Monopolkommission

Excerpt from Chapter III of the Twenty-First Biennial Report of the Monopolies Commission (2016) on the topic:

Competitive Significance of Institutional Investors' Minority Shareholdings

Report of the Monopolies Commission (*Monopolkommission*) in accordance with Section 44 Paragraph 1 Sentence 1 of the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen – GWB*)

Summary

The Monopolies Commission sees a considerable potential for competition distortion by indirect horizontal shareholdings between portfolio companies within the same economic sector through institutional investors. This potential arises despite the low level of shares held and the limited possibilities for institutional investors to influence strategic decisions of their portfolio companies. The competition-distorting potential of indirect horizontal cross-holdings is exacerbated by additional factors such as the presence of shared interests among various different institutional investors and institutionalised voting advice. Furthermore, transnational and trans-sectoral empirical analyses on the dissemination of indirect horizontal affiliations through institutional investors demonstrate the quantitative relevance of this kind of shareholding concentrations in Germany and Europe.

Concerning the idea of expanding the scope of application of the EU Merger Regulation to include non-controlling minority shareholdings the Monopolies Commission does also see the potential of horizontal and vertical non-controlling minority shareholdings to distort competition. However, the Monopolies Commission agrees with the conclusion of the European Commission that an urgent expansion of the scope of application of the Merger Control Regulation to non-controlling minority shareholdings between companies linked horizontally and vertically along a value-creation chain for the time being does not appear proportionate. This assessment cannot, in the view of the Monopolies Commission, be transferred to the phenomenon of indirect minority shareholdings by institutional investors, which due to its omnipresence is of greater competition-policy relevance. Accordingly, it would be welcome if indirect minority shareholdings through institutional investors received more attention on the European level, not least in the framework of a possible further development of the European Merger Control Regulation. Nevertheless, the Monopolies Commission sees further need for clarification in the sense of economic-policy recommendations.

The Monopolies Commission is a permanent, independent expert committee which advises the German government and legislature in the areas of competition policy-making, competition law and regulation. Its legal responsibilities encompass, among others, the preparation of a Main Report analysing the development of competition on a bi-annual basis. The Monopolies Commission has five Members appointed by the Federal President based on a proposal of the German government. Prof. Achim Wambach, Ph.D., is the chairman of the Monopolies Commission.

The complete Twenty-First Biennial Report of the Monopolies Commission (in German) is accessible at the Monopolies Commission's home page: http://www.monopolkommission.de.

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6 The competitive significance of institutional investors

667. In the following the Monopolies Commission will expand its analysis of the competitive significance of minority shareholdings to those that via institutional investors are held in more than one supplier of an economic sector. The competitive significance of minority equity holdings of institutional investors represents a further aspect of corporate relationships. In economic research, as well as in competition policy, the opinion is widely held that interest in minority shareholdings by institutional investors such as banks, insurers and mutual funds are of slight to no competitive significance for the target markets. The reason for this is that as a rule these are portfolio investments without the incentive of exerting strategic influence. Nevertheless, some economics studies and practical experience on the part of competition agencies show that precisely this form of corporate linkage gives rise to competition-policy concerns.[59] Institutional investors play a special role in this context, primarily due to the increasing volume of their investments and diversified investment strategies: [60] In many sectors of the economy shares in several large suppliers are held by one and the same investor, and it must be assumed that this is not only the case with regard to economic sectors, but also on competitively relevant markets.[61] Thus in many areas of the economy the interest of diversified investors in the total market yield is stronger than their interest in the individual performance of their portfolio companies. From this vantage point in such cases a fundamental interest in parallel conduct and less intensive competition between portfolio companies can be supposed in favour of the total market return.

With respect to the US-American economy the omnipresence of this phenomenon is at times seen as the explanation for fundamental connections, such as the increase of economic inequality and the failure of employment rates to rise in firms that have just recently reported formidable profits. In this context there have been demands for a resolute application of applicable antitrust law to such indirect horizontal cross-holdings in concentrated markets.[62] In the same context, the US Department of Justice – the body competent to enforce antitrust law – is currently conducting investigations into anticompetitive agreements in the aviation sector.[63]

6.1 Institutional investors and minority shareholdings

668. Institutional investors are specialised financial institutions that carry out bundled investments of capital from a great many investors on their behalf and in doing so pursue the goal of maximising returns with a reasonably low risk. The actual management of the capital need not be carried out by the institutional investor, but can also be executed by specialised asset managers.[64] Among those defined as institutional investors are insurance companies, asset managers, investment and pension funds, but also private equity firms, banks, hedge funds and funds of funds, as well as sovereign wealth funds. The total volume of assets managed by institutional investors world-wide, according to OECD statistics, has in the past several decades steadily risen in the context of the institutionalising of financial management: while in the year 1980 it was almost USD 3 trillion, in 2007 the amount was USD 48 trillion, and in 2014 over USD 85 trillion.[65]

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[59] Cf. Section 2 in this Chapter.

[60] With regard to equity holdings of banks in non-bank companies the Monopolies Commission pointed out in its very first Report for 1973–1975 a central effect of concentration in this context; cf. Monopolies Commission, First Biennial Report, Mehr Wettbewerb ist möglich, Baden-Baden 1976, e.g. para. 79.

[61] The term "market" is used in the following to denote competition-relevant markets in the sense of competition law and is not synonymous with investment markets from the perspective of investors.

[62] Elhauge, E., Horizontal Shareholding, Essay, Harvard Law Review, 129, 1267–1317.

[63] Cf. inter alia Bloomberg, U.S. Looks at Airline Investors for Evidence of Fare Collusion, 22 September 2015, http://www.bloomberg.com/news/articles/2015-09-22/do-airfares-rise-when-carriers-have-same-investors-u-s-asks, current as of 20 June 2016, last accessed on 20 June 2016.

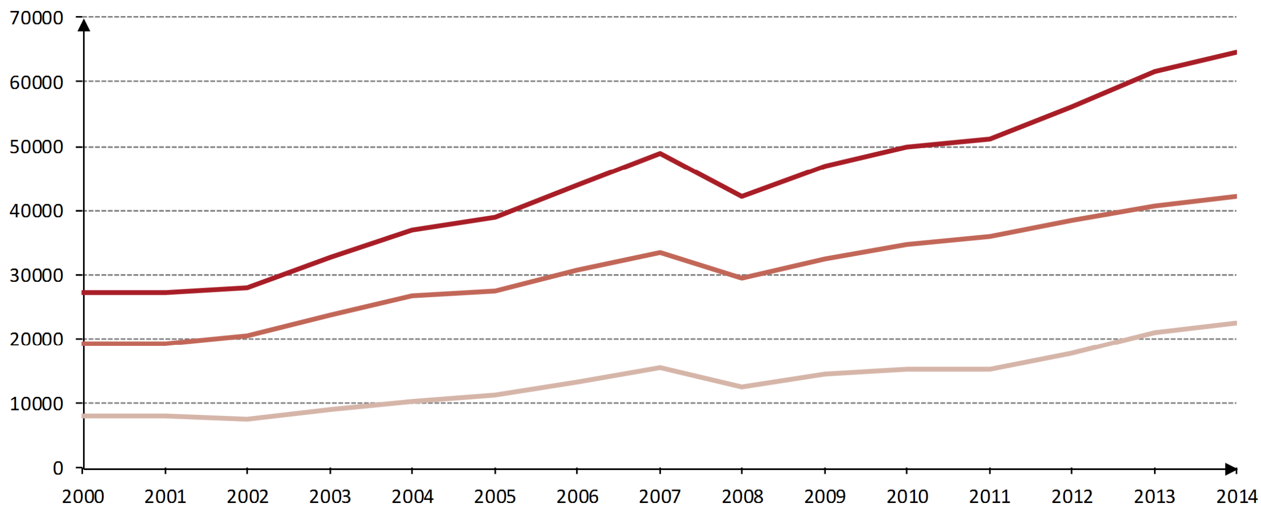
[64] Cf. Davies, E. P./Steil, B., Institutional Investors, MIT Press, 2001.

