Blockholders and Corporate Governance

Prepared for the Annual Review of Financial Economics
Available at http://ssrn.com/abstract=2285781

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June 2013

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 Bhide (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