a variety of regulatory barriers and potential conflicts of interest that make active monitoring difficult, if not impossible in many cases. Legal or regulatory restraints may prevent some regulated financial firms from accumulating the necessary size block that makes monitoring cost effective. For instance, a diversified fund, as defined in the Investment Company Act of 1940, may hold no more than 5% in any one company, and not more than 10% of any firm's outstanding shares. These constraints are binding for many investors. Likewise, conflicts of interest may exist when mutual funds consider activism against current or potential clients. Davis and Kim (2006) use proxy voting to show that mutual fund companies are less likely to vote against those firms with which they have a business relation. Similarly, pension funds are typically bound by ERISA regulation. This forces pension funds to only hold prudent securities limiting their investment opportunity set (Gerken 2014).

[4] By estimating subsample models, we explicitly allow for differences in all coefficients across the two subsamples, and meaningful cross-sectional variation in the effects of the control structure proxies also alleviates concerns that our findings are driven by correlated omitted variables.

Below we define in detail the variables of our analysis. Appendix 1 summarizes the variable descriptions.

3.2 Measures of foreign blockholdings

Key variable used in this study is the foreign blockholdings. To identify it, avoiding that the results depend on the definition of the variable itself, we use three different proxies and test the consistency of the findings over all of them: 1) *Largest foreign blockholding*, equal to the ownership of the largest foreign blockholder in each firm, to take into account the foreigner who has the large incentive to undertake intervention via *voice*; 2) *Total foreign blockholdings*, calculated as the total ownership of all foreign blockholders in each firm, used to measure the impact of foreigners as a cohesive block; 3) *Herfindahl index of foreign blockholders*, calculated as sum of squared ownership stakes of all foreign blockholders in each firm, to account for the degree of foreign blocks concentration.[5]

In addition, since one of our purposes is to examine the impact on large foreign ownership at a disaggregated level, we further recalculate our foreign blockholdings variables considering two investor categories: financial blockholders and corporate blockholders. Financial blockholders are defined as those whose primary operation is in the areas of banking, insurance, investment banking, brokerage, mutual and pension fund management, and other non-collective investment schemes, while corporate blockholders are defined as any other foreign blockholder who does not fall into the financial classification, excluding government blockholders and natural-person blockholders (Liu et al. 2012).

3.3 Firm-level corporate governance variables

As discussed before, the hypotheses refer to the link between proxies for poor internal corporate governance and foreign blockholdings. In particular, we need a proxy that captures the potential firm-level consumption of private benefits of control at the expense of outsiders. We discuss these internal governance metrics here below.

A) Family/management ownership percentage. Similar to Leuz et al. (2009), we consider *Family/management ownership* as our main measure of the potential risk of

[5] Results for all three blockholdings proxies are very consistent in all our analyses. For reasons of brevity, we report Herfindahl-based results only in the first table with multivariate results (Table 3). All other results based on the Herfindahl blockholding ownership concentration are available upon request from the authors.

expropriation, i.e. internal corporate governance problems. The presence of a family or a manager as a significant ownership category can influence many aspects of the firm's economic activity (Faccio and Lang 2002). The concentration of ownership in the hands of a family and/or a manager may lead to problems of expropriation against minorities (Villalonga and Amit 2006), particularly in the presence of low investor protection and an inefficient market for corporate control (La Porta et al. 1997, 1999). Given these arguments, we construct a proxy indicating ownership structures that are likely to be costly to evaluate and, at least in principle, more conducive to governance problems. In constructing our ownership-based governance proxy, we focus on managerial and family ownership because it is the management group and/or the family that actually makes the operational and financial decisions of a firm, and these decisions may potentially lead to expropriation of outside investors when the company is located in a poor institutional setting. In this sense, the proxy captures the ability and incentives of families and managers to consume private control benefits at the expense of outsiders.[6]

B) Board dependence. As an alternative corporate governance proxy, we use the percentage of *dependent* directors as a proportion of the total board members. It is generally accepted that independence of directors is a key criterion that drives the extent of insider monitoring (Hermalin and Weisbach 2003). When the insiders have *bargaining power*, the board's independence typically declines (Baker and Gompers 2003; Boone et al. 2007; Ryan and Wiggins 2004); conversely, more independent boards find it easier to confront the insiders than less independent boards (Adams et al. 2010). If indeed directors' effectiveness is a function of the board's independence from insiders, it is reasonable to accept that the higher the proportion of *dependent* members serving on the board, the less likely that the particular firm will be strongly governed. Again, the proportion of *dependent* board members may be particularly important in weak institutional quality countries because expropriation risk is potentially largest in these particular settings. We measure board dependence as 1 minus the proportion of independent directors sitting in the board.

3.4 Country-level institutional quality variables

As previously mentioned, our hypotheses focus not only on potential governance problems at the firm-level, but also on country-level differences in governance and

[6] Note that this proxy relates negatively to the level of foreign blockholdings in a mechanical way (see 3.5 for a more detailed description).

information flow. Therefore, to distinguish between strong and weak countries at the institutional-level, we use two different proxies for weak country-level governance as listed below.[7]

A) Investor protection rights. First of all, we use the revised Anti-director rights index as proxy of outside investor rights as in La Porta et al. (2006). It is a measure of shareholder protection in over a hundred articles, based on laws and regulations applicable to publicly-traded firms. The revised index relies on dimensions of corporate law, and summarizes the protection of minority shareholders in the corporate decision-making process, including the right to vote, so that a higher index level corresponds to better institutions. The index covers the following six areas: (1) vote by mail; (2) obstacles to the actual exercise of the right to vote; (3) minority representation on the Board of Directors through cumulative voting or proportional representation; (4) an oppressed minority mechanism to seek redress in case of expropriation; (5) pre-emptive rights to subscribe to new securities issued by the company; and (6) right to call a special shareholder meeting. The general principle behind the construction of the Anti-director rights index is to associate better investor protection with laws that explicitly are favorable to minority shareholders. The index ranges from 1 to 5 and we classify countries with low and high Anti-director rights index based on whether a country is below or above our sample median score.

B) Disclosure requirements. Every country has different requirements for when and how firm information must be disclosed. Disclosure rules make it easier for all investors to obtain information to evaluate firms' governance structures, while well-enforced governance rules and investor protection make knowledge about private benefits of control and expropriation less important. An important aim of the disclosure rules is to improve market discipline by enabling market participants to compare the composition of firm capital and value. In particular, we test the role of disclosure by using *Disclosure requirements* values reported in La Porta et al. (2006), that ranges from 0 to 1, distinguishing high and low quality of information environment at country-level. We distinguish between low and high disclosure countries based on whether a country is below or above our sample median score.

[7] In unreported analyses (available upon request), we test for the robustness of our findings across other interpretations of poor institutional quality (i.e., external corporate governance). In particular, we test for alternative proxies such as (1) legal origin; (2) tax haven status; and (3) cash-flow voting wedge. In all additional analyses, results are very similar to the ones reported in the paper.

3.5 Control variables

In line with prior work on (foreign) shareholdings, we additionally control for a battery of firm characteristics that have been identified as potential drivers of ownership blockholding.

Adjusted total domestic ownership. Foreign investors can find it difficult to obtain a substantial equity stake when domestic owners has a large proportion of stock. In other words, considerable presence of domestic ownership may deter the phenomenon of foreign blockholdings, limiting the possibilities for foreigners to be able to directly influence the operations of a firm (Dahlquist and Robertsson 2001; Goyer and Jung 2011; Liu et al. 2012). Hence, we expect a natural negative association of domestic ownership with our dependent variable. We mainly calculate domestic ownership net of family/management domestic ownership, to avoid to double-count *Family/management ownership* present in the explanatory variable of main interest. As a consequence, it summarizes the rest-category of domestic ownership.

