Superstar firms and market power: The role of common ownership and corporate spillovers

Davide Sinno - davide.sinno@usi.ch

Swiss Finance Institute & USI Lugano

Summary

- Does the surge of common ownership contribute to the rise of superstar firms and their market power?
- Passive common owners help superstar firms to internalize technological and managerial knowledge spillover resulting in higher profits and markups.
- Negative impact of common ownership on profits of not-commonly owned firms.

Motivation

Fact 1: The average markup of U.S. firms has increased substantially in the last years.

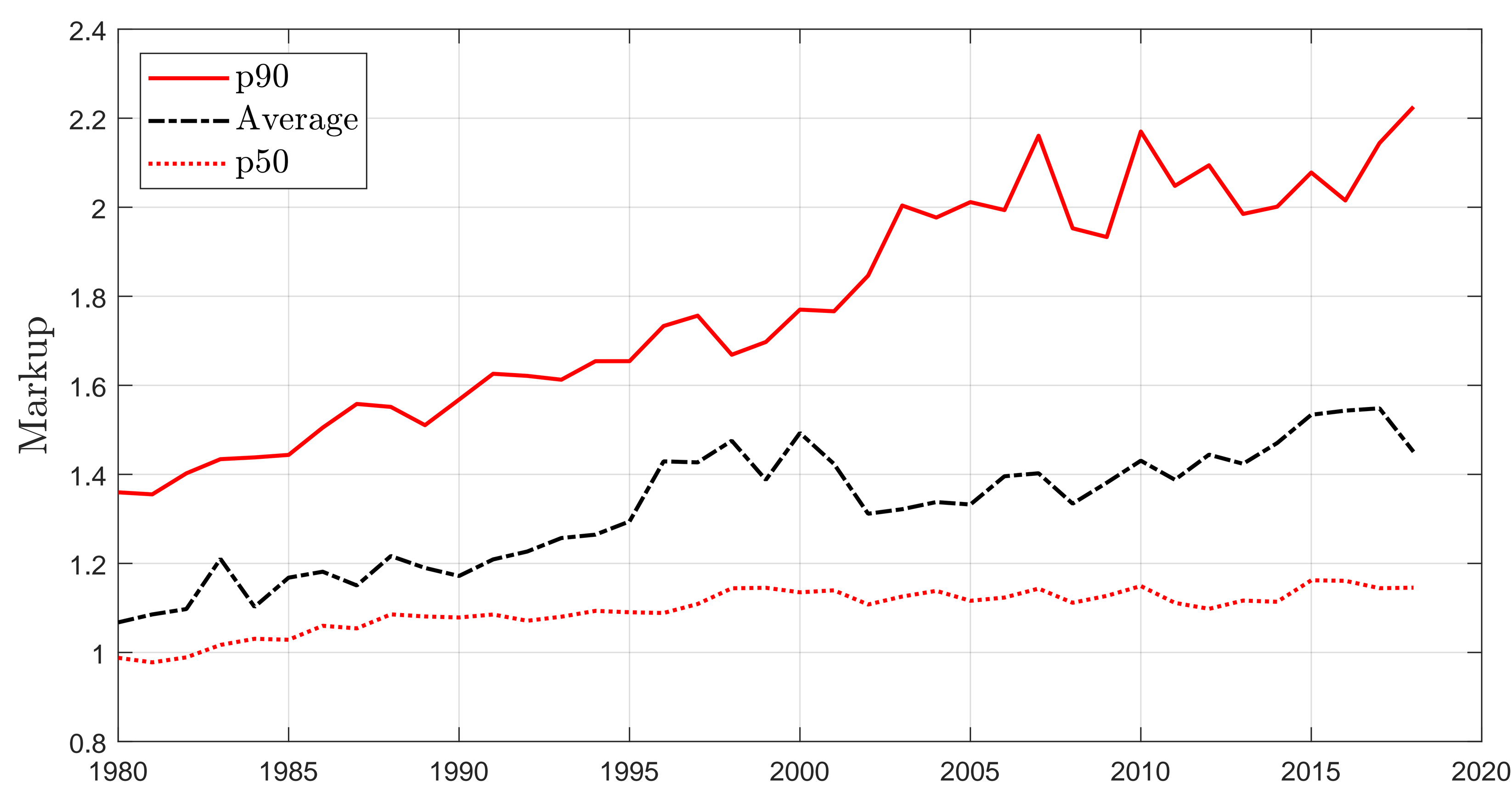

Figure 1: Markup distribution over time

- Average markup has risen from 15% in the '80s to 60% nowadays.
- Surge driven by firms in the upper tail of the distribution → **Superstar firms**.
- Near-monopoly or efficiency-based market power?

Fact 2: The evolution of institutional ownership with a shift from active to passive investors has changed the firm's ownership structure.

