

Bolstering Family Control: Evidence from Loyalty Shares

Finance Working Paper N° 619/2019

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Abstract

In order to favor shareholder investment over a longer time horizon, Italy introduced loyalty shares in late 2014, which allow double voting rights after a two-year continuous holding period. Italian listed firms which adopted loyalty shares (about 20 percent of those listed in the main market segment) are significantly more likely to be controlled by families and have a more concentrated ownership structure. We report no evidence of a negative market reaction at the announcement's adoption, nor a reduction in holdings by institutional investors, despite institutional investors generally voting against the introduction of loyalty shares. Notwithstanding the short period of analysis, we find some evidence that controlling shareholders reduce their holdings after loyalty shares are adopted.

Keywords: Loyalty shares, Family firms, Long-term shareholders, Control-enhancing mechanisms

JEL Classifications: G32, G34

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In order to favor shareholder investment over a longer time horizon, Italy introduced loyalty shares in late 2014, which allow double voting rights after a two-year continuous holding period. Italian listed firms which adopted loyalty shares (about 20 percent of those listed in the main market segment) are significantly more likely to be controlled by families and have a more concentrated ownership structure. We report no evidence of a negative market reaction at the announcement's adoption, nor a reduction in holdings by institutional investors, despite institutional investors generally voting against the introduction of loyalty shares. Notwithstanding the short period of analysis, we find some evidence that controlling shareholders reduce their holdings after loyalty shares are adopted.

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1. Introduction

The dramatic increase in assets managed by institutional investors has heightened the short-term pressure exercised by the stock market on listed company managers (e.g., [Agarwal et al., 2018](#); [Asker et al., 2015](#); [Brochet et al., 2015](#); [Edmans et al., 2017](#)). This short-term pressure has led managers, regulators, and politicians to discuss and examine solutions aimed at promoting longer holding periods and, therefore, long-term behavior. Among several proposals, the 2012 European Commission's Action Plan on "*Modernising Company Law and Enhancing Corporate Governance in the European Union*" suggested the introduction of instruments, like loyalty shares, to stimulate long-term investments by shareholders and counteract short-termism, viewed as one of the causes of the great financial crisis of 2007-08 ([Bolton and Samama, 2013](#)). Following this debate, some European countries like France, Italy, Belgium, and the Netherlands promulgated laws that either introduced or modified the discipline of loyalty shares.

Loyalty shares constitute another way of departing from the typical one-share one-vote recommendation contained in corporate governance codes around the world. Indeed, loyalty shares create deviations from this principle, and such deviations have been found to favor tunnelling ([Johnson et al., 2000](#)), reduce market discipline in takeover contests ([Grossman and Hart, 1988](#); [Harris and Raviv, 1988](#)), and be in general detrimental to shareholder value ([Bebchuk et al., 2000](#); [Adams and Ferreira, 2008](#)). Corporate governance activists and institutional investors heavily promoted one-share one-vote in the 1990s and early 2000s, resulting in a wave of dual class unifications ([Hauser and](#)

Lauterbach, 2004; Lauterbach and Pajuste, 2015).^{1,2} While proponents of loyalty shares stress their bright side, i.e. the supposed ability to mitigate short-termism, a dark side exists as well. Controlling shareholders can use loyalty shares as a control enhancing mechanism to insulate themselves from market pressures and weaken minority investors. If the loyalty rewards are not properly designed, the benefits of incentivizing long-term investment could be outweighed by the costs originating from the increased separation between ownership and control (Bolton and Samama, 2013). This concern is particularly relevant in Continental Europe, where ownership is often concentrated, and family control is common (Faccio and Lang, 2002; Barontini and Caprio, 2006; Lins, Volpin, Wagner, 2013).

In this paper, we examine how controlling shareholders adopt and exploit loyalty shares. This question is particularly relevant because of the long-term horizon of controlling shareholders. Families are known to provide firms with patient capital (Bertrand and Schoar, 2006). In this type of situation, the availability of loyalty shares may generate incentives that are opposite to those that loyalty share advocates have in mind. Loyalty shares may help controlling shareholders to control the firm with less

¹ At the same time, an attempt to ban dual class firms at the European level (see the European Commission “*High Level Group of Company Law Experts*” report, also known as Winter report, HLG, 2002 a and b) was aborted, as mixed evidence on their effects on total shareholder value was reported by the survey studies commissioned by the European Commission (Adams and Ferreira, 2008; Burkart and Lee, 2008).

² Dual class shares and CEMs in general have recently gained new momentum. Famous tech giants such as Google, Facebook, LinkedIn and Alibaba have adopted multiple voting shares to keep their founders in control. In 2018, the Hong Kong Stock Exchange overturned rules barring the listing of companies with multiple voting rights in order to avoid losing tech companies to US stock exchanges.

capital invested, thus increasing the separation between ownership and control, or to strengthen their grip on the firm. Controlling shareholders' usage of loyalty shares is also important to understand the behavior of institutional investors. Enhanced voting rights may be less valuable to institutional investors when a controlling shareholder already exists, and this may reduce the effectiveness of loyalty shares as a solution to short-termism.

To study the effect of loyalty shares in an environment dominated by large shareholders, we focus on Italy. Italy is characterized by a strong prevalence of firms with concentrated ownership. The largest shareholder is typically a family (Faccio and Lang, 2002; Barontini and Caprio, 2006), that has historically relied on control enhancing mechanisms like dual-class shares (Caprio and Croci, 2008). Since the controlling family on average owns more than 50 percent of the firm's equity, Italy provides an ideal venue to analyze the behavior of these shareholders, in a situation where they already have majority control, and therefore the introduction of an additional control-enhancement mechanism (CEM) does not appear at first sight to be markedly valuable to them. Differently from France, where loyalty shares already existed before the *Loi Florange* of 2014,³ this mechanism was not available to Italian listed firms before 2014. This provides a perfect setting because their introduction represents a complete novelty for

³ According to this law, loyalty shares (which already existed in the French system) were transformed from optional to mandatory for all listed companies, unless they chose to opt out.

