

What are the Costs of Conflicts between Controlling and Minority Shareholders in a Concentrated Ownership Environment?

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Abstract

The main agency conflict in concentrated ownership environments occurs between controlling and minority shareholders. We investigate the impact on share prices when news released on the specialized media indicates that the interests of these groups diverge. Specifically, we analyze 24 announcements of conflicts between shareholder groups in Brazil using two different event study methodologies. The results strongly support our hypothesis that such news constitutes an evidence of relevant agency costs taking place, leading to a higher perception of risk and reduced share prices. We find a strong negative stock price reaction to the announcement of such conflicts, with cumulative abnormal returns of around 12% for the 15 days surrounding the event date. Besides, this negative impact do not seems to be transitory, since there is no post-event positive drift. Overall, the results reinforce the importance of the adoption of good corporate governance practices in order to avoid corporate value destruction due to problems between shareholder groups.

Key words: agency costs, corporate governance, event study, controlling shareholders, minority shareholders.

JEL Classification: G32; G34.

1. Introduction

Ownership structure is crucial for the determination of the relevant agency costs taking place in a given firm. In environments characterized by dispersed ownership structures, it is more important to measure the costs of the managers–shareholders relationship. However, these environments are the exception rather than the norm worldwide (La Porta et al. (1999)). In countries characterized by companies with concentrated ownership structures, it becomes more important to measure the agency costs of the controlling shareholders–minority shareholders relationship, since there is a permanent probability that the former will try to extract private benefits of control (Nenova (2003), Dyck and Zingales (2004)).

The Brazilian capital market is typically characterized by companies with high levels of ownership concentration, so that discretionary decisions are concentrated in the hands of few shareholders. It is, therefore, a large emerging market with predominance of firms under family, state, shared¹, and/or foreign control. Therefore, the main governance problem among Brazilian companies occurs between controlling and minority shareholders, and local disputes tend to happen upon attempts of economic expropriations by controlling shareholders through going private decisions, tunneling², biased related party transactions, etc.

This paper aims to assess the relevance attributed by investors to the announcement of disputes taking place between two shareholder groups: controllers³ and minority⁴ shareholders. The basic hypothesis is that these announcements, brought to the public by news on specialized newspapers, indicate that relevant agency costs are taking place. This, in turn, would lead investors to immediately take into account such potential expropriating decisions, reducing share prices of companies involved in these corporate governance problems. By disputes or conflicts, we consider public displays of dissatisfactions by minority investors before or after corporate decisions are made by controlling shareholders, such as mergers and

acquisitions, public share offers in case of control transfers, going private decisions, tentative of dilution of minority shareholders stakes, related party or self-dealing transactions, etc.

In order to measure the costs of such conflicts, we estimate abnormal returns by applying two different event study methodologies: the well known one presented by Campbell, Lo, and Mackinlay (1997), and an alternative method presented by Cooper, Dimitrov, and Rau (2001). Whereas the former computes market-adjusted abnormal returns relative to the Ibovespa index, the later compares returns between sample firms and selected peer companies not affected by the announcements (the so-called “non affected control group”).

The results are striking in support of our hypothesis. Sample firms involved in such public conflicts lose about 6.6% of their value at the event date. This loss reaches about 12% over a larger fifteen-day event window around the announcements. All results are statistically significant using both alternative methodologies. We also do not find any signs that the negative impact is transitory. There is no post-event positive drift and the abnormal returns stabilize at zero three days after the event. In plain words, investors seem to fly away from these firms, not coming back afterwards. The economic impact of the bad corporate governance announcements is also relevant. The 24 events of the sample destroyed about US\$ 7.8 billion on market value, and we estimate that the value destruction for each firm ranges from US\$ 325 to US\$ 497 million.

To our knowledge, this is the first paper to estimate the impact of specific agency costs between controlling and minority shareholders in an environment characterized by concentrated ownership structures. We believe that this is the main contribution of our paper. The paper is structured as follows: section 2 presents the methodology, including the sampling criteria, research model and event study methodologies employed. Section 3 presents the main results, and section 4 concludes.

2. Methodology

2.1. Population and sampling criteria

The population consists of all publicly traded companies listed on the São Paulo Stock Exchange (Bovespa). We search for announcements about conflicts between controlling and minority shareholders on the two largest Brazilian newspapers specialized in capital markets (*Valor Econômico* and *Gazeta Mercantil*). The search was performed by search tools on the newspapers' websites, looking for events published between 2001 and 2007 through three main keywords:

- *Minoritários* [minority shareholders];
- *Controlador* [controlling shareholder or controlling group] and;
- *Governança corporativa* [corporate governance].

As a sample selection criterion, we only considered announcements about companies whose shares had sufficient liquidity to perform the event study. As liquidity threshold, we analysed companies whose shares were traded on at least fifty percent of the trading days within both the estimation and event windows. Since it is usual to have firms with two share classes traded in Brazil (voting and non-voting stocks), we analyze the behavior of the most liquid share class, according to the liquidity index of Economática® database.

Data for the shares in the sample, as well as the Bovespa index (Ibovespa⁵) were collected in the electronic database Economática®. We've considered closing prices in order to calculate daily stock returns, and stock prices were obtained with adjustments for proceeds, including dividends.

During the selection of the events to be analyzed, we take into account any announcement that could be clearly regarded as a dispute or explicit conflict between the two shareholders groups that stand out in a concentrated ownership environment such as Brazil: controlling and minority shareholders. Therefore, we pick events that were clearly considered public

complaints by minority investors against proposals or decisions by controlling shareholders. It's important to note that these disputes or conflicts could either be on courts or not (for instance, some complaints from minority shareholders are not necessarily related the possibility of lawsuits), since we aim to investigate if the mere announcement of conflicts provokes abnormal changes on share prices.

Since the correct event date is obviously extremely important, the search for the first announcement in chronological order was made with special careful, in order to avoid the analysis of news previously announced to the public by other reports.

The initial search resulted in 51 distinct events from 42 different companies considered within the scope of the research. Twenty-seven of these were excluded due to two reasons: lack of minimum share liquidity during both estimation and event windows, and announcements of other major corporate governance or corporate finance news within the event window (making it difficult to isolate the specific effects of the conflict under analysis). Some companies presented more than one conflict during the period. Both were included in the sample, since they were considered of different types and the publication date of a given conflict did not coincide with the period of the other conflict taking place in the same company.

After the exclusions, we analyze 24 distinct events from 21 different companies. The set of events under analysis is summarized in Table 1 below:

< Please insert Table 1 here >

2.2. Research model and event study methodologies

We estimate abnormal returns by applying two different event study methodologies: the well known one presented by Campbell, Lo, and Mackinlay (1997), and an alternative method presented by Cooper, Dimitrov, and Rau (2001).

2.2.1. Event study using Campbell et al. (1997) methodology

Based on Campbell et al. (1997) methodology, we calculate the expected stock returns computing market-adjusted abnormal returns relative to the Ibovespa index. The event date is defined as the day $D=0$. Abnormal returns are calculated for three event windows: i) on the event day ($D=0$ to $D+1$); ii) over two days surrounding the event day ($D-2$ to $D+2$); and, iii) over a fifteen day window around the announcements ($D-5$ to $D+10$).

In order to calculate the event window expected return, we estimate betas and the parameters of the market model by running simple linear regressions based on a 50-day estimation window before the 15 day event window. The figure below describes the timeline adopted:

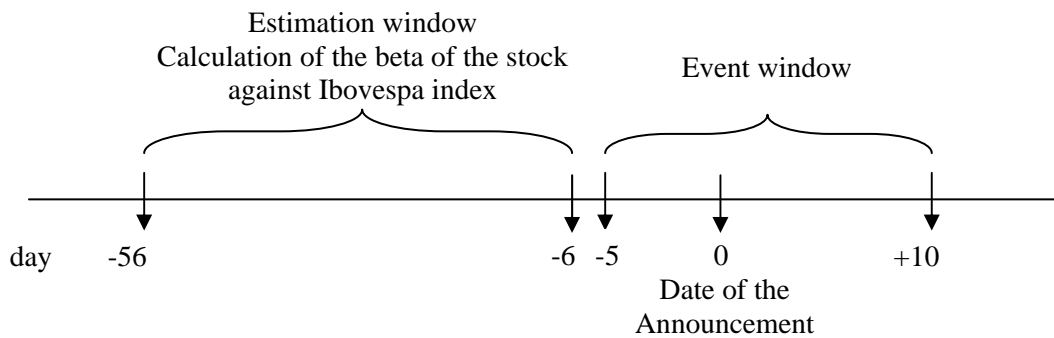


Chart 1 – Timeline adopted for estimation and event windows.

