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Common Ownership

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Abstract

Common ownership refers to situations where the same group of investors ('common owners') simultaneously hold shares in several competing firms. The term came to existence to highlight a recent financial phenomenon with potentially significant competitive implications: a small group of large and diversified institutional investors increasingly have parallel minority investment positions in many publicly listed companies, not only across the economy but also within one and the same industry. 'Horizontal shareholding' is an alternative term used to describe this phenomenon when common shareholdings are held in horizontal competitors specifically (Elhauge 2016). Common ownership by minority financial investors can be situated in the broader context of the theory of mergers and acquisitions. It is the latest manifestation of the manifold ways that rival industrial firms may come under common ownership and control: suggesting that, besides full mergers and controlling partial acquisitions, standalone non-controlling partial acquisitions may also give rise to significant antitrust concerns (Tzanaki 2022). Interestingly, common ownership may also produce efficiencies under certain circumstances. Yet, the extent to which merger control rules may capture and remedy common minority shareholdings is neither comprehensive nor uniform across jurisdictions.

Synonyms

Horizontal Shareholding, Overlapping Ownership

Definition

Common ownership refers to situations where the same group of investors ('common owners') simultaneously hold shares in several competing firms. The term came to existence to highlight a recent financial phenomenon with potentially significant competitive implications: a small group of large and diversified institutional investors increasingly have parallel minority investment positions in many publicly listed companies not only across but also within certain industries (Azar 2012). 'Horizontal shareholding' is an alternative term used to describe this phenomenon when common shareholdings are held in horizontal competitors specifically (Elhauge 2016). However, common ownership is a broader phenomenon not limited to a specific type of common shareholders, such as the Big Three asset managers, or to a specific type of commonly held firms, such as publicly traded companies or firms in direct competitive relationship. Venture Capitalists may be common owners of private startup companies while common shareholdings may be found also in companies that are vertically related (Tzanaki et al. 2023; Azar & Vives 2021). Depending on the legal and economic context, each form of common ownership bears distinct competitive implications.

Introduction

Common ownership is a special term of art recently introduced in the competition law dictionary. In its predominant form, common or overlapping ownership refers to the simultaneous ownership of minority shares in competing firms by the same group of large institutional investors. Recent scholarship has revealed that this is a ubiquitous practice with an accelerating trend in the context of US public listed companies. Extensive common ownership by minority institutional investors such as mutual and index funds is a natural consequence of the enthusiastic embrace of Modern Portfolio Theory and the dramatic increase in popularity of portfolio diversification and passive investment strategies (Azar 2020).

This major reorganization of the investment ecosystem has led to an unprecedented transformation of corporate ownership. The direct result is a recurring pattern of significant albeit partial overlaps in the share capital of multiple rival firms within many US industries. Furthermore, as an indirect result, the three largest US institutional investors - BlackRock, Vanguard and State Street – tend to collectively own and vote a large portion of shares of most significant US public companies (Bebchuk and Hirst 2019; Coffee 2021).

These changes drew economists' attention to the potential implications of common ownership for firm behaviour and market structure and performance (Rotemberg 1984; Azar 2012; Schmalz 2018). Early ground-breaking empirical studies found that at least in some concentrated industries such as airlines and banking in the US, common ownership may give rise to anticompetitive effects (Azar et al. 2018; Azar et al. 2022). These findings raised alarm within the antitrust and corporate governance community with radical solutions put forward (Posner et al. 2017; Lund 2018) and triggered further studies with sometimes opposing results (Backus et al. 2021b; Azar & Vives 2022).

Common ownership in private companies and startups is a less studied but equally important phenomenon as a potential driver of growth and innovation. In this context, theoretical and empirical research suggests that common shareholdings are neither as prevalent nor as problematic (Tzanaki et al. 2023; Eldar & Grennan 2024). Although the presence of large institutional or VC investors is not as dominant outside the US, common ownership is not an isolated phenomenon with relevance only in that context. Rather, common shareholding is found in Europe and other jurisdictions in significant proportions but different forms (Rosati et al. 2020; Frazzani et al. 2020; Banal-Estañol et al. 2022). The competitive implications of such common shareholdings vary depending on the enabling surrounding conditions (Tzanaki 2022).

