

Expropriation, Unification, and Corporate Governance in Italy

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Abstract

Extant literature has usually argued that firms that unify dual class shares are likely to increase shareholder value. We examine the universe of Italian dual class unifications over the 1974-2005 period and show that the unification process is considerably more complex than it appears *prima facie*. Italian voting shareholders are typically not compensated for allowing their voting rights to be diluted. While there is some evidence that the unification increases shareholder value, we identify a subsample of firms where the unification process also allows controlling voting shareholders to expropriate wealth from minority shareholders. While the literature has typically used the divergence between cash flow and voting rights as a proxy for expropriation, we argue that in reversing this process, share unifications themselves create potential for expropriation.

JEL Classification: G32, G34

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1. Introduction

A large number of corporations around the world issue different classes of common share equity. Typically in these firms, one share of a given class has a claim to voting rights disproportionately different from its share of the firm's cash flow. These multiple class share structures allow controlling shareholders to separate their cash flow and ownership rights in a firm and maintain control even though their cash flow rights may be relatively weak. Grossman and Hart (1988) derive sufficient theoretical conditions under which deviations from the one-share one-vote principle will not maximize shareholder value and extant empirical research (see for example, Jarrell and Poulsen, 1988) finds significant negative abnormal price reactions at the announcement of dual class recapitalizations in the U.S. Consequently, a reversion from a dual to a single class of shares, a share unification, eliminates the wedge between voting and cash flow rights and thus is expected to be beneficial to shareholders.¹ In recent years, an increasing number of firms have decided to recapitalize their equity into single class stocks (see for example, Amoako-Adu and Smith, 2001, and Hauser and Lauterbach, 2004).

In this paper, we examine the wealth effects of a unique sample of dual-class share unifications (DCUs) in Italy. Our sample consists of the entire universe of 46 share unifications in Italy between 1974 and 2005. To the best of our knowledge, the wealth effects we document for unifications have not been examined in prior literature, although the implication from dual-class recapitalization studies is that unifications ought to be associated with positive shareholder wealth effects.

¹ Mayer and Franks (2006) outline the pros and cons of legislating the one-share one-vote rule for all listed firms, and conclude that the debate on the social usefulness of dual-class shares "... is just in its infancy". They argue that any social usefulness of outlawing dual-class share structures needs to be balanced against the freedom of pursuing alternate contracting mechanisms but conclude overall that there are clear potential benefits to eliminating dual-class voting structures.

Italy is an interesting country to study share unifications for a simple reason. By design, stock unifications involving shares of differential voting rights will result in a dilution of the voting rights of superior voting shareholders and a corresponding strengthening of the voting rights of inferior or non-voting shareholders. Typically the empirical research has found that voting shareholders are paid extraordinary dividends or new voting shares to compensate them for the loss of voting premium. Hauser and Lauterbach (2004), for example, document that in Israel, in 52% of share unifications, voting shareholders are assigned new voting shares to compensate for the dilution in their voting power. In the U.K., Ang and Megginson (1989) report that, in 45 of the 49 stock unifications in their sample, voting shareholders received an extraordinary dividend equal, on average, to 12% of the voting share's stock price. In contrast, in Italy, voting shareholders are, as a rule, *not* compensated in stock unifications. Why then do voting shareholders agree to these unifications?

We examine two hypotheses to explain this apparent conundrum. The *corporate governance* hypothesis suggests shareholders with voting control will favor unification because they believe that a single share class structure will result in improved corporate governance and therefore, higher stock valuations.² In contrast, the *expropriation* hypothesis argues that controlling shareholders of superior voting shares might use the unification itself as a method to tunnel wealth from non-controlling shareholders of voting shares. One way of doing this is for them to build up stakes of non-voting shares before submitting the proposal for unification for shareholder approval. Note that as long as voting shareholders were correctly compensated for their loss in voting power, this would not affect them adversely. The expropriation happens because the minority voting shareholders are not compensated during the unification process.

² Unifications may also help firms to join or get listed on national and international indices. In addition, they may also improve liquidity, and consequently ought to lead to increases in shareholder value.

We first develop a general model to compute the wealth effects of dual-class share unifications on voting and non-voting shares separately. Our model is descriptive - we make no attempt to model the equilibrium behavior of voting and non-voting shareholders. The main components of our model are a set of variables that predict the price effect on voting and non-voting shares upon the unification announcement. We then use this model to analyze the actual returns earned by voting shareholders on the unification.

The Italian firms in our sample that announce DCUs are not different from their industry peers. They are characterized by the presence of a majority shareholder, typically a family owning more than 50% of votes. In at least 21 unifications (almost half of the whole population), the majority shareholder also owns a large block of non-voting shares before the unification decision.

We find that while non-voting shares earn significantly positive market-adjusted excess returns of 11.7% in the three day period surrounding the announcement date, voting shares earn significantly negative excess returns of -1.6% over the same period, while the overall firm value does not change significantly. Over the universe of dual-class share unifications, the wealth transfer from voting shareholders to non-voting shareholders is significantly smaller than that predicted by the model. This is consistent with the corporate governance hypothesis.

Our results change dramatically however when we analyze the sub-sample of firms where the controlling voting shareholder holds a large block of non-voting shares prior to the unification announcement. These firms earn significant negative excess returns. Specifically, voting shareholders in these firms earn significantly negative three day market adjusted excess returns around the announcement date of -3.7%, as opposed to 0.46% for voting shareholders in firms where the largest shareholder does not hold a block of non-voting shares before the unification

announcement. For these firms, the corporate governance effect is to a large extent outweighed by the expropriation effect, though it does not completely disappear. A multivariate analysis shows that the change in the market value of the firm from before to after unification is negatively correlated with the pre-unification voting premium (a proxy for the prior extent of governance problems), with the fraction of non-voting equity in the firm.

Finally, we provide case studies for five dual class unifications where we have more detailed data. In these cases, a few months before the unification announcement, the majority shareholder typically buys large blocks of non-voting shares, approves stock option plans for non-voting shares and sells voting shares. Both the behavior of the controlling shareholders and the sharp drop of the voting share price at the announcement (ranging between -5% to -10%) are consistent with the hypothesis that dual class unifications can be a form of expropriation of wealth from minority shareholders.

Our paper contributes to the literature on corporate governance and share recapitalizations by showing that dual class share unifications can indeed improve shareholder value in line with the results on share recapitalizations. In addition, our paper also contributes to the growing body of literature on tunneling and expropriation in publicly listed firms. Johnson, La Porta, Lopez-de-Silanes, and Shleifer (2000), for example, discuss how controlling shareholders can tunnel resources away from minority shareholders by selling assets, goods, or services to the company through self-dealing transactions, by obtaining loans on preferential terms, or by transferring assets from the listed company to other companies under their control. Investigating how expropriation happens is important because as Stulz (2005) argues, the agency problems created when corporate insiders and rulers of sovereign states pursue their own interests ultimately may limit the economic growth and financial development of the country. However, despite

considerable anecdotal evidence, little systematic evidence is available on the specific transactions through which expropriation occurs. Most of the literature on expropriation has measured the expropriation of minority shareholders indirectly,³ though a number of recent studies have examined connected transactions between listed companies and their controlling shareholders to directly measure the extent of expropriation of minority shareholders.⁴ The form of “tunneling” we document in this paper is unique and adds to the list of such activities described in Johnson, La Porta, Lopez-de-Silanes, and Shleifer (2000) and in Cheung, Rau, and Stouraitis (2006). In addition, it is important to note that one indirect proxy for expropriation in the literature is the divergence between cash flow and voting rights (Bertrand, Mehta, and Mullainathan, 2002). By eliminating this divergence, dual class unifications might seem to reduce the potential for expropriation and improve shareholder value. We argue however, that the process of unification itself creates potential for expropriation.

While the Italian experience may be unique in sheer scale - both the voting premium and the wealth effects for controlling shares are large compared to those documented in other countries – we argue that DCUs in any setting are subject to similar abuses. Part of the reason why the effects we document have not been previously reported is because the limited extant literature on DCUs has focused chiefly why companies choose to unify their share classes and the announcement price effects. The literature has not examined wealth transfers between non-controlling and controlling shareholders of the same class of shares (voting shares).

³ Studies measuring the expropriation of minority shareholders indirectly use different proxies for the degree of expropriation, such as the legal system (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1998; Johnson, La Porta, Lopez-de-Silanes, and Shleifer, 2000), the divergence between cash flow and control rights (Bertrand, Mehta, and Mullainathan, 2002), dividend payouts (Faccio, Lang and Young, 2001), and the premium paid by large private shareholders in order to acquire controlling stakes in state-owned enterprises privatized through mass voucher schemes (Atanasov, 2004).

⁴ For example, Cheung, Rau, and Stouraitis (2006) examine connected transactions between Hong Kong listed companies and their controlling shareholders and find that, on average, firms earn significant negative excess returns both at the initial announcement and during the 12-month period following the announcement of connected transactions that are *a priori* likely to result in expropriation of minority shareholders.

The rest of the paper is structured as follows. Section 2 discusses related literature on share class recapitalizations and unifications. Section 3 describes the institutional background and the main reasons for Italian stock unifications. We present a simple model of the wealth transfer effect in section 4. Section 5 reports results for empirical tests for our sample of 35 DCUs while Section 6 analyzes five case studies in detail. Section 7 concludes.

2. Related literature

On the theoretical side, there is a large literature that analyzes the circumstances under which it is optimal to have only one class of share. Grossman and Hart (1988) and Harris and Raviv (1988), for example, show that the one share-one vote rule is an optimal corporate governance scheme in that better management teams are always elected in takeover bidding contests. In contrast, Burkart, Gromb, and Panunzi (1998) show that issuing non-voting shares may be optimal when it leads to higher takeover probabilities or increases security benefits in competitive takeovers. Faccio and Lang (2002) document that non-voting or limited voting shares are rarely used in Belgium, Portugal and Spain, while they are common in Italy, Germany, Switzerland and countries in northern Europe.

The empirical evidence on the valuation effects of the creation of a second class of shares with differential voting rights is mixed. Partch (1987) finds no evidence that current shareholders are harmed by the creation of limited voting common shares for firms in the U.S. Cornett and Vetsuypens (1989) examine the wealth effects of the announcement of an issue of stock with differential voting rights. They document that their sample of 70 U.S. firms earned positive abnormal returns when they announced a dual class recapitalization. Ang and Megginson (1989) and Liljeblom and Rydqvist (1991) find similar results in the U.K. and Sweden. In contrast, Jarrell and Poulsen (1988) find significant negative excess returns for U.S. firms announcing dual-class recapitalizations while Jog and Riding (1986) find similar results in Canada.

In contrast to the research on the creation of multiple share classes, there is a more limited amount of research on stock unifications. Some of these papers document a recent trend towards share class unification in several countries, such as Canada (Amaoko-Adu and Smith, 2001) and across Europe (Pajuste, 2005), emphasizing the necessity for studying these unifications. As

mentioned in the introduction however, most of this research examines why firms choose to unify their share classes, not on the potential for wealth transfers between controlling and non-controlling shareholders of the same class of shares.

Amoako-Adu and Smith (2001) conduct a longitudinal study of Canadian dual class firms over the fifteen year period following their IPOs. They find 56 cases of stock unifications in the 1979-1998 period. They report three main reasons why firms choose to re-capitalize into a single class of shares: they put into place a debt restructuring plan that requires elimination of dual class shares; they need to facilitate the sale of a control block and avoid coattail provisions⁵; or they need to increase liquidity and institutional investor appeal, especially before a seasoned equity offering.