2.2.2. Event study using Cooper et al. (2001) methodology

The methodology employed by Cooper et al. (2001) is based on a comparison between the returns of the firms of the sample and the returns of selected peer companies not affected by the announcements. Therefore, we compute abnormal returns relative to a matched control

group of firms selected based on three main attributes: industry, market capitalization, and operational profitability. We refer to this comparison group as the “non affected control group”. Table 2 presents the firms selected as the matched control group of our sample.

< Please insert Table 2 here >

The abnormal return for each firm is then calculated as the difference between its returns during the event window and the returns earned by its matched control firm. Based on Cooper et al. (2001, p. 2377) and Brown and Warner (1985), the aggregated abnormal returns, cumulative abnormal returns (CAR) for a D-5 to D+10 window, and parametric t -statistics to measure whether the CAR is significantly different from zero are calculated as follows:

$$AR_t = \frac{\sum_{i=1}^N R_{it} - \sum_{j=1}^N R_{jt}}{N}; CAR = \sum_{t=-5}^{10} \sum_{i=1}^N \frac{AR_{it}}{N}; \text{ and, } t = \frac{\sum_{t=l}^k AR_t}{\sqrt{\sigma_{est_window}^2 \times M}}$$

Where R_{it} and R_{jt} are the return on the sample firm i and its corresponding matched firm j from the non affected control group for day t . N is the number of firms. $\sigma_{holdout}^2$ is the variance of the abnormal return computed over the estimation window and M is the number of days from $t=l$ to k (we use an estimation period of 50 days, with $l = D-6$ and $k = D-56$).

2.3. Research limitations

One strong limitation of our study deals with the subjectivity inherent to the choice of the “events”. We try to overcome this limitation by only selecting cases where, in our view, there was a clear distinct point of view between minority and controlling shareholders over corporate decisions, with the former publicly contesting the decisions made by the later. However, the conservatism to the choice of the events has led us to other limiting factor: the

small sample of only 24 events. The possibility that we have missed other similar events taking place in the sampling period, and the subjectivity on the choice of both event and estimation windows are also obvious limitations. Nevertheless, the main limitation of our paper rests on the theoretical side, since it's a purely empirical work.

3. Analysis of Results

3.1. Descriptive statistics

Table 3 provides some descriptive statistics, grouping the sample according to four different aspects: 1) identity of controlling shareholder; 2) type of conflict; 3) industry; and, 5) year of occurrence.

< Please insert Table 3 here >

Table 3 starts with the identity of controlling shareholders, which are classified in four different categories: family-controlled companies, foreign-controlled companies, companies controlled by a shareholders' agreement involving two or more large block holders, and state-owned companies. About half (11) of the conflicts took place in family-controlled companies. This is probably due to two main aspects: the majority of Brazilian listed companies are still controlled by families, and, since most of the companies are part of business groups, these kind of control could be more prone to expropriate minority investors by making decisions in order to extract private benefits of control. In addition, about 30% of the conflicts (7) took place in companies with shared control. This result may be due, among other causes, to the privatization model adopted in Brazil, which created large companies with shared control, often with relationship problems within controlling shareholders or between these and minority shareholders.

The second block of Table 3 divides the sample according to three broad types of conflicts: i) disputes related to merger and acquisition decisions by controlling shareholders or by public share offers in case of control transfers or going private decisions; ii) disputes over the control of the company, including dilution of minority shareholders stakes, and attempts to avoid or difficult the vote of minority investors on general assemblies; and iii) disputes related to managerial decisions, including related party transactions (self-dealing) issues and potential accounting frauds. Appendix A illustrates this classification, presenting two cases from each type of conflict abovementioned. The majority of the conflicts (10 events) fit into the first category. Therefore, we find that most of the conflicts publicly reported in Brazilian listed companies do not deal with decisions made in the ongoing process of operational corporate activity, but rather with decisions related to control transfers, going private processes, and acquisition of other companies with significant equity stakes of the controlling shareholders. In other words, minority shareholders in Brazil tend to complain about the exchange or acquisition terms of their shares during takeover or going private processes, rather than complain on operational decisions made by the companies' controllers / managers.

The third block of Table 3 classifies the conflicts based on the industry classification. The telecom sector presented the large number of observations (6 events), followed by Iron and Steel (5 events). Together, they comprise about half of the conflicts under analysis. The fact that most news were about the telecom sector may come from three possible reasons, among others: i) this industry faces problems due to governance arrangements created during the privatization process promoted by the government in order to make the privatization process feasible; ii) this industry consists of large companies with good share liquidity, which could simply lead to stronger attention by analysts and the specialized media; and, iii) it is a highly regulated sector, under close scrutiny by regulatory agencies.

The last block of Table 3 presents the annual frequency of the announcements. The events are well distributed across the 2001-2008 period, with most observations coming from 2007 and fewer observations coming from 2001 and 2005 years. In spite of the improvement of corporate governance practices in Brazil during the sampling period (reported in Silveira et al. (2007)), it's not possible to argue that the number of conflicts has been decreasing in Brazil in recent years despite the whole movement towards the adoption of good corporate governance practices.

3.2. Event study results

Table 4 reports the cumulative abnormal returns (CARs) for three event windows for all firms based on the two event study methodologies previously presented: one computing market-adjusted abnormal returns relative to the Ibovespa index, and an alternative method comparing returns of the sample firms with returns of selected peer companies not affected by the announcements.

< Please insert Table 4 here >

According to Table 4, the negative impact of the announcement of disputes between controlling and minority shareholders is remarkably strong across all event windows surrounding the event date, independently of the methodology employed. Specifically, the results by applying the market model show that firms lose on average an abnormal return of 6.6% of their value at the event date. This loss reaches 12.6% over the fifteen-day period from date D-5 to date D+10. All results are statistically significant at 1% level. Interestingly, the estimation of CARs through the alternative “non affected control group” methodology provides very similar results in terms of magnitude and statistical significance. In this case,

the results also point to a loss of 6.6% of share price for all firms on the event date, with a value destruction of 11.3% over the complete fifteen-day event window from D-5 to D+10.

The daily evolution of CARs around the fifteen-day event window for both methodologies is also presented in Tables 5 and 6. In addition, CARs are also graphed in Figures 1 and 2.

< Please insert Table 5 here >

< Please insert Figure 1 here >

< Please insert Table 6 here >

< Please insert Figure 2 here >

Figures 1 and 2 allow three relevant observations: i) the evolution of share prices has a pattern similar to the predictions of the market efficiency hypothesis, with an abrupt share drop on the announcement date, with subsequent stabilization of share prices; ii) there isn't any clear sign of a reversion on share prices (no post-announcement positive drift), suggesting that firms do experience a permanent value decrease; and, iii) in line with other previous event studies, share prices start their downward course a few days before the public announcement, indicating that some rumors about the problems between shareholders groups could spread before the public announcement, prompting share sales by insiders and/or by previously informed outside investors.

