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Agents of Inequality: Common Ownership and the Decline of the American Worker

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AGENTS OF INEQUALITY: COMMON OWNERSHIP AND THE DECLINE OF THE AMERICAN WORKER

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ABSTRACT

The last forty years have seen two major economic trends: wages have stalled despite rising productivity, and institutional investors have replaced retail shareholders as the predominant owners of the U.S. equity markets. A few powerful institutional investors—dubbed common owners—now hold large stakes in most U.S. corporations. And in no coincidence, when U.S. workers acquired this new set of bosses, their wages stopped growing while shareholder returns increased. This Article explains how common owners shift wealth from labor to capital, thereby exacerbating income inequality.

Powerful institutional investors pushing public corporations en masse to adopt strong corporate governance has an inherent, painful

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tradeoff. While strong governance can improve corporate efficiency by reducing management agency costs, it can also reduce social welfare by limiting investment and thus hiring. Common owners act as a wage cartel, pushing labor prices below their competitive level. Importantly, common owners transfer wealth from workers to shareholders not by actively pursuing anticompetitive measures but rather by allocating more control to shareholders—control that can then be exercised by other shareholders, such as hostile raiders and activist hedge funds. If policymakers wish to restore the equilibrium that existed before common ownership dominated the market, they should break up institutional investors by limiting their size.

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INTRODUCTION

Workers in the United States are more productive than ever, but they take home the same pay they did forty years ago.¹ While firms have enjoyed blockbuster profits²—and the gross domestic product (“GDP”) has nearly tripled³—most U.S. households have not shared in this increasing prosperity. As wages have stagnated, income inequality has skyrocketed.⁴ Causes like de-unionization,⁵

1. See, e.g., *Estimating the U.S. Labor Share*, U.S. BUREAU LAB. STAT. fig.1 (Feb. 2017), <https://www.bls.gov/opub/mlr/2017/article/estimating-the-us-labor-share.htm> [<https://perma.cc/DG5U-8DEY>] (finding that the labor share of output has declined from 64 percent in 1982 to a low of 56 percent in 2011); JOSH BIVENS, ELISE GOULD, LAWRENCE MISHEL & HEIDI SHIERHOLZ, ECON. POL’Y INST., *RAISING AMERICA’S PAY: WHY IT’S OUR CENTRAL ECONOMIC POLICY CHALLENGE* 10 fig.A (2014), <https://files.epi.org/pdf/65287.pdf> [<https://perma.cc/6QUR-4QF9>] (finding that while productivity and compensation grew almost in tandem from 1948 until 1979, thereafter between 1979 and 2013 productivity grew 64.9 percent while hourly compensation grew only 8.2 percent).

2. See Robert Hughes, *Corporate Profits Hit a New Record as GDP Growth Is Revised Higher*, AM. INST. FOR ECON. RSCH. (Aug. 29, 2018), <https://www.aier.org/article/corporate-profits-hit-a-new-record-as-gdp-growth-is-revised-higher> [<https://perma.cc/KR37-5QJJ>] (reporting that in 2018, corporate profits after tax totaled a record-breaking \$1968.5 billion); Nir Kaissar, Opinion, *The Hard Part of Ending Inequality Is Paying for It*, BLOOMBERG (Sept. 2, 2019, 9:00 AM), <https://www.bloomberg.com/opinion/articles/2019-09-02/hard-part-of-ending-inequality-is-paying-for-it> [<https://perma.cc/K6XG-QT2C>] (reporting that corporate profits as a percentage of GDP hit the highest on record in 2012 and remained elevated, according to the U.S. Bureau of Economic Analysis); Jan De Loecker, Jan Eeckhout & Gabriel Unger, *The Rise of Market Power and the Macroeconomic Implications*, 135 Q.J. ECON. 561, 575 (2020) (“In 2016, the average markup charged [was] 61% over marginal cost, compared with 21% in 1980.”).

3. *GDP (Constant 2015 US\$) - United States*, WORLD BANK, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD?locations=US> [<https://perma.cc/SEM7-HNJ7>].

4. See Juliana Menasce Horowitz, Ruth Igielnik & Rakesh Kochhar, *Trends in Income and Wealth Inequality*, PEW RSCH. CTR. (Jan. 9, 2020), <https://www.pewsocialtrends.org/2020/01/09/trends-in-income-and-wealth-inequality> [<https://perma.cc/ND9Z-TPFP>] (explaining that from 1970 to 2018, “the share held by upper-income households increased from 29% to 48%”).

5. See, e.g., LAWRENCE MISHEL, ECON. POL’Y INST., *UNIONS, INEQUALITY, AND FALTERING MIDDLE-CLASS WAGES* 1 (2012), <https://files.epi.org/2012/ib342-unions-inequality->

globalization,⁶ immigration,⁷ labor market concentration,⁸ and technology⁹ have been blamed for these trends. But so far, an additional culprit has escaped detection: *common owners*—a few powerful institutional investors controlling large stakes in most U.S. corporations.¹⁰ As this Article explains, the rise of these powerful shareholders has been a significant cause of wage stagnation and income inequality.¹¹ Indeed, institutional investors have done a good job at avoiding blame, in large part due to their massive investments in Environmental, Social, and Governance public relations campaigns and lobbying efforts to avoid regulation.¹² Unfortunately, the current crisis-driven irregularities in the labor market further mask the four

middle-class-wages.pdf [<https://perma.cc/XBK5-GEGF>] (stating that a major factor behind increased wage inequality is the erosion of unionization); Henry S. Farber, Daniel Herbst, Ilyana Kuziemko & Suresh Naidu, *Unions and Inequality over the Twentieth Century: New Evidence from Survey Data*, 136 Q.J. ECON. 1325, 1326 (2021) (finding “consistent evidence that unions reduce inequality”).

6. See, e.g., Guido Cozzi & Giammarco Impullitti, *Globalization and Wage Polarization*, 98 REV. ECON. & STAT. 984, 999 (2016) (“[G]lobalization . . . can be an important source of wage polarization.”).

7. See, e.g., L. Jason Anastasopoulos, George J. Borjas, Gavin G. Cook & Michael Lachanski, *Job Vacancies and Immigration: Evidence from the Mariel Supply Shock*, 15 J. HUM. CAP. 1, 2 (2021) (“[T]he existing literature amply demonstrates the difficulty of measuring the impact of immigration on wages.”).

8. See generally, e.g., José Azar, Ioana Marinescu & Marshall Steinbaum, *Labor Market Concentration*, 57 J. HUM. RES. S167 (2022) [hereinafter Azar et al., *Labor Market Concentration*] (finding geographic concentration in labor markets throughout the United States).

9. See, e.g., Daron Acemoglu & Pascual Restrepo, *Robots and Jobs: Evidence from US Labor Markets*, 128 J. POL. ECON. 2188, 2188 (2020) (finding that “[o]ne more robot per thousand workers reduces the employment-to-population ratio by 0.2 percentage points and wages by 0.42%”); Clemens Lankisch, Klaus Prettnner & Alexia Prskawetz, *How Can Robots Affect Wage Inequality?*, 81 ECON. MODELLING 161, 161 (2019) (finding that “automation contributes towards our understanding of the driving forces of rising inequality”).

10. See generally Matthew Backus, Christopher Conlon & Michael Sinkinson, *Common Ownership in America: 1980–2017*, 13 AM. ECON. J.: MICROECON. 273 (2021) (documenting the increase in common ownership).

11. This Article explains that the wage and inequality effects are driven by reduced investments caused by common ownership, *see infra* Part II. A study has found that the aggregate-level investment gap is mostly explained by low competition and high common ownership, *see* Germán Gutiérrez & Thomas Philippon, *Investmentless Growth: An Empirical Investigation*, BROOKINGS PAPERS ON ECON. ACTIVITY, Sept. 2017, at 89, 120 [hereinafter Gutiérrez & Philippon, *Investmentless Growth*].

12. See generally Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1251 (2020) (arguing that “[i]n response to competition for money to manage, the largest pools of assets in our economy have turned their power as shareholders to advancing investors’ social agenda”); *infra* notes 285–286 and accompanying text.

decades of common owners' anticompetitive effects on the labor market.¹³

Since the 1980s, control of the U.S. stock markets has shifted from individual retail investors to powerful financial institutions that own shares in practically all public corporations.¹⁴ Today, these highly diversified institutional investors own more than 70 percent of U.S. publicly traded equity, up from less than 25 percent in the 1980s.¹⁵ The three largest asset managers—BlackRock, Vanguard, and State Street—collectively constitute the largest shareholder in nine out of ten S&P 500 firms.¹⁶ The once-prevalent dispersed ownership structure¹⁷ has now been replaced by common ownership.¹⁸ Effectively, common owners have hung an “Under New Management” sign over publicly traded corporations. And, as a result, while these corporations previously employed more than 40 percent of the U.S. workforce in 1973, after a steady decline, they only employed 29 percent in 2019,¹⁹ and wages stopped growing through the same period.

Powerful institutional shareholders move public corporations *en masse* toward strong corporate governance, which provides shareholders with greater control over managers and allows them to

13. See generally OECD, OECD EMPLOYMENT OUTLOOK 2021: NAVIGATING THE COVID-19 CRISIS AND RECOVERY 15 (Andrea Bassanini ed., 2021) (explaining how “[t]he burden of the COVID-19 crisis has fallen disproportionately on already vulnerable groups”).

14. See, e.g., Edward Rock, *Institutional Investors in Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 365–67 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) (describing the “‘de-retailization’ of the capital markets” as a result of labor regulations and market forces).

15. José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1514 (2018) [hereinafter Azar et al., *Anticompetitive Effects*]; Germán Gutiérrez & Thomas Philippon, *Investment-less Growth: An Empirical Investigation* 15 fig.9 (Nat'l Bureau of Econ. Rsch., Working Paper No. 22897, 2016) [hereinafter Gutiérrez & Philippon, *Investment-less Growth (Working Paper Version)*], <https://www.nber.org/papers/w22897> [<https://perma.cc/BJ6Y-G55S>].

16. Jan Fichtner, Eelke M. Heemskerck & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 313 (2017).

17. A dispersed ownership structure of a publicly traded corporation means that there is no individual shareholder with sufficient voting power and an incentive to exercise control over management. See John C. Coffee Jr., *Dispersed Ownership: The Theories, the Evidence, and the Enduring Tension Between “Lumpers” and “Splitters,”* in THE OXFORD HANDBOOK OF CAPITALISM 463, 463–64 (Dennis C. Mueller ed., 2012).

18. See Backus et al., *supra* note 10, at 285 fig.4 (showing the rise in share ownership by common owners).

19. Frederik P. Schlingemann & René M. Stulz, *Have Exchange-Listed Firms Become Less Important for the Economy?*, 143 J. FIN. ECON. 927, 928 (2022).

fire managers easily.²⁰ The conventional wisdom praises institutional investors for strengthening corporate governance because it improves corporate efficiency by deterring disloyal managers from *overinvesting* and wasting resources on pet projects.²¹ But, at the same time, strong governance also discourages loyal managers from investing in value-increasing projects. Managers who are more exposed to shareholder intervention are less likely to pursue bold, long-term, or transformative investments.²² Such investments are hard to evaluate and might be misperceived by shareholders as inefficient investments, increasing managers' risk of being mistakenly fired.²³ Instead, managers increase payouts to shareholders through dividends and share buybacks.²⁴ Therefore, both loyal and disloyal managers are likely to decrease investing under a strong-governance regime.²⁵

20. See, e.g., Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2104 (2019) (documenting that the Big Three institutional investors “have been very active in supporting [shareholders’] proposals advocating governance changes favored by their governance principles”); Asaf Eckstein, *The Virtue of Common Ownership in an Era of Corporate Compliance*, 105 IOWA L. REV. 507, 507–08 (2020) (showing the benefits of common ownership in improving compliance).

21. See generally Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986) (introducing the problem of management overinvestment); Steven Kaplan, *The Effects of Management Buyouts on Operating Performance and Value*, 24 J. FIN. ECON. 217 (1989) (offering evidence in support of the empire-building—pursuing size for the sake of size rather than profitability—hypothesis); Scott Richardson, *Over-Investment of Free Cash Flow*, 11 REV. ACCT. STUD. 159 (2006) (finding that strong governance reduces overinvestment); Micah S. Officer, *Overinvestment, Corporate Governance, and Dividend Initiations*, 17 J. CORP. FIN. 710 (2011) (finding that reductions in overinvestment at firms with poor investment opportunities are reflected in higher dividends).

22. See Zohar Goshen & Doron Levit, *Irrelevance of Governance Structure* 8 (Eur. Corp. Governance Inst., Working Paper No. 606/2019, 2020), https://ssrn.com/abstract_id=3340912 [<https://perma.cc/HDQ7-9NXL>] (modeling the choice facing managers between whether to invest in pet projects or value-creating investment projects).

23. Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 787, 803 (2017); Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE. L.J. 560, 580–81 (2016).

24. A corporation can distribute accumulated profits to its shareholders either in the form of dividends or buybacks. See generally, e.g., EDWARD YARDENI, JOE ABBOTT & MALI QUINTANA, YARDENI RSCH., INC., CORPORATE FINANCE BRIEFING: S&P 500 BUYBACKS & DIVIDENDS (2022), <https://www.yardeni.com/pub/buybackdiv.pdf> [<https://perma.cc/6G3F-G459>] (detailing the dividends and buybacks of S&P 500 firms from 1999 to 2021).

25. It is debatable whether, between these two opposing effects—decreasing management agency costs while discouraging value-creating investments—strong governance is, on average, socially beneficial. The empirical findings are inconclusive. For a review of these studies, see Goshen & Squire, *supra* note 23, at 814–25.

As investment falls, so too will hiring, as companies no longer require the labor force to operate new factories or staff new divisions.²⁶ This hiring shortfall artificially depresses wages, allowing firms to enjoy a wage discount and moving wealth from workers to shareholders. By switching firms *en masse* to strong governance, institutional investors reduce the total investment in the economy and the demand for labor. In other words, they create the anticompetitive twin of a *monopoly*, known as a *monopsony*. While a monopoly is a powerful *seller* that reduces supply and raises prices of *products*, a monopsony is a powerful *buyer* that reduces demand and lowers prices of *resources* (in this case, labor).²⁷ They create a labor market monopsony without resorting to collusion,²⁸ and indeed, likely without intending to create one.²⁹ Common owners' labor monopsony is driven by *shareholders'* market power over *managers* of numerous firms, each separately pursuing its economic interest. This concentration of ownership results in lower

26. See Frederico Belo, Xiaoji Lin & Santiago Bazdresch, *Labor Hiring, Investment, and Stock Return Predictability in the Cross Section*, 122 J. POL. ECON. 129, 131–32 (2014) (examining the relationship between hiring and investment).

27. COUNCIL ECON. ADVISERS, LABOR MARKET MONOPSONY: TRENDS, CONSEQUENCES, AND POLICY RESPONSES 2 (2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20161025_monopsony_labor_mrkt_cea.pdf [<https://perma.cc/ZFZ9-826K>] (“[A] firm with monopsony power has the ability to pay lower prices for its inputs . . .”). While monopolies use market power to increase the price of goods they sell to consumers, *monopsonies* use market power to decrease the price of goods they *purchase* from suppliers. See *id.* Although common owners own *multiple firms* that collectively should be termed an *oligopsony*, this Article elects to use the somewhat more palatable *single-firm* term *monopsony* as a matter of style. See *Oligopsony*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/oligopsony> [<https://perma.cc/BLP7-74CE>] (defining “oligopsony” as “a market situation in which each of a few buyers exerts a disproportionate influence on the market”).

28. While this Article's thesis—that common owners create a monopsony—applies to *all* inputs, such as materials and equipment, we focus on labor for two reasons. First, when the inputs in question are goods and services rather than labor, common owners benefit less from monopsony pricing. Because they likely also own stakes in the suppliers, their gains via the buyer firms are offset by losses in the seller firms. However, when the resource in question is labor, common owners capture economic value that otherwise would be reflected in wages and salaries, in which they have no stake. Second, workers tend to have less discretion to withhold their services from the market, as they need to earn a living. Thus, workers wield less bargaining power than providers of goods and services. See Orley Ashenfelter, Kirk Doran & Bruce Schaller, *A Shred of Credible Evidence on the Long-Run Elasticity of Labor Supply*, 77 ECONOMICA 637, 637 (2010) (noting the “relatively broad consensus that the long-run elasticity of labour supply is not likely to be large”).

29. As explained *infra* in Part III.D, pushing firms toward stronger governance manifests itself in higher profits, making common owners believe they are reducing agency costs. Unfortunately, the true effect of high profitability is driven by the depressed wages.

demand, and consequently a lower equilibrium price, for labor, causing wages to stagnate rather than rise with productivity increases.³⁰

Using the empirical finding that two-thirds of the decrease in investment is attributable to common ownership and corporate governance,³¹ this Article presents a novel economic model that exposes the mechanism by which common ownership and corporate governance reduce investment, thereby leading to stagnant wages. Indeed, just recently, two empirical studies confirmed that an increase in institutional investors' shareholding *reduces wages and employment*, thereby providing the "last mile" evidence supporting our model. In the first study (April 2021), the authors found that "firms that experience an increase in ownership by larger and more concentrated institutional shareholders have lower employment and wages."³² In the second study (November 2021), Professor José Azar and his co-authors found that "an increase in common ownership in a labor market is associated with decreases in both wages per employee and the employment-to-population ratio."³³

In a competitive market, shareholders will respond to abnormally low wages by switching to weak governance in order to free managers to invest and take advantage of discounted labor prices.³⁴ As more firms switch to weak governance and increase their investments, increased hiring will push wages up, decreasing the profitability of investments until it is no longer worthwhile to switch to weak governance. A symmetric process of firms switching to strong governance kicks in to discourage investments when wages are abnormally high. Wages and governance structure thus form a feedback loop, resulting in a competitive equilibrium where a certain number of strong- and weak-governance corporations coexist and are equally profitable—and, importantly, where wages are determined competitively.³⁵

30. See *infra* Part III.E.1.

31. See Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 89.

32. Antonio Falato, Hyunseob Kim & Till M. von Wachter, *Shareholder Power and the Decline of Labor* 0 (Nat'l Bureau of Econ. Rsch., Working Paper No. 30203, 2022), <https://www.nber.org/papers/w30203> [<https://perma.cc/RJ8W-FUP7>].

33. José Azar, Yue Qiu & Aaron Sojourner, *Common Ownership Reduces Wages and Employment*, FOX SCH. BUS. 0 (Nov. 1, 2021), <https://ssrn.com/abstract=3954399> [<https://perma.cc/67PX-HSGD>].

34. See *infra* Part III.B.

35. See *infra* Part III.C.

Common owners break this feedback loop. Unlike in the competitive equilibrium, common owners push firms toward strong governance *regardless of prevailing labor prices*. More firms with strong governance leads to lower investment, reduced demand for labor, and decreased wages.³⁶ The remaining investments of weak- and strong-governance firms see increased profits due to the labor discount. And because common owners hold the entire portfolio of strong- and weak-governance firms, their portfolio values go up. By preventing firms from switching to weak governance, common owners disable the market mechanism—the choice of governance structure—that drives wages back up when they are below their competitive rate. As a result, our model predicts wages will be persistently low under common ownership without the need for collusion among firms.³⁷ And because the labor monopsony means greater profits for (typically wealthier) shareholders and lower wages for (typically less wealthy) employees, it exacerbates income inequality.³⁸

Importantly, this Article shows that common owners exert labor-monopsony power not by *exercising* control over management decisions (as existing literature argues³⁹) but rather by *allocating* control to shareholders (pushing toward strong governance⁴⁰), which can then be exercised by other shareholders such as activist hedge funds⁴¹ or hostile raiders.⁴² That is, institutional investors do not need to engage in any illegal anticompetitive conspiracy—such as coordinating production cutbacks across firms⁴³—to enjoy a labor

36. See *infra* Part III.D.

37. In our model, common owners increase shareholder profits at the expense of other stakeholders not through illegal coordination in the pricing of products (output) as suggested by other theories, but rather through strong governance resulting in monopsony pricing of labor (input). For discussion of the other theories, see *infra* Part III.E.

38. See, e.g., Joshua Gans, Andrew Leigh, Martin Schmalz & Adam Triggs, *Inequality and Market Concentration, When Shareholding Is More Skewed Than Consumption*, 35 OXFORD REV. ECON. POL'Y 550, 550 (2019) (finding that in 2016, “the top 20 percent consumed approximately as much as the bottom 60 percent, but had 15 times as much corporate equity” and that “[b]ecause ownership is more skewed than consumption, increased mark-ups increase inequality”).

39. For a description and analysis of these studies, see generally C. Scott Hemphill & Marcel Kahan, *The Strategies of Anticompetitive Common Ownership*, 129 YALE L.J. 1392 (2020).

40. See *infra* Part I.B.

41. See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013).

42. See *infra* Part I.B.1.

43. When organizing a cartel, each corporation affects the other corporations, requiring the cartel to allocate quotas and monitor against defections. See *generally* Joseph E. Harrington &

discount. Rather, they only need to strive to maximize the value of their shares in each corporation. Thus, the common ownership monopsony theory does not share the same drawbacks as other theories alleging anticompetitive effects of common ownership.⁴⁴

Indeed, scholars have heralded institutional investors as guardians of shareholder rights whose ability to monitor corporations and hold disloyal managers accountable creates a net social benefit, a portion of which accrues to employees through their retirement plans.⁴⁵ However, this Article shows that in exchange for this marginal increase in the value of their pension's stock portfolio, employees are resigning themselves to depressed hiring and stagnant wages, even as their productivity—and consequently their value to the corporations—surges to record levels.

