# Is shareholder democracy a myth? Shareholder agreements and contracting corporate control

SUSAN PERKINS*
New York University, Stern School of Business

November, 2023

**Abstract**

Agency theory often suggests that firms with "good governance" practices provide representative voting rights to equity stakes—one share, one vote. There are, however, corporate governance mechanisms that deviate from this practice to provide disproportionate control rights to certain shareholders and not others. This article elevates our understanding of shareholder agreements and the use of such contracting practices that bind together corporate control of voting, decision rights, and board of directors, defying the agency theory notion of separation between ownership and control. Such corporate governance practices are most commonly found in business group affiliated firms, firms making an IPO with founder's shares, international joint ventures, and firms with dual-class shares for which lock-in governance arrangements are the norm.

**Keywords:** Shareholder agreements, corporate governance, business groups, dual-class shares, IPOs, international joint ventures

* sperkins@stern.nyu.edu

*I am grateful for helpful feedback and suggestions from Vit Henisz and the participants of the 2019 Mitsui Symposium on Comparative Corporate Governance; the American Law and Economics Association Conference, 2016; Academy of International Business 2013 Conference, Puebla, Mexico; Academy of Management Annual Meeting, 2017; and the Strategic Management Society Conference on earlier versions of this paper. I thank Mae Morris, Igor Pereira, and the Northwestern Law School LLM/Kellogg 2010 cohort from Brazil for their dedicated research assistance and generous funding from Stanford University Library Access Grant, Robert Crown Law Library. All errors and omissions are my own.*

## INTRODUCTION

The hallmark of agency theory is shareholder democracy, represented by voting rights proportional to equity stakes, a practice commonly known as “one share, one vote” (Jensen and Meckling, 1976). In the field of strategic management, this axiomatic theoretical assumption has mostly been accepted without challenge. Over the last few decades, strategic management scholars have made great strides with increasing our understanding of the corporate governance mechanisms designed to incentivize managers (agents) to maximize the wealth of the firm for their rightful owners (principals)  (Zajac & Westphal, 1994; Walsh & Seward, 1990). However, agency theory’s presumed separation between ownership and control ignores the fundamental corporate governance notion that separation of firm ownership from managerial control is a strategic choice that is interdependent with other corporate governance decisions. Our gaze of strategic inquiry  - mainly focused on the mechanisms of governance that incentivize and monitor managers  - has largely overlooked other strategic choices outside of the bounds of the classic agency theory model. Even further, the field of strategic management offers very few answers for how these varying interdependent corporate governance choices affect firm performance.

Observing this phenomenon in practice reveals that firms’ corporate governance decisions to separate ownership and control have become less common. Recent trends in the U.S. capital markets reveal a decline in one share, one vote corporate governance practices. Fifteen percent[1] of newly listed companies offer dual-class stocks, which create disproportionate control rights to equity stakes for select shareholders. In 2020, these types of IPOs represented over 60% of the total IPO market capitalization (Council of Institutional Investors, 2021). What once were anomalies in the US capital markets—companies such as Nike and Berkshire Hathaway—have become common practice. Recent dual-class initial public offerings (IPOs) include Google (now Alphabet), Uber, Lyft, Snap, Dropbox, Facebook (now Meta) and Zoom. These U.S.

[1] The Council of Institutional Investors tracks all companies that go public on US stock exchanges; the percentage of IPOs offering dual-class stocks was 19% in 2017, 11% in 2018, and 19% in 2019 and 15% in 2020.

corporate governance trends of combined ownership with control are no longer anomalies. In fact, scholars of global corporate governance studying capital markets across 39 countries show that dual-class shares are not all that rare. Dyck & Zingales' (2004) study demonstrates that dual class shares are found at the highest rates in Italy and Brazil, 31% and 59% of listed firms respectively. From another global lens, Perkins (2019) provides descriptive data on the largest Latin American capital markets, that shows across these markets the main shareholder accounts for a majority (>50%) of the control. The concern these types of corporate governance choices raise are governance hazards such as control premiums, managerial entrenchment, and the private benefits of control (Dyck & Zingales, 2004; Morck, Wolfenzon, & Yeung, 2005; Nenova, 2003; Villalonga & Amit, 2009). These global trends that greatly deviate from agency theory reveal a blind spot in our understanding of firms' corporate governance strategic decisions (see Figure 1).

------ INSERT FIGURE 1 ABOUT HERE-------

The blind spot particular to this corporate governance context is both *why* and *under which circumstances* firms decide not to separate ownership from control as agency theory predicts. Part of the interdependent strategic decision that has not been explored are the underlying shareholder agreements that capture the relationships between firm owners. The primary aims of this paper are to (a) provide new insights on a governance mechanism, shareholder agreements, underlying corporate ownership and control and (b) distinguish where these governance contracts are most commonly found.

I propose that the firms most likely to use shareholder agreements are those making an IPO with founder's shares; business group affiliated firms; interorganizational firms such as strategic alliances and international joint venture partners, particularly those with technology transfers outside of their home country; and firms with dual-class shares. One commonality across these ownership types is a necessity to maintain corporate control. My hope is to unveil the corporate governance blind spots of agency theory and provide a new research pathway to capture the heterogeneity of firm-level corporate governance strategic decisions and their performance outcomes.

## WHAT ARE SHAREHOLDER AGREEMENTS?

What are shareholder agreements and how do they differ from the one-share, one-vote model of corporate governance? Agency theory makes three assumptions about shareholder democracy: voting rights are conferred proportionally to equity stakes; ownership shares have free transferability (which in theory makes it less relevant who any one shareholder actually is); and there is separation between ownership and control. These establish the incentives by which firms operate in Jensen and Meckling's metaphorical "black box" (1976, pp. 306-307). In practice however, shareholder agreements support quite different corporate governance incentives. These contracts regulate the relationship between select shareholders, binding their corporate governance behaviors regarding voting rights, the transferability of voting shares, and decision rights concerning who will govern the company (Mock, Csach, & Havel, 2018). Although shareholder agreements, like company bylaws, articles of incorporation, and strategic alliance contracts, are enforced by corporate and contract law, they differ from these significantly. In defiance of agency theory's premise of separation between ownership and control, shareholder agreements closely align ownership and control. In defiance of agency theory's premise of voting rights being proportional to equity stakes, shareholder agreements bind only select shareholders, giving them the power to decide what actually entails the boundaries of the firm (Coase, 1937). In fact, the primary reason shareholders create these contracts is just what it appears to be—to keep corporate control.

