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Comments on "Common Ownership, Competition, and Top Management Incentives"

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If one shareholder owns two competing firms, he will want the firms to compete less with each other. We show theoretically and empirically that if the ownership of the companies in an industry is more concentrated in a group of large shareholders, then industry executives are paid more but their pay depends less on their firm's absolute performance and less on how it does relative to its competitors. Our conclusion remains the same even when we instrument for common ownership by using changes resulting from the 2003 mutual fund trading scandal.

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As measured by their own assertions, almost half of the hundreds of engage-ment meetings conducted every year feature discussions about executive compensation (Melby, 2016).

BlackRock (BLK) âĂŞ the largest shareholder of about one fifth of all American corporations (Davis, 2013)

Schlangenstein (2016) reports that a common owner of six US airlines explicitly demanded that Southwest Airlines (SWA boost their fares but also cut capacity a move against what SWA managers believe to be in SWA best interest; see also Levine (2016).

However, all told RPE is used in less than half of all contracts (Gong et al., 2011; De Angelis and Grinstein, 2016; Bettis et al., 2014). We are interested in whether common ownership helps explain the variation n the use of RPE. Specifically, we measure how common ownership concentration relates to the actual pay managers receive, and therefore how the RPE provisions aËŹect managersâĂŹ economic incentives.

POINT: Over time, RPE has increased surely, while common ownership has also increased I bet.

if the most powerful shareholders of a firm also own stakes in the firmâĂŹs competitors, shareholders want to incentivize managers to compete less aggressively (e.g., avoid price wars with the goal to increase market share). Instead, shareholders then reward top managers more for industry profits, irrespective of whether the profits come from the firms the managers actually run or from the firms against which they compete.

common ownership implies it is better not to benchmark pay packages against aggregate industry fluctuations, thus rendering managerial pay packages riskier than they would be if common industry shocks were filtered out. Risk-averse managers with a given outside option therefore demand higher baseline pay as compensation for the additional risk.

Specifically, one novel contribution of our paper is to document both how many firms and what fraction of firms have a particular common investor among the top shareholders. For example, today both BlackRock and Vanguard are among the top five shareholders of almost

70 percent of the largest 2,000 publicly traded firms in the US; twenty years ago that number was zero percent for both firms. As a result of such common ownership links, ownership-adjusted levels of market concentration are frequently twice as large as suggested by traditional concentration indexes that counterfactually assume completely separate ownership.

POINT: 10 pages at 10 references per page and 2 authors per reference— this cites a crowd of 200 people!

POINT This reminds me of something Larry Summers maybe— said back in the 1980s: According to optimal portfolio theory, everybody holds the market portfolio and uses debt to adjust their risk. In that case, all firms have exactly the same shareholders, so they shouldn't compete with each other.

Proposition 1. Under both forms of competition, the optimal inverse compensation ratio xxxx increasing in $1x$ for $1/2 \leq x \leq 1$.

POINT: Endogeneity problem: Maybe an investment fund owns stock in lots of firms in one industry because that industry uses relative compensation. I don't see

why, though.

"Real-world ownership patterns are endogenously determined and could potentially be related to top management incentives, be that because of their effect on competition or for other reasons." HOW?

In 2003 there was a shareholder mistreatment scandal that meant about 5% of mutual fund assets left the bad mutual funds and went to other mutual funds. That affected common ownership percentages. How, is theoretically unclear. The shock is exogenous, but maybe the mutual funds getting teh new assets invested in common ownership in a way that depended on executive compensation too.

So I'd drop that section. It's usefulness is unclear.

Kisin (2011) shows that the eËŹect of withdrawals lasted until December 2006, and that outflows of implicated families amounted to 14% the first year, and over 21% the second year. Implicated families had an aggregate amount of assets under management of $236.5b, which amounts to 24.8% of the US mutual fund universe.

Table 4(4) is the key.

Don't use keys, use labels, on diagrams.

use boldface or soemthing on tables.

Table 4. Panel regressions: top management pay as a function of own-firm and rival profits, market concentration, and common ownership. This table presents the effects of product market differentiation (HHI) and common ownership (MHHID) on total compensation (TDC1) as described in equation (23). An industry is defined at the CRSP 4-digit SIC code. Column 1 presents the Aggarwal and Samwick (1999a) set-up âĂŞ own and rival profits, and product market differentiation, and their interactions âĂŞ complemented with industry and year fixed effects. Column 2 adds the measure of common ownership (MHHID) and the interactions with own and rival profits. Column 3 adds controls. Columns 4 and 5 run run specification 3 on the CEO and non-CEO subsample. Panel B reports the inverse compensation ratio test as described in equation (25): S is the change in the ratio of rival-firm pay-performance sensitivity over own pay-performance sensitivity (i.e. Îš) relative to the cdf of common own-

ership (MHHID). All standard errors are clustered at the firm level.