Acknowledging the inherent tradeoff of strong governance—reducing management agency costs while creating a labor monopsony—presents a dilemma for policymakers. Should they side with employees or shareholders? If shareholders' interests are the concern, nothing should be done. The power of common owners will continue to grow, and with it, the effects of strong governance.⁴⁶ If the interests of employees are the concern, however, then policymakers should act. To return markets to their previous competitive equilibrium, where labor and capital efficiently and equitably shared corporate value, they must eliminate common owners' monopsony effect.

Andrzej Skrzypacz, *Private Monitoring and Communication in Cartels: Explaining Recent Collusive Practices*, 101 AM. ECON. REV. 2425 (2011).

44. See *infra* Part III.E.

45. See, e.g., Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1644 (2013) (arguing that “shareholder ability to intervene . . . provides long-term benefits to companies, shareholders, and the economy”); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 815 (1992) (“[I]nstitutions are the only watchers available.”); Audra L. Boone & Joshua T. White, *The Effect of Institutional Ownership on Firm Transparency and Information Production*, 117 J. FIN. ECON. 508, 508 (2015) (finding that institutional investors “facilitate[] information production, which enhances monitoring”); Alan D. Crane, Sébastien Michenaud & James P. Weston, *The Effect of Institutional Ownership on Payout Policy: Evidence from Index Thresholds*, 29 REV. FIN. STUD. 1377, 1377 (2016) (finding that “even nonactivist institutions play an important role in monitoring firm behavior,” leading to increased dividends).

46. Mergers in the asset management industry are expected to increase concentration. See, e.g., Leslie P. Norton, *Trian's Nelson Peltz Wants To Fix the Fund Industry*, BARRON'S, Oct. 5, 2020, at 16.

To achieve this goal in the absence of collusive activity that can be directly policed, this Article suggests breaking up the large institutional investors by limiting their size. Several institutional investors have assets under management (“AUM”) in the trillions of dollars.⁴⁷ Limiting institutional investors to holding no more than a half-trillion dollars in AUM would increase the number of institutional investors, encourage competition in the market, and readjust the balance of power between managers and shareholders. These shifts would reignite corporate managers’ incentives to increase corporate investment and labor demand, restoring the labor market’s competitive equilibrium and leading to higher wages and greater income equality. Indeed, institutional investors have engaged in a massive “capture” of Congress through political spending,⁴⁸ making a breakup hard to achieve. However, with the Biden administration’s commitment to extending antitrust policy to “promote the interests of American workers,”⁴⁹ including breaking up big tech behemoths,⁵⁰ and both parties’ attention shifting to the hitherto neglected middle class, one can still hope that Congress can find common cause in arresting the decline of the American worker by breaking up common owners.⁵¹

This Article proceeds as follows. Part I describes the rise of common ownership and the shift toward strong governance. Part II presents the empirical evidence that the shift to strong governance has decreased investment and caused wages to stagnate. Part III sets out an economic model that explains the link between governance structure and wages and shows how common owners break the governance equilibrium by altering the balance of strong- and weak-governance companies. Part IV outlines the policy implications of the monopsony effect. Finally, the Conclusion summarizes key takeaways.

47. See *infra* note 64 and accompanying text.

48. See *infra* Part IV.

49. Exec. Order No. 14,036, 86 Fed. Reg. 36,987 (July 14, 2021).

50. Zephyr Teachout, *A Blueprint for a Trust-Busting Biden Presidency*, NEW REPUBLIC (Dec. 18, 2020), <https://newrepublic.com/article/160646/bidenantitrust-blueprint-monopoly-busting> [<https://perma.cc/5VA4-DHX3>].

51. See, e.g., Susan Davis, *Top Republicans Work To Rebrand GOP as Party of Working Class*, NPR (Apr. 13, 2021, 5:00 AM), <https://www.npr.org/2021/04/13/986549868/top-republicans-work-to-rebrand-gop-as-party-of-working-class> [<https://perma.cc/AV79-8YEE>] (“The battle for the working class is even more urgent for the two parties because it’s a growing bloc of voters.”).

I. THE RISE OF COMMON OWNERSHIP

The move from dispersed ownership to common ownership dramatically changed how corporations are owned and run. Retail shareholders—everyday folks holding stock in pensions or investment accounts—could not meaningfully monitor corporate conduct.⁵² By contrast, large asset managers such as BlackRock and State Street have the power and sophistication to influence their portfolio companies.⁵³ Common owners have used this newfound influence to usher in a new era of strong governance, pushing for measures that empower shareholders over managers.⁵⁴ As this Article will show, the shift from weak to strong governance, precipitated by the rise of common ownership, has had far-reaching consequences.

Part I.A describes how common owners unseated retail investors as the dominant force in the U.S. equity markets. Part I.B shows how common owners have used this influence to institute strong-governance measures that make directors and officers responsive to shareholders' desires.

A. *From Dispersed to Common Ownership*

Sixty years ago, the equity markets were dominated by dispersed shareholders and managers who ran corporations more or less exactly how they saw fit.⁵⁵ The three largest institutional investors—BlackRock, State Street, and Vanguard, the so-called “Big Three”—did not yet exist.⁵⁶ Today, their collective AUM exceeds the GDP of

52. See Barbara Black, *Are Retail Investors Better Off Today?*, 2 BROOK. J. CORP. FIN. & COM. L. 303, 303 (2008) (defining retail investors as “individual investors who, compared to institutional investors or wealthy individual investors, have modest portfolios, a lesser degree of investment acumen and less individualized attention from professional advisors”).

53. See *supra* note 45 and accompanying text.

54. See *infra* Part I.B.

55. See ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 6 (1932); see also Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 10–11 (1991) (coining the term “Berle-Means corporation” and defining it as one with “fragmented shareholders buying and selling on the stock exchange”).

56. See *Vanguard at a Glance: Facts and Figures*, VANGUARD, <https://corporate.vanguard.com/content/corporatesite/us/en/corp/who-we-are/sets-us-apart/facts-and-figures.html> [<https://perma.cc/H4DL-UUAZ>] (noting that Vanguard was founded in 1975); *History*, BLACKROCK, <https://www.blackrock.com/corporate/about-us/blackrock-history> [<https://perma.cc/9UZ7-DYXD>] (noting that BlackRock was founded in 1988); *Our History*, STATE STREET GLOBAL ADVISORS, <https://www.ssga.com/us/en/individual/etfs/about-us/our-history> [<https://perma.cc/RK2F-XWF4>] (noting that State Street Global Advisors, the asset management arm of State Street, was founded in 1978).

China.⁵⁷ This transformation of U.S. equity markets precipitated the labor monopsony effect that is the subject of this Article.

A few figures regarding institutional investors—mutual funds, pension funds, and insurance companies—help put the magnitude of this change into perspective. The dominant aspect of all investment strategies used by institutional investors is reducing risk through diversification—buying shares in many corporations.⁵⁸ The most common diversification is buying all of the shares of an index (such as the S&P 500 or the Russell 2000). In 1965, institutional investors collectively held a relatively small fraction of the stock market—about 14 percent.⁵⁹ Then, as described by Professors Ronald Gilson and Jeffrey Gordon,⁶⁰ shifts in employee retirement savings regulation toward privatization and investment of pension funds created a huge source of funds under institutional investors' control.⁶¹ Consequently, by 1980, institutional investors controlled about 25 percent of the stock

57. BlackRock, State Street, and Vanguard have a combined AUM of more than \$20 trillion. *See infra* note 64. The gross domestic product of China as of 2020 was \$14.7 trillion. *GDP (Current US\$)*, WORLD BANK, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=true [<https://perma.cc/REE6-3XTN>].

58. *See* Gilson & Gordon, *supra* note 41, at 884–85.

59. *See* BD. GOVERNORS FED. RSRV. SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: HISTORICAL ANNUAL TABLES 1965–1974, at 95 tbl.L.213 (2014), <http://www.federalreserve.gov/releases/z1/20140306/annuals/a1965-1974.pdf> [<https://perma.cc/6V7U-QPQK>] (showing that the entire equity market of all U.S. public shares was worth less than \$750 billion at the time). Shares of U.S. corporations not held by institutional investors were held directly by the public or by large shareholders, including controlling shareholders. *See* John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 848 (1999) (discussing ownership patterns of U.S. corporations and noting the presence of controlling shareholders in an appreciable segment of the economy).

60. *See* Gilson & Gordon, *supra* note 41, at 878–79.

61. Specifically, three regulatory choices were the main cause: the reliance on privately funded pensions (instead of Social Security), “the enactment of the Employee Retirement Income and Security Act of 1974 (ERISA),” and later, the shift from defined-benefit to defined-contribution pension plans by employers. *See id.* First, “substantial tax incentives encouraged workers and employers to look to private plans” rather than Social Security. *See id.* at 879. Next, ERISA mandated that companies must hold pension funds in fully funded special entities with fiduciary duties to the employees; public pension funds followed suit, and pension-fund assets increased more than threefold to \$3 trillion between 1980 and 1990. *See id.* at 879–80. Finally, the shift to defined contribution (specified contributions to retirement accounts in the employee’s control) accelerated demands for the services of institutional investors. *See id.* at 880–81.

market, with pension funds alone holding 17.4 percent.⁶² And by 2015, institutional investors collectively held over 50 percent of the market.⁶³

Importantly, this shift toward privatization created a concentrated class of shareholders that is both highly diversified and dominant. First, institutional investors are *concentrated* insofar as a few firms wield especially significant influence.⁶⁴ Overall, the largest twenty-five institutional investors hold more than 30 percent of all U.S. corporate shares,⁶⁵ and the largest ten hold the vast majority of those assets.⁶⁶ Second, they are *diversified* insofar as their holdings essentially span the global equity markets.⁶⁷ The largest asset managers have between 80 percent and 97 percent of their equity invested in index funds,⁶⁸ encompassing mid- and small-cap companies as well as large ones. For instance, BlackRock has a 5 percent or greater stake in more than 2000

62. James M. Poterba & Andrew A. Samwick, *Stock Ownership Patterns, Stock Market Fluctuations, and Consumption*, 1995 BROOKINGS PAPERS ON ECON. ACTIVITY 295, 313 tbl.5 (describing the changing pattern of stock ownership during the previous three decades).

63. See Gutiérrez & Philippon, *Investment-less Growth (Working Paper Version)*, *supra* note 15.

64. See Stephen Choi, Jill Fisch & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35, 55 (2013) (stating that three specific mutual funds dominate other mutual funds in terms of the size of AUM). For example, in the commercial sector, BlackRock holds approximately \$8.68 trillion in AUM, Vanguard holds \$8.1 trillion, Fidelity holds \$4.28 trillion, and State Street holds \$4.02 trillion. *About BlackRock*, BLACKROCK, <https://www.blackrock.com/sg/en/about-us> [<https://perma.cc/W9L5-QN6V>] (reporting total as of Dec. 20, 2020); *Vanguard at a Glance: Facts and Figures*, VANGUARD, <https://corporate.vanguard.com/content/corporatesite/us/en/corp/who-we-are/sets-us-apart/facts-and-figures.html> [<https://perma.cc/H4DL-UUAZ>] (reporting total as of Mar. 31, 2022); *Fidelity by the Numbers: Asset Management*, FIDELITY, <https://www.fidelity.com/about-fidelity/our-company/asset-management> [<https://perma.cc/2JLP-CGMA>] (reporting total as of Mar. 31, 2022); *Who We Are*, STATE ST. GLOBAL ADVISORS, <https://www.ssga.com/us/en/individual/mf/about-us/who-we-are> [<https://perma.cc/YES4-AUKB>] (reporting total as of Mar. 31, 2022).

65. See Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915, 939–40 (2019).

66. As of December 2016. Itzhak Ben-David, Francesco Franzoni, Rabih Moussawi & John Sedunov, *The Granular Nature of Large Institutional Investors* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 22247, 2017), <https://www.nber.org/papers/w22247> [<https://perma.cc/233K-XQKV>].

67. See Gilson & Gordon, *supra* note 41, at 884–85; see also Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1267 (2016) [hereinafter Elhauge, *Horizontal Shareholding*] (describing “horizontal shareholding,” where large financial institutions hold significant shares in competing corporations, as pervasive).

68. See Fichtner et al., *supra* note 16, at 304. For example, funds that track the S&P 500 hold five hundred of the largest publicly traded U.S. corporations representing some 80 percent of available market capitalization. See *S&P 500*, S&P DOW JONES INDICES, <https://us.spindices.com/indices/equity/sp-500> [<https://perma.cc/B6HG-CWFZ>].

of the 3900 publicly traded U.S. corporations.⁶⁹ Third, they are *dominant* insofar as they hold large stakes in most publicly traded corporations.⁷⁰ Institutional shareholders own, on average, over 70 percent of the stock in the one thousand biggest firms.⁷¹ The Big Three, when considered together, are the “single” largest shareholder in almost half of all publicly listed U.S. companies (1662 out of approximately 3900 firms) and most of the S&P 500 (438 out of 500 firms).⁷²

The dominance of these horizontal shareholders has resulted in increasing overlap in the ownership of all major U.S. corporations. For instance, in 1999, the odds that two public companies in the same industry shared a 5 percent owner were one in five. By 2014, that figure was nine out of ten—that is, 90 percent of public companies shared an owner that held at least 5 percent of each company.⁷³ The portfolios of common owners encompass entire industries; for example, horizontal shareholding is prevalent in the airline, banking, technology, and pharmacy sectors.⁷⁴

Importantly, although the terms “horizontal shareholders”⁷⁵ and “common ownership” are relatively new, the phenomenon dates back to the advent of institutional ownership: any highly diversified shareholder holds shares of competing corporations and is practically

69. Giovanni Strampelli, *Are Passive Index Funds Active Owners? Corporate Governance Consequences of Passive Investing*, 55 SAN DIEGO L. REV. 803, 811 (2018).

70. See *id.*; Luis A. Aguilar, Commissioner, Sec. & Exch. Comm’n, Speech: Institutional Investors: Powers and Responsibility (Apr. 19, 2013) (transcript available at <https://www.sec.gov/news/speech/2013-spch041913laahtm> [<https://perma.cc/2NG3-2G7C>]) (“Simply stated, institutional investors are dominant market players . . .”).

71. See MATTEO TONELLO & STEPHAN RABIMOV, CONF. BD., THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN ASSET ALLOCATION AND PORTFOLIO COMPOSITION 27 tbl.13, http://shareholderforum.com/e-mtg/Library/20101111_ConferenceBoard.pdf [<https://perma.cc/QB5Y-MCYL>] (showing that in 2009, ownership concentration of institutional investors in the top one thousand U.S. corporations by market value was 73 percent).

72. Fichtner et al., *supra* note 16.

73. See José Azar, *Portfolio Diversification, Market Power, and the Theory of the Firm 2* (IESE Bus. Sch. Univ. of Navarra, Working Paper No. 1170-E, 2017), <https://media.iese.edu/research/pdfs/WP-1170-E.pdf> [<https://perma.cc/5D5X-Y6JQ>]. One study found that the level of overlap in stock ownership grew by more than fifteen times between 1980 and 2012. See Erik P. Gilje, Todd A. Gormley & Doron Levit, *The Rise of Common Ownership 19* (Apr. 19, 2018) (unpublished manuscript), http://gcbc.global/wp-content/uploads/2018/05/6.-Levit_The_Rise_of_Common_Ownership_June_6_2017P-1.pdf [<https://perma.cc/RR5K-LENN>].

74. See Elhaage, *Horizontal Shareholding*, *supra* note 67, at 1267–68.

75. *Id.* at 1268.

a common owner.⁷⁶ But only when institutional investors grew in power was the term “common owners” coined by scholars concerned with their anticompetitive consequences on product markets.⁷⁷ This Article thus uses the terms common owners and institutional investors interchangeably.

B. The Push for Strong Governance

While corporate law scholars have described institutional investors as “rationally reticent” to actively govern their portfolio companies,⁷⁸ common owners themselves sing a different tune. For example, William McNabb, Vanguard’s chief executive, commented in a letter to Vanguard’s portfolio corporations, “[S]ome have mistakenly assumed that our predominantly passive management style suggests a passive attitude with respect to corporate governance. Nothing could be further from the truth.” McNabb further clarified, “We have no interest in telling companies how to run their businesses, but we have valuable governance insights to share with the board of directors.”⁷⁹ McNabb’s letter illustrates how, over the past four decades, common owners have reshaped the corporate governance paradigm by pushing for strong-governance measures that give shareholders substantial control over corporate managers.⁸⁰

Even the most “passive” of investors—index funds that mimic market portfolios such as the S&P 500—actively agitate for strong governance. Of course, index funds cannot express dissent by selling, as the essence of an index fund is the commitment to its clients to hold the shares of the corporations included in the given index to mimic the

76. See Gilson & Gordon, *supra* note 41, at 884–86 (describing diversification as institutional investors’ dominant investment strategy).

77. See generally Azar et al., *Anticompetitive Effects*, *supra* note 15, who were among the first to use this term.

78. See Gilson & Gordon, *supra* note 41, at 895.

79. Letter from F. William McNabb III, Chairman & CEO, Vanguard, to Bds. Dirs. Vanguard Funds Largest Portfolio Holdings 1 (Feb. 27, 2015), https://pcg.law.harvard.edu/wp-content/uploads/2016/09/7-CEO_Letter_03_02_ext.pdf [<https://perma.cc/3WKQ-8Y6R>].

80. See Zohar Goshen & Sharon Hanes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263, 277–82 (2019) (explaining how institutional investors have pushed for strong governance and shareholder empowerment, obviating to a large degree the need for courts to protect shareholders’ rights); Barry B. Burr, *Money Managers Increasing Activism on Governance—But Quietly*, PENSIONS & INVS. (Mar. 19, 2012), <https://www.pionline.com/article/20120319/PRINT/303199980/money-managers-increasing-activism-on-governance-but-quietly> [<https://perma.cc/K8ED-LAVR>].

index's performance. However, they can—and do—vote. And they vote disproportionately in favor of measures that empower shareholders⁸¹ and mostly as part of one-size-fits-all voting policies.⁸² On the other hand, active funds, unconstrained in their trading, use the threat of exit—that is, selling—to influence corporate governance.⁸³ Additionally, asset managers engage both formally and informally with their portfolio companies by discussing strategy and governance with management.⁸⁴

The most prominent outcome of these activities has been the push for strong governance.⁸⁵ While the particular policies promoted by institutional investors have changed over the decades, they share the goal of increasing shareholders' influence over their portfolio companies.

1. *The 1980s: The Age of Hostile Takeovers.* Before 1980, managers of public corporations were loyal to the corporation, not the shareholder, and governance mechanisms were hardly used.⁸⁶ Hostile takeovers were relatively few, and proxy fights were uncommon, with

81. See Ian R. Appel, Todd A. Gormley & Donald B. Keim, *Passive Investors, Not Passive Owners*, 121 J. FIN. ECON. 111, 113–14 (2016) [hereinafter Appel et al., *Passive Investors*].

82. See generally, e.g., BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: PROXY VOTING GUIDELINES FOR U.S. SECURITIES (2022), <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf> [<https://perma.cc/94V6-BUQX>] (describing general BlackRock voting policies); VANGUARD, VANGUARD FUNDS: PROXY VOTING POLICY FOR U.S. PORTFOLIO COMPANIES (2021), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/2021_proxy_voting_policies.pdf [<https://perma.cc/6F85-GH6Q>] (describing general Vanguard voting policies); Rick Lacaille & Rakhi Kumar, *2019 Proxy Voting and Engagement Guidelines: North America*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 27, 2019), <https://corpgov.law.harvard.edu/2019/03/27/2019-proxy-voting-and-engagement-guidelines-north-america> [<https://perma.cc/8K43-GYPF>] (outlining general proxy voting principles).

83. See, e.g., Joseph A. McCahery, Zacharias Sautner & Laura T. Starks, *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors*, 71 J. FIN. 2905, 2912 & tbl.II (2016) (documenting institutional investors use of exit, the threat of exit, and “behind the scenes” discussions with boards and management to achieve governance goals).

84. See *id.* at 2912 (finding “widespread use of private discussions [with portfolio firms] support[ing] the view that investors try to engage firms behind the scenes through direct negotiations”).

85. See Edward S. Adams, *Bridging the Gap Between Ownership and Control*, 34 J. CORP. L. 409, 425 (2009) (“[I]nstitutional investors tend to acquire a significant portion of stock in a corporation to gain a measure of control in the corporation.”).

86. Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, 15 J. ECON. PERSPS. 121, 123 (2001) [hereinafter Holmstrom & Kaplan, *Merger Activity*].

little chance of success.⁸⁷ Boards were mainly composed of insiders supporting management. Long-term performance plans were expansively employed and referenced accounting measures instead of stock market prices, tying managerial incentives only indirectly to shareholder value.⁸⁸ Accordingly, management ownership of equity was modest; in 1980, only 30 percent of chief executive officers' ("CEOs") compensation was tied to stock market performance.⁸⁹

By 1980, institutional investors crossed the 25 percent ownership mark,⁹⁰ reaching a size that allowed them to end the era of managerial freedom by unleashing a wave of hostile takeovers.⁹¹ Notably, hostile takeovers are a powerful external strong-governance mechanism that can hold inefficient managers accountable by replacing them upon a successful acquisition of corporate control.⁹² Hostile takeovers are a profit-making opportunity for institutional investors. When a manager underperforms, the corporation's share price decreases, making the corporation an attractive target for a hostile bidder who will buy the corporation for the depressed price plus premium. Institutional investors will benefit by getting the premium and the deterrence effect on other underperforming managers in their portfolio. The bidder will change management to improve performance and enjoy the increase in price that will result from the improved performance.⁹³

The takeover activity that started "to accelerate in the early 1980s and boomed throughout much of the decade"⁹⁴ was fueled by the rise of institutional investors in two ways. First, because institutional

87. *Id.*

88. *Id.*

89. Brian J. Hall & Jeffrey B. Liebman, *Are CEOs Really Paid Like Bureaucrats?*, 113 Q.J. ECON. 653, 663 (1998) ("[B]oth the level of CEO compensation and the sensitivity of compensation to firm performance have risen dramatically since 1980, largely because of increases in stock option grants.").

90. Paul A. Gompers & Andrew Metrick, *Institutional Investors and Equity Prices*, 116 Q.J. ECON. 229, 233, 236 (2001) (finding that institutional investors controlled 26.8 percent of the market value of all publicly traded stocks in early 1980).

91. See Bengt Holmstrom & Steven N. Kaplan, *The State of U.S. Corporate Governance: What's Right and What's Wrong?*, 15 J. APPLIED CORP. FIN. 8, 11 (2003) ("It was the potential for improved corporate performance, combined with the increased ownership of institutional investors, that gave birth to the takeovers, junk bonds, and [leveraged buyouts] of the 1980s.").

92. See Henry G. Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 DUKE L.J. 231, 236–37 (arguing that the threat of raiders encourages managers to manage their companies as efficiently as possible).

93. *Id.* at 236.

94. See Holmstrom & Kaplan, *Merger Activity*, *supra* note 86.

investors were more interested in extracting high returns and less loyal to incumbent management than individual investors, they were the main sellers of large blocks of shares in takeovers.⁹⁵ Second, institutional investors were also the takeovers' main financiers, investing large amounts in buyout funds and the market for high-yield bonds.⁹⁶ Indeed, Nobel Laureate Bengt Holmstrom and Professor Steven Kaplan explained that without a large increase in institutional investors' funds, it is unlikely that there would have been a willingness and ability to support multibillion dollar takeovers.⁹⁷

Unleashing takeovers was just the beginning. More importantly, the rise of institutional investors shifted the power from stakeholders to shareholders, giving rise to what is known as *shareholder primacy*.⁹⁸ This shift became the norm in corporate America—even after the takeover wave subsided in the 1990s⁹⁹—leading to increased shareholder power and stronger governance.

2. *The 1990s: The Age of Independent Boards.* Institutional investors kept growing in power, crossing the 40 percent ownership mark in 1990 and surpassing the 50 percent majority ownership mark by the end of the decade.¹⁰⁰ While in the 1980s, institutional investors activated an external governance mechanism—hostile takeovers—in the 1990s, they cemented the shift to shareholder primacy through internal governance mechanisms—*independent boards*¹⁰¹ and equity

95. *Id.* at 132.

96. *Id.* Most of the financing for takeovers came in the form of high-risk, high-yield bonds, also known as “junk bonds,” most famously issued by Michael Milken through the investment bank Drexel Burnham Lambert. See Elijah Brewer III & William E. Jackson III, *Requiem for a Market Maker: The Case of Drexel Burnham Lambert and Junk Bonds*, 17 J. FIN. SERVS. RSCH. 209, 209–10, 232 n.9 (2000).

97. See Holmstrom & Kaplan, *Merger Activity*, *supra* note 86, at 132.

98. Shareholder primacy is a form of corporate governance that prioritizes the interests of shareholders over all other corporate stakeholders. See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440–41, 443 (2001).

99. See Holmstrom & Kaplan, *Merger Activity*, *supra* note 86, at 132.

100. Gompers & Metrick, *supra* note 90, at 237 fig.I.

101. Independent boards are comprised of directors that do not have a material stake in the company and, consequently, are less subjected to influence by managers of a corporation. See Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1526 (2007) (detailing the rise of independent boards).

compensation.¹⁰² Both mechanisms were aimed at aligning management incentives with shareholders' interests and stock market prices.

As thoroughly detailed by Professor Jeffrey Gordon, in the 1990s, public companies' boards became markedly more independent and active monitors than in the past.¹⁰³ While in 1980 independent directors comprised on average 31 percent of boards, in 1990 they became the majority, holding 60 percent of the seats and 69 percent in 2000.¹⁰⁴ This trend continued, eventually reaching a supermajority of independent directors. In 2016, for instance, in most corporations on the S&P 500, independent directors held more than 70 percent of the seats.¹⁰⁵ As independent directors are more inclined to hold managers accountable to shareholders,¹⁰⁶ this shift led to a marked increase in turnovers and more hiring of new CEOs from outside the company.¹⁰⁷ In the largest five hundred U.S. firms, internal turnovers went up from an annual rate of 12.62 percent in 1992 to 19.15 percent in 2000, shortening the average tenure from about eight years to about five years.¹⁰⁸ And around half of all CEO turnovers were performance-induced.¹⁰⁹ Similarly, external hires as a percentage of all new CEO appointments

102. Brian J. Hall & Jeffrey B. Liebman, *The Taxation of Executive Compensation*, 14 TAX POL'Y & ECON. 1, 1–2 (2000) [hereinafter Hall & Liebman, *Taxation*] (finding that the dramatic explosion in stock options involves changes in the fraction of shares held by large institutional investors, corporate governance, and the market for corporate control, rather than tax considerations).

103. Gordon, *supra* note 101, at 1475 fig.2.

104. *Id.* at 1565 app. tbl.1.

105. Renee Lightner & Theo Francis, *Inside America's Boardrooms*, WALL ST. J. (Jan. 19, 2016, 1:30 PM), <http://graphics.wsj.com/boards-of-directors-at-SP-500-companies> [<https://perma.cc/WR4S-FYCF>].

106. That attitude was bolstered by reducing the influence of management on directors' appointments, Gordon, *supra* note 101, at 1496, and by increasing the amount of directors' equity-based compensation, Holmstrom & Kaplan, *Merger Activity*, *supra* note 86, at 135.

107. See Holmstrom & Kaplan, *Merger Activity*, *supra* note 86, at 135.

108. Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 INT'L REV. FIN. 57, 61 (2012) ("In the earlier period from 1992 to 1996, total CEO turnover using definition 1 is 12.62% per year implying an average tenure of 7.9 years. In the period from 1997 to 2002, total turnover increases to 19.15% per year, implying an average tenure of just 5.2 years.").

109. Alex Edmans, Xavier Gabaix & Dirk Jenter, *Executive Compensation: A Survey of Theory and Evidence*, in 1 THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 383, 421 (Benjamin E. Hermalin & Michael S. Weisbach eds., 2017).

increased from 15 percent in the 1970s to 27 percent during the 1990s and 32 percent during the 2000s.¹¹⁰

Increased monitoring increases CEOs' dismissal risk, and, at the same time,¹¹¹ CEOs' compensation goes up.¹¹² For example, an S&P 500 CEO's average total compensation increased from about \$2 million in 1980 to more than \$4 million in 1990, peaking above \$18 million in 2000.¹¹³ And while in 1980 equity-based compensation was about 20 percent of total CEO compensation,¹¹⁴ in 1996 it surpassed 50 percent, and in 2000 it peaked at 78 percent.¹¹⁵ These changes increased CEO pay-to-performance sensitivities by a factor of ten times from 1980 to 1998,¹¹⁶ strongly aligning managements' interests with those of shareholders. Consequently, maximizing shareholder value became a powerful guide to managerial behavior.

These changes of the 1990s were fueled by the growing ownership of institutional investors and their activism. These investors used shareholder value to measure performance, publicly targeted underperforming firms, strongly backed equity-based compensation for CEOs, and "organized 'just vote no' campaigns in director elections to protest continued poor performance."¹¹⁷ The next decades have shown a further increase in shareholder power and strong governance.

3. *The 2000s: The Age of Hedge Fund Activism.* The increase in power of institutional investors continued in the 2000s. In parallel to strengthening internal governance mechanisms,¹¹⁸ a new powerful

110. *Id.* at 433.

111. Benjamin E. Hermalin, *Trends in Corporate Governance*, 60 J. FIN. 2351, 2351 (2005).

112. Edmans et al., *supra* note 109, at 433.

113. Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, in 2 HANDBOOK OF THE ECONOMICS OF FINANCE 211, 225 & fig.3 (George M. Constantinides, Milton Harris & René M. Stulz eds., 2013).

114. Edmans et al., *supra* note 109, at 399 fig.5.

115. Lucian Bebchuk & Yaniv Grinstein, *The Growth of Executive Pay*, 21 OXFORD REV. ECON. POL'Y 283, 290 tbl.4 (2005).

116. Hall & Liebman, *Taxation*, *supra* note 102, at 5.

117. Gordon, *supra* note 101, at 1528–29.

118. For example, "[a]nnual director elections, majority vote rules for director elections, shareholder approval for poison pills, and proxy access bylaws are some of the critical governance practices that have become common practice thanks to investor support," as one booster put it. See Kosmas Papadopoulos, *The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance (2000-2018)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 6, 2019), <https://corpgov.law.harvard.edu/2019/02/06/the-long-view-the-role-of-shareholder-proposals-in-shaping-u-s-corporate-governance-2000-2018> [<https://perma.cc/3JVD-ARYN>]. A more skeptical

external governance mechanism—hedge fund activism—has emerged.¹¹⁹ Activist hedge funds, which have gained dominance in the market over the last two decades,¹²⁰ have carved out a market niche by acquiring stakes in underperforming firms and implementing measures to boost performance.¹²¹ Although common owners do not normally agitate for operational change at their portfolio firms, activists do—and common owners support them, especially when the proposed changes align with their governance agenda.¹²² The presence of common owners makes it more likely that an activist hedge fund will (successfully) try to replace a company’s managers.¹²³ Support for hedge fund activists is, therefore, a strong-governance mechanism in its own right.

observer described how activists have capitalized on the “rhetorical high ground” of director accountability to push for special meetings power, the ability to act through majority consents, the elimination of supermajority requirements, and more. Latham & Watkins LLP, *Future of Institutional Share Voting: Three Paradigms*, CORP. GOVERNANCE COMMENT. (July 2010), https://www.lw.com/upload/pubcontent/_pdf/pub3617_1.pdf [<https://perma.cc/4H87-NRKA>]. The larger point is that institutional investors support a diverse and rapidly evolving group of strong-governance measures including those mentioned here, the effect of which is to put the fate of directors more and more into the hands of their shareholders.

119. Brian Cheffins & John Armour, *The Past, Present and Future of Shareholder Activism by Hedge Funds* 34 (Univ. of Cambridge Fac. of L. Legal Studs. Rsch. Paper Series, Paper No. 38/2011, 2011), https://ssrn.com/abstract_id=1932805 [<https://perma.cc/2JDC-9JEL>] (addressing the rise to prominence of hedge fund activism in the 2000s).

120. Activist hedge funds grew from less than \$3 billion in AUM in 2000 to almost \$200 billion in 2015. See AIMA & SIMMONS & SIMMONS, UNLOCKING VALUE: THE ROLE OF ACTIVIST ALTERNATIVE INVESTMENT MANAGERS 12 fig.1 <http://www.sewkis.com/wp-content/uploads/9386e594-838e-46c0-a842-3d914714aee3.pdf> [<https://perma.cc/DEW2-29WQ>]; Paula Loop, Catherine Bromilow & Leah Malone, *The Changing Face of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 1, 2018), <https://corpgov.law.harvard.edu/2018/02/01/the-changing-face-of-shareholder-activism> [<https://perma.cc/WX7P-VHTS>]. Meanwhile, activist events increased from 78 in 2000 to almost 428 in 2016. Mark R. DesJardine & Rodolphe Durand, *Disentangling the Effects of Hedge Fund Activism on Firm Financial and Social Performance*, 41 STRATEGIC MGMT. J. 1054, 1063 (2020).

121. See generally Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008) [hereinafter Brav et al., *Hedge Fund Activism*] (using a novel data set to chronicle the acquisition and proxy behavior of activist hedge funds).

122. See Ian R. Appel, Todd A. Gormley & Donald B. Keim, *Standing on the Shoulders of Giants: The Effect of Passive Investors on Activism*, 32 REV. FIN. STUDS. 2720, 2752 (2019) (“[W]e only find . . . increased activists’ successes in areas that passive investors view as beneficial for their long-term interests; in particular, effective boards, good governance, and a strong market for corporate control.”).

123. See Brav et al., *Hedge Fund Activism*, *supra* note 121, at 1755 (“Governance issues, including rescinding takeover defenses, ousting CEOs, promoting board independence, and curtailing executive compensation, are also commonly cited as reasons for activism.”).

Additionally, hedge fund activism and its support among common owners has a more direct impact on governance. Hedge funds often use weak governance as an excuse to mount activist campaigns against corporate management.¹²⁴ Activist campaigns are more likely to succeed when they advocate for board efficiency and independence and against takeover defenses.¹²⁵ In other words, hedge funds do the work of fighting for stronger shareholder rights, with passive owners supporting them from the sidelines.

Indeed, during the 2000s, with the help of activists, common owners kept pushing firms toward increased shareholder power, particularly campaigning against antitakeover protections.¹²⁶ The conventional wisdom is that removing antitakeover protections deters *inefficient* investments by exposing underperforming managers to a hostile takeover threat.¹²⁷ But the fear of a takeover also deters loyal managers from making *efficient* investments.¹²⁸ Because some

124. *Id.*

125. *See supra* note 122 and accompanying text.

126. As early as 1999, corporate law scholars noted that “[i]nstitutional investors ha[d] gone from expressing intense criticism of this device[, the poison pill.] to challenging particular aspects of its operation, in addition to seeking mandatory removal of it from the arsenal of corporate defenses.” *See* John H. Matheson, *Corporate Governance at the Millennium: The Decline of the Poison Pill Antitakeover Defense*, 22 *HAMLIN L. REV.* 703, 704 (1999); *see also* Francis J. Aquila, *Adopting a Poison Pill in Response to Shareholder Activism*, *PRACTICAL L.* 22, 24–25 (2016).

127. *See, e.g.*, Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 *U. CHI. L. REV.* 973, 993 (2002) (arguing that “takeover threat provides managers with an important source of incentives to serve shareholders”). In today’s market, such a takeover would likely be dressed up as a “friendly” acquisition. *See, e.g.*, Tingting Liu & J. Harold Mulherin, *How Has Takeover Competition Changed over Time?*, 49 *J. CORP. FIN.* 104, 104 (2018) (“[W]e find that takeover competition across the entire auction process between deal initiation and completion has not declined. In effect, takeover competition via auctions has gone underground.”).

128. *See, e.g.*, Mark Humphery Jenner, *Takeover Defenses, Innovation, and Value Creation: Evidence from Acquisition Decisions*, 35 *STRATEGIC MGMT. J.* 668, 668 (2014) (finding that hard-to-value firms that have antitakeover provisions make acquisitions that generate more shareholder wealth and are more likely to increase corporate innovation); Thomas J. Chemmanur & Xuan Tian, *Do Antitakeover Provisions Spur Corporate Innovation? A Regression Discontinuity Analysis*, 53 *J. FIN. & QUANTITATIVE ANALYSIS* 1163, 1163 (2018) (“[Antitakeover provisions] help nurture innovation by insulating managers from short-term pressures arising from equity markets.”); Vivian Fang, Xuan Tian & Sheri Tice, *Does Stock Liquidity Enhance or Impede Firm Innovation?*, 69 *J. FIN.* 2085, 2085 (2014) (finding that liquidity impedes innovation because of increased exposure to hostile takeovers and higher presence of institutional investors); Mark S. Johnson & Ramesh P. Rao, *The Impact of Antitakeover Amendments on Corporate Financial Performance*, 32 *FIN. REV.* 659, 686–87 (1997) (finding that R&D expenditure increases with the adoption of antitakeover amendments because managers are less fearful of takeover attempts as a result of poor performance). A study that found the opposite result was criticized for using antitakeover *laws* as an exogenous event. *See* Julian Atanassov, *Do Hostile Takeovers*

visionary, hard-to-evaluate, or long-term investments are underpriced by the market, talented and loyal managers are often exposed to unjustified hostile takeovers.¹²⁹ Nonetheless, as shown below, common owners have more or less eliminated the use of the most potent antitakeover protections—poison pills and staggered boards—creating a chilling effect on investment levels.

a. Poison Pills. Poison pills restrict shareholders' right to sell to a hostile buyer, preventing potential raiders from taking over a company without board approval.¹³⁰ The poison pill, also known as a "shareholder rights plan," is a corporate device that allows a board of directors to make the purchase of the company's shares beyond a specified threshold prohibitively costly and thereby block hostile takeovers.¹³¹ Practically, selling to a raider who intends to replace the board amounts to a vote to fire the management. Thus, common owners see poison pills as entrenching boards and preventing shareholders from holding corporate managers accountable by

Stifle Innovation? Evidence from Antitakeover Legislation and Corporate Patenting, 68 J. FIN. 1097, 1097 (2013) (finding a decline in the number of patents and citations per patent for firms incorporated in states that pass antitakeover laws relative to firms incorporated in states that do not); Jonathan M. Karpoff & Michael D. Wittry, *Institutional and Legal Context in Natural Experiments: The Case of State Antitakeover Laws*, 73 J. FIN. 657, 668 (2018) (criticizing studies using the legislation of state antitakeover laws as a relevant event); Emiliano M. Catan & Marcel Kahan, *The Law and Finance of Antitakeover Statutes*, 68 STAN. L. REV. 629, 629 (2016) (providing additional analysis to explain why studies using antitakeover laws are flawed).

129. See, e.g., Jeremy Stein, *Takeover Threats and Managerial Myopia*, 96 J. POL. ECON. 61, 61 (1988) ("If stockholders are imperfectly informed, temporarily low earnings may cause the stock to become undervalued, increasing the likelihood of a takeover at an unfavorable price; hence the managerial concern with current bottom line."); Eitan Arom, *Hidden Value Injury*, 121 COLUM. L. REV. 937, 950–52 (2021) (arguing that markets may fail to factor long-term value information into short-term prices).

130. Effectively, poison pills stand between a willing seller—the shareholder—and a willing buyer—the tender offeror. See Scott Hirst, *The Wrong Prescription? Revisiting the Justification for Poison Pills*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 18, 2009), <https://corpgov.law.harvard.edu/2009/11/18/the-wrong-prescription-revisiting-the-justification-for-poison-pills> [<https://perma.cc/H2ZE-HUPA>].

131. Specifically, in adopting a pill, a company will issue rights to its stockholders that allow them to buy the company's stock at a substantial discount to the prevailing market price. These rights are triggered only if a stockholder buys enough stock to cross a specific ownership threshold of the company's total shares, such as 20 percent. Importantly, the pill voids any rights issued to the offending stockholder who crossed the threshold, so only other investors are allowed to buy discounted shares. This substantially dilutes the offending stockholder's ownership position, making it economically irrational to ever buy enough stock to cross the threshold in the first place. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill*, 114 COLUM. L. REV. 1549, 1570 (2014).

selling.¹³² Indeed, while poison pills became widely popular after Marty Lipton invented them in the 1980s,¹³³ they have since come under fire from institutional investors.¹³⁴ Not only do proxy advisors suggest voting against poison pills, but they also recommend voting against any *director* who votes to adopt one without shareholder approval.¹³⁵ Consequently, the 299 S&P 500 companies with poison pills in 2000 dwindled to 84 by 2009.¹³⁶

b. Staggered Boards. Staggered boards are elected in classes: a third of the board comes up for election each year, rather than all at once.¹³⁷ Accordingly, they protect corporate managers by preventing shareholders from replacing the entire board at once.¹³⁸ A shareholder who gains control of a company with a staggered board must wait for two rounds of annual director elections to gain a board majority.¹³⁹ Because of their entrenching effect, staggered boards have drawn the ire of common owners.¹⁴⁰ Consequently, institutional investors provided the momentum for the “de-staggering movement”¹⁴¹ that left

132. See Aquila, *supra* note 126.

133. David Futrelle, *Corporate Raiders Beware: A Short History of the “Poison Pill” Takeover Defense*, TIME (Nov. 7, 2012), <https://business.time.com/2012/11/07/corporate-raiders-beware-a-short-history-of-the-poison-pill-takeover-defense> [<https://perma.cc/CK5X-7X4Z>].

134. Appel et al., *Passive Investors*, *supra* note 81, at 114 (finding that companies with higher levels of index fund ownership were less likely to have takeover defenses or dual-class structures).

135. See Aquila, *supra* note 126, at 25.

136. Michael Useem, *The Ascent of Shareholder Monitoring and Strategic Partnering: The Dual Functions of the Corporate Board*, in THE SAGE HANDBOOK OF CORPORATE GOVERNANCE 136, 143 (Thomas Clarke & Douglas Branson eds., 2012).

137. See *Staggered Board of Directors*, THOMSON REUTERS: PRACTICAL L. (2020), <https://us.practicallaw.thomsonreuters.com/7-382-3831> [<https://perma.cc/4RS3-AA45>] (defining a staggered or classified board as a “board which is comprised of directors that have different overlapping, multi-year terms, so that not all of the directors’ terms expire in the same year”).

138. See Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501, 528 (2007) (concluding that “classified boards benefit management at the expense of shareholders” and “a movement toward greater accountability demands the destaggering of corporate boards”).