Cash holdings. The bias displayed by foreign investors towards firms with large cash positions on their balance sheets can be understood in terms of asymmetric information, that is, foreigners appreciate firms with a high objective measure of financial strength (Dahlquist and Robertsson 2001). Cash and highly liquid assets are also able to finance investment opportunities and ensure the future ability of the company to seize growth opportunities. In addition, high amounts of cash holdings also enable foreign blockholders to reap some benefits from their targets, e.g., either in terms of stock repurchases or stock dividends (Goyer and Jung 2011). Therefore, we expect a positive effect on foreign blockholdings.

Leverage. Highly levered firms are more financially vulnerable and, thus, might attract less foreign investment, also because information about highly indebted firms is less readily available (Dahlquist and Robertsson 2001; Kang and Stulz 1997; Leuz et al. 2009); therefore, the expected sign of the coefficient of this variable is negative.

Size. Large firms are better known abroad than small firms, such that foreign investors may prefer larger companies, since information asymmetries between foreign and domestic investors might be less important for such firms (Dahlquist and Robertsson 2001; Goyer and Jung 2011; Kang and Stulz, 1997; Leuz et al. 2009; Liu et al. 2012), thus the expected sign of the coefficient related to this variable is positive.

Market to book ratio. We include this proxy for growth in our models. A preference of foreign investors for firm with high growth opportunities will be reflected in a tendency to hold high market-to-book stock (Dahlquist and Robertsson 2001; Leuz et al. 2009), so the expected effect of this variable is positive.

Return. The use of this variable is connected to the fact that classical Asset Pricing models predict that foreign investors hold portfolios of securities according to a certain level of stock return (Dahlquist and Robertsson 2001; Kang and Stulz 1997; Liu et al. 2012). Since we are dealing with large investors, the latter are *not* "momentum investors". Therefore, foreign blockholders may tend to increase their equity stake after market decline, so we expect a negative relationship between foreign blocks and stock return.

Stock price volatility. The use of an indicator inherent the volatility of the stock price lies in the fact that foreign investors may favor particular stocks simply for their risk characteristics (Dahlquist and Robertsson 2001; Kang and Stulz 1997; Liu et al. 2012). However, there is a literature that interprets volatility as a measure of stock price efficiency (Morck et al. 2000; Roll 1988) rather than risk. In this sense, foreign blockholders may have a preference for more efficient stocks, i.e., with higher volatility, so the expected effect of this variable is positive.

MSCI membership. We also control for the firm's inclusion in the MSCI World Index. Including this control variable captures the firm's visibility to investors (Covrig et al. 2007; Leuz et al. 2009), and makes it harder to find a relation between governance and foreign holdings, because *MSCI membership* is at least indirectly related to a firm's ownership and governance structure (Defond et al. 2011; Doidge et al. 2004 and 2009; Harvey et al. 2004). Greater visibility is expected to attract more foreign investors, so the expected sign of the coefficient of this control variable is positive.

Finally, we control for industry, country and year fixed effects in all our models.

4 Sample selection and summary statistics

We obtain firm-level data from two main sources: accounting, board and ownership data come from the Amadeus database, while stock-market information comes from the Datastream database. Ownership data are compiled manually at the end of every year of the observation period from 2002 to 2009, since the online access to Amadeus ownership data, until recently, only reported the most recent composition of ownership ties. We therefore

identify all recorded shareholders for each year during the observation period. *Amadeus* reports total ownership and direct ownership of each shareholder[8]. Total ownership is based on both direct and indirect shareholdings, i.e. via other firms. For this study we use data on total ownership. When total ownership is missing but direct ownership data are available, direct ownership is used. In addition to firm-specific data, we use country-level data extracted from various sources (La Porta et al. 1997, 1998 and 2006; Faccio and Lang 2002; World Bank). Similar to Leuz et al. (2009) we exclude financial firms. Further, we delete observations with missing data for our analysis. In addition, we winsorize the top and bottom percentile for each variable to avoid the impact of influential outliers. The final sample consists of an unbalanced panel of 3,628 listed companies and 18,021 observations in 26 European countries, with investors that are from all over the world[9].

Figure 1 shows the dynamics of the foreign blockholding shares. The blue line displays the trend of the average percentage of equity stake held by the largest foreign blockholder. The red line illustrates the average *Total foreign blockholdings* in each year. The green line indicates the average *Herfindahl index of foreign blockholders* in each year.

*****Insert Figure 1 around here*****

The average largest share of foreign blockholder appears to be steadily increasing over the years until 2008, to witness again the growing importance of this type of investor; subsequently there is a decrease, probably due to foreign investors' concerns related to the onset of the current financial crisis, which has led to an increase in home bias phenomen.[10] This trend is even more pronounced taking into account the total amount of foreign blockholdings. The concentration level of foreign blockholding, measured by the Herfindahl index, seems to have remained unchanged over the years of analysis.

[8] One can argue that it would be more accurate to consider the exact amount of ownership of voting equity, i.e. taking into account control enhancing mechanisms (e.g. dual-class share). Unfortunately, we do not have this information. However, our model does not necessarily assume that blockholders have control rights. In our study, a blockholder is simply any party with a sufficient stake to induce intervention (Edmans and Manso 2010).

[9] In the current study, we focus on a sample of listed companies only because (1) ownership ties are less complete and (2) board level data is missing in many cases for non-listed firms.

[10] In times of financial crisis the risk of internationally investing appears to be too great for the premium received. The additional downside risk into the measure for risk may therefore explain the extent of the risk perceived by investors, and for the premium prevailing, why investors tend to prefer to invest in their home markets (Pownall and Koedijk, 1999). Growing retrenchment literature uses capital flows and transactions data to conclude that during financial crisis investors left foreign markets for home (Forbes and Warnock, 2012; Fratzscher, 2012; Milesi-Ferretti and Tille, 2011).

We identify foreign block investments from source to host countries in Table 1. More specifically, we report average foreign blockholdings, in percentage terms, from the different parts of the world (*sources*: column title) to the European countries of the sample (*hosts*: row title).

*****Insert Table 1 around here*****

Table 1 shows that foreign blockholdings from the U.S. account for almost half of total foreign blockholdings (48.48%) and that foreign blockholdings from Western Europe are also significant (44.34%). At the country-level, we observe substantial variation in that some countries have fairly little U.S. foreign blockholdings (e.g., 10 countries have less than 10% coming from the U.S.) and in that cases have more blockholdings coming from either Western or Eastern Europe.

Taking the descriptive analyses at a different level, Table 2 provides summary statistics on foreign blockholdings as well as other firm characteristics for our full sample and by a firm's country of domicile.

*****Insert Table 2 around here*****

In line with the economic importance of large countries, the majority of observations come from the United Kingdom (23.2%), France (20.6%) and Germany (10.8%). On average, foreign blockholders have 10.8% of firms' ownership. Also, the largest foreign shareholder alone has an average value of 7.9%. However, because not all firms have foreign blockholders' presence, these proportions mount to 27.9% for total foreign blockholders' stake and 20.4% for the largest foreign blockholder excluding the observations without foreign blockholdings. The firms in our sample are quite large overall, with average total assets of 1.698 billion Euro. *Family/management ownership* is on average 16.5%, and also it has substantial between-country variation. However, this average value is calculated taking also into account the observations in which *Family/management ownership* is zero, i.e. with the absence of family or managers in the ownership structure. After exclusion of the cases with zero *Family/management ownership*, the mean increases to 27.2%. In addition, in order to make comparison with the statistics reported in existing studies, in particular with that of

Faccio and Lang (2002), we also consider the average values of the variable where family and/or manager have at least 5% of ownership. In that case, the mean value reaches 36.6 %.

