Privately Negotiated Repurchases and Monitoring by Block Shareholders

Murali Jagannathan
College of Management
Binghamton University
Binghamton, NY
607.777.4639
Muralij@binghamton.edu

Clifford Stephens
Department of Finance
E. J. Ourso College of Business and Administration
Louisiana State University
Baton Rouge, LA 70803
225.578.6334
csteph5@lsu.edu

Abstract:

We examine the effect of large privately negotiated share repurchases. Since these large blocks are repurchased directly from insiders they are different from other types of repurchases. Privately negotiated repurchases also present a unique opportunity to analyze the removal of a large block, since these blocks are generally split-up when traded on an exchange. With a sample of 1,180 block repurchases from the period 1985 through 2001, we then trace back the history of the block formation and segment the sample based on the type of seller and the reason for the formation of the block. Based on this, we then predict which of these types of repurchases are likely to be from active versus passive shareholders. Our primary empirical prediction is that repurchases from passive shareholders will likely have a negative impact on the firm's market and operating performance, while repurchases from active shareholders (likely to provide valuable monitoring) are likely to have a positive impact on market and operating performance. We find that the market reaction to block, or targeted, share repurchase announcements is unambiguously positive. Our evidence differs from the findings of earlier studies using samples of block repurchases from the 1970s and 1980s. We also find that the original formation of the blocks is generally viewed positively. However, the market appears to be skeptical of the value of blockholders that are also on the board of directors. Repurchases from directors are viewed more positively, while the formations of blocks who also take directorships are viewed more negatively. Overall, our evidence is consistent with outside blockholders providing a valuable monitoring role that ultimately improves the firm's market performance.

JEL Classification: G32, G35

Keywords: repurchases, private repurchases, block-holders, monitoring.

Date: March 22, 2004

Introduction

It is relatively common for a firm to repurchase large blocks of stock from existing blockholders in privately negotiated transactions. Privately negotiated block, or targeted, repurchases are the second most common method of repurchasing stock in terms of both number of occurrences and value of shares repurchased.[1] During the period 1985 through 2001 there were 1,392 block repurchases with a value of approximately $88 billion.[2] In this paper, we examine the impact of these repurchases of large share blocks.

Conventional wisdom, and much of the prior research, suggests that the reduction of managerial discretion assumed to be associated with large blockholders and concentrated outside ownership is unambiguously beneficial. Shliefer and Vishny (1986) suggest that large blockholders have an incentive to monitor the actions of management and that due to the free-rider problem smaller shareholders have no such incentive. Burkart (1995) shows that blockholders increase take-over premiums by challenging outside raiders. The elimination of these outside equity blocks through privately negotiated repurchases would be detrimental. However, while there are clear benefits to blockholders, the additional monitoring may also impose costs. For some types of firms, the restrictions on managerial discretion imposed by some types of blockholders may outweigh the potential benefits. Managers are less likely to make investments that maximize firm value when shareholders are likely to interfere. Additionally, some types of blockholders may not provide any monitoring benefits and serve only to further entrench managers. Impact of the reduction in monitoring resulting from a block repurchase is ambiguous. Since blockholders generally split these blocks into many small transactions when disposing of the blocks on the open market, privately negotiated repurchases offer a unique opportunity to examine the impact that the removal of a large blockholder has on the firm.

[1] Block repurchases are sometimes called privately negotiated repurchases or targeted repurchases. The terms are used interchangeably in this paper.
[2] Figures are from Thompson Financial Securities Data Company mergers and acquisitions database.

Block repurchases are unique in a number of dimensions and the market may perceive them quite differently from other types of share repurchases. The sellers in these privately negotiated transactions are by necessity holders of large blocks of shares; whereas, the typical sellers of shares in a tender-offer, Dutch auction or open-market repurchase are holders of relatively small amounts of shares.[3] Many of these blockholders are also current or, more often, past officers or directors of the firm. The blockholders are aware that they are selling their stock back to the firm (although this is also true for tender-offers and Dutch auctions, it is unlikely true for sellers via open-market repurchases). Unlike other types of repurchases, block repurchases can be initiated by either the buyer or the seller and may take place at either a premium or a discount. Consequently, the firm is unlikely to have a significant informational advantage. The direction and value of any signal is ambiguous; particularly, considering outsiders may logically view such blockholders as sophisticated, informed investors.

Perhaps more importantly, the repurchase of a relatively small number of shares from a relatively large number of different shareholders is inherently different than the repurchase of a large number of shares from a single blockholders, or small, related group of blockholders. Blockholders are thought to provide a unique function within the firm. At least since Bearle and Means (1938?), we have understood some of the problems associated with the diffuse ownership structure of the modern corporation.

Although most repurchases are accompanied by positive announcement returns (generally, repurchased from small investors in the open-market or via tender- offer), the market has historically greeted the announcement of a block, or targeted, share repurchase with skepticism. Dann and DeAngelo (1983), Bradley and Wakeman (1983), Denis (1990) and Mikkelson and Ruback (1991) examine block or targeted share repurchases during the 1970s and 1980s. The block share

[3] See Peyer and Vermaelen (2004).

repurchases during these time periods were made at a significant premium over the market price and are associated with significant negative abnormal returns. Many of the block-repurchases during these time-periods appear to be take-over defenses frequently associated with "greenmail" and often accompanied with standstill agreements.[4] More recently, Peyer and Vermaelen (2004) report that only the block repurchases associated with greenmail experience negative announcement returns. Most announcements of privately negotiated repurchases result in positive abnormal returns, regardless of whether the transaction took place at a discount or premium.