Italian firms and their shareholders. To put it differently, we can safely assume that the decisions about loyalty shares have not been influenced by prior beliefs.

We investigate the adoption decisions of Italian listed firms after the introduction of the new law in 2014 which allowed them, through an extraordinary general meeting resolution, to turn voting shares into loyalty shares rewarding “loyal” shareholders with an additional vote per share.⁴ Forty-five Italian listed firms (approximately, one-fifth of all firms listed on the main segment of Borsa Italiana) introduced this new device between 2015 and 2018. The peak of adoptions was reached in 2015, with 18 instances. After that the number of new adoptions stabilized at around 9 per year).

By contrasting the sample of Italian listed firms adopting loyalty shares to the universe of Italian listed firms, we find that family status increases the likelihood of adopting the new voting system. This result is economically sizeable, as family firms are from 2 to 4 times more likely to opt for loyalty shares than non-family firms. Therefore, despite already having majority control, these families exploit the new tool to strengthen their grip on the firm. We also report some evidence that majority shareholders use loyalty shares to decrease their holdings in the controlled firms without affecting their control of voting rights. Since the largest shareholder is typically a family and usually under-diversified, decreasing their equity stake without losing control allows them to reduce idiosyncratic risk. Family firms may also be prone to adopting loyalty shares in

⁴ After registering in a special register and a continuous holding period of at least two years.

preparation for an expected equity-diluting operation, such as a merger or an equity issue. Our evidence does not support this conjecture, as the decrease in equity capital held is not correlated with ownership-diluting events like acquisitions and seasoned equity offerings. In fact, we find no evidence that loyalty shares are introduced to preserve family control in times of external growth or financing. Overall, we interpret these findings as evidence that families exploit loyalty shares to reduce their exposure to firm-specific investment while preserving control, but not to foster external growth.

While controlling shareholders have welcomed loyalty shares, institutional investors in Italian listed companies have voiced a negative reaction at shareholder meetings calling for their adoption but have not voted with their feet. As in France ([Belot et al., 2018](#)), in fact, we document that institutional investors opposed loyalty shares and voted against their introduction at the shareholder meeting. However, even if institutional investors have manifested discontent with loyalty shares, we do not observe a negative market reaction either at the announcement or at the adoption, and we find no evidence of a decrease in their stake in adopting firms. While institutional investors did not favor the adoption of loyalty shares, their adoption did not affect their investment decisions either. This evidence differs from [Bourveau et al. \(2018\)](#), who show a decrease in institutional ownership, especially foreign investors.

Our paper extends and complements previous work on loyalty shares that mostly focuses on France, where companies have been using loyalty shares since 1966, and the *Loi Florange* of 2014 made loyalty shares the default choice for listed companies. In

contemporaneous papers, [Belot et al. \(2019\)](#) and [Bourveau et al. \(2018\)](#) study the effects of this law on French companies. [Belot et al. \(2019\)](#) document that family firms were more likely to adopt loyalty shares in the pre-*Loi Florange* regime. They document that loyalty shares were popular in France and almost two-thirds of companies have introduced them since 1966. However, [Belot et al. \(2019\)](#) are mostly concerned with the post-2014 period, examining the choice of opting out of loyalty shares. They find that opting-out has a negative effect on firm value and interpret this result as suggesting that shareholders have a positive view of loyalty shares. This result is not confirmed by [Bourveau et al. \(2018\)](#), who show a positive reaction to successful opt-out votes. Our results support neither of these views for the Italian market. While family firms are eager to introduce loyalty shares in Italy, there is no evidence of a wealth effect at the adoption. The different results for these two countries, characterized by relatively similar institutions and legal origin ([La Porta et al., 1998](#)) as well as ownership ([Faccio and Lang, 2002](#)), suggests that investors behave differently depending on the situation they face. Differently from the French law, which automatically grants double-voting rights to all shares of listed firms unless shareholders decide to opt out, in Italy firms must voluntarily adopt loyalty shares. These papers, including ours, are part of a growing literature on loyalty shares. [Ginglinger and Hamon \(2012\)](#) find that loyalty shares have no impact on the liquidity of large companies, but they increase the liquidity of small caps. [Becht et al. \(2018\)](#) analyze the 120 largest French companies included in the SBF120 index and report that 70 percent of them decided to opt out when forced to introduce loyalty shares in 2014, thus supporting the Coase theorem.

The remainder of the paper continues as follows. In the next section we describe the institutional background, the data we use in our study and the descriptive statistics of our sample. Section 3 reports and discusses the empirical results. Section 4 concludes.

2. Institutional background to loyalty shares and data

2.1 Institutional background

Until 20 years ago, Italy was one of the European countries where ownership-control (O/C) separation was more severe, thanks to an extensive use of control enhancement mechanisms (CEMs), such as shareholder agreements, pyramidal groups, non-voting shares, and often a combination of these (Faccio and Lang, 2002). In recent years, these CEMs have lost their appeal and Italian companies have relied progressively less on them for several reasons. A new stricter discipline on related party transactions in 2010 (CONSOB regulation 17221/2010) limited the private benefits potentially delivered by shareholder agreements. Besides, a change in the tax regimes of dividends paid to controlling companies in 2007 has reduced the appeal of pyramidal groups. Eventually, non-voting shares have become less attractive for two main reasons. Firstly, institutional investors and hedge funds have progressively directed their investments to one-share one-vote companies. Secondly, the dramatic drop in interest rates made the dividend privilege offered to such shareholders extremely expensive for the issuing firms (Bigelli and Croci, 2013), and many companies decided to return to a one-share one-vote equity

structure through a dual class unification (Bigelli et al., 2011). As a result, the percentage of listed firms using non-voting shares dropped from 31.9 in 1998 to a modest 7.4 percent in 2017 (CONSOB, 2018).

