

Is Blockholder Diversity Detrimental?

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Abstract

We examine whether blockholder diversity, i.e., a firm being held simultaneously by multiple types of blockholders, is detrimental to firm performance. Block ownership is frequently revealed around a random pre-specified date (Feb. 15), and we show that around such dates the market responds significantly more negatively when filings reveal that block ownership has become diverse. Moreover, firms held by heterogeneous blockholders consistently perform worse than firms held by homogeneous blockholders. These results prevail following exogenous shocks to block ownership—death/retirement of blockholders and outflows following the mutual fund scandal. These patterns may be explained by our finding that heterogeneous blockholders experience frequent disagreement: shareholders are more likely to sue the firm when heterogeneous blocks exist, and disagreement rates at shareholder votes are larger when blockholders are diverse. Our findings imply that blockholder diversity is detrimental to performance and exacerbates disagreement.

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1. Introduction

Different types of blocks can coexist in a company.² The extant literature typically investigates how the presence of any, or one specific type of blockholder, is related to company performance and operations.³ In addition, recent literature has investigated the impact of multiple common financial blocks.⁴ To the best of our knowledge, however, this paper is the first to investigate whether heterogeneous block ownership is detrimental to firm value, and if so, why.⁵ Diversity among blockholders can potentially have a two-sided effect on firm value. On the one hand, blockholders' beliefs, expertise, risk preferences, skills, and access to different information might lead to synergies or to cross monitoring (e.g., Dhillon and Rossetto (2015)). On the other hand, each blockholder may try to extract private benefits (e.g., Zwiebel (1995)), and different types of blockholders may have conflicting views and objectives (Holderness and Edmans (2017)), which may lead them to clash and be detrimental to firm performance. We find support for the latter possibility.

To address our question, we manually assemble a unique panel-dataset that covers the universe of the blockholders (i.e., shareholders holding at least 5% of the firm's outstanding shares) of all publicly traded firms in the U.S. during the 1994-2018 period, using more than half-million of 13D and 13G filings (see details in Appendix A). Our data documents that U.S. firms have a diverse blockholder base: More than 80% of the U.S. publicly traded firms are held by at least two blocks, each holding at least 5% of the firm's outstanding shares. We measure block diversity as a function of the number of different types of blockholders (i.e., passive institutions, active

² See Cronqvist and Fahlenbrach (2009), Edmans and Holderness (2017), and Hadlock and Schwartz-Ziv (2019).

³ Admati and Pfleiderer (1994), Kahn and Winton (1998), Shleifer and Vishny (1986) theoretically explore the ability of a single large blockholders to influence the company. Konijn, Kraussl, and Lucas (2011), Laeven and Levine (2008), (2005) empirically investigate how block ownership and block concentration relate to company value.

⁴ See for example He and Huang (2017), Azar, Schmalz, and Tecu (2018), Dennis, Gerardi, and Schenone (2018), and Lewellen and Lowry (2018).

⁵ Perhaps some particularly related papers are Cronqvist and Fahlenbrach (2009) who detect a significant heterogeneity in the impact different types of blockholders on governance and firm value, and Maury and Pajuste (2005) who show that a relatively equal distribution of votes among large blockholders has a positive effect on firm value.

institutions, individuals, and all other private blocks). We show that 36% of the firms with multiple blocks are held by at least two different types of blocks.

In our first test aimed at understanding whether block diversity enhances or is detrimental to firm value, we take advantage of the fact that a substantial portion of blockholders purchasing a block (46% of the blocks) disclose the block purchase on a random pre-specified date (approximately around February 15 that follows the purchase of the block). This occurs because blockholders who do not declare themselves as active blockholders (i.e., they file a 13G) are permitted to file the 13G filing disclosing their purchase up to 45 days after the calendar year ends, i.e., Feb 14th.⁶ We find that the majority of the 13G filings are filed between Feb 8th-18th (we observe that some of the 13G filings are made immediately after the Feb. 14th deadline). We view these latter filings as filings filed on an exogenously predetermined date.

