“Active Mutual Fund Common Owners’ Returns and Proxy Voting Behavior”

by Ben Charoenwong, Zhenghui Ni, Qiaozhi Ye

Discussion by Ahmed Guecioueur (INSEAD)

AFBC

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Summary

Common ownership (CO) setting

- Broader research agenda: effects of CO of industry competitors by institutional investors
  - In this case, active mutual funds
- In theory, CO can lead to collusion between “competitors,” who instead jointly maximize profits for their shareholders
- Empirical evidence for link between CO and (lack of) product market competition (e.g. Azar, Schmalz, and Tecu, 2018)
- Behavior of the institutional investors has been less studied
  - ⇒ this paper contributes both to the CO literature + mutual funds literature

Paper fills two interesting gaps in CO literature

- Shows that **fund managers have an incentive** to pursue CO strategies, as they are rewarded (alphas, fees, etc…)
  - Checking an implicit assumption in the CO literature

- Provides empirical evidence of a **mechanism for CO-strategy funds to encourage anticompetitive behavior**: voting for the election of directors who also direct competitors
  - New empirical channel for the CO effect
  - Occurs despite being illegal (Clayton Act)
  - I think this is especially interesting!

Comments

Why is CO strategy correlated with small-cap exposure?

- Figure 3: CO vs. SMB: monotonically increasing relationship
- *"However, this is not surprising. All else equal, a fund holding smaller stocks [has] a larger influence on their policy."* (pp. 17)
  - Still, would help to reassure there's no mechanical effect
  - For example, can you show CO funds are more likely to influence close director votes in smaller companies?
- Alternatively, do larger companies have fewer product market competitors, so there is less scope for large-cap funds to purse a CO strategy?

Tension between consumers vs. end-investors?

- *"Most common owners are institutional investors who have an incentive to create value for their* ***end clients****."* (pp. 2) Who are they?

- The returns to a high-CO fund strategy benefit end-investors, but must ultimately come at the expense of consumers
  - Are they the same consumers/investors? Then maybe end-investors hedge against welfare losses in product markets.
  - Are they different? Then must be some distributional impact

- High-CO fund features (share class types, 12b1 fees, prospectuses, geographic advertising spend, …) can suggest who buys them

- Industry exposures of high-CO funds can suggest which consumers are being harmed

Other thoughts I had reading the paper

- A lot of the discourse on CO is around giant passive funds
  - Can you **sell your results on active funds even more strongly?**
  - Maybe your results show CO concerns are even more widespread than thought previously? (Depending on state of lit. on active-fund CO)
- Curious as to **timing of return realization**
  - Distinct from return persistence (Table 9)
  - Immediately? i.e. market anticipates CO-induced future profits?
  - Gradually? i.e. CO fund owner needs to persuade competitors to collude over time / other frictions slow price rises
- Intuition for why CO stock picking (**COSP**) should fail? (Table 7)

Wrapping up

Conclusion

- Evidence active managers incentivized to follow CO strategy
- Evidence of a voting/governance channel to induce CO behavior among holdings
- Thought-provoking, opens doors to further research
- Nice paper - good luck!

Thank you!

Bibliography

- Azar, J., Schmalz, M. C., & Tecu, I. (2018). Anticompetitive effects of common ownership. *Journal of Finance*, *73*(4), 1513-1565.

- Charoenwong, B., Ni, Z., & Ye, Q. (2022). Active Mutual Fund Common Owners' Returns and Proxy Voting Behavior. *Available at SSRN 4184584*.