Institutional Investors and Corporate Governance: The Theoretical Literature

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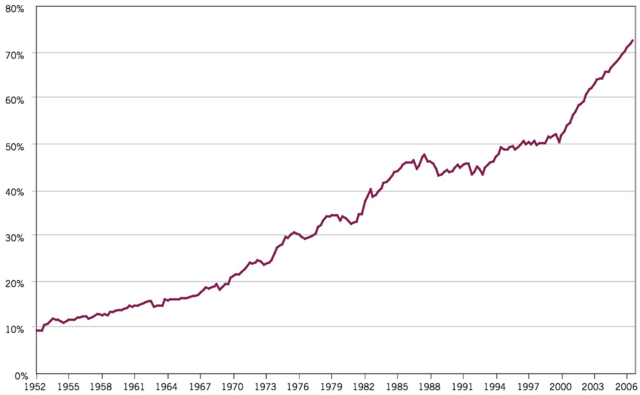
A big change in equity ownership (Gillan and Starks JACF 2007)

Figure 1 **Percentage Ownership of Institutional Investors in U.S. Stock Markets**

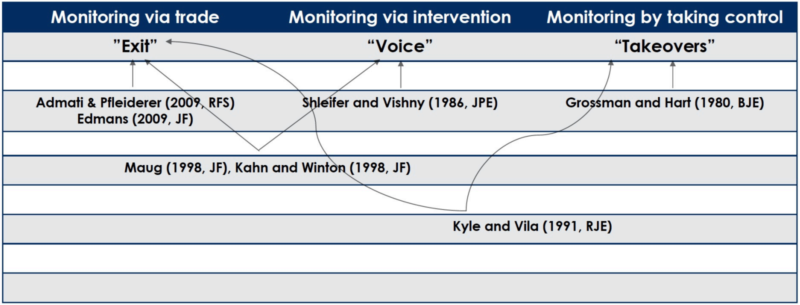


Asset managers (MF, HF, PF), Banks, Insurance Companies.

Plan for this short "survey" talk

- Trace how the theoretical literature on governance by external shareholders has responded to this change.
- In the process, I'm going to highlight how the 6 theory papers on the programme fit into this "response".
- To get started, I want to go back to the beginnings of the literature on governance by outside shareholders.
    - By necessity, I'll be brief in my remarks on papers, including those written by people in this room. Please forgive me if I am inadvertently superficial in representing your work!

Corporate governance: The classics



General models: Could apply to both institutions and individuals *in principle*.

Indeed individuals feature famously in classic governance mechanisms *in practice!*

- Voice: Main actors until mid-1980s were individuals. "Gadfly investors": Lewis and John Gilbert, Evelyn Davis
- Takeover: Victor Posner—the original corporate raider—first hostile take-over of Detroit cigar maker based on his private real-estate fortune.

Placing some conference papers in context

Monitoring via trade	Monitoring via intervention	Monitoring by taking control
"Exit"	"Voice"	"Takeovers"
Admati & Pfleiderer (2009, RFS) Edmans (2009, JF)	Shleifer and Vishny (1986, JPE)	Grossman and Hart (1980, BJE)
Maug (1998, JF), Kahn and Winton (1998, JF)		
	Kyle and Vila (1991, RJE)	
Back, Collin-Dufresne, Fos, Li, Ljungqvist (2017)		*Burkart and Lee (2017)* *Corum and Levit (2017)*

Dual-class shares literature (Grossman and Hart 1988, JFE; Harris and Raviv 1988, JFE): Optimality of 1S1V.

Point of departure: Institutional investors are professional traders, can trade in a sophisticated manner to separate "influence" from economic exposure.

1. **Kalay and Pant (2009, WP):** Ability to endogenously (dynamically) separate influence from exposure can enhance firm value in takeovers.
2. **Brav and Mathews (2011, JFE):** Empty voting (generated by institutional trading) can be good since it places more voting power with more informed party, even if occasionally they do nefarious things.
3. **Zachariadis and Olaru (2016, ROF):** Cross-market trading in equity and debt can deliver suboptimal outcomes in corporate restructuring even when proposals are endogenous.

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	Kyle and Vila (1991, RJE)	
Edmans, Levit, Reilly (2017, WP)		

Point of departure: Institutional investors monitor using *other people's money*.

Dasgupta and Piacentino (2015, JF): Common delegation friction—flow-sensitivity—weakens the credibility of exit threats.

1. If a firm has a flow-sensitive blockholder (e.g. a MF) exit will be less effective than if it has a single (relatively) flow-insensitive blockholder (e.g. a HF).
2. If threat of exit makes it more likely that managers will heed blockholder voice, flow sensitive institutions will use voice less than flow-insensitive ones.

Goldman and Strobl (2013, JFI): Effect of (given) blockholder short-termism on firm investment policy.

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	Kyle and Vila (1991, RJE)	
	Song (2017, WP)	
Dasgupta and Piacentino (2015, JF)	*Piacentino (2017, WP)*	

Emerging themes: Blockholder heterogeneity and interaction

Edmans and Holderness (2017): Blockholders are heterogenous, take heterogeneity seriously.

Dual layered structure: "Natural" source of heterogeneity, e.g., flow-sensitivity manifests differently across institutions.
Banks or hedge funds less (purely) flow-driven than mutual funds?

How would this manifest more richly in behaviour? Could heterogeneous blockholders *interact* in governance?

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	Song (2017, WP)	
Dasgupta and Piacentino (2015, JF)		*Brav, Dasgupta, Mathews (2017, WP)*

Looking forward...

- Two sets of agency frictions
  1. between shareholders and corporate executives, and
  2. between (delegated) shareholders and the ultimate capital providers
- Both are ubiquitous.
- The small (but growing!) literature that recognizes the co-existence of these two frictions is only the beginning.
- There is much more to do.
- I hope that over time this literature will impact the way in which economists and practitioners view corporate governance.