We enter this debate by examining the affect of large privately negotiated share repurchases. We isolate a sample of 1,180 block, or targeted, repurchases from the period 1985 through 2001. We then trace back the history of the block formation and segment the sample based on the type of seller and the reason for the formation of the block. Based on this, we then predict which of these types of repurchases are likely to be from active versus passive shareholders. Our primary empirical prediction is that repurchases from passive shareholders will likely have a positive impact on the firm's market and operating performance, while repurchases from active shareholders (likely to provide valuable monitoring) are likely to have a negative (less positive) impact on market and operating performance.

Contrary to the previous findings of negative abnormal returns associated with the announcement of the repurchase of large blocks of stock, we find that the market reaction to block, or targeted, share repurchase announcements is unambiguously positive. Our evidence differs from the findings of earlier studies using samples of block repurchases from the 1970s and 1980s that the authors suggest are likely to be associated with greenmail. However, our findings are consistent with those of Peyer and Vermaelen (2004), who in a related study also find that block repurchases made in the 1990s were, on average, greeted positively by the market. Finally, we find little difference in

[4] See Peyer and Vermaelen (2004).

the announcement period returns and subsequent performance of firms repurchasing shares from active blockholders versus firms repurchasing share from passive blockholders. The announcement period returns are almost universally positive and subsequent operating performance does not appear to significantly change.

The remainder of this paper is organized as follows: in Section I, we provide a brief review of the literature and discuss our primary hypotheses. In Section II we discuss our sample, our data and our specific empirical predictions. We detail our empirical method and report our results in Section III. Our concluding remarks are provided in Section IV.

I. Literature Review and Hypotheses Development

This section provides a review of the pertinent repurchase and blockholder literature. We then rely on the theoretical basis and previous empirical observations provided in this research to form our primary hypotheses.

A. Literature Review

There has been a significant amount of empirical and theoretical research on common stock repurchases. Early research by Dann (1980), Vermealen (1980) and Comment and Jarrell (1991), among other, have documented significant positive abnormal returns associated with the announcement of tender-offer, Dutch auction, and open-market common stock repurchases.

The positive returns associated with the announcement of a repurchase are generally attributed to signaling. Consistent with this idea, the announcement returns are positively correlated to the percentage of shares repurchased. Comment and Jarrell (1991) report that single-price tender offers generally target about 17% of the firms common stock outstanding and are associated with an average 11% announcement period abnormal return; Dutch auctions generally target about 11% of the shares outstanding and are associated with a 8% abnormal return; and open-market repurchases generally target about 5% of the outstanding shares and are associated with 3% announcement

period return. Further, Ikenberry, Lakonishok and Vermaelen (1995) report that positive abnormal returns are observed for several years following the announcement of an open-market repurchase program; similarly, Lakonishok and Vermaelen (1990) report a similar finding for small firms engaging in tender-offer repurchases. These findings are generally consistent with the signaling hypothesis and suggest that the market under-reacts to the information content of the repurchase announcements.[5]

Dittmar (2000) suggests that firms repurchase stock for a variety of different reasons. While undervaluation appears to be the primary motive for share repurchases, she also finds that repurchases are frequently used to distribute excess cash flows and at times used to alter capital structure, fend off takeovers or mitigate the dilution effects of stock options. Grullon and Michaely (2002) suggest that while firms may repurchase shares when managers perceive the stock to be under-valued there is little evidence that repurchases precede operating performance improvements. Similarly, Jagannathan and Stephens (2003) also find little evidence of any performance improvements, but report that operating performance of repurchasing firms is significantly greater than that of their peers and remains that way for at least two years following the repurchase announcement. Further infrequent repurchases tend to be proceeded by periods of poor market performance (suggesting that perceived undervaluation may be a motive for these types of repurchases) and frequent repurchases are preceded by periods of relatively normal market performance, but are associated with the conversion of stock options.

While tender-offer and open-market repurchases have been the subject of a considerable amount of recent research. The research on block, or targeted, share repurchases is more limited. Previous research by Dann and DeAngelo (1983), Bradley and Wakeman (1983), Denis (1990) and

[5] A number of other possible motives for share repurchases and hypotheses explaining the observed positive announcement returns have been posited in the empirical finance literature, but these are largely beyond the scope of this paper. See Grullon and Ikenberry (1999) for a overview of the repurchase literature.

Mikkelson and Ruback (1991) report that significant premiums are paid for targeted or block share repurchases and that the market greets these announcements negatively. The authors attribute many of the block repurchases made during their sample periods (1970s and 1980s) to greenmail and other defensive measures used in takeover fights.

More recently, Peyer and Vermaelen (2004) find that, on average, the returns around the announcement of a block repurchase are positive. They analyze the abnormal returns based on whether the block was repurchased at a positive, negative or zero premium. Only the transactions considered to be greenmail are associated with negative returns. Further, the long-run returns are similar to those observed for other types of repurchases suggesting that signaling or undervaluation may also be a motive for these types of repurchases.

Our research appeals to much of the theoretical and empirical literature on the nature and value of block shareholders. Traditionally, the existence of large blockholders and the associated reduction of managerial discretion were thought to be unambiguously beneficial. Large blockholders or concentrated (outside) ownership enhances firm value by creating incentives for outsiders to monitor the actions of managers. Shleifer and Vishny (1986) suggest that large outsider shareholders mitigate the free-rider problem in take-overs. More dispersed ownership triggers shareholder intervention only when gains from exercising control are large. Recent research suggests that while there are clear benefits associated with the formation and existence of large external equity blocks, there are also potential costs.