Like other contracts studied by strategy scholars (Argyres, Bercovitz, & Mayer, 2007; Hegde, 2014; Reuer & Ariño, 2007) —such as joint ventures, strategic alliances, licensing agreements, and technology sharing agreements—, the overarching premise is that these legally binding agreements between counterparties increases transaction efficiency (Williamson, 1973). The content of these contracts known as clauses (or provisions) provides detailed insights on firm-level strategy. Consider for example, one such shareholder agreement clause that legally tied three founders' voting rights together to allow them exclusively to control the company's direction, until their death or legal incapacitation, in which case the decision rights would be passed along to the remaining founder(s).[2] Such contract clauses that regulate governance are common in shareholder agreements with the overall intention of the controlling shareholders to maintain not just their relationships between each other, but control of the firm. To provide more helpful insights into the content of these contracts, I provide summary statistics using a unique hand-collected dataset of shareholder agreements (Perkins & Zajac, 2019). Legal scholars point out that shareholder agreements are underexplored by scholars of corporate governance because they are often created when firms are still privately held and have therefore been much less accessible to researchers (Bebchuk & Kastiel, 2017). In addition, when firms go public, the lack of regulatory requirements to disclosure these contracts make their accessibility difficult.

To move beyond these constraints, this study examines firms in an institutional context, the BOVESPA stock exchange in Brazil, where regulations mandate the disclosure of shareholder agreements to the national securities and exchange commission (Brazil Federal Law 6.404/76, Article 118, 1976)—transparency that is not required in the US. The data include 291 shareholder agreements totaling over 5,800 pages of contract clauses, representing 4,330 firm-year observations from 2000–2008. I find that shareholder agreements designed to reinforce corporate control are far more commonly used on capital markets than the agency theory conception of shareholder democracy. Over 30 percent of the publicly listed firms in our sample from Brazil used shareholder agreements designed to strategically maintain corporate control.

Table 1 provides descriptive data on the 10 most frequent clauses used in these shareholder agreements of publicly listed firms. Of the two most common, both found in 75 percent of the contracts, one is rights granted to the controlling shareholders to select the board of directors. These clauses stipulate how

[2] This example comes from the Natura Cosmetics SA shareholder agreement submitted to the Brazilian securities and exchange commission upon the firm's initial public offering in 2004.

many members each shareholder can appoint and which board positions each member will hold (such as chairman and vice-chairman). The allocation of the number of board seats is most frequently based on the percentage of voting rights. Equally common are rights of first refusal. When voting shares are being sold by a departing shareholder, other controlling shareholders have the right to purchase them in order to preserve the control block's power. This restriction to keep transferability within the circle of controlling owners reinforces the wedge between ownership classes. The third-most common provision, found in 67 percent of the contracts, is that shareholders joining the control block are bound to the terms of the exiting shareholder agreement. Another important element in two of the top five clauses is the rules governing dispute resolution. Seventy percent of the contracts have a clause to specify the legal forum and the laws to be used to adjudicate disputes. Similarly, 67 percent of the contracts specify arbitration as a remedy, providing the rules and location. These two clauses are often used in tandem, attempting first to settle disputes through nonbinding arbitration and, if shareholders still cannot resolve their differences, letting the courts become a secondary and stronger enforcement arm of the contract clauses. Though it may be expected that the controlling shareholders vote as a block, we find block voting clauses in only 50 percent of the contracts. The remaining most-frequent clauses grant decision rights to the controlling shareholders to either approve or restrict strategic actions such as mergers, acquisitions, liquidations, and changes to the corporate purpose and rightful use of the firm. Beyond these top 10 most frequent clauses, there are 71 different types of clauses in total.

--INSERT TABLE 1 ABOUT HERE—

## THEORIZING ON CORPORATE CONTROL & OWNERSHIP TYPES

Certain corporate ownership structures lend themselves to need contracts for corporate governance arrangements found in shareholder agreements. Firms with a known overlap between ownership and agency roles require greater contract specificity in the governance requirements needed to execute firm strategy.

Without such provisions, the owner-managers might lose decision rights and control of assets to other shareholders. Below, we propose which firms are most likely to need such protections in the form of shareholder agreements.

**Initial public offerings**

Often, when firms go public, the founder is still engaged in daily strategic operations and is the primary owner (Nelson, 2003), undermining separation of ownership and control. The primary governance goal then is to lock in control for long enough to ensure that the business model is imprinted and the strategic vision is fulfilled. For example, when Gol, Brazil's first low-cost airline, had its IPO in 2004, the founders and controlling shareholders created a shareholder agreement that specified a "locked-up [agreement] for a period of twelve months following the date of the public offering" to ensure that the CEO, who was also the board chairman and main shareholder, remained in all three roles (Gol Shareholder Agreement, Clause 28.2, 2004)[3]. Another objective of IPOs is to ensure, by restricting the free transferability of shares, that the founders collectively maintain ownership and thus decision rights. In Gol's case, the transferability restriction clause specified that "each shareholder undertakes not to transfer its shares, in whole or in part" (Gol Shareholder Agreement, Clause 9) to limit other shareholders from penetrating the control block. Nelson (2003) shows that founders are often an organization's longest-tenured managers. One mechanism that legally binds the founder-firm relationship is to specify the governance terms in the shareholder agreement. Gol's agreement states that the contract "shall remain valid until the earlier of the occurrence of a qualified public offering or a 20-year period" (Gol Shareholder Agreement, Clause 53, 2004). Such "sunset clauses" guarantee that the founding leadership is there to guide the firm's strategic direction.

**Proposition 1.** *Initial public offerings (IPOs) are more likely than seasoned equity offerings (SEOs) to use shareholder agreements to maintain corporate control*.

[3] All clauses referenced are available in the appendix.

**Business-group–affiliated firms**

Business groups are a ubiquitous ownership form globally and perhaps most infamous for their "parasitic" potential for expropriation schemes (Khanna & Yafeh, 2007; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1999; Perkins, Morck, & Yeung, 2014). These conspicuous ownership structures behave differently than the conventional widely-held standalone firms depicted by Jensen and Meckling (1976), due to, among other things, highly concentrated ownership and the overlapping roles of the owners, board members, and mangers (Lazzarini, 2011). Zingales (1994) suggests that the primary driver of their behavior is desire for the private benefits of control. Khanna and Rivkin (2001) suggest that group firms can overcome insufficient jurisprudential development by constructing loose intra-group regulatory schemes and imposing internal sanctions for opportunism among affiliates. Shareholder agreements are often used by business groups, especially those with pyramid structures, to legally tie together several listed and unlisted firms controlled, directly or indirectly, by the apex firm. This ownership chain allows the controlling owner(s) of the apex firm to maximally leverage their capital by disproportionately distributing it in a downward net of listed firms that draw in minority shareholders, while exposing the ultimate owner to minimal risk (La Porta et al., 1999). For example, the shareholder agreement of Ripasa, one of the largest paper and pulp companies in Brazil, stated that the sole purpose of the contract was to bind together voting control of the three family-owned business groups holding the controlling shares into a single holding company, which had direct control of the publicly listed firm Ripasa and indirect control of its four subsidiaries (Ripasa Shareholder Agreement, Clauses 4 and 8.1.2, 1993).

