

# **The Geography of Corporate Governance and Source of Target Gains in Block Acquisitions**

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# **The Geography of Corporate Governance and Source of Target Gains in Block Acquisitions**

## **ABSTRACT**

Using a large sample of partial block acquisitions in the U.S., we examine the importance of geographic proximity in corporate governance and target returns. We find that block acquirers have a strong preference for geographically proximate targets and acquirers that purchase block shares in such targets are more likely to engage in post-acquisition target governance activities than are remote block acquirers. Moreover, the targets of these acquirers realize higher abnormal announcement returns and better post-acquisition operating performance than do targets of other types of acquirers. The positive valuation effects for targets are stronger when targets are smaller, when targets are riskier, when targets have a higher level of R&D investments, when targets perform poorly, or when targets have higher insider ownership, suggesting that information asymmetries or monitoring costs associated with geographic proximity are an important source of gains in partial block acquisitions.

It is well known that despite the substantial gains from international diversification, investors exhibit a strong preference for domestic stocks (French and Poterba (1991), Kang and Stultz (1997)). Recent studies show that this so-called home bias phenomenon in international portfolio selection exists even in domestic portfolio selection, and that investment returns in local holdings are higher than those in nonlocal holdings. For example, Coval and Moskowitz (1999) show that U.S. mutual fund managers exhibit a strong preference for local stocks, and using data on individual investments, Zhu (2002) and Ivkovic and Weisbenner (2005) find that a strong preference for local stocks also exists for individual investors. Coval and Moskowitz (2001) and Ivkovic and Weisbenner (2005) also show that U.S. mutual fund managers and individual investors, respectively, earn significant abnormal returns on geographically proximate investments. Several studies establish that such local bias is largely driven by information asymmetry between local and distant investors. For example, Coval and Moskowitz (1999) show that the extent of the local bias is higher for small, highly leveraged firms that produce nontraded goods, and in a similar vein, Ivkovic and Weisbenner (2005) find that abnormal returns for local investments are higher among non-S&P 500 index stocks for which information asymmetry problems are severe. Finally, using a large sample of analysts, Malloy (2005) shows that geographically proximate analysts issue more accurate earnings forecasts than do other analysts and that this accuracy is strongest for firms located in small cities or remote areas.<sup>1</sup>

Overall, these findings suggest that investors and analysts located near a firm have an information advantage over other investors and analysts with respect to the firm, possibly due to relatively easier access to value-relevant information about the firm. In turn, this informational advantage allows geographically proximate investors to earn superior returns from their investments.

In this paper, we extend this new literature on geographic proximity by studying how both corporate governance activities of block acquirers in targets and target announcement returns are affected when the

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<sup>1</sup> Loughran and Schultz (2005) examine the effect of a firm's geographic location on liquidity and find that rural stocks attract less analyst coverage and observe less trading than do urban stocks. These results suggest that geographic location also affects liquidity.

acquirers are located near the targets. We take the information asymmetry that arises from geographic proximity to be a key determinant of block acquirers' governance activities in targets and target announcement returns. The rationale for this prediction is as follows. Geographically proximate acquirers should enjoy significant information advantages with respect to local targets. For example, acquirers located near targets have better access to information than remote acquirers because they can more easily obtain valuable private information about the targets through informal talks with CEOs, employees, and customers, or they can readily visit the targets and directly observe the targets' operations. It is also possible that compared to remote acquirers, acquirers located near targets expend less time collecting information about their targets since they are on-the-spot. These information advantages provide block acquirers of geographically proximate targets with enhanced monitoring capabilities, and thus stronger incentives to monitor their proximate targets.

Moreover, monitoring of target management involves substantial costs, and such costs are likely to increase with the distance between the acquirers and their targets because monitoring of remote targets usually requires increased communication and transportation costs. For example, Sussman and Zeira (1995) present a model in which banks face monitoring costs that increase in distance. Consistent with this prediction, Peterson and Rajan (2002) and Degryse and Ongena (2005) show that transportation costs cause price discrimination in bank lending. Similarly, in the context of U.S. venture capital, Lerner (1995) finds that the board membership of venture capital in private biotechnology firms is partly determined by the distance between firms and venture capitalists. Lerner (1995) argues that the large monitoring costs associated with frequent visits to the firm and intensive involvement in the firm's operation discourage more remote venture capitalists from actively participating in governance activities in the firm.

These arguments suggest that compared to remote acquirers, geographically proximate block acquirers have significant advantages in their ability to actively pursue post-acquisition target governance activities and thus create higher value for their targets. First, to the extent that geographically proximate block acquirers face lower governance-related transactions costs, they may have stronger incentives to

monitor target performance and thus are more likely to pursue active governance strategies compared to remote acquirers. Similarly, since geographically proximate block acquirers can closely monitor targets and can quickly respond to inefficient target managerial behavior, they may be more effective monitors than remote acquirers and thus, again, are more likely to be involved in post-acquisition governance activities compared to remote acquirers. Second, if geographic proximity facilitates more effective monitoring, to the extent this translates into better target performance, targets of geographically proximate acquirers should experience both higher abnormal announcement returns and better post-acquisition operating performance than other types of targets. Further, to the extent that the benefits of monitoring are likely to be especially valuable for firms that are perceived by the market as having high information asymmetries, positive target announcement returns and post-acquisition operating performance should be particularly pronounced when targets are small or risky, when they have a higher level of R&D investments, when they have high insider ownership, or when they experience poor past performance.

Using state identifiers and physical distance as our primary measures of geographic proximity, we find results that are consistent with the predictions above. Defining a partial acquisition as one in which the bidding firm acquires at least 5% but less than 50% of the target's voting shares, for a sample of 799 partial acquisitions in the U.S. during the 1990 to 1999 period, we find that geographically proximate block acquirers are more likely to be involved in post-acquisition governance activities in targets than are remote block acquirers.<sup>2</sup> Specifically, acquirers located within the same state as the target (hereafter referred to as "in-state acquirers") and those located within 250 miles or 100 kilometers of the target (hereafter referred to as "local acquirers") are more likely to have their representatives on the target's board and to replace poorly performing target management after block share purchases. Therefore, information advantages that arise from geographic proximity provide blockholders located near targets with strong incentives to actively monitor target managers, fostering corporate governance activities in targets. To the extent investors' monitoring costs increase with physical distance from the target because

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<sup>2</sup> We focus on acquisitions by block acquirers since more detailed information on ownership changes and post-acquisition governance activities is publicly available for these acquisitions.

of extra communication and transportation costs, the results also suggests that monitoring costs are an important determinant of governance activities of acquirers in targets.

Furthermore, targets of in-state acquirers and those of local acquirers experience both higher abnormal announcement returns and better post-acquisition operating performance than those of other acquirers. The positive valuation effects are more pronounced when targets are smaller, when targets are riskier, when targets have a higher level of R&D investments, when targets experience worse past performance, or when targets have higher insider ownership. The effects are also particularly strong for geographically proximate targets in which the acquirers have their representatives on the targets' boards. To the extent that the benefits of monitoring are likely to be more valuable for targets that have greater information asymmetries, such as small or risky targets, targets with high R&D intensity, targets with poor past performance, and targets with high insider ownership, and that local information related to these targets is more difficult to obtain by nonlocal acquirers, our findings also suggest that geographically proximate investors are better able to exploit their informational advantage when local firms have opaque information environments.

We also examine whether block acquirers exhibit a bias toward geographically proximate targets. We find that the actual fraction of targets acquired by firms located in the same state is 19.77% while the mean and median expected probabilities of being acquired by firms located in the same state (the fraction of all public firms that reside in a certain state relative to all public firms in the U.S.) are only 7% and 5.44%, respectively. Thus, block acquirers exhibit a strong preference for targets located near them, indicating that geographic proximity plays an important role in determining acquirers' choice of targets.

In evaluating the role of geographic proximity in acquisition decisions, we extend the existing literature in two important ways. First, several studies document that it is the information asymmetry between local and nonlocal investors that drives the preference for local stocks (Coval and Moskowitz (1999), Ivkovic and Weisbenner (2005)). Our paper shows further that geographic proximity has an important effect on investors' target choices and their incentives to perform an active governance role in targets.

Second, by providing a link between geographic proximity and firm value, our analysis offers additional evidence on the role of distance in investment performance, and on how the extent of information asymmetry is related to the source of gains in partial block acquisitions.<sup>3</sup>

It should be noted, however, that targets in our sample are relatively small, with a median book value of total assets of only about \$68 million. This small sample bias limits our ability to generalize the paper's findings to other settings in which targets involved in acquisitions are large.

The remainder of the paper proceeds as follows. Section I describes the data and methodology we use to measure the distance between the acquiring firm and the target firm. In Section II, we provide the frequency of post-acquisition governance activities of block acquirers in targets and the results from logistic regressions. In Section III, we report abnormal returns and long-term operating performance for targets and present results from cross-sectional regressions. Section IV presents the results from robustness tests. Finally, we present summary and concluding remarks in Section V.

## **I. Data and Methodology**

### *A. Data*

Our sample consists of domestic block share acquisitions between 1990 and 1999. The initial sample of block share acquisitions comes from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions, that is, those in which the acquirers initially hold less than 5% of a target firm's outstanding shares and then purchase more than 5% but less than 50% of its outstanding shares. We then exclude deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares within the three years following the acquisition and cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust. We also exclude cases in

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<sup>3</sup> The only paper that investigates the association between geographic proximity and firm value in mergers and acquisitions is that of Kedia, Panchapagesan, and Uysal (2004). However, they focus on acquirer returns in takeovers that lead to a complete transfer of ownership and do not examine whether geographic proximity affects the extent to which acquirers monitor targets.

which the acquirer is a group of companies, individuals, or investment firms (i.e., more than one acquirer), since the identity of the acquirer that initiates post-acquisition governance activities in targets is not clear. To avoid distance outlier effects, we also exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. Finally, we require that a block share purchase's initial public announcement date be available in *Factiva*, where the announcement date is the date that a news announcement first appears in this publication, and that stock returns and financial data for targets be available in the CRSP returns and COMPUSTAT tapes, respectively. These restrictions result in a final sample of 799 targets.

We obtain data on the top executive, board of directors, and managerial ownership of targets from proxy statements and annual reports. We examine these sources during the period associated with a block holding, specifically, for the three years following the acquisition. We define the holding period as the period from the date when an investor announces the acquisition of a target firm's block equity to the date when it decreases its holding in the target to less than 5%.

### *B. Descriptive Statistics and Methodology*

Table I reports the distributions of the sample of 799 block acquisitions according to target industry, year, and whether the acquirer and target are located in the same state. Most of the targets are in manufacturing (46.3%), services (21.5%), and wholesale and retail trade (10.8%). The years 1996 and 1995 are the most active years with respect to acquisition announcements, with 110 (13.8%) and 94 (11.8%) cases, respectively. In-state (out-of-state) acquisitions in which the acquirer and the target are located in the same (different) state account for 19.77% (80.23%) of the sample. While most of the bidders engage in a single acquisition activity, some bidders participate in multiple activities. Of 799 block acquisitions, 616 are single acquisition activities while 183 are multiple activities undertaken by 65 bidders. Of these 183 acquisitions, 16 are in-state acquisitions and 167 are out-of-state acquisitions.

