11-8-2021

The Real Monopoly Is in the Boardroom

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Posted on November 8, 2021 by Ramsi Woodcock

We have always thought of the problem of monopoly as a problem of size or of markets. We say that Facebook is a monopoly *because it is too big*, or because it is in the nature of networked markets to reward scale.

But what if the problem of monopoly were really a problem of firm governance?

We don't hate monopolies in themselves; we hate them for what they do. They charge us higher prices or deliver us lower-quality products. They pay us less or make our jobs harder.

But what a monopolist *does* is determined not by its size or market position, for these things are just enablers, but rather by how the firm is governed.

The reason a monopolist chooses to charge a monopoly price, rather than the competitive price that it could still charge notwithstanding its monopoly power, has to do with monopoly of a different kind—not of markets, but of the boardroom. For a monopolist to exploit us, the firm's board must be dominated by an interest or interests that are antagonistic to our own.

That is because, as I argue in a forthcoming book chapter, if all of a monopolist's potential victims were to have a say in the firm's governance—thereby breaking the monopoly in governance—then the monopolist would charge competitive prices notwithstanding its power to do otherwise.

Our Monopolized Boardrooms

All of a monopolist's potential victims do not, of course, have a say in the firm's governance today.

The corporate form that we have today is, by design—not to mention the efforts of a generation of well-intentioned corporate governance scholars—dominated by a single interest: that of shareholders.

It is only for this reason that a monopolist in a sell-side market can be expected to exploit its power to harm consumers. And it is only for this reason that a monopolist in a buy-side market can be expected to exploit its monopsony power to harm workers or suppliers. The shareholders dominate governance of the firm, and so they can impel the firm to exploit its power and pay the proceeds out to themselves.

The proof that monopoly of governance makes for exploitation of monopoly power is evident in the one, pervasive, area of monopoly power that corporations today do not exploit: the firm's monopoly in relation to its shareholders.

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There is nothing at all unique about the relationship of the shareholders to the firm. They are suppliers like any other. What they supply is cash, in exchange for a return to be paid out to them as dividends or share buybacks. And the rate of return implied by the dividends and buybacks is the price that shareholders are paid for their cash.

While it is true that no market is more competitive than the market for financing, it is also the case that, once shareholders have supplied their cash to a firm, they are locked into it, unable to withdraw their money until the board votes to pay a dividend or buy back shares.

That means that shareholders are under the thumb of a monopolist. One might then expect the monopolist to impose on shareholders a low, monopsony rate of return. According to Daniel H.J. Greenwood, that return should be zero, nought, nothing, cipher, nil. The firm is free to take shareholders' money and run, because shareholders have been foolish enough to pay their money into the firm without obtaining a legal guarantee that they will earn a return.

Of course, if the firm wishes to raise capital in the future, it would do well not to exploit its power and instead to pay the shareholders a competitive price, otherwise known as the market rate of return.

But in fact the firm does neither.

Instead, shareholders pay themselves "the residual," which is a polite term for *the highest possible price*.

That's right: every other supplier to the firm gets paid a fixed price. But the shareholders get the highest possible price consistent with the amount of money that the firm has on hand to pay. There is no cap. If it is a profit of the firm, the shareholders get it.

So, whereas the shareholders, due to their locked-in status, are often the most vulnerable of all of the firm's counterparties, they are in fact paid as if they were the strongest and could dictate monopoly prices for their capital to the firm.

When corporate governance scholars write that the corporation allocates control over the firm to shareholders because shareholders are the most vulnerable of the firm's counterparties, they acknowledge the paramountcy of the monopoly of governance over the monopoly of markets.

Breaking Up the Monopoly in the Boardroom

If concentrating power over the board makes the exercise of monopoly power possible, then deconcentrating power over the board puts a stop to the exercise of monopoly power.

I show in my book chapter that bringing all of a monopolist's potential victims—that is, all of its counterparties—into the firm's governance on equal terms does the trick. If all of a firm's counterparties—workers, suppliers, and consumers, in addition to shareholders—were to be given an equal vote or the board, they would vote against all exercises of monopoly power and the monopolist would charge competitive prices in all markets.

This is a theorem, and it is worth repeating in italics: *if a monopoly's counterparties all have equal say over the monopoly's governance, then the monopoly will behave with respect to each as it would behave in a perfectly competitive market.*

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Comcast might be the only cable provider in my neighborhood, but if consumer advocates were to have the same number of votes for the Comcast board as do shareholders, then Comcast would not charge me a monopoly price for cable. I would get a competitive price even thought I would not buy in a competitive market.