Using a logistic analysis, Dittmann and Ulbricht (2005) examine a sample of 29 stock unifications in Germany and find that the probability of abolishing a dual class structure is higher for (i) firms that issue new equity in the same calendar year; (ii) larger firms; (iii) firms with a high proportion of voting shares; and (iv) firms where the largest block of voting shares is small. They interpret the strong correlation between a stock unification and subsequent equity offering as indicative of the presence of growth opportunities. In 29 of the 37 stock unifications from their 1990-2001 sample, Dittmann and Ulbricht (2005) find an average abnormal return in the five days around the announcement (day -4 to day +1) of 9.9% for non-voting shares, 3.9% for voting shares, and 5.4% for the firm as a whole.

Pajuste (2005) estimates a logistic regression on the determinants of 108 coercive stock unifications from seven European countries (Denmark, Finland, Germany, Italy, Norway, Sweden and Switzerland) in the 1996-2002 period. She finds that the probability of a coercive

⁵ Coattail provisions are meant to provide equal treatment to all classes of shareholders upon a takeover involving an acquisition of at least 50% of the superior voting shares of a dual class company. Since August 1987, a coattail provision has been a listing requirement on the Toronto Stock Exchange under TSX Policy 624(l).

stock unification is positively related to the issue of new equity, the number of acquisitions, and the presence of growth opportunities, and negatively related to the presence of a high voting premium.⁶

Ang and Megginson (1989) report that 49 of 152 U.K. listed firms with restricted voting shares in the 1955-1982 period decided to extend full voting rights to restricted voting shareholders. In 45 of these 49 operations, voting shareholders received an extraordinary dividend equal, on average, to 12.3% of the voting share stock price as a form of compensation for their surrender of special voting privileges.

Hauser and Lauterbach (2004) analyze 84 stock unifications in a sample of Israeli firms between 1990 and 2000, after a new regulation banned new issues of inferior voting shares at the Tel Aviv Stock Exchange. The typical Israel dual class shares structure involves a superior voting class (one share to one vote) and an inferior voting class (five shares to one vote). All stock unifications transformed inferior voting shares into superior voting ones. In 55% of their sample (46 out of 84 cases) voting shareholders were compensated for the loss in voting power through a new issue of superior voting shares distributed to superior vote shareholders free of charge. The authors use this compensation to infer the value of a voting right and find that the price of votes in unifications (as compensation for the vote dilution) is similar to the market price of votes. They find that family-controlled firms sell votes at higher prices and both stock classes respond positively to the unification announcement in a subsample of 44 observations.

Finally, Ehrhardt, Kuklinski, and Nowak (2006) analyze 43 German unifications in the 1987-2003 period. They report a dilution of the controlling block of votes due to the unification (on average, from 56% to 45%), a significantly positive market reaction at the announcement for

⁶ Pajuste (2005) examines twelve Italian share unifications in her sample. In contrast, our sample contains 26 stock unifications announced over the same period, 13 of which were coercive and 13 non-coercive.

both the voting and non-voting shares (of about 4% each) and an increase in the stock's liquidity after the unification.

To summarize, the extant literature on unifications has focused on why companies choose to return to a one share-one vote equity structure. This paper in contrast, focuses on the potential for wealth transfers surrounding stock unifications. Italian unifications, characterized by high voting premia and no form of compensation for voting shareholders, provide a powerful setting to examine the wealth effects of unifications on different classes of shareholders. Our simple framework presented in section 4, the empirical evidence documented in section 5, and case studies presented in section 6 are consistent with the hypothesis that Italian stock unifications adversely affect the welfare of non-controlling shareholders. Ironically, such unifications have been warmly endorsed by the financial press.⁷

⁷ For example, *Il Sole 24 Ore*, a prominent financial newspaper, described the CIR unification announcement as a “market friendly” operation. At the announcement of the unification, voting shares dropped in price by about 9% around the announcement date. Moreover, the CIR board approved three different stock options plans involving non voting shares some months before the announcement and the controlling majority shareholder had sold voting shares and bought non-voting shares few months before the announcement. (See *Il Sole 24 Ore*, September 14th, *Finanza e Mercati*, page 1).

3. Italian non-voting shares

In this section, we describe the regulations governing Italian non-voting shares, and main factors driving the conversion to one-vote one-share equity structures, both across the world and in Italy.

3.1 Regulations governing Italian non-voting shares

Italian listed companies can issue non-voting shares for up to 50 percent of their equity capital. While these non-voting shares do not have any voting rights, the law which allowed their introduction (L. 216/1974) set some minimum privileges (which could be increased by amending the corporate charter). They include:

- a minimum dividend equal to five percent of par value;
- if a dividend is paid to voting shares, the dividend to non-voting shares has to be greater by an amount equal to two percent of the par value or more;
- in case dividends are not paid because of accounting losses, when dividends are paid again, non-voting shares have the right to receive up to two past unpaid minimum dividends in addition to the dividend of the current year;
- when accounting losses cancel out the company's equity, voting shareholders must put new equity in the company;
- in case of bankruptcy, non-voting shares have a prior claim on the company's assets.

In 1998, a new Italian financial code (D. lgs 58/1998) improved minority shareholders' rights. As measured by La Porta et al. (1998), the protection index in Italy improved from below to above the continental European average. The new financial code also modified the legal framework governing non-voting shares. Among the major changes are the following:

- Corporate charters are free to define the rights of non-voting shares and no minimum rights are imposed by law. Notwithstanding this provision, all listed non-voting shares enjoy at least the minimum rights set by the earlier institutional code.
- When voting shareholders vote on proposals deemed harmful to non-voting shareholders, the decision must be approved by a special meeting of non-voting shareholders (as per rule 216) and at least 20% of the non-voting shares must approve the decision.

Notwithstanding the higher dividends they receive, non-voting shares usually trade at deep discounts from the price for the voting shares. This is largely due to the high value of the voting right. In Italy, Nenova (2003) computes this value at 29.4% of firm value based on the price difference between voting and non-voting shares in 1997. Similarly, Dyck and Zingales (2004) compute the value of the voting right at 36.9% of the firm's total market capitalization, computed from the higher price paid for controlling blocks of shares in Italy in the 1990-2000 period.

The number of Italian dual class listed firms has been declining in the past decade. At the end of 2005, there were only 38 dual class firms listed on the Milan stock exchange, out of 266 Italian listed companies (14%), versus 85 out of 233 in the 1990 (36%). The market capitalization of non-voting equity as a fraction of total equity value has declined even more precipitously, from 15% in 1990 to only 3.4% at the end of 2005.

3.2 Why do Italian firms choose to unify their share classes?

Below we discuss some of the reasons underlying why Italian firms choose to unify their share classes. The first set of two factors are common to share unifications in other countries while the second set is unique to Italy.

3.2.1 Factors common to other countries

Over the last decade, as in other countries, Italian firms have experienced increasing internationalization of their investor bases. This internationalization, together with institutional investors' preferences for a one share-one vote equity structure, may have caused some Italian firms to choose to unify their share classes. Amaoko-Adu and Smith (1995) argue that direct institutional pressure towards a more desirable one share-one vote structure is one of the main reasons underlying Canadian unifications. Hauser and Lauterbach (2004) report that the trend towards unification in Israel was triggered by the Stock Exchange's decision to ban any new issue of limited voting stock in 1990. In Italy, in August 1998, Parmalat had to cancel a \$500 million non-voting share issue targeting US investors due to an adverse market reaction.⁸ This attempt to create new non-voting shares was the last made by an Italian blue chip. The new awareness that stock market would reject the creation of new non-voting shares may have favored the conversion of the existing ones (as in Israel).

In addition, in order to be included in domestic or international stock indices, the two most common criteria are usually the firm's market capitalization and share turnover. Since a dual class unification increases both parameters, companies might find it easier to be listed on these indices following a share unification. As Dhillon and Johnson (1991) and Beneish and Whaley (1996) note, an inclusion in a major index, such as the S&P 500, increases the investor base, stock liquidity, and firm value. Since equity indexes in Italy typically use only voting shares to compute market capitalization and share turnover, we expect an increase in the DCU firm's

⁸ The Financial Times described the failed offering in an article beginning "Tired of milking cows? Try the shareholders". (See "Parmalat - Lex", *Financial Times*, 14 August 1998, page 16).

weight in the index or a higher probability of being included in the index after conversion of non-voting shares into voting shares.

3.2.2 *Factors unique to Italy*

First, in the aftermath of the European Monetary Union in 1999, Italian interest rates plunged to rates more in line with the average in the EMU countries. Unlike previous drops in interest rates, this sharp decrease (of more than 5% in 1998-1999) was structural, and affected the relative costs of debt and equity capital. Since non-voting shares involve a minimum dividend payment based on their par value, a general decline in interest rates resulted in dividend yields that sometimes exceeded the company's cost of debt, especially in the wake of market-wide depressed stock prices (as in 2001 and 2002) and large discounts on non-voting shares relative to voting shares. The higher dividend yield on non-voting shares may have favored some unification decisions. For example, Cofide decided to convert non-voting shares into voting shares in December 2001 when non-voting shares were trading below par and forcing the company to pay a minimum legal dividend yield equal to 5.7% on these shares.

Second, Italian firms, similar to most continental European firms, use the rights offering method in equity offerings, involving a longer execution period and an issue price below market price.⁹ The issue of new non-voting shares at prices below depressed market quotes could bind the company to paying an high minimum yield. This might provide an incentive for unification *prior* to the rights offering. This is probably the reason underlying at least one recent Italian stock unification (IFIL in 2003). This incentive is also consistent with the significant correlation

⁹ On average, new shares were pre-emptively offered at 42.1% of market price in the 1980-1994 period (Bigelli, 1998).

between unifications and equity offerings found by Dittmann and Ulbricht (2005) for share unifications in Germany.

Third, when non-voting shares are trading at high discounts to voting shares, a dual class unification can be structured such that non-voting shareholders pay a cash premium to participate in a 1:1 conversion. When the majority shareholder does not own non-voting shares, such an operation is equivalent to raising new equity capital, with no financial involvement by the majority shareholder but a dilution of his control. For example, the Italian mobile phone company TIM proposed a unification where non-voting shares (quoted at €5.96 at the time of the announcement) could be converted into voting shares (quoted at €11.45) by paying a €3.70 cash premium. TIM was able to raise €5 billion as part of this unification.¹⁰ After the unification, TIM's controlling block was diluted to 56%, down from 60% prior to the unification.¹¹

Fourth, Italian takeover regulations, introduced in 1998, have reduced the threshold necessary to exercise control in two ways. When a bidder buys more than 30% of votes, he must launch a tender offer on *all* voting shares (coattail provision). In addition, the quorum to control extraordinary shareholders' meetings is now 66.67% of voting shares (from 50%). This means that a 34% voting block can stop any extraordinary meeting decision and thwart a hostile takeover. Thus, the twin effects of increasing minority shareholder protection as well as control value of blocks works in tandem to make unifications more palatable. Because of this new regulation, unifications which would previously have significantly diluted the controlling voting block, could now take place without threatening the controlling shareholder. For example, the

¹⁰ To put this amount into perspective, it was sufficient to finance the entire investment in third generation mobile technology for TIM.

