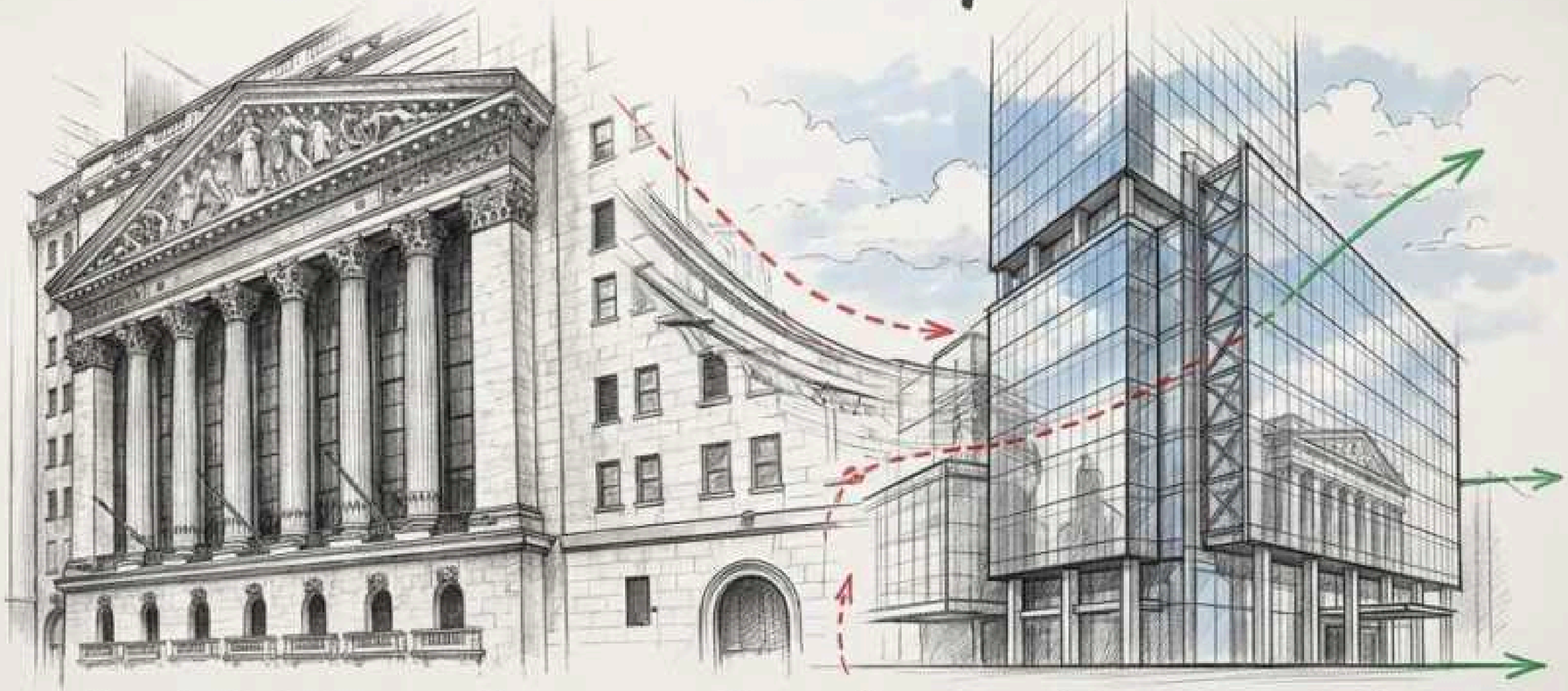
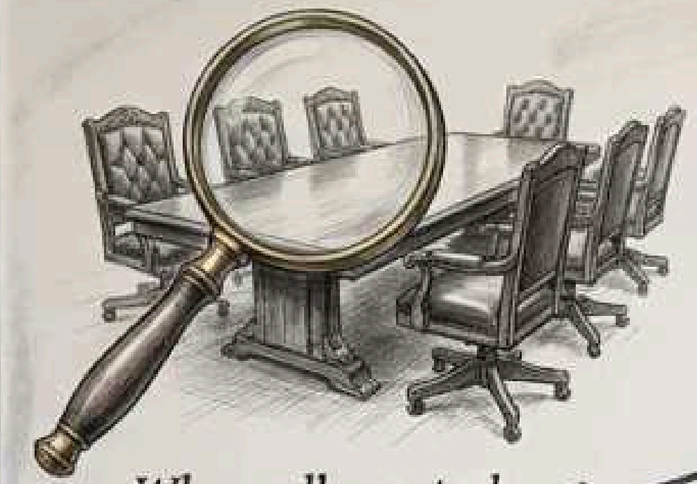
Lecture 3 — Ownership and Control



Berle & Means, the separation of ownership, Coase's firm, and the global evolution of agency theory.

¶ 3.1



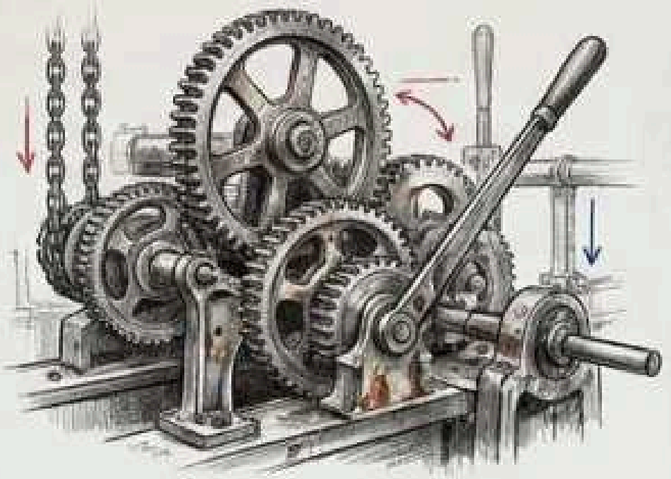
Corporate Charter

Who really controls a large corporation?

Board aivenns are a board hierarchy ?

Shareholders → Board of Directors ? → CEO ?

What tools can owners use to ensure managers work in their interest?