[65] The reasons conjectured for the rapid growth of institutional investors during recent decades are many: factors on the side of supply include an increasing deregulation or the facilitation of diversified investments. Among the factors cited on the demand side are the demographic shift and increased prosperity. For a detailed discussion of the reasons for the growth of institutional investors, see Davies, E. P./Steil, B., Institutional Investors, MIT Press, 2001, pp. 3–50. Volume of investments by institutional investors cited refer to OECD states with information available, excluding banks. Cf. OECD Institutional Investors Statistics,

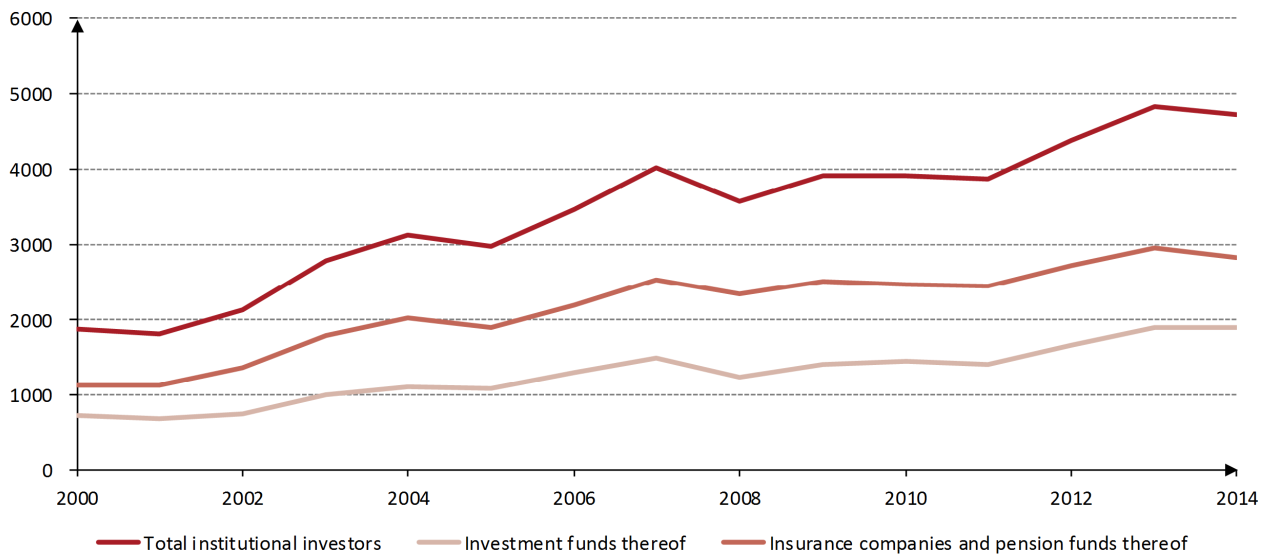
Figure III.11 shows the development of the investment volume of institutional investors in OECD States and Germany in the period from 2000–2014 and illustrates a constant international upward trend that was only interrupted by the onset of the global financial crisis in 2008.

Figure III.11: Financial investment assets managed by institutional investors (in billions of USD)

a) In OECD nations*



b) In Germany



N.B.: All data on current prices and exchange rates are at year's end. *The countries included are Belgium, Germany, Finland, Iceland, Canada, Spain, Sweden, Hungary and the USA, as well as the United Kingdom, the Netherlands, Norway and Switzerland. However, for the last four, no information on the investment volumes of investment funds was considered.

Source: OECD Institutional Investor Statistics

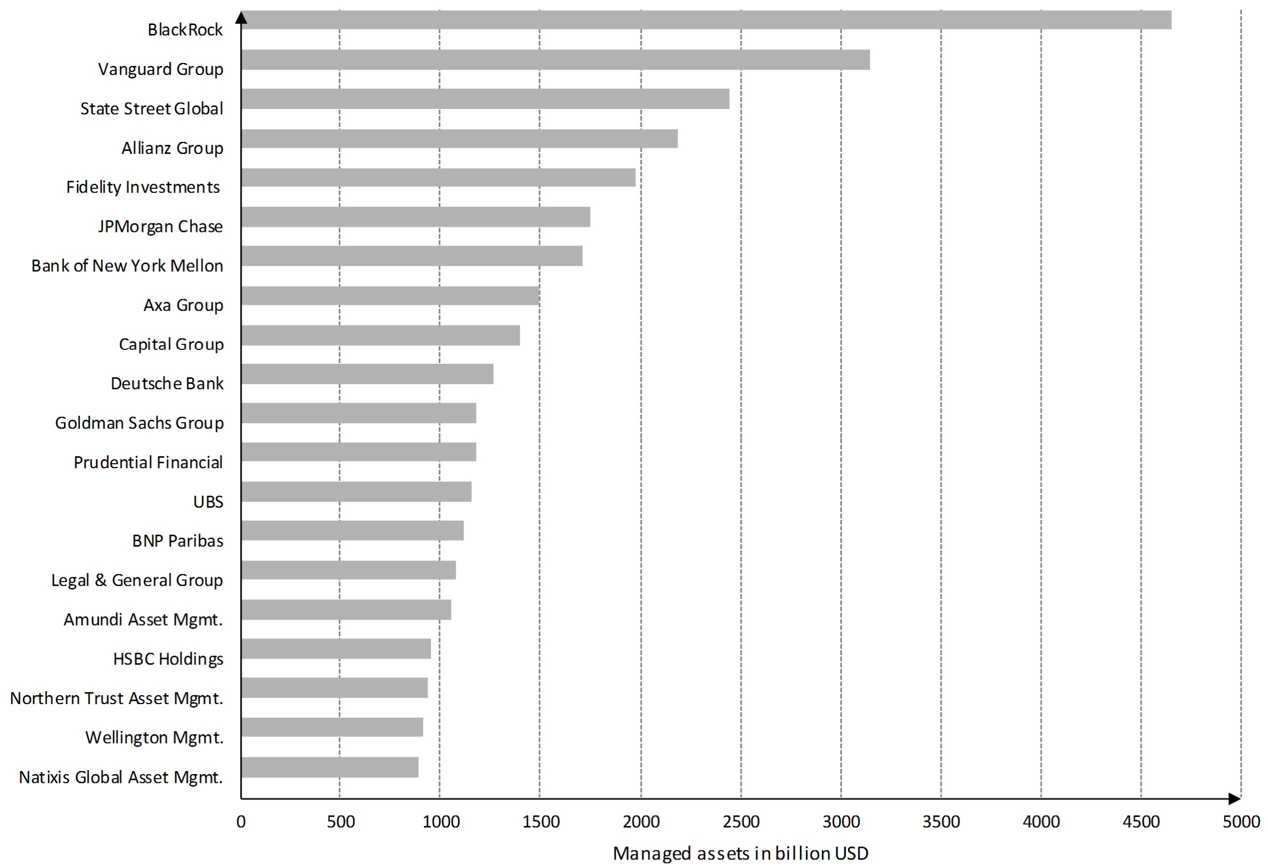
669. Figure III.12 shows the largest companies active in asset management, by volume of assets managed in the year 2014. Topping the list is the US company BlackRock, followed at a distance by the Vanguard Group, State Street and the Allianz Group. Figure III.13 shows the 30 largest institutional investors in the German stock exchange index (DAX). Here,

http://www.oecd-ilibrary.org/finance-and-investment/oecd-institutional-investors-statistics_2225207x, last accessed on 20 June 2016.