[insert Table I about here]

We use state identifiers as our primary measure of geographic proximity since a firm's state can serve as an important geographic constraint to information flows. Specifically, in-state acquirers may realize information advantages over other acquirers located in different states as the former can derive more relevant information about local firms from statewide information sources. For instance, local media such as newspaper, radio, and television regularly provide coverage of events within the state. In addition, in-state acquirers can access information about state regulations that influence their corporate policy, performance, and even governance activities more easily and accurately than can out-of-state acquirers. Consistent with this view, Audretsch and Feldman (1996) emphasize that the most relevant unit of policy-making is at the level of the state. Coffee (2004) also argues that in the U.S., state regulatory agencies play a more important role in investor protections than the Securities and Exchange Commission (Federal Securities Report Letter, February 4, 2004). These arguments suggest that state-level government and legal systems, including state courts and legislatures, have an important influence on the operation and governance activities of acquirers. Thus, a firm's geographic proximity as proxied by its state is likely to capture an important local-investor information advantage and hence to serve as a good proxy for the measure of informational distance.

As in the previous literature, we also use physical distance between the headquarters of the acquirer and the target as an alternative measure of geographic proximity. In particular, we use the SDC database to obtain the location of acquirers and targets.<sup>4</sup> We then match the location data with data from the U.S. Census Bureau's Gazetteers and Zip Code Database to obtain information on the latitude and longitude of acquirers and targets and use the standard formula for calculating the distance,  $d_{i,j}$ , between the acquirer and the target as follows:

$$d_{i,j} = \arccos\{\cos(lat_i)\cos(lon_i)\cos(lat_j)\cos(lon_j) + \cos(lat_i)\sin(lon_i)\cos(lat_j)\sin(lon_j) + \sin(lat_i)\sin(lat_j)\}2\pi/360,$$

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<sup>4</sup> Since SDC does not provide information on individual acquirers' geographic location, we collect their location information from 13D filings and news articles.

where *lat* and *lon* are the latitudes and longitudes of the acquirer and the target locations, respectively, and *r* denotes the radius of the earth (approximately 6,378 kilometers).

Figure 1 presents the geographic distribution of our sample acquirers and targets across the continental U.S. The figure shows that our sample distribution resembles a plot of population across locations. In addition, Table II shows that on average, large-block acquirers are 1,559 kilometers from their targets. The mean distance between the acquirer and the target for the sample of in-state block acquisitions is 92 kilometers, with a median of 15 kilometers, and the corresponding mean distance for the sample of out-of-state block acquisitions is 1,921 kilometers, with a median of 1,662 kilometers. To measure the extent of local bias, we follow Kedia, Panchapagesan, and Uysal (2004) and estimate the expected probability that the target will be acquired by a firm within the same state. We assume that all public firms located within the same state as a target could be potential acquirers. Thus, the fraction of all public firms that reside in a given state relative to all public firms in the U.S. is the target's expected probability of being acquired by firms located in the same state.<sup>5</sup> Specifically, using company headquarters data from COMPUSTAT, for every partial block acquisition transaction we estimate this fraction for the year prior to the announcement. We find that the mean and median expected probability of being acquired by a firm located in the same state is 7% and 5.44%, respectively. As shown in Table I, since the actual fraction of targets purchased by in-state acquirers in our sample is 19.77%, our findings suggest that like U.S. fund managers and individual households, U.S. block shareholders exhibit a strong preference for geographically proximate firms.<sup>6</sup>

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<sup>5</sup> One concern in using this measure of expected probability is that it does not include privately held firms and individual investors as potential acquirers. Thus, to the extent that the proportion of privately held firms and individual investors located within the same state as a target is not equally distributed across the states, our definition of expected probability is subject to measurement bias.

<sup>6</sup> Our sample includes cases in which mutual funds (SIC code = 6722) acquire block shares in targets. These cases, however, account for only 1.3% (10 cases) of the total sample. The extent of local bias documented in this paper is not affected when we exclude these cases from our analyses.

[insert Figure 1 about here] [insert Table II about here]

Table III presents summary statistics for the sample targets. We measure target characteristics at the fiscal year-end that immediately precedes the announcement date of block share acquisitions. The mean (median) total assets are statistically different between targets in in-state acquisitions and those in out-of-state acquisitions: The mean (median) total assets for the targets in in-state acquisitions is \$293 (\$38) million, and the corresponding total assets for the targets in out-of-state acquisitions is \$943 (\$78) million. The mean (median) equity ownership by managers (the sum of equity ownership by officers and directors) is also distinguishable between targets in in-state acquisitions and those in out-of-state acquisitions, at 27% (23%) versus 21% (15%), respectively. Thus, block acquirers prefer firms that are small or firms that have high insider ownership when they choose to purchase shares in local targets. In contrast, equity ownership by other institutional investors, equity ownership by other institutional blockholders, and past operating performance (operating income / total assets) are lower for targets in in-state acquisitions than for those in out-of-state acquisitions. Leverage (total debt / market value of equity plus book value of debt), prior stock return (three-digit SIC industry-adjusted return for the past one year before the block acquisition), and Tobin's  $q$  (market value of equity plus book value of debt / book value of total assets) show little statistical difference between the two groups.

[insert Table III about here]

Following Denis, Denis, and Sarin (1997), we define the CEO as the top executive of the firm. If a firm has no CEO, the chairman (or president if there is no chairman) is assumed to be the top executive of the firm. The mean and median ages of top executives are significantly younger for the targets in in-state acquisitions than for those in out-of-state acquisitions. However, the mean and median tenures of top executives and the fraction of targets in which a chairman is the top executive are not statistically distinguishable between the two groups. Defining founders as executives who are described as founders in the proxy statement or annual statement, or as those who have held the position of top executive since the inception of the firm, the fraction of targets in which a founder is the top executive is also not significantly different between the two groups.

Next, we find that in-state acquirers purchase a larger percentage of shares up to three years after the first transaction than do out-of-state acquirers. The tests of differences in mean and median percentages of shares acquired across the two groups reject the null hypothesis of equal percentages. Finally, we find that the standard deviation of monthly target stock returns over the past five years and the ratio of R&D expenditures to total assets are not significantly different between the two groups.

In Table IV, we compare important transaction characteristics between in-state and out-of-state acquisitions. Panel A presents summary statistics for block ownership holding periods. The panel shows that 45% of in-state acquirers hold block shares for longer than three years, in comparison with 29% of out-of-state acquirers. Moreover, while 44% of the out-of-state acquirers hold block shares for less than one year, the corresponding number for in-state acquirers is only 27%. These holding period differences between in-state and out-of-state acquirers are significant at the 1% level, indicating that in-state acquirers tend to hold block ownership for a longer period of time than out-of-state acquirers. These results are consistent with those of Coval and Moskowitz (2001), who show that fund managers trade far more frequently in their remote holdings than in their local holdings. To the extent that “dedicated” institutional investors have a long investment horizon and actively engage in monitoring management, whereas “transient” institutional investors have a short-term horizon and behave more like passive investors (Bushee (1988)), our findings also indirectly suggest that in-state acquirers are more likely to function as dedicated investors and out-of-state acquirers are more likely to function as transient investors.

[insert Table IV here]

Panel B of Table IV summarizes the fractions of acquirers who indicate that the motivation behind their share purchases is to secure control of their targets. It also reports the fraction of acquirers who operate in the same industry as the targets and the fraction of acquirers who are corporations, financial institutions, or individual investors. We classify the acquisition as control related if the acquiring firm discloses in a 13D filing that it seeks control of the target. According to this classification, 6% of the deals in in-state acquisitions and 5% of the deals in out-of-state acquisitions are control motivated. The

difference between the two groups, however, is not statistically significant. We also find that the fraction of acquirers who operate in the same industry as the targets (at least to the first two digits of the SIC code) and the fraction of acquirers who are either financial institutions or individual investors are statistically indistinguishable between in-state and out-of-state acquisitions. However, the fraction of acquirers who are corporations is significantly different at the 10% level between in-state and out-of-state acquisitions (30% versus 37%).

## **II. Geographic Proximity and Governance Activities**

To explore the link between geographic proximity and corporate governance, in this section we examine the effects of distance on the extent to which block acquirers monitor targets. We examine two types of governance activities that block acquirers initiate after an acquisition, namely, board representation and nonroutine top executive turnover activities. We examine board representation by block acquirers because previous studies show that having outside directors on the board plays an instrumental role in internal governance. Brickley and James (1987), Weisbach (1988), and Byrd and Hickman (1992), for example, show that independent outside directors protect the interests of shareholders when there are agency problems between managers and shareholders. Given that the board members represented by block acquirers are independent outside directors, we expect that they play an important role in monitoring target management. We also examine nonroutine top executive turnover since removal of the top executive is considered to be one of the most aggressive actions taken in the course of corporate governance. See, for example, Denis, Denis, and Sarin (1997), Bethel, Liebeskind, and Opler (1998), and Kang and Shivdasani (1995), who document that outside blockholders play an important role in top executive turnover.

### *A. Univariate Results*

We obtain information about board representation and top executive turnover events from proxy statements and annual reports by searching these sources for the three years from the date of the

acquisition. Following Denis, Denis, and Sarin (1997), we refer to turnover events in which the top executive is removed due to death, illness, or other nongovernance-related reasons as routine turnover. Also, we classify a management change as normal if the stated reason for the change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all others as nonroutine turnover.

Table V summarizes the frequency of both director appointments in the target's board and nonroutine top executive turnovers initiated by block acquirers. The table shows that 47.5% (75 out of 158) of in-state block acquirers and only 26.2% (168 out of 641) of out-of-state acquirers actively seek or demand representation on the target's board after the acquisition. Similarly, the board representation ratio of block acquirers on the target's board (number of members of the board of directors in target appointed by acquirers / total number of members of the board of directors in target) is 14% for in-state acquisitions and 6.2% for out-of-state acquisitions. These differences in the frequency of board representation and board representation ratios between in-state and out-of-state acquisitions are significant at the 1% level. Thus, in-state block acquirers are more likely to actively intervene in the internal governance process of targets than are out-of-state acquirers.

[insert Table V about here]

Table V also shows that 41.8% (66 out of 158) of targets in in-state acquisitions experience nonroutine top executive turnover during the holding period, for up to three years after the acquisition. In contrast, only 20.7% (131 out of 641) of targets in out-of-state acquisitions experience nonroutine top executive turnover. Thus, in-state acquirers are about two times as likely to be involved in removals of the top executive as are out-of-state acquirers. Moreover, the top executive turnover rate over the three years following the acquisition, regardless of acquirers' holding periods, is also higher for targets in in-state acquisitions (48.7%) than for targets in out-of-state acquisitions (30.8%).

### *B. Effect of Distance on the Board Representation Ratio*

To examine further the role of geographic proximity in block acquirers' board representation activity, we perform multivariate Tobit regressions using the board representation ratio as a dependent variable.

As a measure of geographic proximity, we use a dummy variable that equals one if the acquirer and the target are located within the same state (hereafter referred to as the “in-state dummy”). As an alternative measure of geographic proximity, we also use a dummy variable that equals one if the acquirer and the target headquarters are within 250 miles of each other (hereafter referred to as the “local dummy”). Ivkovic and Weisbenner (2005) argue that the distance of 250 miles is a plausible upper bound on the span of “local information,” that is, information reachable with a daily roundtrip by car. Accordingly, we set the perimeter of locality at a distance of 250 miles and classify acquisitions in which the acquirer and the target are located within 250 miles of each other as local. We also use 100 kilometers as an alternative measure of locality because Coval and Moskowitz (1999, 2001) and Malloy (2005) define local investors as those located within 100 kilometers of a firm’s headquarters. To the extent that in-state and local acquirers bear lower governance-related transaction costs than do remote acquirers, we expect that these dummy variables have a positive effect on the board representation ratio.