139. See *Carmody v. Toll Bros.*, 723 A.2d 1180, 1186 n.17 (Del. Ch. 1998) (noting that “a classified board would delay—but not prevent—a hostile acquiror from obtaining control of the board”).

140. See Guhan Subramanian, *Delaware’s Choice*, 39 DEL. J. CORP. L. 1, 13 (2014) (claiming that institutional investors dislike staggering boards because it leaves them with “little recourse” in the everyday course of business against specific directors that they wish to punish”).

141. Lucian Bebchuk, Scott Hirst & June Rhee, *Toward Board Declassification in 100 S&P 500 and Fortune 500 Companies: The SRP’s Report for the 2012 and 2013 Proxy Seasons*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 25, 2014), <https://corpgov.law.harvard.edu/2014/02/25/>

about 10 percent of the S&P 500 corporations with staggered boards in 2017,¹⁴² compared to 60 percent in 2002.¹⁴³

The mechanisms detailed above are by no means exhaustive of common owners' forty-year campaign for strong governance. However, these mechanisms and many others—pushed as part of a one-size-fits-all policy to strengthen corporate governance across the board¹⁴⁴—serve to subject managers to shareholders' will. Consequently, common owners have reshaped the corporate hierarchy, putting shareholders at the top. Part II shows how this fundamental shift has led to a downturn in investment, with inauspicious effects on U.S. workers.

II. STRONG GOVERNANCE AND LABOR MARKET MONOPSONY

The rise of common ownership has led to a troubling shift in the U.S. labor market. Even as workers became more and more productive, wages stopped growing.¹⁴⁵ Income inequality climbed to its highest levels since the Roaring Twenties,¹⁴⁶ while firms enjoyed blockbuster profits and growing profit margins.¹⁴⁷ Moreover, wage

toward-board-declassification-in-100-sp-500-and-fortune-500-companies-the-srps-report-for-the-2012-and-2013-proxy-seasons [https://perma.cc/Y6LH-8C89].

142. Matteo Tonello, *Corporate Board Practices in the Russell 3000 and S&P 500*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 18, 2020), <https://corpgov.law.harvard.edu/2020/10/18/corporate-board-practices-in-the-russell-3000-and-sp-500> [https://perma.cc/3QRT-3JGA] (“[C]lassified boards are still found at . . . 10.9 percent of S&P 500 companies (down from 15.4 percent in 2016) . . .”).

143. K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. FIN. ECON. 422, 422, 428 fig.1 (2017) (finding that “staggered boards promote value creation for some firms by committing the firm to undertaking long-term projects and bonding it to the relationship-specific investments of its stakeholders”).

144. See, e.g., Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 917 (2007) (describing how institutional shareholders, with the help of governance advisory firms, have developed a “one-size-fits-all model [that] essentially standardizes corporate governance and discourages company-specific (or even industry-specific) governance policies”).

145. See Simcha Barkai, *Declining Labor and Capital Shares*, 75 J. FIN. 2421, 2459 (2020) (“The decline in the labor share since the early 1980s measures the growing gap between labor productivity (which has continued to grow) and compensation (which has stagnated).”).

146. See *infra* note 215 and accompanying text.

147. See Barkai, *supra* note 145, at 2434 fig.3 (modeling firm “profit share”—profits over gross value added—to show it has grown at least since the 1980s). According to a Bloomberg opinion piece,

[t]he profit margin for the S&P 500 Index, or income as a percentage of revenue, swelled to 10.2 percent in 2018, the highest since 1990. The ratio of corporate profits as a percentage of GDP hit the highest on record in 2012, according to the U.S. Bureau of Economic Analysis, and that ratio has remained elevated.

elasticity—a measure of labor market competitiveness—has fallen over recent decades, suggesting that employers have cartelized the labor market.¹⁴⁸ So far, scholars who have pointed to common ownership as a cause of stagnating wages and rising income inequality have focused on product-market monopolies and concentration,¹⁴⁹ a theory that is highly debated.¹⁵⁰ Thus, despite the magnitude of the shift to common ownership, observers have failed to find a convincing explanation linking it to the struggling labor market.¹⁵¹ After all, if common owners were rigging the market—against either workers or consumers—one would think they would leave some traces.¹⁵² If common owners are indeed the source of labor market malaise, where is the evidence?

This Article provides a simple answer: because of their size and influence, common owners need not consciously *act* as a cartel to have a cartel’s effects. Instead, those effects flow naturally from common owners’ push for strong governance. Under strong governance, both loyal and disloyal managers will decrease investments for fear that shareholders will (mis)perceive their investments as inefficient pet projects.¹⁵³ Under a strong-governance regime, a rational manager—

Kaissar, *supra* note 2.

148. One set of researchers surveyed recent scholarship of wage elasticity and found that “even if one takes a conservative approach and believes the studies with weaker findings, it remains clear that monopsony causes considerable harm both to the economy and to workers.” Suresh Naidu, Eric A. Posner & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 536, 568 (2018) (reviewing the empirical data on mergers and suggesting an antitrust remedy).

149. See generally Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11 (testing industry and firm level data sets); Azar et al., *Anticompetitive Effects*, *supra* note 15 (“We conclude that a hidden cost—reduced product market competition—accompanies the private benefits of diversification and good governance.”).

150. See *infra* note 264 (citing studies debating common ownership theory).

151. See Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 108 n.24 (noting that “the exact mechanisms through which common ownership reduces competition remain to be identified”).

152. See Hemphill & Kahan, *supra* note 39, at 1426 (noting that the anticompetitive effects of common ownership, “if important in practice, would leave a visible trace”).

153. The main task of a firm’s CEO is selecting investment projects that maximize the value of the firm. However, a central tenet in the agency theory is that some investment projects deliver pecuniary or nonpecuniary private benefits to the CEO and drive a wedge between the incentives of managers and shareholders. In such cases, the CEO might select a project that maximizes his or her private benefits but not the firm’s value. The literature in corporate governance has pegged such inefficient investments as CEO pet projects. For an illustration of such projects, see generally, for example, Paul H. Décaire & Denis Sosyura, CEO Pet Projects (Apr. 9, 2021) (unpublished manuscript), http://ssrn.com/abstract_id=3747263 [<https://perma.cc/3HNJ-KJW2>].

regardless of loyalty—will distribute profits instead of investing them in either innovative or long-term projects (loyal managers) or in pet projects (disloyal managers) to avoid running afoul of shareholders and risking termination.¹⁵⁴ By pushing firms toward strong governance, common owners thus create an investment shortfall.¹⁵⁵ Less investment means less hiring¹⁵⁶; less hiring means lower labor demand¹⁵⁷; lower labor demand leads to stagnant wages. Thus, common owners’ push for strong governance has exacerbated—if not altogether caused—the last forty years of labor market stagnation.

The previous Part shows how the market has shifted from retail to primarily common ownership and how common owners have brought on an era of strong governance. This Part shows that strong governance holds wages below their competitive level, effectively denying workers the fruits of their labor. The empirical evidence for the monopsony effect can be broken into two categories: evidence that strong governance has led to an investment shortfall and evidence that the labor market has become less competitive due to common owners’ influence. Part II.A addresses the former, examining the evidence that strong governance depresses investment. Part II.B looks at the latter, showing how stagnant wages and rising income inequality can be attributed directly to common owners. Together, these empirical findings supply a comprehensive explanation for rising inequality and stagnating wages over the past four decades.

154. See *infra* Part II.A.1.

155. See, e.g., Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 89 (finding that the lack of investment represents a reluctance to invest despite high Tobin’s Q (a measure of profitability) and that the investment wedge is linked to the rise of intangibles, decreased competition, and changes in governance that encourage payouts instead of investment).

156. See Belo et al., *supra* note 26, at 138 (reporting that “the hiring and investment rates are positively correlated”). Indeed, investment in technology and innovation can decrease employment (say, the development of a robot). This is the essence of the theory associating technology and intangible assets with decreased investment and labor share. However, an empirical study has found that this effect can only explain a third of the drop in investment. Germán Gutiérrez & Thomas Philippon, *Ownership, Concentration, and Investment*, 108 AEA PAPERS & PROC. 432, 436 (2018) [hereinafter Gutiérrez & Philippon, *Ownership, Concentration, and Investment*]. This Article contends that the rest is explained by common ownership and governance.

157. See generally Daniel S. Hamermesh, *New Measures of Labor Cost: Implications for Demand Elasticities and Nominal Wage Growth* (Nat’l Bureau of Econ. Rsch., Working Paper No. 821, 1981), <https://www.nber.org/papers/w0821> [<https://perma.cc/3ZVJ-BRF7>] (measuring labor elasticity, or the responsiveness of labor prices to labor demand).

A. *Strong Governance and Investment*

Prior to the rise of institutional investors, directors and officers ran corporations more or less exactly how they saw fit. The poster children of this era were domineering corporate leaders such as longtime Chrysler chief Lee Iacocca, whose surname was famously said to be an acronym for “I Am Chairman Of Chrysler Corporation Always.”¹⁵⁸ Managers like Iacocca were free to build empires and hoard private benefits of control, or otherwise nurture bold visions of the future and undertake daring investments.¹⁵⁹ As ownership concentrated in the hands of powerful institutional shareholders with the wherewithal to oversee corporate affairs,¹⁶⁰ managers became less likely to invest. This Section first examines the mechanism by which strong governance decreases investment and next details the empirical evidence that it indeed has had that effect.

1. *The Manager’s Dilemma: To Invest, or Not to Invest?* Generally, managers face a choice between two options: reinvest surplus cash in projects that will hopefully pay off later, or distribute that surplus to shareholders in the form of dividends and share buybacks.¹⁶¹ When shareholders do not interfere, managers can decide based on their conscience and best judgment. Loyal managers will make beneficial, efficient investments, and disloyal managers will make self-serving, inefficient investments and consume private benefits.¹⁶² However,

158. *‘I Am Chairman Of Chrysler Corporation Always’: 8 Facts About Lee Iacocca*, REUTERS (July 2, 2019), <https://www.reuters.com/article/us-people-lee-iacocca-facts/i-am-chairman-of-chrysler-corporation-always-8-facts-about-lee-iacocca-idUSKCN1TY06X> [<https://perma.cc/YU L9-SEKM>].

159. See Roe, *supra* note 55, at 14 (describing the criticism that, under dispersed ownership, “[m]anagers build empires and pursue bad strategies without shareholder intervention until matters are so out-of-hand that the violence of the hostile takeover or the instability of the leveraged buyout results”).

160. See Gilson & Gordon, *supra* note 41, at 865 (noting that, because of the concentration of ownership in the hands of a few financial institutions, “the Berle-Means premise of dispersed share ownership is now wrong”).

161. See William Lazonick, *Profits Without Prosperity*, HARV. BUS. REV. (Sept. 2014), <https://hbr.org/2014/09/profits-without-prosperity> [<https://perma.cc/4VFX-6WD6>] (describing how the “retain-and-reinvest” approach to corporate resource allocation gave way to a “downsize-and-distribute” approach (emphasis omitted)).

162. See, e.g., Jarrad Harford, Sattar A. Mansi & William F. Maxwell, *Corporate Governance and Firm Cash Holdings in the US*, 87 J. FIN. ECON. 535, 535 (2008) (finding that in the United States, weakly controlled managers choose to spend cash quickly on acquisitions and capital expenditures, rather than hoard it); Matthew T. Billett, Jon A. Garfinkel & Yi Jiang, *The*

when shareholders are breathing down managers' necks, this choice is much more fraught. An investment that causes shareholders to doubt a CEO's loyalty could cost the CEO's job.¹⁶³ Under strong governance, then, managers will disproportionately choose to distribute profits.¹⁶⁴

Key to this insight is the fact that shareholders are imperfect judges of manager performance and loyalty: being human, they will sometimes make mistakes.¹⁶⁵ Even sophisticated investors can mistake a competent and loyal manager for an incompetent and disloyal one. Steve Jobs' early tenure at Apple is illustrative.¹⁶⁶ Jobs was the company's visionary but was notoriously difficult to work with, and he lost his job after the board of directors sided against him and with the CEO. More than a decade later, he took back the company's helm as it teetered on the edge of bankruptcy and reasserted Apple's tech dominance by releasing the iMac.¹⁶⁷ Even sophisticated and deeply informed *directors* with a real stake in Apple's continuing performance were wrong about Jobs: despite his domineering attitude and exacting

Influence of Governance on Investment: Evidence from a Hazard Model, 102 J. FIN. ECON. 643, 643 (2011) (finding that poor governance associates with overinvestment).

163. See, e.g., Heitor Almeida, Vyacheslav Fos & Mathias Kronlund, *The Real Effects of Share Repurchases*, 119 J. FIN. ECON. 168, 168 (2016) (finding that managers are willing to trade off investments and employment for stock repurchases that allow them to meet analyst earning-per-share forecasts); Huasheng Gao, Jarrad Harford & Kai Li, *CEO Turnover-Performance Sensitivity in Private Firms*, 52 J. FIN. & QUANTITATIVE ANALYSIS 583, 583 (2017) (finding that CEOs in public firms have higher turnover rates and exhibit greater turnover-performance sensitivity than in private firms, mainly due to investors' myopia).

164. See Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 104 (showing that firms with higher passive institutional ownership have higher payouts and lower investment); Todd A. Gormley & David A. Matsa, *Playing It Safe? Managerial Preferences, Risk, and Agency Conflicts*, 122 J. FIN. ECON. 431, 432 (2016) (arguing that managers are motivated by their career concerns to "play it safe" by taking on less risk—and thus lower return—than shareholders would prefer in order to avoid being fired); Pornsit Jiraporn, Jang-Chul Kim & Young Sang Kim, *Dividend Payout and Corporate Governance Quality: An Empirical Investigation*, 46 FIN. REV. 251, 275 (2011) (showing that "firms with better governance quality" disproportionately distribute profits instead of reinvesting them).

165. See Goshen & Squire, *supra* note 23, at 803 ("[I]nvestors could misattribute disloyalty, bad measurements, or bad luck to incompetence, and then generate principal costs by firing a competent manager."); Roe, *supra* note 55, at 13–14 ("[D]ispersed investors cannot cheaply distinguish egoistic empire-building from a high net present value project.").

166. See Matt Weinberger, *This Is Why Steve Jobs Got Fired from Apple—and How He Came Back To Save the Company*, BUS. INSIDER (July 31, 2017, 2:17 PM), <https://www.businessinsider.com/steve-jobs-apple-fired-returned-2017-7> [<https://perma.cc/N5Y2-ZYHK>].

167. *Id.*

attention to detail, he was a good bet.¹⁶⁸ In their capacity as *shareholders*, managers of institutional investors spread their attention across thousands of portfolio corporations and, consequently, are even more likely to make these types of mistakes than Apple's onetime directors.¹⁶⁹

By reducing investments and increasing payouts, disloyal (loyal) managers decrease the possibility they will be perceived (misperceived) as disloyal and fired. Even for loyal managers, undertaking a complex, long-term, or innovative investment project introduces a chance of failure, reprimand, and removal.¹⁷⁰ Thus, under strong governance, CEOs will rationally choose to distribute profits instead of taking a career risk by reinvesting them.¹⁷¹

By contrast, the managers of weak-governance firms do not have to worry about being removed by shareholders, whether in response to an inefficient investment or to a bold, visionary one. Another tech company—Facebook (now Meta)—illustrates this point. In 2019, Facebook's Chairman and CEO, Mark Zuckerberg, introduced the cryptocurrency project Libra as an important new objective for the company and a revolution in digital finance. Critics saw it as a pet project with no apparent benefits to the company.¹⁷² The same month that Facebook announced Libra, outside investors attempted to strip Zuckerberg of the chairmanship as a check on his leadership. More than two-thirds of outside investors voted in favor of the move.¹⁷³ However, while Zuckerberg owned only a small minority of Facebook's economic value, he held 58 percent of its voting power by

168. See Goshen & Hamdani, *supra* note 23, at 580 (citing Jobs as an example of idiosyncratic vision being inefficiently disrupted by shareholders).

169. John C. Wilcox & Morrow Sodali, *Getting Along with BlackRock*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 6, 2017), <https://corpgov.law.harvard.edu/2017/11/06/getting-along-with-blackrock> [<https://perma.cc/CG78-GRQU>] (noting that BlackRock's "Investment Stewardship" team of thirty employees votes in about 17,000 shareholder elections and meets with 1500 companies each year).

170. See Goshen & Squire, *supra* note 23, at 786–87.

171. See *supra* note 164.

172. See Lionel Laurent, Opinion, *Facebook's Answer to Bitcoin Poses a Double Threat*, BLOOMBERG (June 17, 2019, 9:00 AM), <https://www.bloomberg.com/opinion/articles/2019-06-17/facebook-libra-crypto-currency-is-another-zuckerberg-threat> [<https://perma.cc/SRA8-UVFU>] (noting that the "bid to launch an online payments revolution carries plenty of risks, from antitrust concerns to the threat that it might pose to financial stability").

173. See Betsy Atkins, *Facebook Strong Arms Investors Who Want Zuckerberg Out*, FORBES (June 7, 2019, 3:30 PM), <https://www.forbes.com/sites/betsyatkins/2019/06/07/facebook-strong-arms-investors-who-want-zuckerberg-out/#37f0d85b5901> [<https://perma.cc/4BSX-9BAX>].

virtue of a dual-class structure and easily blocked the measure.¹⁷⁴ Of course, only time will reveal who was right. Still, the Libra saga illustrates that in weak-governance firms such as Facebook, managers can invest in projects they see as worthwhile without worrying that shareholders might disagree—and fire them.

Indeed, dual-class structures employed by many technology corporations are the strongest form of weak governance.¹⁷⁵ However, weak governance can insulate managers even within the more common one-share-one-vote structure. One such illustration is the famous attempt of Air Products to take over Airgas in 2010 for \$5 billion. Despite the major support among Airgas shareholders for the takeover bid, Airgas management resisted the takeover using an antitakeover defense that combined a poison pill and a staggered board, which effectively meant that an acquirer needed to win two consecutive proxy contests in order to effect a hostile takeover.¹⁷⁶ Air Products challenged these measures in court, but the Delaware chancery court approved them.¹⁷⁷ Airgas continued with its business strategy as an independent corporation, and in 2015, it was sold for \$10 billion, twice as much as the takeover price.¹⁷⁸

In sum, because shareholders can easily remove managers under strong governance, those managers generally will refrain from investing and choose to distribute excess cash instead. In weak-governance companies, managers can invest according to their business sense and conscience (loyal or disloyal) without worrying about discipline from shareholders and thus are likely to invest more. This logic predicts that, by moving firms *en masse* toward strong governance, common owners will create an investment shortfall. Indeed, the following subsection shows that they have done just that.

174. *Id.*

175. Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litov, *The Rise of Dual-Class Stock IPOs*, 144 J. FIN. ECON. 122, 123 (2022) (documenting and explaining the rise of dual-class IPOs in recent years).

176. See Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 904 (2002) (describing the combined effect of poison pills and staggered boards and testing their effect on insulating management).

177. *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 55 (Del. Ch. 2011).

178. Leslie Picker, *Why Airgas Was Finally Sold, for \$10 Billion Instead of \$5 Billion*, N.Y. TIMES (Sept. 5, 2016), <https://www.nytimes.com/2016/09/06/business/dealbook/why-airgas-was-finally-sold-for-10-billion-instead-of-5-billion.html> [<https://perma.cc/2BVC-EXRW>].

2. *Strong Governance and the Investment Shortfall.* The investment shortfall affects many types of corporate activities—such as less investment in research and development (“R&D”), fewer new factories, and fewer new stores and branches—all of which will lead to less hiring. Different measures track the beginning of the investment shortfall to different periods. The investment growth rate as a portion of the U.S. GDP has fallen since 1980.¹⁷⁹ Investment relative to firms’ profitability has declined since the middle of the 1990s¹⁸⁰ or, at the latest, since 2000.¹⁸¹ Notably, the latter study linking common ownership to decreased investment claimed it has shown *causation*.¹⁸² Rather than reinvest profits, firms have increasingly distributed them to shareholders, including through share buybacks.¹⁸³ Moreover, in industries with high proportions of common ownership, one study found that “firms spend a disproportionate amount of free cash flows buying back their shares.”¹⁸⁴ In sum, firms are investing less than they once did *because of common owners’ influence*.

179. *Total Investment (% of GDP)*, WORLD BANK, https://tcdata360.worldbank.org/indicators/inv.all.pct?country=USA&indicator=345&viz=line_chart&years=1980,2024 [<https://perma.cc/P9QP-3YFZ>]; Jordan Brennan, *Rising Corporate Concentration, Declining Trade Union Power, and the Growing Income Gap: American Prosperity in Historical Perspective* 12 fig.3 (Feb. 2016) (unpublished manuscript), http://www.levyinstitute.org/pubs/e_pamphlet_1.pdf [<https://perma.cc/6EBV-ZLB9>].

180. Lee and coauthors find that the decline had already started in the middle of the 1990s. See Dong Lee, Han Shin & René M. Stulz, *Why Does Capital No Longer Flow More to the Industries with the Best Growth Opportunities?* 0 (Nat’l Bureau of Econ. Rsch., Working Paper No. 22924, 2016), <https://www.nber.org/papers/w22924> [<https://perma.cc/JT74-LGD7>] (showing that since the middle of the 1990s, firms in high-Q industries increasingly repurchase shares and decrease capital expenditures).

