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Related-Party- Transactions in the spanish stock market¹

Las operaciones entre partes vinculadas en la bolsa española

I. INTRODUCTION

Accounting scandals such as Enron, WorldCom, Adelphia and Tyco in the United States or Parmalat, Vivendi or Tesco in Europe have revealed that Related Party Transactions (RPTs) might constitute a major problem in corporate governance. Although these transactions were supposedly conducted at arm's length, in practice, they benefit the principals involved (e.g., managers, large shareholders or their relatives). Thus, previous accounting scandals have increased the interest in RPTs, although, according to Gordon *et al.* (2004) there is not yet a policy-relevant academic research on RPTs. As a result, it is still difficult to separate legitimate RPTs from opportunistic ones (Duprey, 2006).

Order EHA/3050/2004 considers RPTs as a transfer of resources, services or obligations between related parties, regardless of whether a price is charged. Furthermore, according to previous legal standard, one party shall be considered to be linked to the other when either one of them, or a group acting together, exercises or holds the possibility of directly or indirectly exercising, or in virtue of pacts or agreements between shareholders, control over the other or an important influence on the financial or operational decision taking of the other party

The scant preliminary evidence on RPTs suggests two alternative explanations for their existence. First, according to the transaction cost theory (Coase, 1937; Pennings and Williamson, 1979), RPTs are efficient operations aimed at decreasing transaction costs. According to this view, RPTs might benefit all shareholders by reducing transactions costs and increasing firm value (e.g., Chang and Hong, 2000; Jian and Wong, 2010; Khanna and Palepu, 2000;

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EXECUTIVE SUMMARY

Despite the relevance of related-party transactions (RPTs) in the Spanish capital market, empirical evidence on RPTs is anecdotal. Thus, in the current work we provide evidence on the configuration of RPTs for Spanish listed firms along the period 2004-2014. Our results show a significant presence of RPTs, with more than half of listed Spanish firms committing to RPTs. Moreover, our results show that RPTs are greater in large-cap companies, in companies with higher ownership concentration, in family firms and in those companies where controlling owners' voting-cash flow wedge is higher.

RESUMEN DEL ARTÍCULO

A pesar de la relevancia que con el paso de los años han ido adquiriendo las operaciones entre partes vinculadas (OVs) en los mercados de capitales, no existe ningún estudio previo que analice la presencia de este tipo de transacciones en la bolsa española. De esta manera, en el presente trabajo estudiamos las OVs en mercado continuo español a lo largo del período 2004-2014. Los resultados ponen de manifiesto una presencia importante de OVs, estando presentes este tipo de operaciones, algunos años, en más la mitad de las empresas cotizadas. Asimismo, también se aprecia que en las empresas de mayor dimensión, las más concentradas, las controladas por familias y aquellas que forman parte de un grupo piramidal, existe una mayor implicación en la realización de OVs.

Stein, 1997). On the contrary, agency theory (Berle and Means, 1932; Jensen and Meckling, 1976) predicts that RPTs might be considered one form of opportunism (Cheung *et al.*, 2006; Gordon *et al.*, 2004; Jiang *et al.*, 2010; Morck *et al.*, 2005) because these transactions might be used by internal agents as a vehicle to tunnel resources outside the company.

In the present work, we analyse RPTs in Spain. Particularly, we examine the configuration of RPTs for listed Spanish firms during the period 2004-2014. The Spanish environment offers an interesting setting to study RPTs for several reasons. First, Law 26/2003 was passed to increase the transparency of listed firms'

disclosures. In later modifications included in Ministerial Order ECO/3722/2003 and Circular 1/2004 of the Spanish Security Exchange Commission (Comisión Nacional del Mercado de Valores), Law 26/2003 expanded the disclosure requirements of listed Spanish firms, making it mandatory for Spanish companies to disclose related-party transactions in their annual corporate governance reports. Second, unlike what occurs in Anglo-Saxon countries, Spanish firms operate in an institutional setting where the legal system provides weak investor protection (e.g., La Porta *et al.*, 1998). Thus, according to the Global Competitiveness index 2015-2016,

Spain ranks 94th among 140 economies³ in protection of minority shareholders' interests. According to previous report, Spain obtains notably worse scores in terms of corruption (Spain ranks 80th out of 140) and government efficiency (Spain ranks 94th out of 140). Third, the ownership structure of Spanish listed firms is characterised by the large presence of dominant shareholders with the ability and incentives to monitor managers (Bebchuk, 1999; Burkart *et al.*, 2003; Grossman and Hart, 1988; La Porta *et al.*, 1998; La Porta *et al.*, 2000). Therefore, the presence of concentrated ownership shifts the classic agency problem away from the divergence of interest between managers and shareholders to conflicts between controlling and minority shareholders (Burkart *et al.*, 2003; La Porta *et al.*, 2000; Villalonga and Amit, 2006).

Thus, our study contributes to the literature on RPTs in three ways. First we provide novel evidence on the configuration of RPTs in a capital market where minority shareholders' protection is weak, ownership concentration is prevalent and public ownership is practically non-existent. This allows for an easy extrapolation of

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our results to other continental European countries with similar institutional features. Second, our evidence adds to the tunneling literature by showing a potential mechanism through which insider agents could tunnel resources outside the firm in the Spanish context (de Miguel *et al.*, 2005). Third, compared with the available evidence on RPTs, our work analyse the total RPTs included in listed Spanish firms' annual corporate governance report.