There is a trade-off between managerial initiative and gains from external monitoring. Burkart, Gromb and Panuzi (1997) model the trade-off between managerial initiative, firm-specific investment and external monitoring. Their model further suggests that monitoring associated with concentrated outside ownership might conflict with incentive based compensation, such as stock

options. Similarly, Fee (2002) examines the association between artistic freedom and external financing in the motion picture industry. The more critical the producer views artistic freedom to the success of the project the less likely it is to be financed by one of the major motion picture houses that are likely to limit producer/director discretion and artistic freedom. Holmstrom and Tirole (1983) suggest that large blocks might reduce liquidity and inhibit information production in the market and Schleifer and Vishny (1997) suggest that blockholders may act in their interests at the expense of other claimants. Finally, Edwards and Hubbard (2005) suggest that institutional ownership has increased dramatically in recent decades and we would expect to observe more active shareholders, but this has not happened. They conclude that despite the increase in institutional ownership and anecdotal accounts of the rise in institutional ownership activism, institutions are unlikely to affect the way firms are governed.

Another line of research, more directly related to this paper, examines the pricing of large block trades. Barclay, Holderness and Sheehan (2001) report that block trades occur at an 11% premium, while private placements of large blocks occur at an average 19% discount. Barclay and Holderness (1989) suggest the premiums paid by purchasers of large blocks of stock represent the costs of private benefits of control. Wruck (1989) suggests that the discount received by investors purchasing large blocks of shares directly from the firm in a private placement could be compensation for future monitoring and Hertzel and Smith (1983) suggest the discount could compensate the blockholders for certifying the firm's investment opportunities. Barclay, *et. al.* argue that *ex ante* it should not matter whether the investor purchases the block from another shareholder or directly from the firm as a private placement. The differences result from the subsequent activities of the new blockholders. Purchasers in block trades tend to become active participants in the firm, while purchasers of private placements tend to become passive shareholders. Bethel, Liebeskind and Opler (1998) show that purchases of share blocks by activist investors are followed

by increased asset divestiture, increased share repurchases, improved operating profitability, decreased acquisition activity and abnormal stock price appreciation. This suggests that activist block holders limit agency costs associated with separation of ownership and control. The nature and identity of the blockholders are critical.

A block or targeted repurchase is intuitively the opposite of a private placement and similar rationale can be utilized. We appeal to this literature in formulating our hypotheses and specific empirical predictions. We add an additional piece to the block pricing puzzle by analyzing the effect of block repurchases conditioned on the nature of the blockholders. We expect that the repurchase of blocks from an active shareholder will be viewed negatively and the repurchase of blocks from a passive shareholder will be viewed positively.

B. Hypotheses

Our primary hypotheses are that there is value for the firm created by large active blockholders and that there are costs associated with large passive blockholders.

1. Repurchases from active blockholders

Hypothesis 1: Active blockholders enhance firm value and the repurchase of a large block of shares from an active blockholders harms firm value. Active blockholders potentially enhance firm value through monitoring activities and restrictions on managerial discretion. Alternatively, there are potential costs associated with active investors.

Alternative hypothesis 1: Active blockholders hinder firm value and the repurchase of shares from an active blockholders enhances firm value. Active blockholders potentially impose costs through, reduced managerial initiative and reduced effectiveness of incentive compensation.

2. Repurchases from passive blockholders

Hypothesis 2: There are significant costs associated with passive blockholders and the repurchase of shares from passive blockholders improves firm value. Passive blockholders potentially harm firm

value by helping entrench management, potentially reducing information production in the market and reducing float and liquidity.

Alternative hypothesis 2: The costs associated with passive blockholders are insignificant and the repurchase of shares from passive blockholders has no impact on firm value.

II. Sample Selection, Data Collection and Empirical Predictions

This section describes the selection of our sample of privately negotiated repurchases, the categorization of sellers of those blocks and our predictions based on those categorizations.

A. Sample Selection and Data Collection

Our initial sample includes all share repurchases in Thompson Financial's Securities Data Company mergers and acquisition database designated as privately negotiated repurchases over the period 1984-2001. Many open-market repurchases announcements also allow for the possibility of privately negotiated repurchases – these types of announcements are not included in our sample. The vast majority of privately negotiated repurchases are announced either concurrent with the actual repurchase or more commonly after the actual transaction has been completed. The announcement dates of our privately negotiated repurchases are verified using Dow Jones News Retrieval.

Table 1 provides a comparison of the number and value of privately negotiated repurchases versus open-market repurchases. While open-market repurchases are clearly the most common method for a company to buy back shares, privately negotiated repurchases were the second most common method in terms of both numbers of announcements and value of shares. During the period 1985 through 2001 there were 1392 block repurchases with a value of approximately $88 billion. Over the same period, there were 9686 open-market repurchases with an estimated

announced values of $1119 billion.[6] The average block repurchase has a value of about $79 million and the average open-market repurchase has announced value of about $127 million. While the average value of the open-market repurchases is larger than that of the block repurchases, the block repurchases are arguably more significant events to their firms. Block repurchases are represent very significant single transactions for the firms (comparable in size to many mergers or acquisitions). The average block repurchased represents more than 14% of the shares outstanding, almost twice the relative size of the open-market repurchase. The average open-market repurchase program targets about 7.5% of the shares outstanding. Further, the open-market repurchases represent a series of small transactions taking place over a period of months or years, whereas the block repurchases are single, large transactions.

