Common Ownership
by
Xavier Vives
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Remarks by
Ernst-Ludwig von Thadden
Universität Mannheim

The Theme:
Secular increase in institutional ownership (S&P500):

Source: Backus, Conlon, Sinkinson (2019)
The Big Picture:

Is common ownership a problem for
- corporate governance
- firm performance
- competition policy
- industry productivity
- corporate input markets
- macroeconomic growth
- society
- ...?

The Question

“Stealth Socialism”

First Fundamental Theorem of Welfare Economics:
If preferences are rational and locally non-satiated and firms maximize profits, any competitive equilibrium allocation is Pareto efficient.
1) How to measure common ownership and its consequences

Common ownership is multi-dimensional and thus difficult to measure.

Example: 2 firms, retail investors (small, diversified), 2 large investors

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<thead>
<tr>
<th>Retail</th>
<th>Inv. A</th>
<th>Inv. B</th>
<th>Firm 1</th>
<th>Firm 2</th>
<th>Indexer</th>
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<tr>
<td>Firm 1</td>
<td>70</td>
<td>30</td>
<td>0</td>
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<tr>
<td>Firm 2</td>
<td>70</td>
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Measuring the possible consequences of common ownership for managerial decision making:

(Along the lines of Bresnahan-Salop (1986), O’Brien-Salop (2000) etc.)

Consider a firm j and a universe of I shareholders, i=1,...,I.

- Profits (distributed cash flows) \( \pi_j \).
- Profit (cash flow) rights of each shareholder \( v_{ij}, \sum_i v_{ij} = 1 \).
- Total profit income for investor \( i: \sum_j v_{ij} \pi_j \).
- Firm j maximizes weighted average of its investors’ profits, places Pareto weights \( w_{ij} \) on investors \( i \).
Firm objective:

\[ Q_j = \sum_i w_{ij} \left( \sum_{k \neq j} v_{ik} \pi_k \right) \]

\[ = \sum_i w_{ij} v_{ij} \pi_j + \sum_i w_{ij} \sum_{k \neq j} v_{ik} \pi_k = \sum_i w_{ij} v_{ij} \left( \pi_j + \sum_{k \neq j} r_{jk} \pi_k \right) \]

where

\[ r_{jk} = \frac{\sum_i w_{ij} v_{ik}}{\sum_i w_{ij} v_{ij}} \]

is firm j’s profit weight for firm k (describing the degree of internalization of k’s profits by j).

Traditional theory (perfect or imperfect competition):

\[ r_{jk} = 0 \text{ for } k \neq j. \]

The main free variable (or open question) in this theory:

- what are the shareholder weights \( w_{ij} \)?
- proportional to cash flow rights: \( w_{ij} = v_{ij} \)?
- generalized proportionality: \( w_{ij} = v_{ij}^a, a > 0 \)?
- democracy: \( w_{ij} = 1/1? \)
- function of formal voting rights (if no one-share-one vote)
- function of shareholder characteristics
  - passive-active?
  - vertically related?
  - domestic-foreign?

Note: Under (generalized) proportionality the weight of retail investors vanishes, that of larger investors matters much (convexity).
The evidence (raw data): The internalization weights $r_{jk}$

![Graph showing internalization weights from 1979 to 2019.]

Source: Backus, Conlon, Sinkinson (2019)

Market interaction:
Most papers depart from the First Welfare Theorem in two ways:
- firms are not competitive
- firms maximize $Q_j$ instead of $\pi_j$

In the non-competitive case, the market matters (4 digit SIC codes). Interaction: Cournot, differentiated Bertrand, etc. Outcomes in terms of MHHI or similar measures. Note: These depend on the $r_{jk}$ within market.

Example: SIC code 2066:
4 large players:
- 2 in the S&P 500
- 1 private
- 1 foreign
Main conceptual questions for understanding the data:
- Disentangle non-competitive behavior from $Q_j$-maximization
- Correlation vs. causality
- What is $w_{ij}$?
- Endogeneity of market structure
  (the modern “Structure-Conduct-Performance” problem)

Main policy question: Do we get
- Competition with coordination on fixed costs? (the best of both worlds) or
- Central planning without accountability? (the worst of both worlds)

2) Topics for discussion: Firm decisions

Classical literature: Cournot, Bertrand competition $\rightarrow$ classical collusion.
More relevant probably:
- long-term decisions (product choice, variety)
- entry, exit

Market becomes endogenous, dito number of firms.

Think of firm decision as a general $x_j$. Then the traditional
$\pi_j(q_j, q_{-j})$ becomes $Q_j(x_j, x_{-j})$, and the game changes.
3) Topics for discussion: Owner-manager relation

How do corporate managers and common owners communicate?
- explicit communication: evidence?
- Larry Fink’s letters
- anticipatory obedience (“vorauseilender Gehorsam”)
- information about the investors behind $v_j$?

Is it possible to identify different communication styles that can be used to estimate the mapping $v_j \rightarrow w_j$?

Classical collusion vs. coordinated collusion: how to detect and punish deviations? Stability?

4) Topics for discussion: Takeovers

Matvos-Ostrovsky (2008): Takeovers have a higher chance of succeeding and yield a higher return to the bidder if bidder and target have common owners.

Can one use this reasoning to identify the $w_{ij}$?

Scenario: Classify takeover bids according to
- whether there was a competing offer to that of firm $j$
- whether there were potential competing bidders $k$ in the same industry who did not bid

Prediction: Missing bids by competitors are more likely the higher $r_{kj}$. The probability of completion is higher and the takeover premium is lower the higher $r_{kj}$. 
5) Topics for discussion: CEO pay

Prediction: CEO pay is less performance-sensitive if the firm is part of a sub-group of the industry with high $r_{jk}$.


6) Topics for discussion: Find the $w_{ij}$

Remember: Everything is driven by the shareholder weights $w_{ij}$. Can one identify them by estimating the $r_{jk}$ in two different set-ups?
7) Topics for discussion: Europe

Europe has many ownership – control arrangements that are rare in the U.S. What does this imply for the theory? Does this help to better identify the empirical results?

Of particular interest: Private firms. Is the CO problem another reason for the alleged superiority of economies with many strong (independent) SMEs?

Europe: Cross-Ownership in Germany

(1996)