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The Role of Index Funds in Promoting Sustainable Corporate Governance

A review of theory and evidence of the stewardship efforts of the Big Three

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Abstract

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The rise of index funds over the last two decades has attracted significant attention due to their large accumulated market shares and prominent shareholder power. As the largest index fund providers in the world, the Big Three are seen by many to have a fiduciary duty to use this power to promote sustainable corporate governance in their portfolio companies. However, it is unclear whether the Big Three have incentives or capabilities to do so. Despite various academic studies contributing to this question, the divisiveness of the results does not suggest conclusive answers. Therefore, this research aims to address the questions of whether the Big Three have incentives to act as forceful stewards and how do the Big Three demonstrate this in practice.

A qualitative research method was chosen in the form of an extensive literature review of the current academic literature and reports. The research questions are answered by a review of theory and incentives, and by a review of empirical evidence. The review of theories and incentives shows a dichotomy of valid incentives for and against active stewardship efforts on behalf of the Big Three, thus providing no conclusive answers. The review of current empirical evidence suggests a somewhat weak demonstration of forceful stewardship by the Big Three. Despite some signs of improvement that could warrant optimistic hopes for the future, the reviewed literature suggests that the stewardship efforts of the Big Three are more in accordance with the agency-costs view than the value-maximisation view.

Keywords:	Index Funds, The Big Three, Corporate Governance, Stewardship, Literature Review

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Glossary

Acronyms and Abbreviations

AUM	Assets under management
E&S	Environmental and Social
ESG	Environmental, Social, and Governance
ETF	Exchange-traded fund
PRI	Principles for Responsible Investors
PSLRA	Private Securities Litigation Reform Act
S&P 500	Standard & Poor's 500 market index
SEC	U.S. Securities and Exchange Commission
SSGA	State Street Global Advisors

Key Terminology

Active fund	A mutual fund that actively manages its portfolios while attempting to "beat the market"
Agency-costs view	A theory that suggests that index funds do not have incentives to act as forceful stewards because it bears disadvantages (costs) to index funds (the agent) that are not experienced by their clients (the principal)
Asset manager	Can refer either to a company that manages invested assets, or an individual employee who manages the invested assets
Corporate Governance	The structure of rules, processes, and practices by which companies are controlled and governed. Fundamentally affects how companies are managed and steered.

"Exit"	Refers to shareholders selling, or "exiting" their investments
Fund family	Refers collectively to all the different investment funds offered by an investment company
Index fund	A mutual fund that tracks indexes, thus a type of a passive fund. However, this paper uses index funds also as a collective name for both index funds and index ETFs
Mutual fund	An investment fund that pools investors' money and uses the "mutual" assets to invest in different securities
Passive fund	A mutual fund that invests in tracked indexes or market segments, thus not requiring active management
Shareholder value	A theory that suggests that the purpose of business is to maximise shareholders' profits as long as it is done lawfully and ethically
Stakeholder value	A theory that suggests that the purpose of business is to satisfy not only shareholders but all stakeholders, including employees, customers, suppliers, creditors, society etc.
Stewardship	The practice of protecting and advancing investors' wealth in the best interests of the investors, through different activities
The Big Three	Collective name for BlackRock, Vanguard, and SSGA, the three largest index fund providers (index funds & ETFs)
Value-maximisation view	A theory that suggests that index funds do have incentives to act as forceful stewards because it maximises long-term value of their portfolios, which is also in their best interest
"Voice"	Refers to shareholders voicing their preferences to affect company decisions, for example by voting, engaging, or otherwise influencing

1 Introduction

1.1 Research topic

Index investing has increased in popularity enormously during the past two decades. The low-fee structures, broadly diversified portfolios, and relatively good and stable returns of indexed mutual funds and exchange-traded funds (ETFs) have increasingly attracted the assets of both retail investors and institutions (Fichtner & Heemskerk, 2020: 494-495). The three largest index fund providers – BlackRock, Vanguard, and State Street Global Advisors (SSGA), also known as the “Big Three” – have accumulated massive amounts of assets under management (AUM) and have become among the largest asset managers in the world with approximately USD 21 trillion in assets under management combined (Ross, 2021). As a reference point, that is roughly equivalent to the gross domestic product of the largest economy in the world, the United States (World Bank, 2021). Therefore, the Big Three have become shareholders in thousands of companies across the world, often holding the largest blocks of shares in large publicly listed companies (Bebchuk & Hirst, 2019a). Consequently, the shareholder power that the Big Three have amassed has ignited hot debates surrounding their role as shareholders. In the last five to ten years, many published academic papers have contributed to this ongoing debate in an attempt to prove or disprove certain theories with empirical data, and to put forth suggestions for the future.