Although the number and value of privately negotiated repurchases varies over the sample period. The basic pattern is similar to that observed for open-market repurchases, but as might be expected, the annual variation appears to be significantly less. This might suggest that privately negotiated repurchases are less correlated to under-valuation and cash flows and are potentially used for different reasons than the other repurchase methods.

Our analysis requires that we are able to identify the seller of the share block. This restriction eliminates 212 observations from our final sample. Our premise is active blockholders and passive blockholders have a significantly different impact on firm value and operations. Finally, a Lexis-Nexis search is made for the announcement of the block formation. We are able to identify the formation of 208 of the share blocks. We use this information to help categorize the blockholders and analyze their impact on firm returns. We identify several categories of blockholders, as shown

[6] Open-market repurchases announcements are merely a statement of intent to repurchase the stated number of shares; the firm is not committed to doing so. Stephens and Weisbach (1998) show that while most firms follow through with their announced intention to repurchase shares, a significant number of firms repurchase few or no shares.

in Table 2, and group these categories into blocks held by affiliated firms and those that are likely to be active blocks or passive blocks.

B. *Types of Blockholders and Empirical Predictions*

Our primary hypotheses are that active blocks enhance firm value and their repurchase has a negative impact on the firm and that passive blocks have a negative impact on the firm and their repurchase enhances firm value. Each of the categories and our empirical predictions regarding the impact of the blockholders on the firm and the repurchase are described below.

Active Blocks

In general, active blockholders are thought to improve firm performance through the additional monitoring they provide and influence they may exert on firm management. Barclay, Holderness and Sheehan (2001) suggest that active blockholders enhance firm value and we predict that most repurchases from active shareholders will have a negative impact on the firm. We expect repurchases from active blockholders to be associated with negative abnormal returns (and that formation of the block is associated with positive returns). We also expect these types of blocks to be associated with good market and operating performance since formation of the block that declines after the repurchase.

As shown on Table 2, there are 247 repurchases we classify as from active blockholders. Our classification of active blocks includes 43 equity private placements of venture capitalists, lenders and bought out firms. Additionally, we classify those blocks associated with mergers and acquisitions as active blocks. There are 68 blocks repurchased that were used to form toeholds and 136 repurchases from hostile blockholders which could represent greenmail.

Passive Blocks

Passive blockholders serve to entrench management and reduce share float and liquidity. We expect these types of repurchases to be associated with positive returns (and their formation

associated with negative returns). We also expect these types of blocks to be associated with poor market and operating performance since formation of the block that improves after the repurchase. There are 559 transactions that we classify as repurchases of passive blocks. The largest portion of these repurchases is from blocks formed through financing arrangements with underwriters and financial institutions; there are 421 such repurchases in our sample. Blocks originally formed as stock payments for a purchased asset account for another 80 of our passive block repurchases and the remaining 50 passive blocks repurchased were formed as a result of product market relationships, such as joint ventures and strategic alliances.

Affiliated Blocks

Our final category is affiliated blocks. Affiliated blocks are share blocks held by related companies that are not the parent. In general, we do not expect affiliated blockholders to monitor or otherwise exert influence over firm management. There are 374 block repurchases where we identify the seller as an affiliated company. We argue that these are most like passive blockholders and we expect these types of repurchases to be associated with positive returns (and their formation associated with negative returns). We also expect these types of blocks to be associated with poor market and operating performance since formation of the block that improves after the repurchase.

The common theme in our empirical predictions across the groups is that impact of the block repurchase is dependent on whether the seller is an active or passive shareholder. However, we also predict that there are significant differences in the types of active and passive blockholders and these differences will influence the impact the block repurchase has on the firm.

In Table 2, we also report the number of each type repurchase by year. As might be expected, the majority of repurchases from blockholders classified as hostile are clustered in the first half of our sample from 1985 through 1991. This is expected since the take-over market was much more active during this period. The remaining categories exhibit a pattern with the majority of the

transactions occurring during the middle of the sample period from 1989 through 1995. Although there appears to be some temporal clustering of privately negotiated repurchases, the patterns exhibited by the different categories are similar and we don't expect clustering to affect the observed differences based on these categories (the exception is hostile take-over category). When possible, we also sub-divided each of our three main categories by whether the blockholder holds a directorship with the firm or not.

III. Empirical Method and Results

A. Transaction Characteristics

In Table 3 we report descriptive characteristics of the repurchase transaction segregated by type of blockholder. The average block of shares repurchased represents about 13-14% of the firm's shares outstanding. The average value of a block of shares repurchased is about $75 million. In terms of individual transaction value, blocks repurchased from directors classified as active blockholders tend to be the largest with and average value of about $275 million, while blocks repurchased from active shareholders that are not directors have an average value of about $65 million. The average repurchase from an active blockholder is valued at almost twice that of repurchases from passive blockholders.

B. Block Holding Periods and Returns

We are able to isolate the original formation date of 208 of the blocks through a Lexis-Nexis search. In the first three columns of Table 4 we report the average block holding period and the annualized returns earned over that holding period. The average holding period of all blocks in our sample is 3.35 years. The blockholders that are also directors have the longest holding period, averaging about 4.4 years, while those without directorships have an average holding period of about 2.7 years. There are no significant differences in the holding periods of active versus passive or affiliated blockholders. In the last four columns of Table 4 we report the raw return over the year

leading up to the repurchase, the abnormal control adjusted return over that year and the average share turnover over that year. In the year leading up to the repurchase, firms repurchasing from active and affiliated blockholders experience an average return of 21.23% and 20.45%, respectively. . In the year leading up to the repurchase, firms repurchasing from passive blockholders experience an average return of only 9.4%. This suggests that passive blockholders may hamper market performance. The abnormal control-adjusted returns paint an even clearer picture.[7] The median firm repurchasing active blocks out performs their matched peers by 15.4%, which is significant at the 1% level. Meanwhile, the median (and average) firm repurchasing passive blocks significantly underperforms their peers. Finally, Barclay *et. al.* suggest that a potential cost of passive blockholders is lower stock liquidity. Although it does appear that the stock of firms repurchasing passive or affiliated blocks is less liquid, as evidenced by lower share turnover, the differences among the groups is not significant.