the first place is held by the Norwegian State Fund, with more than USD 25 billion capital invested in 2015. However, the asset manager BlackRock can be assigned more than twice the investment volume for 2015 – USD 53 billion – if the subsidiaries BlackRock Fund Advisors, BlackRock Asset Management AG and BlackRock Advisors Ltd. are aggregated.

670. Institutional investors primarily hold highly diversified minority shareholdings in a number of companies worldwide in different sectors of the economy, in order to attain the desired balance between risk and yield. Despite small capital shares of usually a very few percent or less than one percent held in a company, institutional investors frequently constitute the largest single investor because the remaining shares are spread widely over diverse ownership. Altogether, institutional investors in 2015 held over 60 percent of the shares of DAX companies.[66] Independent of the fact that institutional investors merely manage the investment assets of their clients, the exercise of the voting rights obtained thereby – with a few exceptions – falls to the institutional investors. Figure III.14 illustrates by way of examples the largest shareholdings of the asset manager BlackRock in equity capital of DAX listed companies.

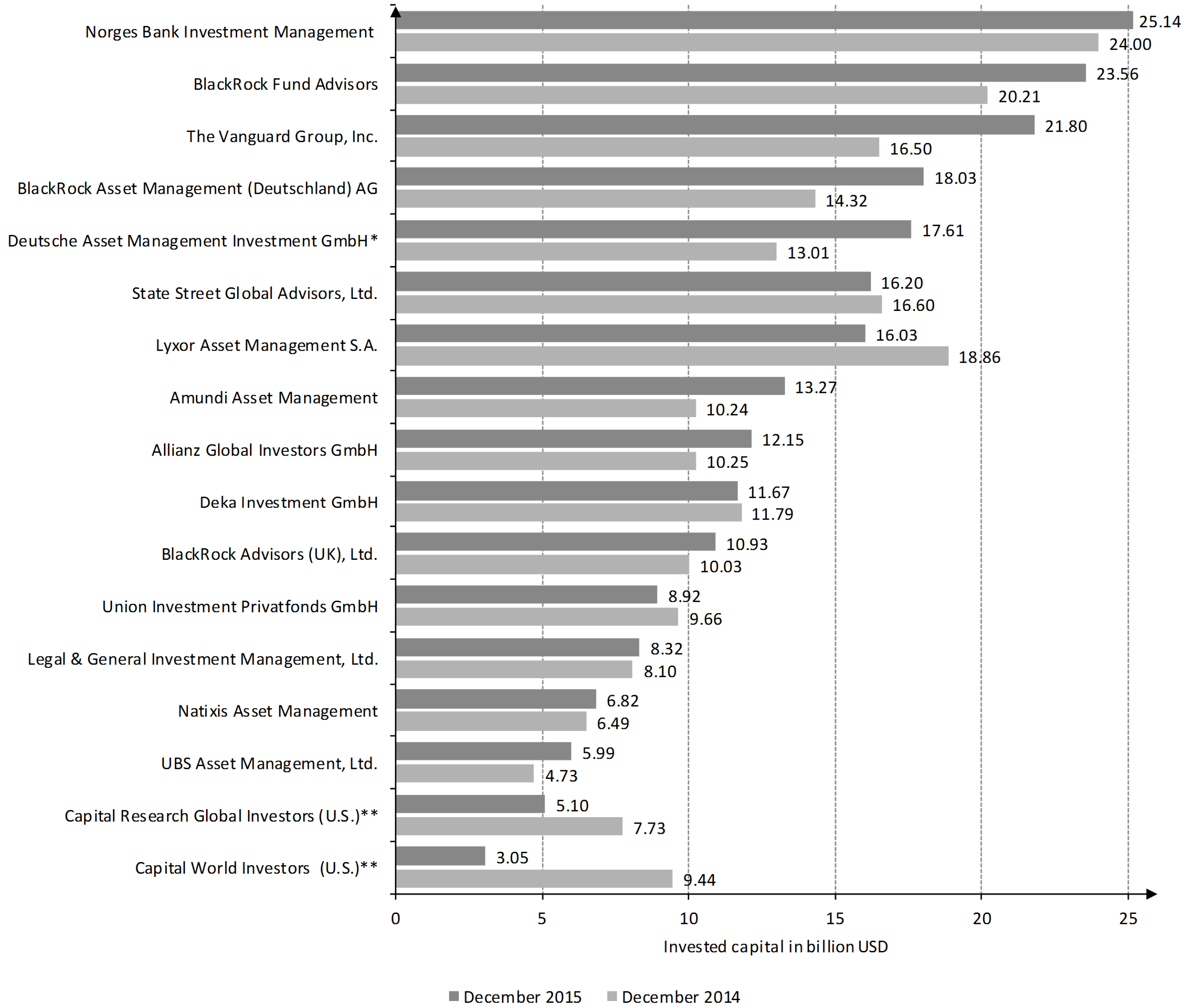
Figure III.12: Largest companies active in asset management by global assets managed (2014)



Source: Towers Watson, The 500 largest asset managers. The P&I/Towers Watson global 500 research and ranking. Year end 2014, November 2015

[66] DIRK/Ipreo: Investoren in der Deutschland AG 3.0, May 2016, p. 7.

Figure III.13: 15 largest institutional investors on the DAX 2014 and 2015



Note: *For 2014 the numbers refer to the Deutsche Asset & Wealth Management Investment GmbH. Investors marked ** were no longer among the 15 largest in the year 2015.