The research topic of this study relates to the discussion concerning the role of index funds as shareholders. More specifically, the research topic focuses on the role that the Big Three play in terms of promoting sustainable corporate governance in their portfolio companies. The research topic is connected to a more profound, underlying academic debate of shareholder value vs stakeholder value, which tries to answer very nuclear questions about business and its place in society. The shareholder vs stakeholder debate incorporates considerations regarding the social responsibility of business, the purpose of business, the role of directors, performance measurement, executive

compensation, and shareholder rights, to name a few. However, the rise of index funds brings a new perspective to the shareholder vs stakeholder debate, due to index funds' different structure of ownership and approach to asset allocation. This significant change in financial equity markets has inspired numerous academic papers in the fields of corporate governance, corporate law, and financial markets. However, within the debate of the role of index funds in corporate governance, there are still many open and ongoing discussions since the topic is relatively new. Due to the novelty and significance of the topic, as well as the increasing number of academic papers being published in the field, this research is conducted as an extensive literature review. This type of research contributes to the current state of the literature by gathering, summarising, analysing, synthesising, and presenting the main arguments of relevant papers, thus reflecting the current state of the debate. Therefore, the research contributes to the discussion of the role of index funds in corporate governance, which ultimately connects to the deeper underlying debate of shareholder value vs stakeholder value.

1.2 Motivation

The role of index funds in corporate governance is significant because, as the Background chapter will highlight in more detail, index funds are gaining tremendous shareholder power in the largest companies in the world and can therefore play a significant role in how these companies conduct their business and contribute to society. Moreover, index funds are prominent shareholders in such a large number of meaningful companies, that the effects of these companies' behaviour significantly influence the economy. In addition, regular working people are increasingly investing in index funds as a way to potentially grow their retirement accounts, so people's life savings are also part of the equation. Therefore, the discussion on the role of index funds and how they affect corporate governance is of utmost importance since the effects can be potentially experienced in whole economies and societies. Furthermore, although the research is conducted focusing on the Anglo-American business environment (mostly American), the relevance of this topic should concern other

parts of the world as well, since the Anglo-American influence on the rest of the world is strong.

1.3 Research problem, questions, and objectives

The research builds from the shareholder vs stakeholder debate, from which the research identifies the significance of the rise of index funds in corporate governance. As index funds have grown (the Big Three in particular), their power has been increasingly questioned about whether it can be harnessed to improve corporate governance, or whether it has negative effects on corporate governance. As fiduciaries of their clients' money, the Big Three have a duty to act in the best interests of their customers, which for index investors, is usually sustainable long-term results (Bogle, 2009; Fichtner & Heemskerk, 2020). Therefore, the Big Three should ensure their clients' long-term results by acting as forceful stewards of their clients' assets. As forceful stewards, the Big Three should promote sustainable corporate governance in their portfolio companies as a way to minimise "wicked" or short-sighted conduct by portfolio companies, thus ensuring desired long-term results (European Commission, 2021; 2019). However, it is unclear whether the Big Three have incentives or capabilities to act as forceful and diligent stewards. Furthermore, many academic papers have contributed to this discussion, but nonetheless, the debate remains unsolved due to a vast number of theories, arguments, and empirical studies put forth, which often suggest varying and contradicting results. Therefore, the aim of this research is to address this problem in light of the current literature, by conducting an extensive literature review and trying to make better sense of the current state of the discussion. To better guide the research and the relevance of selected literature, the following research questions were formulated:

Research question 1:

What are the incentives (or the lack thereof) for the Big Three to act as forceful stewards that promote sustainable corporate governance in portfolio companies?

Research question 2:

What is the evidence (or the lack thereof) to support the claim that the Big Three act as forceful stewards that promotes sustainable corporate governance in portfolio companies?

In other words, the first research question focuses on *why* would the Big Three act as forceful stewards (or not), and the second research question follows by asking *how* do the Big Three act as stewards in practice, which thus suggests their true incentives on whether or not to act as forceful stewards that promote sustainable corporate governance. To help navigate through the research while maintaining a focus on relevant topics and activities, the following research objectives were formulated:

- To collect and examine relevant academic literature and reports related to the Big Three and their incentives or actions of stewardship,

- To analyse and identify theories, arguments, and evidence of the stewardship actions of The Big Three,

- To synthesise the literature and categorise it accordingly,

- To present and compare the theoretical arguments and the evidence of the actions of the Big Three as stewards,

- To interpret the findings and determine whether, and how, the findings answer the research questions,

- To assess the research and its findings critically, including the limitations, reliability, and validity of the research, as well as its implications,

- To present suggestive reflections and conclusions of the current state of the literature.

1.4 Structure overview

Following the introduction, the Background chapter provides a more detailed background of the research topic in the form of a brief preliminary literature review. This review starts with background information on the stakeholder vs shareholder debate, which provides the underlying theories and principles that many arguments in the index fund discussion rely on, or stem from. It is essential to recognize the literature and the arguments made in the shareholder vs stakeholder debate to better explore the role of index funds in corporate governance. From there, the Background chapter evolves into the discussion concerning the role of index funds as shareholders, where main themes are briefly presented and discussed. The Methodology chapter then outlines the approach, method, and context of the research, and discusses the methods of gathering and analysing the data. Also, considerations of reliability and validity are presented.

