

Blockholders and Corporate Governance

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Theory: Governance Through “Voice” / Intervention

- Shleifer and Vishny (1986): blockholders overcome free-rider problem
- Kahn and Winton (1998): even if blockholder’s incentives are sufficient, may “cut and run”
 - Coffee (1991) and Bhidé (1993): liquidity undesirable
 - EU mandated disclosure of short positions (11/12) and financial transactions tax (9/11)
- Maug (1998), Faure-Grimaud and Gromb (2004): liquidity can improve intervention
- Burkart, Gromb, and Panunzi (1997): intervention may be *ex post* desirable but *ex ante* undesirable



Theory: Governance Through “Exit” / Trading

- Admati and Pfleiderer (2009), Edmans (2009)
 - Blockholders can govern even without control
- Liquidity may ↑ rather than ↓ governance
 - Aggressive trading
 - Fully offset by camouflage in a Kyle (1985) model
 - Information acquisition
 - Block formation
- Multiple blockholders may ↑ rather than ↓ governance
 - Edmans and Manso (2011)



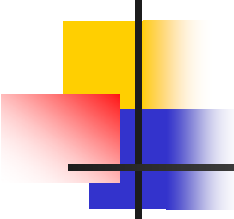
Theory: Governance Through “Exit” / Trading (cont’d)

- Implies a new way of thinking about blockholders – as informed traders, rather than controlling entities
 - Links corporate finance to asset pricing
 - Bond, Edmans, and Goldstein (2012): “The Real Effects of Financial Markets” (*Annual Review of Financial Economics*)
- New research directions incorporating other features of informed trading models (which currently assume exogenous firm value)
 - Goldman and Strobl (2013): blockholder faces a liquidity shock
 - Dasgupta and Piacentino (2013): blockholder has career concerns



Empirical Challenges

- Identification
 - Reverse causality
 - Omitted variables
- Blockholders are a diverse class
 - Considering them as a homogenous entity may miss interesting effects at a granular level
- Theories are about the *threat* of exit and voice, not just the actual act
- Far from ↓ attractiveness as a research topic, these empirical challenges ↑ it



Evidence: Blockholders and Firm Outcomes

- Barclay and Holderness (1991): 16% return to block trades
- Holderness and Sheehan (1988), McConnell and Servaes (1990), Mehran (1995): little effect on outcomes
- Cronqvist and Fahlenbrach (2009) disaggregate and find blockholder FE
 - Investment and financial policies, accounting perf, exec comp
- Becker, Cronqvist, and Fahlenbrach (2011): density of wealthy individuals as an instrument for *individual* blockholders



Evidence: Voice

- McCahery, Sautner, and Starks (2011): survey
- Yermack (2010): “the success of institutional activism to date appears limited”
- Brav, Jiang, Partnoy, and Thomas (2008), Klein and Zur (2009), Boyson and Mooradian (2011): activist hedge funds’ 13D
- Carleton, Nelson, and Weisbach (1998), Becht, Franks, Mayer, and Rossi (2009): private letters



Evidence: Exit

- Parrino, Sias, and Starks (2003): investor sales precede CEO turnover and –ve returns
- Gallagher, Gardner, and Swan (2013): frequent trading →↑ price informativeness and profits
- Fang, Noe, and Tice (2009): liquidity →↑ firm value
 - Bharath, Jayaraman, and Nagar (2013): particularly if blockholders and equity-aligned manager
- Edmans, Fang, and Zur (2013): liquidity attracts blockholders, and induces governance through exit



Directions for Future Research

- Voice: data entrepreneurship (esp. finer data), identification of causal effects
- Exit: incorporate ideas from asset pricing
 - T: Multiple trading rounds, front-running
 - T: Interaction between voice and exit (undertaken by different blockholders) and other governance mechanisms (e.g. executive compensation!)
 - E: blockholders' relationship with microstructure variables
 - E: Regulatory changes may help identify causality
- Agency problems at the blockholder level
 - T: Interaction with private benefits of control
 - E: Gather data on blockholder agency problems