The regressions also include as transaction characteristics the duration of block ownership, the percent of shares acquired over the three years following the transaction date, the type of block acquirers, and industrial relatedness (a dummy variable that equals one if the acquirer and the target are in the same two-digit SIC industry, and zero otherwise).<sup>7</sup> First, block ownership holding-period length can influence the acquirer’s incentives to perform governance activities. For example, Demsetz and Lehn (1985) argue that large shareholders with a long-term horizon have strong incentives to monitor management. Alternatively, the duration of block ownership can affect an acquirer’s ability to access information about the target. Investors with a long investment horizon are likely to accumulate better quality information about the firm over their holding periods and thus may have significant information advantages over those with a short investment horizon. Therefore, the incentives of large shareholders to monitor targets can be positively influenced by the duration of their block holding period. To measure this effect, we include an

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<sup>7</sup> Using the same four-digit SIC codes leaves results for the coefficient on the dummy variable for industrial relatedness below unchanged. In 17 in-state (42 out-of-state) acquisitions, the acquirer and the target are in the same four-digit SIC industry.

indicator variable that equals one if the holding period of block shares acquired by investors is longer than three years, and zero otherwise.

With respect to the percent of shares acquired, in their theoretical work Shleifer and Vishny (1986) show that the optimal level of monitoring by block shareholders increases with the size of their equity ownership. As a consequence, we expect a positive relationship between the size of equity ownership acquired by block acquirers and the extent of their governance activities in targets.

The incentives to monitor can also depend on the identity of the block acquirers (i.e., corporations, financial institutions, and individual investors). For example, if corporate investors who have maintained business relationships with targets purchase large shares of the targets, they would have few incentives to monitor target management since active intervention can jeopardize such relationships. In some cases, these corporate blockholders may act as white squires to entrench the target managers. These arguments suggest that corporate blockholders are less active in disciplining target managers than blockholders who are financial institutions or individual investors. Corporate blockholders, however, typically possess industry knowledge or operating expertise that is superior to that of other types of blockholders. Since the stock prices of acquirers are affected by those of targets via a change in the market value of their equity holdings in targets, corporate blockholders might have strong incentives to fully utilize their information advantage and operating expertise in order to maximize target value. In this case, we expect corporate blockholders to be more actively involved in governance activities in targets than other types of blockholders. To examine this issue, we include an indicator variable that equals one if block acquirers are individual investors, and zero otherwise, and an indicator variable that equals one if block acquirers are financial institutions, and zero otherwise.

To control for other target characteristics, we include managerial ownership, firm size, leverage, Tobin's  $q$ , and past operating performance. In unreported tests, we also control for 39 dummy variables for the acquirers' state and nine dummy variables for the year and obtain results very similar to those reported in the paper. The reported results are therefore robust to this basic check for state and time effects.

Table VI reports the regression results. In the first two regressions, we use the state as a measure of geographic proximity. In the first regression, we include an in-state dummy variable and target characteristics. The coefficient on the in-state dummy variable is positive and statistically significant at the 1% level, indicating that the acquirer's board representation ratio in targets is greater for in-state acquisitions than for out-of-state acquisitions.

[insert Table VI about here]

In the second regression we add transaction characteristics. The estimated coefficients for the in-state dummy variable are again positive with  $p$ -values of 0.00. Thus, controlling for transaction characteristics, block acquirers are more likely to have board representation on the target's board when they are located within the same state as targets. These findings suggest that geographic proximity has a significant influence on large shareholders' incentives to perform an active governance role in targets. The coefficients on target size are negative and significant at the 5% level. This result suggests that block acquirers are more likely to have their representatives on the target's board when targets have greater information asymmetries. Although the coefficients on managerial ownership and leverage are positive and significant in the first regression, they lose significance in the second regression. We also find that the board representation ratio is positively associated with both the percent of shares acquired and the dummy variable for the duration of block ownership, supporting, respectively, Shleifer and Vishny's (1986) argument on the monitoring role of large shareholders and Demsetz and Lehn's (1985) argument that blockholders with a long-term investment horizon have strong incentives to monitor management.<sup>8</sup> The coefficients on both the dummy variable for financial institution blockholders and the dummy

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<sup>8</sup> It should be noted, however, that the duration of block ownership and the percent of shares acquired can be endogenous and thus their coefficient estimates could be interpreted in the other direction. For example, the positive coefficients on these variables do not necessarily mean that longer holding periods or larger equity stakes give acquirers incentives to perform more active governance activities. Instead, it could be that acquirers hold blocks longer or purchase larger equity stakes because they want to gain or maintain board representation in the first place, and longer holding periods or larger equity stakes can help them do that. Thus, the regression results for these two variables should be interpreted with caution.

variable for individual investor blockholders are negative and significant. These results suggest that incentives to perform an active governance role in targets are weaker for financial institutions and individual investors than for corporations. In contrast, the coefficients on Tobin's  $q$  are positive and significant at the 1% level. The coefficients on other variables are not significant, however.

In regressions (3) and (4), we use a local dummy variable that equals one if the acquirer and the target are within 250 miles of each other as the measure of geographic proximity. The estimated coefficients on the local dummy variable are positive and significant at least the 1% level. These results are consistent with those of Lerner (1995), who finds that the distance between a venture capitalist and the firm is an important determinant of the board membership of venture capitalists in private biotechnology firms. Our results show further that even for large shareholders in public firms, distance plays an important role in board representation decisions.

In regressions (5) and (6), we replace a dummy variable that sets the locality cutoff at 250 miles with a dummy variable that sets the locality cutoff at 100 kilometers. In the last regression, we use as the distance variable the logarithm of the physical distance between the acquirer and the target. We find that the board representation ratio is positively and negatively related to these alternative measures of geographic proximity at the 1% level, respectively.

In sum, to the extent that target information asymmetries and monitoring costs increase with physical distance between the acquirer and the target, our findings suggest that information asymmetries and monitoring costs are important determinants of the acquirer's board appointment decisions in targets.

### *C. Likelihood of Top Executive Turnover*

Table VII presents the results of logistic regressions in which the dependent variable equals one if a nonroutine turnover event occurs and zero otherwise. We use robust standard errors to adjust for heteroscedasticity (White 1980) and industry clustering. Since the higher frequency of top executive turnover at targets of local block acquisitions may be due to poor stock return performance of these targets prior to the transactions, we control for prior three-digit SIC industry-adjusted return in the

regressions in addition to including the explanatory variables used in Table VI.<sup>9</sup> We also control for other variables that may affect top executive turnover. Specifically, we include the age and tenure of the top executive, and a chairman dummy, which equals one if the top executive is the chairman of the board, as well as a founder dummy, which equals one if the top executive is the founder of the firm.

[insert Table VII about here]

In the first four regressions, we estimate the regression separately for targets in in-state acquisitions and for targets in out-of-state acquisitions. Consistent with evidence from the previous studies, we find that the coefficients on prior three-digit SIC industry-adjusted returns are negative and significant in both subgroups, suggesting that the poor performance increases the likelihood of nonroutine top executive turnover at targets. However, the magnitude of the coefficients for targets in in-state acquisitions is about three times larger than the magnitude of the coefficients for targets in out-of-state acquisitions. This indicates that the relation between turnover and performance is significantly stronger for targets in local block acquisitions than for targets in remote block acquisitions.

In the next five regressions, we use the pooled sample of in-state and out-of-state acquisitions. Following Weisbach (1988), we include interaction terms between governance variables and prior stock performance as key explanatory variables. The coefficients on prior three-digit SIC industry-adjusted returns are negative and significant in regressions (5), (6), and (8) and the coefficients on the in-state dummy variables are positive and significant in all regressions. Thus, after controlling for prior stock performance in-state block acquirers play a more active role in nonroutine top management turnover than do out-of-state acquirers.

In regression (6), the interaction between performance and the in-state dummy is negative and significant. This result is consistent with those in regressions (1) through (4) and suggests that the

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<sup>9</sup> In untabulated tests, we repeat all analyses below using Fama-French (1997) 48 industry-adjusted returns for the past one year before the block acquisition as the measure of prior industry-adjusted stock returns and obtain results that are qualitatively similar to those reported in the paper.

relation between turnover and performance is stronger when firms are targets of in-state acquirers than when firms are targets of out-of-state acquirers.

If other large institutional shareholders and block acquirers interact with each other to monitor poorly performing target management, effectively cooperating in governance activities in targets, we expect the presence of other institutional blockholders increases the likelihood of the block acquirer's post-acquisition governance activity when target performance is poor (Zwiebel, 1995). To examine this issue, in regression (7) we include the interaction between prior stock performance and the institutional blockholder dummy (= one if the target has other institutional blockholders prior to the transaction, and zero otherwise). The coefficient on this interaction variable is negative and significant, indicating that the sensitivity of top executive turnover to performance is higher when targets have other institutional blockholders prior to the transaction. However, the interaction between firm performance and the institutional ownership dummy (= one if institutional ownership in the target is above the sample median, and zero otherwise) is not significant in regression (8).

Outside directors are generally believed to perform an important corporate governance function in the U.S. For example, Weisbach (1988) finds that when the board is comprised of a majority of outside directors, the likelihood of CEO turnover in the U.S. is inversely related to firm performance. Therefore, in regression (9) we include the interaction between firm performance and the outside director dummy (= one if the ratio of the number of outside members of the board of directors to the total number of members of the board of directors in target is larger than 0.5, and zero otherwise). We obtain information on the number of outside members of the board of directors from the IRRC's Directors Dataset. Because many of our sample firms are not covered in the IRRC's Directors Dataset, our test employing this interaction variable is conducted over a smaller sample. Consistent with Weisbach (1988), we find that the interaction between firm performance and the outside director dummy variable is negative and significant.

For control variables, the coefficient on the age of top management is positive and significant, indicating that the top executive is close to retirement (Weisbach (1988)). However, the coefficient on

the tenure of top management is not significant. The coefficient on the dummy for the chairmanship of top management is negative and significant. This finding is consistent with Fama and Jensen (1983), who argue that the concentration of decision management and decision control in an individual reduces the effectiveness of the internal governance system in monitoring top management. Similar to the results reported in Table VI, the coefficients on the percent of shares purchased by acquirers and the duration of block ownership are positive and significant, indicating that nonroutine turnover is significantly more likely when acquirers purchase a large portion of target shares outstanding or hold target equity for a long period. The coefficient on managerial equity ownership is negative and significant, suggesting that substantial voting power by target managers prevents governance mechanisms from removing inefficient management teams (Stulz (1988)).

Overall, the results in Table VII confirm those of the previous analysis for the board representation ratio and further suggest that information asymmetry and monitoring costs associated with geographic proximity affect large shareholders' incentives to undertake active governance activities in targets. The results also suggest that the sensitivity of turnover to stock price performance is stronger for targets of local block acquisitions, targets with other institutional blockholders, and targets with outsider-dominated boards.

#### *D. Marginal Effects of Geographic Proximity*

In order to gauge the economic significance of geographic proximity for governance decisions, we calculate the marginal effect of the state and local dummy variables on the probability of undertaking governance activities in targets. Table VIII presents the marginal effect of the state and local dummy variables and other key explanatory variables from logistic regressions. The marginal effect of the state (local) dummy variable indicates the difference in the probability of governance activities between in-state (local) block acquirers and out-of-state (nonlocal) block acquirers. For other continuous variables, the marginal effect is evaluated at the mean of the explanatory variables and indicates the change in the probability when each independent variable changes by one unit from its sample mean.

