SUBMISSION

Submission to the Standing Committee on Economics — Inquiry into the implications of common ownership and capital concentration in Australia

13 September 2021

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Standing Committee on Economics
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Via email: economics.reps@aph.gov.au

13 September 2021

Dear Sir/Madam

Inquiry into the implications of common ownership and capital concentration in Australia

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Standing Committee on Economics' Inquiry into the implications of common ownership and capital concentration in Australia.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $3.3 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 17 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact me on (02) 8079 0805 or by email mfahy@superannuation.asn.au, or Mr Andrew Craston, Director of Economics, on (02) 8079 0817 or by email acraston@superannuation.asn.au.

Yours sincerely

Dr Martin Fahy
Chief Executive Officer

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A. Executive summary

In recent years, academic literature has emerged on the ownership by institutional investors of multiple companies that operate in the same market, and the potential harm to competition in those markets and consumer outcomes.

The theory of harm of common ownership rests on the assertion that institutional investors, explicitly or implicitly, have incentives to reduce competition in particular industries.

For institutional investors, it is argued that these incentives arise from the very nature of diversified portfolio investment. While an investor who holds the equity of a single company within a particular market has a preference for that company to increase its profits (even at the expense of competitors), an investor who holds equities in multiple competing companies has a preference for all those companies to increase their profits – that is, a preference for higher industry-wide profits.

However, the empirical evidence for the both the extent and effects of any potential harm of common ownership is thin. Indeed, within the academic literature, and with respect to papers that argue there may be harm and papers that question the premise, a point of agreement is that more and better data is required.

The small number of case studies that put forward evidence of harm of common ownership relate to certain industries – in particular, the impact of common ownership in the US banking sector (as higher bank fees) and the airline industry (as higher ticket prices). In both cases, the studies only find a correlation between common ownership and higher prices, rather than a causal relationship. This suggests that, as is made clear in those papers, reduced competition may reflect the peculiar features of those markets rather than the effects of any common ownership.

Given that any concerns around insufficient competitive dynamics are likely to relate to the particular features of markets, this should be the focus of competition policy rather than moves to address a merely speculative link between common ownership and competition.

Any regulatory responses to the perceived harm of common ownership are likely to be harmful. For consumers, limits and restrictions on investment activities would limit the capacity for investment managers to diversify investments, potentially leading to lower long-term investment outcomes. For listed companies, restrictions on investment activities would likely lead to an increase in the cost of capital. If widespread, this would necessarily lead to a lower level of gross fixed capital investment in the private sector, and lower long-term economic growth than otherwise would be the case.

Given these likely impacts, it is evident that potential remedies require a substantial burden of proof that common ownership has a measurable, and substantial impact on competition, and that this harms consumer outcomes.

B. General comments

1. The theory of harm of common ownership

In the context of diversified portfolio investing, ‘common ownership’ refers to where institutional investors have equity holdings across a set of listed companies that operate within the same market and are likely to be in competition with each other for consumer and/or business customers.

The theory of harm of common ownership relates to the supposed deleterious impact on competition between listed companies that are subject to common ownership (by institutional investors). In broad terms, the theory suggests that in affected markets, companies will have reduced incentives to compete.

In affected markets, the direct impacts of softer competition would include reduced incentives within companies to reduce costs, to undertake capital investment and to innovate. Customers, which include business entities in other (particularly downstream) markets as well as consumers, would face higher prices of goods and services than otherwise would be the case and/or limited improvements to goods and services on offer. For business customers, this would result in a combination of higher costs and lower profits. For consumers, this would result in reduced consumer welfare.

However, the harms of common ownership suggested by the theory rely on a chain of supposition (underpinned by substantial qualifications and disclaimers), that:

- institutional investors, explicitly or implicitly, have incentives to reduce competition in particular industries
- institutional investors have the required degree of influence on executive and managerial decisions within the companies that are subject to common ownership
- company executives and managers in companies within affected industries have *common* incentives to pivot to meet the supposed investor preferences
- common executive and managerial decisions manifest as an actual reduction in market competition, and lead to adverse outcomes for consumers.

For each of these points, the empirical evidence is thin. Indeed, within the academic literature, with respect to papers that argue there may be harm and papers that question the premise, a point of agreement is that more and better data is required. This relates to both the extent and effects of any potential harms.

2. Institutional investors have heterogeneous investment incentives and preferences

In the first instance, the theory of harm of common ownership rests on the assertion that institutional investors, explicitly or implicitly, have incentives to reduce competition in particular industries.

