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Asset Manager Capitalism?

The Influence of Institutional Investors on Corporate Governance and the Varieties of Capitalism

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Abstract: This thesis considers the link between changes in the shareholder ownership structure and the governance of firms. Making use of extensive interview data it assesses the governance activities of asset managers in Germany, the UK and the US. The thesis makes use of the varieties of capitalism framework to assess the extent of convergence or divergence between the respective national varieties. Since the largest asset managers are US firms, the institutionalisation of share ownership could be expected to lead to the Americanisation of global corporate governance. However, despite a convergence in form, no corresponding convergence in function is observed. Instead a considerable continuity in the heterogeneity of national models of capitalism is noted. This is due to national differences in the relative resourcing of active and passive asset managers, of proxy advisors and corporates as well as the approach followed by the respective governments. In the US, where index funds have a comparatively larger market share, the domestic regulatory approach results in a bigger potential for conflict between shareholders and corporate managers. In the UK and Germany, on the other hand, the relationship between asset managers and corporates is shown to be less antagonistic. This is due to the greater relevance of proxy advisors, the smaller market share of US index funds, the stewardship approach of domestic asset managers and because of the regulatory approach pursued by the governments in the UK and Germany, which seeks to balance expanded shareholder influence with greater consideration of stakeholder concerns.

Lay Summary: Over the past century the shareholder ownership structure of the typical stock market listed company has been turned on its head. Instead of holding shares directly, most households today hold shares indirectly via pensions and investment products offered by asset management firms. Because of substantial economies of scale, the asset management industry is dominated by a relatively small group of very large firms. The voting rights that come with these shareholdings give this small number of asset managers substantial say in how companies are to be run. It is therefore important to understand how these asset managers cast their votes and what the consequences of this are for individual firms and for their respective national models of capitalism. To answer these questions a large number of UK, US, and German asset managers and stock market listed companies and their advisors were interviewed. The results show that differences in attitudes as well as differences in the relative resourcing of actors (index funds, active funds, domestic funds, foreign funds, corporates and proxy advisors) mean that in each of these countries the relationship between asset managers and companies differs. Instead of the growth of the asset management industry leading to an Americanisation of national models of capitalism, national models of capitalism therefore continue to exhibit considerable differences.

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Chapter 1

Introduction

Introduction

Most people, whether they live in Germany, the UK or the US, will not be aware that through their pension funds as well as any household savings invested in mutual funds or Exchange Traded Funds (ETFs), they have an indirect say about how some of the biggest companies in the world are run. They will also not have heard of proxy advisors such as ISS or Glass Lewis that assist the institutional investors, who manage those savings, in voting their shareholdings. They will therefore be unaware of the struggle that is unfolding between corporates and shareholder interests to different degree in the three countries concerned.

The influence of institutional investors, and consequently the indirect say of private investors and pensioners, stems from the voting rights that come with shareholdings. In principle, each ordinary share has one voting right.[1] The more shares an investor holds, the greater the percentage voting rights they represent. The growth of institutional investors documented in this thesis has therefore resulted in an increase in the size of asset managers' average voting blocs, which in turn has changed the balance of power between corporate executives and institutional investors in Germany, the UK and the US.

[1] There are exceptions to this: Some companies issue "preference" shares alongside "ordinary" shares that typically make up for a lack of voting rights with higher dividends. Other firms, particularly from US tech firms, have been criticised for either issuing shares without voting rights, or providing their founders with voting rights that are up to 500x higher ("dual class" shares). It is considered "best practice" for companies to only have share with equal voting rights. For further information, see: https://www.cfainstitute.org/en/research/survey-reports/dual-class-shares-apac-survey-report (Accessed 14 January 2020).

Up until 1965 individual shareholders held the vast majority of shares of listed companies, representing approximately 84 percent of all outstanding shares in the US (Useem, 1996).[2] During this time, individual shareholders faced a collective action problem in organising their interest vis-à-vis company management. In the UK and Germany, the level of individual ownership was not as high as in the US, however, the collective action problems were comparable. Since a large number of private individual investors each held a very small part of the company's shares, they were thus likely to be rationally apathetic when it comes to exercising corporate control (Berle and Means, 1932; Grossman and Hart, 1980). Berle and Means therefore concluded that the listed corporation has 'destroyed the unity that we commonly call property' and split 'the old atom of ownership into its component parts, control and beneficial ownership' (1933: 8). The result of this separation was that control of the firm rested with management. The era from the 1930s to the late 1980s therefore became known as the era of "managerialism" (Davis, 2009).

Since the time of Berle and Means the ownership structure of publicly listed companies in the United States and Europe has been turned on its head. From holding less than thirty percent of outstanding shares in 1965, institutional shareholders grew to control 50 percent of the shares of US listed companies in 1990 and continued to increase their holdings by approximately one percentage point per year, reaching approximately seventy percent of shares outstanding in 2018 (Useem, 1996; PwC, 2018). In the case of the largest US companies, those contained in the S&P 500 index, institutional ownership stands even higher at eighty percent of shares as of

[2] Data for the UK and Germany is incomplete. Rydqvist et al. (2010) report that UK households held 65.7 percent of UK share capital in 1957, and German households held 32.8 percent in 1953, therefore showing that UK and German households never held as many shares as their US peers. However, the overall trend of falling household share ownership and rising institutional share ownership is.

April 2017 (Pensions & Investments, 2017). Furthermore, much of the remaining individual ownership today is by employees, especially company founders and top management.[3]

The development in the UK and Germany largely mirrored that seen in the US. Institutional share ownership increased continually from the 1970s to reach 44 percent in the UK and 77 percent in Germany by 1990 and then continuing to increase further, to reach approximately 90 percent in both countries by the middle of this decade (European Commission, 2013; Jürgens and Rupp, 2002; UK ONS, 2018).

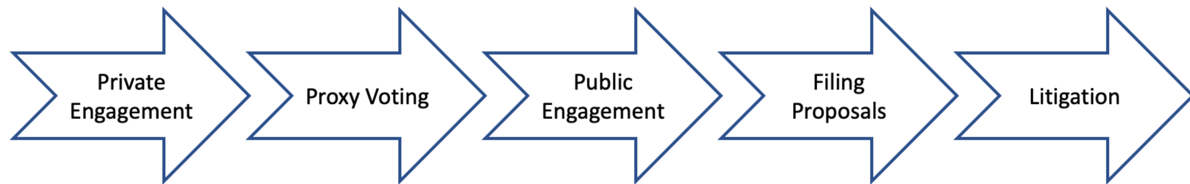
This re-concentration of corporate ownership has had the effect that corporate managers are today faced with shareholders that represent much larger stakes, are better resourced and are able to coordinate their actions with greater ease. The biggest of these institutional investors are the large asset managers, who manage funds on behalf of private individuals, corporates and pension funds as well as other investors such as family offices and sovereign wealth funds. Their large stakes have provided asset managers with the means to exert greater influence over corporate strategy. While they have these means this does not, however, mean they necessarily make use of them.

The way in which asset managers seek to influence companies' corporate governance is through "engagement" or "stewardship" activities. In the process of stewardship, most investors follow "escalation policies" or "escalation strategies". These policies arrange different means of engagement along a spectrum of options, typically starting with private

[3] Technology companies such as Facebook, Amazon, Alphabet or SAP are examples of companies where the founders maintain stock ownership. Furthermore, the National Center for Employee Ownership reports that employee share ownership plans (ESOPs) or ESOP-like plans in the United States held assets of $1.4 trillion as of 2015. Source: https://www.nceo.org/articles/statistical-profile-employee-ownership (Accessed 20 October 2019)

engagements (emails, letter, phone calls, meetings) and ending with the filing of resolutions or in rare cases in litigation. Public engagement may include press interviews, investor coalitions, or speaking at company's AGM. Figure 1 provides an example, based on recommendations by the NGO ShareAction and the United Nations Principles of Responsible Investment (PRI).

Figure 1: Spectrum of Shareholder Engagement



Source: ShareAction, UN PRI[4]

At times asset managers have shied away from using their powers, leading to accusations of their resembling "absentee landlords" (Investments & Pensions Europe (IPE), 2011). However, when they have sought to take on a more active role, they have also come in for criticism from corporate interests who have accused them of pursuing political goals when supporting shareholder proposals on environmental, social and governance (ESG) issues (The New York Times, 2018). This two-sided pressure means that asset managers might therefore appear to have to tread a tightrope in protecting the financial interest of their investors while facing opposition from corporate interests and having to ensure they maintain a social license to operate from society as a whole. The consequence is that it is not clear whether this new world deserves the nomenclature of "asset manager capitalism" (Braun, 2016). Asset manager capitalism for the purpose of this thesis is defined as a governance model in which asset managers are the primary supplier of equity funding and where they are able to demand changes

[4] For details on the ShareAction policy recommendation, see: https://shareaction.org/wp-content/uploads/2018/03/InvestorReport-GoodEngagement.pdf For the UN PRI, see: https://www.unpri.org/listed-equity/developing-an-active-ownership-policy-/2724.article (Accessed 4 April 2020).

to corporate policies, when they deem it necessary, against the preferences of corporate executives.

How, and to what extent, shareholders are able to exercise control over their investee companies is determined by a set of "corporate governance" rules and institutions. Corporate governance is a complex concept, the definition of which may take on a number of forms (Clark and Wójcik, 2007). Shleifer and Vishny (1997), pioneers of the law and finance literature, define corporate governance as the set of rules by which suppliers of capital can assure themselves of receiving the returns from their investments. Benton (2017) takes a broader relational approach to corporate governance, which does not focus exclusively on shareholder rights. Instead he considers corporate governance as the set of rules that sets out how power is allocated within a company, in particular amongst its board of directors, managers and shareholders.[5] The different focus on shareholder interests implicit in these two definitions mirrors a schism present in the finance literature with respect to the purpose of the firm. On the one hand, there is the "shareholder value" literature, commonly attributed to the work of Jensen and Meckling (1976) and Friedman (1970) and on the other hand there is the "stakeholder" literature, typically attributed to Freeman (1984).

Proponents of shareholder value maximisation expect a company's managers, as the agents of the owners, to focus their efforts on maximising the returns for shareholders.[6] Furthermore, this literature regards shareholders as the "residual claimants" on a company's assets (Easterbrook

[5] The US Securities and Exchange Commission (SEC, 2010) defines corporate governance as follows "Corporate governance establishes a system of accountability among shareholders, directors and managers through rules and regulations, the corporate charter and bylaws, formal policies, and customs. This process helps determine the leadership, organization, and direction of the company".
[6] A number of legal scholars dispute the interpretation of shareholders as owners, highlighting that share ownership does not equate to company ownership and that such rights are not to be found in law (Bainbridge, 2003; Ireland, 1999; Stout 2012).

and Fischel, 1985; Jensen, 2000). Since shareholders will only be paid once all others have been paid, they are, it is argued, best placed to be the ones monitoring the performance of the managers.

Proponents of stakeholder theory, on the other hand, regard shareholders as just one of several groups of stakeholders, each with legitimate claims on the company. Freeman defines stakeholders as "any group or individual who can affect or is affected by the achievement of the organization's objectives" (1984: 46). Accordingly, it is the duty of company directors to operate the firm in the interests of all stakeholders and to act as an impartial referee with only the interests of the firm in mind (Aoki, 1984). Doing so will ensure companies operate at an optimal rate as individual self-interest is bounded and stakeholders respond to reciprocity (Bosse et al., 2009; Phillips, 1997). The concept of reciprocity contends that stakeholders respond positively and disproportionately to positive deeds. Raising wages or providing for flexible working arrangements, for example, is said to increase employees' productivity by a greater magnitude than the cost incurred by the employer.

Corporate governance is set at two distinct levels: the societal level and the company level. The company level is set by its shareholders in the articles of incorporation and often revised at companies' general meetings. With regards to the societal level, corporate governance frameworks result from a country's laws, which in turn are a product of its politics, business practices and norms. The World Bank therefore recommends that each country should endeavour to devise its own corporate governance code, as "whilst globalization of economies has increased, and international corporate guidelines have been adopted, each country has its own values, societal norms, way of doing business, and special circumstances" (2005: 1). Corporate governance is therefore an intrinsically political undertaking. In this line of thought

Gourevitch and Shinn (2005) explain that corporate governance lies at the heart of comparative political economy since it determines the conditions under which funding is provided, thereby affecting countries' economic prospects.

The corporate governance literature can be grouped along the four broad questions that it seeks to answer. Firstly, there is the literature that sets out to explain the nature of the modern firm, the contractual arrangements that create it and by what means shareholders interest can be secured. The basis of this literature is to be found in the "theory of the firm" and principal-agent relationships (Berle and Means, 1932; Easterbrook and Fischel, 1991; Jensen and Meckling, 1976). This literature also discusses the extent of shareholders' ownership rights of the firm (Bebchuk, 2005; Friedman, 1970; Stout, 2012; 2016) and considers how shareholders may seek to respond to challenges to their rights.

Related to this, the "law and finance literature" (La Porta et al., 1998) links the shareholder ownership structure to national variations in shareholder protection and contends that shareholders will seek to protect their minority rights by amassing larger stakes, which result in higher ownership concentration. Such "blockholders" (Edmans and Holderness, 2016) play a special role with the governance of firms since their larger stakes reduce the collective action problems faced by smaller stakeholders. An adjacent literature looks at financial intermediaries and private governance authorities that help investors overcome information asymmetries in the principal-agent relationship. This includes the literature on credit ratings agencies, index providers and proxy advisors (Petry et al., 2019; Robertson, 2018; Sinclair, 2005).

Third, there is the literature that seeks to determine how, and in whose interest, companies should be managed. This includes the literature on shareholder primacy and shareholder value

(Jensen, 2002; Keay, 2010), stakeholder value (Freeman, 1984; Freeman et al., 2010), as well as the literature on corporate social responsibility (Carroll, 1999; 1999; Friedman 1970).

The fourth block of literature is concerned with the broader consequences of how companies are governed. It is this third block of literature, in particular the literatures on the varieties of capitalism (Amable, 2003; Crouch and Streeck, 1997; Hall and Soskice, 2001, Hardie et al., 2013) and the process of financialisation (Maxfield et al., 2017; van der Zwan, 2014) that this thesis will be primarily concerned with. The most comprehensive and prominent contribution to the varieties of capitalism has been provided by the eponymous work of Hall and Soskice (2001). Hall and Soskice advance a number of propositions such as the fact that individual countries' models of capitalism can be divided into two broad categories: liberal market economies (LMEs) such as the United Kingdom and the United States and coordinated market economies (CMEs) such as Germany. In LMEs, it is argued, companies finance themselves primarily via capital markets, while in CMEs close relationship to domestic banks provide firms with funding.

The literature also makes a number of other explicit and implicit assumptions about how national models are likely to develop. Central to these is the belief that CMEs and LMEs represent stable and reinforcing equilibria (Hall and Soskice, 2001) and that CME's are naturally doomed to extinction, leaving only LMEs ultimately to prevail (Goodin, 2003). This thesis seeks to assess to what extent the rise of the asset management industries in Germany, the UK and the US has affected these propositions. This includes asking questions, such as, whether it is still appropriate to consider the US and Germany as representing stable equilibria, looking for signs that the German CME model is converging on the US LME model, and

assessing whether executives of UK and US firms retain managerial autonomy in their decision-making.

In doing so this thesis builds on the literature on pension fund capitalism (Clark, 1998; Hebb, 2008; Webber, 2018), asset manager capitalism (Braun, 2016; Fichtner et al., 2017; Harmes, 2001; Useem, 1996;) and fiduciary capitalism (Hawley and Williams, 2000; Richardson, 2013), which stress the need to differentiate between shareholder types as different institutional requirements lead to different allocation and engagement practices. Pension funds, for example, have longer investment horizons and generally broader portfolio holdings than, for example, active mutual funds or hedge funds, meaning that they can be considered as "patient capital" (Deeg and Hardie, 2016) and "universal owners" (Hawley and Williams, 2007).

While the academic literature has long realised the significance of corporate governance, the attention it has given it has increased substantially over recent years. Gillan (2006) finds that a search on the Social Science Research Network (SSRN) for research documents containing the term "corporate governance" returned 3,500 results in 2006. While this was already a very large body of research, a repeat of this search in May of 2020 returned 15,398 documents. A look at the results bears testament not only to the level of academic interest the topic is receiving but also the interdisciplinary nature of the concept.

Chapter Structure

With a focus on changes in, and implications of, the shareholder ownership structures in Germany, the United Kingdom and the United States, this thesis investigates the relationship between changes in ownership structure and changes to companies' corporate governance, and

the implications for the varieties of capitalism in the three countries. The next section will set out the central research question of this thesis. This is followed by an explanation of why institutional investors are the appropriate level of analysis.

Engagement, including shareholder voting, is the primary means by which shareholders exercise influence over a company. Throughout, shareholders have the choice between employing their voice, exiting their shareholdings in their portfolio companies ("the Wall Street walk"), or remaining silent while remaining invested ("loyalty"). The work of Hirschman (1970) is therefore introduced next, as it provides an appropriate framework for the analysis of shareholders' choices.

Following on from this, five developments that either result from or contribute to, the increasing ownership concentration will be introduced. These five developments are divided into two first-order and three second-order developments. The first-order developments are those that have caused the increasing levels of ownership concentration, while the second order developments are consequences of that rising ownership concentration. Together these five developments make up the independent variables of the research question and will each be discussed in more depth in dedicated chapters of this thesis.

The remainder of this introductory chapter will explain the methodological approach of the thesis. This will include the reasoning behind the choice of the three countries as well as the selection of interviewees, an explanation of the decision to interview and an outline of the interview data collected. This chapter concludes with an outline of the structure of the remainder of the thesis.

The Research Question

By helping to overcome the collective action problems previously faced by the highly dispersed share ownership amongst individual shareholders, the re-concentration of corporate ownership that has resulted from the growth of asset managers has provided shareholders with the necessary conditions to exercise greater control over corporate management. In many cases, shareholders today are able to nominate corporate directors more easily, submit shareholder proposals and ensure there is an increased likelihood that they pass through concerted actions, which have been eased by regulatory overhaul (see, for example, European Parliament, 2012; United States Court of Appeals, 2011).

However, whether institutional investors are assuming this control and what that control, if assumed, might mean for national varieties of capitalism, is not yet certain. While there have been instances of asset managers using their powers to, for example, force Exxon Mobil Corp to report on climate risks,[7] there are also reports that investors, particularly the three biggest asset managers BlackRock, Vanguard and State Street Global Advisors (collectively known as the "Big Three"), fail to challenge corporates on issues such as excessive CEO pay (As You Sow, 2020). There is also, as will be discussed, evidence of considerable heterogeneity across the three countries considered.

Gourevitch and Shinn (2005) take a top-down macro approach in their investigation of how politics shape public policy and how the resulting regulations influence shareholder structure. In focussing instead on how changes in ownership structure result in changes in corporate

[7] Reuters, 31 May 2017, "Exxon shareholders approve climate impact report in win for activists", available at: https://www.reuters.com/article/us-exxonmobil-climate/exxon-shareholders-approve-climate-impact-report-in-win-for-activists-idUSKBN18R0DC (Accessed 20 October 2019)

governance frameworks, this thesis seeks to contribute to the literature a bottom-up micro understanding of changes to corporate governance. My research question is:

> *What are the consequences of the changes in the shareholder ownership structure for the corporate governance of stock market listed firms?*

My dependent variable, the corporate governance of stock market listed companies, will follow the definition of Hall and Soskice (2001), by differentiating between LME and CME systems. Due to networks of cross-shareholdings and interlocking directorships the literature assumes that corporate managers in CMEs are less sensitive to current profitability while managers in LME are considered to be more exposed. Furthermore, management in CMEs is considered to be more by consensus, whereas executives in LMEs are considered to be more independent in their decision-making (Hall and Gingerich, 2009).

The following chapters will document that the rise of the asset management industry in all three countries has resulted in asset managers on average holding much larger ownership blocs. Combined with the fact that a greater proportion of assets is today managed in index strategies, this means that the selling of shares has become increasingly difficult. Engagement therefore takes on a more important role. Greater investor stewardship may have considerable consequences for the governance of firms, and differences in the stewardship approaches of asset managers in different countries may impact the trajectory of individual countries' varieties of capitalism.

In looking at consequences for corporate governance, the aim of this thesis is therefore not to conduct quantitative tests to ascertain whether shareholder value orientation (SVO) has

increased in Germany; this has already been done by others (Bradley and Sundaram, 2004; Fiss and Zajac, 2004). Instead the focus is on identifying and understanding how the different dynamics that are changing the shareholder ownership structure are influencing the way companies are governed by shareholders in Germany, the UK and the US both from a micro perspective and from the perspective of the varieties of capitalism.

To this end the independent variable, changes in shareholder ownership structure, is separated into two first-order developments. These first-order developments are the institutionalisation of shareholder ownership and the growth of index investing. Next, three second-order consequences, which result from one or both of these first-order developments are considered. These are the internationalisation of share ownership, the advent of proxy advisors, and the corporate (lobbying) response to growing shareholder ownership concentration.

All of these developments are related. Institutionalisation created the foundations for index investing and the rise of index investing has further super-charged the institutionalisation of asset management. Together these two developments lead to a diversification of both domestic and international portfolio holdings. For asset managers this has meant that they have to vote at a growing number of individual companies, thereby creating the need for proxy advisors. Finally, the rise of shareholder ownership concentration that resulted from institutionalisation and indexation has created the preconditions necessary to shift the balance of power from corporate managers to institutional investors. All of the aforementioned developments therefore triggered the current corporate backlash, detailed in Chapter 7.

The appropriate level of analysis

While previous studies such as Gourevitch and Shinn (2005) and La Porta et al. (1998), have employed the degree of ownership concentration as an indicator of corporate governance, financial innovations such as Exchange Traded Funds (ETFs) have resulted in the creation of "blockholders" whose purpose is not primarily the protection of shareholder rights.[8] As I will show in Chapters 2 and 3, these developments have resulted in the levels of ownership concentration in Germany, the UK and US equalising, leading to talk of convergence in corporate governance models across countries. However, I will demonstrate that ownership concentration by itself is today no longer sufficient to draw conclusions as to the governance of firms. I therefore contend that it is necessary to look beyond the mere level of ownership concentration before drawing any conclusions with regards to corporate governance and shareholder protection.

Different types of investors will face different regulatory and cost pressures, have different time horizons and performance pressures and will thus make different uses of their governance powers. The causal link between ownership concentration and shareholder protection, as well as the motivation behind the creation of blockholdings, historically made by the law and finance literature therefore no longer applies. As I will go on to illustrate, the present-day levels of ownership concentration are primarily driven by economies of scale and not by governance considerations.

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[8] ETFs are forms of passive investing. Passive investments are defined here in line with Braun (2016a) as those that aim to track, rather than beat, the performance of a benchmark index. Unlike passive mutual funds, which can only be bought and sold once per day (typically a time lag of one or more days), ETFs trade like ordinary stock and can be bought and sold continually on stock exchanges during market hours.
Shareholders with stakes in companies exceeding 5% of the issued share capital are commonly referred to as blockholders. This is a very simplistic definition and as Edmans and Holderness (2016) suggest, it may also be worth considering stakes below the 5% threshold and to expand the definition to take account of the dollar value of a shareholding.

These economies of scale result in significant cost pressures in the asset management industry, thereby limiting the funding available for governance activities. Yet the rising indexation of investment management also means that the proportion of investors for whom it is impossible to provide a governance signal by selling shares has been increasing, and therefore the role of engagement within corporate governance should be expected to increase. There is thus an inherent tension between growing cost pressures and growing governance requirements. These pressures are further exacerbated by increasing regulatory demands as well as social pressures for stewardship.

Investor Type

Davis defines institutional investors as “specialised financial institutions which manage savings collectively on behalf of small investors, towards a specific objective in terms of acceptable risk, return-maximisation and maturity of claims” (1996: 64). The one qualification I would add to this definition, is that institutional investors such as mutual funds, may also manage investments for other institutional investors such as corporate pension funds or sovereign wealth funds. Institutional investors provide a number of common features, most notably risk pooling, fiduciary management and economies of scale (Harmes, 2001).

Asset owners and asset managers sit at the centre of the investment industry. Asset owners are typically defined to include endowments, family offices, insurance companies, pension funds and sovereign wealth funds (Clark and Monk, 2018). In addition to these institutional asset owners, private individuals are a further large ownership group. While these asset owners may choose to manage assets themselves, many of them outsource at least some of their assets to asset management firms who manage them on their behalf (The Investment Association, 2016).

What results is an "investment chain", which is "the set of intermediaries that 'sit between' savers and companies or governments" (Arjaliès et al., 2017).

The ownership concentration highlighted in this thesis is primarily a result of the growth in pension fund assets and the institutionalisation of private "retail" investments. On a global level, Willis Towers Watson (2018a) estimates that institutional investors control $132 trillion in savings (across all asset classes) as of the end of 2017. Of these pension funds and mutual funds manage $45 trillion each with the remainder managed by insurance companies, sovereign wealth funds and endowments and foundations.

The corporate governance literature has traditionally been concerned only with one single relationship; the principal-agent relationship between shareholders and managers of the firm (Berle and Means, 1932; Easterbrook and Fischel, 1991; Jensen and Meckling, 1976). Yet, the investment chain is significantly more complex than much of the finance and law literature would have us believe. Instead Gilson and Gordon (2013) have coined the term "agency costs of agency capitalism" to illustrate how the multiple relationships that exist within the investment chain have resulted in multiple levels of agency problems, beyond that identified by Berle and Means (1932). This chain can be longer or shorter depending on the respective institutional set up.

For example, it may start with a retail investor, connect to her asset manager and from there connect directly to the corporate executive that runs the firm, at which point it ends. In the case of an employee investing in a company pension fund the chain could be substantially longer. It may start at the employee, from there connect to the pension trustee, who select the pension fund manager, who in turn may invest through an ETF, whose asset management firm then

(may) ultimately engage with the corporate manager. However, in some cases the pension fund will manage the assets in-house, thereby fulfilling the function of both asset owner and asset manager and thus resulting in a shorter chain. Asset owners in the context of this thesis are defined here as the ultimate beneficial owners of assets. This definition therefore includes, for example, private individuals and insurance companies.

The institutional consequences of rising shareholder ownership concentration

Since increasing ownership concentration has created the conditions to enable increased shareholder oversight, this raises the question of how investors are harnessing their new influence. By what means are they exercising their control, to what end are they doing so, and what are the differences between countries? In this regard, Hirschman (1970) provides a compelling framework. He explains that consumers, or in this case shareholders, have three choices if they are unhappy with the conduct of a company. They can move on and leave (exit) the company, they can raise their voice and seek to change it, or they can remain silent and loyal. Hirschman further explains that the "decision on whether to exit will often be taken in the light of the prospects for the effective use of voice" (1970: 37).

While providing a remedy for the collective action problem, the growth of asset managers also poses a new challenge. Ever-greater shareholdings by a relatively small number of very large institutional investors means it is increasingly difficult for these institutions to sell their shares in a company without substantial negative price effects. The tracking error constraints that come with passive management further limit the ability to sell.[9] While asset manager capitalism

[9] Tracking error indicates how closely a fund follows its benchmark index. A tracking error constraint is sometimes introduced to limit the extent to which a fund manager may diverge from a reference benchmark.

has potentially given investors greater influence over company strategy, if this influence does not suffice to achieve the desired effect in corporate policies, then investors may find themselves in a situation where they have little say and no ability to sell. In Hirschman's terms, the growth of institutional investors has increased the potential of voice but decreased the ability to exit (a dynamic discussed in detail in Chapter 3).

The question thus arises of which institutional consequences for the varieties of capitalism will result from the rise of a shareholder base increasingly incentivised to utilise voice. North (1990) defines institutions simply as "the rules of the game". Jackson and Deeg build on this definition to explain that "[i]nstitutions exist in distinct national configurations or types that generate a particular systemic logic or economic action and competitive advantages related to complementarities among those institutions" (2008: 541). These national configurations are what makes up the varieties of capitalism.

Hall and Soskice (2001) explain that these national configurations differ in how actors strategically interact with one another and that those institutions that condition the interactions of actors will be the most important differentiators. In their firm-centred approach. Hall and Soskice (2001) focus on five spheres within which firms must resolve coordination problems in order to remain successful: industrial relations, vocational training and education, inter-firm relations, their own employees and corporate governance. Each of these spheres is important (as stakeholder theory teaches us), but the focus of this thesis lies only on the latter sphere of corporate governance and specifically, how institutional investors, their proxy advisors and corporates interact.

With regards to the complementarities amongst institutions, raised by Jackson and Deeg in the above quotation, Amable (2003) explains that complementarities exist, when the presence of one institution increases the returns or efficiency of another. Deeg (2010) illustrates complementarities with the example of 'radical innovation', which is said to be one of the competitive advantages of LMEs. He explains that this radical innovation can only be achieved because labour markets are flexible enough to allow for a dynamic reallocation of resources to new ideas, while the financial markets provide the necessary risk-oriented capital. In LMEs the labour and financial markets thus complement each other to achieve comparatively high levels of innovation.

In order to fruitfully integrate the concept of complementarity into theories of institutional change, "it is necessary to have a political economy definition of complementarity, which should not take institutions as some sort of inputs in a production function, but as socio-political compromises established in historically-specific conditions" (Amable, 2016: 1). Chapters 3, 5 and 7 will therefore focus on highlighting the strategic interactions of asset managers, proxy advisors and corporates respectively to show how such socio-political compromises are reached in the age of asset manager capitalism. Differences in these interactions result in different compromises, which in turn may contribute to varieties of capitalism diverging. As the following chapters will document, the nature of the relationship between institutional investors in the three countries studied differs substantially. Chapter 8 confronts the comparative political economy literature with the contemporary insights presented in the previous chapters in order to highlight where the present-day shareholder ownership structure has resulted in institutional configurations that differ from what the literature would lead us to expect.

The financialisation literature

The varieties of capitalism framework predicts that countries are likely to continue to develop in heterogenous ways as national models of capitalism confront challenges by doubling down on their respective strengths. The existence of complementarities between different spheres of economic coordination dictates a country's response and creates a degree of path dependency. Since complementarities dictate the logic of how countries respond to institutional change, there are important insights to be drawn from their analysis.

However, in order to ensure the thesis provides the necessary depth of micro-level analysis of market practices, an equivalent analysis of how changes in corporate governance influence the functioning of other spheres such as employee relations is largely beyond the scope of this thesis. Yet, there are important insights to be gained with regards to the political economy discourse by consider how the asset management induced changes to corporate governance are influencing society at the macro level, particularly with regards to inequality. To this end, this thesis will employ the literature on financialisation alongside the varieties of capitalism. Doing so will help situate the findings of the thesis in the broader debate about the relative power of financial and nonfinancial actors in the economy.

Financialisation assesses "how an increasingly autonomous realm of global finance has altered the underlying logics of the industrial economy and the inner workings of democratic society" (van der Zwan, 2014: 100). It is these logics that may otherwise be missed by an exclusive focus on complementarities in the varieties of capitalism. Whereas the VoC literature represents a firm-focussed approach, the financialisation literature takes a multi-layered perspective, considering effects on the household, the firm and the state. Considerations of the financialisation of the "everyday life" of individuals (Langley, 2008; 2020a) make it better

suited to address social issues. The financialisation literature will therefore be employed when discussing issues of inequality resulting from the distributional consequences of asset manager capitalism.

Both the varieties of capitalism and the financialisation literature implicitly address the convergence/divergence hypothesis. Financialisation is “a process that grants an increasing role to financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies” (Maxfield et al., 2017: 1007). It therefore describes the shift from industrial to finance capitalism (van der Zwan, 2014) of which the growth of the asset management industry is one potential indicator.

Since finance capitalism is generally considered to be most advanced in the US (Davis and Kim, 2015), there is an implicit assumption of a ‘financialisation convergence hypothesis’ (Maxfield et al., 2017) akin to the convergence of CME to LME countries often assumed in the VoC literature. Yet the extent to which financialisation is advancing differs greatly from country to country and does not equate to a homogenization of economic models (Karwowski et al., 2020; Maxfield et al., 2017).

Karwowski et al. find that “while the behavior of the world's largest globally active financial institutions is converging irrespective of home domicile, their activities are not necessarily leading to the general global homogenization of financial forms and activities implied by the financialization convergence hypothesis” (2020: 957). The financialisation literature thus risks sharing the problem of VoC in not looking more closely at finance. Instead this thesis notes a convergence in form only, without a corresponding convergence in function. Asset managers are not behaving the same in different jurisdictions. While previous research has highlighted

the growing role of asset managers within US corporate governance (Fichtner, et al. 2017), this thesis contributes a comparative perspective to the literature by focussing on differences in asset managers' conduct across countries.

Chapter 2 will show that the relatively larger asset management industries in the United Kingdom and the United States are the result of relatively weak social security and pensions provisions that require individuals to ensure greater private provisioning. Financialisation of pensions provisions thus provided the nurturing soil for asset manager capitalism to grow, but the extent of this support provided differed from country to country. Sticking with the image of nurturing soil, the nutritional content differs by country and has contributed to the heterogenous development of individual country's asset management industries. Dixon and Sorsa find that the increasing relational proximity between national pensions systems and global financial markets "is deeply embedded in existing institutional practices typical of each political economy, simultaneously supporting continuity and change" (2009: 347).

Chapter 3 and 4 will show that asset manager capitalism is also contributing towards financialisation's continued expansion. First, the products that asset managers are providing are attracting ever more households to the financial markets. They are doing so as a result of the growing fund offering, the falling management fees and the implicit reduction in risk that results from the diversification inherent in many funds, particularly index funds. Second, the policies that many of the largest asset managers are advocating are advancing, or at the very least tolerating, an increased focus on short-term returns and on the principles of shareholder value. Considered together the reduction in risk is very short term. Longer term damage results from not thinking of other stakeholders and therefore in the long-term the diversification looks increasingly illusory (systemic environmental and social risks cannot be diversified away).

Pagliari and Young (2020) explain that financialisation is a political phenomenon both because it has resulted from the political decisions of deregulation and also because it is creating the conditions for its own reproduction by influencing politics. This influence, the authors explain, is the result of both direct lobbying activities as well as indirect changes in households' policy preferences towards more pro-finance policies as a result of a greater proportion of households now having an interest in financial markets. While to date it has arguably been the banking sector that has been driving the majority of the deregulation agenda, Chapter 6 will show that asset managers too are spending increased financial resources on lobbying and political donations.

The financialisation literature can help to bring in the politics of asset manager capitalism more explicitly than is possible in a pure VoC framework. Yet both the VoC and the financialisation literature suffer from an excessive focus on US developments. This is why this thesis employs a comparative approach. The results do note that the growing power which asset managers have attained as a result of their increasing assets has tilted the balance of power in favour of shareholders and at the cost of other stakeholders, particularly investee companies' workers. However, these consequences of asset manager capitalism differ widely across countries. Full recognition of this requires careful consideration of the domestic regulatory context as well as acknowledgement that different types of investors behave differently in different countries, and that even the same institution will behave differently in different countries. The following chapters will, for example, demonstrate just how great the differences between the regulatory approaches of the UK and the US are and how these differences condition the investor-corporate relationship (thus calling into question the appropriateness of referring to an Anglo-Saxon financial system).

Five Developments in relation to the Shareholder Ownership Structure

As previously mentioned, this thesis identifies a total of five trends, two of which (institutionalisation and indexation) I consider to be first-order developments and three that are treated as second-order developments resulting from the first-order developments. In the following sections I will now introduce each of them in turn.

The Institutionalisation of Investment (First-Order Development)

Much has changed since Hirschman first published his thoughts on exit and voice in 1970. While the initial era of globalization from the 1950s onwards was focused on the trade of goods, by the 1990s the role of finance independent of trade became increasingly important. Davis remarks that while "twentieth-century American society was organized around large corporations, particularly manufacturers and their way of doing things. It is now increasingly organized around finance" (2009: xi).

Institutional ownership has been growing because individual investors increasingly delegate their asset management decisions to institutional investors. They do so for a number of reasons including the diversification benefits funds offer, access to specific investment themes, as well as the perceived stock selection expertise on offer.[10] Around the turn of the century, when institutional ownership surpassed 50 percent of all US shares in issuance, Useem (1996), Hawley and Williams (2000), and Harmes (2001) drew attention to this phenomenon, referring to it as investor capitalism, fiduciary capitalism and mass investment respectively.

[10] The prospectus of the first British mutual fund, the Foreign and Colonial Government Trust highlighted the benefit of diversification in its prospectus stating that the goal of the fund was to give "the investor of moderate means the same advantage as the large capitalist in diminishing the risk of investing … by spreading the investment over a number of different stocks". Quoted in Kahn (2018: 9-10).

The initial growth of institutional shareholdings was driven by pension funds, whose assets were growing as a result of the rapid growth in private employment and employer pensions in the 1950s. This led Drucker (1976) to talk of the advent of "pension fund socialism". Drucker notes that pension funds at the time controlled 25 percent of the shares outstanding in US companies and thus voices concern that socialism, which he defines at the ownership of the means of production by workers, will take hold as a result. While he showed remarkable foresight in predicting the rise of pension fund assets, as I will go on to demonstrate, his fear of pension fund socialism has largely failed to materialise.

Clark (1998) documents how UK pension fund assets rose in earnest from £106.6bn in 1980, to £528bn in 1990, reaching £1,080.3bn in 1996. Developments in the US were similarly rapid, with pension assets rising from $1,176bn in 1980 to $3,788bn in 1990 and $7,003bn in 1996. Pension consultants Willis Towers Watson (2018a) estimate that UK pensions assets reached £2,393bn ($3,111bn) in 2017, while US pensions assets reached $25,411bn (21.6x the 1980 level). In Germany, however, where the state pension system is more important, company pension assets are today still comparatively small at just $472bn.[11]

In the 1980s and 1990s mutual funds took over from pension funds as the driver behind the continued institutionalisation of savings. This led to the coining of the term "mutual fund capitalism" (Hawley and Williams, 1997). While the modern mutual fund industry has its roots

[11] While the size of German pension assets is already considerably smaller than those in the UK or US, what further reduces their significance in the context of shareholders' corporate governance practices, is the extremely low equity allocation of German pension funds. Willis Towers Watson (2018a) reports equity allocations of 50% in the United States and 47% in the United Kingdom. In Germany pension funds as recently as 2012 had equity allocations of just 21%, although the low interest environment has forced a reallocation towards equities which has seen their allocations increase to 35% by 2015. Source: https://www.ipe.com/reports/german-asset-management/pension-assets-measuring-the-pension-world/10010008.article (Accessed 20 October 2019)

in 1940, it was not until much later that its growth started to pick up in earnest. Initially US assets increased from less than $2bn in 1949 to $50bn in 1977, but then exploded to reach $4trl in 1987 (Fink, 2008). The initial growth in mutual fund assets was supported by reforms to pensions regulations, most notably the switch from defined benefit (DB) to defined contribution (DC) pensions and the creation of "401(k)" individual tax advantaged retirement savings plans in the US in 1978. The UK has undergone similar shifts from DB to DC pensions. The Independent newspaper, referring to a study by a leading actuarial firm, reports that "in 1993 "virtually all" FTSE 100 companies offered traditional final salary schemes to new employees. By 2018 "not a single one does".[12] Chapter 2 discusses this transformation from DB to DC schemes in more detail.

In addition to pensions reforms, financial innovation played a major role in the popularity of mutual funds. Birdthistle (2016) ascribes the popularity of mutual funds to a trinity of benefits: instant diversification, professional money management and easy redemption. Instant diversification refers to the benefit of an improved risk to reward ratio that results from constructing a portfolio of different stocks. This understanding is derived from the work of Markowitz (1952) on "modern portfolio theory" (MPT).

Furthermore, mutual funds are managed by professional full-time portfolio managers, who at least in theory should have an information, analytical and timing advantage over private individuals, though this of course comes at the cost of a management fee. The alternative is for an individual investor to construct their own portfolios of say 50 different stocks, and to continually adjust them as share prices rise and fall and companies' fortunes change. The third

[12] The Independent, 10 August 2018, "Britain's great pension robbery: How defined benefits schemes became a thing of the past". Available at: https://www.independent.co.uk/news/business/analysis-and-features/pension-retirement-defined-benefit-contribution-funds-risky-a8479426.html (Accessed 20 October 2019)

benefit, easy redemption, is related to the portfolio diversification and professional management benefits. With the mutual fund, there is always a buyer for the asset one sells, and settlement typically takes just three days, between sending the sell order and receiving the cash. This is much easier than having to sell fifty individual shares, for example.[13]

The main result of this institutionalisation of the pensions and investment landscape is that asset managers had grown much larger by the end of the 20th century. However, while many observers considered these levels of institutional ownership as sufficient for investors to play a much more influential role in the governance of the firm (Harmes, 2001; Hawley and Williams, 1997; Useem, 1996), I will show that institutional ownership at the time did not suffice for shareholders to take control. One ingredient that was as yet missing was ownership concentration. Without it, institutional investors, while better organised than individual shareholders, still faced substantial collective action problems. These were diminished with the rise of index investing, which due to its focus on economies of scale, resulted in a material increase in ownership concentration.

The Indexation of Investment (First-Order Development)

The second first-order development is the growth of index investments. Their comparatively low fee base has made investment management accessible to a much broader population thereby providing a substantial contribution to the aforementioned institutionalisation of investment management. But not only have they contributed to institutionalisation, because

[13] The general point I seek to make is that for ordinary investments in highly liquid indices, mutual funds have benefits to constructing and rebalancing individual stock portfolios. However, with regards to liquidity, there are exceptions, especially when a fund invests in illiquid assets, or assets too illiquid for the fund size, such as happened in the case of the Woodford equity income fund in the UK in 2019. Besides conventional "open-ended" funds, commonly referred to as mutual funds, there are also "closed-ended" funds. While open-ended funds do not have a limit on how many shares they can issue, a closed-ended fund issues shares similar to a company in an IPO. The value of these shares then moves with demand and supply, meaning that a closed-ended fund's shares can trade at a discount or premium to its net asset value.

they are unable to sell shares at will, they have also had a very profound influence on corporate governance.

While active funds seek to beat the performance of broad market indices, index funds seek to track them as closely as possible. The business model of index funds is based around low fees and in order to deliver these investment managers have to ensure they operate with the lowest costs possible. Index investments are not a new phenomenon they have been around since 1971. The first index fund launch followed closely on the footsteps of Fama's (1970) assertion that markets are efficient because they incorporated all publicly available data and that it was therefore impossible for anyone (beyond insiders) to consistently outperform (MacKenzie, 2006).

The initial growth of index funds was driven by pension funds (Fouse, 1998). These early index funds were typically structured as conventional mutual funds but charged just a tenth of the management fee of a typical active mutual fund. They thus presented pension fund trustees with a cheap means of diversification of investments. The switch to index fund investments by pension funds was further supported by observations from industry insiders that noted that the multitude of active mandates that many pension funds had invested in effectively left them with a portfolio of stock holdings so broad that it resembled a high-cost index fund (United States Senate, 1979: 22).

Despite index funds having been around since the early 1970s, it was not until the creation of Exchange Traded Funds ("ETFs") in 1993 that the general public ("retail investors") got on board. Because ETFs trade on stock exchanges like ordinary stocks, they provide a highly liquid means for investors to invest in funds. Investors can buy them through their stock trading

accounts and do not require special documentation as may be the case for certain mutual funds. ETFs can also be sold in real-time, while orders to buy or sell mutual funds typically take one to two days to settle. Because they are index investments, their constituents are known by market participants, which means that arbitrage ensures that their prices do not diverge substantially from their net asset value.[14] If a discount should develop, arbitrageurs could otherwise buy the ETF and short the underlying stocks to capture the discount. Finally, ETFs have no "sales load" or "front-end load" fees, which mutual funds often charge when fund shares are purchased (these fees are then passed on to distribution partners for their sales efforts). For funds that charge front-end load fees these typically stand at five percentage points (Heyden and Röder, 2020; Thune, 2019). This means that an order to purchase $1000 of such a fund results in the investor receiving only an investment of $950 in the underlying fund.

The boom of ETFs, which began in earnest in 2000, took Birdthistle's (2016) trinity of benefits of institutional asset management to another level. Investors retained the benefit of diversification, indeed it increased even further, as for minimum investments of as low as $140 investors can invest in ETFs that hold shares in more than 3500 companies (in the case of the Vanguard U.S. Total Market Shares Index ETF). The professional management of active funds is replaced with the diversification offered by index investing, with the added benefit of substantially lower management fees. The liquidity too is greatly improved thanks to the on-exchange trading of ETFs.

To provide some perspective to the growth of index investing, Morningstar (2019a) reported in August of 2019, that assets invested in US equity index funds for the first time exceeded

[14] There are currently a very limited number of fund managers that are testing active ETFs and ETFs that do not disclose their holdings.

those managed by US active equity funds. Morningstar further reports that over the previous 10 years active U.S. equity funds have had $1.3 trillion in outflows and their passive counterparts nearly $1.4 trillion in inflows. For Europe, James et al. (2019) report that index funds have grown from 15 percent of investment fund assets in 2007 to 30 percent of total fund assets in 2017.

While index funds have taken market share from active funds, they have also helped attract new investors into the stock market. They are thereby contributing to the overall growth of the asset management industry. By the end of 2018, the Investment Company Institute (ICI, 2019) estimates the assets of investment companies in the US (defined as mutual funds, closed end funds, exchange traded funds, and unit investment trusts) at approximately $21.4trl, triple what they were at the turn of the century ($7.1trl). Of that three hundred percent increase approximately eighty percentage points can be attributed to stock market gains (as proxied by the S&P 500 index), meaning that more than two-thirds can be attributed to inflows.

The significance of the rise in the assets under management (AuM) of index mutual funds and ETFs for the corporate governance of firms lies in the fact that index funds alter the means of control that asset managers have available. Since index construction dictates which shares should be in the fund, asset managers are no longer able to discretionarily exit their shareholdings. In Hirschman's (1970) terms they are therefore left with only the options of raising their voice or remaining loyal. With exit unavailable, this should necessitate a greater focus on the use of voice.

Further complicating matters is the fact that index construction may lead to ETF providers inadvertently finding themselves as large holders in, for example, high carbon-emitting

companies such as coal producers or in other controversial industries such as arms producers. Such holdings in turn will put these asset managers under the spotlight of critical public attention, as evidenced by the anti-gun protests that have occurred outside BlackRock's headquarters in New York.[15] These protests are neither limited to the US nor are they limited to index investors. There have, for example, also been protests by members of Extinction Rebellion outside the offices of the UK asset manager Baillie Gifford in Edinburgh.

The rise of ETF assets has therefore increased the capacity of voice (through greater AuM) while simultaneously reducing the number of assets that are able to exit. Also, through their holdings in ETFs, the general public has become more aware of the role of asset managers within corporate governance, demanding greater stewardship as they now feel entitled to have a say in how asset managers engage. The growth of the asset management industry has therefore provided society with an additional target to register their grievances, as evidenced by the aforementioned protests.

How fund managers engage differs greatly from country to country and by investor type and size. Stewardship is a concept that has several dimensions. Firstly, there is the stewardship of capital, which requires asset managers to manage their customers' assets in their customers' best interest. The second aspect of stewardship is that regulators, particularly in the UK, expect asset managers to guide the executives of the companies they invest in and failure to do so can have consequences for asset managers, as stated in the UK Stewardship Code (Financial Reporting Council, 2012). The UK's Financial Reporting Council defines stewardship as "the

[15] See, for example, New York Daily News, 23 May 2018, "Anti-gun protesters rally outside BlackRock shareholder meeting to condemn its Sturm Ruger investments" Available at: https://www.nydailynews.com/new-york/anti-gun-protesters-rally-blackrock-shareholder-meeting-article-1.4005409 (Accessed 20 October 2019)

responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society" (Financial Reporting Council, 2019).

Gilson and Gordon (2013) argue that mainstream asset managers (both active and passive), due to their business models that focus on keeping costs to a minimum, will be "rationally reticent", keeping their governance activities to a minimum. Work by Fichtner et al. (2017) in particular has drawn attention to the lack of opposition to management proposals in the proxy voting behaviour of the largest index investors. This in turn has led to debates regarding the desirability of these large asset managers for corporate governance of firms generally (Bebchuk and Hirst, 2018; Fisch et al., 2018) and with regards to possible anti-competitive influences (Azar et al., 2018; Elhauge, 2016). Braun therefore describes an asset manager capitalism in which shareholders are "fully diversified and economically disinterested" (2019: 4).

While Fichnter et al. (2017) show limited opposition to company management in the voting behaviour of the biggest asset managers, their respective stewardship reports do show an increase in the number of governance meetings held. As will be shown in Chapter 3, the degree to which ETF providers engage in voice appears to be a function of their size, with larger asset managers engaging to a greater extent. Two reasons are likely responsible for this. Firstly, the limited holdings of smaller ETF providers receive less public attention thus necessitating less engagement. In other words, the social and regulatory pressure for them to be seen to engage in stewardship is less pronounced. Secondly, due to the economies of scale inherent in the asset management industry, they are financially more constrained than larger asset managers.

The sheer size of these asset managers has also had the effect of pushing them into the public limelight, with the result that their social licenses to operate are increasingly being challenged for lack of perceived corporate governance leadership. In a growing number of countries, such as the United Kingdom, there are also real regulatory consequences for failures to engage in stewardship. Asset managers have been responding by increasing their corporate governance headcounts.

As of March 2020, BlackRock's governance team is made up of 47 full-time employees, almost four times the 13 employees it had in 2008 (IPE, 2019a; Financial Times, 2020b). Furthermore, in its 2018 annual stewardship report BlackRock (2018a) announced that it plans to double the team size by the end of 2020 (implying a growth from 36 to approximately 72 members). While these headcounts are constantly rising, Chapter 3 will illustrate that they remain inadequate given the size of the task. To put these numbers into perspective, the 2019 BlackRock Investment Stewardship Annual Report states that BlackRock voted on 155,131 proposals at 16,124 company meetings.

The Internationalisation of Investment (Second-Order Development)

The institutionalisation of investment management brought a greater focus on diversification both domestically and internationally. The indexation of investment management in turn provided easy access to foreign markets. Investors no longer have to search for qualified investment managers for foreign markets, who themselves are oftentimes domiciled abroad in the market in question. Instead the availability of index funds gives easy access to stock markets as remote as Vietnam. The great economies of scale inherent in the investment management industry furthermore mean that it makes strategic sense for fund management

companies to engage in international mergers and acquisitions such as the 2009 acquisitions of the UK asset manager Barclays Global Investors by the US asset manager BlackRock. The internationalisation of asset management is a more recent development than institutionalisation. French and Poterba (1991) estimate that in December of 1989 more than 94 percent of the equity portfolios of US investors and 82 percent of UK investors were held domestically.

This thesis identifies two dimensions of internationalisation. The first is reflected in the internationalisation of the shareholder register of public companies. This can be observed by the fact that the average foreign ownership of companies in both the UK and Germany is above fifty percent. In the US it has also grown but remains substantially lower at approximately 14 percent.[16] The second dimension of internationalisation has occurred at the level of the asset management firms themselves through international expansion as well as through the aforementioned international mergers and acquisitions. This second dimension is not usually part of the discourse of internationalisation. However, looking only at the foreign ownership levels of companies misses an important aspect for corporate governance.

This thesis finds that the growth of multinational asset managers has nevertheless left domestic asset managers with a special role to fulfil with regards to corporate governance. My findings concur with Dimson et al. (2018) who report that an investor is more likely to lead the dialogue

[16] For US data see: See https://ticdata.treasury.gov/Publish/shlprelim.html and https://ticdata.treasury.gov/Publish/shlptab1.html
For UK data see:
https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2016
and for German data see: Handelsblatt, 17 December 2007,
https://www.handelsblatt.com/unternehmen/industrie/dax-30-konzerne-gehoeren-mehrheitlich-auslaendern-deutsche-firmen-in-fremder-hand/2906102.html and Handelsblatt, 25 April 2018,
https://www.handelsblatt.com/finanzen/maerkte/boerse-inside/aktionaersstruktur-so-stark-dominieren-auslaendische-investoren-die-dax-konzerne/21211152.html?ticket=ST-681442-PgEroIZc1inAPGQPQhLf-ap1
(Accessed 20 October 2019)

when the company is domestic, and that coordinated shareholder engagement are more likely to be successful if they are led by domestic shareholders. Similarly, my asset management interviewees reported themselves to be more likely to engage with domestic firms due to the more material size of their shareholdings in those firms and because those engagements are more likely to result in public attention. While German and UK asset managers are typically much smaller than their US peers, interviews showed that they focus their more limited governance resources on the domestic market, ensuring that they have sufficient impact to make it worthwhile (fulfilling regulatory requirements and gaining public attention from it).

The Significance of Proxy Advisors (Second-Order Development)

The institutionalisation and indexation of investment management has resulted in both the number of individual company shareholdings as well as the number of foreign jurisdictions in which shares are held growing significantly. This highly diversified and heterogenous holding base has brought with it a number of challenges for investors' corporate governance activities. Firstly, there is the sheer number of agenda items, for some asset managers as many as 100,000 ballot items per year (Bew and Fields, 2012), that has to be processed annually by asset managers. Secondly, with each foreign country come separate regulatory requirements as well as national corporate governance standards. This poses a major challenge to an asset management industry exposed to significant cost pressures. Together with changes in regulation this has created the business case for proxy advisors, as unlike individual shareholders, institutional shareholders in the UK and the US are today required to submit proxy votes and report on their voting decisions.[17]

[17] At the time of writing the SEC is reviewing the wording of its proxy voting requirements. Voting all proxy votes was never explicitly required in the US, however, that was the interpretation applied by asset managers.

Proxy advisors are consultants that analyse corporate elections and advise shareholders on how to vote (Choi et al., 2010). Their services range from recommendations of how to vote, to providing the infrastructure to submit the vote, and the reporting structure to publish voting records and reasoning. The proxy advisory industry has received limited academic attention to date. However, the fact that the industry is dominated by two companies, ISS and Glass Lewis, has led to increasing regulatory interest. Together the two companies are said to control 97 percent of the market for proxy advisory services (ESMA, 2012). This high level of concentration has led to accusations of outsized influence (Allaire, 2013; Larcker and Tayan, 2011). Not only has their influence been questioned, so too has the quality of their work with accusations of them following a "box-ticking" and "one-size-fits-all" approach coming from both academics and companies (Glassman and Verret, 2013; Rose, 2011).

Further adding to the controversy surrounding proxy advisors is the fact that one of the two proxy advisors (ISS) advises both corporates and shareholders, while the other large proxy advisor (Glass Lewis) is co-owned by the Ontario Teachers' pension fund, leading to accusations of conflicts of interest (Copland et al., 2018). These concerns were confirmed by a number of the corporations I interviewed, with one describing as "bullshit" the scenario where ISS pitched for consulting business after contributing to the company losing the vote on its executive pay package at its AGM. He described the aftermath of the failed vote as follows: "it was kind of annoying that after ISS recommended against, we got 12 emails over the past 4 months as well as several calls asking whether we wanted to buy their services".[18]

German institutional investors have no legal requirement to vote, though the largest asset managers tend to similarly vote all domestic proxies.

[18] Investor Relations, US company, telephone interview, 16 January 2018.

Following the corporate accounting scandals of 2001/2002 (WorldCom, Enron etc.) and the bankruptcies that followed the Global Financial Crisis, governments have been looking for ways to ensure greater investor oversight of corporate conduct. The degree to which investors are required to engage, however, differs greatly from country to country. In the United States, the SEC (2003) introduced legislation in 2003 to require mutual funds with AuM exceeding $100m to disclose both how they voted in shareholder proxy votes as well as to disclose the policies and procedures followed in order to make those voting decisions. While, this regulation does not require asset managers to vote their shares, only to consider it, the largest asset managers do still seek to vote all shares.[19]

The UK went further with the introduction of the Stewardship Code in 2012 (Financial Reporting Council, 2012). It considers responsibility for a company's operations to be shared between the management board and shareholders, advocates voting of all shares, and states that investors should be willing to act collectively when needed.[20] The importance that the British system assigns to the joint responsibility for stewardship was evident in the aftermath of the collapse of the building services company Carillion PLC, when UK members of parliament summoned representatives of its major shareholders to examine whether they complied with the Stewardship Code.[21]

[19] See keynote remarks by SEC Commissioner Elad L. Roisman to the ICI Mutual Funds and Investment Management Conference, 18 March 2019, transcript available at: https://www.sec.gov/news/speech/speech-roisman-031819 (Accessed 20 October 2019)

[20] Principle 6 of the UK Stewardship Code states "Institutional investors should seek to vote all shares held". https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf (Accessed 20 October 2019)

[21] CityWire, 1 February 2018, "MPs grill fund groups over Carillion's collapse". Available at: https://citywire.co.uk/funds-insider/news/mps-grill-fund-groups-over-carillions-collapse/a1088523 (Accessed 20 October 2019)

In Germany, regulatory demands are less explicit to date. The result of this is that the biggest asset managers appear to be voting a very high percentage of their shares while smaller asset managers for the most part refrain from voting. One portfolio manager at a medium-sized German asset manager explained that he had recently been put in charge of governance and proxy voting matters and was surprised to find out that voting was not required.[22] The code of good conduct of the German fund association (BVI Wohlverhaltensregeln) does not require the voting of shares and, unlike the UK or the US, there has to date been no regulatory intervention in this regard. Nevertheless, the big asset managers in Germany, like the UK and US, seek to vote the vast majority, if not all, of their shares.[23]

Estimates of the impact of proxy advisor recommendations vary from 13.6 percent (Bethel and Gillan, 2002) to 29.7 percent (Cotter et al., 2010). Choi et al. (2010) contend that many studies substantially overestimate the influence of proxy advisors due to the difficulty of separating correlation from causality. Proxy advisors see their role as data aggregators, seeking to create policies that match the preferences of their clients (Bew and Fields, 2012; Calluzzo and Dudley, 2015; Thomas et al., 2012). If there were no correlation between their recommendations and the way clients vote, then they would not be doing their job well. However, even if we assume the low estimates of 6-10 percent, their influence is substantial, nevertheless.

The debate surrounding proxy advisors is in fact a proxy battle in itself.[24] Proxy advisors are the pawn in a struggle between shareholders and corporate interests. Corporates are attacking the services of proxy advisors and calling for their regulation as a means to rein in the powers

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[22] Portfolio Manager, German asset manager, telephone interview, 21 March 2018.
[23] The UN PRI signatory database provides summary data (in the "Transparency Reports") of voting practices. For 2018 these reports (under section LEA 21.1) show that Allianz Global Investors (AGI) cast 99% of all of its votes, for Deka Investment the result is 90%, for Union Investment 85% and for DWS Group it is 68%.
[24] See also Cappucci (2019). Cappucci is Senior Vice President, Harvard Management Company and from the perspective of an investment manager describes "a proxy war against proxy advisors" (2019: 1).

of shareholders. Proxy advisors are a valuable tool for shareholders without whose support they would struggle to process all of their proxy ballots. They are enabling institutional investors to meet regulatory requirements resulting from the indexation and internationalisation of investment management. In targeting proxy advisors, corporates are able to avoid openly calling for curtailment of shareholder oversight, which would likely be politically more troubling. Multiple corporate interviewees admitted that proxy advisors did indeed fulfil an important role and did not have too much power per se, but that instead it was asset managers that were not doing their work that were bestowing proxy advisors with power.

The Corporate Response to Institutionalisation (Second-Order Development)

The debate about the role of proxy advisors is just one example of potential conflict between companies and their shareholders. The institutionalisation of asset management and the economies of scale that have driven its concentration have created asset managers, that in theory, have significantly more influence over corporate executives than shareholders have had in the past. Furthermore, the indexation of asset management, with its associated limits on exit, require shareholders to get involved when things turn against them. The alternative of quietly selling out of shareholdings and walking away are no longer available for index funds. Proxy advisors have further reduced the collective action problems of the past, giving shareholder voice greater leverage by helping to construct a consensus of best-practice on corporate governance. Together these developments have resulted in a more unified shareholder base that more frequently challenges corporate opinion, which in turn has triggered a corporate response. The intensity of this response differs from country to country, but in the case of the US has led to a very elaborate campaign against shareholder interests.

US corporates, for example, employed a lobbying group disguised as representing the interests of small “Main Street” investors, thereby “astroturfing” their campaign to hide its corporate roots. This group lobbied the SEC and succeeded in having it review the proxy voting process. Bloomberg (2019) later reported that in justifying the changes to its policies, the SEC cited letters of support from “ordinary Americans”. SEC Chairman Jay Clayton commented that "some of the letters that struck me the most came from long-term Main Street investors, including an Army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single mom, a couple of retirees who saved for retirement" (SEC, 2019). However, as Bloomberg reported the letters were written by the lobbyists themselves and “they are the product of a misleading — and laughably clumsy — public relations campaign by corporate interests”.[25]

This corporate behaviour contradicts the prevalent view in the traditional CPE literature that portrays corporates as mere passive actors adapting to whatever institutional framework they are confronted with. Instead, as the US examples show, corporates are active agents seeking to influence the design of the framework within which they operate. This is therefore supportive of the decision to follow the varieties of capitalism approach set out by Hall and Soskice in this thesis (rather than comparative political economy approaches taking a more macro approach). Although the approach of Hall and Soskice (2001) is firm-centred, they consider it “unrealistic” that firms construct or control the overarching institutional structures of the political economy. Importantly, they conclude that there will be national differences in the strategies chosen by companies to overcome their coordination problems, but that these will be determined by the respective institutional structures and political economy they operate in. Therefore, while Hall

[25] Bloomberg, 19 November 2019. “SEC Chairman Cites Fishy Letters in Support of Policy Change”. Available at: https://www.bloomberg.com/news/articles/2019-11-19/sec-chairman-cites-fishy-letters-in-support-of-policy-change Accessed 23 December 2019.

and Soskice do approach the varieties of capitalism from a firm-centred approach, they too take the institutional structures as given.

Furthermore, a core argument that I will set out in this thesis is that differences in the ways in which companies have chosen to engage regulators and shareholders are influencing the direction that the varieties of capitalism are taking. That is, the orthodox interpretation of laissez-faire free-market capitalism that is being imposed by corporate interests in the US is contributing to a widening of the differences between the US LME form of capitalism and the forms of capitalism seen in the UK and Germany. In contrast, the UK regulator's approach of taking a more inclusive approach to stakeholder concerns and the decision to enlist institutional shareholders in order to assist in the policing of corporate conduct is having the effect that in the sphere of corporate governance, the UK LME model is moving closer to the German CME model.

Methodological Approach

The Decision to Interview

The decision to interview was made because many of the critical issues concerning the growth of asset management firms struggle with differentiating between correlation and causation. The aforementioned issue of attempting to calculate the influence of proxy advisors is just one such example.[26] Secondly, any study of corporate governance faces the difficulty that much of the engagement today happens behind closed doors.

[26] See Maxwell (2004) for a detailed reasoning of why a qualitative research approach such as interviewing can provide insights with regards to causality.

Many of the largest asset managers do not provide lists of which companies they have engaged with on what topic, thereby precluding any attempts to evaluate the success of shareholder engagement.[27] There therefore is no quantitative data to answer the question of whether engagement is happening and whether or not it is successful. The only quantitatively observable variable is whether asset managers voted and how they voted. Without interview data this always leaves the possibility that what is not observable in the voting data has been addressed in private meetings.

Questions regarding the extent to which asset managers seek to influence corporate governance and the extent to which they have been successful therefore cannot be answered quantitatively. Also, insights into the nature of interactions, such as between activist hedge funds and index funds, cannot be observed quantitatively. Instead this thesis makes use of interviews to compare public policy statements with interviewee responses. In order to penetrate through prepared responses, interviewees were at times confronted with anonymised responses from other investors or corporates as to their firm's engagement practices.

This thesis draws primarily on information collected in interviews with 82 individuals at 61 different institutions. In total interviews were conducted with 18 institutional investors, 33 stock market-listed companies ("corporate issuers"), 4 proxy advisors (including three founders and former CEOs), 3 proxy solicitation companies (these help firms reach out to their shareholders and provide insights into shareholders' governance policies) as well as 3 NGOs to arrive at a multi-dimensional understanding of how engagement is conducted in practice.

[27] State Street is one noticeable exception to this. The company recently started publishing quarterly and annual engagement reports that include the names of the companies they engage with. See, for example: https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/stewardship-activity-report-q4-2018.pdf (Accessed 21 October 2019). BlackRock announced on 14 January 2020 that it would in the future also provide a list of companies engage and the issues discussed.

The semi-structured interviews were mostly conducted in the spring and summer of 2018 and interviewees were selected from the United States, the United Kingdom and Germany, with the aim of having approximately one third from each jurisdiction. Prior to this, a small number of exploratory interviews were held in 2014 and 2015 to ensure the practical relevance of the research question and approach.

In sum the investors interviewed managed total assets of $14.3 trillion as of October 2019 with the smallest asset manager managing assets of $4bn and the largest asset manager managing assets of several trillion dollars. The companies interviewed for this paper had a combined market capitalization of approximately $2.5 trillion, with individual market capitalizations ranging from $4bn to $400bn. Balancing both assets under management and market capitalizations is important as these are proxies for the financial means companies have at their disposal. Interviewing both asset managers and corporates provided the opportunity to confront each side with the experience of the other and enabled a degree of cross-checking of the claims that were made about the degree and nature of engagement.

All the interviews with corporates were conducted via telephone due to the number of interviews and the broad geographic spread of corporations. As the asset management industry is geographically more focussed, I was able to do in-person interviews in London, Edinburgh, Frankfurt and New York and to compliment these with telephone interviews. With regard to the mix of in-person and telephone interviews, Novick (2008) notes that despite telephone interviews being a principal survey method and the most widely used survey modality in industrialized nations (Bernard, 2002; Shuy, 2003), an apparent bias against telephone interviews exists in qualitative research. Yet studies that have sought to investigate differences in interview modalities have found that quality of data obtained by telephone interviews is

comparable to in-person interviews (Carr and Worth, 2001; Lyu et al. 1998, Minnick and Young, 1999; Rogers, 1976).

The main shortcoming of telephone interviews is said to be a lack of visual cues (Aquilino, 1994; Groves, 1990; Novick, 2008). Yet much of the research that compares in-person and telephone interviews is based on nursing and mental health case studies in which such non-verbal cues are of greater importance. Shuy (2003) explains that choosing the appropriate interview mode involves a trade-off between persuading individuals to participate and the elicitation of information. The decision to use telephone interviews alongside in-person interviews in this thesis has been a conscious decision based on belief that the loss of visual cues is a small price to pay to ensure greater accessibility of interviewees.

The interviews were mostly not recorded, as it became apparent in the exploratory interviews that contacts felt unease about being recorded and that the value of the interviews would be negatively impacted if I sought to push for their recording. Researchers have noted different experiences with regards to whether interviewees object to being recorded. Hardie (2007) reports that interviewees rarely withheld permission. However, my experience matched that of Sobel (1994) who found that almost all interviews preferred not to be recorded. Unease at being recorded is one of three interview challenges identified by Esterberg (2002) and it is also acknowledged by Saunders et al. (1997), Hayes and Mattimoe (2004) and Allen (2017). Several times, it was made clear to me that interviews were the result of individual personal favours and that the interviewees could not publicly speak for their employers. These comments reaffirmed my decision not to record the interviews and confirmed the findings of Byron (1993) and Harvey (2011) that opting to not record interviews provides the potential for more detailed off-the-record information.

The likely reason for the differences in reaction is the fact that in my case the interviewee's conduct is the subject of the questions and not some third-party conduct. Furthermore, some of my questions requested their opinion of the corporate governance practices of other institutions, a potentially awkward question to ask of a member of this small group of experts. With regards to the quality of data, Hayes and Mattimoe report the results of two studies, one with and one without taping, and suggest that there is no "one-best-way". Instead they suggest that when the research topic is "more structured and the researcher is reasonably clear about what is to be asked during the interview", it is easier to use the manual method of recording data (2004: 6).

The selection of companies was a random sample from each of the countries, with the aim of ensuring a balance across sectors and market capitalizations. Companies in the United States and Germany were very open to talking, while engaging with corporates in the United Kingdom was complicated by the fact that engagement on matters of corporate governance is split across several functions including investor relations, the corporate secretary, and human resources. This necessitated a higher number of outreaches in the United Kingdom versus the other countries.

My requests for corporate interviews were targeted at companies' investor relations (IR) departments, typically at the head of investor relations. This is because IR department act as the gatekeepers to corporate management and are typically involved in all investor dialogue. It became apparent that a number of corporates, particularly in the US, were keen to air their frustration with the quality of investor engagement. While an interview with an IR representative was the goal, in the case of a handful of corporations, I had human resources, company secretaries, and in one case even the chief financial officer on the call.

Interviews with asset managers were set up with the help of a "snowballing" approach, which started with existing contacts of mine in Germany and the UK. Once initial interviews were secured, interviewees were asked whether they would be prepared to provide further introductions. While this snowballing approach risks the selection of interviewees becoming non-random, the fact that I had a pre-set list of quadrants (size, type and location of investors), meant that in practice I mostly suggested investors I wanted to speak to and either received an introduction or not.

The social context within the corporate governance community is important, as it is made up of a very small number of individuals who regularly meet at industry conferences and workshops. While portfolio managers already represent an exclusive subset of employees of asset managers, corporate governance teams are typically much smaller still. While some institutions such as Hermes EOS or BlackRock have teams consisting of twenty to thirty professionals,[28] the typical team size is only around five headcounts per firm (Bew and Fields, 2012). Referrals were thus very fruitful. What became apparent throughout these interviews is how close-knit the corporate governance community is. Not only do many governance experts know one another from industry conferences but the CVs of interviewees showed that many had moved between firms.

Asking investors for introductions to other investors also provided insights into investor networks and highlighted who was and who was not actively engaged in the governance debate. Combining this knowledge with the feedback from corporate issuers was insightful, as part of the interview consisted of me reading out names of investors and asking the corporates how

[28] For BlackRock numbers, see: https://www.ft.com/content/657b243c-e492-11e6-9645-c9357a75844a For Hermes EOS staffing numbers, see: https://www.hermes-investment.com/uki/stewardship/eos-team/ (Accessed 23 February 2020).

much interaction they had had with these investors on governance issues. The resulting picture was consistent with both corporates and investors singling out the same institutions, both in regard to a lack of engagement and in regard to best-practice engagement. To round off the picture, I conducted a number of interviews with both proxy advisors and proxy solicitation firms, who advise investors and corporates respectively. These meetings proved very informative and helped to fill out the overall picture of governance activities.

The interviews were given on the basis of anonymity. Anonymity was important for a number of reasons. Firstly, most firms have policies preventing employees from talking to press and academics without prior approval. In the case of one asset manager, who had initially agreed, simply asking whether I could list the name of her institution as having participated, led to her having to check with compliance, with the result being that she ultimately withdrew the consent for the interview. In another example, I was only able to interview a governance staffer outside of their building and the entire interview had a very "hush-hush" feel to it.

Interviewees highlighted that many companies in the asset management industry use company specific job titles and ranks and have therefore requested that I only reference their job titles in generic terms. I therefore use terms such as "corporate governance analyst" instead of "Director, ESG and Engagement Team" in order to obscure the organisations of the respective interviewee. However, wherever relevant and possible, I provide further descriptive information about the interviewees in the text. The mantra followed with regards to information is "as little as necessary to ensure confidentiality, as much as possible to provide context".

The interviews followed a semi-structured approach, with each interview starting with a couple of open-ended questions in order to allow the interviewee to raise the issues they considered

important (Rubin and Rubin, 2005). These were then followed up with a number of closed questions, such as “Do you believe proxy advisors have too much power?” Interviews were scheduled for 30 minutes but typically ran for approximately one hour, as is typical for semi-structured interviews. In the case of one proxy advisor, the interview ran for a full three hours.

The questions asked of asset management interviewees were divided into three blocks. The first asked about how engagement had changed over time and how engagement differed from country to country. In particular, whether the volume of engagement had increased and whether the issues of concern had shifted over time. The second block focussed on how investors arrived by their proxy voting decisions and, in particular, how they employed the services of proxy advisors. The third block asked about the extent to which investors coordinated their activities with other investors and any changes that have arisen, or are anticipated, as a result of the rise of index investing.

Engaging with investors proved more challenging than engaging with corporates. Due to the high level of interest that academics have shown for issues of sustainability (which typically are also handled by the corporate governance teams), investors reported being inundated with requests for access to data and interviews. One corporate governance analyst at a European asset manager, whom I have known for several years, explained to me that she declined all requests for assistance from all students simply due to the sheer number of requests. What likely also played a role was the increasing public attention given to asset managers’ corporate governance activities, which at least initially lead to requests for further background information before committing to interviews.

The interview response rate differed considerably by interviewee type and by interviewee domicile. It became apparent early on, that both asset management firms and proxy advisors were oftentimes hesitant to provide interviews due to both the number of interview requests they have received from academics and due to the multiple regulatory reviews ongoing. Making use of personal networks I was nevertheless able to attain interviews with most of my desired targets. These networks are the result of my personal professional background as a portfolio manager and research analyst at one of Germany's four largest asset managers.

With regards to the asset management interviewees in Germany, the small number of firms and correspondingly small number of corporate governance and portfolio management employees meant that I had at least one contact at each of the firms to reach out to. These personal contacts often helped provide access to the relevant interviewees. More generally though, it is likely that interviewees at fund managers and proxy advisors were prepared to support my research because of an implicit assumption by some, that my research was likely to either be less critical or more understanding of the many resource-constrained challenges faced by practitioners. To be clear, I made no such promises, made it clear in all communication that I was approaching the industry from an academically critically perspective.