¹¹ In 2005, TIM's controlling shareholder (Telecom Italia) launched a tender offer for both TIM voting and non-voting minorities' shares before merging with TIM. The offered price (€5.6) was the same for both classes of shares and both were trading at almost the same values. Non-voting shareholders who converted their shares and kept them in their portfolio probably regret having paid €3.70 for a worthless voting right.

Cofide unification diluted the majority shareholder block (Carlo De Benedetti & Figli S.a.p.a.) to 34.7%, down from 43.2%.

Fifth, some of the unifications in Italy could have been driven by the privatization of state firms. The 1992 CIPE directives on future Italian privatization stated that future privatized dual class companies “*will favor solutions which allow conversion of non-voting shares into voting*”. Five of the 46 Italian unifications made in the 1982-2003 period were announced by privatized companies (Credit, Comit, Alitalia, Bnl, Finmeccanica), which followed the above guidelines.

Finally, for controlling shareholders, buying non-voting shares at a discount prior to the unification announcement provides a means of tunneling wealth from minority-voting shareholders to themselves. At the minimum, this affords them an opportunity to hedge against the negative wealth effect of unification on voting shares. In at least five of the 46 Italian unifications in our sample (Finpart, Cir, Alleanza, Ras, Banca Finnat), the majority shareholder had bought a block of non-voting shares a few months before the announcement of the unification. In section 5, we provide details on these five unifications, highlighting the expropriation of minority voting shareholders. The existing literature on dual class unifications has not examined the potential for such wealth expropriation.

4. The total wealth effects of a dual class unification

To understand the mechanics of wealth effects in dual class unifications, it is easiest to examine a simple 1:1 conversion. When voting shares trade at a premium relative to non-voting shares, a unification announcement will bring about a convergence in the relative prices of the voting and non-voting shares. The magnitude of the price change for the voting and non-voting shares in this convergence should depend upon the relative amounts of voting and non-voting shares outstanding prior to the unification, the level of the voting premium and the characteristics of the unification. Additional adjustments are required when the unification is non-coercive, when cash payments are required from non-voting shareholders to convert to voting shares, and when the conversion ratio is not unity.

The simple framework developed below (based on Manne, 1964) accounts for these adjustments in calculating the wealth impact of unifications on different classes of shares. We only consider two classes of shares, although the framework can easily be expanded to incorporate a third equity class. Time superscripts 0 and 1 denote the pre and post unification periods.

We first define the value of the firm as a whole, V , as the sum of the values of the two share classes, voting (V_v) and non-voting (V_{nv}) separately. In turn, the value of each share class is the market capitalization of the share class defined as the price of the share in each share class times the number of shares in each share class.

The price of each voting share, P_v is the sum of its cash flow rights CF_v , computed as the present value of its expected future dividends, and its voting rights VR_v . In other words,

$$P_v = CF_v + VR_v \quad (1)$$

The price of a non-voting share is just its cash flow right, CF_{nv} . In general, the cash flow right of a non-voting share is higher than that of a voting share since non-voting shares are entitled to higher dividends as per the company charter. The relation between the two can be expressed by the equation:

$$CF_{nv} = CF_v + \Delta CF \quad (2)$$

where ΔCF is the difference in the cash flow rights for a non-voting share and a voting share.¹²

Before the unification, at time 0, therefore the total market capitalization of the firm is the sum of its total cash flow (TCF) and total voting rights (TVR). Using our notation:

$$V^0 = TCF^0 + TVR^0 = CF_v^0 \times N_v^0 + CF_{nv}^0 \times N_{nv}^0 + VR^0 \times N_v^0 \quad (3)$$

After the unification, at time 1, the market value of the company's equity, V^1 , is the sum of the total market capitalization before the unification announcement, V^0 , and the increase in the market capitalization due to any required additional payments, ΔV by the non-voting shareholders. Let C denote the additional cash payment required from each non-voting share for conversion, and let A denote the acceptance rate, i.e. the percentage of non-voting shares that participate in the conversion (which is 1 in coercive unifications).

$$V^1 = V^0 + \Delta V = V^0 + N_{nv}^0 \times A \times C \quad (4)$$

Note that we assume that unification does not affect the overall firm's equity value except if

¹² Assuming a risk-free discount rate for simplicity, ΔCF can be estimated as the present value of a perpetuity whose cash flow is the statutory extra dividend payable to non-voting shares. Defining $D\%$ as the extra dividend payable to a non-voting share as a percentage of its par value, Par as the non-voting share's par value and r_f as the long-term risk-free rate, $\Delta CF = \frac{D\% \times Par}{r_f}$

additional cash payments are paid in. In practice, dual class unifications could raise the firm's market capitalization through an increase in the stock's liquidity, inclusion of the stock in a major stock index and a lower deviation from the one share-one vote principle.

As in equation (3), the value of the firm after the unification is also given by¹³

$$V^1 = TCF^1 + TVR^1 = CF_v^1 \times N_v^1 + CF_{nv}^1 \times N_{nv}^1 + VR_v^1 \times N_v^1 \quad (5)$$

The number of voting shares after the unification (N_v^1) will equal the pre-unification number (N_v^0) plus the expected number of non-voting shares submitted for conversion ($N_{nv}^0 \times A$).

$$N_v^1 = N_v^0 + N_{nv}^0 \times A \quad (6)$$

In coercive unifications, the number of non-voting shares (N_{nv}^1) after the unification will be zero, while in non-coercive unifications, it will be equal to the number of pre-unification shares (N_{nv}^0) times the percentage of shares not submitted ($1-A$):

$$N_{nv}^1 = N_{nv}^0 \times (1 - A) \quad (7)$$

We assume that the value of the total voting rights for all shares is unchanged after the unification.¹⁴ Therefore, the value of the voting right for a single voting share after the unification is given by:

$$VR_v^1 = \frac{TVR^1}{N_v^1} = \frac{TVR^0}{N_v^0 + N_{nv}^0 \times A} \quad (8)$$

¹³ It is straightforward to modify the equation to take into account any risk-adjusted changes in market values. For example, if the beta of the firm is 1, then $V^1 = V^0 \times (1 + R_m)$ where R_m is the return to the market portfolio.

¹⁴ In general, this is not true if the unification gives rise to a different ownership structure or to a change in the probability of a takeover. However, in practice, Italian unifications have not changed the control exercised by the dominant pre-unification shareholder. See footnote 15 for a more general expression which does not make this assumption.

Similarly, applying equations (2) and (3) to the post-unification period 1, the cash flow right per voting share is given by:

$$CF_v^1 = \frac{TCF^1 - \Delta CF \times N_{mv}^1}{N_v^1 + N_{mv}^1} \quad (9)$$

Intuitively, in equation (9), the value of the cash flow rights for the voting shares is computed as the post-unification total cash flow rights for the firm less the extra cash flow right (ΔCF) value of the post-unification non-voting shares. The residual amount is then divided by the post-operation overall number of shares to obtain the value of the cash flow right for the voting shares.

From equations (1), (8) and (9), we can therefore get the post-unification price per share of the voting shares as:

$$\begin{aligned} P_v^1 &= \frac{V^1 - TVR^1 - \Delta CF \times N_{mv}^1}{N_v^1 + N_{mv}^1} + \frac{TVR^1}{N_v^1} \\ &= \frac{(V^0 + \Delta V) - TVR^0 - \Delta CF \times [N_{mv}^0 \times (1 - A)]}{N_v^0 + N_{mv}^0 \times A + N_{mv}^0 \times (1 - A)} + \frac{TVR^0}{N_v^0 + N_{mv}^0 \times A} \end{aligned} \quad (10)$$

Intuitively, the two components in equation (10) are the value of the cash flow right and the voting right of a voting share respectively after the unification.¹⁵ Similarly, the value of a non-voting share after the unification is given by

$$P_{nv}^1 = CF_{nv}^1 = CF_v^1 + \Delta CF \quad (11)$$

¹⁵ For fractional conversion ratios or cash payment from non-voting shareholders, the formula modifies to:

$$P_v^1 = \frac{(V^0 + \Delta V) - [TVR^0 + f'(\Delta V)] - \Delta CF \times [N_{mv}^0 \times (1 - A)]}{N_v^0 + N_{mv}^0 \times \frac{y}{x} \times A + N_{mv}^0 \times (1 - A)} + \frac{TVR^0 + f'(\Delta V)}{N_v^0 + N_{mv}^0 \times \frac{y}{x} \times A}$$

where f' describes an increase in the total voting rights to the firm due to cash payments from non-voting shareholders and y is the number of voting shares exchanged for every x shares of non-voting shares. f' is assumed linear in ΔV .

We use equations (10) and (11) to describe the price effects of share unification. Based on these two equations, we can derive the theoretical returns earned by the two classes of shares.

Appendix I describes the predictions of the above model for a 1:1 coercive unification ($A=1$) on the two classes of shares. The table reports the theoretical returns earned by voting and non-voting shares for several different levels of the voting premium and the fraction of the company's equity represented by non-voting shares. We assume that the voting shareholders do not receive any compensation. The reported returns document how the voting shares earn negative returns due to the dilution of voting rights. Intuitively, the dilution effect becomes more important for higher values of the voting rights and for larger fraction of non-voting shares in the company's equity. When non-voting shares represent only a small fraction of the firm's equity, the dilution of the voting rights is negligible. In this case, the return to the converted non-voting shares depends only on the level of the voting premium. For example, when voting shares trade at a 100% premium to the stock price for non-voting shares and the non-voting class represents only 1% of the total outstanding shares, a 1:1 coercive unification would increase the value of non-voting shares by almost 100% (99%) while voting shares would drop by a negligible -0.50%. With the same level of voting premium but with non-voting shares representing 50% of the outstanding equity, the dilution of the voting right is much larger. Consequently, voting shareholders earn significantly lower returns: voting shares drop as much as -25% and non-voting shares appreciate by 50% to the new equilibrium price of a voting share.

5. Empirical evidence

In this section, we describe the main results of our paper. We first report the incidence of dual-class share unifications in Italy from 1974 through 2005. We then report the reasons for unification as cited by the companies, describe the sample firms' characteristics, and report the wealth effects surrounding unification announcements. Finally, we conduct cross-sectional tests to shed light on the determinants of wealth effects documented earlier in this section.

5.1 Types and frequency of Italian stock unifications

We search Mediobanca's "*Indici e Dati*" and *Il Sole 24 Ore* for announcements of stock unifications made by Italian listed companies from 1974 (when non-voting shares were introduced) till 2005. Overall, our sample consists of 41 different companies who undertook 46 DCUs¹⁶, 32 of which were made after 1998. Half these 32 unifications in turn were announced in the 1998-2001 period, i.e. the year before and three years after the introduction of the Euro, which led to a sharp and permanent decrease of Italian interest rates.

Table 1 shows the yearly frequency (ordered by the shareholders' approval day) and the type of unification. Out of 46 unifications, 22 were coercive and structured in one of the following three ways:

- 1:1 *coercive* (18 cases): one non-voting share is converted into a voting share without any additional payment;¹⁷
- 1:1 *coercive plus a cash refund* (1 case): one non-voting share is converted into one

¹⁶ Four companies went through one or two non-coercive unifications before concluding with either a final coercive unification or a delisting of the few outstanding non-voting shares.