For institutional investors, it is argued that these incentives arise from the very nature of diversified portfolio investment. While an investor who holds the equity of a single company within a particular market has a preference for that company to increase its profits (even at the expense of competitors), an investor who holds equities in multiple competing companies has a preference for all those companies to increase their profits – that is, a preference for higher profits in total within an industry.

As such, it is argued, institutional investors with common ownership interests in a particular industry (under the right conditions – as discussed in Section 5) will seek to reduce competition within that industry in order to increase total profits for that industry – from hereon, referred to as higher *industry-wide* profits.

Notionally, higher industry-wide profits could arise from industry-wide productivity, which could lead to lower costs or higher revenues (from sales of higher quality goods and services). However, institutional investors would have little influence on companies in this regard. On the other hand, it is argued, where institutional investors can reduce market competition, this will lead to higher prices than otherwise would be the case, and thus higher profits.

There are a number of shortcomings with this proposition.

Putting aside whether institutional investors hold such incentives in the first instance, a key oversight of the proposition is that it assumes that higher prices necessarily will result in higher profits. However, this ignores the fact that reduced competition in a market would tend to reduce incentives within companies to seek opportunities to increase efficiencies and limit future rises in operating costs. Thus, while softer competition is likely to lead to higher prices than otherwise would be the case, it is also likely to lead to higher costs. The likely impact on profits is ambiguous.

Incentives to reduce competition in particular industries are not well-defined, nor aligned

The above proposition ignores the heterogeneity of incentives and preferences within the universe of institutional investors, and the fact that these are not necessarily aligned. In particular, management of asset portfolios is differentiated by investment strategy and investment style, and the basis of performance measurement.

As is outlined below, this means that while some institutional investors may well have preferences and incentives that align with the theory of harm of common ownership, other cohorts of institutional investors will have quite different preferences and incentives – this latter group includes both institutional investors that have a common ownership stake and those that do not.

This section looks at listed equity investments.

Some proponents of the theory of harm of common ownership argue that higher industry-wide profits (in a particular industry) might be the preference of some institutional investors, in particular where investments in listed equity markets are made with consideration of the relative expected performance of certain industries – that is, where portfolios are managed to be under/over-weight with respect to various industries. However, this is a simplistic view and ignores the obvious flow-on effects.

While *in isolation* higher profits across a particular industry would tend to lead to higher industry-wide profits, this ignores the impact on the profits in other industries. Assuming that the goods and services in the particular market are not price elastic, higher prices for goods and services in one market, will reduce effective real incomes in the economy. For consumers, higher prices imply lower real disposable income to spend on other goods and services – which in turn will lead to lower revenues for affected companies. For downstream business entities, higher prices for goods and services imply higher costs. Both of these effects imply some offsetting lower profits elsewhere in the economy, and by extension lower equity prices.

For investment managers with portfolios designed to track the broader equity market index (passive index-tracking strategies), efforts to boost particular industry-wide profits are likely to be perceived as a zero-sum game at a minimum, but also potentially a source of lower overall investment performance.

Passive index-tracking portfolios, by construction, exhibit common ownership. Passive index-tracking strategies reduce company-specific unsystematic risk by investing in the equity market as a whole, often defined through benchmark market indices. The selection of individual company equities is driven by the index itself.

In effect, passive index-tracking strategies are investments in the entire economy. As such, investors that manage passive index-tracking portfolios are likely to perceive efforts to boost particular industry-wide profits as a potential source of mis-allocation of resources within the economy, and thus detrimental to long-term GDP growth. It is therefore likely that the incentives and preferences of such investors may indeed be in opposition to those of investors that do have a preference for higher particular industry-wide returns. More broadly, it is unlikely that preferences to soften competition *anywhere* in the economy would be perceived as a means to boost the returns of investors with economy-wide diversification (and as discussed in Section 5, the nature of the market would require that if an industry became uncompetitive and overpriced, new entrants would be unable to enter and disrupt the market by offering lower prices and/or better products and services).

But even for common ownership investors that may perceive benefits of reduced competition on industry-wide profits *in isolation*, the likely impact on broader portfolio performance is not straight-forward. Given the likely economy-wide effects as outlined above, these investors would tend to increase their allocation to the affected industry at the expense of others. However, in doing so, the investor would have distorted its diversification strategy that helps minimise the impact of idiosyncratic shocks on investment portfolios.

For those institutional investors that are not common owners, but do own equities of some of the companies, their incentives and preferences are also not straightforward – reflecting those described above. On the one hand, investors may perceive benefits of reduced competition on industry-wide profits *in isolation*, but also be aware of potential distortions to their broader portfolios.