Another interesting finding is the economical significance of the results. The average market value of the sample firms one month before the event date is US\$ 3.96 billion. Since they lose on average 12.6% of their value at the end of the fifteen-day window, on average firms lose about US\$ 497 million of their value due to news pointing disputes between controlling and minority shareholders. Another calculation can be made by multiplying each

firm's market value one month before the event took place with each firm's respective CARs. In this case, the calculation results in a net value destruction of about US\$ 325 million per sample firm (overall, the 24 events destroyed US\$ 7.8 billion in market value). Therefore, the mere public announcement of conflicts, independently on who is right about the subject on debate, results in a value destruction for the firm involved of US\$ 325 to US\$ 497 million.

Overall, our results strikingly support the research hypothesis of a substantial negative market reaction to announcements about clashes between controlling and minority shareholders.

4. Conclusions

Most of the empirical studies on corporate governance aim to assess the potential positive impact of the adoption of better governance practices. Our study goes in the opposite way: we try to measure the impact of the announcement of bad corporate governance news. Specifically, we analyze how market reacts when conflicts between controlling and minority shareholders become public. These conflicts are usual in environments characterized by concentrated ownership structures, like Brazil.

We find striking results in support of our hypothesis that announcements of complains by minority investors against policies and decisions made by controlling shareholders increase the perception of the so-called "governance risk factor" on such companies, therefore resulting in value depreciation. By using two different event study methodologies (market model and comparison with a matched peer group of companies not affected by the news), we find that sample firms on average lose about 6.6% of their value at the event date. This loss reaches about 12% over the larger fifteen-day event window, from date D-5 to date D+10. All results on both methodologies are statistically significant at 1% level.

We also do not find any indication that these negative impacts are transitory. There is no post-event positive drift and the abnormal returns stabilize at zero three days after the event. In plain words, investors seem to fly away from these firms, not coming back afterwards. The economic impact of the bad corporate governance announcements is also relevant. The mere announcement of disputes between shareholder groups results in a value destruction for the firm involved of US\$ 325 to US\$ 497 million.

Due to limitations on the number of observations, we could not empirically assess whether some corporate attributes (such as the identity of controlling shareholders or industry) or event characteristics (like the type of conflict announced) influence the level of market reaction. In other words, we could not answer questions such as: what type of conflict between controlling and minority shareholders does the market perceive as more relevant? Is the type of controlling shareholder (state-owned, family-owned, shared control, etc.) relevant for the magnitude of the market's reaction? These are important extensions that are intended to be addressed later. Our paper also provides theoretical implications, since it suggests that is important to model the probability of such events taking place, based on the abovementioned corporate attributes. This has not been done yet and was out of the scope of this paper.

In sum, our research provides relevant evidence for investors and policy regulators about the potential damage that conflicts resulting from inadequate governance practices can cause on companies. It also points out the relevance of the media for promoting better corporate governance practices, since these relevant announcements would not be made public without an independent and specialized coverage (prompting other controlling shareholders to be fearful of their own possible wealth loss in case of not making decisions in the best interest of all shareholders). Academically, this research line offers a fertile ground for studies, besides generating practical results for the development of capital markets in emerging economies characterized by concentrated ownership structures like Brazil. Finally, the economically

significant results reinforce the importance for firms to adopt good governance practices, in order to avoid the destruction of corporate value due to problems between shareholder groups.

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Table 1 – Summary of the events involving announcements of conflicts between controlling and minority shareholders

The table below summarizes the 24 events under analysis. They refer to announcements of conflicts between controlling and minority shareholders of Brazilian listed firms from 2001 to 2008. The first column displays the name of the company involved. The second presents the company's industry. The third contains the event date, which corresponds to the date of the initial announcement of the dispute. Special care was made to collect the correct date of the first news, since some cases extended for a long period of discussion between shareholder groups. The last column presents the public announcement. It corresponds to the news title displayed by one of the two largest Brazilian newspapers specialized in capital markets (*Valor Econômico* and *Gazeta Mercantil*, which were used as data sources).

Company	Industry	News date (dd/mm/yy)	Announcement (News)
1. Cosipa	Iron and Steel	10/24/01	Minority shareholders of Cosipa threat to go to court in order to force Usiminas to make a public share offer
2. Polialden	Chemical	06/27/02	Association of minority investors want to contest Polialden dividends on court
3. Cia Sider. Nacional	Iron and Steel	08/12/02	Minority shareholders debate their vote on the CSN general meeting about Metalic acquisition (a steel can firm then wholly owned by CSN's controlling family)
4. Gerdau I	Iron and Steel	10/15/02	Loan from Gerdau to stud farm owned by its controlling family displeases the market
5. Tele Centroeste Cel.	Telecom	01/16/03	Association of minority investors turns to CVM against exchange relation proposed in the purchase of TCO
6. Telefonica	Telecom	08/25/03	Telefonica executives are prosecuted over supposed power abuse on Atento's contract (Atento was at that time a private company subsidiary of Telefonica Spain, parent company of Telefonica Brazil)
7. Brasil Telecom	Telecom	09/22/03	Dispute between shareholders avoids the appreciation of Brasil Telecom shares
8. Cataguazes	Electrical Energy	12/09/03	Cataguazes and foreign shareholders fight on court
9. Bombril	Retailing	01/13/04	Shareholders fight for Bombril's control
10. Ambev	Food and Beverage	03/03/04	Previ (a Pension Funda with a minority stake at Ambev) asks explanations from CVM about AmBev/Interbrew merger
11. Telemar Norte Leste	Telecom	09/23/04	General attorney decides to go on court to try and annul Telemar's acquisition of Oi (a private company totally held by Telemar's controlling shareholders at that time)
12. Ripasa	Pulp and Paper	07/22/05	Ripasa sale causes friction among controlling and minority shareholders
13. Gerdau II	Iron and Steel	05/05/06	Royalties paid to controlling shareholders Displeases the market
14. Telemar NL Partic.	Telecom	05/11/06	Investor reacts against Telemar's new dividend policy
15. Tim Participações	Telecom	05/19/06	Mutual Funds try to annul TIM shareholders assemblies

Company	Industry	News date (dd/mm/yy)	Announcement (News)
16. Arcelor-Mittal	Iron and Steel	6/28/06	Minority shareholders vindicate offer from Arcelor
17. Trafo	Machinery	03/07/07	Minority shareholders want to suspend Trafo's offer made by Weg
18. Nossa Caixa	Finance	03/28/07	Minority shareholders object operation at Nossa Caixa
19. Cosan I	Agriculture	06/26/07	Cosan's proposed plan dilutes minority shareholders' voting power
20. Eletrobrás	Electrical Energy	08/23/07	Minority shareholders charge debt R\$ 8 billion owned by Eletrobras
21. Cosan II	Agriculture	11/19/07	Cosan's plan to equity capital increase cast doubt on minority investors
22. Agrenco	Agriculture	06/25/08	Minority investors look for ways to be compensated by losses caused by Agrenco controllers
23. Aracruz	Pulp and Paper	08/20/08	Minority shareholders question the change of control at Aracruz
24. Tenda	Constructing	09/02/08	Strategy for acquisition of Tenda by Gafisa (another constructing company) displeases investors

Table 2 – Matched control group for the sample

The table below presents the 24 firms selected as peer companies for the 24 events of the sample. This group is called “non affected control group”, and is selected based on three main attributes: industry, market capitalization, and operational profitability. These companies, therefore, are considered the closest ones listed on the Bovespa to the sample companies at the time of the announcements of the conflicts, and are used as a control group when the methodology described by Cooper, Dimitrov, and Rau (2001) is applied.

