

Ownership structure in publicly listed equity capital markets – observations and issues

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Good afternoon,

First I'd like to thank Professor Vives for his very interesting presentation and paper.

I am very pleased to be here at this meeting of the European Corporate Governance Institute (ECGI) as the OECD's Director for Financial and Enterprise Affairs.

The directorate supports the OECD's Competition Committee, which has held some very interesting discussions on the subject of common ownership.

I will cover 3 things today.

1. The broader context of today's discussion, particularly what we know about corporate ownership at a company level.
2. The implications of common ownership for corporate governance.
3. The implications for competition.

Context

Ownership structures are closely linked to the structure and functioning of capital markets. In recent years, the market structure of publicly traded equity has changed significantly through: growing dominance of institutional investors; and increased concentration of ownership; which together has led to an increased concentration of ownership by institutional investors.

Institutional dominance in main developed markets

Institutional dominance has been driven in large part by a shift in saving and investment patterns away from retail – or household – investors towards institutional – or intermediary – investors.

Institutional ownership in most advanced markets is growing in importance at the expense of direct ownership by retail investors.

This overall shift is most pronounced in the United States, the United Kingdom and Canada, where institutional ownership in the largest listed companies at the end of 2016 was 73%, 66% and 48% respectively.

Ownership concentration at company level

While this overall shift from retail to intermediaries is well known we also require an understanding of the structure of ownership and control at company level to set good public policy in areas such as: corporate governance; capital market development; and competition.

This is not only about who the owner is. It is also about the degree of ownership concentration or control.

Much of the corporate governance debate is based on the assumption that management has been able to detach itself from a fragmented shareholder base, where no single shareholder has control, and collective action among a myriad of small shareholders is too difficult or expensive.

However, in many markets and large companies, this assumption does not hold up against reality.

When concentration is measured as ownership by the three largest shareholders, ownership in most markets is actually highly concentrated among a small number of investors.

In more than half of the countries in the figure, the largest three owners on average hold more than 50% of the company's capital.

In general, family owned corporations are the most common category of large shareholders. This is the case for example in Russia, Turkey and Indonesia.

- The markets with the least concentration at company level are the United States, United Kingdom, Japan and Canada.

Concentration of ownership in the hands of institutional investors

This doesn't mean that these markets with the least concentration of ownership correspond to the traditional assumption of a fragmented ownership structure. And actually, the largest owners are typically institutional investors.

- In the largest US listed companies, for example, the 10 largest institutional investors on average hold 30% of listed company's capital. In the United Kingdom, Canada, Poland, South

Africa and Japan the largest 10 institutional investors hold between 13% and 22% of listed capital.

Some of the drivers behind this development are that assets under management by institutional investors have increased; and institutional investors portfolio allocation to public equity has grown faster than the number of new companies.

Total assets under management by pension funds and insurance corporations have increased by 500% over the past two decades - from almost USD 10 trillion in 1995 to USD 50 trillion in 2016 .

Implications for corporate governance

Overall, institutional owners are by far the largest category of public equity owners in the US, the UK and Canada, holding between half and three quarters of the capital.

Institutional investors are also the single largest category of owner in many other countries, including Poland, South Africa, France and Germany –

What does this mean for corporate governance?

It means the active exercise of corporate governance in many advanced economies is largely in the hands of these institutional holders, and depends on their business models, incentives, and investment strategies.

The shift towards institutional ownership has inspired several regulatory and voluntary initiatives aimed at increasing the level of ownership engagement by institutional investors.

For example, several countries have adopted stewardship codes that institutional investors are invited to sign up to on a voluntary basis.

These initiatives have resulted in increased voting by institutional investors. However, increased voting doesn't necessarily mean effective ownership engagement.

Large institutions may minimize the costs of complying with voting commitments by using proxy advisers or consultants or internal templates that provide standardized formulas for how to vote.

This kind of 'box ticking' may not take the particular circumstances of countries and companies into account.

If truly informed shareholder engagement is not at the heart of the institution's business model and investment strategy, commitments to engage, for example through voting, may be ineffective and lead to a box-ticking approach.

This is reflected in the newest chapter of the G20/OECD Principles of Corporate Governance which covers institutional investors.

The increased popularity of passive investment in capital markets is also lifting the importance of institutional investors.

Investment in exchange traded funds is growing fast. Asset managers are increasingly adopting passive strategies due to their attractiveness to investors in terms of:

- Lower costs.
- Low tracking error.
- Diversity.
- Liquidity.

Again, for some indexed passive funds, ownership engagement may have no role at all in the business model and might be seen as nothing but a net cost.

Implications for competition

This leads me back to the topic of Professor Vives' paper: the effect on competition when rival businesses have shareholders in common.

We have observed a lively debate in the research community on this topic.

The competition concern essentially boils down to this: if businesses observe that they have large institutional shareholders in common, they may make decisions that reflect the specific interests of those shareholders, and compete less aggressively than they otherwise would. To give three examples of the concerns identified:

1. Management may have certain incentives to take into account the effect of their decisions on their competitors with whom they have shareholders in common – for example pay packages based on industry-wide growth.
2. There may be herding behaviour among managers of firms with common major shareholders.
3. Investors in multiple businesses in a market may not push for those businesses to aggressively compete with one another as we would expect from an undiversified investor.

This applies even to passive investors, which hold an implicit power over senior appointments through voting rights which, even if not exercised, may still be felt by managers and influence their decisions.

As I'm sure we will hear today, these theories are not without their critics.

While much of the debate to date focuses on the impact of common ownership on prices, Professor Vives examines the impacts on research and development, which is of growing importance to competition in many markets.

The findings of his paper reflect well the current state of the debate on common ownership. The answer to whether common ownership harms competition seems to be: it depends.

In particular, it depends on 4 things:

1. The extent of common ownership links in a firm's capital structure.
2. The level of market concentration.
3. The approach of firm managers in considering shareholder interests – either explicitly or implicitly.
4. And now, thanks to Professor Vives' paper, we have a new factor: technology spillovers.

As a result, the degree to which common ownership is leading to competition harm today is still very much an open question. And competition authorities don't have clear evidence that supports an automatic presumption of competition problems.

It seems premature, then, to contemplate major legislative changes to competition laws to address common ownership, as has been proposed by some.

However, this does not mean competition authorities should ignore the research – or the risks.

We've already seen several competition authorities, including the European Commission, look at common ownership ties during the merger review process.

The European Commissioner for Competition, Margrethe Vestager, has specifically pointed to common ownership as an area of emerging interest.

Businesses should be aware that competition authorities and market regulators have this issue on their radar, which is showing no signs of going away.

Tools for regulators

Competition authorities have several tools at their disposal to evaluate whether common ownership generates competitive harm in a market – to be able to tell when “it depends”.

I see three tools of particular importance:

1. Including common ownership in the list of issues they look at in market studies.
2. Watching for industry-wide ownership concentration when looking at mergers, as the European Union did in the Dow/Dupont merger.

3. Collaborating with researchers to better explore the controversial empirical findings that have been introduced to date in this area.

Conclusion

To sum up, competition authorities need to better understand common ownership risks before they change course.

For their part, institutional investors should be aware of the risks in this area. For instance, care should be taken to ensure that an investor is not engaged in activities that could facilitate collusion between competing businesses in their portfolio.

And, finally, there is a need for continued dialogue between competition researchers and the investment community to understand the nature of their influence in corporate governance. Events such today's are an excellent starting point, and I look forward to a lively discussion.

Thank you.