- Principal-Agent problem
- Heartonent their members

Principal-Agent Problem

Stock Options ✓ | Performance Bonuses ✓ | Hostile Takeovers ✗



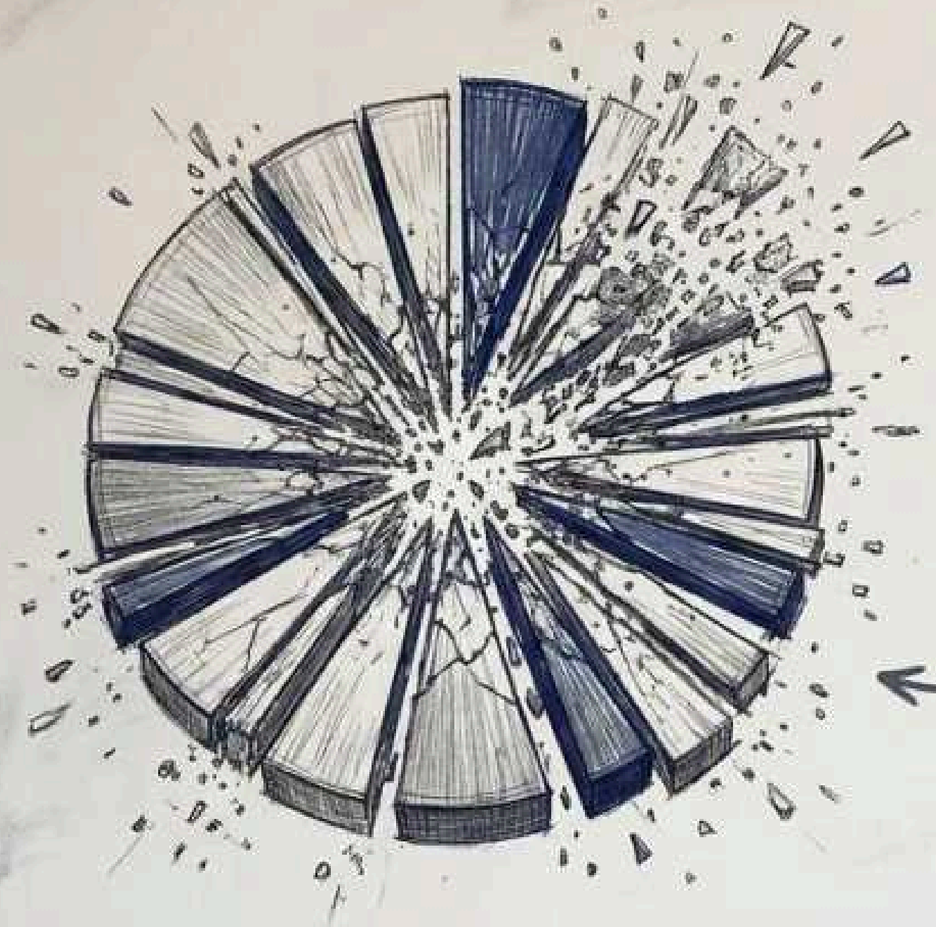
Why do firms exist at all, rather than everything being bought on markets?

Hewe do firms or being bought on markets

Transaction Costs → Information Asymmetry → Verfical Integration

- Transaction costs
- Information and selection asymmetry

The market are mead of cost facterys.



Top 200 US non-financial corporations characterized by extreme fragmentation. Shares spread across tens of thousands of small holders.

The 1932 Discovery



Source: The Modern Corporation and Private Property

Conclusion: No single shareholder group can control the board.

Owners
(Supply Capital + Bear Risk)

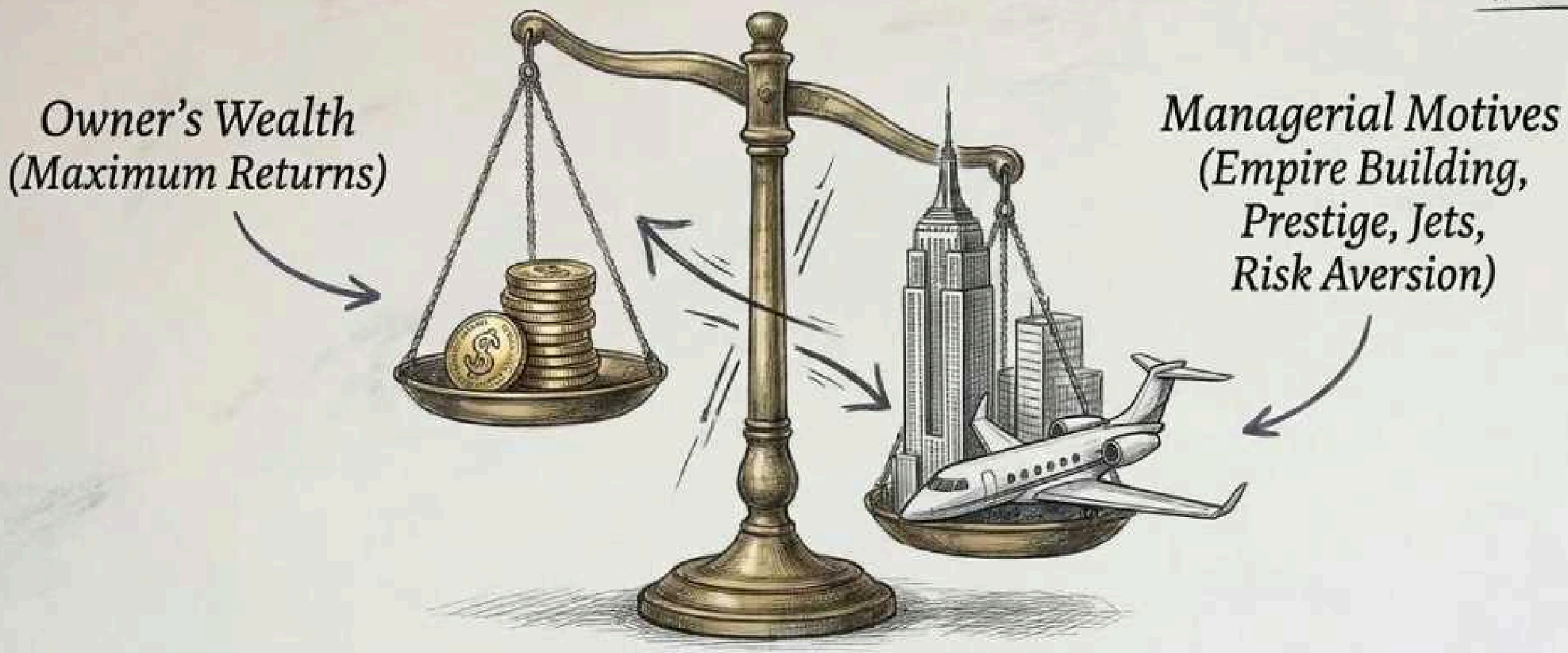


Passive Paper Claims

Managers
(Make Decisions + Select Board Candidates)



Shareholders are reduced to bystanders while salaried managers self-regulate.