The Findings chapter consists of two main parts: the review of theories and incentives, and the review of the evidence. The review of theories and incentives presents several different arguments for and against the incentives of the Big Three to act as forceful stewards. The arguments are divided into five separate main themes and are presented in a back-and-forth manner, resembling a discussion with contrasting points of view. The review of evidence presents empirical studies and findings according to six different stewardship activities: investment, litigation, advocacy, monitoring, engagement, and voting. The Discussion chapter then summarises key findings and answers to the research questions. It also outlines how the findings were interpreted by the author, discusses theoretical and practical implications of the research, considers the limitations of the study, and makes suggestions for future research. Finally, the Conclusion chapter concludes the research by summarising the structure and the findings of this study, followed by the list of all references used in this thesis.

2 Background

2.1 A brief history of shareholder value

During the 1970s and 1980s, the growing influence of shareholder value maximisation literature in the U.S. was justified based on the argument that managers of companies are agents of shareholders and should therefore act in the best interest of shareholders, which generally is to increase share value (Friedman, 1962: 133; Friedman, 1970; Jensen & Meckling, 1976; Rappaport, 1986/1998; Jensen & Murphy, 1990). The view of shareholder value maximisation began to gain popularity in the 1970s, with Milton Friedman's *New York Times* article, in which he argues that the only social responsibility of business is to increase its profits, as long as it is achieved within legal and ethical customs (Friedman, 1970). This view was reinforced six years later in an article around the theory of a firm's ownership structure, which considers agency costs in a company's management and proposes a new structure where managers' incentives are aligned with shareholders' interests by including performance-based compensation such as stock options in executives' salary models (Jensen & Meckling, 1976).

Other arguments supporting shareholder value maximisation include the argument that the lack of shareholder value maximisation can create a "value gap" in a company's market valuation and attract corporate raiders to overtake the company for quick profits (Rappaport, 1986/1998; Schmid & Frankl, 2015). From the 1980s onward, the shareholder primacy view gathered support and has since become the prevalent gospel of business purpose and objective (Stout, 2013; Denning, 2017: 5). However, especially after the Great Recession of 2008, the support for more stakeholder inclusive ideologies such as the stakeholder theory, corporate social responsibility, and creating shared value -ideology, has grown stronger, and today even shareholder value proponents acknowledge that the tide is turning (Bebchuk & Tallarita, 2020; Porter & Kramer, 2011; Crane, Palazzo, Spence & Matten, 2014). However, for example, Bebchuk & Tallarita (2020) defend the shareholder value doctrine on the basis

that “stakeholderism” increases the insulation of directors and makes them less accountable.

2.2 A brief history of stakeholder value

In 1932, a debate between Adolf Berle and E. Merrick Dodd already addressed the issues of whom should businesses serve and according to which rules and principles should they act (Stout, 2002: 1189). However, the more modern school of thought of stakeholder theory (which is not that different from what Dodd proposed in the debate) was introduced by Edward Freeman (1984), who in his book *Strategic Management: A Stakeholder Approach* attempts to address the managerial confusion of business purpose and performance of the time by introducing the idea of the stakeholder value approach as a basis for strategic management. Despite Freeman’s and other academics’ writings promoting the ideas of a stakeholder approach to business, the shareholder value approach “won the race” and became the dominant ideology from roughly the 1980s onward (Rappaport, 1999; Lazonick & O’Sullivan, 2000). The effects of the shareholder value approach have then become the subject of various books and academic papers, many of which criticise the shareholder value doctrine on the basis of empirical evidence suggesting contrary results of what the doctrine promotes. For example, the works of Lazonick & O’Sullivan (2000), Stout (2002), Krippner (2005), Dobbin & Zorn (2005), Lazonick, Mazzucato & Tulum (2013), Denning (2015), Krein (2018), and Smithers (2020) all criticise the shareholder value doctrine on the basis of empirical examination. For instance, Lazonick & O’Sullivan (2000) provide a historical analysis of the rise of shareholder value as a principle of corporate governance in the U.S., compare it to the performance of the U.S. economy, and conclude that the pursuit of shareholder value has been inefficient and harmful. Similarly, Dobbie and Zorn (2005) concluded that the shareholder value mentality has encouraged firms to focus only on earnings projections, leading to accounting shenanigans, hostile takeovers, and popularising stock options.