Considering these effects together, it seems unwarranted to assume that efforts to reduce competition in a particular industry, in order to increase industry-wide profits, would translate into superior performance for institutional investors. Indeed, the examples presented in the literature that argues for the harm of common ownership tend to only account for the incentives and preferences of institutional investors related directly to a particular industry, rather than a broader investment portfolio.[1]

In Australia, like many other similar jurisdictions, the variety of strategies among institutional investors for investments in listed equities can be considered a continuum from portfolios designed to track the broad equity market index to different various degrees and forms of active management. Broadly speaking, passively-managed equity portfolios may be considered to be close substitutes (for investors), while a greater degree of heterogeneity among active funds might mean that active funds are not necessarily substitutable.[2]

This highlights the likely diversity of incentives and preferences among investors. Indeed, given that major investment firms are involved across the continuum of investment strategies, the diversity of incentives and preferences exist *within* investment firms.

Beyond investment strategy, a further consideration regarding the incentives and preferences of institutional investors is around institutions' approach to investing. A significant proportion of institutional assets under management in Australia relates to superannuation funds. If one accepts that the ultimate mission of

[1] See for example, José Azar (2020), 'The common ownership trilemma', *University of Chicago Law Review,* 87(2).
[2] Deloitte Access Economics 2021, *Competition in Funds Management*.

superannuation funds is to deliver quality retirement outcomes, it is non-controversial that a fund's investment approach should focus on long-term investments that build wealth for members, and in particular, investments that generate long-horizon cash-flows. Seen in this context, investment practices that result in common ownership should be considered as being not motivated by a desire to encourage anti-competitive practices.[3]

Ultimately, in the first instance, the theory of harm of common ownership rests on the assertion that institutional investors, explicitly or implicitly, have incentives to reduce competition in particular industries. As argued in this section, even for those investors who might perceive benefits in reducing competition in particular industries, the incentives to do so are not necessarily clear. For other investors, there are clear opposing incentives and preferences.

3. Institutional investors do not have the required degree of influence over company managers

Putting aside the fact that incentives and preferences among institutional investors are not well-defined, nor aligned (with respect to reducing competition in particular industries), the next question is whether those institutional investors would be able to influence the decisions of executives and managers of portfolio companies across those industries – to reduce the degree by which their companies compete with each other. In this regard, two key issues include:

- the degree and dispersion of ownership of, and the voting rights attached to, listed Australian equities

- efficacy of mechanisms to influence the decisions of executives and managers.

At a high level, the composition of ownership of listed Australian equities has shifted somewhat over the last two decades. Direct ownership by individuals has decreased somewhat, while individual ownership intermediated via institutional investors has increased – including through superannuation funds. Overall, for many individuals, institutional superannuation has provided exposure to the equity market (as well as a range of other types of assets) that they otherwise would not have.

Australian superannuation funds, as institutional investors, make investments on behalf of individual members – and do so pursuant to their statutory obligations to act in their members' best financial interests. The capacity for superannuation funds to make investments that otherwise (for individuals) would be unavailable or more expensive, and with more sophisticated risk management, is a source of empowerment for individuals.

The combination of directly-held equities and equities held through self-managed superannuation funds has declined from around 20 per cent of ASX market capitalisation to around 16 per cent, while the share for institutional superannuation funds has increased slightly from around 18 to 20 per cent (the ownership share reached a minimum of around 15 per cent in 2006 and 2007, as funds switched to more defensive assets – Chart 1).

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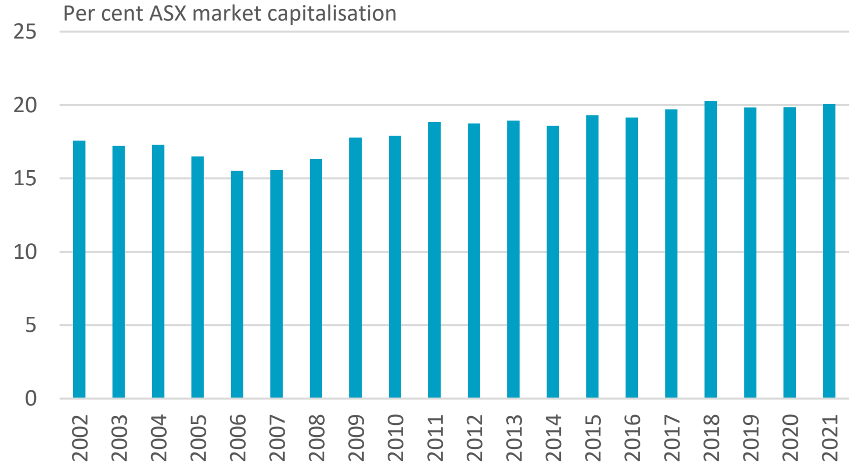
[3] George S. Dallas (2018), *Common ownership: Do Institutional Investors Really Promote Anti-competitive Behaviour?,* Harvard Law School Forum on Corporate Governance.