181. See Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 89.

182. *Id.* at 131 (finding that higher quasi-indexer common ownership leads to higher buybacks and less investment).

183. See *id.*; Kathleen Kahle & René M. Stulz, *Why Are Corporate Payouts So High in the 2000s?* 0 (Nat’l Bureau of Econ. Rsch., Working Paper No. 26958, 2020), <https://www.nber.org/papers/w26958> [<https://perma.cc/TB33-U9B6>] (finding that inflation-adjusted amount paid out through dividends and repurchases by public industrial firms was three times larger from 2000 to 2019 than from 1971 to 1999); Ian Strauss & Jangho Yang, *The Global Investment Slowdown: Corporate Secular Stagnation and the Draining of the Cash Flow Swamp* 0 (Oxford Martin Programme on Tech. & Econ. Change, Working Paper No. 2019-5, 2019), <https://www.oxfordmartin.ox.ac.uk/downloads/academic/The-Global-Investment-Slowdown.pdf> [<https://perma.cc/C8EE-ET87>] (finding that firms “are increasingly net external ‘releasers’ of funds to shareholders, creditors, and bondholders, reflecting cross-cutting exogenous factors creating a chronic excess of cash flow over weakening investment opportunities”).

184. Germán Gutiérrez & Thomas Philippon, *Declining Competition and Investment in the U.S.* 1 n.1 (Nat’l Bureau of Econ. Rsch., Working Paper No. 23583, 2017), <https://www.nber.org/papers/w23583> [<https://perma.cc/G87B-3R3U>].

Additional empirical studies support the claim that companies are reducing investments because of the influence of strong governance.¹⁸⁵ Increased shareholder rights are associated with lower capital expenditures¹⁸⁶ and less R&D spending.¹⁸⁷ More recent studies have confirmed the negative correlation between strong governance and investment, finding, as one example, that strong-governance firms less frequently make large investments.¹⁸⁸ In short, firms with strong governance invest less.¹⁸⁹

Declining investment has had profound economic consequences. Lower investment across the board means less hiring, and less hiring means lower wages. The following Section shows how reduced investment has created a wage monopsony, taking money out of the pockets of workers and putting it into the hands of shareholders.

B. Strong Governance and Wage Stagnation

The previous Section shows how strong governance has created an investment shortfall, which naturally reduces hiring. As investment declined compared to GDP,¹⁹⁰ the percentage of the U.S. workforce working for public firms has fallen sharply from more than 40 percent

185. The discussion above excludes the effects of governance on mergers and acquisitions because while strong governance decreases inefficient *buying* of other corporations (a demand side effect), it increases efficient *selling* of corporations (a supply side effect). It is inconclusive which effect dominates. Moreover, the welfare effects of mergers are also unresolved. See Bronwyn H. Hall, *The Effect of Takeover Activity on Corporate Research and Development*, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 69, 70 (Alan J. Auerbach ed., 1988) (“The question whether increased merger activity is a good thing for the economy in general remains unresolved and unlikely to be resolved by focusing solely on the experience of the firms involved.”).

186. Paul Gompers, Joy Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107, 133–34 (2003).

187. See Florence Honoré, Federico Munari & Bruno van Pottelsberghe de La Potterie, *Corporate Governance Practices and Companies’ R&D Intensity: Evidence from European Countries*, 44 RSCH. POL’Y 533, 541 (2015) (finding that strong-governance measures are negatively correlated with R&D intensity and are detrimental to long-term R&D investments); Tao-Hsien Dolly King & Min-Ming Wen, *Shareholder Governance, Bondholder Governance, and Managerial Risk-Taking*, 35 J. BANKING & FIN. 512, 513 (2011); *supra* note 128 and accompanying text.

188. Billett et al., *supra* note 162, at 644 (“[W]eak shareholder protection (managerial entrenchment)[] associates with more frequent investment spikes.”).

189. See Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 121, 122 tbl.3 (estimating that common ownership and governance explain 80 percent of the reduced investment effects).

190. See *supra* note 179 and accompanying text.

in 1973 to 29 percent in 2019.¹⁹¹ This Section looks at the evidence linking common ownership to wage stagnation.

The monopsony effect makes a powerful set of predictions that are borne out in labor market data.¹⁹² In particular, it predicts that under common ownership, even when workers become more productive, firms will still refrain from increased hiring because the strong-governance regime makes investing (hiring) risky for managers.¹⁹³ Hiring and wages will remain low even as marginal productivity rises, with shareholders capturing the difference. In short, the monopsony effect predicts wages will not increase as much to reflect the higher productivity while shareholder returns grow—a prediction borne out in macroeconomic data.

Recently, Professor José Azar and his co-authors tested the relationship and causation between common ownership, wages, and employment. They have found that “an increase in common ownership in a labor market is associated with decreases in both wages per employee and the employment-to-population ratio.”¹⁹⁴ Moreover, they have conducted an event study using the acquisition of Barclays Global Investors by BlackRock in 2009—which made BlackRock the world’s biggest asset manager¹⁹⁵—and found that “markets that were more affected by the acquisition experienced post-acquisition decreases in annual wages per employee and employment-to-population.”¹⁹⁶ This is direct evidence supporting our model describing the transmission mechanism between common ownership and wage stagnation.

Similarly, using confidential establishment-level data from the U.S. Census Bureau’s Longitudinal Business Database from 1982–2015, Antonio Falato and his co-authors. found that “firms owned by

191. Schlingemann & Stulz, *supra* note 19.

192. For one study offering an alternative explanation of the data focused on the decline of “worker power,” see Anna Stansbury & Lawrence H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy* 2–3, 6–7 (Nat’l Bureau of Econ. Rsch., Working Paper No. 27193, 2020), <https://www.nber.org/papers/w27193> [<https://perma.cc/68KH-WY8B>]. However, because the study defined “worker power” as the product of de-unionization and changes in *corporate ownership*, *see id.* at 2, it partially overlaps with the explanation of this Article.

193. *See supra* Part II.A.1.

194. Azar et al., *supra* note 33.

195. Svea Herbst-Bayliss, *BlackRock To Buy BGI, Becomes Top Asset Manager*, REUTERS (June 11, 2009, 7:48 PM), <https://www.reuters.com/article/us-blackrock-barclays/blackrock-to-buy-bgi-becomes-top-asset-manager-idUSTRE55B06X20090612> [<https://perma.cc/5TKG-H9EN>].

196. Azar et al., *supra* note 33.

larger and more concentrated institutional shareholders have lower employment and payroll” and that “[t]he labor losses are accompanied by higher shareholder returns.”¹⁹⁷ This is additional direct evidence supporting our model.

Moreover, the so-called “productivity-pay gap” provides further damning evidence of the monopsony effect.¹⁹⁸ Before the 1980s, the higher their marginal output, the more workers were paid—that is, the more revenue they netted for their employers, the more money they took home.¹⁹⁹ At about the same time common owners came on the scene, productivity and wages began to diverge.²⁰⁰ Since then, wages and productivity have drifted apart, a telltale sign of anticompetitive labor pricing.²⁰¹ One study estimates that labor has become four-and-a-half times more productive in the last forty years while wages stalled.²⁰²

With wages flatlining and worker productivity rising, common owners are taking a bigger and bigger cut of corporate revenue. Profits-per-worker have grown year-over-year since at least the 1980s, but they have accrued to shareholders rather than workers. In 2014, companies captured \$14,600 more in profits for each worker than they did in 1980—an increase in corporate profits totaling \$1.2 trillion.²⁰³ And workers got the short end of the stick. Median hourly wages rose just 0.2 percent annually between 1979 and 2013, and more specifically, between 2000 and 2013, hourly wages of the vast majority of workers either fell (bottom 30 percent) or were essentially flat (next 40

197. See Falato et al., *supra* note 32.

198. Cf. *The Productivity–Pay Gap*, ECON. POL’Y INST., <https://www.epi.org/productivity-pay-gap> [<https://perma.cc/DA5U-R5MM>], (last updated Aug. 2021) (“From 1979 to 2020, net productivity rose 61.8%, while the hourly pay of typical workers grew far slower—increasing only 17.5% over four decades (after adjusting for inflation).”).

199. See Barkai, *supra* note 145 (“Labor compensation in the U.S. economy used to track labor productivity. Up until the 1980s, increases in labor productivity were accompanied by equally sized increases in labor compensation.”).

200. See *id.* (“The decline in the labor share since the early 1980s measures the growing gap between labor productivity (which has continued to grow) and compensation (which has stagnated).”). For a discussion of market concentration as a possible cause of the productivity-pay gap, see *infra* Part III.E.3.

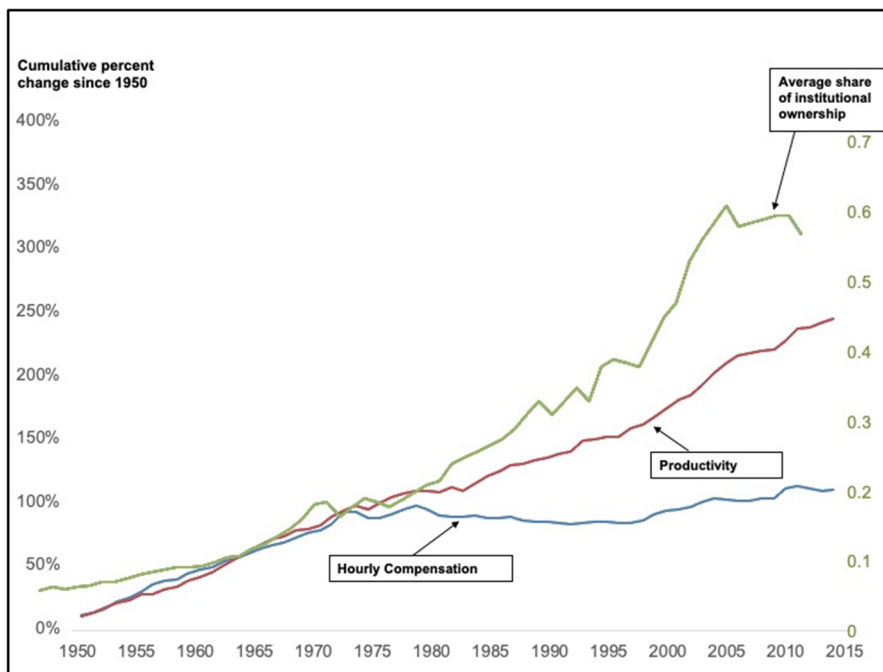
201. See Barkai, *supra* note 145, at 2460.

202. Abdul A. Erumban & Klaas de Vries, *Wage-Productivity Growth Gap: An Analysis of Industry Data* 14–15 (Conf. Bd. Econ. Program, Working Paper No. 16-01, 2016), https://www.conference-board.org/pdf_free/workingpapers/EPWP1601.pdf [<https://perma.cc/5EQV-NJUH>].

203. See Barkai, *supra* note 145, at 2423.

percent).²⁰⁴ In short, while workers are bringing greater returns to their employers, shareholders are taking a larger and larger cut of each corporate dollar, suggesting that common owners have the market power to reduce hiring and keep wages down.²⁰⁵

Figure 1 puts this finding in stark relief: as the average percentage of shares held by common owners passed the 20 percent mark in the late 1970s, compensation and productivity, both of which had previously risen in concert, decoupled from each other, leaving workers providing increasing economic value to corporations as their hourly compensation has stagnated.



204. See BIVENS ET AL., *supra* note 1, at 5.

205. In aggregate, this trend is captured by the labor share of income—the portion of annual economic output that goes to labor as opposed to capital. After holding more or less steady since World War II, that figure saw a significant decline since the 1980s, from 64 percent to 58 percent, driven by a decrease in earnings for the lowest earners. Michael W.L. Elsby, Bart Hobijn & Ayşegül Şahin, *The Decline of the U.S. Labor Share*, BROOKINGS PAPERS ON ECON. ACTIVITY, Fall 2013, at 2.

Figure 1. Common Ownership, Productivity, and Hourly Compensation²⁰⁶

To see how a rising pay-productivity gap suggests a labor monopsony,²⁰⁷ imagine a market where wages and marginal productivity are initially equal at x , but productivity rises to $2x$. In a competitive economy, firms would compete to hire up workers until wages rose to $2x$, at which point wages would equal marginal product, and firms would stop hiring.²⁰⁸ However, under a monopsony, firms could refrain from hiring in order to keep wages at or near x and pocket the difference.

Hedge fund activism provides a vivid example of how strong-governance mechanisms allow shareholders to capture value from workers. Being a strong-governance mechanism, hedge fund activism campaigns supported by institutional investors reduce investments, either by cutting inefficient investments of disloyal managers²⁰⁹ or deterring efficient investments of loyal managers.²¹⁰ These campaigns often lead to layoffs and other spending cuts,²¹¹ and wages at target firms stagnate even as productivity increases.²¹² The firm gets more profitable, shareholders get richer, and workers get—you guessed it—*nothing*.

The monopsony theory makes one final prediction: rising income inequality.²¹³ By holding wages below their competitive rates, the labor

206. In Figure 1, we combined the data from Gutiérrez & Philippon, *Investment-less Growth (Working Paper Version)*, *supra* note 15, and the data from Poterba & Samwick, *supra* note 62, with data from BIVENS ET AL., *supra* note 1.

207. See Naidu et al., *supra* note 148, at 556 (explaining that a monopsonist will set wages below marginal revenue).

208. *Id.* (“In a competitive labor market, firms equate the going wage of workers to their ‘marginal revenue product,’ the amount of additional revenue the worker can generate.”).

209. See Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1087, 1093 (2015) (describing the changes that activists request that corporations will adopt, including reducing long-term investments).

210. See, e.g., John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 605–06 (2016) (describing the activist hedge fund practice of slashing research and development in pharmaceutical industry targets).

211. See DesJardine & Durand, *supra* note 120, at 1070–72.

212. Alon Brav, Wei Jiang & Hyunseob Kim, *The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes*, 28 REV. FIN. STUD. 2723, 2753 (2015) (“[O]n average, workers at target firms do not share in the improvements associated with hedge fund activism. They experience stagnation in wages, while their productivity improves significantly.”).

213. The focus of this Article is on inequality between wage-earners and capital-earners and not between different classes of wage-earners. For the latter, see Jae Song, David J. Price, Fatih

monopsony shifts wealth from labor-earners to capital-earners, who tend to already be wealthier.²¹⁴ Like Robin Hood in reverse, it steals from the poor and gives to the rich. Indeed, it hardly needs to be recounted here that income inequality has reached historic rates. The wealth-to-income ratio—a measure of economic wealth captured by the highest earners—has skewed sharply upward, doubling between 1970 and 2010 and appearing to return to its 1920 level.²¹⁵ Similarly, the income Gini index, which measures the degree of income inequality, has consistently risen from about 36.6 percent in 1979 to 44.8 percent in 2016, a record high.²¹⁶

This Part has outlined the *empirical* evidence that common ownership contributes to wage stagnation and economic inequality. The following Part lays out the *theory* behind these effects. In particular, it presents a stylized economic model that explains the connection between wages and governance—and shows how common owners act, inadvertently or not, to break that connection and profit from decreased wages.

III. WAGE AND GOVERNANCE: BREAKING THE COMPETITIVE EQUILIBRIUM

To better understand common ownership and the monopsony effect, this Part outlines how common owners disrupt the relationship between wages and governance structure. Part III.A models how shareholders' choice between weak and strong governance affects managers' investment decisions. Part III.B explains how the wage rate depends on which governance structures shareholders choose. Part III.C outlines the competitive equilibrium and explains that even though it imposes management agency costs on shareholders, it maximizes social welfare. Part III.D explains how common owners

Guvenen, Nicholas Bloom & Till von Wachter, *Firming Up Inequality*, 134 Q.J. ECON. 1, 1 (2019) (finding earning inequality between high-wage and low-wage workers).

214. See Naidu et al., *supra* note 148, at 537 (arguing that labor monopsony “reduces the incomes of workers relative to those of people who live off capital, and the latter are almost uniformly higher earners than the former”).

215. Thomas Piketty & Gabriel Zucman, *Capital Is Back: Wealth-Income Ratios in Rich Countries 1700–2010*, 129 Q.J. ECON. 1255, 1257, 1259 fig.IV (2014).

216. Kaissar, *supra* note 2; James Elwell, Kevin Corinth & Richard V. Burkhauser, *Income Growth and Its Distribution from Eisenhower to Obama: The Growing Importance of In-Kind Transfers (1959-2016)*, at 43 tbl.2, col.5 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26439, 2019), <https://www.nber.org/papers/w26439> [<https://perma.cc/AJW5-MZFM>].

break the competitive equilibrium and create a labor monopsony. Finally, Part III.E compares the explanatory power of the common ownership monopsony theory with other alternative theories.

A. *Corporate Governance: The Risk of Management Disloyalty*

Shareholder exposure to manager disloyalty depends on the governance structure they choose. Weak governance increases the risk of manager disloyalty, as managers can invest inefficiently and expropriate private benefits without being disciplined by shareholders. Strong governance minimizes this risk, as shareholders can hold disloyal managers accountable.²¹⁷ However, as explained above, weak or strong governance will have parallel effects on *loyal* managers.²¹⁸ Weak governance increases the incentive for both loyal and disloyal managers to invest, while strong governance decreases that incentive. The choice between strong and weak governance thus depends both on the probability and cost of management disloyalty and the relative gains from investing. In the absence of common ownership, each firm's shareholders will make governance choices the same way they would make any other decision: which option will maximize the corporation's value? In other words, shareholders will choose between weak and strong governance based on which structure increases their expected returns.

A stylized economic model serves to illustrate this choice.²¹⁹ Assume a market with one hundred corporations where none of the corporations has market power over either products or resources.²²⁰ Shareholders—without market power over ownership of firms²²¹—must choose a governance structure for their respective corporations.

217. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 323–28 (1976) (describing how shareholders can invest in monitoring and bonding to reduce the cost of manager disloyalty).

218. See *supra* Part II.A.1.

219. The model presented here draws on the work of Goshen and Levit, *supra* note 22, at 4.

220. That is, firms are price takers inasmuch as they hire at the competitive rate determined by the market. See David W. Berger, Kyle F. Herkenhoff & Simon Mongey, *Labor Market Power* 10 (Nat'l Bureau of Econ. Rsch., Working Paper No. 25719, 2019), <http://www.nber.org/papers/w25719> [<https://perma.cc/5WLS-ZCPE>] (noting that all firms in a competitive equilibrium are price takers).

221. See *Market Power*, OECD GLOSSARY OF STATISTICAL TERMS, <https://stats.oecd.org/glossary/detail.asp?ID=3256> [<https://perma.cc/G3AR-C73G>], (last updated Mar. 16, 2002) (“Market power refers to the ability of a firm (or group of firms) to raise and maintain price above the level that would prevail under competition . . .”).

Of course, corporate governance is a spectrum of structures allocating various levels of control between shareholders and managers.²²² However, for simplicity, assume that only two poles of governance structures are available for shareholders²²³: either they can easily fire a manager (“strong governance”), as in dispersed-ownership firms without staggered boards or poison pills,²²⁴ or they cannot fire a manager (“weak governance”), as in dual-class firms²²⁵ where public shareholders own low-voting shares.²²⁶ Shareholders want to hire only loyal managers but cannot distinguish between loyal and disloyal CEOs.²²⁷ Suppose, further, that half of all candidates for the CEO job are loyal and half are disloyal.²²⁸

Managers, once hired, face a discrete set of investment decisions. They can either choose project A or project B. Both require the firm to spend \$1 million to hire a team of workers. Project A is a good investment. At the end of the project, it will yield \$1.5 million, representing \$500,000 in profits after accounting for the \$1 million in labor costs—a 50 percent profit. Project B is a pet project that allows the manager to travel in style, hire relatives, elevate their social status, and so on. It will yield an expected value of \$500,000, representing \$500,000 in losses after accounting for the \$1 million investment—a 50 percent loss. However, these investments take time to pan out, and initially, shareholders cannot easily tell the difference between the two. Both cost \$1 million and otherwise resemble each other, so shareholders cannot tell whether managers have invested in the good project, A, or the bad project, B, until it is too late.

222. See Goshen & Squire, *supra* note 23, at 805 (explaining the concept of corporate governance as a spectrum, rather than a binary).

223. The model’s conclusions will not change if shareholders can choose any governance structure along the spectrum between weak and strong governance. See Goshen & Levit, *supra* note 22, at 27–28.

224. See *supra* Part I.B.3.

225. See, e.g., *supra* notes 172–174 and accompanying text (discussing how equity majority owners were unable to remove Zuckerberg due to Facebook’s dual-class structure).

226. For simplicity, we use the two poles of the governance spectrum. However, as mentioned, the model’s conclusions will not change if shareholders can choose any governance structure along the spectrum between weak and strong governance. See *supra* note 223.

227. See Goshen & Squire, *supra* note 23, at 770 (“When investors exercise control, they make mistakes due to a lack of expertise, information, or talent, thereby generating principal competence costs.”).

228. Of course, this represents an uncharitable view of human nature. As will be shown in the following part, the model will work the same way with any proportion. See *infra* Part III.B.

Managers face a third option: do nothing. They can run the company as usual, make no new investments, and distribute to the shareholders the \$1 million that would otherwise be spent on labor. While shareholders cannot distinguish between projects A and B, they can distinguish between a manager who invests and one who distributes free cash.