Ultimately, for firms at the bottom of the business group pyramid structure, if the owner at the apex has a perplexingly negligible share of cash-flow rights, the opportunities for expropriation of minority shareholders are ripe (Bebchuk, Kraakman, & Triantis, 2000). The controlling owner can benefit from private gains by such means as (a) engaging the firm in suboptimal transactions that afford preferential terms to other companies that he or she owns, (b) employing related parties within the firm and rewarding them with excessive compensation and perks, (c) siphoning information and assets to related companies within the pyramid, or (d) using the company as a guarantor for other related companies—opportunistic practices collectively known as "tunneling" (Bae, Kang, & Kim., 2002; Joh, 2003; Johnson, Lopez-de-Salines, & Shleifer, 2000). Shareholder agreements can mitigate tunneling by restricting the use of third-party transitions, by offering assurances of tagalong rights to minority shareholders lacking both decision rights and voting control or by restricting the firm from being used as a source of outside collateral. For example, the shareholder agreement for Pão de Açúcar, Brazil's largest grocery chain, gives minority shareholders the "option to tag along" and sell their shares at the same price offered to the majority shareholder should a third-party offer arise (Clause 12.1, 1999). Tagalong clauses are designed as anti-tunneling assurances, usually for minority shareholders, so that the majority shareholder will not sell shares to a third party at favorable terms to the majority shareholders as a way to siphon off profits from the minority shareholders. Other anti-tunneling clauses combat self-dealing and mitigate expropriation of minority shareholders. Pão de Açúcar's shareholder agreement grants veto rights to the minority-appointed board member for any corporate decision related to guarantees or liens on company assets (Clause 9.5). Such contract clauses directly combat self-dealing through tunneling.

**Proposition 2.** *Business groups are more likely than other corporate ownership types to use shareholder agreements to maintain both direct and indirect control.*

## International joint ventures

Interfirm collaborations such as international joint ventures (IJVs) allow firms to strategically acquire new customers and to gain access to natural resources, new knowledge combinations, and often new technologies by competing globally (Harrigan, 1988; Khan, Lew, & Sinkovics, 2015; Lane, Salk, & Lyles, 2001; Tsang, 2002). However, these gains do not come without risks; IJVs have high failure rates, largely driven by the difficulty of finding the right balance amongst the partners (Franko, 1971; Makino, Chan, Isobe, & Beamish, 2007; Merchant, 2014; Reuer, & Koza, 2000). By collaborating with a local firm that already has a powerful presence in an unfamiliar market, a foreign firm can mitigate its exposure to so-called "liability of foreignness" (Zaheer, 1995; Zaheer & Mosakowski, 1997). However, such partnerships often expose the foreign firm to unanticipated corporate governance risks (Perkins, Morck, & Yeung, 2014; Reuer, Klijn, van den Bosch, & Volberda, 2011). Perkins et al. (2014), for example, show that IJVs that do not strategically mitigate the corporate governance and ownership structure differences amongst their IJV partners are more likely to fail. Luo (2002) argues that successful IJVs must focus both on ongoing cooperation between partners and contract specificity that preempts partnership dilemmas. Shareholder agreements, different and separate from joint venture agreements, are a governance mechanism to address such concerns directly by assigning shared corporate control amongst joint venture partners. For example, the shareholder agreement for an IJV involving Arcelor Mittal, one of the world's largest steel producers, included clauses solidifying its role on the IJV's governing board and specifying how, when, and where conflicts would be mitigated. Clause 2.1 states that "[t]he Board of Directors of Acesita [the IJV] shall be composed of up to eleven members [of which] four directors shall be appointed by Arcelor, being one of them the Vice-Chairman of the Board," while Clause 8.0 states that "[t]he parties hereto agree that any dispute resulting from this [agreement] shall be resolved by arbitration in the city of Rio de Janeiro, RJ, according to the Rules of Conciliation and Arbitration of the International Chamber of Commerce (ICC, Paris, France)" (Acesita Shareholder Agreement, 2005).

**Proposition 3.** *International joint ventures are more likely than other corporate ownership types to use shareholder agreements to maintain corporate control.*

**Dual-class shares**

Firms with dual-class shares already have a legal obligation to honor the disproportions in voting rights assigned to each stock-listing class. Dual-class shares, on the rise in the US, are common in many capital markets around the world (Bebchuk, Kraakman, & Triantis, 2000; Dyck & Zingales, 2004; Nenova, 2003). In Brazil, for example, over 47% of companies listed on the BOVESPA have offered dual-class shares, where common shares confer voting rights while preferred shares do not (admittedly counterintuitive). But beyond these explicit differences between owner classes, the more naïve observer typically doesn't know who has rights to own the voting-class shares and whether those owners will vote collectively. Shareholder agreements can provide specificity on these related questions. For example, the shareholder agreement of Ambev, Brazil's largest brewery and soft drink company, requires shareholders to vote as a block: "Each shareholder undertakes their right to exercise their vote at the shareholders meetings …in single block with the other shareholder" (Ambev Shareholder Agreement, Clause 5.5.1, 1999).

Shareholder agreements also offer provisions such as anti-freeze-out and anti-squeeze-out clauses to alleviate minority or nonvoting shareholder expropriation risks. Ambev's agreement specifies that any change to the dividend payout plans requires the approval of both the minority and majority shareholder (Ambev Shareholder Agreement, Clause 5.4, 1999). A freeze-out generally occurs when a majority uses its voting power to force a merger with a separately controlled company under terms which require the minority shareholders to sell their shares for an unfairly low price. A squeeze-out results when a majority uses its voting power to strip minority shareholders of any possible return on their investments and force them to sell their shares back to the majority for an unreasonably low price. For example, the majority might direct the board to declare little or no dividends, depriving the minority of income from their ownership stakes, while paying the majority and their affiliates high salaries. Ambev's shareholder agreement includes liquidation, dissolution, and shareholder dilution clauses to protect either of the controlling owners from being squeezed out. These governance concerns are exacerbated in firms with dual-class shares.

**Proposition 4.** *Dual-class stock firms are more likely than one-share, one-vote firms to use shareholder agreements to maintain corporate control.*

## LIKELIHOOD OF CONTRACTED CORPORATE CONTROL

To identify which public firms did and did not have shareholder agreements, we first obtained the annual disclosures to the Brazilian securities and exchange commission (Comissão de Valores Mobiliários

(CVM)) of each listed firm during the time of this study and recorded whether the firm had any contracts on file for each firm-year. The disclosure regulation requires that all listed firms submit new shareholder agreements, amendments to the existing shareholder agreement, and cancelations. Three hundred and forty-six shareholder agreements were collected. Fifty-five were excluded from the contract clause analysis because the IPO was beyond the scope of this study (13%), the submitted disclosure was a cancelation (e.g., termination agreements) (5.5 %), or the disclosure was a duplicate of a contract disclosed in a previous year (81.5%). The remaining 291 shareholder agreements were included in the analysis. These disclosed contracts were from 169 listed firms (see Table 2), which make up 48 percent of the 352 firms listed on the BOVESPA. On average, each firm filed 1.8 contracts. Forty-nine percent of the firms with shareholder agreement specified a contract duration ranging from 10 to 20 years. Contracts that did not specify a term remain—according to the law—enforceable for the life of the firm. The sample includes 4,337 firm-year observations. Firm-level data were also collected from Economatica, CVM ITR, and Valor Economico Grandes Grupos.