Inspired by the regulation discussed at the European level, a new control enhancement mechanism was made available to Italian firms in 2014 (Law 116/2014 and art. 127 quinquies of the Consolidated Law on Finance, TUF). Listed firms can now introduce loyalty shares, allowing “loyal” shareholders an extra vote per share after a continuous holding period of at least two years.⁵ Differently from France after the *Loi Florange* was enacted on March 29, 2014, the Italian legislator implemented an opt-in regime, leaving firms the choice to introduce loyalty shares.

2.2 Mechanics of loyalty shares

Under the Italian regulation, the granting of enhanced voting rights does not create any new special category of shares. All shares meeting the requirements set forth by the law and by the issuers by-laws benefit from the increase. This increase is up to two votes and it is applicable only to those shares which the same shareholder holds for at least two consecutive years without interruption. The transfer of the shares automatically terminates the enhanced voting rights. Shareholders opting for enhanced voting rights must be registered in a special register held by the issuer. Such enhanced voting rights then come into effect two years from this date for shareholders of already

⁵ The same law allowed unlisted companies to issue multiple voting shares, carrying up to three votes each.

listed companies, and immediately for companies that opt in at the time of their IPO. Loyalty shares can be introduced by an amendment of the company charter approved by the extraordinary shareholder meeting with a two-thirds resolution majority,⁶ and can be reverted in the same way.

Loyalty shares enhance shareholders' voting rights only in particular circumstances. In fact, they carry up to two votes only at the shareholder meetings, and not when such votes should be counted for exercising some specific minority rights, such as calling a meeting, suing directors, etc. Finally, loyalty shares may affect control contests. In fact, shareholders can exceed the threshold that triggers a totalitarian takeover in compliance with the equal opportunity rule because of the double voting power of their shares. However, when a takeover attempt is pending, loyalty shares do not allow the extra vote.

2.3 Data

Our analysis covers the period from 2015 to the end of 2018. The sample period begins in 2015 because loyalty shares were introduced in Italy on August 11, 2014 (Development Decree, Act 116/2014 converted in Law 116/2014), and companies started to adopt the new voting system in January 2015.⁷ We collect information on the

⁶ The required majority was only 50 percent plus one vote in the first six months after the introduction of the law.

⁷ The first company opting for loyalty shares was Campari on January 29, 2015, date of the annual general meeting.

introduction of loyalty shares from the Italian market regulator (CONSOB) website, which maintains an updated list of companies adopting loyalty shares.⁸ Forty-five companies adopted loyalty shares between 2015 and 2018, six of which announced the adoption at the time of their IPO. We manually collect information on the announcement date using internet searches. Data on the outcome of the general meeting vote, and the percentage of voting capital are obtained from the companies' official filings.

For our analysis, we create a sample of all Italian listed companies (including those adopting loyalty shares) available in the Thomson Reuters Worldscope database (now Refinitiv).⁹ This list contains 343 firms, including firms that carried out their IPO between 2015 and 2018. For all these companies, we obtain stock prices and financial data from Thomson Reuters Datastream and Worldscope, respectively. Corporate governance data related to the composition of the boards are gathered from the Association of Italian Joint Stock Companies (Assonime) annual report “*Corporate Governance in Italy: Compliance, Remunerations and Quality of the Comply-or-Explain.*” Ownership data for the largest blockholders are from the CONSOB website, while data for institutional investor ownership are taken from the Thomson Reuters Eikon database. This allows the inclusion of institutional investor holdings below the threshold of 3 percent that do not require a filing with CONSOB. Finally, data on acquisitions and

⁸ The list is available at the following URL:

http://www.consob.it/web/area-pubblica/quotate/main/emittenti/societa_quotate/voto_maggiorato_plurimo_lnk.htm?nav=true.

⁹ We use the companies included in the list WSCOPEIT.

equity issuance are from Thomson Reuters' Thomson One Banker M&A and Equity issues databases, respectively.

3. Results

3.1 Introduction of loyalty shares

Table 1 shows that 45 companies adopted loyalty shares in Italy between 2015 and the end of December 2018.

Please insert table 1 here

The number of listed companies in Italy at the end of 2018 (as reported by the Italian Stock Exchange) was 355, almost 70 percent of them (242 companies) belonging to the main market segment (*Mercato Telematico Azionario* – MTA), the remainder being listed on the AIM Italia.¹⁰ Therefore, about 13 percent of the companies listed on the Italian Stock Exchange have introduced loyalty shares, confirming the relevance of the phenomenon. This percentage grows to 19 percent, if we only consider the main market segment (as all but 1 company opting for loyalty shares belong to this segment). The breakup by year in table 1 shows that 18 companies (40 percent of the sample) amended

¹⁰ There are also 2 companies listed on the Market for Investment Vehicles (MIV), the market for the listing of close-end funds and capital vehicles.

their bylaws in 2015, as soon as the Development Decree allowed them to opt for the new voting system.

Table 2 provides some information on the voting results of the extraordinary shareholder meeting (ESM) in which loyalty shares were introduced, as reported by the minutes of the meetings.

