A Proposal to Limit the Anti-Competitive Power of Institutional Investors

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Recent scholarship has shown that mutual funds and other institutional investors may reduce competition among product market rivals in concentrated industries because of their significant ownership stakes in those firms. To address this problem, the Department of Justice and the Federal Trade Commission should adopt a public enforcement policy of the Clayton Act that is geared to the challenges posed by institutional investors to market competition. Investors in firms in well-defined oligopolistic industries should be required to limit their holdings of an industry to a small stake (no more than 1% of the total size of the industry) or to hold the shares of only a single "effective firm" per industry, with an exemption for free-standing index funds that commit to being purely passive. Using simulations based on empirical evidence, we show that under broad assumptions this rule would generate large competitive gains while having minimal negative effects on diversification and other values. The rule would also improve corporate governance by institutional investors.