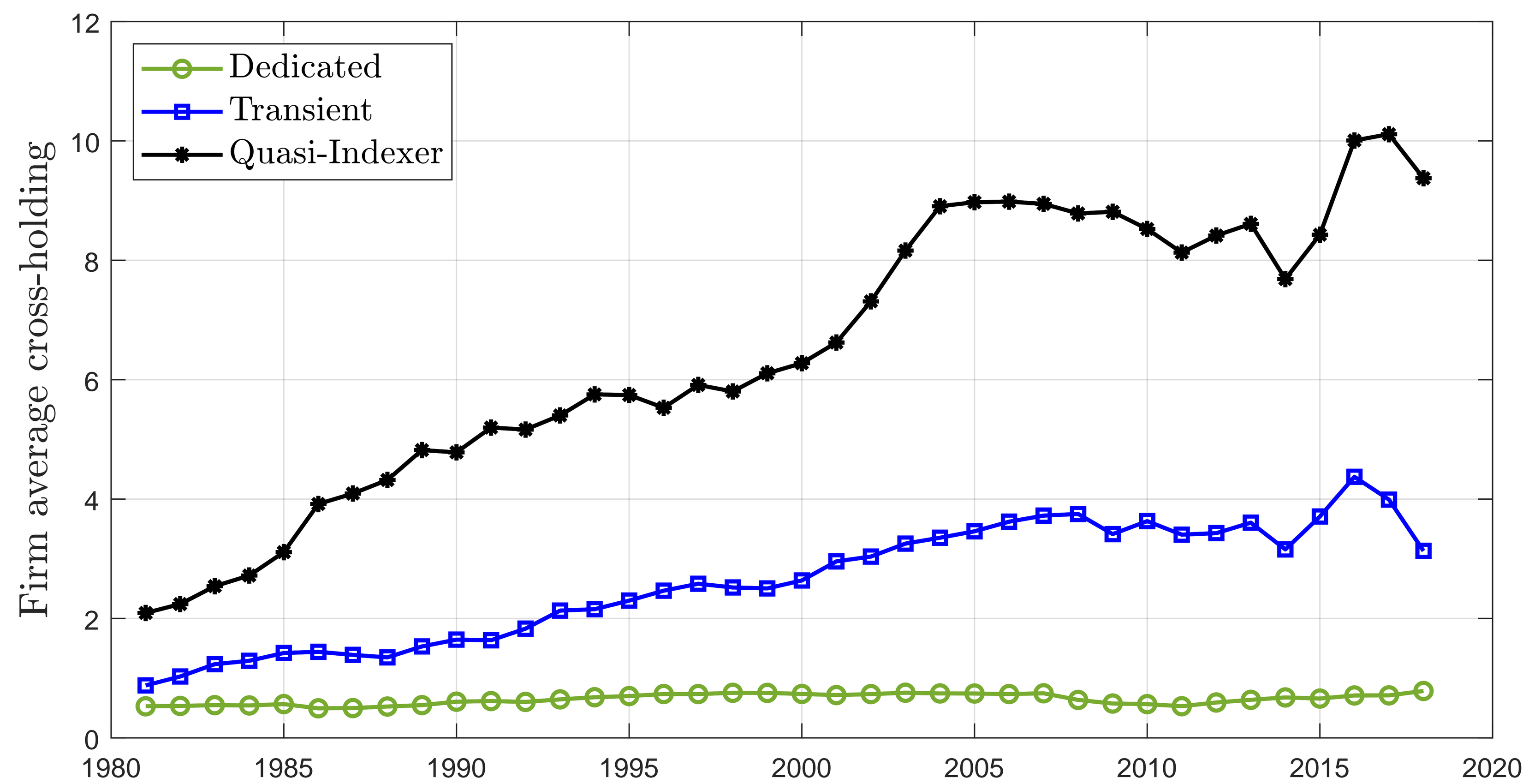

Figure 2: Common ownership evolution

- Firms share blockholding institutional investors with competitors.
- Industry common ownership by passive institutional blockholders is climbing.

Research question

- Is there a relation between the rise of common ownership and superstar firms?
- Does common ownership sustain near-monopoly or efficiency-based market power?

Theory background

Common ownership facilitates information sharing, which helps firms to internalize spillovers resulting in higher markups and profits (Lopez and Vives [2019], Vives [2020]).

Anecdotal evidence

"We are an active voice, we work with companies, but we need to work for the long-term interest. In my mind activists are trying to improve the company, in most cases, in the short term because they improve the company and then leave. We are not going to leave."

—Larry Fink, BlackRock CEO

Data

- Institutional ownership data: Thomson Reuters
- Institutional investor classification data: Bushee (1998, 2001)
- Common ownership measure: He and Huang (2017)
- Technology spillover data: Bloom et al (2013)
- Management practice data: World Management Survey
- Markup and profit rate: De Loecker et al (2020)

Methodology

Two types of spillovers:

1. Technological spillover
   - Spillover internalization more beneficial for firms with similar technologies.
2. Managerial knowledge
   - Spillover internalization more beneficial for firms with good management practice.

I exploit cross-industry variation in technology spillover and management practice within U.S states.

Identification

Superstar firms in high tech spillover/good management practice industry should have relatively larger margins in state with higher common ownership.