Sample Company	Selected Non Affected Peer Company	Industry
1. Cosipa	CST	Iron and Steel
2. Polialden	MG Poliester	Chemical
3. Cia Sider. Nacional	Usiminas	Iron and Steel
4. Gerdau I	Usiminas	Iron and Steel
5. Tele Centroeste Cel.	CRT Celular	Telecom
6. Telefonica	Telemar	Telecom
7. Brasil Telecom	Telemar	Telecom
8. Cataguazes	Transmissão Paulista	Electrical Energy
9. Bombril	Unipar	Retailing
10. Ambev	Bunge	Food and Beverage
11. Telemar Norte Leste	Telesp	Telecom
12. Ripasa	Klabin	Pulp and Paper
13. Gerdau II	Usiminas	Iron and Steel
14. Telemar NL Partic.	Telesp	Telecom
15. Tim Participações	Vivo	Telecom
16. Arcelor-Mittal	Usiminas	Iron and Steel
17. Trafo	Whirlpool	Machinery
18. Nossa Caixa	Banestes	Finance
19. Cosan I	São Martinho	Agriculture
20. Eletrobrás	Cemig	Electrical Energy
21. Cosan II	São Martinho	Agriculture
22. Agreco	SLC Agrícola	Agriculture
23. Aracruz	Klabin	Pulp and Paper
24. Tenda	PDG Realty	Constructing

Table 3 – Descriptive statistics

The table below provides descriptive statistics for the 24 events analyzed of conflicts between controlling and minority shareholders of Brazilian listed firms from 2001 to 2008. The first block displays the frequency of the events by the identity of controlling shareholders: family-controlled companies, foreign-controlled companies, companies controlled by a shareholders’ agreement involving two or more large block holders, and state-owned companies. The second block divides the sample according to three broad types of conflicts: i) disputes related to merger and acquisition decisions by controlling shareholders or by public share offers in case of control transfers or going private decisions; ii) disputes over the control of the company, including dilution of minority shareholders stakes, and attempts to avoid or difficult the vote of minority investors on general assemblies; and iii) disputes related to managerial decisions, including related party transactions (self-dealing) issues and potential accounting frauds. The third block describes the frequency of the conflicts based on the industry classification, whereas the fourth block presents the yearly frequency of announcements.

Descriptive statistics							
1. Identity of controlling shareholder		2. Type of conflict		3. Industry		4. Year of the occurrence	
Family-control	11	M&A decisions and public share offers	10	Telecom	6	2001	1
Shared-control through block holdings	7	Managerial decisions / related party transactions	8	Iron and Steel	5	2002	3
Foreign-control	4	Fights for control / voting rights	6	Agriculture	3	2003	4
State-owned	2			Energy	2	2004	3
				Pulp and Paper	2	2005	1
				Construction	1	2006	4
				Food and Beverage	1	2007	5
				Others	4	2008	3

Table 4 – Cumulative Abnormal Returns (CARs) relative to Ibovespa index (market model) and to a matched control group of firms (peer comparison)

This table reports the percentage cumulative abnormal returns (CARs) based on two event study methodologies: one computing market-adjusted abnormal returns relative to the Ibovespa index described by Campbell, Lo, and Mackinlay (1997) (using the so-called “market model”); and an alternative method presented by Cooper, Dimitrov, and Rau (2001), based on the comparison between returns of the sample firms and returns of selected peer companies not affected by the announcements (the so-called “non affected control group”). The control sample firms are selected based on three main attributes: industry, market capitalization, and operational profitability. The CARs are calculated for various event windows for companies that were involved in announcements of conflicts between controlling and minority shareholders from 2001 to 2008. Each cell reports the average CAR across all firms for the respective event window. *t*-statistics are reported in parentheses. ***, **, and * denote statistical significance at 1%, 5%, and 10%, respectively.

	Event Period		
	1	2	3
	0 to 1	-2 to +2	-5 to +10
Panel A: CARs adjusted by Ibovespa (Market Model)			
All (n = 24)	-6,6%*** (-11,66)	-9,9%*** (7,07)	-12,6%*** (-5,50)
Panel B: CARs adjusted by Non Affected Control Group			
All (n = 24)	-6,6%*** (-3,45)	-9,6%*** (-2,81)	-11,3%*** (-3,71)

Table 5 – Daily Abnormal Returns (ARs) e Cumulative Abormal Returns relative to Ibovespa index (market model)

This table reports the percentage daily abnormal returns (ARs) and Cumulative Abnormal Returns (CARs) computed by the market model relative to the Ibovespa index, applying the methodology described by Campbell, Lo, and Mackinlay (1997). The ARs are calculated for a 16 day event window surrounding announcements of conflicts between controlling and minority shareholders from 24 sample observations. The first column refers to the day surrounding the event day (D=0). The second presents the mean abnormal return for the 24 aggregated events. The third presents the standard deviations of the abnormal returns, whereas the fourth displays the *t*-statistics of the daily abnormal returns.

Day	Mean AR	Std Dev AR	t AR	Mean CAR	Std Dev CAR	t CAR
-5	-1.0%	0.6%	-1.68	-1.0%	0.6%	-1.68
-4	-3.5%	0.6%	-6.22	-4.5%	0.8%	-5.58
-3	0.1%	0.6%	0.15	-4.4%	1.0%	-4.48
-2	0.5%	0.6%	0.85	-3.9%	1.1%	-3.46
-1	-0.4%	0.6%	-0.70	-4.3%	1.3%	-3.40
0	-6.6%	0.6%	-11.66	-11.0%	1.4%	-7.86
1	-1.7%	0.6%	-2.95	-12.7%	1.5%	-8.39
2	-1.6%	0.6%	-2.87	-14.3%	1.6%	-8.86
3	0.2%	0.6%	0.34	-14.1%	1.7%	-8.25
4	0.3%	0.6%	0.46	-13.8%	1.8%	-7.68
5	0.3%	0.6%	0.45	-13.6%	1.9%	-7.19
6	0.8%	0.6%	1.34	-12.8%	2.0%	-6.49
7	-0.3%	0.6%	-0.59	-13.2%	2.1%	-6.40
8	-0.3%	0.6%	-0.60	-13.5%	2.1%	-6.33
9	0.9%	0.6%	1.48	-12.6%	2.2%	-5.71
10	0.1%	0.6%	0.14	-12.6%	2.3%	-5.50

Figure 1 – CARs relative to Ibovespa index (market model)

