New Evidence, Proofs, and Legal Theories on Horizontal Shareholding

Einer Elhauge
Petrie Professor of Law
Harvard Law School
June 13, 2018
Horizontal Shareholding

- When the leading shareholders of horizontal competitors overlap.
- Decreases incentives to compete: equivalent to increased marginal cost because taking sales from rival costs shareholders profits in other firms.
- Industry studies confirm horizontal shareholding raises airline & banking prices significantly.
- Merchant of Doubt critiques rely on invalid methods
  - Use “proxies” for HS that are negatively correlated with HS
  - Assume longer flights have lower costs
  - Ignore fund family combinations of stock
  - Set shared voting rights equal to zero
Economic Proofs

• If managers maximize (1) expected vote share or (2) probability of re-election, they will maximize weighted average of their shareholders’ profits from all their stockholdings.

• If (1), weight by voting shares, so increased horizontal shareholding proportionally increase prices

• If (2), weight by odds particular shareholder’s vote will be pivotal, so extra weight to the largest shareholders

• Proof accounts for shareholder heterogeneity

• Communication unnecessary, but can increase weight of communicating shareholders
Effect on Executive Compensation

• Puzzle: Efficient for incentive-based compensation to be based only on firm performance, but much instead reflects industry performance.

• Economic proof: with horizontal shareholding, maximize shareholder interests by increasing weight of industry performance. (With full horizontal shareholding, equal weight on rival and firm performance.)

• Empirical evidence: markets with higher horizontal shareholding do just that. 99% statistical confidence.

• Requires no coordination or communication.

• Provides direct incentive to lessen competition.
Effects on Investment & Inequality

• From 1999 to 2014, probability that two large competing firms have a large horizontal shareholder increased from 16% to 90%.

• Over same period
  – gap between corporate investment and profits increased by the largest extent since World War II.
  – Greatest decline in labor share of income since World War II.

• Regression analysis: investment-profit gap driven by
  – level of horizontal shareholding in concentrated industries
  – within those industries, by the firms with high horizontal shareholding levels.
Connections to Economic Inequality

- Increases prices \(\rightarrow\) effectively reduces wages by reducing purchasing power. Disproportionately hurts workers, because they spend higher percent of income on consumption.
- Reduces corporate investment \(\rightarrow\) suppresses demand for labor \(\rightarrow\) lower wages.
- Increases monopsony power against labor \(\rightarrow\) lower wages.
- Increases corporate profits. Disproportionately benefits wealthiest 10% who own 81% of stock.
- Increases executive compensation \(\rightarrow\) larger gap with labor
- Increases inequality between laborers/shareholders who are in markets restrained by anticompetitive horizontal shareholding versus other laborers/shareholders.
Clayton Act §7 Remedy

- Stock acquisitions likely to have anticompetitive effects violate Clayton Act §7, even if no control or influence.

- Passive investor “exception” no obstacle because applies only if
  - solely for investment = don’t vote or otherwise influence
  - and does not actually have likely anticompetitive effects

- Should investigate if HHI > 2500 & ΔMHHI > 200 & condemn if likely anticompetitive effects are found
Sherman Act § 1 Remedy

• Any “contract, combination in the form of trust or otherwise, or conspiracy” that imposes a net restraint on competition is illegal.

• Horizontal shareholding involves formal contracts whose voting & financial rights create the anticompetitive effects.

• Antitrust law aimed to prohibit trusts that were horizontal shareholders. So also a “combination”.

• Effect of multiple contracts aggregated: e.g., exclusive dealing and vertical price-fixing

• Given possible efficiencies, rule of reason, so need to show anticompetitive effects.
U.S. Enforcers

- Trump administration seems disinclined.
- No private litigation yet.
- State AGs could bring parens patriae actions on behalf of any residents injured by horizontal shareholding. 15 U.S.C. § 15c-e.
  - Can use statistical or sampling methods to show aggregate damages without providing individual claims or damages, avoiding class action limits.
  - Damages are trebled & can be distributed to injured parties or treated as civil penalty and deposited in state treasury.