Nevertheless, securing asset management interviewees particularly in the UK initially proved challenging. While overall prospective asset management interviewees were responsive to unsolicited emails in the US and Germany, for the most part I failed to gain a response from such emails in the UK. Instead I was reliant on introductions, and one very well-regarded interviewee proved to be particularly supportive (an example of successful snowballing). She asked what asset managers I had yet to have a response from and then proceeded to list names of people at each of the firms, offering to provide her name as a reference. From that point on,

I was able to access many of the firms I had previously failed to engage with. Overall the response rate amongst German fund management firms was 88 percent (6 of 8 firms), amongst UK asset managers it was 40 percent (6 of 15) and amongst US asset managers it was 38 percent (6 of 16).[29] Specifically, with regards to the Big Three, I was able to secure interviews with two of them, with the third responding on multiple occasions throughout the six-year research period that they were unavailable due to resource constraints.

The highest response rate was achieved from corporate interviewees. In Germany there was only one company that declined to participate, in the UK there was one decline and one non-response, while in the US there was one decline and four non-responses (all from "big tech" Silicon Valley companies). The overall interview response rate from corporates was therefore very high at 80% (33 of 41).[30]

There are three factors which likely explain this high response rate. First, unlike the asset management and proxy advisory firms, corporate issuers have to date not become overrun with interview requests from academics. Second, there was big interest from corporates to tell their side of the story. As will become apparent throughout this thesis, but particularly in Chapter 7, many corporates felt that the investors' resource demands with regards to information on sustainability issues were becoming too great and with regards to proxy voting that investors were not doing their jobs but simply blindly following proxy advisors, who in turn have gained too much power in their eyes.

[29] Note this is the number of asset management firms at which interviews were secured. The total number of individual interviewees was higher at 29, as at several asset managers I was able to speak to multiple employees.
[30] Note this is the number of corporates at which interviews were secured. The total number of individual interviewees was higher at 39, as at several firms I was able to speak to multiple employees.

Third, and particularly with regards to corporate interviewees in Germany and, to a lesser extent the interviewees at UK corporates, my day job as a portfolio manager at a leading German asset manager undoubtedly played a role in gaining access. While all interviews were arranged from my University of Edinburgh email account and it was made clear that these interviews were unrelated to my day-job, for full disclosure potential interviewees were nevertheless made aware of my role as a portfolio manager. With regards to the information collected during the interviews, I do not, however, believe that the answers were influenced by the fact that I also work as a portfolio manager. Interviewees were remarkably frank and even gave critical feedback as to the corporate governance activities of my employer. As some of the interview quotations contained in this thesis will show, interviewees in full knowledge of anonymity spoke openly, oftentimes making use of swear words to stress their discontent with the status quo of investor engagement. In fact, a number of corporate interviewees appeared to enjoy the opportunity to provide straightforward feedback to a member of the investment community.

The Choice of Countries

This thesis investigates the relationship between investors and companies in Germany, the United Kingdom and the United States to allow comparative insights to be drawn. The three countries were chosen primarily for two reasons. First, as previously stated, corporate governance is the subject of several disciplines, most notably law, finance and politics. The law and finance literature (La Porta et al., 1998) employs legal origin and the level of investor protection as the most common country-level factors used as independent variables in cross-country governance research (Schiehll and Martins, 2016; Schnyder et al., 2018). Since

Germany is a civil law country, while the United States and the United Kingdom are common law countries, both legal traditions are included.

Secondly, taking a comparative political economy approach should allow for insights to be drawn with respect to the "varieties of capitalism" literature (Hall and Soskice, 2001; Jackson and Deeg, 2008). This literature seeks to explain how differences in institutional characteristics of national economies lead to differences in national competitive advantages in production (Witt and Jackson, 2016) and typically divides economies into LMEs and CMEs, as previously mentioned. The United States and the United Kingdom are often presented as typical LMEs while Germany is considered to be a quintessential example of a CME (Hall and Soskice, 2001; Vitols, 2001). In fact, Crouch (2009) counts the number of times the analysis in Hall and Soskice (2001) refers to each country and concludes that their study, rather than being a comparison of systems, is really a comparison of the UK/US with Germany. Accordingly, much of the subsequent literature on the varieties of capitalism has been about the degree to which Germany is, or is not, converging with the UK/US (O'Sullivan, 2003; Schmidt, 2002; Streeck, 2010; Vitols, 2001).

What unites the law and finance literature with the comparative political economy literature, is the significance they ascribe to blockholders. While the law and finance literature primarily consider the ownership structure to be a necessary compensation for shortcomings in shareholder protection vis-à-vis company management, the political economy literature considers blockholders part of the institutional framework of "Rhenish Capitalism," which provides a competitive advantage through the provision of "patient capital" (Fichtner, 2015).

In the Opening Keynote of the 2019 Global Research Alliance for Sustainable Finance and Investment (GRASFI) conference, Professor John Kay similarly compared "The Concept of the Twenty-First Century Corporation" by looking at Germany, the UK and the US. He explained that in Germany, the duty of directors is to operate in the best interest of the company, in the UK the situation is less clear as the Companies Act reflects a deliberate compromise between competing groups which "appears to give a particular role to shareholders but does not give priority". In the US it is not actually the government but individual states that set the laws. Since management decides where to incorporate, states have competed to attract registrations by allowing governance policies that serve to insulate management from capital market pressures. The result is that "US law is not so much shareholder friendly as management friendly".[31]

For all of these reasons, the UK, the US and Germany represent an appropriate mixture of political economy models, of legal origin, and of institutional investor types. The fact that there is a rich academic literature on all three countries, also enables selective temporal comparisons across countries.

Summary of Findings

This thesis investigates the process of change in the varieties of capitalism that results from the growth of the asset management industry. This growth has caused a transformation in the identity of the shareholder: from individual shareholders to institutional investors, and from majority active to increasingly indexed shareholdings, concentrated in a small number of fund

[31] For conference details, see: https://www.smithschool.ox.ac.uk/research/sustainable-finance/events/GRASFI-Conference-Programme-2019.pdf (Accessed 20 October 2019)

management companies. Institutional shareholders today represent different preferences to the individual shareholder of the past. Index funds and large active funds today provide capital on more patient terms than in the past, but also have the potential to take a greater influence over company strategy.

This thesis concludes that the growth of the asset management industry, and the homogenisation of the shareholder ownership structure that it has brought about in the UK, the US and Germany, to date represents a convergence of corporate governance only in form but not in function. Instead, and despite the widespread internationalisation documented in this thesis, significant differences in the institutional logic of individual countries remain. The prime reason for this is that different actors have different resources as well as different preference in each of the respective countries. These differences are exacerbated by the heterogeneity of government approaches. As a result, asset manager capitalism reflects some of the idiosyncrasies present in the national varieties of capitalism.

The interview and proxy voting data presented clearly show the differences between different types of investors. Index funds are likely to vote differently to active funds, domestic funds often engage differently to foreign funds, and the engagement approach of the Big Three asset managers is altogether different from that of other US and European asset managers. There are therefore three dimensions along which asset managers differ: their size, their domicile and whether they are predominantly active of passive. This therefore results in a possible nine types of asset managers. However, this thesis will show that in practice one dimension suffices to analyse the behaviour of asset managers: there are the Big Three asset managers, and then there are all the other asset managers (all of which are smaller and offer mostly active investment strategies).

Corporates, proxy advisors and the respective governments are presented as three further central types of actors. The institutional framework presented in the final chapter of this thesis therefore consists of five primary actors. The way asset manager capitalism unfolds is furthermore shown to be the result of seven factors influencing the nature of change in corporate governance, which determine the way in which the above five groups of actors interact.

First, there is the approach of the government in setting out the ground rules of corporate governance and investor stewardship. This dictates how the remaining six dimensions interact with one another. Second there is the approach followed by corporates, the level of confrontation being in large part determined by the extent to which the national regulatory context allows for this. Third, there is the relative influence of proxy advisors in each of the three countries. Their recommendations are shown to frequently diverge from those of their asset management clients, particularly the Big Three. The aforementioned three dimensions are confronted with four asset manager specific dimensions. These are: asset managers' intent to bring about change, the nature of the change they seek to bring (greater focus on shareholder value versus stakeholder interests), their physical resources (stewardship headcounts), and the size of their respective voting blocs.

The following chapters will show that the functioning of the varieties of capitalism in the three respective countries continues to exhibit a number of significant domestic features. Domestic asset managers continue to play an important governance role despite their comparatively smaller size, proxy advisors' recommendations do not represent the orthodox shareholder value maximisation policies that we would expect, and the influence of the three biggest US asset managers differs from country to country.

Instead of asset manager capitalism causing the Americanisation of the global corporate governance regime, significant differences therefore continue to persist. Indeed, there are signs that rather than converging on one global model of capitalism the rise of the asset management industry is contributing towards moderate divergence, particularly between the models seen in the UK and the US. In the UK, where the government has enlisted asset managers as stewards of their portfolio companies, and where the Big Three asset managers have a comparatively smaller market share, asset managers are increasingly considering the concerns of other stakeholders alongside their own. A similar situation can be observed in Germany. In the US, on the other hand, where the government has not been a supporter of greater asset manager stewardship, and regulators are generally more sceptical of environmental and social affairs, asset manager capitalism to date has failed to bring about substantial change to the domestic governance model.

The Big Three US index investors continue to follow what can best be described as an orthodox interpretation of fiduciary duty, one that is focussed primarily on short-term financial returns. This stands in stark contrast to the approach of many UK and (to a lesser extent) German investors, who are increasingly reconceptualising their role as that of "universal owners" (Hawley and Williams, 2007). The theory of universal ownership argues that the shareholdings of many institutional investors are today so widely dispersed that they effectively own a slice of the entire economy. The increasing share of indexed investments has contributed to this. Furthermore, their ultimate beneficiary base, the clients of the asset managers, represent an increasing portion of the population that is saving for retirement. Because of this asset managers should care about externalities such as pollution or even social unrest as it risks

negatively affecting the performance of the widely diversified portfolio as well as affecting the physical environment that their beneficial owners will encounter in retirement.

The policy consequence of this is that asset managers that conceive of themselves as universal owners will show greater regard to the concerns of other stakeholders besides themselves. This manifests itself by asset managers demonstrating greater support for shareholder proposals concerning environmental, social and political issues. Chapter 4 will show that the evidence shows that asset managers in the UK and Germany indeed back a large and growing percentage of such shareholder proposals, whereas the Big Three US asset managers, who we would expect to be the most likely to see themselves as universal owners, vote with management and against the vast majority of such proposals. The Big Three thereby provide corporate managers with insulation from some of the changing policies of other investors.

The extent to which the Big Three US asset managers' understanding of their fiduciary duty changes in the future will therefore be of critical importance for how the varieties of capitalism are influenced by institutionalisation going forward. Such change may occur as a result of updated regulations, because of an increased acknowledgment of the financial materiality of sustainability concerns, or because increased public scrutiny by activists leads to increased social pressure to change. Should the result be that the Big Three US asset managers adjust their understanding of fiduciary duty to align it with the understanding favoured by European asset managers, then the rise of the asset manager capitalism has the potential to cause a convergence in the varieties of capitalism that goes beyond a mere convergence in form to one also of function. It would not, however, represent a convergence on the US model.

Limits of the Analysis

This thesis considers only one of the five spheres identified by Hall and Soskice (2001) in which firms have to maintain relationships to be successful. In general, the varieties of capitalism deals with a broad range of issues including workers representation and innovation, but financing and corporate governance are central to most of the discussions. A further point to note is that the focus of this study lies only on the listed equity market as a source of funds. Countries differ in the extent to which their firms use private equity or venture capital (Black and Gilson, 1998), bank funding (Hardie and Howarth, 2013; Hardie et al., 2013), or finance expenditure out of retained earnings (Braun and Deeg, 2019). Furthermore, there are also differences between countries in the proportion of the companies that are listed on the stock market, with Germany and its Mittelstand in particular being largely in private ownership and thus funded initially by paid-in owners' equity, borrowing and retained earnings (Perry and Nölke, 2006).

The following chapters repeatedly straddle the law and economics and the varieties of capitalism literatures. Corporate governance is central to both, but the questions that the respective literatures ask are very different. Hall and Soskice's (2001) description of an ideal-type LME model, for example, refers to managers' focus on share price, on short-term developments and on shareholder value. Though they do talk about bank blockholders having monitoring advantages within CMEs, agency problems between corporates and shareholders are not the focus of their analysis. Instead the focus is on comparative institutional advantage achieved through complementarities between institutions. The law and economics and corporate governance literature on the other hand is focussed on the degree of managerial autonomy as it seeks to limit agency problems but for the most part does not question how different shareholders' preferences may differ. Managerial autonomy by itself, however, tells

us little about where a country sits on the continuum between the two ideal-type poles of LME and CME models.

Bridging the conceptual gap between the corporate governance literature and the varieties of capitalism literature analysis requires a focus on the type of shareholder policies that replace managerial autonomy. If managerial autonomy is reduced in favour of greater shareholder control, this represents a reduction in agency problems but by itself does not imply a change in corporate strategy. Should shareholder policies merely seek to advocate for the same policies previously already pursue by management, then nothing will change (as is the case at many US companies today). If, on the other hand, managerial autonomy is replaced by shareholder policies seeking to give greater consideration to the interests of other stakeholders (the following chapters will show that this is the case in the UK and Germany), then this is of relevance for the varieties of capitalism as it would represent a change from an LME towards a CME model of capitalism, requiring managers to adopt greater coordination and longer time horizons.

There is one further point that has to be addressed in order to ensure the conceptual integrity of the above link between the law and economics and varieties of capitalism literatures and that is that the influence of shareholders on corporate executives has historically been exaggerated in the literature (exceptions being Knafo and Dutta, 2019; Pistor; 2019; Roe, 1994). Rather than acting as the impartial referees of stakeholders' concerns as Aoki (1984) and others have envisaged, managers have run companies mainly for their own benefit (particularly in the US), taking account of shareholder demands only where necessary. Even though large remuneration packages ensured that shareholder returns were given substantial attention, when it came to corporate strategy, shareholders have generally had limited influence.

Pistor (2019) highlights the irony in the fact that the Business Roundtable, an association of the largest firms in America, in August of 2019 announced that it "redefines the purpose of a corporation to promote 'an economy that serves all Americans'".[32] The statement made clear that Americas largest firms would no longer seek to maximise shareholder value but instead follow a stakeholder approach. The statement effectively sought to pass the blame for past social failings on to shareholders; managers as agents where only doing what their principals were telling them. Yet if managers were truly lacking autonomy in their decision making, then they could not simply choose a new master (stakeholders) and abandon their old (shareholders).

Instead managerial autonomy in LME countries such as the US has historically always been substantial, and the control of shareholder has been exaggerated. In CME countries such as Germany, managerial autonomy has historically been limited by dual board structures and employee representation (see also Goyer, 2011). For managers of companies in CME countries the greater attention that asset manager capitalism gives to stakeholder concerns simply represents a moderate rebalancing of the relative power of stakeholders without material changes to managerial autonomy. For executives in LME countries such as the US, however, the rise of asset manager capitalism can represent a decrease in managerial autonomy as it requires managers to give greater consideration for other stakeholders' concerns and thus demands increased levels of coordination as well as moderate adjustment of investment horizons.

[32] Full statement available at: https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans (Accessed 1 May 2020).

The Structure of this Thesis

This thesis identifies five distinct developments influencing the corporate governance of companies in Germany, the UK and the US. Two first-order phenomena, rising institutional ownership and the rise of index investment and three second-order developments: the internationalisation of fund management, the need for proxy advisors, and the corporate response. In the chapters that follow, each of these phenomena will be addressed in a dedicated chapter.

Chapter 2 documents the historical roots of the institutionalisation of the asset management industry with particular attention given to the role played by national social security and pensions systems. Chapter 3 looks at the significance of the growth of "passive" index investing on the corporate governance activities of asset managers. Chapter 4 assesses the internationalisation of share ownership, both in terms of the internationalisation of the corporate share register as well as the increased internationalisation of asset management firms themselves. Chapter 5 illustrates how this has given rise to the services of proxy advisors and investigates their role in the struggle between shareholder and corporate interests. Chapter 6 discussed the role of the asset management sector within the overall process of financialisation and specifically with regards to the repercussions for workers and the relationship to growing economic inequality. Chapter 7 considers the role of the firm within this changing shareholder ownership structure and documents how corporates, particularly in the United States, are engaging in lobbying in order to challenge shareholders' increased governance assertion. Chapter 8 concludes with a consideration of what these governance changes entail for our understanding of the comparative political economy literature.

Chapter 2

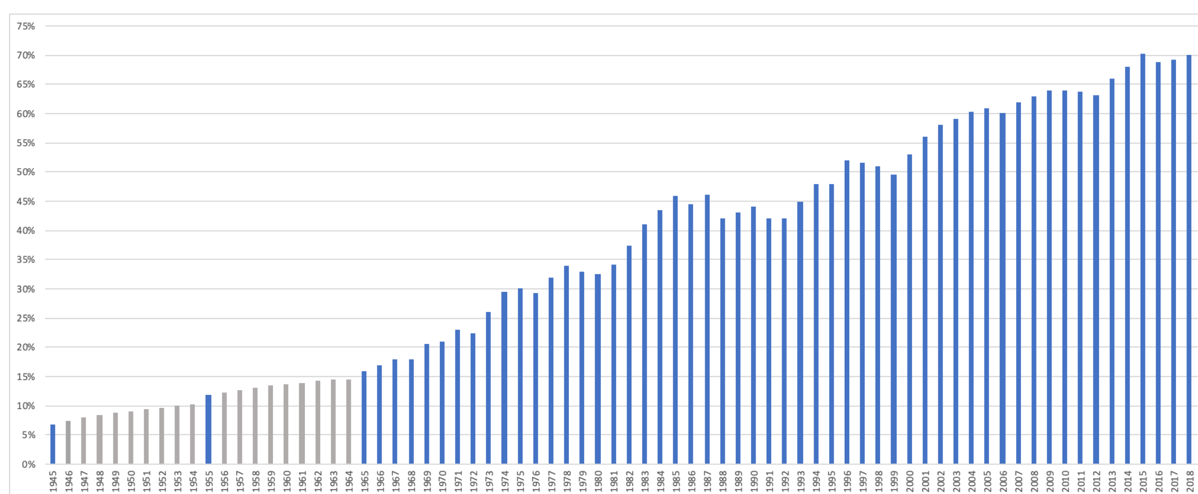
The Institutionalisation of Share Ownership

Introduction

In 1904, John Moody, the founder of the synonymous bond rating agency, published a book in which he outlined his expectations that in the future the US would have delegated all of its corporations to the control of a single group around the Rockefeller family (Moody, 1904). Instead, blockholding families such as the Rockefellers soon lost their control over US corporations, spurred on by antitrust policy and the ability of bankers like J. P. Morgan to successfully sell large blocks of stock to a wide public (Becht and DeLong, 2005). The result was that by the end of 1929 only eleven percent of the 200 largest corporations in the US were still controlled by large blockholders (Becht and DeLong, 2005). This then was the background which led Berle and Means (1932) to observe that the atom of ownership had been separated into its components of beneficial ownership and control.

The dispersed ownership noted by Berle and Means (1932) was, however, only to be a temporary phenomenon. Figure 2 illustrates the extent to which institutional share ownership has increased in the US over the past century. From less than 7 percent in 1945 US institutional ownership has grown to approximately 70 percent in 2018, with some estimates putting it as high 80 percent (SEC, 2019). While this "great re-concentration" (Braun, 2019) represents one continual transfer of shareholdings from individuals to institutional investors, this chapter will show that below the surface of this consistent development there have been multiple waves of institutional leadership bringing with them numerous changes to corporate governance.

Figure 2: Percentage of US Corporate Equities Held by Institutional Investors (1945-2018)



Source: Flow of Funds Accounts of the United States, The Federal Reserve, grey bars represent interpolated levels.

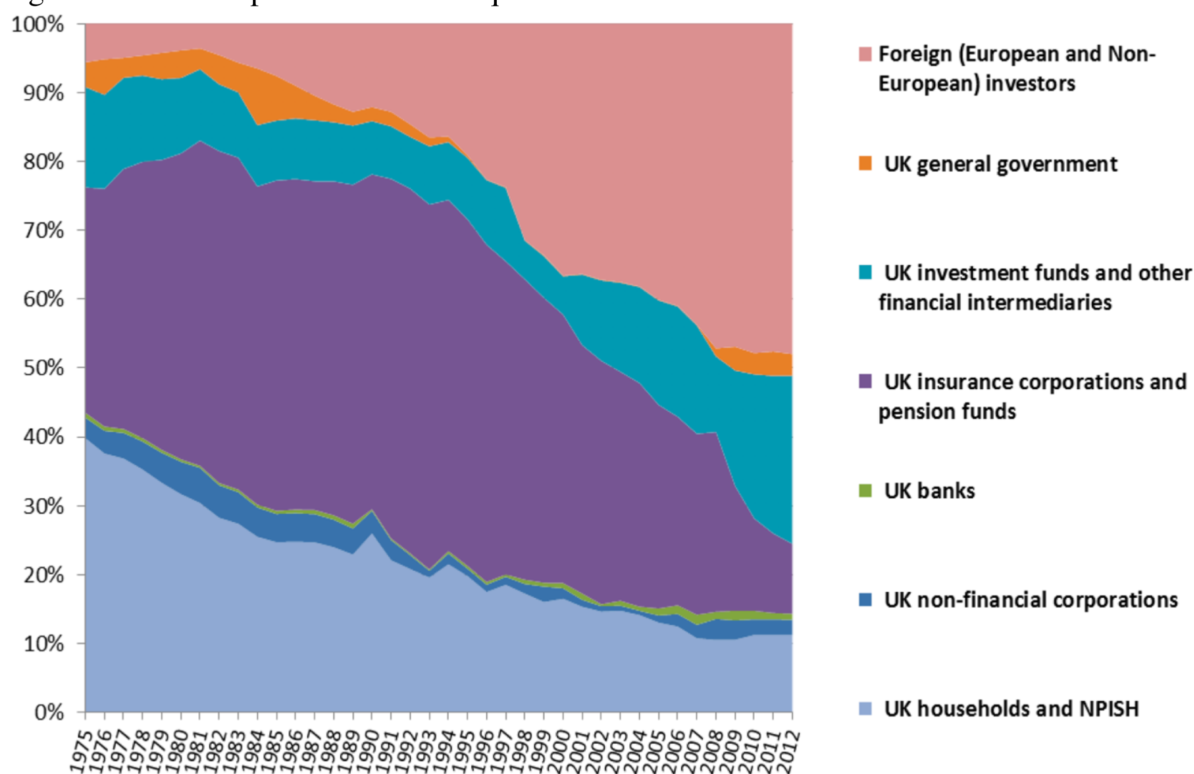
Institutionalisation in the context of this thesis refers to the transfer of shares from individual investors to institutional investors. Institutional investors are asset managers (including mutual fund and Exchange Traded Funds (ETF) companies), pension funds, hedge funds, sovereign wealth funds and corporations (including banks and insurance companies). The primary focus in the context of this thesis are those cases where these institutional investors act as intermediaries in the investment chain, where they represent a new link in that chain, managing the assets of individuals that would have previously been directly held by individuals. This therefore eliminates sovereign wealth funds, and corporates from the analysis, putting the focus of this chapter on insurance companies, pension funds and especially on asset managers.

Harmes (2001) explains that all institutional investors have three common characteristics that differentiate them from individual investors: First, they provide individual investors with a means of risk pooling, enabling them to diversify their investments even for small sums of money. Second, they are able to spread the costs of investment management across a large asset base, thereby taking advantage of economies of scale and lowering the costs of investment

management. Third, while regulatory requirements differ from country to country, there are generally requirements for institutional investors to act in the interest of their ultimate investors.

The institutionalisation of share ownership is far from an exclusively US phenomenon. Figure 3 shows how UK individual (household) share ownership declined from approximately 40 percent in 1975 to approximately 11 percent by 2012. The most recent data from the UK Office for National Statistics puts UK individual share ownership at 13.5 percent of UK quoted shares at the end of 2018.[33] The overall trend in the UK thus mirrors the developments observable in the US, with individual shareholdings declining and institutional holdings increasing.

Figure 3: Ownership structure of UK quoted shares



Source: European Commission (2013)

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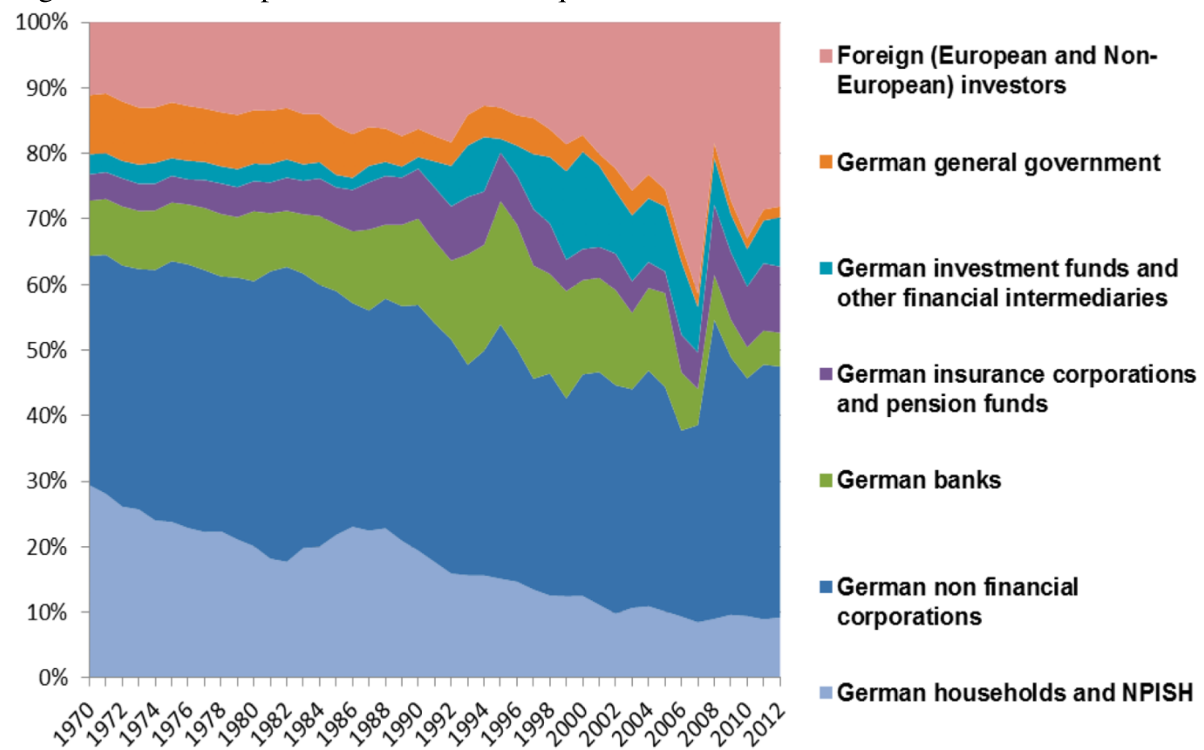
[33] Source:
https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018
Accessed 25 December 2019.

Figure 4 shows a comparable trend in Germany with household ownership declining from approximately 30 percent in 1970 to approximately 9 percent in 2012. As the European Commission (2013) notes, the data for assets in investment funds is distorted by the fact that many German funds are listed in Luxembourg and Ireland for regulatory and tax reasons and thus do not appear in this graph. If one were to include these figures, the percentage of quoted shares held by German investment funds would be slightly higher, and the share or Foreign investors slightly lower.

Figure 4: Ownership structure of German quoted shares



Source: European Commission (2013)

A number of authors have already covered different aspects of institutionalisation in detail, including pension funds (Clark, 1998; Hawley and Williams; 2000; van der Zwan, 2017), mutual funds (Davis, 2009; Useem, 1996;) and ETFs (Braun, 2016; Fichtner, et al. 2017). The aim of this chapter is to bring these different aspects together, to show how they form part of a bigger process of institutionalisation. Furthermore, despite national differences in the

respective importance of pension funds versus mutual funds and versus ETFs, the end result is that the percentage of shares held by institutional investors in Germany, the UK and the US today is approximately equal. While this has created the preconditions necessary for shareholders to take on a greater governance role, this chapter will show that it still left them short of the ownership concentration necessary to assume meaningful control over corporate governance. Both Figure 3 and Figure 4, for the UK and Germany respectively, also show a substantial increase in foreign ownership during the period. This development of increasing internationalisation will be the focus of Chapter 4.

Chapter Structure

This chapter will set out the following five arguments. First, the twentieth century witnessed a massive shift of shareholdings from private individuals to institutional shareholdings in all three countries, though to slightly differing degrees. Second, the relative lack of support provided by the social security and unemployment systems in the UK and US provided the foundations for the dominance of the asset management industry by Anglo-Saxon asset management firms. Third, the replacement of defined-benefit pension plans with defined-contributions pension schemes resulted in a transfer of assets from pension funds to asset managers and further boosted the relative size of UK and US asset managers versus German investment managers.

Fourth, with a small number of exceptions, institutional investors in Germany, the UK and the US only had limited influence over corporate governance during the twentieth century. Ownership concentration increased as shares passed from individuals into the hands of asset managers. But overall concentration within the asset management sector at the end of the

twentieth century, did not suffice for asset managers stewardship efforts to provide broad oversight. Finally, with regards to the varieties of capitalism this means that while many of the preconditions for Anglo-Saxon asset managers to play a greater role in corporate governance were set in the twentieth century, the limited influence they had at the time was focussed on their domestic markets. The chapters that follow will show that this largely continues to be the case today.

The next section will explain the significance of the process of institutionalisation for the corporate governance of firms. This is followed by a section which shows that the dominance of Anglo-Saxon asset managers has its roots in the foundations of the pensions systems in the late 19th century and early 20th century. Next the retrenchment of the welfare state that occurred in all three countries from the late 1970s onwards and the corresponding transition of corporate pension plans from a defined benefit to a defined contribution structure, particularly in the UK and the US is analysed. This is then followed by an investigation of the factors that contributed to the rise of mutual funds in each of the three countries from the late 1980s.

Also discussed are a number of offsetting factors that occurred concurrently. First, in Germany there was the special case of the Deutschland AG ownership network, the dissolution of which offset some of the growing ownership concentration that resulted from institutionalisation in Germany. Second, the decline in UK insurers' equity holdings similarly offset some of the growing ownership concentration. This chapter closes with a consideration of the consequences that the shifting shareholder structures have had for the governance of firms, concluding that the ownership structure in place at the end of the 20th century did not suffice to give shareholders a notable say over corporate matters.

The significance of institutionalisation

> *"It's amazing how all those tiny nest eggs can add up when you put them together and let a handful of people decide how to invest them". Harmes (2001: 9)*

As the above quote from Harmes (2001) suggests, the transfer of millions of individual savings and pension accounts into the hands of a small number of very large financial institutions can have significant consequences for the governance of firms. There are a number of ways in which institutionalisation changes shareholder behaviour, all of which explain why institutionalisation is considered a first-order development in this thesis. Firstly, from a purely arithmetic perspective, institutionalisation leads to larger average ownership stakes. Ownership concentration is not proof of institutionalisation, it may also occur as a result of highly concentrated private holdings, but it is a strong symptom of it.[34]

Institutionalisation brings about ownership concentration in two ways. Firstly, there is the transfer of a large number of comparatively small individual investments to a smaller number of larger institutional investors. This has the result of reducing the collective action problems amongst shareholders, thereby in principle increasing their influence. Secondly, because of the extensive economies of scale inherent in the asset management industry, there is a tendency for the industry to consolidate, with a very small number of very large asset managers capturing the majority of assets (Fichtner et al., 2017). This inevitability of a winner-takes-all market structure has only been exacerbated with the trend towards index investment and internationalisation, covered in Chapter 3 and 4 respectively.

[34] There may be countervailing developments, such as the aforementioned divestments by the early US industrialist families at the beginning of the 20th century as well as the break-up of the Deutschland AG network. Both of these events had the effect of at temporarily offsetting the growing ownership concentration resulting from institutionalisation.

Besides the arithmetically higher stakes there are two further ways in which institutionalisation may influence the governance of firms. Firstly, institutional investors are able to spread the cost of governance activities across a larger asset base, thereby lowering the cost of engagement. An example of how the resources of institutional investors differ from those of individual investors can be seen in the way they have sought to reduce the free-rider problem inherent in governance activity. To do so institutional investors have established investor networks to consolidate and amplify their collective voice while reducing the individual institution's costs of engagement.

Today, institutional investors regularly meet both in general forums, such as the United Nations Principles for Responsible Investment (PRI), as well as at designated networks, such as the International Corporate Governance Network (ICGN) or the Ceres Investor Network on Climate Risk and Sustainability (CERES).[35] The degree of coordination that can occur at such events is still subject to collusion regulations and thus discussions are limited to the design of general best-practice principles of corporate governance as opposed to company-specific discussions. But despite these limits, these networks nevertheless do contribute to coordination amongst investors.

Secondly, institutional investors are subject to regulations that do not affect individual investors (Harmes, 2001). Institutional investors may, for example, be required to vote all of their proxies as well as to engage in further stewardship measures. In the US, for example, legislation in the 1970s formalised the role of fiduciary duty.[36] Asset managers are fiduciaries, they manage money on behalf of asset owners, also referred to as beneficial owners. The

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[35] The Ceres Investor Network on Climate Risk and Sustainability comprises more than 150 institutional investors, collectively managing more than $24 trillion in assets.
[36] 1974 ERISA legislation, 1979 US Department of Labor regulations.

resulting ownership structure has therefore been referred to as both "fiduciary capitalism" (Hawley and Williams, 2000) and "agency capitalism" (Gilson and Gordon, 2013).

The reason concepts such as fiduciary duty matter is because they formalise requirements for institutional investors. In the US the SEC, for example, requires "an investment adviser who exercises voting authority with respect to client securities to adopt and implement written policies and procedures that are reasonably designed to ensure that the investment adviser votes proxies in the best interest of its clients" (SEC, 2019a). The determination of a client's best interest is a highly controversial issue. To date institutional investors' interpretation of SEC guidance had been that it requires them to vote all shares, though this is an issue the SEC is seeking to address in update regulation in 2020. There is also disagreement of how fiduciary duty should be interpreted in regard to environmental and social concerns.

Each country has different rules, but each sets out a framework according to which institutional investors have to operate. In the UK there is less focus on the concept of fiduciary duty, but more emphasis on a general requirement for institutional investors to engage in "stewardship" of their investee companies (Financial Reporting Council, 2012; 2019). In Germany legal requirements to date are still being formulated, though most asset managers adhere to the German Investment Association (BVI) "Wohlverhaltensregeln" (translates as rules of good conduct). These best-practice rules of good conduct state that proxy ballots only have to be voted when it is in the interest of the beneficiary. In practice this means that most large asset managers in Germany seek to vote the vast majority of their shares. Interviewees at large German asset managers explained that they sought to vote all German shares and an increasing proportion of foreign shares. However, since German law does not compel asset managers to vote, one smaller asset manager explained that they almost never voted. The reason for this

was a shortage of resources. Besides being one of the portfolio managers, he was also recently selected as the person responsible for any corporate governance matters that might arise.[37]

To summarise, the institutionalisation of share ownership is of particular significance as it reduces collective action problems amongst investors, lowers the relative cost of engagement and puts shares in the hands of institutions who are for the most part compelled to vote. The result is that in principle this has created the conditions for institutional investors to play a greater role within corporate governance. The extent to which this has actually occurred to date, and differences between the three case study countries, will be investigated throughout the chapters of this thesis.

Phase 1: 1840s to 1980s – the rise of pension funds

The roots of Anglo-Saxon dominance of the asset management industry are to be found in the decisions made during the design of the social security systems in the late 19th century. From the outset, the design of the UK pensions system, and especially that of the US, was such that there would only be minimal support and that people would therefore be incentivized to care for themselves.

Pensions in the UK and the US were primarily the result of economic realities. The early railway pensions were set up as employers were concerned by increased unionisation (Hannah, 1986). The same is true for the period after WW2 in which unemployment in the UK did not exceed 2 percent for two decades. Employers sought to retain skilled workers through pension promises. In Germany on the other hand, Bismarck's challenge was of a broader political nature

[37] Portfolio manager, German asset manager, telephone interview, 21 March 2018.

in that he sought to stop the rise of socialism with the help of his "Anti-Socialist Law" of 1878. Bismarck's "political project" (Bonoli, 2000) was therefore about appeasing the "increasingly restless German working class" (Hill, 2007), rather than ensuring the loyalty of a given group of employees.

This required a more wide-ranging and inclusive approach to pensions coverage. From the outset the German pension system was (and still is) compulsory, employees and employers contributed equally, with the government also contributing. Initially it was partially funded but reforms saw partial funding replaced with a PAYG system based on an intergenerational contract. In this intergenerational PAYG system the current workforce pays for the current generation of pensioners, the system therefore requires no additional funding. However, it does rely on a balanced and stable demographic pyramid. Chancellor Adenauer famously quipped that "Germans will always have children".[38]

In the UK the popularity of life insurance and private pension policies was by design. Life insurance policies received tax relief from as early as 1853 and pensions from 1921 onwards. Both Hannah (1986) and Davis (1995) consider taxation as the most important incentive for pension fund savings in the UK and credit it with the substantial growth of pension assets. Not only were corporate pensions encouraged through tax policies, state pensions were also capped at minimalist levels. "The consequence of this approach was that the exclusion of the better off from non-contributory pensions and social insurance meant that they had strong incentives to develop private pensions" (Hill, 2007: 24-25). This steering of workers and corporations

[38] https://www.spiegel.de/international/germany-s-baby-bust-why-aren-t-germans-having-babies-a-336760.html (Accessed 26 May 2019)

towards private pension solutions has been a continuous hallmark of the UK approach to pensions and social security.

The publication of the Beveridge report in 1942 laid the groundwork for the introduction of a national social security system in the UK, though it was the post-war Labour government that brought it in. The system was applicable to all people in employment and funded by a flat-rate contribution by all workers. Beveridge's recommendations were almost implemented in their entirety, except for the fact that the timetable was expedited. Rather than following Beveridge's recommendation of adopting a "National Insurance" system in a gradual process over a twenty-year period, the government sought to introduce the system in ten years or less. The increased financial burden that came with a quicker implementation, Hill (2007) notes, probably had the consequence of reducing the level at which the support operated, putting it closer to the subsistence level. Thereby the faster implementation of the national insurance system, once more ensured that individuals were steered towards private pensions.

Similar to the UK, the first US private pensions were provided by the railway companies. These were joined by military pensions, which commenced in 1890. But extensive occupational pensions were slow to develop (Sass, 1997). It was the New Deal, which was introduced following Roosevelt's inauguration in 1933, that led to a step change in public and private pensions. However, similarly to the developments in the UK, there were disagreements about how the system was to be phased in. While the legislation initially passed Congress unscathed, the bill met with substantial resistance in the Senate as lobbyists took their last stand (Berkowitz, 1991). Berkowitz quotes a lawyer for Edison Electric Illuminating Company who spoke of how "paternal government aid sapped the 'virtues of self-reliance and frugality' and bred 'a race of weaklings'" (1991: 43).

The result of the curtailment of state support in the US and the UK and the tax support provided to private pensions was that by the end of the 1970s, pension funds were the largest institutional investors in the UK and the US. Their governance activity during this period was, however, limited. This was in part because of the absolute size of their ownership stakes. While pension funds represented the largest institutional investor in the US with approximately 22 percent of assets, approximately 70 percent of assets remained in the hands of individual investors (Jackson, 2010), meaning corporate executives faced little serious resistance from a dispersed shareholder base in this time of "managerialism" (Davis, 2009). With regards to the US, Bebchuk (2004) and Black (1990) also highlight the restrictive role of legislation, which prohibited (and to a large extent still does) investors from forming coalitions.

Besides the absolute size of their holdings there were other factors contributing to subdued pension fund activism during this time, chief of which were conflicts of interest (Hawley and Williams, 2000; Black, 1990). Corporates, cognizant of the fact that any activism by their pension funds at other corporate elections could result in retaliatory behaviour at their own annual general meetings, on the whole sought to tone down involvement. US legislation furthermore ensured that trade unions were constrained in their ability to influence investment decisions at corporate pension funds (McCarthy, 2014). This left public pension funds as the most active advocates for better corporate governance (Hawley and Williams, 2000).

The situation in the UK and Germany at the time was quite different from that in the US. While levels of institutionalisation today are approximately equal in all three countries, the degree of institutionalisation in 1980 differed substantially across countries: The UK was actually ahead of the US, with levels of institutional ownership of approximately 70 percent as early as the

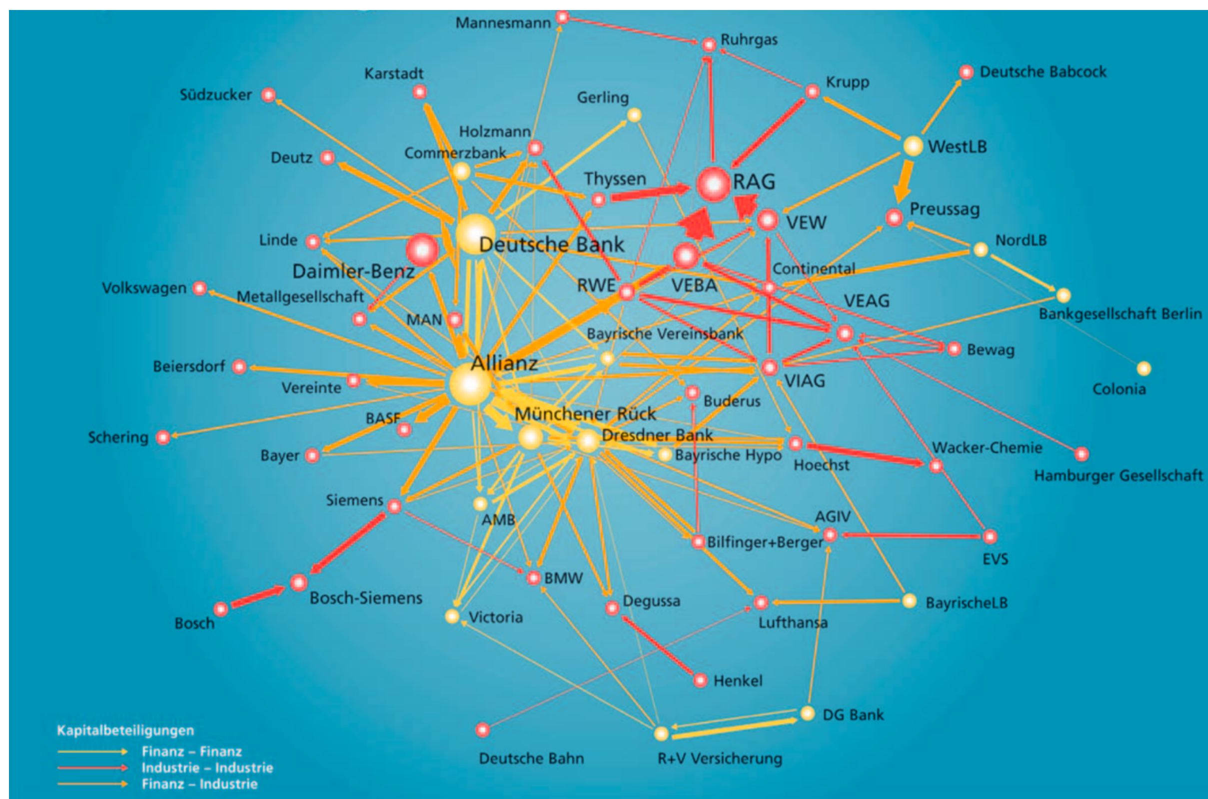
1980s, at a time when the US stood at 32 percent and Germany had reached only approximately 10 percent (European Commission, 2013). The reason for this divergence is two-fold.

With regards to the UK, the reason for the higher levels of institutional ownership was primarily to be found in the large equity holdings of UK insurers and pension funds. Black and Coffee (1994) explain that US insurance regulation forbade American insurers from holding large equity stakes and that British insurers were also permitted to manage mutual funds, a business denied to American insurers by law. The result of this is that the largest US institutional investor in mid-1991 would not have even made the Top-10 in the UK when measured by assets under management (Black and Coffee, 1994).

Further documenting the UK experience with institutional stewardship, Black and Coffee (1994) report on interviews with Prudential Portfolio Managers (PPM), at the time the largest UK institutional investor. PPM estimated that it held stakes of 5 percent or greater in approximately 200 UK companies, and in some instances held stakes as high as 14 percent. This example shows both the role of regulatory differences in facilitating or hindering the process of institutionalisation and the fact that the present-day UK stewardship initiative can look back on a long history of institutional oversight. The comparatively low level of German institutionalisation, on the other hand, can be explained by the continued presence of the Deutschland AG network up until the end of the twentieth century (Figure 5). The definition of institutionalisation employed in this chapter focusses on pension funds and asset managers and thus excludes the holdings of families, banks and non-financial corporates, all of which held substantial stakes in Germany at the time.

Known as “Deutschland AG” or Germany Inc, the shareholder ownership structure of large German companies was characterised by a tight-knit network of crossholdings between industrial firms, banks and insurance companies. This network had its roots in the era of industrialisation in the second half of the nineteenth century (Höpner and Krempel, 2004). From the founding of both Deutsche Bank and Commerzbank in 1870, these banks were closely intertwined with German industrial companies. Georg von Siemens of Siemens AG, for example, was the first spokesman of the board of management of Deutsche Bank.

Figure 5: Deutschland AG in 1996



Source: Höpner and Krempel (2005)[39]

[39] Höpner and Krempel explain that the “size of the point represents the degree of involvement in the network rather than company size. […] Financial companies are plotted as white points and non-financial companies as dark grey points. Finally, three different kinds of links between firms are distinguished: white arrows show connections among financial companies; dark grey arrows represent connections between industrial companies;3and light grey lines indicate industrial shares held by financial companies, as well as the rare case of financial companies held by industrial firms” (2004: 341).

Höpner and Krempel (2004) report that the creation of Deutschland AG was at least partially unintentional. Banks often retained stakes in companies that they listed on stock markets, and when demand was particularly low, they would hold the balance that they were unable to sell. But the authors also explain that cooperation between banks and industrial companies was encouraged by the state. State promotion of cartels was preferred, and inter-firm relationships were preferred to outright competition. Since the prevailing view amongst politicians and companies at the time was that cartels were to be preferred to pure competition, the Stock Cooperation Act of 1884 awarded the supervision of the executive board to the supervisory board and not to shareholders (Höpner and Krempel, 2004; Jackson, 2001). The idea being that interlocking directors would ensure better cooperation than purely return-oriented shareholders.

A central feature of the cross-shareholdings was that managers would sit on each other's boards thereby creating networks of directors. Since it is the board's responsibility to decide on any potential takeover proposal and the future of the CEO, this cross-shareholding provided a quasi-mutual insurance system amongst participating companies, partially insulating them from pressure from minority shareholders (Streeck, 2010). Besides the absence of a funded pensions system, this shareholder network thus further explains the relative insignificance of institutional investors within German corporate governance during the 1970s and 1980s.

Overall it can be said that while institutionalisation started to accelerate in all three countries in the 1960s and 1970s, it largely failed to result in greater corporate governance activity from institutional investors. Cheffin notes that "[w]hile corporate governance concerns might be endemic to the corporate form, the now ubiquitous term 'corporate governance' was largely

unknown in the United States until the 1970s—and not until the 1990s in the rest of world" (2015: 718).

The 1980s and 1990s – The retrenchment of the welfare state and the rise of mutual funds

If pension funds were the winners in terms of asset growth in the decades leading up to the 1980s, it has been asset managers that have been dominating ever since. There are three main factors responsible for the ascendancy of mutual funds. These are the increasing substitution of defined benefit pension plans with defined contributions plans, the dawn of "mass investment" and the understanding gained from finance theory, notably from modern portfolio theory (Markowitz, 1952). I will now consider each of these factors, starting with the transformation of pensions provision in this section.

While the period from the 1940s to the 1970s saw a gradual expansion of social security and pension systems in the UK and the US, the period from the mid 1970s onwards saw a retrenchment. In the UK there was a brief effort by the Conservative and later the Labour governments in the early 1970s to introduce a limited additional pension scheme known as State Earnings Related Pensions Scheme (SERPS). However, with the arrival of the Thatcher government in 1979 the benefits guaranteed under SERPS were cut.

In Germany the expansion of the pensions system initially continued under Chancellor Schmidt in 1972 with more flexible retirement options, which contributed to the retirement costs for the state doubling between 1970 and 1975 (Willis Towers Watson, 2018b). However, in the mid 1970s Germany faced the same economic and demographic challenges as the UK and the US and the government started looking for ways to secure the continued affordability of the pensions system. One policy was the creation of corporate pensions, the legal conditions for

which were only created with the 1974 'Law for the Improvement of Company Pensions' (Willis Towers Watson, 2018b). The law provided for insolvency protection and mandatory indexation to inflation. From thereon, the German pensions system consisted of three pillars, though the state pension continues to dominate to this day. According to Willis Towers Watson (2018b) the breakdown between the three pillars in 2018 was as follows: 80 percent of the workforce were covered by the state pension plan and 10 percent each by occupational pension plans and by private provision.

With the US similarly facing economic hardship with the onset of the 1973 oil crisis, critics of state intervention intensified their attacks on the New Deal and the post-war Keynesian policies. The bankruptcy of the Studebaker motor company in 1963 led to the creation of wide-reaching pensions regulations, known as Employee Retirement Income Security Act (ERISA), a decade later in 1974. ERISA codified the legal status of defined-benefit corporate pension plans and imposed strict minimum-funding requirements (Davis, 1995).

From this followed the most fundamental change to the US pensions system with the introduction of tax-advantaged individual retirement accounts (IRAs) in 1974 as part of ERISA. IRAs were followed in 1978 by an even more tax-advantaged product, the 401(k) individual tax advantaged retirement savings accounts, which were actively promoted by the Reagan administration (Hyde and Dixon, 2008). In contrast to the early days of the pension industry, Harmes (2001) notes that since labour was more readily available in these more uncertain economic times, employers no longer needed to ensure workers' loyalty by offering them pension promises.

While DB schemes guarantee employees a certain level of pensions income from the time of retirement, typically a percentage of an employee's final salary ('final salary schemes'), DC schemes provide no guaranteed level of benefit but instead only specify what level of contribution the employer will make every year throughout employment. The important difference is that in DB schemes the employer bears the risk of longevity of the employee as well as the underlying financial return risk that portfolio returns may not suffice to cover the pensions guarantee. With DC pensions the employee carries the risk that the sum of the received pension contributions will not suffice to cover necessary pension income in retirement.

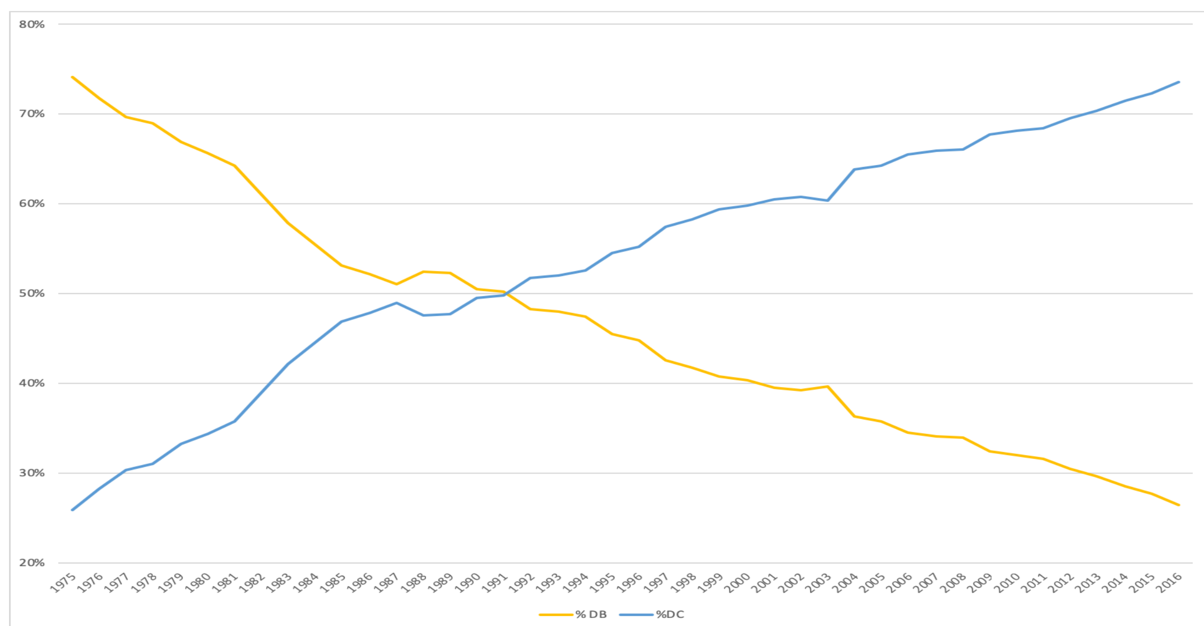
Besides contributing to the level of aggregate pension savings, the creation of 401(k) plans in the mid 1970s therefore also created the vehicle that facilitated the switch from DB to DC plans in the US. The reason why companies everywhere, not just the US, started shutting down their DB schemes can be found in a combination of rising longevity risk as well as structurally declining interest rates. As employees lived longer, pension promises became increasingly expensive for companies to uphold. Pension promises are liabilities on companies' balance sheets. In order to match assets with these future liabilities, pension funds historically invested in longer dated bonds.

However, longer-dated interest rates started to decline substantially from the early 1980s. From a high of 16 percent under the Thatcher government in 1981, the yield on 10-year UK government bonds declined to 10 percent by 1990 and to almost 4 percent in 1999. Similar developments occurred in the US, where the yield on 10-year treasury bonds declined from a high of almost 16 percent in 1981 to 8 percent by the early 1990s and 5 percent by the turn of the century. In Germany the Bundesbank kept yields in a tighter corridor but 10-year

government bond yields nevertheless fell from a high of above 10 percent in the early 1980s to a low of 4 percent in 1999. However, for Germany rates were less important as the majority of pensions savings were, and still are, in the state PAYG system, which is mostly unfunded.

Since pension guarantees represent liabilities to a company's balance sheet and the declining interest rate represents a lower discount rate on those liabilities, pension liabilities started to balloon relative to corporate earnings, thereby substantially increasing the pressure on corporates to close DB schemes to new joiners and convert existing DB plans to DC plans. Figure 6, below, illustrates the rapid decline in DB pensions in the US from 1975 onwards. From 74 percent of all participants in DB pension schemes in 1975, their proportion quickly declined, falling to 50 percent by 1990 and just 26 percent by 2016.

Figure 6: Percentage of participants in US pension plans by type of plan, 1975-2016



Source: U.S. Department of Labor

The switching of DB to DC pensions, which started in the US in the 1970s did not reach the UK until approximately 1990, a point at which half of all US DB plans had already been moved to DC plans. While the UK transformation started considerably later, the pace at which the transition happened was much faster and the end result more extreme. Willis Towers Watson (2018b) reports that by 2015 ninety-six percent of FTSE 100 companies offered DC-only pension plans. This compares to 71 percent of Fortune 100 companies (Americas 100 largest corporations by revenues) offering DC-only pensions. The result of this development is that both the US and the UK today have comparatively large private household pension savings.

For Germany, the issue of DB/DC switching to date has been largely irrelevant as the majority of employees are covered by the PAYG state pensions system and only a handful of companies offer DB pensions. However, because the various pension and social reforms of the Schröder government failed to plug the pensions gaps, in 2017 further reforms were announced. These seek to enlist company pensions to fill the gap. The law envisions DC plans by collective agreement. Employers will not have to provide a minimum benefit or interest guarantees. There can be no lump-sum payments, only annuities, and the DC plans are not guaranteed through the pensions' protection fund. The critical point here is that they can only be introduced with union approval and the underlying fund needs to be jointly operated by unions and employees (Willis Towers Watson, 2018b).

Despite the fact that the 2017 German pensions law came into force on the 1st of January 2019 (one year later than originally planned), to date no occupational DC pensions have been set up.[40] While labour unions, such as the IG Metal (the steel workers' union with more than 2

[40] https://www.ipe.com/countries/germany/germany-unlikely-to-see-new-dc-plans-before-2020/10027937.article (Accessed 2 May 2020)

million members) supported the original law, they appear lukewarm on its actual introduction. For now, unions are demanding that employers fund the new DC plans with some initial capital in order to provide a safety net (as the DC plans are not insured).

Unlike the creation of pension funds, which launched the process of institutionalisation, the shift from DB to DC in itself does not influence the degree of institutionalisation.[41] Pension assets, whether DB or DC were already managed by institutional investors. Instead the shift from DB to DC changed the structure of the investment chain and correspondingly the nature of engagement. While many of the DB pensions had been managed by in-house corporate pension funds, when it comes to DC plans, individuals select asset managers to run their pension plans. With regards to the shareholder ownership structure, the result of this pension switching is an increase in the overall level of ownership concentration amongst institutional investors as the same asset managers that administer people's individual investment accounts now also manage those individuals' DC retirement accounts.

More importantly still, pension funds are generally considered to take a more active, and oftentimes more socially conscious, approach to corporate governance oversight than mutual funds (Chen et al., 2007; Del Guercio and Hawkins, 1999). One interviewee at a US pension fund explained that what made pension funds so powerful was their "monolithic beneficiary base", which enabled them to take a more active stance on certain social issues that mutual funds would shy away from.[42] Such monolithic beneficiary bases have, for example, allowed the California State Teachers' Retirement System (CalSTRS) to divest from tobacco stocks in

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[41] For a detail analysis of pension fund capitalism, see Dixon (2008) and McCarthy et al. (2016).
[42] Governance analyst, US pension fund, telephone interview, 24th of July 2019.

the year 2000 and more than half of all UK university pension funds to divest from fossil fuel investments in recent years.[43]

As a result of the transfer of pension savings from DB to DC plans, the associated proxy voting rights transferred from pension funds to mutual funds. Interviewees explained that while pension funds themselves have always outsourced some mandates to third-party asset managers, in such cases they would typically retain the proxy voting rights for these assets.[44] With the switch from DB to DC therefore, the proxy voting rights related to retirement assets that were hitherto exercised by the pension funds transferred to the big asset managers. This further increased the size of their voting blocs, further decreased collective action problems, and created the condition for greater shareholder influence over corporate strategy.

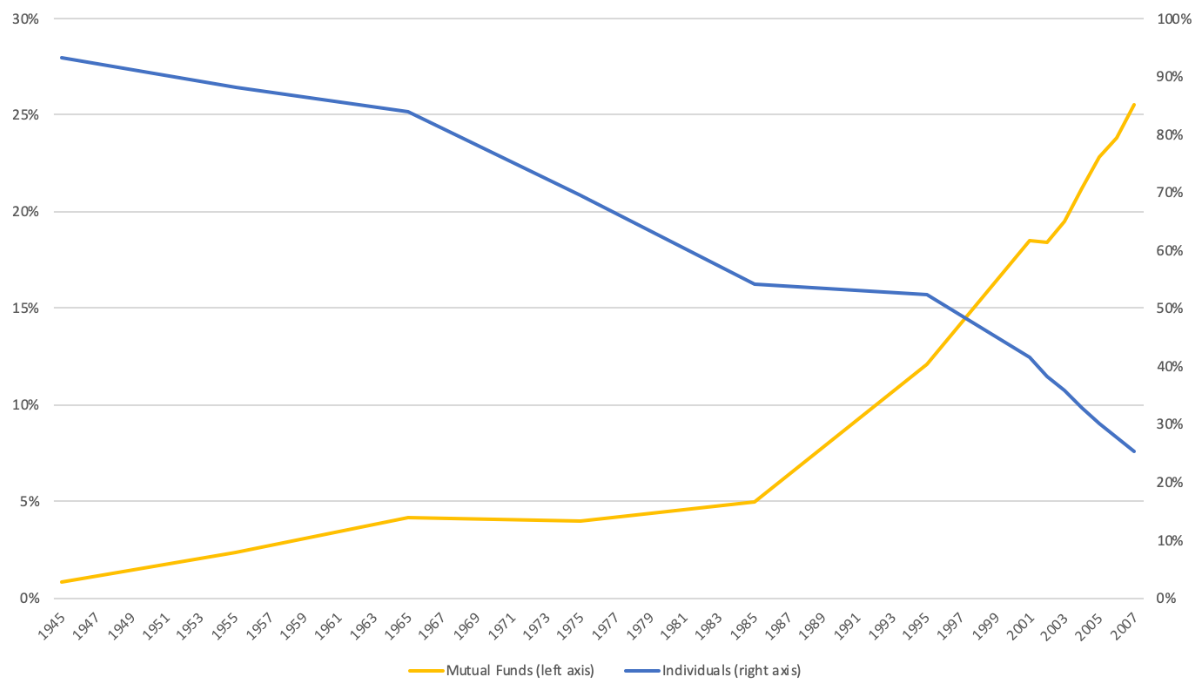
The dawn of mass investment

While the first UK investment trusts had been set up as early as 1868, it took many more decades for modern day mutual funds to become established. It was only in 1925 that the Foreign and Colonial Government Trust (founded in 1868) changed from investing in bonds to equities (Kahn, 2018). In the US the first open-ended fund, the Massachusetts Investment Trust, was similarly launched in 1924.[45] However, it was not until the Investment Act of 1940 that mutual funds as we know them today came into existence (Hawley and Williams, 2000). In Germany the first investment trusts had also been launched in the early 1920s but closed

[43] For further information on CalSTRS's decision to divest from tobacco stocks, see: https://www.latimes.com/archives/la-xpm-2000-apr-05-mn-16182-story.html For UK university divestments of fossil fuels, see: https://www.theguardian.com/environment/2020/jan/13/half-of-uk-universities-have-committed-to-divest-from-fossil-fuel (Accessed24 February 2020).
[44] Governance analyst, US pension fund, telephone interview, 24th of July 2019.
[45] Investment trusts are examples of open-ended funds and are what we today consider to be the common mutual fund. Unlike closed-ended funds, open-ended funds are able to issue new fund units whenever new investors decide to invest into the fund.

shortly afterwards due to high tax burdens. After that it was not until 1949 that the first German mutual fund was established and the mid 1950s before banks launched their own funds (Corner and Stafford, 1977).

Figure 7: US stock ownership by individuals and mutual funds (1945-2007)



Source: Data from Jackson (2010).

Despite being around for such a long time, mutual funds struggled to gain substantial assets. As late as 1985, mutual fund holdings did not represent more than five percent of the outstanding shares of US companies (Figure 7). This was even lower than the levels seen in Germany and the UK at the time (both at approximately 15 percent; European Commission, 2013). This all changed in the aftermath of the aforementioned pension plan switching. But there was a second reason why mutual funds' share of total assets grew so rapidly in the later part of the 20th century, and that was to be found in the growing popularity of mutual funds for individuals' non-pension investments. Prior to the 1990s more than half of all shares were held by private individuals who up until then chose to invest in the stock market primarily via direct

investments, picking their own stocks and not relying on professional services from mutual funds.

According to Davis (2009), the ensuing shift from individual shareholdings to mutual fund holdings was driven primarily by technological innovations that made finance accessible for many more people and in so doing dramatically reduced the "cover charge" on mutual fund investing. Mutual funds therefore employed their economies of scale and technological innovation to provide retail investors with affordable investment solutions that took advantage of risk pooling. From under 6 percent in 1980, the number of US households invested in mutual funds increased to nearly half by 2005 (Davis, 2009).

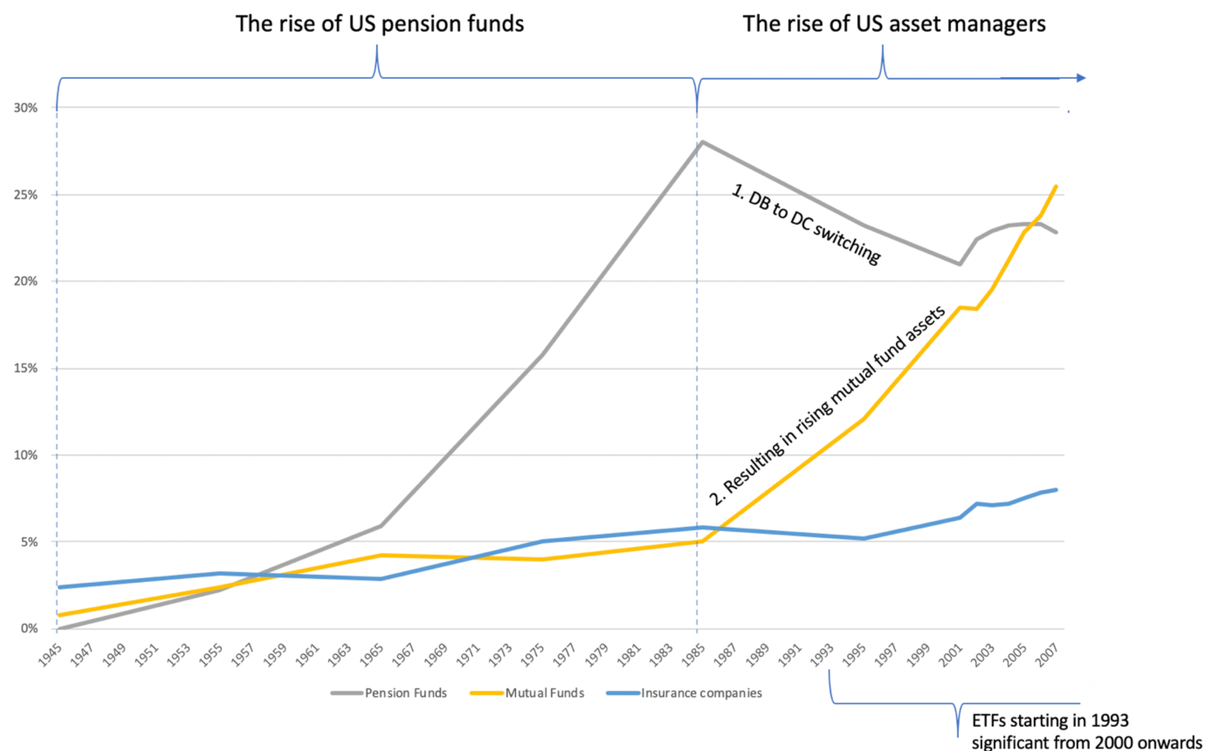
These technological advances allowed academic insights into portfolio management to be put into practice. In 1952 the Nobel laureate Harry Markowitz published his paper, which would lay the foundations for what we know today as Modern Portfolio Theory. In it he explains the undesirability of volatility in stock prices and sets out how a diversified portfolio of stocks provides a superior solution to putting all of one's savings into a single stock with the highest expected returns. He further notes the importance of taking account of correlations between stocks, highlighting that this required a portfolio that is diversified across industries exposed to different economic characteristics. Mutual funds provide affordable access to such diversified investment portfolios to the individual retail investor. The benefits of diversification are provided for a much-reduced capital outlay and costs are lower than if an individual were to pay to construct and regularly rebalance their own portfolio.

Harmes (2001) lists two further factors that contributed to the "revolution of mass investment". First, there was a growing perception of a coming crisis in social security in the US during the

1990s, which led to households increasingly seeking to find alternative means of ensuring retirement income. Second, the global bull market in equities and the media hype it brought with it led to big inflows in the US and Europe. This was the age of the Neuer Markt and the Dotcom bubble.

While it had taken almost half a century, from the Investment Act of 1940 until 1985, for mutual fund assets in the US to exceed five percent of the overall US share capital (blue line in Figure 8 below), the subsequent revolution of mass investment and the switching of pension plans meant that mutual fund assets grew from five percent to 25 percent in just two decades from 1985 to 2005 (Figure 8). Further demonstrating the relative importance of pension assets to the growth of mutual funds, Braun (2019) reports that the share of pension assets in total mutual fund assets doubled from twenty to forty percent during the 1990s alone (Braun, 2019).

Figure 8: US stock ownership by institutional investor type



Source: Own graph, data from Jackson (2010).

Despite the conditions for greater influence by asset managers being increasingly met, asset managers showed a strong reluctance to engage. Commenting on the US, Black notes an overreliance on the market for corporate control (takeovers), lamenting overall levels of "shareholder passivity" and remarks that "[p]erhaps thrice in a thousand cases, unhappy shareholders mount a proxy fight. About one fourth of the time, they win" (1990: 521). This observation was underlined by a founder of the US proxy advisor ISS who explained that the original idea was for them to set up an advisory business, assisting institutional investors to become activists in 1983. However, there was no demand, indeed they met with outright hostility as US asset managers did not want to become activists and did not even want to know of the fact that they had the means to do so.[46]

Chapter 5 will explain I detail what has changed since, but the summary is that from 1985 corporate raiders started targeting companies they considered to be underperforming, corporate executives responded with a raft of poison pill proposals to protect themselves, and asset managers were regularly coerced into support these proposals or risk losing corporate pension mandates. This came to the attention of the US Department of Labor, which responded by making the proxy vote part of the fiduciary duty of asset managers, and to many assert managers, proxy advisors presented a solution to outsource this duty.

Institutionalisation and the prospect of greater use of voice

The previous sections have described how institutionalisation has contributed to establishing the preconditions for greater shareholder influence by helping to overcome collective action problems, lowering the relative cost of engagement and changing the regulatory framework

[46] Former executive, US proxy advisor, telephone interview, 10 February 2020.

under which shareholders operate. This section will document how the rise of the active fund management industry provided the preconditions for greater shareholder influence by changing the relative capacity for the use of voice versus exit. This will be followed in Chapter 3 with a dedicated analysis of index funds and their rapid rise since the turn of the century.

The revolution of mass investment and the growth of active mutual funds that it represents has resulted in the average size of mutual funds growing substantially. The decision by any individual retail shareholder to sell is generally an unremarkable event. However, for institutional investors liquidity is an important constraint when considering whether to buy or sell a stock. "Market liquidity can be broadly defined as the ability to swiftly execute financial transactions, notably exit, at low cost with limited price impact" (Rommerskirchen, 2019: 125). Active funds seek to outperform the market (also referred to as "capturing alpha"). The influence they have on market prices when they buy and sell shares ("market impact") may at times become a significant trading constraint.

Active fund managers will want their positions in any individual stock to be no bigger than what can be absorbed by the market within a day or at most a week without substantially affecting the stock price. Otherwise they will drive up stock prices when they build the position and again drive down stock prices when they seek to exit, thereby reducing the outperformance they are able to capture. The individual active fund size is therefore theoretically capped by the ability to capture alpha (Chen et al., 2004; Pollet and Wilson, 2008; Reuter and Zitzewitz, 2010).

Institutionalisation has therefore changed the relative capacity for the use of voice versus exit. Bigger shareholdings mean that asset managers on average represent a greater percentage of

proxy votes, giving greater potential for the use of voice. At the same time the growth of assets has reduced the relative liquidity, making exit comparatively more difficult. Since the use of voice is a function of its likely success (Hirschman, 1970), the growth of mutual fund holdings should result in greater use of voice versus exit.

Besides liquidity, the ability to sell shares and exit a stockholding is primarily determined by the fund managers' willingness to take on tracking error risk. Active managers typically have a universe from which they may pick stocks and a benchmark against which their performance is tracked. If a fund manager decides to sell her holding in a stock that is contained within her benchmark this will increase her fund's "tracking error" (similarly buying a stock that is not included in the benchmark will do the same). Even when funds do not have an official benchmark they track, the fund manager will often have an internal benchmark according to which her performance is measured. In some cases, fund managers may have a formal quantitative "tracking error constraint", which specifies how much tracking risk they may take, in other cases it will be down to their own discretion and thus their personal risk appetite.[47]

Risk appetite will be a function of the pay structure of the fund management company as well as the career risk a fund manager perceives will result from a bad result. A study by McKinsey & Company (2015) estimates that ten percent of U.S. assets qualify as "benchmark-hugging".[48] Benchmark-huggers or "closet indexers" are funds that have a mandate to actively select stocks but instead exhibit a portfolio construction that mostly mirrors a benchmark index. From a regulatory perspective, the problem this creates is that the consumer is paying the price of an

[47] There is a large academic literature on risk aversion and career risk in the asset management industry. See, for example: Gibbson and Murphy (1992), Hu et al. (2011) and Klement (2016).
[48] For Europe, ESMA (2016) conducted a study on a sample of 2600 funds for the period 2012-2014. Their results presented in 2016 indicate that between 5 and 15% of equity funds "could potentially be closet indexers".

active fund but only getting the performance of a benchmark index, with the portfolios often not deviating sufficiently to enable the fund to make up for the higher fee it charges. Importantly, the concept of a tracking error constraint will influence even those who are not closet indexers. Selling a stock that is a large index component is a high conviction trade for any active investor.

Closet indexing and institutionalisation also have an institutional relationship that goes beyond the individual portfolio manager. The larger any one individual fund's assets under management, the larger the risk to the asset management firm if that one fund sees outflows. To mitigate this risk, firms may seek to ensure that a fund is ranked in the middle of its peer group by targeting the performance of a benchmark index, rather than seeking to be at the top of its peer group as this also runs the risk of coming bottom. In this regard Pollet and Wilson (2008) note that funds diversify their holdings in response to asset growth. As funds gain size, the economic considerations therefore change from gaining additional assets to retaining fund assets.

Benchmark hugging must not be voluntary though. There are also fund managers who would like to be more active but are liquidity-constrained due to the size of their funds. Any institutional investor looking to sell out of a stock holding on the open market will have a negative impact on that company's share price when the size of the institutional investors' stake is greater than the available liquidity in the stock. Any such 'market impact' resulting from a negative impact on the share price contributes to the cost of exit. For a typical mutual fund where the fund manager's performance is evaluated versus that of her peers, at the end of the year a few basis points often make the difference between coming say third or fifteenth in a league table. The consequence of institutionalisation for corporate governance is therefore to

increase the relative propensity for the use of voice over the use of the exit option by decreasing the cost of the former while simultaneously increasing the cost of the latter.