In Panel A of Table VIII, we report the marginal effect of the state and local dummy variables and other key explanatory variables on the probability of board representation. The logit regressions include an intercept, the log of the book value of total assets, equity ownership by managers, leverage, Tobin's  $q$ , the dummy for individual investors, the dummy for financial institutions, and the dummy for acquirer-target industrial relatedness, in addition to the variables reported in the panel. The marginal effect of the in-state dummy variable is a significant 0.2, indicating that, after controlling for other target and transaction characteristics, board representation is 20% more likely when the acquirer and the target are located in the same state than when they are located in different states. In comparison, the marginal effect of the local dummy variable is a significant 0.116, indicating that board representation is 11.6% more likely when the acquirer is located within 250 miles of a target. The marginal effect of the dummy variable for block acquirers who are located within 100 kilometers of targets also records a similar result.

[insert Table VIII about here]

Panel B of Table VIII shows the marginal effect of geographic proximity on the probability of nonroutine top management turnover. In addition to the variables reported in the panel, the logit regressions include an intercept, the log of the book value of total assets, equity ownership by managers, leverage, Tobin's  $q$ , the dummy variable for acquirer-target industrial relatedness, top executive tenure, and the chairmanship and founder dummies. The marginal effect of the in-state dummy variable is a significant 0.184. Thus, the probability of nonroutine target top management turnover is about 18.4% greater for in-state acquisitions than for out-of-state acquisitions. The corresponding marginal effects of dummy variables for 250 miles and 100 kilometers are, respectively, 11.1% and 15.2%, both of which are significant at the 1% level.

Overall, these findings suggest that acquirers' incentives to engage in governance activities in targets are economically as well as statistically significant when they are geographically close to targets.

### III. Geographic Proximity and Target Performance

#### A. Announcement Effects

In this section, we examine the effect of geographic proximity on target performance by analyzing the valuation effect of acquisition announcements.

##### A.1. Univariate Results

To assess the valuation effect of acquisition announcements, we compute abnormal returns using standard event study methodology. We obtain our estimates of the market model by using 200 trading days of return data, beginning 220 days before and ending 21 days before the announcement of the block share purchase. We use as the market return the CRSP equally weighted return. We sum the daily abnormal returns to get the cumulative abnormal return (CAR) from day  $t_1$  before the announcement date of the block share purchase to day  $t_2$  after the announcement date of the block share purchase.

Table IX reports the CARs for the targets in in-state and out-of-state block acquisitions for different event windows. On average, target firms earn statistically significant positive gains over the different event windows, including a (-10, -2)-day window. This finding is consistent with that of Mikkelsen and Ruback (1985), who document positive announcement returns for target firms who sell 5% or more of their equity stakes to other companies. The average CAR (-1, 1), CAR (-5, 5), CAR (-10, 10), and CAR (-10, -2) for the targets in in-state acquisitions are 9.3%, 12.6%, 17.9%, and 5.8%, respectively, all of which are significant at the 1% level. The corresponding CARs for the targets in out-of-state acquisitions are 6.9%, 8.4%, 9.1%, and 3.5%, respectively, all of which are also significant at the 1% level. The differences in mean CAR (-1, 1), CAR (-5, 5), and CAR (-10, 10) between the two groups are statistically significant. The medians show a similar pattern.

[insert Table IX about here]

In the subsequent analysis we focus on CARs (-10, 10) rather than CARs (-1, 0) or CARs (-1, 1) as our key measure of announcement effects. We use a (-10, +10)-day window because, according to the William Act, an individual, group of individuals, or corporation is required to file Schedule 13D to the Securities and Exchange Commission within ten days of the accumulated acquisition of more than 5% of any class of a company's voting equity (Mikkelson and Ruback (1985)). To the extent that the Schedule 13D filing occurs after actual purchases of shares are made, there is a possibility that information about block share acquisitions of targets in these acquisitions may be leaked. Thus, using a shorter event window for the return analysis can underestimate the true extent of the announcement effects associated with block share acquisitions. Allen and Phillips (2000) also use a (-10, +10)-day window in their return analysis of corporate block share acquisitions.

#### *A.2. Cross-sectional Variation in Target Returns*

Table X presents the estimates from multivariate regressions. All regressions are estimated using ordinary least squares (OLS). In the first regression, we regress the CAR (-10, 10) on an in-state dummy variable and the other target and transaction characteristics used in Table VI. The coefficient estimate on the in-state dummy variable is 0.071 with a  $p$ -value of 0.01. This result indicates that all else constant, the targets in in-state acquisitions realize a 7.1% higher abnormal announcement return than the targets in out-of-state acquisitions. Therefore, the effect of geographic proximity on target returns seems to be both statistically and economically significant, suggesting that geographic proximity has an important effect on target valuation.

[insert Table X about here]

To more closely examine the effect of geographic proximity on target value, we include interaction terms between the in-state dummy variable and firm-specific variables that proxy for the extent of information asymmetries in targets. The first variable we consider as the proxy for the extent of information asymmetries is target size. It can be argued that large firms have smaller informational asymmetries and are more established than smaller firms. Firm size is also a useful measure of the rate of

information diffusion. For example, Hong, Lim, and Stein (2000) argue that information about small firms gets out more slowly than that of large firms because investors who face fixed costs of information acquisition are willing to spend more resources to learn about a firm in which they can take large positions. These factors suggest that small firms face greater information asymmetries and have lower quality information environments than large firms (Coval and Moskowitz (1999), Malloy (2005)). To address this issue, in the second regression we include a dummy variable that takes the value of one if the target size is in the bottom 25% of the sample and an interaction term between this dummy variable and the in-state dummy variable. We find that the coefficient on the interaction term is positive and significant at the 1% level, but the coefficient on the in-state dummy variable is not significant. Thus, in-state targets experience larger wealth gains than do out-of-state targets, particularly when they are small, suggesting that the gains from geographically proximate acquisitions are larger for targets in which acquirers have a greater information advantage.

Managerial ownership can also have an effect on the quality of targets' information environments. Stulz (1988) argues that concentrated managerial ownership can insulate managers from outside influence and leave them less constrained. This view suggests that managers who want to maximize private benefits opportunistically withhold or manipulate the information they provide outside investors. These incentives for managers to limit or manipulate the flow of information have a negative effect on the quality of corporate communication (Ruland, Tung, and George (1990)), and in turn, lower-quality corporate communication increases information asymmetries between outside investors and insiders (Moyer, Chatfield, and Sisneros (1989), Lang, Lins, and Miller (2004), Baik, Kang, and Morton (2005)). We examine this issue in the third regression by introducing a dummy variable for the high managerial ownership of targets (= one if managerial ownership is above the sample median) and an interaction term between this dummy variable and the in-state dummy variable. The coefficient on the interaction term is positive and significant at the 1% level, but the coefficient on the in-state dummy variable is not significant. This finding suggests that targets realize higher returns when in-state acquirers have more of an information advantage than remote acquirers.

Another variable that proxies for the extent of information asymmetries in targets is the standard deviation of past stock returns. The higher the standard deviation of stock returns, the greater the uncertainty about a firm's perspectives. Thus, firms that have a higher standard deviation of stock returns are likely to have greater information asymmetries than those that have a lower standard deviation of stock returns. We address this issue in the fourth regression. We include the standard deviation of monthly target stock returns over the past five years and the interaction between this variable and the in-state dummy variable. We find that the coefficient on the interaction term is positive and significant at the 5% level, but the coefficient on the in-state dummy variable is not significant. This result again suggests that information asymmetries associated with geographic proximity are an important source of target gains.

The next variable we consider as a proxy for targets' information environments is R&D intensity. To the extent that targets with high R&D expenditures have great information asymmetry and are those in which in-state acquirers have superior access to information relative to out-of-state acquirers, one would expect that the gains from geographically proximate acquisitions are larger for targets that invest more in R&D. Consistent with this view, in the fifth regression, which includes the ratio of R&D expenditures to total assets and the interaction between this variable and the in-state dummy variable, the coefficient on the interaction term is positive and significant at the 1% level.

Past performance can also be related to targets' information environments. Previous studies suggest that firms with good news are more likely to be publicly forthcoming with this news (Verrecchia (1983)). Lang and Lundholm (1993) and Miller (2002) also show that firms are less likely to be forthcoming when they have bad news. To the extent that poorly performing firms have more bad news and they perceive higher costs from communicating such news to outside investors, managers of these firms are likely to have strong incentives to opportunistically withhold or manipulate information when they have unfavorable information about firm performance. Therefore, we expect that the gains from geographically proximate acquisitions are larger for poorly performing targets. In the sixth regression, which includes the ratio of a target's operating income to total assets and the interaction between this

variable and the in-state dummy variable, the coefficient on the interaction term is negative and significant at the 1% level. This result again suggests that the gains from geographically proximate acquisitions are larger for targets in which acquirers have a greater information advantage.

If the stock market takes into account acquirers' value-enhancing governance activity in targets when assessing the market values of targets, we would expect the targets' returns to be related to this activity. To examine this issue, in the seventh regression we include both a dummy variable indicating whether the acquirers have board representation in targets following block share purchases and an interaction term between this dummy variable and the in-state dummy variable. The coefficient on the interaction variable is positive and significant at the 10% level. This finding, together with the previous section's finding of a positive relation between the in-state dummy and the likelihood of governance activity, suggests that a positive wealth effect for the targets in in-state acquisitions is largely due to anticipated monitoring activity by in-state block acquirers.

Audretsch and Feldman (1996), Audretsch and Stephan (1996), and Jaffe, Trajtenberg, and Henderson (1993) show that geographic proximity has an effect on innovative activity and knowledge spillovers in various industries. Further, Ellison and Glaeser (1997) show that industries tend to be geographically concentrated because of cost advantages and industry-specific spillovers. These findings suggest that block acquirers that operate in the same industry as targets have different investment incentives compared to those of other block acquirers. To the extent that same-industry transactions are likely to have more geographic synergies such as cost savings and industry-specific spillovers than different-industry transactions, they also suggest that in-state targets that operate in the same industry as acquirers realize higher announcement returns than do other types of targets. In the eighth regression, we examine this issue by including the interaction between the dummy variable that equals one if the acquirer and the target are in the same industry at least to the first two digits of the SIC code and the in-state dummy variable. We find that the coefficient on the interaction variable is not significant, indicating that the findings above of higher returns for in-state targets are unlikely to be due to synergies associated with geographic proximity.

In the last two regressions, we examine whether targets with poor corporate governance benefit more from monitoring by local acquirers. Williamson (1983) argues that the marginal product of a particular governance mechanism depends upon the relative importance of alternative mechanisms for corporate governance. Thus, when certain mechanisms for corporate governance such as institutional ownership and board composition are not well developed or are limited, the marginal product of an alternative mechanism such as local block ownership is increased. This argument suggests that the benefits of monitoring by local acquirers will be greater when targets' other corporate governance mechanisms are poor. In the ninth regression, we address this issue by including interactions between the in-state dummy variable and the low institutional ownership dummy variable (= one if institutional ownership in the target is below the sample median, and zero otherwise). We find that the coefficient on this interaction is positive and significant at the 5% level. In the tenth regression, we use the insider-dominated board dummy (= one if the ratio of the number of outside members of the board of directors to the total number of members of the board of directors in the target is smaller than or equal to 0.5, and zero otherwise) as the proxy for poor governance and find that the coefficient on the interaction term between the in-state dummy variable and the insider-dominated board dummy variable is also positive and significant at the 1% level. These results suggest that local block ownership serves as an important governance mechanism that substitutes for other missing monitoring mechanisms in targets.