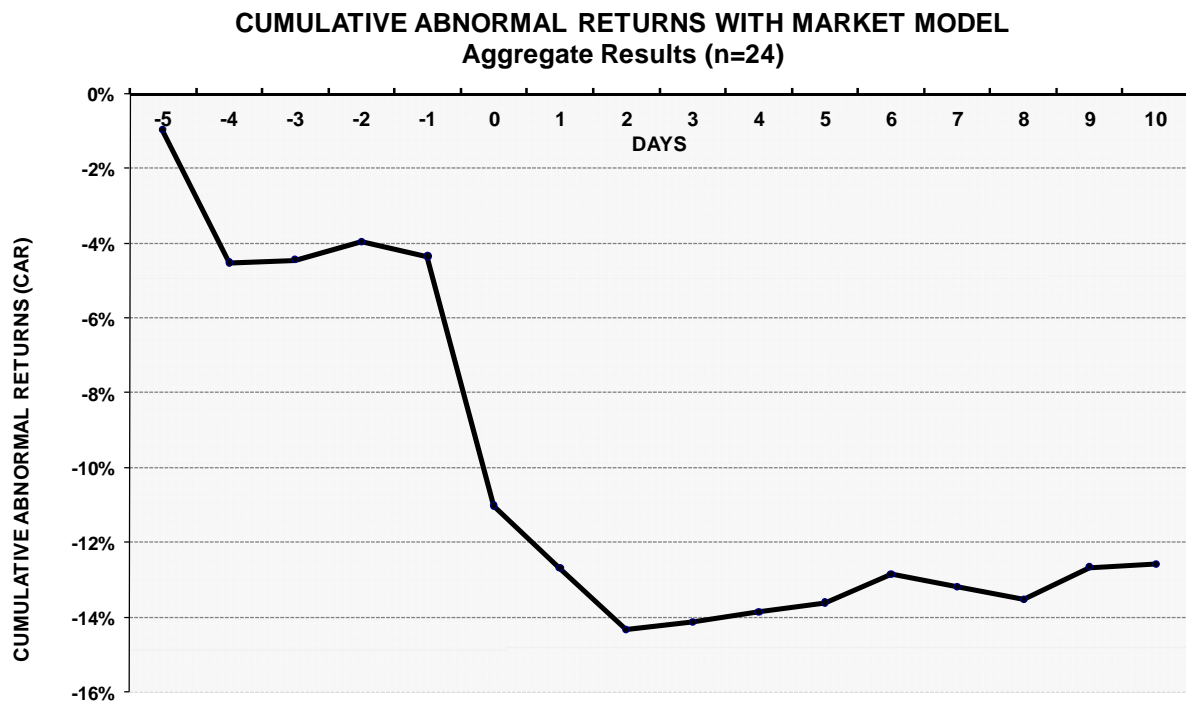
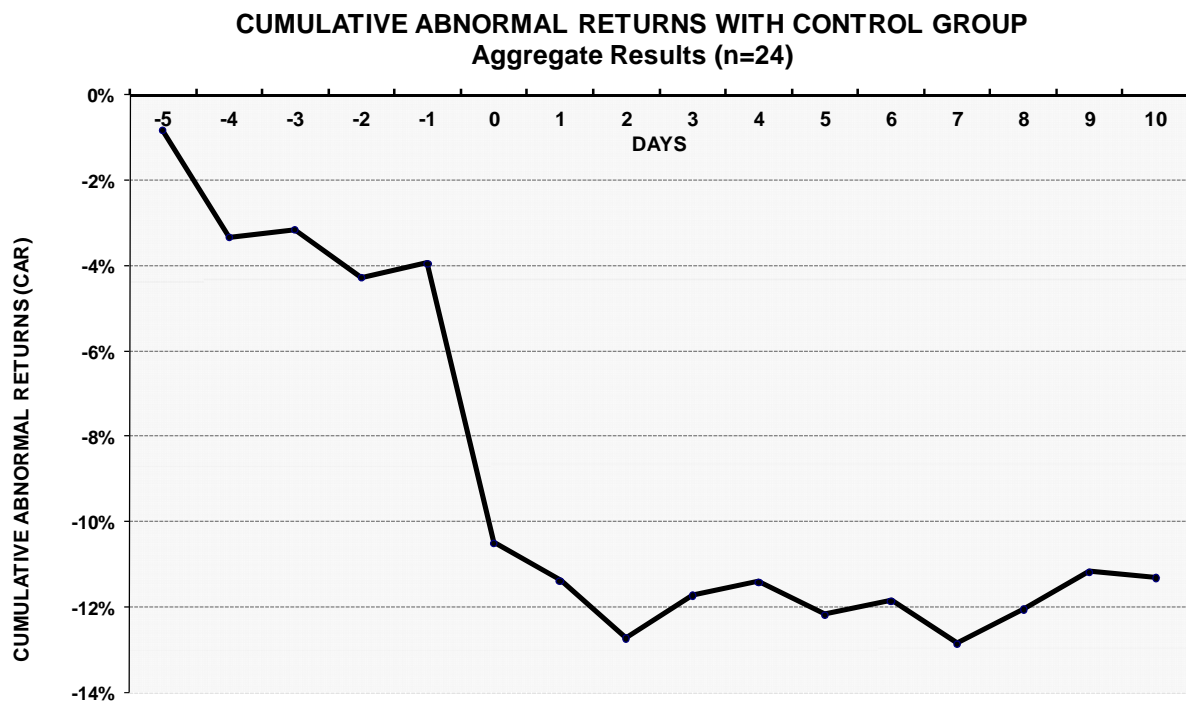


Table 6 – CARs relative to matched control group of firms (peer comparison)

This table reports the percentage Cumulative Abnormal Returns (CARs) computed by the comparison between returns of sample firms and returns of selected peer companies not affected by the announcements (the so-called “non affected control group”), applying the methodology described by Cooper, Dimitrov, and Rau (2001). The CARs are calculated for a 16 day event window surrounding announcements of conflicts between controlling and minority shareholders from 24 sample observations. The first column refers to the day surrounding the event day (D=0). The second presents the mean cumulative abnormal return for the 24 aggregated events. The third presents the *t*-statistics.

Day	Mean CAR	t CAR
-5	-0.8%	-0.27
-4	-3.3%	-1.09
-3	-3.1%	-1.03
-2	-4.3%	-1.40
-1	-3.9%	-1.29
0	-10.5%	-3.45
1	-11.4%	-3.74
2	-12.7%	-4.18
3	-11.7%	-3.85
4	-11.4%	-3.75
5	-12.2%	-4.00
6	-11.8%	-3.90
7	-12.8%	-4.22
8	-12.0%	-3.96
9	-11.2%	-3.67
10	-11.3%	-3.71

Figure 2 – CARs relative to matched control group of firms (peer comparison)



Appendix A – Six Illustrative Cases

This appendix details six illustrative cases selected among the twenty four that comprise the sample. We have selected two cases from each of the three broad types of conflicts that we have categorized the events (please see Table 3 for more details). All CARs were computed by using the market model.

Case 1

Type of Conflict: Managerial decisions / related party transactions.

Firm involved: Gerdau.

Industry: Iron and Steel.

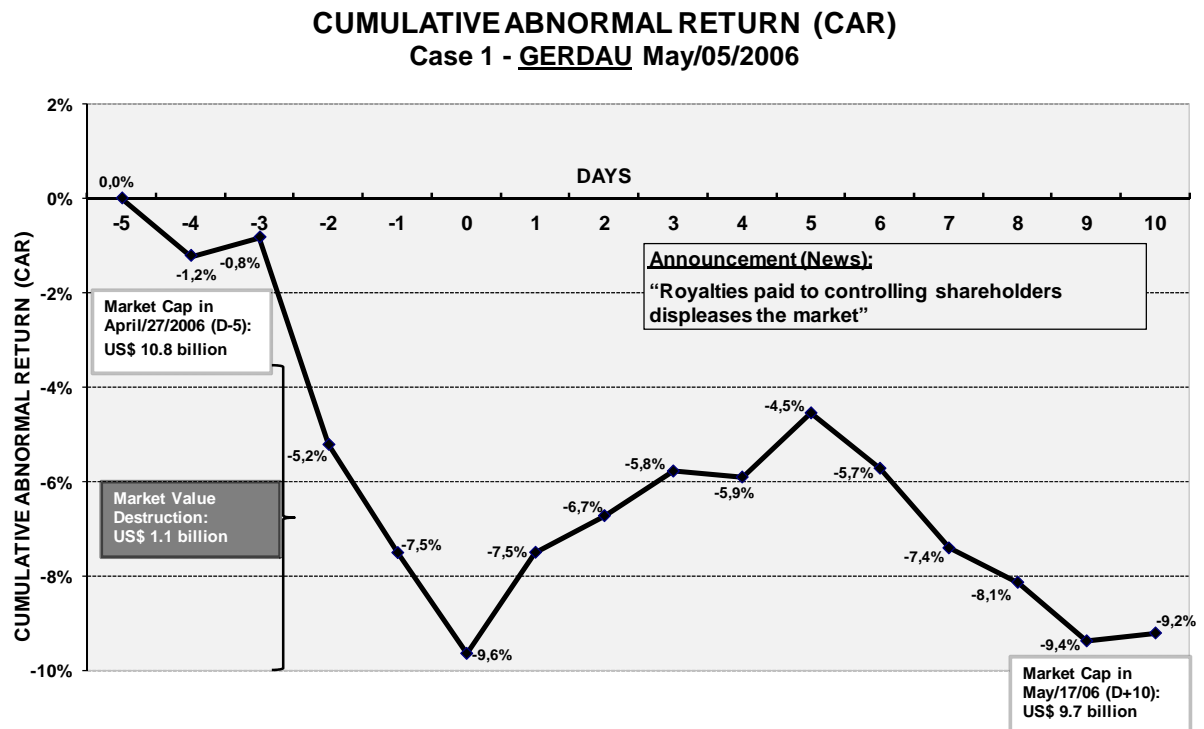
Identity of control: Family controlled.

Event date: May/05/2006.

News title: “Royalties paid to controlling shareholders displeases the market”.