2. DATA AND OBJECTIVES OF THE STUDY

In order to examine RPTs along the period 2004-2014, the initial sample comprises 99 non-financial firms listed on the Spanish stock exchange at the end of 2014, included in the OSIRIS database by Bureau van Dijk Electronic Publishing (BvDEP). The information on RPTs is collected from the firms' annual corporate governance reports (CGR). Since the information was incomplete and it was not provided on a regular basis in 2003, largely because of the absence of a standard format for disclosure, our sample begins in 2004. Thus, we initially obtain 17 RPT variables that, after a screening process, have been grouped in three different categories. First, Operating Transactions which includes Operating Income and Operating Expenses among related-parties. The second category, named Loans Contracts and Guarantees, includes Borrowing Contracts, Lending Contracts, Financial Income, Financial Expenses and Loan Guarantees among related-parties. The remaining 11 RPTs, less frequent in Spain, have been included in the category Other Related-Party-Transactions.

Based on previous categories, the analysis of RPTs is accomplished on a company by company basis and by considering certain economic and corporate governance features. Thus, the firms are initially grouped according to the level of market capitalisation. Then, we classify the firms considering their ownership structure. Particularly, we consider the controlling shareholder's voting rights, the family nature of the controlling shareholder and the controlling shareholder's voting-cash-flow wedge. This latter corporate governance mechanism distorts the principle "one share, one vote" and leads to the presence of a pyramidal group. We select these variables due to the significance presence of concentrated and family firms in the Spanish setting (Faccio and Lang, 2002). The

KEY WORDS

Related-Party Transactions, Size, Ownership Concentration, Family firms, Divergence.

PALABRAS CLAVE

Operaciones entre partes vinculadas, Tamaño, Concentración de propiedad, Empresa familiar, Divergencia.

corporate governance variables have been obtained from Guerra *et al.* (2016), Bona *et al.*, (2013), Bona *et al.* (2014) and Santana (2010). For each test, we analyse the variance in order to determine if significant differences exist in the use of RPTs among the different groups.

3. RELATED-PARTY TRANSACTIONS IN THE SPANISH STOCK MARKET

Table 1 shows an increasing trend in the number of RPTs carried out by firms listed on the Spanish stock market. Thus, in the years 2006, 2008, 2010 and 2012 more than half of the firms engage in some type of RPT, which reveals the importance of these transactions in the Spanish case.

Regarding the type of RPT, our results show that Operating Transactions are globally more frequent, followed by Loans, Contracts and Guarantees.

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Table 1. Related-Party Transactions in listed Spanish firms

	2004	2006	2008	2010	2012	2014
Percentage of firms that commit to Related-Party transactions	41.55	56.62	53.84	51.61	50.53	43.01
Number of Related-Party transactions	294	563	428	548	622	532
Type of Related-Party transactions (%)						
Operating Transactions	44.2	33.92	56.53	42.15	47.9	50.74
Loans, Contracts and Guarantees	39.1	41.89	29.89	43.08	36.63	25.17
Other Related-Party-Transactions	16.7	24.19	13.58	14.77	15.47	24.09

Below, we show descriptive statistics for RPTs according to different corporate features, such as the size of the firm (using the median of the firm’s market capitalisation in order to distinguish between larger and smaller firms), the ownership structure (using the median of the controlling shareholder’s voting rights, to differentiate between more and less concentrated firms), the controlling shareholder’s family nature (considering the controlling shareholder becoming a person or a family who owns at least 10% of the voting rights of the firm) and the firm’s belonging to a pyramid structure (considering the

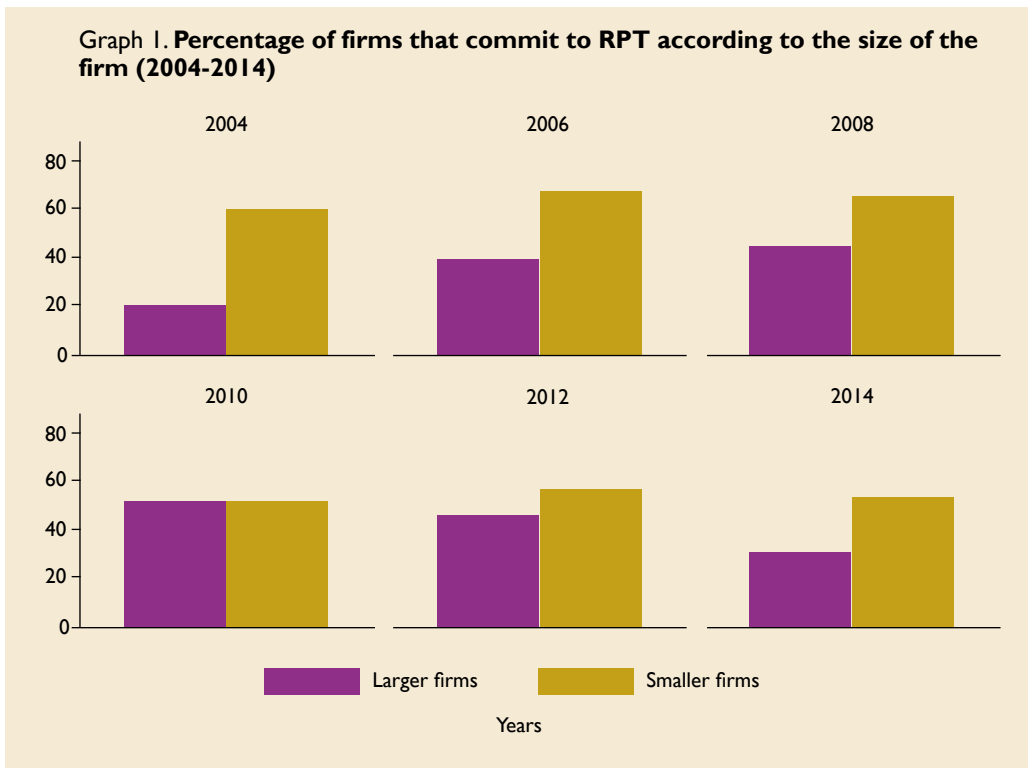
company's belonging to a pyramid, which arises when the controlling shareholder controls the firm through different subsidiaries so that the structure gives him/her more voting than cash flow rights).