Please insert table 2 here

Due to some missing shareholder meetings minutes, the number of companies goes down from 45 to 38. Out of the seven missing companies, six introduced loyalty shares at the time of their IPO, and therefore were private companies at the date of the shareholder meeting. One company was instead listed on the AIM Italia. In all these cases the minutes of the meetings are not publicly available. On average, companies introducing loyalty shares are characterized by a controlling shareholder holding almost 55 percent of the voting capital, while the second largest shareholder has a stake of about 6 percent. Table 2 also reports that, on average, 68 percent of the voting capital attended or was represented at the extraordinary shareholder meeting, and that about 60 percent of voting capital voted in favor of the introduction of loyalty shares. Interestingly, 7.7 percent of the voting capital voted against and 0.1 percent chose to abstain. This preliminary evidence suggests that it is mainly the controlling shareholder's votes that strongly drive the results of the extraordinary shareholder meeting. According to Italian legislation, resolutions at the extraordinary shareholder meeting are passed with the

favorable vote of at least two-thirds of the voting capital represented at the meeting.¹¹ Due to the presence of the controlling shareholder, loyalty shares were approved with a large majority of the voting capital represented at the meeting (on average, 88 percent, i.e. 60 percent over 68 percent). However, if it had not been for the controlling shareholder, the resolution would have been largely rejected by 59 percent of the remaining capital represented at the meeting ($= 7.8/(68.0 - 54.7)$). This is the first preliminary evidence of the fact that the perceived benefits of the new voting systems are possibly different between the majority shareholder and the minorities.

Institutional investors consistently voted against the introduction of loyalty shares. From reading the board proposals to the shareholder meetings on the adoption of loyalty shares, we find that the main official reason for their introduction is to build shareholder loyalty and favor their long-term involvement in the firm's decision-making process. Conversely, in some company meetings institutional investors highlight the risk of agency costs brought about by a larger separation between ownership. In many cases they also emphasize that the augmented voting stake of the first shareholder may end up completely controlling the extraordinary shareholder meeting.

¹¹ The Development Decree allowed companies to adopt loyalty shares with a simple majority vote until January 31, 2015. Three companies chose to call the extraordinary shareholder meeting before this date, i.e. Campari, Astaldi, and Amplifon.

Figure 1 shows the hypothetical change of the voting capital in the hands of the first shareholder once the vote of loyalty shares was doubled, assuming that no other shareholders registered their shares in the special register held by the company.

Please insert figure 1 here

As of December 31, 2018, this assumption is not far from reality, as from checking this register (publicly available on the company's website) we report that in 6 cases only one shareholder other than the first appears.¹² The median voting capital of the first shareholder would increase to about 70 percent (from 54 percent), well above the 66.67 percent threshold which would guarantee control of the extraordinary shareholder meeting. As we will report later in the paper, however, there is evidence of a reduction in the holdings of the first shareholder following the adoption of loyalty shares, consistent with the hypothesis that families are under-diversified and seek to reduce idiosyncratic risk without losing control.

3.2 Comparative analysis of companies with loyalty shares

¹² Only 3 of them are institutional investors: Cedar Rock Capital in Campari, Quaestio Capital Management (an Italian asset management company) in Sabaf, and APG Asset Management in De' Longhi.

Table 3 describes the characteristics of the companies adopting loyalty shares and compares them with the universe of Italian listed firms. Variable definitions are presented in the Appendix.

Please insert table 3 here

Firms with loyalty shares are significantly smaller on average, both considering accounting (total assets and sales) and market variables (market capitalization). However, when looking at medians, differences narrow considerably, and loyalty share companies appear instead to be larger (€309 v. €147 million considering market capitalization). This is because size is considerably skewed to the right, with the first 3, 5, and 15 companies counting for about 25, 34, and 60 percent of the total market capitalization (as of the end of December 2018, according to information provided by the Italian Stock Exchange), respectively, and none of them opted for the loyalty shares. Firms adopting loyalty shares are slightly more valued by the market (median market-to-book equal to 1.7x *vs.* 1.4x) and cash-richer (12.6 percent of the total assets *vs.* 9.7 percent). Also, they invest more (the differential median CAPEX is 0.6 percent of total assets), and they are more profitable, both considering ROE (9.6 *vs.* 5.3 percent) and ROA (9.2 *vs.* 6.9 percent), and more able to pay out dividends (66 *vs.* 56 percent). In a nutshell, companies with loyalty shares are more profitable, generate more cash, pay more dividends, invest more, and are more valued by the market.

The second set of variables in table 3 represents the ownership structure and governance characteristics of the two subsamples. It is apparent that companies introducing loyalty shares have a more concentrated ownership structure, as the first shareholder's average (median) voting capital is 53.6 (53.7) percent, against 46.3 (51.0) percent for the complementary subsample. Also, 90 percent of the companies opting for the new voting system are controlled by a family, against a smaller 54 percent for companies with no loyalty shares. The voting capital held by institutional investors is also higher for loyalty share companies (14.9 *vs.* 10.8 percent). This is likely the consequence of the higher profitability, cash richness, and higher growth opportunities suggested by the previous descriptive analysis. Finally, when looking at the corporate governance characteristics of the two subsamples, we find some differences in terms of board size and independence. Only *Minority directors dummy* is strongly significant, as only 25 percent of companies with loyalty shares have a minority director (against 46 percent in the complementary subsample), consistent with the loyalty share companies' status of family firm.

3.3 Likelihood of introducing loyalty shares

We now extend the previous univariate analysis studying the likelihood of adopting loyalty shares in a multivariate setting. Table 4 presents the results of a Cox's proportional hazard regression for the likelihood of adopting loyalty shares (Cox, 1972).

For each firm, the dependent variable takes the value of 1 in the year in which loyalty shares are adopted. Hazard ratios, rather than coefficients, are reported.

Please insert table 4 here

Model 1 represents our baseline specification, where the likelihood of adopting loyalty shares is explained by the *Family control dummy*, firm-specific profitability, liquidity, leverage, payout variables, and the *Financial dummy*. Model 2 replicates model 1 but excludes financial companies, whilst models from 3 to 5 progressively add explanatory variables to model 1. In particular, in model 3 we include ownership variables, such as the voting capital of the first shareholder and that of institutional investors, while in model 4 we also add the voting capital of foreign investors in general. Model 5 includes corporate governance variables such as the size of the board of directors, the percentage of independent directors, the dummy for a CEO also serving as chairman, and the presence of minority directors. Interestingly, *Family control dummy* is strongly significant in all of our models. It is also very relevant from an economic point of view. Family-controlled companies are 2 (= 3.01 – 1) to 3.8 (= 4.8 – 1) times more likely to adopt loyalty shares than their non-family-controlled counterparts, depending on which model we consider. This is consistent with the univariate analysis reported in the previous table 3. As the controlling family is generally under-diversified and bears significant idiosyncratic risk, adopting loyalty shares in such companies would be compatible with a strategy of liquidating a portion of their shares without reducing their control.

