

Finance and Industrial Organization

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Summary

The primary topics below concern the interaction between the firm's real decisions and its financial decisions in different equilibrium industrial organization settings. Understanding the links between finance and industrial organization involves a fair amount of microeconomics and industrial organization in addition to finance. I emphasize the links between theoretical and empirical research in both industrial organization and corporate finance.

I present material for both underlying theoretical work and also empirical work which gives the basis for an interaction between finance and industrial organization. In addition, at the end of each section I give some background citations that while not the private focus are important in the areas development. These background materials are not focused on but you should consult these citations to understand fully the more advanced articles.

In general, I have tried to organize articles within sections by development of "themes" in the literature. Thus, articles do **not** necessarily proceed chronologically within sections - but do in most cases proceed chronologically by section.

Section 1: Theory of the Firm: From Perfect Markets to Contracting Problems and Information Problems

a. Transaction Costs and Agency Theories of the Firm (Sessions 1 & 2)

Session 1:

*1 Williamson, Oliver E., 1967, Hierarchical control and optimum firm size, *Journal of Political Economy*, 75: 123-138.

-----, 1971, The vertical Integration of production: Market failure considerations, *American Economic Review*, 61, 112-123.

*2 -----, Oliver E., 1983, Transaction-Cost Economics: The Governance of Contractual Relations, *Journal of Law and Economics*, 233-261.

Also, "Transaction Cost Economics", *Handbook of Industrial Organization*, Chapter 3, Volume 1.

Jensen, M. and W. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics*, 1976, 3:305-360.

*3 Klein, Benjamin, Robert Crawford, and Armen A. Alchian, Vertical Integration, Appropriable Rents and the Competitive Contracting Process, *Journal of Law and Economics* 21, 1978, 297-326.

Session 2:

*4 Grossman, Sanford and Oliver Hart, 1986, The costs and benefits of ownership: A theory of vertical and horizontal integration, *Journal of Political Economy* 94, 691-719.

*5 Masten, Scott E., 1993, Transaction Costs, Mistakes, and Performance, *Managerial and Decision Economics*, 14, 119-129.

The following is a good summary of some of this area.

Holmstrom and Tirole, 1989, The Theory of the Firm, *Handbook of Industrial Organization*, Chapter 2. Volume 1.

Session 3

Hart, Oliver and J. D. Moore, 1990, Property Rights and the Nature of the Firm, *Journal of Political Economy*, 98, 1119-58.

(read over!) Whinston, Michael, [On the transaction cost determinants of vertical integration](#), *Journal of Law, Economics, and Organization*, 2003

Rajan, Rajharam, G. and Luigi Zingales, 1998, Power in a theory of the firm, *Quarterly Journal of Economics* 113, 387-432.

Harris, M. and Raviv, A. (1992), "Financial Contracting Theory", in J. Laffont (ed.) *Advances in Economic Theory*: Sixth World Congress, Vol. II

*1 Kaplan, Steven N. and Per Stromberg, 2003, Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contract, *Review of Economic Studies*.

*2 Allen, Jeff and Gordon Phillips, 2000, Corporate Equity Ownership, Strategic Relationships and Product Market Relationships, *Journal of Finance*. Paper available on SSRN (more complete version).

*3 C. Edward Fee and Charles Hadlock, Shawn Thomas, "Corporate Equity Ownership and the Governance of Product Market Relationships", *Journal of Finance*, 2006, vol. 61, issue 3, pages 1217-1251

*4 Kale, Jayant and Husayn Shahrur, 2006, "Corporate capital structure and the characteristics of suppliers and customers" *JFE*.

*5 Laurent Fresard and Gerard Hoberg and Gordon Phillips. 2015. "The Incentives for Vertical Mergers and Vertical Integration," *working paper updated paper to be distributed*. *R&R Journal of Finance*.

Section 2: Financing Decisions, Capital Structure and Product Markets

Sessions 4-6:

a. The Classics & Background

Miller, Merton H., 1988, "The Modigliani-Miller Propositions After Thirty Years," *Journal of Economic Perspectives*. 2:99-120. (with comments following by Joseph Stiglitz, Stephen Ross, Sudipto Bhattacharya, and Franco Modigliani.)

Myers, S., "The Capital Structure Puzzle," *Journal of Finance*. July, 1984, 39:575-592.

