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# Wanting It All: Issues When You Already Have Control

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## Abstract

Can a controlling buyer (i.e., a buyer that already owns over 50% of a seller's shares) that purchases the remaining outstanding shares of a seller (i.e., the remaining stake) expect to pay a premium or a discount for the purchase? In analyzing sixty-seven such transactions between January 2001 and September 2005, we found evidence that supports a remaining stake premium in the range of 30% to 45%. As a result of these findings, we explored reasons for such a premium and give a few final thoughts for additional research.

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## Introduction

Within the business valuation field, great effort has been spent on studying premiums observed when a buyer acquires what is considered a controlling stake, which, for the purpose of this article, we assume is achieved when a buyer acquires more than 50% of a seller's outstanding shares. FactSet Mergerstat LLC publishes a well-known annual publication *Mergerstat Review*, which is frequently cited as a guide to quantifying control premiums. *Mergerstat Review* calculates premiums by comparing the stock prices of blocks of shares that provide control and stock prices of exchange-traded minority shares. For the years 1987 through 2006, *Mergerstat Review* shows median control premiums ranged from roughly 20% to 40%. Other control premium studies from Houlihan Lokey Howard & Zukin and *Direct Investments Spectrum* echo similar results.

Intuitively, little convincing is needed to argue that a purchaser will pay a premium to acquire control, since control can give the purchaser the right to elect board members, formulate strategic plans, determine compensation, or otherwise exert control over an enterprise. However, it is uncertain whether a controlling buyer would pay a premium or, contrarily, expect a discount for the remaining stake that it does not already own. Whatever the reason for a controlling party to seek total ownership, would it pay a premium or a discount for the remaining stake? Simple logic might suggest that the buyer would pay a premium to ensure "total control." However, based on prevailing minority interest research that suggests that a discount should apply to a minority interest that lacks a control character, a discount for the remaining stake could be reasonable. Perhaps, in practice, such a "total control" premium would counteract a minority interest discount for a net neutral transaction effect. We were divided in our expectations.

## Empirical Study

The question of whether to pay a discount or premium on a remaining stake interest was first brought to our attention during a recent client engagement. This client, a publicly traded company, owned 80% of another public company and, for various reasons, wanted to purchase the remaining 20%. We were engaged to provide an opinion as to the price the client should offer for this remaining stake. Because the target was a public company, the stock price was available as a reference point. As we worked toward a conclusion, we wondered if there was general guidance for such a scenario that should be incorporated into our analysis, especially in relating our conclusion to the target's stock price.

We did not feel that the previously mentioned control studies accounted for such a scenario, and, therefore, we felt those studies provided little guidance for our remaining stake scenario. Furthermore, we found little to no business valuation specific research that dealt with this remaining stake scenario.<sup>1</sup> Thus, we conducted a limited empirical study of recent U.S. acquisitions where the controlling buyer, already owning over 50% of the target entity, purchased all remaining shares. Through our limited empirical study, we sought two goals: (1) to gain general guidance on the nature of discounts or premiums paid for such remaining stake acquisitions; and (2) to gain insight into factors that might contribute to such a discount or premium.

We gathered transaction data of domestic targets from January 2001 through September 2005 from FactSet Mergerstat's mergers and acquisitions database. FactSet Mergerstat's database includes formal transfers of ownership where at least one of the parties is a U.S. entity and the target entity is traded on a public exchange. We selected observations (i.e., acquisitions)

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<sup>1</sup>As noted in "Control Premiums and Strategic Mergers, 1989 to 2002" (*Business Valuation Review*, Vol. 22, No. 1, pp. 18–31.), George Roach discusses median acquisition premiums for partial interest acquisitions from 1997 through 2002. His analysis demonstrated that partial interest acquisitions (i.e., transactions where less than 100% is acquired) resulting in 100% ownership of the target company had a median premium of 45.1%. However, only 4 of 120 observations in his dataset for years 1997–2002 were acquisitions of 49% or less of the target company and, of those, only 1 acquisition was for 20% or less of the target company. Since our analysis investigates those acquisitions where 49% or less of the target company is acquired by the pre-existing controlling party, we felt this information, although helpful, did not provide sufficient guidance for the purpose of our analysis. Importantly, however, Mr. Roach also states in his article that "acquisition premiums for the purchase of minority interests show similar but smaller acquisition premiums which cannot be explained by even the expectation of synergy" (p. 18).