Source: Monopolies Commission, adapting market studies by the German Investor Relations Association and Ipreo (DIRK/Ipreo, Investoren der Deutschland AG 3.0. Die Aktionärsstruktur des deutschen Leitindex DAX 30, May 2016)

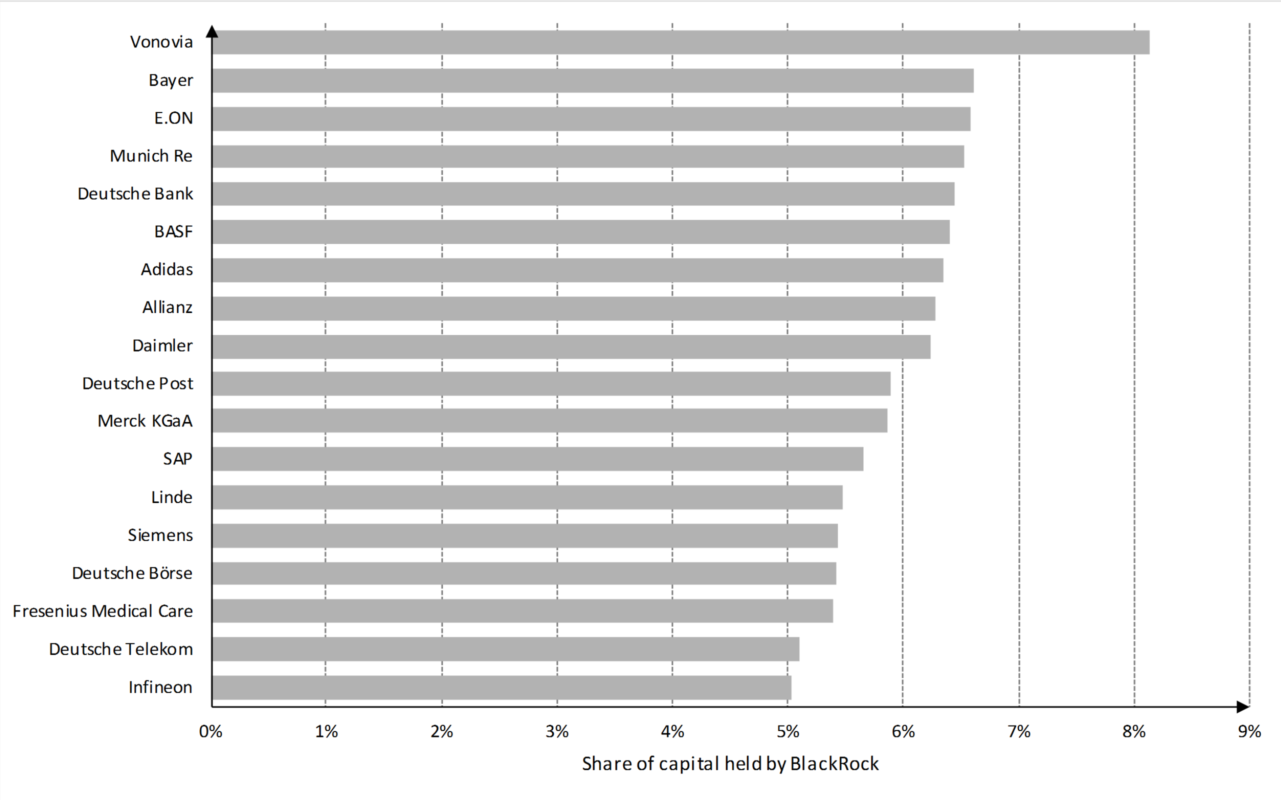
6.2 Incentives for less competition through indirect horizontal cross-holdings

671. Institutional investors are neither active in the same markets as their portfolio companies, nor are they located up- or downstream from them in a value-creation chain. This distinguishes institutional investors from shareholders with an operatively strategic interest, and at the outset does not give reason to suspect competition-distorting effects in the sense of foreclosure effects. However, incentives to dampen the intensity of competition in the market of the portfolio companies could occur through the ownership of shares by one and the same institutional investor in several suppliers on this market. The theory that minority shareholdings with purely financial interest can lead to less competition is not new in the economics and competition-policy debate. Bresnahan and Salop (1986), for example, for this reason in the late 1980s developed a modified version of the Herfindahl-Hirschman Index to take account of minority equity holdings with voting rights when measuring corporate concentration.[67] The Monopolies Commission pointed out in its first

[67] Bresnahan, T. F./Salop, S. C., Quantifying the competitive effects of joint ventures, International Journal of Industrial Organisation 4, 1986, pp. 155–175.

Biennial Report of 1973–74, with a specific reference to sector-foreign owners of minority shares, a fundamental concentrating effect of indirect horizontal links through banks.[68]

Figure III.14: Largest shareholdings by BlackRock in equity capital of DAX companies (March 2016)



Source: Ariva.de

672. If a diversified investor holds shares in several suppliers in one market, it is in that investor's interest to maximise overall returns from all shares. Intensive competition between the portfolio companies of a market would initially work against this goal, as the prices and the profit margins of all the portfolio companies would, as we know from experience, go down. With this in mind, it appears to be in the interest of the portfolio companies, as well as in the interest of the diversified investor, to keep the profit margins of the portfolio companies above the competitive level through less intensive competition. If there were incentives for individual portfolio companies to behave competitively, say, because by doing so monopoly-level profits would for a time arise from individual competitive advantages, this would contradict the interest of the diversified investor unless the losses in the rate of return of other portfolio companies are overcompensated.

673. Due to the lack of an operatively strategic interest in the portfolio companies in the classic sense of a common value-creation chain, institutional investors can be assumed to have a common interest in optimising their portfolio returns. Not only, but primarily, if the volume of the portfolio companies held by different institutional investors overlaps in a market to a certain degree, these investors would even have a common interest in less intense competition in the respective market. Such a consensus of interests needs no linkage between the institutional investors themselves. However, it can be observed that precisely the large institutional investors are in fact linked to each other through minority shareholdings. Vanguard, State Street and Wellington, for instance, directly hold shares of up to six percent and more in BlackRock. In addition, all three hold shares of up to over ten percent in the investment company Financial Services Group, which at almost 24 percent is the largest shareholder of BlackRock. In turn, BlackRock holds shares in,

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[68] Cf. Monopolies Commission, First Biennial Report, op.cit., e.g. para. 79.

for instance, State Street directly and indirectly through funds in Vanguard.[69] This interrelation of institutional investors themselves lends additional emphasis to the assumption of a commonality of interests.

674. Still, the interest of institutional investors with a long-term orientation in a less intense level of competition on the market of the portfolio companies is not likely to be unbounded. The reason for this is that a lack of competition entails the risk that efficiency enhancements and long-term investments will fail to appear. Competitive conduct could therefore itself be in the interest of diversified investors as long as the losses in the rate of return caused by prices at competitive level do not exceed the losses incurred by the absence of investments and efficiency enhancements. However, as an alternative, other incentives for investment and innovation activities could also be created.

675. The Monopolies Commission recognises in certain conditions an interest of institutional investors in less intensive competition between their own portfolio companies in a given market. This is in general also the case with regard to other diversified investors who hold portfolio investments within one market. However, the presence of such an interest alone does not provide a sufficient argument for assuming that a competition-distorting potential is given. In this respect, it remains significant to ascertain to what extent institutional investors have the possibility to enforce their interest vis-à-vis the management of the portfolio companies and/or to what extent indirect horizontal shareholdings facilitate a parallel conduct on the part of the portfolio companies.

6.3 Strategic influence by institutional investors

676. Institutional investors have many ways to exert influence on the management of a stock-listed portfolio company: for instance, by making use of their voting rights at the shareholders' meeting, by membership on the board of directors or by attempting to directly sway the management to make changes. Furthermore, there is the possibility of selling the shares they hold, though one must bear in mind that the very fact that they can sell shares can have a disciplining effect.[70] As regards institutional investors' opportunities for influence, it is primarily the differences in the investment strategies they pursue that must be taken into account: as a rule, passive investment strategies can be distinguished from active strategies. With passive strategies there may be the possibility of divestment, because shares in portfolio companies only exist indirectly, for example through index funds. With active investment strategies, individual portfolios undergo constant adjustment by the managers, and influence by divestment or even just the option of divestment seems much more practicable.[71] In this context, it must be noted that companies generally have an interest in being included – and remaining – in actively managed funds in particular. For this reason, regularly held presentations on performance and financial statements of portfolio companies at their principal shareholders are the rule. Nevertheless, it may by no means be assumed that investors with passive investment strategies necessarily behave passively towards portfolio companies. This is demonstrated by statements by industry insiders as well as the results of empirical economics research.[72] A recent survey of 143 large institutional investors shows that these two complementary means

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[69] Cf. Bureau van Dijk, Orbis-Database, current as of 25 May 2016, last accessed on 25 May 2016.