The Economics of Common Ownership

The common ownership theory is exciting because of its dual nature: economic research shows that common shareholdings may have both harmful and beneficial effects on product market competition, innovation and social welfare depending on the circumstances (Schmalz 2021; López & Vives 2019; Azar & Vives 2022). Common ownership may affect competition either unilaterally or via coordinated effects. The main theory of harm developed in the literature is of unilateral effects. The key premise underlying the theory is that under common ownership in oligopoly the objective function of the firm changes and 'atomistic' firms and shareholders can no longer be assumed which leads to altered market outcomes.

Aggressive competition in oligopolistic markets where firms strategically interact and firm-specific strategies in corporate governance that seek to promote individual firm performance impose negative externalities on the commonly held firms and their common owners. Common shareholders are interested in internalizing these externalities taking a portfolio perspective. Accordingly, shareholders that are diversified and simultaneously invested across industrial competitors are interested in maximizing portfolio value rather than individual firm value. When such common shareholders are relatively powerful in the governance of their commonly held firms, they may have the ability to act on their altered incentives and impose their objectives on their portfolio firms and their managers. In turn, corporate managers are assumed to maximize the total portfolio profits of their common shareholders, taking into account their parallel holdings in rival firms in the same industry.

Economic theory estimates the common shareholders' financial interests and level of control in the commonly held rival firms to quantify the competitive effects of common ownership and the altered unilateral pricing incentives (O'Brien & Salop 2001). Other factors that affect the likelihood and magnitude of the effects are the particular type of common shareholders and commonly held firms, their ownership and governance structures including the distribution and symmetry of the common shareholders' stakes across rival firms, their concentration of control within firms, the size and power of the remaining shareholder base, or any managerial agency costs, the structure and characteristics of the markets in which common ownership is observed, and the surrounding legal environment (Schmalz 2018; Tzanaki 2022). Similarly, in a merger context, the extent to which pre-existing common ownership may affect the direction and size of merger effects will depend on the relative post-merger stakes of the common shareholders in the merging firms vis-à-vis non-merging rivals within the industry, the specific financial structure of the merger deal and factors mitigating the effects of common ownership such as managerial entrenchment (Azar & Tzanaki 2022).

Two main measurement tools have been developed to approximate the economic effects of common ownership: the 'modified' Herfindahl–Hirschman Index (MHHI) and the 'lambdas' or 'kappas' representing the common owners' weights (O'Brien & Salop 2001; Azar & Tzanaki 2022; Backus et al. 2021a). The MHHI is used to quantify the additional market concentration and 'effective' market power due to common ownership in an industry. The lambas are used to measure the degree of internalisation of rival firms' profits relative to own profits in the firm manager's objective function due to common ownership. Lambdas are more tractable and often preferred whereas the MHHI metric has been criticised as endogenous. A major controversy surrounding common ownership theory is the choice of the appropriate 'control weight', i.e. what measure of control over corporate management if any should partial ownership translate to and be incorporated in the firm's objective function (O'Brien & Waehrer 2017).

Control is a key element of the theory of unilateral effects. Indeed, the recent common ownership theory is so intriguing because the novel source of harm comes from overlapping shareholders, typically institutional investors, with minority but substantial equity interests in competitors. Yet, there are different passive and active ways in which minority common shareholdings may influence managers. 'Active' common owners such as private equity and venture capitalists may influence corporate governance in more explicit ways though voice, exit or engagement strategies and in particular through special control rights they may be assigned under the corporate charter, bylaws or shareholders' agreements (e.g. board representation, veto rights, dual class shares) or interlocking directorates. As such, this type of common owners may have disproportionate control over managers and are more frequently observed in private companies and startups (Tzanaki et al. 2023). 'Passive' common owners such as large, diversified institutional investors may exercise *de facto* joint control over management simply by voting their shares in public companies with a dispersed shareholder structure. In the absence of dominant or active non-common shareholders within the governance of public firms, common owners may collectively have relative control over managers despite their standalone minority equity positions. This type of common shareholders may have other ways of influencing management (e.g. engagement) and their large size and systemic presence may also entail disproportionate control (Tzanaki 2022; Schmalz 2018).