5. Empirical results

5.1 Corporate governance and foreign blockholdings

This section reports results of the empirical verification on the relationship between corporate governance and foreign blockholdings. In selecting an appropriate econometric model, the substantial number of observations with zero foreign blockholdings calls for the use of a Tobit model (Wooldridge 2002). In particular, since we are observing an unbalanced panel data, we use a random-effects Tobit model.[11] Table 3 reports the coefficients of Tobit models estimated on the full sample of observations.

*****Insert Table 3 around here*****

In the first three columns, we measure the effect of *Total domestic ownership* (family/management plus other domestic ownership) on the three proxies of foreign blockholdings: 1) Largest, 2) Total and 3) Herfindahl measure. In all regressions, the observed coefficient is negative and highly significant. These results may not come as a surprise since the mechanical mechanism that explains this association is that more domestic ownership levels automatically result in fewer shares that are available for foreign blockholders. To find out more about the association between foreign blockholdings and family/managerial versus other domestic ownership, we separately insert these ownership categories in regressions 4-6. In all columns, the relationship with *Family/management ownership* proportions is weak if not insignificant. At the same time, the significantly negative coefficient with the rest-category of domestic ownership survives. In terms of the control variables, we observe that larger firms (*Size*), more cash-rich firms (*Cash holdings*), firms that belong to MSCI index (*MSCI Membership*) and firms with more volatile stock prices (*Stock price volatility*) attract more foreign blockholdings.

[11] It is appropriate to use this model even though it does not take into account some fixed-effects. Honoré (1992) has developed a semi-parametric estimator for fixed-effect Tobit model, but the unconditional fixed-effects estimates are biased.

Taken together, the results in Table 3 shows that, considering the whole sample, the effect of a weak internal corporate governance on foreign blockholdings does not emerges clearly, presumably because in this analysis we do not take into account the heterogeneity of the analyzed countries. However the effect of opaque firm-level ownership structures on foreign blockholdings is likely to be altered in countries with different investor protection and disclosure rules. To analyze the potential association between *Family/management ownership* and foreign blockholdings in further detail, and also to test the significance of difference between low/high institutional environments in impact of internal corporate governance on foreign blockholdings, we dichotomize the sample according to the domestic institutional quality. Therefore, we examine the association between foreign blockholdings and *Family/management ownership* separately for high versus low institutional quality countries, in line with the reasoning of hypothesis H1.

*****Insert Table 4 around here*****

Table 4 reports the regressions' results using the *Investor protection rights* variable (regressions 7-10) and *Disclosure requirements* (11-14) to partition the sample. The picture that emerges is very persistent for both institutional quality split-ups. In poor investor protection settings, the *Family/management ownership* variable is positively related to the level of foreign blockholdings (0.073; $p<0.05$ for largest foreign blockholder and 0.139; $p<0.01$ for total foreign blockholders). In the subsample of countries with strong investor protection, the association is significantly negative and is in line with the predicted negative mechanical association between foreign blockholdings and domestic shareholdings. For low *Disclosure requirements* countries, the *Family/management ownership* variable is also positively related to the level of foreign blockholdings (0.063; $p<0.01$ for largest foreign blockholder and 0.089; $p<0.01$ for total foreign blockholders). In line with the results for high investor protection countries, the coefficients on *Family/management ownership* for high *Disclosure requirements* countries are significantly negative. The *p*-values reported at the bottom of Table 4 are based on the difference between the *Family/management ownership* coefficients in both pairs of subsamples and is always significant at conventional levels.[12]

[12] The significance level is based on (untabulated) regressions on full sample in which *Family/management ownership* variable is interacted with an indicator variable set equal to 1 when a country belongs to the low protection or disclosure subsample (Leuz et al. 2009).

The combined evidence supports our hypothesis H1 that foreign blockholdings are positively related to weak internal governance in cases where the potential risk for expropriation is high (i.e., poor *Investor protection rights* or low *Disclosure requirements*).[13]

5.2 Foreign blockholders' identity

To test our hypothesis H2 on the importance of ownership type, we focus on two important categories of foreign shareholders in the relation with corporate governance, namely foreign corporate versus foreign financial investors. We refer to Section 3.2 for the definition of corporate versus financial blockholdings variables. The results are reported in Table 5. For reasons of brevity and in line with the predictions in hypothesis H2, we report results for low institutional quality observations only, namely weak *Investor protection rights* (regressions 15-18) and low *Disclosure requirements* (19-22), and we test the significance of difference between the impact of internal corporate governance on corporate foreign vs. financial blockholdings.

*****Insert Table 5 around here*****

The results indicate that the positive association between foreign blockholdings and our proxy for weak internal governance in poor institutional quality settings is driven by *corporate* foreign blockholdings and not by financial foreign blockholdings. For instance, regression (15) shows that the coefficient for *Family/management ownership* in isolation is positive and highly significant (0.158; $p<0.01$). Results are similar when we substitute *Largest corporate foreign blockholdings* with *Total corporate foreign blockholdings*. Also, the results persist for low *Disclosure requirements* subsample. The *p*-value on *Family/management ownership* coefficient difference between models (corporate vs. financial foreign blockholdings ad dependent variables) is always highly significant and confirms that

[13] Furthermore, we split the sample based on the other proxies of a country's overall level of corporate governance such as (1) legal origin, (2) tax haven status, and (3) cash-flow voting wedge. We expect that if firms have ownership structures that, in principle, are conducive to expropriation, foreign blockholders will increase their shares if the institutional environment is opaque or when the expropriation risk is higher, that is, for those countries, we predict that *Family/management ownership* will have a positive effect on foreign blockholding. We find essentially the same results as in the main analyses. In further (unreported) robustness checks, we run our tests only for observations where blockholdings are larger than zero and results remain unchanged. In addition, we scale foreign blockholders' investment by a firm's total blockholding, i.e. the total percentage of shares held by shareholders who have 5% or greater of ownership. We find that *Family/management ownership* is still positively related to this "revised" foreign blockholdings measure in country-level poor corporate governance settings (all results available upon request).

corporate foreign blockholdings are driving the results of Table 4.[14] Overall, these results provide support for hypothesis H2 and highlight that large corporate foreign investors, unlike financial foreign investors, have a preference for *voice* strategy, so they hold larger blockholdings in the presence of larger expropriation risk.

5.3 Robustness checks

In this section, we perform and discuss several sensitivity tests to address concerns about our main empirical analysis.

A) Alternative internal corporate governance proxy

To further corroborate the claim that internal corporate governance problems are non-trivial determinants of our results, we repeat the analysis using an alternative proxy for internal corporate governance problems, namely *Board dependence*. In fact, using an alternative variable mitigates concerns that the results based upon *Family/management ownership* are spurious. Although *Board dependence* is a more convincing measure of weak internal governance, we use it as an alternative proxy because there is a problem of limitation of data related to this variable. Indeed, we observe complete board data only for about 25% of firms in the total sample. For reasons of brevity, we only report the coefficients of interest on the impact of *Board dependence* on the value of foreign blockholdings in the cases of poor institutional quality countries.[15]

*****Insert Table 6 around here*****

Regressions 23 and 24 in Table 6 show that the *Board dependence* proxy is significantly and positively associated with foreign blockholdings in poor *Investor protection rights* countries[16]. We repeat the same analysis regarding the identity of foreign blockholders. *Board dependence* has a significantly positive effect on corporate foreign blockholdings. The results for financial blockholders – be it largest or total – are always insignificant. In addition

[14] The comparison tests are based on the methodology shown by Cohen (1983).
[15] For Table 6, we use as control variable *Total domestic ownership* including the family/management domestic ownership, since our main internal governance proxy is now *Board dependence*.
[16] The coefficient on *Board dependence* is insignificant in countries with strong *Investor protection rights* (not reported).

p-values relative to comparisons of pairs of *Board dependence* coefficients confirm previous findings. Combined, these results for an alternative proxy of weak internal governance again reinforce both our hypotheses. When repeating the analyses for the sample split on *Disclosure requirements* (regressions 29-34), a similar result emerges and coefficients are quasi-identical.

