New Evidence, Proofs, and Legal Theories on Horizontal Shareholding

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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

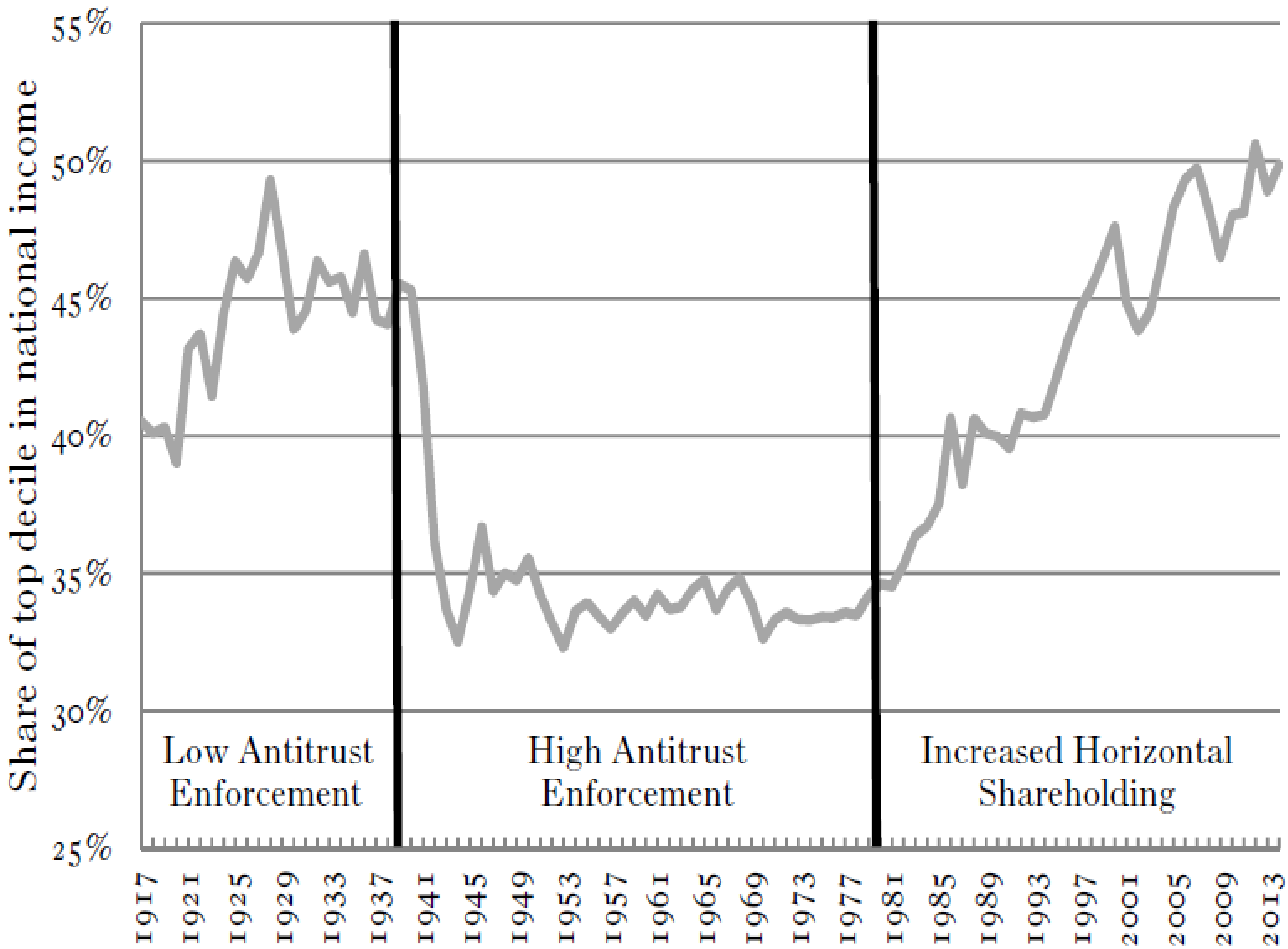
Effect on Executive Compensation

- 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.

Income Inequality in the United States, 1917–2014[129]



Connections to Economic Inequality

- Increases prices → effectively reduces wages by reducing purchasing power. Disproportionately hurts workers, because they spend higher percent of income on consumption.
- Reduces corporate investment → suppresses demand for labor → lower wages.
- Increases monopsony power against labor → lower wages.
- Increases corporate profits. Disproportionately benefits wealthiest 10% who own 81% of stock.
- Increases executive compensation → larger gap with labor
- Increases inequality between laborers/shareholders who are and 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.
- Anti***trust*** 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.