Size

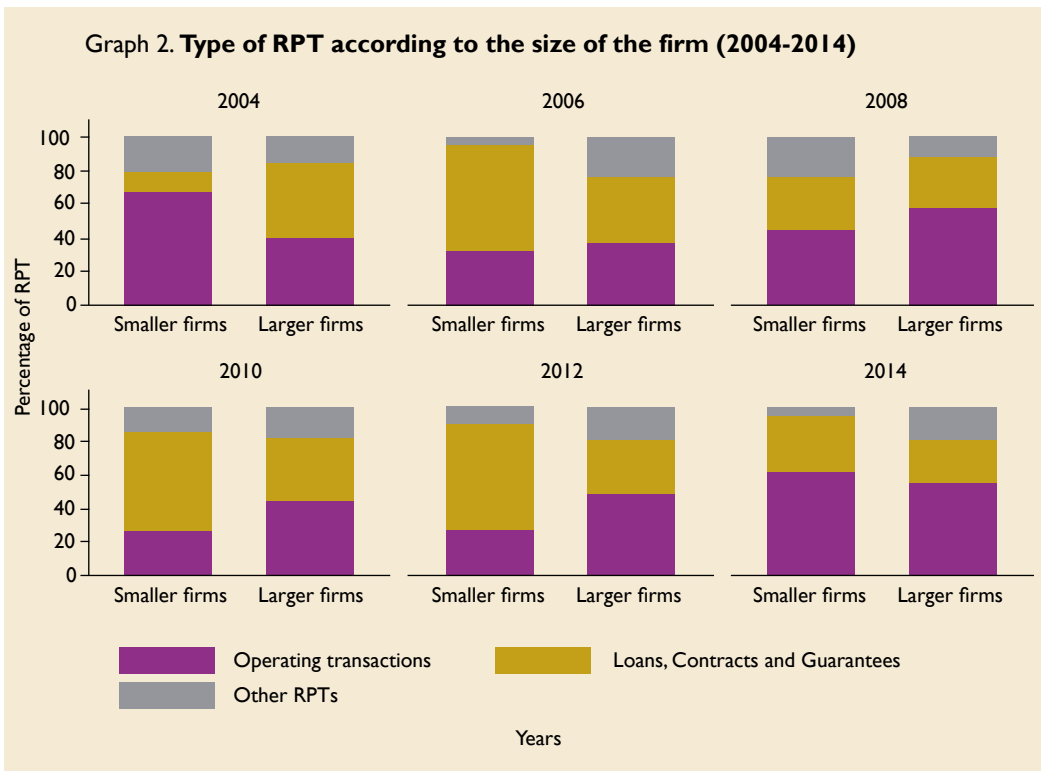
The firm size is a corporate characteristic that might affect the type and level of the firm's agency problems. Thus, **Graph 1** shows the percentage of firms that commits to RPTs according to the size of the firm.

As may be seen, the graph reveals that the percentage of RPTs is three times higher in larger firms in 2004. Although the difference narrows over time, RPTs are always more frequent in larger firms. Thus, the *F-test* (Ficher-Snedecor) shows a statistically significant difference in the percentage of RPTs according to the size of the firm ($F=70,80$; $p<0,01$).

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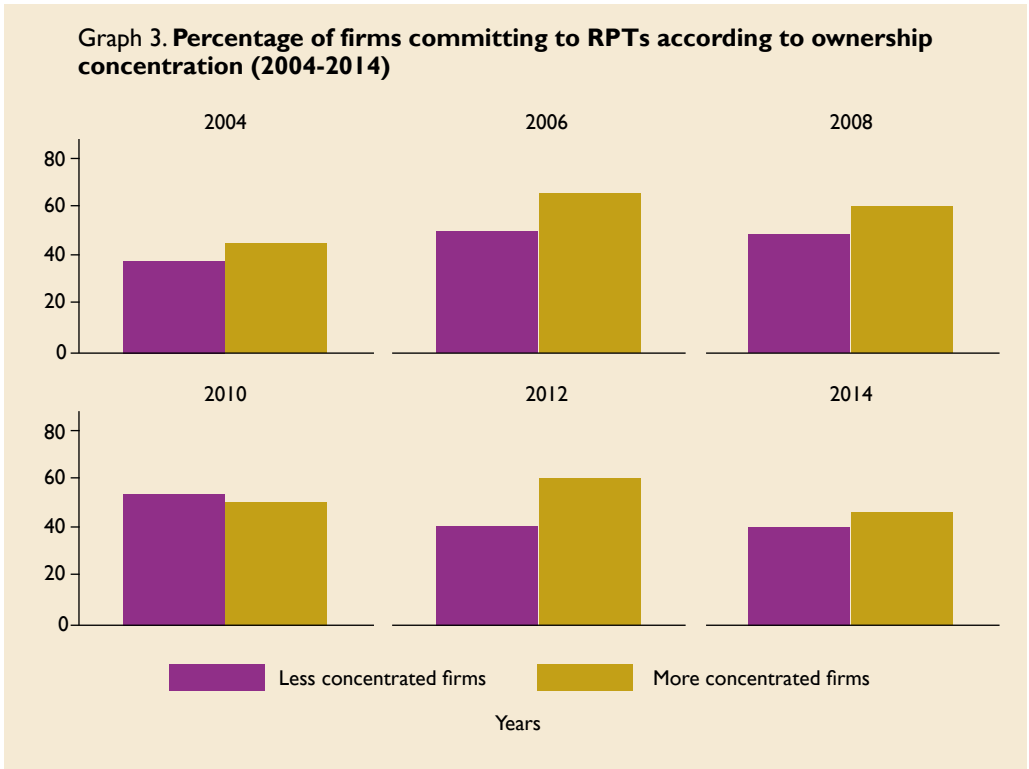