I implement the identification strategy estimating two panel-based fixed effect regressions:

$$Y_{ijt} = \beta_0 + \beta_1(\text{Common ownership}_{it} \times \text{Tech Spillover}_j) + \beta_2 \text{Market share}_{ijt} + \mu_j + \tau_{it} + \epsilon_{ijt}$$

$$Y_{ijt} = \beta_0 + \beta_1(\text{Common ownership}_{it} \times \text{Mgmt. Practice}_j) + \beta_2 \text{Market share}_{ijt} + \mu_j + \tau_{it} + \epsilon_{ijt}$$

- Y_{ijt} is the average log markup (profitability) of firms in the top decile of markup (profitability) distribution of industry j in state i over year t.
- Positive β_1 indicates that a rise in common ownership exerts a disproportionately positive effect on industries with high technological spillover/good management practice.

Main result

Table 1: Superstar firms' markup and profit rate

	CO_{it} × Tech spillover$_j$	CO_{it} × Mgmt practice$_j$	Mkt share$_{ijt}$	R^2	N
Markup	0.031**		0.373	0.74	2913
	(0.011)		(0.272)		
Markup		0.274***	0.062	0.67	379
		(0.081)	(0.240)		
Profit	0.002*		0.086	0.61	2916
	(0.001)		(0.054)		
Profit		0.054***	0.089*	0.54	375
		(0.020)	(0.048)		

I measure the effect of moving common ownership from the 25th to the 75th percentile:

- Superstars firms' markup and profit increase by 5.5% and 2% in sectors with high tech spillover relative to low tech spillover sectors.
- Superstar firms' markup and profit increase by 17% and 15% in sectors with good management practice relative to bad practice sectors.

Additional results

- Common ownership ameliorates monitoring and targeting practices.
- Common ownership harms firms' profit in the lower part of the profit distribution.

Conclusion

Rising common ownership sustains the growth of superstar firms (source of innovation). However, it harms the profit of smaller firms (jeopardizing competition).