Description of the case: Gerdau is the world’s 13th largest steelmaker. It started to operate in 1901, in Porto Alegre, Brazil. Since its inception, it’s run and controlled by the Gerdau Family. The company adopts an unusual business practice: it quarterly pays a “royalty” for the privilege of using the name “Gerdau” to a separate private entity belonging to the controlling family. In spite of this unusual practice, the controlling family announced in May/2006 that, after a revaluation of the brand’s value by a brand consulting firm, it would raise the payments from R\$ 1 million / quarter (about US\$ 500 thousands) to R\$ 16 million / quarter (about US\$ 8 million), an arbitrarily sixteen-fold increase. Several minority shareholders, including foreign investors complained about this decision. A few days later, after a strong market pressure and strong bad repercussion, the controlling family decided to call an extraordinary board meeting, cancelling the increase on the royalties’ payments. However, even with the cancelation of such not welcomed decision, our results from this case show that stock price didn’t fully recover its initial level.

Chart with cumulative abnormal return (CAR):



Case 2

Type of Conflict: Managerial decisions / related party transactions.

Firm involved: Nossa Caixa.

Industry: Finance.

Identity of control: State controlled company.

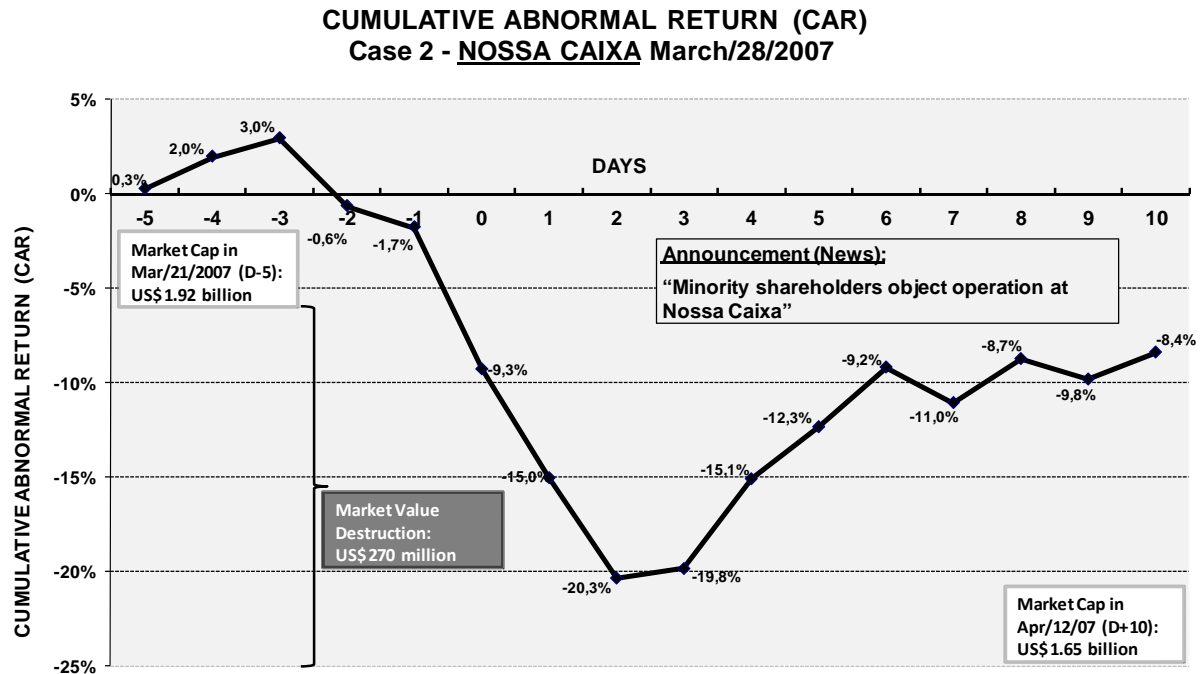
Event date: March/28/2007.

News title: "Minority shareholders object operation at Nossa Caixa".

Description of the case: Nossa Caixa is a bank controlled by the State of São Paulo (the wealthiest state of Brazil, with about 35% of GDP), who holds a 71.25% stake of the banks' total stocks. The bank is listed on the Novo Mercado, the premium listing segment of Bovespa designed for companies who voluntarily commit themselves to stricter corporate governance standards. Earlier 2008, Nossa Caixa decided to make an offer to the Government of the State of São Paulo in order to be the exclusive financial agent for payments of the wage of all State's civil servants (whom would be obliged to open a personal account at the bank, becoming its clients). However, the negotiation on the price to be paid for this exclusive right had a structural conflict of interest: the chairman of the bank's Board of Directors (the buyer) was the State's Finance Secretary, the same person on the other side of the table trying to sell this exclusive right to a financial institution. At the end of March, 2007, Nossa Caixa announced that it has decided to pay R\$ 2.1 billion (about US\$ 1.1 billion) to the Government of São Paulo (its controlling shareholder) for the exclusive right to be the State's financial agent on payments to Civil Servants. This amount, equivalent to 80% of the Bank's total equity at that time, was considered by analyst far above what was previously expected, generating complaints among

minority shareholders. According to an analysis of Deutsche Bank, Nossa Caixa expected earnings for 2007 and 2008 dropped to about 1/3 and 1/4, respectively, after this managerial decision.

Chart with cumulative abnormal return (CAR):



Case 3

Type of Conflict: M&A decisions and public share offers.

Firm involved: Cosan S/A.

Industry: Agriculture.

Identity of control: Family controlled company.

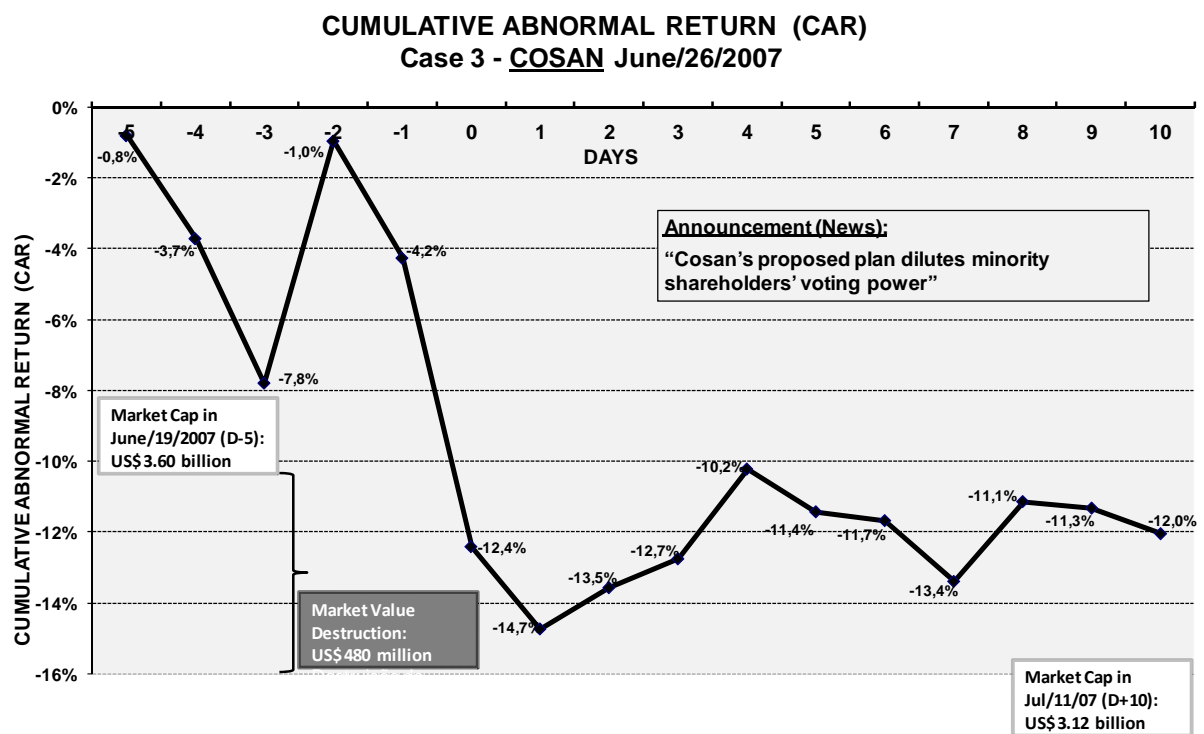
Event date: June/26/2007.