Chart 1: Total institutional superannuation fund investments in listed Australian equities

Share of ASX market capitalisation, as 30 June



Source: ARPA, the ASX and ASFA.

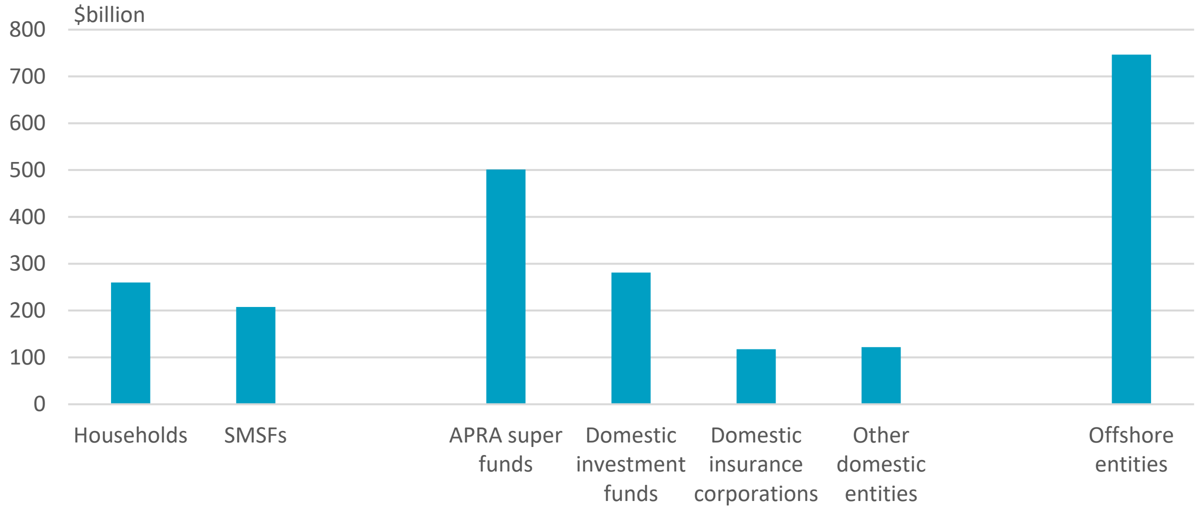
Ownership of listed equities is dispersed

With respect to the ultimate ownership of equities by individual institutions in Australia, it differs and is more dispersed than suggested by the reported equity holdings for listed companies. Listed companies report the entities that hold the largest proportions of their listed equities. While 'headline' figures of holdings of particular investment management companies are often considered as an indicator of influence, the headline figures obscure the actual owners of assets.

For example, major reported holders of listed equities include large global investment firms. While these firms own equities on behalf of their own fund members, they also hold equities as their role as investment managers for other institutions – such as Australian superannuation funds. Similarly, while superannuation funds are the owners of assets on behalf of their individual fund members, they are not necessarily the managers of those assets (Chart 2). These distinctions are a source of confusion in the debate on common ownership and its implications.

Chart 2: Ownership of listed Australian equities (look-through basis with respect to domestic entities)

End March quarter 2021



Source: ABS, APRA, the ATO and ASFA.

The following section looks at the distinction largely from the perspective of Australian superannuation funds.