¹⁷ According to Dittmann and Ulbricht (2005), these are also the typical terms of German stock unifications.

voting share and receives a cash payment;¹⁸

- *coercive option of choosing between a unification of one voting shares for n non-voting shares or a 1:1 unification with a cash payment* (3 cases): non-voting shareholders choose between converting n non-voting shares into one voting share or converting one non-voting share into one voting share with an additional payment.

The other 24 non-coercive unifications are structured in the following ways:

- *1:1 non-coercive* (11 cases): one non-voting share can be converted into one voting share without any additional payment;

- *1:1 with a cash payment* (7 cases): one non-voting share can be converted into a voting share by paying an amount lower than the price differential. None of these seven unifications were coercive because of the cash payment required;¹⁹

- *1:1 with conversion limit* (3 cases): one non-voting share can be converted into one voting share up to a conversion limit of 10% of the non-voting shares owned;

- *non-coercive option to choose between a unification of y voting shares for x non-voting shares or a 1:1 unification with a cash payment* (1 case);

- *one voting share for n non-voting shares* (2 cases): n non-voting shares can be converted into one voting share.

In seven of the 46 Italian DCUs, a cash payment was required to convert a non-voting into one voting share. Consistent with the expropriation hypothesis, 29 of 46 unifications did not involve any compensation for the voting shareholders on conversion.

¹⁸ This anomalous term was used in only one unification (SNIA, 2002), when non-voting shares were trading at a premium to the voting shares.

¹⁹ In German unifications, Dittmann and Ulbricht (2005) report two cases in which the required payment was equal to 2/3 of the price differential. None of the seven Italian unifications had such a provision and all required a fixed amount (lower than the price differential).

5.2 *Stated reasons for share unifications*

Table 2 reports the list of stated reasons for the unification as declared in the company's press announcement or newspaper articles. Desires to improve the firm's attractiveness to international investors, to increase the stock's liquidity, and to simplify the firm's equity structure, are typical reasons cited by Italian firms undertaking dual-class unifications. These reasons are also cited by firms on other markets (see Amoako-Adu and Smith, 2001, for Canada, Dittmann and Ulbricht, 2005, for Germany, and Pajuste, 2005, for other EU countries).

However, unique to Italian firms, four firms in our sample report that the reason for the unification was "to raise cash to finance new investments".²⁰ All cash raised through the DCU came from the non-voting shareholders. Also unique to Italy, six firms used coercive unifications after previous successful non-coercive unifications had decreased the liquidity or forced the delisting of non-voting shares. Finally, five firms unified their shares to comply with the Italian privatization guidelines; three firms unified their shares before entering a merger; and three more before issuing new shares, as is typical of Canadian and German unifications.

5.3 *Descriptive statistics for Italian DCU firms*

Table 3 Panel A reports financial characteristics for the sample of DCU firms (see Appendix II for a detailed description of the variables). The panel reports data on firm leverage, profitability and growth prospects, the latter as measured by the firm's market-to-book ratio. The table also reports data on mean- and median-adjusted abnormal financial characteristics. Across most financial characteristics, our sample firms seem to be similar to their industry peers. They

²⁰ Though Pajuste (2005) does have data on Italian unifications, it does not include non-coercive unifications. Consequently this motivation is not documented in her paper, as all the unifications requiring a cash payment from the non-voting shareholders are non-coercive.

have similar leverage ratios and their profitability and market-to-book measures are not significantly different from their industry peers.

Panel B reports the fractions of voting equity held by the largest shareholder, using the first available ownership data immediately before the share class unification. We obtain ownership data using *Il Taccuino dell'azionista* (period 1982-1995), the Italian Security and Exchange Commission (Consob) paper database (1995-1997) and online database (1998-2005). We distinguish between three types of ownership: family or individuals, government, and financial institutions (banks and insurance companies). The ownership structure of the typical firm announcing a DCU is highly concentrated. The largest shareholder owns, on average, 59.65% of the voting rights before the unification and is usually represented by a family (30 cases), rather than a financial institution (8 cases) or the Italian government (8 cases).

Since Italian non-voting shares are bearer shares, there is no official ownership data on them. In 8 cases (four of which are analyzed below), the financial press or the company's press release reports the percentage amount owned by the majority shareholder, with a mean holding of 41% (Panel C). For all other unifications, we attempt to infer the largest shareholder's ownership of non-voting shares from ownership data on voting shares before and after the unification as well as from the unification characteristics (type of unification, acceptance rate, etc.). We restrict this procedure to cases when there is a relatively short period (6 months) before and after the unification date when ownership data is available from the Consob online database (available since 1998). This reduces the sample size to 33 observations.²¹ For 11 more observations, we cannot infer the ownership of non-voting shares since the unifications coincided with confounding events that may have affected the ownership of voting shares after the unification

²¹ The longer the length of time between the pre- and post-unification dates when data on ownership of voting shares is available, the higher is the chance that majority shareholders traded voting shares between the two dates.

by the controlling shareholder (as a change of the controlling shareholder, a merger, an equity issue, or the firm's privatization). In 21 of the remaining 22 cases, we can infer the stakes of non-voting shares held by the majority shareholder before announcing the unification. The last row of Panel C reports the minimum of the inferred value and the publicly reported value for the ownership of non-voting shares. Using this conservative estimate, we can conclude that in 21 unification announcements, the largest shareholders owned significant stakes of non-voting shares, equal, on average, to 30.6%.

Table 4 reports voting and non-voting share characteristics of Italian DCU firms. On average, non-voting shares represent 17.6% of total equity in Italian DCU firms. In non-coercive DCUs, on average, 83.8% (91% median) of the non-voting shareholders decided to convert their shares. One explanation for the acceptance rate not being 100% could be that the largest shareholders do not convert all their non-voting shares in order to control non-voting shareholders' meetings. Alternatively, perhaps some shareholders simply missed the announcement.

Three days before the announcement date of the DCU, the voting premium averaged 38.7% of the share price for the non-voting shares. When differences in dividends (higher on non-voting shares) are taken into consideration, the value of the voting right averages 54.2% of non-voting share's stock price. On average, the cumulative value of all voting rights represents 29.8% of the total equity value of the firm, almost identical to Nenova (2003) based on 1997 Italian data (29.4%).

Based on pre-announcement market prices, the non-voting shares earned a minimum dividend yield of 1.8% at the mean level (median yield of 1.1%). Both current yield (based on most recent

dividend) and expected yield (based on next year's dividend) averaged 2.9% and were about 3% lower than the 10-year Italian Treasury-bond gross yield.²²

When we compare the ownership structure pre- and post-unification, Table 5 reports that the mean portion of total votes held by the largest shareholder is almost unaffected by the unification. The ownership of non-voting shares by the majority shareholder is one reason why Italian unifications barely affect the fraction of total equity owned by the largest shareholder. On average, the fraction of ownership by the majority shareholder decreases from 55.9% before the unification to 54.2% after the unification. Median values increase slightly. These results contrast with the German evidence (Ehrhardt, Kuklinski, and Nowak, 2006) where unifications reduced the average voting equity held by the largest shareholder from 55.7% to 44.6%. They are consistent with the expropriation hypothesis suggesting that dual-class share unifications in Italy are engineered to retain control and potentially transfer wealth from non-controlling to controlling shareholders. The retention of voting control is also consistent with controlling shareholders taking significant ownership stakes in non-voting shares before the unification.

Following Faccio and Lang (2002), for the subset of firms where we have ownership data, we also compute after 1995 (since the Consob ownership database is only available after 1995), the degree of separation of ownership from control before and after the unification, for each firm, as the ratio of cash flow ownership (Ownership) and voting right ownership (Control). The stock unifications substantially reduce the separation of ownership from control. The mean (median) value for the Ownership/Control ratio increases from 0.762 (0.804) before the DCU to 0.873 (0.999).

²² In five cases, the dividend yield was higher than the T-bond yield.

5.4 *Announcement period returns around the announcement of a unification*

For every firm in the sample, we search the *Il Sole 24 Ore* financial newspaper for announcement dates. Market data information is obtained from the Italian Stock Exchange. Of the 46 sample firms, we are able to compute abnormal returns at the announcement date for 35 paired observations (voting and non voting shares).²³ Table 6 Panel A reports abnormal returns for voting and non-voting shares separately, as well the change in the market value of the firm, for several event windows surrounding the announcement of the unification.

For non-voting shares, the mean (median) three-day announcement date return (from days -1 through +1) is +11.66% (6.75%), while the mean (median) five-day return is 12.50% (6.53%). These results are broadly in line with the positive announcement date wealth effects of unifications from other countries such as Germany (Dittmann and Ulbricht, 2005, Ehrhardt, Kuklinski, and Nowak, 2006) though they are somewhat higher in magnitude.

However, what is unique to Italy is the announcement date wealth impact on voting shares. The voting shares for German firms announcing DCUs earn positive abnormal returns, and the impact on the firm's market capitalization is positive. In contrast, our sample firms earn a three day market-adjusted return of -1.56% (median -1.25%) and a five-day excess return of -1.94% (median -0.60%) for the voting shares. The sharp difference from the German evidence could be due both to the higher average level of the Italian voting premium, which translates in a bigger dilution in the value of a voting right, and in the opportunistic behavior of the Italian majority shareholder described in the next section.

The mean (median) change in the total market value of the firm is 0.57% (0.03%), but is not statistically significant, suggesting either that there are few opportunities for corporate

²³ 11 observations were excluded due to a lack of the announcement date (4 cases); insufficient liquidity of the non-voting share (3 cases); non-voting shares not listed (1 case); voting shares not listed (2 cases); lack of the stock market price series (1 case in 1982).

governance improvements or that such improvements have little, if any, impact on firm value. The market reaction around the announcement is confirmed by the CARs computed for the wider event window (-1, +30), as well as by the pattern in the CARs, graphically illustrated in Figure 1.

Second, we partition the event study subset between those observations for which we are able to determine that the largest shareholder was holding a large block of non-voting shares and all the other observation where it was not possible to report or infer non-voting ownership. Table 6 Panel B shows that when non-voting ownership allows the largest shareholder to protect himself from the negative effects of the unification on voting shareholders, voting shares significantly drop in the three days around the announcement (earning excess returns of -3.71% on average) and with a corresponding reduction in overall firm value (-1.05% on average). In contrast, when the largest shareholder does not hold non-voting shares or investors cannot infer such information, the unification announcement produces an insignificant positive reaction both for the voting shares and the firm's market capitalization. To put this another way, when the largest shareholder owns a block of non-voting shares, the unification terms are set to harm minority voting shareholders, who are more likely to believe this to be a form of expropriation, rather than an attempt to improve the equity structure.

We next report how much wealth is transferred from voting to non-voting shareholders over the unification announcement. To compute the wealth transfer, we start with the three-day market-adjusted abnormal return for voting shares (CAR_V) and non-voting shares (CAR_{NV}). The total increase in abnormal market capitalization (in excess of the market) for the firm equals:

$$\text{Increase in total market capitalization} = CAR_V \times \text{Market Cap}_V + CAR_{NV} \times \text{Market Cap}_{NV}$$

The "fair" change in the value of voting shares equals $\text{Increase in total market capitalization} \times \text{Market Cap}_V / \text{Total Market Cap}$. The actual change in the value of voting shares =

$CAR_V \times \text{Market Cap}_V$. The difference between the expected and actual increase in voting share value expressed as fraction of the total market capitalization is our measure of wealth transferred from voting shareholders to non-voting shareholders.