The alphas from Fama and French (1993) regressions controlling for the market risk-premium, firm size, book-to-market and momentum are reported in Table 5. In general, the alphas for the firms repurchasing active blocks are positive and significant, while the alphas observed for firms repurchasing passive or affiliated blocks are insignificant. This suggests that active blockholders earn an abnormal return, while passive and affiliated blockholders do not.

C. Market Performance Around Block Repurchases

The abnormal stock returns observed around the announcement of the block repurchase and around the formation of the initial block are reported in Table 6. The abnormal returns are 3-

[7] Abnormal control-adjusted returns are calculated by subtracting the returns of the matched firm from the raw returns. The firms are matched based on Fama and French (1993) industry classifications, firm size and market-to-book ratio. Our matched firms must be in the same industry classification and must be with 30% of firm size and book-to-market ratio. In 17 cases we found no match using these criteria; in these cases, we eliminated the industry requirement and matched only on size and market-to-book.

day returns in excess of those estimated using a standard market model.[8] In general, block repurchases are greeted positively by the market, similar to the returns observed around other types of repurchase announcements. The average 3-day cumulative abnormal return (CAR) is 2.29%. The CARs for each of the sub-categories are positive and significant with the exception of those observed around the repurchase of an active block from a non-director suggesting the market values the monitoring provided by these active outside blockholders. The CARs observed around the initial formation of the blocks tell a similar story. In general, the market greets the formation of a large share block positively; the average CAR observed around the formation of a new share block is 3.58%. However, when the new blockholder is also appointed to the board of directors the market views these transactions with more skepticism. The average CAR observed around the formation of a new block where the blockholder does not join the board of directors is 4.84$, while the average CAR observed when the blockholder does join the board is statistically insignificant. Similar to the repurchase CARs, the CARs observed around the block formation suggests that the market values the monitoring provided by outside blockholders. Finally, although not reported, we also examine CARs of the seller around the repurchase. In the 331 cases where the seller return information is available on CRSP the average returns are positive, but statistically insignificant.

D. Multivariate Analysis of Returns Observed Around Block Repurchases and Formation

We report the results of our multivariate regression analysis of the CARs observed around block repurchases and formations in Tables 7 and 8, respectively. Similar to the univariate analysis discussed above, the market, on average, greets the repurchase of a large share block positively as evidenced by the positive and significant intercept terms. Similar to the returns observed for other types of repurchases, the CARs are positively related to the relative size of the block repurchased. The returns are also positively related to a blockholder resigning her position on their firm's board.

[8] The parameters of the market model are estimated over a 250-day period ending 10 days prior to the repurchase announcement.

As predicted, the returns are negatively related to the block being repurchased from an active or hostile shareholder.

Finally, the original formation of the blocks are generally viewed positively, as evidenced by the positive and statistically significant intercept terms for the block formation regressions reported in Table 8. However, the formation of these blocks is viewed negatively if the new blockholder also takes a position on the board.

IV. Conclusions

We examine the affect of large privately negotiated share repurchases from the period 1985 through 2001. We then trace back the history of the block formation and segment the sample based on the type of seller and the reason for the formation of the block. Based on this, we then predict which of these types of repurchases are likely to be from active versus passive shareholders. Our primary empirical prediction is that repurchases from passive shareholders will likely have a positive impact on the firm's market and operating performance, while repurchases from active shareholders (likely to provide valuable monitoring) are likely to have a negative (less positive) impact on market and operating performance. We find that the market reaction to block, or targeted, share repurchase announcements is unambiguously positive. Our evidence differs from the findings of earlier studies using samples of block repurchases from the 1970s and 1980s. We also find that the original formation of the blocks is generally viewed positively. However, the market appears to be skeptical of the value of blockholders that are also on the board of directors. Repurchases from directors are viewed more positively, while the formations of blocks who also take directorships are viewed more negatively.

Overall, our evidence is consistent with outside blockholders providing a valuable monitoring role that ultimately improves the firm's market performance. Our evidence also suggests that the market is skeptical of the value of having large blockholders join the board, consistent with

the Barclay *et. al.* conjecture that these types of blockholders are likely to be a rubberstamp that further entrenches managers.

References

Barclay, M. J.; Holderness, C. G.; Sheehan, D. P. 2001. The block pricing puzzle, working paper University of Rochester.

Bethel, J. E.; Liebeskind, J. P.; Opler, T. C. 1998. Block share purchases and corporate performance, Journal of Finance 53, 605-635.

Bradley, M. and L. Wakeman, 1983. The wealth effects of targeted share repurchases, Journal of Financial Economics 11, 301-328

Choi, D. and S. Park. "Targeted Share Repurchases, Free Cash Flows And Shareholder Wealth: Additional Evidence," Managerial Finance, 1997, v23(3), 49-63.

Dann, L. and DeAngelo, H. 1983. Standstill agreements, privately negotiated stock repurchases, and the market for corporate control, Journal of Financial Economics 11, 275-300.