Overall, our results show that geographically proximate targets realize higher announcement returns particularly when they are small, when they are risky, when they have a higher level of R&D investments, when they experience poor past performance, or when they have higher insider ownership. To the extent that these firms are those in which geographically proximate shareholders have superior access to information and for which such informational advantages are most valuable, our results suggest that information with respect to the target is an importance source of target gains in partial block acquisitions.

### *B. Changes in Post-acquisition Operating Performance*

In this section, we examine the change in operating performance of targets following the acquisition of block ownership. As a measure of the change in post-acquisition operating performance, we use three-digit SIC industry-adjusted percentage changes in operating income to total assets (ROA).<sup>10</sup> Untabulated tests show that over the one to five years following the acquisition announcements, the average and median changes in ROA for the targets in in-state acquisitions are positive and significant. In contrast, the average changes in ROA for the targets in out-of-state acquisitions are negative and insignificant. The tests of mean differences in changes in ROA between targets in in-state acquisitions and targets in out-of-state acquisitions reject the null hypothesis of equality.

Table XI reports the regression estimates. We use as the dependent variable the difference between the average of the ROAs in years +1, 2, and 3 and the ROA in year -1. The independent variables are the same as those we use in Table X.

[insert Table XI about here]

The important findings in Table XI are that the coefficients on most of the interaction terms are significant and have the same signs as those in Table X. Thus, our findings for long-term operating performance are qualitatively similar to those for announcement returns, suggesting further that the effect of geographic proximity on firm performance is more pronounced in firms with greater information asymmetries.

#### **IV. Additional Tests**

To verify the robustness of the results above, we conduct several additional unreported tests. Below, we briefly summarize the results of these tests.

##### *A. Reverse Causality*

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<sup>10</sup> To avoid outlier effects, we delete three targets from the analysis (two from out-of-state acquisitions and one from in-state acquisitions) in which the average of their ROAs in years +1, 2, and 3 is higher (lower) than 300% (-300%).

In interpreting our regression results, the degree to which the geographic distance between the acquirer and the target is endogenously determined must be taken into account. It is possible that acquirers seeking to improve target governance are more likely to purchase companies located nearby, while other acquirers do not have such a geographical preference. This reverse causality explanation is difficult to rule out since it is hard to tell ex-ante which acquirers are governance oriented and which are not. We address this reverse causality issue in the following ways.

First, to distinguish ex-ante which acquirers are governance oriented and which are not, we compare the frequency of control-motivated acquisitions, that is, those in which the acquiring firm discloses in a 13D filing that it seeks control of the target, of in-state and out-of-state acquirers. As Panel B of Table IV shows, the frequency of control-motivated deals in in-state acquisitions is statistically indistinguishable from that of control-motivated deals in out-of-state acquisitions. Thus, it appears that in-state acquirers are not significantly different from out-of-state acquirers in terms of their governance incentives.

Second, we examine whether the need for corporate governance activism in targets is different between in-state targets and out-of-state targets. If firms acquire remote targets that require less governance activism, then they might have fewer incentives to engage in post-acquisition governance in these targets. However, as Table III shows, the fraction of firms with a chairman as the top executive and the fraction of firms with a founder as the top executive are not significantly different between in-state and out-of-state acquisitions. We also find that although equity ownership by other institutional investors is significantly lower for in-state targets than for out-of-state targets, the extent of a free cash flow problem (as indicated by a dummy variable that equals one if the ratio of cash flow to total assets is above the sample median and the Tobin's  $q$  is below the sample median, and zero otherwise), the frequency of outside directors, and the Gompers, Ishii, and Metrick (2003) governance index are not significantly different between the two groups. These results suggest that in general, the need for corporate governance activism in in-state targets is not different from that in out-of-state targets.

Finally, to account for potential simultaneity in the relation between governance activity and geographic distance, we estimate the link between the likelihood of board representation by block

acquirers and the physical distance between the acquirer and the target in a simultaneous equation framework. Since our simultaneous equation models involve two endogenous variables, one that is dichotomous (i.e., board representation) and one that is continuous (i.e., the logarithm of the physical distance between the acquirer and the target), we estimate the models using the two-stage probit least squares regression method described in Maddala (1983). The probit regression of the likelihood of board representation includes as explanatory variables the purpose of acquisitions (i.e., whether the deal is control-motivated or not), prior stock return performance, and equity ownership by other institutional block holders, in addition to the target characteristics used in Table VI. We find that the logarithm of the physical distance between the acquirer and the target is a significant explanatory variable for the likelihood of board representation, but the reverse is not true. The reported results in Table VI are therefore robust to this basic check for endogeneity.<sup>11</sup> Using nonroutine top executive turnover as the proxy for governance activity leads to a similar conclusion. Consistent with these results, Gaspar and Massa (2007) also document evidence on the exogeneity of local ownership.

### *B. Alternative Measure of Geographic Proximity*

It is possible that the acquirer's headquarters is far away from the target, but its major plant or division is close to the target. In this case, the acquirers can easily access private information about the targets and this informational advantage should provide them strong incentives to perform an active governance role in targets. To address this issue, we collect information on plants and divisions of acquirers and targets from several issues of Moody's Manual. When there are multiple plants or divisions for a particular firm, the plant or division that has the largest sales (or square feet if sales information is not available) is identified as the major plant or division. Out of the 799 sample block acquisitions, we find that Moody's Manual covers 84 acquiring firms. Of the 84 acquiring firms, 14 do not have information on sales or square feet in the Moody's Manual, eight have major plants or divisions that are

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<sup>11</sup> We recognize that a drawback of this approach is that the instruments used to estimate the likelihood of board representation are also potential determinants of geographic proximity.

in the same state as the targets' headquarters, and 31 have non-major plants or divisions in the same state as the target's headquarters.

The results from Tobit regressions using the board representation ratio as a dependent variable show that the coefficients on both the in-state dummy variable and the dummy variable that uses information on the acquirer's major plant location as the alternative measure of geographic proximity (= one if the acquirer's major plant (or division) and the target's headquarters are in the same state, but the acquirer's headquarters are not located within the same state as the target's headquarters) are not significant. We find similar results when we replace the dummy variable that measures the closeness of the acquirer's major plant or division to the target's headquarters with the dummy variable that measures the closeness of any of the acquirer's plants or divisions to the target's headquarters (= one if at least one of the acquirer's plants (or divisions) and the target's headquarters are in the same state, but the acquirer's headquarters are not located within the same state as the target's headquarters).

Overall, these results suggest that corporate headquarters provide an important base for the acquirers to obtain information about targets and engage in governance activities, but plants or divisions do not. Alternatively, to the extent that Moody's Manual does not cover small firms and that the local ownership effect is particularly evident for these firms, using only large firms in estimating regressions potentially introduces measurement error and bias into the analysis, and thus the regressions are not estimated precisely.

### *C. Event Window*

We reestimate all regressions in Tables X using CARs (-1, 0), CARs (-1, 1), or CARs (-2, 2) as the dependent variable. Reflecting the possible leakage of information about block share acquisitions in the target firm, several statistically significant key variables in Tables X lose their significance when we use the CARs based on these short event windows as the dependent variable. The results using CARs (-10, 1) or CARs (-10, 2) as the dependent variable, however, are similar to those using CAR (-10, 10).

#### *D. Cross-sectional Variation in Acquirer and Portfolio Returns*

To gain further insight into the role of geographic proximity in block share acquisitions, we perform multivariate regressions separately for the acquirers and for the value-weighted portfolios of acquirers and target. We use the CARs (-10, 10) as the dependent variables and the explanatory variables in Table X as the independent variables. In 144 of the 799 acquisitions, the acquirers are listed on stock exchanges. Thus, for these 144 acquisitions (30 in-state acquisitions and 114 out-of-state acquisitions), we are able to estimate the abnormal announcement returns for the acquirers and the value-weighted abnormal announcement returns for the portfolios of acquirers and targets. The results show that the coefficients on the in-state dummy variable are positive but insignificant in both the acquirer and the portfolio regressions. However, if financial and regulated acquirers are excluded from the analysis, the coefficients on the in-state dummy variable are positive and significant. When we include the interaction term between the in-state dummy variable and the dummy variable for small target size, we find that the coefficient on this interaction term is also positive and significant in both the acquirer and the portfolio regressions. The coefficients on the other interaction terms used in Table X, however, are not significant.

### **V. Summary and Conclusion**

This paper documents that block acquirers have a strong preference for geographically proximate targets and that there is a clear link between geographic proximity and corporate governance. Using a sample of 799 partial block acquisitions in the U.S. during the 1990 to 1999 period, we find that the actual fraction of targets acquired by firms located in the same state is 19.77% while the mean and median expected probability of being acquired by firms located in the same state are only 7% and 5.44%, respectively.

We also find that geographically proximate block acquirers are more likely to engage in post-acquisition governance activities in targets than are remote acquirers. Acquirers who are located in the same state as targets and those who are located within 250 miles or 100 kilometers of targets are more

likely to have their representatives on the target's board and to replace target management after block share purchases.

Furthermore, targets located near acquirers experience both higher abnormal announcement returns and better post-acquisition operating performance than do remote targets, and these effects are particularly strong when targets are small, when targets are risky, when targets have a higher level of R&D investments, when targets experience poor past performance, or when targets have higher insider ownership. These findings suggest that information asymmetries play an important role in explaining the role of geographic proximity in information-sensitive investments such as block share acquisitions. Since geographically proximate block acquirers face lower monitoring costs associated with their governance activities, our findings also suggest that such a cost advantage incentivizes them to pursue more active governance in targets, benefiting target shareholders. We also find that in-state acquirers earn higher abnormal announcement returns than do other acquirers, particularly when their targets are small.

Taken together, the results documented in this paper provide new evidence on the role of geography in facilitating governance activities and in improving target performance.

One important caveat to the above is that although our paper uses a large sample of targets in block share acquisitions to address the importance of geographic proximity in corporate governance, our sample targets represent very small publicly traded companies. This small sample bias limits our ability to generalize the paper's conclusion to other settings in which the targets involved in acquisitions are large. Thus, the important question of the link between geographic proximity and corporate governance is subject to further empirical research.

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**Table I**  
**Distribution of Partial Acquisition Activity by Year and Target Industry**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. In-state (out-of-state) acquisitions are those in which the acquirer and the target are located in the same (different) state.

Target industry (first two digits of the SIC code)	Agriculture, forestry, and fishing (01-09)		Mining and construction (10-17)		Manufacturing (20-39)		Transportation and public utilities (40-49)		Wholesale and retail trade (50-59)		Finance (60-69)		Services (70-89)		Total	
	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State	In-State	Out-of-State
1990	0	0	1	2	5	32	0	1	0	2	1	3	1	5	8	45
1991	0	0	0	3	4	16	0	0	2	4	0	1	1	11	7	35
1992	0	0	2	2	4	26	1	0	3	3	0	5	2	4	12	40
1993	1	0	1	2	2	23	2	4	1	3	0	3	0	5	7	40
1994	0	0	3	1	6	49	0	5	1	10	3	6	3	17	19	85
1995	0	1	2	9	8	45	0	1	1	7	8	11	6	20	25	94
1996	0	2	2	9	10	53	1	3	4	10	8	18	6	15	31	110
1997	0	1	1	5	5	27	0	3	7	11	3	8	6	26	22	81
1998	0	0	2	2	5	22	1	2	2	6	1	4	5	16	16	52
1999	0	1	2	2	5	23	0	3	2	7	1	1	4	19	14	56
Total	1	5	16	37	54	316	5	22	23	63	25	60	34	138	158	641

**Table II**  
**Extent of Local Bias**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. In-state (out-of-state) acquisitions are those in which the acquirer and the target are located in the same (different) state. The expected probability of being acquired by firms located in the same state is the fraction of all public firms that reside in a given state relative to all public firms in the U.S.

