Finance Capitalism 2.0: How BlackRock became the new JP Morgan

Jerry Davis
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Most employers abandoned traditional company pensions in favor of relatively portable 401(k) plans

As a result, households became increasingly invested in the stock market during the 1980s and 1990s

*Changes in US corporate ownership*

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Specifically: investors in mutual funds

Proportion of US households owning mutual funds

Source: Investment Company Institute 2011 Investment Company Fact Book

There are many more US mutual funds now

Number of US mutual funds

Source: Investment Company Institute 2011 Investment Company Fact Book

And they gathered a lot of assets

Billions of dollars in assets held by US mutual funds

Source: Investment Company Institute 2011 Investment Company Fact Book

But name brand funds got most of the benefit

Market share of top 5 fund complexes

Source: Investment Company Institute 2011 Investment Company Fact Book
Leaving US corporate ownership largely “intermediated” by a few mutual funds

Corporate ownership by mutual funds
- 1950: 3%
- 1990: 8%
- 2005: 28%

Mean ownership by institutional investors of 1000 largest US corporations

Source: Spectrum 13F database, various years

Fidelity is now the largest shareholder of one in ten US corporations

Number of US-listed firms in which Fidelity is largest shareholder

# of listed firms in US
- 1990: 3833
- 1995: 5187
- 2000: 5828
- 2005: 4423

Source: Spectrum 13F and 13G databases, various years

How long does Fidelity hold on to “large” blocks?

Of those firms in which FMR owned 5% or more at the end of 1999, how many did it still hold in...

Q: How do funds vote on shareholder governance proposals?

A: The more pension business they do with companies, the more likely they are to vote with management on shareholder-sponsored proposals

Top 5 blockholders of NYSE-listed firms, 2000-2005

<table>
<thead>
<tr>
<th>Owner</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fidelity</td>
<td>(320)</td>
<td>(369)</td>
<td>(416)</td>
<td>(427)</td>
<td>(434)</td>
<td>(464)</td>
</tr>
<tr>
<td>DFA (299)</td>
<td></td>
<td></td>
<td>(260)</td>
<td>(228)</td>
<td>(211)</td>
<td>(209)</td>
</tr>
<tr>
<td>Capital Res.</td>
<td>(224)</td>
<td>Capital Res. (161)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AXA (134)</td>
<td></td>
<td>Wellington (163)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wellington</td>
<td>(126)</td>
<td>Wellington (155)</td>
<td>AXA (142)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Fast forward: Who were the biggest blockholders in 2011?

<table>
<thead>
<tr>
<th>Owner</th>
<th># of 5% stakes in US-listed companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>BlackRock</td>
<td>1803</td>
</tr>
<tr>
<td>Fidelity</td>
<td>677</td>
</tr>
<tr>
<td>Vanguard</td>
<td>524</td>
</tr>
<tr>
<td>Dimensional Fund Advisors</td>
<td>428</td>
</tr>
<tr>
<td>T. Rowe Price</td>
<td>362</td>
</tr>
</tbody>
</table>

The composition of American equity markets has changed radically over the past decade.

The “going public” fad of the 1990s is long gone.

Source: Jay Ritter, University of Florida
As a result, the number of public corporations in the US has dropped by over half since 1997…

…while the number of Exchange Traded Funds (ETFs) has increased 50 fold.

**Mirror Images: ETF Creation and Common Stock Destruction**

- ETFs account for roughly half of all trading in US equities markets today.
- With ~4300 listed domestic companies and 1100 ETFs comprised of indices of these stocks, price movements have become increasingly correlated:
  - "Stocks move together today more than at any time in modern market history...When individual common stocks increasingly behave as if they are derivatives of frequently traded and interlinked ETF baskets, then it is trading in the ETFs that is driving the prices of the underlying stocks rather than the other way around" (Bradley and Litan, 2011)
  - In short: stock prices are highly volatile and often detached from fundamentals.
The new king of the hill: BlackRock

- BlackRock has $3.5 trillion in assets under management
- BlackRock’s iShares funds have a 47.4% market share of ETF AUM in the US
- As of 2011, BlackRock owns 5% or more of over 1800 US corporations (i.e., 42% of all traded companies)
- BlackRock is the single largest shareholder of one in five US corporations, including
  - ExxonMobil, Chevron, GE, IBM, AT&T, Verizon, JP Morgan Chase, Marathon…and over 800 others

MICHIGAN ROSS SCHOOL OF BUSINESS

Under the new proxy rules, BlackRock would have been eligible to nominate directors at well over half of all public corporations in the US by 2013…

...but the Business Roundtable and the Chamber of Commerce got the rule vacated…

MICHIGAN ROSS SCHOOL OF BUSINESS
2. Shareholders with Special Interests

The petitioners next argue the Commission acted arbitrarily and capriciously by “unilaterally fail[ing] to consider an important aspect of the problem.” *Motor Vehicle Mfrs. Ass'n*, 446 U.S. at 43, to wit, how union and state pension funds might misuse Rule 14a-11. Commenters expressed concerns that these employee benefit funds would impose costs upon companies by using Rule 14a-11 as leverage to gain concessions, such as additional benefits for unionized employees, unrelated to shareholder value. The Commission asserts it did consider this problem, albeit not in these terms, along the way to its conclusion that “the totality of the evidence and economic theory” both indicate the rule “has the potential of creating the benefit of improved board performance and enhanced shareholder value.” *5 Fed. Reg.* at 56,761/1. Specifically, the Commission recognized “companies could be negatively affected if shareholders use the new rules to promote their narrow interests at the expense of other shareholders,” id. at 56,772/3, but reasoned these potential costs “may be limited” because the ownership and holding requirements would “allow the use of the rule by only shareholders who demonstrated a significant, long-term commitment to the company,” id. at 56,760/5, and who would therefore be less likely to act in a way that would diminish shareholder value. The Commission also noted costs may be limited because other shareholders may be alerted through the disclosure requirements “to the narrow interests of the nominating shareholder.” Id.

...in part because unions and state pension funds could misuse it to pursue their “narrow interests”

Conclusion: Everything we thought we knew about American stock markets is no longer true

- Markets are less informationally efficient because co-movements in prices of firms in the same indices obscure individual differences
- Due to ETF-induced price volatility, US stock markets are no longer inviting to new issues
- Ownership of individual corporations is no longer highly dispersed
- Prospects for control of corporations by financial institutions has never been this high in a century
- Stay tuned for Finance Capitalism 2.0!

Thankfully, markets always go up eventually...