



CARLSBERG
FOUNDATION



Second Aarhus Workshop on Strategic Interaction in Corporate Finance August 18-20, 2024

Aarhus University
Department of Economics and Business Economics
Fuglesangs Allé 4
8210 Aarhus V

Program chairs: Stefan Hirth (chair) and Matthias Lassak (co-chair)

SUNDAY, AUGUST 18

17.00	Welcome reception	Aarhus Street Food, Green Room Ny Banegårdsgade 46, 8000 Aarhus C https://aarhusstreetfood.com/en/
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MONDAY, AUGUST 19

8.30-9.00	Coffee & welcome	Harvard Auditorium
9.00-10.30	Shareholder voting	
	John Barry (Duke University): "Shareholder voice and executive compensation"	Discussant: Yuri Tserlukevich (Arizona State University)
	Markus Parlasca (Vienna University of Economics and Business): "Voting and Trading on Public Information"	Discussant: Zhen Zhou (Tsinghua University)
10.30-11.00	Coffee break	
11.00-12.30	Industry effects	
	Francesca Zucchi (ECB): "Innovation, industry equilibrium, and discount rates"	Discussant: Alexander Szimayer (Universität Hamburg)
	Boris Nikolov (University of Lausanne): "Beyond peers: Cross-industry competition and strategic financing"	Discussant: Sebastian Pfeil (University of Groningen)
12.30-13.30	Lunch	Caf'Inn
13.30-15.00	Debt structure	Harvard Auditorium
	Giulio Trigilia (University of Rochester): "Short-term debt overhang"	Discussant: Andrea Gamba (Warwick Business School)
	Gregory Weitzner (McGill University): "Relationship lending in bond markets? Evidence from corporate call policies"	Discussant: Jens Dick-Nielsen (Copenhagen Business School)
15.00-15.30	Coffee break	
15.30-17.15	Credit risk	
	Alexander David (University of Calgary): "What do CDO tranche spreads tell us about credit availability and credit rating standards?"	Discussant: Florian Kiesel (Free University of Bozen-Bolzano)
	Keynote by Mike Burkart (London School of Economics): "Bankruptcy law and the market for corporate influence: Extending the creditors' bargain to distress investors"	
17.30	Bus transfer from university to restaurant	
18.00	Dinner	Restaurant Anker Fiskerivej 12, 8000 Aarhus C https://restaurantanker.dk/

TUESDAY, AUGUST 20

8.45-9.00	Coffee & welcome	Harvard Auditorium
9.00-10.30	Sustainable finance	
	Dongkyu Chang (City University of Hong Kong): “Financial market structure for ESG integration”	Discussant: Adam Winegar (BI Norwegian Business School)
	Thomas Geelen (Pennsylvania State University): “Sustainable organizations”	Discussant: Martin Ruckes (Karlsruhe Institute of Technology)
10.30-11.00	Coffee break	
11.00-12.45	Information in Financial Markets	
	Keynote by Itay Goldstein (University of Pennsylvania): “On ESG investing: Heterogeneous preferences, information, and asset prices”	
	Zhiqiang Ye (Zhejiang University): “Information Abundance, Competition for Attention, and Corporate Efficiency”	Discussant: Matthias Lassak (Aarhus University)
12.45-13.45	Lunch	Ca’Inn
13.45-15.15	Managerial Ability	Harvard Auditorium
	Martin Ruckes (Karlsruhe Institute of Technology): “Picking winners: Managerial ability and capital allocation”	Discussant: Tom Aabo (Aarhus University)
	Enrique Schroth (EDHEC Business School): “Why are CEOs rarely succeeded by external candidates?”	Discussant: Boris Nikolov (University of Lausanne)
15.30	Closing reception	Harvard Courtyard

Program committee

Stefan Hirth (chair), Aarhus University
Matthias Lassak (co-chair), Aarhus University