Myers, Stewart C., and Nicholas S. Majluf, 1984, Corporate financing and investment decisions when the firm has information that investors do not have, *Journal of Financial Economics* 13, 187-221

*1 Harris, Milton and Artur Raviv, 1991, "The Theory of Capital Structure," *Journal of Finance*. 46: 297-355.

b. Financial Structure and Intra-Industry competition

*2 Brander, James A., and Tracy R. Lewis, 1986, "Oligopoly and financial structure," *American Economic Review*. 76, 956-970.

*----, (1988), "Bankruptcy costs and the theory of oligopoly," *Canadian Journal of Economics* 21(2), 221-243.

*3 Maksimovic, Vojislav, 1988, "Capital structure in repeated oligopolies," *Rand Journal of Economics*. 19, 389-407.

*4 Bolton, Patrick and David S. Scharfstein, 1990, "A theory of predation based on agency problems in financial contracting," *American Economic Review*. 80, 93-106.

Glazer, Jacob, 1994, "The Strategic Effects of Long-Term Debt in Imperfect Competition," *Journal of Economic Theory*; 62(2), April 1994, pages 428-43.

*5 Phillips, Gordon, 1995, "Increased Debt and Industry Product Markets: An Empirical Analysis," *Journal of Financial Economics*, 37, 189-238. [Download full PDF: Click Here.](#)

Bresnahan, Timothy F., 1989, "Empirical studies of industries with market power," In *Handbook of Industrial Organization*, ed. R. Schmalensee and R. Willig, North-Holland, Amsterdam.

* (just read for summary) Phillips, Gordon, and Dan Kovenock, 1995, "Capital Structure and Product Market Rivalry: How Do We Reconcile Theory and Evidence?", with Dan Kovenock, *American Economic Review*, 1995, 85, 403-408. [Download full PDF: Click Here.](#)

*6 Kovenock, Dan and Phillips, Gordon, 1997, "Capital Structure and Product Market Rivalry: An Examination of Plant Closing and Investment Decisions," with Dan Kovenock, *Review of Financial Studies*, 1997, Volume 10:3. . [Download PDF file: Click Here](#)

Chevalier, Judith, 1995, "Do LBO Supermarkets Charge More? An Empirical Analysis of the Effects of LBOs on Supermarket Pricing," *Journal-of-Finance*; 50(4), September 1995, pages 1095-1112.

Campello, M., [Capital Structure and Product Markets Interactions: Evidence from Business Cycles](#) , *Journal of Financial Economics* 68 (3), 2003, pp. 353-378.

Session 5

*Campello, M., Debt Financing: Does it Boost or Hurt Performance in Product Markets? [Journal of Financial Economics](#), 2006.

Chevalier, Judith, 1995, "Debt and product market competition: Local market entry, exit, and expansion decisions of supermarket chains." *American Economic Review*, 85, 415-35.

Khanna, Naveen and Sheri Tice, 2005, "Pricing, Exit, and Location Decisions of Firms: Evidence on the Role of Debt and Operating Efficiency", *Journal of Financial Economics*.

*1 Maksimovic, Vojislav and Josef Zechner, 1991, "Debt, Agency Costs, and Industry Equilibrium," *Journal of Finance*, 46: 1619-1644

*2 Maksimovic, Vojislav and Gordon Phillips 1998, "**Asset Efficiency and the Reallocation Decisions of Bankrupt Firms.**" *Journal of Finance*, October, 1998, 53, 1495-1532. [Download paper in Adobe PDF Format:](#)

***3 Mackay, Peter and Gordon Phillips, 2005, "How Does Industry Affect Firm Financial Structure?"** [Click here to download in Adobe PDF Format.](#), *Review of Financial Studies*.

Stomper, Alexander, Christine Zulehner, and Pegaret Pichler, "Why leverage affects pricing", RFS 2008. Available at:
<http://homepage.univie.ac.at/Christine.Zulehner/pricing.pdf>

*4 David Matsa, (present, Tina Lang) (2010 JF, [Capital Structure as a Strategic Variable: Evidence from Collective Bargaining.](#), (Click to find paper)

Fresard, Laurent, 2010, Financial Strength and Product Market Behavior: The Real Effects of Corporate Cash Holdings, *The Journal of Finance*, 2012.

Boutin, Xavier et. al., 2014, "Deep-Pocket Effect of Internal Capital Markets" *Journal of Financial Economics*

*5 Bernstein, Shai. 2015. Does going public affect innovation? *Journal of Finance* ,70(4): 1365—1403.