Dann, Larry Y. and Harry DeAngelo. 1983, Standstill agreements, privately negotiated stock repurchases, and the market for corporate control, Journal of Financial Economics 11, 275-300.

Dennis, D., 1991. Defensive changes in corporate payout policy: Share repurchases and special dividends, Journal of Finance 45, 1433-1456.

Denis, D. J.; Denis, D. D. and Sarin, A. 1997. Ownership structure and top executive turnover, Journal of Financial Economics 45, 193-221.

Edwards, D. and Hubbard, G., 2005. The growth of institutional stock ownership: A promise unfulfilled. Corporate governance at the crossroads, edited by Chew, D. and Gillan, S.

Fee, C. Edward. 2002, The costs of outside equity control: Evidence from motion picture financing, Journal of Business 75, 681-711.

Klein, April and James Rosenfeld. "Targeted Share Repurchases And Top Management Changes," Journal of Financial Economics, 1988, v20(1), 493-506.

Klein, April and James Rosenfeld. "The Impact Of Targeted Share Repurchases On The Wealth Of Non-Participating Shareholders," Journal of Financial Research, 1988, v11(2), 89-98.

Mikkelson, W. and Ruback, R. 1991, Targeted share repurchases and common stock returns, RAND Journal of Economics 22, 544-561.

Mikkelson, W. H. and R. S. Ruback. "Targeted Repurchases And Common Stock Returns," Rand Journal of Economics, 1991, v22(4), 544-561.

Peyer, U. C. and Vermaelen, T. 2003. The many facets of privately negotiated stock repurchases, working paper, INSEAD.

Shliefer, A., and Vishny, R. W. 1986. Large shareholders and corporate control, Journal of Political Economy 94, 461-89.

Table 1

Number and Value of Repurchases by Year and Method

This table provides a comparison of the number of announcements and the value of the transactions for privately negotiated repurchases versus open-market repurchases by year. All data is obtained for Thomson Financial's Securities Data Company mergers and acquisitions database.

	Block or Targeted Repurchases				Open-Market Repurchases			
Year	# obs.	Ave. %	Ave. Value	Total Value	# obs.	Ave. %	Ave. Value	Total Value
1985	64	15.67	83.30	4498.16	105	8.13	134.76	13072.02
1986	54	14.86	131.54	6182.16	122	9.10	135.75	13982.35
1987	42	15.25	107.70	3769.38	797	9.21	188.28	43869.99
1988	66	14.12	70.88	3969.02	203	8.67	143.67	26865.54
1989	113	16.06	50.08	4357.28	377	9.53	133.24	45034.80
1990	118	11.94	41.12	3742.13	626	7.36	41.19	22900.26
1991	109	12.26	42.82	3596.74	219	7.45	56.15	11341.78
1992	93	12.40	32.43	2010.50	359	7.74	82.63	27681.64
1993	91	15.08	34.35	2576.39	373	6.31	68.50	24112.96
1994	102	16.54	16.04	1235.13	657	6.60	84.54	54699.94
1995	106	15.08	152.81	13753.10	706	6.11	91.58	61818.30
1996	92	14.76	126.94	9520.73	997	6.78	120.10	114572.24
1997	128	13.74	118.85	13192.17	842	7.17	161.80	133650.05
1998	69	12.42	79.52	4373.69	1407	7.96	127.08	178040.18
1999	58	12.95	71.73	3443.23	1040	8.46	107.14	111210.74
2000	34	17.17	83.66	2342.37	500	8.26	250.35	124675.04
2001	53	15.94	117.42	5518.51	356	7.11	314.39	111608.29
Total	1392	14.29	78.50	88080.68	9686	7.54	127.22	1119136.11

Table 2

Number of privately negotiated repurchases by year and type of block formation.

This table provides our classification of the repurchases of active, passive and affiliated blocks. Active blocks include those formed through private placements (venture capitalists and lenders), blocks used to form toeholds and blocks formed as a potential hostile takeover. Passive blocks include those formed through financing arrangements, product relationships and asset purchases. Affiliated blocks are those held by related companies.

Seller identity – block formation	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Active Blocks																		
Private placements – Venture capital, lenders, buyouts	0		0	1	1	2	1	0	3	4	4	6	11	3	3	1	3	43
Toeholds	1	0	1	5	5	2	3	8	5	12	8	4	3	4	3	2	2	68
Hostile – greenmail	16	17	11	17	15	9	11	4	2	3	3	7	5	4	4	2	6	136
Passive Blocks																		
Financing – underwriters, financial institutions	16	13	14	14	38	37	32	33	33	31	40	29	34	21	14	5	17	421
Product market relationships – joint ventures, strategic alliances	1	3	2	2	8	3	8	5	3	3	5	4	3	0	3	1	4	58
Asset purchases	1	3	2	3	7	6	8	6	2	5	5	5	7	8	4	4	4	80
Affiliated	23	13	11	16	23	47	33	23	28	27	29	21	26	21	17	8	8	374
Total	58	49	41	58	97	106	96	79	76	85	94	76	89	61	48	23	44	1180

Table 3

Transaction Characteristics

This table provides the characteristics of the transactions obtained from the repurchase announcement. Percent sought is the percentage of shares outstanding represented by the block. Average value of the transaction is the negotiated price per share multiplied by the number of shares being repurchased; most of the transactions occur at the most recent closing share price. The active, passive and affiliated categories are further segmented by whether the blockholder has a position of the board of directors or not.