Countervailing trends

While the purpose of this chapter is to document the rise of institutional ownership and explain the factors contributing to it, there have also been offsetting factors that require acknowledgement. The first of these was the divestments by the early US industrialists such as Rockefeller mentioned in the introduction of this chapter. These were brought on by antitrust law that sought to weaken the power of financial institutions as shareholders (Black and Coffee, 1994; Roe, 1991). This process served to dilute the re-concentration of corporate ownership in the US that resulted from the initial phase of institutionalisation, namely the rise of pension fund assets in the period from 1900 to 1945. The result was that the peak of the widely dispersed "Berle-Means corporation" (Roe, 1991) likely occurred after World War II (Cheffins, 2018).

A second countervailing development to the process of institutionalisation occurred in Germany around the end of the twentieth century. Up until that point, the shareholder structure in Germany was characterised by the aforementioned dense network of crossholdings of shares between large non-financial corporations, banks and insurers. Following declining returns from blockholdings and increased opportunity costs, Deutschland AG was dissolved largely as a result of a change to the German tax code in 2000/1, which enabled corporates and banks to sell their crossholdings without incurring capital gains tax (Höpner and Krempel, 2005). Further contributing to this development was a changed understanding of corporate governance.

A large number of scholars have related the demise of Deutschland AG to the rise of shareholder value orientation (SVO) at the end of the twentieth century in Germany (Bradley and Sundaram, 2004; Fiss and Zajac, 2004; Höpner, 2003; Jürgens and Rupp, 2002; Jürgens et al., 2000; Schilling, 2002). These authors suggest that it was pressure from Anglo-Saxon mutual funds and pension funds that led to the decision to dispose of cross-shareholdings. The introduction of stock options compensation plans was one of the principal means by which these shareholders sought to achieve their goals.

Table 1: 1998 vs 2018: Ownership of 10 largest nonfinancial domestic firms by three largest shareholders

	Germany	U.K.	U.S.
Median: LLSV 1998	50%	15%	12%
Median: own data 2018	19%	16%	19%

Source: La Porta et al. (1998), Bloomberg, own calculations, as of August 2018

La Porta et al. (1998) argue that a country's ownership concentration is a reflection of the level of shareholder protection it provides. To demonstrate this, they calculate an "Antidirector Rights Index" and highlight correlation with shareholder ownership concentration. Table 1, above, shows the result of repeating the calculations of La Porta et al. (1998) two decades later. The German level of ownership concentration has come down substantially as a result of the decline of Deutschland AG, while levels in the UK and US have increased as a result of the process of institutionalisation outlined in this chapter.

The academic literature considers ownership concentration to be an important indicator in two regards. First, from a comparative perspective, the presence of blockholders is said to be a both an indicator of the variety of capitalism in place (Hall and Soskice, 2001) as well as a response

to the (lack of) legal protection provided to shareholders (La Porta et al., 1998). Second, from a financial theory perspective, the argument is that shareholders accumulate ownership blocks in order to address free-rider problems in the context of corporate governance activism (Edmans and Holderness, 2016).

However, as Table 1 illustrates, levels of ownership concentration today have homogenized across Germany, the UK and the US, with the consequence that any observation of ownership concentration by itself today no longer suffices to draw conclusions for corporate governance. The nature of the influence of finance on corporate behaviour "can no longer be adequately understood through the simple dichotomy of ownership dispersion or concertation" (Jackson, 2008: 25). This is why the chapters that follow, will go beyond a simple assessment of ownership concentration and instead focus on the investor type and the role of individual institutions such as index funds and proxy advisors.

As a final note, prior to the reform of the German proxy voting system in 2001, German banks were free to vote their customers' proxy votes as they pleased, so long as they had not received instructions, which they mostly never did (Grundlach and Möslein, 2011). This voting behaviour served to further reinforce the foothold of Deutschland AG. Since the German banking sector was heavily concentrated in the hands of Deutsche Bank, Commerzbank and Dresdner Bank, these three banks exercised large voting blocs in companies on whose boards they often sat, typically in the interest of corporate management, in order to ensure continued banking business.

Baums and Fraune (1994) analyse the 1992 AGMs of 24 companies that are within the 100 largest German firms and have more than 50 percent of their shares widely held. They report

that four factors combined to provide banks with a large share of votes cast at the average German company: the votes resulting from their own shareholdings (13%), votes from dependent asset managers (10%), the votes resulting from their retail clients' shareholdings (61%), and a low overall voting participation (58%). The extraordinary result is that despite only directly owning about 7 percent of the average company, the banks controlled 84 percent of all cast votes.[49]

The dominance of banks at the AGMs of German companies came to an end in the late 1990s for a number of reasons. First, with the end of Deutschland AG, German banks divested most of their holds in German companies. Second, a change to the shareholder law (AktG) in 2001 capped the percentage of votes that German banks could represent on their customers' behalf without explicit voting instructions at 5 percent (Bruno and Ruggiero, 2011). These two developments were accompanied by increasing governance activities at domestic and foreign asset management firms. Domestic asset management firms brought voting in-house, while foreign asset management firms started voting their German shares, with the result that overall voting participation increased from the 58 percent observed by Baums and Fraune (1995) in 1992 to 70 percent in 2017 (D. F. King, 2017).

The declining importance of UK and German insurance companies

In the second half of the twentieth century insurance companies in the UK and Germany represented substantial blockholders. In Germany this was primarily due to Deutschland AG. Besides the domestic banks, the insurers Allianz and Munich Re made up the core of the

[49] For the year 1975 Yamazaki (2013) reports similarly high numbers, showing that German banks cast between 79% and 89% of German companies' votes. Franks and Mayer (2001) present an example where Deutsche Bank effectively prevented the takeover of a German company in 1988 by casting 55% of all votes, despite its direct holdings amounting to only 8 percent of outstanding shares.

network, with Munich Re holding 26 percent of the shares of Allianz and Allianz holding 25 percent of the shares of Munich Re (Jürgens and Rupp, 2002). The second reason why German insurance companies held relatively large equity holdings was due to their investment portfolios. These portfolios were in place to invest the received premium income from life, health and property insurance policies.

The most important of these products were life insurance policies, which in the year 2000 represented 70 percent of the total premium volume in Germany (Maurer, 2003). Life insurance policies in Germany serve a dual purpose. They include an insurance protection component that provides benefits on death and an investment component that pays out a cash value at the contract's expiry, on average after about 28 years (Maurer, 2003). To hedge these long-dated liabilities, German insurance companies invest in equities and longer-dated bonds. Life insurance products have been extremely popular in Germany, representing approximately 30 percent of household assets in 2000 (Bundesbank, 2015), and typically guaranteed a minimum return of approximately 4 percent. However, due to the previously described decline in longer-dated bond yields, the liabilities (guarantees) of life insurance companies started to balloon in terms of their net-present-value while the returns on their assets started to fall.

The effect of this was two-fold. First, German insurance companies had to reduce the guaranteed rates of return on new life insurance policies, and secondly, the risk that they were able to take with their investment portfolios declined. The greater the excess savings that they held in their reserves (Deckungsrückstellung), the greater the risk that insurance companies can take on their investments. However, as rates declined, and the value of assets relative to liabilities fell, German insurance companies had to sell equities to buy bonds. The International Monetary Fund (2003) reports that the equity holdings of German insurance companies

dropped from a peak of more than 20 percent in 2000 to about 10 percent at the beginning of 2003.

The equity assets of UK insurers suffered a similar fate to those of German insurance companies. Davies (2015) documents that UK insurers' holdings of UK listed companies increased from 10 percent in 1963 to a high of 23.6 percent in 1997. He explains that the reason for their advance was primarily due to high domestic inflation rates, which reached a high of 25 percent in 1975 and stayed above 10 percent for most of the 1970s. A number of reasons have contributed to a decline in UK insurers' domestic equity holdings since. Between 1997 and 2010 the percentage of the UK stock market held by British insurers dropped from 23.6 percent to 8.8 percent (and to just 4 percent by the end of 2018).[50]

Prior to the removal of capital controls in 1979, UK insurers had held artificially high allocations of domestic stock. Their removal started a gradual reallocation of equities from domestic to international markets (Davies, 2015). With an increasing number of DB pension plans nearing their maturity, UK insurers that operated many of these pension plans on behalf of UK corporates started shifting out of equities and into bonds (Cheffins, 2008, Davies, 2015). Finally, the decline in inflation in an analogous development to Germany, led UK insurers to reallocate assets from equities to bonds (Cheffins, 2008).

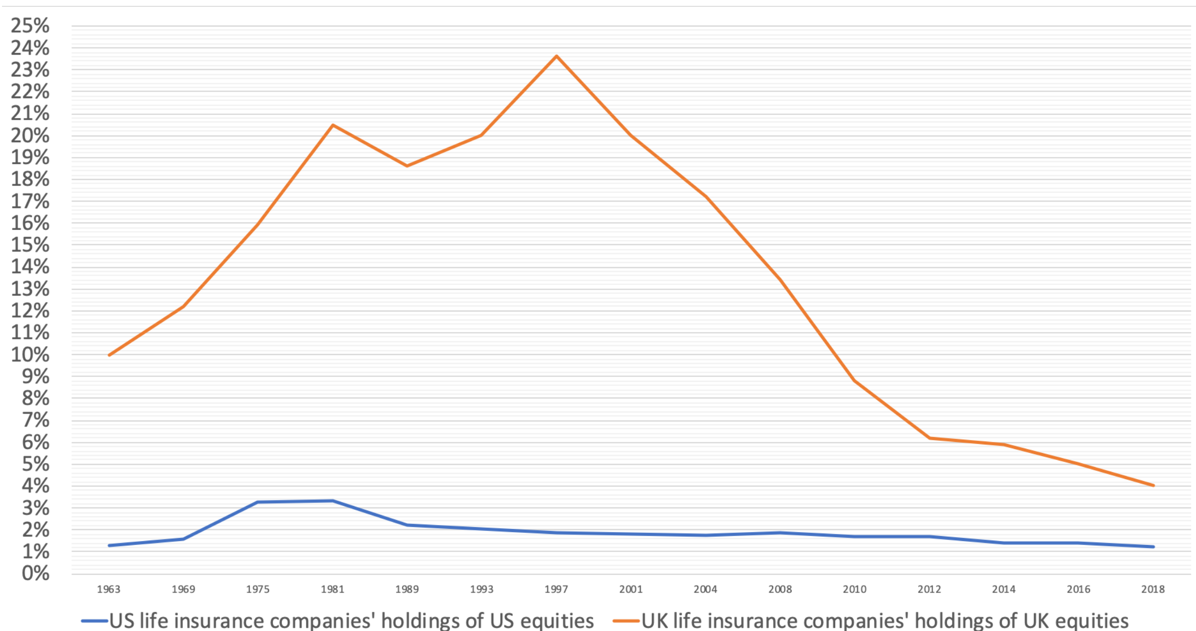
Black and Coffee (1994), in their study of ownership structures in the UK and the US note a tight-knit UK insurance industry controlling large stakes of UK public companies and conclude that "major British institutions intervene to change management, but only a handful of times

[50] 2010 number from Davies (2015). 2018 number from ONS:
https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018
(Accessed 25 February 2020).

per year. Absent a crisis, the institutions generally stay on the sidelines" (1994: 2003). They further highlight the relevance of regulation by noting that British institutions are significantly more active because unlike US institutional investors they do not face such tough regulation on acting jointly.

Irrespective of regulation that complicated the coordination of US institutional investors, the US insurance industry has generally played a relatively minor role in the US stock market, when compared to the British and German insurance industries in their respective domestic markets. As Black and Coffee (1994) explain, the prime reason for this is that they were prohibited by law from offering investment products. As a result of this the average holding of US life insurers represented just one to two percent of the total US stock market capitalisation, with the exception of a short period from the mid-1970s to the mid-1980s, as shown on Figure 9 below.

Figure 9: US and UK insurers' holdings of their respective domestic stock market capitalisation (1963-2018)



Source: Federal Reserve, ONS, Davies (2015).

To conclude, the insurance sectors in Germany, the UK and the US play a relatively small role in corporate governance today. However, with regards to the UK, the almost half a century in which UK insurers held more than 10 percent of the domestic market, has left UK insurers and their trade association, the Association of British Insurers (ABI), with a "track record of showing interest in championing good corporate governance in investee companies" (Barker and Chiu, 2017: 15).

Conclusion - Corporate governance at the turn of the century

The levels of institutionalisation increased continually over the second half of the 20th century. Nevertheless, with a number of noteworthy exceptions such as from US state pension funds such as CalSTRS and CalPERS as well as British insurance companies, the overall influence of institutional investors over corporate governance remained limited, suggesting the influence of shareholders in the twentieth century has been overestimated in the literature.

This chapter has shown that institutionalisation has been a continual development since the start of the nineteenth century. During this time the baton of corporate governance has been passed initially from individual dispersed shareholders to pension funds and insurance companies and subsequently to mutual funds. With each of these phases the nature of shareholder governance changed. This chapter listed a number of factors contributing to these shifts, including changes to pensions regulations, the insights from MPT and the rise of mass investments. As institutionalisation has grown, collective action problems have decreased, and managerial autonomy has been somewhat reduced as a result of greater shareholder influence.

The relevance of these corporate governance developments for the varieties of capitalism is complex. At first glance, it appears that institutionalisation contribute to shareholder value thinking and will thus facilitate an Americanisation of the UK and German models of capitalism. Yet, as the following chapters will show, the fact that governments in both countries have also advocated for institutional investors to show greater consideration of stakeholder concerns (traditionally considered CME attributes) as part of their stewardship responsibilities goes some way to mediate this LME pressure.

The reason this chapter ends in the year 2000 and separates out subsequent developments to the following chapters is three-fold. First, we know from the work of Hall and Soskice (2001) and La Porta et al. (1998) that the corporate governance framework at the turn of the century still very much resembled the ideal-type LME/CME models. Second, and relatedly, it was the German tax reform of 2000/2001 that gave the biggest impetus to the unravelling of the Deutschland AG network, with the result that only 35 of Germany's one hundred largest companies remained part of the crossholding network in 2004, down from 60 in 1996 (Höpner and Krempel, 2005). Finally, as the following chapter will discuss, the rise of index fund management (the second first-order development in the shareholder ownership structure) began in earnest from the year 2000.

The corporate finance literature highlights the special governance role of blockholders, who due to their large stakes, do not face the free-rider problem to the same extent as smaller investors (Bolton et al., 2002; Edmans and Manso, 2011). The literature commonly delineates blockholders as investors that hold stakes in companies exceeding five percent of the issued share capital (Edmans and Holderness, 2016). Taking this simplistic hurdle rate, it was only in

the UK that a group of institutional investors had reached such stakes by the turn of the century so that they could individually or collectively exercise increased oversight.[51]

At the turn of the century, the institutionalisation of investment management was in full swing in all three countries. In the US institutional investors controlled in excess of half of all shares, but the asset management industry structure was still relatively unconcentrated. As a result of this, the largest US investor in 2000, the pension fund TIAA-CREF with $290 billion in assets (Ryan and Schneider, 2002), was only approximately the same size as the largest UK investor, the insurer Prudential with $267 billion in assets (Myners, 2001; Prudential, 2001). This is despite the US stock market capitalisation at the time being approximately six times as big as that of the UK at the end of 1999. Furthermore, if we compare the TIAA-CREF of 2000 with the largest US institutional investor today, BlackRock with US$7.43 trillion as of year-end 2019, the ratio is almost 28 times, despite the market cap having only approximately doubled over the timeframe. This shows that, even though the size of US institutional investors increased considerably between 1990 and 2000, they remained comparatively small when compared to UK institutions until after this time.

Instead of the size of any particular institutional investor, changes in the ownership structure in the US and Germany at the end of the twentieth century were therefore more about changes in aggregate institutional ownerships levels. In the US, for example, institutional ownership jumped from 16 percent in 1960 to 57 percent in 2000 (Ryan and Schneider, 2002). In Germany, with Deutschland AG still in operation, the change was more moderate in absolute

[51] The exception to this was the US fund manager Fidelity who due to their active approach held concentrated positions and held large blocks in select companies therefore as early as the 1980s and 1990s (Davis, 2015).

terms but also represented almost a doubling of institutional shareholding from approximately 20 percent to 35 percent (European Commission, 2013).

These trends were "duly chronicled in detailed explorations of the role of institutional investors in the modern corporation" (Ryan and Schneider, 2002: 554) with book titles such as "Investor Capitalism – how money managers are changing the face of corporate America" (Useem, 1996), "Unseen Power – How mutual funds threaten the political and economic wealth of nations" (Harmes, 2001) and "Pension Fund Capitalism" (Clark, 1998) leaving the casual observer with the impression that corporations and thus society, are now "Managed by the Markets" (Davis, 2009). A closer consideration of these monographs, however, shows that these authors are in fact introducing a much more nuanced assessment of capital market developments, one supported by the findings of this chapter.

While Useem (1996) does see institutional investors play a "catalytic role" in advancing shareholder value, he explains that "investor capitalism" is not meant to imply that mutual funds are now in charge of corporate governance and thus corporate executives. Instead he explains that "[r]ather than one overseeing the other's overseeing of the firm, they oversee the enterprise together. Though the rubric of investor capitalism might seem to imply the owners are back on top, it is meant to connote that a new kind of engaged owner is back in the picture and working closely with – though also sometimes against – company management" (1996: 7). He thus presents investor capitalism as a sort of half-way house between managerialism and what might be termed a future asset manager capitalism.

Similarly, Clark considers pension fund capitalism to be a "further stage in the evolution of capitalism, rather than a profound break with the past" (1998: 43). My point is that instead of

marking the pinnacle of investor capitalism at the turn of the twenty-first century, institutionalisation had merely reached levels that justified using such terminology to mark the start of a new era in which it was expected that shareholder influence would continue to increase.

The impotence of shareholders to engage in decisive oversight was reflected in the corporate scandals of the early 21st century at Enron and WorldCom. The main issue shareholders at the time focussed on was to tie executive compensation to share price performance in an attempt to overcome the perceived agency problem. Kaen (2003) reports how the stock related compensation for the average director at the average US company increased from 28 percent in 1995 to 60 percent in 2000 and how, for example, TIAA-CREF at the time considered it appropriate to have at least half of the compensation package linked to share price performance.

Knafo and Dutta (2019) make the case that the academic literature on the shareholder revolution of the 1980s and 1990s largely overstates the influence of shareholders. Blaming shareholders has served to "deresponsibilize" corporate managers even though it is clear that they have largely been in charge. Knafo und Dutta (2019) further point out that even Michael Jensen (Jensen et al., 2005), the architect of shareholder value and agency theory, was forced to admit that stock options had failed to align the interests of managers and shareholders.

This perception of limited shareholder influence at the time is confirmed by analysis of US shareholder voting data (unfortunately comparable data on the UK and Germany is not available), which shows that in 60 percent of the shareholder proposals that received majority support in 2003, the concerned companies had not followed up with "concrete, responsive action" (Conger, 2004). Along similar lines Ertimur et al. (2010) note that in 1997 only 16.1

percent of governance-related non-binding shareholder proposals at US companies were implemented. Bebchuk (2004), considers the "basic allocation of power between management and shareholders in publicly traded companies" and notes a "considerable weakness" of US shareholders due to a combination of dispersed ownership and US corporate law. The result of this is that US shareholders are precluded from "directly intervening in any major corporate decisions" (2004: 1) at the turn of the century. Bebchuk (2005) also investigates the ability of shareholders to replace the board of directors in US companies during the period of 1996-2005 concluding that this ability was "largely a myth" as there was on average less than one case per year in which a slate of director candidates submitted by shareholders beat the management's own candidates.

In this regard, the example of mandating annual director elections shows the different role that regulators play in each of the three countries. In the UK there is a clear mandate for annual director elections, in Germany the trend is moving in that directions, while in the US the decision on whether or not to hold annual elections is left to the individual company to decide. Shareholders have therefore filed a large number of related proposals in each of the years from 2003 to 2010, with the result that approximately 88 percent of the companies in the S&P 500 today hold annual director elections (Nohel, 2012). The end result of this is that while US investors for the most part now have annual director elections, the route by which they got there was through the laborious task of filing individual shareholder proposals, while in the UK and Germany the regulators have taken on such tasks.

There are thus a number of reasons that can explain why, despite their increased aggregate ownership, institutional investors failed to gain the upper hand over corporate management by the end of the twentieth century. These factors include insufficient ownership concentration,

restrictive legislation, too great a reliance on compensation policies and the market for corporate control (due to focus on agency theory), as well as a lack of resources such as proxy advisors to help manage their diffuse shareholdings.[52]

In Germany there are two primary reasons why shareholders continued to play only a minor role in corporate governance. Firstly, the dismantling of Deutschland AG had only begun, and some crossholdings and interlocking directorships were still in place. Together with the aforementioned proxy voting by banks these factors had the result that hostile takeovers in Germany were rare (Köke, 2000) and thus Germany neither had shareholder control nor a functioning market for corporate control. Further complicating matters, particularly for foreign shareholders, were a multitude of restrictive proxy voting bylaws, for example blocking shares for one or more days around a company's AGM (Baums, 2000).

In the UK and the US corporate governance activities by mutual fund companies for the most part was limited as well. However, both markets had alternative actors that took up some of the governance slack. In the US this was the state pension funds such as CalSTRS and CalPERS, the California State Teachers' Retirement System and the California Public Employees' Retirement System respectively, that launched a number of activism campaigns starting in the late 1980s and continuing into the 1990s (Crutchley et al., 1998). In the UK this role of governance police, looking out for the worst offenders, was fulfilled by the domestic insurance companies.

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[52] A handful of proxy advisors had launched at the time, but investors' use of their services was still in its infancy.

The takeaway with regards to the varieties of capitalism, therefore, is that the period up to 2000 helped to set the stage for the domination (in terms of AuM) of the asset management industry by Anglo-Saxon investors. The roots of this go back to the beginning of the twentieth century and the initial design of the unemployment and social security systems. Changes made during the 1970s and 1980s further ensured that individuals increasingly took retirement care into their own hands. As pensions were switched from DB to DC plans, corporate pension funds increasingly became less relevant while asset managers grew in clout. The little investor stewardship that there was during this time was primarily focused on the domestic markets, so that the influence of the growth of the asset management sector on the varieties of capitalism during this time was limited.

What becomes apparent from this chapter is that at the time of Useem (1996) the economies of scale within the asset management industry had not been fully exploited yet. The primary reason for this is to be found in the continued dominance of active fund management at the time. All this changed with the advent of index investing, examined in the next chapter.

Chapter 3

The Rise of Index Investing[53]

Introduction

The previous chapter closed with an assessment that at the turn of the 21st century institutional investors were not yet in a position to exercise meaningful influence over corporate management teams. This chapter will document the rise of index funds, who represent the new blockholders, and discuss the extent to which their popularity has since contributed to changing the balance of power between shareholders and companies.[54] While the roots of index investing were laid in the 1970s with the publication of the Efficient Market Hypothesis (EMH) by Fama (1970), it was not until after the year 2000 that index strategies entered the mainstream due mainly to the launch of Exchange Traded Funds (ETFs) which brought index investing to the retail market.

Index investing represent the second first-order development that has occurred in the shareholder ownership structure during the past century. The popularity of index investing has both qualitative and quantitative consequences for the nature of governance. First, from a quantitative perspective index funds have turbo-charged the growth of institutional investment. Index funds are able to charge lower fees as they do not need to hire teams of fundamental research analysts or star portfolio managers to pick stocks. Because of this, index funds on average provide substantially cheaper investment solutions for investors. ICI (2019) reports that on average expense ratios for index equity funds stood at only 0.08 percent. Compared to

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[53] This chapter draws on information previously published as "Ownership concentration and institutional investors' governance through voice and exit" (Jahnke, 2019a) in *Business and Politics,* 1-24. doi:10.1017/bap.2019.2

[54] The analysis of this chapter will focus primarily on the Big Three due to their commanding market share. Chapter 7 will also discuss the governance role (or lack thereof) of smaller index fund companies,

this actively managed equity mutual funds, at average expense ratios of 0.76 percent, are nearly 10 times more expensive.

This has led to them being praised for "democratising finance".[55] They have earned this reputation because their low fees and minimum investments have put professional investment management in reach of many households. The fees charged stand in stark contrast to the famous "2 plus 20" fees charged by hedge funds (referring to 2 percent management fee, plus a further 20 percent performance fee on any return above a certain hurdle). Furthermore, since the minimum investment in ETFs is a single ETF share, minimum investments can often be as low as $100, compared to the $100,000 minimum investment that wealth management firms and hedge funds typically require from the wealthy. Finally, by removing the risk of underperformance implicit in active funds, index funds have brought institutional investment to more risk-averse investors. By attracting new investors who would have otherwise shunned investment management, index investing has therefore contributed to the overall level of institutionalisation increasing.

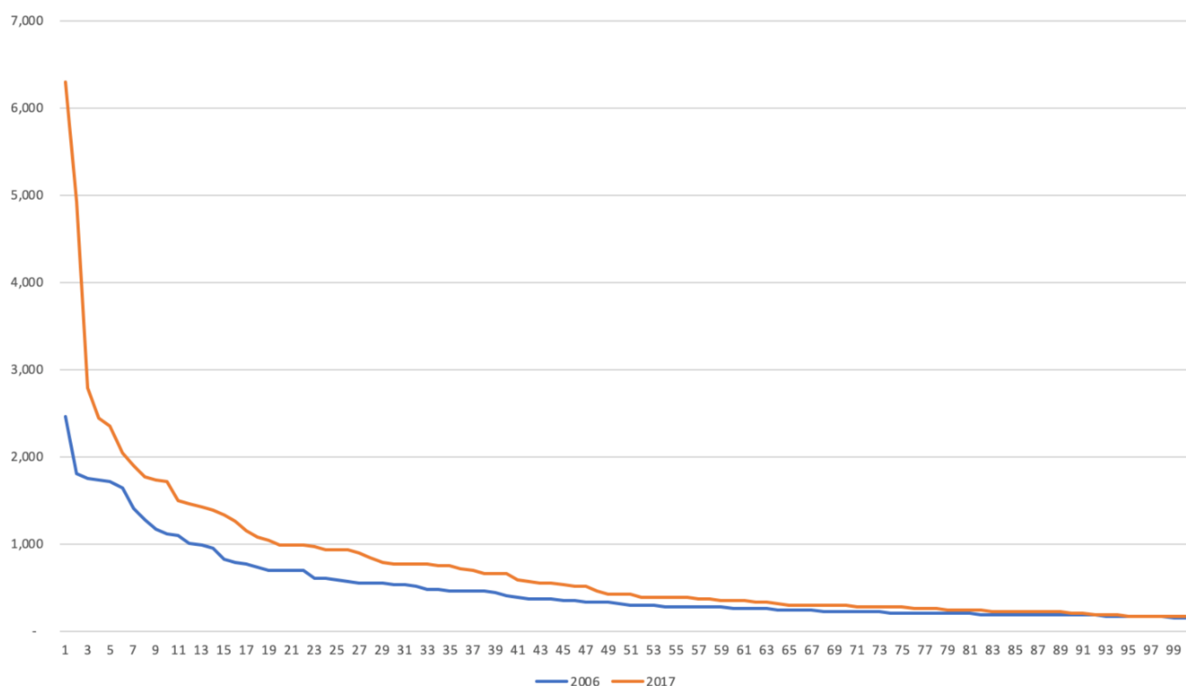
Second, since the stock selection is predetermined by the companies that construct the indices ("index providers" such as MSCI or FTSE), the key differentiator is the level of fees charged. Economies of scale have therefore taken on an even more important role, resulting in a substantial increase in the level of ownership concentration within the asset management industry. Greater ownership concentration further reduces both collective action problems while also enabling investors to spread their engagement costs across a larger asset base thus

[55] See, for example, The Financial Times, "Democratising finance: How passive funds changed investing" (30 January 2015) and The Wall Street Journal, "How Index Funds Democratize Investing" (8 January 2017).

lowering engagement costs even further. The rise of index investment has therefore established the theoretical preconditions for greater shareholder influence.

The Financial Times (2020d) notes that the largest 1 percent of asset managers manage 61 percent of total industry assets. This means that the largest 1 percent manage assets equating to 243 times the assets of the bottom 50 percent, which is up from a factor of 105 times in 2010. Figure 10 illustrates this growing ownership concentration, showing that the largest asset managers globally have grown the most (due to both inflows and mergers and acquisitions), while an asset manager ranked 100th in 2006 has approximately the same assets as in 2017.

Figure 10: AuM of 100 Largest Asset Managers Globally, 2006 & 2017 (US$ bn)



Data source: Watson Wyatt (2006) and Willis Towers Watson (2018c).

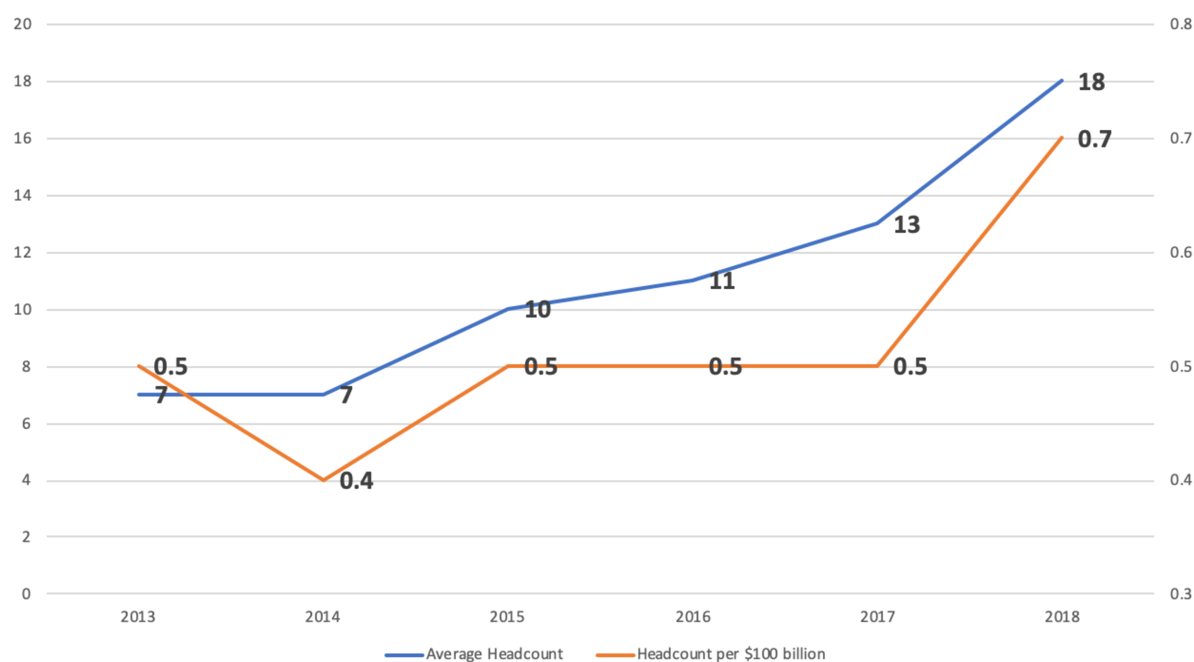
With the theoretical conditions for greater governance oversight having been met with the rise of index funds, the question that follows is whether index funds are also increasing their

influence in practice. Here the evidence is mixed at best. From a qualitative perspective, index investing changes the nature and relative importance of engagement. As briefly outlined in the introduction, index funds seek to match not beat the performance of benchmark indices by replicating the indices' holdings. They can therefore only sell out of an individual stock holding when that stock is excluded from the index, which typically happens only when its market capitalisation has fallen below a certain level.[56] Unable to exit, this leaves index funds only with the voice option, which following Hirschman's (1970) logic we would expect to see greater use of.

Index funds' use of voice is, however, a point of great debate. Since index funds primarily compete on fees, the case has also been made that index funds will underinvest in governance oversight to save costs (Bebchuk and Hirst, 2018; Lund, 2017). Contributing to this impression, others have studied index funds' voting behaviour and noted that they vote with corporate management the vast majority of times (Bubb and Catan, 2018; Fichtner et al., 2017; Heath et al., 2019).

[56] Legally they are not required to do so and may, for example, choose to exclude the smallest stocks in an index, though the decision to do so will increase the tracking error. Also "synthetic" ETFs will enter into "index swap agreements" with banks in order to track the performance of indices rather than buying a basket of individual stocks.

Figure 11: Average development of stewardship headcounts, headcounts per $100bn in assets



Source: Willis Towers Watson (2019)

Figure 11 above, shows an analysis by Willis Towers Watson (2019) of the average stewardship headcounts of six large firms that emphasise index tracking and collectively manage assets in excess of $17trl.[57] The data shows that average stewardship headcounts amongst this group have increased from 7 in 2014 to 18 in 2018 (blue line, LHS). Compared to this the average stewardship headcount when put in context of assets under management has remained relatively stable, moving up only in the past year, rising from 0.5 headcounts per $100 billion in AuM to 0.7 headcounts in the past year (orange line, RHS). While the average headcount has increased by 157 percent, the stewardship headcount per $100 billion in AuM increased by only 40 percent, illustrating how index funds seek to take advantage of their economies of scale.

[57] The six firms are: BlackRock, Legal & General Investment Management, Northern Trust Asset Management, State Street, UBS Asset Management and Vanguard.

Chapter Structure

The following four main points will be made in this chapter. First, index funds in the US have reached a scale at which they have the potential to exert considerable influence over the corporate governance of US firms. Second, to date index funds have, however, for the most part refrained from exercising substantial influence at US, UK and German portfolio companies. Instead, their wholesale backing of corporate managers has insulated firms from the demands of other shareholders. Third, index funds, both domestic and foreign, play a smaller role in the UK and Germany than in the US. They therefore insulate corporates in the US to a greater extent than companies in the UK or Germany. The institutionalisation of asset management together with the indexation of investment management, has necessitated the creation of dedicated stewardship teams within asset managers and resulted in the professionalisation of the corporate governance function. The resulting separation of corporate governance from the portfolio management function is akin to a new separation of ownership from control.

The remainder of this chapter consists of five sections. The first explains the theoretical foundations of index investing and charts the global rise of the index fund industry. The second section explains how this resulted in the creation of an oligopolistic industry structure in the US. The third section contrasts the situation in the US with that in the UK and Germany where index funds are shown to play a comparatively smaller role. The fourth section documents the policy preferences of index funds and shows how for the most part they have to date sided with management. The fifth section concludes with a consideration of what the comparative differences in the size of the index fund industries in the US, the UK and Germany entail for the domestic corporate governance context.

Throughout this chapter I will seek to make use of interview data wherever possible. I do have to acknowledge though that the index fund interviewees tended to stick to a script that did not acknowledge any issues with their approach. They claimed to have highly involved engagement teams, not to rely on proxy advisors and said they were neither too powerful nor lacking critical engagement. This perspective differs substantially from the impressions provided by corporates and NGOs interviewees, who for the most part presented index funds as uninvolved in corporate governance. Chapter 7 will provide a detailed discussion of corporate interviewees' perception of index funds' engagement efforts.

The rise of index investors

While it was the work of Markowitz (1952) that set out the benefits of broadly diversified portfolios, thus laying the ground for institutional asset management, it was Fama's (1970) work on the Efficient Market Hypothesis (EMH) that prepared the ground for index investing. Fama (1970) considers the role of the stock market in the efficient allocation of capital in society and expects market prices to provide accurate resource allocation signals. In an ideal market prices would always "fully reflect" all (publicly) available information. The general question Fama seeks to answer is whether mutual fund managers have any special insights which allows them to outperform the market. After considering several types of information regimes he concludes that his efficient market model stands up well to reality. The implication is that investment managers cannot generate outperformance, as stock prices at all times incorporate all information. Fama's findings thus challenge the business case for active investment.

In a first-person report of the early days of index investing, Fouse (1998), a former executive of Wells Fargo, explains that one of the family members behind the Samsonite company returned home in 1970, having completed a diploma at the University of Chicago where Fama was teaching. He asked his father: "Do you realize we have our pension fund invested in mutual funds? That's wrong". Having been put in touch with Samsonite, Wells Fargo proceeded to set up the first inde fund in 1971 (Fouse, 1998; MacKenzie, 2006).

Index funds come in two main forms: traditional index mutual funds and exchange traded funds (ETFs). The benefit of ETFs is that they provide greater liquidity and ease of trading. They can be bought and sold throughout the trading day and there is no delayed investment, such as is usually the case with mutual funds where subscribers typically get the closing price of the following day. According to analysis by Morningstar, approximately 80 percent of US equity index investments at the end of 2016 were in the form of ETFs and only 20 percent in conventional index mutual funds.[58] In Europe, where ETFs continue to be dominated by institutional investors and retail investors have yet to fully embrace them, the split between ETFs and index mutual funds stands at 50:50 (Morningstar, 2017).

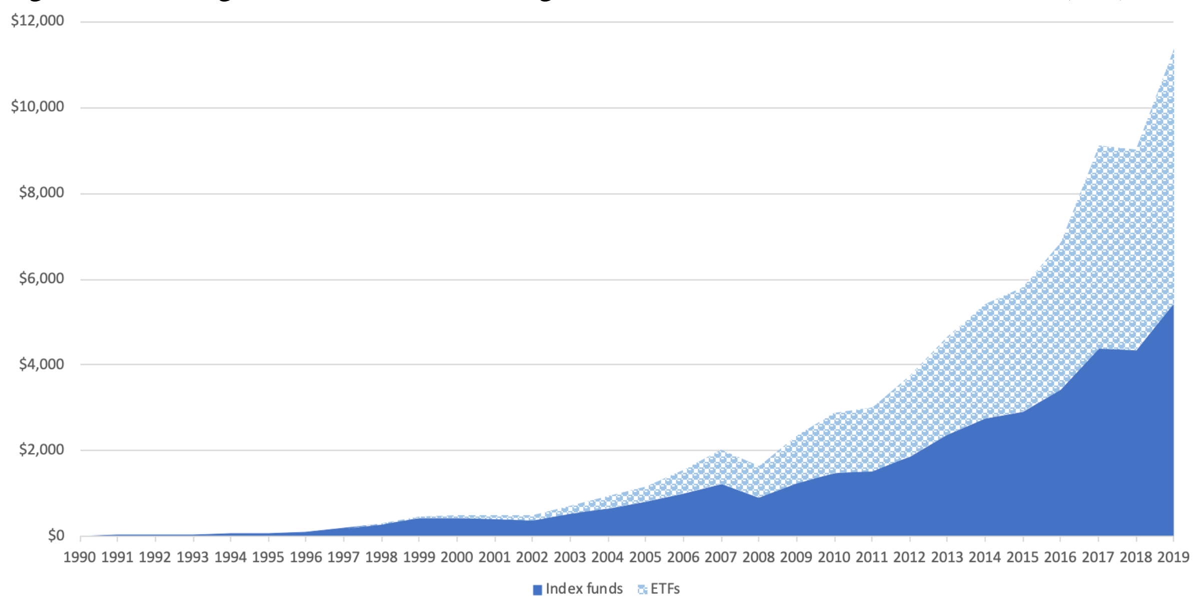
The initial uptake of index investments was slow, by 2000 index investments were still primarily a vehicle used by institutional investors. For the UK the Bank of England noted at that time that "although about 22 percent of pension equity holdings are indexed, the proportion is much smaller for other categories of investor, so that the total estimated investment in indexed funds amounts to 8.6 percent of the capitalisation of UK-traded equities" (2000: 61). The ECB (2001) similarly reported at the time that index investments amongst institutional

[58] For further details, see: https://www.marketwatch.com/story/index-funds-now-are-part-of-an-investors-biggest-problem-2017-12-06 (Accessed 14 January 2020).

investors based in the Euro area represented approximately 15 percent of equity holdings, and notes that this was significantly behind the levels of 30 percent of institutional equity holdings seen in the US.

The popularity of index funds changed markedly with the launch of the first ETFs. The first ETF to be launched in the US was the SPDR ETF on the S&P 500, launched by State Street on the 29th of January 1993.[59] Vanguard, however, did not launch its first ETF until the year 2000. The first ETF to be launched in the UK was also not until the 29th of April 2000 by iShares, followed by the first German listing on the 23rd of October 2000 by Indexchange.

Figure 12: Total global assets under management in ETFs and index mutual funds ($bn)



Source: Data courtesy of the Financial Times

Figure 12, above, shows the total AuM of ETFs (shaded) and index mutual funds (solid) globally since 1990. It shows that index funds only appeared on the scene in any meaningful way in the late 1990s and that it was not until the early 2000s that ETFs contributed in earnest. Focussing just on the US, Fender (2003) reports that assets in US ETFs in 2002 made up just

[59] All references to State Street in this thesis are meant to refer to State Street Global Advisors (SSGA), the asset management arm of State Street Corp.

6 percent of the total index asset base, compared to Morningstar's estimate of approximately 80 percent in 2016. The result of this rapid rise in ETFs has seen them take substantial market share from active equity funds to the point where Bloomberg (2019b) in September 2019 announced "the end of an era" as "Passive Equity Funds Surpass Active in Epic Shift" in the United States. Figure 12 also shows that the assets under management of ETFs exploded after 2008, suggesting that the fallibility of active managers was further exposed by the Global Financial Crisis.

Regulators in Germany, the UK and the US have provided a further factor contributing to the growth of index investments by increasing their focus on fees levied within the asset management industry and the financial advisor network (Mallow, 2019). The increased focus on the fiduciary duty of independent financial advisors (IFAs), particularly in the US, therefore changed the model by which they are being paid for their services. This decreases the disadvantages of index funds versus active funds. In Europe and the US, both independent financial advisors as well as online brokerages and retail banks often received "kick-back" payments in return for their sales efforts. As these payments are typically a percentage of the fee earned by the asset manager, active managers are able to pay higher rewards (due to their higher management fees) than index funds. Changing the pricing model for IFAs therefore removes or at least reduces this disadvantage faced by index funds (Sethi et al., 2018).

In the US the crackdown on fees in the financial system started with the Dodd Frank legislation in 2010. Similar changes have occurred in Europe in response to the introduction of the revised Markets in Financial Instruments Directive (MIFID2) of the European Union in January 2018,

which similarly requires fees paid to intermediaries to be disclosed to ultimate investors.[60] The regulatory changes occurring in Europe have a two-fold implication for its shareholder ownership structure. First, it suggests that index investments as a percentage of assets under management are likely to continue to increase in future years, possibly at a faster rate than in the past. This will have consequences for the nature of engagement, as discussed in the next section. Second, with index funds no longer at such a distributional disadvantage, the likelihood increases that US ETF providers succeed in gaining market share in Europe. This conclusion is supported by the comments of Vanguard (2018), who note that "Although still growing, the U.S. ETF market is in a more mature state than in Europe [...] As a result, U.S. sponsors such as Vanguard, J.P. Morgan and Invesco are ramping up teams in Europe, through organic growth and acquisitions, to capture growth in this market".

The creation of a US oligopoly

Index investing takes the economies of scale present in the asset management industry to another level, effectively turning it into a winner-takes-all industry. Scale has been employed by the larger asset managers to decrease fees with the aim of taking market share from the smaller asset managers who typically have a higher cost base (Bloomberg, 2017a). For institutional investors, facing both tremendous performance pressures as well as fiduciary considerations, choosing the fund with the lowest fees is a major criterion in product selection (Madhaven, 2016). The following quote from Larry Fink, the CEO of BlackRock, highlights the importance he attributes to scale: "When I am able to increase margins and increase market share through price cuts, I am going to do that. The key element is scale" (Bloomberg, 2017a).

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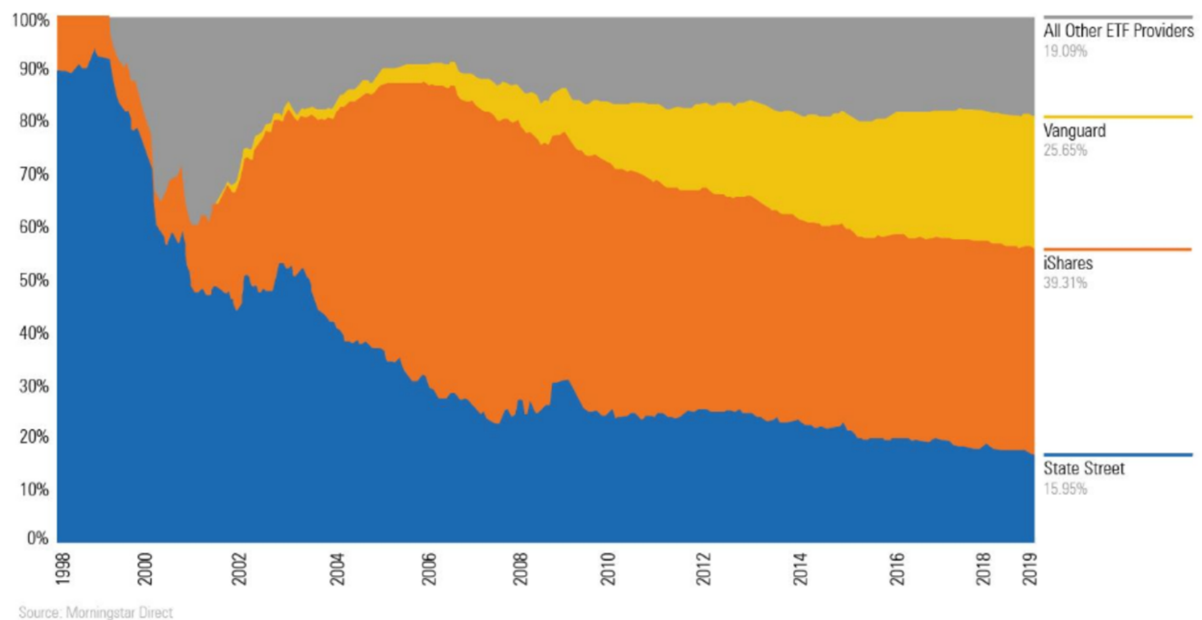
[60] For further information on MIFID2, see the Financial Conduct Authority (FCA): https://www.fca.org.uk/publications/policy-statements/ps17-14-mifid-ii-implementation (Accessed 15 January 2020).

As explained in the previous chapter, index funds are not constrained by the liquidity considerations that implicitly cap the size that active funds can grow to. Index funds merely seek to track indices, and any market impact from inflows will push up the index and thus not materialise as relative underperformance. When a stock exits the index, the reverse will happen. Most indices include quarterly reweights at which point the index weights of individual stocks are recalculated.

A further factor contributing to the oligopolistic structure of the index fund market is the first-mover advantage within the industry. Like the indices they track, the benefit of being the first to market with an ETF are substantial. Investors congregate to the ETFs that have the biggest AuM and the best liquidity (Broman and Shum, 2018). The value of launching alternative "me-too" products on the same indices that already have liquid products on them is therefore very small (Petry et al., 2017). In the case of most indices, only one or two ETFs therefore capture the vast majority of assets on any one index. Bogle, the late founder of Vanguard states that being first mover "has played a major role in our dominance" (2018b: 182).

Together these factors have led to an oligopolistic industry structure in which just three fund managers, BlackRock, Vanguard and State Street ("the Big Three") have captured ninety percent of the US index fund market (Fichtner et al., 2017) and approximately 80 percent of the US ETF market (Morningstar, 2019b).

Figure 13: US market share of major ETF brands, 1998-2019



Source: Morningstar (2019b), used with permission.

Figure 13, above, documents the market share of the largest ETF providers in the US. iShares, marked in orange, is the main ETF brand of BlackRock. The blue area shows the dominance of State Street in the late 1990s when it claimed an ETF market share of 90 percent in 1998 (Morningstar, 2019b). The grey area shows the initial launches of alternative providers many of whom soon either folded under the pricing pressure or were acquired by the Big Three.

The European ETF Landscape

The Financial Times (2020a) reported in January 2020 that European index funds had surpassed $1 trillion in assets as of year-end 2019. This is from a base of just $51 billion in 2005 (Vanguard, 2019a). Describing how the high fees and lacklustre performance of active fund managers contributed to this result, the FT notes that “The sector has doubled in size in just four years in Europe, turbocharged by a brutal price war on fees, the patchy performance

of active managers and another year of robust returns for many of the big stock markets that passive vehicles replicate" (Financial Times, 2020a).

This $1 trillion in index assets only represents approximately 10 percent of the global index fund market, this is despite Europe representing approximately 26 percent of global assets under management (Financial Times, 2020a; PWC, 2017). "ETF usage by retail investors in Europe still lags far behind the US but it has started to catch up from a very low base" (Financial Times, 2020a).[61]

Table 2 demonstrates that BlackRock with its iShares ETF brand is the only one of the Big Three to appear in the European Top-5. The reason for this is iShares' European heritage (IPE, 2017). iShares, as part of Barclays Global Investors, was the first to launch a broad suite of European ETFs. The other ETF providers in the Top-5 are all subsidiaries of European banks (as iShares once was when it belonged to Barclays). Xtrackers is the Deutsche Bank brand (Germany), Lyxor is the Société Générale brand (France), UBS is self-branded (Switzerland), and Amundi is the asset manager of Crédit Agricole (France).

Table 2: European ETF provider Market Share (equities and bonds):

	AuM (€bn)	Market Share (%)
iShares	409.2	44.3
Xtrackers	98.4	10.7
Lyxor	76.2	8.3
UBS	62.0	6.7
Amundi	56.8	6.2
Vanguard	47.1	5.1
Invesco	41.0	4.4
State Street	38.7	4.2

Source: Morningstar, data as of 31 December 2019

[61] Deborah Furr co-founder of the ETFGI consultancy and a former ETF strategist at iShares in an interview with the Financial Times (2020a).

In Europe iShares has a market share of 44.3 percent compared to its 39.3 percent in the US. However, Vanguard and State Street have significantly lower market shares in Europe, meaning that the Big Three together hold just 53.6 percent of the market compared to 81 percent in the US. The European market is generally less concentrated than the US market, with the three largest ETF providers representing 63.3 percent of the market compared to 81 percent for the US.

Unfortunately, there is no country-level data for individual ETF providers' market share in the UK and Germany. However, the fact that four of the 15 largest ETF providers in a Morningstar (2019c) league table of European ETF providers are German (Xtrackers of Deutsche Bank, Comstage of Commerzank, Deka ETFs of the Landesbanken, and the German stock exchange Deutsche Börse) combined with the captive distribution channel in Germany, does suggest that German ETF providers hold a large percentage of the domestic ETF market.

The UK on the other hand appears to be dominated by the Big Three, in particular by BlackRock. This interpretation is supported by the comparatively large UK holdings of BlackRock presented in Table 3 and can be explained by BlackRock's UK heritage. The only two UK firms amongst Morningstar's (2019c) Top-20 list of European ETF issuers by assets are HSBC at number 14 and Legal and General Investment Management at number 16. They are listed with combined assets of €9.3 billion, which works out as 1.2 percent of the total €759.7 billion European ETF market. The four German ETF providers have combined assets equating to 13.3 percent of the European market.

Table 3: Average ownership of 10 largest companies

	Germany	UK	US
Blackrock	6.05%	6.63%	6.51%
Vanguard	3.00%	4.61%	7.53%
State Street	0.48%	1.17%	4.22%
Total	9.53%	12.42%	18.26%

Source: Bloomberg, own calculations as of 31 March 2020

Table 3 above shows the relative importance of the Big Three across the three countries studied. The combined stakes of the Big Three in the US are approximately double the size of their stakes in German companies and approximately 50 percent larger than their stakes in UK companies. To provide some perspective of how these stakes compare in size to other domestic investors, Table 4, illustrates that BlackRock is the largest blockholder in Germany, with 40 holdings of greater than 3 percent and 31 of those being above 5 percent. DIW (2017) further reports that BlackRock's assets invested in German equities have grown from €17 billion in 2007 to €77.3 billion in 2015, making it by far the largest investor. That gives BlackRock twice as many blockholdings of greater than 5 percent than the asset managers of either Allianz or Deutsche Bank.

Table 4: Top blockholders in German publicly listed companies in 2015

	Number of blockholdings >3%	Number of blockholdings >5%
BlackRock	40	31
Allianz Group	32	15
Deutsche Asset Management	24	15
Fidelity Investments	18	4
Berenberg Bank	15	4
NBIM (Norges)	15	2

Source: DIW (2017)

For the UK, Table 5 shows that BlackRock has a holding representing more than 5 percent in each of the seven UK insurance companies and that the Big Three on average hold 11.27 percent of the UK insurance sector. BlackRock's average stake of 7.54 percent is more than three times the size of Legal and General's 2.05 percent average holding, the largest UK investor in the insurance sector. BlackRock's stakes in the UK are even larger than their stakes in the US and Germany. However, while larger than in Germany, the average stakes of Vanguard and State Street are substantially smaller than they are in the US.

Table 5: Percentage Holding in the UK Insurance Sector (%)

	Admiral	Aviva	Direct Line	Legal & General	Old Mutual	Prudential	RSA	Average
BlackRock	5.79	6.89	11.26	7.39	5.74	7.52	8.17	7.54
NBIM	2.72	4.57	3.81	2.53	3.00	3.99	3.66	3.47
Vanguard	1.71	2.76	2.72	2.70	2.62	2.59	2.77	2.55
Legal & General	1.86	2.76	2.54	1.54	2.45	2.70	2.50	2.05
State Street		1.28	1.53	1.00	1.49	1.15	1.79	1.18
Schroders		2.37	0.84	2.80	0.68			1.01
Total Big Three	7.50	10.93	15.51	11.09	9.85	11.26	12.73	11.27

Source: OECD (2017)

The fact that German fund managers have been able to retain their market shares to date is primarily due to three reasons. First, it is illustrative of the continued hold that German banks have over their retail distribution channels. Online retail brokerages such as Charles Schwab, TD Ameritrade, E-Trade or Interactive Brokers, which are popular in the US, are less well known in Europe, particularly in Germany where relational banking is still strong in the retail landscape.

This captive distribution ensures that a larger percentage of equity assets remain in comparatively higher priced active funds, meaning that index funds play a smaller role in Europe. Sushko and Turner (2018) report that index funds' share of investment fund assets in

2017 stood at 30 percent in Europe, compared to approximately 45 percent in the US. Furthermore, while this represents a doubling of index funds' market share in Europe since 2007, the recent trend highlights the continued captivation of the European distribution model. McKinsey (2019) reports fund flow data for the period from 2013 to 2018 which shows that while the US saw $1.24 billion of outflows from active equity funds and $1.71 billion of inflow into passive equity funds, the trend in Europe actually saw greater inflows into active equity funds ($265 billion) than passive equity index funds ($180 billion), meaning that index funds actually lost market share to active funds in Europe.

Second, European ETF providers, particularly from Germany (DB Xtrackers) and France (Lyxor), have been able to compete on fees. They have been able to undercut foreign competitors by lowering the explicit fees charged while making up for the lost income with financing income from "swap-based" or "synthetic" ETFs (Foucher and Gray, 2014). In these cases, the ETF does not purchase the shares that replicate the benchmark index but instead enters into a swap-agreement with its parent/sponsor bank, which promises to pay out the performance of the relevant benchmark index. In return the ETF provider deposits the underlying cash assets of the fund with the counterparty bank to the swap. The bank in turn secures this cash by depositing collateral with the ETF provider (Johnson et al., 2012).

The net effect of these trades is that the ETF provides cash funding to the bank while receiving collateral from the bank's balance sheet. The bank therefore makes a profit from its relationship with the ETF. It is able to deposit collateral with the ETF that it would have limited use for otherwise and get highly valued cash with which it can reduce its regulatory leverage. Foucher and Gray (2014) report that synthetic ETFs account for an estimated 33 percent of the European ETF market but only four per cent of the U.S. ETF market. Table 6 below shows that this level

decreased to approximately 21 percent by the end of 2016, partly as a result of BlackRock continuing to take market share with its physical offering.

Such trades have historically enabled banks to fund themselves more cheaply than on the open market and were particularly supportive during the Global Financial Crisis. The 2009 announcement by Xtrackers that they would cut the fees on their DJ Euro Stoxx 50 ETF to zero illustrates the significance of this income.[62] Besides the funding advantage, swap-based ETFs are also chosen when the underlying indices are complicated to replicate. iShares initially only offered physically replicated ETFs but responded to the European banks' swap-based challenge with their own synthetic ETFs in 2010.[63] However, as illustrated by Table 6, iShares synthetic offering does not appear to have taken off.

Table 6: Five Largest Providers of UCITS ETFs

	Number of Physical ETFs	Number of Synthetic ETFs	AuM of Physical ETFs	AuM of Synthetic ETFs	% AuM in Synthetic ETFs
Amundi	8	91	3.7	21.9	85.5%
Db X-trackers	92	95	32.3	21.7	40.2%
iShares	288	1	252.1	0.8	0.3%
Lyxor	40	173	20.6	31.2	60.2%
Source	12	54	6	11.1	64.9%
Total	440	414	314.7	86.7	21.6%

Source: Morningstar (2017), data as of 31 December 2016.

The relevance of synthetic ETFs for corporate governance is, that because these ETF do not hold the underlying shares but instead only hold a swap agreement with a bank, the ETF holds no voting rights. The voting rights instead sit with whomever has provided the hedge against

[62] Financial Times, "Big ETF providers fight for investors". Available at: https://www.ft.com/content/1c615a40-1a03-11e2-a179-00144feabdc0 (Accessed 14 January 2020).
[63] Financial Times, "iShares launches swap-based ETFs" 19 September 2010, available at: https://www.ft.com/content/0be1160c-c27f-11df-956e-00144feab49a (Accessed 14 January 2020).

the swap, typically an investment bank or a trading house. If these voting rights are exercised, this will be done according to the banks' proxy voting policies, not those of the asset manager. The effect of this is that it diminishes the voting rights of European index funds by approximately one fifth, while not affecting the voting rights of the Big Thee within Europe. The overall percentage of voting rights this represents is, however, comparatively small at 1.7 percent.[64]

However, as Morningstar (2017) reports "synthetic" became a loaded word following fears about the creditworthiness of these models during the European debt crisis in 2011, leading to a decline of the overall share of synthetic ETFs in Europe from approximately 45 percent in 2009 to 20 percent at the end of Q1/2019 (Morningstar, 2019c). Creditworthiness concerns enter into synthetic ETFs because the swaps and their collateral are provided by European banks, some of which ran into trouble during the European debt crisis. In practice these swaps were "over-collateralised" meaning that there was an additional safety buffer, but some concerns were raised, nevertheless. While the overall market share of synthetic ETFs has declined, Table 6 shows how some of the biggest European providers remain heavily reliant on this business model. BlackRock stands out for lack of synthetic offerings.

A final reason for European index fund providers to be able to compete with the much bigger US providers is the aforementioned first mover advantage. The initial focus of US ETF providers on their domestic markets, provided European asset managers with the opportunity to capture the domestic market. The head start that these European providers gained, due to

[64] The Financial Times (2020a) estimates European ETF AuM at approximately $1 trillion, which equates to approximately 8 percent of the European equity market (Gleisner and Thomadakis, 2018). 21.6% x 8% = 1.7%.

being the first to issue products and due to their captive distribution networks, has been a competitive moat ever since.

However, stricter regulation of commission payments for distributions in Germany under MIFID2 and in the UK as a result of the Retail Distribution Review (RDR) means that this moat is being increasingly tested.[65] Further weakening European defences is the falling appetite for synthetic ETFs. Finally, while European ETF providers do have a degree of first-mover advantage over US peers, this is weakened by the large number of domestic banking networks and stock exchanges competing against one another. The result is that there are today 12 separate providers offering ETFs that track the Euro Stoxx 50 index (Morningstar, 2017), compared to the two products that you would typically see in the US market. This explains the 2012 decision by Vanguard to enter the European market, the 2017 decision by Invesco to acquire the European ETF provider Source, and more recently the 2019 decision by Goldman Sachs to enter despite the captive distribution networks.[66] This therefore suggests that we will yet see consolidation in the European ETF market, though this may take some time as consolidation within is initially offset by new entrants from the US.

This section has highlighted that index funds have a smaller market share of the UK and German equity market. Furthermore, within this smaller index fund market, the Big Three have a smaller share than they do in the US. BlackRock is the only one of the Big Three to have a similarly commanding leadership in the UK and Germany as in the US. While Vanguard and State Street are also large shareholders with approximately 2.5 percent and 1.0 percent

[65] The UK RDR banned the payment of commission to independent financial advisers for selling products, was implemented in 2013. Source: https://www.ipe.com/the-market-understanding-the-etf-landscape-and-flows-in-europe/10026998.article (Accessed 17 January 2020).
[66] For further information, see: https://www.etf.com/sections/features-and-news/8378-vanguard-enters-european-etf-market and https://www.ft.com/content/58481371-83ad-35f8-8bad-f02e80167415 (Accessed 17 January 2020).

respectively of the capital of the average UK and German company, this is substantially less than the approximately 4-6 percent they each hold in the average US company. Since the total holdings of the Big Three are smaller in Europe, and since the index assets of European asset managers are nested within much larger active assets, the potential influence of index investing is thus substantially lower in Europe than in the US.

Index funds – power without direction

While the previous sections have laid out how the growth of index funds is creating the preconditions for shareholders to play a greater role in corporate governance, it does not follow that index funds take up this role. This has resulted in a growing controversy, which has moved from academia into the press and into regulatory circles. The result is that index funds are coming under attack from two almost diametrically opposing sides. Barbara Novick, Vice Chairman of BlackRock, refers to this as the "Goldilocks Dilemma".

> "The increased focus on stewardship has led to more transparency and, in turn, has spawned new research asking critical question: Do asset managers do enough? Do they do too much? Or, are they doing just the right amount? Let's call this the Goldilocks Dilemma" (BlackRock, 2019c).

As pointed out by Novick, the criticism can be broadly divided into two camps, those that believe index funds have (or will soon have) too much influence, and those who believe index funds are not engaging enough, thereby creating an unaccountability vacuum for business leaders. What unites the two groups of scholars is that both are concerned by the significant size of the Big Three. Coates, for example, is alarmed by the growing ownership concentration

resulting from index investing and thus warns of indexing leading to a "significant shift towards more shareholder power" (2018: 2). Those that raise concern over the lack of corporate oversight from index funds fear that it may result in either corporate self-dealing or provide the environment for other groups such as financial or social activists to take charge (Bebchuk and Hirst, 2019a; Lund; 2018; Strine, 2018).

Concerns that the Big Three may create a governance vacuum have been furthered by studies showing that the Big Three vote the majority of time with management and against shareholder proposals (Bubb and Catan, 2018; Fichtner et al., 2017). Bebchuk and Hirst (2019a) show that the Big Three can on average cast 25 percent of the votes at S&P 500 companies.[67] Fichtner et al. (2017) find that the Big Three side with management more than 90 percent of the time. While Mallow (2019), a Vice Chairman of BlackRock, explains this is because proxy voting data includes a high proportion of routine proposals re-electing directors, Griffin (2020a) notes a similarly one-dimensional voting behaviour amongst the Big Three with regards only to social and environmental (S&E) proposals. Griffin shows that Vanguard's largest funds supported just 7.5 percent of S&E proposals, BlackRock 7.1 percent and State Street 22.7 percent, concluding that "it is a convenient myth that index fund stewardship teams are even marginally constrained by the "best interests" standard when voting on E&S proposals, and likely other proposals as well. The truth is that these index funds, possessing the power to decide the fate of most E&S proposals, can do as they wish with that power" (2020a: 2).

[67] To get to their estimate of 25%, Bebchuk and Hirst (2019a) consider the fact that many of the shares remaining in the hands of retail investors are not voted, whereas the Big Three vote virtually all of their shares, with the result that the proportion of their votes exceeds their economic value. Fichtner et al (2017) report a mean holding of 17.6% for companies in the S&P 500.

The results of Griffin's (2020a) study concur with a study conducted by the climate advocacy NGO Ceres, which noted that in 2018 BlackRock and Vanguard only backed 10 percent and 12 percent of climate-related shareholder proposals respectively, further noting that "The investors who should be the leaders have so far been the laggards".[68] Further illustrating the consequence of the voting behaviour by the Big Three a report by campaign group Majority Action finds that "BlackRock and Vanguard voted overwhelmingly against the climate-critical resolutions […], with BlackRock supporting just five of the 41, and Vanguard only four. At least 16 of these critical climate votes would have received majority support of voting shareholders if these two largest asset managers had voted in favor of them" (2019: 4).

What the above debate shows is that index funds can have influence both by action and deliberate inaction. Therefore, despite the fact that The Big Three may for now be a long way from controlling the majority of voting rights, they have amassed voting stakes sufficient to decide the outcome of approximately a quarter of the shareholder proposals put to the vote at US companies and approximately half of all environmental and social proposals (Griffin, 2020b). The fact that the combined ownership stakes of the Big Three in the UK and Germany are approximately half of the size means that their impact in Europe is less extreme, though it may also be substantial (unfortunately Europe lacks the same granularity of voting data provided for in the US by the requirement to file the form "NP-X").

With regards to the varieties of capitalism, the consequences of the growth of the asset management sector is thus that it reduces the managerial autonomy of corporate executives in the UK and Germany, whereas only moderately impacting managers of US companies. On the

[68] Source: https://www.cnbc.com/2019/10/08/biggest-us-index-funds-oppose-most-climate-proposals-in-shareholder-votes.html (Accessed 15 January 2020).

one hand there is an increase of shareholder control, a typical LME attribute, on the other hand European asset managers' greater concern for social and environmental considerations increases the extent to which UK and German corporate executives have to consider the interests of other stakeholders, a typical CME feature. Goyer (2007; 2011) shows the extent to which American investors traditionally prefer a strong CEO, an attribute that is increasingly being challenged by shareholder proposals on ESG issues.

A final point to note is that it has also been suggested that BlackRock has attained "infrastructural power" as a result of the significant manpower, systems and specific knowledge the firm has amassed (Braun, 2018; 2020b). This has, for example, resulted in BlackRock assisting the US Federal Reserve in its quantitative easing mandate, as well as supporting the European Central Bank (ECB) in its stress testing of banks' balance sheets as well as in launching its asset-backed security (ABS) mandate.[69] The Financial Times therefore compares the power of BlackRock's CEO Larry Fink to that of JP Morgan in the 1907 financial crisis (2020e). The article explains that BlackRock yields this power through a small consultancy division called Financial Markets Advisory that produces less than one per cent of its revenues.

In another article the Financial Times (2020c) compares BlackRock to the "Vampire Squid", a name previously coined by Rolling Stone magazine to describe the investment bank Goldman Sachs as being "wrapped around the face of humanity". While a discussion of this aspect of power is beyond the scope of this thesis, it is noteworthy that there are signs of greater public

[69] For BlackRock's role in supporting the Federal Reserve's bond buying programme, see: https://www.ft.com/content/f9c7e4de-6e25-11ea-89df-41bea055720b For information on BlackRock's role in helping the ECB stress tests, see: https://de.reuters.com/article/us-ecb-policy-tests/blackrock-helps-ecb-in-bank-stress-test-idUSKCN0Y215S For information on BlackRock's role in the ECB's ABS programme, see: https://www.europarl.europa.eu/doceo/document/E-8-2014-007933_EN.html?redirect (All accessed 1 May 2020).

scrutiny of such mandates. In April 2020, a group of 92 NGOs signed a letter addressed to the head of the European Commission urging the Commission to cancel a recently concluded agreement with BlackRock that will see it provide assistance in the integration of ESG issues into banking stress tests.[70] Chapter 6 will explore in detail this political dimension of asset managers' influence, the role they play in advancing the process of financialisation and the ways in which they contribute to growing economic inequality.

The resource challenges

A possible explanation for why index funds' involvement with portfolio companies appears to be limited results from the sheer number of individual portfolio holdings the average asset manager today holds. This therefore is an important qualification to the thesis that institutionalisation and indexation allow for more engagement between asset managers and corporate issuers. For approximately half of the asset managers interviewed by Bew and Fields (2012) annual meeting volume was between 4,500 and 10,000 and the most common staffing level was 3-5 full-time governance staff. BlackRock's 2019 Annual Stewardship Report shows that the fund manager voted at 16,124 meetings in the 2019 proxy voting season (BlackRock, 2019a).

Further complicating the staffing issue significantly is the fact that the majority of AGMs occur in a period of just three to four months each year. This period is known as the "proxy season" and the reason for the temporal concentration of AGMs in the period from March to June is that most companies have a financial year end that coincides with the calendar year end on the

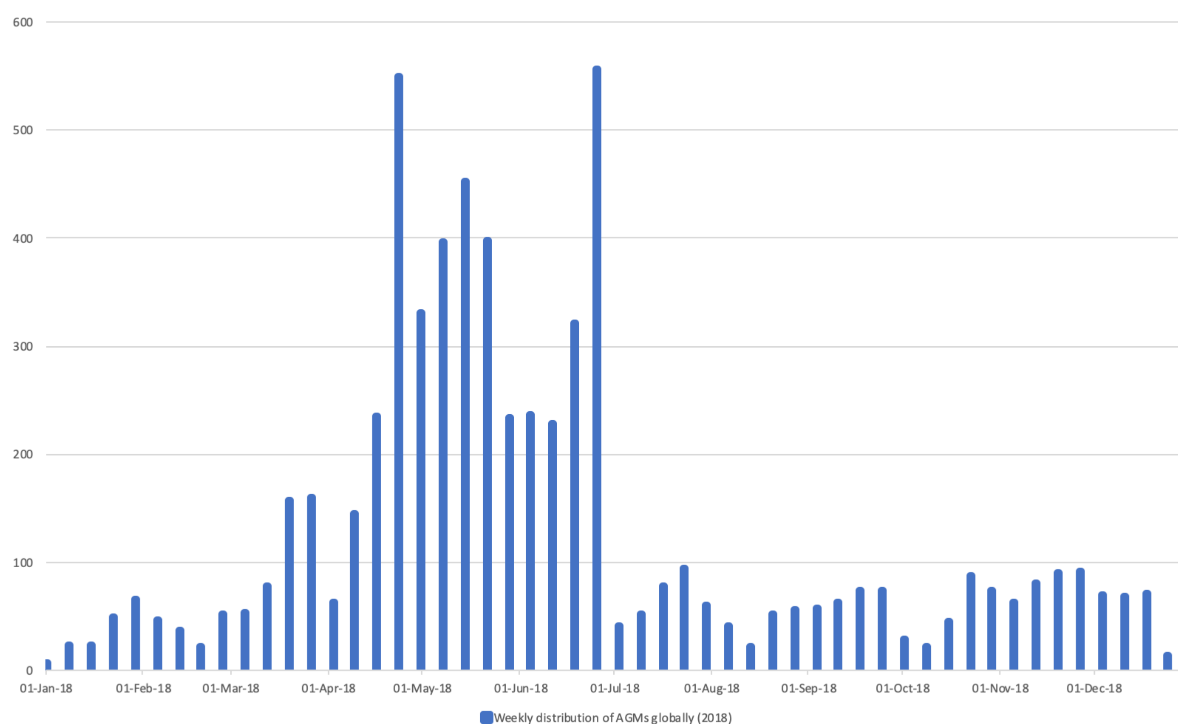
[70] For a copy of the letter, see: https://reclaimfinance.org/site/wp-content/uploads/2020/04/BlackRock-Open-Letter-EU.pdf (Accessed 1 May 2020).

31st of December. The proxy season results from the fact that most countries require companies to hold their AGMs within 4-6 months of the financial year end. It is thus impossible to stretch out the proxy season without moving the financial reporting calendars of companies.

Figure 14 below shows the distribution of the 6,524 annual general meetings (AGMs) globally which the British proxy advisor Minerva covered in 2018. Of these, 64 percent occurred in the period between April and June and 76 percent between March and July. While not applying to any of the three focus countries, it is worth noting that in some countries, companies have been accused of deliberately scheduling their AGMs on the same day to make it difficult for shareholders to attend.[71] The Financial Times explains that the Japanese scheduling of AGMs is a response to a "phenomenon of the 1980s and 1990s: racketeers known as sokaiya. In the sokaiya scam, gangsters threaten to disrupt the AGM by shouting accusations at the board unless they are paid off".[72] Scheduling difficulties have also been reported for other Asian countries such as Singapore. Such intentionally scheduling is, however, not observable in European countries or the US.

[71] For Japan, see: https://dealbook.nytimes.com/2014/06/23/in-japan-hundreds-of-shareholder-meetings-on-same-day/ For Singapore, see: https://www.businesstimes.com.sg/opinion/why-do-companies-make-attending-agms-so-tough-amended (Accessed 20 October 2019)
[72] See: "Corporate Japan guards AGM sanctity". 29 June 2009. Available at: https://www.ft.com/content/e9b26b66-64cf-11de-a13f-00144feabdc0 (Accessed 2 February 2020).

Figure 14: Weekly distribution of AGMs globally covered by Minerva Analytics in 2018



Source: Author's chart, data courtesy of Minerva Analytics

Processing proxy voting items, even with the assistance of proxy advisors, discussed in the next chapter, may therefore take up a significant amount of time.

> "One must also take into account that an analysis takes about 4 to 8 hours, depending on the market. And that only, if one is familiar with the topic at hand and if one understands the information (language) and is in possession of all relevant data (such as the evaluation of the previous year). In the case of complications (shareholder proposals, M&A etc.), it may take days to inspect all relevant documents".[73]

[73] Governance analyst, German asset manager, emailed statement, 9 August 2018.