Shareholders now must choose between strong and weak governance given the risk that they will hire a disloyal manager who will select project B. Shareholders that choose weak governance face a 50 percent chance of disloyalty: If they hire a loyal manager (50 percent chance), she will invest in project A, generating \$500,000 in profits for the firm. If they hire a disloyal manager (50 percent chance), she will invest in project B, generating \$500,000 in losses. The expected value²²⁹ of choosing weak governance, then, is zero.²³⁰

If shareholders choose strong governance, however, managers are unlikely to invest. Disloyal managers will not invest for fear that shareholders will recognize the investment as project B, while loyal managers will not invest in project A because shareholders may misperceive it as project B, thus potentially resulting in termination.²³¹ Instead, managers will distribute the free cash (the \$1 million) through dividends and buybacks rather than investing it.²³² On the margin, they will neither make nor lose money. The expected value of choosing strong governance, then, is also zero.

Under these conditions, shareholders will be indifferent between strong and weak governance. Strong governance yields an expected return of zero because managers will have an incentive not to invest. Weak governance also produces zero expected returns because a loyal manager's potential gains are wiped out by the risk of losses from a

229. Expected value is calculated by multiplying the value of any given outcome by its probability and totaling the weighted outcomes. So here, \$500,000 times 50 percent plus negative \$500,000 times 50 percent is zero. For an explanation of how to calculate expected value, see Will Kenton, *Expected Value (EV)*, INVESTOPEDIA, <https://www.investopedia.com/terms/e/expected-value.asp> [<https://perma.cc/7K6P-NLGU>], (last updated Mar. 10, 2022).

230. An expected return of zero means an appropriate return to compensate for the risk. The assumption here is that the expected return on project A provides an appropriate return to compensate for both the investment risk of project A and the risk of hiring a disloyal manager who will invest in project B.

231. See Goshen & Levit, *supra* note 22, at 13 (modeling the possibility that shareholders "will get the wrong signal" from investments and mistakenly fire a manager).

232. See *id.* at 12 (showing that as long as they care about their jobs, managers will refrain from investing in strong-governance corporations).

disloyal one. Either way, shareholders realize an expected value of zero and will thus be indifferent between strong- and weak- governance.²³³

Of course, the indifference here is only due to the assumptions made: 50 percent loyal managers, with losses and gains that cancel one another out. The following Sections account for what happens when these inputs change. The key insight will be that the preferred choice of governance structure is contingent on market conditions.

B. The Feedback Between Wages and Governance Structure

Previously, we assumed that both investment projects—A and B—cost \$1 million in outlays on labor. Suppose that each project demands ten employees be hired at \$100,000 per employee. Given the other market conditions, this rate makes strong and weak governance equivalent in terms of expected return. Suppose, however, that wages decline to \$80,000 per employee. Each investment project will now cost \$800,000 but will still yield the same returns. Project A will yield \$1.5 million, and subtracting \$800,000 in labor costs leaves a profit of \$700,000 (as opposed to \$500,000 before). Project B will yield \$500,000, and subtracting \$800,000 in labor costs leaves a loss of \$300,000 (as opposed to \$500,000 before).

Shareholders now face a different choice when making decisions about governance structure. Under strong governance, loyal and disloyal managers will refrain from investing.²³⁴ The expected value of strong governance, therefore, remains zero. Weak governance, however, now yields a positive expected value. Shareholders stand a 50 percent chance of making \$700,000 with a loyal manager and a 50 percent chance of losing \$300,000 with a disloyal manager, for an expected return of \$200,000 in profits. When wages are low, we can expect that shareholders will prefer weak governance to strong governance.

At first, this result seems counterintuitive. Typically, shareholders prize the right to fire and replace corporate managers.²³⁵ However,

233. The assumption is that for every level of risk an investment yields the appropriate return to compensate for that level of risk. In other words, all investments yield market returns (zero net present). This is true for the current investments already undertaken by strong-governance firms and for the new investments contemplated by weak-governance firms.

234. See Goshen & Levit, *supra* note 22, at 12 (showing that in equilibrium managers will maintain the status quo as long as shareholders have the right to fire them).

235. Simone M. Sepe, *Board and Shareholder Power, Revisited*, 101 MINN. L. REV. 1377, 1380 (2017) (“Shareholder advocates, in particular, defend the need for a strong shareholders’ power

when wages are low, they may wish to tie their own hands through weak-governance measures, allowing managers to capitalize on discounted wages without fear of being fired.²³⁶ In other words, manager entrenchment makes good business sense if the goal is to encourage investment.²³⁷

Notice that, under these conditions, shareholders would prefer weak governance *in spite of* the management agency costs it generates. While half of the weak-governance companies will make \$700,000 due to loyal managers investing in project A, the other half will lose \$300,000 from disloyal managers investing in project B. This \$300,000 loss represents the management agency costs of weak governance. However, where investment is particularly attractive—as here, with discounted wages—weak governance is *still* preferable to strong governance due to the outsized gains from investing.²³⁸ Thus, shareholders may want to cede control to encourage managers to make investments where they otherwise would refrain—even though some companies will lose money because of management agency costs.

A depressed labor market thus makes governance choices *relevant*: weak governance is preferable given low wages. In a depressed labor market, we expect shareholders in at least some strong-governance companies to switch to weak governance so that their managers have the freedom to invest. As the number of weak-governance companies rises, investment levels will increase, pushing up wages. Firms will continue to move to weak governance until wages rise to \$100,000 per employee, where, as shown above, weak and strong governance have the same expected value. Once wages reach this rate, firms will once again be indifferent between weak and strong

of removal—exercisable virtually at any time—in order to ensure that the exercise of this power (or even just the threat of it) can serve an effective disciplinary function.”)

236. See, e.g., Valentin Dimitrov & Prem C. Jain, *Recapitalization of One Class of Common Stock into Dual-Class: Growth and Long-Run Stock Returns*, 12 J. CORP. FIN. 342, 342 (2006) (studying “a sample of 178 firms that changed from a one-share-one-vote” (strong governance) “into a dual-class common stock structure” (weak governance) during 1979–1998, and finding that dual-class recapitalizations are shareholder value enhancing corporate initiatives).

237. Raymond J. Fisman, Rakesh Khurana, Matthew Rhodes-Kropf & Soojin Yim, *Governance and CEO Turnover: Do Something or Do the Right Thing?*, 60 MGMT. SCI. 319, 320–21 (2014) (presenting a model that suggests some level of boards entrenchment may be optimal, as it protects CEOs from bad firing decisions by shareholders).

238. Dimitrov & Jain, *supra* note 236 (finding that upon a switch from one-share-one-vote to dual-class, shareholders, on average, earn significant positive abnormal returns and that these returns are even larger for firms that issue equity—a clear indication of engaging in substantial investments).

governance, and they will stop switching. In other words, they will have reached a new equilibrium, this time with more weak-governance firms.²³⁹

Conversely, strong governance is preferable when wages are high. Suppose that wages rise to \$120,000 per employee, for an aggregate labor cost of \$1.2 million for each project. Now, the potential profits and losses will flip: project A yields only \$300,000 in profits while project B yields \$700,000 in losses on average. While the expected return of strong governance remains zero, as above, the expected return of weak governance is now \$200,000 in losses. In this market, strong governance is preferable. Thus, weak-governance firms will switch to strong governance, causing investment levels, hiring, and, consequently, wages to fall.²⁴⁰ Firms will continue to switch, and labor prices will continue to decrease until wages fall to \$100,000 per employee, making shareholders once again indifferent between strong and weak governance. At this point, there will be more strong-governance companies than before, but both governance structures will yield the same expected value. This is the feedback loop between wages and governance structures.

In equilibrium, then, shareholders will be indifferent between weak and strong governance. The same can be said of the distribution between loyal and disloyal managers: shareholders will adjust until they are indifferent between governance structures. For instance, assume that 70 percent of managers are loyal, 30 percent are disloyal (as opposed to fifty-fifty before), and the wage level is \$100,000 per employee. Under these conditions, weak governance will be more profitable: 70 percent of managers (the loyal ones) will invest in project A and make \$500,000 in profit, while 30 percent (the disloyal ones) will invest in project B and lose \$500,000. The expected profit of weak governance would then be \$200,000, while the expected value of strong governance remains zero. Companies would switch to weak

239. See Goshen & Levit, *supra* note 22, at 15 (“Essentially, the irrelevance is obtained because in equilibrium market clearing requires the price of resources to be fair in the sense that a change to the status quo is a zero net present value (NPV) investment from the shareholders’ perspective.”).

240. See, e.g., K.J. Martijn Cremers, Beni Lauterbach & Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation* 42 (Eur. Corp. Governance Inst., Working Paper No. 550/2018, 2020), <https://ssrn.com/abstract=3062895> [<https://perma.cc/GXD6-5PXJ>] (finding that 20 percent of dual-class firms (weak governance) unify their shares (strong governance) and experience increase in value).

governance, pushing up wages. Wages would once again rise until they cancel out any gains from weak governance. Thus, in a world with a higher proportion of loyal managers, we can expect that there will be more weak-governance corporations, but the expected value of both governance structures will be the same.²⁴¹

In short, just as wages impact the choice of governance structure, governance structure impacts wage rates. Strong governance discourages investment, whereas weak governance incentivizes it. Investment requires labor to build factories, launch divisions, open stores, build supply chains, and conduct research.²⁴² Thus, if many companies move toward weak governance, investment and hiring will rise, pushing up wages. Conversely, if many firms switch to strong governance, investments will fall, and wages along with it. These symmetrical forces push wages to a competitive level.

C. *The Competitive Equilibrium and Its Parameters*

The stylized model illustrates that governance structure and labor prices will reach an equilibrium where shareholders are indifferent as to governance structure. In this equilibrium, weak- and strong-governance companies will coexist, with none gaining the upper hand by switching from one governance structure to another. Because this equilibrium reflects a labor price determined through competition among hiring firms—where none of the players, corporations, shareholders, and employees, enjoy market power—it maximizes social welfare reflected in the distribution of wealth between labor and capital.²⁴³

To be sure, this equilibrium imposes certain inefficiencies on corporations and their shareholders because some proportion of firms will adopt weak governance.²⁴⁴ Returning to the model where 50

241. For instance, one could set the prior probability that a manager is disloyal equal to a generic variable between zero and one and obtain the irrelevance result regardless. See Goshen & Levit, *supra* note 22, at 8–9.

242. For example, labor costs amount to 13 percent of the revenue of S&P 500 companies. Connor Smith, *Higher Pay Is a Rising Threat to Stocks, Goldman Sachs Says*, BARRON'S (July 10, 2019, 6:00 AM), <https://www.barrons.com/articles/higher-pay-is-a-rising-threat-to-stocks-goldman-sachs-says-51562752800> [https://perma.cc/GN4R-HUJQ].

243. See Berger et al., *supra* note 220, at 43 (concluding that households are worse off in an anticompetitive labor market where firms wield market power than in a competitive labor market).

244. See, e.g., Kevin C.W. Chen, Zhihong Chen & K.C. John Wei, *Agency Costs of Free Cash Flow and the Effect of Shareholder Rights on the Implied Cost of Equity Capital*, 46 J. FIN. &

percent of firms had weak-governance structures and 50 percent of managers were disloyal, probabilistically, twenty-five firms would hire disloyal managers who will destroy value by investing in pet projects (project B). In this case, \$500,000 in losses per firm at twenty-five firms would total \$12.5 million in management agency costs. However, strong governance is also costly. Keeping with the same example, loyal managers in twenty-five strong-governance firms will not invest in project A, forgoing a \$500,000 in profits per firm, for a total of \$12.5 million in “principal costs” (the loss due to shareholders’ inability to accurately distinguish between projects A and B).²⁴⁵

These costs to shareholders are unavoidable in a competitive equilibrium. If shareholders could avoid management agency costs by switching to strong governance only in the firms with disloyal managers, they could prevent those managers from making outlays on labor. In other words, disloyal managers—twenty-five in our example—invest in pet projects when shareholders would prefer that they do not invest at all. This investment represents a benefit to workers, as it increases hiring and bolsters wages. Because shareholders cannot preempt only disloyal managers, corporations spend more on labor than their owners would prefer.²⁴⁶

While this balance is not optimal from the shareholders’ point of view, from a social perspective, it represents a competitive allocation of wealth between labor and capital. Importantly, the equilibrium with higher social welfare includes some level of inefficient management agency costs.²⁴⁷ But, as long as shareholders cannot accurately identify management’s loyalty, management agency costs can only be reduced by creating a greater detriment to some other group of stakeholders.²⁴⁸ That is, even though this equilibrium is not optimal for shareholders, it is efficient overall.

So far, this Part has demonstrated that labor prices and governance structure will counterbalance one another to reach a competitive equilibrium in the absence of common owners. The

QUANTITATIVE ANALYSIS 171, 200 (2011) (concluding that firms that employ takeover defenses—a weak-governance measure—experience higher costs of equity capital).

245. See generally Goshen & Squire, *supra* note 23 (developing the principal-cost theory).

246. See Goshen & Hamdani, *supra* note 23, at 565–67 (outlining the information and competence problems that prevent shareholders from being perfect arbiters of managerial effectiveness and loyalty).

247. See Goshen & Levit, *supra* note 22, at 18 (showing mathematically that a competitive equilibrium of control rights maximizes social welfare).

248. *Id.*

following Section describes how common owners alter this balance by increasing the number of strong-governance companies, resulting in a new and less efficient equilibrium.

D. Breaking the Competitive Governance Equilibrium

Common owners and the push for strong governance represent a departure from the equilibrium described in the economic model above, where governance structure and wages interact in a *competitive* market. With competition, the number of strong-governance companies is determined by the prevailing market wage. However, common owners push for strong governance *regardless of market wages*. As a result, the number of companies adhering to either governance structure is determined not by competition but by the governance preferences of a handful of asset managers.

Recall that we assumed the market contained fifty strong-governance and fifty weak-governance firms, and half of the potential managers were disloyal. None of the players had the market power to change the equilibrium unilaterally.²⁴⁹ As demonstrated, labor prices reach a level such that no firm can boost profits by switching from weak to strong governance or vice versa.²⁵⁰

Now assume that a handful of common owners hold large stakes in each of the one hundred companies in the model,²⁵¹ and due to their pressure, twenty firms switch from weak to strong governance.²⁵² From fifty-fifty, then, the market will now consist of seventy strong-governance and thirty weak-governance firms.

Before, managers could choose to invest in project A and project B, either creating or destroying \$500,000 in value, such that the expected value of weak governance after labor costs was zero. However, as common owners switch more firms to strong governance, investments will fall and the labor market will slacken, causing wages to decrease. Suppose that now each employee costs \$80,000 instead of \$100,000, for an aggregate labor cost of \$800,000 for either project.

249. *Id.* at 5.

250. *Id.*

251. The number of common owners is irrelevant for our purposes. However, if we were to set the number at three, for instance, it would be a good approximation of the U.S. equity markets. Recall that three firms, BlackRock, Vanguard, and State Street, together form the largest stockholder in nine out of ten S&P 500 companies. *See supra* note 16 and accompanying text.

252. This is not an unrealistic assumption: common owners tend to endorse shareholder rights for their portfolio companies regardless of market conditions. *See supra* Part I.B.

Strong governance continues to net an expected value of zero since managers will refrain from investing. However, weak governance will now yield an expected return of \$200,000 in profits.²⁵³

In a competitive market, shareholders would adjust to these abnormal returns by switching their companies to weak governance to take advantage of low wages, eventually pushing wages back up to equilibrium.²⁵⁴ However, in this new market dominated by common owners, shareholders prefer strong governance in spite of the wage rate. Regardless of the expected abnormal returns to any one firm from weak governance, common owners will oppose any move in that direction, meaning that wages will remain consistently low. In effect, common owners have deactivated the market mechanism—that is, the choice of governance structure—that previously corrected any imbalance in the labor market.²⁵⁵ Therefore, common owners will have created a new equilibrium with lower investment and lower wages—in other words, a labor market monopsony.²⁵⁶

253. Half the time, the weak-governance companies will hire a disloyal manager who invests in project B for a gross return of \$500,000, netting a loss of \$300,000. The other half of the weak-governance companies, headed by loyal managers, will make a gross return of \$1.5 million, for a net profit of \$700,000. Thus, the expected value of choosing weak governance is a gain of \$200,000.

254. See Goshen & Levit, *supra* note 22, at 4–5.

255. Like in any cartelized market the abnormal returns will attract new entries which the cartel will need to block. Indeed, while dual-class IPOs were on average 4.59 percent of total IPOs in the years 1980–1989, they increased to 8 percent in the years 1990–1999, to 9.3 percent in the years 2000–2009, and they reached 16.9 percent in the years 2010–2019. Calculated based on Jay R. Ritter, *Initial Public Offerings: Updated Statistics*, WARRINGTON COLL. OF BUS., UNIV. OF FLA. 67 tbl.23, <https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf> [<https://perma.cc/Y2SL-TYME>], (last updated Dec. 23, 2021). Not surprisingly, institutional investors declared a war on dual-class IPOs. See Goshen & Hannes, *supra* note 80, at 281–82. For a different explanation for the rise of dual-class IPOs, see Aggarwal et al., *supra* note 175, at 122 (finding that “the increasing popularity of dual-class structures is driven by founder-controlled firms” and the “increase in founder control over time is due to greater availability of private capital and technological shocks that reduced firms’ needs for external financing”).

256. Importantly, although our model is framed in terms of firms adopting either weak governance or strong governance, the model’s conclusions are valid even if firms can choose governance structures along a spectrum. Assume governance can range from weak to strong along a spectrum, according to the level of managerial freedom to invest. On the limited managerial freedom end, investment is zero, and on the unlimited managerial freedom end, investment is at its maximum. In this structure, firms can adopt any governance on the spectrum, with the corresponding level of investment. For instance, if a firm is on the middle of the spectrum, its manager will invest half of the maximum investment. In such a case, if all firms increase the strength of their corporate governance, the aggregate level of investment will decrease, and each firm will increase its profitability on the investments it is still making. In short, the monopsony effect will work the same way.

The model above predicts that when the dust settles on this new world of common ownership, there will be more strong-governance firms, a lower level of investment, and lower wages. Strong-governance firms will reduce their investment level while weak-governance firms will continue investing unconstrained. Both types will now enjoy a substantial labor discount: strong-governance firms on their lower level of investment and weak-governance firms on their higher level of investment. Because common owners own a market portfolio, they enjoy the extra profits accrued by both types of firms. Notably, despite the abnormally positive investment returns, strong-governance firms will still reduce their investments while enjoying the benefit of depressed labor prices only on their remaining investments.²⁵⁷

In our model, for simplicity, strong-governance firms do not invest but lose nothing on their existing operation (that is, we assumed away the extra profits on their lower level of investment). However, the remaining thirty weak-governance firms in this economy will now benefit from anticompetitive wages. Each firm will net, on average, an extra \$200,000, or an extra \$6 million in the aggregate. Because common owners hold a stake in each company, their portfolio values will rise as the weak-governance firms become more profitable and the strong-governance firms lose nothing. This money did not appear out of thin air but rather came out of workers' paychecks: it represents a \$6 million subsidy from workers to the shareholders of the companies that employ them. It is a \$6 million transfer from the lower and middle classes to the rich.

257. The abnormal profitability implies that there will be incentives for firms to go private or stay private and avoid the public market in order to enjoy the abnormal profitability from investments. Indeed, these two phenomena are empirically documented. See generally MICHAEL J. MAUBOUSSIN, DAN CALLAHAN & DARIUS MAJD, CREDIT SUISSE, THE INCREDIBLE SHRINKING UNIVERSE OF STOCKS: THE CAUSES AND CONSEQUENCES OF FEWER U.S. EQUITIES (2017), https://www.cmgwealth.com/wp-content/uploads/2017/03/document_1072753661.pdf [<https://perma.cc/7WYV-VFC2>] (providing the data on the growth of the private market); John Asker, Joan Farre-Mensa & Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle?*, 28 REV. FIN. STUD. 342, 342 (2015) (finding that “compared with private firms, public firms invest substantially less and are less responsive to changes in investment opportunities”); Ofer Eldar & Jillian Grennan, *Common Ownership and Entrepreneurship*, 111 AEA PAPERS & PROC. 582, 582 (finding that common ownership is forming in the private market to pose competition to the common ownership anticompetitive effects in the public market as “common ownership of start-ups in the same industry is nowadays the norm”). Given the empirical findings that investment levels are still low, it is reasonable to assume that there are frictions in the private market that prevent this market from returning the economy to the competitive equilibrium.

Worse yet, this transfer of wealth to shareholders will also inflict a deadweight loss on society: the twenty firms that switched from weak to strong governance will reduce investment and thus will not employ two hundred employees.²⁵⁸ The severity of the deadweight loss depends on the alternative employment of these employees. If ten employees stay unemployed, the loss would be \$1 million (10 x \$100,000). Alternatively, if all employees find employment but with a \$10,000 lower annual salary, the deadweight loss would be \$2 million (200 x \$10,000). That is, the cost of transferring \$6 million to shareholders includes an additional substantial deadweight loss. By shifting value from the labor market to the capital market, common owners create a new, less efficient equilibrium that reduces aggregate social welfare in the economy at large.²⁵⁹

Notably, common owners have expropriated value from the labor market without resorting to any collusion. Instead, the monopsony results from shareholders behaving as they otherwise would: firing disloyal managers, as they perceive them, and retaining loyal ones. However, because of the increased number of strong-governance firms, this everyday behavior results in underinvestment relative to a competitive market and thus lower wages.