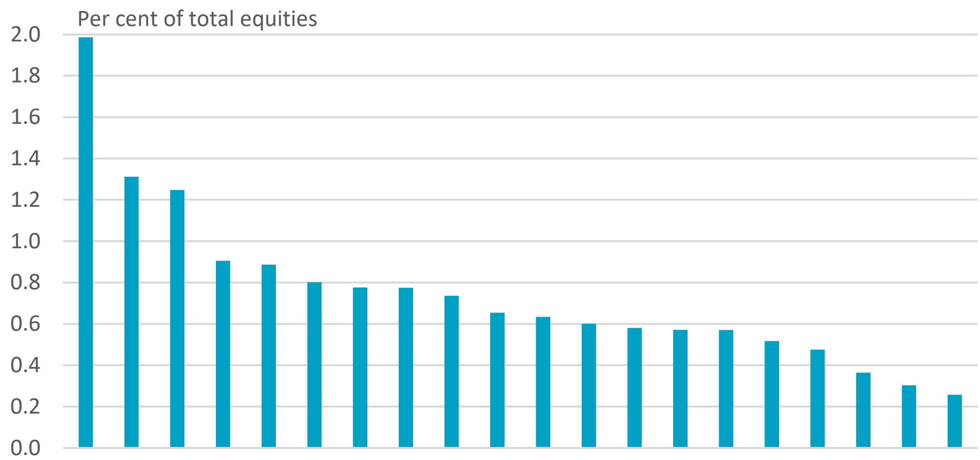
For superannuation funds, asset management functions can be inhouse or outsourced to external asset managers. The relative allocation to either internal or external managers differs across the superannuation universe, but a few stylised facts can be identified. Firstly, the existence of scale economies in asset management means that smaller funds tend to outsource a larger proportion of assets to external asset managers. Secondly, funds are more likely to outsource management for those asset classes where funds are *less* able to build niche expertise (to gain an advantage over rivals).

This is particularly applicable to listed Australian equities. Even the largest of Australia's superannuation funds tend to outsource a large proportion of the management of their listed Australian equity investments, and often use multiple external asset managers as a means to incentivise performance among their external managers. While the extent of outsourcing differs among superannuation funds, in general terms, superannuation funds tend to outsource upward of 80 to 90 per cent of the management of their listed equity investments.

Typically, even the largest of institutional investors *own* (as distinct from *hold*) far less than 5 per cent of the equity of listed Australian companies, and most superannuation funds own less than 2 per cent. This includes superannuation funds (as the ultimate owners of the equities that are held by funds' external managers), and other institutional investors that both act as external managers of behalf of other entities (such as superannuation funds) and own equities on their own account. The latter group includes large global investment firms that may hold listed Australian equities on behalf of Australian superannuation funds, other types of Australian wholesale and retail investment funds, and investment funds in other jurisdictions.

Australian superannuation funds invest in listed equities on behalf, and in the best financial interests, of their individual fund members. While there is no consolidated data for fund investments in equities of individual listed companies, stylised estimates can be derived. If one assumes that for each major superannuation fund, their investment in each listed company is broadly consistent with the company weights in the ASX (and taking account of each fund's aggregate allocation to listed Australian equities), then the scale of investment in the twenty largest superannuation funds in any particular listed company would be as depicted in Chart 3 – that is, for a hypothetical company, the portion of its total stock that is owned by the 20 largest superannuation funds.

Chart 3: Stylised depiction of ownership by 20 largest superannuation funds of each ASX listed company



Source: ARPA, the ASX and ASFA.

What Chart 3 suggests is that even the largest superannuation funds typically would be expected to own far less than 5 per cent of the equities of any particular listed company.

Prevalence of common ownership in Australia

While Chart 3 provides an indication of the typical scale of ownership by Australian superannuation funds of ASX-listed companies, it implies nothing about the actual extent and degree of common ownership by superannuation funds.

There is little compiled data on extent and degree of common ownership in Australia, with respect to superannuation funds or other institutional investment entities. A recent paper by Leigh and Triggs presents estimates for common ownership across Australian industries. Applying a threshold for common ownership as a single shareholder owning 5 per cent of two of the largest four firms in an industry, they calculate that industries with common owners represent 49 of 443 industries, and that industries with common ownership tend to be more concentrated. However, this represents a correlation between common ownership and market concentration, rather than a causal relationship.[4] The authors also present estimates for the effective concentration of those industries, where it is assumed that common ownership translates into control (discussed below).

The authors note that common owners are overwhelmingly institutional investors, and that in 92 per cent of instances of common ownership the common owners are either Vanguard or BlackRock.[5] That said, this figure does not account for the fact that both these organisations hold and manage equities on behalf of institutional investors, including superannuation funds. Many of Australia's superannuation funds engage one or both (as well as others) as investment managers, and as noted above, in aggregate, funds outsource a majority of the management of Australian listed equities.

Voting power on listed equities is dispersed

The dispersion of voting rights associated with listed Australian equities reflects the distribution of ultimate ownership of those equities (as outlined above), but also the pattern and manner of delegation by asset-owners of those voting rights.

For example, while superannuation funds have the voting rights associated with equities managed inhouse, this is not necessarily the case for externally-managed equities. A fund, for each external manager it engages, will have a separate investment management agreement (IMA). An IMA sets out the terms and conditions of service between the manager and the fund, that details the investment objective, strategies, guidelines, and other policies to be followed by the manager. With respect to voting rights, the IMA will set out policies related to the external manager's ability to exercise the rights attached to equities.