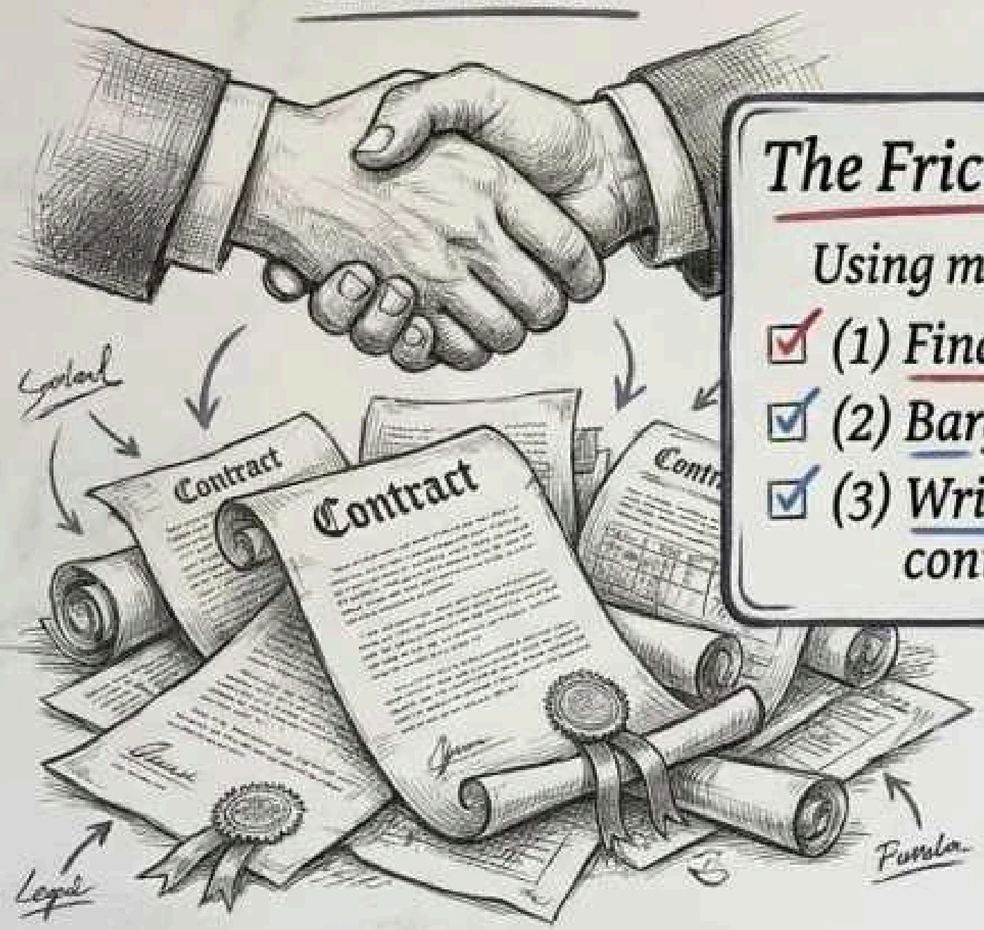


Berle and Means' Warning: A new class of managers wielding concentrated economic power, answerable to no one.

If markets are efficient, why take orders instead of negotiating prices? (The Nature of the Firm, Ronald Coase, 1937).

¶ 3.5

The Market

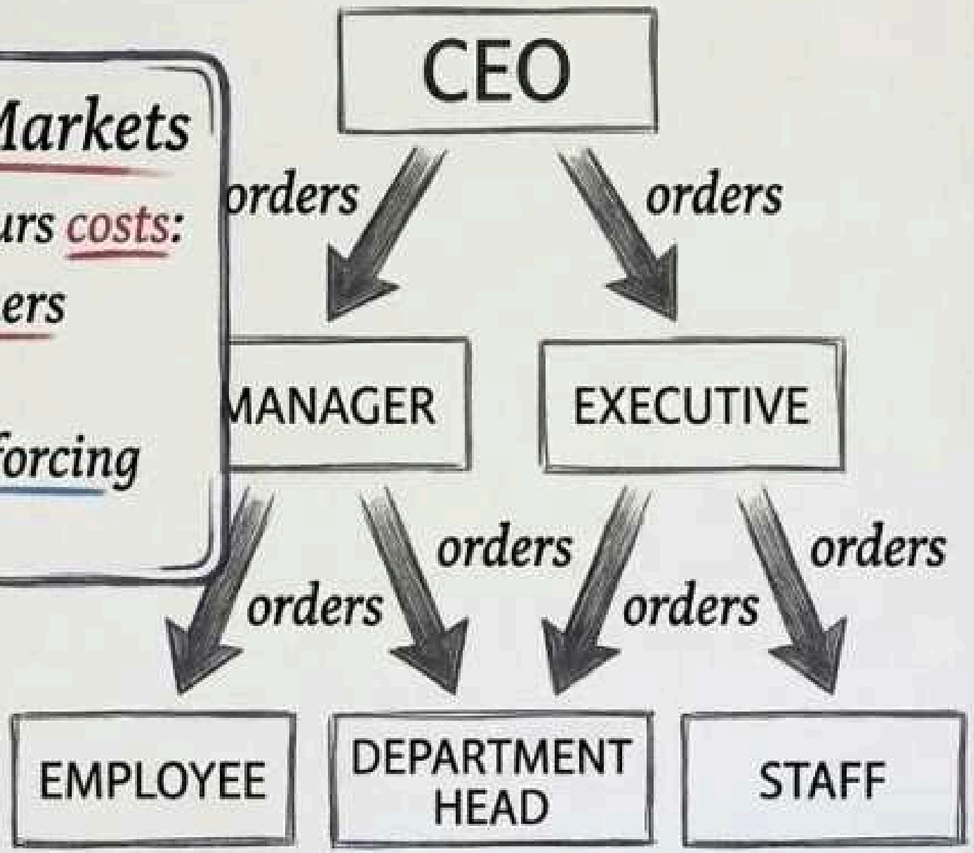


The Friction of Markets

Using markets incurs costs:

- ☑ *(1) Finding partners*
- ☑ *(2) Bargaining*
- ☑ *(3) Writing & Enforcing contracts*