An example of what an absolute minimum staffing level would look like, can be estimated as follows: If one looks at the large number of meetings some institutional investors vote at, say the lower bound of 4,500 given by Bew and Fields (2012), and allocates an average timeframe of six hours to prepare for each meeting as suggested by the interviewee quoted above, then this would equate to 27,000 man-hours to complete. Accounting for the 76 percent of proposals that fall into the proxy season from March to June, and thus dividing the 20,500 hours(76 percent of 27,000 hours) by 16 weeks for the 4 months of the proxy season, and then by 45 hours to represent an average workweek, would result in 28.5 staff needed. Add in managers and this generic asset manager would need to employ a staff of approximately 30 to take care of their voting responsibilities. For a larger asset manager, such as BlackRock with its 16,124 meetings in 2019, the staffing needs would be approximately 110 employees

The above example of four to eight hours of processing time is what it takes with the assistance of proxy advisors, without their support a multiple of the staffing numbers would be required. The governance headcounts of the Big Three compare to the above staffing estimate as follows: BlackRock 47, Vanguard 35 and State Street 12.[74] The impression that these very diverse portfolio holdings do not allow for substantial engagement between asset managers and corporates is supported by BlackRock's (2019a) Investment Stewardship Annual Report, which states that the asset manager engaged with 1,458 companies during the 2019 proxy season.

Even though BlackRock reports that it engaged with 50.4 percent of the equity assets, the percentage of companies it engaged with is much lower due to the fact that a disproportionate

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[74] Financial Times, 8 March 2020, "Jobs bonanza in stewardship and sustainable investing teams".

percentage of engagement is focussed on the largest companies. If we assume each portfolio holds one annual general meeting, this suggests that BlackRock engaged with only approximately 10 percent (1,458) of its 16,124 portfolio holdings.[75] BlackRock's engagement team of 47 professionals is the largest in the industry, yet with approximately 16,124 portfolio holdings, this means that each governance individual is responsible for approximately 343 companies.

Figure 15: Evolution of Vanguard's engagement, 2014-2019

Source: Vanguard (2019b).

For its part Vanguard (2019b) reports that it has engaged with 59 percent of its assets under management, yet this was done by engaging with just 868 companies (Figure 15). The reported 59 percent rate thus obscures the fact that the asset manager engaged with just 6.7 percent of its 13,000 portfolio companies. At those 13,000 portfolio companies Vanguard's stewardship team of 34 people has handled 170,000 individual matters in the 12 months to 30th of June of

[75] In reality, the number of company holdings will be marginally lower, as the meetings that BlackRock has voted on will also include a small number of extraordinary general meetings (EGMs).

2019.[76] That's 382 companies per stewardship team member. Finally, State Street (2019) reports that it engaged with 1,533 companies accounting for about 70 percent of their total AuM, but with holdings in more than 12,000 listed equities this also equates to just 13 percent of companies. More so, of these 1,533 meetings, just 686 were "comprehensive engagements" including in-person meetings and telephone calls. 847 engagements were through letter writing. Looked at this way, State Street therefore spoke to only 5.2 percent of their portfolio companies. Furthermore, of the 686 comprehensive engagements, 600 were with unique companies, suggesting a maximum of 86 companies (0.67%) could have been spoken to more than once during that year. BlackRock similarly reports that of the 1,458 companies it engaged with in 2019, 25 percent were engaged with multiple times, implying that just 2.2 percent of portfolio companies (364 of the 16,124) were engaged more than once.

A proxy solicitor explained that the Big Three operate on a principle of "Bringschuld", which translates as "obligation to deliver". He explained that the Big Three expected companies to reach out to them and that they would rarely reach out themselves.[77] He explained that the reasoning behind this is that companies would know best when there is a need to talk.[78] This does, however, raise the question how they can provide oversight when in many cases they rely on corporates drawing attention on themselves.

Voicing her frustration with the engagement approach of the Big Three, the investor relations director of one German corporate noted that they sometimes ask for meetings with the

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[76] Number of voting items: https://www.institutional.vanguard.co.uk/documents/2019-investment-stewardship-annual-report.pdf (Accessed 26 February 2020). Source of staff numbers: https://www.ft.com/content/9414052a-3142-11ea-9703-eea0cae3f0de (Accessed 26 February 2020).

[77] Proxy solicitors are consultancies that help companies interact with their shareholders.
Proxy solicitor, in-person interview, 14 April 2018.

[78] He explained that this was explained to him by the head of governance of one of the Big Three, when they came to visit the proxy solicitor's offices.

supervisory board chairman but when these are not available at the time, and her company makes an alternative suggestion, there is no further response from investors. She therefore said that she "sometimes get[s] the feeling that for these investors, they feel that they've done what is required of them, the mere attempt to arrange a meeting counts as engagement".[79]

I will leave a full discussion of how corporates perceive index funds to Chapter 7 and will only provide one more example here, which supports the conclusion of the above data showing that the Big Three primarily focus their engagement on a small number of very large companies. The investor relations contact of one medium-sized US company explained that "at Vanguard and State street, god help you if you're trying to get a contact. Even at Blackrock who pride themselves on engagement, it is not easy to figure out who to reach out to. They have a separate section on their homepage, but there are no contact details".[80]

Besides their voting and engagement pattern, the Big Three have also been hesitant to join investor coalitions. One such example is provided by the global Climate Action 100+ coalition. Launched in December 2017 Climate Action 100+ is an investor initiative by more than 370 global investors with more than $35 trillion of assets under management. Notably absent, until January 2020, were all three of the Big Three.[81] This is despite the fact that being a signatory does not require divestment of any assets but instead a focus on engagement with corporates engaged in carbon-intensive industries.

[79] Investor relations, German company, telephone interview, 5 January 2018.
[80] Investor relations, US company, telephone interview, 4 June 2018.
[81] For details on Climate Action 100+, see: http://www.climateaction100.org/ (Accessed 2 January 2019).

One of the Big Three explained that the reason they had not signed up to the initiative was because US regulations on coordinated engagements prevented them from doing so.[82] However, this does not explain why other US investors, including Northern Trust Asset Management, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) were able to sign up. It also does not explain why BlackRock in January 2020 announced that it would sign up as the first of the Big Three after all.[83]

One campaigner explained that BlackRock preferred to set up its own campaigns that typically involved a coalition with corporate representatives where it could control the dialogue.[84] Campaigners therefore suspect that the real reason that the Big Three are avoiding taking sides on controversial issues is for fear of being hit with increased regulation from corporate interest groups seeking to limit their influence.

In further evidence that NGOs are losing patience with the approach of the Big Three, the representative of one NGO explained in the summer of 2019 that they were preparing to sue BlackRock if they voted against future shareholder proposals requesting companies report information according to the Task Force on Climate-related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) standards.[85] Because BlackRock was a signatory/member to both standards, the NGO felt that they should not oppose shareholder proposals seeking to support those standards.

[82] Corporate governance analyst, Big Three asset manager, telephone interview, 24 June 2019.
[83] Shareholder campaigner, NGO, in person interview, 27 June 2019.
[84] Shareholder campaigner, NGO, in person interview, 26 July 2019.
[85] Shareholder campaigner, NGO, in person interview, 27 June 2019.

Further reasons for index funds' lack of critical engagement

Why else might the Big Three show near unanimous support of corporate managers and opposition to the majority of environmental and social shareholder proposals? When asked this question, one of the Big Three explained that they did not believe that they had a wider responsibility to society and that their only responsibility was to the financial wellbeing of their investors.[86] Indeed, the issue of fiduciary responsibility appears to be one reason for the Big Three's hesitancy to support environmental and social proposals. When asked why BlackRock voted against 91 percent of climate change resolutions in 2017, Larry Fink, CEO of BlackRock, explained that "In the United States, we can't put environmental things in front. That's against the fiduciary standard rule of the United States" (BlackRock, 2018b).

Conflicts of interest provide a further explanation for a lack of engagement (Bebchuck and Hirst, 2019a; Braun 2019). Bebchuk and Hirst (2019a) argue from an agency-costs theory approach that index funds have a strong incentive to underinvest in stewardship as the costs of stewardship fall on the fund management company, while the benefits accrue to the fund. Furthermore, any benefits of such stewardship will benefit all shareholders not just the funds that engage in it and that any outperformance of the stocks will not be captured by index funds as it will be reflected in the overall level of the index.

A second conflict of interest results from the fact that asset managers compete for corporate pensions and treasury mandates (Davis and Kim, 2007). In the case where an asset manages is owned by a banking corporation, their parent bank may also compete for financing business (Braun, 2019). Asset managers may therefore be reluctant to engage with portfolio companies for fear of retribution. This second type of conflict of interest may also take on another form:

[86] Corporate governance expert, Big Three index fund, in-person interview, 17 August 2018.

Asset managers may also seek not to appear too environmentally and/or socially conscious for fear of alienating a portion of their existing or potential client base. The same logic may also work the other way meaning that asset managers may not want to appear too uninvolved for fear of putting off the opposite side of the customer spectrum. How politically charged such issues become is made apparent by the following comment, which followed BlackRock's January 2020 announcement to divest of some of their coal assets from their active funds:

> "Montana Senate Majority Leader Fred Thomas, a Republican and legislative liaison with the Montana Board of Investments, for which BlackRock manages assets, said he supports the use of many fuel sources including coal and that BlackRock should be wary of calls to move away from fossil fuels. 'Any effort in my opinion to try to placate this environmental agenda just to get along and go along is a bad decision for any business,' Thomas said".[87]

The fact that many asset managers, including two of the Big Three, are themselves stock market listed corporations furthermore creates the possibility that asset management executives become conceptually captured by their interests as stock market listed corporations. They are tasked with defending the interest of their customers, the ultimate investors, while simultaneously themselves fulfilling the role of company managers. Their boards consist of many past and present executives of both financial and non-financial stock market listed corporations. The managing board of BlackRock, for example, includes the CEOs of Cisco, Estée Lauder and PNC Financial Services, as well as past and present executives from

[87] Reuters Business News, 14 January 2020, "BlackRock vows tougher stance on climate after activist heat". Available at: https://uk.reuters.com/article/uk-blackrock-fink/blackrock-vows-tougher-stance-on-climate-after-activist-heat-idUKKBN1ZD150 (Accessed 27 February 2020)

Microsoft, General Electric, Verizon Communications, Swiss Re, Aviva and EQT Corporation (a gas pipeline operator).[88]

Asset managers thus have a number of reasons not to critically engage with their portfolio companies. Any shareholder proposals on social and environmental issues has the potential to force asset managers to take sides. This may therefore explain why none of the Big Three opposed the SEC's proposals to make it more difficult for shareholders to submit proposals at US companies. While a very long list of active fund managers submitted forceful letters of objection to the SEC's proposed new set of rules on proxy voting, Reuters noted that BlackRock "declined to back or reject a regulatory proposal to reform the shareholder resolution process".[89] The proposed rules seek to increase the minimum dollar value of stock an investor has to hold before being able to submit a shareholder proposal.

Since many of the proposals are submitted by small shareholders, such a rule change has the potential to drastically reduce the number of proposals submitted. Yet, State Street's head of stewardship commented that "I don't feel like I need to have a position on an issue that's not impacting us".[90] The increased dollar hurdle would not impact any of the institutional investors, but the way the investment ecosystem works, it is often smaller investors that submit the proposals. Yet as one interviewee explained, such rule changes would have a big impact on the voting ecosystem, as it is irrelevant who submits the proposals, as long as somebody does, what matters is that everyone votes on them.[91] If these smaller investors did not submit proposals, corporates would face considerably less shareholder pressure.

[88] Source: https://ir.blackrock.com/governance/board-of-directors/default.aspx (Accessed 10 April 2020).
[89] https://www.reuters.com/article/us-blackrock-investors/on-shareholder-vote-reforms-blackrock-sits-on-the-fence-idUSKBN2002ED (Accessed 27 February 2020).
[90] https://www.nasdaq.com/articles/top-u.s.-fund-firms-split-over-new-limits-on-shareholder-votes-2020-01-31 (Accessed 27 February 2020).
[91] Former executive, US proxy advisor, telephone interview, 10 February 2020.

Vanguard's (2019c) policy documents explicitly state that Vanguard does not file shareholder proposals, and the Financial Times reports that BlackRock said it had never submitted a shareholder proposal either.[92] This is significant because if one thinks about the spectrum of engagement options, the two most powerful are submitting a shareholder proposal and publicly threatening to divest from a stock (Figure 1, Page 4). Since index investors' shareholdings follow from equity indices, by ruling out shareholder proposals index funds are unable to make use of two of their most compelling tools as means for disciplining portfolio companies.

In October 2020, billionaire hedge fund manager Sir Christopher Hohn called out the big asset managers accusing them of "total greenwash" and remarking that "asset managers are sheep" and that "a lot of them will say 'we will vote for someone's else's resolution', but why aren't they filing their own resolutions?"[93]

Index funds are therefore "systematically staying on the side lines on those decisions and generally avoiding expressing any position or preference with respect to the SEC proposals and Judicial decisions" (Bebchuk and Hirst, 2019a: 79). The result of this approach is that the Big Three are helping to insulate US corporations from pressures brought on by other, potentially more socially concerned, investors. The fact that the Big Three have a smaller market share in Europe than in the US means that this insulating effect is particularly evident in the US, where their average voting bloc of approximately 25 percent of the votes cast has enabled them to scupper a number of shareholder proposals, as documented by the NGO Majority Action (2019).

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[92] https://www.ft.com/content/44110919-84d9-30d5-a346-e9ac30eef204 (Accessed 27 February 2020).
[93] https://www.ft.com/content/2ea426f2-b338-4921-882b-7c99076489fe (Accessed 10 November 2020).

A recent report on CEO pay by the NGO As you Sow (2020) furthermore noted how the voting behaviour of the Big Three contrasted with the voting behaviour of European asset managers. The report noted that while BNP Paribas Asset Management opposed pay packages termed excessive 91 percent of the time in 2019, and Allianz Global Investors opposed 93 percent of these packages, BlackRock opposed just 8 percent and Vanguard 10 percent of such excessive pay packages.

The inaction by the Big Three has added to frustration amongst activists, to the point where some are now engaging in what can best be described as "corporate governance squared". Rather than filing shareholder proposals at a large number of individual firms, activists have now resorted to filing shareholder proposals also at the level of the asset management firm at BlackRock Inc and Vanguard (Bloomberg, 2019). These proposals seek changes to asset managers' proxy voting policies at their respective portfolio companies.[94]

A new separation of ownership and control and the fear of instrumentalization

The institutionalisation and indexation of investment management has resulted in the professionalisation of the corporate governance function within asset managers. This has created a new separation of ownership and control within asset managers just as a "great re-concentration (Braun, 2019) is occurring amongst shareholders.

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[94] While Vanguard is a private company, it does hold irregular general meetings, whenever required. The last meetings were held in 2002, 2009 and 2017. At these meetings Vanguard has faced calls "to institute transparent procedures to avoid holding investments in companies that, in management's judgement, substantially contribute to genocide or crimes against humanity, the most egregious violations of human rights". Vanguard's management has recommended voting against these proposals (as they consider them covered by other policies) and have succeeded in defeating these proxy campaigns repeatedly. Source: https://www.sustainableinvest.com/vanguard-proxy-vote/ (Accessed 3 April 2020).

Historically, asset managers' corporate governance function was comprised by a very small team of either admin staff or lawyers, "back office lackeys",[95] who would primarily be responsible for completing voting ballots, while engagement was conducted by the portfolio managers and research analysts sat in the "front office". This has changed over the past two decades, primarily due to two reasons. First, voice has taken on a more important role as investors have gained rights to vote on a greater number of corporate items, larger stakes have made selling out of stock holdings increasingly more challenging, and regulatory pressures for stewardship have increased. Second, the growth of index funds, who are unable to sell, means there is today a large group of investors for whom voice represents the only option for influence.

Asset managers have responded to this changed environment by adding substantial, though often still insufficient, resources. As the following chapters will show, large investors' stewardship teams have reached average headcounts of 18 people and the largest team (at BlackRock) consists of 47 team members. "Within the asset management firms the amount of resources has changed, stewardship teams have grown. Twelve years ago, corporate governance was a one to two-person team, usually consisting of a compliance officer".[96] The new separation of ownership and control results from the fact that these teams have acquired specialist knowledge on issues such as the design of executive remuneration policies, that differ between countries, that it is near impossible for front office staff to keep abreast of this as well as "ordinary" corporate developments.

[95] Investor relations, UK company, Webex video conference, 14 June 2018.
[96] Former employee, large US proxy advisor, telephone interview, 10 February 2020.

Ownership continues to sit with the portfolio managers and fundamental research analysts, while corporate governance control sits with the stewardship teams.[97] This separation has been formalised at most asset managers by the fact that the stewardship teams typically report into the Chief Operating Officer, the Chief Financial Officer or directly into the Chief Executive Officer. At most firms there is no reporting line into the fund management team. The Global Head of BlackRock's Investment Stewardship Team, for example, reports into the Vice Chairman and co-founder of the firm.

Stewardship teams organises dedicated governance meetings with company management, in addition to those organised by the portfolio management team. While the portfolio managers will meet with the executive team of CEO, CFO and/or investor relations to assess the financials, the stewardship teams meet with the chairman and the non-executive directors, especially those heading committees (remuneration, audit etc).[98] Specialist stewardship resources, such as proxy advisors (discussed in Chapter 5), contribute to this separation of ownership and control, as their reports are typically only provided to the stewardship teams.

Corporates fear losing control over their relationships as a result of this new separation within asset managers. With active managers they have the option of lobbying the portfolio managers, whereas with index funds there was no means of recourse should they disagree with the stewardship team's interpretation of a situation. Companies have to "learn how to manage them [stewardship teams], investor relations need to evolve their contacts to beyond the PM [portfolio manager] and analysts that they are used to speak to".[99] Since the topics of discussion

[97] There are a small number of exceptions, where fund managers retain the vote such as, for example, at the US asset manager Invesco. For details on Invesco's approach to proxy voting, see: https://www.unpri.org/Uploads/z/i/a/Invescos-differentiated-Proxy-Voting-Approach.pdf (Accessed 5 May 2020).
[98] Stewardship team member, UK asset manager, in-person interview, 16 April 2015.
[99] Investor relations, US company, telephone interview, 3 April 2018.

are often times very technical,[100] investor relations people have reported not being able to have an "intelligent conversation" with stewardship teams, instead requiring company lawyers to be present as investor relations cannot "talk the language".[101]

The result is that corporates described asset managers' approaches to corporate governance and fundamental equity analysis as "disjointed" and representing a "ticking the box exercise instead of conviction".[102] Instead of separating corporate governance from portfolio management, corporates suggested that "non-financial KPIs and sustainability should all be integrated [...] if taken to the natural conclusion, all these topics are so interwoven, and part of the same narrative strategy".[103]

The separation of the stewardship teams has led to fear amongst many of the interviewed corporates that the Big Three and the proxy advisory firms may become instrumentalization by activists (Chapter 7 discusses the corporate reaction in detail). Feeding this fear is a general lack of contact with these stewardship teams, particularly amongst smaller capitalisation companies.[104] The reasoning is that, without regular contact governance risks becoming a "tick the box" exercise as stewardship teams will lack company-specific insights.[105]

Corporates therefore have the challenge of needing to build new relationships with these governance teams, but "can't build a rapport if we do not have regular issues to discuss".[106] Many stewardship teams will only take calls from companies outside of the main proxy voting

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[100] Investor relations, US company, telephone interview, 5 June 2018.
[101] Investor relations, US company, telephone interview, 20 June 2018.
[102] Investor relations, UK company, Webex video conference, 14 June 2018.
[103] Ibid.
[104] Investor relations, German company, telephone interview, 20 June 2018.
Governance expert, US company, in-person interview, 26 June 2018.
[105] Deputy company secretary, UK company, telephone interview, 11 June 2018.
[106] Investor relations, US company, telephone interview, 24 January 2018.

season and only when there are issues to discuss.[107] "A governance group will have oversight and they will never care as much as that one active fund manager".[108] Portfolio managers by contrast will take calls most of the time even if there are no urgent issues, as there is always something to be gained, be it about the company itself or its competitors.

The separation of ownership and control is perceived to be particularly relevant within index fund managers, where corporates have no alternative contact points. "The more indexed houses become, the more important the corporate governance person becomes. And it is a challenge to get to know them".[109] Corporates noted that the rise of passive investors represents both a chance and a risk. A chance that they may not participate, thereby not voting against management, but also a risk if they lend out their voting rights to activist investors, "then you have a problem".[110]

Several corporates suggested that challenges resulting from the separation of ownership and control are greater with US investors than with European investors.[111] "There is still a gap, a separate world. In some firms you go through the PM [portfolio manager] or analyst to get to corp gov meetings. This is weird. In the US a buy-side analyst will actually warn you this does not concern him; you have entered the corporate governance realm and he will pass you on to colleagues. It's unclear to me how they can separate an investment decision from a governance one. In Europe there's more of a connection but it's not perfect".[112]

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[107] Governance expert, proxy solicitor, telephone interview, 26 February 2018.
Investor relations, US company, telephone interview, 22 February 2018.
[108] Investor relations, US company, telephone interview, 4 June 2018.
[109] Investor relations, UK company, Webex video conference, 14 June 2018.
[110] Investor relations, German company, telephone interview, 18 January 2018.
[111] Ibid.
[112] Corporate Secretary, US company, telephone interview, 22 February 2018.

Conclusion

This chapter has documented that index funds have contributed to an increase in the levels of shareholder concentration and to the degree of overall institutionalisation. The larger voting blocs have provided the conditions necessary for shareholders to exercise meaningful control over corporate governance. However, rather than resulting in greater shareholder influence over corporate strategy, the rise of the Big Three asset managers has provided corporations, particularly in the US, with a degree of insulation from other shareholders' policy advances. The resulting corporate governance vacuum is evidenced by the failed shareholder proposals on climate change at US oil companies. US corporate managers thus retain greater managerial autonomy than UK and German executives, with the result that they have comparatively less need to coordinate their policies with stakeholders.

The indexation of investment management is therefore affecting the three countries to a different extent. The two-pronged regulatory approach in the UK and Germany is balancing greater shareholder rights with the requirement for shareholders to take greater account of other stakeholders' concerns. The consequence of this is that the ostensibly LME attribute of greater shareholder power is directed not at a further maximisation of shareholder value but instead directed at supporting other stakeholders' interests, therefore requiring corporate executives to engage in greater coordination of company strategy (a classical CME attribute).

What the outcomes of the climate change proposals have also shown, is that the Big Three as a group have now amassed sufficient holdings to cast the deciding vote on a growing number of shareholder proposals in the US (up to two-thirds of US shareholder proposals have been decided by a margin of thirty percent or less). Bebchuk and Hirst (2019b) raise the spectre of a "Giant Three", suggesting that if the Big Three continue to grow at their current rate they will

likely reach 34 percent voting blocs in the S&P 500 within one decade and 41 percent within two decades.

Coates (2018) similarly draws attention to what he calls the "Problem of Twelve", the "likelihood that in the near future roughly twelve individuals will have practical power over the majority of U.S. public companies" (2018: 1). Coates explains that the number 12 is an imprecise number, he uses it as a proxy for the typical size of a corporate board. His argument is that index investing is leading to a winner-takes-all result in which just one management board, that of the largest asset managers, will control all of corporate America. The management team of Vanguard, the fastest growing of the Big Three asset managers, consists of 12 executives.[113]

For now, Europe appears to be approximately 10 years behind the US in the adoption of ETFs. Index funds are growing at a similar pace but from a lower base. BlackRock is larger in the UK than in the US and Germany, but the combined holdings of the Big Three are still considerably smaller in the UK than in the US, and much smaller still in Germany. In the UK and Germany, the governance agenda is therefore still set primarily by domestic investors and the Big three are not yet in a position to provide the level of governance vacuum seen in the US and are thus unable to scupper domestic investors' policy initiatives.

Regulatory changes outlined in this chapter suggest that the Big Three are likely to gain greater market share in Germany and the UK going forward. This raises the question of what the consequence of greater market share will entail for the corporate governance models in the UK and Germany. Since the Big Three serve to insulate corporate managers, rather than themselves

[113] For further details, see: https://about.vanguard.com/who-we-are/our-leaders/ (Accessed 4 April 2020).

advocating for any particular model of capitalism, the likely outcome is that greater index fund market share in Europe may halt but not reverse changes to the German and UK models. As a secondary consequence, there is, however, the potential that greater US index fund market share in Europe will lead to declining revenue income for European asset managers, thereby negatively impacting the stewardship budgets these investors have available.

Chapter 4

The Internationalisation of Share Ownership

4.1 Introduction

The previous chapter documented how the growth of the Big Three, all of which are US headquartered, has provided asset managers with the scale and ownership concentration necessary to play a meaningful role in corporate governance going forward. It has also shown, however, that to date this new influence of the Big Three primarily serves to insulate US corporate managers from the stewardship efforts of other shareholders. This chapter will detail the internationalisation of the asset management industry, which represents the first of the three second-order developments to be discussed. While institutionalisation and indexation have created the necessary preconditions for shareholder control, internationalisation creates the precondition necessary for the growth of the asset management industry to influence the individual national varieties of capitalism on other countries outside the United States. Internationalisation is the means by which the governance activities of any one investor can reach beyond the national context.

Whereas the institutionalisation of investment management has led to a focus on diversification of portfolio holdings for both asset managers and individuals, the indexation of investment management provided an affordable means for delivering this diversification, both nationally and internationally. In questioning the value of active fund management, the rise of index investing has furthermore called into question the value of foreign asset managers as necessary experts for international investment allocations. Indexation has thus enabled domestic financial institutions to offer a credible investment product for foreign investments. Investors now have

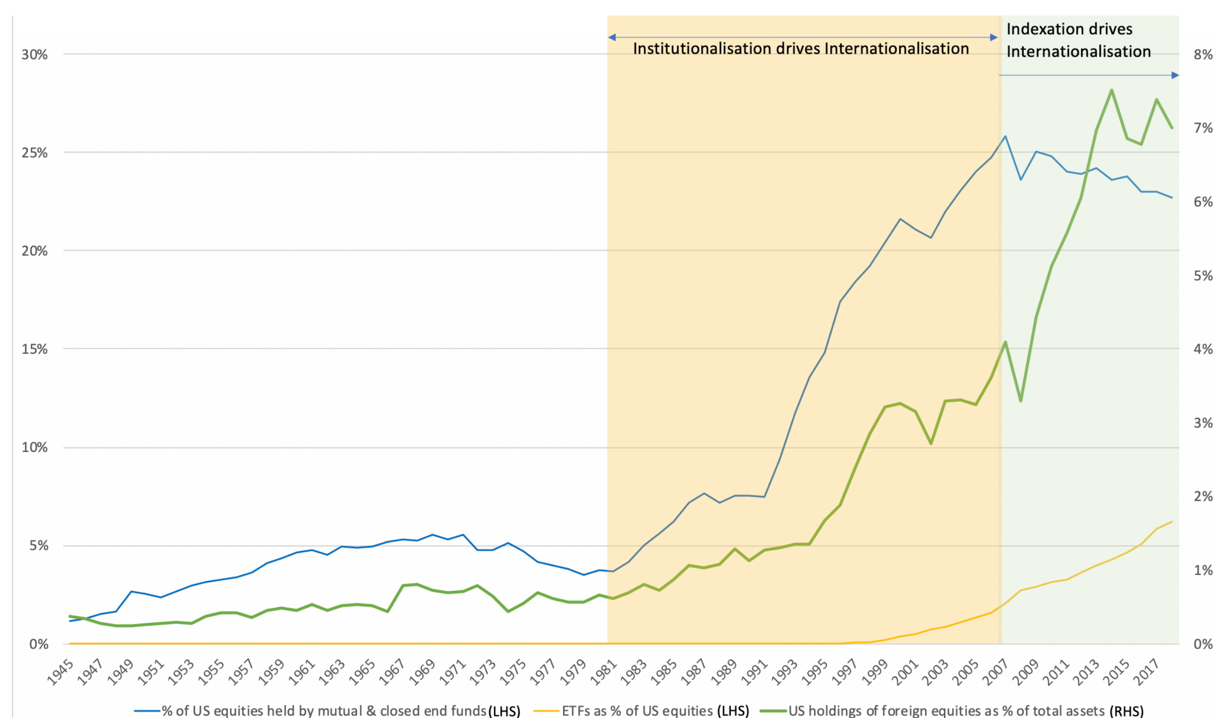
the option to pick a global, regional or country-specific index fund to capture returns from any part of the world they choose.

As of the end of the 2018, foreigners held $7.9 trillion in US equities, equating to approximately 14 percent of outstanding shares (US Treasury, 2019). Compared to this, the foreign ownership of UK and German stocks stand considerably higher. In the UK, foreign ownership reached an all-time high of 54.9 percent of the value of the UK stock market (£2.04 trillion) at the end of 2018. In Germany, foreign ownership almost equalled the UK level, standing at 53.7 percent in 2018.[114] The high levels of foreign ownership of German equities is partly explained by high cross-border ownership amongst European investors. The European Commission (2013) notes that approximately half of the foreign ownership of German equities comes from within the European Union.

The causal relationship between institutionalisation, indexation and internationalisation is shown in Figure 16. Institutionalisation is proxied by the percentage of assets invested in US mutual funds and closed-end funds (blue line, LHS), indexation is depicted by the percentage of US equities held in ETFs (orange line. LHS), and internationalisation is represented by the percentage of total US assets invested in foreign equities (green line, RHS). Figure 16 shows that internationalisation received two boosts, first from institutionalisation starting approximately in 1980 (US institutional investors allocating funds abroad), and then again from indexation, from 2007 onwards.

[114] For UK data see: https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018 and for German data: https://www.handelsblatt.com/unternehmen/industrie/dax-30-konzerne-gehoeren-mehrheitlich-auslaendern-deutsche-firmen-in-fremder-hand/2906102.html and https://www.handelsblatt.com/finanzen/maerkte/boerse-inside/aktionaersstruktur-so-stark-dominieren-auslaendische-investoren-die-dax-konzerne/21211152.html (Accessed 9 February 2020).

Figure 16: Institutionalisation, Indexation and Internationalisation from the US perspective



Source: Federal Reserve.

The developments in the UK and Germany have been similar to those in the US, with the exception that internationalisation started later. Whereas the internationalisation of US equities has been a steady development from approximately 1965 onwards, internationalisation in the UK only started in earnest in approximately 1980 and even later, in approximately 1997, in Germany (the developments in both countries will be discussed in detail below).

This chapter demonstrates that internationalisation has occurred in two dimensions. First, there is the generally acknowledged increase in the level of foreign shareholdings reported by companies. Second, internationalisation is occurring also at the level of the asset management firms themselves. Due to the economies of scale present in the asset management industry, mergers are highly accretive to corporate earnings. Mergers also provide a solution to entering markets with domestically captive distribution channels, such as in the case of Germany,

described in the previous chapter. What results are asset managers with offices and stewardship teams in multiple countries.

The first dimension of internationalisation in principle provides investors from different countries with the means to influence companies domiciled in other countries. The second dimension has contributed to the scale of individual asset managers and to the creation of global giants such as the Big Three. Together they have therefore provided the theoretical means for asset managers to influence the varieties of capitalism.

In the 2009 annual report of BlackRock, published around the time that ETFs entered the global spotlight, CEO Fink addresses both of the aforementioned dimensions of internationalisation. Firstly, he acknowledges the importance of scale and thus the need for consolidation amongst asset managers and secondly, he highlights that clients will increasingly look more widely across the globe for investment opportunities.

> "Scale has never been more important, and may well be the catalyst that drives consolidation in our highly fragmented industry. [...] I believe that clients will increasingly cast a wider net for attractive investments, and that global economic growth will depend on the growth of the global capital markets and on trade policies that facilitate the free flow of capital across borders. In short, I believe that globalization is our collective destiny" (BlackRock, 2009: 6-7).

What then are the consequences of the rise of internationalisation for the corporate governance of firms in the UK, the US and Germany? The common inference in the literature is that

internationalisation leads to financialisation, neoliberalism and thus an Americanisation of the financial system (Hansmann and Kraakman, 2001; Harmes, 1998; Streeck and Thelen, 2005; Useem, 1996). Harmes, for example argues that "institutional investors possess specific characteristics which are serving to reproduce neoliberal restructuring in both coercive and consensual ways" (1998: 92), while Useem notes that the "days of divergent governance systems are numbered" as "US investors insert their money into other national economies" (1996: 266).

Instead this chapter shows that the influence of institutional investors on national models of corporate governance is highly complex. Investors engage with companies in foreign countries to differing degrees and investors from different countries also follow substantially different policies. A diverse international policy discourse therefore persists, and this chapter documents that institutional investors from both the UK and Germany are successfully pursuing policies with divergent aims to those of US investors.

The result of this is that instead of the US functioning as the model for corporate governance and the object of possible convergence, the UK is increasingly being considered to represent the best-in-class model of corporate governance.[115] In many ways the UK model today represents a compromise between the shareholder value and stakeholder value understanding of corporate governance. Since the US and UK models of governance are increasingly at odds with one another, it also suggests that referring to an "Anglo-Saxon" model of corporate governance will become increasingly inappropriate in the future.

[115] ESG portfolio manager, UK asset manager, in-person interview, 15 April 2015.

4.2 Chapter Structure

This chapter will show that internationalisation does not equate to Americanisation of the asset management industry. This is because asset managers' influence differs between countries. Since the Big Three hold comparatively smaller voting stakes in the UK and Germany than in the US, the degree of insulation they provide to corporates in Germany and the UK is not able to provide the same governance vacuum as it does in the US. In Germany and the UK, domestic investors therefore play a comparatively larger role in corporate governance.

There is an emergent international governance discourse amongst which a governance compromise, one that focusses on shareholder value but also considers stakeholder concerns, is being conceived. The UK is considered by many to be the best-practice model of this governance compromise.[116] "Disclosure is better in the UK. [...] However, US companies still have an attitude, 'who are you, why are you talking to us, leave us alone'. [...] Germany is not high on the list for corporate governance problems".[117]

This chapter is structured as follows. The next two sections document the internationalisation of the shareholder ownership structure and of the asset management firms themselves, respectively. This is followed by a section outlining the degree to which the Big Three are involved in the governance discourse in Germany and the UK. This is then contrasted with the governance approaches of German and UK asset managers, before moving on to a section presenting the UK model of corporate governance as a compromise between the shareholder value and stakeholder value-oriented models of capitalism.

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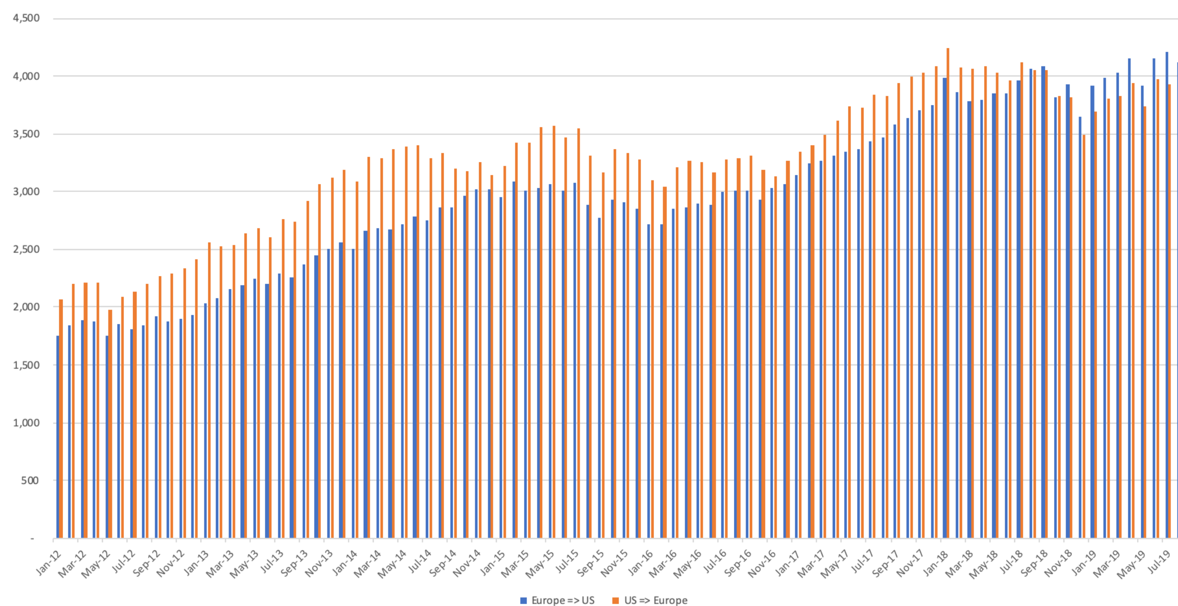
[116] Governance expert, European proxy advisor, in-person interview, 5 October 2018.
Governance expert, German asset manager, telephone interview, 9 April 2018.
Two governance expert, UK asset manager, telephone interview, 25 September 2018.

[117] ESG portfolio manager, UK asset manager, in-person interview, 15 April 2015.

4.3 Country-Level Data

There are two perspectives from which to consider internationalisation. The first is from the country level. That is to look at the extent to which shareholdings in any one country or region have come to be made up of investors from another country or region. While one may expect such equity investments to be dominated by US investments abroad, this is not in fact the case. Figure 17 below shows equity holdings by domestic US investors in orange, and European shareholdings of US domestic companies in blue. It shows that these investments have been approximately equal, with European investments in the US in fact slightly exceeding US investments in Europe throughout 2019.

Figure 17: US holdings of European equities, European holdings of US equities. Jan-12 to Aug-19

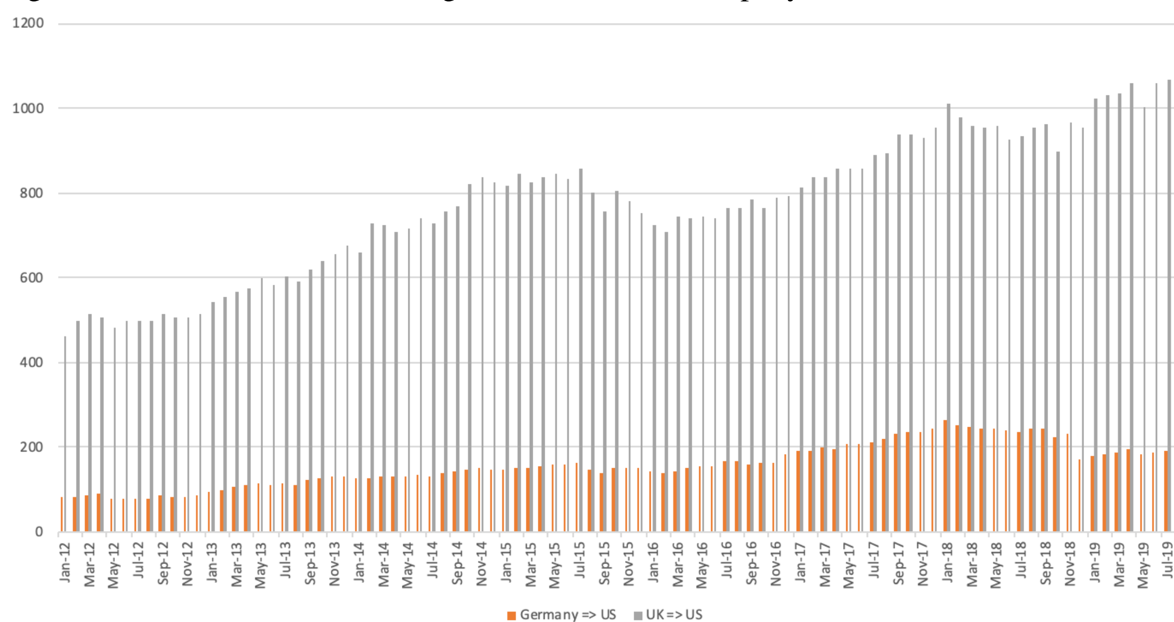


Source: Federal Reserve.

The picture looks less balanced on an individual country basis. While shareholdings between the UK and the US are similarly balanced at approximately $1.04 trillion each, the US holdings of German equities at approximately $340 billion are substantially larger than the $190 billion German holdings of US equities (bond investments are of greater importance for German

investors on the whole). The reason that the holdings between European and US countries balance out overall, is in part due to the Swiss National Bank's holding of approximately $100 billion in US equities.[118] More remarkable, the US holdings of UK equities dwarf the US holdings of German equities at a ratio of approximately three to one. This shows that the Anglo-Saxon relationship is reflected in substantial reciprocal shareholdings. Similarly, the UK holdings of US stocks are almost five and a half times the size of German holdings of US stocks (Figure 18).

Figure 18: UK and German holdings of domestic US company shares



Source: Federal Reserve

These large reciprocal shareholdings are in part a reflection of the relative size of the domestic equity markets. The UK equity market capitalisation at $4 trillion (£2.36trl) is approximately 2.4x the size of the German market capitalisation of $1.7 trillion (€1.53trl).[119] But this alone

[118] Source: https://www.swfinstitute.org/news/76039/swiss-national-bank-almost-owns-100-billion-worth-of-u-s-stocks (Accessed 1 May 2020).
[119] ECB data as of year-end 2018. Source: http://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=181.SEE.A.GB.LSE0.MKP.W.N (Accessed 22 January 2020).

does not explain the difference, as the resulting US stock holdings as a percentage of the UK and German markets are quite different. US holdings of UK equities equate to approximately 28% of the domestic market capitalisation, while US holdings of German equities equate to just 14% (US Treasury, 2019). Indeed, the Federal Reserve (2019) data shows that US holdings of other countries' domestic market capitalisation on average represents just 16%, substantially less than the 28% holding it has in the UK stock market. In emerging market economies, it is even lower at just 6% on average. While this data supports the notion of some form of Anglo-Saxon relationship, it questions the idea of an Americanisation of the world's equity markets.

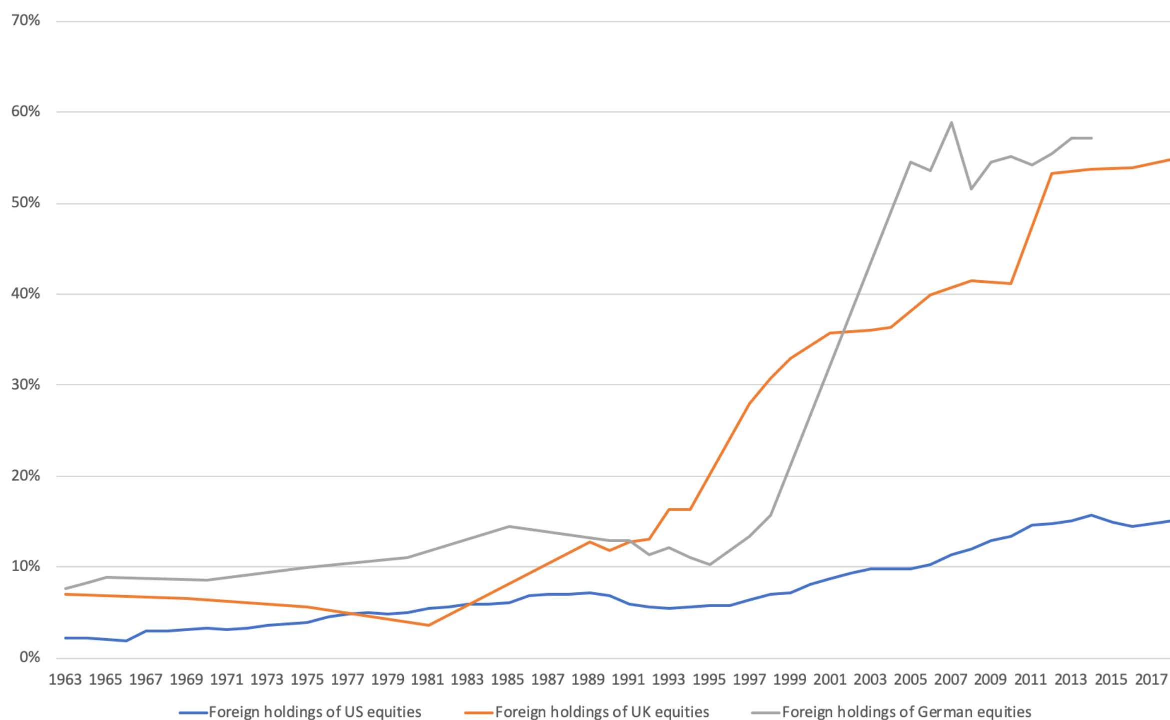
The previous chapter highlighted the convergence of ownership concentration levels in the UK, the US and Germany that has resulted from the dismantling of Deutschland AG and the rise of asset managers. The above data shows that merely looking at ownership concentration levels on its own is not enough. Additionally, looking at the domicile of investors adds a further level of understanding.

Figure 19 shows the chronological development of foreign ownership in the UK and Germany, compared to the US. It shows that while growth in the UK (orange line) started earlier (in the 1980s), Germany (grey line) saw a subsequent surge in foreign ownership to bring it back into line with the UK. In Germany foreign ownership only started in earnest in 1997. From a base of ten percent in 1997 it grew to 30 percent in 2002 and to 53 percent by 2007.[120] In the UK, for comparison, foreign ownership in 1997 already stood at 28 percent, growing to 35.9 percent

[120] See: https://www.handelsblatt.com/unternehmen/industrie/dax-30-konzerne-gehoeren-mehrheitlich-auslaendern-deutsche-firmen-in-fremder-hand/2906102.html (Accessed 19 October)

in 2002 and to 41.5 percent in 2008.[121] Foreign ownership in Germany therefore caught up with the UK in the period between 1997 and 2007.

Figure 19: Foreign ownership levels of equities in Germany, the UK and the US



Source: Federal Reserve, ONS, Bundesbank, Morck (2005).

Part of the explanation for why Germany saw greater foreign ownership growth between 1997 and 2007 is that this timeframe includes the introduction of the Euro in 1999. While not covering the introduction of the Euro, European Commission (2013) data shows that between 2001 and 2006 European investors added approximately 10 percentage points to the foreign holdings of German equities, including 5 percentage points which came from European insurance companies. Other factors that will have contributed to the rise in foreign ownership

[121] See:
https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2016
(Accessed 19 October)

during the period from 1997 to 2007 is the aforementioned acquisition of the German index fund manager Indexchange by then still UK domiciled asset manager Barclays Global Investors, as well as the dismantling of Deutschland AG and finally the dotcom-induced craze that was the Neuer Markt (the former technology segment of the Deutsche Börse, since defunct). In the years since, these high levels of foreign ownership on a national basis have even been surpassed on an individual company basis. The Handelsblatt reported in 2017 that at several blue-chip companies, including Bayer, Deutsche Börse and Adidas, foreign ownership stood "at well over 70 percent".[122]

4.4 Investor-Level Data

A second dimension of internationalisation has occurred at the level of the asset management firms themselves. Since many of the economies of scale that apply to the asset management industry domestically can also be captured internationally, the asset managers themselves expanded internationally, in part through merger and acquisitions and in part through organic growth. Despite the rapid growth of financial assets in India and China over the past decade, the share of global assets managed by US firms therefore further increased from 41.5 percent in 2007 to 53 percent in 2017 (Braun, 2019).

Economies of scale led initially to the creation of national leaders and subsequently to the creation of global giants, led by the Big Three. As already reported, BlackRock grew through a number of significant acquisitions. Consider the following two chains of mergers: In 2006 BlackRock acquired Merrill Lynch Investment Managers, which itself had previously acquired

[122] Source: https://www.handelsblatt.com/today/finance/corporate-globalization-the-daxs-foreign-invasion/23572594.html?ticket=ST-44220293-QDjAW0xitptXkrdf7YeP-ap1 Accessed 16 October 2019.

the UK asset manager Mercury Asset Management. Then in 2009 it acquired Barclays Global Investors (BGI, with approximately $1 trillion in assets under management [AuM]), which included the iShares ETF brand. Ishares, a UK asset manager, had in turn acquired the German ETF provider Indexchange from HypoVereinsbank in 2006.[123]

A list of the twenty-five largest fund managers globally compiled by IPE (2018) shows the dominance of both British and American asset managers. Of the top twenty global asset managers that make up the league table produced by IPE (2018), three are French, one is German and 16 are either UK or US based. The one German entry, DWS / Deutsche Asset Management, ranks as twentieth, while Allianz Global Investors (AGI) with €505bn in AuM comes in at rank 30. This is despite Germany having the fourth biggest economy in the world and the 19th highest GDP per capita.[124]

A second set of data looking at 2006 and 2017, illustrates that while the domiciles of the largest asset managers show only minor changes, the share of assets amongst those asset managers has changed dramatically (Watson Wyatt, 2006; Willis Towers Watson, 2018c). In 2006, asset managers domiciled in either the UK or US accounted for 53 percent of the AuM of the 25 largest asset managers globally (41% US, 12% UK). But by 2017, this proportion has increased to 75.8 percent of AuM (70.8% US, 5% UK). The assets of German asset managers within the Top 25 remained stable at approximately 8 percent. The fact that the UK has fallen behind Germany suggests that internationalisation has equated to Americanisation of institutions within the Anglo-Saxon construct, but not beyond it.

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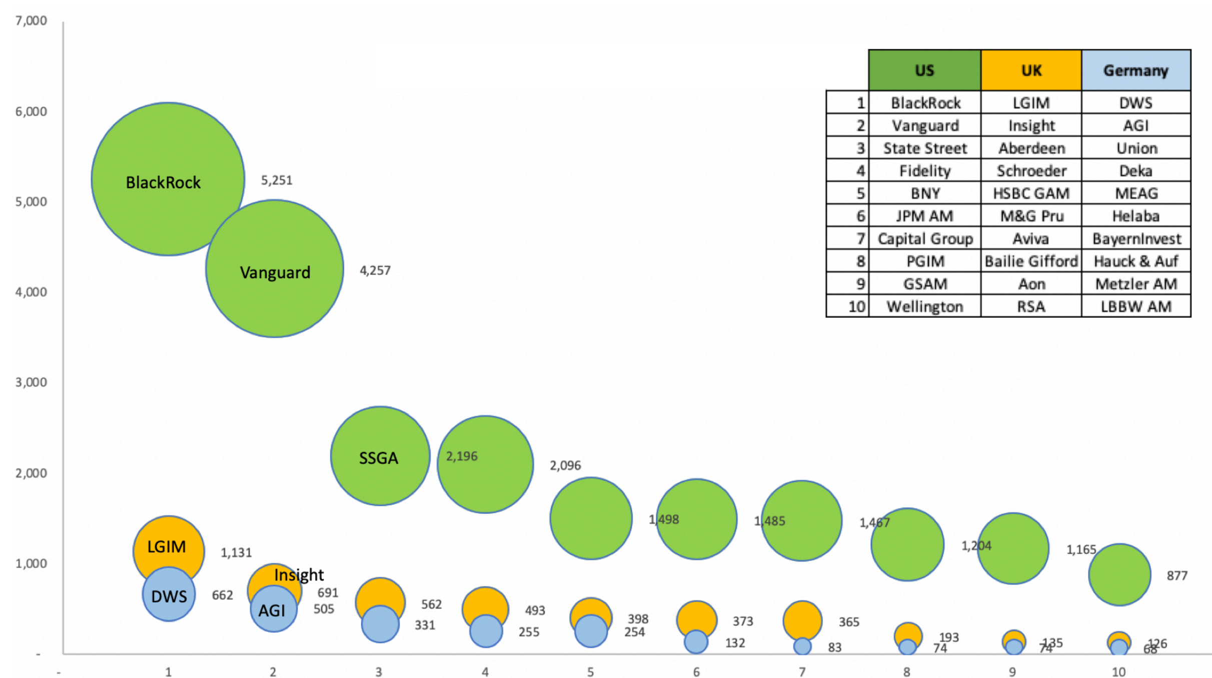
[123] For a history of BlackRock, see: https://www.blackrock.com/corporate/about-us/blackrock-history For details of Ishares' acquisition of Indexchange, see: https://www.ipe.com/analysis/analysis/bgis-ishares-buys-indexchange-in-germany-market-build-up/20231.article (Accessed 19 October)

[124] See World Economic Forum as of 2018: https://www.weforum.org/agenda/2018/04/the-worlds-biggest-economies-in-2018/ and World Bank as of 2017: https://data.worldbank.org/indicator/ny.gdp.pcap.cd?year_high_desc=true (Accessed 26 May 2019)

Figure 10 in Chapter 3 showed how the fortunes of the 100 largest asset managers has changed, highlighting that the majority of all assets had been captured by the largest asset managers. Figure 20 below further provides context to the relative size of the ten largest asset managers in each of the three countries; green bubbles representing US asset managers, orange UK asset managers and blue German asset managers. The y-axis shows the AuM in million dollars (as does the size of the bubble), the x-axis the domestic rank of the respective asset managers.

Figure 20: Ten largest asset managers by total AuM in Germany, the UK and the US.[125]



	US	UK	Germany
1	BlackRock	LGIM	DWS
2	Vanguard	Insight	AGI
3	State Street	Aberdeen	Union
4	Fidelity	Schroeder	Deka
5	BNY	HSBC GAM	MEAG
6	JPM AM	M&G Pru	Helaba
7	Capital Group	Aviva	BayernInvest
8	PGIM	Bailie Gifford	Hauck & Auf
9	GSAM	Aon	Metzler AM
10	Wellington	RSA	LBBW AM

Source: data from IPE (2019b).

While the above data support the standard view that internationalisation means Americanisation, in the remainder of this chapter I will outline a number of factors that serve to moderate convergent pressures on the VoC and help explain why governance changes to date have been limited.

[125] The second largest UK asset manager in the above list is Insight Investment. Insight is, however, a subsidiary of the US Bank of New York Mellon, and could therefore be instead listed as a US firm.

Asset managers' five dimensions of stewardship

The extent to which asset managers influence corporate governance depends on a number of overlapping factors that can be divided into five dimensions of stewardship. The first dimension is the extent to which regulators encourage institutional investors to engage in stewardship of their portfolio companies. The second is asset managers' intent to bring about change. The third is the direction of change, which can be observed by the extent to which asset managers' policy preferences seek to advance LME (shareholder) or CME (stakeholder) aspects of governance respectively. The fourth dimension is asset managers' available resources to engage with corporates. The final dimension is the size of asset managers' ownership stakes and the voting power that results from their holdings.

The interaction between these five dimensions will ultimately determine whether or not asset managers have influence and whether internationalisation can be considered to equate to Americanisation or not. Each of these dimensions will now be discussed in a dedicated section. Chapter 5 and Chapter 7, respectively, will introduce proxy advisors and corporates as two further dimensions, affecting the extent to which asset managers are able to influence corporate governance.

The regulatory dimension

The regulatory framework represents the first dimension that impacts the degree to which asset managers are able to influence corporate governance. Government regulations impact the effectiveness of the other four dimensions, as they set out the ground rules on which corporates and their shareholders are to engage. One such example was provided in the previous chapter, which highlighted that regulators in the UK and Germany set the frequency with which

company directors are to be put up for re-election, whereas in the US investors have had to fight for such rights by submitting shareholder proposals at the individual company level.

This shows that in the UK and Germany a substantial part of governance change is regulatorily driven and thus not the result of pressure by US shareholders to Americanize the domestic governance model. In the UK the government through the Financial Reporting Council (FRC) sets the rules that make up both the UK Corporate Governance Code and the UK Stewardship code.[126] These list the obligations of corporates and investors respectively. While there is a consultation process and there are advisory groups, it is the government and its civil servants that ultimately set the rules.

In Germany the Kodex is drafted by the Kodex commission, which consists of "managing and supervisory board representatives of German listed companies and their stakeholders, i.e. institutional and retail investors, academics (economics, jurisprudence), auditors and a trade union federation. The members of the Commission are appointed by the German Federal Minister of Justice and for Consumer Protection".[127] The Kodex thus represents a compromise between corporates and shareholders as well as other civil society representatives and resembles the classic CME model of coordination.

In the US, the corporate governance rules are set by the SEC, the five members of which are appointed by the US President.[128] Since there are always two members each from the Republican and the Democratic parties, the SEC and its rulemaking has a narrow political

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[126] For further details, see: https://www.frc.org.uk/directors/corporate-governance-and-stewardship (Accessed 8 February 2020).
[127] Source: https://www.dcgk.de/en/commission.html (Accessed 27 January 2020).
[128] For further details, see: https://www.sec.gov/Article/about-commissioners.html (Accessed 8 February 2020).

dimension not seen in the UK or Germany, which instead have civil servants arrange and companies and investors lead the process.

The result of this is that the policies of the UK and German regulators have moved in substantially different, almost perfectly opposing directions, from the US in recent years. For the UK, the FRC has increased demands on both institutional investors and corporates alike, with the result that shareholder rights have been increased further while considerations for social and environmental concerns have also increased substantially (FRC, 2019). In Germany, where corporate representatives are part of the Kodex commission, the changes have been less far-reaching, but developments have been in the same conceptual direction as in the UK (increasing the areas of corporate governance in which shareholders have a say and therefore potentially moving away from the CME model). In the US on the other hand, the SEC is currently (in May 2020), considering whether to make it more difficult for shareholders to submit proposals and whether to severely restrict the work of proxy advisors.[129] The following two statements illustrate the gulf that has developed between the approaches seen in the UK and the US.

For the UK, the FRC notes that companies are falling short of investors' expectations for clearer reporting on climate-related issues, with its CEO thus commenting that "[a]s societal and investor expectations evolve, alongside the regulatory environment, it is clear companies need to rapidly increase their transparency and improve their reporting to meet this demand. […] The FRC itself recognises the need to play a more active role in this space and this report

[129] Reuters has identified more than two dozen measures the SEC has taken under the Trump administration alone that "make life easier" for US corporates. Source: https://www.reuters.com/article/us-usa-sec-publiccompanies/how-the-sec-is-making-life-easier-for-corporate-america-idUSKBN1XH2V7 (Accessed 7 March 2020).

is an important step in recognising climate change as a priority and building on the FRC's activities" (FRC, 2019: 1).

Compare this to the extraordinary language of SEC commissioner Hester Peirce who criticised proxy advisors, investment banks and ESG ratings agencies for "labelling based on incomplete information, public shaming, and shunning wrapped in moral rhetoric preached with cold-hearted, self-righteous oblivion to the consequences, which ultimately fall on real people. […] there is a group of people who take the lead in instigating their fellow citizens into a frenzy of moral rectitude. Once worked up, however, the crowd takes matters into its own brutish hands and finds many ways to exact penalties from the identified wrongdoers" (Peirce, 2019).

European governments' actions, particularly those of the UK government, are therefore two-pronged: on the one hand shareholder rights are being improved, which is very LME, but on the other hand, there is an expectation that shareholders are to be longer-term stewards of the wider economy, which is very CME. This is why the influence of asset manager capitalism on the varieties of capitalism is complex. Implicitly the assumption in the comparative political economy literature is that an increase in shareholder power represents a move towards the LME model. However, due to a mixture of government legislation and public pressure, European asset managers are shown to use their increased power in part to give a greater voice to other stakeholders. The fact that shareholders in Germany or the UK have gained additional levers of control, such as say-on-pay votes, should therefore not be interpreted to confirm an Americanisation of the UK and German varieties of capitalism.

Interviewees explained that the result of the US regulator's approach is that "most of the US resolutions are asking for the sort of governance reforms that have been established in Europe

through other means such as the Governance Code".[130] This is why "the higher level of rejection [of management proposals] in the US is a sign of the [worse] quality of corporate governance there".[131] Interviewees also highlighted the importance of better board access as it enables investors to take a less prescriptive approach on other governance issues. "In the UK access to the board enables a subtler approach to engagement".[132] The result of this is that "corporates in the UK do not take personal offence when you vote against them, this used to be the case".[133]

In Germany, on the other hand, interviewees noted that both sides were still learning how to adapt to the new expectations for joint-stewardship and that resources were still in the process of being allocated.[134] "The challenge is that German managers will turn up with lawyers, their general counsel, to a governance meeting. But many governance discussions are not well suited for formal discussions. […] Issues are often not black or white but grey".[135] There is therefore "much more to do outside the UK. Engagement in the UK is mature, far more investors do it, there are more opportunities to engage, there is good board access in the UK, down to the individual board members".[136]

"The UK code often has a ripple effect across the market […] What shows up in the UK today will often be in other markets in the next five years".[137] For example, "lots of items can be voted on in the UK" already today, "in Europe this will likely also change with the introduction

[130] Executive, proxy advisor, email exchange, 1st of April 2014.
[131] Corporate Governance Analyst, German asset manager, telephone interview, 9 of April 2018.
[132] Ibid.
[133] Corporate governance analyst, UK asset manager, in-person interview, 15th of April 2015.
[134] Investor relations, German company, telephone interview, 16 February 2018.
Investor relations, German company, telephone interview, 8 June 2018.
[135] Corporate Governance Analyst, German asset manager, telephone interview, 9 of April 2018.
[136] Two corporate governance experts, UK Asset Manager, Telephone Interview, 25th of September 2018.
[137] Rakhi Kumar, head of State Street Global Advisor's asset stewardship team, quoted in the Financial Times, "State Street tells boards to focus on corporate culture". 15 January 2019.

of the SRD II".[138] The Shareholder Rights Directive (SRD) of the European Union, initially introduced in 2007 (SRD I), seeks to improve shareholder rights. This was followed in 2017 by the SRD II, which "aims at encouraging long-term engagement of EU listed companies' shareholders" (Deloitte, 2019: 1) in a similar way to the UK Corporate Governance Code and the UK Stewardship Code. It targets companies, proxy advisors and institutional investors and seeks to improve the general voting process, particularly with regards to directors' remuneration. This therefore is evidence that both the UK and the European Union are pursuing the aforementioned two-pronged approach to governance reform, increasing both shareholder power, while simultaneously instructing how that additional power is to be employed.

As Chapter 7 will show, the approach that governments take on regulation is of considerable relevance for how corporates react to shareholder pressures. In the US companies will often turn to the SEC to have shareholder proposals thrown out before they can even be put to a shareholder vote.[139] In Germany and the UK on the other hand, governments have made it clear to varying degrees that they expect shareholders and managers to jointly steward the firm. As regards internationalisation, regulation can therefore both advance and inhibit the influence it has over corporate governance in any one country.

The intent to bring about change

In general, the interviews showed that rather than seeking to enforce their vision of governance on the world, asset managers sought to take a measured and balanced approach, recognising

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[138] Two corporate governance experts, UK Asset Manager, Telephone Interview, 25th of September 2018.
[139] Rule 14a-8(i)(7) of the Securities Exchange Act of 1934, the "ordinary business" exception, permits a company to exclude a proposal that "deals with a matter relating to the company's ordinary business operations". For further details see: https://www.sec.gov/corpfin/staff-legal-bulletin-14k-shareholder-proposals (Accessed 10 March 2020).

both local practices as well as their own policy preferences. In fact, there was only one asset management firm (based in Germany) who claimed to follow a single global best-practice approach to corporate governance.[140] None of the big US firms did so. Even that German firm qualified this statement by remarking that their policy is "more or less global", but that it takes into account local differentiation if there are legal differences or if ownership and control structures are different, such as in Asia.[141]

Nevertheless, there was still a noted difference in UK, German and US investors' approach to stewardship. Starting with US investors, the previous chapter already discussed the fact that the Big Three do not file shareholder proposals. Vanguard further underlines its hands-off approach to governance in its policy documents by stating that "We don't: Chase trendy fads or name and shame companies in the media" and "We don't: Offer opinions on company strategy, seek to influence it" (2019c: 9) as well as "We don't: Nominate directors or seek board seats, submit shareholder proposals" (2019c: 11). Comparing these statements to the policy options available to institutional investors (Figure 1, Page 4), suggests that Vanguard is ruling out engaging in all but the gentlest forms of stewardship.

Table 7: Percentage of proposals voted with management

	BlackRock		Vanguard		BlackRock & Vanguard Combined		
	US	Europe	US	Europe	US	Europe	Difference (US-Europe)
2019	93%	91%	92%	93%	93%	92%	0.5%
2018	95%	90%	93%	93%	94%	91%	2.6%
2017	91%	91%	95%	95%	93%	93%	0.0%
Average	93.0%	90.6%	93%	94%	93.1%	92.1%	1.0%

Source: BlackRock, Vanguard, annual stewardship reports

[140] Corporate Governance Analyst, German Asset Manager, Telephone Interview, 20th of March 2018.
[141] Corporate Governance Analyst, German Asset Manager, Telephone Interview, 9th of April 2018. Different governance expert at same asset manager as in footnote 13.

The results of this approach are illustrated in Table 7, which shows the voting decisions for BlackRock and Vanguard by region (State Street does not report region-level data). What becomes apparent from the above data is that BlackRock and Vanguard provide similarly very high levels of support to management in Europe (92.1 percent) as in the US (93.1 percent). This data is for all shareholder proposals, so includes routine proposals on director elections. But even if we break this data down and look only at proposals submitted by shareholders, regional differences are hard to make out. Vanguard, for example, supported an average of 4.6 percent of shareholder proposals on environmental and social issues submitted at US companies in the three years from 2017-2019, compared to 1.4 percent at European companies.

The stewardship activities of the Big Three in Europe therefore do not notably differ from their US stewardship activities discussed in the previous chapter. As in the US, there is no observable intent to bring about change, and the proxy voting and stewardship activities of the Big Three therefore provide European corporates with a degree of insulation against the policies advanced by other shareholders. The level of overall insulation is, however, diminished by the fact that the Big Three on average hold smaller voting blocs in European companies. The internationalisation of the asset management industry from this perspective therefore does not result in an Americanisation of the corporate governance models of the UK and Germany.

Amongst the US active investor base, particularly from pension funds, there was a noticeably more engaged approach to stewardship (than from the Big Three). Whereas the European approach tends to focus on individual companies, two state pension funds described how they sought to select thematic priorities, such as better access to company boards, and to work with asset managers to target a large number of corporates simultaneously (with one coordinated

campaign).[142] One such example is provided by the New York state pension funds, which under the "Boardroom Accountability Project", of which there have now been three iterations, has sought to tackle a number of issues.[143] In the "Project 1.0" the funds submitted shareholder proposals at 75 companies at once in the fall of 2014 in order to demand "proxy access" bylaws. These bylaws provide shareholders with the right to nominate a limited number of company directors.

Launched in September 2017, "Project 2.0" targeted 151 companies simultaneously, this time focussing on board diversity and climate competence. In the third campaign, launched in October 2019, 56 letters were sent to US companies demanding further board diversity improvements. However, all companies targeted in the three projects were US companies, meaning that their relevance for internationalisation and Americanisation of European corporate governance is limited. Instead these US investors' relevance is in the US corporate governance context, where their policy preferences often align with those of European investors and proxy advisors.

Moving to Europe, one major difference between German and UK index funds and their US peers is that in Europe the majority of index funds are provided by asset managers that operate much larger active platforms. Their active funds should ensure that the European asset managers are incentivised to engage with their portfolio companies as they retain the ability to generate active outperformance with such engagement. The more frequent contacts that come with being an active asset manager, from management roadshows, conference visits and analyst

[142] Governance expert, US pension fund, in-person interview, 24 April 2015.
Governance expert, US pension fund, telephone interview, 24 July 2019.
[143] For a history of the three Boardroom Accountability Projects to date, see: https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview/ (Accessed 10 March 2020).

days, should also ensure that these institutions as a whole have a greater awareness of their portfolio companies' activities.

In the UK the largest asset manager, Legal & General Investment Management (LGIM) has £1.1 trillion in AuM, of which £390 billion (35 percent) are managed in index strategies.[144] Many of these index assets, however, are from pension schemes that are coming to an end, leading to outflows from LGIM's index business. Legal and General (2019) explains that "[f]or the past several years we have had consistent net outflows from our UK DB index funds and we expect this trend to continue as many clients transition into LDI strategies where we are well positioned to retain the assets'.[145] As regard new retail index funds, LGIM only entered the ETF market with the acquisition of ETF Securities' platform in November 2017, and only launched a list of core products one year later in November 2018.[146] As of 30 June 2019, LGIM's ETF platform managed a mere £2.4 billion in AuM, equating to just 0.2 percent of its overall AuM.

DWS (Deutsche Bank's asset manager, and the owner of the Xtracker ETF brand) is both Germany's largest asset manager and ETF provider and the second largest ETF provider in Europe after BlackRock's iShares.[147] But even for the biggest European domiciled provider of index funds, the index equity assets (at 13 percent) are only equal to those of active equity assets (at 12 percent). Those figures look only at pure equity mandates and exclude a further 17 percent of AuM that DWS manages in active multi-asset mandates (the balance of DWS' assets is in fixed income funds). The second largest asset managers in the UK and Germany,

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[144] https://www.lgim.com/uk/ad/capabilities/index/ (Accessed 1 March 2020).
[145] LDI refers to a liability-driven approach to investment, in which such pension plans are likely to allocate a higher proportion of assets to bonds as they approach maturity.
[146] https://www.ft.com/content/7ad4db3e-e610-3a23-91ea-a4ced6c5b84a (Accessed 1 March 2020).
[147] https://www.statista.com/statistics/274218/leading-players-on-the-etf-market-in-europe/ (Accessed 1 March 2020).

Insight and AGI respectively, do not have any ETF offerings of their own. AGI's entire branding is centred around the slogan "Active is: Allianz Global Investors", and the company reports 0 percent passive equity assets in the UN PRI database.[148] Active equity assets therefore continue to dominate the European landscape.

Unlike the Big Three, many UK and German index investors (who mostly are the same as active investors) are seeking to bring change by adopting a measured approach to engagement in order to achieve results, meaning that any pressure to convergence will be moderate and only show up over the long term: "Governance is very local; it is rooted in culture and has a historical context. In order to be relevant, you need to understand this. It is a question of how you bring effective change. If you are highly principled and have preconceptions of how things should be done, you might not be able to bring change".[149]

A macro analysis of the global proxy voting behaviour of the three largest US, UK and German asset managers reveals that the largest German investors on average voted 73.3 percent of all proposals in favour of management, compared to UK investors on 86.4 percent, and US investors on 90.0 percent.[150] This already shows that the three largest German and UK investors are on average more critical than the Big Three. The next section will zoom in on this macro analysis to show that the contrast between the voting behaviour of UK and German investors compared to US investors is much more distinctive when considering only environmental, social and governance (ESG) proposals submitted by shareholders.

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[148] https://uk.allianzgi.com/en-gb/adviser/our-firm (Accessed 1 March 2020).
For the UN PRI reports, see: https://reporting.unpri.org/surveys/PRI-reporting-framework-2019/F2924091-B95F-4DD6-8812-15B224A98117/6c78c45b1e874fbaa7011f6a3bae511e/html/2/?lang=en&a=1 (Accessed 1 March 2020).
[149] Corporate Governance Analyst, UK fund management company, telephone interview, 25 September 2018.
[150] Data from 2019 UN PRI Transparency Reports. Available at: https://www.unpri.org/signatories/transparency-reports-2019/4506.article (Accessed 6 March 2020).

Finally, an issue that is becoming of increasing relevance and may soon change the behaviour of the Big Three is the concept of social license to operate. Asset managers, like all companies, are required to maintain a social license to operate (Morrison, 2014; Gjølberg, 2009; Porter and Kramer, 2006; Gunningham et al., 2006; Post et al., 2002). In a democratic capitalist society, failure to do so may result in consumer boycotts, worker strikes and ultimately in calls for stricter regulation. In today's connected world, consumers and activists are better informed than ever before. As asset management firms have grown in size, they have become household names. Concurrently society's understanding of their business model, its profitability, and its latent power has expanded.

The end result is that society's expectations of asset managers continues to grow, increasingly seeing their social license to operate challenged. Evidence of this can already be seen with activists protesting at the AGM of BlackRock, protesting outside BlackRock's office, and in one instance even occupying and vandalising the Paris office of BlackRock.[151] Activists hope that this increased pressure on asset managers to back up their words (in the form of CEO letters) with actions (in the form of proxy voting) may result in a more critical consideration of shareholder proposals in the future. They are seeking to "stop the money pipeline" by which the financial sector is "funding, insuring, and investing in the climate crisis".[152]

The direction of influence

One of the biggest differences to become apparent between engagement practices of US asset managers when compared to UK and German asset managers is the relevance attributed to

[151] For further details, see: https://www.ft.com/content/2a27f446-4f15-11ea-95a0-43d18ec715f5 (Accessed 13 April 2020).
[152] For further information, see: https://stopthemoneypipeline.com/ (Accessed 9 May 2020).

sustainability (often framed as ESG; Environmental, Social and Governance issues) when engaging in both the US and Europe. Data presented in this chapter will highlight that the Big Three provide little support for shareholder proposals and instead mostly support corporate management, whereas European investors support a far greater proportion of such shareholder proposals. Interviews showed that the reason for this is that European investors take a substantially more "integrated" approach to ESG issues.

My interview questions did not specifically target sustainability issues. Instead they focussed on the nature of investor engagement with corporates, how this differed across countries, and how it had changed over the years. Yet repeatedly the discussions with both investors and corporates turned towards sustainability. In this regard, both investors and corporates noted that sustainability plays a much greater role in Europe.[153] The data presented in this chapter is of relevance for the varieties of capitalism discussion because it suggests that European investors are the agents of change within asset manager capitalism and that, therefore, the rise of the asset management sector cannot be equated to an Americanisation of international governance models.

This section will document significant differences in the voting behaviour of the biggest German and UK domiciled investors when compared to the largest US investor. The large UK and German asset managers are far more likely to support shareholder proposals concerning environmental and social issues than their US peers. The argument that will be made is that because such issues have been traditionally considered to be stakeholder concerns, they are

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[153] Chief Financial Officer, Head of Human Resources and Head of Investor Relations, US company, telephone interview, 23rd of April 2018.
Corporate governance expert, UK asset manager, telephone interview, 12th of June 2018.
Investor relations, US Company, telephone interview, 3rd of July 2018.

advancing aspect of corporate governance more commonly associated with the CME model than LME models. However, it does have to be noted that traditional conceptions of CME models do not engage with environmental issues. The environment is traditionally not considered to be a stakeholder (Phillips and Reichart, 2000) and it is therefore necessary to illustrate the relevance of ESG shareholder proposals for the varieties of capitalism.