B) Dealing with endogeneity

As another robustness check, we try to address endogeneity concerns between internal governance and foreign blockholdings, since our results may be suffering from reverse causality. To address this potential issue, we use a Two Stage Least Square (2SLS) regression where we instrument for *Family/managerial ownership* using the firm's age (Ayyagari et al. 2013). Given that ownership diffuses over time, it is reasonable to assume that older firms on average have lower levels of family/managerial holdings (Su 2004). At the same time, there is no theoretical reason to expect that the age of the firm would be directly correlated with foreign blockholdings, except indirectly through the effect of *Family/managerial ownership*. However, these assumptions about the appropriateness of the instrument must be properly tested. The results of the second stage regressions on the test of hypotheses H1 and H2 are presented in Table 7. Also here, the number of observations differs from these in the main analyses because for some firms *Age* variable is missing or ambiguous. We report the results for the subsamples of low *Investor protection rights* and low *Disclosure requirements*, and, for brevity, we again only report the principal coefficients of interest.

*****Insert Table 7 around here*****

The strongly negative coefficients of *Age* variable in the first stage regressions (the *p*-value is always smaller than 0.001 [unreported]) confirm our conjecture that older firms have lower family/managerial holdings. In addition, in the second stage regressions, the positive and significant coefficients of the predicted value of *Family/Management ownership* variable in subsamples formed by countries with low investor protection are again consistent with our previous results. Again, results are highly similar for low *Disclosure requirements* sample splits and persist for both largest and total foreign blockholders. Combined, these results

where we explicitly control for potential endogeneity problems reconfirm hypothesis H1.[17] In terms of investor type, we again observe that the predicted value of *Family/management ownership* positively impacts on corporate foreign blockholdings, but not on financial foreign blockholdings. This reconfirms our second hypothesis H2. At the bottom of the table, the *p*-value on ΔSargan-Hansen statistics shows that *Age* variable is an exogenous instrument, since the *p*-value of the test is always not statistical meaningful.[18] In addition *p*-values relative to comparisons of pairs of *Family/Management ownership* coefficients give the same conclusions of previous findings.

C) Propensity-score matched sample

Finally, it may be important to carefully consider the features of firms in high versus low institutional quality countries. One may be concerned that firms belonging to countries with different (high versus low) institutional quality settings are dissimilar with respect to a number of features and that these features are potentially driving the association between foreign blockholdings and internal governance. To alleviate such a concern, we use propensity-score matching models[19] for the analysis of the first hypothesis, as developed by Rosenbaum and Rubin (1983). The matching estimator technique helps us minimize such concerns, by accounting for the effect of observables in a non-parametric way.

We selected a comprehensive list of attributes that differs between the two subsamples that includes substantially all of the explanatory variables in our regression models, as well as the dependent variables. The differences with respect to that firm characteristics warrant the use of propensity-score matched samples as a robustness check. Essentially, this strategy entails forming a group of "control" observations from the population of "non-treated" observations, by selecting the closest match to the treated observations in terms of firm

[17] We note that the results for strong investor protection observations now have an insignificant coefficient on the proxy for *Family/management ownership* (not reported for brevity), since we have reduced the spurious part of the link (the negative mechanical correlation).

[18] The endogeneity test implemented is defined as the difference of two Sargan-Hansen statistics: one for the equation without the instrument, and one for the equation with the instrument. The estimated covariance matrix used guarantees a nonnegative test statistic.

[19] Not using the propensity score matching, two groups of firms are compared by examining regressions with control variables included to take care of differences in firm characteristics. However, if the control variables have a poor distributional overlap between the two groups of firms, the controlling strategy can become ineffective. The matching estimator minimizes this problem since it selects the closest covariate values when forming the control group. The matching estimator also minimizes outlier problems. Finally, matching estimator is a natural fit to contexts in which non-linear modeling is more appropriate to explain the economic phenomena, as in our case.

characteristics (covariates). In our context, this procedure generates two groups of firms, one for the companies belonging to weak institutional contexts (treatment group), and one for firms belonging to strong institutional contexts (control group), such that these groups are very similar in terms of firm characteristics. Then, we repeat the regression analysis using these subsamples. We match control firms with treated firms in terms of both categorical and continuous variables. Although the categorical variables are matched exactly, the continuous variables cannot. Rather, the matching procedure selects the control firms with the covariate values in the closest neighborhood of covariate values of the treated firm. In order to account for this problem, the matching estimator allows for a bias-correction in the estimation. In particular, we consider a matching method that first defines a subset of potential controls which are close to treated firms on the propensity score (i.e., within "calipers"[20] according to Althauser and Rubin 1971) and then selects the control firms from this subset by using nearest available matching. We match on the logit of the propensity score using calipers of width equal to 0.00001, excluding the observations that do not meet these criteria.

We select the nearest observation with replacement, so the 1:1 nearest neighbor matching procedure yields 5,632 observations (3,043 treatment and 2,589 control observations) if we split data by investor protection index and 5,794 (3,144 treatment and 2,650 control observations) if we split by disclosure score. In Appendix 2 we show the mean values of our variable of analysis for the propensity score matched samples, distinguishing between firms that are in the sub-samples characterized by low and high level of institutional governance, according to our proxies of reference. We learn that the 1:1 nearest neighbor propensity-score matched samples appear to be useful, given that in most cases average values in the pairs of sub-samples are not statistically different. We report the regressions results based upon the propensity score matched samples in Table 8. Also here, for brevity, we report only the main coefficients of interest.

*****Insert Table 8 around here*****

After repeating the analyses for the propensity-score matched sample. we obtain qualitatively very similar results. We continue to observe that in weak *Investor protection rights* countries and low *Disclosure requirement* countries, *Family/management ownership* is positively related to foreign blockholdings. By contrast, the coefficients of the main effect are

[20] In the most common implementation of propensity-score matching, groups of treated and untreated subjects are formed whose propensity scores differ by at most a pre-specified amount (i.e. the caliper width).

again negative for the propensity-score matched sample in countries with strong *Investor protection rights* and high *Disclosure requirements*. In addition, the differences between the pairs of coefficients are still statistically significant.

6. Conclusions

This paper studies the determinants of foreign blockholdings in Europe across variations in corporate governance and expropriation risk presence. We conduct our tests on a sample of 3,628 firms from 26 EU countries. Using annual ownership and financial data from 2002 to 2009, we obtain a number of interesting conclusions. After providing novel large-sample descriptive evidence of foreign blockholdings in Europe, we test our two main hypotheses. First, we show that foreign blockholdings are positively related to weak firm-level corporate governance in poor institutional quality host countries. We argue that foreign blockholdings are more likely to appear and are higher in cases of potentially problematic governance structures, such as when there is a high level of family/managerial control in poor institutional settings. The underlying claim for this rationale is that when foreign investment opportunities may appear dangerous from an expropriation perspective, foreign blockholders will try and prevent potential expropriation incidence by taking on substantial equity stakes to increase their *voice*, expecting eventually to take control. Related to this rationale is the evidence found for hypothesis H2, so that corporate foreign blockholders, rather than financial foreign blockholders, build up larger ownership stakes to increase their *voice* in strategic debates. The evidence is important because it shows that large corporate foreign investors are not necessarily deterred by weak corporate governance, and may be willing to bear the investment risk if they can protect themselves via requiring a higher amount of shares.