There is no evidence that other firm-specific variables significantly affect the likelihood of adopting loyalty shares, except for the size of the board (positive effect) and the presence of directors appointed by minority shareholders (negative effect). Thus, while institutional investor ownership *per se* does not discourage the introduction of loyalty shares, directors nominated from minority lists decrease the probability of their adoption.

3.4 Market reaction

Loyalty shares contribute to increasing the wedge between ownership and control, and in turn they may generate incremental agency costs. If this is the case, their introduction may trigger a negative market reaction. Table 5 presents the results of an event study at the announcement and at the adoption of loyalty shares.

Please insert table 5 here

We have computed CARs using three event windows, that is $[-1; +1]$, $[-2; +2]$, and $[-5; +5]$, centered on both the announcement date and the date of the extraordinary shareholder meeting (ESM) introducing loyalty shares. Average CARs are small and none of them are statistically distinguishable from zero. On the one hand, in several cases the press release announcing the proposal of the board to introduce loyalty shares also discloses other price sensitive financial information. On the other hand, looking at the

ownership structure of companies introducing loyalty shares as in table 3, the probability of rejecting the resolution during the shareholder meeting is very low, as the first shareholder holds on average about 54 percent of the vote, making the incremental informational content at the date of the meeting very limited. In any case, table 5 does not provide any evidence of a tangible effect on prices with the introduction of loyalty shares.

3.5 Institutional investors

The first two models of table 6 focus on institutional investor holdings and their dynamics, as a function of firm-specific variables.

Please insert table 6 here

Models 1 and 2 regress the institutional investors' voting stake in Italian listed companies on variables at firm level, along with the *Financial* dummy. Larger and more profitable companies are more likely to attract the investment of institutional investors. Institutional investors have a preference for liquidity ([Gompers and Metrick, 2001](#)), and family-controlled companies have less free float. Also, for family-controlled companies the risk of expropriating minorities is higher, and the probability of influencing the management is lower. For both these reasons, institutional investors tend to invest less in family-controlled companies ([Fernando et al., 2014](#)). The variable *Board size* is slightly

significant and positive. Finally, after correcting for size and profitability, the *Loyalty dummy* is insignificant. We also investigate the investment behavior of institutional investors following the adoption of loyalty shares through the inclusion of the binary variable *Loyalty dummy post*. This variable takes the value of 1 in the post-adoption period for companies opting for introducing loyalty shares. Evidence shows that institutional investors do not reduce their holding in such companies, as this variable is insignificant in both models.

This evidence allows us to conclude that institutional investors do not shy away from loyalty share companies, as profitability, growth, and the payout policy of such companies prevail over the risk of increased agency costs brought about by the new control-enhancing mechanism.

3.6 First shareholder

We now investigate the behavior of the first shareholder after the introduction of loyalty shares. Since the first shareholder is typically a family, and its wealth is highly concentrated in the firm's equity, loyalty shares may allow the under-diversified controlling shareholder to reduce the firm stake without losing control. The last two models of table 6 show the results of such an empirical analysis. We regress the largest

shareholder's voting stake on firm-level variables and the *Financial dummy*.¹³ Controlling for other firm characteristics, the *Loyalty dummy* is positive and strongly significant, as the stake of the first shareholder is about 6 percent larger in firms adopting loyalty shares. Financial companies have instead a more dispersed ownership structure. The variable *Loyalty dummy post* is negative and significant in both models, suggesting that the stake of the first shareholder is lower for companies adopting loyalty shares in the post-adoption period. The coefficient of this variable suggests that, controlling for other firm-specific variables, the first shareholder reduces his/her holdings by 5 to 6 percent after loyalty shares are in place, depending on the specification.

Please insert figure 2 here

Figure 2 zooms in on the behavior of the first shareholder around the adoption of loyalty shares. The three box plots depict the distribution of the first shareholder's stake at years $t - 1$, t , and $t + 1$, respectively, year t being the year in which loyalty shares are introduced. It is apparent that the holdings of the first shareholder progressively decrease. Considering medians, the common equity of the first shareholder passes from 54 percent to 49 percent within two years. After doubling the votes, assuming that minority shareholders remain completely passive, a 49 percent median common equity capital means about 66 percent of the voting capital ($= (49 \times 2)/(100 + 49)$). This confirms

¹³ We exclude the Family control dummy from the explanatory variables, as we showed in table 3 that 90.3 percent of loyalty share companies are family controlled.

the evidence that the first shareholder surrenders some shares, but still reinforces their control over the company.

3.7 Equity-dilutive corporate transactions

Another motivation for adopting loyalty shares could be the desire of families to retain control in case of ownership-diluting events, like acquisitions and seasoned equity offerings. Despite the short time span, we check whether the introduction of loyalty shares affects the likelihood of completing an acquisition or issuing new equity capital in the subsequent year. To this purpose we run two logit regressions, where the explanatory variables are the same as in tables 6.

The first regression uses the completion of at least one acquisition in year $t + 1$ as the dependent variable, where t is the year when loyalty shares are adopted. The second regression employs instead the completion of a seasoned equity offering in year $t + 1$ as the dependent variable. Untabulated results show that the *Loyalty dummy* is insignificant in all specifications. This evidence rules out the hypothesis that loyalty shares are introduced to preserve family control in times of external growth or financing.