Consider the following example to illustrate our measure of wealth transfer from voting to non-voting shareholders. Suppose that the unification is associated with a 4% increase in the total market value of the firm, and that the pre-unification market value of voting shares is the same as that of non-voting shares. In this case, in the absence of wealth transfer effects, the value of both voting and non-voting shares ought to increase by 2% of the total firm value. Now suppose that the actual value of voting shares declines by 5%. In this case, the wealth transfer from voting shareholders is $2\% - (-5\% \times 0.5) = 4.5\%$ expressed as a fraction of total firm value.

Our results support the expropriation hypotheses for the subset of firms where the largest shareholder owns a block of non-voting shares. For this group of firms, significantly more wealth is transferred from voting to non-voting shareholders (2.11% at the median level) than for firms where we have no information on the ownership of non-voting shares (0.14%). However, in all cases, we find – but do not report in the table – that the actual level of wealth transfer is less than that predicted by our model based on the characteristics of the unification, implying that corporate governance improvements offset some of the negative expropriation effects associated with unification.

5.5 *Regression analysis*

We next estimate a set of OLS regressions using different dependent variables. Coefficient estimates are reported in Table 7. The several models allow us to explain the value changes for

voting and non-voting shares around the unification announcement, the differential return between the two classes of shares and the aggregate change in firm value.

We first report the regression estimates using announcement period abnormal returns (days –1 to +1) for voting shares as our dependent variable. The abnormal returns are inversely related to the fraction of equity represented by non-voting shares. This is not surprising since the larger the fraction of pre-unification non-voting equity, the greater is the dilution of voting rights. There is also a positive relation between the abnormal returns and the size of holdings by the largest and second largest blockholders of voting shares. This is consistent with the interpretation that very large voting shareholders find hedging against the unification-related dilution more difficult (average ownership is about 60%). The positive coefficient on the pre-unification stake held by the second-largest blockholder is consistent with the hypothesis that the second largest shareholder exercises a monitoring role, limiting the expropriation by the controlling shareholder. Finally, the indicator variable for the dummy variable indicating non-voting share ownership by the largest shareholder is significantly negative (at the 10% level), consistent with our earlier univariate results.²⁴

We report regression results using the three-day announcement period abnormal returns for the non-voting shares as the dependent variable (model 2). As expected, abnormal returns to the non-voting shares increase with the pre-unification voting premium, and decline in the presence of any indirect form of compensation for the unification (such as a cash payment, a conversion ratio based on the market price, or any limits on the amount of non-voting shares that can be converted). Ownership by the largest or second largest blockholder is not significantly related to the abnormal returns earned by the non-voting shares.

²⁴ In unreported regressions, we also use alternate definitions for this indicator variable such as a variable for the actual % of non-voting shares held, an indicator variable for the cases when non-voting shares were declared by the largest shareholder. Our results are qualitatively similar.

Next, we turn to the differential wealth impact on non-voting shares relative to voting shares associated with the unification announcement. In these regressions, we use the difference between the three-day announcement period returns to voting and non-voting shares as a dependent variable. We first find (not reported in the table) that the expected value of the difference in returns based on our model explains 82% of the variation in the actual difference²⁵ (significant at the 0.01 level). We then regress the actual difference in abnormal returns on several explanatory variables (model 3). The voting premium is again seen to be significantly positively related to the difference in returns, as it determines the appreciation on non-voting shares and, hence, the return differential between the two classes of equity. The relative amount of non-voting equity does not appear to affect the difference, as the high return differential can be present both when non-voting shares are scarce and when they are abundant, as long as the voting premium is large. As in the earlier case, compensation for conversion is negatively associated with the difference, as it reduces the appreciation of non-voting shares and the harm to voting shareholders. Finally, the ownership by the second-largest shareholder is associated with a smaller differential price impact, consistent with the hypothesis that the second largest shareholder plays a monitoring role.

In model 4 and model 5, we examine the unification effect on total market capitalization of the firm in the three-day announcement period. In both models, the significantly positive coefficient estimates for voting premium indicate that wealth gains are greater where the potential for abuse by controlling shareholders is higher. As in previous models, ownership by the largest and second largest shareholders, being associated with more fair unification, translates into more positive changes in firm's value. It is significant in model 4, but not in model 5. When we control for other variables (model 5), unifications involving direct or indirect compensation

²⁵ These results are not reported for brevity, but are available from the authors upon request.

result in significantly positive changes in firm value, perhaps because they are identified as fairer unifications.

To summarize, a reduction in the wedge between ownership and control, and the more aligned interests of all shareholders after the unification, seems to produce benefits for companies with more severe agency conflicts between majority and minority shareholders. However, unifications lead to significantly lower firm value when the fraction of non-voting equity converted into more valuable voting shares is higher. In the presence of high Italian voting premia, in fact, such unifications translate into wealth transfers and dilutions of voting rights. As shown in the next section on case studies, and consistent with our wealth transfer findings in Table 6, in such situations, majority shareholders seem to try to hedge the unification's negative effect by holding or buying large blocks of non-voting shares before the unification announcement. The general positive effect for such operations is therefore more than offset by the expropriation of wealth from the minority shareholders. When the fraction of non-voting equity is small instead, the wealth transfer is negligible, minority voting shareholders are not harmed and the overall reaction to the DCU announcement is dominated by the positive effects of a more efficient equity structure and more aligned interests.

6. Case studies of tunneling via dual-class share unifications

Why should a majority shareholder ever favor a DCU which harms himself and favors non-voting shareholders? One reason why he may choose to do so is because he buys a block of non-voting shares at a discount before the conversion. Though as we note previously, there is no official ownership data on non-voting shares, in 21 cases in our sample, we are able to infer that the majority shareholder owned large blocks (30.5% on average) of non-voting shares. In 8 of these cases, the ownership of non-voting shares was publicly reported in the popular press or the company's press releases. We were able to obtain detailed financial data on five of these 8 cases, which we report below as case studies.²⁶

Interestingly, this opportunistic behavior of majority shareholders has attracted the attention of the Italian Security and Exchange Commission (Consob), which in an official communication on March 22nd 2001 stated: *“In recent years we have observed a significant increase of extraordinary operations involving non-voting shares issued by listed companies followed by their delisting. Such operations are sometimes decided by the same issuer (mergers, unifications) and some other times by the controlling shareholders of the listed companies (through public offerings)”*. In order to help investors to take correct investment decisions, *“the Italian regulator therefore asks the controlling shareholders to communicate publicly, in the ways and times indicated by art. 66 of rule 11971/1999, the execution of trades on non-voting shares made by anyone belonging to the controlling group, if, thanks to the above trades, the controlling group ends up owning non-voting shares representing a fraction of the firm's equity greater than 2%, 5%, 7.5%, 10% and subsequent multiples of 5% or the same group reduces its stake below the above thresholds.”*

²⁶ The other four cases of declared non-voting ownership by the majority shareholder were two family-owned companies (Finrex and Recordati) and two government-owned companies (Credit and Comit).

This directive by the Italian regulators to disclose the ownership of non-voting shares is not however mandatory, and firms can and do ignore it. After the 2001 Consob declaration, there have been 12 DCUs. In two of them, the majority shareholder declared her ownership of non-voting shares (Alleanza and Banca Finnat) but we suspect that not everyone did. Using pre- and post-unification data on the ownership of voting shares, in fact, the largest shareholder should have owned blocks of non-voting shares in 6 other cases. Moreover, non-voting shares could also be owned by a fiduciary company, as in the case of the 1:1 coercive unification made in 2002 by Cofide, a holding company controlled by the De Benedetti family.²⁷

6.1 Case studies

In this section, we report five case studies of dual class unifications where majority shareholders bought relevant stakes of non-voting shares some months before announcing the unification. The information is taken from articles published on *Il Sole 24 Ore*, the firms' financial statements, press releases and the Consob online ownership database. In some of the unifications reported in this section, the Italian regulator opened an insider trading file to investigate the anomalous trading activity surrounding the unification announcement date, also documented in the paper. No file has been opened on the trading activity of the majority shareholder for the non-voting shares made a few months before the unification announcement, as it is difficult to prove that the unification decision had already been decided when the trading took place. The following operations described in the five case studies below, are therefore completely legal.

²⁷ The *Il Corriere della Sera* newspaper reports that “at the conversion date (in March 2002), nearly 70% of non-voting shares were held by *Intermobiliare Fiduciaria*, a fiduciary company belonging to a group close to De Benedetti, who is a board member of the *Intermobiliare Bank*”. (See Penati, Alessandro, 2002, *Il Corriere della Sera*, April 14, 2002, page 21).

6.1.1 Fin.part coercive 1 :1 unification

Fin.part is a small financial company whose major assets are in the textile industry. The Fin.part unification was announced by the board on January 24th 2000. The unification involved a coercive 1:1 conversion of non-voting and preferred shares²⁸ into voting ones. Since both preferred and non-voting shares were traded at deep discounts from the voting shares and they represented about 40% of total equity, a 1:1 stock unification would have depressed the voting shares' stock price, as it actually did. Miravan Luxemburg, a company based in Luxembourg, controlled by the controlling shareholders of Fin.part had launched a voluntary tender offer for 100% of preferred and non-voting shares in July 1999 (6 months before the unification announcement). About 66% and 59% of preferred and non-voting shareholders tendered their shares. Volume was abnormally high in the three days immediately preceding the DCU announcement, suggesting some advance knowledge of the event.

From the tender offer prospectus, it is possible to determine that 54% of Miravan Luxemburg was controlled by Valcor. In turn, Valcor was controlled by two Italian industrial families. Overall, Valcor controlled Fin.part through the direct and indirect control of 33.3% of the voting shares (12.06% directly and 22% through Miravan Luxemburg). In other words, the controlling shareholder (Valcor), through a controlled company (Miravan Lux.) tried to buy all the preferred and non-voting shares through a tender offer. Six months later it converted them in the more valuable voting shares in a 1:1 coercive unification.

The majority shareholders were certainly not harmed by the unification. The same cannot be said for the minority voting-shareholders. In the three-day announcement window, the price of

²⁸ Italian preferred shares are generally non-voting, but can vote in the extraordinary meetings. They are entitled to higher dividends relative to common shares.

voting shares declined by about -7% while the price of the non-voting shares rose by +26.80% (Figure 2 and Table 8). In our framework, the predicted increase in price for the non-voting share is 26.8% and the voting shares are predicted to decline by -17.42%. The smaller decline of the voting shares can perhaps be explained by a sharp reduction of the ownership/control separation (non-voting and preferred shares were about 39% of all shares).

6.1.2 Banca Finnat Euramerica coercive 1:1 unification

Banca Finnat Euramerica is a small Italian bank whose main business is private banking. On September 23rd 2003, its board launched a coercive 1:1 unification, whose details were reported in a company press release. The pre-announcement voting and non-voting stock price were respectively €0.3572 and €0.2920. Non-voting shares represented 40% of the company's total equity. The company press release also reported that the majority shareholder, an Italian family, directly and indirectly owned 81.71% of non-voting shares. The same press release states that *“the operation aims to simplify the company's equity structure and all shareholders will benefit.”* Actually, the dilution of the vote segment made minority voting-shareholders suffer a loss of -4.59% while non-voting shareholders saw their shares rise by +14.04%, as shown in Figure 2 and Table 8. Since the majority shareholder owned almost all non-voting shares before the unification, Banca Finnat is another case that illustrates how stock unifications can lead to a significant expropriation of minority voting shareholders.