	Distance (kilometers)
Total sample	
Mean	1558.99
Median	1244.14
Sample of in-state block acquisitions	
Mean	92.33
Median	14.89
Sample of out-of-state acquisitions	
Mean	1920.50
Median	1661.76
The actual fraction of targets acquired by firms located in the same state (%)	
	19.77
Expected probability of being acquired by firms located in the same state (%)	
Mean	7.00
Median	5.44

**Table III**  
**Descriptive Statistics for Targets**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. In-state (out-of-state) acquisitions are those in which the acquirer and the target are located in the same (different) state. Prior stock return is measured by three-digit SIC mean industry-adjusted return for the past one year before the block acquisition. The numbers in the test-of-difference columns denote *p*-values. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Variables	Total N=799		In-State Acquisitions (A) N=158		Out-of-State Acquisitions (B) N=641		Test of Difference (A-B)	
	Mean	Median	Mean	Median	Mean	Median	<i>t</i> -test	Wilcoxon Z-test
<i>Book value of assets (millions of dollar)</i>	814.34	67.80	293.02	37.69	942.84	77.60	0.10*	0.00***
<i>Equity ownership by managers (officers and directors)</i>	0.22	0.16	0.27	0.23	0.21	0.15	0.00***	0.00***
<i>Equity ownership by other institutional investors</i>	0.27	0.23	0.19	0.14	0.29	0.25	0.00***	0.00***
<i>Equity ownership by other institutional blockholders</i>	0.12	0.09	0.09	0.07	0.12	0.09	0.00***	0.00***
<i>Leverage (total debt / market value of equity plus book value of debt)</i>	0.26	0.19	0.25	0.18	0.26	0.20	0.84	0.81
<i>Operating income / total assets</i>	-0.08	0.02	-0.12	0.01	-0.07	0.03	0.18	0.04**
<i>Prior stock return</i>	-0.00	-0.03	-0.03	-0.03	0.00	-0.04	0.43	0.42
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	1.81	1.10	1.95	1.07	1.77	1.11	0.40	0.94
<i>Age of top executive</i>	51.35	51.00	49.36	49.00	51.86	52.00	0.00***	0.01***
<i>Tenure of top executive</i>	6.13	4.00	6.23	4.00	6.10	4.00	0.85	0.93
<i>Fraction of firms with a chairman as the top executive</i>	0.60	-	0.58	-	0.60	-	0.65	-
<i>Fraction of firms with a founder as the top executive</i>	0.20	-	0.20	-	0.19	-	0.45	-
<i>Percent of shares acquired from transaction date to three years after</i>	0.13	0.08	0.15	0.09	0.12	0.08	0.00***	0.00***
<i>Standard deviation of monthly stock returns over the past five years</i>	0.18	0.16	0.18	0.17	0.17	0.16	0.46	0.32
<i>Ratio of R&amp;D expenses to total assets</i>	0.13	0.05	0.15	0.04	0.13	0.06	0.59	0.46

**Table IV**  
**Distribution of Partial Acquisition Activity by Holding Periods, Purposes of Acquisitions, Industrial Relatedness, and Types of Acquirers**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. In-state (out-of-state) acquisitions are those in which the acquirer and the target are located in the same (different) state. We classify the acquisition as control-motivated if the acquiring firm discloses in a filing of 13D that it seeks control of the target. Numbers in parentheses are the percentages of observations in each category. Numbers in the test-of-difference columns denote  $p$ -values. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Distribution by Holding Periods of Block Ownership			
Holding period	In-State Acquisitions (A)	Out-of-State Acquisitions (B)	Test of Difference (A-B)
	N=158	N=641	
Less than one year	43 (27)	284 (44)	0.00***
More than one but less than two years	27 (17)	106 (17)	0.87
More than two but less than three years	17 (11)	66 (10)	0.86
More than three years	71 (45)	185 (29)	0.00***
Panel B: Distribution by Purposes of Acquisitions, Industrial Relatedness, and Types of Acquirers			
	In-State Acquisitions (A)	Out-of-State Acquisitions (B)	Test of Difference (A-B)
	N=158	N=641	
Acquisitions with control purpose	10 (6)	29 (5)	0.35
Acquisitions in which the bidder and the target are in the same industry (at least to the first two digits of the SIC code)	29 (18)	102 (16)	0.46
Acquisitions in which acquirers are corporations	47 (30)	236 (37)	0.10*
Acquisitions in which acquirers are financial institutions	76 (48)	286 (44)	0.43
Acquisitions in which acquirers are individual investors	35 (22)	119 (19)	0.31

**Table V**  
**Frequency of Board Representation Activity and Nonroutine Top Executive Turnover in Targets by the Location of the Acquirer and the Target**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. In-state (out-of-state) acquisitions are those in which the acquirer and the target are located in the same (different) state. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. Following Denis, Denis, and Sarin (1997), we refer to turnover events in which the top executive is removed due to death, illness, or other nongovernance-related reasons over the three years from the acquisition date as routine turnover. We classify a management change as normal if the stated reason for the change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all other turnover events as nonroutine turnover. Numbers in parentheses are the percentages of observations in each category. Numbers in the test-of-difference columns denote *p*-values. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

	Total	In-State Acquisitions (A)	Out-of-State Acquisitions (B)	Test of Difference (A-B)
	N=799	N=158	N=641	
Acquirer firms that have board representation on the target's board during the block ownership holding period (up to three years after the block share purchase)	243 (30.4)	75 (47.5)	168 (26.2)	0.00***
Board representation ratio on the target's board by block acquirers (number of members of the board of directors appointed by acquirers / total number of members of the board of directors in target) during the block ownership holding period (up to three years after the block share purchase)	(7.71)	(14.0)	(6.2)	0.00***
Targets that experience nonroutine top executive turnover during the block ownership holding period (up to three years after the block share purchase)	197 (24.9)	66 (41.8)	131 (20.7)	0.00***
Targets that experience nonroutine top executive turnover for three years after the block shares purchase (regardless of acquirers' holding periods)	272 (34.4)	77 (48.7)	195 (30.8)	0.00***

**Table VI**  
**Tobit Regression Estimates of the Board Representation Ratio on Distance Variables**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. The dependent variable is the board representation ratio in targets by block acquirers (number of members of the board of directors appointed by acquirers over the three years from the acquisition date / total number of members of the board of directors in target). *p*-values are in parentheses. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>Acquirer and target are located in the same state (dummy)</i>	0.177*** (0.00)	0.123*** (0.00)					
<i>Acquirer is located within 250 miles of a target (dummy)</i>			0.097*** (0.01)	0.090*** (0.01)			
<i>Acquirer is located within 100 kilometers of a target (dummy)</i>					0.118*** (0.00)	0.075*** (0.00)	
<i>Log of distance between acquirer and target</i>							-0.021*** (0.00)
<b>Target Characteristics</b>							
<i>Log of book value of total assets</i>	-0.040*** (0.00)	-0.019** (0.03)	-0.042*** (0.00)	-0.020** (0.02)	-0.044*** (0.00)	-0.023*** (0.01)	-0.021** (0.02)
<i>Equity ownership by managers (officers and directors)</i>	0.224*** (0.00)	-0.027 (0.68)	0.236*** (0.00)	-0.030 (0.65)	0.231*** (0.00)	-0.007 (0.90)	-0.032 (0.64)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>	0.272*** (0.00)	0.081 (0.14)	0.251*** (0.00)	0.079 (0.15)	0.281*** (0.00)	0.074 (0.19)	0.075 (0.17)
<i>Operating income / total assets</i>	-0.006 (0.90)	0.060 (0.12)	-0.008 (0.87)	0.048 (0.21)	-0.006 (0.90)	0.041 (0.30)	0.049 (0.19)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	0.013** (0.05)	0.019*** (0.01)	0.014* (0.06)	0.019*** (0.00)	0.014* (0.06)	0.015*** (0.01)	0.018*** (0.01)
<b>Transaction Characteristics</b>							
<i>Holding period of block shares is longer than three years (dummy)</i>		0.166*** (0.00)		0.172*** (0.00)		0.171*** (0.00)	0.165*** (0.00)
<i>Percent of shares acquired from transaction date to three years after</i>		1.539*** (0.00)		1.568*** (0.00)		1.522*** (0.00)	1.528*** (0.00)
<i>Acquirer and target are in the same industry (dummy)</i>		-0.049 (0.16)		-0.045 (0.20)		-0.049 (0.17)	-0.052 (0.14)
<i>Acquirer is a financial institution (dummy)</i>		-0.058** (0.05)		-0.054* (0.07)		-0.054* (0.08)	-0.053*** (0.01)
<i>Acquirer is an individual investor (dummy)</i>		-0.097*** (0.01)		-0.101*** (0.01)		-0.099** (0.02)	-0.098*** (0.01)
<i>Intercept</i>	-0.188*** (0.01)	-0.330*** (0.00)	-0.178*** (0.00)	-0.336*** (0.00)	-0.167*** (0.01)	-0.324*** (0.00)	-0.161*** (0.01)
Pseudo $R^2$	0.0966	0.4371	0.0768	0.4285	0.0785	0.4201	0.4378
No. of observations	793	793	793	793	793	793	793

**Table VII**  
**Logit Regression Estimates of the Likelihood of Nonroutine Top Executive Turnover**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. Following Denis, Denis, and Sarin (1997), we refer to turnover events in which the top executive is removed due to death, illness, or other nongovernance-related reasons over the three years from the acquisition date as routine turnover. We classify a management change as normal if the stated reason for the change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all other turnover events as nonroutine turnover. The dependent variable takes the value of one if nonroutine top management turnover occurs and zero otherwise. Prior stock return is measured by three-digit SIC mean industry-adjusted return for the past one year before the block acquisition. Outsider-dominated board of directors takes the value of one if the ratio of the number of outside members of the board of directors to the total number of members of the board of directors in the target is larger than 0.5, and zero otherwise. *p*-values are in parentheses. *p*-values are estimated using robust standard errors to adjust for heteroscedasticity (White 1980) and industry clustering. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Independent variables	In-State Acquisitions (A)		Out-of-State Acquisitions (B)			Pooled Sample (A + B)			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<i>Prior stock return: a</i>	-1.376*** (0.00)	-1.496*** (0.00)	-0.543*** (0.00)	-0.503** (0.02)	-0.741*** (0.00)	-0.553*** (0.01)	-0.202 (0.45)	-0.622*** (0.00)	-2.114 (0.37)
<i>Acquirer and target are in the same state (dummy): b</i>					0.978*** (0.00)	0.927*** (0.00)	0.874*** (0.00)	0.915*** (0.00)	5.302** (0.05)
<i>Target has other institutional blockholders (dummy): c</i>							-0.083 (0.75)		
<i>Institutional ownership in target is above sample median (dummy): d</i>								-0.033 (0.90)	
<i>Target has outsider-dominated board of directors (dummy): e</i>									-2.146* (0.07)
<i>a * b</i>						-0.861** (0.05)			
<i>a * c</i>							-0.887*** (0.01)		
<i>a * d</i>								-0.397 (0.32)	
<i>a * e</i>									-8.437*** (0.01)
<b>Target Characteristics</b>									
<i>Log of book value of total assets</i>	-0.088 (0.48)	0.038 (0.81)	-0.169*** (0.01)	-0.097 (0.17)	-0.060 (0.34)	-0.061 (0.33)	-0.075 (0.28)	-0.073 (0.36)	-1.496 (0.24)
<i>Equity ownership by managers (officers and directors)</i>	0.671 (0.42)	-0.780 (0.48)	-0.402 (0.49)	-1.928*** (0.01)	-1.336** (0.03)	-1.305** (0.03)	-1.547*** (0.01)	-1.050*** (0.01)	-5.121 (0.42)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>	0.211 (0.82)	-1.073 (0.25)	0.590 (0.17)	0.010 (0.98)	-0.239 (0.59)	-0.231 (0.61)	-0.218 (0.65)	-0.272 (0.56)	-6.240 (0.38)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	0.133 (0.26)	0.121 (0.37)	-0.069 (0.21)	-0.042 (0.48)	0.004 (0.92)	0.006 (0.88)	-0.016 (0.75)	-0.014 (0.77)	1.112 (0.13)

