January 15, 2018

Office of the Secretary
Federal Trade Commission
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex C)
Washington, D.C. 20580

Submitted online via regulations.gov

Re: FTC Hearing #8: Competition and Consumer Protection: Holdings of Non-Controlling Ownership Interests in Competing Companies

Given the recent rise in common ownership of U.S. public firms, some researchers have argued that institutional investors might have incentives to promote anticompetitive behavior in the companies they hold. To evaluate the magnitude of these incentives, Lewellen and Lewellen (2018) estimate how much an institutional shareholder of one firm gains (in extra management fees) when the firm's 'rivals' (other firms in the same industry) do well, by virtue of the institution's ownership of those rivals. In industries with fewer firms, for which concerns about anticompetitive practices are most relevant, institutions have modest gains when rival firms increase in value because, conditional on having a significant stake in one firm, institutions typically have relatively small stakes in the firm's rivals. As a result, the incremental cash flow the institution gains from its rival holdings are also modest, especially given the potentially significant costs to the institution from promoting coordination.

The weak evidence of incentives raises questions regarding the seemingly contradictory findings in recent academic papers that common ownership causes increases in firm profitability and returns, allegedly due to either increased cooperation or decreased competition among firms. Lewellen and Lowry (2018) attempt to reconcile this evidence by revisiting the findings on the effects of common ownership in several broad-scale studies. A particular challenge to this stream of research lies in determining whether increased common ownership "causes" various effects, or whether observed patterns merely reflect correlations that are driven by other forces within the economy. The punchline of our paper is that they likely reflect correlations.

To overcome the challenge of causation versus correlation, researchers have focused on significant events that affected common ownership for some firms but not others. This allows them to compare the subsequent behavior of the affected vs. unaffected firms. We evaluate four such events that have been used in prior literature: (i) the Blackrock-BGI merger; (ii) a broader set of mergers between financial institutions; (iii) additions to the S&P500 index; and (iv) Russell index reconstitutions. We find serious problems with all of these approaches. For example, the fact that the Blackrock-BGI merger

occurred around the time of the financial crisis results in some perhaps unexpected correlations. This is because firms that became more commonly owned as a result of this merger were also unique along certain dimensions, for example, they were high-growth firms. Failure to control for these differences results in the misleading impression that common ownership caused increases in firm performance. The second candidate instrument, a broader set of financial-institution mergers, suffers from similar problems. While these events are spread throughout calendar time, the largest mergers, i.e. those with a potential to increase common ownership among the most firms, were again concentrated near the financial crisis. Finally, the third and fourth candidate instruments, S&P500 index additions and Russell index reconstitutions, either do not cause significant changes in common ownership at the institutional level (Russell reconstitutions), or do cause such changes but coincide with other major shifts in the affected firms, so the effects of common ownership are very difficult to isolate (S&P500 additions).

This analysis across the candidate methodologies leads us to consider as a viable alternative financial-institution mergers that occur outside the crisis period. Using this approach, we find no evidence that common ownership has a causal effect on firm outcomes, including stock returns, operating performance, and investment.

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Michelle Lowry, Drexel University

References:

Lewellen, Jonathan and Katharina Lewellen, 2018. "Institutional investors and corporate governance: The incentive to be engaged." Working Paper, Dartmouth College

Lewellen, Katharina and Michelle Lowry, 2018. "Does common ownership really increase firm coordination?" Working Paper, Dartmouth College and Drexel University.