6.1.3 CIR coercive 1:1 unification

CIR is a mid-cap financial company in the second tier of a pyramidal group controlled by the De Benedetti family. CIR's controlling company is Cofide (another financial listed company).

After the company had bought back non-voting shares in the past and cancelled the corresponding equity on November 1998 and November 1999, on September 13th 2000, the board proposed a 1:1 coercive unification, which was approved on October 27th. Non-voting shares represented 22.5% of the firm's equity.

Three days before the announcement voting and non-voting stock prices were at €4.256 and €3.497 respectively. In the three days around the announcement date (-1+1), the voting shares dropped by -6.73%, more than the -4.01% expected, while non-voting shares gained +6.44%, less than the +16.82% expected (Figure 2 and Table 8). The worse than expected reaction on both classes of shares is perhaps due the decrease in valuation of the entire firm, whose market capitalization dropped by about 4%.

One reason for the decrease is perhaps the way the unification was managed increased expectations of managerial misconduct in the future. This more than offset the benefits offered by a return to a one share-one vote equity structure. In this case, not only had the majority shareholder bought non-voting shares in advance of the unification announcement, but the board had assigned stock option plans on non-voting shares before the unification. A year prior to the unification (in 1999), a stock option plan based on non-voting shares was approved by the CIR's board of directors. The first exercise date was set on December 22nd 1999, followed by additional exercise dates on March 31st, June 30th, September 30th, and December 31st through the end of 2003. All board members exercised their stock options on the first exercise date, i.e. December 22nd 1999. The CEO (a member of the controlling family) exercised his stock options for 2 million shares on that date. On March 7th, 2000, six months before the unification announcement, the board approved a new stock option plan based on non-voting shares. The stock market decline in April 2000 (the collapse of the Internet bubble) meant that these new options remained

out-of-the-money²⁹. As noted above, CIR is controlled by another financial company, Cofide, which is controlled by the De Benedetti family. “Il Sole 24 Ore” reported, on September 14th 2000, that during the months of April and May 2000, Cofide had bought CIR non-voting shares and sold CIR voting shares.³⁰ From the pre- and post-unification ownership data, we infer that Cofide owned about 20% of the non-voting shares of CIR.

6.1.4 R.a.s. 1999 non-coercive 1:1 unification with additional payment

R.a.s., the second Italian insurance company, carried out two voluntary unifications: in 1994 and in 1999. Before the second unification, the R.a.s. controlling shareholder, Allianz A.G., increased the percentage of non-voting shares in its possession few months before the unification announcement. According to reports in *Il Sole 24 Ore*, (on July 30th1998), Allianz (who owns 51% of R.a.s. voting shares) increased its stake of R.a.s. non-voting shares to 43% of all non-voting shares over the preceding month (the inferred ownership in Table 6 is about 49%). Nearly eight months after, on March 25th 1999, the R.a.s. board announced a voluntary 1:1 unification with a required cash payment equal to €1.059. The declared reasons were the following: “...*in order to increase the security’s liquidity and market capitalization and be therefore included in the main market indexes*”. Two days before the announcement, voting shares were traded at 10 euros while non-voting shares at €7.29. Given these market prices, the discount at which non-voting shares were traded equaled 27%, and the required cash payment was set at about 39% of the price differential between the two classes of shares (€1.059/€2.1). As reported in Figure 2 and Table 8 , in the three days around the announcement date (-1+1), the voting shares dropped

²⁹ CIR is a financial company and at that time was valued especially for its internet and media participations.

³⁰ See *Il Sole 24 Ore*, September 14th, 2000, Finanza e Mercati, page 1.

by -4.05% while non-voting shares gained +13.16%. More than 95% of non-voting shareholders accepted the offer to convert to voting shares.

6.1.5 *Alleanza coercive 1:1 unification*

Alleanza Assicurazioni is the largest Italian life insurance company and is controlled by Generali, the first Italian insurance company and one of the largest in Europe. On September 25th, 2001 Generali declared that its group had increased ownership of Alleanza non-voting shares to 6.0%. On October 1st 2001 another Generali press release stated that its non-voting shares stake had been further increased to 7.8%. Just 44 days after, on November 13th, 2001, Alleanza's board announced a 1:1 coercive unification. Before the announcement, the market price for the voting and non-voting shares was respectively equal to €12.196 and €9.527.

According to the financial press, "*Maintaining the same overall market capitalization of the last trading date preceding the announcement, the price of a voting share should drop from 12.13 euro to 11.7 euro with a drop of 3.5%*".³¹ Our model predicts a drop of the voting shares equal to 3.72% (Table 8). In the three days around the announcement date the voting shares dropped by -7,78% while non-voting shares gained +17.12% (Figure 2 and Table 8).

The unification was approved in December by both the voting and non-voting shareholders. Before the approval, Generali increased its stake in Alleanza non-voting shares substantially, ending up with 10.25% of non-voting shares. Since the additional non-voting shares were purchased after the unification announcement, and shareholder approval would be a given event, it seems that Generali's actions were designed to mitigate the unification's dilution effect on Generali's controlling block of voting shares.³²

³¹ See *Il Sole 24 Ore* on November 14th, 2001, page 1.

³² The post unification percentage of Alleanza voting shares owned by Generali dropped to 47.3% (from 54.3%).

7. Conclusions

Italian dual class unifications present a puzzle – their announcements are associated with price increases for non-voting shares and price declines for voting shares. Why do voting shareholders agree to such unifications? In this paper, we present a framework showing the price effect of unifications on voting as well as non-voting shares. Our main conclusion is that unifications, while appearing to be favoring non-controlling shareholders, are a lot more complex in execution. Using a comprehensive sample of 46 share class unifications in Italy, as well as five case studies, we provide *prima facie* evidence that unifications have been used by controlling shareholders to transfer wealth from non-controlling voting shareholders to themselves by purchasing non-voting shares ahead of the unification announcement.

The extant literature on dual class unifications suggests that the main factors underlying the increasing trend towards the one share-one vote rule are the internationalization of the shareholder base, a preference for a unitary class structure by institutional shareholders and the increase of the market capitalization of the firm and liquidity making it easier for the firm to enter or remain in a major stock index. We argue, in addition, that the decision to return to a single class of stock can also be driven by domestic factors such as a sharp decrease in interest rates and corresponding higher cost of non-voting shares' minimum dividend yield. A unification may also serve as an opportunity to raise equity from non-voting shareholders when an additional payment is required, an opportunity for insider trading ahead of unification announcements and an expropriation of minority voting shareholders.

The framework developed in the paper shows that unifications may harm voting shareholders, as the dilution in the value of a voting right increases the higher is the percentage of the non-

voting shares on the firm's equity and the larger is the price discount at which they are traded. In other countries such kind of expropriation has often been compensated either by an extraordinary dividend (Ang and Megginson, 1989, UK) or by assigning new voting shares to voting shareholders (Hauser and Lauterbach, 2004). In Italy, where the price differential between voting and non-voting shares is one of the highest in the world (Nenova, 2003, Zingales, 1994, Dyck and Zingales, 2004), voting shareholders have not received any explicit compensation. The Italian setting is therefore unique to study the wealth effect of a stock unification.

Our empirical evidence is also unique. We analyze the entire population of 46 Italian unification made in the 1974-2005 period. In the three days around the announcement date, non-voting shares earn significantly positive excess returns of 11.66% and voting shares earn significantly negative returns of -1.56%.

Our empirical results are consistent with our theoretical framework. Overall, we find that unifications do not seem to affect firm's value. Firm values tend to decrease however, when unifications are made in the presence of high voting premia and large fractions of non-voting equity. These conditions translate in a larger dilution of the vote segment. They are typically associated with the majority shareholders holding large blocks of non-voting shares to hedge against the negative effect on their voting block. Thanks to their ownership of non-voting shares, majority shareholders barely dilute their controlling block of voting shares. Our detailed analysis of five cases of Italian unifications shows that majority voting shareholders hedge or even take advantage of such unifications by engaging in buying relevant blocks of non-voting shares, selling voting shares or approving stock option plans on non-voting shares few months or days before the announcement date. In the five cases, on average, the largest shareholder owned about 46% of non voting shares which appreciated by +15% while voting shares dropped by -6%.

Overall, our evidence is consistent with the hypothesis that while dual class unifications can benefit minority shareholders by improving corporate governance, liquidity and visibility of the listed firms, the *process* of unification can also serve as a method of expropriating minority shareholders.

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Table 1**Distribution of Italian dual class share unifications**

This table reports the distribution of all Italian dual class share unifications from 1982 through 2005. Counts are based on the year of approval of the unification by the shareholders. Coercive unifications are defined as those where the non-voting shareholders are forced to convert. Refund refers to a unique case where the non-voting share was trading at a premium to the voting share, and the unification involved payment in cash to the non-voting shareholders. Payments represent cash paid to voting shareholders. 1:1 and n:1 represent the number of non-voting shares needed to convert into 1 voting share.

Year	Number	Coercive			Non-coercive			
		1:1	1:1 + refund	n:1 or 1:1 + payment	1:1	1:1 + payment	1:1 conversion limit	n:1 or 1:1 + payment
1982	1	0	0	0	1	0	0	0
1986	1	0	0	0	1	0	0	0
1990	1	0	0	0	1	0	0	0
1991	2	0	0	0	1	0	1	0
1992	1	0	0	0	0	0	1	0
1993	3	1	0	0	0	2	0	0
1994	4	1	0	0	1	1	1	0
1996	1	1	0	0	0	0	0	0
1998	6	2	0	0	3	0	0	1
1999	4	1	0	0	1	2	0	0
2000	8	4	0	1	0	2	0	1
2001	5	2	0	2	1	0	0	0
2002	2	1	1	0	0	0	0	0
2003	4	3	0	0	0	0	0	1
2004	2	2	0	0	0	0	0	0
2005	1	0	0	0	1	0	0	0
Total	46	18	1	3	11	7	3	3

Table 2

Stated reasons for abolishing dual class shares

This table reports the stated reasons to unify the dual class share structure compiled from company disclosures and newspaper articles. Some firms provided multiple reasons.

Stated reason	Number
Increase float and liquidity	9
Simplify equity structure	8
Before or after the firm's privatization by the government*	5
Raise cash for new investments	4
Improve attractiveness for international investors	4
Before a merger*	4
Before an equity issue*	3
Secure and increase current index membership	1
No reasons given	19

*Reason not declared but unification preceding or immediately following extraordinary event.

Table 3**Financial and ownership characteristics of Italian DCU firms**

This table reports financial variables calculated based on the last annual financial statement before the unification announcement date (panel A). None of the industry adjusted variables are significant at the 10% level. Panel B reports summary statistics for the fraction of voting equity held by the largest and second largest shareholders preceding the unification. Panel C shows ownership of non-voting equity by the largest shareholder. Detailed variable definitions and construction are provided in Appendix II.