--INSERT TABLE 2 ABOUT HERE—

The goal is to understand what contract clauses firms are using strategically to maintain corporate control and which ownership types are most likely to use shareholder agreements.

To identify the ownership type and corporate governance characteristics for each publicly listed firm, we assessed each of the controlling shareholders listed as signatories in the shareholder agreement and triangulated this data with the Economatica stock class and shareholders database and the Grandes Grupos list of Brazil's largest business groups to determine whether the firm is an IPO, a dual-class shares firm, a business-group–affiliated firm, or an international joint venture. An indicator variable (0/1) is created for each type. Control variables at the firm-year level are included for firm size (using sales revenues as a proxy), whether the firm is family owned (Anderson & Reeb, 2004; Villalonga & Amit, 2006, 2009), geographic distance from the home country if one of the controlling shareholders is a foreign entity, control premiums (Dyck & Zingales, 2004; Nenova, 2003), and whether or not the firm adopted a BOVESPA corporate governance reform (e.g., Novo Mercado, Level 1 or 2). I use logistic regression to determine the likelihood of whether a firm has a contractually binding shareholder agreement , for each firm-year observation.

**RESULTS**

Table 3 provides results for Propositions 1-4. The logit regression results for each governance structure provide the likelihood that shareholder agreements are used more frequently by that ownership type, compared to other listed firm ownership types. Accounting for firm-level corporate governance and ownership controls and industry fixed effects tested in Model 1, Model 2 reveals that IPOs are significantly more likely than SEOs to use shareholder agreements, which supports Proposition 1. This supports the notion that shareholder agreements are a frequently used governance mechanism for younger firms with founder-owners seeking to lock in their control. Model 3 supports Proposition 2 that business-group–affiliated firms are more likely than non-business group firms to use shareholder agreements. Model 4 supports Proposition 3 that international joint ventures are more likely than all other firm ownership types to use shareholder agreements. Model 5 supports Proposition 4 that dual-class stock firms are more likely than one-share, one-vote firms to use shareholder agreements to maintain corporate control.  When comparing the marginal effects of the four ownership types, Figure 2 shows that  international joint ventures,, by far, are the ownership  type most likely to use a shareholder agreement. Overall, these results suggests that there is variation in firms’ motivation to seek corporate governance strategies to lock in long-term corporate control.

--INSERT FIGURE 2 &TABLE 3 ABOUT HERE—

**DISCUSSION AND CONCLUSION**

*Shareholder agreements and contracting corporate control*

This study explored how shareholder agreements are used as a corporate governance mechanism to contractually help the controlling shareholders maintain control. The corporate governance view of shareholder democracy—one share, one vote—has limited ability to explain the governance mechanisms incentivized by many corporate ownership types; namely, IPOs, firms with business-group affiliations, international joint ventures, and firms with dual-class shares. This study opens a black box—the rarely studied content of strategic contracts—by analyzing specific corporate governance clauses. It sheds light on how firms can use contracts strategically to reinforce corporate control.

The implications of this governance mechanism are many. First, understanding how controlling shareholders protect their voting and decision rights can help us understand why strategic alliances have such high failure rates. My findings also suggest that when alliance partners have different governance incentives, there is a greater need for such contracts to design the best governance practices and incentive structures amongst differing shareholders. Those firms that do not recognize the use of shareholder agreements as a safeguard against shareholder conflict are more susceptible to expropriation schemes of non-transparent controlling shareholders or even hostile takeovers or creeping takeovers from well-coordinated and aligned controlling shareholders prepared to leverage their power in the market. The corporate ownership and governance strategies in these contract help provide strategic clarity on where the wealth maximizing incentives are aligned. Future research opportunities for scholars studying strategic alliances, mergers and acquisitions could explore specific shareholder clauses such as anti-freeze-outs, anti-tunneling or proxy voting rights (see Appendix for a full list of clauses) to better predict the success and failure of certain types of M&A deals.

Second, the implication for IPOs is that shareholder agreements allow for tractability on how long founders have a contractual obligation to stay with the firm. Examining these disclosures allows a deeper understanding of the effect of the founder's presence on a firm's productivity and value. Shareholder agreements can be a useful lens onto an understudied phenomenon—the duration of sunset clauses. Future studies examining the founder's participation in firm governance might therefore do well to examine the strategic use of shareholder agreements.

Finally, this study provides insight on the mechanism that binds business groups. Prior explanations mainly focus on the social ties, such as family, that bind pyramids; this study shows that legal ties may be just as significant. Business groups that use shareholder agreements defy our understanding of the definition of business groups; that is, that each member is a separate legal entity and that the ties that bind them are social (Granovetter, 1994; Khanna & Rivkin, 2001). Further research could trace the use of contracts throughout the business group structure to explore whether social and legal ties exert different influences. Future studies could examine more deeply the mechanisms of corporate governance and ownership structure to more clearly unpack their influence on firm performance.

As a field, we must reconcile how shareholder agreements shape corporate governance, ownership structure, and the boundaries of the firm. Each of these contractual terms provides greater insight on the strategic decision making process of the firm (Leiblein, Reuer, & Zenger, 2018). Understanding the incentives that motivate controlling shareholders increases our understanding of how governance decisions shape corporate strategy.

**REFERENCES**


Anderson, R.C. & Reeb, D.M. 2003. Founding-Family Ownership and Firm Performance: Evidence from the S&P 500, *Journal of Finance*, 58: 1301-1328.

Argyres, N.A., Bercovitz, J, & Mayer, K.J. (2007). Complementarity and evolution of contractual provisions: An empirical study of information technology services contracts. *Organization Science*, 18: 3-19.

Bae, K., Kang, J. & Kim, J. (2002). Tunneling or Value Added? Evidence from Mergers by Korean Business Groups, *Journal of Finance*, 57(6): 2695-2741.

Bebchuk, L. A. & Kastiel, K. (2017). The Untenable Case for Perpetual Dual-Class Stock (April 18, 2017). *Virginia Law Review*, 103: 585-631.

Bebchuk, L. A., R. Kraakman, & Triantis, G. G. (2000). Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights, in *Concentrated Corporate Ownership*, ed. R. K. Morck. NBER, University of Chicago Press, 295-315.

