Common Shareholding: Discussion

Giacinta Cestone (Cass Business School and ECGI)

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Competition Policy and the Blurring of Firm Boundaries

1. Many firms are affiliated with business groups, i.e. groups of legally independent firms partly or wholly owned, and thus controlled by a common parent.
2. Diversified institutional investors hold (non negligible) minority shares in competing firms within given industries.
3. Private equity and VC investors often specialise by industry $\rightarrow$ common investor holds stakes and actively interferes in management of competing companies.

$\implies$ Research bridging IO and corporate finance/governance has become more relevant to competition policy.

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- Interestingly, this also links to growing research on labor market power → surge in dubious labor market practices (eg, unpaid internships) in specific industries characterised by PE funding, such as publishing, media, services.

Common Ownership in Private Equity: the Carlyle and Riverstone Case

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- ***Key feature:*** firm boundaries are blurred in many dimensions. (1) Funds are separate legal entities (limited liability) but within a same family they behave as one. (2) Investors' stakes in a parent company will affect the subsidiary.

Common Ownership in Private Equity: the Carlyle and Riverstone Case (ctd)

The FTC objected that the minority stake acquisition could cause anticompetitive harm because of:

- Carlyle/Riverstone right to **board representation** at both firms
- Its right to exercise **veto power** over actions by Magellan
- Its right to receive non-public, competitive sensitive **information** by both firms

$\Longrightarrow$ FTC concluded this was sufficient to trigger a (Clayton Act) Section 7 violation.

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Impact of CO on corporate strategy via alternative corporate governance channels:

1. Exert **voice** (via board representation) to actively facilitate coordination across competing firms
2. Exercise **voting** rights and **veto rights**, eg to prevent activism involvement that would lead to more aggressive product market stance
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5. Enforce **punishments** to managers/firms deviating from a collusive path
6. Limit access to **funding** for disruptive incumbents and entrants (not relevant if passive investors).

Common Ownership: The Mechanism Matters

Efficiency gains?

- "Quiet Life" channel implies that Common Ownership is also less likely to generate efficiency gains.
- Conversely, information dissemination favored by a common owner may bring about efficiency gains (Bhattacharya & Chiesa 1995, Lindsey 2008, Anton et al. 2017)).

Role of Concentrated Activists?

Can anti-competitive effects of CO be mitigated by the presence of concentrated owners?

- In the presence of common owners with voting/veto rights, can concentrated owners engage in effective activism?
- CO can discourage the acquisition of concentrated ownership.

Role of Concentrated Activists?

Consider an industry with two symmetric, A and B, with one fully diversified investor holding a share α_I in each firm.

What if an **outside investor** buys a stake α_O in firm A only?

- The concentrated owner will have an interest to spur A to compete aggressively. This would increase π_A and damage π_B.
- Note that the concentrated owner's presence in the industry will be reflected in a reduced $\Delta MHHI$

Concerns:

- Would the concentrated investor be able to truly change A's corporate strategy? CO can make concentrated owners less effective activists!
- Would such asymmetric ownership structure of the industry emerge in equilibrium? CO can discourage concentrated ownership.

Current Policy Proposals

Posner et al (2017):

- Argue that anticompetitive effects of CO call for litigation under Section 7 of Clayton Act.
- Propose a *safe harbor* if investors either (i) limit their holding of an industry to a small stake (at most 1%), or (ii) hold shares of only a single effective firm in the industry. Passive index funds would be not limited.

My concerns:

- It would favour emergence of quasi business groups, with institutional investors holding substantial stakes in firms across different markets $\rightarrow$ This comes with its own anticompetitive risks.
- It may limit access to funding for new entrants in the market.