Institutional Investors and Concentration of Financial Power: Berle and Means Revisted: Discussion
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was lost for want of a shoe, and the rider was lost for want of a horse, but the *kingdom* was lost because of overregulation.

DISCUSSION

S. M. TINIC*: Potential repercussions of increasing institutional participation in the stock market continues to be a concern frequently addressed by public agencies empowered with overseeing and regulating securities markets and commercial banks. Volumes of testimony before various committees and subcommittees of the Congress exist on different sides of the issue. Some people, concerned about institutionalization of common stock ownership, advocate restricting securities holdings of financial institutions.

As the director of the SEC's *Institutional Investor Study* almost a decade ago, Donald Farrar is one of the few individuals who are intimately familiar with the vast amount of information that is contained in that voluminous paper. In this paper, Farrar and Girton (FG) bring some of that data to bear on two questions: (1) Do the frequently expressed concerns about the growth of institutional ownership of common stock have a basis in facts? and (2) Is share ownership by financial institutions (especially bank trust departments) concentrated in particular common stocks.

After examining the data on the proportion of common stocks held by different types of financial institutions over the years, FG conclude that institutional ownership of equity securities has indeed increased. This increase, however, has been very gradual and at different rates for different institutions. FG also indicate that ownership of common stocks is relatively concentrated among large bank trust departments, large investment advisory complexes and insurance companies. Since the data pertains only to 1969, it is impossible to ascertain whether concentration of stock ownership has exhibited significant changes during the last decade.

Nevertheless, it may be appropriate to make some general observations about the gravity of increasing institutionalization of common stock ownership. Especially, for public policy purposes the following questions need to be addresed:

(1) Has the growth of large institutional investments in common stocks distorted the level and structure of stock prices and thereby detracted from the market's efficiency? (2) Do institutional investors interfere in the affairs of portfolio companies in ways which benefit them, at the expense of individuals or beneficiaries to whom they have a fudiciary responsibility? In other words, to what extent are potential conflicts of interest actually acted upon to the detriment of the investors whose funds are being managed by financial institutions? and (3) Do financial institutions garner inside information and translate it to superior investment performance, in a way which diminishes the confidence of individual investors in the marketplace?

The answer to the first question is "no." So far, there is no convincing evidence that institutions detract from the efficiency of markets in pricing securities. The

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Wharton Study [3, pp. 21–3], the *Institutional Investor Study* [2, pp. 1464–5], and the Friend, Blume, Crockett [1, p. 16] mutual fund study all reported that institutional investors had no measurable impact on the efficiency of the stock market. Furthermore, the efficiency of the heavily institutionalized market for government bonds, should also dispel worries about adverse effects of institutional participation in the securities markets.

As far as the power of institutional investors over the management of portfolio companies is concerned, evidence is much more sparse and mostly impressionistic. Friend, Blume and Crockett reported that mutual fund managers demonstrated their approval or disapproval of management policies of portfolio companies primarily by buying and selling their stocks [1, pp. 27–8]. There was no discernible effort to force changes in management policies. Similar evidence was also presented in the *Institutional Investor Study* [2, pp. 2749–2763 and 2846]. A sizable fraction of institutional investors have a policy of voting in blank or with the management. Only a few institutions responded that they take an active interest in the management of portfolio companies. Indeed, generally high concentrations of large issues in institutional portfolios may be motivated, not only by concerns about marketability, but also by the reluctance of money managers to assume portfolio positions in smaller issues where they may be encouraged to interfere with management policy.

Based on the fragmentary evidence that is available, it seems reasonable to conclude that there is no uniformity among institutional investors in exercising influence on the management of portolio companies. In this light, it is hard to believe that a number of institutions would make a special effort to exert their voting power collectively as a group. In any event, on a priori grounds, rigors of competition among investment advisory complexes, bank trust departments and other financial institutions for the funds of existing and prospective clients, make potential conflict of interest problems associated with the portfolio companies highly unlikely to materialize.

Finally, virtually all of the empirical evidence that we have accumulated on the investment performance of institutional investors—including samples of bank trust departments—fail to confirm that financial institutions have consistent and widespread access to inside information. Even if the presumed information advantages of institutions exist in reality, institutions do not appear to be able to translate them into superior performance.

In this perspective, the data on the concentration of common stock holdings among financial institutions looks much less worrisome. Money management appears to be a very competitive business and performance of portfolios is amenable to relatively easy, objective methods of evaluation. Investors who perceive that their funds are not managed efficiently by a particular institution can obtain redress in the market.

Although it is important to keep abreast of changing patterns of common stock ownership, the agenda for future research needs to emphasize the behavior of costs and prices to gage the effectiveness of competition in the money management industry rather than focusing solely on the number and size distribution of financial institutions that manage common stock portfolios.

REFERENCES

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DISCUSSION

R. S. BOWER*: A regulated firm facing a return constraint is not like other firms. For a regulated firm the net operating income stream that maximizes market value is not only dependent on demand, production, input price and security market relationships but also on the decisions of a regulatory agency. Because the decisions recognize financial structure effects on net operating income requirements a regulated firm finds that neither the level nor the risk of net operating income is independent of its financial structure. Firm and regulatory agency actions reflect this link between net operating income and financial structure and Robert Taggart's paper analyzes these actions.

The analysis is helpful. It distinguishes the direct effect of financial structure from the indirect, price influence, effect. It shows that the price influence effect depends on how the regulatory agency varies its decision on utility prices with changes in financial structure, how prices influence net operating income and how net operating income affects market value. It indicates the conditions under which the price influence effect is likely to cause the financial structure of the regulated firm to vary most from the structure that would exist without regulation. And it illustrates how a firm would respond to various regulatory agency decision functions and how an agency might react. But there is a problem in this analysis. The model being analyzed may not be a good abstraction of the regulatory process.

The process that is analyzed is one in which the firm chooses initial capital stock and financial structure and the agency sets prices in each period to provide a fair return. The simplifying assumptions are that capital stock and financial structure do not change through time, that the agency may revise prices but not its price-effect analysis from period to period and that the only risk is in the quantity demanded, which is unknown at the time price is set.

I think there is a better description of the process. The firm files revisions in its price schedule from time to time at its own initiative or at the insistence of the regulatory agency. The time between filings will vary with demand, production, input price and other conditions. A filing is the occasion for a full review of all aspects of the firm's operation and structure. The review is conducted in an adversary proceeding in which the firm must bear the burden of proving that its capital stock, financial structure, required return and operating cost justify the

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