And the same is true of workers and other suppliers to Comcast. If Comcast's labor unions were to have the same number of votes as shareholders, or the movie studios (an example of suppliers) were to have the same number of votes as shareholders, then Comcast's workers would receive a competitive wage and the movie studios would be paid a competitive price for their content.

And indeed if all these groups were to be brought into firm governance, then Comcast would charge or pay competitive prices to everyone with whom Comcast does business.

Giving all of a firm's counterparties an equal say in firm governance ends the monopoly of governance that is the sole cause of a monopolist's decision to exploit its power. As a result, it works what appears to be magic to those who are used to thinking about monopoly exclusively as a problem of markets: it achieves competitive pricing in markets in which there is in fact no competition.

That makes the breakup of the monopoly in the boardroom *antitrust by interior means*—the title of [my chapter].

The Magic of Competitive Pricing in Monopolized Markets

But why exactly would giving counterparties an equal say in a monopolist's governance lead to competitive pricing?

The reason is that monopoly power is pervasive in the modern economy, and so every counterparty fears it.

Every firm has monopoly power to some extent, because every firm sells a differentiated product. Even in a world of [fifty different Facebooks], some people would prefer one Facebook over another, and the extent of that preference would determine the extent of that little Facebook's power. It gives the company discretion to degrade its product a bit without needing to worry that it will lose business—how much depends on the extent of the consumer preference.

Similarly, to the extent that this little Facebook offers a different employment experience, or a different supply experience, the company will also have discretion to alter its wages, or the prices that it pays for inputs, without fear of losing its workers or suppliers.

But the fact that every firm has some amount of monopoly power means that each of its counterparties—its suppliers, workers, shareholders, and customers—has a good reason to fear that it will become a target of the firm's monopoly power.

And so for the same reason that public opinion tends to condemn government brutality directed at any discrete section of the public, a corporate board that is subject to the control of multiple counterparties will tend to condemn the exploitation of monopoly power directed at any one counterparty. Every voter thinks: "[that could happen to me]."

If consumers, workers, and suppliers can vote for the board along with shareholders, and the board resolves to exploit its power to raise prices in consumer markets, then not only consumers, but workers and suppliers, too, will vote against this resolution.

Because each counterparty will need the support of the others when the firm one day comes for that counterparty.

Indeed, even shareholders will vote against the resolution because, in a boardroom that shareholders no longer dominate, shareholders, too, will fear the firm's monopoly power. To be sure, shareholders can sell their shares if they do not like the rate of return that the firm pays them, but the price shareholders will receive for their shares is determined by the market's expectations regarding the rate of return that the board will pay on the shares. If the board decides to stiff shareholders on their dividends, the share price will fall. So shareholders cannot use the sale of their shares to escape the consequences of a firm's decision to exploit them.

Shareholders will, therefore, vote against a resolution by the board to charge monopoly prices to consumers for the same reason that consumers will vote against a resolution by the board to pay monopsony dividends to shareholders in exchange for their capital.

Why Not "Equality Pricing"?

It is a famous attribute of competitive pricing that it does not divide wealth equally between all players in the market. If counterparties having equal voting rights are willing to protect each other against the exercise of monopoly power, why won't they go further and insist that each counterparty take an equal share of the gains from trade with the firm?

That might be the better world for which we all pine, but an equal distribution of governance power among firm counterparties is not likely to produce it.

For more than one counterparty will likely stand to lose if the board votes to equalize gains, and a coalition of two can deadlock the board. If, for example, shareholders and consumers take the lion's share of gains from trade in a particular monopoly, they will vote against any policy of equalizing the gains from trade among counterparties, because equalization would make them poorer. In a quadripartite government, the resolution will not pass.

By contrast, only one party stands to lose from a move to competitive pricing by a monopolist: shareholders, because shareholders alone dominate corporate governance today.

All the other counterparties of the monopolist have either nothing to lose—if the markets in which they interface with the monopolist are at present competitive—or something to gain if they are currently victims of the monopolist's power over markets. If suppliers, workers, and consumers are each given an equal say over firm governance, they will, therefore, vote for competitive pricing, and outvote the shareholders.

So, equality of governance power among a firm's counterparties means competitive pricing, and therefore the distribution of wealth implied by competitive pricing as opposed to an equal distribution of wealth.

But it might come close.

