

Inquiry into the implications of common ownership and capital concentration in Australia

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Dear Tim

Inquiry into the implications of common ownership and capital concentration in Australia

The Australian Competition and Consumer Commission (**ACCC**) welcomes the House of Representatives Standing Committee on Economics' Inquiry into the implications of common ownership and capital concentration in Australia (**the Inquiry**). We appreciate the opportunity to provide a submission to assist the Committee in considering these emerging issues.

The ACCC is an independent Commonwealth statutory agency that promotes competition, fair trading and product safety for the benefit of consumers, businesses and the Australian community. The primary responsibilities of the ACCC are to enforce compliance with the competition, consumer protection, fair trading and product safety provisions of the *Competition and Consumer Act 2010*, regulate national infrastructure and undertake market studies. The ACCC has a dedicated Competition Enforcement and Financial Services Branch that focuses on competition issues in the financial services sector.

This submission focuses on matters within the remit of the ACCC, specifically the potential influence of capital concentration and common ownership on competition in markets. It does not consider in detail other matters from the Inquiry terms of reference that are outside of the ACCC's remit.

Overview

There is a risk that the ownership of Australian listed companies will become increasingly concentrated in the coming years and that there will be increasing levels of common ownership of competing companies. It is difficult to draw broad conclusions on how any such developments might affect competition within the Australian economy. That is because the effects will vary depending on the specific circumstances of the companies and sectors concerned.

Some of the factors shaping the possible competition effects include the incentives of the investors with the common ownership interests, the extent of alignment between those investors, the extent of the ownership interests, the degree of market concentration in the

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sector in which the commonly owned companies operate and the capacity of common investors to influence the commercial strategies of the companies in which they invest. For example, competition in a sector could be limited if a group of common investors all favour a commercial strategy of chasing higher profits at the expense of market share and those investors have substantial influence in the major firms in that sector.

In the course of its work, the ACCC engages in some monitoring of potential competition issues and is aware of the possibility that common ownership of competing firms could reduce the level or vigour of competition. The ACCC has functions and powers that enable it to investigate competition concerns, including those arising from common ownership of competing companies. However, depending on the specific circumstances, investigations can be complex and protracted, and associated enforcement outcomes uncertain. When directed by the Treasurer, the ACCC can also conduct market studies into perceived competition problems in specific markets.

Australia's growing funds management sector

The Australian funds management sector has grown by over 75% in real terms¹ in the past decade when measured by consolidated assets under management. The consolidated assets of managed funds were \$3.3 trillion as at 31 March 2021.ⁱ This is a significant sum of money; the equivalent of about 144% of the market capitalisation of all companies listed on the Australian Securities Exchange (ASX) and 174% of Australia's nominal gross domestic product over the year to 31 March 2021.ⁱⁱ

Institutional investors have significant shareholdings in Australian companies

The strong growth of the funds management sector in Australia over the past decade has led to a rising level of ownership of Australian publicly listed companies by domestic institutional investors.² As at 31 March 2021, domestic institutional investors were estimated to own just over half of the value of Australian listed equities.ⁱⁱⁱ Foreign investors (including overseas based institutional investors) were estimated to own approximately one third of the value of listed equities, while households directly own about 11%.³ Of domestic institutional investors, superannuation funds are the largest owners of Australian listed equities, followed by managed funds.^{iv}

While there have likely been numerous factors behind the increasing level of institutional ownership of Australian listed companies, an important driver has been the growth of Australia's superannuation system. To put that growth into perspective, the value of Australian listed equities owned by APRA regulated superannuation funds⁴ grew by over 50% in real terms⁵ between September 2013⁶ and March 2021. The value of Australian listed equities owned by those funds in March 2021 was \$467 billion.^v

The inflow of money into superannuation funds^{7,vi} and the need for that money to be invested has contributed to the increased ownership of publicly listed companies by superannuation

¹ The nominal growth rate has been adjusted into real terms using the GDP deflator.

² Institutional investors are typically considered to be entities that pool together funds to invest in various financial instruments. Institutional investors can include, but are not limited to: superannuation and pension funds, managed funds, authorised-deposit taking institutions and life insurance companies.

³ The remaining 2% of the value of listed equities is held by private non-financial corporations, public non-financial corporations, and federal and state Government.