One central subject among critics of the shareholder primacy model is that since managers' salary model changed to a more bonus-centred performance-based model, managers took it as their purpose to deliver maximum returns for their "owners" (shareholders) in maximising share value by sometimes contradictory means. Instead of striving for long-term growth and reinvesting profits in research and development, they were more focused on raising share prices "artificially" by using profits to buy back shares and distribute cash back to shareholders via dividends (Lazonick, 2015; Krein, 2018; Smithers, 2020). Another main issue of the debate is the accountability of management. In response to Bebchuk & Tallarita (2020) who argued that stakeholderism decreases managers' accountability by insulating them, Mayer (2020) states that it is exactly the purpose and the values of companies that hold executives accountable when these values are properly placed. This is an argument used earlier by John Kenneth Galbraith in 1967, who suggested that managers are part of a "technostructure", which incorporates the set of rules by which its members must act, thus also holding managers accountable (Waller, 2008: 20).

2.3 Critical evaluation between the two views

The main arguments for shareholder value maximisation as provided by Friedman (1962; 1970) and Jensen & Meckling (1976) - for example, that shareholders are the owners of a company, managers are their agents and thus their compensation should be aligned with shareholders' interests, and that the purpose of business is to maximise profits – have experienced a serious backlash backed with quite sound evidence. As Stout (2002; 2013) and Ciepley (2013) acknowledge, legally speaking, shareholders are not owners of a company. Instead, they only own the stocks of a company, which is a contract including claims on certain benefits of the company, but also with limits. For example, shareholders do not own a part of the company's property, equipment, or other possessions, nor do they own liability and responsibility for shortcomings and malpractice of the company. Also, some studies indicate that by changing executive compensation to highly performance-based in terms of share valuation, executives tend to take part in a short-sighted game of

boosting share price via buybacks, dividends, and “silly” acquisitions, which in many cases has led to slower growth in the long run (Lazonick, 2015; Krein, 2018; Smithers, 2020). Surely, this benefits shareholders who, after the increase in share price, can sell their shares for a profit, but those who want to stick for the long run can be disappointed to see less innovation in the company and possibly competitive problems in the future. This begs the question of which shareholders benefit the most from shareholder primacy since clearly, not all shareholders have equal interests. Also, it is worthwhile considering what is the time horizon of “maximising shareholder value”, since there are different investment strategies to choose from, and different shareholders expect different outcomes in different lengths of time. Respectively, the problem of considering the individual differences among shareholders also applies to the stakeholder approach, and perhaps to an even greater degree. Shareholders are just one “subgroup” of stakeholders, and all subgroups of stakeholders can have equally different interests and expectations of a company. Therefore, in a stakeholder approach, how does a company decide which desires of different stakeholders to consider the most? Perhaps this is the reasoning of shareholder value advocates such as Friedman, who argued that if companies should act for the benefit of many stakeholders (the public good), their managers should be elected officials in order to somewhat satisfy the most popular desires of their stakeholders (Friedman, 1970).

2.4 The rise of index funds and their role in corporate governance

An extension of the shareholder vs stakeholder debate started to emerge at the beginning of the 21st century, as the growth of passive institutional investors started to become recognised. Capital started to increasingly shift from active funds to more passive funds, for example in the form of mutual index funds, or more recently, index exchange-traded funds (ETFs) (Aglietta, 2008; Moarefy, 2020; Bebchuk & Hirst, 2019a; Fichtner & Heemskerk, 2020). Simply put, index funds are investment funds that pool investors’ money and equally invest this money into all of the companies listed on the given index that it tracks (U.S. Securities and Exchange Commission, 2021). For example, if an index fund

tracks the S&P 500 index, it means the fund builds an investment portfolio that mirrors the S&P 500 index, thus matching the index's performance. Therefore, the allocation of assets in index funds is quite different from traditional active funds, since there is no need for active investment management, hence the name of passive funds. For the sake of brevity, this paper refers to mutual index funds and index ETFs collectively as index funds. The growth of index funds has been strong, and today the three largest US index funds are together already the largest owners in nearly 90% of the S&P 500 companies, casting around 25% of all S&P 500 votes (Fichtner & Heemskerk, 2020: 505; Bebchuk & Hirst, 2019a: 17). The three largest companies – BlackRock, Vanguard, and State Street – have accumulated such large market shares that they are referred to by many as the “Big Three”, or the “Universal Owners”, because of their dominant shareholdings in various companies, both American and foreign (Moarefy, 2020; Fichtner & Heemskerk, 2020; Barzuza, Curtis & Webber, 2020; Griffin, 2019; Jahnke, 2019a). This change in ownership structure and capital allocation of equity markets is significant and has raised academic interest, as well as concern, related to the effects on competition, corporate governance, and use of power.

