Opinion **Financial & markets regulation**

There is no need to curb common shareholding

Evidence that companies are not competing due to shared ownership is mixed at best

HAL SCOTT

In 2018 United Airlines stock rose nearly 24 per cent, while Delta Air Lines shares fell about 10 per cent. Barring cross-shareholding would expose investors to the risk of choosing the wrong company © Reuters

Hal Scott YESTERDAY

US and EU regulators recently held hearings on concerns that overlapping corporate ownership could be harming competition. Some witnesses advocated restricting institutional investors, who own 80 per cent of shares in the largest US companies, from owning more than one group in the same industry. Such limits would have a devastating effect on capital markets and investors.

Some scholars worry that "common ownership" leads to higher prices for goods and services, like airline tickets, because companies with shared owners may not compete as strenuously with each other. The issue has become more urgent with the rapid growth of index tracking funds, which maximise their returns by diversifying their holdings across many public companies.

However, evidence that companies are not competing due to shared ownership is mixed at best. A 2018 study in the Journal of Finance found that common ownership increased airline ticket prices in recent years by 3 to 7 per cent. However, a University of Virginia study found no effect on airline ticket prices and separate research by Federal Reserve economists found shared ownership had no effects on banking.

But critics of common ownership nonetheless argue that antitrust regulators should broaden their definition of "concentrated industries" that lack sufficient competition. Right now officials determine this based only on the number of companies and their market shares in a given sector. But the legal academics Einer Elhauge and Eric Posner argue that common ownership by institutional investors should also be considered.

A committee of finance industry figures and academics that I lead concluded that 199 out of the 206 US sectors would be considered concentrated under the expanded definition. That could subject institutional investors that own more than one company per sector to antitrust scrutiny.

The effects on capital markets would be monumental, and could lead to a massive transfer of ownership and potential funding challenges for US companies. We estimate that this could lead institutional investors to sell $4tn-worth of shares of S&P 500 companies.

Limits on common ownership could also substantially increase costs for retail investors. Applied stringently, they would ban index tracking funds, which own all the large companies in each industry.

Prof Posner argues that investors could achieve adequate diversification by owning one company in each concentrated industry, but evidence shows this is wrong. The performance of stocks within a sector vary widely. In 2018 United Airlines stock rose nearly 24 per cent, while Delta Air Lines shares fell about 10 per cent. Barring cross-shareholding would expose investors to the risk of choosing the wrong company.

A BlackRock-funded study retroactively applied concentration limits from 1990 to 2017. An unlucky portfolio holding one underperforming company in each sector would have underperformed the S&P 500 by 8 per cent.

Some proposals to limit common ownership have exceptions that allow institutional investors to own more than one group in a concentrated industry. However, these safe harbours are also deeply flawed. One would prevent investors that own more than one company in the same sector from voting their shares, unfairly limiting their ability to influence key decisions on executive pay, governance and dealmaking. Engagement by knowledgeable shareholders is good for public companies and should be encouraged.

Another safe harbour would limit big investors to no more than 1 per cent of each company in a concentrated industry. But the committee study suggests that is more disruptive than limiting them to a single company, requiring the sale of $5.1tn in S&P 500 company shares.

The common ownership proposals are far more burdensome than the allegedly anti-competitive behaviour that they seek to cure. Regulators should ignore these ideas and focus on protecting consumers from real problems.

The writer, an emeritus Harvard law professor, heads the Committee on Capital Markets Regulation

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