Our unique setting offers a substantial strength because examining the market response around non-random dates at which blockholders purchase blocks does not allow disentangling whether the market response around the filing date is to the blockholder's entrance, or to some other event which also facilitated the entry of the blockholder. In our analysis, which excludes all blocks that have revealed their position in an earlier filing, the filing date typically occurs months after the date the block actually entered, and thus, we may attribute the observed market response specifically to the entrance of the block. When on a random pre-specified date a block entry is reported, thereby also revealing a new heterogeneous blockownership base, the market responds significantly more positively when compared to block entries filed around the same time that maintain a homogenous blockownership base.

These results suggest that having a diverse blockownership base is detrimental to performance. To further test this conclusion we conduct several additional tests. First, we create portfolios in which we take a long position on firms that have a diverse blockholder base (i.e., they

⁶ As specified on the SEC webpage: <https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm>

are held by at least two different types of blockholders), and a short position on firms that have a homogenous blockholder base (i.e., they are held by at least two blockholders and all blockholders are of the same type). We find that such a portfolio produces an annual return of 2.4%-6.1%. Second, we find that firms that have a heterogeneous blockholder base are expected to have a lower Tobin's Q, ROA, ROE and profit margin relative to firms with a homogenous shareholder base.

To establish a casual effect of diversity on firm performance for the latter test, we conduct two tests. In the first test we define an exogenous block departure as a departure resulting from the death or retirement (i.e., above age 65) of an individual blockholder. We find that when such a departure leads to a decrease in block diversity, it is followed by an increase of Tobin's Q, ROA, and profit margin—which is consistent with our prior findings. In the second test, we define an exogenous block departure as the departure of a blockholder that was one of the 25 institutions accused of illegal trading in the 2003 mutual fund scandal, and the block ceased to exist following the scandal, leading to a decrease in block diversity. We find that following such departures, Tobin's Q and profit margin increase, consistent with our prior findings demonstrating enhanced profitability for firms with a more homogenous blockholder base.

We hypothesize that the channel for block diversity being detrimental to performance is increased conflict emerging when blockholders are heterogeneous. Figure 1 demonstrates this hypothesis. Figure 1 portrays a picture based on a Russian tale written by Ivan Krylov (1814) demonstrating how a swan, a fish and a lobster all try to move together a wagon. Because each animal pulls/ pushes the wagon in a different direction (air, sea, and ground, respectively) they are not able to move the wagon. Similarly in our context, we hypothesize that different types of blockholders will have different visions, views and opinions on where and how the company should proceed, and thus conflict is more likely to arise when the blockholder base is diverse.

Indeed, we find evidence for this hypothesis. We assemble a unique dataset which focuses on lawsuits by shareholders, and find that shareholders are more likely to sue the firm when the

blockholder base is diverse. In addition, we find that shareholders are more likely to disagree with each other at shareholder meetings if the blockholder base is diverse. These findings suggest that having a diverse blockholder base incites disagreement, and can create challenges in coordinating shareholders.

In our view, our paper makes three main contributions. First, we are the first to investigate the relation between block diversity and firm performance, and we demonstrate that diversity among blockholders has a negative impact on firm value. Second, we demonstrate that firms with a diverse blockholder base are more likely to experience disagreement. Our analysis offers a mechanism that explains why firm performance suffers when blockownership is diverse—coordination is challenging among a diverse blockholder base. Finally, we construct a comprehensive and unique dataset covering every block position in all U.S. public companies between 1994 and 2018.⁷ The dataset includes data on 262,417 block positions and 22,330 unique blockholders in 11,812 unique companies. To the best of our knowledge, this dataset is the most comprehensive and up-to-date panel dataset that has been assembled for an academic study. We provide insights on block composition for different samples (e.g., broken down by indexes), and reveal patterns on block diversity: For example, that firms are increasingly likely to have a diverse blockholder base.

⁷ Hadlock and Schwartz-Ziv (2019) construct a dataset on blockholder ownership for the 2001-2014 period, but their dataset includes, roughly, only the Russell 3000 firms. Thus, the current dataset offers coverage for a larger number of firms and includes a longer period.