One of the debates involving the role of index funds as universal shareholders is whether or not passive “common ownership” has anticompetitive effects on companies, and how significant are these effects if present. According to the works of Posner, Morton & Weyl (2017), Azar, Schmaltz & Tecu (2018), Elhauge (2019), and Elhauge (2016), horizontal shareholdings, and their claimed anticompetitive effects, are shown to potentially increase prices among industries when competitor companies are owned by common owners. To prevent these effects, academics in the fields of corporate law have even suggested legislative action to combat these issues (Elhauge, 2016; Posner, Morton & Weyl, 2017). However, the anticompetitive effects of common ownership are inconclusive, since other academics argue that the hypothesis of common ownership leading to anticompetitive behaviour is not well established (O'Brien & Waehrer, 2017; Dennis, Gerardi & Schenone, 2019; Bebchuk & Hirst, 2019b). The reason being, that studies concluding that passive investors

have anticompetitive effects, have mainly studied these effects relating to the airline industry and the rise in its prices, while they share common owners. However, the correlation between common ownership and rising prices may not imply causality, as Dennis et al. (2019: 2) suggest. What's more, drawing conclusions relating to the whole of passive investors, based on industry-specific studies, could be argued to lack proper academic caution.

Another theme of discussion involving the rise of index funds as shareholders is whether index funds have incentives and/or means to act as active and forceful stewards of companies. Given their business model of low fees and large portfolios of hundreds of companies, it seems reasonable to argue that taking an active role in corporate governance participation with hundreds of companies is expensive, and the low-fee structure does not cover the expenses. Therefore, the works of Bebchuk, Cohen & Hirst (2017), Bebchuk & Hirst (2019b), Kim, Kim, Kim & Park (2019), Heath, Maccionacchi, Michaely & Ringgenberg (2021), and Lund (2018) suggest that passive index funds do not have incentives to invest in stewardship and therefore often do not challenge management. This is further highlighted by the notion that expenditure in stewardship activities, which potentially increases the value of portfolio companies, benefits other competitor index funds as well, without them themselves spending on these activities (Moarefy, 2020). Therefore, index funds have incentives to not spend money on corporate governance enhancement activity, since these benefits would be experienced by their competitors for free. As a consequence, the competitive advantage of an index fund, which spends more than its peers on stewardship activity, would likely diminish. However, an interesting angle raised by Barzuza, Curtis, and Webber (2020), is that, given their business model, index funds have little space to differentiate from their competitors, and therefore, one way index funds could do that is by indicating an active commitment to social issues as shareholders and voters. The relevance of this dimension is highlighted by the fact that the millennial generation generally places high value on social issues and is soon reaching an age of significant wealth accumulation, hence, constituting a potential segment of customers for index funds (Barzuza et al., 2020).

Despite the costs that stewardship activity in corporate governance of portfolio companies involves, index funds could still have incentives to improve the corporate governance of portfolio companies because “the return of their portfolio is tantamount to the average return in the whole economy” as Aglietta (2008: 220), puts it. This view, although not exclusively concerned with index funds but passive institutional investors in general, is also supported by the works of Hawley & Williams (2000) and Fitchner & Heemskerk (2020). Mullins (2014) also suggests that firms with increased index fund ownership appear to experience heavier monitoring despite the prevailing view, which suggests otherwise. Some academics argue that since index funds do not have the option of “exit”, they, therefore, have the incentive to influence portfolio companies by “voice” in order to steer portfolio companies in the direction they prefer (Aglietta, 2008; Jahnke, 2019a; Fichtner, Heemskerk & Garcia-Bernardo, 2017). Based on this notion, academic papers by Aglietta (2008) and Fitchner & Heemskerk (2020) show optimism that the rise of index funds, together with their different ownership structure and asset allocation protocol, could provide a needed counterbalance to equity markets, which for decades, have often served short-sighted interests. These short-term interests, rooted in the shareholder value maximisation doctrine, have been increasingly served since the 1980s, and now the rise of index funds could potentially change the nature of equity markets by better serving the interests of long-term investors. Whether index funds will indeed enhance the nature of corporate governance by acting as forceful stewards for long-term results, depends largely on their capabilities and incentives to do so. As described in this preliminary literature review section, there are many different angles to the discussion about the role of index funds as shareholders, many of which are still debated and inconclusive. However, the literature is growing to be quite extensive, and it can be hard to keep up with all of the different discussions related to index funds and their role as stewards of invested assets and portfolio companies. Therefore, there is a gap for a more extended literature review to sort the literature to date and reflect the main arguments and conclusions of the current state of the debate.

3 Methodology

3.1 Research approach, method, and context

The research paradigm will be interpretivist, and therefore, the research will adopt a qualitative approach, where the data collected and analysed will consist mostly of qualitative data, although some relevant quantitative data is included, where appropriate. Due to the nature of the research topic and the research question, a qualitative approach is likely to produce the best results and answer the research questions more clearly than using a quantitative research approach. Quantitative data is included in the research where it provides relevant numeric information, for example in expressing market shares, amounts of money, ratios, trends, or percentages, to name a few. The data collected and analysed will be almost exclusively secondary, as there are significant limitations included in the process of acquiring primary data about the research topic. These limitations include the lack of experience, time, money, access, and status required to be able to conduct primary research that would answer the research questions.

