Commentary on “The Rise of Common Ownership” (Gilje, Gormley and Levit)

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Introduction

Broad themes in GGL paper:-

• Does common ownership by institutional investors across corporations in the same economic sector have anti-competitive outcomes eg negative effects on quality and price of goods and services?

• Does the increasing popularity of index fund investing contribute to common ownership, and if so, how much?
• “A small group of institutions has acquired large shareholdings in horizontal competitors throughout our economy, causing them to compete less vigorously with each other.”

Elhauge 2016. (See also Elhauge 2017; Elhauge 2018.)

• **Primary culprits** – BlackRock, Vanguard, T. Rowe Price, Fidelity and State Street Global.
• “The great, but mostly unknown, antitrust story of our time is the astonishing rise of the institutional investor...and the challenge that it poses to market competition.”

Posner, Morton & Weyl 2016. (See also Posner, Morton & Weyl 2017).

But blockbuster theory is big on impact, short on fine-tuning.
The paper attempts to “fill a void” and fine-tune debate by:-

(i) Constructing measures to quantify levels of common ownership (calculated between 1980 and 2012).

(ii) Constructing a model-driven measure to quantify the impact of common ownership on the managerial motives and strategic choices of investee firms.

(iii) Analyzing how index investing relates to common ownership.

• **Contextualisation** – shifting ownership patterns, the rise of institutional investors + US and international shareholder empowerment developments.
Some Preliminary Comments About the Common Ownership Debate

• Strong focus on index investing, but broader implications.

• Possible versions of common ownership debate. Eg:-

  **Version 1** – Fund managers will remain passive, because adequate incentives to monitor individual firms’ performance – 1990s passivity story.

  **Version 2** – Passive institutional investors are really active and have incentives to pursue anti-competitive ends (Posner, Morton & Weyl 2016).
• “[A] totally passive investor…may be easier to accept than an active one” (Buxbaum 1991).

• “We believe that our active engagement demonstrates that passive investors don’t need to be passive owners” (Vanguard website (cited in Posner, Morton & Weyl 2016)).
• **Version 3** – Corporate managers of investee firms have reduced incentives to compete, irrespective of institutional investors’ conduct.

• Irrelevant that:-

• All the financial interests are minority shareholdings (Azar, Schmalz & Tecu, forthcoming, 2018, *J Fin*).

• Institutional investors are passive.

• No attempt by institutional investors to communicate with, or influence, investee company.

• No coordination between institutional investors (Elhauge 2016).

• But many “known unknowns” and “unknown unknowns” re shareholder preferences.
Nature of the Allegedly Anti-Competitive Incentives Under Version 3

• The anti-competitive incentives are therefore “purely structural” – shareholders still liable if holdings lessen competition, irrespective of passivity (Elhauge 2016).

• “There is no such thing...as an innocent stockholder” (Justice Brandeis (1915)).

• Appropriately Draconian regulatory proposal - divestment.

• GCL uses Versions 2 and 3 (but findings re index funds partly support Version 1).
• Drucker 1976; Clark, 1981.

• The rise of “agency capitalism” (Gilson & Gordon 2013):

• Institutional ownership in the top 1,000 US companies rose from 10% in the early 1950s to over 70% today (Thompson 2015) + 80% of S&P 500 stock (Elhauge 2016).

• Major GCL contribution.
US Industries “Plagued” By Common Ownership (Elhauge, 2016)

Airlines + Technology + Banking + Pharmaceuticals
(See eg Azar, Schmalz and Tecu (forthcoming, 2018); Yadav 2017).

- Common Ownership in US Airlines:-
  - BlackRock and Vanguard - 9/9 US airlines.

Azar, Schmalz and Tecu (forthcoming, 2018, Table 1).
The Changing Image of Shareholders in Corporate Governance

• Berle and Means 1932 – shareholders presented as powerless vis-à-vis management and in need of legal protection.

• Traditional image of institutional investors - “A paper colossus, alternatively greedy and mindless, but in all events a less important corporate constituent than the other kind of investor, the real shareholder” (Gilson & Kraakman1991)

• Everything changes after the 1990s – rise of powerful institutional investors + hedge funds.

• Competing narratives about shareholder power.
Positive Images of Shareholders and their Role in Corporate Governance

• Walker Committee (2009) on corporate governance in UK banks – Advocated greater activism and engagement by institutional investors as a protective mechanism.

• Legacy of the Walker Committee – global shift to Stewardship Codes (eg ISG, Framework for US Stewardship and Governance (2017); Hill 2017).

• Australia’s “two strikes rule” for executive remuneration.

• Coordinated action by institutions encouraged by regulators (eg FRC (UK) and ASIC (Australia)).

• Agency capitalism – institutional investors as an activism filter – they can support or “tame” the activists (Gilson & Gordon 2013; Lipton 2015).
“One consequence of a more dispersed and disinterested ownership structure is that it becomes harder to exert influence over management, increasing the risk of sub-optimal decision-making”.

Andy Haldane (2015)
Negative Images of Institutional Investors and their Role in Corporate Governance

- Shareholders – predatory + disloyal to ultimate beneficiaries + prone to short-termism.


- Coordinated shareholder action viewed with alarm (eg “wolf packs”, “swarms of locusts”).

- New goal of corporate law - to protect the company from shareholders.

- But CO argument goes even further (ie law needs to protect entire industries from certain shareholders + extends to passive investors).
• CO is just a theory (and a very broad-brush theory at that!).

• Questionable underlying presumptions about shareholder power – “private ordering combat” (Hill, forthcoming 2018 *U Ill L Rev*) vs underinvestment in stewardship by mutual fund managers (Bebchuk, Cohen and Hirst 2017; GGL paper re index investing).

• CO and anti-trust issues are not new (Black 1990; Buxbaum 1991). See also Rock & Rubinfeld 2017.
Concluding Comments (2)

• ESG issues – BlackRock’s letter to top 300 UK companies + sustainability (BlackRock 2017a; Lipton 2017). 2018 AMP remuneration vote – ethics.

• CO debate is US-centric (cf eg SOEs, Norwegian Oil fund - $870b in assets + 1.3% of every group listed globally).

• CO’s dire corporate governance consequences – unintended, or intended, result? (Rock & Rubinfeld 2017; BlackRock 2017(b)).
Conclusion

• “The Competitive Effects of Common Ownership: We Know Less Than We Think” (2017).

• Thanks to GGL paper we now know considerably more than we did before!