The Firm

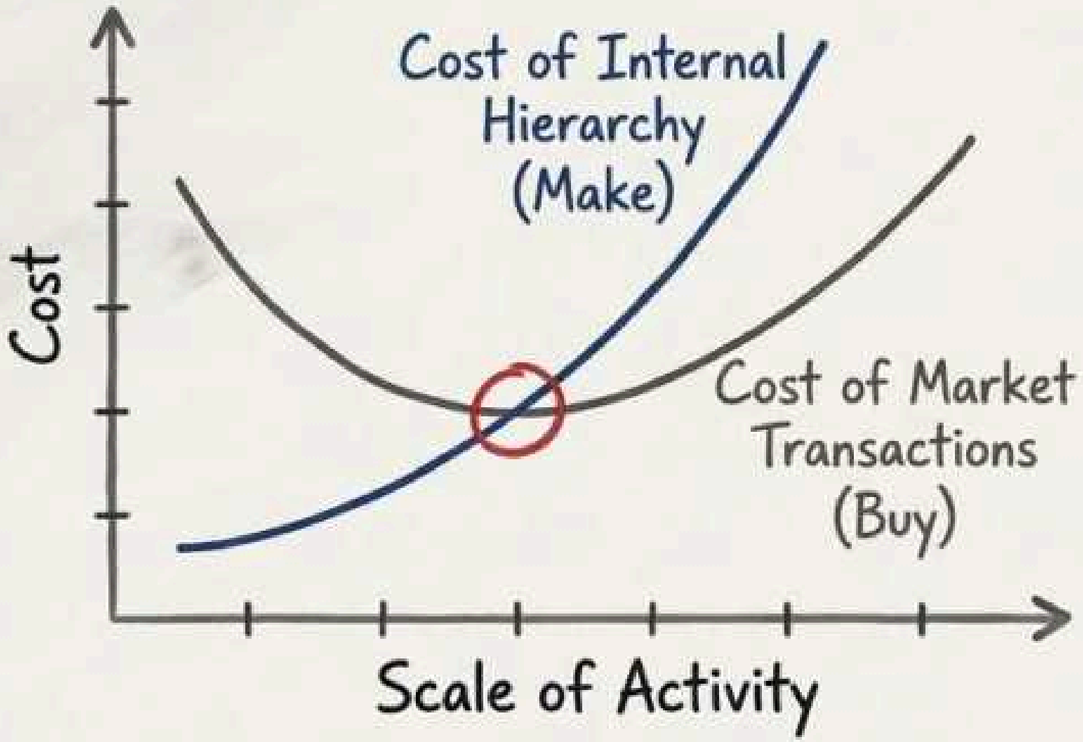


The Boundary Equation

¶ 3.6

$$\text{Cost}(\text{Internal}_{x+1}) = \text{Cost}(\text{Market}_{x+1})$$

A firm grows until organizing one more activity internally costs the same as buying it on the open market.



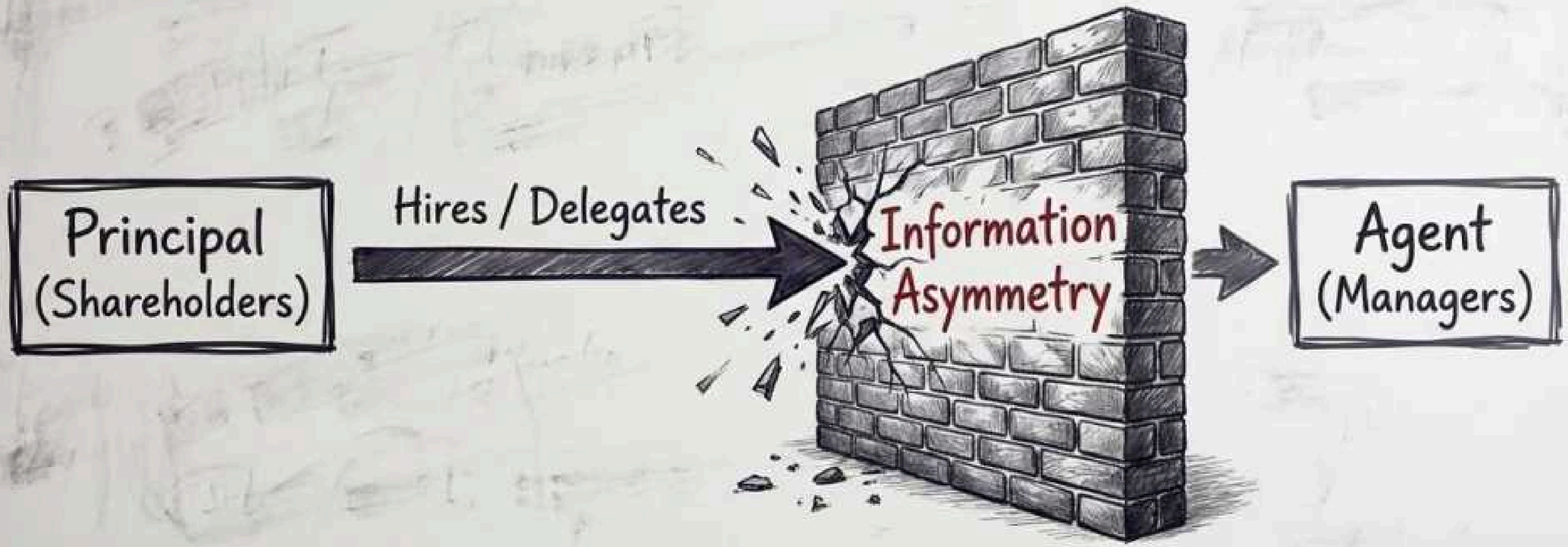
Transaction Cost Economics (Oliver Williamson)

When assets are specialized and contracts incomplete, it is safer to bring activities inside the firm.

Footnote: Nobel Prizes in Economics: Coase (1991), Williamson (2009).

¶ 3.7

The Agency Relationship (Jensen & Meckling, 1976)



Core Friction: The agent knows more and cannot be watched constantly, ensuring they will not always act as the principal wishes.

¶3.8

$$C_{Agency} = C_{Monitoring} + C_{Bonding} + L_{Residual}$$

$C_{Monitoring}$



Audits and board oversight.

$C_{Bonding}$



Agent's costs to reassure principals (e.g., publishing accounts).

$L_{Residual}$



Unrecoverable value lost because decisions still diverge from owner's desires.

Goal: Good governance minimizes the total sum.

Solution 1: Aligning Incentives Through Pay.

¶ 3.9

Mechanism: If managers hold shares/options, they gain only when owners gain.

