ICI Q&A on Common Ownership and Related Research

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Q1: Why is the issue of institutional common ownership in "concentrated" industries, such as airlines and banking, under discussion in policy and academic circles as well as the media?

A: Two recent research papers, one on airline pricing and the other on bank fees, claim to show empirically that minority shareholdings by institutional investors in competing airlines and banks raised prices in those industries. More recent research shows that these initial papers do not establish that common ownership increased prices.

Nevertheless, the preliminary research generated an echo chamber of one-sided discussion on the potential harms associated with common ownership in "concentrated" industries. On the assumption that these empirical claims were true, several commentators even proposed sweeping "reforms" that would harm the asset management industry and the more than 100 million shareholders that invest in regulated funds.

Q2: Is the academic research linking institutional investor ownership to higher prices sound?

A: No. The research finding that common ownership has increased prices has methodological flaws and does not establish that common ownership causes higher prices. A growing body of academic research describes these flaws. Two are particularly noteworthy.

First, the researchers assume that common ownership raises prices, even though their data show only that prices can rise following an increase in common ownership. This is like concluding that a rooster's crow causes the sun to rise. These events are correlated, but one does not cause the other.

The researchers err by inferring that common ownership influences prices, based on a relationship between price and concentration that could be independent of common ownership. Market shares (one measure of concentration) change over time for a variety of reasons, including some that are unrelated to common ownership or price. Airline ticket prices to popular ski destinations may rise during ski season because demand increases, for example. An airline's share of the market to these destinations also might increase during ski season if it can add flights or fly bigger planes but its competitors cannot. In this case, the higher prices and the increased market share of the more flexible airline are each independently due to the presence of snow and thus, more skiers, and have nothing to do with whether there is common ownership of the airlines.

Second, the research relies on unjustified assumptions about the influence that minority shareholders have on corporate managers. The researchers assume that if an investor owns even a small share of a company's stock, the investor has influence over the company's business strategy that rises with even small increases in the manager's ownership share. There is no empirical evidence to support this assumption, however.

Take an easy case: a company has two owners, one with 95 percent of the voting shares and the other with 5 percent. The 5 percent owner very likely has no control at all. The question of control gets more complicated with a more diverse shareholder base, but neither economic theory nor plain common sense support the wooden assumption that a minority shareholder controls a corporation in proportion to the size of its holdings.

Q3: Does the preliminary research that links common ownership to increased prices accurately describe the interests of asset management clients?

A: Not at all. This research assumes wrongly that all of an asset manager's clients—such as pension funds, mutual funds, and separate accounts—have the same objectives and would benefit from artificially high prices across an entire industry. In reality, these clients pursue different objectives. The prospectuses of different mutual funds advised by a single asset manager are one concrete example evidencing varied investment objectives. A typical asset manager's fund line-up could include growth funds, value funds, index funds, sector funds, and dividend funds, among others.

Many of these funds would benefit if a single airline outperforms others in the industry. Assume that an asset manager reports a 3 percent stake in each of United and American Airlines. This means that the asset manager's clients hold, in aggregate, 3 percent of each airline. This aggregate ownership figure does not provide information about the holdings of individual clients. One client, client X (which could be a mutual fund, pension fund, hedge fund, or other entity), might hold only United Airlines, while another client, client Y, holds only American Airlines. Because the asset manager's clients ultimately own the shares of these two airlines, and because the clients have differing objectives, the asset manager would have no basis for encouraging "soft competition" between the two airlines. Rather, Client X's returns are affected only by United's performance. Similarly, Client Y's returns are affected only by American's performance.

Q4: Are mutual funds driving airline ticket prices higher? If not, what is?

A: Two empirical papers (available here and here) find no evidence that common ownership has raised airline ticket prices. Airline ticket prices are driven by a number of factors, including fuel costs, airline mergers, economic recovery, and demand.

Q5: Should policymakers in the US and EU work to enact new laws or regulations on this issue?

A: Evidence that common ownership raises prices is tenuous and disputed. What is clear, however, is that institutional investing through pension funds and mutual funds provides enormous benefits to the public and economy by allowing individual investors to diversify their portfolios at low transaction costs and by helping companies raise financing to grow their business, create jobs, and innovate. Policy makers should not consider "reforms" that could reduce these benefits based on the speculative and disputed claims of the existing research.

Q6: What is the effect on investors and the economy of the growth of the fund industry?

A: Mutual funds benefit investors and the economy in many ways. Funds provide investors with a low cost, efficient mechanism to obtain professional money management and build a diversified portfolio to meet their financial objectives. The investments that mutual funds make in businesses help entrepreneurs obtain capital to create jobs, expand their businesses, and innovate, fueling economic growth. Moreover, the mutual fund industry is highly competitive. Asset managers and fund companies compete vigorously to win the confidence of the millions of Americans who invest in mutual funds.

Q7: The research by Dan O'Brien and Keith Waehrer indicates the Investment Company Institute supported the work. Why should we trust a paper paid for by the mutual fund industry?

A: When the Investment Company Institute turned to Drs. O'Brien and Waehrer, they already had stated preliminary views about the airline and banking papers. For example, Dr. O'Brien had published an article in an ABA Antitrust Law publication expressing concern about the researchers' approach and calling for more research. Turning to Dr. O'Brien made particular sense because he is one of the developers of the partial ownership theory that underlies the concentration measure used in the airline and banking papers. Both the airline and banking papers cite his work repeatedly.

Drs. O'Brien and Waehrer, moreover, are highly respected and credentialed economists with backgrounds in government and academia. Their representation that neither the Investment Company Institute nor its members had any substantive input into their research is entirely accurate.

In the end, of course, the best test of the quality of Dr. O'Brien's and Dr. Waehrer's analysis is to subject it to peer review and rigorous discussion, which they invite.

Q8: Given that the Bates White research is industry funded, how do we know that the authors did not determine the desired result and then reverse engineer specifications to reach that result?

A: First, Drs. O'Brien and Waehrer, have been completely transparent as to their empirical approach (and the data they used). Second, they went to great lengths to replicate a data set that closely resembles the data set used by the authors of the airline paper so that those researchers and others can check their calculations. Third, Drs. O'Brien and Waehrer used several different transparent, empirical approaches as robustness checks on their own work and the work of others. Finally, they invited others to study their results and encourage further research on the subject.

Moreover, although Drs. O'Brien and Waehrer were some of the first economists to question the research linking common ownership to decreased competition, they are not the only ones. A number of new papers criticize the methodology and conclusions of the airline and banking papers.

Q9: What is next in this area?

A: We expect that researchers will continue to assess any potential links between minority shareholdings and control. Economists historically have assumed that minority shareholders do not have control over companies, and we expect there will be more theoretical and empirical research to test this assumption. We also expect that research will continue to assess possible links between common ownership and higher prices.

Mutual funds have established a track record of helping investors and businesses for almost eight decades. It would be inappropriate to pursue policy proposals that could reduce these benefits—and harm millions of individuals—based on a handful of academic studies that rely on an unproven methodology.