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Common Ownership and Competition

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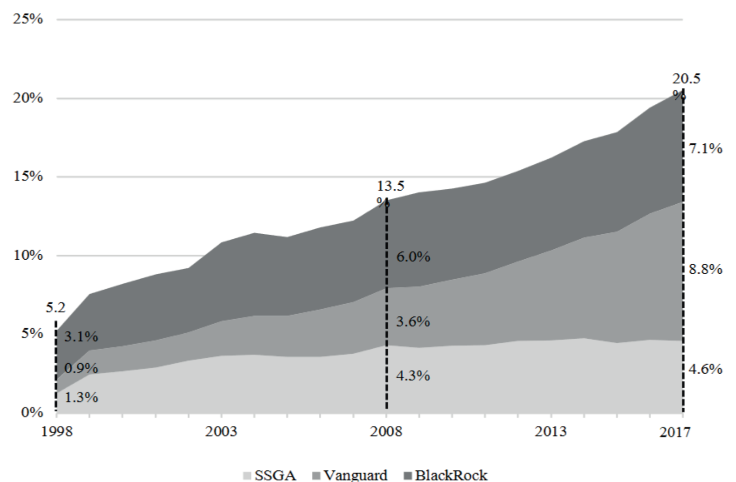
- Recent years have seen a rapid expansion in common ownership, which is where an investor holds minority shares in multiple firms operating, and potentially competing against each other, in the same market.
- Common ownership is primarily a practice of institutional investors (banks and insurance companies, but also collective investment undertakings such as investment funds and pension funds), which hold shares on behalf of their clients and collect their voting rights.
- The past two decades have seen a rise in institutional shareholding internationally, which has the effect of reducing research and analysis costs for investors and, ultimately, financing costs for firms.
- The expansion of institutional shareholding has led to an increased prevalence of common ownership in listed companies. In the United States, the average combined ownership stake in S&P 500 companies held by the three largest institutional investors grew from 5% in 1998 to roughly 20% in 2017 (see chart). With the rise in popularity of index funds, the ownership stake in US listed companies held by institutional investors with positions of 5% or more in other companies in the same industry grew from less than 10% in 1980 to nearly 60% in 2014. In Europe, in 2016, common ownership with at least 5% participation involved 67% of listed companies.
- Common ownership may weaken competition in concentrated sectors, such as in the airline or pharmaceutical industries. However, there is a lack of consensus as to the overall economic impact of common ownership.

Ownership stake in S&P 500 companies held by the top three US asset managers



Source: Bebchuk L. A. and Hirst S. (2019), "The Specter of the Giant Three", NBER Working Paper No. w25914, National Bureau of Economic Research.

1. The rise of common ownership in the United States and Europe

Common ownership is when an investor holds minority shares[1] in multiple firms operating, and potentially competing against each other, in the same market.[2]

The expansion of common ownership can be attributed to the growing share of equity holdings by institutional investors.[3] In choosing equity investments, institutional investors favour listed companies whose shares are more liquid and more easily valued. One reason institutional investors hold positions in so many companies listed on major stock exchanges is the rising popularity of passive management, an investment strategy used by index funds[4] that involves building a portfolio to mirror a stock market index, significantly reducing the management fees paid by retail investors (on average 0.75% vs 2% per annum).[5] This style of investing, which does not involve any active stock picking, explains why the same index fund may hold positions in potentially competing firms.

Between the globalisation of capital markets and the accompanying expansion of institutional shareholding in recent years,[6] there has been an increased prevalence of common ownership in listed companies.

In the United States, the percentage of listed companies held by asset managers that also hold at least 5% of the common equity of other companies in the same industry increased from less than 10% in 1980 to around 60% in 2014.[7] Bebchuk and Hirst (2019)[8] show that in 2017, the "Big Three" asset managers (BlackRock, Vanguard and State Street Global Advisors) collectively controlled roughly 20% of the shares (up from 5% in 1998) and 25% of the voting rights of S&P 500 companies. In Europe, in 2016, common ownership with at least 5% participation involved 67% of listed companies.[9] The share of stock market capitalisation of firms collectively owned by the Big Three grew from 4% in 2007 to 12% in 2016 in the oil and gas industry; from 2% to 8% in electricity; and from 1% to 6% in telecommunications.[10] However, the use of such measures for an activity sector is not straightforward, since measures of concentration are only pertinent for actual competitors. The industry used for statistical classification purposes may not necessarily match the definition of a relevant market for competition identification purposes.