4. Conclusion

Since shareholder engagement over a longer-term horizon is considered beneficial to reducing short-termism and favoring firm value in the long term, loyalty shares have begun to be seen by regulators as a possible instrument to achieve such an objective and are progressively becoming more internationally widespread. In the wake of this surging trend, in 2014 France made loyalty shares mandatory (unless firms decide to opt-out), Italy introduced them for the first time, and in 2019 Belgium approved a company law reform which allows their introduction on a voluntary basis in 2020. In the present paper, in the ideal setting of the Italian market, characterized by concentrated ownership and family firms, we study the four years that followed the introduction of loyalty shares (2015-2018) and show that 45 Italian listed firms (about one fifth of those listed on the main stock market segment) have already taken advantage of this new control enhancement mechanism. The results of our investigation on the population of Italian companies adopting loyalty shares show that they are significantly more likely to be introduced by firms with a majority shareholder, a more concentrated ownership structure, and controlled by a family. We report no evidence of a negative market reaction at the announcement's adoption (and at the shareholders' meeting), and no reduction in the holdings by institutional investors, though they generally vote against their introduction. Their vote "with their hands" was not followed by a "vote with their feet," probably as family firms introducing loyalty shares are significantly more profitable, faster growing, more cash generating and pay more cash dividends than other firms. Giving a double voting power after two years of continuous holding, loyalty shares not only may favor long term shareholder investments, but may help controlling

shareholders to strengthen control over their firms, engage more in ownership diluting operations (as merger or equity offerings), and also disinvest part of their stakes without any effect on pre-loyalty control of voting rights. We find that the introduction of loyalty shares help majority shareholders to strengthen their control, as usually almost no other shareholders apply to have their voting rights doubled. Notwithstanding our short available period of analysis, especially after the two-year loyalty period for doubling the voting rights, we find some evidence that controlling shareholders reduce their holdings after loyalty shares are adopted.

The present study should contribute to the scarce existing literature on loyalty shares for a deeper understanding of this new share feature, which could be considered both as an instrument to reduce short termism and as an additional control enhancement mechanism for family firms. When longer time horizons after their introduction become available, future researchers will be able to test the long-term effects of their introduction and verify if they have fulfilled the goal they were meant for.

Appendix – Variable definitions

Variable	Definition
<i>Family control dummy</i>	Dummy variable which takes the value of 1 if the company is family-controlled (based on a threshold of 10 percent of the common equity capital) (source: CONSOB)
<i>Log total assets</i>	Natural logarithm of total assets (source: Datastream/Worldscope)
<i>Leverage</i>	Ratio between total debt and total assets (source: Datastream/Worldscope)
<i>MTB</i>	Ratio between market and book value of common equity (source: Datastream/Worldscope)
<i>Cash</i>	Ratio between cash and cash equivalents and total assets (source: Datastream/Worldscope)
<i>ROA</i>	Ratio between EBITDA and total assets (source: Worldscope)
<i>Dividend-paying dummy</i>	Dummy variable which takes the value of 1 if the company pays a cash dividend (source: Worldscope)
<i>Financial dummy</i>	Dummy variable which takes the value of 1 if the company belongs to the financial sector
<i>First shareholder's votes</i>	Share of common equity capital of the largest shareholder (source: CONSOB)
<i>Institutional investors' votes</i>	Share of common equity capital of institutional investors (source: Eikon)
<i>Foreign voting capital</i>	Share of common equity capital of foreign investors (source: Eikon)
<i>Independent directors</i>	Percentage of independent directors on the board (source: Assonime)
<i>CEO duality dummy</i>	Dummy variable which takes the value of 1 if the CEO is also chairman of the board (source: Assonime)

Minority directors dummy

Dummy variable which takes the value of 1 if there exists at least one director elected from a list presented by minority investors (source: Assonime)

Board size

Number of directors composing the board (source: Assonime)

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<i>Year</i>	<i>N</i>	<i>N, %</i>
2015	18	40.0
2016	8	17.8
2017	9	20.0
2018	10	22.2
Total	45	100.0

Table 1 – *Number of companies adopting loyalty shares in Italy by year.* The table shows the number of companies adopting loyalty shares in Italy between 2015 and the end of December 2018.

	<i>N</i>	<i>Mean</i>	<i>SD</i>	<i>Min</i>	<i>Median</i>	<i>Max</i>
<i>First shareholder's voting capital, %</i>	38	54.7	10.0	30.7	54.1	73.0
<i>Second shareholder's voting capital, %</i>	38	6.0	6.5	0.0	4.9	22.1
<i>Voting capital at the ESM, %</i>	38	68.0	12.9	37.0	70.9	88.2
<i>Capital voting in favour, %</i>	38	60.2	9.3	37.0	60.3	81.1
<i>Capital voting against, %</i>	38	7.7	8.2	0.0	4.2	24.7
<i>Abstentions/not voting, %</i>	38	0.1	0.4	0.0	0.0	2.6

Table 2 – *Voting results of the extraordinary shareholders meeting approving loyalty shares.* The table shows the voting results of the extraordinary shareholders meeting (ESM) amending the company's bylaws and introducing loyalty shares, as reported by the minutes of the meetings. Relative to the number of companies reported in the previous table (45), 6 of them adopted loyalty shares in preparation of the IPO, and therefore at the date of the ESM they were private companies, while 1 company was listed at the AIM Italia. In both cases, the minutes of the meeting are not public.