[70] Cf. Hirschman, A., Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States, Cambridge, MA, Harvard University Press, 1971.

[71] Cf. on distinguishing between active and passive investment strategies of institutional investors, Davies, E. P./Steil, B., Institutional Investors, MIT Press, 2001, p. 58 et seq.

[72] See as an example of this the statements by the former head of the corporate-governance department of one of the world's largest pension funds (TIAA), John Wilcox, in the Financial Times, e.g.: "Having a passive investment strategy has nothing to do with your behaviour as an owner", Financial Times, Passive investment, active ownership, 6 April 2014, accessed on 13 May 2016. A recent econometric study finds positive effects in this context on the management quality through a greater share held through index funds; Mullins, W., The Governance Impact of Index Funds: Evidence from Regression Discontinuity, MIT Working Paper, 7 January 2014. Cf. on this also the assessment of the German Investor Relations Association (Deutscher Investor Relations Verband) on the significance of the investor BlackRock, which follows primarily passive strategies: "Trotz der Größe des passiven Anteils ist BlackRock einer der wichtigsten Kunden einer IR-Abteilung, da die Bedeutung des indexierten Geldes des Hauses besonders bei der Abstimmung eine große Rolle spielt. Für deutsche Unternehmen fließen in der Regel aktive und passive Investments in den Entscheidungsprozess ein." (Despite the size of its passive share, BlackRock is one of the most important clients of an IR department, as the significance of the establishment's indexed money plays a big role, especially when it comes to voting. For German companies, active and passive investments generally enter into the decision-making process.), DIRK/Ipreo, Investoren in der Deutschland AG 3.0, May 2016, p. 13.

of exerting influence are both used regularly. Primarily “behind-the-scenes“ talks between the representatives of institutional investors and the managers and members of the board of directors of the portfolio companies must be seen as highly significant.[73]

677. If an institutional investor holds minority shares in several suppliers in a market, then a fundamental interest of the investor in maximising the total portfolio returns and thus possibly an interest in less competition can be derived from this. It must further be assumed that even for institutional investors with passive investment strategies, there at least exist ways to exert influence on company management, and thus a potential for distortion of competition arises on such markets. In the view of the Monopolies Commission, in such cases the weight of non-diversified shareholders indeed must always be taken into consideration: if a supplier with a sufficient share in the market is majority-owned by a non-diversified investor, then there may be an interest here in competitive behaviour on the part of the target company if it is capable of raising its profits at the cost of its rivals – and thus possibly at the cost of the portfolio returns of diversified shareholders. In the case of majority shares, it would be possible for such a non-diversified shareholder to prevail against minority shares of diversified investors, which might reduce the potential for distortion of competition. For this reason, one must take account of the voting weight and the interests of non-diversified shareholders. This aspect is not sufficiently considered, for instance, in the calculation of market concentration by means of a modified Herfindahl-Hirschman Index, among others. However, in the case of collusive conduct on the part of portfolio companies not only could the diversified investors profit from prices above competitive level, but also the involved portfolio companies and thus also a non-diversified shareholder.

678. As explained in paragraph 672, there are arguments for assuming a certain congruence of interest among different institutional investors on a market. For this reason, it can prove advisable to look at the total equity share in a portfolio company that is held by institutional investors in the aggregate. This would resemble an effective minority control, where several minority shareholders effectively control a target company by means of concerted activity. However, an essential difference is that in the case of institutional investors, an agreement on conduct, which – in the framework of “acting in concert” – would in any case have legal consequences, may not even be necessary.[74] In this context therefore, one could also call this a kind of passive effective minority control. Also, as opposed to classic forms of minority control, such a passive form of strategic influence does not fall, for instance, within the scope of application of the European Merger Control Regulation. An example will serve to illustrate: in a market, the shares of all suppliers are in diverse hands, so as a rule all companies are deemed independent and therefore no competition-policy issues arise, as it is assumed that each supplier follows the incentive to maximise its individual profits at the cost of its competitors. However, if i) a majority of the shares of all suppliers are held by institutional investors, ii) who additionally have holdings in other suppliers of the same market and therefore iii) a common interest in the total market return exists, this generates an enormous competition-distorting potential. This does not necessarily require a common share of equity in the hands of institutional investors of more than 50 percent; one crucial possibility to influence strategic decisions could exist with a blocking minority of 25 percent. Not just the size of institutional investors’ shares, but also their potential for influence is oriented towards the distribution of the remaining voting rights and their actual use. Thus the percentage of

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[73] McCahery, J.A./Sautner, Z./Starks, L. T., Behind the Scenes: The Corporate Governance Preferences of Institutional Investors, Journal of Finance, 2016, doi: 10.1111/jofi.12393. Congruent with these results is, for instance, the statement of BlackRock’s representative for company engagement and voting in European holdings, Amra Balic: “Wenn es soweit kommt, dass wir auf einer Hauptversammlung sprechen müssen, um unsere Interessen durchzusetzen, ist das doch ein Zeichen dafür, dass der Dialog mit einem Unternehmen gescheitert ist” (When it reaches the point that we have to speak at a general meeting to assert our interests, that is not a sign of a failed dialogue with a company), WirtschaftsWoche, Interview: BlackRock “Wir können nicht einfach verkaufen und weglaufen”, 8 April 2016, p. 83. Cf. also on the discussion on active exertion of influence Azar, J./Schmalz, M.C./Tecu, I., Anti-Competitive Effects of Common Ownership, Ross School of Business Working Paper No. 1235, April 2015.

[74] And yet the allegation of acting in concert raised by portfolio companies against institutional investors is not a rare occurrence. On the other hand, the very expression of such an accusation can be a strategic tool of the portfolio companies to exclude the respective investors from voting, as the latter tend to have no interest in a further legal prosecution of the allegation.

those present at the annual general meetings of the DAX-30 companies in 2015 was ultimately under 55 percent, which means that on average a mere 28 percent of votes could yield a simple majority.[75]

679. The level of shares of institutional investors only becomes crucial when (individual) portfolio companies represent opposing interests. This could for instance be the case if a portfolio company has incentives to behave competitively because this conduct could generate an advantage to the detriment of its competitors. However, in many cases on the side of the portfolio companies as well as that of the institutional investors, an interest in parallel conduct with aligned goals could dominate, which would be made much easier for institutional investors by a diversified shareholding structure, and this completely independent of the level of shares. A further reason why the degree of an institutional investor's holdings can play a secondary role with regard to its possibilities for influence is that portfolio companies are aware that in future they may be dependent on this or other institutional investors for covering their financing needs.