News title: "Cosan's proposed plan dilutes minority shareholders' voting power".

Description of the case⁶: Cosan S/A is one of the world's largest producers of sugar and ethanol. It is controlled and run by the Ometto family. The firm is listed on the Novo Mercado, Bovespa's corporate governance premium listing segment. At the end of June, 2007, Cosan's controlling shareholders decided to create another company – Cosan Limited – in an off-shore location where minority shareholders receive less favorable treatment. The announcement of this decision was not welcomed by minority shareholders, who saw the proposal as a way to escape from the one-share one-vote principle. Specifically, the restructuring of the Cosan group, was executed in three stages. First, a global offering was made by Cosan Limited, headquartered in the Bermudas. This was followed by a corporate reorganization which actually did not alter the shareholding control structure. Finally, an offer was made to the minority shareholders of Cosan S/A to migrate to Cosan Limited, which would have two classes of ordinary shares: "A" and "B" shares. The "A" class shares, to be offered to Brazilian investors, would be represented by Brazilian Depositary Receipts (BDRs). The "B" class

would be exclusively offered to the controlling shareholders (the controlling family). The difference between one class of shares and the other lies in their respective voting rights. The “B” class shares have the right to 10 votes, whereas the “A” class shares have the right to just one vote. Overall the market had little doubt that the rules and principles of corporate governance were seriously threatened by this proposal. As a result, several minority shareholders complained on this decision. A couple of days later, after strong pressure by both local and foreign institutional investors, Cosan’s controlling shareholders reconsidered the proposal. The decision was that, as part of the public offer of a voluntary exchange of shares in Cosan S/A for shares in Cosan Limited, the company would grant shareholders in Cosan S/A the right to exchange, of their own free will, their ordinary shares in Cosan S/A for Class “A” shares issued by Cosan Limited or for class “B” shares of a second series to be issued by Cosan Limited. However, our results from this case show that stock price didn’t fully recover its initial level afterwards.

Chart with cumulative abnormal return (CAR):



Case 4

Type of Conflict: M&A decisions and public share offers.

Firm involved: Companhia Força e Luz Cataguazes Leopoldina (Cataguazes).

Industry: Electrical Energy.

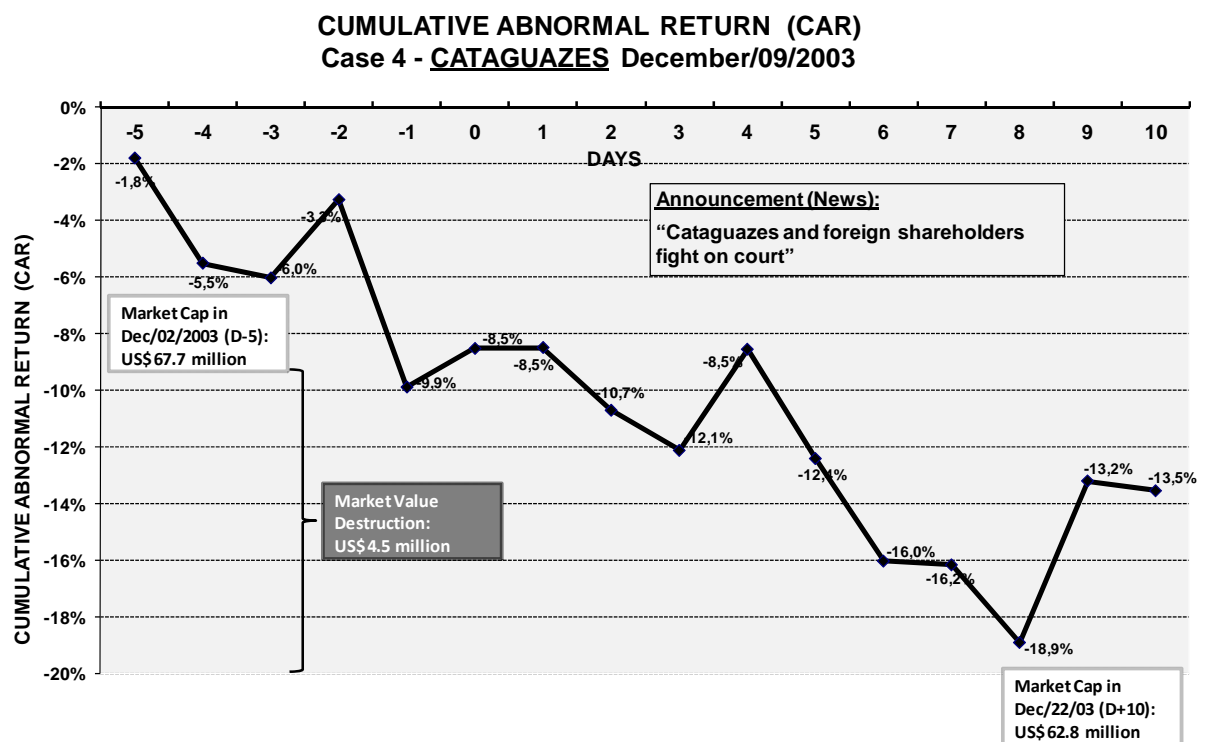
Identity of control: Family controlled company.

Event date: December/09/2003.

News title: “Cataguazes and foreign shareholders fight on court”.

Description of the case: Cataguazes is an electrical energy distribution company founded in 1905. The company, whose corporate name was changed in 2007 to Energisa, is controlled and run by the Botelho family (who holds 35% of the company’s total shares and 63% of the company’s voting shares). In the beginning of this decade, the firm went under a period of losses. According to the Brazilian Corporate Law, preference shareholders (holders of nonvoting shares) acquire the right to vote on shareholders meetings if the company fails to pay dividends three years in a row (losing again their right to vote after dividends are paid). Since the company was moving to the third year without dividend payments in 2003, minority shareholders were expected to be able to vote on the company’s general meeting in earlier 2004. However, the controlling shareholders announced an unusual move in December 2003: they called an extraordinary general meeting, aiming at approving a reduction on the company’s equity capital in order to pay dividends to shareholders, therefore impeding them to acquire the right to vote on the next year’s general meeting. Since the dividends were not paid with cash generating by the firm’s operations, minority shareholders strongly complained on such decision. Among them, there were some large foreign institutional investors, such as Fondelec Growth Fund (holder of 12% of preference shares), and Alliant Energy Holdings (holder of 50% of preference shares). Both went on courts against the controlling shareholders’ decision, and the proposed extraordinary shareholders’ meeting was suspended. In april 2004, minority investors were able to elect a board member.

Chart with cumulative abnormal return (CAR):



Case 5

Type of Conflict: Fights for control / voting rights.

Firm involved: Ambev.