Considering the type of RPT, the F-test shows an statistically significant difference between larger and smaller firms ($F=24,05$; $p<0,01$). Thus, Graph 2 reveals that overall Operating transactions are more frequent in larger firms, followed by Loans, Contracts and Guarantees, although in the first two years these categories exchange this trend. Nevertheless, overall there are twice as many Operating transactions as Loans, Contracts and Guarantees in larger firms.



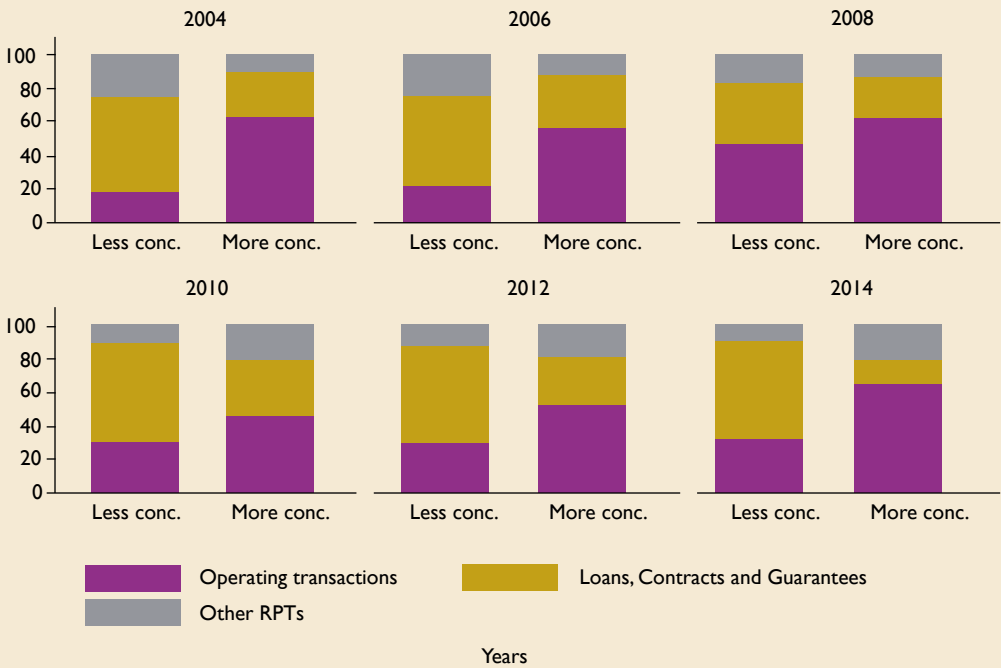
Ownership structure

Considering that ownership structure of Spanish listed firms is characterized by the widespread presence of dominant shareholders with the ability and incentives to influence corporate decisions (e.g., Faccio and Lang, 2002), in **Graph 3**, we analyse the percentage of RPTs according to ownership concentration. This way, the graph reveals that RPTs are more frequent in concentrated firms, being the difference statistically significant ($F=3,08$; $p<0,1$).



Graph 4 shows that differences are still statistically significant if we consider in the analysis the type of RPT ($F=9,75$; $p<0,01$). More exactly, the graph reveals that Operating transactions are more frequent in the more concentrated firms, while Loans, Contracts and Guarantees are more common in the less concentrated firms. Thus, there are five times as many Operating transactions as Loans, Contracts and Guarantees in the more concentrated firms. In some years, the percentage of Loans, Contracts and Guarantees are even below the percentage of Other RPTs.

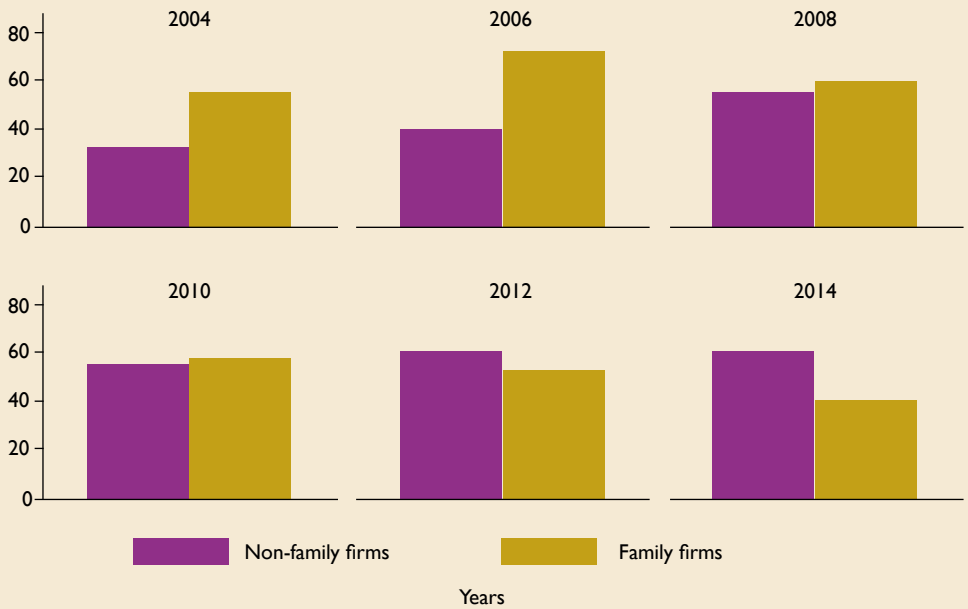
Graph 4. Type of RPT according to ownership concentration (2004-2014)



