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Comment on 'Determinants of Intercorporate Shareholdings'

B. ESPEN ECKBO
Stockholm School of Economics and The Norwegian School of Economics and Business Administration

While intercorporate shareownership is common among publicly traded firms, systematic empirical evidence on this particular aspect of corporate ownership structure is sparse. Based largely on aggregated ownership data provided by various stock exchanges, we know that intercorporate holdings represent a relatively large proportion (above 40%) of the total equity value of exchange- listed firms in Japan and Germany, and a relatively low proportion (less than 10%) in the U.S. and the U.K. Thus, the Anglo-American corporate governance system appears to produce substantially lower levels of intercorporate shareholdings than does the German–Japanese governance model. While financial institutions in Germany and Japan play an integral role in the governance structures of those countries, securities laws inspired by early populist sentiments in the U.S. have prevented American financial institutions from playing a similar active role.[1] Much like the Anglo-American system, securities laws in Norway, the empirical laboratory of Bøhren and Norli (1997), also restrict the equity ownership and direct corporate governance participation of financial institutions. Perhaps as a result the level of intercorporate ownership on the Oslo Stock Exchange (OSE) is also relatively low (around 10%).

A country's corporate governance system is a complex set of economic and legal forces which explicitly and implicitly provide a commitment to suppliers of risk capital that they will receive a competitive return on their investments. These forces include legal (contractual) protection of securityholders,[2] firms' internal control systems,[3] as well as disciplinary effects of competition in product and capital markets.[4] What role is intercorporate ownership likely to play within this corporate

[1] See Roe (1990).

[2] Important examples include protection of minority interests, restrictions on transferability and use of voting rights, the illegality of various side-payment schemes (bribes), rules governing bankruptcy, and insider trading-regulations. See also Shleifer and Vishny (1995).

[3] The internal control system includes the board of directors in particular and the internal organizational structure and labor market in general.

[4] See Jensen (1993) for an extensive discussion of the effect product market competition in a corporate governance context. The disciplinary forces from the capital market include the possibility of hostile takeovers and the general high cost of external capital for a firm perceived to have entrenched management.

governance maze? Since a company's decision to hold shares in another firm is controlled by management itself, the answer depends on the market's perception of the quality of management: Entrenched management will use its discretion to try to offset utility-decreasing constraints imposed by the governance structure, while efficient management will try to enhance its value-increasing effects. Under the managerial entrenchment hypothesis, intercorporate shareholdings is a way of diversifying firm-specific risk, of 'parking' free cash flow (when it should be paid as dividends), and of 'grooming' white knights or partners for future 'lock-up' agreements when management expects a hostile takeover. Alternatively, value-maximizing managers' purchase of shares is part of a general cash-management program designed to lower the costs of holding an inventory of liquid assets. Such an inventory can be valuable when information asymmetries make external financing particularly costly.[5]

Bøhren and Norli address these alternative hypotheses using a unique database which contains disaggregated intercorporate ownership information for the population of the OSE listed firms from 1980–94. The strongest empirical results of the paper can be summarized as follows:

(1) *Intercorporate shareholdings*
   (a) occur frequently (80% of OSE firms have some corporate shareholders),
   (b) are low in terms of market values (on average, firm i invests 7.2% of total investments in other firm's shares, holds 2.8% of company j's shares),
   (c) have a short lifespan (median one year, 82% less than 2 years).

(2) *The value of intercorporate shareholdings* as a proportion of the firm's total assets (*VIS* in Table 7)
   (a) increases with the level of cash dividend paid next period,
   (b) decreases with the firm's free cash flow and the period's current-period investment, and
   (c) increases with insider (CEO and board) shareownership.

Overall, these findings give little indication of important managerial entrenchment motives behind the cross-sectional variation in the proportion VIS, but are generally consistent with cash–management explanations.