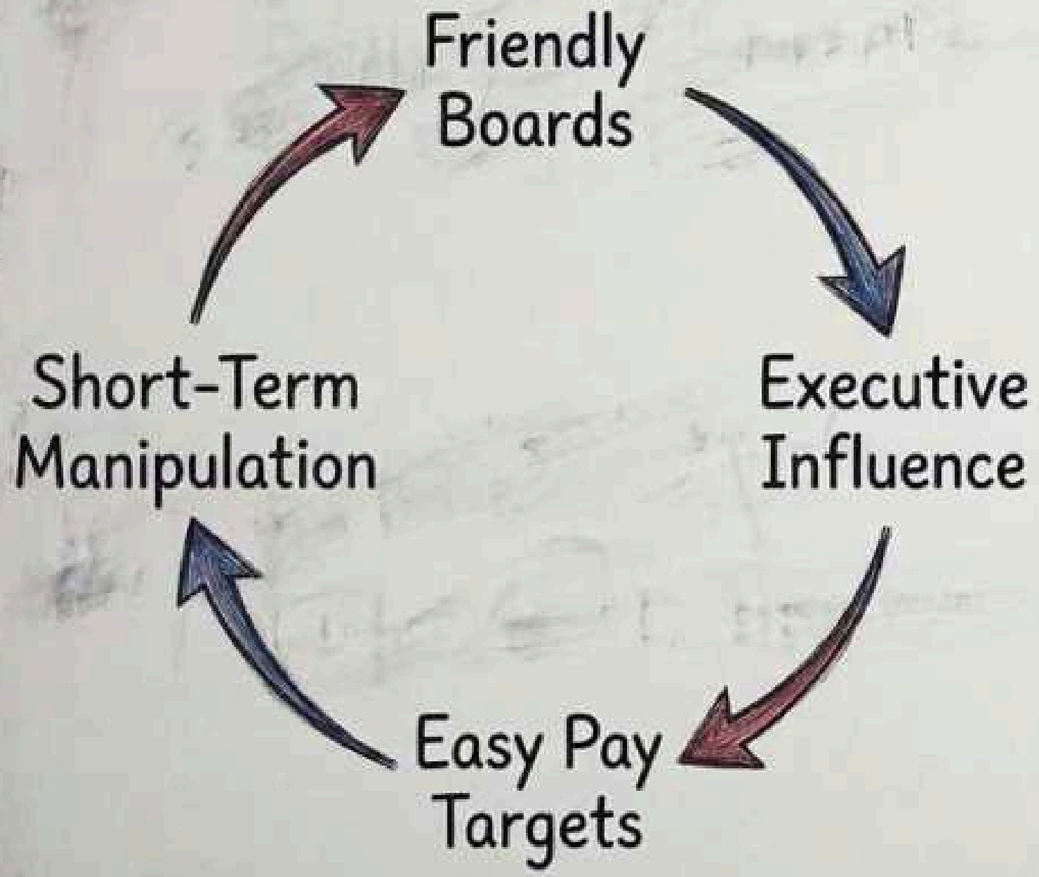


Driven heavily by the 1980s shift toward stock and options.

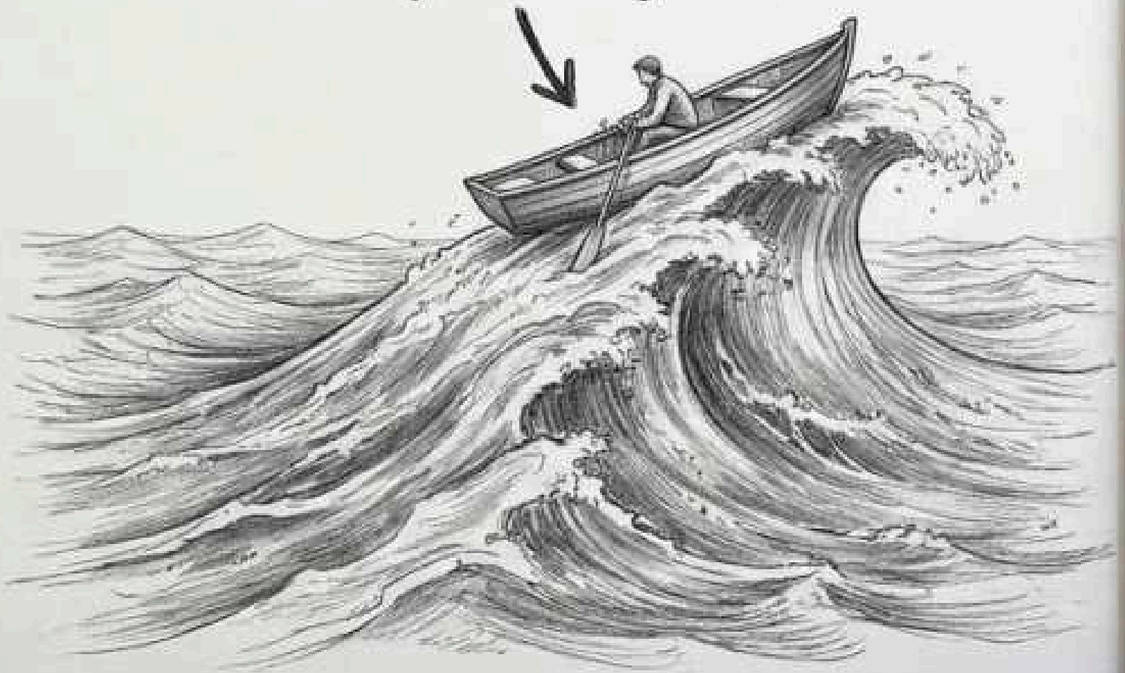
The Critique of Equity Pay

¶ 3.10

(Bebchuk & Fried, Pay Without Performance, 2004)



Options frequently reward managers for general market booms they did absolutely nothing to cause.

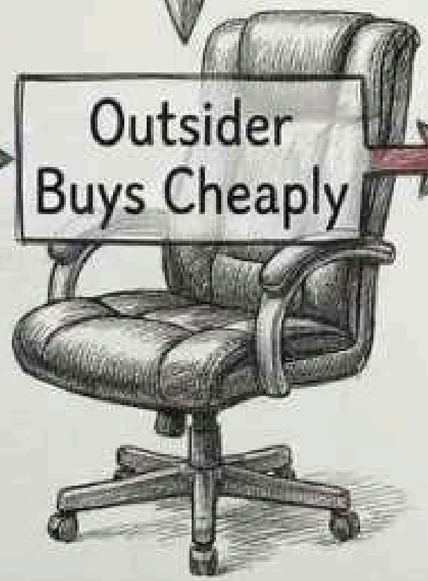


Solution 2: The Market for Corporate Control (Henry Manne, 1965).