Environmental as well as social shareholder proposals are relevant indicators for the varieties of capitalism as they provide insights into the extent to which corporations, as well as their shareholders, pursue a strategy focussed on shareholder value maximisation versus one that takes a broader account that also incorporates negative externalities such as pollution. As regards corporate managers, a greater consideration of environmental considerations implies a management style that comprises a greater degree of cooperation. Also, taking account of the environment typically entails giving greater weight to the concerns of employees and the local community. From the perspective of the shareholder, the fact that many environmental issues, particularly global warming, have material financial consequences mostly in the long-term, suggests that asset managers' support for such proposals provides an indication for the extent of their investment horizons. Longer investment horizons and greater patience typically being associated with CME models.

Patience by itself must not, however, always be positive. If it merely serves to isolate corporate managers, as many of the Big Three voting decisions to date have done, corporate investment horizons will not necessarily be extended. Therefore, for index investors' implicitly infinite investment horizon to translate into longer investee company investment horizons, governments must assist in creating the necessary institutions. The most fundamental of these is fostering an interpretation of fiduciary duty that challenges asset managers to conceive of

their role as one of universal owners and "stewards of the commons" (Serafeim, 2018). Doing this will prompt asset managers to ensure that their more patient provision of funds is matched by corresponding changes to business strategy. Regarded from the perspective of the varieties of capitalism, this adjustment to fiduciary duty supports the continued functioning of complementarities between corporate governance and other spheres such as employee relations continue to exist.

A report by the shareholder activism NGO As You Sow questions whether fund managers are "asleep at the wheel" and notes that "[t]he largest fund managers – particularly BlackRock [...] opt to vote against only a very few of the CEO pay packages, and their votes are hard to understand" (2020: 4). The end of the report lists asset managers by the level of opposition to the Top-100 most overpaid CEOs and shows that Aberdeen Standard Life opposed 81 percent of these, LGIM 65 percent, DWS 34 percent and AGI 93 percent. Compared to the largest UK and German investors, the Big Three have strikingly lower levels of opposition, of just 8 percent from BlackRock, 10 percent from Vanguard and 15 percent from State Street.

Table 8: Largest Asset Managers and their voting behaviour on shareholder proposals

	Assets under management (USD millions) Dec 31, 2018	Percent votes in favor of say on pay votes	Percent votes in favor of climate-critical resolutions
Legal & General Investment Management	$1,296,007	73.0%	95.0%
DWS	$758,548	85.0%	95.0%
Standard Life Aberdeen	$644,590	36.0%	56.0%
Average Top-3 UK & Germany		64.7%	82.0%
BlackRock	$6,015,521	100.0%	12.0%
Vanguard	$4,876,840	100.0%	10.0%
State Street	$2,516,565	96.0%	27.0%
Average Top-3 US		98.7%	16.3%

Source: Majority Action (2019).

A second report shows that UK and German investors' opposition to corporate interests extends beyond CEO pay to include environmental concerns. Table 8 above documents the striking difference between the three largest asset managers in the UK and Germany (average support

of 82 percent of climate-critical resolutions) and the three largest US asset managers (backing on average just 16.3 percent). The report on climate action by the non-profit Majority Action (2019) notes that "across all 41 resolutions [at US companies], PIMCO, BNP Paribas, DWS Group, and Legal & General most consistently voted in favor of these resolutions, voting in support more than 95% of the time. By contrast, Vanguard, BlackRock, J.P. Morgan and Prudential[154] demonstrated the lowest level of support for these resolutions, voting for them less than 15% of the time" (2019: 17). The four institutions with the greatest support for climate proposals are all European-owned, while the bottom four are all US owned.[155]

A third, and final, example underscoring the different approaches of US and European investors is provided by the March 2020 study conducted by the NGO ShareAction. The report (ShareAction, 2020) assesses the responsible investment approaches of the world's 75 largest asset managers and analyses their performance on stewardship, transparency and governance. The ratings scale ranges from AAA (which no asset manager achieved) to E.[156] State Street and BlackRock were each rated D with Vanguard receiving an E rating. Only five asset managers achieved an A rating, all were from Europe. Dividing the 75 asset managers by region, shows that European asset managers on average received a rating of CCC compared to US investors three notches lower on D. On an asset-weighted basis the difference is even larger, with European asset managers receive an average B rating, while US investors receive an average rating four notches lower at D.

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[154] Prudential Financial Inc. is a US financial services firm, which is not related to the British insurer Prudential PLC.

[155] I use the term owned rather than domiciled due to the inclusion of Pimco in this list. Pimco is majority US based but owned by the German insurer Allianz.

[156] The ratings scale is as follows: AAA, AA, A, BBB, BB, B, CCC, CC, C, D, E.

As the above examples on environmental shareholder proposals (Majority Action, 2019), executive pay (As You Sow, 2020) and overall ESG stewardship (ShareAction, 2020) demonstrate, European investors are substantially more supportive of social and environmental shareholder proposals and more critical of management pay than the Big Three. Because some of the issues supported by UK and German investors have been traditionally considered to be stakeholder concerns, they are advancing aspect of corporate governance more commonly associated with the CME model. Since UK and German investors represent comparatively larger voting blocs in their respective domestic markets, their stewardship activities are ensuring that the rise of the asset management sector has to date not resulted in an Americanisation of corporate governance.

Corporates repeatedly noted the distinction between the attitudes of European and US investors towards issues of sustainability, remarking that it was a "European thing" and that it was "harder to sell" certain governance components such as a combined role for the CEO and Chairman to European investors.[157] A large US corporate noted a new focus in recent years on diversity, the environment and expense disclosure, "here it's definitively more the European investors, especially on environmental issues".[158] A UK asset manager explained "we try to keep on the pressure, not just on emissions, but broader on sustainable business models more generally".[159]

Asset managers could therefore exhibit some of the same national variations as reported between banks in the varieties of capitalism framework. One US corporate summed up the

[157] Investor relations, US Company, telephone interview, 3rd of July 2018.
[158] Chief Financial Officer, Head of Human Resources and Head of Investor Relations, US company, telephone interview, 23rd of April 2018.
[159] Corporate governance analyst, UK asset manager, telephone interview, 25 September 2018.

difference between investors as follows: "In New York you get asked about the prospects for the next 90 minutes, maybe the next 90 days. In London its perhaps the next year, in continental Europe it's the next 5 years".[160]

The resource levels and the focus on domestic stewardship

Chapter 3 highlighted the enormous resource and time constraints associated with voting and engaging with the large modern-day portfolios of most asset managers. Asset managers have recently started responding to this challenge by expanding their stewardship teams. As a result, the average headcount of index funds' stewardship teams increased from just 7 in 2014 to 18 in 2018 (Willis Towers Watson, 2019). Unfortunately, there is no data on the historical regional split of headcounts, but Vanguard only established its European stewardship team in London in 2018 and State Street only created the role of Head of EMEA for Asset Stewardship in 2017.[161] To put this into perspective, this means that much of the European governance infrastructure of the Big Three has only been established after I began this PhD.

BlackRock, the only one of the Big Three that reports on London-based headcount, explains that "all companies listed in Europe, the Middle East and Africa, are voted by the team in London, regardless of where the portfolio manager is based or the client funds originated" (2019g: 12). As of 2019, BlackRock's London stewardship team consists of 11 people, up from 10 in 2018. That team of 11 therefore voted on 46,598 proposals at 3,347 company meetings and held approximately 550 engagement meetings during 2019 (BlackRock, 2019a). An online

[160] Corporate secretary, head of investor relations, US company, telephone interview, 22nd of February 2018.
[161] See https://www.fnlondon.com/articles/vanguard-opens-london-office-20081110 and https://www.investmentweek.co.uk/investment-week/news/3026880/vanguard-hires-european-investment-stewardship-head and https://newsroom.statestreet.com/press-release/corporate/state-street-global-advisors-grows-esg-and-corporate-governance-team-globall (Accessed 10 March 2020)

presentation by State Street from 2018 lists a team of 10 governance staff globally, of which just 2 appear to be based in London.[162] Investor relations at a large German corporate "cannot remember at all to ever have received any queries from the US". She did, however, qualify this statement by adding that BlackRock and Vanguard have teams in London and other US investors have representatives in Frankfurt and Paris.[163]

To handle the workload with this relatively small team, State Street's employs a proprietary model to alert it to companies that are falling behind. This approach focusses on identifying companies that fail to comply with regional codes of best practice. This thus gives regional best-practice standards, developed with input from domestic as well as international investors, an important role in deciding which companies State Street engages with. "In order to monitor compliance with these various governance codes, we have developed principles-based compliance screens for our key markets in the US, UK, Australia and Europe. These screens enable us to proactively monitor compliance with the appropriate market governance codes and to address any concerns with governance practices" (State Street, 2019: 59). The reference to regional governance codes thus contributes to mitigating the potential for index funds such as State Street to advance the Americanisation of international corporate governance regimes.

The geographical distribution of asset managers' assets plays a significant role in determining the degree to which asset managers will engage. While BlackRock has a similarly commanding market share in Europe and the US, the previous chapter has shown that both Vanguard and State Street have considerably smaller holdings in Europe than in the US. The result of this is, for example, that Vanguard reported that 86 percent of its engagements were with US based

[162] Source: https://19of32x2yl33s8o4xza0gf14-wpengine.netdna-ssl.com/wp-content/uploads/2019-02-13-RM-ELECTRONIC-FOLDER-1.pdf (Accessed 28 February 2020).
[163] Investor relations, German company, telephone interview, 20th of June 2018.

companies, despite "only" 76 percent of their assets being invested there (Vanguard, 2018). On an asset-weighted basis Vanguard engaged with 67 percent of their assets in the US but only with 47 percent of their assets in Europe (Vanguard, 2019b). State Street (2019) reports that in 2018 US domiciled companies represented 65 percent of their engagement efforts, while UK companies represented 8 percent, and Europe (ex. UK) a further 13 percent.

Despite British and German investors' greater desire to bring about change and their greater degree of policy divergence, they too are faced with resource constraints. Due to their relatively smaller size, these investors have lower absolute budgets, though the relatively greater importance of active assets (with its higher fees) does help to offset some of the cost pressure. Table 9 below shows the average headcount at some of the largest asset managers in each category. This table shows the relative size of the largest stewardship teams in the US (24 people) and UK (19) when compared to those at German asset managers (10). Size here definitively plays a role, with the largest German asset manager DWS being approximately half the size as the largest UK asset manager LGIM (in terms of AuM).

Table 9: Stewardship headcounts by investor type and location

	Type	Stewardship Headcount	vs. Average
BlackRock	US Index	47	28
Vanguard	US Index	35	16
State Street	US Index	12	-7
Fidelity	US Active	12	-7
Capital Group	US Active	18	-1
CalPERS	US Pension Fund	29	10
CalSTRS	US Pension Fund	12	-7
Hermes EOS	UK Advisory	27	8
Schroders	UK Active	12	-7
Legal & General Investment Management	UK Active	16	-3
Aberdeen Standard Life	UK Active	21	2
DWS	German Active	6	-13
Union Investment	German Active	14	-5
AGI	German Active	9	-10
	Average Headcount	19	

Source: Interviews, company websites, Financial Times.[164]

[164] The UK investment manager Hermes is a special case. Hermes, which has its roots in the Post Office and British Telecom pension schemes, has become both an asset manager for third-party assets as well as a stewardship

These staffing levels suggest, for example, that while DWS' proxy voting decisions are challenging US corporates, they are likely to be unable to support these with substantial behind the scenes engagement in the US. This impression is confirmed by an examination of DWS (2019) engagement report, which shows that DWS attend the AGMs of 16 investee companies to make speeches, of these 14 were at German companies (and one each in the Netherlands and Italy). Speeches are one of the most intense engagement levels, and one particularly favoured by German asset managers. Union Investment made 15 such AGM speeches at German companies and explained that they prefer such open engagements to "backroom conversations" which are "not very transparent".[165]

DWS (2019) furthermore reports that it engaged with only 35 companies (representing 26 percent of total engagements) in the US compared to 61 (46 percent) in Germany and 7 in the UK. Similar engagement biases are also visible at other US, German and UK asset managers. The German asset manager AGI (2019) reported that 17% of its engagements were with German companies, 24 percent with UK (the team is primarily located in London), and only 17 percent with US companies. LGIM (2019) similarly reports that 48% of the companies they met with were based in the UK.

Asked whether it is a fair assumption to say that the further away from home a holding is the less likely they are to engage, a German asset manager replied that "the holdings in Germany

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advisor for external mandates through its Hermes Equity Ownership Services (EOS). In the case of Hermes EOS, the assets sit with other asset managers but investors, particularly pension funds, have given the mandate to engage to Hermes EOS. Hermes (2019) reports £33.5 billion in AuM and £389.5 billion in assets under stewardship, meaning that its stewardship services represent more than ten times as many assets as its asset manager. This makes Hermes unique, because it is managing the voice of a large number (637) of clients from 28 countries, collectively representing 29 million current and future pensioners and savers (Hermes, 2019). This is why Hermes is listed in this table as "UK Advisory"

[165] Interview with Ingo Speich, former head of corporate governance at Union Investment. Available at: https://www.ecoreporter.de/artikel/aktives-engagement-bei-union-investment-hinterzimmer-gespraeche-sind-wenig-transparent-18-09-2017/ (Accessed 1 March 2020).

are more significant when considered as a percentage of the companies in question. Besides this the level of engagement is determined by where our people sit. The ESG team predominantly sits in Europe. Also, the fundamental active PMs [portfolio managers] sit mainly in Europe, so that is why they will engage more there".[166]

Investors' domestic focus helps to explain why a German company that has had substantial environmental and governance issues in recent years reported that it had no interactions with foreign investors on corporate governance issues, only with domestic investors and associations of retail investors.[167] With resource capacities and allocation considerations limiting many asset managers' foreign stewardship activities, there was some evidence that asset managers sought to learn from one another across markets, with one asset manager reporting that they would reach out to US investors to get their insights on new US policy proposals, French investors on French policy changes, etc.[168]

Overall, my interviews supported the above engagement data, showing that engagement beyond proxy voting is to date primarily (but not exclusively) a domestic exercise, focused on the largest companies in each country. This is because domestic companies typically represent investors' largest holdings, both in terms of the percentage of the funds' assets and in percentage of the companies' outstanding shares. These engagement considerations are driven in part by a resource constraint on behalf of the asset manager as well as financial considerations (costs to the fund versus benefit of voting). Investors therefore reported introducing minimum voting thresholds, such as 0.3 percent of the shares outstanding of any

[166] Corporate Governance Analyst, German Asset Manager, Telephone Interview, 9th of April 2018.
[167] Investor relations, German company, telephone interview, 20th of June 2018.
[168] Corporate Governance Analyst, German Asset Manager, Telephone Interview, 9th of April 2018.

company, that had to be met before exercising their voting rights.[169] Such thresholds mean that in many cases German and UK investors will not even vote at US companies.[170] The point to come out of this is that investors are generally targeting their engagement where they think they can have an impact, rather than necessarily where they have the greatest financial interest.

As will be further elaborated on in Chapter 7, corporates reported engagement primarily from their domestic investors and only rarely from international shareholders. Confrontations between investors and their domestic corporations are most likely to gain the attention of the investors' domestic press and thus their local customer base.[171] Furthermore, in countries such as the UK, where the government has enlisted asset managers to steward their portfolio companies, there may be litigation risk if asset managers fail to give their portfolio companies sufficient attention. Since the UK government will be primarily concerned with the conduct of UK companies, it is unsurprising that UK investors should focus their attention on domestic companies.[172]

The Voting Power

The final dimension of asset managers' stewardship efforts is the size of their voting blocs in their respective portfolio companies. Voting blocs in turn are, of course, a function of the size of an asset manager's shareholdings, which are also a crucial determinant of an asset manager's

[169] Senior portfolio manager, German asset manager, telephone interview, 21 March 2018.
[170] Ibid.
[171] This finding is in line with Dimson et al. (2018) who note that investors are more likely to lead coordinated engagement when the firms are domestic and that the success rates are also elevated when the lead investor is domestic.
[172] See the following link for a summary of the UK Parliament's questioning of the shareholders of Carillion, following the UK service company's collapse: https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/carillion-letters-17-19/ (Accessed 19 October)

engagement budget and thus the size of its stewardship team. Table 10 below presents approximations of the voting power (percentage of shares held) of different types of investors in the US, the UK and Germany. The table shows how domestic investors in each of the three countries continue to represent the largest voting bloc. The purpose of this section is to highlight the degree to which proxy voting by foreign investors may enable them to play a role in other countries' domestic governance discourses as well as to estimate the degree of insulation that certain groups of investors may be able to provide to domestic companies.

Table 10: Approximation of institutional investors' voting power by country

	US	UK	Germany
US Institutional Investors	51.9%	28.0%	15.0%
US Household	30.0%		
US Non-Financial Investors	4.1%		
UK Institutional Investors	2.3%	29.0%	6.0%
UK Household		13.5%	
UK Non-Financial Investors		2.6%	
German Institutional Investors	0.5%	5.0%	16.2%
German Household			11.8%
German Non-Financial Investors			18.3%

Source: Federal Reserve, ONS, Bundesbank, Bloomberg.

Starting with the US, the largest block of shares is held by US institutional investors. If we dig down into this data, then of that 51.9 percent, approximately 41 percentage points of this are held by investment funds, with approximately half in active and half in passive funds (Federal Reserve, 2019; Bloomberg 2019b). There is therefore a block of approximately 20 percent of shares, representing approximately 25 percent of the votes cast (taking account of 70-80 percent voter participation), at the average US company that is cast by US index funds (see also Bebchuk and Hirst, 2019a; Fichtner et al., 2017).

Table 10 further illustrates that with approximately 30 percent of the shares outstanding, US households continue to have sizeable shareholdings in US companies. Brav et al. (2019) show

that voter participation for this group is low, with just 32 percent of votes cast on average. Furthermore, they find that retail shareholders back management at a very high rate, for example, voting with management in 88.5 percent of all say-on-pay votes in 2017. US households may therefore be counted alongside index funds as shareholders likely to provide insulation to corporate managers.

Chapter 3 showed that the Big Three hold approximately 12 percent of the outstanding shares of the average UK listed company, accounting for approximately 15 percent of all votes cast. Assuming UK households adhere to similar voting patterns to households in the US, this has the potential to increase the proportion of shares likely to vote with management by a further 5 percent, for a total of approximately 20 percent. Corporates in the UK therefore enjoy a far lower level of insulation from active (and activist) shareholders than corporates in the US. Instead they are exposed to UK domestic institutional investors holding 29 percent of shares (equating to approximately 40 percent of cast votes) in addition to a further approximately 20 percent of shares held by foreign, non-US, institutional investors.

The relationship between differences in managerial autonomy, as those highlighted above, and the varieties of capitalism is that in principle active, and especially activist, investors could use this lower autonomy to push LME type changes. Indeed, the previous sections have shown that European investors are pushing for change, but instead of the LME type (shareholder value maximisation) it is of a more CME related nature. The agents of change are therefore the domestic active investors, not the Big Three, and they are not advancing an Americanisation of national models of capitalism.

For Germany Chapter 3 showed that the Big Three hold approximately 9.5 percent of the average shares in a German company, representing approximately 13.5 percent of all votes cast. Again, adding to this the shares held by German households (11.8 percent at a participation rate of 30 percent), increases the block of shares likely to vote with management to approximately 17 percent. Germany has a peculiarity in that even after the dismantling of Deutschland AG, considerable bloc holdings by founding families and their trusts remain. With 18.3 percent of the average shares outstanding German non-financial investors therefore continue to play an important role. This 18.3 percent adjusted for the average voter turnout of 70% equates to approximately 26 percent of the votes cast.

However, employing averages in these cases is misleading as many companies will have no insider holdings while others, such as BMW (50 percent family holding), will have much higher insider ownership. If one were to add the 26 percent of non-financial investors to the 17 percent of US index investors and German households, the resulting level of shareholders likely to vote with corporate management is approximately 43 percent. The more appropriate take away from all this is, however, that for many German companies the percentage of shareholders likely to vote with managers on the vast majority of all votes equates to approximately 17 percent is even lower than the 20 percent in the UK. However, those companies with large insider holders will enjoy substantially higher levels of insulation from domestic and foreign shareholders.

From an internationalisation perspective the consequences are two-fold. First, despite internationalisation, domestic investors in all three countries continue to play an important governance role. Second, US companies benefit from a comparatively large block of shareholders that are likely to vote the vast majority of all shares with them, thereby providing

a governance vacuum. Companies in the UK and Germany on the other hand are comparatively more exposed to shareholders seeking change to their corporate governance models. Yet since many of the policies being advocated by shareholders in the UK and the US are or relevance also to the interests of other stakeholders, the direction of the resulting impulse is in the conceptual direction of the CME model of governance.

Conclusion

This chapter started out by mapping the internationalisation of share ownership. The picture presented was one of growing foreign ownership levels in all three countries. Germany and the UK, each with just over half of all shares held by foreigners appeared particularly susceptible to foreign influence. An analysis of the structure of the asset management industry further confirmed that US asset managers dominated industry league tables by AuM and that the size of the Big Three in particular dwarfed UK and German asset managers. Despite all of this suggesting that internationalisation will result in an Americanisation of corporate governance, this chapter has documented a very different reality. This is because this convergence in form, has not been matched by a convergence in function. Despite an apparent homogenisation of the shareholder ownership structure in the US, the UK and Germany, governance in the latter two countries continues to operate substantially different. This is because asset managers continue to behave differently in different countries.

Instead of being dominated by US investors, the governance dialogue in the UK and Germany is being led by domestic asset managers. These domestic asset managers are focussing their limited resources on where they have their biggest assets and where they expect to have the greatest impact, which for the most part is their domestic market. A second factor explaining a lack of Americanisation is the behaviour of the Big Three. Their voting records document the

same corporate-aligned voting behaviour as seen in the US. However, due to their relatively smaller voting blocs, they are unable to provide the same level of insulation that they provide for US companies. Furthermore, even though the Big Three have built out their stewardship teams, engagement in Europe remains underrepresented.

As regards UK and German investors having influence in the US, the evidence is similarly scarce. With many focusing their more limited stewardship resources on their domestic markets, engagement beyond proxy voting in the US is limited. Proxy voting by both German and British investors does show a significantly more confrontational approach than for the big US asset managers, in particular the Big Three. However, the insulation that the Big Three provide to management, together with the minority of retail investors that do cast their votes, means that US corporates remain well insulated from the pressures of foreign shareholders.

For the varieties of capitalism this means that the US remains relatively steady for now, though this appears to be a result of inertia rather than a stable self-reinforcing equilibrium. For the most part the signs are also that the German model of corporate governance remains largely unchanged as a result of internationalisation. There are minor signs that shareholders are having a greater say on certain issues, such as executive pay, but on the whole the way in which shareholders are increasingly using their voice is to amplify ESG concerns. Such ESG concerns are more consistent with traditional CME models than LME models as they are oftentimes aligned with the interests of other stakeholders. In the meanwhile, the governance model in the UK continues to evolve moderately, with some signs that the UK's LME model is giving greater weight to stakeholder concerns previously associated with CME models such as seen in Germany, thereby causing a moderate divergence between the UK and US models of corporate governance.

Chapter 5

Proxy Advisors

Introduction

The growing internationalisation and indexation of investment management have left most asset managers with stock holdings in a very large number of companies, spread across many countries. The institutionalisation of shareholder ownership has furthermore ensured that these assets are managed by institutions that are subject to rules that oblige them to consider the use of the voting rights attached to their shareholdings. Together the trends presented in the preceding four chapters have therefore created the need for a voting solution that enables institutional investors to handle their voting responsibilities.

Besides growing their in-house governance teams, most investors have hired advisors to help with the processing of their proxy voting items. Such 'proxy advisors' are "private firms that analyse corporate elections and advise investor clients on how to vote their shares" (Choi et al., 2010: 870). In practical terms, proxy advisors help asset managers keep track of all their shareholder meetings as well as the agenda points to be voted on, highlighting controversial issues and suggesting how to vote. Some proxy advisors also provide the electronic voting infrastructure to submit the votes as well as confirmations of voting records. The $1.2 trillion US asset manager T. Rowe Price explains:

> "We retain the proxy advisory firm Institutional Shareholder Services ("ISS") to provide proxy advisory and voting services. These services include voting recommendations that are customized to conform with T. Rowe Price voting guidelines, as well as vote execution and regulatory reporting across the many markets globally where we invest. Last year, T. Rowe Price's global proxy voting

activity included voting on 56,532 proposals – 55,561 management proposals and 971 shareholder proposals – at 6,444 shareholder meetings. We cast votes at more than 5,000 portfolio companies in 79 countries. To perform these voting obligations, we rely on ISS to provide advisory and voting administration services that are accurate, timely, and objective" (T. Rowe Price, 2020).

This indicates the scale of the challenge faced by large asset managers today. This chapter will explain the size of corporate governance teams this necessitates, even with the help of proxy advisors. Proxy advisors have come in for regulatory scrutiny in both Europe and the US, though the accompanying criticism from corporate interests has been much more ferocious in the US. Many corporates believe: "the majority of large [asset] managers are defaulting to these folks".[173] Yet proxy advisors disagree: "the mission is to empower clients to express their own views".[174]Another proxy advisor stated "we are not the activist, we are here to enable the activist".[175]

This perception that it is proxy advisors and not shareholders that are making the proxy voting decision is what feeds the narrative of proxy advisors' outsized influence. Since the two dominant proxy advisor firms, ISS and Glass Lewis, are both American firms and provide services in most countries, it could therefore also be tempting to see proxy advisors as supporting convergence by furthering Americanisation.[176] This chapter will show, however, why this is not the case.

[173] Investor relations, US company, telephone interview, 4 June 2018.
[174] Former governance analyst, US proxy advisor, telephone interview, 10 February 2020.
[175] Governance analyst, European proxy advisor, in-person meeting, 9 January 2020.
[176] On 17 November 2020, the German stock exchange Deutsche Börse announced the acquisition of an 80 percent ownership in ISS from Genstar Capital for $1.8bn. It remains to be seen whether being majority owned by a European institution will impact ISS's policy approach or the way in which it is perceived by corporates and investors. Source: https://www.reuters.com/article/us-iss-m-a-deutsche-boerse/deutsche-boerse-to-buy-80-of-iss-for-18-billion-idUSKBN27X2MJ (Accessed 18.11.2020).

The significance of proxy advisors for the corporate governance of firms results from the fact that they help investors overcome information and coordination problems. Proxy advisors are a solution to a resource constraint that affects smaller asset managers disproportionately. The influence of proxy advisors' recommendations will therefore differ amongst asset managers within a country but also between countries, depending on the structure of the respective domestic asset management industries.

Since asset management fees are much lower in index funds than active funds, the percentage of a country's equity market held by index investors is a further point of relevance for proxy advisors' influence (with the smaller index funds using proxy advisor services instead of expanding in-house corporate governance teams). Finally, since interviewees also acknowledged deferring to the advice of proxy advisors to a greater extent in foreign markets, the degree of foreign share ownership is also likely to be a factor in proxy advisors' influence.[177] This finding is in-line with Schouten (2012) who finds that fund managers are approximately three times as likely to deviate from the recommendations of proxy advisors for domestic portfolio companies as they are for foreign holdings.

In order to determine proxy advisors' influence on corporate governance, it is therefore necessary to consider the degree of institutionalisation, the structure of the domestic asset management industry, as well as the degree of indexation and internationalisation of a given market. The fact that these issues were all addressed in relation to the asset management industry in the preceding chapters is telling about the central role that proxy advisors play: 1)

[177] ESG portfolio manager, UK asset manager, in-person interview, 15 April 2015.
Governance expert, UK asset manager, in-person interview, 16 April 2015.

they focus investors' voice and 2) their influence is entirely relational, deriving from the advice they provide to their clients.

Chapter Structure

The aim of this chapter is first to ascertain the scope of proxy advisor influence, and second to investigate the nature of their influence. It is impossible to discuss proxy advisors without at least touching on the criticism levelled at them from corporate quarters. This chapter will therefore help set the scene for the following chapter, which discusses how corporates are responding to the rise of the asset management industry.

Based on the interview data collected, the following arguments will be made in this chapter: First, proxy advisors help investors, particularly resourced-constrained smaller asset managers, overcome coordination problems. They therefore represent a second governance authority alongside the Big Three index funds. Second, the authority of proxy advisors is entirely relational, stemming from their relationship as advisors to institutional investors. Third, the governance policies of proxy advisors and the voting decisions made by the Big Three show considerable differences, especially with regards to social, environmental and political shareholder proposals.

The creation of the Proxy Advisor Industry

In total I spoke to three founders of proxy advisor agencies. One described how the original plan for ISS was to be a consultant to institutional investors, helping them to file shareholder

proposals and become activists.[178] This idea, however, was a dead end, as asset managers had no interest in becoming activists. Instead investors explained that they required help with the handling of their proxy voting workload. Furthermore, the founders decided that the business model of a proxy advisor was far more attractive than running a consultancy for two reasons: First, one could sell the same piece of research to multiple clients, and second, unlike with investment research, clients would want other clients to read the same research for only if the majority voted the same way could they have success.

Up until 1984 all the votes were relatively standard, concerning the re-election of directors and auditors. Then from 1985 onwards three factors came together to create the demand for proxy advisor services.[179] First, corporate raiders such as Michael Milken put fear into entrenched corporate management teams who responded by proposing a raft of poison pill proposals to prevent hostile takeovers of their companies.[180] What then became apparent is that asset managers were voting with corporate executives virtually all the time and that this was the result of serious conflicts of interest. Corporates were threatening to pull pension fund mandates if asset managers did not vote their shareholdings in support of corporate management. In a 1985 report by the Investor Responsibility Research Center (IRRC) quoted in a 1986 report by the U.S. Department of Labor, it was noted that

> "several individuals have reported […] that their institutions have moderated their opposition to anti-takeover charter amendments after they received pressure from

[178] Former executive, US proxy advisor, telephone interview, 10 February 2020.
[179] Ibid.
[180] In response to a wave of takeovers in the 1980s, corporate executives sought to introduce various amendments to their corporate charter that would make it more difficult for their firms to be taken over without their consent (Davis, 1991). Such "poison pills" included, for example, "staggered boards" in which the terms that directors serve overlap with each other, so that there is no one year in which all directors were up for election and could be replaced by hostile shareholders.

> clients. One insurance company reportedly changed its policy from voting against anti-takeover proposals to voting in favor of almost all. Another insurance company stopped reviewing proposals independently and instead switched to a policy of uncritical support. A third institution, a major bank, changed its policy from opposition to support of fair price proposals" (U.S. Department of Labor, 1986: 56).

These findings were followed up in 1988 by the U.S. Department of Labor ruling that the proxy vote was as much part of the fiduciary responsibility as looking after the shareholdings from which they resulted. The rule never explicitly stated that it was compulsory for US investors to vote all of their shares, only to consider whether it was in the best interest of their fiduciaries, but it was nevertheless interpreted that way. With harmful poison pill proposals increasing, rules ensuring that investors voted, and awareness of the potential for conflicts of interest in proxy voting, institutional investors were eager to receive impartial voting advice.[181]

A former executive of a European proxy advisor believes that the US ruling effectively compelled US investors over night to vote all of their shares. The downside to this is that they "never really developed a love affair with voting" and that this is why US corporate governance is struggling to mature to this day. In the UK on the other hand, the speed of regulatory development was more moderate, focussing initially on voting in the UK only.[182]

The Industry Structure

Proxy advisors enjoy huge economies of scale. Rather than have hundreds of asset managers each individually employing a big staff, proxy advisors each have one large governance team

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[181] Former executive, US proxy advisor, telephone interview, 10 February 2020.
[182] Former executive, European proxy advisor, telephone interview, 10 February 2020.

and can charge asset managers a fraction of the cost of processing all these voting items than if investors did all the work themselves. The structure of the proxy advisor industry is a likely outcome of the huge economies of scale, with pricing pressure from the fund management industry further compounding these. The fee pressure in the proxy advisor industry has led to criticism that the proxy voting industry produces the lowest product quality that fulfils investors' regulatory requirements (Larcker et al., 2013).

The proxy advisor industry is effectively a duopoly. Estimates of the combined market share of ISS and Glass Lewis range from 90 (Calluzzo and Dudley, 2015) to 97 percent (ESMA, 2015). ISS is larger, with a 50 to 61 percent share. This highly concentrated market share has brought parallels with the influence of credit ratings agencies (Belinfanti, 2009). For one corporate: "ISS and Glass Lewis are the King and Queen of governance".[183]

ISS was founded in 1985 and covers about 44,000 meetings in 115 countries annually, it executes a total of 10.2 million ballots annually, representing 4.2 trillion shares for about 2,000 clients, it does so with nearly 2,000 staff.[184] Since ISS reported a staff of 700 in a 2014 press release this implies that ISS increased its staff by almost 200 percent in the past six years. Glass Lewis was founded in 2003 and according to its company website has more than 360 employees (still a small number considering the size of the task) and more than 1,300 clients representing assets under management in excess of $35 trillion.[185] Glass Lewis has been an active consolidator in the industry; acquiring Sydney-based Corporate Governance (CGI) in 2006, Washington Analysis in 2008, and the German proxy advisor IVOX in 2015.

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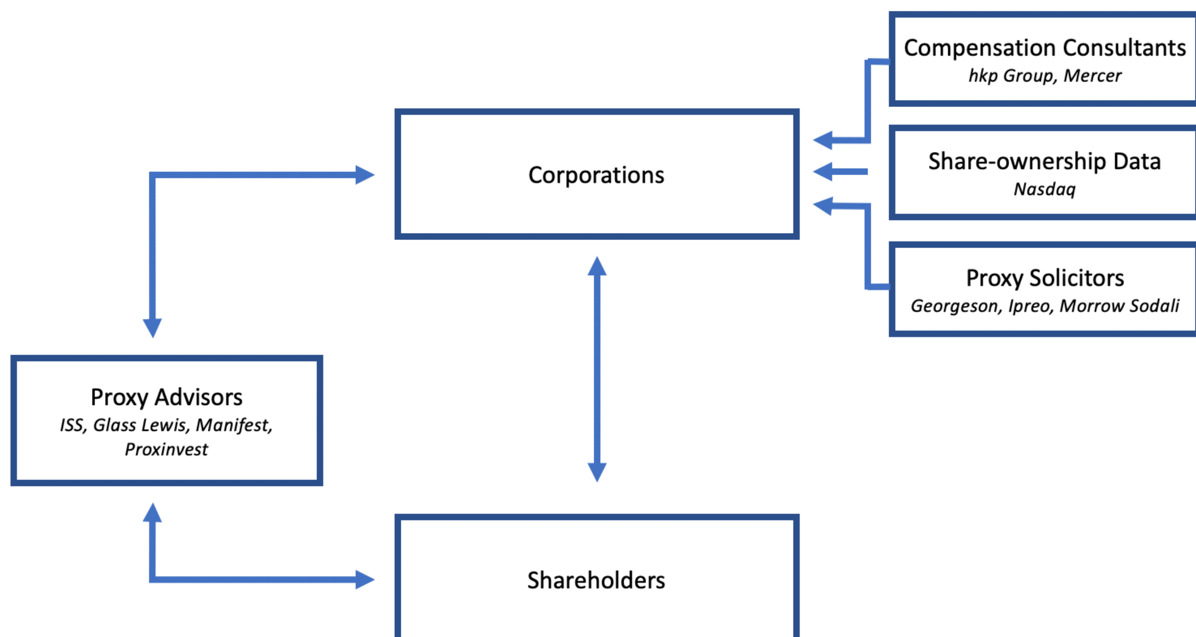
[183] Investor Relations, US company, telephone interview, 4 June 2018.
[184] ISS company website: https://www.issgovernance.com/about/about-iss/ (Accessed 8 February 2020)
[185] Source: https://www.glasslewis.com/company-overview/ (Accessed 15 November 2020)

The sheer number of institutional investors and corporates, each seeking to interact with one another, has created an industry of advisors (Figure 21). On the one side are investors who work with the aforementioned proxy advisors and on the other side are corporates, many of which reported employing the services of "proxy solicitors". Proxy solicitors help companies to keep abreast of changes at the investor level, and one such proxy solicitor, IPREO, has developed a proxy advisor tracking score (PATS) to estimate the extent to which a given investor is likely to vote with the big proxy advisors (IPREO, 2017).

Figure 21: The Proxy Landscape



Source: author's image.

In Europe the market share of the two big proxy advisors is similarly dominant, though at a somewhat lower absolute level (approximately 10 percent less).[186] "US based proxy advisors tend to have a more global presence and are also active in Europe, whereas European firms

[186] Former executive, European proxy advisor, telephone interview, 10 February 2020.

have a more national or regional focus" (ESMA 2012: 10). Examples of European proxy advisor firms are Minerva Analytics, PIRC and IVIS in the UK, Proxinvest in France and until 2015 IVOX in Germany.[187] IVIS and IVOX are examples of federations of institutional investors setting up their own, or working in close cooperation with, proxy advisors (the Association of British Insurers and the German asset management association BVI respectively). Using Germany as a setting, Heinen et al. (2018) suggest that the recommendations of local proxy advisors diverge further from those of ISS and GL than do the recommendations between ISS and GL.

As is the case with index funds, a first-mover advantage operated in the industry (Tountopoulos and Veil, 2019). With the US capital market being the biggest in the world, this gave ISS a significant scale advantage versus European peers that were either launched later such as IVOX (launched in Germany in 2005) and/or were launched in smaller domestic markets such as PIRC (launched in 1986 in the UK). An interviewee felt that following its international expansion, ISS has been aggressively chasing global market share in order to attain critical mass. The problem for European proxy advisors is that this does not only mean that they struggle to get any share in the US, the US proxy advisors have also "destroyed" pricing in the European market. The result of this is that ISS was said to offer company reports for $7 to $8 a piece when an appropriate price to cover costs should have been $30 to $40.[188]

The Proxy Policy Formulation Process

Proxy advisors typically provide two types of analysis services. The first is the provision of "benchmark policies". These are proxy voting policies designed by the proxy advisors

[187] IVOX was acquired by Glass Lewis in June 2015.
[188] Former executive, European proxy advisor, telephone interview, 10 February 2020.

themselves on the basis of their respective policy formulation frameworks. In these policies the proxy advisors set out their views on what is and what is not good practice. The second type of proxy voting policy are "custom policies" which proxy advisors implement on the basis of policy documents provided by their clients. Here the voting decisions are based not directly off proxy advisors' recommendations but on investors' own in-house governance principles.

ISS and Glass Lewis both report that at least 80 percent of the ballots they process follow custom policies. ISS furthermore reports that they have approximately 2,000 clients and more than 400 custom policies (20 percent), implying that the majority of large clients use custom policies while smaller clients mostly follow the benchmark policy (as 80 percent of ballots are processed with custom policies).[189] A UK investor explained that having a "custom policy overlay is an essential part of what is means [for an investor] to have good governance".[190]

Each proxy advisor employs a proprietary policy formulation process for their benchmark policies. In this section I will outline the process followed by ISS, both because ISS is by far the largest proxy advisor and because they have responded to criticism regarding a lack of disclosure with a very detailed, publicly available, benchmark policy formulation framework. ISS reviews and updates its proxy voting guidelines annually. ISS divides its research into three regions: the Americas, EMEA (Europe/Middle East/Africa), and Asia-Pacific. Each region has its own proxy voting policies, which will be discussed below. The challenge for proxy advisors is to translate feedback into a proxy rule that a voting system can process. A graphical representation of ISS' policy formulation process is given in Figure 22 below.[191]

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[189] Sources: ISS company website as of 4 March 2020. ISS (2018) letter to US SEC. Glass Lewis CEO in testimony to the SEC Roundtable on the Proxy Process, minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

[190] Corporate governance expert, UK asset manager, telephone interview, 30 August 2018.

[191] https://www.issgovernance.com/policy-gateway/policy-formulation-application/ (Accessed 4 March 2020).

Figure 22: ISS Policy Formulation & Application

Source: ISS

The policy review process starts with an "internal review of emerging and notable trends across global markets" which is based on data collected from investors and corporates throughout the year (ISS, 2019). Next, ISS sets up "policy committees" by governance topics and by region. These policy committees then compile the questions that are to be asked of investors and corporates as part of the annual survey and the roundtable discussions that make up the "policy outreach cycle". While the policy survey is one global survey for everyone in all regions to participate, it does ask region-specific questions. The roundtables are also region-specific.

> "We also host a number of roundtables and what we call 'fall briefings,' where we literally go to various cities, not only in the United States but around the world, and have frank and open conversations with the institutional shareholders that essentially represent the vast majority of the equity holdings around the world. And

> we listen to what the issues are that they are facing, what matters to them, what has changed this year versus in the prior year. And we incorporate all that into our policy development process".[192]

Because of all the investor outreach that take place, ISS' and Glass Lewis' policy formulation frameworks function as consensus-building processes.[193] "We bring institutions in together to talk about policy".[194] One of the two big proxy advisors explained that "everyone has input, but clearly BlackRock is more important than some random Swiss pension fund. Its logical that a large, world-wide present fund would carry more weight".[195]

Once the draft policy has been composed with the help of these resources, the draft policy is published online and investors, corporates and other stakeholders are given a two-week period to provide comments. Following this comment period, ISS' analysts compile the final policy update in November. These policy frameworks, one for each region (plus many more for individual countries), will then be effective for shareholder meetings held after the 1st of February of the following year.

How Asset Managers employ Proxy Advisors' Services

Besides the policy survey and the roundtables, proxy advisors further reduce coordination difficulties through the pre-season and post-season voting reports they produce. With these

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[192] ISS CEO in testimony to the SEC Roundtable on the Proxy Process, minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

[193] Multiple asset management interviewees reported having participated in ISS' consultations, examples include: Corporate governance expert, UK asset manager, telephone interview, 12 July 2018, and corporate governance expert, German asset manager, telephone interview, 9 April 2018.

[194] Glass Lewis CEO in testimony to the SEC Roundtable on the Proxy Process, minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

[195] Senior employee from one of the two big proxy advisors, telephone interview, 20 September 2018.

reports proxy advisors keep investors abreast of new trends in corporate governance. Investors report using these post-season summaries to plan policy changes for the subsequent year.[196] These post-season summaries aggregate proxy voting trends (new issues receiving increased shareholder support) and help to set the agenda for the following proxy season by highlighting where best practice is changing. By channelling investors' attitudes in this way, they formalise standards, for example by specifying how much additional equity companies can raise without requiring a shareholder vote or by specifying on how many companies' boards a director can sit on simultaneously before being considered to be "overboarded" (sitting on too many boards and thus not having enough time to dedicate to each).

For investors that make use of custom policies, proxy advisors code investors' own in-house governance policies into their proxy voting system. They agree with their customers what the default recommendation for different policy items should be and then suggest how to vote shares accordingly.

> "When the institutional investor becomes a client, it's not like they just sign a contract and say, oh, yeah, we've taken a cursory look at your policy and that seems to make sense So go ahead and do the voting and then send us the reporting at the end of the year. I mean, there's a lot of work that goes into reviewing and adopting the policies that we put in front of them for them for them to review".[197]

[196] Governance expert, German asset manager, telephone interview, 9 April 2018.
[197] Glass Lewis CEO in testimony to the SEC Roundtable on the Proxy Process, minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

Some proxy advisors also provide the ability for straight through processing, whereby proxy votes will be automatically submitted according to the customer's policy framework. Most, if not all, investors specify a list of proxy items to "flag" up. In cases where proxy items are flagged, the asset manager's governance team takes a closer look at the issue and may engage with the corporate before deciding how to vote. These are typically all those cases where the proxy advisor recommends a vote against management, where the proxy item is a proposal submitted by shareholders, or where the customer's policy framework cannot automatically be applied due to the difficulty of categorizing the issue. Describing this process, a UK investor explained that they look at shareholder proposals (as opposed to management proposals) on a "case by case basis. Every one of them is flagged up. The devil is often in the detail".[198] One of the Big Three asset managers explained that as a result of such flagging they typically look at the ballots of approximately 30 percent of their companies manually in-house.[199]

Chapters 3 and 4 highlighted the significant resource challenge posed by the extensively diversified portfolios that most large asset managers have today. There are only limited workarounds that an asset manager can implement, such as bringing in temporary staff from other departments, as a US asset owner explained they did.[200] The challenge here are competitive pressures that the asset management industry is facing. In practice it is therefore very difficult, if not impossible, for most asset managers to handle their large proxy voting workload without a degree of automation and external support. Investors confirmed that they used proxy advisors as data aggregators and structurers, saying that they are "highly necessary

[198] Corporate Governance Analyst, UK asset manager, telephone interview, 30 August 2018.
[199] Corporate Governance Analyst, Big Three asset manager, telephone interview, 24 June 2019.
[200] Corporate Governance Analyst, US pension fund, in-person interview, 16 April 2015.

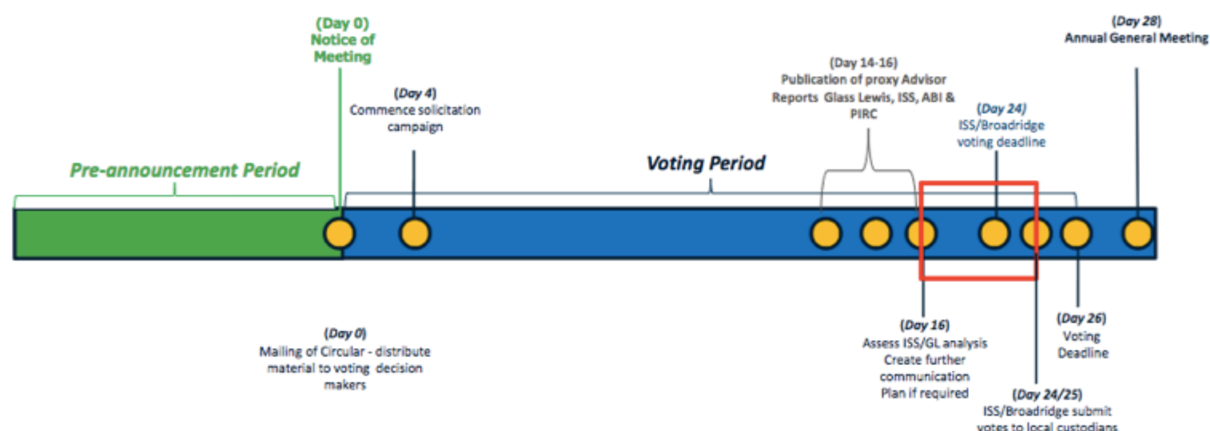
(…) There is no way of having effective voice without proxy advisors' help. They provide structured information".[201]

The smaller an investor's asset base, the bigger the challenge they face, as they will have fewer assets from which to recover the associated costs. This will either put downward pressure on their profitability or upward pressure on the fees they will have to charge their clients, thereby worsening their competitive situation. Corporates commented on this, explaining that "for large investment houses they have the resources, and there is much less frustration. […] I think it's a function of size, the smaller the house the less wiggle room there is to diverge" (from proxy advisor recommendations).[202]

Besides the fact that most of the AGMs fall within a period of just three to four months there is a second time constraint. As outlined in Figure 23, the typical timeline between a company publishing the agenda and voting points for its AGM and the convening of the AGM is just 28 days. In order to ensure that all the votes are transmitted to the various jurisdictions and reach the companies on time, the voting systems typically close after 26 days. To allow time for their own operations Broadridge, which handles the vast majority of the proxy "plumbing", closes its systems on day 24. This therefore leaves a period of just 24 days for proxy advisors to compose their reports, for corporates to review the data used, and for investors to make their voting decisions.

[201] Corporate governance Analyst, UK asset manager, telephone interview, 25 September 2018.
[202] Director, Investor Relations, US Company, telephone interview, 5 June 2018.

Figure 23: Typical Voting Timeline



Source: Sydorowitz (2015)

Proxy advisors typically issue their reports 14-16 days after the companies publish their voting agenda. This leaves investors with 8-10 days to make their voting decisions. According to IPREO (2017) there are a total of 7 analysts at ISS responsible for the 500 German companies under coverage. Based on these numbers each analyst has on average 71 companies to look at. Assuming all of these meetings fall within a period of 12 weeks, this would equate to 1.2 companies per day (500 companies / 7 analysts / 60 days).

This indicates the number of additional corporate governance staff an asset manager would require if they were to do all analysis without employing the services of proxy advisors. To have a similar staff as ISS in Germany, with 7 Analysts for 500 companies, would require an additional staff of between 9 and 32 for a company with global shareholdings in 4,500 to 16,000 companies, in addition to the estimated 30-110 staff estimated in Chapter 3. For BlackRock with its approximately 16,000 individual shareholdings this would imply a required governance headcount of 143 made up of the 110 stewardship staff listed in Chapter 3 plus an additional 32 staff to compensate for the theoretical scenario where they were to do without the support of proxy advisors. BlackRock (2018a) reports that it plans to double its stewardship team size by 2020, from 36 in 2018, thus implying a team size of 72 (though in May 2020 the latest

available data suggest the team has only grown to 47). Thus, in practice, not even the largest asset managers have governance teams sufficiently staffed to cope without the support of proxy advisors.

The above time constraints have the effect of increasing the potential influence that proxy advisors may have, as the shorter the time, the larger the team size needed to tackle all issues in-house. In order to tackle the seasonality of proxy voting, proxy advisors (like some investors) make substantial use of seasonal hires. Oftentimes these are interns or recent graduates, the best of which will receive job offers to return the following year as a permanent employee.[203] A former employee of one the two big proxy advisors described that for every full-time employee there would typically be five to ten seasonal staffers.[204] One interviewee criticised the industry for its reliance on a workforce comprised of many part-time students as well as mostly low entry wages, noting that it would take 2 years before an analyst is fully up to speed.[205]

Controversies surrounding the industry

Before turning to the controversies surrounding proxy advisors, it is necessary to highlight the role played by grey literature. Grey literature composed by "free market" think tanks and corporate lobbying groups makes up a substantial part of all the documents that have been published on proxy advisors. Examples include a paper by Doyle (2018b) entitled "The conflicted role of proxy advisors" (Doyle is Vice President of Policy and General Counsel of

[203] Former executive, European proxy advisor, telephone interview, 10 February 2020.
[204] Former employee, one of the two big proxy advisors, in-person interview, 5th of June 2018.
[205] Former executive, European proxy advisor, telephone interview, 10 February 2020.

the American Council for Capital Formation, ACCF).[206] The debate has become heated, with accusations of conflicts of interest. One interviewee at a proxy advisor suggested that the Rock Center for Corporate Governance at Stanford University is playing a central role in issuing critical reports.[207]

Both ISS and Glass Lewis have been accused of conflicts of interest (Clark and Van Buren, 2013; Doyle, 2018a; Glassman and Peirce, 2014). In the case of Glass Lewis, the accusations stem from the fact that it is owned by the Ontario Teachers' Pension Plan, described by the Financial Times (2007) as "one of the world's largest and most aggressive pension funds", and by the Alberta Investment Management Corp. Glass Lewis' response to these accusations is that they try to disclose all potential conflicts.[208]

In the case of ISS, the accusations stem from the fact that it also advises companies. ISS is the only proxy advisor to advise both asset managers and corporates. ISS acknowledges this potential conflict in their Regulatory Code of Ethics (ISS, 2017) and has registered in the US as an investment advisor. In this regard a US corporate complained that ISS are "aggressively trying to sell their products" to his company.[209] Another US corporate described how after his company lost a say-on-pay vote, in part because ISS recommended against them, they subsequently were targeted by ICS' sales team. He said it was "kind of annoying that after ISS

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[206] The American Council for Capital Formation (ACCF) is a think tank that prides itself on "economic growth through sound tax, regulatory, and environmental policies" and seeks to expose "the politization of corporate governance". They have issued a number of reports criticising socially responsible investment, for example, arguing that CalPERS' pension fund liabilities have risen as a result of the pension funds' decision to consider social and environmental issues. Records show they have been funded by the likes of ExxonMobil Corp. For further information, see: http://accf.org/about/ and https://www.sourcewatch.org/index.php/American_Council_for_Capital_Formation as well as the following for information on their funding: https://exxonsecrets.org/html/orgfactsheet.php?id=77 (Accessed 20 October 2019)

[207] Proxy Advisor, in-person interview, 5 October 2018.

[208] CEO of Glass Lewis in testimony to the SEC Roundtable on the Proxy Process, minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

[209] Investor relations, US company, telephone interview, 3 April 2018.

recommended against, we got 12 emails over the past 4 months as well as several calls asking whether we wanted to buy their services".[210]

Other proxy advisor companies also commented that they considered the ISS set-up troublesome:

> "I cannot defend the indefensible. What I mean by that is that there are conflicts that arise from consulting when you're also in the proxy advisory business. If you're getting paid to give corporations early indications on voting and then turn around and vote, most people consider that to be problematic, and we're probably in that camp. We don't get involved in consulting, either directly or indirectly".[211]

ISS acknowledges the potential for conflicts but claim that firewalls and transparency are sufficient to prevent them.[212] While corporates are concerned about conflicts of interest at ISS,[213] asset managers, who are the paying clients of their proxy advisory services, did not see a problem: "[w]e have seen no evidence that there has been any impact from conflicts of interest on the services provided to us, and we feel comfortable with the level of disclosure that we get".[214] Other proxy advisors suggest ISS did not divest of its ICS consulting arm because they relied on it for income as the profitability of proxy advice was too low.[215]

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[210] Investor relations, US company, telephone interview, 16 January 2018.
[211] CEO of Egan-Jones, third largest US proxy advisor in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf
[212] CEO of ISS in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf
[213] Investor relations, German company, telephone interview, 11 January 2018.
Investor relations, German company, telephone interview, 17 January 2018.
CFO, Head of Human Resource, Head of Investor Relations, US company, telephone interview, 23 April 2018.
[214] Jonathan Bailey, Managing Director and Head of ESG Investing, Neuberger Berman, LLC, in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf
[215] Governance expert, European proxy advisor, in-person interview, 5 October 2018.

A central tenant of the criticism of proxy advisors is that they have outsized influence because asset managers blindly follow their recommendations. For this the grey literature has created terms such as "robo-voting" (Doyle, 2018; Placenti, 2018) to give the impression that proxy analysis has been automated. ISS' CEO suggests that "robo-voting, the term itself, is used in a way that seems to be pejorative in some fashion. [...] If you're talking about one vote or one recommendation and it is then executed by every client that ISS has, that could not be further from the truth".[216]

A US private wealth manager agrees: "the idea that automation of input that we give the proxy advisory firm is -- you know, robo-voting -- misrepresents the level of diligence that goes into the review of the benchmarks to begin with. If you've ever actually reviewed the benchmarks, whether it's ISS or anybody else, they're very extensive and much more detailed than small firm like ours could ever develop with our own independent research".[217] This comment also highlights the expertise that ISS has accumulated and that even their basic "benchmark" policies are much more sophisticated than most investors would be able to construct on their own.

The nature of their Influence

Comparing proxy advisors with credit ratings agencies is revealing. Ratings agencies have been described as "private authorities" that act as "gatekeepers" and "invisible switchmen" based

[216] CEO of ISS in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

[217] Scot Draeger, Vice President, Director of Wealth Management, General Counsel and Chief Compliance Officer, R.M. Davis Private Wealth Management, testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

on the "monopoly of expertise" that they have created (Kerwer, 2001; Sinclair, 2005). First, the influence of ratings agencies is of a much broader range of both investors and therefore borrowers (including governments). Second, ratings agencies influence the flow of funds, whereas proxy advisors with few exceptions do not.[218] Proxy advisors for the most part have not created a monopoly of expertise, the closest they get is a near monopoly on resources, but even that is partially challenged by the largest asset managers.

Proxy advisors are "pretty influential but not too powerful", unlike credit ratings agencies, who are "much more powerful" as they determined the price of financing.[219] Instead the interviewee compared their services to the research reports published by investment banks, explaining that investors have the option of deciding whether to follow proxy advisors recommendations or not. Finally, and significantly, because proxy advisors are paid by investors (and not the corporates they rate), the same conflicts of interest as for credit ratings agencies do not apply.[220] Arguably this reduced the influence that corporates are able to have over their ratings and at least in part explains corporates' mostly hostile attitude to proxy advisors.

Sinclair (2005) explains that ratings are not strictly rules-based decisions that are black and white but instead always include a degree of judgement. This concurs with how proxy advisors regard corporate governance: "speaking for Glass Lewis, that our approach is that we take a case-by-case approach and we apply bounded judgment".[221] Both proxy advisors and credit ratings agencies therefore do make judgements, but whereas the judgements of credit ratings

[218] In those cases where companies put the right to raise additional equity capital to a shareholder vote, proxy advisors to have influence over the potential flow of funds, but this is a very small sub proportion of overall votes.
[219] Investor relations, German company, telephone interview, 24 January 2018.
[220] Proxy Advisor, in-person interview, 5 October 2018.
[221] CEO of Glass Lewis in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf

agencies are primarily based on internal models, those of proxy advisors involve interpretations of investors' consensus opinions. Proxy advisors' judgements are thus a second-order judgement, "we're incorporating whatever we think is appropriate in our policy formulation".[222]

Corporates acknowledged the relational nature of proxy advisors' influence "it's because investors give them the power, as investors just look and follow"[223] and "they have the ability to influence corporate policy because investors follow with their votes".[224] Despite these comments, corporates and their proxy solicitors both saw value in the services provided by proxy advisors. While there were misgivings about their processes and potential conflicts of interest, the "channelling" of investors' opinions that results from proxy advisors' activities was seen as simplifying also the work of corporates.

> "It is helpful to get a tendency for what direction a vote will go. They highlight trends for the upcoming proxy season in a timely manner. We then have an idea of what to expect. Proxy advisors have a reputation to consider and they have credibility that is at stake. It gives us a better impression what way the undecided will lean, it is a channelling that is happening, this is good".[225]

[222] CEO of ISS in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf
[223] Investor relations, US company, telephone interview, 24 January 2018.
[224] Investor relations, German company, telephone interview, 31 January 2018.
[225] Investor relations, three team members on call, German company, telephone interview, 18 January 2018.

Estimates of Proxy Advisors' Influence – what proportion of investors are influenced?

A number of academic studies have set out to quantify the impact of proxy advisors' recommendations on the voting outcomes of corporate elections (Bethel and Gillan, 2002; Cai et al., 2009; Iliev and Lowry, 2014). The results show a relatively wide distribution, ranging from 13.6 percent to 29.7 percent of votes impacted.[226] The difference depends to a large extent on what is being measured. Are the studies evaluating say-on-pay (Larcker et al., 2013; Malenko and Shen, 2016) or director nominations (Cai et al., 2009), and do the studies look at the combined impact of both proxy advisors recommending in the same direction or at the recommendations of individual proxy advisors?

Overall, while the market share of ISS and GL is commonly given as 97 percent (ESMA, 2012), there is no reliable data on the percentage of equity assets covered by proxy advisors. There is also no data available on the European market structure, even the ESMA regulatory investigation of the proxy industry did not ascertain such information. An approximation of proxy advisors' market share for both the US and Europe can be made with the following equation: 70% (market share of institutional investors) x 63% (ISS market share) = 44% maximum ISS market share, assuming all institutional investors employ a proxy advisor. An alternative calculation is taking data from ESMA (2012) which reports that ISS advises assets totalling $26 trillion (and GL $15 trillion).[227] At the time the global market capitalisation of all

[226] Choi et al. (2010) estimate a 20-30% impact, although this drops to just 6-10% after taking into account firm-specific criteria. Bethel and Gillan (2002) estimate 13.6-20.6%, Cai et al. (2009) show 19%, Cotter et al. (2010) show 29.7%, Iliev and Lowry (2014) show a greater than 25% impact, Larcker et al. (2013) estimate a 20% impact on say-on-pay voting behaviour, and Malenko and Shen (2016) show a 25% impact on say-on-pay votes.
[227] These market shares have changed since. While ISS does not provide an update on its website, the website of GL now states that they advise investors with AuM exceeding $35trl. Source: https://www.glasslewis.com/company-overview/ (Accessed 6 July 2019)

stock exchanges approximated to $51.1 trillion, implying that ISS advised approximately 51 percent of all equity assets globally ($26 trillion / $51.1 trillion).[228]

If one combines these estimates with the statement of the CEO of ISS to the SEC that 87 percent of ballots voted in 2017 were processed based on custom policies, this suggests that approximately six to seven percent of all shares are voted in accordance with ISS benchmark policy ((100 percent minus 87 percent) x 51 percent). While this estimate is significantly lower than the typically quoted range of 13.6 to 29.7 percent (Bethel and Gillan, 2002; Cotter et al., 2010) those estimates are for the entire proxy advisor industry. This estimate of six to seven percent is also close to the estimate given by an employee of one of the two big proxy advisors, who suggested that it was only “a small single digit percentage of investors” that blindly followed ISS’ recommendations.[229]

The estimate of six to seven percent is furthermore in-line with Choi et al. who estimate that ISS recommendations shift only six to ten percent of shareholder votes and conclude that “popular accounts substantially overstate the influence of ISS” (2010: 869) and that ISS’ impact is reduced greatly once further factors are taken into account. This is still a substantial impact however one measures it and would make shareholders voting according to ISS’ benchmark policy one of the biggest shareholders in most companies.

The challenge in studying proxy advisor influence is separating correlation from causation. Is the “impact” that is being measured merely the percentage of investors following proxy advisors’ advice or are any voting decisions actually changed as a result of the advice? If proxy

[228] For the source of global market capitalisation, see: https://data.worldbank.org/indicator/cm.mkt.lcap.cd (Accessed 16 June 2019)
[229] Governance expert, US proxy advisor, telephone interview, 20 September 2018.

advisors do a good job as data aggregators and consensus-builders, we would expect their recommendations to reflect the preferences of the majority of investors. The fact that so many agenda items that are voted on concern routine items contributes to high levels of correlation; "high correlation exists but is normal" (ESMA, 2013: 12). In this regard Choi et al. (2010) identify four reasons why correlation may exist (a) investor and proxy advisor come to same conclusion, (b) proxy advisors may gather information that investors use to make their decision, (c) investors may select proxy advisors based on ex-ante agreement with their benchmark policies, and (d) investors may view the recommendation alone as the basis for making a decision. The authors note that only the last of these reasons can be truly characterised as causality.

Throughout the interviews, investors were eager to emphasize that it was them making the voting decisions and that proxy advisors' reports were only providing input. One UK investor stressed that they only "supplement" their approach with the ISS functionality (meaning that they used their systems to help process the voting data), while another explained that they use ISS to "provide context on where companies sit relative to peers".[230] All of this points to (b) in the list of reasons given by Choi et al. (2010) above. However, such responses from investors are to be expected "causality is difficult to establish since investors are not likely to admit blindly relying on proxy advisors" (ESMA, 2013: 12).

Many corporate interviewees, however, were adamant that proxy advisors have power. "I think they have a lot of power, yes I think they have too much power".[231] Another said: "If they

[230] Corporate Governance Analyst, UK asset manager, telephone interview, 30 August 2018, and Corporate Governance Analyst, (different) UK asset manager, telephone interview, 12 July 2018, respectively.
[231] Investor relations, German company, telephone interview, 7 February 2018.

recommend against, you see their influence".[232] Twenty percent was the estimate of proxy advisors' impact given by a US corporate who noted that "the day the ISS report is released, within 24 hours we see a meaningful, a significant vote come through and these votes are spot-on the ISS recommendations".[233] This suggests that there is a section of investors that do vote systematically with proxy advisors. These are the "box tickers", "blind followers" and "robo-voters" that the critics complain about. Most interviewees suggested that these were primarily the smaller institutions that cannot afford large corporate governance teams.

ISS and GL thus represent significant voting blocs alongside those of the Big Three in all three countries. Any such influence that proxy advisors may have is entirely relational, resulting from customers following their advice. Corporates are cognizant of this, as one US corporate explained that "they are actually filling a vacuum for lazy investors. I find it criminal that [investors] have not done what's right".[234] Some investors concurred with this interpretation: "the only reason they have this [influence] is because too many investors don't do proper proxy voting […] Proxy advisors are mandated by investors, but it's not their fault, its investors' fault".[235]

Furthermore, while in-house governance teams moderate proxy advisors' influence, even large in-house teams are influenced by proxy advisors' recommendations: "if both proxy advisors recommend against the company, then the hurdle to convince investors in dialogue is very high".[236] A UK corporate similarly reported a discussion they had had with a US active investor, who told them that "[i]f we have to vote against proxy advisors then we need to put together a

[232] Group general counsel and corporate secretary, UK company, telephone interview, 12 June 2018.
[233] Corporate Secretary, US company, telephone interview, 22 February 2018.
[234] Investor relations, US company, telephone interview, 20 June 2018.
[235] Governance expert, German asset manager, telephone interview, 9 April 2018.
[236] Investor relations, German company, telephone interview, 8 June 2018.

very strong case".[237] "This is because the decision makers at the investors will then need to argue in front of a committee why they differ from the recommendation of a proxy advisor. Such cases need to be documented in case the auditor seeks an explanation [at the annual fund audit]".[238] An asset management interviewee confirmed that they needed to note down a justification in cases where they diverged from proxy advisors' recommendations in case auditors were to look into it as part of their annual fund audit.[239]

Therefore, while a very small number of global asset managers, those with the largest in-house governance teams (the Big Three, Hermes, LGIM and Norges), might be able to regularly diverge from the recommendations of their proxy advisors, for most of the other investors this will not be the case. This highlights that proxy advisors' influence is more complex than the simple differentiation between investors that use custom and benchmark policies. It thus extends beyond those investors that "blindly" follow proxy advisors to those that have their own governance teams.

The exact number of votes whose actual direction is changed by proxy advisors is impossible to ascertain due to the interaction between the four factors identified by Choi et al. (2010). It is clear that they do have some influence, but the extent of this influence is likely to be much smaller than the duopolistic industry structure would suggest. As with the Big Three in the previous chapter, voting impact is most visible when one focusses only on a subset of voting results. Since the launch of non-binding executive compensations votes in the US in 2011, Glass Lewis has recommended voting against 14 to 18 percent of these on average, yet GL highlights that on average just two percent of these fail to pass each year, with average

[237] Investor relations, UK company, Webex video conference, 14 June 2018.
[238] Investor relations, German company, telephone interview, 8 June 2018.
[239] Senior executive, German asset manager, telephone interview, 21 March 2018.

shareholder support for say-on-pay proposals exceeding 90 percent on average.[240] This suggests that the block of shareholders that follows corporate managers is larger than the block that follows proxy advisors. Proxy advisors may therefore be influential, but as the next section will further illustrate, their influence is bounded by the fact that their recommendations reflect investors' preferences and by the fact that the voting decisions of the Big Three differ considerably.

Estimates of Proxy Advisors' Influence – what is the influence regarding

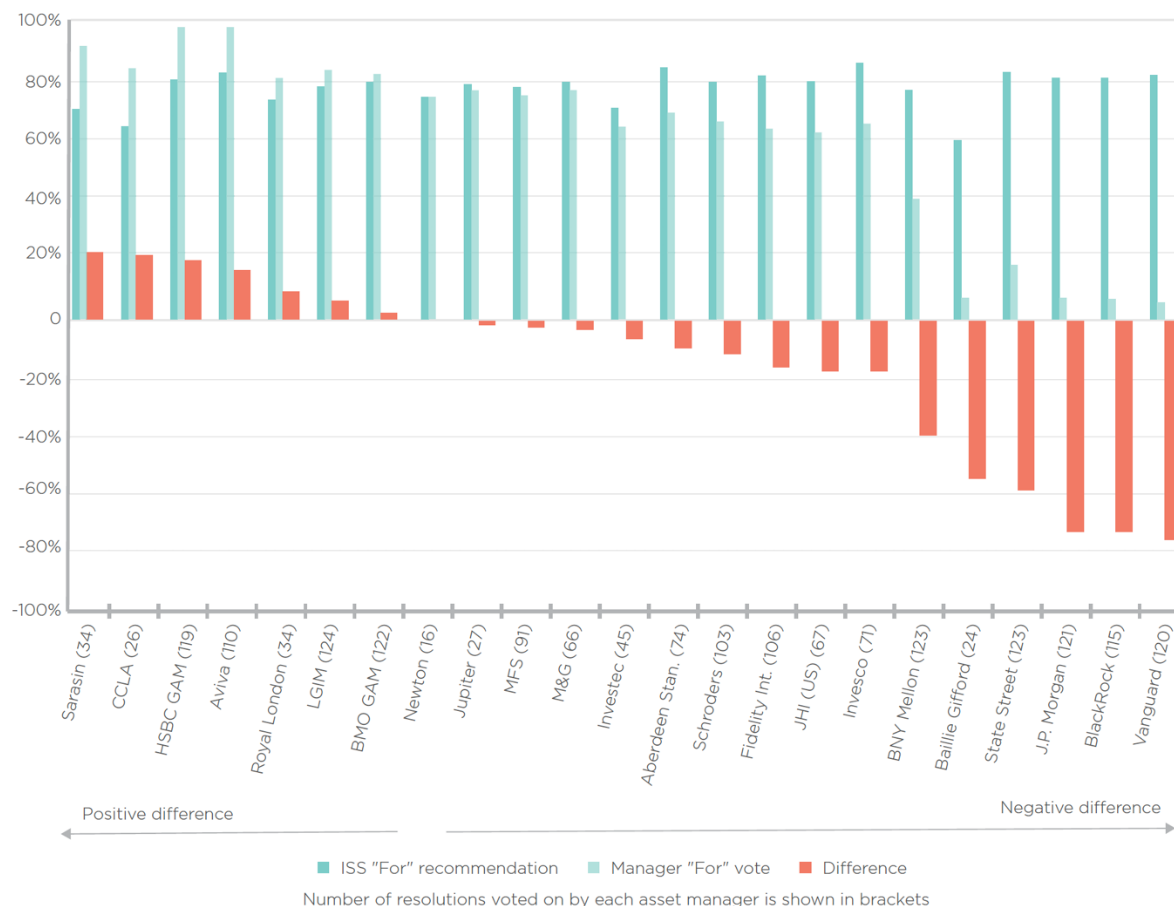
The studies listed in the previous section that estimated proxy advisors' influence to be in the region of 13.6 to 29.7 percent concerned proxy voting on 'traditional' corporate governance metrics such as director elections and say-on-pay. Focussing instead on ESG proposals gives a very different impression (Ceres, 2019; ShareAction, 2020; Strine, 2018). Rather than suggesting an overreliance by asset managers on the recommendations of proxy advisors, a study of ESG proposals shows that "asset managers routinely ignore the recommendations of their proxy advisor to vote down action on these important issues" (ShareAction, 2020: 10).

The ShareAction (2020) report shows that asset managers voted for such proposals only 35 percent of the time as often or more than their proxy advisors recommended, and 65 percent of asset managers voted in support less often than recommended by their proxy advisors.[241] Furthermore, the results of the ShareAction (2020) study show the same investor-level pattern indicated in the previous chapter, namely that UK and German asset managers are more likely to back ESG proposals than US asset managers. Vanguard, BlackRock, JP Morgan Asset

[240] Katherine Rabin, CEO of Glass Lewis, in testimony to the SEC Roundtable on the Proxy Process. Minutes available at: https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf
[241] The study involved UK and US asset managers at the 2019 AGMs of UK and US portfolio companies.

Management and State Street indicated support for just 8 percent of these resolutions, compared to 79 percent by ISS (Figure 24).

Figure 24: Asset managers' votes "For" shareholder resolutions, compared to ISS' recommendations to vote "For" resolutions.



Source: ShareAction (2020).

The data from ShareAction (2020) is supported by a report from the law firm Sullivan & Cromwell (2018a), which notes that in 2018 ISS supported 74 percent of all shareholder proposals on environmental, social or political matters. The report notes that despite this almost uniform recommendation by ISS, these proposals received an average support of just 26 percent and even more striking just six percent of those proposals (8 out of 128) actually passed (Sullivan & Cromwell, 2018b). This data thus further serves to question the claims that proxy

advisors have outsized influence over their clients. Instead, "[c]orporate lobby groups have managed to paint proxy advisers with a bad brush".[242]

The most dramatic difference between the voting behaviour of asset managers and ISS' recommendations according to ShareAction (2020) can be seen on shareholder proposals calling for greater transparency on political lobbying activities. Whereas the majority of asset managers voted in support of these proposals 80 percent of the time, ShareAction found that BlackRock, Vanguard and JP Morgan voted against the recommendations of their proxy advisors 93 percent of the time (when proxy advisors recommended voting in support).

Strine (2018) reports similar data, showing that Vanguard and Fidelity supported no such proposals in 2018, while BlackRock supported just 4.1%. The previous chapters explained that BlackRock and Vanguard have formal investment policies that defer to management on political issues. Strine (2018) labels this as the "fiduciary blind spot" of the Big Four (he includes the active manager Fidelity alongside BlackRock, Vanguard and State Street), remarking that "they let corporate management spend the Worker Investors' entrusted capital for political purposes without constraint" (2019: IV). This substantially more critical proxy voting approach of ISS and GL, when compared to the Big Three, likely explains why they have been exposed to the sustained criticism from corporates, detailed in the next chapter.

[242] Isobel Mitchell, co-author of the ShareAction report, quoted in the Financial Times, "Big investors ignore proxy advisers on controversial votes", 8 February 2020. Available at: https://www.ft.com/content/fd275eff-39b9-438d-bf15-31bb242a1924 (Accessed 15 March 2020).