<i>Variable</i>	<i>Loyalty shares</i>			<i>No loyalty shares</i>			<i>Difference</i>	
	<i>N</i>	<i>Mean</i>	<i>Median</i>	<i>N</i>	<i>Mean</i>	<i>Median</i>	<i>Mean</i>	<i>Median</i>
<i>Total assets, € mln</i>	165	1,208.1	457.6	1,087	14,398.7	376.5	-13,190.6 **	81.1
<i>Sales, € mln</i>	167	804.3	377.0	1,098	3,231.9	171.3	-2,427.6 **	205.7 ***
<i>Market cap, € mln</i>	201	932.7	309.3	1,211	1,914.1	147.3	-981.3 **	162.0 ***
<i>Leverage, %</i>	165	25.6	25.8	1,077	28.2	26.4	-2.6	-0.6
<i>MTB</i>	159	2.8	1.7	984	2.3	1.4	0.5	0.3 **
<i>Tobin's Q</i>	159	1.6	1.2	1,019	1.4	1.1	0.2 *	0.1 *
<i>Cash, %</i>	164	14.6	12.6	969	13.1	9.7	1.5	2.9 ***
<i>CAPEX, %</i>	160	3.0	2.2	992	2.9	1.6	0.1	0.6 **
<i>ROE, %</i>	165	6.2	9.6	1,092	-1.1	5.3	7.3	4.3 ***
<i>ROA, %</i>	165	9.4	9.2	1,031	5.9	6.9	3.5 ***	2.3 ***
<i>Dividend-paying dummy</i>	164	66.5	.	1,052	56.4	.	10.1 *	.
<i>Financial dummy</i>	225	11.1	.	1,490	23.8	.	-12.7 ***	.
<i>First shareholder's votes, %</i>	155	53.6	53.7	776	46.3	51.0	7.3 ***	2.6 ***
<i>Institutional investors' votes, %</i>	210	14.9	13.6	1,420	10.8	5.7	4.0 ***	7.9 ***
<i>Foreign voting capital, %</i>	210	15.8	13.4	1,420	14.0	4.8	1.8	8.6 ***
<i>Family control dummy</i>	155	90.3	.	776	54.3	.	36.1 ***	.
<i>Board size</i>	112	10.2	10.0	556	10.0	9.0	0.2	1.0 *
<i>Independent directors, %</i>	112	41.4	40.0	556	42.4	42.9	-1.0	-2.9 **
<i>CEO duality dummy</i>	112	30.4	.	556	24.1	.	6.3	.
<i>Minority directors dummy</i>	112	21.4	.	556	46.8	.	-25.3 ***	.

Table 3 – Descriptive statistics of Italian companies partitioned by companies adopting vs. not adopting loyalty shares. The table reports the descriptive statistics for the sample of Italian companies listed between 2015 and 2018. Variables are defined in the appendix.

	(1)	(2)	(3)	(4)	(5)
<i>Family control dummy</i>	4.049** (2.257)	3.099** (1.657)	4.677*** (2.574)	4.837*** (2.660)	2.984** (1.597)
<i>Log total assets</i>	1.000 (0.0850)	1.021 (0.0930)	0.946 (0.0904)	0.970 (0.0958)	0.804 (0.136)
<i>Leverage</i>	1.477 (1.251)	3.337 (2.680)	1.646 (1.439)	1.453 (1.305)	3.843 (4.462)
<i>MTB</i>	1.029 (0.0453)	1.045 (0.0446)	1.018 (0.0552)	1.020 (0.0552)	0.891 (0.0993)
<i>Cash</i>	1.210 (1.215)	1.690 (1.758)	1.294 (1.309)	1.382 (1.409)	0.251 (0.426)
<i>ROA</i>	1.326 (1.589)	2.174 (3.181)	0.754 (1.031)	0.850 (1.228)	0.504 (0.933)
<i>Dividend-paying dummy</i>	1.382 (0.560)	1.532 (0.705)	1.313 (0.540)	1.272 (0.513)	1.195 (0.592)
<i>Financial dummy</i>	0.891 (0.547)		0.784 (0.529)	0.853 (0.575)	0.662 (0.603)
<i>First shareholder's votes</i>			0.998 (0.00955)	0.996 (0.0102)	0.990 (0.0122)
<i>Institutional investors' votes</i>			1.019 (0.0169)	1.029 (0.0207)	1.025 (0.0212)
<i>Foreign voting capital</i>				0.987 (0.0181)	0.983 (0.0181)
<i>Independent directors</i>					3.659 (3.994)
<i>CEO duality dummy</i>					0.804 (0.381)
<i>Minority directors dummy</i>					0.361** (0.179)
<i>Board size</i>					1.251** (0.114)
Observations	719	623	719	719	543
Pseudo R-squared	0.0315	0.0295	0.0367	0.0395	0.0709

Table 4 – *Likelihood of adopting loyalty shares*. The table estimates a Cox proportional hazard model for the likelihood of adopting loyalty shares and displays hazard ratios (i.e., exponentiated coefficients) of the reported variables. Variables are defined in the appendix. Heteroskedasticity-consistent standard errors clustered at firm-level are reported in parentheses. ***, **, * indicate statistical significance at 1, 5 and 10 percent level, respectively.

	<i>N</i>	<i>Announcement</i>		<i>ESM</i>	
		<i>Average, %</i>	<i>SE, %</i>	<i>Average, %</i>	<i>SE, %</i>
CAAR [-1, 1]	39	0.71	0.76	-0.36	0.50
CAAR [-2, +2]	39	0.48	0.83	-0.09	0.58
CAAR [-5, +5]	39	-0.94	1.08	0.79	0.85

Table 5 – *Market reaction at the announcement and at the adoption of loyalty shares.* The table presents the average CARs (and their standard errors, SE) at the announcement and at the approval of loyalty shares (date of the extraordinary shareholder meeting, ESM), respectively.