6.4 Institutional voting rights advice

680. Of increasing significance as regards the implementation of voting rights of institutional investors are institutional voting rights advisors, so-called proxy advisors. Voting rights advisory companies are charged by institutional investors with preparing votes at shareholders' meetings in the sense of providing voting recommendations. The recommendations made are usually followed by the clients. The market for institutional voting advisors displays an oligopolistic structure with high barriers to entry and is not subject to comprehensive regulation. The latter fact has actually been the subject of discussion in the legal sciences as well as in competition policy circles in recent years.[76] Among the largest proxy advisors are the US companies ISS, MCG and Glass Lewis.

681. Despite the return-enhancing potential of institutional investors' voting rights in shareholder meetings, these investors have regularly refrained from taking part in votes in the past.[77] From a legal-economics perspective this can – due to the separation of ownership and control in corporations – be seen as problematic in the sense of a principal–agent conflict. One fundamental reason for the lack of participation of institutional investors in shareholder votes is seen in the risk of contravening legal provisions. The legal consequences here are a result of, inter alia, concerted practices by several shareholders, so-called "acting in concert",[78] or insider trading. The prohibition of insider trading places strict limits on the communication of information by issuers to institutional investors in the framework of personal conversations.[79] As shareholder votes are normally prepared in face-to-face talks, this entails a great risk of breaching laws. Furthermore, institutional investors have the possibility to profit from the shareholder activism of other institutional investors, which can lead to free-riding.[80]

682. Employing proxy advisors gives institutional investors the possibility to avoid legal risks and to fulfil their corporate-governance responsibility as shareholders. For the institutional investors, the option of voting advice is linked to an economic reappraisal of voting rights, which has a direct impact on the ways in which they can influence strategic decisions of their portfolio companies. What is desirable from a corporate-governance and legal-economic perspective exacerbates competition concerns from the perspective of the Monopolies Commission, by greatly facilitating parallel

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[75] Cf. Schutzgemeinschaft der Kapitalanleger e.V., SdK-Präsenzstatistik, current as of 30 September 2015, http://www.sdk.org/assets/ Statistiken/HV-Praesenzen/praesenz-dax15.pdf, current as of 20 June 2016, accessed on 20 June 2016.

[76] Cf. on this e.g. Schwarz, P., Institutionelle Stimmrechtsberatung. Rechtstatsachen, Rechtsökonomik, rechtliche Rahmenbedingungen und Regulierungsstrategien, Duncker & Humblot, Berlin, 2013; Weimer, S., Regulierungsmöglichkeiten des Proxy Advisor Marktes. Bedarf und Möglichkeiten eines Markteingriffs, Akademikerverlag, Saarbrücken, 2013; Rose, P., On the Role and Regulation of Proxy Advisors, Public Law and Legal Theory Working Paper Series, 142, 31 January 2011.

[77] Cf. on the so-called "rational apathy" of institutional investors Schwarz, P., Institutionelle Stimmrechtsberatung. Rechtstatsachen, Rechtsökonomik, rechtliche Rahmenbedingungen und Regulierungsstrategien, Duncker & Humblot, Berlin, 2013, p. 135 et seq.

[78] Cf. para. 678 in this Report.

[79] Cf. 1. Section 14(1) German Securities Trading Law (WpHG).

[80] Cf. Fleischer, H./Strothotte, C., Ein Stewardship Code für institutionelle Investoren: Wohlverhaltensregeln und Offenlegung der Abstimmungspolitik als Vorbild für Deutschland und Europa?, Die Aktiengesellschaft, 221–233, 2011, p. 224 et seq.

conduct on the part of the portfolio companies. Here, it is therefore crucial for proxy advisors, on the one hand, to be able to assume a coordinating role between various institutional investors and thus steer clear of the acting-in-concert offence. On the other hand, proxy advisors have ways at their disposal to obtain information on portfolio companies that can also be taken into consideration in voting recommendations without falling under the insider-trading prohibition.[81] From a competition-policy perspective those situations are especially problematic in which proxy advisors simultaneously act as advisors to those companies whose shareholders they provide with voting recommendations.[82]

6.5 Empirical evidence

683. The Monopolies Commission has undertaken an in-house empirical analysis on the basis of the data described in Section 3 of this chapter to estimate the actual presence of situations that are problematic in competition-policy terms arising from indirect horizontal minority shareholdings by institutional investors. To carry out this analysis, we identified companies in which the largest institutional investors – irrespective of the size of their investments – have equity holdings or a financial interest. The selection of investors refers to the parent companies of the largest companies active in asset management in terms of assets managed world-wide.[83] Additionally, Société Générale, Deka Investment and DZ Bank were included as among the 15 largest single investors in the free-floating DAX shares.[84] Direct holdings by the parent companies in portfolio companies were considered, as well as those that are held indirectly through their subsidiaries. As portfolio companies, only those companies were included that are not further consolidated within the reporting population. Holdings were included when it was possible to find either the parent company or the subsidiary by its ID number among the shareholders of one of the companies included in the study or the name of a shareholder is nearly identical with that of the parent company of the institutional investor.[85]Table shows the number of the consolidated portfolio companies identified in Germany listed by investor and economic sector for the year 2012.[86] Here, one can clearly see that many institutional investors hold several different portfolio companies in one economic sector. This is particularly pronounced in the producing trades "manufacture of data processing hardware, optical and electronic equipment" and "manufacture of machines and vehicles". In the latter, for example, 28 portfolio companies can be assigned to the Deutsche Bank Group, 15 to DZ Bank, 14 to Vanguard and 13 each to Allianz Group and the Norwegian State Fund. Table shows the number of portfolio companies identified in the EU-28 Member States plus Norway and Switzerland for the year 2012. In the "manufacture of machines and vehicles" sector, for instance, Vanguard and BlackRock hold shares in 74 and 65 portfolio companies, respectively. However, the number of portfolio companies per investor in a given economic sector can be much higher: for BPCE, in the "real estate activities" sector it was possible to identify 123 portfolio companies in Europe. Table III.12 identifies the average number of the largest institutional investors that own equity shares in a portfolio company. In Germany, there are more than five in the "manufacture of machines and vehicles" sector. In Europe, there are indeed more than six in the "mining and quarrying"

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[81] Cf. Schwarz, P., Institutionelle Stimmrechtsberatung. Rechtstatsachen, Rechtsökonomik, rechtliche Rahmenbedingungen und Regulierungsstrategien, Duncker & Humblot, Berlin, 2013, p. 149 et seq. and 267.

[82] The company ISS can serve as an example.

[83] Cf. Figure III.12. Here it must be noted that individual subsidiaries can represent legally independent units that are linked by a majority equity investment with the parent concern. Despite widespread mechanisms to avoid information exchange and conflicts of interests between individual shareholders or business sectors, so-called "Chinese walls", the Monopolies Commission deems a consolidation of the single components of the group in the present context in the sense of an economic unit to be advisable. However, this consolidation should be subjected to an examination in a review of the individual case.

[84] Cf. Figure III.13.

[85] The latter is intended to prevent, among other things, shareholders clearly belonging to this category from slipping through the cracks due to a different ID number. For instance, the designation "Vanguard via its funds" designates shareholders listed in Orbis. Further, shares were excluded from the analysis when they are held explicitly in the name of a third legal person because in these cases it cannot be assumed with sufficient certainty that voting rights can be implemented by the respective institutional investor. We could not identify shares that are held through institutional investors indirectly through ultimate group heads outside the reporting population in companies within the reporting population.