<i>Age of top executive</i>	0.030*	0.019	0.026*	0.033**	0.030***	0.031***	0.025**	0.029***	0.152
	(0.10)	(0.38)	(0.06)	(0.02)	(0.01)	(0.01)	(0.02)	(0.01)	(0.22)
<i>Tenure of top executive</i>	0.017	-0.013	-0.005	0.001	-0.001	-0.001	-0.001	-0.0041	-0.225
	(0.40)	(0.64)	(0.80)	(0.97)	(0.99)	(0.94)	(0.94)	(0.97)	(0.39)
<i>Top executive is a chairman (dummy)</i>	-0.217	0.006	-0.453**	-0.500**	-0.322	-0.362*	-0.314	-0.317	-5.932*
	(0.54)	(0.99)	(0.03)	(0.03)	(0.11)	(0.07)	(0.12)	(0.12)	(0.06)
<i>Top executive is a founder (dummy)</i>	-0.688	-0.756	0.177	0.153	-0.048	-0.049	0.072	0.052	-1.809
	(0.13)	(0.21)	(0.40)	(0.55)	(0.84)	(0.84)	(0.76)	(0.82)	(0.45)
<b>Transaction Characteristics</b>									
<i>Holding period of block shares is longer than three years (dummy)</i>	1.483***			0.990***	1.084***	1.080***	1.066***	1.055***	6.096
	(0.00)			(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.15)
<i>Percent of shares acquired from transaction date to three years after</i>	9.453***			7.551***	7.745***	7.865***	7.689***	7.742***	-8.876*
	(0.00)			(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.07)
<i>Acquirer and target are in the same industry at least to the first two digits of the SIC code (dummy)</i>	-0.836			-0.105	-0.273	-0.685	-0.293	-0.272	2.968
	(0.17)			(0.75)	(0.35)	(0.35)	(0.33)	(0.36)	(0.38)
<i>Acquirer is a financial institution (dummy)</i>	-0.245			-0.579**	-0.448**	-0.480**	-0.477*	-0.463*	
	(0.65)			(0.04)	(0.05)	(0.04)	(0.06)	(0.07)	
<i>Acquirer is an individual investor (dummy)</i>	0.128			-0.514*	-0.335	-0.366	-0.357	-0.338	
	(0.86)			(0.10)	(0.25)	(0.21)	(0.22)	(0.25)	
<i>Intercept</i>	-1.955*	-3.078**	-1.720**	-3.057***	-3.382***	-3.399***	-2.964***	-3.156***	0.585
	(0.06)	(0.03)	(0.03)	(0.01)	(0.00)	(0.00)	(0.00)	(0.00)	(0.87)
Pseudo $R^2$	0.0948	0.2834	0.0413	0.1837	0.2144	0.2192	0.2165	0.2107	0.6326
No. of observations	155	155	633	633	788	788	753	753	75

**Table VIII**  
**Marginal Effects of Key Variables on the Likelihood of Governance Activities**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. We define the top executive as the CEO. If a firm does not have a CEO, we use the chairman of the board as the top executive. Otherwise, the top executive is defined as the president. Following Denis, Denis, and Sarin (1997), we refer to turnover events in which the top executive is removed due to death, illness, or other nongovernance-related reasons over the three years from the acquisition date as routine turnover. We classify a management change as normal if the stated reason for the change is retirement and the retiring manager is between the ages of 64 and 66. We refer to all other turnover events as nonroutine turnover. For the dummy variables, the marginal effect indicates the difference in probability between having the characteristic versus not having the characteristic. For the continuous variables, the marginal effect is evaluated at the mean of the explanatory variables and indicates the change in the probability when each independent variable changes by one unit from its sample mean. In Panel A, the logit regressions include an intercept, the log of the book value of total assets, equity ownership by managers, leverage, Tobin's  $q$ , the individual investor dummy, the financial institution dummy, and the same-industry dummy in addition to the variables reported in the table. The dependent variable takes the value of one if the acquirer has representatives on the target's board and zero otherwise. In Panel B, the logit regressions include an intercept, the log of the book value of total assets, equity ownership by managers, leverage, Tobin's  $q$ , the same-industry dummy, top executive tenure, and the chairmanship and founder dummies in addition to the variables reported in the table. The dependent variable takes the value of one if nonroutine top management turnover occurs and zero otherwise. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Panel A: The Likelihood of Board Representation by Block Acquirers			
Independent variables	(1)	(2)	(3)
<i>Acquirer and target are in the same state (dummy)</i>	0.200***		
<i>Acquirer is located within 250 miles of a target (dummy)</i>		0.116***	
<i>Acquirer is located within 100 kilometers of a target (dummy)</i>			0.106**
<i>Percent of shares acquired from transaction date to three years after</i>	2.257***	2.284***	2.274***
<i>Operating income / total assets</i>	0.036	0.024	0.027
Mean dependent variable	0.304	0.304	0.304
No. of observations	798	798	798
Panel B: The Likelihood of Nonroutine Top Executive Turnover			
Independent variables	(1)	(2)	(3)
<i>Acquirer and target are in the same state (dummy)</i>	0.184***		
<i>Acquirer is located within 250 miles of a target (dummy)</i>		0.111***	
<i>Acquirer is located within 100 kilometers of a target (dummy)</i>			0.152***
<i>Percent of shares acquired from transaction date to three years after</i>	0.984***	0.988***	0.973***
<i>Operating income / total assets</i>	-0.153**	-0.123**	-0.155***
<i>Acquirer has representatives on the target's board (dummy)</i>	0.179***	0.193***	0.193***
Mean dependent variable	0.249	0.249	0.249
No. of observations	791	791	791

**Table IX**  
**Cumulative Abnormal Returns (CARs) for Targets around the Announcement Date**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. We compute abnormal returns using the market model. We estimate the market model by using 200 trading days of return data ending 21 days before the acquisition announcement. We use the CRSP equally weighted return as a proxy for the market return. In-state (out-of-state) acquisitions are those in which the acquirer and the target are located in the same (different) state. The numbers in the test-of-difference columns denote *p*-values. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Event windows	In-State Acquisitions (A) N=158		Out-of-State Acquisitions (B) N=641		Test of Difference (A - B)	
	Mean	Median	Mean	Median	Mean	Median
CAR (-1, 0)	0.062***	0.023***	0.048***	0.020***	0.20	0.35
CAR (-1, 1)	0.093***	0.057***	0.069***	0.038***	0.09*	0.14
CAR (-5, 5)	0.126***	0.091***	0.084***	0.049***	0.03**	0.00***
CAR (-10, 10)	0.179***	0.113***	0.091***	0.070***	0.00***	0.01***
CAR (-10, -2)	0.058***	0.011***	0.035***	0.013***	0.16	0.76
CAR (2, 10)	0.028**	0.005	-0.012**	-0.015***	0.00***	0.01***
CAR (-20, -2)	0.058***	0.020**	0.053***	0.031***	0.80	0.69
CAR (2, 20)	0.022	0.001	-0.018*	-0.015**	0.03**	0.12
CAR (-20, 20)	0.173***	0.106***	0.103***	0.081***	0.06*	0.24

**Table X**  
**OLS Regression of Cumulative Abnormal Returns (-10, 10) for Targets on Explanatory Variables**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. We compute abnormal returns using the market model. We estimate the market model by using 200 trading days of return data ending 21 days before the acquisition announcement. We use the CRSP equally weighted return as a proxy for the market return. The dependent variable is cumulative abnormal returns (-10, 10) for targets. Insider-dominated board of directors takes the value of one if the ratio of the number of outside members of the board of directors to the total number of members of the board of directors in the target is smaller than or equal to 0.5, and zero otherwise. *p*-values are in parentheses. *p*-values are estimated using robust standard errors to adjust for heteroscedasticity (White 1980) and industry clustering. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