Common ownership may also give rise to coordinated effects in which case competitive harm may materialize due to the collective exercise of market power. Specifically, common shareholdings in industrial competitors by the same set of owners may increase the likelihood of explicit or tacit coordination in concentrated markets (Rock & Rubinfeld 2020; Boller & Scott Morton 2020). For instance, common shareholders may act as cartel initiators or facilitators by promoting a common policy of reducing industry output among their commonly held companies that may in turn lead to increased prices and reduced output when non commonly held rivals are capacity constrained. Common investors' engagement and privileged access to management, private meetings or earning calls may be conducive channels to inducing and sustaining coordination. In addition, common owners may facilitate coordination and information exchange or access to competitively sensitive information of the commonly held firms through shareholders' statutory information rights, interlocking directors nominated by the common shareholders or by encouraging adoption of corporate disclosure or other policies that enable monitoring compliance with the common owners' objectives (*Texas et al. v. BlackRock, Inc. et al.*).

Adoption of executive compensation packages tied to rival or industry performance may provide a structure to align incentives between common owners and managers of their portfolio firms and serve as facilitating devices (Antón et al. 2022; Rock & Rubinfeld 2020). Common ownership may further increase the likelihood of tacit collusion depending on the characteristics and oligopolistic structure of the market, the symmetry and distribution of common shareholdings across firms in the industry, the incentives of non-commonly held rival firms that may benefit from the coordinated outcome or the presence of a ‘maverick’ firm that is (not) commonly owned, the extent to which common ownership increases managers’ patience and the range of discount factors for which tacit collusion can be sustainable (Rock & Rubinfeld 2020; Boller & Scott Morton 2020).

Interestingly, common ownership may also generate efficiencies and have positive effects on competition and innovation. This can be achieved either unilaterally or via coordinated means, by common owners inducing managers to unilaterally internalize positive externalities among their portfolio firms or facilitating beneficial coordination or information exchange among them. Antitrust enforcers will consider only competition related efficiencies rather than any broader beneficial effects of common ownership in terms of corporate governance or diversification. More specifically, they will typically trade off only ‘within-market’ efficiencies against anticompetitive effects of common ownership – i.e. efficiency gains manifesting in the same relevant market and affecting the same group of consumers (Azar & Tzanaki 2022).

Innovation is an important parameter of competition and a driver for growth, productivity and social welfare and as such valuable for competition policy. Common ownership may mitigate disincentives to corporate innovation and R&D investment especially in the presence of large technological spillovers (López & Vives 2019; Antón et al. 2024). In addition to these benefits, common ownership by VC investors may improve innovation efficiency, boost startup portfolio companies’ prospects of raising more capital, failing less, and exiting more successfully or enhance intra-portfolio information flows and facilitate knowledge transfer and strategic alliances that lead to increased innovation (Eldar & Grennan 2024).

Merger Control Analysis of Common Ownership

Common minority shareholdings are analytically similar to mergers or joint ventures (Bresnahan & Salop 1986; O’Brien & Salop 2001). From an economic point of view, common ownership by minority financial investors may illustrate a new way of competing companies coming under common ownership and control. For instance, perfect common ownership (where all shareholders are overlapping and fully diversified across all firms in an industry) can be equated to a full merger leading to joint profit maximization or the monopoly outcome (Azar 2020). Acquisitions of partial ownership whereby individual common investors hold minority interests in competitors may also result in some control, i.e. influence over the decision-making of their commonly held firms, in ways that may substantially lessen competition (US Merger Guidelines 2023, §2.11). Such partial acquisitions may thus entail partial internalization of rivals’ profits.