- Adelina Barbalau, University of Alberta
- Ajay Subramanian, Georgia State University
- Alexander Schandlbauer, University of Southern Denmark
- Alexander Szimayer, Hamburg University
- Andrey Malenko, Boston College
- Anil Kumar, Aarhus University
- Boris Nikolov, University of Lausanne
- Cecilia Bustamante, University of Maryland
- Chong Huang, University of California, Irvine
- Christian Hilpert, Sun Yat-sen University
- Christoph Schneider, University of Münster
- Christopher Hennessy, London Business School
- David Lando, Copenhagen Business School
- Dion Bongaerts, Erasmus University Rotterdam
- Emilio Bisetti, Hong Kong University of Science and Technology
- Enrique Schroth, EDHEC Business School
- Evgeny Lyandres, Tel Aviv University
- Florian Kiesel, Free University of Bozen-Bolzano
- Francesca Zucchi, ECB
- Francesco Sangiorgi, Frankfurt School of Finance & Management
- Francesco Sannino, Frankfurt School of Finance & Management
- Grzegorz Pawlina, Lancaster University Management School
- Günter Strobl, University of Vienna
- Jan Schneemeier, Indiana University
- Jing Zeng, University of Bonn
- Joel Shapiro, Saïd Business School
- Kornelia Fabisik, University of Bern
- Larissa Schäfer, Frankfurt School of Finance & Management
- Magdalena Rola-Janicka, Imperial College
- Marliese Uhrig-Homburg, Karlsruhe Institute of Technology
- Martin Ruckes, Karlsruhe Institute of Technology
- Matthias Efung, HEC Paris
- Matthieu Bouvard, Toulouse School of Economics
- Nadya Malenko, Boston College
- Naveen Gondhi, INSEAD
- Paul Voss, HEC Paris
- Simon Gervais, Duke University
- Thomas Geelen, Pennsylvania State University
- Tom Aabo, Aarhus University
- Vladimir Vladimirov, University of Amsterdam
- Yunzhi Hu, University of North Carolina at Chapel Hill
- Yuri Tserlukevich, Arizona State University
- Zacharias Sautner, University of Zurich
- Zhen Zhou, Tsinghua University

Keynotes

Bankruptcy Law and the Market for Corporate Influence: Extending the Creditors' Bargain to Distress Investors

Mike Burkart¹, Samuel Lee², Vladimir Vladimirov³

¹London School of Economics, United Kingdom. ²Santa Clara University, USA.

³University of Amsterdam, Netherlands

The canonical view of bankruptcy law is that it solves a market failure by imposing a collective choice process that supplants the market. We propose that a bankruptcy law instead catalyzes the market if the collective choice process provides scope for rent seeking. Based on a model in which coordination failure is the key friction, as in the canonical theory, we argue that such a law induces activist investing which improves the efficiency of distressed restructuring. We interpret the evolution of Chapter 11 and its surrounding market environment through this lens.

On ESG Investing: Heterogeneous Preferences, Information, and Asset Prices

Itay Goldstein¹, Alexandr Kopytov², Lin Shen³, Haotian Xiang⁴

¹University of Pennsylvania, USA. ²University of Rochester, USA. ³INSEAD, France. ⁴Peking University, China

We study how ESG investing reshapes information aggregation by prices. We document that the information content of asset prices changes with ESG investing. We then develop a rational expectations equilibrium model in which traditional and green investors are informed about financial and ESG performances of a firm but have different preferences about them. Two investor groups trade in opposite directions based on the same information, resulting in a potential multiplicity of equilibrium price. The growth of green investors and an improvement in ESG information quality can reduce price informativeness about a firm's financial performance and raise its cost of capital.

Abstracts

Shareholder Voice and Executive Compensation

John Barry

Duke University, USA

Managerial influence on the Board of Directors induces an agency problem in the design of executive compensation. I evaluate the role of shareholder voice in disciplining compensation practices by estimating a model of CEO compensation with non-binding shareholder approval votes (Say-on-Pay). The Board sets CEO pay and is biased towards a high wage; shareholders can fail the Say-on-Pay (SOP) and punish the Board for overpayment. Failed votes are perceived as costly by both the Board and shareholders: a cost of 2.06% (0.76%) of value for the Board (shareholders) is sufficient to match the data. SOP thus resembles a costly punishment mechanism and the disciplining effect on compensation increases firm value by 4.6% on average. Empirical evidence suggests the Board cost is a career and reputation concern for directors, and shareholders internalize a cost to dissenting from the Board on a prominent policy. I construct a counterfactual SOP mechanism which emulates giving a focal shareholder an advisory seat on the Board; this lowers the SOP failure rate, decreases wages and further increases firm value.