[86] For Table III.10 and Table III.11 it must be noted, on the one hand, that the very roughly defined subcategories of economic sectors do not reflect competition-relevant market definitions. On the other hand, the companies have been assigned to an economic sector according to their main profit area, so that individual companies can of course also be active in other domains.

sector. This shows that many companies can be found simultaneously in the portfolio of several of the largest institutional investors, which indicates a common interest of the investors involved. If in addition to the largest investors, other institutional investors are also included in the analysis, then the number of those portfolio companies identified in all sectors of the economy rises considerably: in the "manufacture of machines and vehicles" sector, in Germany 34 companies and in Europe 232 were identified as portfolio companies of the largest institutional investors. The number of portfolio companies of all institutional investors, on the other hand, is in Germany 369 and in Europe 4,002. Although these figures indicate absolute frequencies, it must nevertheless be assumed that the portfolio companies identified are those with above-average market shares. This is also evident from the relative frequencies in Table III.12, which gives the total percentage of portfolio companies in the companies of one economic sector in the data on the one hand and on the other the percentage of portfolio companies in all stock-listed companies of an economic sector: in the "manufacture of pharmaceutical products" sector, portfolio companies of institutional investors, in Germany with 13 percent, as well as in Europe with 22 percent, make up the largest part. The amount of stock-listed portfolio companies in all stock-listed companies in one and the same economic sector, both in Germany and in Europe, reaches almost 93 percent.

686. While the analysis of the distribution of portfolio companies over investors and economic sectors can provide initial indications of the presence of shareholding structures that may present competitive concerns, they cannot contribute to answering the question of whether actual competition-distorting effects will arise. However, in general a pronounced proven competition-harming potential can already be ground enough for a need to act. Nevertheless, there exist empirical studies that trace price increases back to the shareholding of institutional investors. For example, a recent research paper on this topic compares the effects of the Barclays Global Investors takeover by BlackRock with the prices in the aviation sector in the USA. The authors come to the conclusion that the potential for competition-harming conduct without consideration of minority shareholdings of institutional investors is greatly underestimated, and they also find price increases caused by an increase in the concentration of shareholdings.[87] A further study shows that higher prices for financial products in the bank sector can be linked to higher rates of shareholdings by diversified institutional investors and minority shareholdings held reciprocally by the market participants.[88]

6.6 Conclusion and outlook

687. The Monopolies Commission sees considerable potential for competition distortion by indirect horizontal shareholdings between portfolio companies within the same economic sector through institutional investors. In theory, the same applies to shareholdings in portfolio companies located along a value-creation chain. This potential is given despite the low level of shares held and the limited possibilities for institutional investors to influence strategic decisions of their portfolio companies. The competition-distorting potential of indirect horizontal cross-holdings is exacerbated by additional factors such as the presence of shared interests among various different institutional investors and institutionalised voting advice.

688. Transnational and trans-sector empirical analyses of the distribution of indirect horizontal cross-holdings across institutional investors for the year 2012 demonstrate the quantitative relevance of such shareholding concentrations in Germany and Europe. Against the backdrop of a strongly burgeoning investment volume of institutional investors around the globe and the tendency for the database used to capture too few shareholdings, the respective corporate linkage has likely increased in the meantime.

689. Regardless of whether minority shareholdings exist directly between companies that are linked horizontally or vertically on a value-creation chain, or indirectly through institutional investors, the theories of harm essentially follow the same mechanisms. The Monopolies Commission agrees with the conclusion of the European Commission that an urgent expansion of the scope of application of the Merger Control Regulation to non-controlling minority shareholdings between companies linked horizontally and vertically along a value-creation chain does not, for the time being, appear

[87] Azar, J./Schmalz, M.C./Tecu, I., Anti-Competitive Effects of Common Ownership, Ross School of Business Working Paper No. 1235, April 2015.

[88] Azar, J./Raina, S./Schmalz, M., Ultimate Ownership and Bank Competition, preliminary SSRN Working Paper, 16 March 2016.

proportionate.[89] This assessment cannot, in the view of the Monopolies Commission, be transferred to the phenomenon of indirect minority shareholdings by institutional investors, which due to its omnipresence is of greater competition-policy relevance. Accordingly, it would be welcome if indirect minority shareholdings through institutional investors received more attention at the European level, not least in the framework of a possible further development of the European Merger Control Regulation.

690. Nevertheless, the Monopolies Commission sees further need for clarification in the sense of economic-policy recommendations. Particularly advisable are sector-specific studies on the cross-ownership of companies by institutional investors and the significance of shareholders with competitive interest, as well as their effects on market outcomes.

[89] Cf. Section 5 in this Chapter.

Table III.10: Number of portfolio companies by largest investors in Germany (2012)

	BlackRock	Vanguard	State Street	Allianz	Fidelity	JPMorgan Chase	Bank of New York	Axa	Deutsche Bank	Goldman Sachs	Prudential	UBS	BNP Paribas	Legal & General	Sas Rue La Boetie	HSBC	Northern Trust	Wellington	BPCE	Capital Group	Société Générale	Norway	Deka Bank	DZ Bank
Agriculture and Forestry	0	2	0	2	0	1	0	0	2	0	0	2	1	0	0	0	0	0	0	1	0	1	1	1
Mining and Quarrying	1	1	1	1	0	1	0	1	2	0	0	1	0	0	0	0	0	0	0	0	1	1	1	2
Manufacture of Food and Tobacco	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Manufacture of Textiles	2	2	1	2	0	1	2	1	4	0	1	1	2	0	1	0	0	0	1	2	1	2	1	3
Manufacture of Wood and Paper Products, Print Matter etc.	1	1	0	1	0	0	0	0	2	0	0	2	1	0	0	2	0	1	0	0	0	1	0	1
Manufacture of Chemical Products	3	5	3	3	0	2	1	3	3	0	1	4	1	0	3	3	0	1	3	2	1	5	4	5
Manufacture of Pharmaceutical Products	2	1	1	2	0	1	2	1	6	0	1	3	1	0	1	3	0	1	1	1	1	1	5	2
Manufacture of Plastic, Rubber, Glass and Ceramic Goods	2	2	1	2	0	1	0	1	4	1	0	2	1	0	1	2	0	1	1	0	1	2	1	3
Metal Production and Metal Products	1	1	1	1	0	0	0	1	5	0	0	3	0	0	0	2	0	0	1	0	1	4	0	4
Manufacture of Computer Products etc.	12	10	3	15	0	10	5	5	19	1	0	8	3	0	1	5	1	2	5	4	2	13	8	14
Manufacture of Machines and Vehicles	10	14	5	13	1	12	3	7	28	0	4	12	6	0	5	6	0	1	3	5	1	13	10	15
Utility Supply and Environmental Services	3	3	1	3	0	1	2	1	4	0	0	1	1	0	1	0	0	0	3	1	1	3	3	1
Retail	5	6	3	15	1	7	5	5	11	1	3	4	3	0	2	5	0	0	2	4	0	8	5	9
Hospitality	0	0	0	0	0	0	0	0	2	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0
Construction and Infrastructure	3	3	1	4	0	2	2	2	7	0	0	4	2	0	2	3	1	1	3	0	1	3	4	5
Publishing, Media and Telecommunications	8	10	6	10	1	7	3	3	12	2	2	5	2	1	1	4	1	1	3	4	4	7	4	8
ICT Services	4	3	3	6	2	2	1	4	11	1	1	4	2	0	1	1	0	0	1	1	0	2	4	8
Real Estate Activities	5	5	4	8	0	4	2	5	7	1	1	3	5	0	3	4	1	1	3	0	3	3	3	7
Other Services	6	8	3	21	0	9	2	11	24	3	3	8	4	1	1	13	0	0	7	2	4	4	9	15

N.B.: Included are direct shareholdings and indirect holdings by majority-controlled subsidiaries in consolidated companies based in Germany (cf. the data used Section 3 in this Chapter); Assignment of portfolio companies to economic sectors is by primary profit area.