**Table 1**  
Descriptive Information for Sample

Timeframe of Remaining Stake Acquisitions	January 2001–September 2005	
Total Transactions Based on Five-Day Prices	65	
Total Transactions Based on Thirty-Day Prices	67	
	No. of Deals	% of Total
Percentage Sought < 10%	3	4.5%
Percentage Sought < 20%	14	20.9
Percentage Sought < 30%	11	16.4
Percentage Sought < 40%	25	37.3
Percentage Sought < 49%	14	20.9
Deal Size < \$5 Million	17	25.4
Deal Size < \$10 Million	13	19.4
Deal Size < \$25 Million	10	14.9
Deal Size < \$50 Million	13	19.4
Deal Size > \$50 Million	14	20.9
Target Revenue < \$25 Million	17	25.4
Target Revenue < \$100 Million	16	23.9
Target Revenue < \$250 Million	17	25.4
Target Revenue < \$500 Million	8	11.9
Target Revenue > \$500 Million	9	13.4

where a controlling buyer purchased all remaining shares of the target entity, excluding transactions that either had incomplete data or had not closed. This resulted in sixty-seven observations with useable data, where we collected the following information for each transaction: premiums computed by comparing the price ultimately paid to the unaffected stock price five and thirty business days prior to the announcement date (purchase price per share divided by the five- or thirty-day price); the target entity's net sales prior to the announcement date; deal value, or aggregate purchase price; and the percentage of ownership sought. As can be seen in the descriptive information found in Table 1, our sample generally included a wide breadth of transaction types.

The results of our study are telling. As seen in Table 2, when first examining our dataset, the sample transactions varied greatly in deal size (from \$700,000 to \$6.1

billion), percentage sought (from 6.2% to 49.0%), and premiums paid (from -34.4% to 1,209.5%). A simple analysis of the five- and thirty-day premiums resulted in average premiums of 70.1% and 65.9%, respectively, and median premiums of 31.8% and 32.6%, respectively. When we removed outliers that could be seen as unduly influencing the data, the average premiums were more in line with the median premiums at 42.7% and 43.0%, respectively. Clearly the empirical evidence suggests that a relatively significant premium can be expected when purchasing the remaining stake of a company, with likely premiums ranging roughly between 30.0% and 45.0%. Table 3 gives further information on the distribution of the premiums or discounts of the observations.

We also sought to gain insight into factors that may be driving these results and employed multilinear regression tests on our dataset. We separately tested for association between the five- and thirty-day premium data

**Table 2**  
Range of Values for Remaining Stake Acquisitions

	% Sought	Deal Size (\$ Millions)	Target Revenue (\$ Millions)	Five-Day Premium	Thirty-Day Premium
High	49.0%	6,084.4	38,823.0	1,000.0%	1,209.5%
Low	6.2%	0.7	3.8	-34.4	-34.1
Average	30.9%	207.3	1,028.5	70.1	65.9
Median	32.3%	15.3	114.3	31.8	32.6
Average (Excluding Outliers)				42.7	43.0

**Table 3**  
Distribution of Premiums and Discounts

	> 200%	> 100%	> 50%	> 25%	> 0%	≤ 0%	Total
Five-Day Premium	4	7	8	18	21	7	65
As % of Total Sample	6.2%	10.8%	12.3%	27.7%	32.3%	10.8%	100.0%
Thirty-Day Premium	3	8	15	14	17	10	67
As % of Total Sample	4.5%	11.9%	22.4%	20.9%	25.4%	14.9%	100.0%

and three control variables: deal value, target net sales, and percentage of ownership sought. While the results of our preliminary multilinear regression tests were inconclusive, there was some evidence to suggest that deal size had a negative effect on the premium paid. Because of limitations on available data, it should be noted that in our limited empirical study we did not establish whether the purchase prices of the dataset encompassed fair market value, investment value, or elements of both.