	<i>Institutional investors' votes</i>	<i>Institutional investors' votes</i>	<i>First shareholder's votes</i>	<i>First shareholder's votes</i>
<i>Family control dummy</i>	-5.558*** (1.968)	-5.641** (2.342)		
<i>Loyalty dummy</i>	3.400 (2.378)	2.786 (2.685)	6.337*** (2.418)	5.909** (2.384)
<i>Loyalty dummy post</i>	-0.169 (2.368)	-0.0750 (3.279)	-6.469*** (1.809)	-4.694* (2.775)
<i>Log total assets</i>	2.676*** (0.426)	2.365*** (0.527)	-0.796 (0.763)	0.0393 (0.878)
<i>Leverage</i>	-7.041* (3.967)	-8.002* (4.514)	3.108 (7.083)	4.243 (7.591)
<i>MTB</i>	1.027*** (0.364)	1.242*** (0.460)	0.638* (0.373)	0.673 (0.438)
<i>ROA</i>	24.27*** (7.908)	27.54*** (9.160)	1.627 (12.36)	4.515 (14.19)
<i>Dividend-paying dummy</i>	1.184 (1.884)	0.354 (2.013)	-1.941 (2.635)	-2.448 (2.663)
<i>Cash</i>	-3.452 (5.324)	-6.997 (5.869)	10.33 (8.735)	13.30 (9.784)
<i>Financial dummy</i>	1.984 (2.784)	1.901 (2.952)	-13.53*** (3.502)	-13.30*** (3.990)
<i>Independent directors</i>		-0.751 (5.407)		-14.31** (6.574)
<i>CEO duality dummy</i>		-0.137 (1.543)		-1.836 (2.400)
<i>Minority directors dummy</i>		-0.0748 (1.342)		-0.944 (2.229)
<i>Board size</i>		0.506* (0.273)		-0.640 (0.471)
<i>Constant</i>	-3.816 (3.100)	-5.518 (4.126)	52.54*** (5.010)	59.71*** (5.911)
Time fixed effects	Yes	Yes	Yes	Yes
Observations	761	560	761	560
Adj. R-squared	0.275	0.291	0.0952	0.0108

Table 6 – *Institutional investors' and first shareholder's common equity capital*. The table shows the results of a linear regression for the voting capital of institutional investors (first two models) and the first shareholder (last two models) as a function of the reported explanatory variables. Variables are defined in the appendix. Heteroskedasticity-consistent standard errors clustered at firm-level are reported in parentheses. ***, **, * indicate statistical significance at 1, 5 and 10 percent level, respectively.

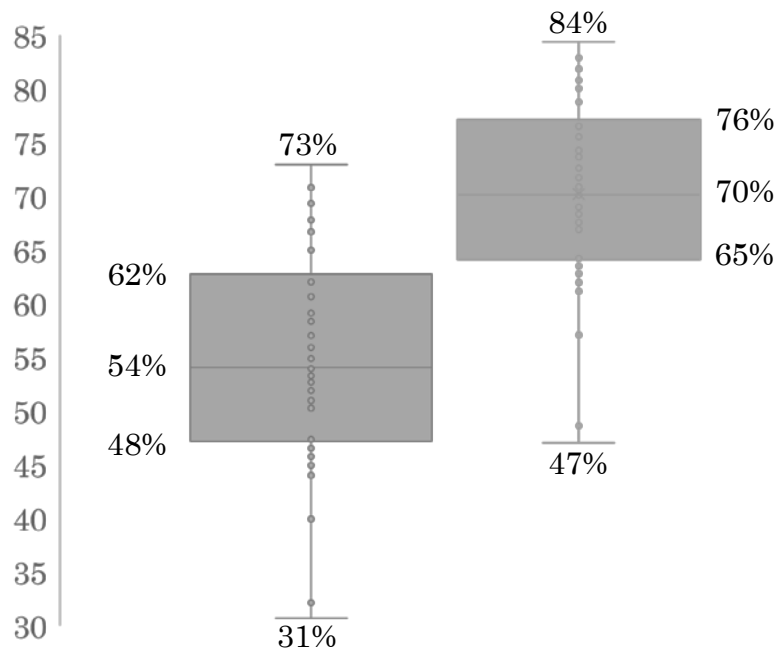


Figure 1 – *Box plot for the hypothetical voting capital of the first shareholder before and after the adoption of loyalty shares.* The figure depicts the box plot for the voting capital of the first shareholder at the extraordinary shareholders' meeting which introduces loyalty shares (left chart). The box plot at the right represents the same voting capital under the assumption that the first shareholder is the only one who gets her votes doubled.

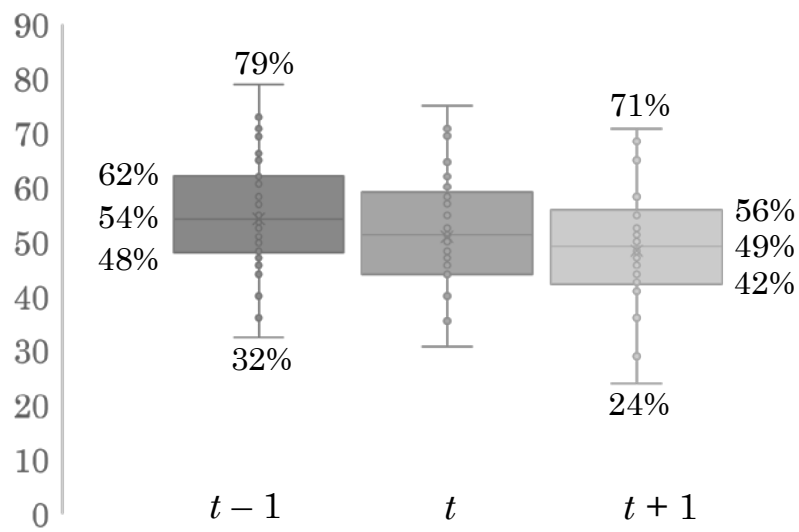


Figure 2 – *Box plot for the actual capital of the first shareholder.* The figure depicts the box plot for the end-of-year common equity capital of the first shareholder at the introduction of loyalty shares (year t), one year before ($t - 1$), and one year after ($t + 1$).

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