Source: Calculations by Monopolies Commission using data from Bureau van Dijk

Table III.11: Number of portfolio companies by largest investors in Europe (2012)

	BlackRock	Vanguard	State Street	Allianz	Fidelity	JPMorgan Chase	Bank of New York	Axa	Deutsche Bank	Goldman Sachs	Prudential	UBS	BNP Paribas	Legal & General	Sas Rue La Boetie	HSBC	Northern Trust	Wellington	BPCE	Capital Group	Société Générale	Norway	Deka Bank	DZ Bank
Agriculture and Forestry	9	7	4	10	0	10	5	6	5	1	1	8	6	2	11	8	1	2	5	1	9	10	2	2
Mining and Quarrying	55	37	37	22	4	58	29	39	31	30	19	47	38	30	29	68	26	13	12	16	53	47	15	14
Manufacture of Food and Tobacco	31	33	30	24	5	28	16	23	26	15	15	32	24	16	24	25	13	4	26	16	26	33	11	8
Manufacture of Textiles	14	8	9	11	2	10	6	12	9	4	8	15	14	8	6	12	4	3	11	4	12	10	2	5
Manufacture of Wood and Paper Products, Print Matter etc.	33	37	29	20	1	25	22	25	17	9	13	30	30	13	16	35	10	5	14	9	16	43	8	8
Manufacture of Chemical Products	31	33	25	20	1	18	17	33	24	10	17	32	15	10	21	32	13	4	15	13	25	41	11	12
Manufacture of Pharmaceutical Products	30	31	14	19	4	17	12	20	22	9	13	35	27	8	16	30	10	13	17	7	20	36	15	6
Manufacture of Plastic, Rubber, Glass, etc.	19	20	14	15	1	13	11	20	15	4	7	16	18	8	8	26	4	3	8	5	13	19	5	8
Metal Production and Products	40	39	24	23	3	33	15	28	19	9	11	30	39	16	14	39	16	4	19	10	21	46	8	16
Manufacture of Computer Products etc.	65	58	39	50	7	56	37	67	54	17	24	60	55	27	28	57	22	12	46	26	49	71	27	23
Manufacture of Machines and Vehicles	65	74	51	52	6	60	28	57	55	17	27	63	56	23	41	55	16	8	57	25	39	84	21	27
Utility Supply and Environmental Services	33	32	25	23	3	18	16	20	17	11	7	24	23	7	27	16	7	1	20	6	19	45	14	13
Retail	59	70	44	74	9	63	40	63	46	27	30	56	67	31	46	76	25	7	67	27	52	82	18	29
Hospitality	10	11	11	10	2	12	6	13	9	6	6	11	23	7	7	11	6	3	15	1	17	14	2	6
Construction and Infrastructure	65	69	50	60	11	68	36	62	52	19	31	61	67	34	68	64	30	10	99	17	70	89	13	21
Publishing, Media and Telecommunications	59	57	46	40	16	50	38	52	42	21	27	54	50	31	37	47	17	7	49	20	49	87	13	30
ICT Services	26	25	17	38	17	25	23	43	21	7	11	22	37	13	20	33	7	2	60	7	20	32	7	17
Real Estate Activities	52	52	41	46	2	26	25	61	31	18	24	103	69	19	58	32	15	3	123	5	30	51	6	9
Other Services	77	58	67	92	15	83	53	106	80	39	47	82	102	59	74	132	39	12	121	23	111	83	17	30

N.B.: Included here are direct shareholdings and indirect holdings by majority-controlled subsidiaries in consolidated companies based in EU-28 Member States plus Norway and Switzerland (cf. the data used Section 3 in this Chapter); Assignment of portfolio companies to economic sectors is by primary profit area.

Source: Calculations by Monopolies Commission using data from Bureau van Dijk

Table III.12: Total numbers of portfolio companies by economic sector (2012)

	Number of portfolio companies of the largest institutional investors*		Average number of largest institutional investors* in portfolio companies (%)		Number of portfolio companies of institutional investors in total		Share of portfolio companies of all institutional investors in companies of the economic sector (%)		Share of portfolio companies of all institutional investors in stock-listed companies of the economic sector (%)	
	Germany	Europe	Germany	Europe	Germany	Europe	Germany	Europe	Germany	Europe
Agriculture and Forestry	3	47	4.67	2.66	30	688	2.98	4.78	100.00	62.50
Mining and Quarrying	4	127	3.50	6.06	14	545	5.05	15.14	100.00	93.57
Manufacture of Food and Tobacco	2	99	1.00	5.09	88	2.021	2.75	8.99	57.91	69.23
Manufacture of Textiles	6	53	5.00	3.75	59	1.058	4.43	7.90	53.33	70.07
Manufacture of Wood and Paper Products, Print Matter etc.	6	108	2.17	4.33	85	1.466	2.29	7.71	50.00	76.22
Manufacture of Chemical Products	11	87	5.09	5.44	75	946	7.56	14.86	81.82	83.33
Manufacture of Pharmaceutical Products	11	89	3.36	4.84	35	348	13.41	22.34	92.86	92.37
Manufacture of Plastic, Rubber, Glass etc.	7	75	4.14	3.73	165	2.058	4.54	10.17	61.54	82.09
Metal Production and Products	15	144	1.67	3.63	192	2.872	2.40	7.95	63.64	79.19
Manufacture of Computer Products etc.	30	199	4.87	4.91	203	1.671	5.41	11.88	86.28	85.71
Manufacture of Machines and Vehicles	34	232	5.12	4.34	369	4.002	4.15	9.74	70.97	80.00
Utility Supply and Environmental Services	7	88	4.71	4.85	96	1.160	4.75	12.06	71.43	78.91
Retail	40	321	2.60	3.45	1.188	14.208	2.85	6.91	80.85	74.16
Hospitality	3	63	1.00	3.48	80	2.484	3.18	9.41	0.00	82.47
Construction and Infrastructure	11	326	4.82	3.58	399	8.940	1.52	6.29	52.63	71.55
Publishing, Media and Telecommunications	25	230	4.36	4.08	148	1.631	9.84	15.83	76.67	86.17
ICT Services	25	217	2.48	2.44	231	2.164	6.73	14.06	68.97	77.55
Real Estate Activities	22	356	3.55	2.53	268	3.019	8.60	13.06	70.59	80.26
Other Services	80	586	1.98	2.73	1.062	8.913	5.42	11.43	76.19	77.23

N.B.: *Cf. institutional investors in Table III.10 and Table III.11. Included are direct shareholdings and indirect shareholdings by majority-controlled subsidiaries in consolidated companies based in Germany and in EU-28 Member States plus Norway and Switzerland (cf. data used Section 3 in this Chapter); Assignment of portfolio companies to economic sectors is by primary profit area.

Source: Calculations by Monopolies Commission using data from Bureau van Dijk