*6 Phillips, Gordon and Giorgio Sertsios, "[Financing and New Product Decisions of Private and Publicly Traded Firms](#)," *Forthcoming: Review of Financial Studies*, 2017.,

Financial Structure and Product Quality:

Titman, Sheridan, 1984, "The effect of capital structure on a firm's liquidation decision," *Journal of Financial Economics*, Vol. 13, 137-151.

* Maksimovic, Vojislav; Titman, Sheridan, "Financial Policy and Reputation for Product Quality," *Review of Financial Studies*; 4(1), 1991, pages 175-200.

* Phillips, Gordon and Giorgio Sertsios, 2013, "How Do Firm Financial Conditions Affect Product Quality and Pricing?" *Management Science*. pp 1754-1782.

Background articles:

Bresnahan, Timothy, 1982, "The oligopoly solution concept is identified," *Economic Letters*. 10, 87-92.

Fudenburg, Drew and Jean Tirole, 1986, "A signal jamming' theory of predation" Rand Journal of Economics. 17, 366-376.

Poitevin, Michel, 1989, "Financial signaling and the "deep-pocket" argument," Rand Journal of Economics. 20, 26-40.

Rotemberg, Julio J. and David S. Sharfstein, 1990, "Shareholder Value Maximization and Product Market Competition," RFS, 3:367-91.

(review) Maksimovic, V., 1995, Financial Structure and Product Market Competition, in Jarrow, R., Maksimovic V. and W. Ziemba, (eds.), Handbook of Finance, North-Holland.

Zingales, Luigi, 1998, "Survival of the fittest or the fattest? Exit and financing in the trucking industry," *Journal of Finance*.

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2. Graham, John R. and C.R. Harvey, 2001, The theory and practice of corporate finance: The evidence from the field, *Journal of Financial Economics*
3. Shyam-Sunder, Lakshmi and Stewart Myers, Testing Static Trade-Off Against Pecking Order Models of Capital Structure, *Journal of Financial Economics*, 1999.
4. Frank, Murray Z., and Vidhan K. Goyal, 2003, Testing the pecking order theory of capital structure, *Journal of Financial Economics* 67, 217-248.
5. Gomes, A., and G. Phillips, 2012, Why do public firms issue private and public securities? *Journal of Financial Intermediation*.
6. Leary, Mark and Michael Roberts, "[Do Firms Rebalance Their Capital Structures?](#)," *Journal of Finance*, 2005, 60, 2575 - 2619
7. Hennessy, Chris, and Toni Whited, 2005, "[Debt Dynamics](#)," *Journal of Finance* 60 (2005): 1129-1165
8. Hennessy, Chris, and Toni Whited, 2006, "[How Costly is External Financing? Evidence from a Structural Estimation](#)." *Journal of Finance*.

Conglomerates and the Theory of the Firm (Sessions 7-9)

*** SEE also survey by Maksimovic and Gordon Phillips: Conglomerate Firms and Internal Capital Markets, Handbook of Empirical Finance, editor: Espen Eckbo.

*Williamson, Oliver, Chapter 2: Internal Firm Organization and limits to Firm Size, In: Oliver Williamson, Corporate Control and Business Behavior, also: Chapter 7: The Multidivisional Form Innovation, & Chapter 9: Applications of the Multidivision Form Hypothesis.

*Lang, Larry, and Rene Stulz, 1994, Tobin's q, Corporate Diversification, and Firm Performance, *Journal of Political Economy*. v102 n6 December 1994, pp. 1248-80.

*Berger, Philip G. and Eli Ofek, 1995, Diversification's effect on firm value, *Journal of Financial Economics*, 39-65.

*Shin, H. and Rene Stulz, 1997, Are Internal Capital Markets Efficient, *Quarterly Journal of Economics*.

Lamont, Owen, 1997, Cash Flow and Investment: Evidence from Internal Capital Markets, *Journal of Finance*

David S. and Jeremy Stein, 1997, The Dark Side of Internal Capital Markets: Divisional Rent Seeking and Inefficient Investments, mimeo, MIT.

Scharfstein, David S., 1997, The Dark Side of Internal Capital Markets II, mimeo, MIT.

*1 Rajan, Raghuram G., Henri Servaes and Luigi Zingales, 2000, The Cost of Diversity: The Diversification Discount and Inefficient Investment, JF.

Khanna, Naveen and Tice, Sheri, 2001, "The Bright Side of Diversification", *Journal of Finance*, 2001.