Research method

The research will be conducted in the form of an extensive literature review, or integrative literature review (Torraco, 2005). The reason for choosing this approach is because the field of literature surrounding the research topic is relatively new, as most of the relevant literature is less than ten years old, perhaps even less than five years old. As the literature is rapidly growing, there is a need for a systematic literature review that collects, categorises, critically evaluates, synthesises, and presents the available literature surrounding the research questions. The value of this type of research derives from the service that organizing large amounts of qualitative data provides. The data selected will be strictly focused on the research questions, and after the research is conducted, the newly organized and synthesised data can provide the needed answers for the research questions of this study.

Research context

Geographically, the research will focus on the rise of index funds in the United States and will specifically target the three major index funds in the U.S.: Vanguard, BlackRock, and State Street, collectively also known as the Big Three. The reason for focusing on these three companies specifically is that they are the dominant players in the index fund market and are likely to grow even larger in the future. Considering the power these three companies have on the U.S. stock market, large U.S. companies, and the U.S. economy, the importance of this research is significant. Another reason to focus the research on The Big Three and the U.S. is that most of the research and literature conducted so far focuses on this area, and therefore it provides the most amount of secondary data for a literature review type of research such as this one.

3.2 Data collection methods

The relevant data needed to conduct this research will be secondary data collected primarily from online sources and will consist mostly of peer-reviewed academic papers, other academic papers, and grey literature, such as reports published by companies, organizations, institutions, and governments. The criteria for retaining or discarding literature will depend on relevance, such as the content, date, and author, but also accessibility, referring to literature behind a pay-wall. The process of collecting the necessary literature will start by searching articles in appropriate databases, using relevant keywords. The relevance of the articles shown on the search engine will be determined by an elimination process of assessing the relevance first by the title of the article, then by the abstract of the article, then by scrolling through key parts of the article, and where appropriate reading the article thoroughly. The Ctrl + F function will also be used to find specific keywords from the text. Table 1 below illustrates the strategy for selecting the relevant literature.

Table 1. Strategy for selecting the literature

Strategy for selecting the literature
1. Keywords Index funds, Passive funds, Passive capital, Passive investors, Shareholder, Corporate governance, Stewardship, Universal owners, The Big Three, Incentives, Evidence, Voting, Engagement, Economy, Effects
2. Search engines / Databases SSRN Taylor & Francis Online Google Scholar EBSCO Host Finna.fi MetCat Finna Emerald Insight ProQuest Science Direct
3. Types of secondary data Peer-reviewed academic journals Non-peer-reviewed academic journals Professional journals Trade journals Books and E-books Newspapers Reports Websites

Table 1 describes in more detail the relevant keywords to be used to find articles that address the research questions. Also, databases and the different types of secondary data to be used in the research are listed in the table.

3.3 Data analysis and analytical approach

The data analysis phase will consist of three different stages, which are likely to overlap each other in the process, as well as overlap with the data collection phase. The first stage requires reading the literature, or parts of the literature, skimming, and trying to grasp the basic themes and topics of the text. This is also known as inspectional reading (Adler & Doren, 1972: 24-32). This enables getting a holistic understanding of the different literature and will also

complement the data collection process. The next two stages will also follow the reading guidelines provided by Adler & Doren (1972), as the second stage will involve analytical reading. This is the stage where the content of the literature will be read through an analytical lens, examining the arguments presented more thoroughly. This will include identifying theories and theoretical frameworks upon which arguments and conclusions are made. The analytical stage should result in a deep understanding of different theories and arguments presented, as well as in a critical evaluation of these arguments and theories. This means questioning the reasoning of the arguments and asking what potential problems or flaws exist in these arguments. This will lead to the last stage which will consist of syntopical reading, where arguments and reasonings from different texts will be synthesised and compared to each other. This includes comparing and contrasting differing or conflicting views but also combining and joining similar views. As a result of synthesising previous works of others, potentially new knowledge of the topic can occur, which will contribute to answering the research questions (Torraco, 2005). At the very least, a better understanding of existing knowledge will take place, which will also help to answer the research questions. At this point of research, the different arguments and theories presented in the literature should be relatively clear, and therefore, synthesising different texts and papers should start to happen almost intuitively.

As a practical approach to this three-stage analytical reading process, all of the literature will be downloaded when possible and saved as a PDF file, in a research folder. As the research progresses, and the themes of different texts become clearer, a systematic coding and categorising function will start to take place. This enables to divide and categorise the data in a meaningful way so that the relevant data is easy to access during the research. Different batches of data will be labelled according to the themes they contain and the main arguments they present. Later the data can be further coded and categorised by more specific arguments and theories that they represent. The goal of this is to have a well-organised set of data so that in the writing phase of the project, different themes are easily identified and accessed. This will also function as a

part of the data analysis and synthesis stages. At later stages of the research, the overall conclusions and reflections of the literature will be analysed and interpreted to provide conclusions or answers to the research questions.

