Asset Pricing:
Institutional Investors

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2024

Institutional Investors

- Institutional investors are one important part of the market participants. As they are institutions, most of them are in the form of firms.

- Just like any other firms, what happens there will happen in mutual funds and hedge fund as well.

- Accordingly, there is a strand of literature that regard the mutual funds and hedge funds as just one type of firms. The main difference of these funds from other firms is that, the main work of the funds is investing.

Question

- How the mutual fund and hedge fund vote for their investment companies?
- What's the difference between mutual fund holder with other block holders?
- How mutual fund and hedge fund influence other firm's corporate governance?
- How mutual fund and hedge fund interact with other firms in general?

Shleifer and Vishny (1997)

- Due the free ride problem, the quality of corporate governance is negatively correlated with dispersion of shareholders.
- Else equal, a firm with concentrated shareholder would have better corporate governance.
- Blockholder would have more incentive to actually monitor the corporate, due to their huge stake.
- The reality is that with the fast growing in passive investing, the largest shareholders of some firms become the giant passive investors like Blackrock, Fidelity and Vanguard.
- How institutional investor influence the firms?

Azar, Schmalz, and Tecu (2018): How large institutional investors influence market competition?

- They document that common ownership of stocks leads to higher product prices.
- To keep the product's comparability, they focus on a specific market: airplane.

$$ln(P_{rjt} = \beta \times MHHIdelta_{rt} + \gamma HHI_{rt} + \theta X_{rjt} + \alpha_t + \nu_{rj} + \epsilon_{rjt}$$

where MHHIdelta is the difference bewteen MHHI and HHI.

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One attractive property of the MHHI is that it allows one to decompose total market concentration (MHHI) into two parts: industry concentration as measured by HHI, $\sum_j s_j^2$, where s_j is the market share of firm j; and common ownership concentration, referred to as MHHI delta. HHI captures the number and relative size of competitors while MHHI delta captures the extent to which those competitors are connected by common ownership and control links. Formally,

$$\underbrace{\sum_j \sum_k s_j s_k \frac{\sum_i \gamma_{ij}\beta_{ik}}{\sum_i \gamma_{ij}\beta_{ij}}}_{\text{MHHI}} = \underbrace{\sum_j s_j^2}_{\text{H}HI} + \underbrace{\sum_j \sum_{k \neq j} s_j s_k \frac{\sum_i \gamma_{ij}\beta_{ik}}{\sum_i \gamma_{ij}\beta_{ij}}}_{\text{MHHI delta}}, \tag{1}$$

where β_{ij} is the ownership share of firm j accruing to shareholder i, γ_{ij} is the control share of firm j exercised by shareholder i, and k indexes firm j's competitors.

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Azar, Duro, Kadach and Ormazabal (2021)

- The holding of BalckRock, Vanguard and State Street Global Advisors would significantly reduce the investment firm's carbon emission.

$$\ln(CO_2)_{it} = \alpha + \beta \cdot \text{Big3}_{it-1} + \gamma \cdot \text{NonBig3}_{it-1} + \Phi \cdot \text{Controls}_{it-1} + \tau_t + \delta_i + \epsilon_{it}.$$

Azar, Duro, Kadach and Ormazabal (2021)

Table 4
Big Three ownership and firms' carbon emissions

This table presents an analysis of the association between levels of Big Three ownership and levels of total carbon emissions. The sample spans from 2005 to 2018 and includes 19,224 firm-year observations in the MSCI subsample and 22,969 firm-year observations in the non-MSCI subsample. The dependent variable is the logarithm of CO_2 (i.e., the firm's total GHG emissions measured in equivalents of metric tons of CO_2). The experimental variable, *Big3_hldg*, is the fraction of the firm's equity owned by mutual funds sponsored by BlackRock, Vanguard, or State Street. *NonBig3_hldg* is the fraction of the firms' equity owned by funds managed by institutions other than BlackRock, Vanguard, and State Street. The control variables are defined in Appendix A. Columns (1)–(3) report results corresponding to the subsample of firms that are members of MSCI World Index. Columns (4)–(6) report results corresponding to the subsample of firms that are not members of MSCI World Index. Both subsamples span the period from 2005 to 2018. Independent variables are measured at the end of the prior year. Standard errors are clustered at the firm and year level. *t*-statistics are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels (two-tail), respectively. Intercepts are omitted.