For a firm in which power is divided equally between counterparties is also likely to be a firm in which profits are shared equally among those counterparties. Shareholders will no longer capture the entire residual. Workers, suppliers, and consumers will get the equivalent of dividends too, although the dividends may just come in the form of higher wages (for workers), higher supply prices (for suppliers), or lower product prices (for consumers), instead of quarterly checks.

In markets in which the profits of the firm at competitive prices happen to be high relative to the profits of its counterparties in the markets in which they do business with the firm, any inequality in the distribution of gains from trade among the counterparties will be small in relation to the (equal) share of the firm's profits distributed by the firm to each counterparty. So each counterparty will, overall, enjoy an approximately equal distribution of the wealth generated by the firm, inclusive of both the gains the counterparties earn in their market transactions with the firm and the profits the firm pays out to them.

Breakup in the Boardroom as an Antitrust Remedy

Deconcentrating power *in the boardroom* is the great unused tool of antitrust. Should we use it?

I think the answer is yes.

For breaking up power over boards solves a major problem for antitrust: what to do about good monopolies?

Firms get big by being bad, but they also, often, get big by being better. And often bigger *is* better, as seems to be the case with social networks, whether we like it or not.

Antitrust's traditional remedial kit doesn't have the tools to handle the good monopolist. Breakup (not of shareholder power over the board but of the entire firm) either destroys value for consumers or punishes legitimate success. And an injunction ordering a firm to desist from anticompetitive conduct or behave better is pointless when the firm got big by being better, rather than by engaging in anticompetitive conduct.

Antitrust in America has traditionally dealt with this problem by doing nothing. But that is not really a solution either, because monopoly power is still monopoly power, no matter how it is acquired: it enables the monopolist to dictate the share of the gains from trade that it extracts from its counterparties for itself, and so to make private decisions regarding the very public question how the surpluses generated by production—which by definition do not need to be given to any one group in order to ensure that production takes place—should be distributed.

Europe has tried to deal with this problem by making the charging of excessive prices an antitrust violation. But the rule is rarely enforced because the competitive price—the baseline against which excessiveness must be measured—is a theoretical construct. Predictions about what the competitive price would have been in any given market are just that: predictions. And easy for defendants to impeach.

This problem has also troubled the only other two solutions available in the American context: price regulation and its close cousin, corporate taxation. Even Congressionally created sector regulators can get prices wrong, and, in so doing, risk the same sin as antitrust breakup of entire firms: punishing a business for being better. The same goes for corporate taxation at excessive rates.

More plausibly, price regulators and the IRS fail to go far enough, allowing monopolists to keep most of their monopoly profits.

The beauty of breaking up power over the board is that it preserves the good monopolist intact. There is no breakup of the company. And no danger that a price or tax imposed upon it will leave the company insolvent. The monopoly is merely made to internalize its victims—that is, its counterparties. And in being internalized, the monopoly's victims, who now stand to profit from the monopoly's business, are made to internalize the monopoly's interests as well.

The result is a change in the monopolist's behavior that is at once consistent with the continued health of the firm and with the interests of the firm's counterparties. The firm itself can now be relied upon to find the competitive price, and to charge it. No bureaucracy necessary.

Another nice thing about breaking up power over the board is that the courts can start doing it today. Antitrust law is federal law, supreme over conflicting state corporate laws. And if a court applying the antitrust laws can force a company to break itself up, it can force the company to make fundamental changes in governance.

All courts would need to get there would be an action for no-fault monopolization, and that they have all but recognizedin the past, and could recognize again.

That is not to say that breaking up power in the boardroom would be without costs.

Much of the corporate governance literature of the past generation has been concerned with the problem of how to help numerous and disorganized groups of shareholders wield their power over the board effectively. Adding three more governing groups, each often more disorganized and heterogeneous than shareholders, will surely further paralyze corporate action, and give managers freer reign to mismanage.

But monopoly also has its costs—both the famous deadweight losses associated with pricing willing buyers and sellers out of markets and the costs associated with wasteful competition by firms to achieve monopoly positions.

Breaking up power in the boardroom will eliminate these monopoly inefficiencies for the vast population of good monopolies that until now have been entirely free to charge whatever prices they wish. The costs of board democratization certainly could outweigh the benefits.

But the benefits could also outweigh the costs.

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This post is adapted from his paper, "*Antitrust by Interior Means*" available on SSRN.

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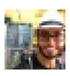

Ramiro de Ávila Peres says:

November 8, 2021 at 2:46 pm

Great post! I saw you mention, en passant, some examples of cooperative corporations… I wonder if your case would imply that a credit union can't abuse its customers, as it congregates lenders (i.e., depositors) and borrowers.

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