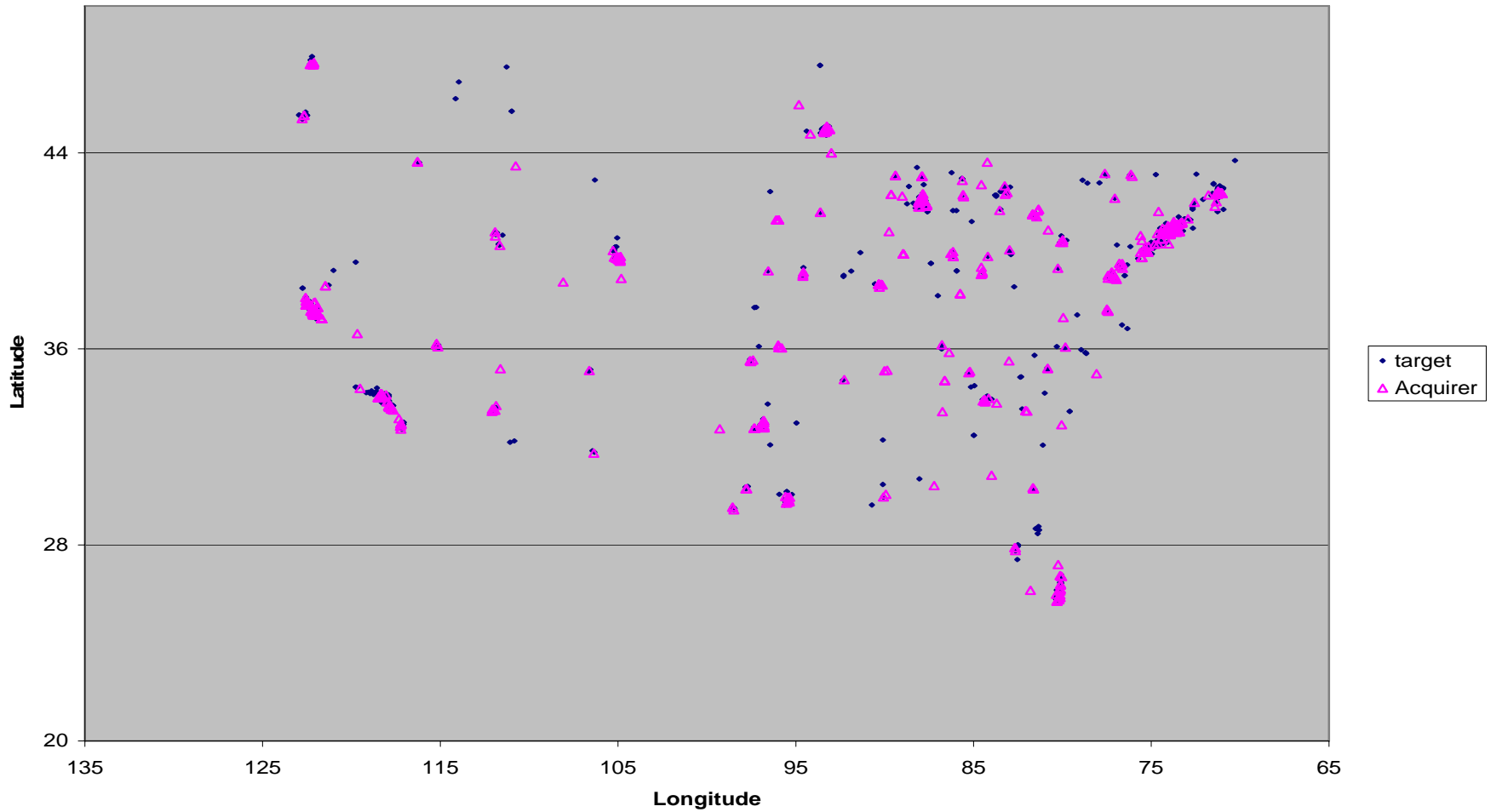
Independent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>Acquirer and target are in the same state (dummy): a</i>	0.071*** (0.01)	0.018 (0.47)	-0.010 (0.78)	-0.062 (0.29)	0.042* (0.08)	0.036 (0.16)	0.032 (0.39)	0.070** (0.02)	0.014 (0.60)	-0.046 (0.58)
<i>Target size (log of book value of total assets)</i>	-0.005 (0.52)		-0.006 (0.45)	-0.009 (0.20)	-0.009 (0.22)	-0.011 (0.17)	-0.006 (0.49)	-0.005 (0.52)	-0.005 (0.59)	-0.022 (0.20)
<i>Target size is in the bottom 25% of the sample (dummy): b</i>		-0.016 (0.67)			-0.006 (0.54)					
<i>Equity ownership by target managers is above the sample median (dummy): c</i>			0.015 (0.47)							
<i>Standard deviation of monthly stock returns over the past five years: d</i>				-0.334* (0.07)						
<i>R&amp;D expenditure / total assets: e</i>					0.062 (0.42)					
<i>Operating income / total assets: f</i>	-0.090 (0.15)	-0.089 (0.14)	-0.090 (0.15)	-0.094 (0.11)	0.027 (0.63)	0.055 (0.15)	-0.090 (0.15)	-0.090 (0.15)	-0.086 (0.20)	0.042 (0.83)
<i>Acquirer has representatives on the target's board (dummy): g</i>							-0.002 (0.95)			
<i>Acquirer and target are in the same industry at least to the first two digits of the SIC code (dummy): h</i>	0.033 (0.21)	0.037 (0.15)	0.035 (0.18)	0.032 (0.22)	0.035 (0.19)	0.036 (0.15)	0.035 (0.18)	0.031 (0.33)	0.038 (0.16)	0.122** (0.05)
<i>Institutional ownership in target is below sample median (dummy): i</i>									-0.023 (0.39)	
<i>Target has insider-dominated board of directors (dummy): j</i>										-0.064 (0.15)
<i>a * b</i>		0.188*** (0.01)								
<i>a * c</i>			0.322*** (0.00)							
<i>a * d</i>				0.718** (0.05)						
<i>a * e</i>					0.425*** (0.00)					
<i>a * f</i>						-0.353*** (0.00)				
<i>a * g</i>							0.088* (0.09)			

$a * h$								0.007 (0.92)		
$a * i$									0.088** (0.04)	
$a * j$										0.347*** (0.00)
<b>Target Characteristics</b>										
<i>Equity ownership by managers (officers and directors)</i>	0.107 (0.11)	0.103* (0.06)		0.097 (0.12)	0.095 (0.12)	0.084 (0.16)	0.103* (0.10)	0.103* (0.11)	0.057 (0.36)	0.221 (0.33)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>	0.070 (0.14)	0.068 (0.16)	0.081* (0.09)	0.077 (0.12)	0.081* (0.08)	0.070 (0.11)	0.070 (0.15)	0.070 (0.14)	0.077 (0.11)	-0.077 (0.51)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>	0.007 (0.51)	0.007 (0.53)	0.006 (0.56)	0.007 (0.51)	0.007 (0.49)	0.008 (0.44)	0.006 (0.58)	0.007 (0.51)	0.008 (0.47)	-0.017 (0.33)
<b>Transaction Characteristics</b>										
<i>Holding period of block shares is longer than three years (dummy)</i>	0.002 (0.91)	0.004 (0.83)	0.001 (0.96)	-0.001 (0.95)	0.001 (0.98)	0.007 (0.74)	-0.004 (0.83)	0.002 (0.92)	0.002 (0.99)	-0.051 (0.22)
<i>Percent of shares acquired from transaction date to three years after</i>	0.098 (0.42)	0.078 (0.53)	0.089 (0.44)	0.101 (0.40)	0.105 (0.41)	0.054 (0.66)	0.062 (0.64)	0.098 (0.43)	0.098 (0.25)	0.008 (0.96)
<i>Acquirer is a financial institution (dummy)</i>	-0.011 (0.64)	-0.012 (0.61)	-0.016 (0.50)	-0.010 (0.66)	-0.014 (0.54)	-0.017 (0.45)	-0.012 (0.62)	-0.011 (0.64)	-0.005 (0.82)	
<i>Acquirer is an individual investor (dummy)</i>	-0.056** (0.04)	-0.058** (0.04)	-0.059** (0.03)	-0.052* (0.07)	-0.070** (0.01)	-0.074*** (0.01)	-0.055** (0.05)	-0.056** (0.04)	-0.047* (0.07)	
<i>Intercept</i>	0.053 (0.38)	0.036 (0.28)	0.074 (0.22)	0.133** (0.02)	0.078 (0.19)	0.109** (0.04)	0.063 (0.30)	0.054 (0.38)	0.036 (0.40)	0.273** (0.02)
Adjusted $R^2$	0.0413	0.0540	0.0483	0.0484	0.0665	0.0919	0.0429	0.0401	0.0396	0.0901
F-value	4.12***	4.79***	4.37***	4.09***	5.37***	6.46***	3.75***	3.77***	3.41***	1.67*
No. of observations	798	798	798	798	798	798	798	798	798	76

**Table XI**  
**OLS Regression of Change in Industry-adjusted Ratio of Operating Income to Total Assets for Targets Following Block Share Purchase on Explanatory Variables**

The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm's outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm's outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands. Operating performance is measured by a three-digit industry-adjusted ratio of operating income to total assets (ROA). The dependent variable is the difference between the average of ROAs in years +1, 2, and 3 and ROA in year -1. *p*-values are in parentheses. *p*-values are estimated using robust standard errors to adjust for heteroscedasticity (White 1980) and industry clustering. The symbols \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

Independent variables	(1)	(2)	(3)	(4)	(5)	(6)
<i>Acquirer and target are in the same state (dummy): a</i>	0.053*	0.035	-0.015	-0.112***	-0.006	0.021
	(0.09)	(0.18)	(0.57)	(0.01)	(0.70)	(0.37)
<i>Target size (log of book value of total assets)</i>		0.029***		0.022***	0.024***	0.034***
		(0.00)		(0.01)	(0.00)	(0.00)
<i>Target size is in the bottom 25% of the sample (dummy): b</i>			-0.136***			
			(0.00)			
<i>Standard deviation of monthly stock returns over the past five years: c</i>				-0.524***		
				(0.00)		
<i>R&amp;D expenditure / total assets: d</i>					-0.171***	
					(0.01)	
<i>Operating income / total assets: e</i>		-0.403***	-0.393***	-0.414***	-0.345***	-0.175**
		(0.00)	(0.00)	(0.00)	(0.00)	(0.04)
<i>a * b</i>			0.171**			
			(0.04)			
<i>a * c</i>				0.806***		
				(0.00)		
<i>a * d</i>					0.519***	
					(0.00)	
<i>a * e</i>						-0.454**
						(0.00)
<b>Target Characteristics</b>						
<i>Equity ownership by managers (officers and directors)</i>		0.134***	0.089*	0.132**	0.119**	0.223***
		(0.01)	(0.06)	(0.03)	(0.03)	(0.01)
<i>Leverage (total debt / market value of equity plus book value of debt)</i>		0.130***	0.176***	0.120***	0.113***	0.155***
		(0.01)	(0.00)	(0.01)	(0.00)	(0.00)
<i>Tobin's q (market value of equity plus book value of debt / book value of total assets)</i>		0.008**	0.008*	0.008	0.010**	0.007
		(0.05)	(0.08)	(0.11)	(0.04)	(0.61)
<b>Transaction Characteristics</b>						
<i>Holding period of block shares is longer than three years (dummy)</i>		0.039**	0.037*	0.040**	0.039**	0.076***
		(0.04)	(0.06)	(0.03)	(0.02)	(0.00)
<i>Percent of shares acquired from transaction date to three years after</i>		0.034	0.009	0.059	0.005	-0.007
		(0.73)	(0.92)	(0.56)	(0.96)	(0.96)
<i>Acquirer and target are in the same industry at least to the first two digits of the SIC code (dummy)</i>		-0.026	-0.022	-0.026	-0.016	0.004
		(0.46)	(0.52)	(0.48)	(0.68)	(0.93)
<i>Acquirer is a financial institution (dummy)</i>		0.011	0.020	0.009	0.013	0.011
		(0.63)	(0.42)	(0.69)	(0.56)	(0.78)
<i>Acquirer is an individual investor (dummy)</i>		-0.009	-0.008	-0.017	-0.020	-0.030
		(0.76)	(0.79)	(0.57)	(0.47)	(0.55)
<i>Intercept</i>	-0.014	-0.270***	-0.116**	-0.145**	-0.223***	-0.174***
	(0.23)	(0.00)	(0.00)	(0.04)	(0.00)	(0.00)
Adjusted $R^2$	0.0041	0.2125	0.2180	0.2300	0.2429	0.1283
F-value	3.52***	16.11***	15.31***	15.02***	16.20***	26.56***



**Figure 1. Distribution of block acquirers and targets across the U.S.** The sample consists of 799 domestic partial block share acquisitions between 1990 and 1999. We obtain the initial sample of block share acquisitions from Thomson Financial’s Security Data Corporation (SDC) Platinum database. We first identify partial acquisitions in which the acquirers initially held less than 5% of a target firm’s outstanding shares and then purchased more than 5% but less than 50% of its outstanding shares. We then exclude from the sample deals in which the acquirer ends up with more than 50% of a target firm’s outstanding shares after the acquisition. We also exclude cases in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust and cases in which the acquirer is a group of investors, companies, individuals, or investment firms (i.e., more than one acquirer). Finally, to avoid the distance outlier effects, we exclude cases in which acquirers or targets are located in Alaska, Hawaii, Puerto Rico, or the Virgin Islands.