The Dark Side of Concentrated Ownership:

Tunneling Through Loans to Controlling Shareholders in Japan

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Abstract

This empirical study examines the economic consequences of loans provided to controlling shareholders by Japanese listed firms. Using hand-collected data on related party loans disclosed by companies with controlling shareholders, we investigate the determinants of such loans and their impact on firm performance. The results indicate that controlling shareholders are more likely to obtain loans from firms with better performance, lower growth potential, larger size, lower ownership ratio of the controlling shareholder, poorer external audit quality, and financial distress. Further analysis reveals that an increase in loans to controlling shareholders has a significant negative effect on the firm's return on assets and return on equity in the subsequent fiscal year. These findings are robust to controlling for potential endogeneity issues and suggest that loans to controlling shareholders serve as a tunneling mechanism in Japan, with adverse economic consequences for the lending firms. This study contributes to the literature by providing direct empirical evidence on tunneling via related party loans in the Japanese market and offers insights into the importance of monitoring and governance mechanisms to mitigate the risks associated with such transactions.

Keywords: tunneling, expropriation, conflict of interests, controlling shareholders, loans, determinants, future performance of companies, economic consequences, Japanese market.

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