Common Shareholding: Discussion

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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 → common investor holds stakes and actively interferes in management of competing companies.

⇒ Research bridging IO and corporate finance/governance has become more relevant to competition policy.
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- Private equity and VC investors specialise by sector (growing trend, see Gompers, Kovner and Lerner 2009).

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- Kinder Morgan Inc. and Magellan Midstream Partners are direct competitors in the market for gasoline and other petroleum product terminals and pipelines.
- **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.
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

⇒ FTC concluded this was sufficient to trigger a (Clayton Act) Section 7 violation.
Common Ownership: Which Mechanism?

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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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 $\alpha_I$ in each firm.

What if an outside investor buys a stake $\alpha_O$ in firm $A$ only?

- The concentrated owner will have an interest to spur $A$ to compete aggressively. This would increase $\pi_A$ and damage $\pi_B$.
- 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 → This comes with its own anticompetitive risks.

▶ It may limit access to funding for new entrants in the market.