Voting and Trading on Public Information

Markus Parasca¹, Paul Voss²

¹Vienna University of Economics and Business, VGSF, Austria. ²HEC Paris, France

This paper studies how public information, such as proxy advice, affects shareholder voting and, thus, corporate decision-making. Although public information improves the voting decisions of uninformed shareholders, it also induces privately informed shareholders to sell their shares rather than to vote. As a result, public information impairs information aggregation by voting but improves information aggregation by trading. We show that, overall, public information can undermine corporate decision-making. Furthermore, the effect of more precise public information on corporate decision-making is non-monotonic. Our results give rise to new empirical predictions and have implications for regulation.

Innovation, industry equilibrium, and discount rates

Francesca Zucchi¹, Cecilia Bustamante²

¹ECB, Germany. ²University of Maryland, USA

We develop a model to examine how discount rates affect the nature and composition of innovation within an industry. Challenging conventional wisdom, we show that higher discount rates do not discourage firm innovation when accounting for the industry equilibrium. Higher discount rates deter fresh entry—effectively acting as entry barriers—but encourage innovation through the intensive margin, which can lead to a higher industry innovation rate on net. Simultaneously, high discount rates foster explorative over exploitative innovation. Considering fluctuations in discount rates, the model further rationalizes observed patterns in innovation cyclicity, and shows that innovation by rivals inflates incumbents' risk premia.

Beyond Peers: Cross-Industry Competition and Strategic Financing

Boris Nikolov, Norman Schürhoff, Zepeng Wang
University of Lausanne and Swiss Finance Institute, Switzerland

Using data on firms' self-declared competition networks, we identify over ten competition communities in the U.S. economy, defined as groups of firms within and across industries that are direct or indirect competitors. Based on this observation, we build a model in which firms strategically respond to their direct and indirect competitors in both product market and financing. Due to predatory strategic interactions, shocks to a firm can impact any other firm's financing decision in the same competition community. The model predicts complementarity in financing when the competition community's network structure is of heavy-tailed degree distribution, which we validate empirically.

Short-Term Debt Overhang

Pavel Zryumov¹, Giulio Trigilia¹, Kostas Koufopoulos²
¹University of Rochester, USA. ²University of York, United Kingdom

We consider a dynamic asymmetric information model where firms face multiple investment opportunities and their capital structure is endogenous at all times. We identify a new economic force, short-term debt overhang, which leads firms to issue short-term debt and subsequently underinvest in growth options. This force, which arises at the optimal mechanism and is time-consistent, generates several new testable predictions. Strikingly, we find that greater retained earnings, or cash, can reduce the investment in positive net present value projects by firms with intermediate credit ratings, and that these firms are the most likely to issue short-term debt.

Relationship Lending in Bond Markets? Evidence From Corporate Call Policies

Paul Beaumont, David Schumacher, Gregory Weitzner
McGill University, Canada

Can relationship lending be sustained in public financial markets? We use firms' call decisions as a laboratory to study this question. After a fixed-price call forces existing bondholders to sell their bonds back at below market prices, existing bondholders are far less likely to participate in firms' subsequent bond issuances. The effects are strongest for the largest fund families, such that the call leads to a reduction in their total ownership of these firms' bonds. In turn, firms delay calling their bonds when they have more large fund families in their bondholder base. Finally, firms' borrowing costs are affected by the reputation they develop from their past call decisions. Our results reveal the importance of relationship lending in bond markets and show how financial policies affect these relationships.

What Do CDO Tranche Spreads Tell Us About Credit Availability and Credit Rating Standards?

Alexander David¹, Maksim Isakin²

¹University of Calgary, Haskayne School of Business, Canada. ²Cleveland State University, USA

We introduce a Credit Rating Agency (CRA) to a consumption-based model to explain the time-series variation of credit spreads on CDO tranches. Practising Bayesian persuasion, the CRA controls the type-II error of ratings to maximize the proportion of investment-grade rated firms while attempting to maintain their probability of default below a threshold. The model's type-II error strongly predicts a measure of rating standards from an ordered probit model. Our analysis suggests the importance of credit rating standards in explaining the clustering of defaults of investment-grade firms. Out-of-sample, it implies moderate tranche spreads during the pandemic despite disastrous economic growth.