Our empirical results confirm the theoretical equilibrium model in Liu et al. (2012) for settings where potential expropriation is high. In addition, taken together, our findings are consistent with the explanation that corporate governance plays an important role in the decision of foreigners to become blockholders and use a *voice* mechanism to overcome potential expropriation problems. However, we acknowledge that albeit large foreign blockholdings may be a solution to reduce potential expropriation risk, it does not automatically solve all expropriation risk issues. Future research might investigate the heterogeneity and origin of foreign blockholders and their corporate governance impact in

more detail. In addition, it would be interesting to focus on the aftermath of the financial crisis and see if the hypothesis tested in this study are still valid during the crisis.

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Tables and Figures

FIGURE 1
Evolution of foreign blockholdings

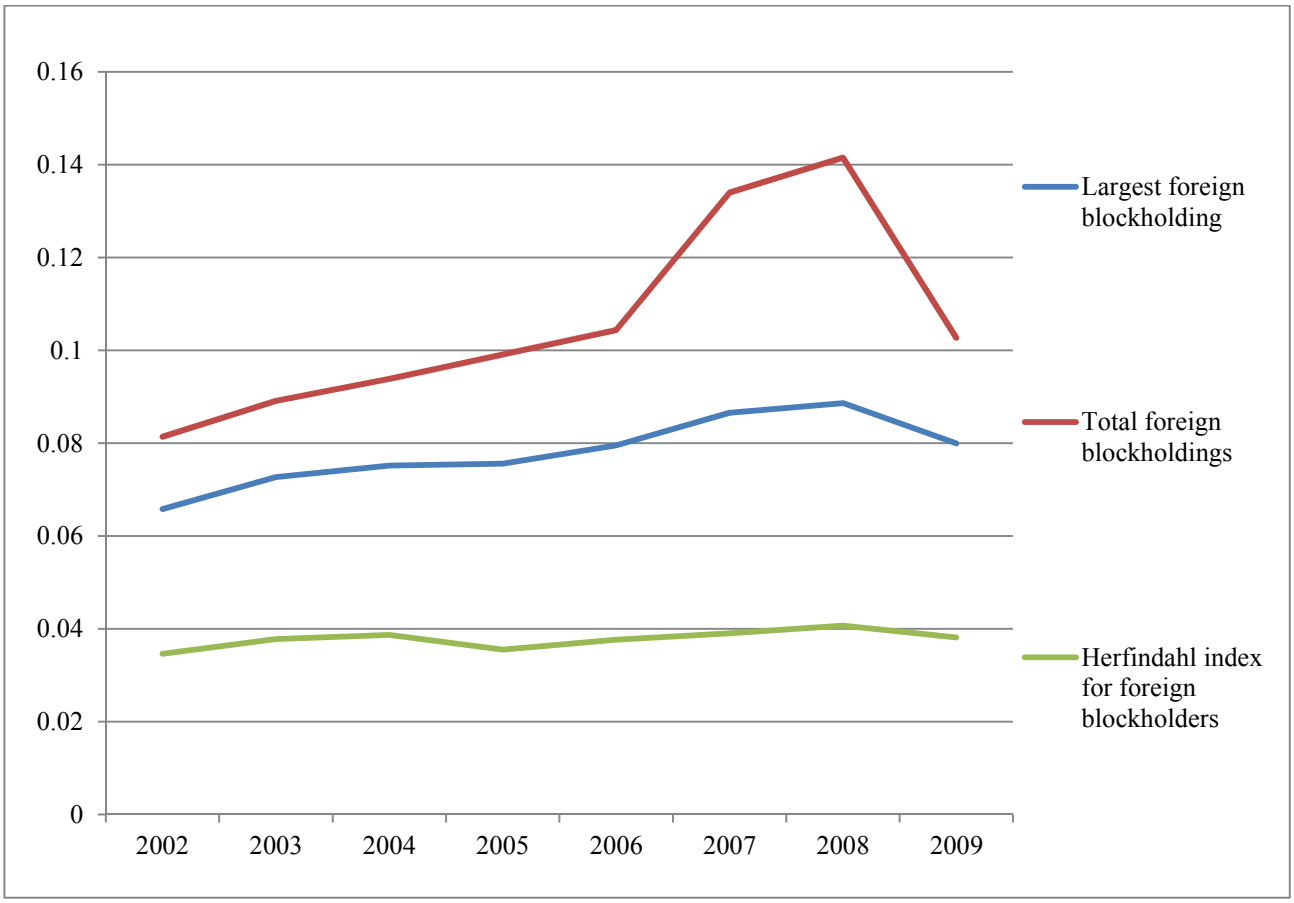

TABLE 1

Foreign block investments from source to host countries

Hosts/Sources	North America	South America	Western Europe	Eastern Europe	Other
All	48.48%	0.19%	44.34%	0.01%	6.98%
Austria	27.37%	0.00%	50.07%	0.00%	22.56%
Belgium	8.76%	0.00%	90.98%	0.00%	0.26%
Bulgaria	55.72%	0.00%	24.96%	0.44%	18.88%
Czech Republic	1.47%	0.0%	96.98%	1.55%	0.00%
Estonia	6.04%	0.00%	93.96%	0.00%	0.00%
Finland	25.36%	0.00%	72.57%	0.00%	2.07%
France	33.99%	0.17%	59.26%	0.00%	6.58%
Germany	25.91%	0.00%	53.52%	0.01%	20.56%
Greece	39.07%	0.00%	57.86%	0.05%	3.02%
Hungary	71.87%	0.00%	28.13%	0.00%	0.00%
Iceland	0.00%	0.00%	100.00%	0.00%	0.00%
Ireland	89.37%	0.00%	8.29%	0.05%	2.30%
Italy	21.46%	0.07%	78.19%	0.07%	0.21%
Latvia	1.80%	0.00%	98.20%	0.00%	0.00%
Luxembourg	28.59%	0.00%	28.59%	0.00%	0.00%
Norway	61.99%	0.00%	35.46%	0.00%	2.55%
Poland	10.48%	0.00%	87.45%	0.0%	2.07%
Portugal	3.78%	0.18%	94.59%	0.00%	1.45%
Romania	4.12%	0.00%	91.95%	0.29%	3.63%
Slovakia	5.72%	0.00%	64.88%	27.83%	1.57%
Slovenia	0.00%	0.00%	67.04%	32.96%	0.00%
Spain	21.51%	0.20%	22.8%	0.0%	9.0%
Sweden	16.8%	0.0%	74.8%	0.0%	8.4%
Switzerland	54.3%	0.0%	43.1%	0.0%	2.6%
Ukraine	0.0%	0.0%	81.5%	0.0%	18.5%
United Kingdom	62.9%	0.0%	31.1%	0.0%	6.0%

The table reports average foreign blockholding investments, in percentage terms, from the different part of the world (*sources*) to the European countries of the sample (*hosts*).