Bertrand, M., P. Mehtra, & Mullainathan, S. (2002). Ferreting Out Tunneling: An Application to Indian Business Groups, *Quarterly Journal of Economics*, 117(1): 121-48.

Claessens, S., S. Djankov, J. Fan, & Lang, L. (1999). The Rationale for Groups: Evidence from East Asia, unpublished manuscript, The World Bank.

Coase, R.H. (1937). The Nature of the Firm. *Economica*, 4: 386-405.

Council of Institutional Investors (2021). Dual-Class IPO Snapshot: 2017–2020 Statistics, *2020 IPO Update*, Washington, D.C.

Dyck, A., & Zingales, L. 2004. Private Benefits of Control: An International Comparison, *Journal of Finance*, 59(2): 537-600.

Franko, L. (1971). *Joint venture survival in the multinational corporation*, New York, NY: Praeger Publishers.

Granovetter, M., (1994). *Business Groups* in Handbook of Economic Sociology, Princeton University Press.

Hambrick, D.C. & Finkelstein, S. (1995), The effects of ownership structure on conditions at the top: The case of CEO pay raises. *Strategic Management Journal*, 16: 175-193.

Hegde, D. (2014). Tacit Knowledge and the Structure of License Contracts: Evidence from the Biomedical Industry. *Journal of Economics & Management Strategy*, 23: 568-600.

Jensen, M. C. & Meckling, W. H., (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure, *Journal of Financial Economics*, 3(4), pages 305-360.

Joh, S. W. (2003). Corporate governance and firm profitability: Evidence from Korea before the economic crisis, *Journal of Financial Economics*, 68(2): 287-322.

Johnson, S., F. Lopez-de-Salines, & Shleifer, A. (2000). Tunneling, *American Economic Review*, 90(2), 22-27.

Heifer, A. & Vishnu, R. W. (1997). A Survey of corporate governance. *Journal of Finance*, 52(2): 737-83.

Khan, Z., Lew, Y. K., & Sinkovics, R. R. (2015). International joint ventures as boundary spanners: technological knowledge transfer in an emerging economy. *Global Strategy Journal*, 5(1), 48-68.

Khanna,T. and Rivkin, J. (2001). Estimating the Performance Effects of Business Groups in Emerging Markets, *Strategic Management Journal*, 22(1): 25-74.

Khanna, T. & Yafeh, Y. (2007). Business groups in emerging markets: paragons or parasites?, *Journal of Economic Literature*, XLV:331–372.

Lane, P. J., Salk, J. E., & Lyles, M. A. (2001). Absorptive capacity, learning, and performance in international joint ventures, *Strategic Management Journal*, 22(12), 1139-1161.

La Porta, R., F. Lopez-de-Silanes, A. Shleifer, & Vishny, R. (1999). Corporate ownership around the world, *Journal of Finance,* 54, pp. 471-517.

Lazzarini, S.G. 2011. ***Capitalismo de laços: Os donos do Brasil e suas conexões.*** Rio de Janeiro: Elsevier.

Leiblein, M., Reuer, J. & Zenger, T. (2018). What makes a decision strategic?, *Strategy Science*, 3(4): 558-573.

Luo, Y. (2002). Contract, cooperation, and performance in international joint ventures, *Strategic Management Journal*, 23(10), 903-919.

Mock, S., Csach, K., & Havel, B. (Eds.). (2018). International Handbook on Shareholders´ Agreements. Berlin, Boston: De Gruyter.

Makino S, Chan C, Isobe T, Beamish, P. (2007). Intended and unintended termination of international joint ventures. *Strategic Management Journal*, 28(11): 1113–1132.

Merchant, H. (2014). Configurations of governance structure, generic strategy, and firm size: Opening the black box of value creation in international joint ventures. *Global Strategy Journal*, 4(4), 292-309.

Morck, R., D. Wolfenzon, & Yeung, B. (2005). Corporate governance, economic entrenchment and growth, *Journal of Economic Literature*, 43(3):655.

Nelson, T. 2003. The persistence of founder influence: management, ownership, and performance effects at initial public offering. *Strategic Management Journal*, 24: 707-724.

Nenova, T. (2003). The value of corporate voting rights and control: A cross-country analysis, *Journal of Financial Economics*, 68(3): 325-351.

Perkins, S. (2019). The Dominance of Pyramidal Business Groups in Latin America Persist, AIB Insights, 19(2).

Perkins, S., Morck, R., & Yeung, B. (2014). Innocents abroad: The hazards of international joint ventures with pyramidal group firms. *Global Strategy Journal*, 4(4): 310-330.

Perkins, S., Zajac, E. (2019) Fit to Be Tied: Using Contracts Strategically to Ensure Partner Performance, *working paper*.

Reuer, J., & Ariño, A. (2007). Strategic alliance contracts: Dimensions and determinants of contractual complexity. *Strategic Management Journal*, 28(3), 313-330.

Reuer, J.J., Klijn, E., van den Bosch, F.A. and Volberda, H.W. (2011). Bringing corporate governance to international joint ventures. *Global Strategy Journal*, 1: 54-66.

Reuer, J. J., & Koza, M. P. (2000). Asymmetric information and joint venture performance: Theory and evidence for domestic and international joint ventures. *Strategic Management Journal*, 21(1), 81-88.

Tsang, E. W. (2002). Acquiring knowledge by foreign partners from international joint ventures in a transition economy: learning-by-doing and learning myopia, *Strategic Management Journal*, 23(9), 835-854.

Villalonga, B., & Amit, R. 2006. How do family ownership, control, and management affect firm value? ***Journal of Financial Economics,*** 80: 385-417.

Villalonga, B., & Amit, R. 2009. How are U.S. family firms controlled? ***Review of Financial Studies,*** 22(8): 3047–3091.

Walsh, James P.; Seward, James K. Academy of Management Review. Jul1990, Vol. 15 Issue 3, p421-458.

Williamson, O. 1973. Markets and Hierarchies: Some Elementary Considerations, *The American Economic Review*, 63(2): 316-325.

Zaheer, S. (1995). Overcoming the liability of foreignness. *Academy of Management Journal* 38(2): 341-363.

Zaheer S, & Mosakowski, E. (1997). The dynamics of the liability of foreignness. *Strategic Management Journal* 18(6): 439-464.

Zajac, E.J., & Westphal, J.D. 1994. The costs and benefits of managerial incentives and monitoring in the largest U.S. corporations: When is more not better? ***Strategic Management Journal,*** 15: 121-142.

Zingales, L. 1994. The value of the voting right — A study of the Milan stock-exchange experience. Review of Financial Studies, 7(1): 125–148.