Essentially, common owners have externalized some of their management agency costs to employees. Management agency costs are minimized because fewer disloyal managers are investing in inefficient projects, and the loss from these inefficient projects is smaller, given the labor discount. Moreover, the efficient investments of the remaining loyal managers will be disproportionately profitable. By cutting these management agency costs, common owners have made the market work more efficiently for them—but less efficiently for everyone else.

E. Common Ownership Monopsony Compared to Other Explanations

Thus far, this Part has explained how common owners operate to create a labor monopsony and shift wealth from labor to capital. This

258. In the basic setup of the model, we assumed that both investment projects—A and B—cost \$1 million in outlays on labor, and that each project demands ten employees be hired at \$100,000 per employee. When twenty firms do not invest, two hundred employees are not hired (twenty firms times ten employees).

259. See Goshen & Levit, *supra* note 22, at 17–19 (showing that “any deviation from the competitive allocation is socially inefficient”).

Section examines some of the alternative explanations for macroeconomic trends such as wage stagnation and increased economic inequality and shows how common ownership either supplants or complements these alternatives.

1. *Product Monopolies.* Emerging literature attributes anticompetitive effects to common owners by suggesting that they reduce competition in the *product markets* rather than labor markets.²⁶⁰ To be sure, this theory would also explain the declining investment and stagnant wages: by decreasing output in order to raise prices of products, common owners would also incidentally reduce investment, hiring, and wages. Monopsony and monopoly, after all, “are two sides of the same coin, and both harm labor and product markets.”²⁶¹ Because common owners hold stakes in competing corporations, they could theoretically benefit by incentivizing their portfolio companies to raise consumer prices by not competing with one another.²⁶² For instance, economists have noted anticompetitive effects of common ownership on the prices of airline tickets.²⁶³

However, the monopoly theory faces a key limitation not shared by the monopsony theory: it requires common owners to take explicit or implicit steps to facilitate a monopoly in the product markets. In other words, the monopoly theory contends that household names, such as BlackRock and Vanguard, incentivize firms to raise prices. So far, scholars have not provided convincing evidence that such systematic anticompetitive behavior exists,²⁶⁴ and absent this evidence,

260. See Hemphill & Kahan, *supra* note 39, at 1401–09 (outlining the theories regarding the anticompetitive effects of common ownership and reviewing the evidence supporting them).

261. Naidu et al., *supra* note 148, at 559.

262. See Hemphill & Kahan, *supra* note 39, at 1402–03 (describing how common owners stand to gain by discouraging portfolio companies from competing with one another).

263. See Azar et al., *Anticompetitive Effects*, *supra* note 15, at 1518. This study has been strongly challenged. See, e.g., Patrick J. Dennis, Kristopher Gerardi & Carola Schenone, *Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry*, J. FIN. (forthcoming) (manuscript at 1), https://ssrn.com/abstract_id=3063465 [<https://perma.cc/5WT5-L4BA>] (“We show that the documented positive correlation between common ownership and ticket prices stems from the market share component of the common ownership measure, and not the ownership and control components.”); Hemphill & Kahan, *supra* note 39, at 1397–98 (describing how the airline study has been subject to scrutiny). And for counterarguments to these challenges, see generally Einer Elhauge, *How Horizontal Shareholding Harms Our Economy—And Why Antitrust Law Can Fix It*, 10 HARV. BUS. L. REV. 207 (2020).

264. See, e.g., Erik P. Gilje, Todd A. Gormley & Doron Levit, *Who’s Paying Attention? Measuring Common Ownership and Its Impact on Managerial Incentives*, 137 J. FIN. ECON. 152,

it is difficult to believe those common owners could rig the product markets for four decades without attracting notice.

By contrast, the monopsony theory explains wage stagnation and income inequality without pointing to collusion. This Article contends that common owners create a labor monopsony by doing what they always do: pushing for strong governance and disciplining disloyal or incompetent managers. Contrary to common wisdom, strong governance is not the benefit of common ownership against which we must weigh their anticompetitive costs (less competition in the product market). Rather, the costs and benefits of common ownership are *both* generated by institutional investors' policy of pushing public corporations to adopt strong governance (reducing agency costs while creating labor monopsony).

Viewed in this light, it is clear that the monopsony effect does not share the monopoly theory's limitations. Common owners increase shareholder profits at the expense of other stakeholders not through illegal coordination in the pricing of products (output) but through strong governance resulting in monopsony pricing of labor (input).

152 (2020) (showing that properly measured, common ownership does not affect managers' incentives to consider employing anticompetitive devices because common owners are inattentive); Hemphill & Kahan, *supra* note 39, at 1410–19 (providing a comprehensive challenge and criticism of the studies suggesting anticompetitive behavior by common owners); Edward Rock & Daniel Rubinfeld, *Does Common Ownership Explain Higher Oligopolistic Profits?* 1 (Eur. Corp. Governance Inst., Working Paper No. 528/2020, 2020), <https://ssrn.com/abstract=3627474> [<https://perma.cc/XC8A-KUDP>] (criticizing the anticompetitive monopolies claim and offering alternative explanations for the data); John Morley, *Too Big To Be Activist*, 92 S. CAL. L. REV. 1407, 1407 (2019) (explaining why large institutional investors cannot be activists); Thomas A. Lambert & Michael E. Sykuta, *The Case for Doing Nothing About Institutional Investors' Common Ownership of Small Stakes in Competing Firms* 0 (Univ. Mo. Sch. L., Legal Stud. Rsch. Paper No. 2018-21, 2018), <https://ssrn.com/abstract=3173787> [<https://perma.cc/RV3F-PULA>] (criticizing the studies claiming that common ownership leads to anticompetitive monopolies); Edward B. Rock & Daniel L. Rubinfeld, *Antitrust for Institutional Investors*, 82 ANTITRUST L.J. 221, 223 (2018) (criticizing the economic analysis and findings of the anticompetitive monopolies claim); Daniel P. O'Brien & Keith Waehrer, *The Competitive Effects of Common Ownership: We Know Less Than We Think* 2–3 (Feb. 22, 2017) (unpublished manuscript), https://ssrn.com/abstract_id=2922677 [<https://perma.cc/KH54-JHWV>] (“[T]he emerging research at present does not scientifically establish that an increase in common ownership involving minority shareholdings causes higher prices in the industries examined.”). For a conflicting view, see generally Einer Elhauge, *The Causal Mechanisms of Horizontal Shareholding*, 82 OHIO STATE L.J. 1 (2021).

2. *Shareholder Primacy*. The shift to shareholder primacy has been blamed for increasing income inequality.²⁶⁵ The argument is that as managers started to maximize shareholders' value, they were doing so at the expense of other stakeholders, such as employees.²⁶⁶ Indeed, today "shareholders versus stakeholders" is at the center of academic debate, with many arguing in favor of shifting corporations back to maximizing stakeholders' value.²⁶⁷

While shareholder primacy is a contributing factor to the rise of strong governance,²⁶⁸ it cannot explain income inequality in itself. At the level of an individual firm, no amount of attention lavished on shareholders could transfer wealth away from other stakeholders in a competitive market. Where wages are determined by competition among rival employers, even the most zealous efforts by management could not lower those wages in the interest of enriching shareholders. Only by incapacitating the feedback loop between wages and corporate governance in most firms have common owners been able to transfer value from employees to shareholders. Shareholder primacy alone cannot explain these trends.

3. *Classic Labor Monopsony*. Commonly, the theory of labor monopsony focuses on firms' market power over labor—that is, on the

265. See, e.g., Ezra Wasserman Mitchell, *Corporate Governance and Income Inequality: The Role of the Monitoring Board*, 3 BUS. & FIN. L. REV. 49, 49 (2019) (blaming the monitoring board which enforces shareholder primacy); Matthew T. Bodie, *Income Inequality and Corporate Structure*, 45 STETSON L. REV. 69, 70 (2015) (blaming inequality on shareholder primacy).

266. For more on this position, see generally Leo E. Strine, Jr., Aneil Kovvali & Oluwatomi O. Williams, *Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice and Power Within American Corporate Governance*, 106 MINN. L. REV. 1325 (2022); Leo Strine & Kirby Smith, *Toward Fair Gainsharing and a Quality Workplace for Employees: How a Reconceived Compensation Committee Might Help Make Corporations More Responsible Employers and Restore Faith in American Capitalism*, 76 BUS. LAW. 31 (2020/2021); Leo Strine, *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* (Univ. of Pa. Inst. for L. & Econ., Research Paper No. 19-39, 2019), <https://ssrn.com/abstract=3461924> [<https://perma.cc/T3UL-KL7E>]; Leo Strine, *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870 (2017).

267. See generally, e.g., Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020) (presenting the stakeholderism arguments and rejecting them).

268. See *supra* Part I.B.2; Falato et al., *supra* note 32, at 2 ("Shareholders with large and concentrated ownership . . . can more easily monitor managers and force them to fire workers or cut payroll against their will . . .").

relative bargaining power of firms versus employees and the factors affecting it.²⁶⁹ However, this focus does not conflict with the explanation offered by the common ownership monopsony theory.

a. Market Concentration. A firm's market power is commonly achieved through market concentration, either in a geographic area, a production technology, or the product market.²⁷⁰ When the employee's bargaining power is low, the firm can offer a lower salary. For instance, imagine a geographic area where there used to be ten factories, and now there are only two.²⁷¹ As the competition among factories over employees in an area decreases, so does the employee's bargaining power. Although this theory potentially explains wage stagnation and income inequality, studies increasingly challenge the empirical evidence of labor market concentration.²⁷²

By contrast, this Article contends that the monopsony is driven by *shareholders'* market power, not *firms'* market power. Thus, firms' geographic or product market concentration is unnecessary for the labor monopsony to work. Indeed, common ownership has the greatest

269. See generally, e.g., Orley C. Ashenfelter, Henry Farber & Michael R Ransom, *Labor Market Monopsony*, 28 J. LAB. ECON. 203 (2010) (explaining the theories of labor market monopsony).

270. See generally, e.g., Azar et al., *Labor Market Concentration*, *supra* note 8, at S169 (finding geographic concentration in labor markets throughout the United States "consistent with labor market concentration creating labor market power"); Efraim Benmelech, Nittai K. Bergman & Hyunseob Kim, *Strong Employers and Weak Employees: How Does Employer Concentration Affect Wages?*, 57 J. HUM. RES. S200 (2022) (exploring the sources of firms' market power over labor).

271. Thus, mergers have been a major focus as the driving force behind concentration that leads to labor monopsony. See generally, e.g., David Arnold, *Mergers and Acquisitions, Local Labor Market Concentration, and Worker Outcomes* (Jan. 21, 2020) (unpublished manuscript), <https://papers.ssrn.com/abstract=3476369> [<https://perma.cc/T4SX-AL52>] (finding that mergers that increase concentration also decrease wages).

272. See, e.g., Brad Hershbein, Claudia Macaluso & Chen Yeh, *Concentration in U.S. Local Labor Markets: Evidence from Vacancy and Employment Data* 33 (Soc'y for Econ. Dynamics, Working Paper No. 1336, 2019), https://economicdynamics.org/meetpapers/2019/paper_1336.pdf [<https://perma.cc/HY66-XSBA>] (finding that in the last decade, at most 5 percent of new U.S. jobs are in moderately concentrated local markets and that local labor market concentration has decreased by at least 25 percent since 1976). See generally, e.g., Kevin Rinz, *Labor Market Concentration, Earnings, and Inequality*, 57 J. HUM. RES. S251 (2022) (finding that local industrial concentration has generally been declining from 1976 to 2016); Esteban Rossi-Hansberg, Pierre-Daniel Sarte & Nicholas Trachter, *Diverging Trends in National and Local Concentration*, 35 NBER MACROECON. ANN. 115 (2021) (finding that local labor market concentration is falling in the U.S. economy).

effect of lowering investments in industries that are less concentrated at the firm level.²⁷³

b. De-unionization. Another source of firms' increased market power over employees is the de-unionization of the U.S. labor market. Collective bargaining increases employees' market power, allowing them to receive competitive salaries according to their productivity.²⁷⁴ Moreover, strong unions also have a spillover effect on other nonunion firms, forcing them to increase wages as well. However, the percentage of employees represented by unions fell rapidly in the 1980s and continued to fall in the 1990s and the early 2000s.²⁷⁵ The falling rate of unionization, and the decreased spillover effect that followed, have contributed to lower wages.

This theory's critics ascribe the decline in workers' power not to the de-unionization itself but to parallel trends that separately eroded the unions' bargaining power, such as global trade pressures, the shift to services, and ongoing technological change.²⁷⁶ In that vein, our theory can add another trend affecting the bargaining power during the same period. Powerful institutional investors shifting firms to strong governance and shareholder primacy changed labor negotiation dynamics—employers took a militant stance against unions and employees.²⁷⁷ Notably, this may be because the market is less competitive: when there are fewer investments, employees have less bargaining power in the first place.

c. Globalization and Immigration. Employees' bargaining power also decreases when they compete with a greater number of other employees: the greater the number of employees, the lower the wages. Competition with employees from other countries can take the form of either production moving to another country²⁷⁸ or employees moving

273. See Gutiérrez & Philippon, *Ownership, Concentration, and Investment*, *supra* note 156, at 434 (finding that common ownership has a substantial effect on industries that appear competitive according to traditional measures).

274. See generally, e.g., Farber et al., *supra* note 5 (finding consistent evidence that unions reduce inequality).

275. See, e.g., MISHEL, *supra* note 5, at 2.

276. See *id.*

277. See *id.*; Stansbury & Summers, *supra* note 192, at 2–3 (defining the decrease in “worker power” as the product of de-unionization and changes in *corporate ownership*).

278. See generally, e.g., Jonathan Haskel, Robert Z. Lawrence, Edward E. Leamer & Matthew J. Slaughter, *Globalization and U.S. Wages: Modifying Classic Theory To Explain*

to the United States.²⁷⁹ While immigration cannot explain the decrease in investments and the lower percentage of employees working in public corporations, globalization can. However, a study of the causes of decreased investments assigned a low explanatory power to globalization.²⁸⁰ These trends may be a parallel cause of wage stagnation, along with common ownership.

d. Technology. Technology affects labor in two related ways. First, it displaces some employees (via automation and robots).²⁸¹ Second, it differentiates between employees—educated employees who can produce or operate technology (and get high salaries and equity) and employees who cannot (and get stagnant wages).²⁸² Studies have found that technology can explain about a third of the effects on labor.²⁸³ The common ownership monopsony theory aims to explain the other two-thirds.

In sum, while other theories may hold some purchase, common ownership monopsony greatly contributes to some of the more troubling macroeconomic trends of this day and age. The detrimental effect of common ownership on labor markets and the economy requires a rethinking of how the law treats common owners and strong governance. The following Part begins to analyze the policy implications of the monopsony effect.

IV. REVERSING THE MONOPSONY EFFECT: BREAK UP BLACKROCK

Given the inherent tradeoff of strong governance—reducing management agency costs while creating a labor monopsony—policymakers face a dilemma. Should they side with employees or shareholders? If shareholders' interests are the primary concern,

Recent Facts, 26 J. ECON. PERSPS. 119 (2012) (reviewing “how globalization might explain the recent trends in real and relative wages in the United States”).

279. See generally George Borjas, *The Labor Demand Curve Is Downward Sloping: Reexamining the Impact of Immigration on the Labor Market*, 118 Q.J. ECON. 1335 (2003) (estimating the labor market impact of immigration).

280. See Gutiérrez & Philippon, *Investmentless Growth*, *supra* note 11, at 147 (“[T]he decline in U.S. investment is not (entirely) explained by rising globalization.”).

281. See generally, e.g., Acemoglu & Restrepo, *supra* note 9 (showing that automation may reduce employment and wages).

282. See generally, e.g., Lankisch et al., *supra* note 9 (finding that automation contributes to rising inequality).

283. See Gutiérrez & Philippon, *Ownership, Concentration, and Investment*, *supra* note 156 (“[W]e argue that rising intangibles accounts for a quarter to a third of the [investment] gap.”).

nothing should be done. Common owners' power will continue to grow, and with it, the destructive effects of strong governance. If the interests of employees are the primary concern, however, policymakers should act.

Policymakers should eliminate the monopsony effect by increasing the number of market players. Fragmenting the market reduces each individual player's influence—thereby shifting the balance back toward weak governance and managerial freedom.²⁸⁴ That is, to solve the problems caused by common ownership, the answer is to break up common owners.

At present, Congress, to all appearances, does not have the political will to break up common owners, as institutional investors have effectively “captured” Congress through political spending. Since the 2008 financial crisis, institutional investors have drastically ramped up both their campaign contributions²⁸⁵ and lobbying expenditures,²⁸⁶

284. See, e.g., José Azar & Xavier Vives, *Oligopoly, Macroeconomic Performance, and Competition Policy* 4 (Dec. 18, 2018) (unpublished manuscript), https://ssrn.com/abstract_id=3177079 [<https://perma.cc/P5CB-8FCM>] (“[I]ncreased market concentration—due either to fewer firms or to more common ownership—depresses the economy by *reducing* employment, output, real wages, and the labor share . . .”). A small but growing literature has begun to examine the effect of oligopolistic (and, by the same token, oligopsonistic) control of the capital markets. Fiona Scott Morton & Herbert Hovenkamp, *Horizontal Shareholding and Antitrust Policy*, 127 *YALE L.J.* 2026, 2032 (2018) (“[S]hareholding by a small number of institutional investors is causally linked with reduced output and higher prices.”). To be sure, however, the idea that concentration of ownership has negative economic effects still draws fierce criticism. See Douglas H. Ginsburg, *Why Common Ownership Is Not an Antitrust Problem*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 4, 2018), <https://corpgov.law.harvard.edu/2018/12/04/why-common-ownership-is-not-an-antitrust-problem> [<https://perma.cc/UY7X-96XL>] (“[T]he current empirical evidence that common ownership causes anticompetitive harm is limited and hotly disputed.”).

285. *Compare Securities & Investment: Money to Congress*, OPENSECRETS, <https://www.opensecrets.org/industries/summary.php?ind=F07&recipdetail=A&sortorder=U&mem=Y&cycle=2006> [<https://perma.cc/XN3E-8VAD>] (showing that institutional investors spent approximately \$50 million on campaign contributions in the 2006 election cycle), *with Securities & Investment: Money to Congress*, OPENSECRETS, <https://www.opensecrets.org/industries/summary.php?ind=F07&recipdetail=A&sortorder=U&mem=Y&cycle=2012> [<https://perma.cc/34YZ-G8PA>] (showing approximately \$104 million in the 2012 election cycle), *and Securities & Investment: Money to Congress*, OPENSECRETS, <https://www.opensecrets.org/industries/summary.php?ind=F07&recipdetail=A&sortorder=U&mem=Y&cycle=2020> [<https://perma.cc/S4TP-2GAK>] (showing approximately \$154 million in the 2020 election cycle).

286. See *Securities & Investment: Lobbying, 2021*, OPENSECRETS, <https://www.opensecrets.org/industries/lobbying.php?cycle=2006&ind=F07> [<https://perma.cc/MWM8-VX5N>] (showing that institutional investors spent approximately \$65 million on lobbying efforts in 2006, compared with approximately \$106 million in 2010 and \$105 million in 2020).

with a particular focus on members of congressional finance committees.²⁸⁷ In exchange, institutional investors seem to have bought themselves the servility of congressional decisionmakers, who have stood up for them against regulating agencies.²⁸⁸ It is therefore difficult to imagine that efforts to break up institutional investors would be successful.

Nevertheless, one can hope that with the Biden administration's commitment to extending antitrust policy to "promote the interests of American workers,"²⁸⁹ including breaking up big tech behemoths,²⁹⁰ and both parties' attention shifting to the hitherto neglected middle class, Congress can find common cause in arresting the decline of the American worker by breaking up common owners.²⁹¹ This Article, therefore, presents the breakup alternative and its expected effects.²⁹² Part IV.A outlines the restriction on AUM in order to limit the monopsony effect. Part IV.B shows how breaking up multitrillion-dollar asset managers will affect the relationship between shareholders and management, thereby increasing managerial freedom. Part IV.C concludes that these changes would disrupt the monopsony effect by tipping the market away from strong governance and restoring the competitive equilibrium. Finally, Part IV.D addresses counterarguments.

A. *Break Up BlackRock*

The small group of common owners that control the vast majority of publicly traded corporations prevents any move toward weak

287. See CAMPAIGN FOR ACCOUNTABILITY, BLACKROCK'S WASHINGTON PLAYBOOK: HOW THE WORLD'S LARGEST ASSET MANAGER BOOSTED ITS POLITICAL SPENDING AND FOUGHT OFF GOVERNMENT SUPERVISION 4 (2019), <https://campaignforaccountability.org/work/blackrocks-washington-playbook> [<https://perma.cc/3PZL-5SKK>] ("Unsurprisingly, BlackRock contributed most of its money to members of Congress who sat on committees with jurisdiction over the company.").

288. See *id.* at 6–7 (recounting how two senators who had received large donations from BlackRock questioned Treasury Department officials about a report finding they were "by far the largest asset manager in the country," which "represented a major threat to their business model").

289. See Exec. Order No. 14,036, 86 Fed. Reg. 36,987 (July 14, 2021).

290. See Teachout, *supra* note 50.

291. See, e.g., Davis, *supra* note 51 ("The battle for the working class is even more urgent for the two parties because it's a growing bloc of voters.").