The paper also provides information on the subset of *two-way* (cross-) holdings. The probability of a two-way holding is estimated to be higher for (same-period) takeover targets and for two firms with relatively high contemporaneous cross-correlation of daily stock returns, and is lower for firms with greater insider share-ownership. The authors view this as partially supporting the managerial entrenchment argument. However, it is also possible that managers take advantage of private information of a forthcoming takeover bid (such information is more likely to materialise between two cross-owners), thus increasing their investment

[5] See also Myers and Majluf (1984).

in targets. The latter explanation is complementary to the more general (value-maximizing) cash management story.

Over the sample period, firms on the OSE had a relatively low dividend policy,[6] and operated in an environment of relatively lax regulation of insider trading,[7] both of which reduces the cost of intercorporate shareownership. Thus, I find the evidence of small and short-lived intercorporate shareholdings both interesting and surprising. As to the panel data estimation in Table 7, however, it would have been preferable to generate coefficient estimates of the determinants of *VIS* using a simultaneous-equation setup with one equation for each of three joint decision variables: dividends, external financing and cash management decisions. By examining the latter in a single-equation setup, some of the coefficient are susceptible to simultaneous-equation bias. I would also have added proxies for firm-specific asymmetric information, as well as inclusion of the cost of alternative liquid investments such as the risk-free rate typically used in the cash management literature.

Moreover, with the exception of dividends, the paper focuses exclusively on contemporaneous effects between intercorporate ownership and its determinants. Particularly under the corporate governance arguments, there are a number of reasons to expect non-contemporaneous and discrete effects in the data as well. However, detecting such effects may require an 'event-study' setup rather than the paper's time-series framework. To illustrate, bidder firms often acquire an equity stake ('toehold') in the target in preparation for making the takeover bid.[8] While these toeholds have been shown to have significant effects on the bid itself,[9] toehold effects are unlikely to be captured in the panel data setup used here. In other words, the approach lacks power to capture potentially important corporate governance effects, while at the same time adequately representing cash management hypotheses. As a result, the econometric setup (and the results) fundamentally favors cash management stories.

Finally, given the relative novelty of the OSE in the academic literature, most readers would have benefited from additional background information on the general OSE ownership structure. In fact, as indicated by the following table, OSE firms experienced a dramatic change in ownership structure over the sample period, suggesting that the paper ought to account for structural shifts in the data:

[6] Bøhren, Eckbo, Michalsen and Smith (1997).

[7] Eckbo and Smith (1997).

[8] In the U.S., approximately 13% of Schedule 13d filings with the SEC (i.e. reports of acquisitions of toeholds of 5% or more) result in subsequent public takeover bids. See Mikkelson and Ruback (1985).

[9] Betton and Eckbo (1997).

OSE owner-category	Percent share-ownership of OSE firms[a]			
	1985	1995[b]	1995–1985	Percent change
Non-financial corporations	37.6%	19.8	−17.8	47.3
Financial corporations[c]	15.3	15.9	0.6	3.9
Norwegian government[d]	8.9	21.8	12.9	145.0
Individual investors	22.5	9.3	−13.2	−58.7
Foreign investors[e]	16.7	33.0	16.5	98.8
Sum	100.0	100.0	–	–

[a] Source: The OSE and Reve (1996).
[b] The numbers for 1994 are close to the ones reported for 1995.
[c] Banks, insurance companies and mutual funds.
[d] If one includes (unlisted) state-owned firms such as the oil company Statoil, the telecommunications firm Telenor and all the (typically hydro-powered) electric utilities, the Norwegian government owns directly close to 50% of the Norwegian corporate sector.
[e] Includes both corporate and individual investors.

The most significant evidence in this table concerns the increase in state-ownership of OSE-listed firms. Since the government tends to act as a passive, long-term investor,[10] this change has fundamental implications for the corporate governance environment on the OSE. On top of this comes the almost 50% reduction in the non-financial corporate category, traditionally the source of active owners in Norway. The table suggests that, particularly from a corporate governance perspective, it would be interesting to disaggregate the intercorporate ownership data of Bøhren and Norli along the same lines.

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[10] However, in 1996, the government created substantial attention by forcing major banks to pay a higher dividend that what was initially proposed by management. Thus, the stereotype view of the government as a passive investor may be changing.

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