(1) A stake with less than 50% of the voting rights attached to the shares of the issuing company.
(2) There is a distinction to be drawn between common ownership and cross-shareholding, which is where one company has a direct minority interest in another, possibly a competitor, which itself holds a minority interest in the first company.
(3) Institutional investors are entities that collect funds to invest in the markets for themselves or on their clients' behalf; in this paper the term also encompasses collective investment undertakings (index funds, etc.).
(4) Also known as index trackers or exchange-traded funds (ETFs).
(5) Services centraux et régionaux de la DG Trésor (2021), "Le capitalisme avant la crise du Covid", *Document de travail* No. 2021/4 de la DG Trésor.
(6) OECD iLibrary | OECD Institutional Investors Statistics 2020 (oecd-ilibrary.org); Services centraux et régionaux de la DG Trésor, op. cit.
(7) He J. and Huang J. (2017), "Product Market Competition in a World of Cross-Ownership: Evidence from Institutional Blockholdings". This study uses Standard Industrial Classification (SIC) codes to define product markets (industries). A SIC code is a four-digit code that identifies the main industry a firm belongs to based on its business activities.
(8) Bebchuk L. A. and Hirst S. (2019), "The Specter of the Giant Three", *NBER Working Paper* No. w25914, National Bureau of Economic Research.
(9) Report from the Joint Research Centre, European Commission, (2020), *Common Shareholding in Europe*. The analysis was conducted on a database comprising all listed companies active in the European Union in 2007-2016. The NACE (statistical classification of economic activities in the European Community) industry classification is used to identify economic activity sectors, which may not necessarily match the definition of a relevant market.
(10) Posner E. A., Scott Morton F. M. and Weyl E. G. (2017), "A Proposal to Limit the Anti-Competitive Power of Institutional Investors", *Antitrust Law Journal*, vol. 81, issue 3; Report from the Joint Research Centre, European Commission (2020), *Common Shareholding in Europe*.

2. The effects of common ownership on market competition

In some cases, common ownership can be a source of benefits and efficiency gains from a corporate management perspective. An institutional investor could facilitate beneficial collaboration[11] with the potential to generate efficiency gains (He and Huang, 2017). An institutional investor could also acquire knowledge specific to the industry, thereby improving its corporate governance expertise for the companies in its portfolio (OECD, 2011).[12]

However, more recent research has highlighted the antitrust risks stemming from common ownership. Investors in a common ownership situation could be incentivised to discourage competition between the companies they own shares in, in order to maximise the value of their overall portfolio. Common ownership could facilitate the formation of a cartel or increase its stability.[13]

To account for common ownership in measures of industry concentration, the most commonly used tool in the academic literature (O'Brien and Salop, 2000)[14] is the Modified Herfindahl-Hirschman Index (MHHI). The MHHI breaks down the total market concentration into two parts: the standard industry concentration, as measured by the Herfindahl-Hirschman Index (HHI), capturing the number and relative dimension of competitors; and the concentration corrected for common ownership, which captures how competitors are connected by common ownership (called "MHHI delta").