292. We are not the first to suggest that antitrust law could be applied to common owners. See, e.g., Elhauge, *Horizontal Shareholding*, *supra* note 67, at 1301–16 (suggesting antitrust prosecution as a solution). However, this Article is the first to suggest capping AUM as a solution to the ills of common ownership.

governance—even though it would be profitable for individual firms. Capping the AUM that any one firm can manage would require the breakup of large common owners into smaller owners, limiting the extent to which they can influence the governance structure of portfolio firms. Corporations would have the freedom and incentive to shift back to weak-governance regimes, thereby disrupting the monopsony effect.

In other words, policymakers should limit common owners' power by reducing their size, as power is the crucial variable. For example, even under dispersed ownership—with millions of small, diversified shareholders—each diversified investor would benefit from increased returns resulting from the monopsony effect. However, such small shareholders do not have the power to push corporations to adopt strong governance. In other words, portfolio diversification creates the incentive to push for stronger governance, but it is size that provides the power to achieve it. Without that power, the monopsony effect is impossible.

Limiting the AUM of any one institution would force large asset managers to break up into smaller ones. For example, capping the AUM of asset managers at a half-trillion dollars would require BlackRock—which holds over \$8 trillion in AUM²⁹³—to break up into fifteen different fund families and State Street, Fidelity, and Vanguard to split into an additional twenty-five fund families.²⁹⁴ With a smaller AUM, no single fund or group of funds could gain dominance over the entire market.²⁹⁵ A fund might attain a common owner's status but could no longer act as the type of *powerful* common owner that has led to the monopsony effect.²⁹⁶

The particular amount at which to cap AUM should take into account the minimum size to achieve economies of scale in investing—

293. See *About BlackRock*, *supra* note 64.

294. See *supra* note 64.

295. The sum of all U.S. public equities (all the companies listed on the New York Stock Exchange plus the NASDAQ and OQTOX Market) is valued at about \$53 trillion. *Total Market Value of the U.S. Stock Market*, SIBLIS RSCH., <https://siblisresearch.com/data/us-stock-market-value> [<https://perma.cc/3SFX-3WLT>].

296. Investors of a certain absolute size are mathematically able to capture significant shares in *every firm*, allowing them to influence governance decisions across the board. See *supra* Part I.A–B. Hence, under a breakup, asset managers could become common owners but might not have the same influence over the whole market.

an investigation beyond the scope of this Article.²⁹⁷ However, the fact that the median AUM of the top five hundred asset managers globally is below \$50 billion²⁹⁸ suggests that AUM does not need to be in the trillions to achieve economies of scale. For the sake of discussion, half-a-trillion is a convenient number—but clearly, as the cap decreases, the number of players in the stock markets increases.²⁹⁹ To maintain the same relative size over time, the AUM cap could also be indexed to the increases in the value of the stock market as a whole.³⁰⁰ While the appropriate cap needs further study, the monopsony effect demonstrates that over the last four decades, the balance has tipped toward *too few* powerful owners. Thus, moving toward *more, smaller* owners—as regulations have historically sought³⁰¹—would reduce labor market monopsony.³⁰²

297. For a small cross-section of the scholarly discussion on this topic, see, for example, Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 729 (2019); Patrick Jahnke, *Ownership Concentration and Institutional Investors' Governance Through Voice and Exit*, 21 BUS. & POL. 327, 335 (2019); Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 26 (2019).

298. BOB COLLIE, MARISA HALL, TIM HODGSON, ROGER URWIN & LIANG YIN, THINKING AHEAD INST., THE WORLD'S LARGEST 500 ASSET MANAGERS 11 (2019), https://www.thinkingaheadinstitute.org/content/uploads/2020/11/PI500_2019.pdf [<https://perma.cc/3Q5R-9HSN>].

299. For instance, the breakup of AT&T in 1984 resulted in a number of smaller, leaner “Baby Bells” coming into existence. See George B. Shepherd, Joanna M. Shepherd & William G. Shepherd, *Antitrust and Market Dominance*, ANTITRUST BULL., Winter 2001, at 860.

300. For an explanation of the relationship between firm size and market concentration, see, for example, Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 HARV. L. & POL'Y REV. 235, 266 (2017).

301. Roe, *supra* note 55, at 11 (explaining that politicians have generally responded to Americans' mistrust of large powerful financial institutions “by enacting rules restricting private accumulations of power by financial institutions”).

302. Notably, capping the amount that an asset manager could hold in *any one industry or corporation* could achieve similar effects: fund families would be prevented from holding huge stakes in competing businesses. Such a scheme would preclude common owners within industries, as well as across the entire market. This proposal has most prominently been championed by Professors Eric Posner, Fiona Morgan, and Glen Weyl. See generally Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, *A Proposal To Limit the Anticompetitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669 (2017) (proposing enforcement policy for institutional investors). Under their proposal, asset managers could hold *at most* 1 percent of the shares in any given industry or one company in each industry. *Id.* at 678. However, capping the amount that institutions could hold in any one corporation or industry would be more disruptive than a global cap. For a review of the transaction costs on both the regulatory and the corporate ends of such a proposal, see Lambert & Sykuta, *supra* note 264, at 44–47. While Lambert and Sykuta's concerns that curtailing the influence of institutional investors would increase agency costs is addressed later, see *id.* at 49–50; *infra* Part IV.E, they also outline the extensive regulation that would go

Indeed, the effect of AUM's size is vividly illustrated in Azar et al.'s event study mentioned above.³⁰³ After the acquisition of Barclays Global Investors by BlackRock in 2009—which made BlackRock the world's biggest asset manager—affected markets experienced post-acquisition decreases in annual wages per employee and employment-to-population.

B. The Impact of Breakup on Common Ownership

The monopsony effect arises not because common owners are diversified but because they can impose their governance agenda on essentially the entire market, impacting the balance of strong- and weak-governance companies.³⁰⁴ A larger group of smaller investors would not have the power to assert similar dominance over the corporate sector. Particularly, smaller asset managers operating under an asset cap could not generate a monopsony effect for at least two reasons: (1) directors would be free to act independently without worrying about the “800-pound gorilla” of institutional-investor voice, and (2) activist investors would face greater transaction costs in pushing for strong governance.

1. *The 800-Pound Gorilla.* Controlling shareholders have been colorfully described as an 800-pound gorilla—their will may be ignored only at one's peril.³⁰⁵ Although the Big Three institutional investors rarely exert outright control, together they are the largest shareholder in almost 90 percent of the S&P 500.³⁰⁶ Breaking up the largest asset managers would go a long way toward sidelining the stock markets' King Kong,³⁰⁷ allowing directors to exercise greater independence in investing and hiring.

into a proposal like that of Posner and coauthors. See generally Posner et al., *supra*. Of course, with increased regulation comes increased compliance costs.

303. See *supra* notes 194–196 and accompanying text.

304. See *supra* Part III.D.

305. See Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 509 (2002) (describing the controlling shareholder as “an 800-pound gorilla [that] wants the rest of the bananas”).

306. See Fichtner et al., *supra* note 16.

307. See Kara Haar, *King Kong Through the Years: How the Giant Gorilla Has Evolved Since 1933*, HOLLYWOOD REP. (Mar. 9, 2017, 8:00 AM), <https://www.hollywoodreporter.com/lists/king-kong-years-how-giant-gorilla-has-evolved-1933-982360/item/king-kong-1933-983416> [<https://perma.cc/PN9L-HBYB>] (explaining that King Kong is a gargantuan gorilla who has wreaked cinematic havoc for nearly nine decades).

For example, a director would be unlikely to defy BlackRock without fear of reprisal. That same director might also serve as a director³⁰⁸ or executive³⁰⁹ at another firm where BlackRock holds a large stake. Now, multiply that effect threefold if *all* the Big Three oppose a move. Directors with career and reputation concerns cannot risk their relationship with the Big Three or other major asset managers because these same key investors wield influence throughout the corporate sector.³¹⁰ Disappointing a controlling shareholder may lead to dismissal from a single board, but a run-in with a giant institutional investor could have more far-reaching consequences.³¹¹ A smaller asset manager does not create the same career and reputation risks.³¹² Accordingly, breaking up the largest institutional investors would allay director concerns and allow them to act independently and according to their best judgment, without significant fear of reprisal.

2. *Increased Transaction Costs for Proxy Fights.* Increasing the number of asset managers would also make it more difficult for activist investors to build the coalitions necessary to wage proxy campaigns, limiting one of the central tools common owners use to restrict managerial freedom. Instead of working with the same few repeat players in every proxy fight, activists would have to engage many more

308. In 2019, most S&P 500 independent directors sat on more than one board, with 31 percent sitting on three or more. SPENCER STUART, 2019 U.S. SPENCER STUART BOARD INDEX 17, https://www.spencerstuart.com/-/media/2019/ssbi-2019/us_board_index_2019.pdf [<https://perma.cc/B7W2-QV8N>].

309. A large proportion (41 percent) of CEOs sit on boards outside their own companies. *Id.* at 22.

310. This argument is a variation of the same argument that applies to *managers*. See *supra* Part II.A.1. Of course, if directors had no career or reputational concern, this would be a nonissue.

311. See Gordon, *supra* note 101, at 1488 (arguing that directorial independence is limited by the career concerns of directors); see also Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971, 983 n.60 (2019) (noting that directors' career concerns are magnified because "they are likely to meet the same money managers at other public companies").

312. For instance, industry leaders devote time to decoding BlackRock CEO and Chairperson Larry Fink's famous annual letter. See, e.g., Larry Fink, *The Power of Capitalism*, BLACKROCK (2022), <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter> [<https://perma.cc/R3Y6-AZ8R>]; Dan Pontefract, *Decoding BlackRock Chairman Larry Fink's Letter to CEOs on the Importance of Purpose*, FORBES (Jan. 26, 2019, 7:29 AM), <https://www.forbes.com/sites/danpontefract/2019/01/26/decoding-blackrock-chairman-larry-finks-letter-to-ceos-on-the-importance-of-purpose/#749bf2aa2995> [<https://perma.cc/H4W3-XC9C>]. There would be no great need to decode, analyze, and ultimately act on the annual letter of an asset manager one-fifteenth the size.

shareholders³¹³ and win over a much larger cadre of investors.³¹⁴ A larger number of investors presents not only a challenge in terms of time, energy, and communication costs but also a strategic difficulty in forming a coalition.³¹⁵ The larger the number of asset managers, the greater the possible divergence of opinions among them as to both the appropriate governance structure and the quality of investments undertaken by managers.³¹⁶ A larger number of investors with differing opinions would also allow managers to counteract activists by persuading a substantial number of shareholders to support management over the activist.³¹⁷ Consequently, even in corporations with strong governance, the probability of mistakenly firing loyal managers would decrease.³¹⁸

These effects explain why a smaller asset manager lacks the means and incentive to influence corporate governance in the same way that megamanagers such as BlackRock and Vanguard do. The sum of a smaller set of large voices is greater than the sum of a larger set of small ones. In short, following a breakup, common owners would no longer

313. See generally John C. Coffee, Jr., *The Agency Costs of Activism: Information Leakage, Thwarted Majorities, and the Public Morality* (Eur. Corp. Governance Inst., Working Paper No. 373/2017, 2017), https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=3058&context=faculty_scholarship [<https://perma.cc/TA4X-5NQX>] (outlining the relationship between activist hedge funds and “permanent shareholders”—BlackRock, Vanguard, and State Street).

314. See John Armour & Brian Cheffins, *The Rise and Fall (?) of Shareholder Activism by Hedge Funds* 8–9 (Eur. Corp. Governance Inst., Working Paper No. 136/2009, 2009), https://ssrn.com/abstract_id=1489336 [<https://perma.cc/ER7V-NYXQ>] (describing the “various types of transaction costs” that arise from an activist bid, including “communication costs,” or the costs of communicating with shareholders).

315. See Khan & Vaheesan, *supra* note 300 (“In short, concentration increases the likelihood that actors will share interests and decreases the costs of organizing to advocate for their agenda.”).

316. See Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 B.Y.U. L. REV. 1015, 1018–19 (observing that widespread shareholder activism is possible only because the rise of institutional investors have reduced collective action problems in assembling a winning coalition); A.N. Licht, *Corporate Governance*, in HANDBOOK OF KEY GLOBAL FINANCIAL MARKETS, INSTITUTIONS, AND INFRASTRUCTURE 369, 375 (Gerard Caprio ed., 2012) (noting that in dispersed-ownership firms, “[m]ounting a proxy fight to promote a proposal not sponsored by the board is a cumbersome, expensive exercise that may be reserved for special occasions”).

317. DELOITTE, *ACTIVIST SHAREHOLDERS: HOW WILL YOU RESPOND?* 3 (2015), <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/finance/wallace-cfo-insight-activist-shareholder.pdf> [<https://perma.cc/846X-KFYF>] (encouraging management to fend off activists by “proactively engaging with investors,” and especially with “major shareholders, who can be cornerstones of an activist defense”).

318. So, too, will the probability of correctly firing disloyal managers.

have the ability to impact corporate governance to the extent of creating a monopsony effect.

C. Restricting Proxy Advisers' Advice on Corporate Governance

To reinforce the effects of breaking up powerful institutional investors, the coordination between institutional investors through proxy advisers should be prevented. Institutional investors discharge their duty to vote if they vote according to a predetermined policy and based on the recommendations of an independent third party—a proxy advisory firm.³¹⁹ Indeed, many institutional investors have outsourced their voting responsibilities to proxy advisory firms—especially the two leading firms, Institutional Shareholder Services and Glass, Lewis & Co., with a combined market share of 97 percent.³²⁰ Consequently, proxy advisers have an enormous influence on share voting at publicly traded corporations in the United States,³²¹ and they are often perceived as “de facto corporate governance regulators.”³²²

Although proxy advisers provide economies of scale and scope in voting, their brand of one-size-fits-all voting has contributed to the labor monopsony. Most notably, proxy advisers' corporate governance policies universally favor strong governance.³²³ Given the externality that such policies impose on employees, regulators should prohibit proxy advisers from making recommendations on corporate governance issues. To be sure, this would hamper the economies of scale in voting that proxy advisers foster. But the burden on institutional investors to research governance proposals for themselves is justified by the need to break the lockstep toward strong governance that has hamstrung labor markets. Proxy advisers act as the ringmasters of a cartelized labor market; sidelining them would make cartel-like behavior harder to perpetrate.

319. Asaf Eckstein, *Great Expectations: The Peril of an Expectations Gap in Proxy Advisory Firm Regulation*, 40 DEL. J. CORP. L. 77, 92–93 (2015).

320. *Id.* at 93–94.

321. Asaf Eckstein & Sharon Hannes, *A Long/Short Incentive Scheme for Proxy Advisory Firms*, 53 WAKE FOREST L. REV. 787, 789 (2018) (describing the influence of Institutional Shareholder Services and Glass, Lewis & Co. in the United States).

322. Letter from Wachtell, Lipton, Rosen & Katz, to Elizabeth M. Murphy, Sec'y, SEC 6 (Oct. 19, 2010), <http://www.sec.gov/comments/s7-14-10/s71410-129.pdf> [<https://perma.cc/XTE7-EQJC>].

323. See Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2596 (2021) (describing proxy advisers' voting recommendations).

D. The Monopsony Model Revisited

The monopsony model above demonstrates how common owners push the corporate governance balance away from its equilibrium, resulting in a disproportionate number of strong-governance firms.³²⁴ After a mandated breakup, common owners would no longer have the same power to influence governance decisions *en masse*. Their ability to create a monopsony effect would be impaired or disrupted altogether. Thus, after a mandated breakup, investments would rise, stimulating hiring and pushing labor prices back to equilibrium.

Consider again the model introduced above, where, due to the influence of common owners, wages are \$20,000 below equilibrium (employees earn \$80,000 a year).³²⁵ From an equilibrium of fifty-fifty strong- and weak-governance firms, common owners have created a market of seventy strong-governance firms and thirty weak-governance firms. Moreover, common owners oppose any attempt to move corporations back toward weak governance, resulting in higher returns to their portfolios due to below-market wages.³²⁶

Now, however, suppose a mandated breakup has sidelined those common owners. Individual firms are once again free to make governance decisions that maximize their profits. To benefit from the \$20,000 additional profit from each employee hired, some strong-governance firms will switch to weak governance, incentivizing managers to invest and hire workers and generate abnormal returns.³²⁷ As more and more firms switch to weak governance, wages will rise until they equal the marginal revenue of each new hire.³²⁸ That is, wages will climb back to \$100,000. Moreover, as productivity increases over time, so too will wages, eliminating the monopsony effect in the long run.

A mandated breakup would disrupt the central mechanism of the monopsony effect. Capping AUM would restore competition to the labor market and balance to the aggregate corporate governance.

324. See *supra* Part III.D.

325. See *supra* Part III.D.

326. See *supra* notes 254–256 and accompanying text.

327. See *supra* Part III.B.

328. Under classical economic competitive conditions, wages are said to track productivity. Roy J. Rotheim, *Keynes and the Marginalist Theory of Distribution*, 20 J. POST KEYNESIAN ECON. 355, 356–57 (1998) (describing the “orthodox theory of distribution where factors of production receive unique rewards equal to the value of their respective marginal products”).

Thus, breaking up large asset managers is a significant step policymakers could take to eliminate the monopsony effect and return wages to their competitive levels.

E. Breakup, Agency Costs, and Inequality

The breakup proposal goes against the view of agency-costs essentialists that strong governance is an unmitigated good.³²⁹ This Article advocates for breaking up asset managers for precisely the reasons that other scholars have lauded their interventions. To take one example, scholars have praised institutional investors supporting activist hedge funds' campaigns to implement cost-saving and shareholder-empowering measures.³³⁰ Meanwhile, this Article views the “one-two punch” of common owners and activists as a threat to competitive labor markets, as it leaves directors and managers less willing to invest in hiring workers.

The key to allaying these concerns is the understanding that while agents introduce costs, so too do principals. Empowering agents increases agent costs while empowering principals increases principal costs.³³¹ For the past several decades, scholars have focused on how to ameliorate agent costs by empowering principals—that is, how to police corporate malfeasance by empowering shareholders to hold disloyal managers accountable.³³² This Article argues that the fight against agent costs has neglected to consider the principal costs it inflicts in the form of a labor market monopsony.

To be sure, a return to a world with more dispersed ownership would mean greater management agency costs. If activist investors are hamstrung in their ability to wage proxy fights against disloyal managers, for example, more inefficient investments would follow.

329. See Goshen & Squire, *supra* note 23, at 775 (describing agency-cost essentialism as the belief that “the reduction of agency costs is the essential role of corporate law and of related fields such as securities regulation”).

330. For example, Professors Gilson and Gordon describe activist investors as “governance arbitrageurs” who work alongside institutional investors in the service of “maximizing performance.” Gilson & Gordon, *supra* note 41, at 896–97.

331. Goshen & Squire, *supra* note 23, at 771 (“Principal costs and agent costs are substitutes for each other: Any reallocation of control rights between investors and managers decreases one type of cost but increases the other.”).

332. See John Armour, Henry Hansmann & Reinier Kraakman, *What Is Corporate Law?*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 1, 2 (Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock eds., 2d ed. 2009).

However, there would also be fewer downsizings,³³³ fewer mass layoffs,³³⁴ and fewer managers *mistakenly* fired for being disloyal.³³⁵ In the aggregate, both loyal and disloyal managers would be freer to invest. Indeed, shareholders would suffer a loss from more inefficient investments by disloyal managers, but shareholders would only be losing the value previously taken from employees.³³⁶ The result would not be a windfall to employees but rather a return to a more efficient and equitable balance between labor and capital.³³⁷

In short, agent costs have fallen too much, and principal costs have increased too much. In a competitive equilibrium, investors bear some *efficient* level of *inefficient* investments due to agent costs.³³⁸ Under the present equilibrium, those agent costs are too low, coming at the expense of lower wages. The claim that muffling institutional voices would increase management agency costs is correct, but it misses the point. Indeed, smaller asset managers would be less able to promote shareholders' interest in minimizing agent costs. But other interests—particularly those of employees—would be better served, as would the interests of the market as a whole.

CONCLUSION

In addition to explaining macroeconomic trends such as wage stagnation and growing income inequality, the monopsony effect of common ownership challenges the conventional wisdom in corporate law scholarship that strong governance is a net economic good. This Article identified the long-suspected—but until now, elusive—anticompetitive implications of common ownership and strong governance. While strong governance reduces management agency costs, it simultaneously discourages investment and hiring. Common ownership brings about a new and less efficient equilibrium, with

333. See Lazonick, *supra* note 161 (arguing that the new mantra of activist hedge funds has become “downsize-and-distribute” (emphasis omitted)).

334. See Brav et al., *supra* note 212, at 2764 (finding that employees at target firms experience stagnating hours and wages); Mariah Summers, *Employees Often End Up the Losers in Activist Investing Campaigns*, BUZZFEED NEWS (Apr. 21, 2014, 12:05 PM), <https://www.buzzfeednews.com/article/mariahsummers/employees-often-end-up-the-losers-in-activist-investing-camp> [<https://perma.cc/8ML4-4S8B>].

335. See *supra* notes 163–165 and accompanying text.

336. See *supra* notes 246–248 and accompanying text.

337. See *supra* Part III.C (arguing that the competitive distribution of wealth between labor and capital maximizes social welfare).

338. See *supra* note 247 and accompanying text.

higher corporate profits, lower wages, and increased income inequality. The inherent tradeoff of strong governance suggests that policymakers must choose between siding with shareholders or employees. If they choose employees, policymakers should consider breaking up common owners, thereby restoring wages to their competitive equilibrium.