Measure Common Ownership

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November 22, 2018

What Is Common Ownership?

- Common ownership reflects scenarios where two firms are at least partially owned by the same investor.

- Common owners might affect firms' strategic choices from self-organization (e.g., executive compensation, CEO turnover, equity grant, board structure, etc.) to integration with other firms (e.g., collaboration, alliance, M&A, etc.).

- Common owners can influence firms' decisions through the following three ways:
    - engagement: involving in-person conversations, telephone calls, emails and letters with the directors and managers of the firms.
    - vote: voting for/against proposals at the annual meeting.
    - exit: disciplining managers by threatening to sell their shares in the secondary market.

Features of Common Owners

- Common owners have at least following features:
  - Since they care about the value of their portfolio instead of single firm, they have an incentive to make efforts and support firm's actions that will increase the value of other firms in the portfolio, even it will harm this firm.
  - Since they hold comparable firms simultaneously, they can draw on experience and monitor them more effectively.
  - They can transmit policies in one firm in their portfolio to another, which will result in co-movement.

Measure Common Ownership 1

- We are going to measure common ownership as "incentive to support/deny a policy considering its externality".
  - Suppose the focal firm A launchs an annual meeting to decide whether adopt the policy or not through voting.
  - This policy will bring externalities to other firms, called peer firms, denoted by Γ.
  - These externalities are presented as a vector: $(\Delta_{1,A}, ..., \Delta_{N-1,A})$.
  - Suppose there are I investors in the market. $\alpha_{i,A}$ denotes the fraction of firm A owned by investor i. And $\beta_{i,A}$ represents the weight of firm A in the portfolio of investor i.

Measure Common Ownership 1 (Cont'd)

- Then the incentive of investor i on the policy coming from externality $\Delta_{B,A}$, $B \in \Gamma$ is:
    - $Incentive_{A,B,i} = \eta(\alpha_{i,A})g(\beta_{i,A})\alpha_{i,B}\Delta_{B,A}$
    - $\eta(\alpha_{i,A})$ is the extent to which the manager cares about investor i. Specially, when it equals $\alpha_{i,A}$, manager cares all investors' threat of exist; when it equals $\alpha_{i,A,voting\ share}$, manager cares all votes; when it equals $\alpha_{i,A} \cdot \mathbb{1}\{\alpha_{i,A} \geq 5\%\}$, manager only cares blockholders.
    - $g(\beta_{i,A})$ is the probability that investor i notice the detail and influence of this policy. Specially, when it equals to 1, all investors are perfectly informed.
    - $\alpha_{i,B}\Delta_{B,A}$ denotes the magnitude of externality.

Measure Common Ownership 1 (Cont'd)

- Aggregating across all investors, we obtain $GGL_{A,B}$ measure, which means incentive per externality.
  - $GGL_{A,B} = \sum_{i \in I} \eta(\alpha_{i,A}) g(\beta_{i,A}) \alpha_{i,B}$

- Aggregating across all peer firms, we obtain $Incentive_{A,\Gamma}$
  - $Incentive_{A,\Gamma} = \sum_{B \in \Gamma} \sum_{i \in I} \eta(\alpha_{i,A}) g(\beta_{i,A}) \alpha_{i,B} \Delta_{B,A}$

- If externalities are the same among all peers, we obtain $GGL_{A,\Gamma}$
  - $GGL_{A,\Gamma} = \sum_{B \in \Gamma} GGL_{A,B}$

- If each externality is a fraction of the market capitalization, we obtain $GGL_{A,\Gamma}$
  - $GGL_{A,\Gamma} = \sum_{B \in \Gamma} \frac{v_B}{v} GGL_{A,B}$

Measure Common Ownership 1 (Cont'd)

- Examples:
  - whether to deny a goverance-related proposal
  - whether to support a M&A
  - whether to support a stronger tie between consumer and supplier
  - whether to support to organize a technological alliance

Measure Common Ownership 2

- Next, we consider the second feature of commen owners, who can monitor the firms in their portfolio more effeciently by drawing on experience of other firms. Suppose the management/monitor experience sharing between firm A and its peers Γ.
  - $CO_A = \sum_{i \in I} \sum_{B \in \Gamma} \eta(\alpha_{i,A}) \epsilon(\alpha_{i,B})$
  - $\eta(\alpha_{i,A})$ captures investor i's monitor power on manager A.
  - $\epsilon(\alpha_{i,B})$ denotes the former goverance-related experience investor i can draw on.

Measure Common Ownership 3

- Finally, we focus on the information transmission role of the common owners. They can obtain policies from one firm in their portfolios, and then tell this information to other peer firms. As a result, they can accelerate the co-movement process.

- For example, when one firm in oil industry decides to disclose more product risk, common owners will tell this information to its peers in the same industry, and give them a pressure to disclose more information.

- Suppose firm A proposes a policy, and the pressure from common owners on B is:
  - $CO_{B,A} = \sum_{i \in I} \eta(\alpha_{i,A}, \alpha_{i,B})$
  - Specially, it may be the number of common blockholders.

Reference

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