This exemplifies the fact that there is a spectrum of voting arrangements across the institutional investment sector.

With respect to superannuation funds, one extreme is where a fund retains complete voting discretion with respect to the equities it owns, while the other extreme is where a fund fully delegates voting power to an investment manager. Between these extremes, is where a fund constrains the investment manager – such as the degree to which managers may rely on the voting recommendations of third-party advisory firms. Of

[4] Andrew Leigh and Adam Triggs (2021), *Common Ownership of Competing Firms: Evidence from Australia*, IZA Institute of Labour Economics, Discussion Paper 14287.
[5] Andrew Leigh and Adam Triggs (2021), *Common Ownership of Competing Firms: Evidence from Australia*, IZA Institute of Labour Economics, Discussion Paper 14287.

course, external managers engaged by superannuation funds typically straddle the broader funds management industry, and so also manage listed Australian equities on behalf of other types of domestic wholesale and retail investment funds, and investment funds in other jurisdictions. Thus for external managers, matters of delegation (and related matters) extend beyond their superannuation clients.

The translation of ownership to voting patterns is complex. It might be expected that asset owners and the investment managers to which asset owners delegate voting rights would have incentives and preferences in line with those described in Section 2 – that is, a collection of heterogeneous incentives and preferences that are not necessarily aligned. What this ultimately implies at an institutional level is unclear – depending, of course, on the extent to which voting rights held *within* an institution are exercised jointly.

Domestic third-party advisory firms provide non-binding voting recommendations to their institutional-investor clients. In Australia, there are four major advisory firms, and typically large institutional investors receive voting recommendations from more than one of these advisory firms. Ultimately, voting recommendations provided by advisory firms are an input into an asset owner's broader decision-making on voting.

The requirement for a common purpose

Given the broad distribution of ownership and voting rights across institutional investors, it is difficult to see how a single institutional investor with a small absolute ownership stake would have the influence to promote uncompetitive practices across an industry.[6]

This excludes the possibility of explicit, active efforts to stymie competition in a particular industry, including encouraging companies to agree to act in an anti-competitive manner, or passing sensitive information between two commonly-owned competitors. Even among the proponents of the theory of the harm of common ownership, such actions are considered to be highly unlikely, and ASFA is not aware of any examples in the literature.[7] In this regard, the Australian Competition and Consumer Commission (ACCC) is able to take action where market participants give effect to an anti-competitive agreement or engage in a concerted practice that has the purpose, effect or likely effect of substantially lessening competition in a market (regardless whether there is a common owner).[8]

Some proponents of the harm of common ownership argue that even small shareholders can exert the required influence, if for example, there are low levels of attendance at shareholder meetings and a highly dispersed shareholder base (although this ignores proxy voting). More formally, proponents argue that institutional investors exercise proportional control – that is, influence or control is proportional to ownership stake. With respect to this latter point, there is lack of empirically-tested theory that shows to what degree shareholdings in a common-ownership setting translate into control, and that shareholder control is linear in respect of ownership (particularly at low levels of ownership). The lack of evidence in this regard is discussed in a paper by Hemphill and Kahan, who conclude that such direct mechanisms put forward by the proponents of the theory of the harm of common ownership either lack significant empirical support or are implausible.[9]

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[6] George S. Dallas (2018), *Common ownership: Do Institutional Investors Really Promote Anti-competitive Behaviour?,* Harvard Law School Forum on Corporate Governance.

[7] Jacob Greenspon (2019), 'How big a problem is it that a few shareholders own stock in so many competing companies?', *Harvard Business Review*, 22 February 2019.

[8] ACCC (2021) *Submission to House of Representatives Standing Committee on Economics: Inquiry into the implications of common ownership and capital concentration in Australia*.

[9] Scott C. Hemphill and Marcel Kahan (2020), 'The strategies of anticompetitive common ownership', *The Yale Law Journal*, 129(5).

As such, the theory of harm of common ownership rests significantly on the premise that holdings of different investors may legitimately be counted together for determining the degree of potential influence on board and management decisions.

Given that it is common for institutional investors to hold shares in multiple companies in the same industry, it is likely that institutional investors will tend to hold the same, or a similar, portfolio of equities. Grouped together, this implies common ownership on a larger scale. But this in itself is not sufficient – as outlined above, it requires the alignment of incentives and voting power among institutional investors, while also taking account of the likely contrary incentives (from other institutional investors).