⁴ Superannuation funds do not hold all of their investments directly. In total, across the superannuation industry, around 44% of investments were held by superannuation funds, while the remaining 56% is invested through investment vehicles, such as a wholesale trust or pooled superannuation trust.

⁵ The nominal growth rate has been adjusted into real terms using the GDP deflator.

⁶ Data is not available from this source before September 2013.

⁷ Contributions into APRA regulated superannuation funds were \$121.2 billion over the year to 31 March 2021.

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funds.^{vii} As at March 2021, APRA regulated superannuation funds' holdings of listed equities represented about 20% of the market capitalisation of all ASX listed companies.^{viii}

Another influence on the growth of institutional shareholdings has been changes in the ways that individuals and businesses invest in publicly listed companies, especially over the past decade. Individuals and businesses, both domestically and globally, are increasingly investing through managed funds that pool together assets and provide diversification, rather than making direct purchases of company shares.^{ix}

In particular, passively managed funds (including index funds) have exhibited strong growth in inflows of funds in recent years.^x As an example of the size of these funds, the collective ownership interests of three major foreign-owned fund managers (Vanguard, Blackrock and Statestreet Global Advisors, who each primarily provide index funds) was estimated by Orient Capital to have been 14% of the issued capital of ASX200 companies in 2019.^{xi}

While there is some aggregated data on listed equities ownership (such as that referred to above), there are limits to understanding the level of institutional ownership in individual Australian listed companies. This arises from factors including that investors are only required to notify their shareholdings if they and their associated entities have a relevant interest in voting shares in a company of 5% or more of the total votes attached to all shares. Another factor is the use of nominee holding companies, whereby the nominee company is listed on the share register as opposed to the investor. The identity of the investor is only required to be disclosed if they exceed the 5% statutory threshold for notification.

Increasing concentration of ownership of listed equities

The rising level of institutional ownership has been accompanied by an increase in the concentration of ownership of listed companies among institutional investors. In the superannuation sector, this increase in concentration has been further caused by factors including:

- A shift in recent years for superannuation funds to manage more of their investments 'in-house', as opposed to outsourcing that function to other investment managers.^{8, xii} Typically, when superannuation funds outsource their investment management function, they engage a number of investment managers. This may result in the ownership and voting rights of securities being spread across a number of investment managers. In contrast, if a superannuation fund moves its investment management function in-house, the ownership and voting rights of securities becomes consolidated under a single entity (the superannuation fund).
- Mergers between superannuation funds, with a key driver of these mergers being to ensure funds have sufficient scale to compete. These mergers have resulted in a decreasing number of superannuation funds holding a growing share of superannuation assets.^{9, xiii}

⁸ Research by Orient Capital found that over the five years to July 2018, superannuation funds had doubled their direct investment in publicly listed companies in the ASX200.

⁹ In June 2015, the largest 10 superannuation funds accounted for 56% of member accounts and 49% of total superannuation assets. In June 2020, the largest 10 superannuation funds accounted for 63% of member accounts and 64% of total superannuation assets.

More recent analysis by KPMG found that after the merger transactions in progress during 2021 have concluded, the largest 12 superannuation funds would be estimated to account for 76% of total assets and 77% of member accounts.

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The trend toward greater consolidated in the superannuation sector seems likely to continue. In a speech to the Australian Industry of Superannuation Trustees in May 2021, Helen Rowell (APRA Deputy Chair) stated:

All things being equal, the evidence suggests that larger funds are better placed to deliver stronger investment performance and lower fees... Over the past eight years, about 70 APRA regulated funds have finalised mergers. In addition, APRA has recently stated there are around a dozen potential mergers in the superannuation sector... The emerging industry view seems to be that any fund with less than around \$30 billion¹⁰ in assets under management is increasingly going to be uncompetitive against the so-called “mega-funds”.^{xiv}

It would seem that the increasingly concentrated ownership of listed equities is likely to lead to greater potential for the simultaneous ownership of shares in competing companies by institutional investors. Such ownership interests in competing companies are sometimes referred to as common ownership or as horizontal-share ownership (common ownership is the term used in this submission).

How common ownership might affect competition

A factor likely influencing the level of common ownership in Australian listed companies is the industry concentrations in key market indices, such as the S&P/ASX20 and S&P/ASX200. For example, several of the largest companies in each of the banking, food and staples retailing, and materials sectors are all constituents of the S&P/ASX20. As a result, fund managers using passive investments strategies based on these indices are likely to have ownership interests in a number of competing companies within these sectors, as well as other sectors.

