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ICI VIEWPOINTS

NOVEMBER 30, 2018

Common Ownership: Ignoring the Age-Old Conflict Between Owners and Managers

By Mike McNamee

The claim that competition in a concentrated industry suffers when institutional investors own shares in firms across that industry continues to garner attention, as advocates pen op-eds and seek press attention. But as more and more experts examine "the common ownership story," critical commentary is tearing large holes in this claim. Both the theoretical and empirical bases for this "story" are looking increasingly threadbare.

In his first public remarks as a member of the Federal Trade Commission, Commissioner Noah Joshua Phillips tackled what he called "the common ownership story"—and concluded that "this 'economic blockbuster' seems a little light on plot."

Like many other experts, Commissioner Phillips sees problems with both the empirical evidence and the theoretical basis for the claim of anticompetitive harm. On the empirical side, he notes, "the available evidence does not identify a clear mechanism by which common shareholding *actually causes* a lessening of competition" (emphasis original). Proponents "offer hypotheses as to the mechanism—and even policy prescriptions to stop it—just not evidence."

On the theoretical side, Phillips puts his finger on a crucial flaw. Proponents rely on a "core intuition" that "corporate managers, cognizant that their large institutional shareholders also hold stock in competitors, soften competition to benefit those shareholders.* That is the fundamental claim underlying the common ownership debate."

But, as Phillips points out, "as intuitions go, it is rather counter-intuitive.…The theory of corporate behavior underlying the harm from common ownership runs contrary—directly contrary—to our ancient and well-established concerns about the relationship between managers and shareholders."

At stake: the "principal-agent problem" that arises whenever the owner of an enterprise hires a manager to run it. Identified in the New Testament, the misaligned incentives of owners and managers have been a concern of such scholars as Adam Smith in 1776, Adolf Berle and Gardiner Means in the 1930s, and Michael Jenkins and William Meckling in the 1970s. "For centuries, literally," Phillips notes, "we have concerned ourselves with the problem of making managers care more about shareholders—precisely because there are innumerable reasons to fear that they do not."

Indeed, Phillips notes, "managers have such strong, demonstrated incentives to derogate from their duties to shareholders that we have erected robust common law and statutory regimes"—among them the duty of care, the duty of loyalty, and the securities laws—"to keep them from doing so."

Claims that common ownership suppresses competition, however, stand that history on its head. "The common ownership story rests squarely on the belief that managers care quite a bit about some shareholders, specifically those who hold shares in competitors, and quite a bit less about others," Phillips notes. "We have seen many cases where managers failed shareholders generally. And we have seen cases where management—or others—favored the majority over the minority.…But I am not aware of a demonstrated tendency of management to favor a particular set of minority shareholders without some other incentive."

The common ownership story collides head-on with the principal-agent problem, because acting to favor the interests of common owners "may, in fact, require managers to put shareholder interests over their own financial well-being," Phillips says.

Managers want to prove that they deserve higher pay, bigger titles, better jobs, and greater fame—and “it is easy to market success when the firm you ran bests its competitors,” Phillips says. But it is “much harder to earn that reputational reward,” he notes, “from presiding over a lessening of competition in a particular industry, which only one or a few shareholders see.”

The fact that some shareholders are institutional investors doesn’t change the conflict between owners and agents, Phillips says. Reviewing the literature on institutional investing, he concludes: “Our experience with corporate managers and institutional investors runs counter to the common ownership story, and may explain the absence of a clear mechanism of harm.”

Like others, Phillips calls for more research into the common ownership story. “For now, I do not believe we know enough to warrant policy changes,” he concludes. But with such a fundamental contradiction in its plot, this story looks more and more like fantasy.

*The presumed “benefit” to those shareholders of softening competition is debatable.Other authors have questioned the faulty assumptions about asset managers’ “economic interests” embedded in the common ownership hypothesis.

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