‘Concentrated’ common ownership where the common shareholders have asymmetric stakes in industrial competitors and clear disproportionate control (standalone control) over some of them call for a ‘merger-like’ analysis. Here, there might be at least one ‘controlling’ acquisition – partial ownership translating into full or partial control – by an individual common owner over at least one of the commonly held firms which may be subjected to merger control review (Tzanaki 2022). It is characteristic of these situations that the partial internalization of rivals’ profits may be asymmetric which may lead to more detrimental effects than a full merger (O'Brien & Salop 2001).

On the other hand, there are common ownership cases where all partial acquisitions may involve 'non-controlling' shareholdings on a standalone basis. A paradigmatic example could be the case of index funds. 'Diffuse' common ownership where the common shareholders may have roughly symmetric stakes (financial interests) in rival firms and proportionate minority control under the one-share-one-vote principle typically governing large publicly listed companies may nonetheless entail *de facto* joint control by all common owners as a group but not by any of them individually over the commonly held firms. These situations call for a 'joint venture-like' analysis as the partial internalization of rivals' profits is likely symmetric across portfolio firms. Given the symmetry of the common shareholdings and the relative greater influence of common owners in the governance of their portfolio firms, the absolute size of the individual shareholdings and control stakes are immaterial and not good proxies for excluding potential competitive harm. These common ownership cases would go under the radar of most merger control regimes due to their formalistic structure (Tzanaki 2022; Tzanaki 2023).

Furthermore, common ownership or partial acquisitions of minority shareholdings that result in no control may nevertheless present significant competitive concerns. Even absent the ability to influence the target firm's conduct, common ownership may reduce the acquirer's incentives to compete and alter its strategic decisions or it may give the acquirer-common owner access to non-public, competitively sensitive information from the rival commonly held firms (US Merger Guidelines 2023, §2.11).

Although these is a spectrum of antitrust risks that common ownership by minority financial investors may lead to, its legal treatment under merger control laws is neither uniform nor comprehensive across jurisdictions. The reason is that varying conceptions of control or influence are a key element for the legal definition of a notifiable or a reviewable merger or partial acquisition transaction with the US being a notable exception That is, merger control laws may universally capture cases involving controlling shareholding acquisitions by a single investor but are more limited in their review of non-controlling shareholdings. Specifically, EU merger control may only reach to and scrutinize partial acquisitions that confer on the acquirer, *de jure* or *de facto*, the possibility of exercising 'decisive influence' pursuant to Article 3 of the EU Merger Regulation. Situations of individually 'non-controlling' minority shareholdings (sole control) or *de facto* joint control that is not based on fixed and symmetric voting or board representation rights, or ex ante stable voting coalitions cannot be subject to EU merger control review (Tzanaki 2022). Nonetheless, there have been two recent cases (*Dow/DuPont* and *Bayer/Monsanto*) where the European Commission considered common ownership as an 'element of context' during the substantive assessment of notifiable mergers (Azar & Tzanaki 2022).

Other jurisdictions have more extensive rules that may capture minority shareholdings conferring lesser or no influence but giving rise to competition concerns. In Germany, a 'competitively significant influence' test may address partial acquisitions involving *de facto* blocking minority interests as well as *de facto* joint influence situations. In the UK, a 'material influence' test automatically applies to shareholding acquisitions above 25% and may reach shareholdings of 15% or more in the presence of 'plus factors' but merger review is not excluded for even lower shareholdings in exceptional cases. In the US, merger review is fully 'effects-based' and finding a merger anticompetitive is not contingent on any notion of control (*Denver & Rio Grande*, 501). Any merger or partial acquisition that 'may be substantially to lessen competition' is unlawful under Section 7 of the Clayton Act. Only actually 'passive investments' may qualify for exception from the premerger filing obligation under the Hart-Scott-Rodino Act (presumed for acquisitions of 10% or less, or acquisitions of 15% or less by institutional investors) and from substantive liability under the US merger control statute. What is more, US merger enforcement may aggregate and target 'passive' minority shareholdings at any time, even after their acquisition, when their use may prove to be anticompetitive (*du Pont*, 597-598, 607) (Tzanaki 2022; Elhauge 2016; Scott Morton & Hovenkamp 2018).

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Passive Minority Interests

Non-controlling Minority Interests

Merger Control

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