¶ 3.11



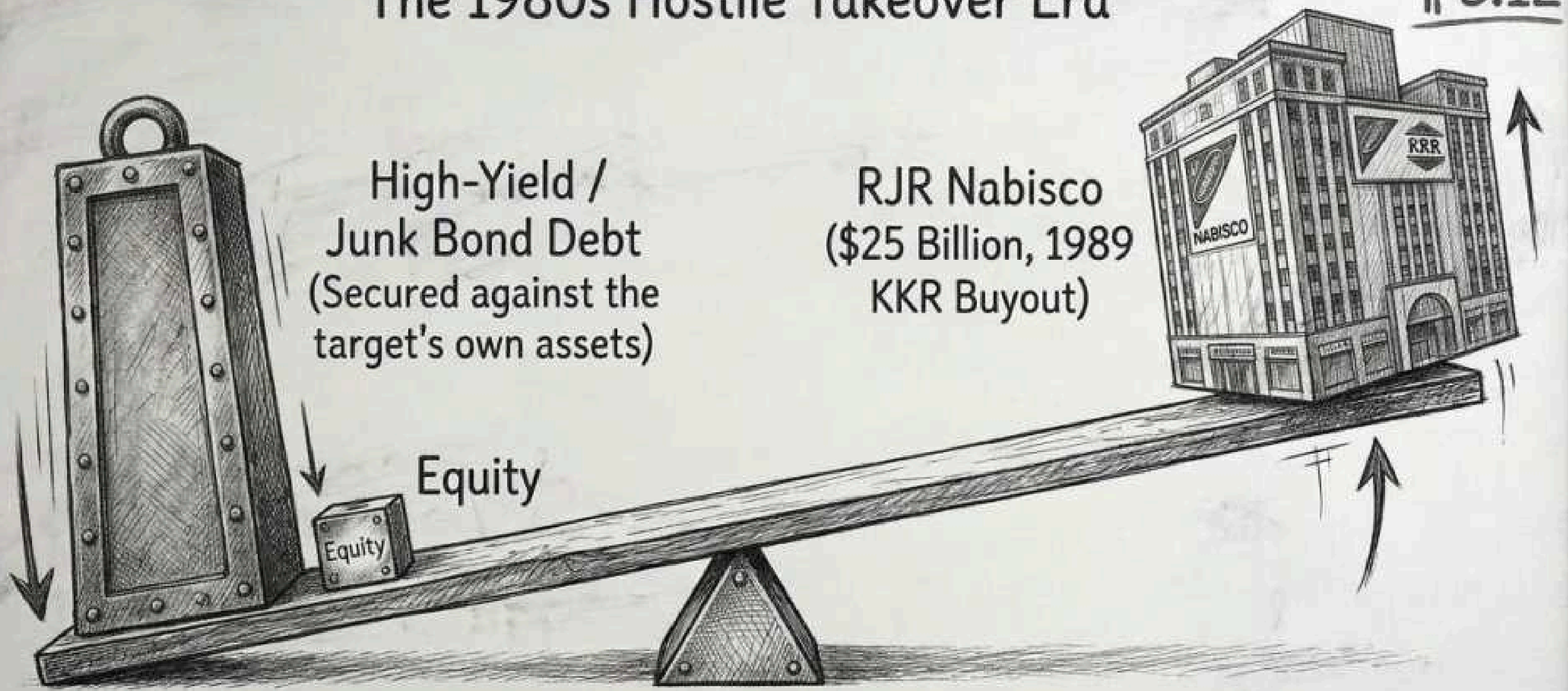
The Sword of Damocles:
The mere possibility of a takeover disciplines all managers, even those who are never bought.



Bad Management → Share Price Drops → Outsider Buys Cheaply → Replaces Managers → Profits from Improvement