### Qualitative Discussion

As previously mentioned, one could expect a controlling buyer to pay either a premium, neutral, or discount price for a remaining stake. Clearly our preliminary findings indicate a premium of 30.0% to 45.0% could be expected for a remaining stake. In attempting to explain this result, we examined our client's situation and their motivations for purchasing the remaining shares to ascertain factors that might warrant paying a premium. First, as a result of owning 100% of the target, our client could realize certain cost-saving synergies that may not be fully priced into the target's stock, including the elimination of regulatory, board, and administrative fees. Additionally, our client sought to present a more coherent and unified message to investors from the vantage of a single viewpoint (e.g., that of a single management team).

Beyond our client's situation, other possible reasons for paying a premium may be to remove dissenting or disruptive minority shareholders or to acquiesce to stubborn and irrational shareholders demanding a higher price for the relinquishment of their shares. For whatever reason a buyer seeks to attain 100% ownership, if the seller is cognizant of the gains or synergies expected by the buyer, the seller may have greater leverage in demanding a higher price. Last, there may be tax advantages for an acquiring entity to attain 100% ownership as it relates to dividends, as affiliated corporations are allowed a 100% dividends-received deduction for dividends received from members of the affiliated group.

We also revisited past business valuation literature to search for viable explanations. While it was mentioned

earlier that little research existed that explored remaining stake issues, related studies have found that investors are willing to pay a premium for a minority interest, even if a block of shares will not help them realize control. "Swing vote" premiums, which have been argued by the IRS, may exist when the voting power of a minority interest can be combined with the voting power of other minority interests to create a quasi-controlling interest. Similarly, in a sample of transactions in blocks of Italian exchange traded shares, Nicodano and Sembenelli (2000) concluded that the average premium across block trades (nonmajority purchases) is 27%.

Studies in fields outside of business valuation have also found evidence of a remaining stake premium. In the real estate sector, Yuming, McMillen, and Somerville (2004), when examining 700 real estate transactions in Hong Kong where property developers sought to redevelop city blocks, found that a premium of 23% to 28% was paid to the small plot owners who held out. From such research, it is not difficult to extend the argument that a controlling buyer may expect to pay a premium for the remaining portion of the target, in order to gain total control and/or achieve a strategic or synergistic advantage not otherwise realized.

### Final Thoughts

Although our preliminary findings demonstrate that a remaining stake premium may be empirically justified, additional research is warranted. Notably, it would be meaningful to explore whether a premium exists as it relates to valuation multiples, since the price paid by acquirers is commonly based on a value represented by a multiple. In addition, as our empirical study was performed with a limited universe of transactions and transactional data, an analysis that incorporates transaction data over a longer time horizon with a larger array of control variables would be beneficial and could shed light on the principal factors that contribute to the existence of premiums. Last, it may also be useful to study market evidence for discounts or premiums paid for an additional, nonremaining stake in an already-controlled target.

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From our preliminary findings, we believe we have made the first step in building a case for applying a premium to remaining stake acquisitions, even when the minority interest is not considered a swing vote. We advise others that, when faced with a similar situation, they should, at the very least, be aware that a premium may be warranted to determine the most appropriate value.

## References

1. Nicadano, Giovanni and Allesandro Sembenelli. 2000. "Private Benefits, Block Transaction Premium

and Ownership Structure." *International Review of Financial Analysis*, 13(2): 227–244.

2. Yuming, Fu, Daniel McMillen, and Tsur Somerville. 2004. "Measuring the Cost of Hold-out: Size and Sequencing in Land Assembly." Working paper cited with author permission.

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