Estimates of Proxy Advisors' Influence – US vs. international influence

Previous chapters have shown that the UK and Germany have substantially higher foreign ownership levels than the US. The UK and Germany both also have on average smaller asset managers than US investors. Both these factors would indicate that proxy advisors should play a bigger role in the British and German equity markets.

With regards to indexation, however, the previous chapter showed that most of the index funds in Germany and the UK have been issued by asset managers that have much larger active assets. Since standalone index funds are more likely to rely on proxy advisors, this would suggest that proxy advisors will be of greater relevance in the US market. One such example was reported by a US basic resources company, which had not even been able to contact one of their ten largest shareholders, a US sector ETF launched by a small US index provider.[243] However, since 81 percent of the US ETF market is controlled by the Big Three with their comparatively higher absolute stewardship staffing levels, this is likely to mostly offset the greater relevance of index funds in the US context.

The differences in the dependency on, and thus the susceptibility to influence from, proxy advisors are therefore likely to be largely similar across countries. Instead, as with the Big Three in the previous chapter, there are a number of factors that explain why the policies of ISS and GL are not advancing a US-centric understanding of corporate governance. First, proxy advisors have acknowledged attaching increased significance to the opinions of domestic investors. Having asked a representative of one large proxy advisor what role domestic

[243] Investor relations, US company, telephone-interview, 16 January 2018.

investors play in setting governance practices, he explained that a "home advantage is always there. They are not more important but have greater expertise".[244]

Secondly, US proxy advisors, like the Big Three operate European offices. In Europe GL is headquartered in Limerick in Ireland but following the acquisition of IVOX also maintains a large German office. On its website ISS lists offices in Paris, Zurich, Brussels, Berlin, Stockholm, Munich and London. A former employee of one of the big proxy advisors commented on the significance of this "For the most part, analyses for European companies are written in the rather autonomous European bureaus, if only because of the required language skills. The accusation that Americans would dictate to European companies what they have to do or should not do therefore falters a bit".[245]

Third, in these regional offices, regional policy documents different from those for the United States are drafted. ISS divides its voting policies into three regions (Asia-Pacific, Europe the Middle East and Africa, and the Americas). The Asia-Pacific region, for example, lists ten separate voting policies for China, Hong Kong, India, Japan, Korea, Singapore, Taiwan, Australia, New Zealand as well as a "Asia-Pacific Regional Proxy Voting Summary", which covers markets not listed separately.[246] Whereas an inspection of the regional proxy voting guidelines of the Big Three reveals almost no differences between regions, the guidelines of ISS show substantial regional variations. Proxy advisors' regional policies therefore serve to limit the Americanisation that might otherwise arise from their services.

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[244] Specialist, Proxy Advisor, Telephone Interview, 20th of September 2018.
[245] Emailed comment, former proxy advisor employee. 6 June 2018.
[246] For further details, see: https://www.issgovernance.com/policy-gateway/voting-policies/ (Accessed 20 October 2019)

ISS' UK policy (ISS, 2019a) starts out by explaining that prior to 2015 they used the voting guidelines of the UK Pensions and Lifetime Savings Association and that today it remains broadly consistent with that. Since the UK follows a "comply or explain" approach the ISS policy takes account of this and "[w]hen assessing the quality of a company's explanation, ISS follows the guidance provided by the Financial Reporting Council (FRC) in the UK Corporate Governance Code (the Code)" (ISS, 2019a: 4). Throughout the UK policy references are repeatedly made to UK regulation serving as a guide. For gender diversity reference is made to the UK Corporate Governance Code and for renumeration "[t]he ISS approach is aligned with the five remuneration principles for building and reinforcing long-term business success developed by the Pensions and Lifetime Savings Association in conjunction with a number of leading UK institutional investors, originally published in 2013" (ISS, 2019a: 14).

Germany does not have its own policy but forms part of ISS' Continental European proxy voting policy. With some exceptions, the European policies do not refer to specific country-level laws but instead "boards should adhere to domestic legal requirements or local best market practices or, in the absence thereof, be in line with European established practice" (ISS, 2020: 12). Whereas the UK policy has an explicit mission statement in favour of shareholder value, which is balanced by a dedicated section on ESG, the European policy has neither. ISS explains that it's European "approach is not "one-size-fits-all" and takes relevant market-specific factors into account in our research and recommendations" (ISS, 2020: 4).

ISS' US proxy voting policies at 70 pages is almost twice as long as the policies for the UK and Continental Europe. This is due to the fact that the US lacks a national, government-enforced corporate governance code and ISS policy thus has to describe each policy item in

detail without the ability of referring to national legislation.[247] "What market participants in the United Kingdom regard as uncontroversial or settled in their best practice governance codes is still a source of dispute for their U.S. counterparts" (Tuch, 2019: 1462). ISS' US policy therefore appears to walk a tight rope between focussing on shareholder value and allowing for the integration of ESG. One section on mergers states "Stakeholder Provisions: General Recommendation: Vote against proposals that ask the board to consider non-shareholder constituencies or other non-financial effects when evaluating a merger or business combination" (ISS, 2019b: 28). In the absence of national legislation, ISS is forced to spell out how it considers certain ESG policies and the following examples show why as a result of these policies their recommendations diverge to such a large extent from the voting practices of the Big Three.

On "Climate Change/Greenhouse Gas (GHG) Emissions" the policy recommends to "[g]enerally vote for resolutions requesting that a company disclose information on the financial, physical, or regulatory risks it faces related to climate change on its operations and investments or on how the company identifies, measures, and manages such risks" (ISS, 2019b: 58). The Big Three on the other hand have to date considered most such cases to be issues of "ordinary business" and thus best left to management's discretion. The policy document contains pages with individual ESG policy items, but in general can be summarised as supporting proposals that seek further information from companies. Another example is provided by shareholder proposals calling for greater transparency of political contributions, which the Big Three generally reject, whereas ISS recommends to "[g]enerally vote for

[247] Instead corporate governance matters are provided in state and federal laws, regulations and listing rules. For further detail, see: https://uk.practicallaw.thomsonreuters.com/w-011-8693?transitionType=Default&contextData=(sc.Default)&firstPage=true (Accessed 15 November 2020).

proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities” (ISS, 2019b: 64).

Besides these country and regional voting policies, ISS also offers Climate, Faith-Based, Public Fund, Sustainability, Socially Responsible Investment (SRI) and Taft-Hartley proxy voting guidelines.[248] ISS policy approach is therefore best described as a menu approach: they offer investors a large selection of benchmark policies to choose from, their website lists 32 benchmark policies as of 15 March 2020, with investors deciding which one of these benchmark policies to choose or to have their own custom policy designed.

A former employee of one of the big US proxy advisor firms explained that “while there are overarching principles, such as the rule of law, policies always have to be tailored to the markets. Taking into account the legal system, the ownership structure, the position of the economy, whether it is emerging or developed, and cultural factors”. He would therefore “not advocate to use the same policies across the world, but principles are helpful. I think markets learn from each other. The UK clearly led the way with say on pay. They all learn from each other”.[249] This “learning” implies a degree of conversion on individual policies, but not that there is convergence in an overall singular direction.

Conclusion

This chapter documented that the scale and time pressure of the proxy voting process has left asset managers dependent on the services of proxy advisors. However, this dependence on their resources does not equate to a widespread overreliance on their recommendations. While there

[248] Source: https://www.issgovernance.com/policy-gateway/voting-policies/ (Accessed 15 March 2020).
[249] Former governance analyst, US proxy advisor, telephone interview, 10 February 2020.

is evidence that a group of investors blindly follows proxy advisors, asset managers for the most part explained that they were using proxy advisors merely as data aggregators and decisions were being made based on investors' own custom policies. This impression is confirmed by the fact that the vast majority of all proxy items are approved with high levels of support, despite proxy advisors' frequent recommendations to the contrary.

What the services of proxy advisors have achieved is to coordinate the views of the smaller asset managers. In effect proxy advisors have helped to coordinate the voice of smaller asset managers the way that economies of scale and thus asset growth has done for the larger asset managers. They have created a secondary voting bloc alongside, and often in opposition to, the voting blocs of the Big Three. Proxy advisors have thereby added to the potential for shareholders' use of voice.

Proxy advisors are less constrained than asset managers when it comes to confronting corporate conduct since they are not subject to the same conflicts of interest as detailed for asset managers in the previous chapter.[250] Because the policy recommendations of proxy advisors, particularly as regards environmental, social and political issues, have been shown to be more critical of corporate managers, than the voting policies pursued by the Big Three, the coordination they provide may therefore enable other asset managers to break the governance vacuum provided for by the Big Three. They thus represent a further agent of change alongside US pension funds, UK and German asset managers.

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[250] While ISS does seek corporate mandates, the resulting conflicts of interests is different to that which arises from asset managers competing for corporate pension mandates. Corporate interviewees' accusations of conflicts of interest at ISS have focussed on the fact that they intentionally increase the demands on corporate governance standards each year "they would have to change something every year". This suggests that conflicts of interests would result in ISS issuing a greater number of critical reports (not a smaller number) in order to ensure continued demand for their consulting services from corporate issuers.
References: Investor relations, German company, telephone interview, 11 January 2018.

If one compares the 13.6 to 29.7 percent influence attributed to proxy advisors by the academic literature (Bethel and Gillan, 2002; Cotter et al., 2010) to the 25 percent of votes cast by the Big Three at the average S&P 500 company (Bebchuk and Hirst, 2019s), this suggests that within the US corporate governance landscape the influence of the Big Three likely exceeds that of the proxy advisors. This conclusion is supported by the proxy voting data presented in this chapter. The fact that the shareholdings of the Big Three are substantially smaller in the UK and Germany than in the US, at approximately one third less and fifty percent less, respectively, suggests that proxy advisors are relatively more influential in Germany and the UK than they are in the US.

Since proxy advisors' recommendations have been shown to be more supportive of shareholder proposals on environmental and social issues, the greater influence of proxy advisors relative to the Big Three in the UK and Germany may provide a partial explanation for why those countries' understanding of corporate governance is changing to a greater extent than that of the US (the regulatory environment also playing a role). Rather than being a tool that promotes an Americanisation of corporate governance, proxy advisors therefore appear to advance the policy preferences of domestic investors.

Chapter 6

Asset Management, Financialisation and Inequality

Introduction

The previous chapters have focussed on the relationship between shareholders and the corporate and though social issues have been touched on throughout, this approach nevertheless runs the risk of falling into the trap of agency theory by removing workers from the analysis. The research question seeks to identify changes to corporate governance as a result of changes in the shareholder ownership structure. As such I have shown that there is an increasing demand from institutional investors for greater integration of social considerations into corporate policies. However, the Big Three asset managers have frustrated many of these efforts to differing degrees across countries.

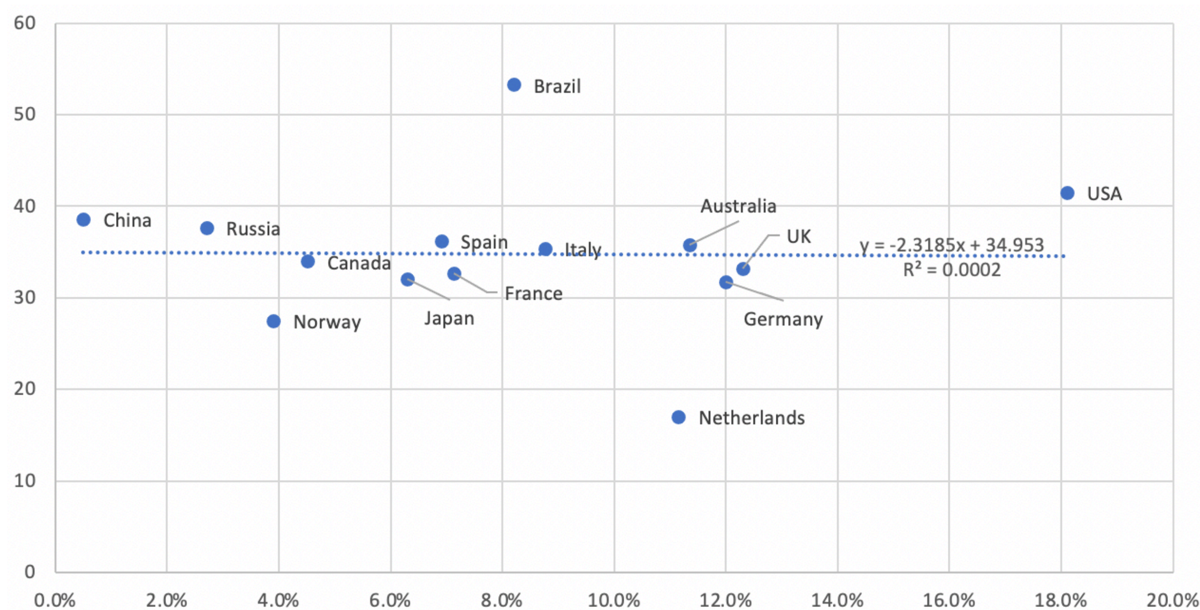
To ensure the social consequences of asset manager capitalism receive the attention they deserve, this chapter will make use of the financialisation literature. The introduction defined financialisation as a process that grants a greater role for financial motives, financial markets and financial institutions in the economy (Maxfield et al., 2017). Through this growing role financialisation is changing the logics of the industrial economy (van der Zwan; 2014). Davis and Kim (2015) surmise that how finance is intermediated in an economy shapes social institutions in fundamental ways. It is thus the aim of this chapter to draw on the insights of the previous chapters to highlight the role that the asset management sector has played in changing the intermediation of finance and the consequences of this for the three countries in question, with a particular focus on economic inequality.

The bundling of assets and their ensuing securitisation has turned debts into marketable securities, enabling the "assetization" (Langley, 2020b) of ever more objects and relationships. Davis and Kim (2015) thus consider securitisation to be "[o]ne of the most critical yet under-appreciated enablers of financialization". Derivatives more generally have enabled a transformation of the relationship between borrowers and lenders. The consequence of this is that the relational aspect between lenders and borrowers is significantly diluted.

Since the VoC literature places considerable importance on the form of financial intermediation, differentiating between bank-based and market-based forms of financing in CME and LME economies respectively, the increase in financialisation has decreased the significance of this differentiator (Erturk et al., 2008) and instead raising the significance of the differences in the institutional structures of the investment chain, presented in this thesis. With capital markets increasing in relevance in almost all economies, it has therefore become more important to identify differences in financial institutions' conduct across countries.

Figure 25 plots the proportion of shares held by the Big Three asset managers against national levels of inequality. Merely charting inequality (measured by Gini coefficients) as is done in Figure 26 below results in no apparent relationship.

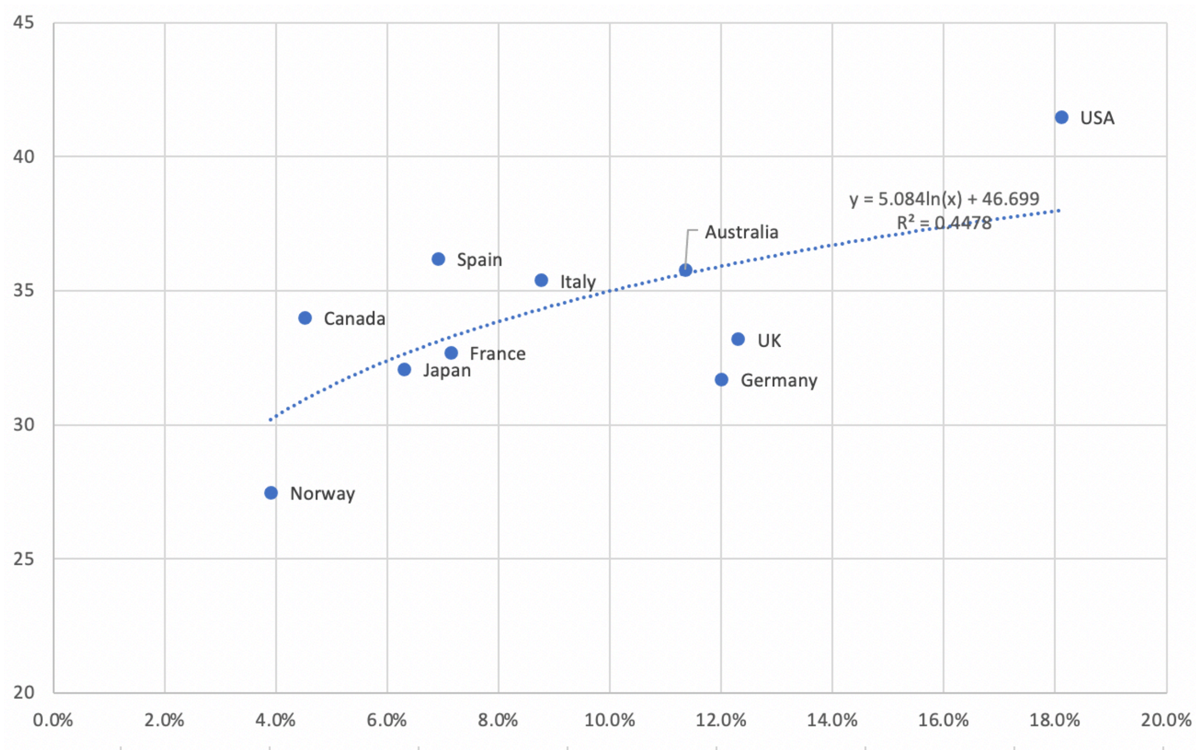
Figure 25: Gini coefficient versus Big 3 shareholdings by country



Source: Bloomberg, World Bank

The relationship is particularly distorted by the inclusion of emerging market countries Brazil, Russia and China as well as the special case of the Netherlands. If we limit the analysis to developed markets as much of the VoC literature does (see Hall and Gingerich, 2009), the relationship becomes much stronger. The Netherlands represents a special case as some of its largest companies (in particular Royal Dutch Shell and Unilever) have dual listings on the UK and Dutch stock markets with corresponding weights in both countries' blue-chip benchmark indices (the FTSE 100 and AEX respectively). The result of this is that these companies are included in ETFs of both countries with the result that the Big 3 have greater shareholdings. With these adjustments made, the correlation increases to 0.69 with an r-squared 0.45 as depicted in Figure 26 below.

Figure 26: Gini coefficient versus Big 3 shareholdings in selected developed market economies



Source: Bloomberg, World Bank

The difference between Figure 25 and Figure 26 confirms the obvious, that there are factors other than the ownership by the Big 3 asset managers that play a more important role in determining levels of inequality across developed and emerging economies. Yet focussing the analysis on developed markets also provides support for the relationship between asset manager capitalism, financialisation and inequality discussed in this chapter. Of course, causality could also be the reverse of course: in unequal societies the rich have money and spend less and save more. All of this confirms that further research on the link between the asset management sector and inequality is needed.[251]

[251] A typical approach in the financialisation literature would be to look at the market capitalisation of the domestic stock market versus levels of inequality, or the asset base of the fund management sector as a percentage as a percentage of GDP in relation to inequality. Instead Figures 9 and 10 consider only the holdings of a select group of actors, the Big Three, and consider how these differ across countries.

The financialisation literature has highlighted the importance of securitization in expanding financial markets into an ever-increasing assortment of assets, ranging from bank loans, mortgages, life insurance policies to commodities (Aalbers, 2008; Davis and Kim, 2015). Private equity and hedge funds are commonly presented as the primary drivers of financialisation (Appelbaum and Batt, 2014; Fichtner, 2013). Yet, while hedge funds and private equity capture much of the popular attention, this focus is misdirected given the size of mutual funds an ETFs. As the preceding chapters have highlighted, these actors cannot succeed without the support of the large mutual fund and ETF companies.

Despite not being the primary agitators, conventional asset managers have therefore played a substantial role in advancing financialisation. For decades they have condoned the actions of other more aggressive actors, particularly activist hedge funds and private equity funds, and silently and passively benefitted from those actors' initiatives. These initiatives include, for example, the break-up of companies into several smaller companies, mergers and acquisitions, and share buybacks as Chapters 3 and 4 have highlighted, the Big Three possess the means to decide the fate of many of today's shareholder proposals.

They have thus become the adjudicators of the market for corporate control. The market for corporate control would not function the same way without the big asset managers' support of activist investors, as for the most part activists only acquire relatively small holdings in target companies, often as little as three to five percent, and then push for change. For activist campaigns to be successful they have to be able to convince (or appear to convince) the majority of the remaining shareholders that their proposals will add value. These proposals from shareholder-value focussed activists are increasingly joined by proposals from social activists calling for greater protection of the environment or better protection for employees.

Such "ESG" (Environmental, Social and Governance) proposals seek to protect or advance stakeholder interests. With some shareholders pushing for shareholder priority and others for stakeholder priority, the large asset management firms have become the arbiters of such contests and therefore to a large extent decide a key potential impact of financialisation.

Chapter Structure

Erturk et al. note that finance matters since the 1970s "because the experience of individual subjects and the trajectory of the macro-economy are both increasingly mediated by new relations with financial markets" (2008: 3-4). The financialisation literature seeks to understand this mediation and, in its efforts, commonly differentiates between three groups of actors: the financial sector, nonfinancial corporations, and households. Some such as Pagliari and Young (2020) include the state as a fourth actor and Trampusch (2019) assesses the role of government debt management offices in financialisation. Scholars have correspondingly conceptualized financialisation as a new regime of accumulation, a guiding principle of corporate behaviour or a central feature of everyday life (van der Zwan, 2014).

Karwowski et al. (2020) identify seven main hypotheses in the financialisation literature. These are: (1) the question of whether financialisation is one uniform process or whether there are several distinct and independent processes across sectors and countries, (2) the argument put forward by some Marxist authors that a slowdown in investment precedes financialisation (Brenner, 2003), (3) that financialisation results from deregulation, (4) financialisation reflects a shift to more market based forms of financial intermediation, (5) that financialisation should be understood as part of a debt-driven demand regime, (6) that that financialisation is driven by foreign financial inflows, and (7) that financialisation is driven by asset price inflation. Of

these seven hypotheses, number 1 and 4, are particularly relevant for this thesis as they both relate to the issue of convergence.

The remainder of this chapter will be structured as follows. The next section will briefly outline how the asset management industry's high salaries directly contribute towards economic inequality. This will be followed by three sections that discuss how asset managers have contributed to the financialisation of households, nonfinancial corporations and the state respectively. Each of these sections will include an investigation of how asset managers' role within financialisation contributes to the growing problem of income inequality. What will become apparent is that financialisation is a heterogenous process, and that both its extent and consequences differ substantially from country to country.

This chapter will show that pensions reforms in particular have created a relationship of dependence between households and financial markets' performance. The section on asset managers and the state will furthermore show that governments and their institutions have also entered a relationship of dependency, one that is based on on the resources, both physical and epistemic, that asset managers have accumulated in recent decades. The section on the financialisation of the nonfinancial firm will highlight the extent to which asset managers' policy preferences have increasingly shifted corporate executives' focus from measures seeking to secure organic growth towards financial engineering. Yet the national heterogeneity also gives hope, as there are signs that asset managers in the UK and Germany are increasingly seeking to rein in some of the worst outcomes of financialisation.

Asset Managers' direct contribution to income inequality

The institutionalisation of share ownership documented in the preceding chapters has created many new financial firms, adding to employment in the high-income finance industry. In 2017 the fund management industry employed 178,000 people in the United States, 38,000 in the UK and 13,900 in Germany.[252] Considered on a national level these absolute numbers are relatively small, however, geographic concentration in a small number of cities increases the local impact.

Only about 10 percent of these employees work in the "front office" managing investment funds. For this small number of people, however, salaries can be high. Data from the website Glasdoor.com taken in July of 2020 show that the average salary for a fund manager in New York was $103,000, in London it was £73,759 and in Frankfurt it was €96,612 per annum. In addition to these salaries, fund managers typically receive bonuses equating to approximately fifty to one hundred percent of their base salary.[253] Though the total number of individuals employed in these new financial intermediaries is small on a national basis, Folkman et al. (2007) point out that they outnumber senior giant firm managers many times over, who oftentimes are the focus of the press when it comes to income inequality.[254] Godechot (2020) explains that in this way the finance sector has contributed directly to increased inequality.

Pay may also contribute a class dimension to corporate governance and financialisation. What the above numbers hide is that there is a small elite within the fund management industry

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[252] US numbers from Statista: https://www.statista.com/statistics/255592/investment-company-industry-employment/ (Accessed 19 September 2020). UK and German numbers from EFAMA (2019).
[253] While high, these average numbers are substantially lower than what can be earned by members of the investment banking, private equity and hedge fund industries.
[254] Folkman et al. (2007) compare the number of executive directors at FTSE 100 companies with the number of senior capital intermediaries in London, also including lawyers, consultants and private equity. However, the same conclusion holds true when focussing only on mutual fund portfolio managers and analysts.

consisting mainly of the owners of asset managers as well as their star fund managers that earn pay packages in the many millions. Braun (2016b) highlights that Bill Gross, the co-founder of US-based asset manager Pimco (owned by the German insurance company Allianz), in 2013 earned $300 million, equating to approximately 20 percent of Pimco's 2013 profit-sharing plan of $1.3 billion. The remaining $1 billion was paid out to the other 60 managing directors of the firm (an average of just under $17 million per person).

Braun (2020a) therefore suggests that corporate managers and asset management executives have formed an amalgamated elite. This is a break from the stakeholder coalition perspective (Gourevitch and Shinn, 2005), which has mostly interpreted shareholder primacy as an allegiance between shareholders and workers against corporate executives. The preceding chapters of this thesis support this conclusion in the case of the US. That is because the Big Three asset managers' voting records evidence a near blanket backing of corporate executives and thus insulation from the concerns of other stakeholders. This conclusion that asset manager capitalism represents a coalition of executives and big shareholders against workers does not translate equally across other countries though, since the regulatory approach and the relatively larger stakes of other shareholders moderate the influence of the Big Three in both the UK and Germany.

Asset Managers and the Financialisation of Everyday Life

Chapter 2 reported how pension reforms ignited the growth of the asset management industry. In the US, pensions reforms were brought in as a response to the crisis of profitability that beset US firms in the 1970s, marking deregulation as one of the key drivers of financialisation (Fligstein, 2001; Krippner, 2005). Instead of being able to rely on a defined benefit in retirement, most employees in the UK and the US today instead have pensions that are linked

to the performance of stock markets. Birdthistle therefore remarks that the US has embarked on a "grand experiment" that seeks to determine whether "millions of ordinary, untrained, busy citizens can successfully manage trillions of dollars in a financial system dominated by wealthy, skilled, and powerful financial institutions, many of which have a record of treating individual investors shabbily" (2016: 1).

With private pensions bringing finance into ever more households, financialisation is laying the ground for its own reproduction by influencing the policy preferences of individuals (Nesser and Davis, 2012; Pagliari et al., 2018). It is doing so by creating a "finance culture" (Fligstein and Goldstein, 2015), which is resulting in a "split personality" dilemma (Harmes, 2001), whereby individuals as shareholders will want higher returns, but reject the resulting negative consequences that might result at a personal level, such as global warming, a higher workload, lower pay, less diverse work environment or, ultimately, the loss of one's own job.

Index funds, and the diversification they entail, have helped to lower both the cost and the perceived risk of investing to millions of households, thereby advancing the financialisation of everyday life. Van der Zwan (2017) explains how the same logic held true for institutional investors, as Dutch and US pension funds increased their exposure to equities in earnest from the mid-1970s onwards as they fully embraced the lessons of modern portfolio theory, namely that stock-specific risk can be diversified away and that markets are efficient and therefore it is futile to try to beat the market.

Whereas the process of financialisation has brought mutual funds and ETFs to many more households in the US, the UK and Germany, what is oftentimes neglected is the role that wealth distribution plays in this process. Financial market risks, whether resulting from the

discretionary investment in mutual funds or the less discretionary investments resulting from pension plans, require both financial literacy as well as risk capital, something that many households lack. The wealthy will be better able to deal with market vicissitudes (not being forced to sell when markets have fallen).

The Federal Reserve (2019) finds that 39 percent of the US adult population would be unable to cover a hypothetical expense of $400 using cash, savings, or a credit card paid off at the next statement. Lacking a starting block of savings, many households are thus unable to participate in the alleged benefits of the democratisation of finance. Accordingly, Froud et al. (2001) and Godechot (2020) find that financialisation has no effect on inequality at the bottom of the income hierarchy but that it drives inequality at the top.

Erturk et al. (2008) furthermore highlight how this narrative of citizen shareholders and the "ownership society" is a political construct. They explain that in the 1920s and 1930s the term "rentier" was widely used for the actors known today as shareholders. The terminology is inherently critical, implying there is no economic value to shareholding beyond extraction of cashflows to the benefit of the individual. Later finance "delivered on its promise of long-term security and capital gains" for the masses as a result of the boom in stock markets in the 1950s and 1960s, thereby forming the "basis for a new connection between finance and the financialized masses" (Erturk et al., 2008: 4). Following this period, the rentier terminology was abandoned as neoliberal supporters in the following decades sought to advance the notion of the "good" shareholder. The authors explain that this reconception was predicated on the fact that whereas the shareholders in the 1920s and 1930s were made up only of the small elite rich, in the late 20th century an ever-increasing proportion of households was invested in financial markets.

Chapter 4 documented that the extraordinary popularity of index funds in recent years has led industry insiders (Novick, 2017) and financial commentators (Financial Times, 2015) to suggest that they are “democratising” finance. The argument is that mutual funds, and index funds in particular, have brought down the risks and costs of investment management with the result that a growing proportion of households today owns a (small) piece of the big pie.

However, this fails to acknowledge the income and wealth distribution amongst households. In the US, for example, the median household had assets of $213,000 in 2018, yet the median assets of households owning mutual funds is four times that level at $856,300, and ETF households were even wealthier with median assets of $929,800 (ICI, 2018). In fact, just 6 percent of US households reported holding ETFs in 2018, and these households were younger, wealthier and better educated with 66 percent reporting a college or postgraduate education, compared to 34 percent for all households (ICI, 2018). The consequence of this is that the less wealthy may have a stake in the stock market, but wealthier have a bigger stake, so rising markets increase inequality rather than reducing it.

The situation in Germany is similar though more complex requiring a brief excursion into the technicalities of German savings products. First, as outlined in Chapter 2, “life insurance” products play a much greater role in private pension provisions than mutual fund or ETF investments. These financial products offered by insurance companies and typically distributed via retail banking partnerships, offer individuals a guaranteed minimum return (“Garantiezins”) for the duration of their life. Individuals then draw down their savings in these products as they enter retirement. At approximately 84 million policies (46 percent of households), they dwarf the 7.1 million of individuals (13 percent of households) in Germany

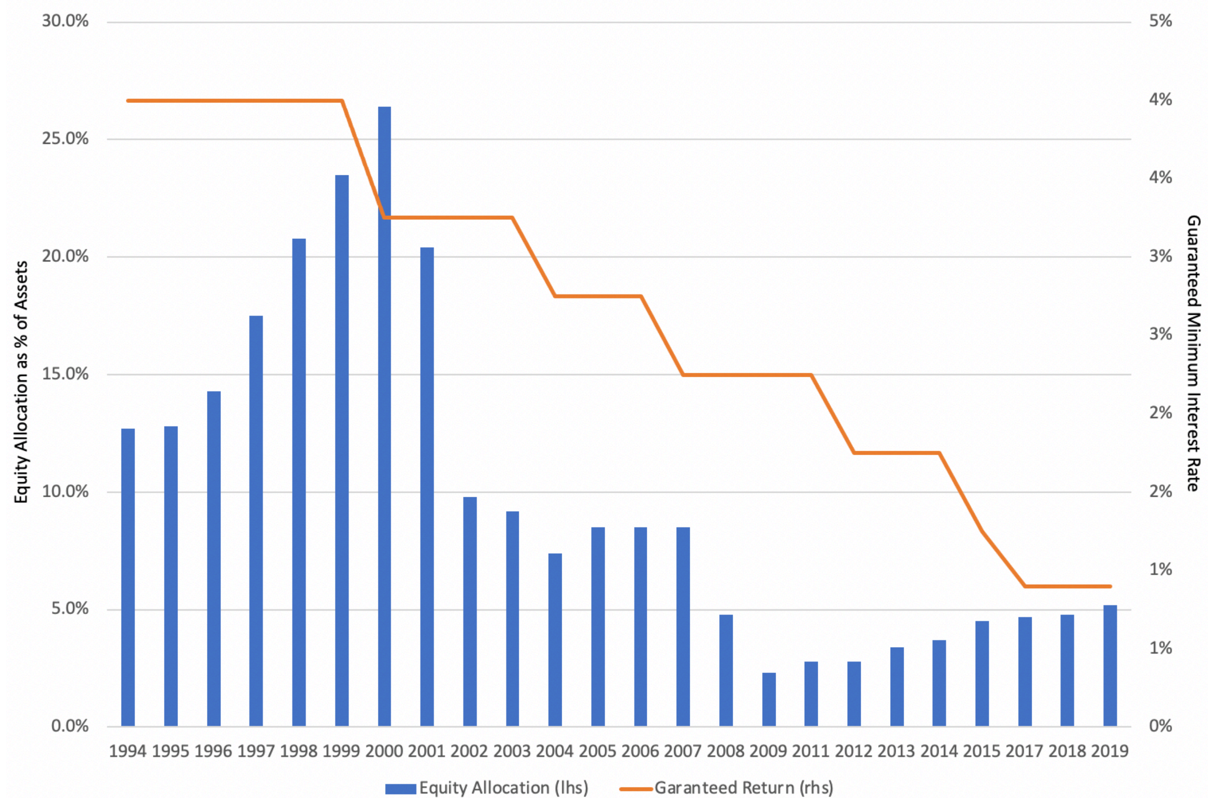
with mutual fund investments (Bundesbank, 2016; DAI, 2019; Handelsblatt, 2019). However, their relevance for equity markets is substantially smaller than this ratio would suggest as these products generally have low investments in equities.

Figure 27 below shows the historic asset allocation of German insurance companies. Two clear drops in the allocation to equities are visible after 2001 and 2008 respectively. In each case financial markets turmoil forced a substantial reduction in insurance companies' equity allocations. The reason for this is to be found in regulatory standards, which prescribe that German insurance companies follow an asset liability approach that ensure that insurers are able to fulfil the minimum return promises they have made. The two primary drivers of such calculations are the reserves that an insurance company has been able to amass over the preceding years as well as the returns they are able to model.

With each financial crisis and resultant stock market collapse, these reserves diminished, forcing a pro-cyclical sale of equity investments.[255] Secondly, as central banks responded to the financial turmoil with rate cuts, this only acerbated insurance companies' troubles as this reduced the future returns they were able to assume in their models, and thus further reducing their ability to carry equity risk. The end result is that these life insurance policies cannot withstand the viscidities of equity markets, in the same way that individuals with low personal wealth can also not withstand them.

[255] There were occasional, temporary, suspensions of these rules at the height of the crisis.

Figure 27: Equities as a percentage of the total allocation of German insurance companies (excluding reinsurance companies) and the minimum interest rate guaranteed by German insurers



Source: GDV, BMF, Das Investment, Statista

Because of the adverse development of equity markets and central bank interest rates is that insurers increasingly find themselves caught in trap, where they need higher equity allocations to pay their guarantees but cannot afford the regulatory risk budget this requires. Insurers have responded by repeatedly cutting the guaranteed interest rate for new policies, to the point where it now sits at just 0.90 percent. As a result, such products have recently fallen out of favour and

Allianz reports that more than 90 percent of new life insurance policies are now issued without a minimum return guarantee.[256]

The relevance of all this for the issue of financialisation is that for the most part German private pension savings have not been invested in stock markets, thus arguably reducing the influence of financialisation (less exposure to stock market volatility). With regards to those households invested in mutual funds and ETFs, however, the dynamics are similar to those seen in the UK and the US. As with the US, the distribution of mutual fund holdings across households is highly unequal (Bundesbank, 2016; DAI, 2019). Both direct share holdings and mutual fund holdings are highly correlated to income, with just six percent of households in the bottom two quintiles holding any mutual funds, while mutual fund ownership amongst the top two quintiles of households is 22 percent and 32 percent respectively (Bundesbank, 2016).[257] Since overall mutual fund ownership in Germany is smaller than in either the UK or the US, the contribution towards increasing inequality has however been lower.

Statistically there is thus little evidence of everyone having an equal stake, and even for those with a stake, there are questions as to how they have influence. Van der Zwan is right in noting that "the democratization of finance has relegated large segments of the population to the status of capital owner, thus upsetting notions of class that regard labour and capital as binary opposites" (2014: 120). Yet from a comparative perspective the extent to which this has happened differs from country to country.

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[256] Central bank monetary policy has thus affected more individuals negatively in Germany, than in the UK or the US. Whereas US and UK private pensions are predominantly in equity markets and have thus benefited from the resulting asset price inflation German life insurance policies have suffered from lower equity market returns as allocations to equities have been decreased as a result of lower interest rates.

[257] Comparable current data is not available for the UK.

Because equity allocations of both public and private pension plans are so much higher in the UK and the US, individuals in Germany have even less of a say in German corporate governance as their combined pensions savings make up a smaller part of the domestic market capitalisation. This is reflected in the comparatively small asset base of German asset managers when compared to their UK and US peers. The four largest German asset managers have a combined average stake of just 4.5 percent of a typical DAX-30 company.[258] As the preceding and following chapters show, the relatively small holdings of German asset managers are partially made up for by the comparatively high salience that domestic institutional investors' voice has within contemporary asset manager capitalism.

Unfortunately, comparable data for the UK is not available. Instead, only the percentage of individuals with direct shareholdings (12 percent) and the percentage of individuals with share based "individual savings accounts" ("ISAs", also 12 percent) is known. Furthermore 20.6 million individuals had active pensions, of these 8m were in the form of employer defined contribution and 1.8 million were private pensions.[259] The value of DC pensions stood at approximately £600 billion in 2020.[260] Besides private pension schemes, the UK also provides the option for private individuals to save tax-free for retirement in the aforementioned ISAs.

As of November 2020, individuals are able to invest up to £20,000 tax-free in ISAs annually. There are different types of ISAs but the most common can hold both mutual funds/ETFs and shares. At the end of 2019 "stocks and shares" ISAs accounted for approximately £315 billion in assets (HM Revenue and Customs, 2020). To put this into perspective, ISAs alone have

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[258] Combined shareholdings of DWS, AGI, Union Investment and Deka Investment in the 10 largest DAX-30 companies. Data as of 14 April 2020. Data source: Bloomberg.
[259] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/financialwealthwealthingreatbritain (Accessed 7 November 2020).
[260] https://www.bbc.com/news/business-51676600 (Accessed 7 November 2020).

investments almost equalling all of the assets of German private corporate pensions (£457 billion).[261] With regards to income distribution and inequality the data shows that the amount subscribed to an ISA increases with the income of the individual. The highest proportion of ISA savers, approximately 44 percent, saved between £1 and £2,499. However, 61 percent of those with income of £150,000 or more saved at the maximum allowed rate of £20,000.

The situation in the UK represents a combination of the developments seen in the US and in Germany. On the one hand, the value of UK domestic pensions savings invested in stock markets is very high (£915 billion just from DC pensions and ISAs). As a result, the assets of personal pension funds as a percentage of GDP at approximately 36 percent (£915 billion / £2.522 billion) is even higher than the 18.1 percent of GDP seen in the US.[262] On the other hand, because these pension assets are invested globally across several asset classes, and because of the relative size of the UK stock market, the percentage of the UK stock market owned by foreigners in 2018 stood at 54.9 percent.[263]

With the majority of both the UK and Germany stock market held by foreigners, this raises the question of whose shareholder democracy it is? One could argue that via their sovereign wealth fund the Norwegians have a say in UK and German capital markets, as do Americans through their big fund management firms. This is why it has been so important to document the differing behaviour of institutional investors across countries and the enduring salience of domestic investors in determining the themes for the national corporate governance discourse.

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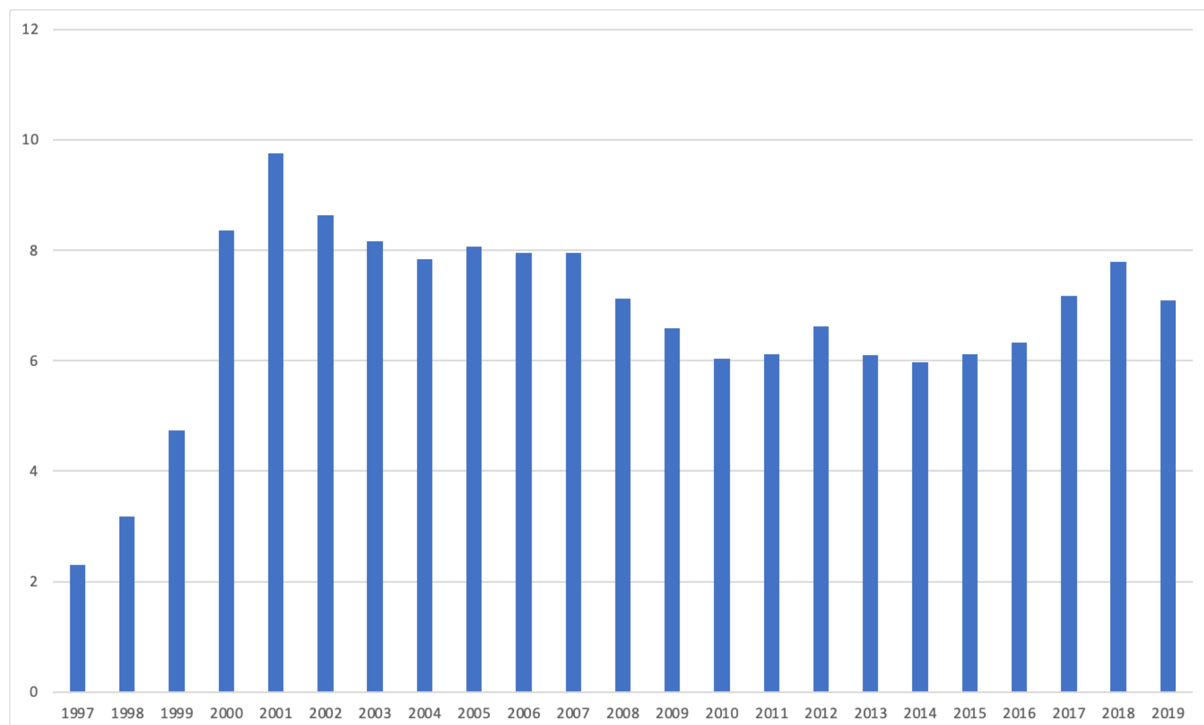
[261] Willis Towers Watson (2018a), exchange rate of £/$ of 1.32.
[262] https://stats.oecd.org/index.aspx?queryid=595# (Accessed 7 November 2020).
[263] https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018 (Accessed 7 November 2020).

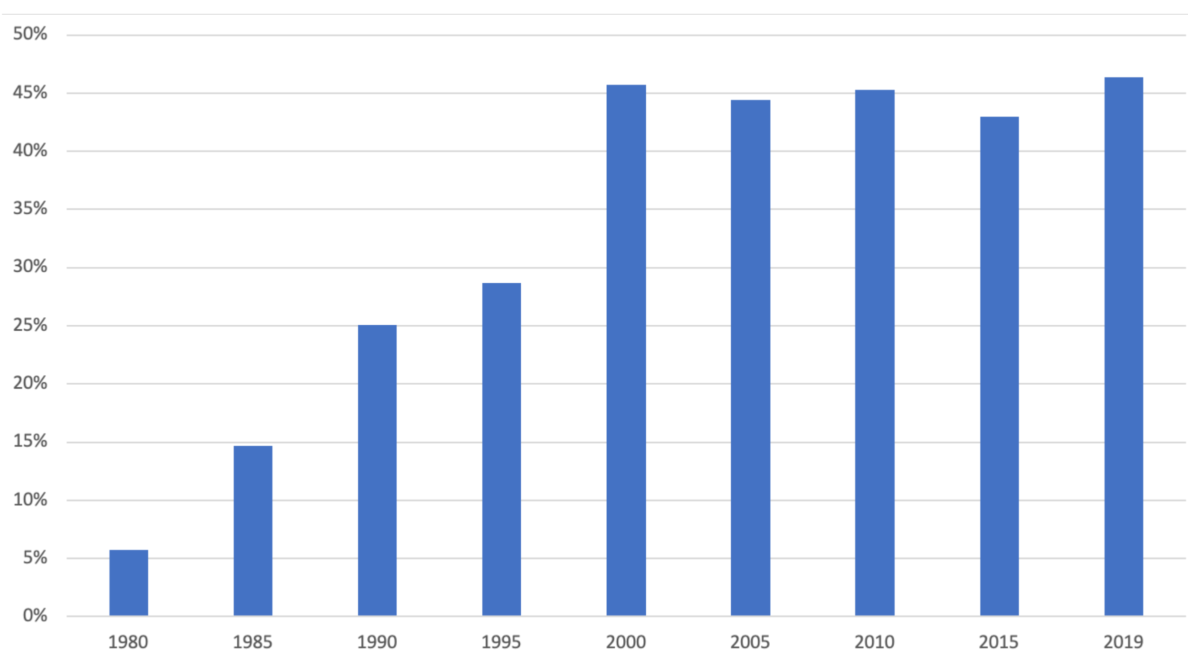
Figures 28 and 29 below illustrates that the rapid growth of households investing in mutual funds peaked in 2000. Since then the number of households with mutual fund holdings has plateaued or even slightly declined. This suggests that household financialisation resulting from the fund management sector has reached a limit for now. It is noteworthy that this plateauing has occurred at a much lower level (approximately 13 percent of households) in Germany than in either the UK or the US, suggesting that the role of the asset management sector and financialisation more generally will continue to play a comparatively smaller role in Germany. Financialisation is therefore far from an inevitable process. The plateauing of households' mutual fund holdings is also not the result of the growth of ETFs. Data from the US shows that in 2019 just eight percent of households held ETFs and of these 92 percent also held mutual funds, implying that including ETFs in Figure 29 would add less than one percentage point to the result.

Figure 28: German Equity Mutual Fund Holders (million individuals)



Source: Deutsches Aktien Institut (2019)

Figure 29: Share of households owning mutual funds in the United States from 1980 to 2019



Source: Statista

To conclude, the contribution of the asset management sector to the financialisation of everyday life appears to have hit a plateau when measured by the percentage of households with mutual fund holdings. This also implies that the "democratisation" of finance has stalled. The headline-grabbing growth in AuM of the largest asset managers should thus not be interpreted as a sign of increasing participation in equity markets, but instead the result of market share gains and of fiscal and monetary policy choices that have driven asset price bubbles and inequality, both of which have in turn contributed to asset managers' rising AuM.

The term democratisation implies that households have an increased say in how both companies and financial markets are run. It also implies a degree of growing equality; which income inequality prevents. Instead the spread of asset management products to ever more households reflects a greater dependence amongst individuals on the prospects of financial

markets. As the later sections of this chapter will show, this dependency on an individual basis is joined by a dependency relationship at the governmental level.

Asset Managers, Financialisation and Nonfinancial Corporations

This section will discuss three ways in which asset managers' business models and policies are contributing to inequality. The first is by supporting, or at the least condoning, high executive compensation at portfolio companies. More important than the direct contribution towards rising income inequality that this provides, are the indirect consequences that result from how compensations sets the course for corporate strategy.

The structure of executive compensation packages is today set in a way that ensures shareholder interests are taken into account. This increased executive focus on financial engineering with the result that nonfinancial corporations are increasingly financialised. The result is corporate downsizing via spin-offs, and the diversion of funds from other avenues that could have otherwise potentially reduced the likelihood of corporate insolvency, increased organic growth or increased employment and wages. This policy shift represents the second means by which asset managers contribute towards increased inequality. The third is via increased consumer prices that result from corporate executives' appreciation of the fact, that as common owners of multiple companies in each sector, institutional investors interests are best served (portfolio returns maximised) when firms do not compete against one another but instead seek to maximise industry profits by raising prices to the consumer.

This section will make clear, that these trends are not uniform, and instead of what the financialisation convergence thesis would suggest, the process of financialisation does not

appear to be inevitable. This is due to both differing regulatory approaches and because of differences in the asset management landscape between countries. One such difference is the concept of universal ownership, which represents the other side to the coin that is common ownership. Whereas common ownership requires no explicit action from asset managers, that is no intention to change corporate policy, universal ownership requires asset owners to understand that their highly diversified portfolios means they own a small part of the entire economy, and thus acknowledge that they are exposed to systematic risks that cannot be diversified away. This in turn requires them to reconceptualise their role towards one focussed on limiting negative externalities including social inequality and environmental risks.

What results is an investment management ecosystem made up of the Big Three, hedge funds, ESG funds, regular asset managers and universal owners.[264] While the financialisation literature would suggest that the direction of change is exclusively in the direction of the American form of capitalism, this thesis has shown that the reality is substantially more complex. For the most part it is activist hedge funds that set the shareholder value agenda, while ESG funds (supported by NGOs) and universal owners increasingly put forward the stakeholder perspective. In what direction the corporate governance discourse develops depends on the relative sizes of these different institutional investors, as well as the respective country's regulatory approach and the attitudes of the corporates in question. As I will go on to show, this in turn means that in the UK and Germany there has been some evidence showings that asset managers have supported the reversal of some of the worst excesses of financialisation.

[264] In practice there are many more players including sovereign wealth funds and central banks, but in most instances the dynamics of the investment ecosystem can be explained without the need for their explicit consideration.

Starting with executive pay, I will now turn to the first of the three mechanisms by which asset managers are contributing to growing inequality as well as the financialisation of the nonfinancial firm. The link between executive firm and financialisation may not seem immediately apparent. Yet pay plays a central role as a result of mainstream economic theory presenting corporate governance as an agency problem. It is through high pay that shareholders have sought to align the interests of management with theirs. "This realignment of corporate manager interests to coincide with those of financial markets has been facilitated by the destruction of union power. This has removed a countervailing force that previously prevented managers from siding excessively with financial interests" (Palley, 2007: 18).

Excessive pay packages are designed to encourage a change in behaviour towards shareholder interests. Since pay packages are oftentimes focussed on short-term results, and since executives are aware that the duration of their average tenure has shortened substantially over recent decades, such pay encourages the consideration of short-term measures.

The support of the Big Three has been particularly strong with regards to US executive remuneration, even when pay packages have been shown to be excessive by industry standards. Chapter 3 documented the astonishing difference between the voting decisions of the biggest UK and German asset managers on the one side and the biggest US asset managers on the other side. Whereas the two largest UK asset managers Aberdeen Standard Life and Legal and General Investment Management opposed 81 percent and 65 percent of the "most overpaid" CEO packages respectively, and the German asset managers DWS and AGI opposed 34 percent and 93 percent respectively, BlackRock and Vanguard opposed just eight percent and ten percent respectively.

As a result of such behaviour by US asset managers (who have themselves seen rising executive pay), the pay of US corporate CEOs has increased by 1,167 percent since 1978, compared to the typical worker compensation which has increased only 13.7 percent, thereby substantially contributing to increased inequality. The pay of US CEOs now stands at 320 times the pay of the average employee, up from 21 times in 1965 (EPI, 2020). Executive pay has increased also in the UK, where the average CEO earned 201 times the salary of the average worker in 2018 and in Germany where the ratio stood at 136 times. Despite the substantial increases in all three countries, the difference between the rations is still pretty remarkable.

Financialisation convergence theory would suggest that Germany and the UK are going in the same direction as the US and will catch up in the future. However, this is a point where the regulatory context comes into play. The Shareholder Rights Directive II (SRDII) of the European Union, the deadline for compliance to which was the 3rd of September 2020, has the aim of reducing short termism and excessive risk taking within companies traded on EU stock exchanges. It stipulates that listed companies must publish a remuneration policy and give shareholders a vote on the remuneration policy. The UK already had comparable rules before the introduction of SRD II, so it is unlikely that the UK's exit from the EU will lead to an abolition of the say-on-pay requirement. Due to this regulatory approach, it is likely that rather than decrease, the gap between executive pay in the US and that seen in the UK and Germany will increase further in the years to come.

Recently there are modest signs that in Europe asset managers may have started to rein in excessive executive compensation. In their study of executive compensation in Germany between 2006 and 2018, Beck et al. (2020) note a substantial increase in executive compensation over the entire period but note that the increase occurred primarily between 2006

and 2013. Between 2013 and 2018, however, CEO median pay has remained largely unchanged at 53 times the average workers' pay in Germany.[265] The UK provides stronger evidence yet of asset managers' success in reining in the growth of CEO pay. After increasing from approximately £1 million in 1994 to £4 million in 2007, a study by the UK Parliament notes that pay of FTSE 100 CEOs has remained largely unchanged since the financial crisis of 2007/2008.[266]

Meanwhile in the US, the compensation of the average CEO continues to increase largely unabated. Interview data presented in the previous chapter suggests the differential development of CEO salaries in the US to the UK and Germany comes as a direct result of the divergent approaches being taken by European investors (as well as their proxy advisors) in Europe. Several European corporate interviewees complained about the fact that investors were too strict on CEO compensation with two in particular making the case that they operated in global industries with US peers and thus were in a global battle for talent.[267] Yet investors refused to support higher pay packages for their CEOs.

Executive pay matters because it sets incentives for corporate behaviour. Executive remuneration plays a central role in what Braun (2020a) refers to as the Berle-Means-Jensen-Meckling ontology. Agency theory considers the relationship between shareholders and company executives as pivotal and pay is regarded as the means to limit perceived agency problems (Jensen and Meckling, 1976; Tosi et al., 1989).

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[265] The authors also show that the percentage of performance-related pay that is tied to longer-term goals has been expanded from 4 percent to 12 percent of total compensation.
[266] Source: UK Parliament, https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/2018/201805.htm (Accessed 25.10.2020).
[267] Investor relations, German company, telephone interview, 17 January 2018.
Investor relations, UK company, Webex video conference, 14 June 2018.

Executives are unlikely to be able to achieve short-term results by increasing research and development expenditure or by raising capital expenditure to support organic growth. The incentive structure has therefore had the effect of shifting the focus of executives towards financial engineering and thus the financialisation of the nonfinancial firm. This has been reflected in record levels of share buybacks by companies in the US and the UK (though not in Germany, as will be discussed below) and the many "spin-offs" in which companies separate business units and sell them off to other companies, private equity funds or list them separately on the stock market.

Examples of spin-offs are the German chemical companies Covestro and Lanxess, both of which were separated from the German pharma/chemical giant Bayer AG, the US chemicals companies Dow Chemical and Du Pont that merged only to then separate into three separate businesses, and the UK insurer Prudential, which spun off its UK and European insurance and asset management business M&G. This represents a clear shift from the traditional "retain-and-reinvest" model to a "downsize-and-distribute" strategy (Froud and Williams, 2007; Lazonick, 2015). The financialisation literature therefore considers the spread of shareholder value thinking (high executive pay, share buybacks, etc.) as evidence of the financialisation of the nonfinancial corporation (Davis and Kim, 2015).

Although the pressure for such policy changes comes mostly from activist hedge funds, such policy changes could not happen without the implicit support of the big mutual fund companies. Hedge funds typically only acquire stakes between three and ten percent and use these to agitate for change (Fichtner, 2020). As will become clear in relation to the common ownership literature discussed below, corporate management may internalise (act according to) what they perceive to be their shareholders' preferences. For activists to be successful they

have to appear to represent the preferences of the majority of shareholders for management to take action. Fichtner et al. (2017) have shown that the Big Three have supported the vast majority of votes calling for share buybacks as well as mergers and acquisitions when these have been supported by corporate management teams.

In the absence of asset managers taking a public stance against share buybacks, it is logical for executives to assume that shareholders welcome them. Share buybacks are a controversial issue with the different literatures giving little regard for the arguments put forward by the other. In what follows I will attempt to present both sides of the argument, but to be clear, the case I seek to make is that share buybacks should be regarded as a transfer of wealth from other stakeholders to shareholders with the associated negative effects for income inequality.

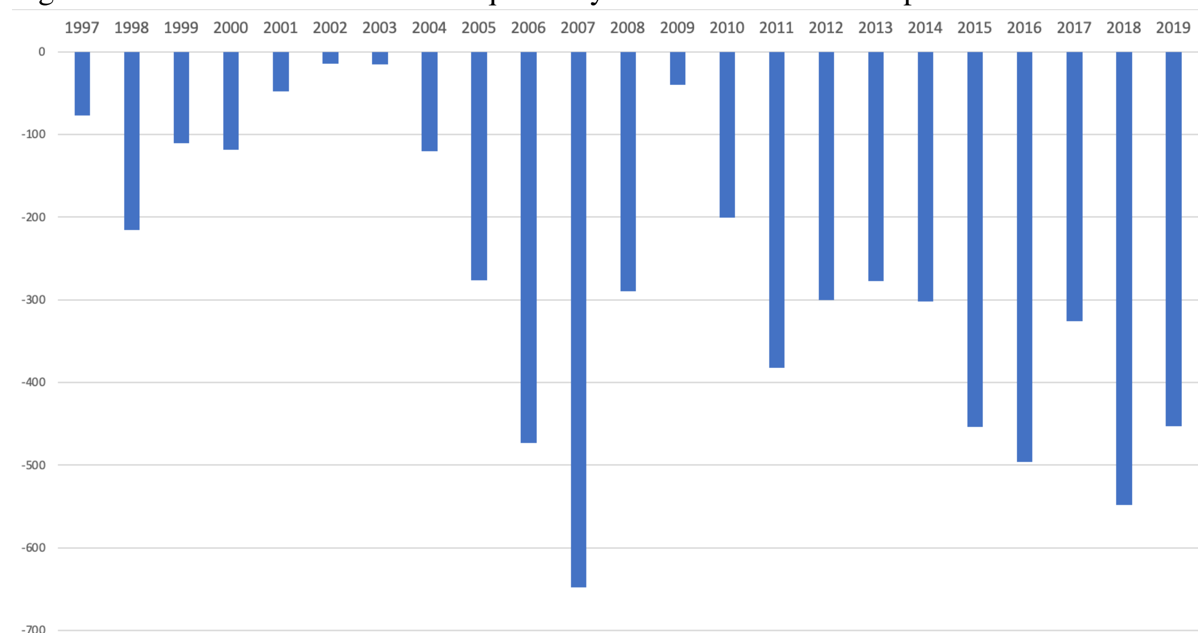
Scholars interested in the social studies of finance mostly regards them as immediate payoffs to shareholders (the result of a "cult of debt Finance", Palley (2007)) that come at the cost to other stakeholders, particularly workers. Once the money has been distributed to shareholders it cannot be used for research and development or other capital expenditure purposes that could grow the firm (Fichtner and Heemskerk, 2020; Lazonick, 2015). Many finance practitioners on the other hand denounce what they consider to be unjust criticism of buybacks, referring to a "buyback derangement syndrome" (Asness et al., 2018). They argue instead that buybacks are appropriate when a company cannot see profitable investment opportunities and wishes to ensure its balance sheet is not underleveraged, which could have tax disadvantages and could also otherwise make it a takeover target.

To assess the argument that share buybacks further inequality and harm economic growth, one needs to consider how they function. Companies use either cash on hand or issue bonds to

finance share buybacks. Since interest rates have been historically low over the past decade, buybacks have been enjoying increased popularity. Shares are bought from existing shareholders, typically via the stock market. Since there are fewer shares, the value of each share appreciates to compensate benefitting shareholders and corporate executives that are incentivised with shareholdings.[268]

The significance of share buybacks from the stakeholder perspective is that they remove cash from the company. Irrespective of whether this cash could have been used to fund company growth, it increases the leverage of the company, making it more vulnerable should the economic situation deteriorate in the future. Airlines have been one sector that has made substantial use of share buybacks, with the result that their leverage going into the coronavirus induced recession was higher than it would otherwise have been.

Figure 30: Annual Net Issuance of Equities by US Non-Financial Corporations



Source: Federal Reserve

[268] Technically this issue is highly disputed. Since the company has more debt (or less cash), the valuation of a company should not be impacted ("Modigliani and Miller theorem"). Yet depending on the earnings multiple employed, the higher debt may (EV/EBITDA) or may not (P/E) be reflected in the multiples. For a discussion of how "research laid the intellectual groundwork for a dramatic erosion of corporate creditworthiness", see: https://www.ft.com/content/87efe5a9-4cb6-493b-a31a-f9efd5ddd242 (Accessed 14 November 2020)

Figure 30 above shows that US non-financial corporations have been delisting more shares via mergers and share buybacks than they have been issuing in every year since 1997. A total of $6.18 trillion was removed from US companies in this 23-year period, with the trend accelerated in recent years. The result is that the stock market has reversed its function "changing from an institution that transports capital from investors to firms that use it for investment into a mechanism that channels money out of listed corporations to their owners" (Fichtner and Heemskerk, 2020: 14). Arguably the financialisation of everyday life, has decreased the opposition to share buybacks amongst a small number of rich households.

In Germany and the UK, the volume of buybacks has also increased in recent years, but at a much smaller total (even after adjusting for the relative size of markets). In the UK FTSE 100 companies have spent £136bn buying back their own shares from 2010 to 2019 (McGachey, 2020). In Germany buybacks in the DAX and MDAX reached a peak of €16.8 billion in 2007 before crashing to €0.4 billion in 2008.[269] They have since steadily recovered to reach €8.4bn in 2018. It is noteworthy that this level is half of the level of annual share buybacks seen at the peak in 2008, while the US market in 2018 set a new record of $700 billion.[270] As with executive remuneration, there are therefore signs that Europe is reconsidering its approach to shareholder value maximisation.

The third way in which asset manager capitalism is contributing towards growing inequality is via "common ownership". Common ownership, or horizontal ownership, occurs when a shareholder holds simultaneous shareholdings in multiple companies within the same industry.

[269] https://www.flossbachvonstorch-researchinstitute.com/en/comments/2018-is-the-year-of-share-buybacks-1/ (Accessed 8 November 2020).
[270] http://union-investment.ch/home/Capital-Market/Themen_Record_level_of_share_buybacks.html (Accessed 8 November 2020).

Research has shown that this results in less competition and higher prices in the airlines industry (Azar et al., 2018), pharmaceutical industry (Newham et al., 2019) and banking (Azar et al., 2019). Such a decrease in competition is in the interest of their common owners, as it maximises portfolio returns. If one firm where to seek to aggressively take market share, the profits of that firm may increase, but the profits of all other firms would likely decrease, leading to lower portfolio returns for the common shareholder.

The social consequence of common ownership is that consumers pays higher prices and shareholders are rewarded by higher company profits. The common ownership research does not imply explicit collusion between firms or that shareholders are explicitly pushing companies to compete less, but that company executives cognizant of their shareholders' other holdings internalize their owners' preferences and thus compete less, in order to maximise industry returns. Common ownership is not limited to index funds, though their large and diversified holdings make them prime examples. Other investors such as Berkshire Hathaway (airlines) as well as the Japanese firm Softbank and a number of hedge funds are also frequently named.

Previous chapters have highlighted the smaller holdings of the Big Three in the UK and Germany compared to the US. Yet in both countries we have different common owners, national champions (Standard Life Aberdeen Asset Management, DWS) as well as the Norwegian sovereign wealth fund, that mostly make up for this in terms of common ownership. Yet it is unclear, whether and to what extent, corporate executives from US and European companies interpret the policy preferences of European investors differently to those of US investors. If corporates perceived different preferences, one could expect common ownership

to result in different policy decisions in Europe versus the US, though the necessary research has to date not been completed.

Because asset managers' business model is to maximise the value of their assets under management, that being a function of returns those asset generate as well as the size of the assembled asset base, it is in asset managers' interests for firms to maximise prices charged to consumers while minimising wages paid to employees Braun (2020a). The reason this holds true is because the resulting negative externalities such as growing inequality are borne by society.

There is, however, another side to the coin that is common ownership. Common ownership feeds of corporate executives' assumption of what their shareholders preferences are. If shareholders were to voice preferences that differed from shareholder value maximisation, the outcome of common ownership could be altered. This is where the concept of universal ownership comes in. Universal ownership typically refers to asset owners, as opposed to asset managers that much of the common ownership attention has focussed on. Institutional asset owners such as pension funds care about externalities such as inequality, as they affect the long-term returns as well as the real-world wellbeing of their beneficiaries (Mattison, 2011; Quigley, 2019).

Urwin explains that "universal owners are asset owners who recognize that through their portfolios they own a slice of the whole economy and the market. They adapt their actions to enhance the return prospects of their portfolios, and hence the prospects for the whole economy and the market as well" (2011: 1). Because of the multigenerational nature of pension funds, they also have longer time horizons and care about "intergenerational equity".

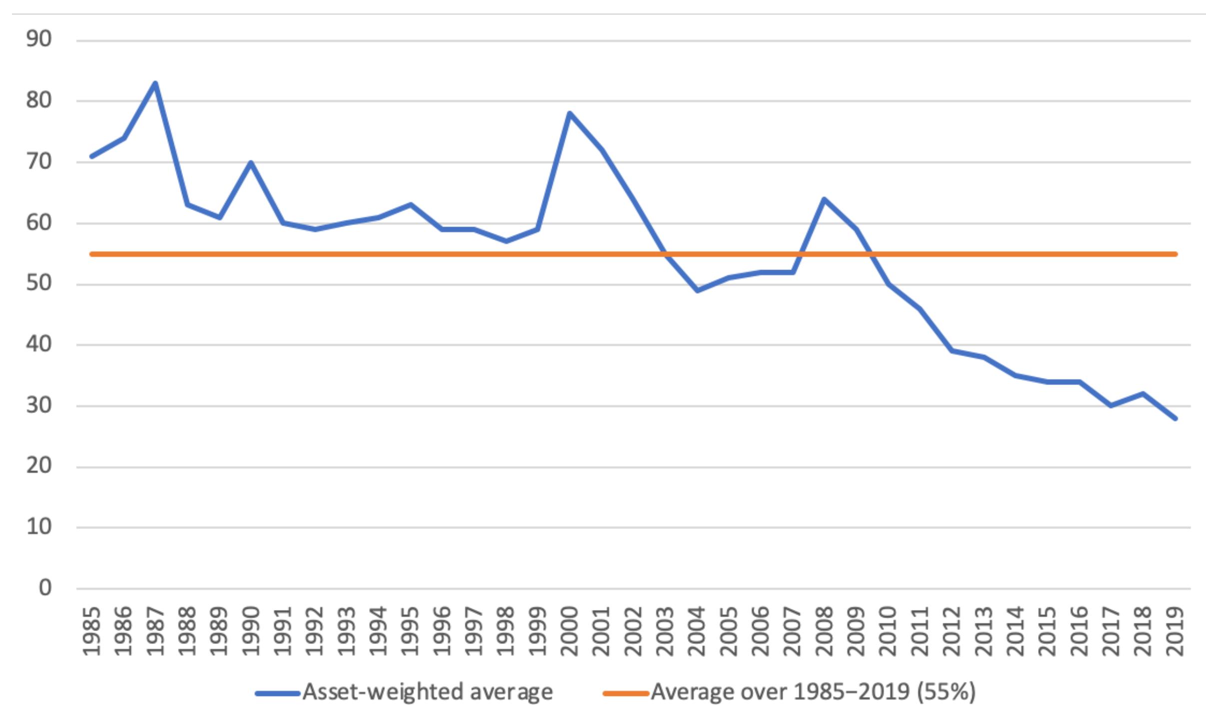
Unlike asset managers, asset owners typically do not have a business model predicated on maximising assets under management. Their high levels of portfolio diversification and the long time horizons mean that their returns are exposed primarily to systematic risks, including global warming and social inequality (which asset managers oftentimes treat as externalities). This is why universal ownership provides an opportunity to seek to address some of the negative consequences of financialisation. The fact that rising inequality leads to greater savings and thus larger AuM, arguably makes asset managers blind to the risks posed by inequality. This research suggests that the relative shareholdings of the Big Three relative to the size of the shareholdings of investors that conceive of themselves as universal owners will play an important role in determining the social consequences that asset manager capitalism will have in any one country.

I will now turn to how asset manager capitalism, with its growing index investments and when conditioned by ESG funds, pension funds and other investors with a sustainability focus, may address some of the negative consequences of financialisation. As the previous chapters have shown, the extent to which this is reflected in the present-day institutional reality differs substantially from country to country, with European investors on the whole generally more supportive. In the US pension funds and ESG investors are driving a comparable agenda to that seen in Europe, but the outcomes are oftentimes very different due to the lack of support from the Big Three.

Godechot (2015) interprets financialisation as marketisation, considering it to be a result of increasing social energy devoted to trading financial instruments such as shares on financial markets. Since index funds have almost no turnover, adjusting their holdings only in response to periodic index reweights, they reduce the volumes of shares that are actively traded on stock

exchanges.[271] From this perspective the increasing market share that is being gained by index funds could be considered to represent a de-financialisation force. Furthermore, the growth of individual active mutual funds has meant that many of them are today so big, that they are restrained in the extent to which they can actively trade their shareholdings, resulting in accusations of closet indexing.

Figure 31: Turnover Rate Experienced by Equity Mutual Fund Investors (asset weighted)



Source: Investment Company Institute

Figure 31 shows how these trends have resulted in the turnover rate by US equity funds declining for the past two decades. The turnover rate of below 30 percent that was observed in the US in 2019 implies that the average fund now holds the average stock position for more than 3 years. From the varieties of capitalism perspective, asset manager capitalism involving

[271] Some of this may be offset by market makers seeking to arbitrate price divergences in ETFs from the underlying shares.

passive funds therefore represents an increase in investor time horizons towards patient capital (Deeg et al., 2016; Deeg and Hardie, 2016).

From this changed trading behaviour results the need for a new engagement approach by the asset management sector, leading to suggestions that asset managers' may contribute towards the de-financialisation of our capitalist system (Fichtner, 2020). From a reduced ability to exit results increased need for voice. At the same time public expectations of asset manager conduct are rising, requiring asset managers to take greater care of their social license to operate. This creates the previously highlighted tension between asset managers' fiduciary duty towards their investors and societal demands.

According to the orthodox interpretation of fiduciary duty prevalent in the US, this requires a focus on shareholder value optimisation, whereas many in society call for greater consideration of stakeholder concerns. In the UK and Germany, however, the implementation of fiduciary duty is much closer to the understanding put forward by the UN PRI (2019). The UN PRI finds that "[i]nvestors that fail to incorporate ESG issues are failing their fiduciary duties and are increasingly likely to be subject to legal challenge" (2019: 8). It further notes that globally there are over 7.320 hard and soft-law policy revisions that "support, encourage or require investors to consider long-term value drivers, including ESG issues."[272] The lack of change from many domestic asset managers in the US, makes that market stand out globally.

In the US, the Big Three have mostly been clinging on to their orthodox interpretation of fiduciary duty, in part due to the partisan political environment prevailing there, and thus out

[272] https://www.unpri.org/fiduciary-duty-in-the-21st-century-final-report/4998.article (Accessed 10 November 2020).

of fear of increased regulation should a change in policies result in upsetting one side of the political spectrum.[273] In Europe the picture is more mixed and there are signs that asset managers are succeeding in slowing down executive pay and perhaps even share buybacks.

Briefly turning to the history of fiduciary standards shows that they were designed with pension funds in mind (Lydenberg, 2012). As Ambachtsheer explains, the fiduciary regulations were broadly concerned that pension fund assets "would end up being managed not in workers' interests, but in the interests of politicians, corporate executives, labor leaders, and the financial services industry" (2011:x). However, somewhat ironically, it is mutual funds who today appear to be particularly restricted by them. This should not be the case since it is the ultimate investors that are making the asset allocation choices. They decide what funds they wish to hold, and while some investors will hold a basket consisting of many different equity ETFs, others may hold only a single ETF.

The fiduciary considerations of index funds thus arise not from the investment decision itself, but from the voting rights that are associated with these fund holdings. Since voting rights at present cannot be separated from the physical stock holdings, and fund companies in most cases have no way of polling their investors' preferences, they have to make the voting decisions on their behalf (as well as the engagement decisions more generally). Fichtner et al. (2017) have shown that the Big Three asset managers engage in centralised voting, voting almost all shares of all funds the same way. Lipton (2017) explains that this "family loyalty", whereby all funds issued by the same fund company vote in unison, raises fiduciary issues. How likely is it that the investor investing only in an ETF tracking the performance of oil

[273] Shareholder campaigner, NGO, in person interview, 27 June 2019.

companies has the same preferences with regards to global warming as an investor investing in an environmentally themed fund?

The outcome of this fiduciary tension is to be seen in the Big Three's lack of support for many of the shareholder proposals that seek to undo some of the excesses of financialisation and agency theory, such as corporates' exorbitant executive. Instead of taking decisive action, they appear to prefer the deferral of most decisions to corporate management. The Financial Times reports that 2020 marked a global record for the number of environmental and social shareholder proposals filed, and that 21 of these resolutions received majority backing of shareholders, up from 13 in 2019 and 2018 and just five in 2017.[274] The trend is thus clear, but the small number of such proposals receiving majority backing is also telling. This thus suggests that we should not have too high expectations that the big asset management companies will contribute meaningfully towards resolving society's big problem.[275]

From the perspective of social activists, the aforementioned work on "common ownership" by economics and law scholars does still provide some hope, as it shows that asset managers can have influence over corporate behaviour even without explicit engagement (Azar et al., 2018; Elhauge, 2016; Schmalz, 2018). This potentially provides a way out for asset managers fearful of challenges to their social license to operate on the one hand and accusations of breaches of fiduciary duty on the other. Recent examples, include calls by the world's largest asset managers, including BlackRock, for drug companies to put aside any qualms about

[274] The FT reports data from Proxy Insight showing that a total of 233 social or environmental shareholder resolutions went to a vote in 2020 (by October). Just over half of those received at least 20 per cent support. https://www.ft.com/content/844783f8-c9c4-4cda-960f-bec2543a5e12 (Accessed 10 November 2020).