	Dependent variable: Log (CO_2)					
	MSCI			Non-MSCI		
	(1)	(2)	(3)	(4)	(5)	(6)
Big3_hldg	−3.44***	−1.69**	−1.00***	−0.76	0.66	0.46
	(−5.76)	(−2.27)	(−2.83)	(−1.09)	(1.41)	(1.60)
NonBig3_hldg	−0.04	−0.12	−0.07	0.36***	0.26**	0.18**
	(−0.25)	(−0.74)	(−0.75)	(3.43)	(2.50)	(2.47)
Controls:						
Size	0.79***	0.80***	0.55***	0.81***	0.79***	0.56***
	(42.88)	(42.21)	(13.77)	(50.85)	(54.50)	(14.96)
Log*(BM)*	0.01	0.01	−0.02**	−0.06***	−0.06***	−0.05***
	(0.55)	(0.30)	(−2.29)	(−3.25)	(−3.16)	(−4.36)
ROA	1.52***	1.53***	0.89***	2.95***	2.83***	0.57***
	(4.55)	(4.65)	(5.39)	(14.26)	(12.89)	(6.30)
Leverage	0.03	0.02	0.05	0.38***	0.41***	0.17**
	(0.23)	(0.15)	(0.69)	(3.03)	(3.29)	(2.22)
PPE	1.27***	1.27***	−0.01	1.19***	1.15***	0.51***
	(8.32)	(8.24)	(−0.08)	(12.01)	(11.54)	(4.38)
Country FE	YES	YES	NO	YES	YES	NO
Industry FE	YES	YES	NO	YES	YES	NO
Year FE	NO	YES	YES	NO	YES	YES
Firm FE	NO	NO	YES	NO	NO	YES
R^2	0.75	0.75	0.98	0.73	0.74	0.98
# obs.	19,224	19,224	19,134	22,969	22,969	22,468

Brav, Jiang, Partnoy and Thomas (2008): Do hedge fund influence the corporate governance and firm performance?

- In 2008, the hedge fund data is severely limited. They use a large sample of hand-collected data to studies if the hedge fund engage in corporate operation and if influence firms' performance.

Hedge Fund Activism, Corporate Governance, and Firm Performance

ALON BRAV, WEI JIANG, FRANK PARTNOY, and RANDALL THOMAS*

ABSTRACT

Using a large hand-collected data set from 2001 to 2006, we find that activist hedge funds in the United States propose strategic, operational, and financial remedies and attain success or partial success in two-thirds of the cases. Hedge funds seldom seek control and in most cases are nonconfrontational. The abnormal return around the announcement of activism is approximately 7%, with no reversal during the subsequent year. Target firms experience increases in payout, operating performance, and higher CEO turnover after activism. Our analysis provides important new evidence on the mechanisms and effects of informed shareholder monitoring.

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Evan, Prado, Zambrana (2020)

- Mutual funds within each mutual fund families may have difference relationships.

Competition and cooperation in mutual fund families☆

Richard Burtis Evans[a], Melissa Porras Prado[b,*], Rafael Zambrana[b]

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ARTICLE INFO

Article history:
Received 8 February 2018
Revised 12 December 2018
Accepted 9 January 2019
Available online 5 November 2019

JEL classification:
G23
J33
J44
L22
M12

ABSTRACT

Using manager compensation disclosure and intra-family manager cooperation measures, we create indices of family-level competitive/cooperative incentives. Families that encourage cooperation among their managers are more likely to engage in coordinated behavior (e.g., cross-trading and cross-holding) and have less volatile cash flows. Families with competitive incentives generate higher performing funds, a higher fraction of "star" funds, but greater performance dispersion across funds. In examining the determinants of incentive schemes, competitive families are more likely to manage institutional money, and cooperative families are more likely to distribute through brokers, consistent with retail demand for nonperformance characteristics.

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- They average 6 competition and cooperation variables to get the competition and cooperation index.

$$
\begin{aligned}
&Competition_{i,t} \\
&= (Individual\ fund_{i,t}^{DecRnk} + Bonus - fund\ performance_{i,t}^{DecRnk} \\
&+ Bonus - paid\ fund\ shares_{i,t}^{DecRnk} + Bonus \\
&- fund\ revenue_{i,t}^{DecRnk} + CIR_{i,t}^{DecRnk} \\
&+ Manager\ ownership_{i,t}^{DecRnk})/6. \qquad (1)
\end{aligned}
$$

$$
\begin{aligned}
&Cooperation_{i,t} \\
&= (Team\ fund_{i,t}^{DecRnk} + Managers/Fund\ ratio_{i,t}^{DecRnk} \\
&+ Manager\ connected_{i,t}^{DecRnk} + Bonus\text{-}paid\ advisor\ equity_{i,t}^{DecRnk} \\
&+ Bonus\text{-}advisor\ level\ determinants_{i,t}^{DecRnk} \\
&+ Other\ funds\ fee_{i,t}^{DecRnk})/6. \qquad (2)
\end{aligned}
$$

Conclusion

- Institutional investors are just one type of the firms.
- Sometimes they behaves just like any other firms. However, even studying the same question in mutual fund setting could generate a meaningful idea.