Since family-controlled firms are relevant in Europe, graphs 5 and 6 show the percentage and type of RPTs according the family nature of the firms. Thus, **Graph 5** reveals that RPTs are more common in family firms along the period 2004-2010 and less frequent in the period 2012-2014, being the difference statistically significant ($F=12,82; p<0,01$).

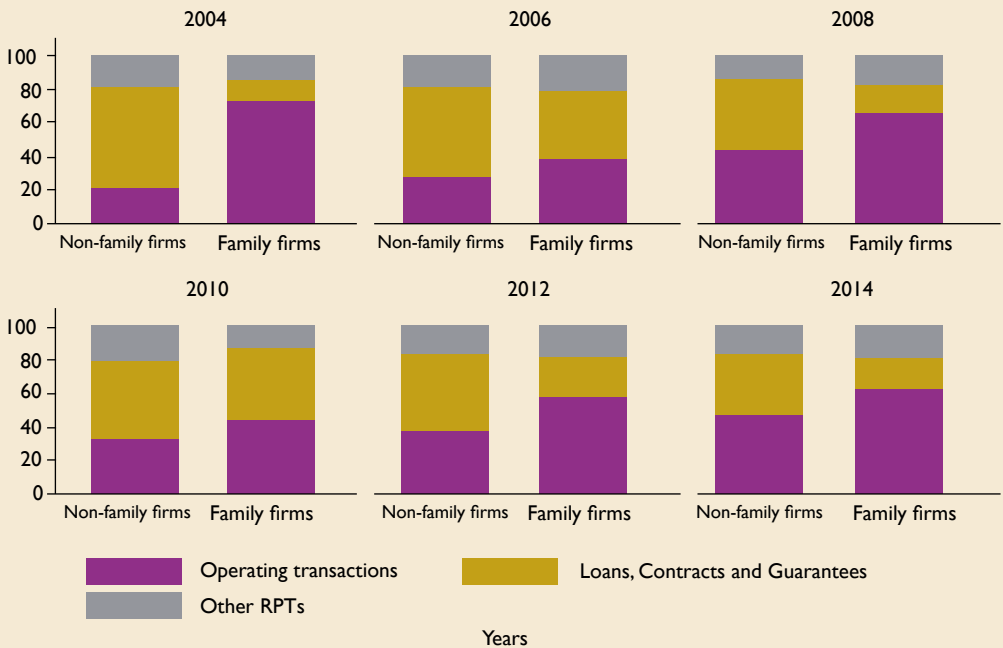
Regarding the type of RPT, **Graph 6** shows a different trend in family firms, being this difference statistically significant ($F=11,22; p<0,01$). Thus, Operating transactions are more frequent in family firms, while Loans, Contracts and Guarantees are more common in non-family firms.

Graph 5. Percentage of family firms committing to RPTs (2004-2014)