3.4 Reliability and validity

The reliability of the research derives from the systematic approach of selecting and reviewing relevant literature, as well as the high-quality academic literature used in this research. Most literature is gathered from relevant peer-reviewed journals, non-peer-reviewed journals, and other professional and academic journals and reviews. For instance, many of the papers are published by the European Corporate Governance Institute (ECGI), and also by high-quality law reviews such as the Columbia Law Review, Southern California Law Review, and Boston University Law Review. Furthermore, most of the authors of the literature selected are professors in prominent universities and law schools, such as Harvard Law School, Columbia University Law School, and University of Pennsylvania Law School. Grey literature, such as reports used in the research, is also from reliable and original sources such as the Big Three annual reports. Websites used in the research are either the official web pages of the sources or otherwise reliable enough webpages and sources for the given reference. Where possible, reference is gathered always from the original source, although in some cases it might be justifiable to use secondary sources that concisely pool information.

Due to the nature of a literature review type of research, the validity of the research is largely based on the reliability of the sourced literature. As explained above, however, the source material is highly reliable, thus validating the use of such literature in this research. The conclusions and answers of this research are reflections of the overall literature, which from a validity point of view, depends on the validity of the source material as well as the validity of the author’s interpretation of the source material.

4 Findings

4.1 Review of theories and incentives

4.1.1 Value-maximisation view vs Agency-costs view

As the late founder of Vanguard, Jack Bogle, said in an interview with Morningstar, “the only weapon [index funds] have, if we don't like the management, is to get a new management or to force the management to reform” (Bogle, 2010). This phrase encapsulates the view of many academics on the incentives that index funds have to engage in forceful stewardship – since index funds cannot “exit” their investments, nor threaten to leave them, they must therefore have greater incentives to actively influence portfolio companies to adopt long-term value creation principles and procedures (Aglietta, 2008; Fisch et al., 2020; Fichtner et al., 2017; Jahnke, 2019a; Kahan & Rock, 2019; Kim et al., 2019; Bioy, Bryan, Choy, Garcia-Zarate & Johnson, 2017). This view is often referred to as the “value maximisation view”, which derives from the notion that index funds should have incentives to engage actively in stewardship in order to maximise the value of their portfolios. As passive long-term holders of their shares, index funds are left with only one option to promote sustainability and performance of their index portfolios - to use “voice” by engaging with portfolio companies and voting in proxy meetings.

The other side of the debate argues that due to the low-fee structure of index funds, sufficient financial incentives are not present to incentivise index funds to invest and engage in stewardship extensively (Bebchuk & Hirst, 2019b; 2021; Bebchuck et al., 2017; Coffee, 2021; Corum, Malenko & Malenko, 2021; Lund, 2018). This “Agency-costs view” or “Passivity thesis” is highlighted by the fact that large fund families, such as each of the Big Three, have several thousand companies in their portfolios, and therefore, meaningful engagement with all of them would be economically impractical. For example, Bebchuk & Hirst (2019b; 2021) illustrate that, theoretically, an increase of USD 1 million in AUM as a result of stewardship investment would only be logical if the investment itself

would be less than USD 1 million. For the end investors, such investment would of course be beneficial. However, given the Big Three’s low fee margins of approximately 0.1%-0.3% of AUM, from the perspective of the index fund manager, such an increase in value would yield only one to three thousand dollars (USD 1,000 – 3,000) for the fund manager, which is quite unattractive. Therefore, the structure and nature of the index fund business itself do not provide incentives to invest in stewardship, since the benefits of these investments would yield only an extremely small fraction for the funds themselves (Bebchuk & Hirst, 2019b; 2021). Bebchuk and Hirst further argue that the Big Three have little incentives to oppose management because investment fund managers can have substantial personal incentives to maintain good relationships with corporate managers. For example, Big Three managers may administer and manage defined contribution plans on behalf of some of their portfolio companies, which yields significant revenues for them (Bebchuk & Hirst, 2019b; 2021). Therefore, Big Three fund managers have an incentive to be excessively deferential to managers who are current or potential clients, since constantly opposing and protesting them in votes could worsen their relationships and negatively affect fund managers’ future revenues (Bebchuk & Hirst, 2019b; 2021; Platt, 2019).