The relationship between common ownership and competition has been studied within different industries in the United States. In the banking industry, there appears to be a positive correlation between the prices charged by banks and MHHI-measured industry concentration.[15] In the seed industry, common ownership was found to have contributed between 6% and 15% to the increase in soy, corn and cotton seed prices over the 1997-2017 period, even after taking measures to separate the effects of market concentration and common ownership.[16] Azar et al. (2018)[17] show that over the 2001-2014 period in the US airline industry, while the HHI remained stable despite various mergers, the MHHI delta doubled between 2009 and 2014 following the combination of two asset managers with holdings in the industry. Under common ownership, competing airlines on a given route were found to have increased ticket prices by an average of 3% to 7% compared to a counterfactual in which the companies remained under separate ownership. In the pharmaceutical industry, common ownership between the developer of a generic drug and its brand-name competitor was found to reduce the probability of market entry of the generic.[18]

Economic analysis of the competitive effects of common ownership is still in its early stages, with few firm conclusions. It is also the subject of criticism, particularly due to the difficulty of establishing causality between the prevalence of common ownership in a market and its level of competition. With the notable exception of the Joint Research Centre (JRC) study, very little analysis has been done on European data. The JRC study, which focused on the EU beverage industry between 2007 and 2016, found a positive correlation between common ownership and the market power of firms. There were, however, notable limitations to the study (small sample size, short observation period).

(11) For example, joint bargaining with suppliers to reduce costs, R&D coordination or sharing technical knowledge.
(12) OECD (2011), The Role of Institutional Investors in Promoting Good Corporate Governance, Corporate Governance, OECD Publishing.
(13) Rock E. B. and Rubinfeld D. (2017), "Antitrust for Institutional Investors", *Law & Economics Research Paper Series, Working Paper* No. 18-40.
(14) O'Brien D. P. & Salop S. C. (2000). Private politics, corporate social responsibility, and integrated strategy competitive effects of partial ownership: Financial interest and corporate control. *Antitrust Law Journal*, 67, 559-614.
(15) Azar J., Raina S. and Schmalz M. (2021), "Ultimate Ownership and Bank Competition", *Financial Management*.
(16) Torshizi M. and Clapp J. (2020), "Price Effects of Common Ownership in the Seed Sector", *Antitrust Bulletin*, 66, 1.
(17) Azar J., Schmalz M. C. and Tecu I. (2018), "Anticompetitive Effects of Common Ownership", *Journal of Finance*, vol. 73, issue 4, 1513-1565.
(18) Newham M., Seldeslachts J. and Banal-Estanol A. (2018), "Common Ownership and Market Entry: Evidence From the Pharmaceutical Industry", *Discussion Paper of DIW Berlin* No. 1738, German Institute for Economic Research.

3. Common ownership and antitrust laws

Between efficiency gains in financial management and potential losses from weakened competition,[19] the economic effects of common ownership are unclear. Competition authorities rarely scrutinise minority acquisitions, which can partly explain the as-yet undeveloped state of economic analysis on the competitive effects of common ownership. That said, some European jurisdictions do conduct reviews of non-controlling acquisitions in certain cases (e.g. Germany, Austria).[20]

However, increasing attention is being paid in Europe to the role of antitrust laws in common ownership situations. In 2017, in the Dow/DuPont case,[21] the European Commission found that a significant prevalence of common ownership increased the risk that the merger would have anti-competitive effects. The following year, when Bayer acquired Monsanto, the Commission found that common ownership by institutional investors was a significant factor in the assessment as it could mean underestimating the market power of players in the biotechnology and agrochemicals industry. The issue has been debated in various European studies published on the subject.[22]

Given the circumstances, if competition authorities were to more regularly use indicators that account for common ownership in measures of industry concentration, it could contribute to a better understanding of these types of situations and their market impacts.

(19) These issues were the subject of a DG Trésor seminar on 25 June 2021 (*Séminaire Nasse*); a recording is available online: www.tresor.economie.gouv.fr/Evenements/2021/06/25/actionnariat-commun-et-concurrence.
(20) In Germany, a review can be launched if two criteria are met (a stake of at least 25% and “significant competitive influence”). In Austria, an acquisition of at least 25% triggers an antitrust investigation.
(21) The merger was conditionally approved by the European Commission in March 2017.
(22) *Barriers to Competition Through Joint Ownership by Institutional Investors*, a May 2020 study commissioned by the European Parliament (ECON committee); *Common Shareholding in Europe*, a September 2020 report by the Joint Research Centre, the European Commission’s science and knowledge service, commissioned by the Directorate-General for Competition (DG COMP).

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