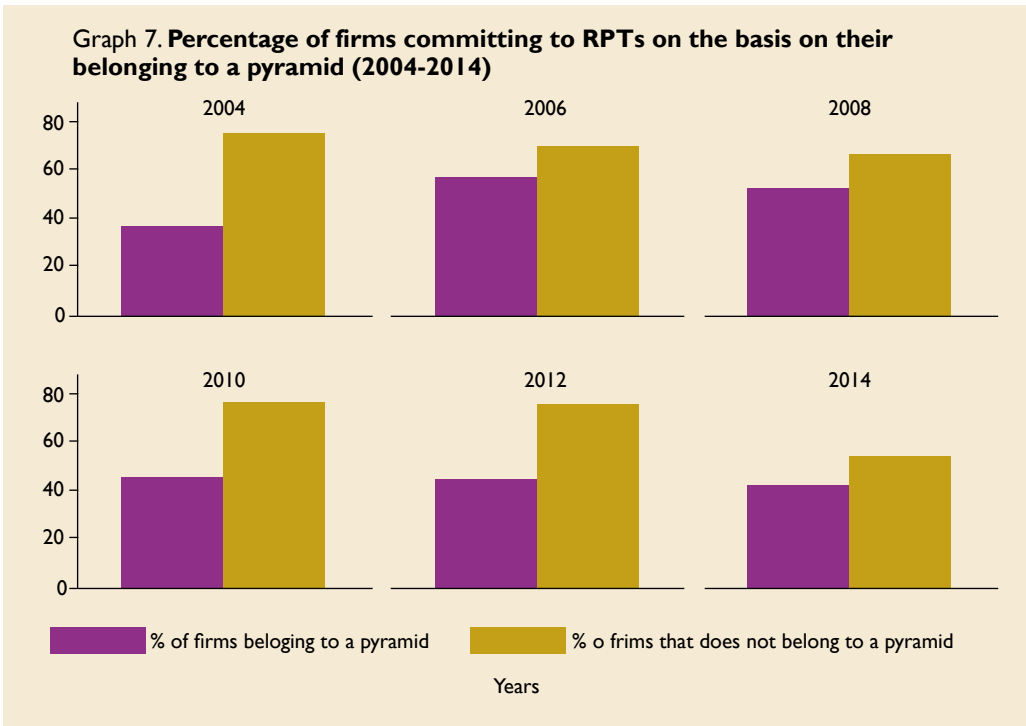


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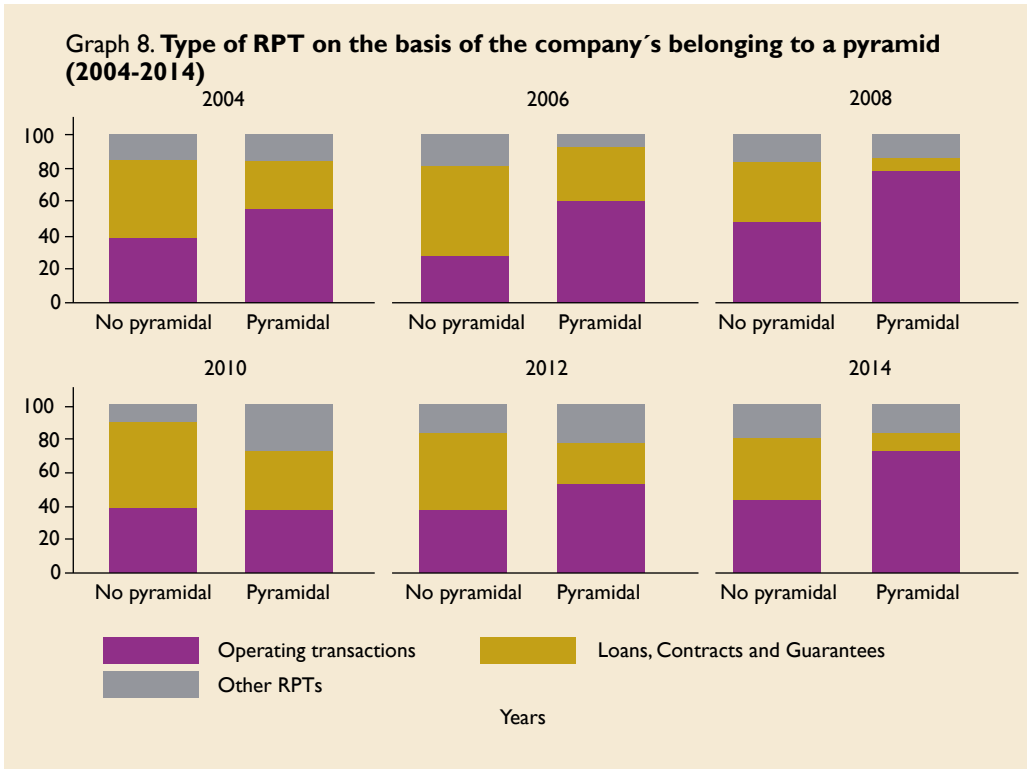
Graph 6. Type of RPT according to the family nature of the firm (2004-2014)



Finally, we analyse RPTs on the basis of the company's belonging to a pyramidal group. Since pyramids allow the controlling owner's voting-cash flow wedge, they might promote the expropriation of minority shareholders' wealth. The **Graph 7** shows that RPTs are much more frequent in firms belonging to a pyramid, being this difference statistically significant ($F=38,25; p<0,01$).



Regarding the type of RPT, statistically significant differences can be observed on the basis of the company's belonging to a pyramidal group ($F=17,39; p<0,01$). Thus, **Graph 8** shows that Loans, Contracts and Guarantees are prevalent in firms belonging to a pyramid, with a decreasing trend along the period. On the contrary, for firms that do not belong to a pyramidal group, our results reveal that there is no clear trend regarding the evolution of Operating transactions, while on net basis the Loans, Contracts and Guarantees category decreases along the period.



4. INCIDENCE OF CORPORATE CHARACTERISTICS ON THE LEVEL OF RELATED-PARTY TRANSACTIONS

In order to analyse the incidence of certain corporate characteristics on the level of RPTs, we have performed a regression analysis where the level of RPTs is the dependent variable and certain corporate characteristics are the explanatory variables (size, ownership concentration, family nature of the firm, and the firm's belonging to a pyramid). The correlation matrix (**Table 2**) shows statistically significant correlations among most of the variables. We conduct a formal test to ensure that multicollinearity is not present in our regressions. In particular, we calculate the Variance Inflation Factor (VIF) for each independent variable included in the estimated model. The highest VIF for our models is well below 5, the threshold value indicating that multicollinearity might not be present (Studenmund, 1997). We therefore conclude that multicollinearity is not a problem in our sample.

