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

GCGC Conference – Harvard Law School

1 June 2018

SYDNEY LAW SCHOOL

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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?

Legal Literature's "Economic Blockbuster"

- "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, Anti-Trust Story of Our Time”

- “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 & Weyll 2017).

But blockbuster theory is big on impact, short on fine-tuning.

Aims of Gilje, Gormley and Levit Paper

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).

Version 2 - Passive Investors are Really Active

- "[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 – Common Ownership Argument

- **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).

Changing Ownership Patterns

- 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 Industry Clusters Examined Through the Common Ownership Lens

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.
- State Street – 7/9 US airlines.
- Fidelity and T. Rowe Price – 6/9 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.

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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 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).

Positive Perceptions of Shareholder Power

- “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.
- US Shareholder Empowerment debate (eg Bainbridge 2006, Lipton & Savitt 2007, Strine 2006, Stout 2006).
- 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).

Concluding Comments (1)

- 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!