TABLE 2

Basic summary statistics on full sample and by country

Country	N	Size	Largest foreign blockholding		Total foreign blockholdings		Family/management ownership		
			All	>0	All	>0	All	>0	<0.05
All	**18,021**	**1,698,061**	**0.079**	**0.204**	**0.108**	**0.279**	**0.165**	**0.272**	**0.366**
Austria	163	826,817.2	0.127	0.309	0.147	0.359	0.067	0.275	0.339
Belgium	689	926,741.9	0.147	0.294	0.190	0.380	0.055	0.150	0.262
Bulgaria	448	40,186.65	0.076	0.339	0.089	0.396	0.088	0.295	0.409
Czech Republic	84	684,112.5	0.262	0.490	0.314	0.587	0.001	0.060	0.117
Estonia	29	62,016.92	0.473	0.508	0.579	0.622	0.000	0.000	0.000
Finland	633	963,144.3	0.049	0.160	0.065	0.213	0.167	0.237	0.359
France	3,716	1,472,369	0.074	0.231	0.096	0.299	0.245	0.357	0.434
Germany	1,952	2,306,009	0.100	0.317	0.118	0.375	0.184	0.379	0.422
Greece	365	266,912.2	0.069	0.238	0.092	0.321	0.473	0.517	0.519
Hungary	2	207,030.3	0.058	0.116	0.217	0.433	0.011	0.022	0.022
Iceland	15	245,069.1	0.008	0.115	0.012	0.173	0.027	0.058	0.178
Ireland	158	1,490,384	0.096	0.135	0.170	0.240	0.122	0.155	0.255
Italy	1,247	2,018,361	0.075	0.221	0.095	0.278	0.221	0.356	0.445
Luxembourg	27	2,062,268	0.089	0.172	0.130	0.251	0.084	0.282	0.316
Latvia	15	52,088.74	0.239	0.398	0.333	0.556	0.079	0.198	0.288
Norway	518	1,067,191	0.070	0.149	0.113	0.242	0.061	0.108	0.175
Poland	74	620,537	0.126	0.360	0.161	0.457	0.252	0.424	0.464
Portugal	349	1,119,678	0.067	0.193	0.111	0.317	0.091	0.229	0.350
Romania	86	280,952.3	0.342	0.626	0.382	0.699	0.046	0.232	0.325
Slovakia	16	83,709.76	0.336	0.359	0.404	0.431	0.000	0.000	0.000
Slovenia	94	335,378.1	0.014	0.117	0.017	0.141	0.017	0.125	0.380
Spain	867	2,488,755	0.097	0.177	0.153	0.279	0.167	0.191	0.332
Sweden	1,138	658.444	0.040	0.129	0.052	0.165	0.116	0.233	0.323
Switzerland	1,129	2,272,586	0.087	0.173	0.136	0.270	0.136	0.295	0.322
Ukraine	34	233,428.9	0.118	0.444	0.156	0.588	0.021	0.353	0.353
U.K.	4,173	2,331,718	0.060	0.135	0.094	0.212	0.124	0.180	0.267

The table reports the number of observations (N), and mean values for total assets, foreign blockholdings proxies, and *Family/managerial ownership* for our full sample and by firm's country of domicile. Values for total assets are in 1,000 Euro.

TABLE 3

Foreign blockholdings and internal corporate governance: full sample of countries

	(1) Largest foreign blockholding	(2) Total foreign blockholdings	(3) Herfindahl index of foreign blockholders	(4) Largest foreign blockholding	(5) Total foreign blockholdings	(6) Herfindahl index of foreign blockholders
Total domestic ownership	-0.249‡	-0.301‡	-0.196‡			
	(0.008)	(0.010)	(0.006)			
Family/mgmt. ownership percentage				-0.032†	-0.027	-0.015
				(0.014)	(0.018)	(0.010)
Adjusted total domestic ownership				-0.243‡	-0.295‡	-0.193‡
				(0.008)	(0.011)	(0.006)
Cash holdings	0.044†	0.058†	0.033†	0.043†	0.057†	0.033†
	(0.021)	(0.027)	(0.015)	(0.021)	(0.027)	(0.015)
Leverage	0.028*	0.030	0.023†	0.028*	0.030	0.022†
	(0.015)	(0.019)	(0.011)	(0.015)	(0.019)	(0.011)
Size	0.028‡	0.040‡	0.020‡	0.028‡	0.040‡	0.019‡
	(0.002)	(0.003)	(0.002)	(0.002)	(0.003)	(0.002)
M/B	0.001*	0.002	0.001†	0.001*	0.002	0.001†
	(0.001)	(0.001)	(0.001)	(0.000)	(0.001)	(0.001)
Return	-0.007*	-0.015‡	-0.005*	-0.007*	-0.015‡	-0.005*
	(0.004)	(0.005)	(0.003)	(0.004)	(0.005)	(0.003)
Stock price volatility	0.083‡	0.131‡	0.057†	0.085‡	0.132‡	0.058†
	(0.031)	(0.040)	(0.023)	(0.031)	(0.040)	(0.023)
MSCI Membership	0.008	0.013*	0.007*	0.008	0.013*	0.007*
	(0.005)	(0.007)	(0.004)	(0.005)	(0.007)	(0.004)
Industry/Country/Year Dummies?	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y
N	18,021	18,021	18,021	18,021	18,021	18,021
Wald χ^2	2,119(58)	2,542(58)	2,149(58)	2,122(59)	2,542(59)	2,150(59)
Log-likelihood	-3,432.78	-5,061.27	-610.05	-3,430.26	-5,060.15	-608.97

The table reports the results of Tobit regressions, in which the dependent variables are, alternatively, three different proxies of foreign blockholdings. The variables are described in Appendix 1. Industry, country and time dummies are included in the model, but the coefficients are not reported. The figures in brackets are standard errors. (*) (†) and (‡) indicate the statistical significance of each coefficient at levels of 10%, 5% and 1%, respectively.

TABLE 4

Foreign blockholdings, internal corporate governance and country-level institutional quality

	Investor protection rights				Disclosure requirements			
	Low		High		Low		High	
	(7) Largest	(8) Total	(9) Largest	(10) Total	(11) Largest	(12) Total	(13) Largest	(14) Total
Family/mgmt. ownership percentage	0.073†	0.139‡	-0.066‡	-0.081‡	0.063‡	0.089‡	-0.071‡	-0.071‡
	(0.029)	(0.036)	(0.016)	(0.020)	(0.023)	(0.029)	(0.018)	(0.023)
Adjusted total domestic ownership	-0.363‡	-0.486‡	-0.221‡	-0.254‡	-0.328‡	-0.428‡	-0.215‡	-0.250‡
	(0.018)	(0.023)	(0.010)	(0.012)	(0.014)	(0.018)	(0.011)	(0.013)
Cash holdings	0.133‡	0.168‡	0.023	0.033	0.059*	0.064	0.009	0.020
	(0.051)	(0.065)	(0.023)	(0.029)	(0.033)	(0.042)	(0.027)	(0.034)
Leverage	0.025	0.027	0.020	0.018	0.004	-0.007	0.033*	0.038
	(0.031)	(0.039)	(0.017)	(0.021)	(0.023)	(0.030)	(0.019)	(0.024)
Size	0.037‡	0.052‡	0.025‡	0.036‡	0.031‡	0.044‡	0.028‡	0.040‡
	(0.005)	(0.007)	(0.003)	(0.003)	(0.004)	(0.005)	(0.003)	(0.004)
M/B	0.003	0.005†	0.001	0.001	0.003†	0.006‡	0.001	0.001
	(0.002)	(0.002)	(0.001)	(0.001)	(0.001)	(0.002)	(0.001)	(0.001)
Return	0.009	0.006	-0.007	-0.016‡	-0.006	-0.008	-0.005	-0.016‡
	(0.008)	(0.010)	(0.004)	(0.005)	(0.006)	(0.008)	(0.005)	(0.006)
Stock price volatility	0.030	0.012	0.099‡	0.164‡	0.023	0.009	0.122‡	0.195‡
	(0.065)	(0.083)	(0.036)	(0.045)	(0.053)	(0.068)	(0.038)	(0.048)
MSCI Membership	0.009	0.007	0.009	0.016†	-0.002	-0.005	0.017†	0.025‡
	(0.011)	(0.014)	(0.006)	(0.008)	(0.008)	(0.011)	(0.007)	(0.009)
Industry/Country/Year Dummies?	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y
N	4,637	4,637	13,384	13,384	6,351	6,351	11,670	11,670
Wald χ^2	633(44)	738(44)	1,662(46)	2,028(46)	-1,074(51)	1,021(51)	1,410(40)	1,794(40)

Log-likelihood	-906.10	-1,335.34	-2,421.77	-3,596.66	-439.28	-1,680.26	-2,233.60	-3,226.58
p-value on F/M ownership coefficient difference between subsamples:			0.02	0.01			0.03	0.09

The table reports the results of Tobit regressions, in which the dependent variables are, alternatively, *Total* and *Largest foreign blockholdings* and split by the median country value on *Investor protection* scores [regressions 7-10] and *Disclosure requirements* score [regressions 11-14]. The variables are described in Appendix 1. Industry, country and time dummies are included in the model, but the coefficients are not reported. The figures in brackets are standard errors. (*) (†) and (‡) indicate the statistical significance of each coefficient at levels of 10%, 5% and 1%, respectively.