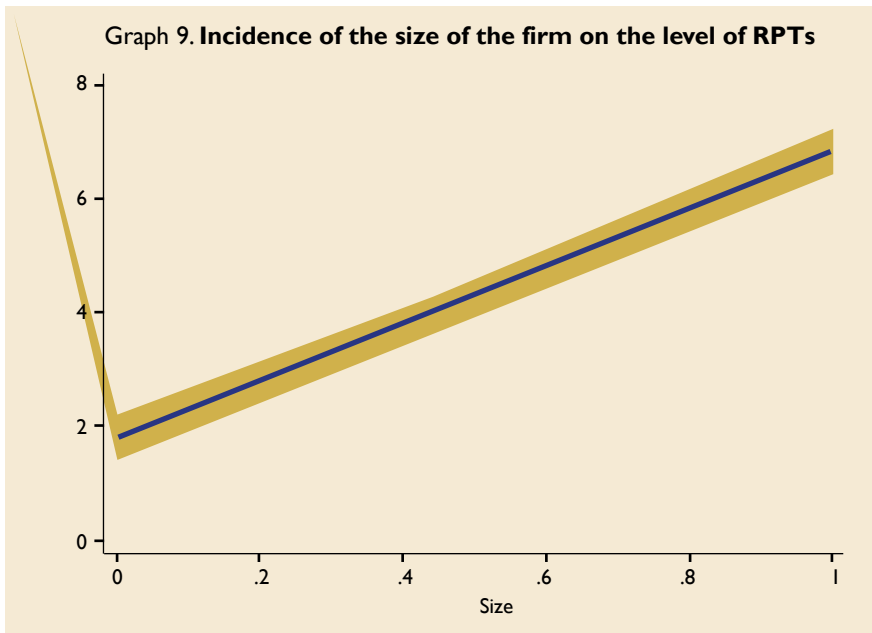
Table 2. **Correlation Matrix**

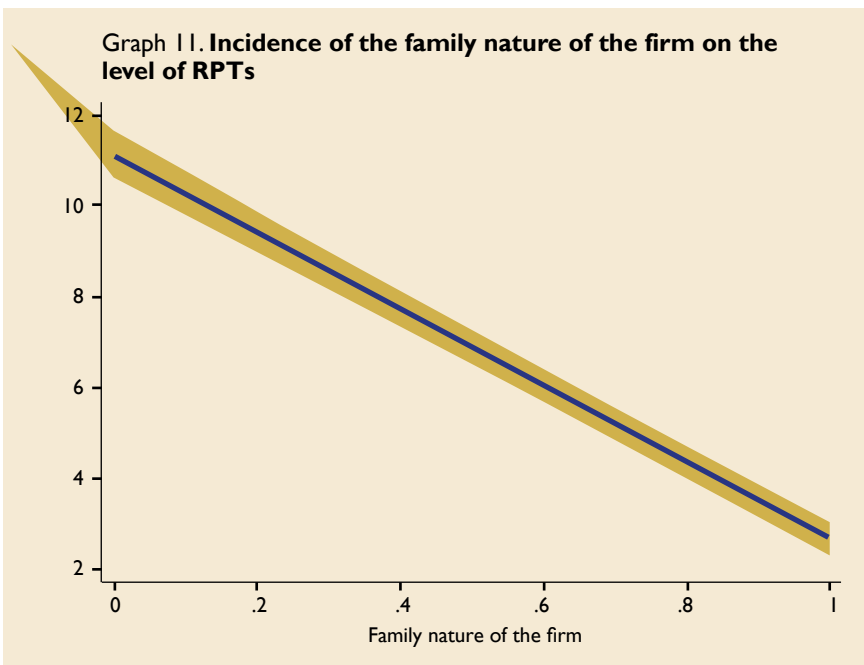
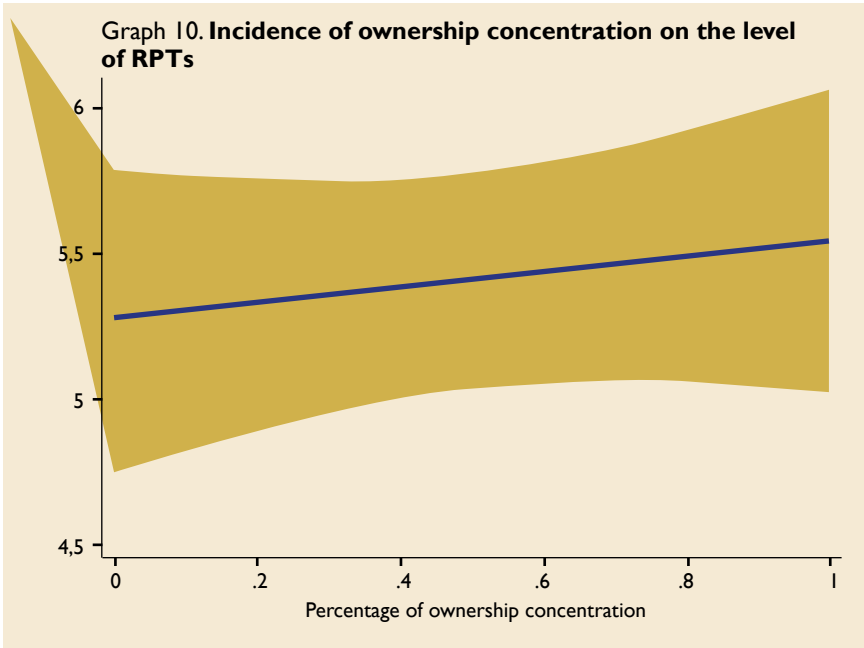
	LEVEL OF RPTS	SIZE	OWNERSHIP STRUCTURE	FAMILY NATURE
Size	0,25***			
Ownership Concentration	0,05*	0,14***		
Family nature	-0,11***	-0,20***	0,24***	
Pyramids	0,19***	0,11***	-0,04	0,03