Just as it is unlikely that an institutional investor would undertake active efforts to stymie competition in a particular industry, as outlined above, it also seems implausible for any explicit collusion *between* institutional investors to promote such behaviour. To ASFA's knowledge, no recorded instances of this type of behaviour has been investigated by the ACCC. And, again, given the likely harsh sanctions, it would be unlikely to occur.

Alternatively, proponents of the theory of harm of common ownership posit the unintentional collusion between institutional investors.[10]

4. Company managers would require incentives to pivot to meet investor preferences

Even assuming sufficient *common* incentives and voting power, actual influence requires alignment between the *common* incentives of institutional investors and the *common* incentives of the managers of the set of companies across a particular industry. From the perspective of companies, it would require managers to internalise the objectives of common owners who have a preference for higher industry-wide profits, while resisting the preferences of investors who seek higher company profits.

Proponents of the theory of harm of common ownership posit that there are a number of mechanisms through which institutional investors may influence decisions of executives and managers of listed companies. This includes mechanisms open to shareholders generally that help align the incentives of management with the interests of investors (for example, voting on resolutions), direct methods of communicating preferences to companies (for example, where institutional investors engage directly with management teams), but also the absence of activism.

A particularly far-fetched view of some proponents of the harms of common ownership centre around the alignment between shareholders and executives and management through explicit mechanisms, such as shareholding voting on elections and corporate initiatives at Annual General Meetings. In Australia, the vast majority of resolutions are non-contentious. The remainder are generally non-binding and advisory in nature (rather than directional), for example voting on remuneration reports or resolutions proposed by shareholders that generally focus on disclosure or risk management – such as climate risk.[11]

As such, corporate strategy that preferences industry-wide profits would require managers to internalise *actively* the objectives of common owners who have a preference for higher industry-wide profits (while resisting the preferences of investors who seek higher company profits). Aside from the issues raised above around the dispersion and the lack of alignment of voting power, this would require the alignment of

[10] Jacob Greenspon (2019), 'How big a problem is it that a few shareholders own stock in so many competing companies?', *Harvard Business Review*, 22 February 2019.
[11] Lloyd Freeburn and Ian Ramsay (2021), 'An Analysis of ESG Shareholder Resolutions in Australia, *University of New South Wales Law Journal*, 44(3), Forthcoming.

investors and managers across all companies in a market. This seems implausible. Indeed, there is little evidence to support the proposition – as noted by Hemphill and Kahan.[12]

More sophisticated arguments rely on possible *common* shifts in the structure of executive compensation schemes – that would alter the incentives of managers. In particular, that instead of compensation structures that incentivise managers to act to maximise company profits (which implies acting to compete with rival companies), compensation structures would allow managers *not* to strive to compete. This shift may not require any activism on the part of shareholders, but instead merely for shareholders to fail to encourage incentives for profit-maximisation.

However, compensation structures that blunt managerial incentives are unlikely to be sustained. Such executive compensation schemes are likely to have substantial adverse side effects. As noted in Section 1, this could include reduced impetus among managers to increase efficiencies and limit future rises in operating costs – which would tend to offset any potential increases in profits from higher (than otherwise) prices. As such, it is not clear that the imagined common shift in compensation structures would be effective in increasing the value of a portfolio of companies within the same industry.

In addition, rising inefficiencies would tend to raise the ire and increase the degree of activism of those typical shareholders who do value higher company profits, and seek (as supported by both theory and practice) to maximise total shareholder value. This is particularly relevant given that the impact of rising inefficiencies on company profitability would become apparent well before any potential impact of higher prices due to diminished industry-wide competition. Again, there is little evidence of such cross-the-board shifts in executive compensation structures that supports the proposition (as discussed in a paper by Burnside and Kidane).[13]

5. Lack of evidence for actual reduction in market competition

Evidence for the harm of common ownership on competition outcomes is thin. This relates to both the impact of common ownership on market dynamics, and the impact of those altered dynamics on consumer outcomes.

With respect to the first point, proponents of the theory of the harm of common ownership point to the potential increase in market concentration brought about by common ownership – that is, common ownership leads to an effective increase in market concentration. In the Australian context, Leigh and Triggs provide estimates for the impact of common ownership on effective market concentration – finding that for the Australian economy as a whole, common ownership increases effective market concentration by 21 per cent.[14]

Of course, in the first instance, any *effective* increase in market concentration requires that common ownership translates into an effective increase in influence – that managers internalise the objectives of common owners who have a preference for higher industry-wide profits, while resisting the preferences of investors who seek higher company profits. As noted in the previous section, there is a lack of evidence in this regard.

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[12] Scott C. Hemphill and Marcel Kahan (2020), 'The strategies of anticompetitive common ownership', *The Yale Law Journal*, 129(5).