*2 (Handin) Maksimovic, V. and Gordon Phillips, 2002, *Journal of Finance*, Do Conglomerate Firms Allocate Resources Inefficiently?, [In Adobe PDF Format](#). *Journal of Finance*, April, 2002, 721-767

Graham, J., M. Lemmon and J. Wolf, 2002, "Does Corporate Diversification Destroy Value?" *Journal of Finance* 57, 695-720

Schoar, Antoinette, *The Effect of Diversification on Firm Productivity*, [The Journal of Finance](#), December 2002, Vol. 62 (6), 2379-2403.

Campello, M., 2002, [Internal Capital Markets in Financial Conglomerates: Evidence from Small Bank Responses to Monetary Policy](#), *Journal of Finance* 57 (6), pp. 2773-2805.

Whited, Toni, 2001, "Is It Inefficient Investment that Causes the Diversification Discount?" *Journal of Finance*.

Also look at the following working papers recently presented at NBER 1999 summer institutue. Link to NBER working papers, Summer 1999, three papers on conglomerates and resource allocation, (1. Judy Chevalier, 2. Jose Campa and Simi Kedia, and Lamont and Polk) see: <http://nber.nber.org/~confer/99/si99/cfprg.htm> (papers 2 and 3 were published in JF and JFE respectively.) You might want to compare early working papers with final published papers.

*3 Inderst, and H. Meuller, 2003, “Internal vs. External Financing: An Optimal Contracting Approach,” *Journal of Finance*.

Villalonga, B., 2004, “Diversification Discount or Premium? New Evidence from the Business Information Tracing Series”, *Journal of Finance* 59, 479 – 506.

*4 Campa and Kedia, 2002, Explaining the Diversification Discount, *Journal of Finance*, papers and proceedings.

*5 Villalonga, B., 2004, “Does Diversification Cause the Diversification Discount”, *Financial Management* 33, 5-23

Dimitrov, Valentin and Sheri Tice, 2006, “Corporate Diversification and Credit Constraints: Real Effects Across the Business Cycle”, *Review of Financial Studies*, Vol 19, Issue 4, pp. 1465-1498.

Santalo, Juan and Manuel Becerra, 2008, [Competition from Specialized Firms and the Diversification-Performance Linkage](#), *Journal of Finance*.

*6 Hoberg, Gerard and Gordon Phillips, 2017, “Conglomerate Industry Choice and Product Language,” with Gerard Hoberg, Forthcoming: *Management Science*, 2017.

Matvos, Gregor, and Amit Seru, 2015, RFS, Resource Allocation within Firms and Financial Market Dislocation: Evidence from Diversified Conglomerates, available at authors web site: <https://sites.google.com/site/gmatvos/>

Mergers and Acquisitions (Sessions 9 and 10)

*1 Shleifer, A., and R. W. Vishny, 1992, Liquidation values and debt capacity: A market equilibrium approach, *Journal of Finance* 47, 1343-1366.

Schlingemann, F. P., R. M. Stulz, and R. A. Walkling, 2002, Divestitures and the liquidity of the market for corporate assets, *Journal of Financial Economics* 64, 117-144.

(just read over quickly) Phillips, Gordon M., and Ortiz-Molina, H. (2014) "[Real Asset Illiquidity and the Cost of Capital](#)," *Journal of Financial and Quantitative Analysis*, 49 (1), 1-32.

*2 Maksimovic, Vojislav and Gordon Phillips, 2001, "The Market for Corporate Assets: Who Engages in Mergers and Asset Sales and Are There Gains?" *Journal of Finance* December, 2001, Vol. 56, 2019-2065. Reprinted in "Corporate Restructuring" volume in *The International Library of Critical Writings in Financial Economics*, ed. J. McConnell and D. Denis. Also reprinted in *Mergers and Corporate Governance*, ed: J. Harold Mulherin.

*3 Rhodes-Kropf, Matthew, David Robinson, "The Market for Mergers and the Boundary of the Firm." <http://www.nber.org/~confer/2004/si2004/cf/rhodeskropf.pdf>, (early version) *Journal of Finance*. 2008)

*4 Hoberg, Gerard and Phillips, Gordon M., (2010) "[Product Market Synergies and Competition in Mergers and Acquisitions: A Text-Based Analysis](#)," *the Review of Financial Studies*, 23 (10), 3773-3811.

*5 Phillips, Gordon and Alexei Zhdanov, 2013, "[R&D and the Incentives from Merger and Acquisition Activity](#)," [Download paper], *Review of Financial Studies*, 2013, 26 (1) 34-78. [Internet Appendix](#).

Session 8

*1 Maksimovic, Phillips and Yang, "[Public and Private Merger Waves](#)," [Download paper], *Journal of Finance*, 2013, Vol. 68, (5), 2177-2217. Best paper award Financial Management Association.