[275] The public responses of the big asset management firms to such concerns have repeatedly been that engagement and policy changes mostly happen in private discussions and that shareholder proposals are a sign of a failure of engagement and thus should only be employed as a last resort. See, for example: https://www.ft.com/content/7a80f33b-a0ed-4dea-b2d3-ce56381f4084 (Accessed 14 November 2020)

collaborating with rivals (Financial Times, 2020f) as well as the Climate Action 100+ investor coalition on climate change that seeks to ensure that corporates "are minimising and disclosing the risks and maximising the opportunities presented by climate change".[276] It may also go some way to explaining the possible motivation (other than marketing) that BlackRock's annual CEO letters may have.

Asset managers' reactions to climate change and the Covid pandemic suggest that in instances where they perceive systemic risks to their portfolios, they are prepared to act. To date, asset managers on the whole have not, however, shown similar concern with regards to economic inequality, even though the World Economic Forum and other institutions have identified it as a systemic risk for some time (OECD, 2003; WEF, 2014). Inequality is of particular systemic importance because of its interconnected nature, connecting social and macroeconomic risks as has been the case with both global warming (migration) and Covid (access to healthcare).

If inequality continues to rise unabatedly, it will ultimately harm the demand for the goods and services of asset managers' portfolio companies. In the short-term rising inequality will, however, support growing savings and thus AuM growth for asset managers. The fact that rising asset prices favour the wealthy is not really something we would expect asset managers to do something about, nor is their pay structures. However, we can expect more on ESG, less on shareholder prioritisation, and more on executive pay. We can also be concerned about the aims of their lobbying. We see from national variation that change to limit inequality and improve stakeholders' position is possible.

[276] Source: Climate Action 100+, https://climateaction100.wpcomstaging.com/investors/ (Accessed 25.10.2020)

Asset Managers, Financialisation and the State

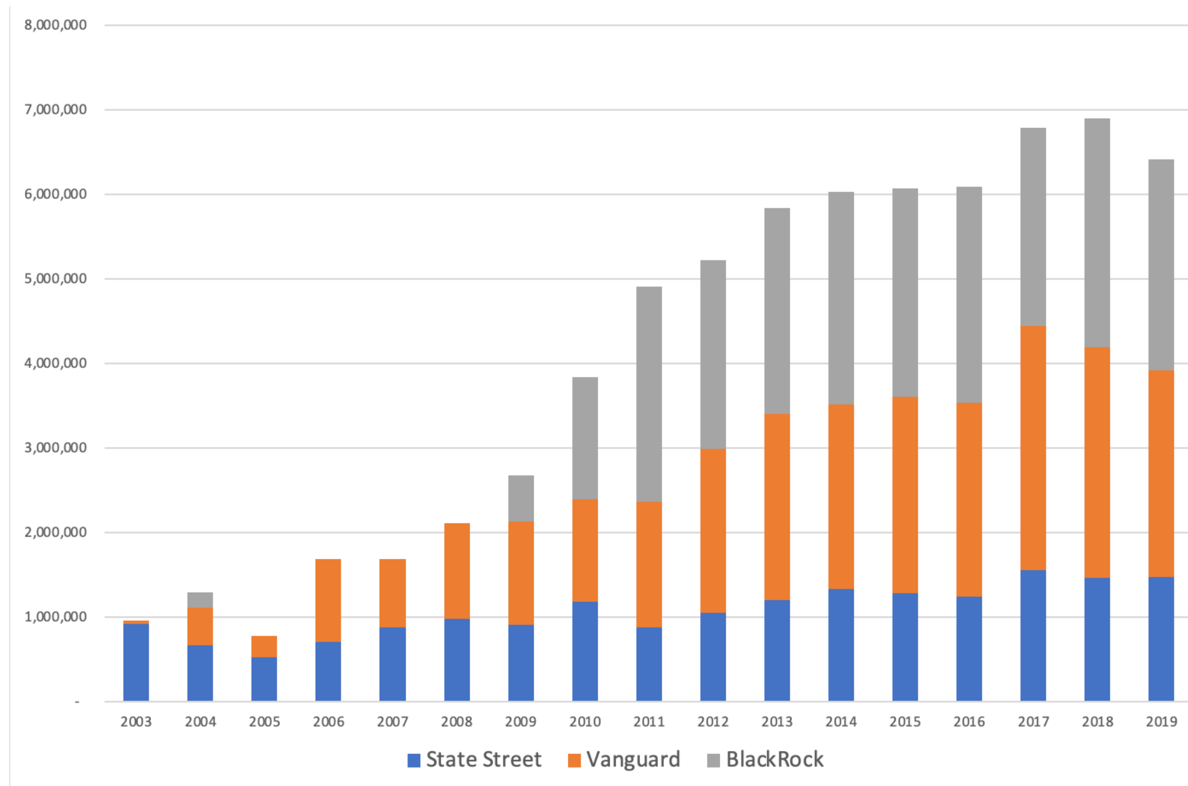
Braun (2020a) highlights the fact that the business model of asset managers is often neglected in their analysis. Their aim is to maximise the assets under management on which they earn returns. Since retirement assets account for the biggest proportion of assets, asset managers have a strong vested interest in retirement policy. He furthermore explains that "[w]hereas social policy has the power to mobilize more of the base ingredient (savings), macroeconomic policy has the power to inflate the pie (asset prices)" (Braun, 2020: 24). Asset managers thus have an interest in ensuring lose monetary policies and deregulated pensions markets.

Asset managers' growing asset bases have provided them with greater resources, which they have employed in part to have a say in the national and supra-national political sphere. This chapter will focus on the US, because the US has the most granular data and comparable data is not available for the UK or Germany. That is not to say that the Big Three do not engage in lobbying outside of the US. A platform monitoring the lobbying activity of corporates at the European Commission estimates that in 2019 BlackRock had a European lobbying budget of approximately €1,5 million and that it held 35 meetings with the European Commission.[277]

Figure 32 and 33 show how annual lobbying expenditures and political donations of the Big Three in recent years. This increased expenditure creates the conditions for financialisation to reproduce politically by conditioning the regulatory environment in which asset managers operate.

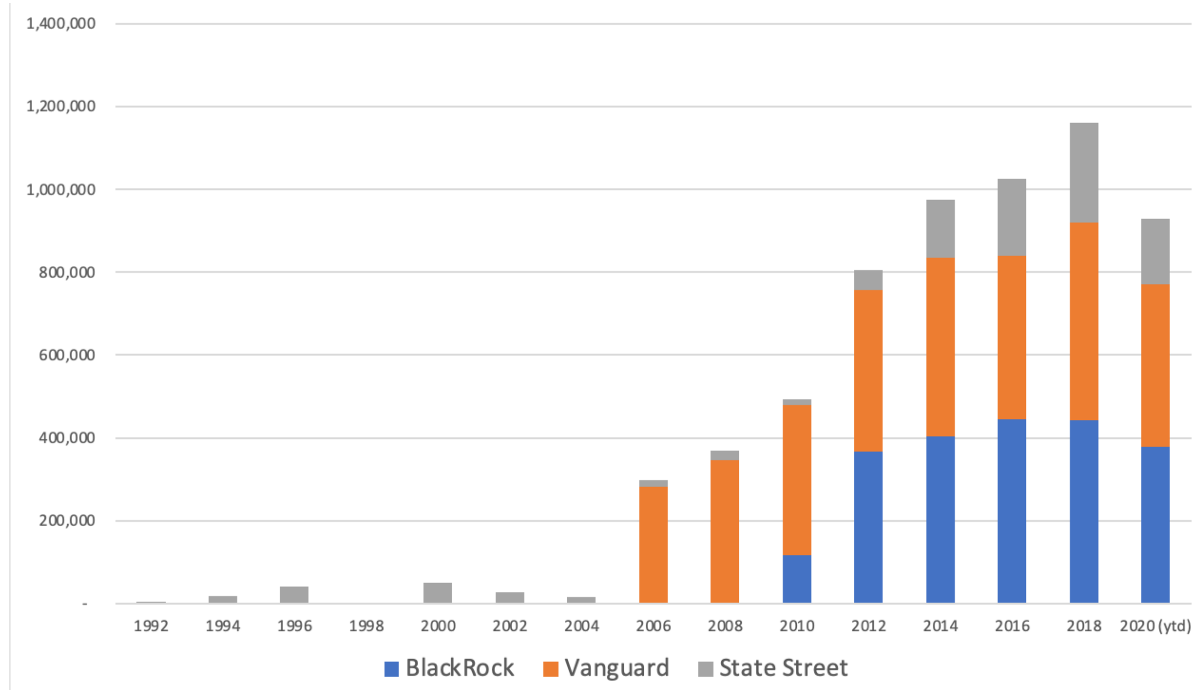
[277] https://lobbyfacts.eu/representative/bc00bbb0e3cb4fd7a03231d84a00f7a5/blackrock (Accessed 9 November 2020).

Figure 32: US Lobbying Expenditure (USD) of the Big Three



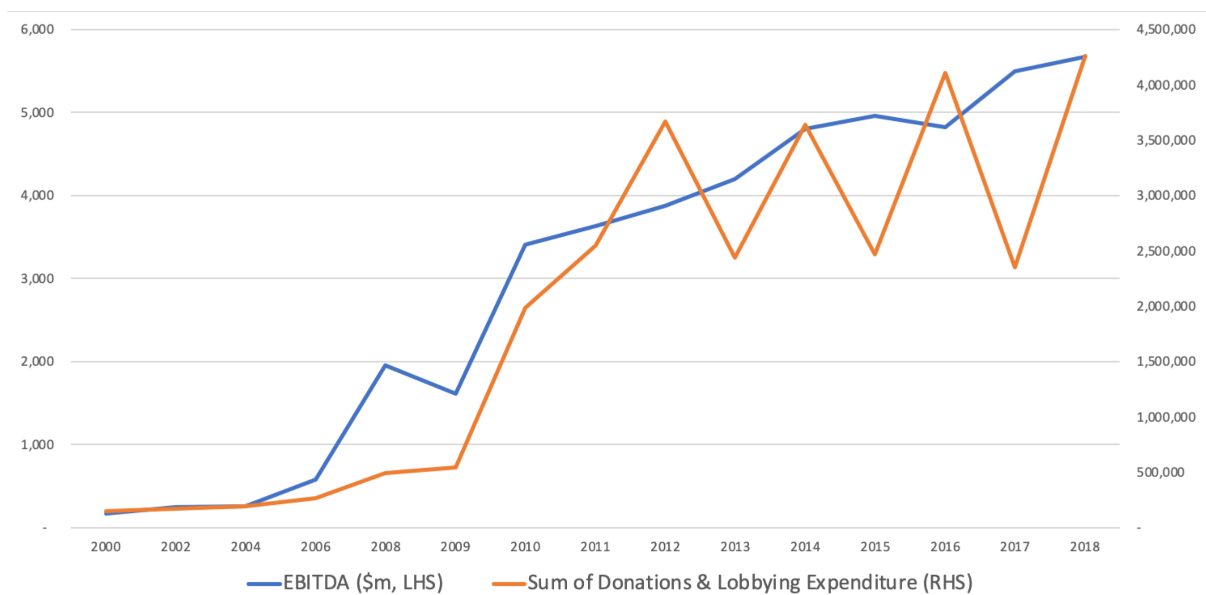
Source: Center for Responsive Politics (OpenSecrets.org)

Figure 33: US Political Donations by Pacs (USD) of the Big Three



Source: Center for Responsive Politics (OpenSecrets.org)

Figure 34: BlackRock Earnings (EBITDA) vs. sum of its US lobbying expenditure and US political donations



Source: Center for Responsive Politics (OpenSecrets.org), BlackRock annual reports

Figure 34 shows that the increase in political donations and lobbying expenditure has tracked the growth in earnings of BlackRock. This supports the thesis of Pagliari and Young (2020) that the financial industry's growth has broadened the resources that financial firms can deploy to lobby policy makers to influence the design of financial regulation. From this perspective, the Big Three's near blanket rejection of shareholder proposals calling for disclosure of political contributions by portfolio companies is no surprise (documented in Chapter 5).

Besides direct efforts to influence government policy, asset managers have also gained influence as a result of governments' increased reliance on their services. This "infrastructural power" (Braun, 2018; 2020), noted in Chapter 3, arises as a result of governments' reliance on, for example, BlackRock's experience in risk management, their understanding of the capital market ecosystem, as well as their ability to conduct market interventions on governments' and

central banks' behalf. BlackRock's epistemic authority has thus created a relationship of dependence.

Asset managers' promises to ministries of finance and central banks that there will be liquidity and well-functioning monetary transmission mechanisms, improves their ability to oppose policy innovations or tighter regulatory measures (Dafermos et al., 2020; Gabor 2016). This infrastructural power is not limited to the US but is also very present in Europe. BlackRock has advised the European Central Bank on issues ranging from its asset backed securities (ABS) purchasing program,[278] banking stress tests,[279] and environmental rules for banks.[280]

Such dependence has recently undergone a step change when in September of 2020 the US Federal Reserve mandated BlackRock to intervene in the US fixed income ETF market on its behalf.[281] The largest high-yield ETFs from BlackRock and StateStreet have assets under management of $28.3 billion and $12.6 billion respectively. The fear is that in periods of high financial distress, such as the one caused by the Coronavirus pandemic, the arbitrage between these bond ETFs and their underlying bonds could break down and lead to "dislocations", which could in turn have knock-on effects for credit markets.

To avoid this happening, the US Federal Reserve provided a mandate to BlackRock that included a remit for BlackRock to ensure that the bond ETF market would not become dislocated. The US financial newspaper Barron's (2020) thus concluded that BlackRock is the

[278] https://www.europarl.europa.eu/doceo/document/E-8-2014-007933_EN.html?redirect (Accessed 9 November 2020)
[279] https://de.reuters.com/article/us-ecb-policy-tests-idUSKCN0Y215S (Accessed 9 November 2020)
[280] https://www.theguardian.com/business/2020/apr/12/blackrock-eu-environmental-rules-for-banks (Accessed 9 November 2020)
[281] For details, see, The Wall Street Journal, 18 September 2020, "Fed Hires BlackRock to Help Calm Markets. It's ETF business wins big". Available at: https://www.wsj.com/articles/fed-hires-blackrock-to-help-calm-markets-its-etf-business-wins-big-11600450267 (Accessed 29 October 2020).

biggest beneficiary of Fed corporate bond purchases as almost half of the purchases made by BlackRock on the Fed's behalf were purchases of BlackRock's own funds. The Wall Street Journal similarly declared that the "[t]he central bank's market intervention helped the largest U.S. provider of corporate bond exchange-traded funds get larger" (The Wall Street Journal, 2020). Not only did BlackRock's assets grow as a result of the intervention it conducted on behalf of the Fed, its business model was also strengthened as the corresponding ETFs were stabilised and got through the crisis without a breakdown of market pricing. This is one very explicit example of how BlackRock is benefitting from the Federal Reserve's dependence on them.

Financialisation has therefore increased the reliance of the state on the asset management sector and the extent to which capital markets and the general economy are intertwined. The increasing complexity of financial products and financial markets, that is one of financialization's hallmarks, has meant that during times of crisis policy makers are left dependent on the finance industry's know-how, while simultaneously being vulnerable to implicit blackmail to bail out capital markets for fear that failing to do so will bring down the wider economy. This dependency relationship further calls into question the appropriateness of the concept of the democratisation of finance.

Only a relatively small fraction of the "demos" profits from stock market appreciation, yet all of its members have to step in to save it when markets break during a crisis. To date the role of asset managers has been considered less consequential than that of banks, with the result that none of them has as yet been categorised as a Systemic Important Financial Institution (Sifi). Yet, the increasing complexity of wealth management products as well as the growth in the assets of exchange traded products (ETPs), all of which are reliant on a functioning

arbitrage mechanism, does mean that their relevance from a financial stability perspective has increased substantially in recent years.

Conclusion

This chapter has highlighted the close relationship between financialisation and the growth of the asset management sector as well as its contribution to income inequality. The convergence hypothesis suggests that the US model will steadily take over the world eroding national heterogeneity as shareholder value orientation proliferates amongst nonfinancial firms. However, as this and the preceding chapters have shown, there have been considerable variations in the way shareholders behave in different countries. Financialisation is therefore not a uniform process but differs across countries (Karwowski et al., 2020). Instead of witnessing an Americanisation of the international corporate governance landscape, this thesis has shown that the national institutional framework continues to matter.

This chapter has furthermore sought to assess the extent to which the narrative of the democratisation of equity markets is evidenced by a change in asset managers' behaviour. Differences in attitudes both between different types of institutions and across countries have resulted in the varied evolution of corporate governance that has been documented in the preceding chapter. Yet overall the evidence suggests that with a small number of exceptions, such as the slowdown in growth of executive compensation in the UK and Germany, the narrative of the democratisation of investment seems mostly without merit.

Instead of ETFs making investment more accessible for the lowest deciles of the income pyramid, evidence presented shows that investors in ETFs are more financially literate and

wealthier. Thus, rather than providing a way around high asset management fees for the less wealthy, the less wealthy are likely more dependent on advice from financial advisers whose incentives will mostly steer them towards more expensive investment solutions, while ETFs instead help the more investment savvy to reduce their management fees.

The increase of lobbying spending in recent years should keep front of mind that asset managers are themselves corporates focussed on making money for their executives and owners. Governments should consider this when deciding what issues to regulate and what to leave to capital markets. When considered alongside the potential for conflicts of interests in the asset management industry, such as those resulting from the fact that money spent on critically engaging with investee companies comes at the expense of asset managers' profits and may threaten corporate pension mandates, the potential for asset manager capitalism to reverse the negative consequences of financialisaton therefore appears limited.

Throughout this thesis I have employed an implicit teleological framework that casts stewardship as progress and resistance to it as being antiquated. This stems from the normative conviction that the status-quo is defective when it comes to social and environmental issues. It also stems from the insights gained from the many corporates interviewed for this thesis. These interviews showed, particularly in the US, but also to a lesser extent in the UK and Germany, that corporates for the most part do not acknowledge that they need to do more.

From this starting point, investor stewardship thus presents an incremental opportunity, alongside regulation and consumer pressure, to seek to enact change at the corporate level. Yet these interviews, as well as my personal experience within the finance industry, have also shown that there is the risk that stewardship is primarily employed as a tool to pre-empt stricter

regulation, to open markets for new financial products, or for marketing purposes seeking to safeguard an asset manager's social license to operate.

It is therefore prudent to consider the motivation behind different asset management industry initiatives. Gabor warns of a "Wall Street Climate Consensus" that seeks to deliver a low-carbon transition without radical political or institutional changes.[282] Sustainable development finance is increasingly market-led instead of regulator-led with private finance writing the rules for how to green the financial market. The danger is that these private ESG taxonomies seek to maximise business opportunities rather than maximising progress. Viewed from this perspective, ESG rather than being a means to unwind some of financialisation's negative consequences, may in fact be a mechanism to drive financialisation further into households, nonfinancial corporation, and the state.

Instead, if one looks at the development of executive pay in the asset management industry itself, it raises the question of whether we have in fact witnessed the creation of a common elite consisting of executives from the asset management industry alongside executives from nonfinancial corporations. The Financial Times (2020g) notes that "[t]he chiefs of 31 US and European asset management businesses took home combined pay and bonuses that rose 12 per cent to $233m last year" and that the CEO if BlackRock once again lead the industry's pay table with an award of $24.3m in 2019 noting that "Mr Fink is also entitled to about $50.8m in stock awards that have not yet vested." This 2019 puts Mr Fink's pay on a ratio of 182 times the pay of the median employee.[283]

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[282] https://www.taxjustice.net/2020/05/28/the-wall-street-climate-consensus/ (Accessed 10 November 2020).
[283] Source: https://www.execpay.org/executive/laurence-d-fink-285/r-154423 (Accessed 25.10.2020)

Useem (1980) notes how in the 1970s US society was run by a corporate elite. In comments that could equally be applied to present day developments, he further remarks that "[e]fforts to describe US corporations as having entered a "post-capital-ist" era, or more simply to banish "capitalists" altogether from the apex of the class pyramid, are premature" as the "corporate elite is united by its primary commitment to capital accumulation" (1980: 68). At the time institutional investors controlled only about one third of all shares, compared to the approximately 70 percent reported for the UK, the US and Germany in the preceding chapters. Yet even with institutions today controlling the majority of shares, the Berle-Means-Jensen-Meckling ontology endures.

To conclude, the higher levels of both executive pay and share buybacks are negative symptoms evidencing financialisaton's role in increasing inequality. Asset managers contribution to this process is two-fold. First, their lobbying activities support an environment conducive to the continued marketisation of household finances. Second, their corporate governance policies to date largely fail to account for the social consequences that an exclusive focus on the shareholder-value entails in the longer-term. The fact that increased inequality in the short term leads to rising savings and thus demand for asset managers' investment products, arguably distorts their perception. The next chapter will highlight the role that corporates play in ensuring investors' focus remains on short-term profits.

Chapter 7

The Corporate Response to Asset Manager Capitalism

Introduction

What we are seeing to different degrees in the three countries is a battle for control of the company. The institutionalisation, indexation and internationalisation of investment management have resulted in a shareholder base, which, aided by proxy advisors, is better coordinated and more incentivised to engage in this battle than has been the case in the past. The previous chapters have demonstrated that the shareholder ownership structure of the typical listed company in Germany, the UK and the US is dominated by two voting blocs: The Big Three and the two big proxy advisors. It is therefore not surprising that this chapter notes particular concern amongst corporates with regards to these two groups.

This chapter will document the corporate response to the rise of the asset management industry. It will show that rather than merely passively adapting to changes in their respective governance frameworks, as the VoC literature would suggest, corporates are actively seeking to influence the design of their national governance frameworks. The extent to which asset managers are therefore able to take on the role of stewards of their portfolio companies depends also on company managers' willingness to cooperate with institutional investors and their ability to resist doing so. Alongside the regulatory approach, asset managers' intent to bring about change, asset managers' policy preferences, their stewardship resources, their voting blocs and the support provided by proxy advisors, the corporate response represents the seventh and final dimension of asset managers' stewardship efforts.

With regard to the research question, this means that the extent to which the varieties of capitalism are changing cannot be assessed without consideration of the role played by corporates. This chapter finds that the extent of companies' resistance to shareholders differs substantially across the three countries studied. While the interviews documented tension in all three countries, the governance relationship between shareholders and companies is most harmonious in the UK and most antagonistic in the US, with Germany falling in between.

Since fear of instrumentalization grows with declining engagement, the greater size of the domestic capital markets contributes to the higher tension in the US. There are 1.145 US companies with market capitalisations greater than $2 billion, compared to 109 in the UK, 103 in Germany and 490 in Europe as a whole.[284] This means that US investors have on average ten times more domestic companies to engage with than investors in the UK and Germany. Yet the stewardship resources of US asset managers, while bigger, are not on average ten times larger than their European peers. Table 9 (Page 184) shows that the Big Three have an average headcount of 31 people, which compares to an average of 19 headcounts at the listed UK asset managers and 10 at the German firms.

This chapter will illustrate that the strong corporate opposition in the US has resulted in a high degree of inertia within the US model of corporate governance over the past ten to twenty years. Having started on its journey of continual corporate governance reform as early as 1992 (Cadbury Report), the UK successively added to legislation, notably with the Combined Report in 1998 and the UK Corporate Governance Code and the UK Stewardship Code in 2010.[285] In

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[284] Definitions differ, but companies with market capitalisations of less than $2 billion are commonly considered to be small capitalisation companies. For the US, the universe used was the MSCI US All Cap Index, for Germany it was the CDAX index and for the UK the FTSE All Share Index. Data as of 26 March 2020.
[285] For a timeline of UK corporate governance reforms, see: https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/25th-anniversary-of-the-uk-corporate-governance-co (Accessed 18 March 2020).

Germany the corporate governance "Kodex" was established in 2002, and the asset management industry's equivalent of a stewardship code ("BVI Wohlverhaltensregeln") were introduced in 2003. Instead of introducing similar governance and stewardship codes, the US merely introduced the Sarbanes-Oxley Act (SOX) of 2002 in the aftermath of the Enron and WorldCom scandals. SOX seeks to address governance failures by strengthening auditing and some of the roles of directors but does "much less to address issues around shareholder engagement or executive compensation" (Jackson, 2010: 38).

While US pension funds and activist hedge funds have challenged company managers for many decades, US corporates have to date been largely successful in restricting the governance activities of the largest asset managers. Besides the implicit threat of withholding corporate pension fund mandates, a central way in which they have done so is by enlisting the SEC to ensure that the concept of fiduciary duty is interpreted for the most part in an orthodox principal-agent understanding focussed on short-term returns. The consequence of this is that as the rest of the world's understanding of fiduciary duty and social responsibility is developing to the point where asset managers are considering their wider role within society and in some instances taking on broader stakeholder concerns, the US understanding of corporate governance is stuck in time, with some actors even seeking to move it in the opposite direction.

This is evidenced by the fact that the SEC, in the spring of 2020, is considering reducing shareholder rights to submit proposals as well as measures to increase regulation on proxy advisors, including making them liable to litigation by companies. It is further underlined by the SEC's March 2020 decision to grant requests by Chevron Corp. and Exxon Mobil Corp. to reject a shareholder proposal calling for reports on how the companies are addressing climate

change goals. US laws allow companies to petition the SEC to do so if they can show that such proposals would interfere with normal business and resemble micromanaging.[286]

Chapter Structure

This chapter starts with three sections detailing the corporate perspective of the overall shareholder governance dialogue in each of their three respective countries. This will be followed by sections outlining corporates' concern with the Big Three and proxy advisors respectively. Since the US is the country with the greatest corporate resistance to asset managers' governance, two case studies will then illustrate the dimension of US corporate opposition to stewardship. The first looks at the role of stock exchanges, particularly Nasdaq, in coordinating the corporate response to the rise of the asset management industry. The second documents the role of the Main Street Investors Coalition, a lobbying group set up by corporate interests with the aim of limiting shareholder influence in corporate governance.

The perspective of UK corporates

In general, the interviews with UK corporates brought up relatively few controversies. The approach by the UK regulator to require both corporates and investors to jointly steward the company has created a somewhat less conflictual relationship between investors and corporates when compared to either the US or Germany. The approach of the UK government is to enlist investors as stewards alongside governmental oversight. In the immediate aftermath of the collapse of Carillion PLC in the United Kingdom, for example, both the Work and Pensions Committee and the Business, Energy and Industrial Strategy Committee (2018) wrote letters

[286] See: https://www.pionline.com/governance/exxon-chevron-given-ok-dismiss-shareholder-climate-proposal (Accessed 25 March 2020).

to the company's top shareholders to examine whether they had complied with the country's Stewardship Code.

The UK government's approach has created the expectation amongst UK corporates that shareholders should engage "our top shareholders should be engaging better. If you hold 2% in a UK FTSE 100 company, it is incumbent on you to engage. […] We would be instigating the engagement; we want to know if you will vote for us".[287] Another corporate noted that "this stewardship thing is ironic. Stewardship has to be a two-way thing. Corporates control engagement by the investor. But they can't control a lack of engagement at the stewardship level, from institutional level investors. There hasn't been stewardship despite all the noise by the loudest investors. And we all know who the noisy few are".[288] He continued that "the notes of generic IR people will tell you they have never had a serious discussion with investors. Yet the notes of the investors will say the IR never brought up corporate governance so it cannot be important to them, there cannot be any issues".[289]

This shows that even in the country considered by many interviewees to represent the best practice of shareholder engagement, tensions between asset managers and corporates remain. A qualitative difference between corporate complaints in the UK and the other two countries is, that UK companies mainly complained about a lack of engagement and a lack in depth of the engagement that there is, whereas the following two sections will show that corporates in Germany and the US still struggle with the basic principle of investor stewardship. This section only provided a bird's-eye view of the UK context, individual policy aspects of the UK model will be discussed in the later sections of this chapter.

[287] Group General Counsel & Company Secretary, UK corporate, telephone interview, 12 June 2018.
[288] Investor Relations, UK company, telephone interview, 14 June 2018.
[289] Ibid.

The perspective of German corporates

On the whole, German corporates expressed unease with greater shareholder involvement, noting that they felt much of it was a fad driven by a desire for a more responsible image. As a result, investors were becoming "more populist" and "stricter" in their evaluation of corporate conduct.[290] Institutional investors "want to go one step further" due to marketing reasons vis-à-vis their ultimate investors.[291] The quality of engagement with German asset managers was worse, it "has a different quality" as it is perceived to be a marketing-led approach.[292] The interviewee thus described these investors as "the dachshund barking especially loud". Explaining that they have strict policies and will never deviate from them. He contrasted this with the UK engagement specialist Hermes, who he said was different "If they agree they would be prepared to publicly back a company's management even on sensitive issues".[293]

Several corporate interviewees suggested corporate governance was a box-ticking exercise, not just the proxy voting but also the engagement, with investors asking for meetings being enough, regardless of whether the meetings actually happened or not.[294] Another German corporate explained that the German Corporate Governance Kodex from 2017 stated that companies should make the supervisory board chairman available for dialogue. They had offered such dialogue to a number of their larger shareholders, but investors were unsure how to proceed as they had no experience with such dialogue, and interest was thus limited.[295]

But besides the above list of grievances, concern amongst German corporates was limited. They reported how in the past they had spent a lot of their time educating foreign investors on

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[290] Investor relations, German company, telephone interview, 11 January 2018.
[291] Ibid.
[292] Investor Relations, German company, telephone interview, 31 January 2018.
[293] Ibid.
[294] Investor relations, German company, telephone interview, 5 January 2018.
[295] Investor relations, German company, telephone interview, 8 June 2018.

domestic corporate governance statutes, but that the understanding of the German corporate governance system had become better. For example, one company explained that the UK guidelines encouraged investor interaction with "the board" but that in the case of Germany some investors had been confused as to which board was meant.[296] "The separation of duties between CEO and the Chairman of the supervisory board is not always well understood by investors from the UK and US".[297] Today, however, the feeling amongst German corporates is that the two-tier system is better understood and that "the guidelines used by investors and proxy advisors are better suited to Germany" and that the system is getting more "Germany-fair".[298]

The perspective of US corporates

If UK corporates are concerned about a lack of engagement, and German corporates consider much of it to be a theatrical performance put on for retail investors, then the response by US corporates stands out because of how serious their alarm is. US companies fundamentally questioned whether investors are the right people to decide on many of the issues such as say-on-pay, or political donations, and suggested it would be better to go back to the "old model of selling companies whose policies you don't like".[299]

The current approach of giving shareholders a say in an increasing number of issues had led to shareholders seeking to micromanage companies, according to one of the big US oil companies.[300] In his opinion, social activists today have identified 4 routes of action: 1) the

[296] Investor relations, German company, telephone interview, 5 January 2018.
[297] Ibid.
[298] Investor relations, German company, telephone interview, 11th of January 2018.
[299] Corporate secretary, US company, telephone interview, 22 February 2018.
[300] Governance expert, US company, in-person interview, 26 June 2018.

traditional activist route, aiming to change legislation, 2) go the regulatory route, 3) if no success then go via the shareholder proxy route, and 4) use lawsuits. "Many activists today go for all four routes simultaneously to create a buzz. To create a culture around the issue".[301] It is this fear that large asset managers, as well as proxy advisors, may become instrumentalised, that appears to be driving the strong opposition of US corporates to investor stewardship.

On the whole US corporates reported that "proactive outreach from investors hasn't changed very much".[302] Instead, it was corporates, and not investors, that are putting in the effort to try and set up engagement, and many reported following a process of regularly reaching out to their top 20-40 investors.[303] However, investors were often times not interested in taking such calls, "it's total bullshit, there is no engagement unless there is a clear activist approach".[304]

Corporates see two reasons for this lack of engagement. First, there is a lack of resources and experience.

> "There is a gap, people are not sure what to do with it [engagement on corporate governance issues], especially the smaller institutions, how to vote and how to staff it and how to deal with ESG issues. The system has not quite figured out how to make it part of the process. There is frustration on both sides as a result. The last couple of years we have been proactively reaching out to investors, but investors are not ready to talk".[305]

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[301] Ibid.
[302] Investor relations, US company, telephone interview, 24 January 2018.
[303] CFO, Head of Human Resources, Head of Investor Relations, US company, telephone interview, 23 April 2018.
Investor relations, US company, telephone interview, 16 January 2018.
Company Secretary, Investor relations, US company, telephone interview, 15 March 2018.
Investor relations, US company, telephone interview, 4 June 2018.
[304] Investor relations, US company, telephone interview, 4 June 2018.
[305] Corporate secretary, US company, telephone interview, 22 February 2018.

Second, US companies, like many German companies, do not feel that investors believe in engagement and only go through the motions in order to be able to refer to it in marketing campaigns.

> "I was IR manager from 2009 until 2012 and when I came back into the IR function in early 2016, I found that there is a much bigger marketing element to governance. Shareholder letters are an interesting dynamic. They are full of platitudes that probably everyone can agree to, but the recommendations are not necessarily actionable. These letters come particularly from passive CEOs and we receive three to five letters regularly. The fact that they are also released to the press tells you a lot about their purpose [marketing]".[306]

Corporates and the Big Three

Despite reporting difficulties engaging with index funds, UK and German corporates were less alarmed by the growth of the Big Three than their US peers. Engagement from the Big Three was said to be limited, though BlackRock was said to be more involved than Vanguard or State Street in the UK and Germany.[307] "Per definition the passive investors have far fewer contact people. At Vanguard there's nobody there, even the brokers have no contacts".[308] To the extent that there has been engagement, this was said to be limited to a small number of "special occasions"[309] such as controversial say-on-pay votes.[310] "Do we have good engagement? We do have good engagement when there is remuneration to discuss".[311]

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[306] Investor relations, US company, telephone interview, 22 February 2018.
[307] Investor relations, German company, telephone interview, 11 January 2018.
Three team members, investor relations, German company, telephone interview, 18 January 2018.
Investor relations, German company, telephone interview, 31 January 2018.
[308] Investor Relations, German company, telephone interview, 24 January 2018.
[309] Investor Relations, German company, telephone interview, 31 January 2018.
[310] Investor relations, German company, telephone interview, 11 January 2018.
[311] Group General Counsel and Company Secretary, UK company, telephone interview, 12 June 2018.

Corporates in all three countries noted the potential for index funds to cast the deciding vote and therefore explained that they sought to maintain an active dialogue with them, "if we are in a fight [with an activist], if we need them, I want them to know me".[312] Another said, "passive guys have tilted the battle, decided who wins. So now there is a much greater incentive for corporates to engage them, but they [index funds] have not stepped up staff, so we need to reconsider our strategy. How to engage with them".[313] It is this voting power, combined with the lack of staff, and thus an overall deficit of engagement, that has created fear amongst corporate issuers that they may fail to get their point of view across, thereby increasing the potential that index funds may become instrumentalised. "If an activist were trying to drive a wedge between the company's management and its shareholders, the best move would be to target index funds".[314]

Chapter 3 explained the new separation of ownership and control that has occurred within asset management firms. Since index funds typically do not have research analysts or fundamental portfolio managers, companies have no alternative means of engagement, should they fail to come to agreement on a policy issue with a member of an asset manager's governance team (or indeed fail to make contact with the governance team). This is why the lack of engagement from index funds is stoking the fears of instrumentalization. "The mandate does matter. Passives don't want to talk. […] it is hard to engage with them. They don't care. I much prefer active firms".[315] Another said that "I don't get the sense that the governance teams are staffed appropriately. Most don't want to meet with you unless its way off season".[316]

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312 Investor relations, UK company, Webex videoconference, 14 June 2018.
313 Investor relations, US company, telephone interview, 22 February 2018.
314 Investor Relations, UK corporate, Webex video conference, 14 June 2018.
315 Investor relations, US company, telephone interview, 16 January 2018.
316 Investor relations, US company, telephone interview, 22 February 2018.

Whereas large members of the S&P 500 index reported having a contact person at each of the Big Three asset managers, there was strong criticism from smaller capitalisation US companies. One company noted that their three largest shareholders were now all passive investors and that there was no engagement. "We never speak to them, never. To be honest with you I wouldn't even know who to talk to at Vanguard".[317] Another said, "at Vanguard and State street, god help you if you're trying to get a contact. Even at Blackrock who pride themselves on engagement, it is not easy to figure out who to reach out to. They have a separate section on their homepage, but there are no contact details".[318] Asked about the quality of engagement with the Big 3 asset managers, he replied "oh god no, not on any basis has there been engagement. […] They talk a big game, tell you to talk between the proxy seasons". He went on to describe how he often gets just the voicemail and has to leave a message. "I usually don't hear back from them. Even to emails I get no reply. […] It's almost all for press, but it's all bullshit".[319]

Amongst companies of all sizes, there was a concern that social and environmental activists will increasingly succeed in setting the engagement and voting agenda of the Big Three. A large US oil company explained that they had already reduced their carbon emissions by 25 percent, but that there is a limit to how far their business model can be adjusted, and "consumers then ask BlackRock 'what are you doing about this'".[320] A US airline similarly explained that they were concerned what would happen if, for example, "BlackRock turn to be an all-out environmental activist, [his company] will never be an environmental poster child".[321]

[317] Investor relations, US company, telephone interview, 5 June 2018.
[318] Investor relations, US company, telephone interview, 4 June 2018.
[319] Ibid.
[320] Governance expert, US oil company, in-person interview, 26 June 2018.
[321] Investor relations, US company, telephone interview, 3 July 2018.

Finally, a number of corporates sought to link index investors with proxy advisors as follows, "if there is a concern its counter intuitive. Passives won't be as engaging; they will not care. […] Essentially there is a large block of owners that are disengaged. The risk is that they will defer to the proxy advisors. But we need to rein them in, not give them more power".[322] Another noted, "as regards the active fund managers these are separating themselves from the recommendations of the proxy advisors. However, passives have now also started voting and in the case of passives, there in the fewest cases a separation takes place".[323]

Corporates and Proxy Advisors

Corporates in all three countries voiced the same concerns about proxy advisors, though as this chapter will go on to show, only in the US has this resulted in a concerted effort to restrain proxy advisors. Corporate criticism of proxy advisors can be divided into three buckets: (a) concern about how investors use them and the relational influence that results from this, (b) concern about how they operate and the quality of their services, and (c) that they may become instrumentalised. I will now discuss each of these in turn.

At the heart of corporate concerns about proxy advisors lies the fear that investors blindly defer to them, thus giving proxy advisors outsized influence. One corporate estimated that half of all US investors follow ISS, "of those the majority will follow blindly. […] The rest will use them but have more ability to overrule them, especially if the analyst or PM gets involved".[324] Companies suggested that even the stewardship teams of the Big Three were not sufficient to cover portfolios consisting of 15,000 individual companies and therefore necessitated the

[322] Investor relations, US company, telephone interview, 4 June 2018.
[323] Investor relations, German company, telephone interview, 22 February 2018.
[324] Investor Relations, US company, telephone interview, 20 June 2018.

support of proxy advisors.[325] For many corporates, however, the issue was not with proxy advisors' services directly, but with investors' overreliance on them "investors give them the power, as investors just look and follow".[326] Another noted: "When it comes to AGM resolutions, investors very much follow proxy advisors. They often don't engage with the company, it's a tick the box exercise. They don't reach out and try to understand. It feels like there is a lot of unfairness".[327]

Corporates suggested that this overreliance was at odds with the value proposition asset managers presented to their ultimate investors. "They [proxy advisors] have an incredible influence that is underappreciated by the ultimate investors that don't vote but provide the funds. People might be surprised by the influence they have and by the rigid ways policies get applied".[328]

Chapter 5 reported that investors are more likely to rely on proxy advisors for foreign share holdings, and that proxy advisors may thus play a greater role at German and UK companies. This conclusion is supported by a German company who noted that they held regular discussions with domestic investors, but that when it came to the US, the response is "I vote with ISS" and therefore their conclusion is that there is no need for dialogue.[329] This therefore supports the argument that foreign asset managers have less of an impact from an "internationalisation equates to Americanisation" perspective but raises the prospect that some of this influence has been transferred onto proxy advisors.

[325] Proxy solicitor, telephone interview, 26 February 2018.
[326] Investor relations, US company, telephone interview, 24 January 2018.
[327] Deputy Company Secretary, UK company, telephone interview, 11 June 2018.
[328] Corporate Secretary, US company, telephone interview, 22 January 2018.
[329] Investor relations, German company, telephone interview, 7 February 2018.

Corporates acknowledged such delegated authority, and suggested that rather than reflecting investors' attitudes, proxy advisors were drafting their own policies. "There is a big problem: there are laws and regulations that are in force in Germany. Yes, proxy advisors think up new rules that one then has to follow. In predisposed obedience one then tries to follow these rules although the law does not require this".[330] This quote relates to proxy advisors' support for annual say-on-pay votes in Germany, which at the time were only required to be held every five years according to German law.

Yet a review of consultation responses filed with the German corporate governance Kodex in 2016, suggests that the majority of investors advocated for a rule change towards annual elections in Germany.[331] Proxy advisors' backing for more frequent say on pay votes in Germany, thus did not represent them drawing up their own policy choices, but instead reflected the preferences of their clients. This illustrates how proxy advisors have become a pawn in a battle between investors and managers for control of the firm.

This relational influence of proxy advisors has created the fear amongst corporates that proxy advisors, like the Big Three, may become instrumentalised by activists.[332] As with the Big Three, this fear is being stoked by a lack of access. Importantly, it does not matter whether the power of proxy advisors is real, the mere perception of power suffices for it to influence corporate decision making. Corporates sought to engage with proxy advisors to "collect bonus points" as "it is easy to get a bloody nose" at the AGM.[333] But often times it was difficult to

[330] Investor relations, German company, telephone interview, 7 February 2018.
[331] Source: https://www.dcgk.de/en/consultations/archive/consultation-2016.html (25 March 2020).
[332] Investor relations, German company, telephone interview, 11 January 2018.
[333] Ibid.

engage, as “once you are comfortably in the box that proxy advisors want you to be in, once they got you where they want you, there is little engagement”.[334]

That final point again highlights the relevance of whether or not asset managers have fundamental research analysts or fund managers that can come to the company’s rescue by overruling the recommendation of the proxy advisors. In the case of active funds, corporates are able to call their established contacts and point out perceived faults in proxy advisors’ reasoning, “active investors still have a real telephone and like to talk”, in the case of index funds, as explained above, their governance departments may not have the resources to engage with corporates.[335]

The fact that proxy advisors face greater resistance in the US than in the UK and Germany is therefore due to a combination of factors. Firstly, the greater market share of index investors in the US already reduces engagement, proxy advisors then further contribute to this separation of ownership and control. Secondly, the perception of influence is increased by the greater extent to which proxy advisors’ policies, particularly with regard to ESG issues, diverge from the domestic status quo in the US. As the previous chapters have shown, proxy advisors are far more likely to back such shareholder proposals and thus provide a challenge to the governance vacuum provided by the Big Three in the US that has hitherto insulated corporate executives.

[334] Investor Relations, US company, telephone interview, 4 June 2018.
[335] Investor relations, German company, telephone interview, 7 February 2018.

The role of US stock exchanges

The lack of opportunity for direct engagement with both proxy advisors and many of the index funds, has led some corporates to seek alternative routes for engagement. Though UK and German corporates also participate in their respective domestic policy-setting discourses, the response of US corporates to harness the co-ordinating abilities of stock exchanges, to set up lobbying organisations, and to enlist the SEC to look at change to shareholder voting is of a different magnitude. This section as well as the next section will therefore document how the battle over shareholder rights is unfolding in the United States.

The stock exchange Nasdaq Inc has taken a leading role in advocating for reform of the proxy voting process, including stricter regulation of proxy advisors and in support of restricting the ability of shareholders to resubmit unsuccessful shareholder proposals in subsequent years. They do this out of concern that the increasing governance demands by proxy advisors and institutional investors will lead to fewer companies choosing to list on US exchanges. This campaign has been waged under the banner of "revitalizing" and "reigniting America's economic engine".[336]

Nasdaq's campaign goes back several years. In 2012 Nasdaq conducted a study in cooperation with The Conference Board and the Stanford Rock Center for Corporate Governance to look into the influence of proxy advisors on executive compensation (Larcker et al., 2012). Nasdaq has also run annual proxy season surveys in which the stock exchange asks corporates about their experiences with proxy advisors. The 2017 survey, for example, noted that a substantial number of corporates that sought meetings with proxy advisors had these meetings declined

[336] See the campaign website for further details: https://business.nasdaq.com/revitalize (Accessed 20 October 2019)

and that, even where engagement occurred, there was "little difference in outcomes" (Nasdaq, 2017).

Nasdaq (2019) followed up on the November 2018 SEC roundtable on the proxy process with a February 2019 letter to the SEC. The letter, signed by several hundred companies (including companies not listed on Nasdaq such as the oil major Chevron and the European budget airline Ryanair), made the case that the proxy system is "part of a poorly-calibrated regulatory ecosystem that is producing fewer IPOs and driving many companies out of the public markets" (Nasdaq, 2019: 1). Academic research, however, shows that the US "listing gap" is explained by a high rate of acquisitions of publicly listed firms and that changes in listing requirements can be ruled out (Doidge et al., 2015). Further contributing to the de-listing is the fact that US companies can find cheaper capital elsewhere due to the low interest rate environment, which is swelling the coffers of private equity funds (Henderson, 2019). There is therefore no proof that proxy advisors or more attentive shareholders are discouraging companies from listing.

The New York Stock Exchange (NYSE), while not as vocal as Nasdaq, has also sought to represent a "strong voice for its community of issuers".[337] Nasdaq and the NYSE are therefore helping companies overcome coordination problems in the same way that proxy advisors are doing for investors. However, since stock exchanges have both investors and corporates as their clients, one would expect them to take a more balanced position.[338] Neither the London Stock Exchange nor the Deutsche Börse have taken similarly partisan stances to that presented

[337] A US corporate interviewee sent me a scanned copy of the letter he had received from the NYSE. For further details on the NYSE campaign, see: https://www.nyse.com/article/bipartisan-bill-advances-reform-of-proxy-advisory-firms (Accessed 20 October 2019)
[338] Besides charging firms to list on their exchanges, stock exchanges make money from selling trading data to asset managers and charging trading fees to banks and asset managers.

by the US stock exchanges.[339] While beyond the scope of this thesis, it is interesting to note an apparent change in the behaviour of stock exchanges. In the past stock exchanges have been promoters of better corporate governance in their listing standards but since the demutualization of many stock exchanges, some observers have raised the concern that a "race to the bottom" may be occurring as for-profit exchanges compete for company listings (Christiansen and Koldertsova, 2009).

The announcement in October of 2020 that the German stock exchange operator Deutsche Börse has acquired an 80 percent stake in the proxy advisor ISS is a potentially significant development.[340] Stock exchanges are to corporates what proxy advisors are to investors: data aggregators and coordinating agents that help overcome collective action problems. They therefore represent two different sides of the corporate governance discourse.

A stock exchange taking over the largest proxy advisor therefore cannot be neutral, in the same way that indices and ratings are not neutral but always involve a degree of judgement.[341] Each exchange is different and Deutsche Börse has not been as openly anti-investor and anti-ESG as Nasdaq, nevertheless caution is still warranted.

This merger furthermore marks another milestone in the horizontal and vertical merger rush that has occurred amongst financial services firms in recent years. Stock exchanges and index providers have merged with ESG ratings agencies, proxy advisors have merged with ESG ratings agencies, as have credit ratings agencies, and now Deutsche Börse's acquisition of ISS

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[339] Though the LSE did consider changing its listing requirements to attract the Saudi state oil company to list in London. See: https://www.theguardian.com/business/2018/jun/08/fca-rule-change-to-lure-saudi-aramco-prompts-criticism (Accessed 19 October 2019).

[340] For further detail, see: https://www.ft.com/content/bcc89bd5-51da-4923-9cad-aa25292f5a9e (Accessed 21 November 2020).

[341] For more on index providers see Petry et al. (2019) and Robertson (2018).

has created a firm that straddles the provision of stock exchanges, index construction, ESG analytics and proxy advice. It is doubtful that the creating of such of an oligopoly of giant private governance actors is in the interest of either asset managers or their ultimate investors.

The one qualifying factor that will be interesting to follow, is how the fact that the largest proxy advisor is now controlled by a German firm will impact its perception by asset managers and corporates alike. Corporates could arguably regard it even less favourably, claiming it represents the Europeanisation of American corporate governance, whereas investors may be further alarmed by the potential for growing conflicts of interests, now that ISS does not only advise corporates alongside investors, but is in fact owned by a corporate (which is also a stock exchange).

The Main Street Investors Coalition

The second vehicle companies in the US have employed against proxy advisors and asset managers is the "Main Street Investors Coalition".[342] This coalition, dressed up to look like it is representing the every-day small investor from "Main Street" (as opposed to Wall Street banks and asset managers), was in fact a lobbying body of the National Association of Manufacturers (NAM), the American Council on Capital Formation (ACCF) and the Small Business & Entrepreneurship Council as well as other business interests. The group demands

[342] For further details, see: https://mainstreetinvestors.org/ (Accessed 20 October 2019). In a November 2020 article, the New York Times published a detail report on the consultancy that was behind the Main Street Investors Coalition explaining its links to big oil companies. See: https://www-nytimes-com.cdn.ampproject.org/c/s/www.nytimes.com/2020/11/11/climate/fti-consulting.amp.html (Accessed 15 November 2020).

"that fund managers focus on maximizing performance – not playing politics with other people's money".[343]

In a coordinated move the American Securities Association (ASA), a trade association of regional financial service firms, has written opinion pieces and run an advertising campaign exclaiming that "workers don't want fund managers playing politics with their retirement savings" (Iacovella, 2018).[344] The ASA states its mission as promoting "investor trust and confidence and to help *small businesses* access the U.S. capital markets to grow and create jobs". It further lists its beliefs on its website as follows "The long-term financial well-being of the investor supersedes all else; The best interests of the investor will be placed ahead of those of the firm and its employees".[345] It is thus both an advocate for US businesses and for shareholder primacy.

This apparent paradox, an alliance between corporate interests and shareholder value principles, is a hallmark of the US corporate response to the rise of the asset management sector. By supporting shareholder value maximisation, a number of US corporates seek to prevent investors from micromanaging their businesses and to prevent ESG considerations from interfering with the maximisation of their profits. To this end, they seek to frame asset managers as illegitimate owners, and denigrate the proxy voting and engagements efforts of investors by coining terms such as 'robo-voting' (Doyle, 2018). As explained in the previous

[343] For more information see: https://web.archive.org/web/20190120202005/https://mainstreetinvestors.org/ (Accessed 15 November 2020). For A critical view of the work of the Main Street Investors Coalition see https://corpgov.law.harvard.edu/2018/06/14/the-main-street-investors-coalition-is-an-industry-funded-effort-to-cut-off-shareholder-oversight/ (Accessed 25 November 2018)
[344] The ASA describes itself as "the only trade association that exclusively represents the wealth management and capital markets interests of regional financial services firms. ASA members are small and regional financial services companies who advise hardworking and retired Americans how to create and preserve wealth, provide Main Street businesses with access to capital and advisory services, raise capital for schools, hospitals, cities and states and work with institutional investors to increase investment returns".
Source: https://www.americansecurities.org/about (Accessed 17 February 2020).
[345] Ibid.

chapter, the use of the term robo-voting seeks to imply that a large portion of the proxy voting decisions that institutional shareholders are making are made by robots and not by individuals.

This corporate pressure leaves US-based asset managers in a situation where any initiatives aimed at considering sustainability concerns may be labelled as 'political' by corporate interests. US-listed companies for their part, however, resist any attempts to curtail their political activities whenever put to a shareholder vote. They are relatively free to engage in political spending, be it in the form of election spending or lobbying expenditure since the *Citizens United v. Federal Election Commission* (2010) ruling protects such behaviour under free speech. Investors' response has been to call for increased disclosure of such spending, though to date with limited success. The result is that corporations are free to use company funds to finance campaigns such as the above examples of the Main Street Investors Coalition and the American Council for Capital Formation aimed at targeting shareholder rights.

US corporates have been able to do so, due to the Big Three's near universal rejection of shareholder proposals seeking greater disclosure of political spending. Former Delaware Chief Justice Leo Strine refers to this behaviour by the Big Three as a "fiduciary blind spot" and criticises "the failure of institutional investors to prevent the illegitimate use of working Americans' savings for corporate political spending" (2018: 1). Along similar lines, SEC Chairman Jackson (Democrat seat on the SEC) notes his surprise in discovering that the Big Three voted with corporate management against shareholder proposals on lobbying disclosure "I was surprised to find that—despite investors' clear preference for transparency—these institutions have so unanimously voted against disclosing corporate political spending. Given the strongly held views on the subject, I wondered whether ordinary investors were aware of these facts" (Jackson, 2019: 5).

US corporates have also succeeded in lobbying the SEC to investigate the proxy voting activities of asset managers and their proxy advisors in a "Roundtable on the Proxy Voting Process" on the 15th of November 2018, while concurrently confronting them at the Federal Trade Commission (FTC) on the issue of "common ownership".[346] What these two investigations have in common is that they investigate the means by which large index managers may influence corporate governance. The implicit threat is that if institutional investors become too involved in the day-to-day business of corporations, or advocate too vociferously for environmental and social concerns, then corporates will step up their lobbying push for greater regulation of asset managers.

Amongst the SEC commissioners, there are members that are clearly supportive of corporate interests, as illustrated in a speech by SEC Commissioner Hester Peirce before the American Enterprise Institute in which she likened the operations of proxy advisors and ESG consultants to a "cold-hearted", "self-righteous" "morality police".[347] Questioned about these statements, a proxy advisor said "they [the SEC] are trying to interfere with a voluntary financial transaction between two highly sophisticated counterparts"[348] while another suggested a degree of regulatory capture of the SEC.[349]

In a major victory for US corporations, Reuters reports that the SEC will issue new guidance on proxy voting that will "clarify that investors do not have to submit votes for every share

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[346] For details on the SEC roundtable, see: https://www.sec.gov/news/upcoming-events/roundtable-proxy-process For details on the FTC hearing, see: https://www.ftc.gov/news-events/events-calendar/ftc-hearing-8-competition-consumer-protection-21st-century (Accessed 20 October 2019). For a background on the discussions surrounding the concept of common ownership, see Azar et al. (2018) and Schmalz (2018).
[347] For the full speech, see: https://www.sec.gov/news/speech/speech-peirce-061819 (Accessed 20 October 2019)
[348] Former executive, US proxy advisor, telephone interview, 10 February 2020.
[349] Executive, European proxy advisor, emailed comment, 1 September 2019.

they own — a misconception that has allowed proxy firms to gain significant influence, say their critics".[350] At the time of the SEC roundtable on the proxy process, in November 2019, SEC Chairman Jay Clayton explained that "[s]ome of the letters that struck me the most came from long-term Main Street investors, including an Army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single mom, a couple of retirees who saved for retirement — all of whom expressed concerns about the current proxy process".[351] However, in a final twist, it was revealed that the SEC was duped by "fishy" letters purported to be written by private individuals but that these were instead part of a corporate lobbying effort, leading two US (Democrat) Senators to call out a "sham" process.[352]

All of this corporate opposition has contributed to silencing the Big Three asset managers to the point where they have largely stayed out of the SEC fight. Although other US investors, such as Neuberger Berman (2020) and T. Rowe Price (2020), have made strong cases opposing the new regulations, Reuters reports that the "corporate lobby so far has faced little push-back from top index fund firms" such as State Street and Vanguard .[353]

Conclusion

An implicit assumption in much of the literature is that companies are continually reacting to institutional changes that have been put before them. They are portrayed as passive institution-takers without any agency (Crouch, 2005). Instead this chapter has highlighted that corporates

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[350] https://de.reuters.com/article/usa-sec-proxy-advisors-idUKL4N2594AM (Accessed 20 October 2019)
[351] Source: https://www.financialadvisoriq.com/c/2596973/299793/senators_call_clayton_were_duped_proxy_initiative (Accessed 17 February 2020).
[352] Ibid.
[353] Source: https://www.reuters.com/article/us-climatechange-investors-proxy/top-u-s-fund-firms-split-over-new-limits-on-shareholder-votes-idUSKBN1ZU1JW (Accessed 18 February 2020).

are actively seeking to influence the institutional framework within which they operate and appear to be having some success in the US. The fact that the level of resistance differs from country to country, furthermore, suggests that the varieties of capitalism may diverge as a result of this.

With regards to the situation in Germany, the corporate interviewees noted that German investors in particular are becoming much more vocal. With regards to international investors Hermes Equity Ownership Services (EOS) was the exception to the rule that was repeatedly brought up as an example of good stewardship. Engagement from index investors for the most part was reported as limited. Unlike their US peers, German companies were less outraged by the state of asset manager stewardship, instead they appeared to be running rather emotionless through the new corporate governance motions, such as setting up calls between the supervisory board members and institutional investors. German corporates also made multiple references to German laws and the dual board structure, indicating that investors have also had to adapt their approaches to the German context. The overall impression I was therefore left with, is that the influence of greater investor stewardship on how German companies operate is likely to be piecemeal.

Further contributing to tensions in Germany is that until recently German portfolio managers and analysts had never asserted themselves as "owners" in company meetings.[354] Investors would ask questions about the operational performance of a firm, but they rarely ever sought to challenge executives seriously. Now that they have started to do this, it is causing the aforementioned strain in the relationships between German corporates and German investors. Voting at German AGMs had hitherto resembled "socialist" results that had tended to be in the

[354] Senior executive, German asset manager, in-person interview, 13 November 2018.

high-90s percentage approval.[355] Up until approximately 2007 "everyone voted for everyone", but "German corporates have now realised that they need to do more".[356]

In the UK the long history of engagement, starting with domestic insurance companies in the 1980s and supported by regulations from 1992 onwards means that the UK has moved beyond the teething problems observed in Germany. Here rather than object to investor demands, corporates were mainly concerned with a lack of engagement from some investors. This concern differed from the US experience in that UK corporates expected UK investors to partner on corporate governance issues.

For the US this chapter has documented both the effort with which US corporates have opposed increasing investor governance activities, as well as the success they have had in lobbying the SEC. The CEO of the US corporate accountability NGO "As You Sow" concluded that "the SEC has apparently inverted its mandate of protecting shareholders to that of protecting companies from shareholder input — even where company action creates increasing risk to shareholders, people, or the environment".[357] Rather than "merely" being stable, there is thus evidence to suggest that shareholder protection in the US is actually deteriorating. Hill (2018) thus refers to the engagement between US shareholders and US directors as "private ordering combat".

Chapter 4 showed that index funds have a larger market share in the US than in the UK or Germany, and that the majority of domestic index funds in the UK and Germany are operated

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[355] Governance specialist, proxy advisor, telephone interview, 20 September 2018.
[356] Governance specialist, proxy solicitor, telephone interview, 26 February 2018.
[357] Source: https://www.thinkadvisor.com/2020/02/03/opposition-to-sec-proxy-proposals-grows/?slreturn=20200117113720 (Accessed 18 February 2020).

by fund managers that have a large active asset base. Since fear of instrumentalization is of greater concern with regards to index funds (due to their lack of fundamental analysts and portfolio managers), this helps to explain why both UK and German corporates were overall less alarmed (due to the smaller market share of index funds compared to the US).

A second reason for greater resistance by US corporates is their general objection to what they consider to be a politization of corporate governance. The two-pronged regulatory approach of the UK and German governments seeks to advance aspects of stakeholder capitalism to a greater extent than the US shareholder value focused approach. As such the increased integration of ESG consideration into investors' policies, conflicts with the US status quo to a greater extent than with the UK or German model of governance.

Overall, the extent to which we arrive by an institutional setup that is deserving of the nomenclature of "asset manager capitalism" will therefore depend not only on the size and ownership concentration of the asset management industry, and on how investors employ the services of proxy advisors, or even the size of their governance teams, it will also depend on the institutional context in which the conflict takes place. If regulators advocate for joint stewardship of the firm by shareholders and corporate managers, as is the case in the UK (and to a lesser extent in Germany), there is less scope for management to resist shareholder involvement than in countries such as the US that lack explicit stewardship regulations.

Chapter 8

Conclusion

Introduction

This thesis has documented how institutionalisation created the preconditions necessary for shareholders to play a greater role in corporate governance. In the initial phases of institutionalisation, asset managers' ownership blocs for the most part were insufficiently large for shareholders to be able to meaningfully influence corporate governance. That changed with the arrival of index funds, who as the new blockholders provided the missing ingredient of greater ownership concentration amongst asset managers.

The title of this thesis raises the question of whether the corporate governance models we have arrived at in the three countries concerned are deserving of the nomenclature of asset manager capitalism. Chapter 1 defined asset manager capitalism as a governance model in which asset managers are the primary supplier of equity funding and where they are able to demand changes to corporate policies, when they deem it necessary, against the preferences of corporate executives.

Since asset managers today represent the primary suppliers of equity capital in all three countries studied, the first part of the above definition is fulfilled. In all three countries ownership concentration has also increased to the point that asset managers' ownership blocs have on average reached sufficient size that, with the coordinating help of proxy advisors, they are able to remove company directors should they fail to carry out their demands. However, as the previous chapters have also illustrated, the possession of the means of control does not necessitate that asset managers have the intent of control and accept their new role as principals

of corporate governance. Thus, while we have arrived in the age of asset manager capitalism, its chief protagonists have yet to allow it to unfold its full potential.

Many scholars have highlighted the challenge in identifying and characterising institutional change (Goyer, 2007; Streeck and Thelen, 2009; Vitols, 2001). Indeed, difficulty in accounting for change is one of the main criticisms levelled at the varieties of capitalism framework (Deeg and Jackson, 2007). Streeck and Thelen (2009) note a conservative bias in the literature and stress the challenge in differentiating between incremental and transformational institutional change, which results in a tendency in the literature to understate the extent of change.

> "Equating incremental with adaptive and reproductive *minor* change, and *major* change with, mostly exogenous, disruption of continuity, makes excessively high demands on 'real' change to be recognized as such and tends to reduce most or all observable changes to adjustment for the purpose of stability" (Streeck and Thelen, 2009: 103).

This difficulty in accounting for change stems from the way the VoC literature conceives of the ideal-type models of capitalism as self-reinforcing equilibria (Hall and Soskice, 2001). CME models are assumed to respond to challenges by doubling down on their coordinating aspects, whereas LME models will respond by increasing the role for markets, doubling down on their liberal characteristics (Hall and Soskice, 2001). A key role hereby is attributed to the "complementarities" between institutions. Complementarities exist when "the co-existence of two or more institutions enhances the functioning of each" (Deeg, 2007: 611). This interdependence between institutions suggests that they must shape the process of change as

"efforts to reform one part of the political economy may yield negative economic results if unaccompanied by parallel reforms in other spheres" (Hall and Gingerich, 2009: 451).

Complementarities are thus said to result in path dependency as institutions reinforce a given path when countries double down on their respective institutional advantages. Since a break with complementary institutions results in a loss of efficiency, complementarities reduce the likelihood of change. What results is a U-shaped relationship between the varieties of capitalism, with efficiency at either pole and sub-optimal conditions in between, as borrowing from "best practice" institutions from different models of capitalism results in decreased efficiency (Hall and Gingerich, 2009). Such understanding of the VoC does not allow for countries to operate successfully in the middle ground between the two ideal-type poles permanently.

What further complicates the observation of change is that "major change in institutional practice may be observed together with strong continuity in institutional structure" (Streeck and Thelen, 2009: 114). For example, while Germany has had co-determination since the beginning of the last century, Jackson (2005) documents how the role that co-determination has played over time has changed substantially. Part of the success of the German export-led growth has been the absence of wage inflation, which was achieved in part because workers at companies such as Siemens agreed to longer working hours for the same pay during the recession of 2001-2003 (Dustmann et al., 2014).

Goergen et al. (2008) therefore explain that there can be a convergence *in function* without a convergence *in form*. For asset manager capitalism, the opposite may also be true. There can be a convergence of form, with all three countries exhibiting asset manager capitalism, yet the

degree to which the arrival of asset manager capitalism changes the functioning of the national corporate governance context may differ substantially. To determine the extent of change in function, it therefore does not suffice to look at, for example, whether Germany still has a dual-board structure or whether Germany has established a corporate governance code. Instead one needs to look at the details of how companies are managed. The result may be, for example, that German firms "engage in decoupling by espousing but not implementing a shareholder value orientation" (Fiss and Zajac, 2004: 1). Similarly, it is not sufficient to simply compare the levels of shareholder ownership concentration of UK companies with that of US companies to draw conclusions about the extent to which these two countries are converging.

This is why this thesis has followed the approach of Sinclair (2005) and Braun (2014) in seeking to contribute to the macro understanding of the domestic and international political economy by studying the micro-level behaviour of specific actors (asset managers, proxy advisors and corporates). The previous chapters highlighted a number of such micro-level changes brought on by the rise of the asset management sector. These include the creation of new institutions such as corporate governance and stewardship codes, of new actors such as index funds and proxy advisors, and of changes in the levels of required cooperation between actors that has seen engagement (voice) become more relevant than the selling of stock (exit).

Chapter Structure

This final chapter will evaluate how the developments documented in the preceding chapters inform our understanding of the comparative political economy literature, specifically as it relates to the varieties of capitalism framework. It will explain why institutions should be considered resources as well as constraints on firms' behaviour, why firms are not simply

passive “institution-takers” but seek to both influence the functioning of existing institutions and establish new ones when needed, why complementarities may influence institutions in both positive and negative ways and finally, why all this suggests that models of corporate governance operating between the two ideal-types are feasible. Asset manager capitalism will be shown to produce both endogenous and exogenous impulses for change, resulting in incremental change, which is best classified as representing a convergence in form but, for the most part, not in function.

The chapter will be structured as follows. The first section will discuss the difficulties in measuring institutional change. This will be followed by a section explaining the role of governments in setting the ground rules for engagement between asset managers and their portfolio companies. The role of institutions within the models of capitalism will be discussed next, highlighting how they should be understood as more than restrictions on economic actors. Based off this understanding, a theory of institutional change in asset manager capitalism will be presented. The final two sections will assess what this entails for the overarching question of whether there is a convergence or a divergence of the varieties of capitalism and close with a deliberation of what the future of asset manager capitalism holds in store for the national models of corporate governance.

Change in the shareholder identity

The institutionalisation and indexation of investment management have resulted in changes at two levels of the shareholder persona. Firstly, private individuals have been replaced by institutional investors as the primary point of contact for corporates. These institutional investors are better resourced and face regulatory requirements of varying degrees to engage

with their portfolio companies. This development started in earnest in the post-World War Two era and has been documented by Useem (1996), Harmes (2001) and others. The second level at which changes have occurred is at the level of the investment style as a result of the rise of index investment. This has resulted in both the identity of shareholders and their preferences having changed. This indexation of investment management and the corresponding rise of the Big Three, which began in earnest at the beginning of the twenty-first century and received a substantial boost following the GFC of 2007 and 2008, has been investigated by Fichtner et al. (2017), Bebchuk and Hirst (2018) and others.

Hirschman (1970) posits that the use of voice will be a function of the likelihood of successful use of voice and the ability of exit. The institutionalisation and indexation of asset management has altered both. The growth in average assets under management, as well as their increased indexation, has made exit increasingly impractical. At the same time the growth in assets under management has reduced the cost of voice by allowing the cost of engagement to be spread across a larger asset base. This has also increased the likelihood of its successful use.

As index funds are unable to sell, these new "permanent universal owners" (Fichtner and Heemskerk, 2019) provide a new source of patient capital. Deeg and Hardie explain that the assumption behind patient capital is that "banks and blockholders are patient because their insider position overcomes information asymmetries, enables them to monitor management and thus capture rents or secure strategic advantages" (2016: 628). Patient capital therefore shields executives from short-term market pressures and enables "complementarities" by, for example, enabling "investment strategies with delayed returns and long-term employment" (Hardie et al., 2013).

Fichtner and Heemskerk (2019) question whether the Big Three should be considered as providers of patient capital and document that their voting practices support measures such as share buybacks and mergers and acquisitions, which they consider to be manifestations of corporate short-termism. However, these types of proposals are typically submitted by the board, and as the previous chapters have shown, the Big Three support the vast majority of all management proposals. While the Big Three therefore support such short-term proposals, they do so at the request of management.

The motivation and quality of index funds' patience may be questionable, but this does not invalidate the availability of their long-term capital and near blanket support of management. Deeg and Hardie (2016) also note an implicit normative assumption in some of the literature that patience must always be good and lead to better financial results. Index funds' behaviour suggests this assumption is incorrect, since they are mostly providing for managerial autonomy.

Index funds' seemingly passive voting behaviour reflects an intentional choice, which is likely the result of the conflicts of interest presented in Chapter 3. Despite mostly reflecting a passive backing of corporate management teams, index funds' voting behaviour still has an active influence on the voting outcome, since "one can't be truly passive while holding significant control rights" (Schmalz, 2020). This is the reason why the definition of asset manager capitalism employed in this thesis only requires that asset managers are able to demand changes instead of being both "willing and able" to do so.

In summary, the institutionalisation and indexation of asset management has had the effect of making voice (engagement) more important than exit (selling stock). There is therefore a greater reliance on strategic forms of coordination relative to market forms than in the past in

LME markets. Index funds are also providing a new form of patient capital, the risk of which is partially controlled by increased stewardship, including calls for greater financial disclosure. Asset manager capitalism has thereby ostensibly adopted two major tenets of the CME model of capitalism.

The Role of the Government in the Theory of Change

Chapter 4 introduced five dimensions of stewardship. The first dimension concerned the role of governments in setting out the ground rules of corporate governance and investor stewardship. This was followed by four dimensions concerning the investor (their intent to bring about change, the nature of the change they are seeking to bring, their physical resources, and their voting power). Together with proxy advisors and corporates, introduced in the subsequent chapters, these seven dimensions determine how asset managers' activities will shape the national models of capitalism. This analysis has further highlighted that there are five main actors that will determine the extent and nature of the change brought about by asset manager capitalism: government, the Big Three asset managers, all other asset managers, proxy advisors and corporates.

How asset managers, proxy advisors and corporates engage is conditioned by government action. The role of governments and their regulators in corporate governance is complex. On the one hand, governments have been shown to demonstrate substantial agency and may serve as a control function for societal concerns. Should asset managers or corporates fail to show sufficient concern for societal interests, activists may pressure the government to enact new legislation to target the shortcomings of corporations, asset managers or proxy advisors.

Governmental agency has been particularly evident in the UK, where the government has set demanding rules for both companies (UK Corporate Governance Code) and asset managers (UK Stewardship Code). The UK government also demonstrated that it is prepared to back up its regulatory framework with parliamentary investigations, such as the one conducted by the UK Work and Pensions and Business, Energy and Industrial Strategy Committees, which put a series of questions to Carillion's major shareholders following its collapse.

In quintessential CME manner, the German government has left the 2019/20 revision of the country's corporate governance code to a commission consisting of representatives of civil society, corporations and shareholders. The government is still in charge, but the design of the rules has been outsourced to a committee nominated by the government.

On the other hand, the previous chapter also presented evidence that governments' policy catalogues can be subject to influence from other actors. Chapter 6 documented the increased lobbying spending by the Big Three in the US and Europe, and Chapter 7 detailed the extensive lobbying of the SEC by US corporates aimed at revising the existing proxy voting guidelines.

The direct lobbying of the SEC is accompanied by indirect lobbying of politicians. A May 7, 2020 letter signed by 36 Republican senators and members of congress to US President Trump shows how politicised corporate governance has become in the US. The signatories criticise what they consider to be BlackRock's "hostility towards the American energy sector" branding it as "unacceptable" and calling for close scrutiny of BlackRock's actions.[358] Activists, as the previous chapters have documented, take the opposite view, complaining about BlackRock

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[358] The letter can be found at: https://www.cruz.senate.gov/files/documents/Letters/2020.05.07%20Letter%20to%20POTUS%20Re%20Energy%20Financial%20Institutions.pdf (Accessed 10 May 2020).

doing too little to change the way the energy sector operates.[359] This highlights the political tightrope BlackRock is having to tread.

With regards to the varieties of capitalism, governments' efforts are therefore complex as the role of government may differ from country to country. The two-pronged approach pursued by the UK government and the European commission seeks to strengthen the voice of shareholders within corporate governance whilst simultaneously directing how it is to be used. Greater shareholder control, when considered by itself, would suggest a development in the direction of the LME model. However, expecting asset managers to take account of stakeholder concerns when exercising their increased influence, is more in-line with the CME model as it helps to amplify the voice of other stakeholder groups and requires a longer-term focus and greater coordination from company executives. In other countries, such as the US, the government and its formal institutions instead represent resources to be employed by corporates and asset managers to help ensure individual victory.

This shows that even in a highly globalised world, governments continue to play an important role. The way in which they set out the rules will considerably influence the way in which asset manager capitalism impacts national varieties of capitalism. Since the US and UK models of governance are increasingly at odds with one another, as a result of the substantially different approaches pursued by the respective governments, it suggests that referring to an "Anglo-Saxon" model of corporate governance will become increasingly inappropriate in the future.

[359] See, for example, Financial Times, "BlackRock accused of climate change hypocrisy", 7th of May 2020. Available at: https://www.ft.com/content/0e489444-2783-4f6e-a006-aa8126d2ff46 (Accessed 15 November 2020).

The role of institutions in the corporate governance of asset manager capitalism

The varieties of capitalism approach to comparative political analysis is an actor-centred approach that considers the firm as the central actor within the capitalist system and thus locates it at the centre of analysis (Hall and Soskice, 2001). This is why this thesis made extensive use of corporate interview data and dedicated one chapter to the corporate perspective. The centre of analysis of this thesis have been shareholders, which today are themselves mostly firms (asset managers). A central finding of this thesis is the extent to which firms, both corporate issuers and asset managers, are seeking to actively shape the institutional framework within which they operate. This suggests that actors are not just "institution-takers" (Crouch, 2005; Deeg, 2007) as suggested by Hall and Soskice (2001).