The 1980s Hostile Takeover Era

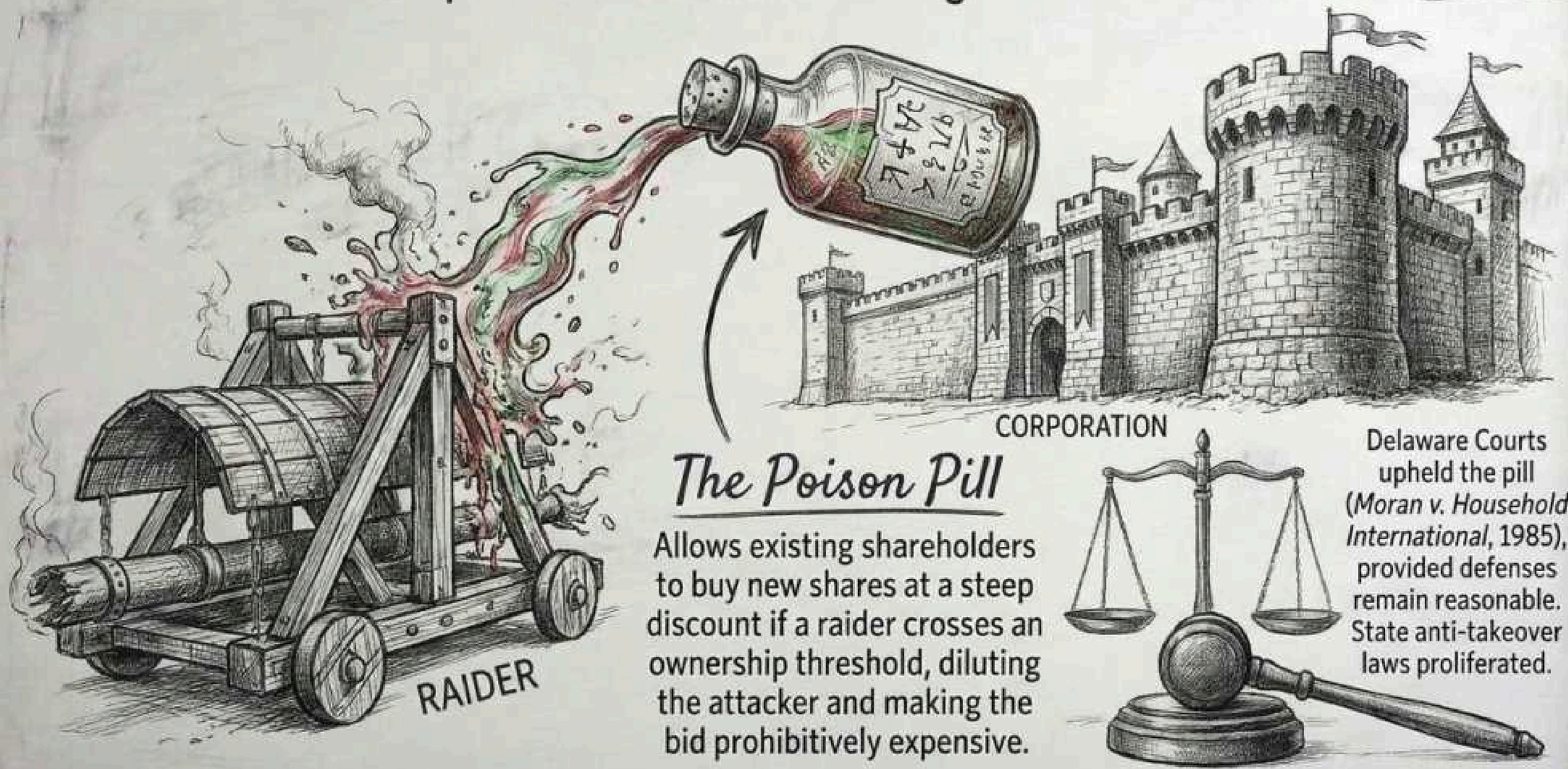
¶ 3.12



Mechanism: Corporate raiders used borrowed money to force buyouts against board wishes.

The Empire Strikes Back: Managerial Defenses.

¶ 3.13



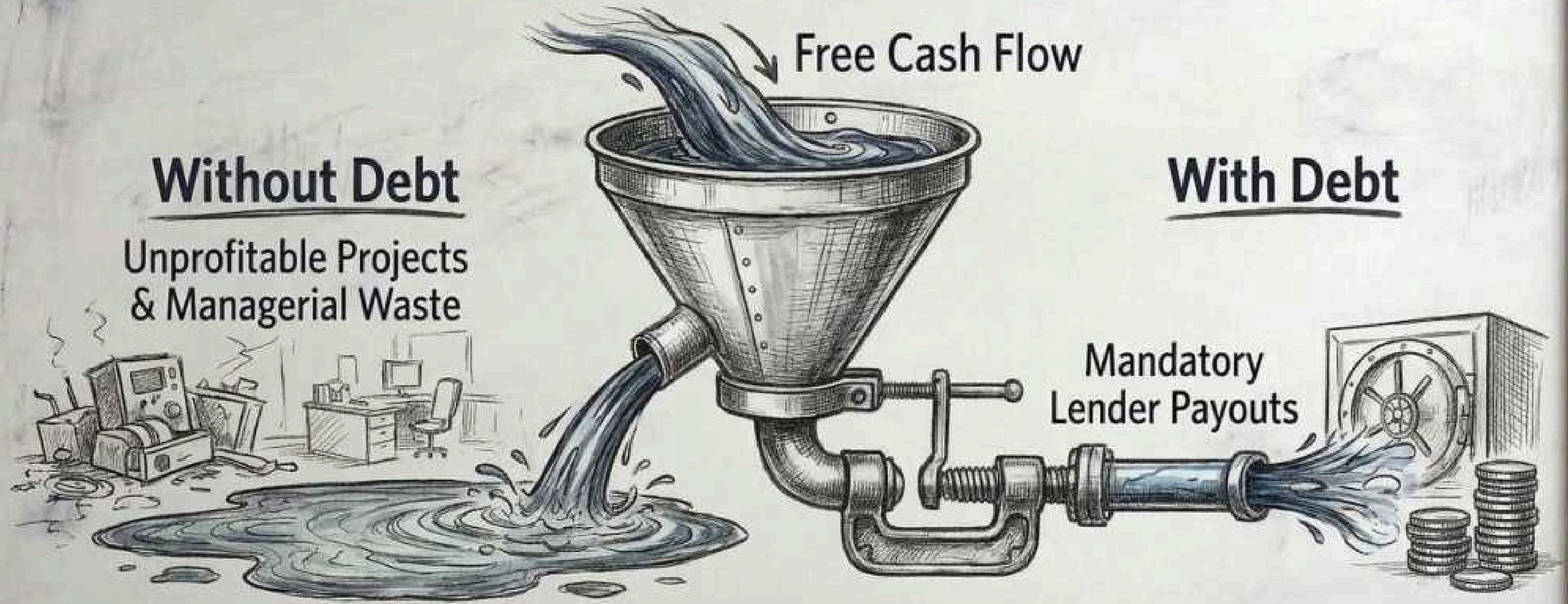
The Poison Pill

Allows existing shareholders to buy new shares at a steep discount if a raider crosses an ownership threshold, diluting the attacker and making the bid prohibitively expensive.

Delaware Courts upheld the pill (*Moran v. Household International*, 1985), provided defenses remain reasonable. State anti-takeover laws proliferated.

Debt as Discipline Mechanism (Michael Jensen).

¶ 3.14



The Private Equity Model: Successors to the raiders.
Load companies with debt → Force cash discipline → Tie pay to results → Sell.

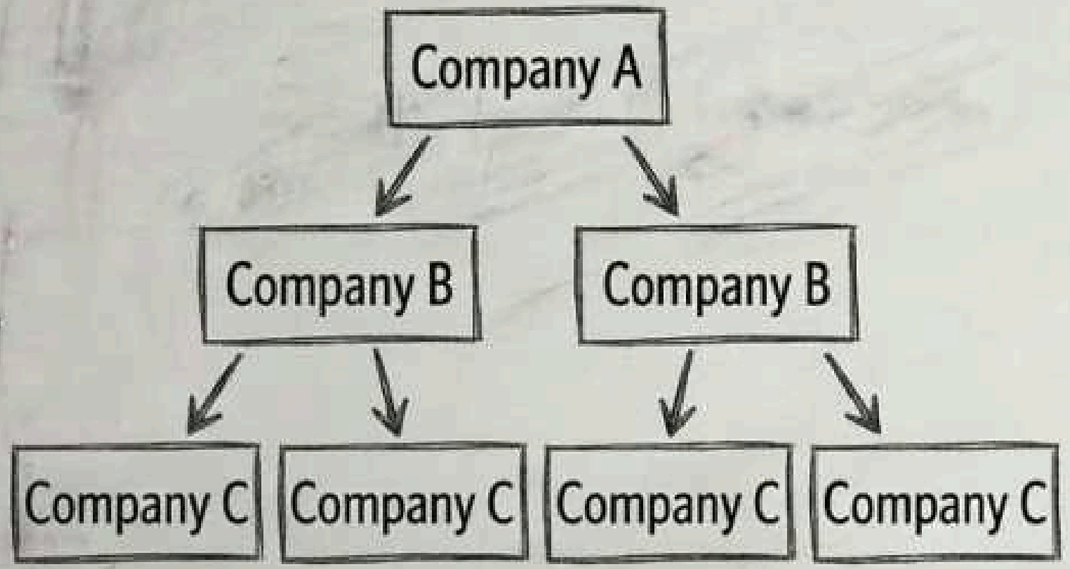
¶ 3.15

Global Ownership Variations (La Porta, Lopez-de-Silanes, Shleifer, 1999).