	Freq	Percent Sought	Average Value of Transactions	Total Value of Transactions
Active				
Directorship		12.95	275.25	
		(10.0)	(21.2)	
	70	63	58	15,964.63
No Directorship		12.33	64.92	
		(9.95)	(19.47)	
	70	66	60	3,895.13
All Active		13.76	122.62	
		(9.75)	(16.09)	
	244	222	204	25,014.14
Passive				
Directorship		15.76	95.47	
		(12.6)	(15.4)	
	159	133	133	12,697.28
No Directorship		13.00	95.94	
		(9.3)	(9.1)	
	57	47	53	5,085.03
All Passive		12.36	66.66	
		(9.0)	(8.26)	
	555	460	461	30,729.26
Affiliated				
Directorship		18.08	106.26	
		(14.7)	(31.3)	
	88	79	81	8607.42
No Directorship		8.05	8.25	
		(5.0)	(2.8)	
	11	11	8	65.96
All Affiliated		14.88	57.10	
		(10.6)	(9.64)	
	370	346	320	18,273.03
Total				
Unknown		12.77	46.79	
		(8.5)	(7.69)	
	714	629	592	27,700.98
Directorship		15.79	137.02	
		(12.1)	(22.7)	
	317	275	272	37,269.33
No Directorship				
		12.2	74.76	
		(9.8)	(14.2)	
	138	124	121	9046.12
All Repurchases		13.51	75.14	
		(9.85)	(10.0)	
	1180	1028	985	74,016.43

Table 4

Holding Periods, Prior Returns and Share Turnover

This table provides the average holding period of the blocks, the annualized return over the holding period, the raw and control adjusted returns for the year preceding the announcement and the average share turnover. Holding period is the number of years from block formation until repurchase. The annualized return is the geometric average annual return over the holding period. We are able to find the formation date for 208 of the blocks repurchased. The past year return is the raw return from CRSP for the year preceding the announcement. The control adjusted return is the raw return minus the return for the control firm. Control firms are matched based on the Fama and French industry classifications, firms size and book-to-market. The control firm must be in the same industry classification and within 30% of firm size and book-to-market. The turnover is the daily share turnover summed across the previous year.

	N	Holding Period (Years)	Annualized Return	N	Past Year Return	Control Adjusted		Turnover
Active								
Directorship		4.45	6.51		23.36	0.1476		1.1105
	31	(3.74)	(11.36)	59	(15.17)	(0.2182)	*	0.9156
No Directorship		2.51	15.91		24.37	0.1231		0.9267
	35	(1.78)	(10.90)	66	(23.35)	(0.1126)		(0.7315)
All Active		3.03	14.30		21.23	0.1441	*	0.9779
	89	(2.34)	(11.33)	211	(17.43)	(0.1542)	***	(0.7421)
Passive								
Directorship		4.19	10.85		9.89	-0.1499		0.8902
	45	(3.56)	(7.14)	130	(8.83)	(-0.0880)	*	(0.6103)
No Directorship		2.78	3.73		6.29	0.1975		0.9511
	27	(1.75)	(0.42)	48	(8.34)	(-0.0201)		(0.6410)
All Passive		3.44	13.14		9.40	-0.1064	**	0.7744
	104	(2.85)	(9.02)	452	(6.17)	(-0.0617)	**	(0.5133)
Affiliated								
Directorship		5.07	3.60		16.42	-0.2997		0.6754
	12	(3.49)	(-2.00)	65	(19.37)	(-0.0999)		(0.4858)
No Directorship		4.93	-14.15		27.83	0.0330		1.256
	1	(4.93)	(-14.15)	8	(8.70)	(0.0946)		(0.8433)
All Affiliated		4.63	-1.80		20.45	-0.2544		0.6728
	15	(2.87)	(-6.66)	296	(11.11)	(-0.1308)		(0.4492)
Total								
Unknown		2.48	21.63		15.39	-0.1409	***	0.7217
	57	(2.11)	(11.32)	283	(8.93)	(-0.0560)	***	(0.4740)
Directorship		4.40	8.33		14.74	-0.1245	*	0.8794
	88	(3.58)	(6.56)	254	(12.20)	(-0.0355)		(0.6361)
No Directorship		2.67	10.25		17.34	0.1427		0.9641
	63	(1.78)	(6.57)	122	(10.53)	(0.1123)		(0.6970)
All Repurchases		3.35	12.56		14.70	-0.1030	***	0.7961
	208	(2.68)	(8.68)	1151	(9.30)	(-0.0319)	***	(0.5403)

Table 5
Fama and French Alphas
This table reports the alphas from Fama and French (1993) regression models controlling for the market risk premium, firm size, book-to-market and momentum.

	Equally Weighted	Value Weighted
Panel A: Active vs. passive		
Active		
(-23,0)	0.9453 **	0.5538
(-11,0)	1.0970 ***	0.9525 *
(1,12)	0.7400 **	1.0152 **
(1,24)	0.6731 **	0.4139
Passive		
(-23,0)	0.1838	0.1582
(-11,0)	0.2729	-0.1338
(1,12)	0.7452 **	0.0164
(1,24)	0.4426	-0.2250
Affiliated		
(-23,0)	0.8078 **	0.2221
(-11,0)	0.8597 ***	-0.3018
(1,12)	0.0680	0.8301
(1,24)	0.3288	0.8984
Panel B: Director versus no directorship		
No Directorships		
(-23,0)	0.8946 **	-0.4427
(-11,0)	1.1064 **	0.5373
(1,12)	0.2885	-0.0897
(1,24)	0.1986	0.6629
Directorships		
(-23,0)	0.5880 **	-0.1627
(-11,0)	0.9387 ***	-2.0008
(1,12)	0.3938	0.4473
(1,24)	0.1289	0.0939

Table 6

Abnormal Returns Observed Around Bock Repurchase and Formation

This table reports the cumulative abnormal returns (CARs) observed around both the block repurchase and original formation. CARs are estimated by subtracting the return predicted by a standard market model from the raw observed return. The market model parameters are estimated over a 250-day period ending 10 days prior to announcement.