The behaviour documented in the previous chapter demonstrates that US corporates are lobbying the SEC to influence the design of the institutional framework by orchestrating investigations into the proxy voting system by the SEC. Firms in Germany and the UK have also employed their associations, including trade bodies, to seek to influence their respective domestic policy designs. The Confederation of British Industry (CBI), for example, objected to the introduction of mandatory say-on-pay regulation in the UK, noting that it would lead to micromanagement by shareholders and warning that "[b]usinesses do not believe binding shareholder votes are the right way to ensure executive reward reflects performance".[360] However, the approach of US corporates differs from that pursued by UK and German corporates in the extent to which it has employed lobbying and the confrontational stance it has adopted.

[360] Source: https://www.irmagazine.com/esg/uk-sets-out-binding-vote-details (Accessed 13 April 2020).

Investors for their part have made use of both domestic and international institutions and associations to help overcome collective action problems. While governments have introduced domestic corporate governance and stewardship codes in an increasing number of countries, asset managers themselves have also created new associations. Examples include the European Fund Management Association (EFAMA) representing €15.2 trillion or the BVI German investment funds association, representing the interests of 114 fund companies and €3.4 trillion in capital. Alongside these there are organisations, which were not set up by asset managers themselves but have been brought to life by them, such as the UN PRI.[361] Asset managers use organisations such as the PRI, the BVI and EFAMA to further reduce collective action problems and ensure cost-effective stewardship.

As noteworthy as the presence of institutions and organisations such as the PRI is the absence of others. In the case of the US, the Corporate Governance Principles of the Investor Stewardship Group (ISG) are a voluntary industry initiative that only went into effect on January 1, 2018. The US to date still lacks a government-enforced federal corporate governance code equivalent to those seen in the UK and Germany. This is indicative of the success that US corporates have had in stifling corporate governance reforms.

Hall and Soskice define institutions as "a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive, or material reasons" (2001: 9). This definition primarily conceptualises institutions as constraints on actors' behaviour and corresponds to many of the institutions typically established by governments. However, alongside such limiting institutions, this thesis suggests that institutions should also be conceptualised as

[361] For further details on the PRI, see: https://www.unpri.org/pri/about-the-pri and for EFAMA, see: https://www.efama.org/about/SitePages/Home.aspx (Accessed 9 April 2020).

resources that actors may make use of in order to overcome coordination problems (Deeg and Jackson, 2007; Hall and Thelen, 2005).

The extent to which institutions constrain some actors, while acting as a resource for others, plays an important role in determining how asset management capitalism unfolds in each country. The concept of fiduciary duty is, for example, employed by US corporates as a constraint on US asset managers. The struggle for control over the firm will therefore be determined on two levels: (a) by the approach adopted by respective governments, and (b) by the respective resourcing of corporates versus asset managers (including index vs. active, domestic vs. foreign) and their proxy advisors (including the Big Three vs. proxy advisors).

A closer look at the United Nations Principles for Responsible Investment (PRI)

The PRI deserves a detailed consideration at this point, as its existence has had a substantial effect on the investment management ecosystem. Originally envisioned by the United Nations in early 2005 and launched in April 2006, the PRI is a network of institutional investors that today represents the "world's leading proponent of sustainable investing".[362] Ahead of its launch the UN had "invited a group of the world's largest institutional investors to join a process to develop the Principles for Responsible Investment. A 20-person investor group drawn from institutions in 12 countries was supported by a 70-person group of experts from the investment industry, intergovernmental organisations and civil society."[363]

[362] Source: https://www.unpri.org/pri/about-the-pri (Accessed 21 November 2020).
[363] Ibid.

A look at the founding signatories shows that they were made up of mainly of asset owners with a declared interest in sustainability. Of the 63 founders, just ten were from the US and none of the mainstream asset managers were signatories. Six were state of religious pension funds (California Public Employees' Retirement System, New York State Local Retirement System, New York City Employees Retirement System, Teachers' Retirement System of the City of New York, Connecticut Retirement Plans and Trust Funds (CRPTF), Wespath Investment Management (General Board of Pension and Health Benefits United Methodist Church)), two were ESG fund managers (Domini Social Investments and Calvert Group), one was a trade-union owned social bank (Amalgamated Bank) and the final one was Generation Investment Management LLP the investment fund co-founded by former US vice-president Al Gore.

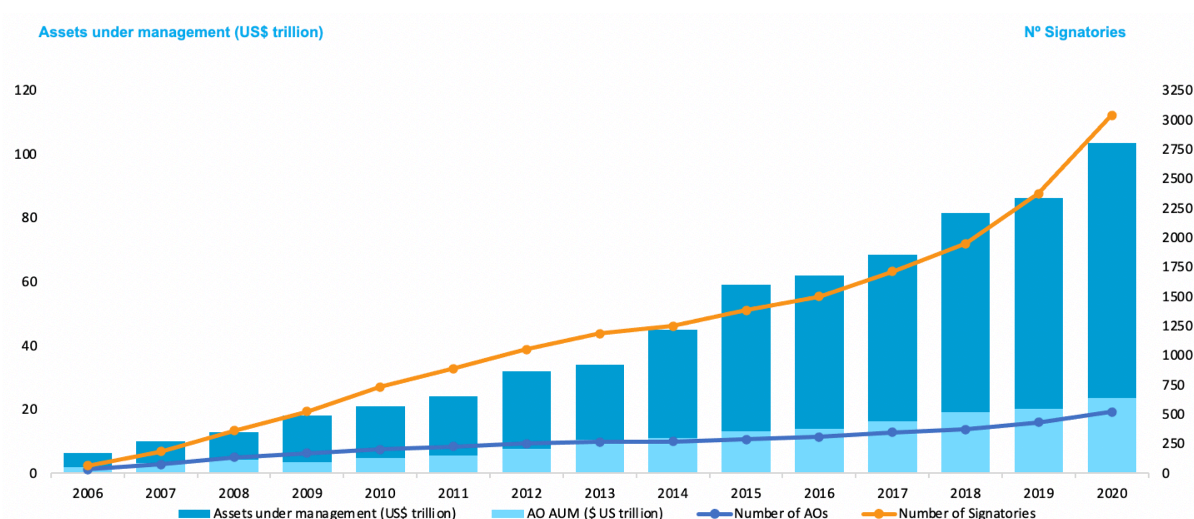
The PRI has six Principles for Responsible Investment, which it describes as voluntary and aspirational. These principles seek to advance the integration of ESG principles into the investment chain.[364] The PRI has further set out to achieve a "sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation."

The sustainable investment roots of the founding members therefore continue to guide the direction of the PRI. As Figure X shows, the PRI has grown substantially from 63 signatories representing $6.5 trillion in AuM in 2006 to 3,038 signatories representing $103.4 trillion in AuM in 2020. Besides the growth in numbers, the shift in signatory type is telling: whereas 51 percent of its founding signatories were asset owners, today asset owners represent just 17

[364] For a list of the 6 principles, see: https://www.unpri.org/pri/about-the-pri (Accessed 21 November 2020).

percent of signatories. Therefore, while the original sustainability focus of the institution remains, the signatories have shifted considerably. Today 73 percent of signatories are asset managers and 11 percent are services providers (including ESG data providers, proxy advisors and index providers).[365]

Figure 35: PRI Signatory growth



Source: PRI, https://www.unpri.org/pri/about-the-pri, as of 21 November 2020

Being a signatory of the PRI has become a qualifying requirement for many if not most "requests for quotes" with which asset owners procure the services of asset managers and many of the asset managers I interviewed prominently displayed their PRI signatory status in their email signatures. The PRI has therefore provided a means for sustainability conscious asset owners to project their preferences onto asset managers.

There are a number of further factors worth considering in regard to the PRI. First of all, while its founding was supported by the United Nations, it is in fact an investment industry body that

[365] https://www.unpri.org/signatories/signatory-resources/signatory-directory (Accessed 21 November 2020).

is entirely independent of the United Nations. Its supervisory board consists of a chair, seven directors directly elected by asset owners (not asset managers!), three directors from non-asset owners, as well as two permanent UN advisors.[366] It is also mostly self-funded from membership fees, which in the year 2019/2020 constituted 80 percent of its budget.[367]

Besides staffing cost of £9.32 million, "bought-in services, consulting and research" at £2.25 million represent by far the most significant expenditure item out of the total expenses of £15 million in the 2019/20 budget.[368] The PRI website lists the following as significant bought-in services, consulting and research: Energy Transition Advisors (Climate Transition Work Programme); London School of Economics (Investing in Just Transition); London School of Economics (TPI); Regnan (Environmental Issues); Vivid Economics (IPR Funding); Danyelle Guyatt (Implications for Strategic Asset Allocation); Freshfields (EU Sustainable Finance Action Plan); Clean Returns Pty Ltd (IPR Implementation Guidance).[369]

The significance of this is that it demonstrates the extent of the policy and lobbying work the PRI engages in both at the European and global level. Together with the United Nations Environmental Programme (UNEP) Finance Initiative, the PRI has sought to break the global deadlock around the issue of fiduciary duty with notable agenda seeking publications (Freshfields Bruckhaus Deringer, 2005; PRI, 2015; 2019). Whereas the 2005 report concluded that "integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions" (Freshfields Bruckhaus Deringer, 2005: 13), the 2015 report declared that "failure to consider

[366] https://www.unpri.org/annual-report-2019/how-we-work/more/board-report (Accessed 21 November 2020).
[367] https://www.unpri.org/annual-report-2019/how-we-work/more/financial-statements (Accessed 21 November 2020).
[368] Ibid.
[369] Ibid.

all longterm investment value drivers, including ESG issues, is a failure of fiduciary duty" (PRI, 2015: 9). It appears that this statement was considered too deterministic and in contradiction to the global diversity in regulatory standards, so that in 2019 the PRI issued a revised "final report", which instead noted that fiduciary duty requires investors to "incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making processes, consistent with their investment time horizons" (PRI, 2019: 8). The inclusion of the reference to consistency with investment time horizons, providing sufficient room for interpretation to, for example, US asset managers.

Such policy work is one way the PRI seeks to influence corporate governance and set policy. The second one is via the standards and reporting commitments it requires from its signatories.[370] In September 2017, the PRI conducted a consultation of its members that showed "strong signatory support for using reporting and assessment data to delist signatories whose progress in implementing the Principles is not sufficient".[371] In response to this the PRI proceeded to delist four asset managers and one asset owner in September of 2020. Furthermore, "23 out of 165 signatories identified as not meeting the requirements in 2018 have since either voluntarily delisted or been delisted for failure to submit their annual PRI report".[372]

In a sign of further enforcement, the PRI announced that it plans to launch an additional consultation in October 2021. Membership requirements will likely be toughened further, with proposed changes "include requiring firms' responsible investment policies to cover 90% of

[370] https://www.unpri.org/reporting-and-assessment/minimum-requirements-for-investor-membership/315.article (Accessed 21 November 2020).
[371] Ibid.
[372] https://citywireselector.com/news/un-pri-delists-four-investment-firms-and-plans-to-boost-requirements/a1406974 (Accessed 21 November 2020).

assets and making that policy public. Engagement and voting would also be made mandatory for those managing equities".[373] Such self-enforcement action is accompanied by annual PRI awards and "leadership showcases". These seek to raise "standards of responsible investment amongst all our signatories".[374] 36 investors were included in the "2020 Leaders' Group", while awards were for prizes including for "ESG incorporation initiative of the year", "Stewardship project of the year", "ESG research report of the year" and further categories.[375]

In this manner the PRI acts as a self-regulatory entity, seeking to set minimum standards with regards to ESG amongst its signatory asset owners, asset managers and service providers. The fact that with more than 3,000 members it is the largest investor network in the world, and that 73 percent of its signatories today are asset managers, means that it also appears to be increasingly fulfilling the functions of an industry association, aiming to improve the investment management industry's image and pre-empt further formal regulator oversight of the industry.

Irrespective of such potential ulterior motives, the above policy work of the PRI has put it in a position to have considerable influence over the global corporate governance discourse. The board structure, with just three out of thirteen members from the asset management industry, mean that asset owners continue to hold the reins, irrespective of the fact that asset managers represent the majority amongst signatories. Amongst the current board of 13, there are just two representatives from US institutions, one from an asset owner (CalSTRS) and one from an

[373] https://uk.reuters.com/article/us-global-investments-pri-exclusive/five-groups-ousted-from-u-n-backed-responsible-investment-list-idUSKBN26J0T9 (Accessed 21 November 2020).
[374] https://www.unpri.org/signatories/showcasing-leadership (Accessed 21 November 2020).
[375] https://www.unpri.org/showcasing-leadership/leaders-group-2020/6524.article (Accessed 21 November 2020).

asset manager (Wellington Management). The PRI board is thus representative of the diversity of its international signatories.

The above paragraphs have explained that the PRI seeks to advance the integration of ESG and to extend investment horizons. This thesis considers both these aspects to be characteristics more common in CME than in LME varieties of capitalism. They are more aligned with a stakeholder value interpretation of the firm than with a focus on the maximisation of shareholder value. The biggest asset managers are today also members,[376] but asset owners, many of them non-US, remain well represented, and the PRI's policy initiatives suggest that it is asset owners' longer-term preferences that are continuing to set the discourse.

Further research into the role of the PRI within the institutional framework of asset manager capitalism is needed. But as outlined in this and the subsequent sections, the PRI should not be regarded as an institution seeking to advance the Americanisation of the asset management industry. To the contrary, the largely international membership, is reflected in policy preferences that represent an international consensus.

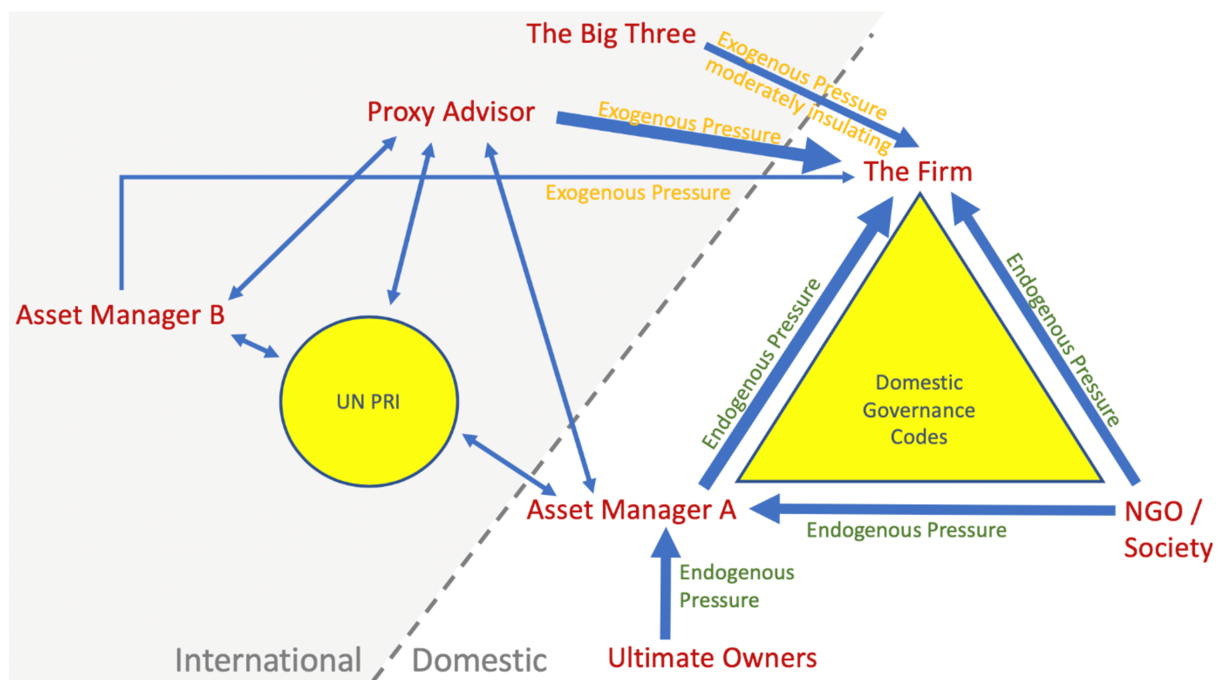
To the extent that the PRI is contributing towards a convergence of international governance standards these standards are, therefore, reflective not of a convergence on the US model but on the international best-practice interpretation of fiduciary duty and ESG; one that is much closer to the CME than the ideal-type LME model of the varieties of capitalism. Furthermore, the PRI provides a framework for asset managers, asset owners and proxy advisors to overcome collective action problems and agree policies, which strengthens their position vis-à-vis stock market listed companies.

[376] BlackRock signed up early in 2008, whereas Vanguard only became a signatory in 2014.

The Theory of Change in Asset Manager Capitalism

The preceding chapters have established that individual shareholders have mostly been replaced by asset managers and that these asset managers face pressure from both their own clients and from society more generally. Firms and asset managers make use of associations such as the PRI, as well as institutions such as governance codes, as resources and create new ones when needed. Figure 36 below illustrates how some of the most important actors and institutions of corporate governance in the age of asset manager capitalism are arranged.

Figure 36: Actors and institutions in the corporate governance of asset manager capitalism



Marked in red are the primary actors in asset manager capitalism, consisting of the asset managers themselves, their customers (the ultimate owners), the portfolio firms, the proxy advisors, and society, often represented by NGOs. The fact that the Big Three are placed on the left side of Figure 36, the international side of the diagram (shaded), indicates that this is a diagram of the UK or German corporate governance model (for some of the big asset managers, that are the result of a number of mergers, and have governance and portfolio management

teams in several regions, assigning nationality can be challenging). Marked in yellow are the primary institution and organisation, the domestic corporate governance and stewardship codes and the PRI respectively. In the case of the US, instead of corporate governance and stewardship codes, the SEC is the primary domestic institution setting the formal ground rules and adjudicating over domestic corporate governance disputes. Not displayed on Figure 36 is the government, which can be considered to represent a red frame around the domestic part of the institutional landscape.

Figure 36 furthermore illustrates that impulses for change may come from international asset managers and proxy advisors (exogenous impulses for change) or from domestic firms, asset managers or NGOs (endogenous impulses for change). Previous chapters have documented that the majority of engagement beyond proxy voting comes from domestic investors. This difference in pressure is represented in Figure 36 by the arrow between the domestic asset manager (Asset Manager A) and the firm being thicker than the arrow between the foreign asset manager (Asset Manager B) and the firm.

The preceding chapters illustrated that proxy advisors, domestic US active asset managers, as well as asset managers from the UK and Germany often vote differently to the Big Three. Besides the policies adopted by the domestic government, the crucial factor determining how national models of corporate governance develop as a result of asset manager capitalism is therefore the relative strength of power relationships (the thickness of the arrows). Particularly the relative influence of the Big Three versus the proxy advisors, as well as the importance of other investors versus the Big Three. The thickness of the arrows between society and asset managers is representative of the extent to which the national context is critical or supportive of the financial sector.

As a result of the internationalisation of asset management foreign asset managers as well as proxy advisors have the potential to bring exogenous change to any national model. At the same time domestic investors as well as domestic institutions such as corporate governance and stewardship codes have the potential to bring endogenous change or to resist it. Examples of endogenous impulses for change include asset managers participating in consultation processes to overhaul the domestic stewardship code, whereas the formation of global shareholder coalitions such as Climate Action 100+ is an example of exogenous impulses. Asset manager capitalism therefore provides a mixture of both endogenous and exogenous sources of change.

The growth of the asset management industry, in conjunction with the regulations that oversee the industry, has created proxy advisors as new actors alongside those new institutions. The business model of proxy advisors matches Hall and Soskice's (2001) explanation of the role that institutions fulfil in CMEs perfectly, suggesting that the role of proxy advisors may be to compensate for some of the losses of information and control caused by the dismantling of the interlocking directorships. Hall and Soskice (2001) explain that in the CME model, institutions fulfil three purposes: "(i) the exchange of information among the actors, (ii) the monitoring of behavior, and (iii) the sanctioning of defection from cooperative endeavour" (2001: 10). Proxy advisors similarly (i) aggregate investors' preferences, (ii) monitor the behaviour of firms, and (iii) suggest sanctioning firms that fail to abide by common standards by voting against their management.

When discussing the role of proxy advisors in this chapter, the intent is not to suggest that they represent a bloc of investors that blindly follows their recommendations. Instead, and in keeping with the findings of Chapter 5, the assumption is that proxy advisors fulfil a

coordinating role amongst the many smaller institutional investors, helping them to overcome collective action problems. Proxy advisors therefore represent a second voting bloc alongside the Big Three. One that regularly advocates for different voting outcomes on shareholder proposals to that pursued by the Big Three.

The relationships within asset manager capitalism can be further boiled down to the following three central relationships: the relative influence of the Big Three compared to proxy advisors in the national context, the degree to which firms and asset managers are able to make use of domestic and international institutions to their advantage (the regulatory dimension), and the relative importance of domestic and foreign asset managers. In order to show why the *convergence in form* that asset manager capitalism represents has not been accompanied by a corresponding *convergence in function*, the following three sections will compare and contrast the nature of the relationships between these key players for each of the three countries respectively.

The dynamics of asset manager capitalism in Germany

Because the German corporate governance Kodex commission, assembled by the government, is made up of representatives from civil society, corporate representatives and shareholder representatives, the German approach to regulation is one of consensus building, fitting for a CME economy. In line with the European Union's Shareholder Rights Directive II (SRD II) the Kodex is being amended to give further rights to shareholders. Importantly though, the SRD II pursues the same two-pronged approach set out by the UK government (which was of course part of the European Union while SRD II was being drafted). SRD II seeks to strengthen the position of shareholder while reducing the short-term focus and excessive risk-taking by

companies. It aims to make use of institutional shareholders as stewards, alongside conventional regulation. It seeks to “encourage long-term shareholder engagement and to enhance transparency between companies and investors” in order to create “a modern legal framework for more engaged shareholders and sustainable companies” (European Union, 2017: 1).

In Germany the Big Three hold a combined average shareholding of 9.5 percent (Table 3, page 122). Even adjusting for voter turnout of approximately 70 percent this indicates that with no more than 13.5 percent of the average votes cast the Big Three are not in a position to positively determine or block shareholder proposals against an otherwise united shareholder base. Second, interview data suggests that investors are likely to rely on the advice of proxy advisors to a greater extent when voting abroad.[377]

With foreigners on average holding in excess of half of all shares outstanding, this implies that the influence of proxy advisors in Germany is likely to be at the upper end of the 13.6 to 29.7 percent range given for the US by Bethel and Gillan (2002) and Cotter et al. (2010) respectively. Furthermore, proxy advisors’ recommendations have been shown to take greater account of the domestic context as well as generally adopting a more supportive approach to environmental and social shareholder proposals. Since these issues are of greater stakeholder relevance and thus closer to the CME model of governance, the influence of asset manager capitalism on the corporate governance of German firms to date has been more limited.

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[377] ESG portfolio manager, UK asset manager, in-person interview, 15 April 2015.
Governance expert, UK asset manager, in-person interview, 16 April 2015.

Further limiting the influence on the German model is the fact that German asset managers are seen to continue to lead the engagement initiatives at domestic companies, as documented by critical speeches delivered at domestic companies' AGMs as well as interviews given to the national press. That domestic asset managers are able to lead engagement despite the four largest asset managers controlling a combined average stake of just 4.5 percent of a typical DAX-30 company, underlines the salience of domestic investors within asset manager capitalism.[378] The fact that German investors are able to fulfil this domestic leadership role despite their comparatively small shareholdings, also bears witness to the balance inherent in the German national corporate governance Kodex, which sets out a number of requirements for companies, without proving the possibility for them to challenge individual shareholder proposals the way that US companies are able to do with the SEC.

The arrival of asset manager capitalism has been assisted by a number of changes to the German model of corporate governance since Hall and Soskice (2001) identified it as the ideal type CME country. Foremost of these has been the dismantling of the Deutschland AG network of cross-shareholdings (Höpner and Krempel, 2004) and the end of relational banking (Hardie et al., 2013), both of which also led to the dismantling of the networks of interlocking board of director networks. This has largely put an end to two of the defining characteristics of the ideal type CME: inside information and patient capital.

Instead of the traditional patient capital provided by relational banks and equity blockholders, German firms have had to find new funding sources. Braun and Deeg (2019) highlight the role that strong corporate earnings have played in enabling firms to increasingly finance their

[378] Combined shareholdings of DWS, AGI, Union Investment and Deka Investment in the 10 largest DAX-30 companies. Data as of 14 April 2020. Data source: Bloomberg.

investment needs out of retained earnings instead. The investment horizon of index fund managers, while a different quality than traditional bank lending relationships, also reflects a greater degree of patience than has commonly been demonstrated by investors focussed on shareholder value.

In Germany, despite a select number of policy changes such as limits to director networks and the introduction of say-on-pay votes, advocated for by institutional investors and formalised by the Kodex commission set-up by the German government, there is limited evidence to suggest that the German model of corporate governance is converging on the US model. Many of the environmental and social issues addressed by shareholder proposals in the UK and the US already receive greater consideration within the German governance model. Large transformative transactions, such as the mega-mergers between Bayer and Monsanto as well as Linde and Praxair, both of which were completed without a prior shareholder vote seeking approval, underline the fact that shareholder influence within German corporate governance remains limited, even after the arrival of asset manager capitalism.

With the exception of a limited number of firms where family insiders continue to represent blockholders, asset managers today represent the new blockholders of German companies. Yet the above illustration of the German governance context demonstrates that the new German institutional framework has not resulted in an Americanisation of the German governance model. Instead asset managers capitalism reflects a convergence in form but not in function for the German model of corporate governance.

The dynamics of asset manager capitalism in the United States

In the US, where asset managers hold an even more commanding share of the equity market and the structural preconditions for asset manager capitalism have similarly been met, the rise of the asset management industry has also had only a limited impact on the domestic model of corporate governance to date, but for very different reasons than in Germany.

First, corporate governance in the US is covered by a mixture of state and federal legislation. As outlined above, the most important formal institution in the US is the SEC. In the absence of a formal corporate governance code, shareholders have to demand governance changes individually at each portfolio company. Issues such as the separation of CEO and chairman have to be put to a shareholder vote, and corporates have to agree to implement the result of the vote. Therefore, from the outset asset manager capitalism in the US has a more confrontational character. Instead of a two-pronged legislative push, the SEC has pursued an orthodox interpretation of fiduciary duty, which while not categorially ruling out issues of sustainability, has oftentimes led to them being excluded from corporate agendas. This provides corporates with substantially more lobbying potential than is the case in either the UK or Germany.

From a breadth perspective this piecemeal approach of filing shareholder proposals at individual companies has not resulted in a comprehensive nationwide change to governance standards. Particularly at smaller companies that have not been the focus of engagement, considerable governance shortcomings remain. This is evidenced, for example, by considerably lower levels of gender diversity at the board level of Russell 2000 companies than

at S&P 500 companies.[379] As a result of this, US corporates for the most part are still in control of the governance discourse.

Second, the level of foreign ownership at approximately 14 percent of the shares outstanding, is considerably smaller than in either the UK or Germany (each above 50 percent). Besides the general bias for domestic investors to set the governance agenda, this further ensures that foreign asset managers play a smaller role in US corporate governance.

Third, the Big Three are oftentimes splintering the unity of the asset management sector's voice. Since they control approximately 24 percent of the domestic vote, therefore exceeding most estimates of proxy advisors' influence, they have been able to insulate corporate managers by scuppering a large number of shareholder initiatives. As up to two-thirds of all US shareholder proposals have been decided by a margin of thirty percent or less, for asset manager capitalism to unfold its full potential in the US the Big Three will have to reconceptualise their governance role.

The increasing rights that shareholders have been assembling have therefore yet to be put to work. The growing shareholder power has not been matched by a corresponding change in the attitude of the largest US shareholders to date. Shareholders may have new tools, but in large part because of the lack of support from the Big Three, they have not yet been employed to change the course of their portfolio companies' strategies. The reason for this is to be found in a mixture of the political tightrope the Big Three are having to tread, in the potential for conflicts of interest, and in the absence of the two-pronged approach pursued by governments

[379] Ernst & Young (2016) finds that 36 percent of Russell 2000 company boards continue to be all male, compared with 3 percent at S&P 500 companies.

in the UK and Germany. Shareholders have greater power but are mostly falling short in employing it (other than for the protection of the status quo).

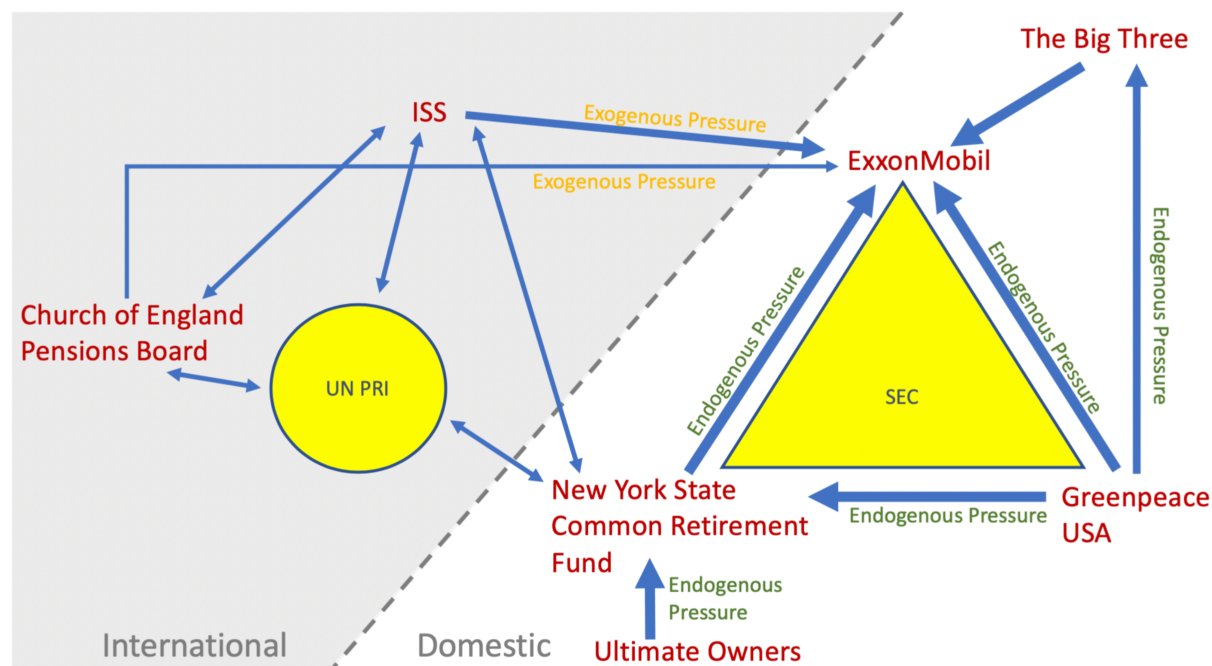
Instead, in keeping with the ideal-type LME model of Hall and Soskice (2001), market forces are meant to play a much bigger role in the US system. Demand and supply results in the creation of price signals that substitute for much of the strategic coordination needed in the CME models. In theory, share prices therefore set the necessary incentives within the corporate governance sphere, creating a "market for corporate control" (Manne, 1965). Corporate executives have to implement policies that support their share prices or else risk their companies being taken over and them being fired.

Yet, with the rise of index funds, the proportion of investors able to send such signals via pricing mechanisms from selling their stock, has decreased considerable. Instead engagement should be taking on a more important function. In the absence of government regulation to support it, this leaves the US system in a difficult position, one that has resulted in the current tension and inertia. Market institutions are no longer as effective as they have been in the past, yet the greater coordination that has come from asset manager capitalism in Germany and the UK has not been able to fully unfold in the US as the Big Three oftentimes vote differently to other institutional shareholders.

Figure 37 provides a practical example showing the 2017 struggle between shareholders and asset managers at the US oil company ExxonMobil. ExxonMobil provides a good example of how the US model of corporate governance operates under asset manager capitalism as it has faced shareholder proposals over a number of years. Since the attitudes of asset managers and

formal institutions such as the SEC changed throughout these years, this example illustrates how asset manager capitalism functions in practice.

Figure 37: 2017 Shareholder Proxy Voting at Exxon



ExxonMobil has faced a long history of climate-related shareholder proposals, starting in 1990 the year after the Exxon Valdez disaster.[380] The 2016, 2017 and 2020 proxy voting seasons will be the focus of this section as they resulted in three very different outcomes. The 2016 proxy included a number of climate-related shareholder proposals, including a vote to elect a climate expert to the board as well as calling on the board to implement a policy to commit the company to support the goal of limiting warming to less than 2°C.[381]

[380] For a history of shareholder activism at ExxonMobil, see: https://insideclimatenews.org/content/exxons-25-years-no-timeline-resolutions-climate-change (Accessed 13 April 2020).
[381] For the full proxy, see: https://www.sec.gov/Archives/edgar/data/34088/000119312516539460/d14941ddef14a.htm#toc14941_24 (Accessed 13 April 2020).

As was the case in all the preceding years, the 2016 climate proposals all failed to gain the support of the majority of shareholders (reaching just 38% on the key proposal, "Item 12").[382] This was in part because BlackRock and Vanguard voted with management (State Street supported the shareholder proposal).[383] In 2017, shareholders including New York State Common Retirement Fund again submitted a similar proposal at ExxonMobil. In a rare exception to the rule, this time the Big Three unanimously decided to back the proposal and the proposal reached a majority of votes. ISS recommended a vote in support of the shareholder proposals on climate change in both 2016 and 2017.[384] The fact, that it only passed in 2017, the year that the Big Three voted in favour, demonstrates the pivotal role that the Big Three play in the US corporate governance model. BlackRock (2017c) explained its decision to vote against management with the Exxon's refusal to make their independent board members available for meetings.

Finally, in 2020, the pension fund of the Church Commissioners for England and the US NGO "As You Sow" co-filed a further climate-related proposal at ExxonMobil. This time the company was successful in convincing the SEC that the proposal should be blocked as it interfered with "ordinary business", and it was therefore not added to the proxy.[385] This demonstrates how the corporates, the Big Three asset managers and the proxy advisors are the

[382] Source: http://exxonknew.org/wp-content/uploads/sites/4/2016/10/10-16-KeyVotes-9-27.pdf (Accessed 13 April 2020).
[383] For an explanation of BlackRock's decision to vote with ExxonMobil management, see: https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2017.pdf (Accessed 13 April 2020).
[384] For ISS voting recommendations in 2016, see: http://aodproject.net/wp-content/uploads/2016/09/AODP-GCI-2016_EXXONMOBIL_VIEW.pdf and for 2017, see: https://www.reuters.com/article/us-exxon-mobil-climate-investors/proxy-firm-iss-advises-vote-against-exxon-exec-pay-plan-idUSKCN18F0A3 (Accessed 13 April 2020).
[385] Source: https://www.ipe.com/news/sec-blocks-church-climate-proposal-for-exxon-agm-again/10044630.article For a copy of the Exxon filing to the SEC, see: https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2020/activehomeexxon011720-14a8-incoming.pdf (Accessed 24 May 2020).

dominant actors and the SEC is the pivotal formal institution in the US corporate governance model.

The fact that US corporates are able to employ regulatory support in defence of asset managers' attempts at stewardship, while oftentimes also being able to rely on the voting allegiance of the Big Three to overcome proxy advisors' objections, means they are better resourced than corporates in either Germany or the UK. Despite a small number of high-profile proxy voting victories by shareholders, US corporates are therefore winning this battle to date.

The dynamics of asset manager capitalism in United Kingdom

The UK regulatory approach is substantially different from that seen in the US. An example of the UK government's desire to transform the UK model is provided by the Kay Review (2012), which sought to reduce "the current role of trading and transactional cultures" to "[a]ddress the disincentives for engagement" and to "[r]educe the pressures for short-term decision making". Because the regulator expects company executives and asset managers to jointly share the responsibility for the stewardship of firms, the relationship between asset managers and corporates is less acrimonious than seen in the US. This leaves UK corporates with less institutional means to push back against shareholders' calls for reforms. The result is decreased CEO independence combined with a greater need by corporate executives to engage in consensus building than in the past.

The level of foreign ownership in the UK, at more than 50 percent, is of similarly high levels as in Germany. Proxy advisors are therefore likely to play a larger role than in the US, therefore likely representing shareholders with combined ownership blocs towards the upper end of the

aforementioned 13.6 to 29.7 percent range. The Big Three, while bigger than in Germany, represent considerably smaller average holdings of 12.4 percent versus 18.2 percent in the US (Table 3, page 122). Proxy advisors are therefore of greater relevance for the outcome of shareholder votes than the Big Three in the UK.

Since proxy advisors have been documented to be considerably more supportive of social and environmental shareholder proposals than the Big Three, this suggests that such proposals are more likely to pass at UK than at US companies (should such proposals indeed be needed in the UK, many issues may be decided differently due to the existence of the Corporate Governance Code and the Stewardship Code). Since such issues are oftentimes aligned with stakeholder concerns, asset manager capitalism in the UK is selectively introducing aspects of the CME model into its LME model.

One of the chief assumptions made in the literature is that the ideal-type models of the varieties of capitalism represent self-reinforcing equilibria. The equilibria are the product of "centrifugal forces", which result from institutional complementarities and lead to a bifurcation and hollowing out of a "dysfunctional middle ground" (Hay, 2019). Yet the behaviour of the UK model suggests that it is possible for countries to continually occupy positions in between the two poles, supporting the case made by, e.g., Amable (2003).

Convergence or Divergence?

With asset manager capitalism present in all three countries, the research question asks what consequences this will have for the corporate governance of stock market listed companies. Internationalisation, in principle provides the means for asset managers from different

countries to project their influence abroad. With the largest asset managers being US domiciled firms, it has been suggested that this will lead to an Americanisation and thus a convergence of the varieties of capitalism (Harmes, 1998; Useem 1996).

However, as the preceding sections have illustrated, the consequences of asset manager capitalism for the corporate governance of firms and thus the prospects of change are complex. Investors exhibit different intentions to bring about change, seek change in different directions, have different resource levels, including the size of their voting blocs. Their engagement will be conditioned by whether they are index funds or active funds, by the regulatory conditions they face as well as the corporate resistance they encounter.

The Big Three have been shown to provide corporate executives with insulation against the majority of shareholder proposals brought by other investors in the US context. Proxy advisors, on the other hand provide a challenge to this governance vacuum. In Germany and the UK, the Big Three have comparatively smaller voting blocs, while the proportion of shareholder votes aligned with proxy advisors is comparatively larger than in the US. In short, within the rules of the game as set out by the respective governments, the direction and extent of change is determined by the relative resources of these respective actors vis- à-vis one another and the portfolio company.

The evidence presented suggests that the UK model is diverging from the ideal-type LME pole. The institutional framework described above is further supported by the two-pronged regulatory approach of the UK government, which ensures that the greater shareholder power (an LME characteristic) is being employed at least in part with the aim of extending investment horizons and giving greater weights to sustainability considerations (CME characteristics). The

convergence in form that asset manager capitalism represent would therefore lead to expectations of a corresponding convergence in function, which would see the UK model doubling down on its LME attributes. Instead government policy helps to ensure a different outcome. While the shift in the UK model is modest, it does raise the question of whether it will in the future continue to be appropriate to refer to an Anglo-Saxon model of capitalism.

Both the UK model's moderate convergence on the CME model, as well as Germany's lack of convergence on the LME model, stand at odds with the expectation that CME countries will ultimately slide towards an ideal-type LME model (Goodin, 2003). Although the US and German varieties of capitalism both present a mostly stable picture, the underlying dynamics are very different. Whereas the German model shows few signs of institutional strain and thus largely continues to represent the stable self-enforcing equilibrium depicted by Hall and Soskice (2001), the US model's apparent stability can best be understood as the result not of a stable equilibrium but of friction between actors resulting in policy inertia. It suggests that a socio-political compromise in the interpretation of fiduciary duty, one that reflects the new realities of asset manager capitalism has yet to be established in the US.

Hall and Soskice (2001) present firms as "institution-takers" (Crouch, 2005; Deeg, 2007) yet the above examples of SASB and the PRI show that firms as well as asset managers (also firms) have agency. They are able to create or amend institutions and associations to assist them where needed. Institutions should therefore also be considered as resources and not simply as constraints (Deeg and Jackson, 2007; Hall and Thelen, 2005). With regards to associations, while neither SASB nor the PRI were created by shareholders (both resulted from civil society initiates), asset managers have been employing these formal institutions to their advantage, thereby bringing them to life. With regards to informal institutions, the discourse around

sustainability and fiduciary duty in the US, shows how corporates have been actively lobbying the SEC in order to ensure that an orthodox interpretation of fiduciary duty continues to be observed in the domestic context.

To conclude, asset manager capitalism has been established in form in all three countries. However, there is no one ideal-type form of asset manager capitalism and its functioning therefore differs. In the US, the large index funds dominate the corporate governance landscape, leaving corporates to operate largely as they always have. In the UK and Germany, asset managers are advancing a limited number of stakeholder concerns and therefore increasingly challenging the conduct of domestic companies. Asset manager capitalism is present in all three countries but demonstrates differences in function analogous to differences seen in the varieties of capitalism.

There has therefore been no meaningful convergence between the two ideal-type models of capitalism depicted by Germany and the US. The UK, on the other hand, shows what happens to an LME country when domestic investors and proxy advisors carry greater weight than the Big Three and when the regulatory institutions accommodate greater shareholder stewardship. While the UK system also experiences friction between shareholders and corporates, the regulatory framework bounds the extent to which this can unfold, leading interviewees to consider the UK model to be the best-in-class representation of corporate governance.[386] Because the UK approach occupies a middle ground between a shareholder-centric and a

[386] ESG portfolio manager, UK asset manager, in-person interview, 15 April 2015.
Governance expert, European proxy advisor, in-person interview, 5 October 2018.
Governance expert, German asset manager, telephone interview, 9 April 2018.
Two governance expert, UK asset manager, telephone interview, 25 September 2018.

stakeholder-centric model, the UK no longer represents an ideal-type representation of the LME model in the sphere of corporate governance.

Reflections on the future of asset management capitalism

Globally the Big Three asset managers enjoy a commanding lead in assets under management, particularly within index investing, which has been the primary driver of their recent asset growth. Since index investing with its lower fee base is likely to continue to take market share from active managers, the market share of the Big Three is likely to continue to grow going forward. The significance of the Big Three in determining how asset manager capitalism impacts national governance models is therefore likely to increase even further.

Two diametrically opposed scenarios appear most likely. In the first scenario index investing continues to grow, accelerating at a fast rate also in Europe. In the US this would cement the special role of the Big Three further strengthening their ability to insulate managers from the pressures of other shareholders. In Europe too, the Big Three will continue to grow to the point where they will be able to provide a similar level of insulation to European corporates as they are for US corporates. Although it is unlikely that any established governance reforms would be unwound in this scenario, further reform is likely to be limited.

In the second scenario, index investing also continues to grow, but the approach of the Big Three changes. In this scenario, the Big Three reconceptualise their role as universal owners and stewards of the commons, likely because of one of the following two reasons. Either there is an explicit change to US governmental regulations that seek to adjust the way in which US asset managers steward their portfolio companies, akin to the one observable in the UK and

Germany, or the Big Three adjust their stewardship approach because they expect this to lead to a better financial outcome for themselves and/or their customers.

Advances in the understanding of the financial materiality of sustainability concerns may result in changed stewardship priorities. Over the longer-term these changed priorities can lead to better portfolio returns for portfolios and thus for the customers of the asset management firms. Alternatively, the Big Three may consider greater incorporation of sustainability criteria to be in the interest of their own public perception and thus their social license to operate. Lately an increasing number of public challenges to their social license to operate have manifested themselves in a growing number of protests, similar in nature to the protests outside BlackRock's offices in numerous countries around the world, including the occupation of the firm's Paris office in 2020. A more responsible image may help to protect the reputation and also to attract new assets. In this scenario it may be that all of the Big Three alter their approach, or it may be that they take opposing stances on a growing number of issues.

To date anecdotal evidence suggests that the second scenario is more likely. State Street has already begun to support a greater number of shareholder proposals than either BlackRock or Vanguard. Also, while Vanguard and BlackRock provide almost blanket support for US corporates, the tone of BlackRock's public messaging is changing. Although we continue to await BlackRock's proxy voting behaviour to align with these public statements, the absence of an equivalent change in the tone of Vanguard is conspicuous. It may therefore be that we witness a bifurcation of the index investing landscape with State Street and BlackRock adopting more sustainable policies, and Vanguard deliberately holding their line in order to capture the part of the customer base that does not recognise a greater role for sustainability.

With fees almost at zero, asset managers will be looking for other ways to differentiate their product offering.

Motivated by a renewed sense of financial materiality and spurred on by protests, the most promising way by which the Big Three may pivot to address issues of sustainability appears to be through the Sustainable Accountancy Board (SASB).[387] Doing so avoids the potential conflict of interest that may otherwise arise between asset managers' social license to operate and the fiduciary duty they hold to their investors (Jahnke, 2019b). Rissman and Kearney (2019) explain that federal security laws are grounded in the principle of disclosure. Yet what is of "materiality" and should therefore be disclosed has been the focus of US Supreme Court deliberations in 1976 and 1988. Ultimately, the SEC "has gone beyond the Supreme Court in favoring a restricted version of disclosure based solely on financial, short-term considerations of materiality" (Rissman and Kearney, 2019: 10162). In the US the concept of materiality and thus of disclosure is therefore exposed to similar controversy as fiduciary duty. This is where SASB's standards have the potential to be game-changing.

> "Disclosure may soon be vastly improved with finalization of the Sustainability Accounting Standards Board's financially material social and environmental reporting standards. While the standards are voluntary, the fact that they have been endorsed as "material" by many of the world's largest investment advisers will transform them into legally action-able standards" (Rissman and Kearney, 2019: 10155).

[387] SASB, founded in 2011, is a non-profit organisation whose primary aim is to construct a set of sustainability standards for use in official SEC filings. SASB was founded by Jean Rogers and is the result of research she conducted with fellow academics at Harvard University's Initiative for Responsible Investment. For further details, see: https://www.sasb.org/governance/ and https://rogersassociatesllc.com/index.php/about-me/ (Accessed 3 April 2020).

While SASB has not been founded by asset management firms, through the acceptance and support that asset managers are providing to its mission, asset managers have effectively created a new organisation outside of the domestic US governance landscape with the potential to shift the US domestic balance of power and break the policy deadlock. To ensure that such voluntary standards are nevertheless of consequence for corporate executives, requires a majority of asset managers to demand them. And here there are signs that the Big Three are ready to throw their weight behind it.

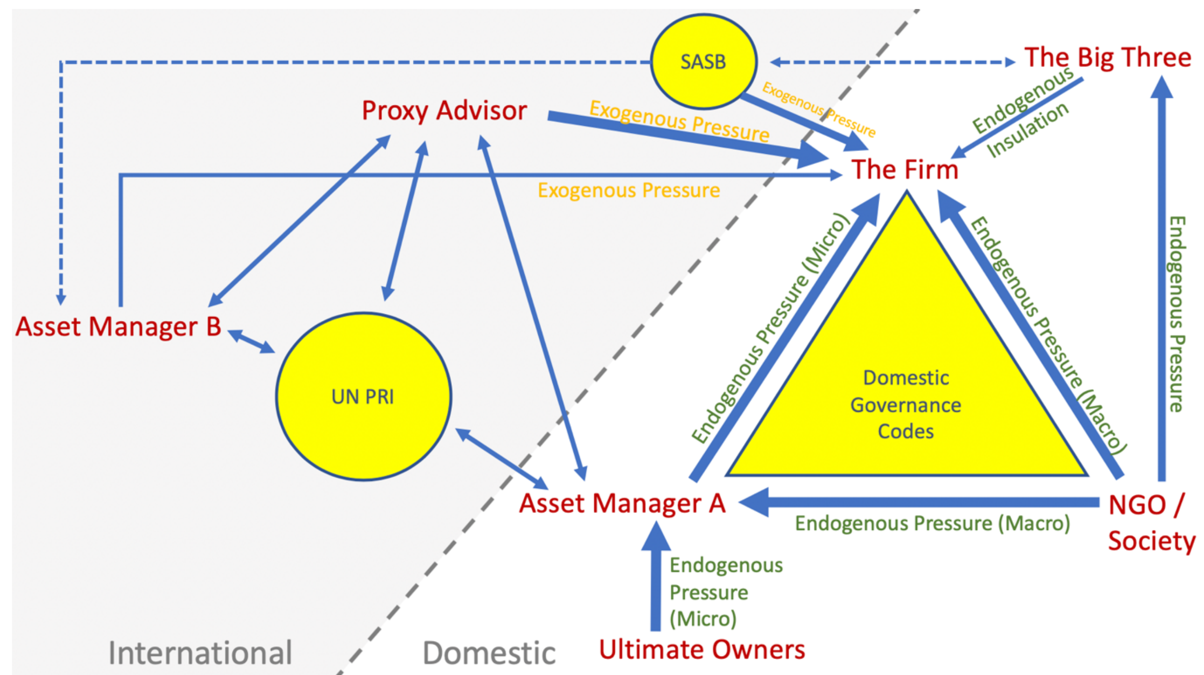
In Larry Fink's 2020 CEO letter, BlackRock's CEO explains that SASB "provides a clear set of standards for reporting sustainability information across a wide range of issues" and that "[i]n the absence of robust disclosures, investors, including BlackRock, will increasingly conclude that companies are not adequately managing risk".[388] Continuing in bold formatting, the letter states that BlackRock "will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them".[389]

In the future SASB may therefore provide additional exogenous incentives to change, while simultaneously decreasing the level of insulation provided by the Big Three. With regards to the US corporate governance framework, depicted in Figure 38 below, this would have the effect of thinning the arrow between the Big Three and the US firm (vs. how it is depicted in Figure 37 above), as the level of insolation they would be able to provide would be bounded by the standards set out by SASB. If the Big Three were to become substantially more

[388] The letter can be found at: https://www.blackrock.com/us/individual/larry-fink-ceo-letter (Accessed 15 April 2020).
[389] Ibid.

supportive of environmental, social and political shareholder proposals, the meaning of the arrow could indeed switch (from insulation to criticism). In this case we would be a big step closer towards asset manager capitalism representing a convergence in function across the three countries.

Figure 38: Actors and institutions in the corporate governance of US asset manager capitalism



As an interviewee explained, what makes SASB such a promising option is that it has set out a “materiality map”, which lists what is and what is not material from the perspective of its signatories and therefore leaves no room for interpretation.[390] Shareholders will therefore be able to tell what companies are failing to meet the standards and vote against their directors. The fact that BlackRock’s endorsement of a standard such as SASB is effectively able to turn it into a universally accepted standard, underlines the central role it plays in the institutional architecture of asset manager capitalism.

[390] Governance expert, NGO, in-person interview, 27 June 2019.

There have also been technical proposals to completely eliminate the "agency cost of agency capitalism" (Gilson and Gordon, 2013), which results from two interlocking fiduciary relationships, the first being between the corporation and the asset manager and now a second between the asset manager and the ultimate beneficial owner (Rohr, 2018). The aim of such proposals is to create an "investor suffrage movement" (Holton, 2006) that passes the proxy voting decisions ("pass-through voting") from the asset manager through to ultimate beneficial owner (Fisch, 2020; Griffin, 2020a; Taub, 2009). Yet it is likely that such solutions will not achieve their desired goals.

Those seeking greater shareholder say in corporate governance are likely to be disappointed by the low voting participation of retail investors, which estimates put at between 12.6 percent (Broadridge, 2015) and 32 percent (Brav et al., 2019). This system would therefore merely lead to a renewed dispersion of stock ownership. Those hoping for a greater support of ESG proposals are similarly likely to be disappointed by the fact that data on retail investors' voting behaviour suggests that they vote with management on almost 90 percent of the votes that they submit (Brav et al., 2019).

Instead what appears more promising are initiatives to improve the transparency of mutual funds' voting decisions to their beneficial owners. One suggestion is to have multiple funds tracking the same index but following different proxy voting guidelines (Rao, 2017). This would require mutual funds to stop voting all their shares as one "mutual fund family" (Lipton, 2017), a feature that an interviewee noted they were considering introducing in the coming years.[391] A simple way to ensure actionable transparency of mutual fund voting intentions, has been suggested by McRitchie (2019), who argues that mutual funds should publish their voting

[391] Corporate governance expert, German asset manager, in-person interview, 9 January 2020.

intentions in real time, enabling beneficial owners to move their investments if they note a discrepancy with how they want to have their fund holdings voted.

Despite the promising work of SASB, and on a more general level, one nevertheless needs to keep in mind that the ability, and perhaps the willingness, of shareholders to provide extensive oversight of corporate conduct has limits. Despite the signs of change, conflicts of interest as well as marketing considerations will limit the extent to which asset managers will bring about change at corporates. There will always remain a strong role for government regulatory oversight. Lipton therefore argues for the necessity of more comprehensive reporting requirements as well as a need to make corporate reporting more easily understood so that it can be used by other stakeholders, besides shareholders, to "maintain social control over corporate behaviour" (2019: 1).

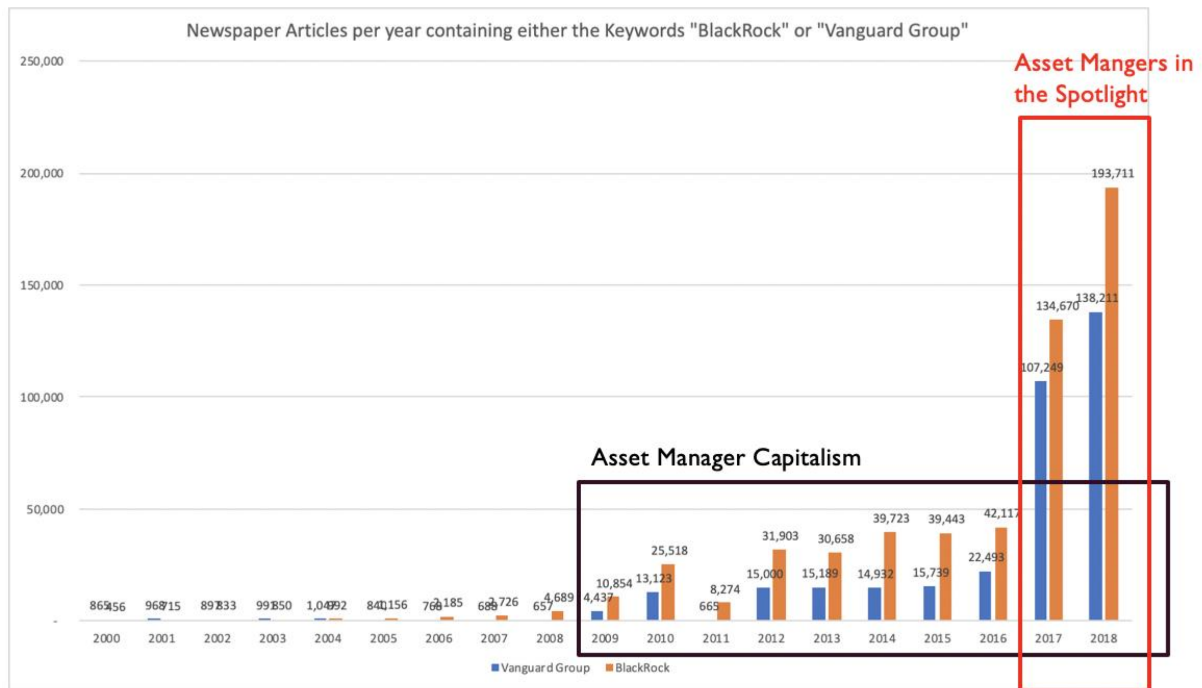
Asset Manager Capitalism and the implications for workers

The growth of the asset management sector has changed the relative strength of shareholders versus corporate management and other stakeholders from a game theory perspective. With executives giving greater consideration to stakeholder concerns, for workers this is on balance a negative development as corporate executives are likely to assume institutional investors have a preference for short-term value maximisation, unless otherwise stated. The fact that institutional investors in the UK and Germany have voiced comparatively greater support for sustainability considerations will moderate negative outcomes to some extent.

The increased size of institutional investors, however, also makes them more vulnerable to public opinion. Figure 39 below shows the rapid rise in the media's attention to BlackRock and

Vanguard. This rise has loosely tracked the increase in their assets. Academic research, in particular by Fichtner et al. (2017), has contributed to this increased attention.

Figure 39: Newspaper Articles per year mentioning BlackRock or Vanguard Group



Source: DiscoverEd, Edinburgh University online library search

The result is that NGOs and governments are today aware of the latent power of asset managers. With the spotlight increasingly on their policy preferences, this thesis has made the case that asset managers will need to give greater consideration to their social license to operate. Whether or not this transfer is beneficial or detrimental to workers' interests will depend on whether asset managers are themselves more easily influenced than corporate executives hitherto.

The problem for workers seeking the support of asset managers is that the diversification that results from index investment has mostly removed the stock specific risk from asset managers' portfolio, leaving only systematic risks. As discussed in Chapter 6, the large index fund companies are to date not recognising inequality as a systematic risk requiring their

intervention. Evidence of this is provided by the 2020 shareholder vote at Amazon.com Inc., which saw employees and shareholders including the state pension funds from New York, California and Illinois urging Amazon to release more data on employee safety.[392]

SEC voting records, however, show that BlackRock and Vanguard voted all ballot items with management and against the shareholder proposals.[393] Similar challenges remain outside of the US also, as social concerns remain largely neglected. Here too, however, regulation has taken up some of the slack left by investors. In the UK, for example, the Modern Slavery Act 2015 has introduced new reporting requirements mandating corporations to annually report on how they identify and mitigate modern slavery in their business and supply chain (Cousins et al., 2020).

Motivated by agency-theory, shareholder engagement initially targeted greater shareholder rights, focussing on the "G" in ESG.[394] More recently, as a result of the climate breakdown, the "E" has taken over much of the limelight. Social considerations, the "S" in ESG, however, remains largely overlooked. Interviewees have explained that this is in part because social issues differ not only between countries but also from industry to industry, making standard setting more complicated than with governance or environmental issues, which can more easily be applied across the board.[395]

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[392] For further information, see: https://www.cnbc.com/2020/05/25/amazon-shareholder-meeting-investors-want-worker-safety-disclosures.html (Accessed 2 November 2020).
[393] For BlackRock voting results, see: https://sec.report/Document/0001193125-20-232474/, for Vanguard voting results, see: https://vds.issgovernance.com/vds/#/MjAxMA==/ (Accessed 2 November 2020).
[394] See also: https://www.jdsupra.com/legalnews/finding-the-s-in-esg-boardroom-and-40332/ (Accessed 2 November 2020).
[395] Portfolio manager, German asset manager, in-person interview, 4 November 2019.

To date "[m]ost U.S. mainstream institutional asset managers/owners and pension funds have not acted on human trafficking and slavery due to a lack of knowledge about the issues, companies, and financial risks involved, as well as a lack of focus on human rights/labor rights more generally (in contrast to SRIs/faith-based investors)" (Responsible Sourcing Network, 2018). In developed countries, workers will in the future need to apply pressure to both corporate executives as well as asset managers, in order to respond to the shift in the balance of power towards shareholders.

The events at Amazon.com are just one example of this already happening today. Webber (2018) describes this approach as labour's "last best weapon." Without concerted efforts by labour representatives to engage with shareholders and to increase public pressure on them whenever engagement fails, the consequences of asset manager capitalism will likely be negative for the interests of workers. Labour's ability to engage is, of course, a function of the resources they have available, which in turn are the result mostly of trade unions. Countries with lower trade union membership are thus likely to endure more adverse results from asset manager capitalism.

Generalizability beyond the three case study countries

Davis and Kim note that "[u]nlike franchise restaurants, financial markets do not come with a handbook that ensures uniformity" (2015: 30). Although there is no such handbook that sets out a uniform set of corporate governance rules for how national models should function, this thesis has shown that certain commonalities of form ensure that the asset management ecosystem in most countries can be assessed with the help of the framework presented in this thesis.

Central to any such analysis is the need to differentiate between different investor types. First consideration has to be given to the extent of shareholder ownership concentration, which is primarily determined by the relative shareholdings of individual investors, company insiders and institutional investors. This will determine the overall extent to which shareholders are able to influence corporate policies.

Amongst institutional investors it is essential to differentiate between different investor groups. There are those investors that set out the policy agenda, these are typically either activist hedge funds or domestic investors that have a strong environmental and/or social agenda. Then there are the proxy advisors, whose influence increases with the percentage of the domestic market held by index funds and by foreigners. Finally, there are the big index fund companies, who for the most part vote with management, though also take account of the local context, so may side with domestic investors against corporate management. Besides these investors, central banks and sovereign wealth funds may play a role in certain markets. Their role was not discussed in this thesis, as neither the UK, the US nor Germany currently have sovereign wealth funds nor central banks that are buyers of equities.

The way in which asset manager capitalism influences the national institutional framework of any individual country will be determined by the relative shareholdings between these different investor groups, as well as by the national regulatory environment, and the scope that this provides for corporates to push back against investors' demands.

Table 11 below provides an international context to ownership concentration, the holdings of the Big Three and domestic central banks, the state and sovereign wealth funds respectively. The table illustrates a strong inverse relationship between ownership concentration and the

ownership stakes of the Big Three. To some extent this is not surprising as there is a degree of endogeneity from the fact that that ownership sums to 100% and any part controlled by blockholders cannot be held by the Big Three asset managers. However, this does not explain the extent of the correlation (-0,80).

Table 11: Share ownership of the 5 largest companies in each country by investor type

	US	UK	Germany	Brazil	Japan	Norway	Russia	China
Combined ownership of 5 Largest Shareholders	27.9%	23.7%	23.4%	24.8%	38.5%	52.3%	47.8%	45.90%
Combined ownership of the Big Three (Vanguard, BlackRock, State Street GA)	18.1%	12.3%	12.0%	8.2%	6.3%	3.9%	2.7%	0.50%
Ownership by the domestic state, central bank or sovereign wealth fund	0.0%	0.0%	0.0%	0.0%	6.2%	31.5%	20.0%	n/a

Source: Bloomberg, own calculations, as of 30 October 2020.[396]

Instead the reason for this is to be found in institutional investors' preference for liquidity as well as good corporate governance. These investor preferences are in turn reflected in index providers' index rules. Fichtner et al. (2019) explain that index providers typically determine the weight of a company's stock by the 'free float' of the market capitalisation. That is rather than weighing the company by its total market capitalisation, only those shares that are in principal freely traded are included in the weighting.

In other words, index providers discriminate against blockholders such as the shareholdings of founders or strategic holdings of other corporates or by the state. The result is that countries with large block holdings, such as Norway, Russia and China will receive smaller weightings in global equity indices as their companies have a smaller free float market capitalisation. Since

[396] Table shows the shareholdings in the five largest companies by market capitalisation in each of the respective countries. Data for government ownership in China is not provided as distinguishing between the many quasi-governmental institutions proved too uncertain.

the holdings of the Big Three largely result from their index funds, the Big Three in turn have smaller holdings in countries with greater blockholdings.

For companies seeking capital from index funds, this thus provides an incentive to reduce longer-term blockholders, with the potential for knock-on effects for their home countries (Fichtner et al., 2019). Furthermore, since market capitalisation is a function of the shares a company has issued and the price they trade at, valuation is a determining factor. Growth companies typically trade on higher multiples of their earnings than "old economy" companies, thus arguably further disadvantaging countries that have smaller technology and biotech sectors (which of course themselves are oftentimes the result of the availability of venture capital).

However, whereas index inclusion may provide incentives for companies to change their governance structure to attract additional capital, the index rules that penalise blockholders also ensure that the extent to which US index funds invest in a highly concentrated company or country is reduced from the outset, thus limiting the extent to which US asset managers can take direct influence over such companies. Norway therefore is an interesting case as its high domestic blockholdings (mainly government stakes) provide a degree of insulation from foreign index investors, while their own sovereign wealth fund invests globally, itself spreading the country's individual flavour of sustainable investment.

With regards to Brazil it is noteworthy that average ownership concentration is in-line with that seen in the UK and the US. Indeed, other large US Investors such as Capital Group are also large shareholders in the country and if one were to include them in Table 11, the

shareholder structure in the US and Brazil would be largely identical. In Japan, Norway, Russia and China on the other hand, large domestic government holdings continue to this date.[397]

In terms of the generalizability of the results of this thesis, irrespective of country, the rule holds that the context matters. The presence of sovereign wealth funds or central banks in the domestic equity market will affect both the size of asset managers' shareholdings as well as the national governance discourse and thus the issues that are put to a shareholder vote. Nevertheless, the same dynamics between local and international institutional investors and between the Big 3 and other mutual fund companies are likely to hold. These will result in substantial variation in outcomes from the US.

The UK and Germany should not be considered as special cases but examples of how asset manager capitalism functions in countries that do not consider sustainability considerations to represent a conflict with fiduciary duty obligations and in which the Big 3 do not hold shareholdings sufficiently large to insulate corporate managers from the concerns of other shareholders.

Since the trend towards index investing appears unstoppable for now, the potential influence of the largest asset managers is very likely to increase further in the years to come in all countries with active stock markets. Whether this development is beneficial or detrimental for the interests of workers and society more generally, will depend to a large extent on how the Big 3 conceive of their corporate governance role going forward. At its core, asset manager capitalism represents a transfer of influence to shareholders. This influence comes at the cost

[397] For information on the growing governance role of sovereign wealth funds, see Aguilera et al. (2016), Clark and Dixon (2017) and Gilson and Milhaupt (2008). For central banks, see Charoenwong et al. (2019) and van 't Klooster and Fontan (2019).

of corporate management but also indirectly at the cost of other stakeholders, particularly workers, as investors capture a greater share of executives' attention.

From the perspective of company management this shift in the balance of power is complex. On the one hand, if rising index fund market share results in less involved shareholders this reduces interference in the day-to-day decision making. On the other hand, the increased ownership concentration means that if executives slip up, shareholders will more easily find the needed majority to remove management teams or agree to takeovers etc. On balance this is likely to make them more attentive to shareholder interests. Whether shareholders actually express these interests or not is secondary. The common ownership literature shows that corporate managers internalise what they consider to be their owners' interests.

Conclusion

This thesis set out to investigate the influence of asset managers on corporate governance and the varieties of capitalism in the UK, the US and Germany. Specifically, it sought to determine the consequences of the changes in shareholder ownership structure for the corporate governance of stock market listed companies. The preceding sections have highlighted that the convergence in form, with asset managers dominating the shareholder ownership structure in all three countries, has as yet not been matched by a corresponding convergence in function. Instead the varieties of capitalism seen in Germany and the US have revealed considerable functional continuity. Indeed, the UK model suggests that rather than resulting in a further reinforcement of LME attributes, asset manager capitalism can have the effect of moderating LME models by raising the profile of other stakeholders.

Functional diversity remains because asset manager capitalism encounters different national institutional frameworks, which mediate its respective functioning. In short: asset managers behave differently in different countries. Corporate interviewees noted that European investors exhibited longer investment horizons than their US peers, thus indicating that patience continues to show national variations, even post the establishment of asset manager capitalism.[398] European investors were also noted to be bigger supporters of environmental, social and political shareholder proposals, suggesting that they, and not the large US asset managers, are the primary agents of change to date.

Instead of facilitating the Americanisation of the global investment management industry towards a model focused on shareholder value maximisation, the rise of the asset management industry creates the opportunity for a greater consideration of other stakeholders' concerns. The extent to which this transformation has materialised differs from country to country and is dependent on the national institutional context.

The intensity of the US corporate resistance suggests that the US model of governance is the one most at odds with the new asset manager capitalism, though it has yet to be successfully challenged by asset managers. The fact that the country whose governance model gave birth to the concept of shareholder value should be the one experiencing the greatest strain as a result of asset manager capitalism at first appears to represent a paradox. Yet, the finding that the

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[398] Corporate secretary, head of investor relations, US company, telephone interview, 22nd of February 2018. Note also reports in the German press documenting how German asset managers came to the aid of the embattled, and ultimately fraudulent, Wirecard AG. Preferring to trust a German corporate executive over reports from the British press (Financial Times) and thus buying stock as many others sold. See, for example, https://www.sueddeutsche.de/wirtschaft/wirecard-kurs-fonds-aktie-1.4942825 and https://www.handelsblatt.com/finanzen/banken-versicherungen/wirecard-skandal-in-vielen-aktiven-fonds-steckten-wirecard-aktien-bis-kurz-vor-dem-absturz/25946192.html?ticket=ST-13034053-qPQp4a5dScSPkdpkWSpH-ap3 (Accessed 15 November 2020).

governance model that attributes the greatest significance to the interests of shareholders should also be the one most exposed to changes in the identity of shareholders is in fact logical.

Critics have suggested that the conceptual framework provided by the varieties of capitalism is too coarse as a conceptual framework to account for such incremental change (Streeck and Thelen, 2005; 2009). Yet, as the previous chapters have shown the analytical toolbox it provides is effective when assessing the nature of the changes resulting from asset manager capitalism. Hall and Soskice (2001) expect economies to respond differently to international pressures. They foresee LME economies as likely to pressure governments for deregulation and predict that "government is likely to be sympathetic because the comparative advantage of the economy as a whole rests on the effectiveness of market mechanisms" (2001: 57).

For CME economies, on the other hand, they predict that governments will be less supportive of deregulation as it threatens the country's comparative institutional advantage. They thus anticipate a "bifurcated response marked by widespread deregulation in liberal market economies and limited movement in coordinated market economies" (2001: 58). Change will unfold in this way because "much of the adjustment process will be oriented to the institutional recreation of comparative advantage" (2001: 63).

These predictions of Hall and Soskice (2001) that there is unlikely to be radical change and that countries will double down on their respective strengths in order to retain or recreate their comparative advantage, conform well to the developments documented in this thesis. Corporates in the US are indeed pushing the government for greater deregulation, although ironically they are also pushing the SEC for increased regulation of asset managers and proxy advisors. At the same time the German and European governments have adopted a corporate

governance framework that pursues a two-pronged approach that seeks to ensure that financial markets retain a focus on the longer term and also account for the concerns of other stakeholders besides shareholders.

The changes to the UK corporate governance framework, however, appear to run contrary to the predictions of Hall and Soskice (2001). Rather than the UK responding to internationalisation with further deregulation of its corporate governance framework, it has adopted a joint stewardship approach that increases the regulatory burden on both corporate executives and shareholders alike.

The divergent approaches of the UK and US governments are, however, not a new development. Instead, as Professor Kay explains, US corporate governance has been management-friendly from the start as a result of the fact that different states compete to attract company registrations (resulting in a race to the bottom with regards to corporate governance). In the UK, on the other hand, the Companies Act reflects a deliberate compromise between competing groups.[399] Hall and Soskice (2001) thus saw greater commonality between the American and British models of capitalism than were present at the time.

This distinction is often neglected in a literature that mostly overstates the role of shareholders within US and UK corporate governance. The implication of this is that the divergent approaches of the UK and US regulators, and thus of their respective national varieties of asset manager capitalism, are in part also the result of inherent differences in their political and legal systems.

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[399] For conference details, see: https://www.smithschool.ox.ac.uk/research/sustainable-finance/events/GRASFI-Conference-Programme-2019.pdf (Accessed 20 October 2019)

Besides highlighting differences in the respective resources of asset managers and corporates in Germany, the UK and the US, the previous chapters have included a selection of the many pieces of policy analysis that NGOs such as Majority Action (2019) and ShareAction (2020) have produced in recent months. The scrutiny of such social activists, and the public pressure that results from it, will also play an important role in determining how the policies of the Big Three develop in the coming years and, therefore, also what direction the respective varieties of capitalism will develop in.

> "If today's activism, which is visible but low, becomes a fundamental challenge to accepted ways of doing things, the fight will move from the economic to the political arena, where politics will settle it" (Roe, 1994: vii).

The above quote from Roe (1994) predicts that tensions between rising shareholder activism and corporate interests will ultimately be resolved in the political arena. His book (Roe, 1994) further highlights the relevance of corporate governance to the national political system and at the same time demonstrates the centrality of the national political context for the evolution of the system of corporate governance. Separately, Amable (2016) reminds us that complementarities within the varieties of capitalism should be understood as socio-political compromises.

The private ordering combat (Hill, 2018) that is evident in the present day US corporate governance context suggests the US has yet to reach a new compromise that reflect the many new realities of asset manager capitalism. The fact that the above quote by Roe (1994) is more than a quarter of a century old, suggests such political processes take a long time to come to

fruition. The direction in which future change occurs will therefore depend on both the approach of the national government as well as the institutional reality, that is the relative resources of the different actors (corporates, index funds, active funds, proxy advisors and governments).

Aguilera and Jackson (2003) highlight the "undersocialized view of corporate governance" that results from the fact that agency theory fails to account for differences between countries and for how corporate governance is shaped by its institutional embeddedness. Hence, they conclude that "the unmet theoretical challenge, in comparative studies, remains to conceptualize corporate governance in terms of its embeddedness in different social contexts" (2003: 449). I hope to have contributed to closing this research gap with this thesis.

The rise of the asset management industry is of fundamental relevance for the varieties of capitalism as it suggests that shareholders may in the future set the agenda on an increasing number of key policy items. Contrary to the common narrative, asset manager capitalism represents the first time in over a century that shareholders have the potential to take over the reins of the economy from corporate executives. Understanding who these new shareholders are, what drives them, and how they interact with other actors in the new institutional framework is of relevance for all stakeholders, not just shareholders, and will help determine whether the observed developments are desirable or not.

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