*2 Fresard, Lauren, Uli Hege and Gordon Phillips "Extending Industry Specialization through Cross-Border Acquisitions," Forthcoming: *Review of Financial Studies*, 2017.

*3 Bai, John and Daniel Carvalho, and Gordon Phillips, 2017, "The Impact of Bank Credit on Labor Reallocation and Aggregate Industry Productivity," *R&R Journal of Finance* (To be distributed).

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(read over briefly) Shleifer, Andrei and Robert Vishny, "Stock Market Driven Acquisitions". JFE, Paper available on SSRN. Journal of Financial Economics.

*4 Rhodes-Kropf, Matthew, and S. Viswanathan, Market Value and Merger Waves," 2004. Journal of Finance [Full Text PDF](#)

*5 Dong, Ming, David Hirshleifer, Scott Richardson, and Siew Hong Teoh, 2003, "[Does Investor Misvaluation Drive the Takeover Market?](http://www.cob.ohio-state.edu/fin/dice/papers/2003/2003-7.pdf)" <http://www.cob.ohio-state.edu/fin/dice/papers/2003/2003-7.pdf>, Journal of Finance, 2006.

*6 Rhodes-Kropf, Matthew, David Robinson, and S. Vishwanthan, 2005, "[Merger Waves and Merger Activity: The Empirical Evidence.](http://www-1.gsb.columbia.edu/faculty/mrhodeskropf/PDFpapers/mergers_test.pdf)" Available at: http://www-1.gsb.columbia.edu/faculty/mrhodeskropf/PDFpapers/mergers_test.pdf, Journal of Financial Economics

Sara Moeller, Rene Stulz and Frederick Schlingemann, "Wealth destruction on a massive scale? A study of acquiring-firm returns in the recent merger wave," Journal of Finance, 2005 757-782.

Recent relevant publications

Journal Articles

1. "[Extending Industry Specialization through Cross-Border Acquisitions](#)," Laurent Fresard and Uli Hege, and Gordon Phillips, *Forthcoming: Review of Financial Studies*, 2017.
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3. "[Conglomerate Industry Choice and Product Language](#)" Gerard Hoberg and Gordon Phillips, *Forthcoming: Management Science*, 2017.
4. "[Financing and New Product Decisions of Private and Publicly Traded Firms](#)" Gordon Phillips and Giorgio Sertsios, *Forthcoming: Review of Financial Studies*, 2017.
5. "[Text-Based Network Industries and Endogenous Product Differentiation](#)" Gerard Hoberg and Gordon Phillips, *Journal of Political Economy*, October 2016.
6. "Real Asset Illiquidity and the Cost of Capital", Hernan Ortiz-Molina and Gordon M. Phillips, *Journal of Financial and Quantitative Analysis*, February 2014, Vol. 49(1): pp. 1-32.
7. "Product Market Threats, Payouts, and Financial Flexibility," Gerard Hoberg, Gordon Phillips and Nagpurnanand Prabhala, *Journal of Finance*, February 2014, pp. 293-332.
8. "Private and Public Merger Waves," Best paper award Financial Management Association, Vojislav Maksimovic, Gordon Phillips and Liu Yang, *Journal of Finance*, 2013, Vol. 68, (5), 2177-2217.
9. "How Do Firm Financial Conditions Affect Product Quality and Pricing?" with Gordon Phillips and Giorgio Sertsios, *Management Science*, 2013, 59(8): 1764-1782.
10. "R&D and the Incentives from Merger and Acquisition Activity," Gordon Phillips and Alexei Zhdanov, *Review of Financial Studies*, 2013, 26(1) 34-78.
11. "Conglomerate Firms, Internal Capital Markets and the Theory of the Firm," Vojislav Maksimovic and Gordon Phillips, *Annual Review of Financial Economics*, 2013, Vol. 5: 225-244.
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Book Chapters

1. Maksimovic, V., Phillips, Gordon M., Prabhala, N. (2013). Post-Merger Restructuring and the Boundaries of the Firm. In Mulherin, H. (Ed.), Mergers and Acquisitions (ch. 5). Northhampton, MA: International Library of Critical Writings in Economics.
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3. Maksimovic, V., Phillips, Gordon M. (2012). Asset Efficiency and Reallocation Decisions of Bankrupt Firms. (Ed.), Economics of Bankruptcy (vol. 2, ch. Volume II, Chapter 6). Northhampton, MA: Economics of Bankruptcy.