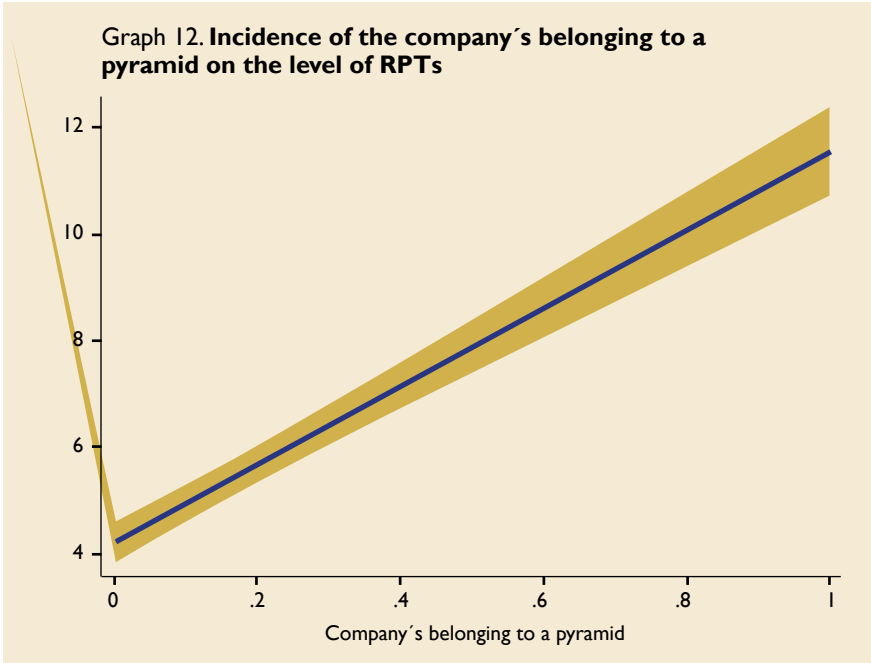
*** p<0,01, * p<0,1

We estimate all the regressions using a panel data procedure, namely, Generalized Method of Moments (GMM), including variables to control for year and industry effects. Thus, **Graph 9** reports, as expected, a positive and statistically significant effect of size on RPTs ($\beta = 4,29$; $p < 0,01$). Similarly, **Graph 10** also shows a positive and statistically significant effect of ownership concentration on RPTs ($\beta = 2,14$; $p < 0,05$). Moreover, **Graph 11** reveals a negative and statistically significant effect of the controlling shareholder’s family nature on RPTs ($\beta = -8,41$; $p < 0,01$). Finally, regarding the belonging of the company to a pyramid, **Graph 12** reports a positive and statistically significant effect of pyramids on RPTs ($\beta = 6,06$; $p < 0,01$).

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5. CONCLUDING REMARKS

The present work provides novel evidence on RPTs in the Spanish capital market. Previous empirical evidence regarding RPTs is inconclusive and consequently there is no a clear view on the true motivation for RPTs. This emphasises the need to continue research into RPTs. In this context, we have analysed all the RPTs accomplished by Spanish listed firms during the 2004-2014 period. Our results reveal the relevance of RPTs in the Spanish capital market, as shown by the fact that more than half of listed Spanish firms commit to RPTs over the analyzed period, being operating transactions and Loans, Contracts and Guarantees the most frequent categories. The results also show that those companies with a higher value of market capitalisation are more committed to RPTs. Previous results emphasize the need to consider this type of transactions that involves the largest listed companies' blockholders and managers in Spain. Furthermore, those companies with the highest ownership concentration show a greater commitment to RPTs, being operating transactions compared to Loans, Contracts and Guarantees the most relevant category. On the contrary, in those companies with the lowest level of ownership concentration

Loans, Contracts and Guarantees are the most prominent RPTs. Finally, family firms are more committed to RPTs during the 2004-2010 period, while over the 2012-2014 period, the trend reverses and in this case the ones more committed to RPTs are non-family firms. Regarding the nature of the RPTs, our results show a clear predominance of operating transactions in family firms, while in non-family firms Loans, Contracts and Guarantees is the most prevalent category. Finally, regarding the companies' belonging to a pyramidal group, the results show that those companies belonging to a pyramid are more likely to engage in RPTs, being Loans, Contracts and Guarantees the most relevant category for these latter companies, although the results show a decline in the relative importance of Loans, Contracts and Guarantees over time. Finally, in those companies that do not belong to a pyramid, no clear predominance of a particular category of RPTs is observed over the analysed period,

In the Spanish case, the weak protection of minority shareholders' rights and the high ownership concentration, as well as the use by controlling owners of governance mechanisms that allow for the separation between ownership and control might promote expropriation of minority shareholders by controlling owners. However, some corporate governance mechanisms might help to decrease the controlling shareholder's tendency to use RPTs as a vehicle to expropriate the minority shareholders' wealth. Thus, family firms' long-investment horizons might increase family firm's reputation concerns consequently decreasing these firms' tendency to use RPTs as an expropriation device. Notice that family firms are not considered a resource to be consumed during the owner's lifetime, but rather an asset to be transferred to his/her heirs in the future (Anderson and Reeb, 2003). Furthermore, some RPTs might add value to the company. Thus, for instance, companies with high ownership concentration can incur higher transaction costs when they enter transactions with non-related parties due to higher information asymmetries in this latter case.

Our work is a first step towards understanding RPTs in the Spanish capital markets and our results emphasize the need to undertake further research regarding RPTs. Thus, although most policy reforms regarding RPTs have focused on ex ante development of more stringent approval requirements for RPTs and on increasing ex post disclosure policies regarding RPTs, we might consider that



these measures may be insufficient to avoid the abuses which might result from their use. In this sense, although previous literature has evidenced that RPTs are a typical way to tunnel resources outside the company, the empirical evidence is not conclusive and there might also be efficient RPTs and even more, tunneling might be implemented by using other devices different from RPTs. According to previous considerations, regulation of these transactions should take a broader scope. On the contrary, companies might seek to place outside the law, even in those cases where the transaction is carried out with an opportunist purpose, but without complying with the legal requirements to be considered RPTs.



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NOTES

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3. The Global Competitiveness Report 2015-2016 assesses the competitiveness landscape of 140 economies, including the United States, Germany, The United Kingdom, Hong Kong and Spain, and provides insights into the drivers of their productivity and prosperity.



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