**Figure 1**

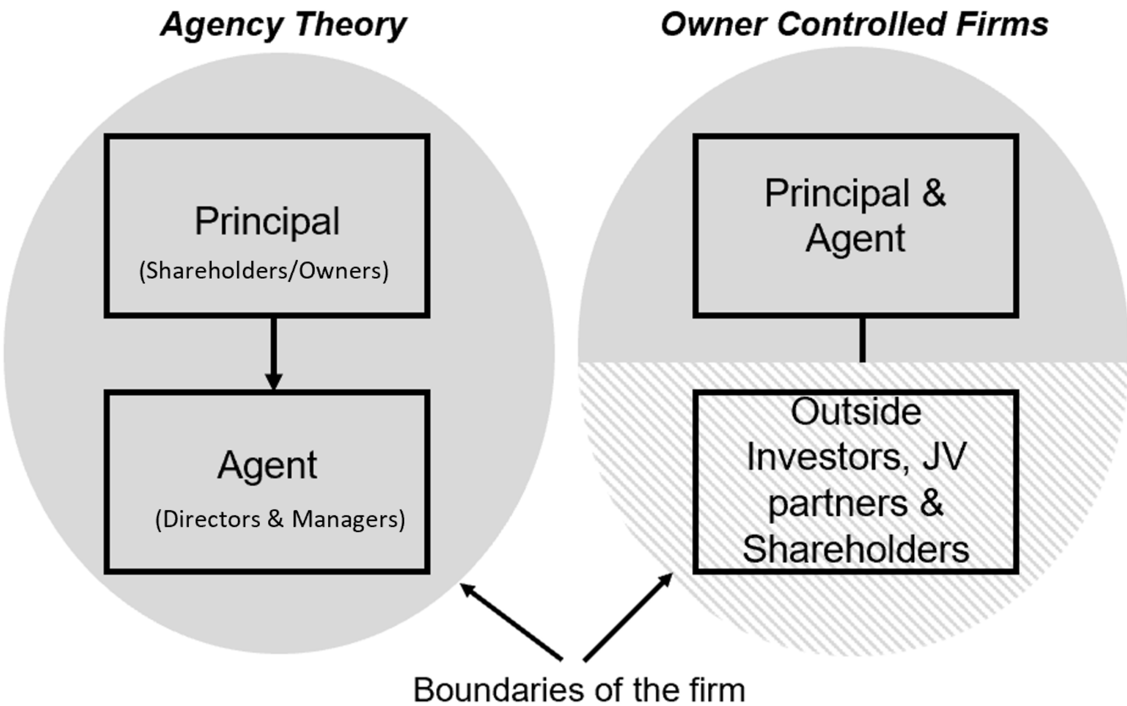


**Figure 2**

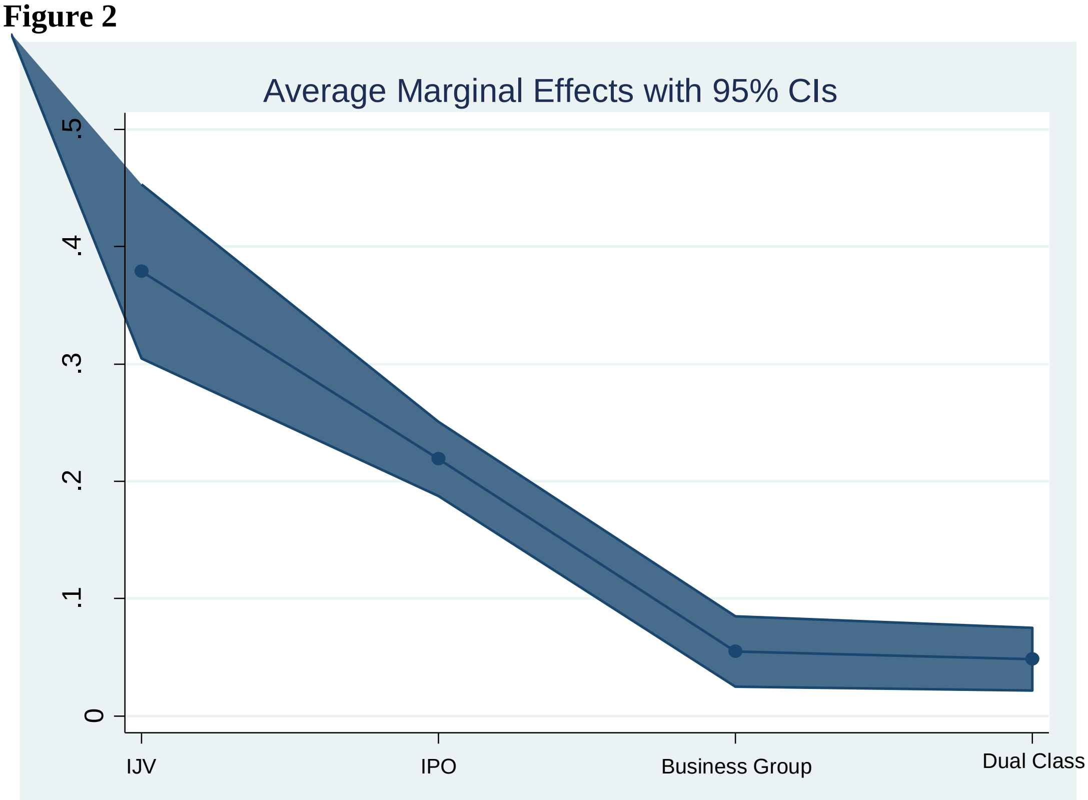

**Table 1.** Most Commonly Used Contract Clauses

| Clause Type | Description | Percent of Contracts Containing Clause |
|---|---|---|
| **Board of Directors Appointments** | Clauses granting specific shareholders decision rights to appoint board members to represent their interests. | 75% |
| **Right of First Refusal on Shares Sold** | Clauses granting rights to the control block voting shareholders to purchase the shares of exiting shareholders. | 75% |
| **Law Forum Selection** | Clauses specifying the courts and location where shareholder disputes will be adjudicated. | 70% |
| **Binds Shares Later Acquired to the Shareholder Agreement** | Clauses guaranteeing future voting shares acquired by existing shareholders will also be bound to the terms of the contract. | 67% |
| **Dispute Resolution through Arbitration** | Clauses that specify dispute resolution procedures for arbitration, including arbitration rules and/or jurisdiction. | 67% |
| **Mergers and Reorganizations** | Clauses requiring approval of mergers or reorganization of the control structure. | 54% |
| **Acquisition/Sale of Assets** | Clauses concerning approval processes/policies for the firm's acquisition of assets, including property and technology. | 51% |
| **Block Voting Rules** | Clauses committing the shareholders to vote as one voice in company meetings. | 50% |
| **Approval for Dissolution or Liquidation of the Company/Subsidiaries** | Clauses concerning the approval processes/policies for liquidating or dissolving the company or any of its subsidiaries, including liquidation rights. | 50% |
| **Approval for Changing the Corporate Purpose** | Clauses requiring approval before changes can be made to the corporate purpose or business mission. | 49% |