Financial Market Structure for ESG Integration

Dongkyu Chang¹, Keeyoung Rhee², Aaron Yoon³

¹City University of Hong Kong, Hong Kong. ²Sungkyunkwan University (SKKU), Korea, Republic of. ³Kellogg School of Management at Northwestern University, USA

ESG integration is difficult to be achieved because borrowers can often deviate from their promises ex-post. We find that borrowers prioritize ESG to reduce borrowing costs when their interest repayment steeply increases with financial returns. Competition between green and brown lenders could indeed lower the overall borrowing rate and induce borrowers to pursue financial profits. Nevertheless, when borrowers privately know their genuine preferences for ESG and when green lenders finance brown borrowers first, subsequent brown lenders perceive the holdout borrowers as ESG-friendly and demand a high borrowing rate. This in turn incentivizes the borrowers to minimize their borrowing costs by pursuing ESG.

Sustainable Organizations

Thomas Geelen¹, Jakub Hajda², Jan Starmans³

¹Pennsylvania State University, USA. ²HEC Montreal, Canada. ³Stockholm School of Economics, Sweden

We develop a theory of stakeholder governance to study how pro-social stakeholders shape organizations. Conflicts of interest arising from diverging pro-social preferences can lead to shifts in control rights, which significantly affect organizational sustainability. We provide conditions under which more pro-social stakeholders benefit or harm an organization's sustainability, showing that they do not necessarily make it more sustainable. The key insight of our analysis is that a top-down approach to addressing sustainability concerns consistently improves organizational sustainability, while a bottom-up approach can harm it. Our results apply to CEO authority and retention, board composition, and shareholder proposals and engagement.

Information Abundance, Competition for Attention, and Corporate EfficiencyZhiqiang Ye

Zhejiang University, China

I study how speculators' information acquisition costs affect real efficiency when information acquisition consumes speculators' attention and firms learn from stock prices. A firm with higher exposure to its risky real project attracts more attention from speculators. Lowering speculators' information acquisition costs improves firms' corporate efficiency when the costs are high. Yet, when the costs are low, speculators use up their limited attention. Then, decreasing their information acquisition costs can backfire: Firms excessively increase risky project exposure to engage in zero-sum competition for speculators' attention, reducing corporate efficiency and social welfare. Raising firms' growth opportunities can reinforce such inefficiency.

Picking Winners: Managerial Ability and Capital AllocationAndreas Benz¹, Peter Demerjian², Daniel Hoang¹, Martin Ruckes³¹University of Hohenheim, Germany. ²Georgia State University, USA. ³Karlsruhe Institute of Technology, Germany

We examine how division managers' human capital affects internal capital allocation using a hand-collected data set of divisional managers at S&P 1,500 firms. Based on a novel measure of division-manager ability, we show that more able division managers receive substantially larger capital allocations. This effect is robust to controlling for the possibility of assortative matching and more pronounced for firms with better governance. We also find that the allocation of extra capital to higher-ability managers creates firm value. These findings suggest efficient fund transfers to high-productivity managers and provide support for a largely unexplored bright side of internal capital markets.

Why are CEOs rarely succeeded by external candidates?Enrique Schroth^{1,2}, Li He³¹EDHEC Business School, France. ²CEPR, France. ³Erasmus University Rotterdam, Netherlands

We claim that large US public firms are run by outsider CEOs only 8.4% of the time mostly because boards have a strong subjective preference for promoting insiders. We estimate a dynamic model of a board's CEO hiring choices to confront the subjective preference channel to other forces against external appointments. Search costs, transition costs, and lower productivity are reasons for infrequent external hiring, but their combined effects are smaller than those of the board's preferences alone. Without such bias, we predict a 49% frequency of outsider control. Younger boards are the most biased towards internal promotions, suggesting that career concerns shape directors' hiring choices.