Panel A: Financial Characteristics

	N	Mean	Industry Adjusted	
			Mean	Median
Total Assets, €millions	38	4249		1062
Market-to-book	46	2.63	-0.404	1.53
Market Leverage	38	0.40	0.038	0.39
Book Leverage	38	0.33	0.042	0.32
ROA	38	0.079	-0.0016	0.064

Panel B: Ownership of voting shares

Owner Type	N	Fraction of votes owned by largest shareholder				Fraction of votes owned by second largest shareholder			
		Mean	Median	Min	Max	Mean	Median	Min	Max
Families	30	0.572	0.582	0.252	0.854	0.053	0.049	0.00	0.243
Government	8	0.696	0.699	0.432	0.867	0.043	0.021	0.00	0.146
Institutions	8	0.589	0.559	0.235	0.974	0.023	0.000	0.00	0.118
Total	46	0.596	0.599	0.235	0.974	0.047	0.034	0.00	0.243

Panel C: Ownership of non-voting shares by largest shareholder

	N	Mean	Median	Min	Max
Non-voting share ownership as declared	8	0.413	0.426	0.078	0.817
Minimum non-voting share ownership (declared or inferred)	21	0.306	0.199	0.045	0.817

Table 4**Voting and non-voting share characteristics of the unification process**

This table reports the mean and median statistics on voting and non-voting shares for 35 Italian dual class unification firms used in the event study. Detailed variable definitions and construction are provided in Appendix II.

Variable	N	Mean	Median	Min.	Max.
Ratio of non-voting to total shares	35	0.176	0.180	0.004	0.456
Fraction unified in non-coercive unification	24	0.838	0.911	0.227	1.000
Voting premium three days before the unification announcement	35	0.387	0.295	-0.180	2.138
Value of voting right three days before the unification announcement	35	0.542	0.492	0.090	2.259
Ratio of value of voting rights to total value of equity	35	0.298	0.289	0.084	0.716
Minimum dividend yield for non-voting shares based on share price three days before the unification announcement	35	0.018	0.011	0.00	0.076
Actual non-voting dividend yield three days before the unification announcement	35	0.029	0.026	0.00	0.087
Expected yield less 10-year T-bond yield [§]	35	-0.031	-0.028	-0.091	0.045

§ The expected dividend yield is greater than the T-bond yield for 5 observations.

Table 5

Ownership and control characteristics before and after dual-class share unifications

Variables are defined for the sub-sample of unifications where there were no intervening financing or merger events between the ownership measurement dates before and after the unification. Detailed variable definitions and construction are provided in Appendix II.

	N	Mean	Median	Min	Max
Largest shareholder ownership before unification	30	0.559	0.546	0.235	0.854
Largest shareholder ownership after unification	30	0.542	0.551	0.235	0.834
Ratio of ownership to voting control before unification	23	0.762	0.804	0.181	0.999
Ratio of ownership to voting control after unification	23	0.873	0.999	0.250	1.000

Table 6**Stock returns surrounding the announcement of dual class unifications**

Panel A reports cumulative market-adjusted returns measured over the window [x, y] for voting shares, and non-voting shares, and the change in the total market capitalization of the firm. Panel B reports the three-day abnormal returns for voting and non voting shares, and the market capitalization for a subset of firms where the largest shareholder owned a block of non-voting shares and for a subset of firms where we have no information on the ownership of non-voting shares. wealth transfer from voting to non-voting shareholders as a fraction of the pre-unification firm's market capitalization. The predicted returns are based on the model presented in section 4 of the paper. ^a, ^b, and ^c indicate statistical significance at the 1%, 5%, and 10% levels for t-tests for zero means and Wilcoxon signed-rank tests for zero medians.

Panel A: Market adjusted abnormal returns surrounding the DCU announcement date, %

Interval	N	Voting shares			Non-voting shares			Market Capitalization		
		# >0	Mean	Median	# >0	Mean	Median	# >0	Mean	Median
[-1, +1]	35	13	-1.56 ^c	-1.25	30	+11.66 ^a	+6.75 ^a	18	+0.57	+0.03
[-2, +2]	35	14	-1.94 ^c	-0.60	31	+12.50 ^a	+6.53 ^a	19	+0.08	+0.01
[-1, +30]	35	13	-1.45 ^c	-3.17	24	+15.12 ^a	+9.14 ^b	14	+1.00	-0.61

Panel B: Three-day abnormal returns and wealth transfer where largest shareholder owned blocks of non-voting shares, %

		Voting shares		Wealth transfer		Market Cap	
		Mean	Median	Mean	Median	Mean	Median
Non-voting shares block ownership	17	-3.71 ^a	-4.59 ^b	2.01 ^a	2.11 ^a	-1.05	-1.62
No information	18	+0.46	+0.80	1.04	0.14 ^b	+2.10	+2.17
Difference		-4.17 ^a	-5.39 ^b	0.97	1.97 ^b	-3.15 ^b	-3.79 ^b

Table 7ter
Regression analysis

OLS cross-sectional regressions of three-day abnormal returns on the voting premium (the pre-unification difference in price of voting and non-voting shares), the fraction of shares represented by non-voting equity, pre-unification stakes of the largest and second largest shareholders of voting equity, pre-unification nv-ownership by the largest shareholder (set equal to zero when it was neither declared or inferred), difference in dividend yield for non-voting and voting equity, and an indicator variable that equals 1 whenever voting shareholders are compensated for the unification (compensation dummy). The dependent variables are (1) the three-day market-adjusted abnormal returns for voting shares, (2) the three-day abnormal return for non-voting shares, (3) the difference between the CARs earned by voting and non-voting shares, and (4), and (5), the three-day total change in firm market capitalization. Detailed variable definitions and construction are provided in the Appendix. ^a, ^b, and ^c indicate statistical significance at the 1%, 5%, and 10% levels.

	Dependent variable				
	(1) CAR _[-1,+1] Voting	(2) CAR _[-1,+1] Non-voting	(3) Difference in CARs for voting and non-voting	(4) Change in total market cap _[-1,+1]	(5) Change in total market cap _[-1,+1]
Intercept	-0.028	0.075	0.103	-0.064 ^c	-0.035
Voting premium	0.016	0.320 ^a	0.303 ^a	0.061 ^a	0.066 ^a
Non-voting equity as fraction of total equity	-0.306 ^a	-0.550 ^b	-0.243	-0.247 ^b	-0.240 ^b
Pre-unification stake of largest shareholder	0.119 ^b	-0.078	-0.197	0.119 ^b	0.090
Pre-unification stake of second-largest shareholder	0.315	-0.754	-1.069 ^b	0.253	0.175
NV-ownership	0.014	0.345 ^a	0.335 ^a	0.061	0.068
Difference in dividend yield between non-voting and voting shares	-0.280	-0.729	-0.449		-0.311
Compensation dummy	0.004	-0.107 ^b	-0.110 ^b		-0.021
Size	-0.002	0.004	0.007		-0.001
Adjusted R ²	0.335	0.554	0.579	0.2785	0.292

Table 8**Detailed ownership and return data for case studies**

In this table, we report the pre-unification voting premium (defined as the ratio of voting to non-voting share price-1), fraction of shares represented by non-voting equity, pre-unification stakes of the largest shareholder of voting equity, inferred and disclosed ownership of non-voting shares by the largest shareholder, three-days CARs for voting, non-voting shares and firm's market capitalization, predicted returns for voting and non-voting shares based and wealth transfer as a percentage of the firm's market capitalization based on the wealth transfer framework described in section 4.

Company Name	Voting-premium %	Fraction non-voting equity	Pre-unification largest blockholder	Non-voting share ownership		Actual returns [-1,+1], %			Predicted returns, %		Predicted wealth transfer %
				Inferred	Declared	Voting	Non-voting	Mkt Cap.	Voting	Non-voting	
Fin.part	53.44	0.39 [§]	0.420	0.595	0.585	-6.90	26.80	2.47	-17.42	26.71	12.85
Banca Finnat	23.53	0.400	0.712	0.940	0.817	-4.59	14.04	0.13	-7.62	14.12	4.95
Cir	21.70	0.225	0.549	0.199	---	-6.73	6.44	-4.50	-4.01	16.82	3.24
Ras	36.99	0.301	0.514	0.490	0.430	-4.05	13.16	-1.46	-4.90	15.96	3.73
Alleanza	31.43	0.155	0.543	0.095	0.078	-7.78	17.12	-1.23	-3.72	26.54	3.26
Mean	33.42	0.294	0.548	0.464	0.478	-6.01	15.51	-0.92	-7.53	20.03	5.61

[§] Includes preferred shares' quota.

Figure 1

Cumulative abnormal returns surrounding the dual class unification announcement

This figure shows the cumulative market-adjusted returns for voting and non-voting shares beginning 30 days before and ending 30 days after the announcement of the dual-class share unifications.