**Table 2.** Shareholder Agreements of Listed Firms on the BOVESPA

| **Contracts** | **Frequency** | **Length** | **Duration** |
|---|---|---|---|
| Initial Shareholder Agreement | 169 | 22 | 10-25 years (average) |
| First Amendment or new shareholder agreement | 69 | 12 | |
| Second Amendment | 28 | 17 | |
| Third Amendment | 15 | 24 | |
| Fourth Amendment or greater* | 10 | 10 | |
| Total | 291 | 5,840 | |

*Note: Maximum is 8 amendments

**Table 3.** Logit Regression - Shareholder Agreements By Ownership Type

| Variables | Model 1 Controls | Model 2 H1 | Model 3 H2 | Model 4 H3 | Model 5 H4 |
|---|---|---|---|---|---|
| Sales Revenue - (log) | 0.146*** | 0.172*** | 0.171*** | 0.163*** | 0.152*** |
| | (0.013) | (0.015) | (0.015) | (0.015) | (0.015) |
| Geographic Distance | 0.000 | -0.000 | -0.000 | -0.000*** | -0.000*** |
| | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |
| Control Premium | 0.014 | -0.002 | 0.012 | 0.018 | 0.022 |
| | (0.074) | (0.080) | (0.080) | (0.081) | (0.077) |
| Family (Main Shareholder) | 0.135 | 0.197 | 0.119 | -0.072 | -0.088 |
| | (0.101) | (0.104) | (0.107) | (0.109) | (0.109) |
| Adopted Corporate Governance Reform | 0.748*** | 0.192 | 0.184 | 0.193 | 0.169 |
| | (0.169) | (0.180) | (0.181) | (0.181) | (0.181) |
| **IPO** | | 1.278*** | 1.313*** | 1.372*** | 1.501*** |
| | | (0.111) | (0.111) | (0.112) | (0.118) |
| **Business Group Affiliated** | | | 0.324** | 0.367*** | 0.375*** |
| | | | (0.105) | (0.106) | (0.106) |
| **International Joint Ventures** | | | | 2.546*** | 2.594*** |
| | | | | (0.270) | (0.270) |
| **Dual-Class Shares - ON/PN** | | | | | 0.330*** |
| | | | | | (0.094) |
| Constant | -2.711*** | -3.606*** | -3.633*** | -3.430*** | -3.501*** |
| | (0.437) | (0.456) | (0.453) | (0.454) | (0.451) |
| Observations | 4367 | 4337 | 4337 | 4337 | 4337 |
| Pseudo R-Sqrd | 0.102 | 0.149 | 0.151 | 0.173 | 0.175 |

Source: CVM,Brazil, 2000-2008
Industry fixed effects included but not reported.

**APPENDIX. Clauses that Maintain Corporate Control**

| CLAUSE TYPE | DESCRIPTION |
|---|---|
| **1. Block Voting Provisions** | Clauses committing the signing shareholders to vote as one voice in company meetings. |
| **2. Linking Obligations to Shares** | Clauses that attach the obligations of the shareholder contract to the shares themselves so that obligations transfer with shares before acquiring the shares of signatories. |
| **3. Linking Obligations to Third Party Shares** | Clauses that attach the obligations of the shareholder contract to require third parties to sign the agreement before acquiring the shares of signatories. |
| **4. Drag Along** | Clauses allowing the majority to force the minority to sell their shares along with the majority's shares. |
| **5. Purpose Statements of Intent to Maintain or Create Control** | Clauses that provide the purpose of a shareholder agreement is to unite disparate shareholders to create a controlling voice. |
| **6. Purpose Statements of Intent to Control Another Company** | Clauses that explicitly states the purpose of the agreement is to maintain control of another company. |
| **7. Lock up Period** | Clauses preventing the shareholders from selling their shares for some duration of time after the contract is signed, freezing the shareholder coalition in its current form. |
| **8. Restrictions on Outside Buying** | Clauses that restrict shareholders' ability to acquire additional shares from parties outside the agreement. |
| **9. Restrictions on Outside Selling** | Clauses limiting shareholders' ability to sell their shares to parties outside of the agreement. |
| **10. Right of First Refusal on Shares Sold** | Clauses granting first in line rights to the control block voting shareholders to purchase the shares of exiting shareholders |
| **11. Right of First Refusal on Newly Issued Shares** | Clauses granting first in line rights to the control block voting shareholders to purchase any newly issues shares |
| **12. Rights Depend on Keeping a Percentage of the Company** | Clauses granting special shareholder rights based upon the percentage ownership of the company, usually granted to the largest shareholder |
| **13. Majority Favoring Options** | Clauses usually granting the majority shareholder put and/or call options to transfer share. |
| **14. Binds Shares Later Acquired to the Shareholder Agreement** | Clauses guaranteeing future voting shares acquired by existing shareholders will also be bound to the terms of the contract. |
| **15. Guarantee or Collateral Restrictions** | Clauses restricting the use of shares as a guarantee or collateral. |
| **16. Termination on Bankruptcy** | Clauses that force sale of shares upon change of control from bankruptcy |
| **17. Termination Agreement** | Clauses that force sale of shares if the shareholder agreement is not renewed. |
| **18. Super voting rights** | Clauses that give select shareholders multiplicative voting power in proportion to the actual number of voting shares. |

**Tunneling Protection Clauses**

| CLAUSE TYPE | DESCRIPTION |
|---|---|
| **19. Approval for Corporate Redemptions** | Clauses concerning the approval processes/policies for corporate redemptions or for the company buying back the shares of any shareholder. |
| **20. Approval for Loans to Related Companies** | Clauses concerning the approval processes/policies for loans to 'related' companies. Related companies are those controlled directly or indirectly by any shareholder, member of management, or director of a company. |
| **21. Approval for Remuneration of the Board or Management** | Clauses concerning approval processes/policies for all forms of remuneration of the company's management or board, including --while not limited to -- salary, grants of stock, and bonuses. |
| **22. Approval for Contracts with Related Companies** | Clauses concerning the approval processes/policies for contracts 'related' companies. These contracts may be for a distinct, one-time transaction or for a more prolonged transaction as, for example, an ongoing supply contract. |
| **23. Approval for Distribution of Special Dividends** | Clauses concerning approval processes/policies regarding the issuance of special dividends (dividends in addition to the regular quarterly or annually issued dividends provided in the corporate bylaws). |
| **24. Approval for Using the Company as Collateral or as a Guarantor** | Clauses concerning approval processes/policies governing the management or controller's use of the company to serve as collateral for a loan, or agreeing to serve as guarantor of a loan to an owner, member of management, or related company. |
| **25.Approval for the Company's Assumption of Debt** | Clauses concerning approval processes/policies for the company's assumption of debt. This includes cases where the company assumes debt on its own behalf or acquires the debt of a related party or company. |
| **26. Say on Granting Options** | Clauses concerning approval processes/policies for the company's granting of options to buy stock to any party. |
| **27. Approval for the Acquisition of Assets** | Clauses concerning approval processes/policies for the company's acquisition of assets, including – while not limited to – all forms of property and technology. |
| **28. Approval for Sale of Assets** | Clauses concerning approval processes/policies for the company's sale of its assets, including – while not limited to – all forms of property and technology. |
| **29. Approval for Buying of Selling Shares of Other Companies through the Company** | Clauses concerning approval for the company's participation – including the buying or selling of stock -- in other companies or subsidiaries. These clauses include those governing the company in obtaining or surrendering control of another company. |
| **30. Tag Along Rights** | Clauses providing shareholders, usually the minorities, the right to receive the same deal when shares are sold by the controlling owner, a.k.a. co-sale rights. |

