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Rise of Institutional Investors Raises Questions of Collusion

By Aicha Ahardane, LL.M. Candidate 2016 | April 29, 2016

In recent years, institutional investors like BlackRock have grown to own 70% of the public stock market. This growth is particularly noticed in horizontal shareholdings in concentrated product market, like airlines, causing them to compete less vigorously with each other. For instance, 7 institutional shareholders who controlled 60% of United Airlines also controlled major rivals such as Delta Airlines (27.5%) and Southwest Airlines (22.3%).

A recent economic study shows that cross-ownership of airlines companies by institutional investors lead to less competition and a 5% raise in airfares between 2001 and 2013. As a result, the Department of Justice decided to investigate potential antitrust issues arising from investors' cross-ownership in firms that compete against each other in concentrated industries.

The cross-ownership theory is new and raises numerous questions, including whether it would violate antitrust laws. On this question, opinions diverge. On the one hand, UC Berkeley Law Professor Davidoff Solomon believes that the DOJ will fail in proving any antitrust violation absent any evidence of collusion. Under Section 7 of the Clayton Act, which prohibits stock acquisitions that may substantially lessen competition, a plaintiff has to show that the institutional investor actively sought to influence management of the company to lessen competition. Indeed, the study does not define how the institutional shareholders interact with the companies they invest in. Institutional shareholders only vote on corporate governance matters such as election of directors and "say on pay." Investors like BlackRock and Vanguard do not necessarily push for less competition in product markets they invest in. But they do not challenge the fact that it makes their portfolio companies vulnerable to a risk of antitrust liability if it can be shown that those horizontal shareholders cause an increase in product prices.

On the other hand, a Harvard Law School professor published a law review article arguing that there is no need for the shareholders to communicate with management to influence the raise of airfares. He believes that "there is every reason to think that the problem of horizontal shareholding is pervasive across our economy." Businesses have less incentive to compete when they have significant minority shareholders in common with their rival. Institutional investors prefer their portfolio companies to avoid competing with one another, and, on the contrary, boost the industry's profits. Moreover, management has incentives to take those institutional shareholders' interests into account to gain support in future elections or to enhance executive compensation. There is no need for active communication between shareholders and management to influence the companies' pricing policy. Thus, the airlines' meetings reports with shareholders whose stakes exceeded 2%, requested by the DOJ, are not likely to reveal the role institutional investors had regarding pricing strategies.