TABLE 5

Foreign blockholdings in weak institutional quality countries: The role of investor type

	Low Investor protection rights				Low Disclosure requirements			
	Corporate		Financial		Corporate		Financial	
	(15) Largest	(16) Total	(17) Largest	(18) Total	(19) Largest	(20) Total	(21) Largest	(22) Total
Family/mgmt. ownership percentage	0.158‡	0.214‡	-0.017	-0.031	0.154‡	0.205‡	-0.051†	-0.050
	(0.043)	(0.053)	(0.027)	(0.040)	(0.039)	(0.048)	(0.021)	(0.031)
Adjusted total domestic ownership	-0.448‡	-0.562‡	-0.159‡	-0.231‡	-0.478‡	-0.603‡	-0.130‡	-0.202‡
	(0.028)	(0.033)	(0.018)	(0.025)	(0.025)	(0.031)	(0.014)	(0.020)
Cash holdings	-0.021	0.012	0.191‡	0.248‡	-0.001	0.014	0.074†	0.098†
	(0.080)	(0.097)	(0.048)	(0.067)	(0.062)	(0.076)	(0.031)	(0.044)
Leverage	-0.015	-0.024	-0.004	0.000	-0.057	-0.086*	0.019	0.027
	(0.047)	(0.056)	(0.030)	(0.042)	(0.041)	(0.050)	(0.022)	(0.031)
Size	0.044‡	0.054‡	0.042‡	0.045‡	0.046‡	0.058‡	0.028‡	0.031‡
	(0.008)	(0.009)	(0.005)	(0.007)	(0.007)	(0.008)	(0.004)	(0.005)
M/B	0.004	0.005	0.005‡	0.006†	0.002	0.002	0.005‡	0.008‡
	(0.003)	(0.003)	(0.002)	(0.002)	(0.002)	(0.003)	(0.001)	(0.002)
Return	0.014	0.015	-0.007	0.003	0.000	-0.004	-0.016‡	-0.008
	(0.012)	(0.014)	(0.008)	(0.012)	(0.010)	(0.013)	(0.006)	(0.008)
Stock price volatility	0.016	0.017	0.032	0.030	0.017	0.034	0.039	-0.017
	(0.096)	(0.116)	(0.071)	(0.100)	(0.0911)	(0.112)	(0.058)	(0.079)
MSCI Membership	0.003	-0.001	0.003	0.007	-0.015	-0.028	0.009	0.013
	(0.017)	(0.020)	-0.017	-0.031	(0.015)	(0.019)	(0.008)	(0.011)
Industry/Country/Year Dummies?	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y
N	4,637	4,637	4,637	4,637	6,351	6,351	6,351	6,351
Wald χ^2	379(44)	394(44)	688(44)	466(44)	604(51)	623(51)	792(51)	589(51)
Log-likelihood	-1,159	-1,354	-659	-1,003	-1,534	-1,768	-867	-1,397

p-value on F/M ownership coefficient difference between models:	0.00	0.00	0.00	0.00

The table reports the results of Tobit regressions, in which the dependent variables are, alternatively, *Total* and *Largest foreign blockholdings* for observations in weak *Investor protection* [regressions 15-18] and low *Disclosure requirements* [regressions 19-22] and split by investor type: Corporate blockholdings versus Financial blockholdings. The variables are described in Appendix 1. Industry, country and time dummies are included in the model, but the coefficients are not reported. The figures in brackets are standard errors. (*) (†) and (‡) indicate the statistical significance of each coefficient at levels of 10%, 5% and 1%, respectively.

TABLE 6

Foreign blockholdings by type and institutional quality: alternative corporate governance proxy

	Low Investor protection rights						Low Disclosure requirements					
	All		Corporate		Financial		All		Corporate		Financial	
	(23) Largest	(24) Total	(25) Largest	(26) Total	(27) Largest	(28) Total	(29) Largest	(30) Total	(31) Largest	(32) Total	(33) Largest	(34) Total
Board dependence	0.195*	0.289†	0.404†	0.498†	0.095	0.133	0.192†	0.251*	0.453†	0.583†	0.033	0.069
	(0.100)	(0.135)	(0.176)	(0.220)	(0.072)	(0.105)	(0.098)	(0.138)	(0.181)	(0.229)	(0.071)	(0.111)
Control Variables?	All	All	All	All	All	All	All	All	All	All	All	All
Industry/Country/Year Dummies?	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y
N	1,181	1,181	1,181	1,181	1,181	1,181	1,355	1,355	1,355	1,355	1,355	1,355
Wald χ^2	184(34)	228(34)	79(34)	85(34)	259(34)	197(34)	217(38)	270(38)	106(38)	111(38)	271(38)	230(38)
Log-likelihood	-99.27	-249.47	-265.54	-323.91	-12.92	-165.94	-20.40	-242.47	-305.88	-379.54	4.70	-173.32
p-value on Board dependence coefficient difference	0.09	0.03			0.06	0.06	0.09	0.09			0.01	0.01

The table reports the results of Tobit regressions for the subsamples of weak *Investor protection* and low *Disclosure requirements* countries, in which the dependent variables are, respectively, proportions of *all* foreign blockholdings (largest and total) and proportions of corporate versus financial blockholders (again: largest and total). The independent variables in this table are identical to those in Table 5, but replace *Family/management ownership* with *Board dependence* as a proxy for internal corporate governance. *Board dependence* is measured by the percentage of not independent directors on the board. All variables are described in Appendix 1. Industry, country and time dummies are included in the model, but the coefficients are not reported. The figures in brackets are standard errors. (*) (†) and (‡) indicate the statistical significance of each coefficient at levels of 10%, 5% and 1%, respectively.

TABLE 7

Foreign blockholdings by type and institutional quality: control for endogeneity

	Low Investor protection rights						Low Disclosure requirements					
	All		Corporate		Financial		All		Corporate		Financial	
	(35) Largest	(36) Total	(37) Largest	(38) Total	(39) Largest	(40) Total	(41) Largest	(42) Total	(43) Largest	(44) Total	(45) Largest	(46) Total
Family/Management Own.	0.102‡	0.156‡	0.120‡	0.147‡	0.003	0.012	0.107‡	0.161‡	0.120‡	0.146‡	0.007	0.017
	(0.025)	(0.032)	(0.023)	(0.028)	(0.017)	(0.019)	(0.022)	(0.029)	(0.021)	(0.025)	(0.016)	(0.019)
Control Variables?	All	All	All	All	All	All	All	All	All	All	All	All
Industry/Country/Year Dummies?	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y
N	3,965	3,965	3,965	3,965	3,965	3,965	5,181	5,181	5,181	5,181	5,181	5,181
R^2	0.19	0.21	0.14	0.14	0.14	0.11	0.19	0.21	0.16	0.16	0.13	0.12
p-value on ΔSargan-Hansen statistics on *Age* variable	0.87	0.88	0.40	0.33	0.33	0.28	0.74	0.68	0.71	0.59	0.43	0.34
p-value on F/M Ownership coefficient difference:	0.06	0.06			0.00	0.00	0.01	0.01			0.00	0.00

The table reports the results of 2SLS regressions for the subsample of weak *Investor protection* and low *Disclosure requirements* countries, in which the dependent variables are, respectively, proportions of *all* foreign blockholdings (largest and total) and proportions of corporate versus financial blockholders (again: largest and total). We instrument for *Family/Managerial ownership percentage* variable using the variable *Age*. We include all the control variables in both the first and second stage regressions. The variables are described in Appendix 1. Industry, country and time dummies are included in the model, but the coefficients are not reported. The figures in brackets are standard errors. (*) (†) and (‡) indicate the statistical significance of each coefficient at levels of 10%, 5% and 1%, respectively.