[13] Burnside and Kidane (2020), 'Common ownership: an EU perspective', *Journal of Antitrust Enforcement*, 8.

[14] Andrew Leigh and Adam Triggs (2021), *Common Ownership of Competing Firms: Evidence from Australia*, IZA Institute of Labour Economics, Discussion Paper 14287.

Regarding the impacts of common ownership on consumer outcomes, the small number of case studies that put forward evidence of harm of common ownership relate to certain industries – in particular, the impact of common ownership in the US banking sector (as higher bank fees) and the airline industry (as higher ticket prices). In both cases, the studies only find a correlation between common ownership and higher prices, rather than a causal relationship. This suggests that, as is made clear in those papers, reduced competition may reflect the peculiar features of those markets rather than the effects of any common ownership.[15]

More broadly, it should be made clear that even if institutional investors were able to influence companies across an industry to reduce competition, the actual impacts on competition would be in particular cases only. Any deleterious impacts on competition would tend to be apparent in more concentrated markets with a small number of large players (for example, oligopolies). Key features of such markets are high barriers to entry for new players (in markets with low barriers to entry, higher market prices would attract new competitor firms who would undercut prices in order to boost profits).

Given that any concerns around insufficient competitive dynamics are likely to relate to the particular features of markets, this should be the focus of competition policy rather than moves to address a speculative link between common ownership and competition.

Australia's competition regulator, the ACCC is charged with promoting competitive markets and has shown that it is highly effective in taking action where there are instances of market conduct that are contrary to consumer welfare. In this regard, the ACCC has broad powers to investigate suspected breaches of competition law, and to undertake compliance and enforcement action where required.

As the ACCC has noted, it is able to take action where market participants give effect to an anti-competitive agreement or engage in a concerted practice that has the purpose, effect or likely effect of substantially lessening competition in a market – regardless of whether there is a common owner or not. In addition, the ACCC is able to take action where an acquisition of shares results in a substantial lessening of competition from coordinated or unilateral effects, including where the acquisition results in common ownership of competing companies.[16]

6. Regulatory responses are likely to be harmful

Any regulatory responses to the perceived harm of common ownership are likely to be harmful for investors, savers and consumers, and for the broader Australian economy.

Potential remedies put forward in the literature include: to limit the percentage of company equity that can be owned by an individual investor that has multiple holdings in companies in the same industry; to restrict the number of companies within an industry in which an individual investor has an equity stake; some form of restriction on individual investor participation in, or engagement with the companies in which they have an equity stake (for example, only permitted to exercise votes in one company within an industry).[17]

[15] José Azar, Martin C. Schmalz, and Isabel Tecu (2016), Anticompetitive Effects of Common Ownership, *Journal of Finance*, 73(4); and José Azar, S. Reina, and Isabel Tecu (2016), *Ultimate Ownership and Bank Competition*.
[16] ACCC (2021) *Submission to House of Representatives Standing Committee on Economics: Inquiry into the implications of common ownership and capital concentration in Australia*.
[17] George S. Dallas (2018), *Common ownership: Do Institutional Investors Really Promote Anti-competitive Behaviour?* Harvard Law School Forum on Corporate Governance.

With respect to limits and restrictions on investment activities, the ultimate deleterious impact would be on savers.

- Restrictions would limit the capacity for investment managers to diversify investments on behalf of clients, and in the case of passive index-tracking funds would lead to lower diversification.
- Reduced diversification would necessarily lead to greater exposure to company-specific unsystematic risk, and potentially lower long-term investment outcomes.
- If restrictions lead to reduced trading of listed equities, this could result in lower market liquidity and higher transaction costs.

In addition, the imposition of any such restrictions would be accompanied by transition costs. In particular, the process of institutional investors divesting their equity holdings would likely lead to heightened market volatility.[18]

For listed companies, restrictions on investment activities would likely lead to an increase in the cost of capital. If widespread, this would necessarily lead to a lower level of gross fixed capital investment in the private sector, and lower long-term economic growth than otherwise would be the case.

Restrictions on individual investor participation in, or engagement with, companies would be to the detriment of corporate governance in Australia, and potentially lead to a reduced degree of accountability of executives and management of listed companies.

Given these likely impacts, it is evident that potential remedies require a substantial burden of proof that common ownership has a measurable, and substantial impact on competition, and that this harms consumer outcomes.

[18] OECD 2017, *Directorate for Financial and Enterprise Affairs Competition Committee: Hearing on Common Ownership by Institutional Investors and its Impact on Competition - Summaries of Contributions*.