The US Model (Berle & Means)	The Global Model (Most Countries)
- Ownership: Dispersed.	- Ownership: Concentrated (Families or the State).
- Core Agency Conflict: Principals (Shareholders) vs. Agents (Managers).	- Core Agency Conflict: Controlling Owners vs. Minority Shareholders (e.g., risk of exploiting minorities by funneling profits to private entities).

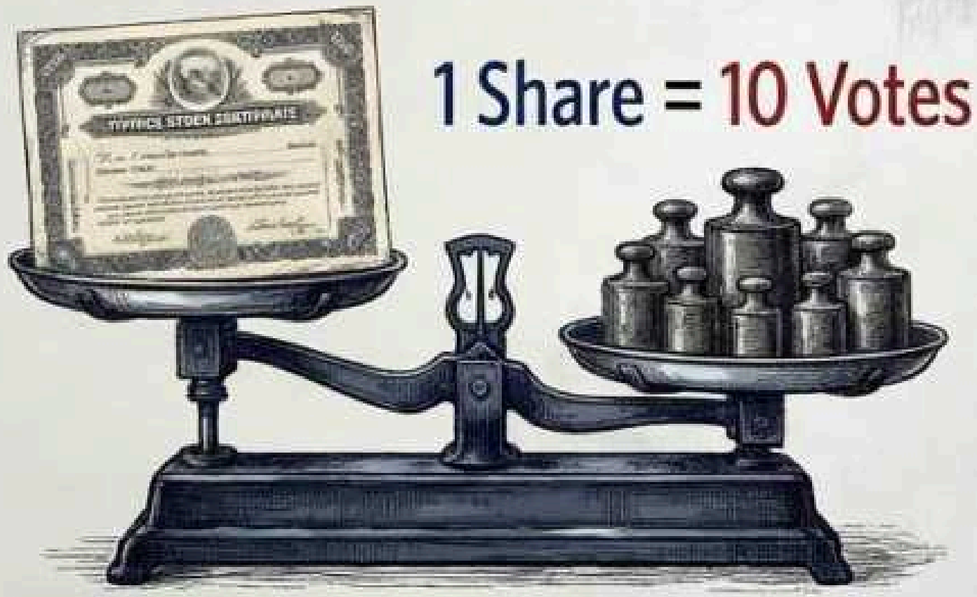
Mechanisms of Concentrated Control (e.g., Wallenberg family, Asian/Latin American family groups).

¶ 3.16



Pyramids: Leveraging minority stakes across multiple layers to control a massive bottom-tier entity.

Dual-Class Shares:
Divorcing cash flow from voting power

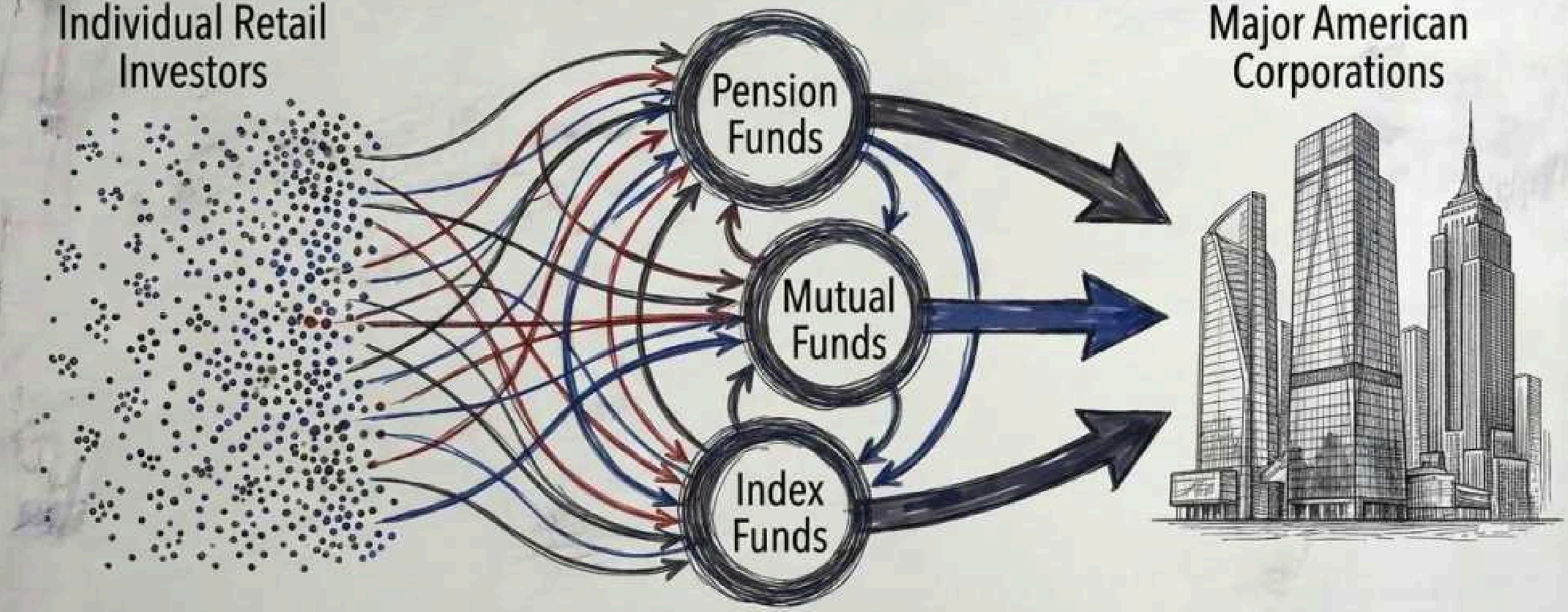


1 Share = 10 Votes

Tradeoff: Provides patient, long-term capital BUT entrenches poor managers and weakens minority protections.

The Reconcentration of America

¶ 3.17



Core Insight: Shares are no longer held primarily by individuals. Ownership is heavily concentrated again—but in the hands of intermediaries managing other people's money.

Closing Exercise: Theory into Practice.

¶ 3.18