	Repurchase returns		Formation returns	
	N	CARs	N	CARs
Active				
Directorship		2.74 ***		1.02
	70	(1.65) ***	15	(0.93)
No Directorship		-0.88		5.28 ***
	70	(0.00)	32	(2.93) ***
All Active		0.81		4.00 ***
	244	(0.26) *	63	(1.89) ***
Passive				
Directorship		3.03 ***		2.32
	160	(1.43) ***	44	(-0.09)
No Directorship		2.78 **		4.30 ***
	56	(2.88) *	26	(1.76) ***
All Passive		3.24 ***		3.76 ***
	551	(1.18) ***	105	(2.03) ***
Affiliated				
Directorship		2.15 ***		0.61
	88	(1.15) ***	10	(0.89)
No Directorship		2.73		
	10	(1.01)		
All Affiliated		1.85 ***		0.11
	369	(0.85) ***	13	(0.46)
Total				
Unknown	710	2.36 ***	54	4.50 ***
		(0.66) ***		(2.61) ***
Directorship	318	2.72 ***	69	1.79 *
		(1.45) ***		(0.25)
No Directorship	136	0.89	58	4.84 ***
		(0.02)		(2.66) ***
All Repurchases	1164	2.29 ***	181	3.58 ***
		(0.92) ***		(1.78) ***

Table 7

Determinants of Repurchase Returns

This table presents the results of our multivariate regression analysis of the CARs observed around the announcement of a block repurchase. Transaction value is natural log of the dollar value of the repurchase. Percent sought is the percentage of shares outstanding represented by the block repurchase. Total assets is the log of total assets from Compustat. Book-to-market is the ratio of the book value of equity to the market value of equity. The analysis also includes discrete indicator variables for active and hostile blocks and director resignations.

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Intercept	0.0136	0.0066	0.0154	0.0221	0.0203	0.0138	0.0227
	(0.3101)	(0.5920)	(0.2531)	(0.0448)	(0.0626)	(0.3059)	(0.0401)
Transaction value (log)	-0.0050	-0.0047	-0.0046			-0.0050	
	(0.1189)	(0.1009)	(0.1492)			(0.1163)	
Percent sought	0.0008	0.0009	0.0009	0.0005	0.0005	0.0008	0.0005
	(0.0136)	(0.0033)	(0.0066)	(0.1007)	(0.0834)	(0.0136)	(0.0913)
Active block dummy	-0.0197		-0.0192	-0.0172		-0.0203	-0.0196
	(0.0066)		(0.0081)	(0.0150)		(0.0068)	(0.0127)
Hostile block dummy		-0.0297			-0.0294		
		(0.0006)			(0.0007)		
Total assets (log)	0.0022	0.0026	0.0021	-0.0017	-0.0015	0.0022	-0.0017
	(0.4664)	(0.3455)	(0.4757)	(0.2764)	(0.3267)	(0.4620)	(0.2686)
Book-to-Market	-0.0033		-0.0039	-0.0006	0.0005	-0.0034	-0.0007
	(0.5171)		(0.4447)	(0.8921)	(0.9221)	(0.5136)	(0.8783)
Director resigns dummy	0.0172	0.0110		0.0177	0.0158	0.0164	0.0144
	(0.0336)	(0.1575)		(0.0246)	(0.0441)	(0.0530)	(0.1167)
Active x Director Resignation							0.0125
							(0.4771)
Hostile x Director Resignation						0.0077	
						(0.7480)	
Adjusted R^2	0.0263	0.0315	0.0207	0.0170	0.0246	0.0249	0.0163
Observations	616	655	616	709	709	616	709

Table 8

Determinants of block formation returns

This table presents the results of our multivariate regression analysis of the CARs observed around the formation of a share block. Transaction value is natural log of the dollar value of the share block. Percent sought is the percentage of shares outstanding represented by the block. Holding period is the time in years from block formation to repurchase. Total assets is the log of total assets from Compustat. Book-to-market is the ratio of the book value of equity to the market value of equity. The analysis also includes discrete indicator variables for hostile blocks and new directorships.

	Model 1	Model 2	Model 3	Model 4	Model 5
Intercept	0.0613	0.0412	0.0856	0.0866	0.0301
	(0.0006)	(0.0278)	(0.0155)	(0.0159)	(0.4768)
Transaction value (log)	-0.0028	0.0021			
	(0.4695)	(0.5850)			
Percent sought	0.0000	0.0016	-0.0004	-0.0004	0.0019
	(0.9762)	(0.0830)	(0.5336)	(0.5297)	(0.0338)
Holding period	-0.0064	-0.0038	-0.0058	-0.0060	-0.0053
	(0.0190)	(0.1392)	(0.0385)	(0.0409)	(0.0530)
Total assets (log)			-0.0033	-0.0032	0.0036
			(0.4494)	(0.4619)	(0.4486)
Book-to-Market			-0.0111	-0.0106	-0.0067
			(0.4984)	(0.5271)	(0.7213)
Hostile block dummy				-0.0035	
				(0.8426)	
Directorship dummy		-0.0565			-0.0438
		(0.0007)			(0.0194)
Adjusted R^2	0.0255	0.1422	0.0189	0.0098	0.1205
Observations	133	96	108	98	80