TABLE 8

Foreign blockholdings and corporate governance: propensity-score matched samples

	Investor protection rights				Disclosure requirements			
	Low		High		Low		High	
	(47)	(48)	(49)	(50)	(51)	(52)	(53)	(54)
	Largest	Total	Largest	Total	Largest	Total	Largest	Total
Family/mgmt ownership percentage	0.060*	0.114†	-0.129‡	-0.153‡	0.058*	0.074*	-0.163‡	-0.179‡
	(0.034)	(0.045)	(0.034)	(0.043)	(0.030)	(0.040)	(0.037)	(0.046)
Control Variables?	Included	Included	Included	Included	Included	Included	Included	Included
Country/Year/Industry dummies	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y	Y/Y/Y
N	3,043	3,043	2,589	2,589	3,144	3,144	2,650	2,650
Wald $\chi 2$	382.06(43)	460.15(43)	454.24(46)	497.20(46)	523.75(51)	570.87(51)	321.96(40)	379.29(40)
Log-likelihood	-665.400	-954.429	-741.069	-985.934	-677.221	-977.519	-825.199	-1,058.358
p-value on F/M Ownership coefficient difference between subsamples:			0.00	0.00			0.00	0.01

The table reports the results of propensity score matched regressions, in which the dependent variables are, alternatively, *Largest* and *Total foreign blockholdings* for observations split by the median country value on *Investor protection* scores and *Disclosure requirements* score. In the first selection stage, firms are matched on all control variables to obtain the 1:1 closest match (*caliper* distance). The variables are described in Appendix 1. The descriptive statistics for the propensity score matched treatment and control sample are reported in Appendix 2. Industry, country and time dummies are included in the model, but the coefficients are not reported. The figures in brackets are standard errors. (*) (†) and (‡) indicate the statistical significance of each coefficient at levels of 10%, 5% and 1%, respectively.

APPENDIX 1

Variables descriptions

Variables	Calculation
Largest foreign blockholding	Percentage of ownership of the largest foreign blockholder who owns at least 5% of ownership stake.
Total foreign blockholdings	Sum of the percentage of ownership of all foreign blockholders who own at least 5% of ownership stake
Herfindahl index of foreign blockholders	Sum of the squared percentage of ownership of all foreign blockholders who own at least 5% of ownership stake
Largest corporate foreign blockholding	Percentage of ownership of the corporate largest foreign blockholder who owns at least 5% of ownership stake
Total corporate foreign blockholdings	Sum of the percentage of ownership of all corporate foreign blockholders who own at least 5% of ownership stake
Herfindahl index of corporate foreign blockholders	Sum of the squared percentage of ownership of all corporate foreign blockholders who own at least 5% of ownership stake
Largest financial foreign blockholding	Percentage of ownership of the largest financial foreign blockholder who owns at least 5% of ownership stake
Total financial foreign blockholdings	Sum of the percentage of ownership held by all financial foreign blockholders who own at least 5% of ownership stake
Herfindahl index of financial foreign blockholders	Sum of the squared percentage of ownership held by all financial foreign blockholders who own at least 5% of ownership stake
Family/managerial ownership percentage	Percentage of ownership of family and managers
Board dependence	Percentage of not independent directors on the total board members
Investor protection rights	Anti-director rights index (source: La Porta et al. 2006)
Disclosure requirements	Disclosure scores (source: La Porta et al. 2006)
Total domestic ownership	Percentage of ownership of total domestic shareholders
Adjusted total domestic ownership	Percentage of ownership of total domestic shareholders exclusive of family/management owners
Cash holdings	Ratio of cash and cash equivalents on total assets
Leverage	Ratio of total debt to total assets
Size	Natural logarithm of total assets
M/B	Ratio of market value of equity to book value of equity
Return	Yearly stock return calculated as the cumulative compounded return using the 52 weekly returns preceding the year-end
Stock price volatility	Yearly standard deviation of index returns of the past 52 weeks
MSCI membership	Dummy variable that is equal to 1 if the firm's equity is listed on MSCI World Index, and 0 otherwise
Age	Firm age
Industry Dummies	19 dummy variables, one for each type of industry (according to 2 digit NACE industry code), that are equal to 1 if the firm belongs to the particular sector to which the dummy refers and 0 otherwise
Country Dummies	26 dummy variables, one for each country, that are equal to 1 if the firm is in the particular country to which the dummy refers and 0 otherwise
Year Dummies	8 dummy variables, one for each year in the period 2002-2009, that are equal to 1 if the observation refers to the corresponding year and 0 otherwise

APPENDIX 2

Mean values of propensity-score matched samples

Panel A: Investor protection rights						
	Low		High		T-test	*p*-value
	N	Mean	N	Mean		
Largest foreign blockholder	3,043	0.0809	2,589	0.0781	0.629	0.529
Total foreign blockholdings	3,043	0.1109	2,589	0.1075	0.610	0.542
Herfindahl index of foreign blockholders	3,043	0.0381	2,589	0.0372	0.269	0.788
Family/managerial ownership percentage	3,043	0.1631	2,589	0.1618	0.196	0.845
Adjusted total domestic ownership	3,043	0.6622	2,589	0.6609	0.157	0.875
Cash holdings	3,043	0.0661	2,589	0.0673	-0.528	0.597
Leverage	3,043	0.4952	2,589	0.4929	0.390	0.697
Size	3,043	11.965	2,589	11.933	0.619	0.536
M/B	3,043	2.0648	2,589	2.1836	-1.859	0.063
Return	3,043	0.1287	2,589	0.1102	1.210	0.226
Stock price volatility	3,043	0.1089	2,589	0.1087	0.094	0.925
Panel B: Disclosure requirements						
	Low		High		T-test	*p*-value
	N	Mean	N	Mean		
Largest foreign blockholder	3,144	0.0682	2,650	0.0790	-2.592	0.010
Total foreign blockholdings	3,144	0.0932	2,650	0.1072	-2.647	0.008
Herfindahl index of foreign blockholders	3,144	0.0299	2,650	0.0378	-2.539	0.011
Family/managerial ownership percentage	3,144	0.1668	2,650	0.1745	-1.175	0.240
Adjusted total domestic ownership	3,144	0.6698	2,650	0.6737	-0.489	0.625
Cash holdings	3,144	0.0907	2,650	0.0893	0.462	0.644
Leverage	3,144	0.4826	2,650	0.4827	-0.011	0.991
Size	3,144	11.946	2,650	11.821	2.288	0.022
M/B	3,144	2.4398	2,650	2.4313	0.118	0.906
Return	3,144	0.1500	2,650	0.1432	0.438	0.661
Stock price volatility	3,144	0.1112	2,650	0.1108	0.227	0.821