Investors owning shares in competing companies may have an incentive to dampen competition in certain markets in order to increase overall profits across their portfolio of commonly owned companies.^{xv} While investors with majority holdings in competing firms will likely have a greater ability to engage in activities to reduce competition, research by the OECD suggests that common ownership interests do not need to have majority shareholdings in competing companies in order to create potential competition issues. That is because the influence of institutional investors over a company can be pronounced even when the ownership structure of a listed entity is highly dispersed.^{xvi}

There are a number of ways, even in the absence of a majority shareholding, that institutional investors could influence the decisions of a company's management in a way that affects competition. These include through direct engagement with company management to prompt or discourage a course of action, or through voting blocs.^{11 xvii}

Institutional investors who hold shares in competing companies could, for example, have an adverse impact on competition between those companies if they were to incentivise or encourage the management of those companies to do things such as cease the development of new products, delay expansion, or de-escalate a price war (among other things) in the interests of favouring short term profits.

The OECD identified voting blocs as one mechanism through which institutional investors might exert control over the management of a company and compel action aimed at dampening competition. Referring to Australia as an example, the OECD noted that the

¹⁰ Later in the speech it is noted that ‘there will inevitably be debate about [this \$30 billion] threshold ...’

¹¹ Bloc voting is where a number of shareholders agree (typically through receiving advice or a recommendation from an entity) to vote the same way with their shareholdings on certain decisions of a public company, such as voting on executive remuneration or the re-election of directors.

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reliance of institutional investors on proxy voting advisers can strengthen the stability of these blocs.^{xviii} However, other research shows the extent to which the recommendations of proxy advisers actually distort overall voting results is unclear.^{xix}

No consensus on the overall effect of common ownership on competition

Two recent studies have found that common ownership may have a detrimental effect on competition in certain concentrated sectors such as airlines or retail banking.^{xx} These studies found that in some oligopolistic markets where competitors have shareholders in common, prices may be higher, management incentives may be oriented towards industry performance and not firm performance and collusion may be more likely.^{xxi} These findings are potentially concerning in the Australian context where many markets are dominated by a small number of providers, including banking, supermarkets, mobile telecommunications, internet service provision, energy retailing, gas supply and transport, insurance, pathology services and domestic air travel.^{xxii}

However, the theoretical and empirical foundations of some of these studies have been the subject of critical comment by academics^{xxiii} and investors.^{xxiv} Other studies critique the mechanisms through which institutional investors may seek to influence the actions of competing companies in which they hold an ownership interest. Those studies emphasise the heterogeneity of institutional investor interests and the fiduciary duties of company directors to act in the best interests of their companies.^{xxv}

Overall, there appears to be no consensus in the research on the effects of common ownership on competition. The potential harm to competition arising from common ownership by an institutional investor is likely to depend on multiple factors including but not limited to: the investor's incentives and the extent of its common ownership, the other shareholders of the commonly owned companies, and the degree of market concentration in the sector in which those companies operate. In this context, it is unsurprising that the OECD concluded in 2017 that further research and analysis is required in order to determine whether and how institutional investor ownership in competing firms can impact competitive outcomes.^{xxvi}

The ACCC's role in relation to competition and common ownership

One of the ways the ACCC monitors for emerging competition issues is by reviewing complaints raised with the ACCC by industry and members of the public. Over the two years to August 2021, the ACCC did not identify any complaints in relation to common ownership adversely affecting competition in any market.

The ACCC is aware of the potential for competition concerns to arise in relation to common ownership. The ACCC has functions and powers that enable it to investigate competition concerns, including those arising from common ownership. For example, the ACCC is able to take action where market participants with a common owner make or give effect to an anti-competitive agreement, or engage in a concerted practice, that has the purpose, effect or likely effect of substantially lessening competition in a market. The ACCC is also able to take action where an acquisition of shares results in a substantial lessening of competition from coordinated or unilateral effects, including where the acquisition results in common ownership of competing companies. This highlights the importance of ensuring that Australia's merger laws are effective. The ACCC has recently initiated a debate about whether Australia's merger laws need to be strengthened to better protect competition.^{xxvii}

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Yours sincerely

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Chair

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