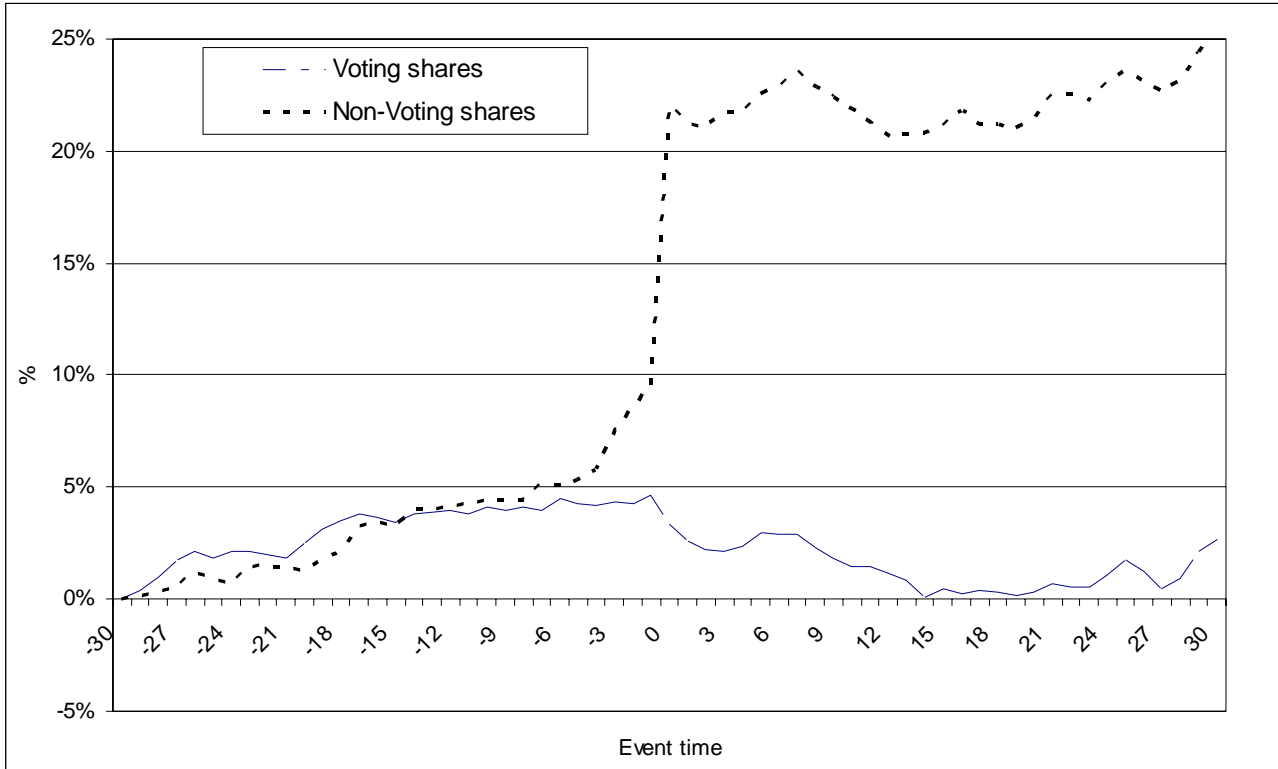
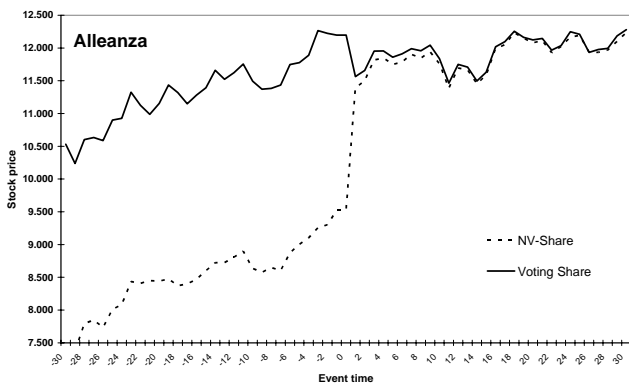
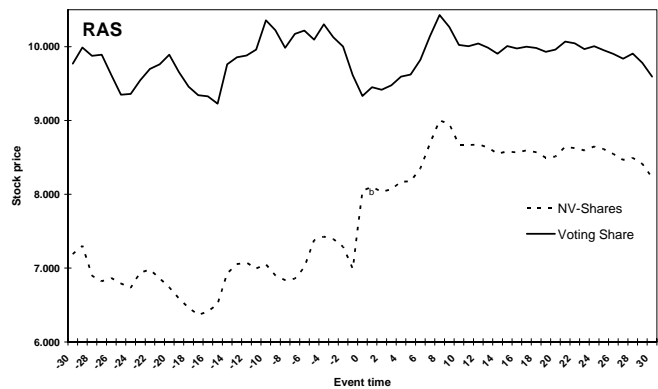
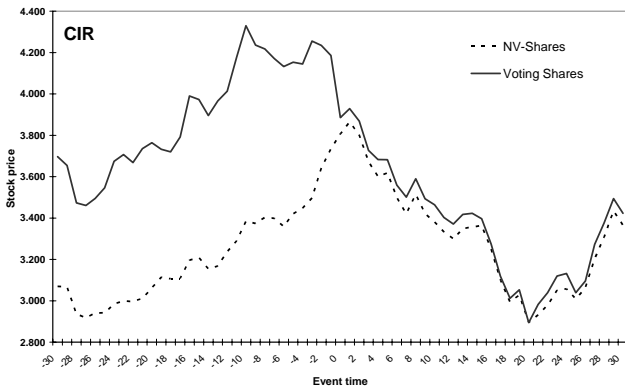
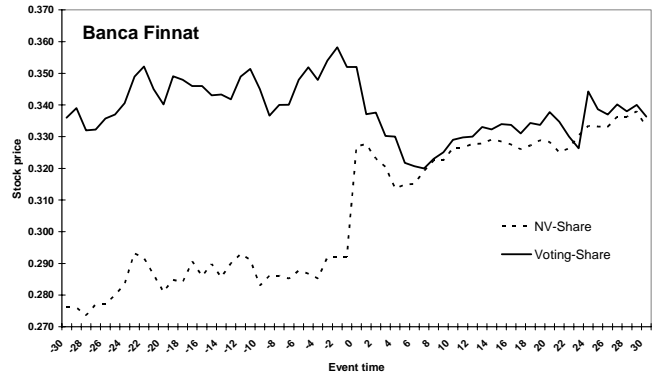
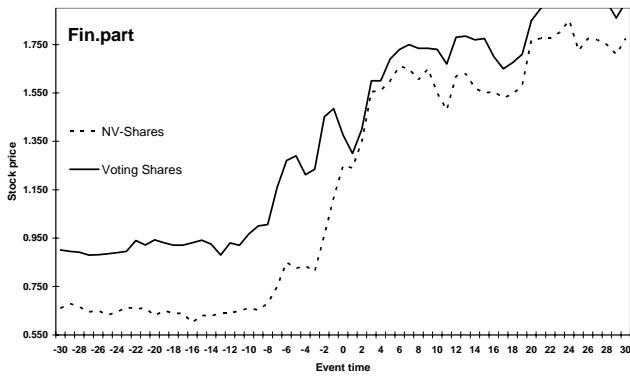


Figure 2

Stock prices for five case studies around the announcement of dual class unifications

This figure presents stock prices for voting and non-voting shares beginning 30 days prior to and ending 30 days after the announcement of dual class unifications for Fin.part, Banca Finnat, Cir, Ras and Alleanza. The stock price of the two classes of shares do not converge at the Ras DCU announcement date since the DCU involved a 1.059 euro cash payment for converting a non-voting share into voting shares.



Appendix I

Theoretical returns earned by voting and non-voting shares in a coercive 1:1 share unification

This table reports the theoretical returns earned by voting and non-voting shares for different levels of voting premium (the price difference between voting and non-voting shares prior to the unification), and for different levels of non-voting equity as a fraction of total equity. For example (see bold-face entries), when non-voting shares represent 25% of the total number of shares, and the pre-unification price premium for voting shares is 50%, the voting share price is expected to decline by 8.33%, whereas the non-voting share is expected to increase by 37.50%, upon unification of the two classes of shares, assuming zero aggregate change in firm value.

Share class	Voting premium	Ratio of non-voting to total shares				
		0.01	0.10	0.25	0.33	0.50
Non-voting shares	100%	99.00%	90.00%	75.00%	66.67%	50.00%
Voting shares		-0.50%	-5.00%	-12.50%	-16.67%	-25.00%
Non-voting shares	50%	49.50%	45.00%	37.50%	33.33%	25.00%
Voting shares		-0.33%	-3.33%	-8.33%	-11.11%	-16.67%
Non-voting shares	20%	19.80%	18.00%	15.00%	13.33%	10.00%
Voting shares		-0.17%	-1.67%	-4.17%	-5.56%	-8.33%
Non-voting shares	10%	9.90%	9.00%	7.50%	6.67%	5.00%
Voting shares		-0.09%	-0.91%	-2.27%	-3.03%	-4.55%

Appendix II
Variable definitions

<i>Variable</i>	<i>Description</i>
<i>Financial variables</i>	
	All accounting variables are from Datastream, with the exception of data for the two earliest unifications (Fisac, 1982 and Reyna, 1986) which have been taken from “Il Taccuino dell’Azionista”. All variables are computed as of the last financial statement before the unification announcement date.
Total Assets	Total assets (in millions of Euros)
Size	Natural logarithm of total assets.
Market-to-book	Market value of equity divided by the book value of equity.
Market Leverage	Total debt divided by total capital (debt plus market value of equity)
Book Leverage	Total debt divided by total capital (debt plus book equity)
ROA	Earnings before interest and taxes (EBIT) divided by total assets.
<i>Industry-adjusted financial variables</i>	
	For each DCU company we classify all the Italian companies belonging to the same industry in three industry definitions in increasing level of detail: INDC3 (SIC2), INDC4 (SIC3) and INDC5 (SIC4). Due to insufficient number of firms in some industries, we use the most detailed industry (INDC5) only if the number of companies in the industry was greater or equal to 3, otherwise we use the less detailed industry (INDC4) or the least detailed (INDC3). We use the median values from the matching industry.
Industry-adjusted Market-to-book	Market-to-book – Industry median market-to-book
Industry-adjusted Market leverage	Market Leverage– Industry median market Leverage
Industry-adjusted Book Leverage	Book Leverage– Industry median book leverage
Industry-adjusted ROA	ROA – Industry median ROA
<i>Other variables</i>	
Fraction unified	Other characteristics of DCU firms are computed using dividend information from <i>Il Taccuino dell’azionista</i> and <i>Il Sole 24 Ore</i> database. Percentage of non-voting shares accepting the unification offer in non-coercive DCUs
Compensation dummy	Indicator variable = 1, if the unification sets an indirect form of compensation to voting shareholders (a cash payment, a conversion ratio based on the market price, or any limits on the amount of nv-shares that can be converted)
Voting premium	Percentage voting premium three days before the announcement date (t = -3) calculated as the price differential between a voting and a non-voting share divided by the price of a non-voting share.
Value of voting right	Percentage voting premium computed as the ratio of voting right over the market price of non-voting shares on date t-3. The vote right adjusts for the higher dividends to non-voting shares.
Total voting right fraction	Fraction of the all equity value represented by the sum of all voting rights (Total Voting Rights).
Regulated dividend yield	Defined as the ratio of minimum dividend (according to the company charter) over the market price of non-voting shares on day t-3.

Current dividend yield	Defined as the ratio of last dividend paid on non-voting shares over the market price of non-voting shares on day t-3.
Expected dividend yield	Defined as the ratio of next DPS paid on non-voting shares over the non-voting share's market price in t-3.
Excess yield over T-bond yield	Expected dividend yield minus 10-year Italian Treasury Bond gross yield in the same month of the announcement date (source: Bank of Italy).
Ownership variables	
Owner type	Ownership data are from <i>Il Taccuino dell'azionista</i> (1982-1995), the Consob material database (1995-1997) and the Consob online database (1998-2005). Equals 1 if the largest voting shareholder is the government, 2 if it is a family or an individual, 3 if it is a financial institution or a blockholder.
Pre-unification stake of largest shareholder	Fraction of the firm's voting rights owned by the largest shareholder before the DCU.
Pre-unification stake of second-largest shareholder	Fraction of the firm's voting rights owned by the second largest shareholder before the DCU.
Post-unification stake of largest shareholder	Fraction of the firm's voting rights owned by the first largest shareholder after the DCU.
Post-unification stake of second-largest shareholder	Fraction of the firm's voting rights owned by the second largest shareholder after the DCU.
Ratio of O/C before unification	Ratio of control rights and cash flow rights before the unification. The ratio is computed using the methodology from Faccio and Lang (2002) and Consob ownership data since 1995.
Ratio of O/C before unification	Ratio of control rights and cash flow rights after the unification.
Non-voting share ownership declared	Fraction of the firm's non-voting shares owned by the largest shareholder as declared by the firm's press announcement or the press, where available.
Non-voting share ownership inferred	Fraction of the firm's non-voting shares owned by the largest shareholder as inferred from the pre- and post-unification stakes of the largest shareholder, and the characteristics of the DCU
CAR variables	
CAR voting shares	The event date for the event study is defined as the first board announcement date or the first next trading date if the stock was suspended by the Italian exchange in the day of the information release. Market-adjusted cumulative abnormal return for voting shares in several event-windows around the DCU announcement dates.
CAR non-voting shares	Market-adjusted cumulative abnormal return for non-voting shares in several event-windows around the DCU announcement dates.
CAR market capitalization	Market-adjusted cumulative abnormal return for the firms' market capitalization (computed also for other classes of shares when present) in several event-windows around the DCU announcement dates.
Difference in CAR between non-voting and voting shares	CAR-non-voting minus CAR-voting in the three-days window [-1,+1] around the announcement date.
Framework variables	
Predicted return voting shares	Predicted return on non voting shares from the framework, based on DCU characteristics and stock prices three days before the announcement date.

Predicted return non-voting shares	Predicted return on voting shares from the framework, based on DCU characteristics and stock prices three days before the announcement date.
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