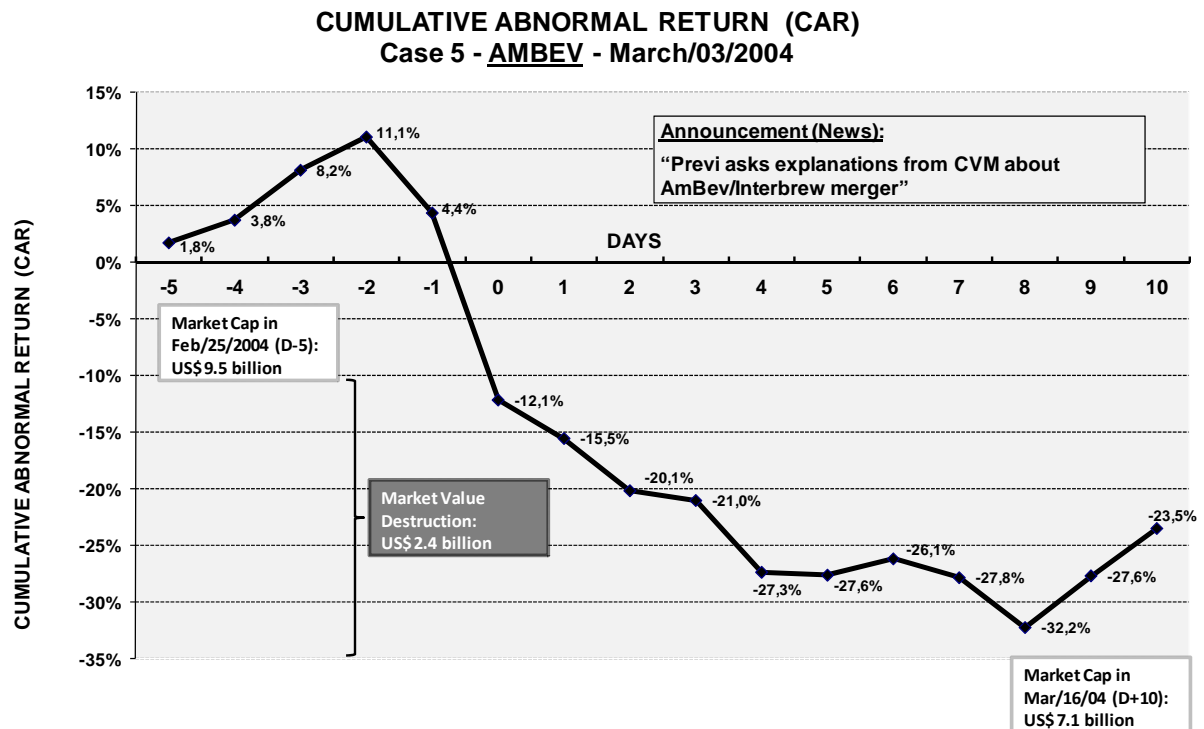
Industry: Beverage.

Identity of control: Shared controlled company.

Event date: March/03/2004.

News title: “Previ asks explanations from CVM about AmBev/Interbrew merger”.

Description of the case⁷: Ambev was the largest South American brewer in earlier 2004. It was by then controlled by a group of individual investors under a formal shareholder’s agreement (being a so-called shared controlled company). On March, 2004, the Belgian brewery Interbrew and AmBev announced a complex deal. Ambev ordinary (voting) shareholders swapped them for Interbrew stock, at a generous control premium of about 56%. Investors with preference (non-voting) shares did not have the same right. As a result, these investors (among them large local and foreign institutional investors) believed that they have been landed with high-priced junk. One of the main public complains on such announcement came from Previ, the largest Brazilian pension fund who held a large stake of nonvoting shares. It’s important to note that most investors used to choose preference shares because of their far largest liquidity, compared with ordinary shares. As a result of such decision, ordinary shares soared while preference shares substantially dropped.



Case 6

Type of Conflict: Fights for control / voting rights.

Firm involved: Ripasa.

Industry: Pulp and Paper.

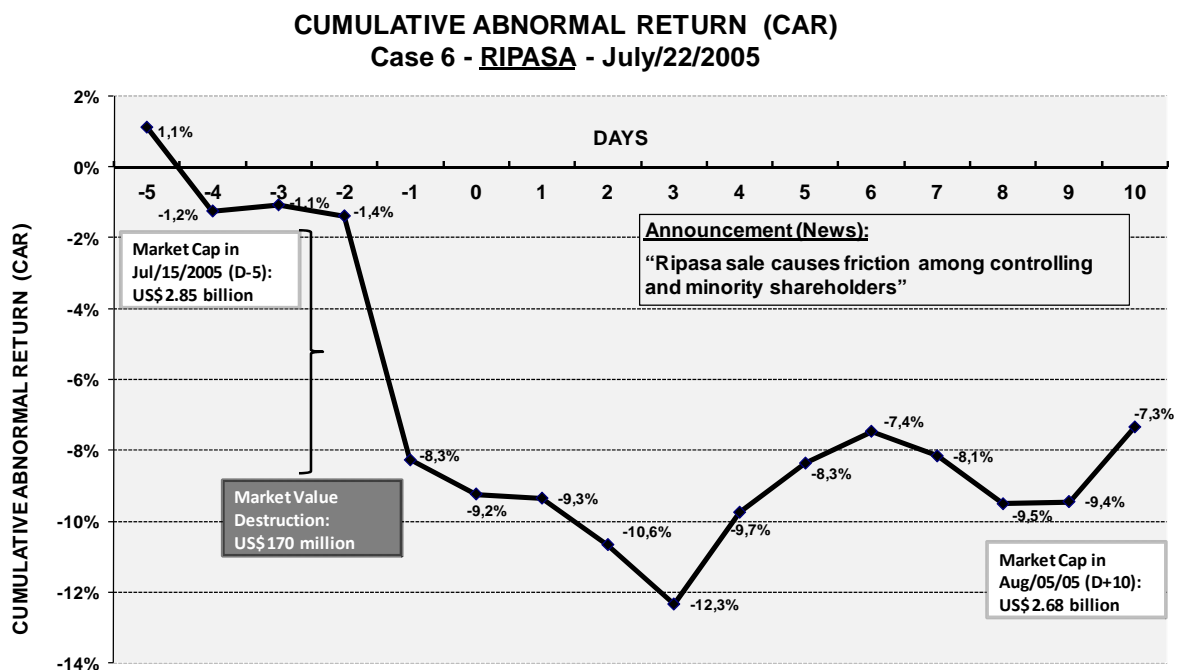
Identity of control: Family controlled company.

Event date: July/22/2005.

News title: “Ripasa sale causes friction among controlling and minority shareholders”.

Description of the case: Ripasa is a pulp and paper company under family control late 2004. In November of that year, two competitors (Suzano Bahia Sul and Votorantim Celulose e Papel) announced that the acquisition of Ripasa. In July 2005, they announced and share restructuring at Ripasa. The decision was to enable Ripasa’s minority shareholders to migrate to Suzano and VCP in a share swap which would involve complex steps, such as the creation and extinction of a holding company in 24h, making them minority investors of both companies at the end. However, non controlling investors complained about the terms of the proposed exchange. According to them, Ripasa’s by-laws established a mandatory bid rule in case of control transfers, allowing them to receive at least 80% of the price paid for the shares of the previously controlling family. This would not be the case in the restructuring plan proposed by the new controllers, generating displeasure among them. A group of activists’ mutual funds went on court, suspending the general assembly that would approve the share restructuring plan. In earlier 2006, an agreement between the new controllers and mutual funds was reached putting an end on this conflict.

Chart with cumulative abnormal return (CAR):



¹ Companies under shared control are companies in which a group of national and/or international investors hold the majority (at least 50% + 1 stock) of its voting shares, usually through a shareholder agreement.

² Tunneling is defined as the transfer of assets and profits out of firms for the benefit of their controlling shareholders (Johnson et. al, 2000).

³ Controlling shareholders are considered as the individual or group of individuals who hold control of the majority of the company's voting shares.

⁴ Minority shareholders are all shareholders but the controlling ones. They may include institutional investors (such as activist funds) as well as individual investors.

⁵ Ibovespa is the main Brazilian index. It is composed of the most traded shares of Bovespa's stock market. Its composition changes quarterly, and normally is composed of about 50 to 60 stocks.

⁶ The Cosan's case was prepared based on the OECD "Country Report Update: The Role of Institutional Investors in Brazil", a report prepared for "The 2008 Meeting of the Latin American Corporate Governance Roundtable. The Latin American Roundtable is a joint effort promoted by OECD, World Bank, and IFC – International Finance Corporation.

⁷ The Ambev's case was based on an article published on The Economist magazine ("Hopping", March 25th, 2004).