**Freeze Out Protection Clauses**

| CLAUSE TYPE | DESCRIPTION |
|---|---|
| **31. Approval for Dissolution or Liquidation of the Company or its Subsidiaries** | Clauses concerning the approval processes/policies for liquidating or dissolving the company or any of its subsidiaries, including clauses governing liquidation rights. |
| **32. Approval for Changing the Corporate Purpose** | Clauses allowing the minority some say or before changes can be made to the corporate purpose or business mission. |
| **33. Say on Changes to Bylaws** | Clauses allowing the minority some say or notice before changes can be made to the corporate bylaws. |
| **34. Say on Mergers and Reorganizations** | Clauses concerning the approval processes/policies for liquidating or dissolving the company or any of its subsidiaries, including clauses governing liquidation rights |
| **35. Say on Changes to the Dividend Policy** | Clauses concerning the approval processes/ policies for any changes made to the dividend policy, whether provided in the agreement or in the bylaws. |
| **36. Approval for Changes in the Number of Board Members** | Clauses allowing the minority some say or notice before the company can change the number of board members. |
| **37. Approval for Changes to Classes of Stock** | Clauses concerning the approval processes/policies for issuing new classes of stock or changing the rights attendant to existing stock classes. |
| **38. Restricts Right to Make Later Agreement with Other Shareholders** | Restricts ability of shareholders to make a later, superseding agreement that limits or changes obligations in any way without the approval of all shareholders signing agreement. |
| **39. Requires that Meetings Be Attended By at Least One Minority Representative** | Requires that board meetings, executive committee meetings, or shareholder meetings be attended by at least one minority representative in order to meet quorum and proceed. |
| **40. Say on Dilution** | Clauses concerning the approval processes/policies for issuing more stock in any form (e.g., as remuneration, for capital increases, etc.) |
| **41. Sets Express rules for Amount and Time of Dividend Distribution** | Includes an explicit plan when, how much, and how the company's profits will be doled out. |
| **42. Say on Changes to Duties of Directors** | Clauses concerning the approval processes/policies for any changes made to the duties of the company's directors vis a vis shareholders or management. |
| **43. Rights to Approve the Annual Budget** | Clauses concerning the approval processes/policies for the company's annual budget or business plan. |

**Decision Rights and Duties of Loyalty Clauses**

| CLAUSE TYPE | DESCRIPTION |
|---|---|
| **44. Balance Sheet Monitoring** | Clauses granting the shareholders rights to monitor the company balance sheet. |
| **45. Balance Sheet Monitoring of the Affiliated Firms** | Clauses granting the shareholders rights to monitor and access affiliated company balance sheet. |
| **46. CEO or Chairman of the Board Appointments** | Clauses provides shareholders the right to appoint the CEO and/or Chairman of the Board. |
| **47. Minority Favoring Options/Puts or Calls** | Clauses concerning the approval processes/policies for liquidating or dissolving the company or any of its subsidiaries, including clauses governing liquidation rights |
| **48. Board Appointments** | Clauses providing the shareholders rights to appoint board members. |
| **49. Special Competition Rights** | Clauses granting special competition rights to a signer for exclusive supply/demand; priority rights, etc. |
| **50. Liquidation Rights** | Clauses providing first in line rights upon liquidation (e.g., liquidation preference clause). |
| **51. Independent Directors** | Clauses granting the rights to appoint independent director(s) to the board. |
| **52. Independent Auditors** | Clauses granting the rights to appoint independent auditor(s) to the board. |
| **53. Non-compete** | Clauses that prohibit shareholders from owning, being affiliated with, serving on the board or management of an affiliated or competing company for a specified duration of time. |
| **54. Representations and Warranties** | Clauses that represent and warrant that there are no conflicting agreements with this shareholder agreement. |
| **55. Duty of Loyalty to Company** | Clauses placing a fiduciary duty on shareholders to be loyal to what is in the best interest of the company. |
| **56. Conflicts of Interest Disclosures** | Clauses requiring shareholders must disclose any current or future conflicts of interest that may arise. |
| **57. Duty of Loyalty to Subsidiaries and Affiliates of Company** | Clauses placing a fiduciary duty on shareholders to be loyal to what is in the best interest of the subsidiaries and affiliated firms of the company. |
| **58. Equity Agreement** | Clauses defining agreement to invest more equity in company and/or establishes the existing equity sharing arrangements among the shareholders. |
| **59. Right/Power to Appoint** | Clauses granting rights to appoint key professionals such as investment managers, asset managers, etc. |
| **60. Valuation Formulation** | Clauses determining agreed upon valuation formulas and specifications by the shareholders. |
| **61. Confidentiality** | Clauses requiring shareholders keep confidential proprietary company information and/or the ultimate shareholders. |

**Remedy Clauses**

| CLAUSE TYPE | DESCRIPTION |
|---|---|
| **62. Unenforceable Provisions** | Clauses agreeing to rewrite or replace any provision in the contract that is deemed unenforceable. |
| **63. Saving Clause** | Clauses confirming that if any part of the contract is unenforceable or cancelled, all of the remaining provisions will stay intact. |
| **64. Dispute Resolution through Arbitration** | Clauses that specify dispute resolution procedures for arbitration, including arbitration rules. |
| **65. Arbitration Jurisdiction and Choice of Forum** | Clauses that specify dispute resolution procedures for arbitration, including specifications for jurisdiction and/or forum |
| **66. Breach of Performance** | Clauses stating the conditions that would constitute a breach of contract. |
| **67. Breach Penalty** | Clauses stating the penalties and procedures when a breach of contract occurs. |
| **68. Choice of Forum** | Clauses specifying the courts and location where shareholder disputes will be adjudicated. |
| **69. Choice of Law** | Clauses specifying the legal system that will be used if shareholder disputes arise. |
| **70. Choice of Language** | Clauses specifying the lingua franca between the shareholders. |
| **71. Term Length** | Clauses specifying the term length of the contract clauses. Note: if not specified, according the Brazilian corporate law, the contract length is the same as the life of the company. |