4.1.2 Competition

Index funds compete fiercely against other index funds to attract investors, and even marginal differences between index funds’ returns can be significant. In terms of stewardship investments, this can result in a problem known as the “free-rider problem”, which translates to the equal increase of portfolio value for all rival index funds, despite only one of them investing in stewardship (Bebchuk & Hirst, 2019b; Lund, 2018; Hu et al., 2020; Moarefy, 2020). If one index fund invests in stewardship to improve the long-term results of a given index portfolio, the exact same improvement will be experienced by rival funds tracking the same index, since the index consists of the exact same companies. Therefore, if the returns for the given index are the same for all rival funds, but one of them invested more than the others, then the fund that invested more in

stewardship would experience *worse* results compared to those who did not invest, thus creating negative incentives to invest in stewardship (Bebchuk & Hirst, 2019b; 2021). However, Fisch et al. (2020) contend that index funds do not only compete against other index funds, but also against other active funds. Therefore, according to Fisch et al. (2020), index funds have incentives to properly engage with portfolio companies, because the better returns they can deliver on their passive portfolios through improved corporate governance, the fewer benefits will active funds provide by stock picking. Consequently, the less attractive active funds are perceived to be, the more assets migrate to index funds. Relating to the migration of assets between passive and active funds, Corum et al. (2021) distinguish between assets migrating between passive and active funds, and assets migrating from personal savings to investment funds in general. Their study suggests that increased index fund (passive) ownership enhances corporate governance when assets flow to passive funds from personal savings. However, when assets flow to passive funds from active funds, corporate governance seems to weaken. This finding therefore suggests that active funds could have better incentives to engage in stewardship, or at least they seem to do it better than passive funds (Corum et al., 2021).

4.1.3 Size and economies of scale

Contributing to the value maximisation view, Kahan & Rock (2019) and Fisch et al. (2020) argue that index funds have many incentives to engage in active stewardship and vote intelligently in proxy votes. One of their main arguments is that the largest asset managers, such as the Big Three, have the largest incentives to invest in stewardship because the positive changes that the investments may yield will proportionally be the largest for them. To illustrate, given that each of the Big Three have trillions of dollars in equity index funds, even tiny increases in portfolio values deriving from better corporate governance will increase fee incomes substantially in dollar terms, compared to asset managers with a fraction of the AUM that the Big Three have (Kahan & Rock, 2019). Jahnke (2019a: 1) also contends that despite the low fee structure of the Big Three, their sheer size of shareholdings “ensures sufficient return on

their governance investments”, thus strengthening their incentives to invest in stewardship. The large size of their holdings also means that their votes are more likely to be pivotal, which empowers the Big Three to actualise their preferences, hence incentivising them to vote (Fisch et al., 2020). Moreover, the size and breadth of the Big Three’s holdings provides them with economies of scale, which can create several benefits. Firstly, the huge number of votes and engagements that the Big Three participate in, creates information, or “intelligence”, that can be aggregated and spread across their entire portfolios (Fisch et al., 2020). Thus, the costs of acquiring this information are simultaneously spread across their portfolios. Effectually, this reduces the costs of monitoring and engagement on a per-company basis (Fisch et al., 2020). Secondly, some argue that stewardship actions targeted at specific companies can have “spill over effects” affecting other portfolio companies, thus potentially increasing the effectiveness of stewardship (Fisch et al., 2020; Bebchuk & Hirst, 2021). One example of such spill over effect could be the strong message that the pursuit of litigation can send to all portfolio companies in lawsuits that follow rare, but salient, corporate misconduct scandals (Platt, 2019). Bebchuk & Hirst (2021) have responded to arguments that are based on the large size and economies of scale of the Big Three by showing that the empirical evidence they have gathered does not support these theories. Nonetheless, Bebchuk and Hirst do agree that such stewardship activities would be favourable for the Big Three’s beneficial investors. Another angle to the “Size”-debate is introduced by Morley (2019), stating that the largest asset managers, such as the Big Three, are too big to be activist managers. This is because large asset managers have hundreds of different funds in their offerings, including passive mutual funds, active mutual funds, and even hedge funds, all of which can have clashing interests. Thus, the large size and breadth of these asset managers can create “intense internal conflicts of interest that make aggressive activism extremely difficult or even impossible” (Morley, 2019: 1407).

4.1.4 Public image and ESG issues

In terms of reputation and marketing purposes, The Big Three could be argued to have significant incentives to invest and engage in forceful stewardship. As suggested by the works of Jahnke (2019a), Kahan & Rock (2019), Bioy et al. (2017), and Platt (2019), engaging and demonstrating active stewardship have substantial benefits for the Big Three in order to retain current investors and attract new ones. This is more relevant today than ever, due to the increasing influence that the public perception has on companies and individuals alike, especially concerning ESG issues.[1] Bebchuk & Hirst (2019b) also acknowledge the importance that reputation brings for the Big Three, although they distinguish the incentives for *actual* forceful stewardship from the incentives to being *perceived* as forceful stewards. In their view, the Big Three have incentives to be perceived as good stewards, but their actions suggest weaker incentives to fulfil those perceptions (Bebchuk & Hirst, 2019b). The reputational incentives for acting (or at least being perceived) as prominent and forceful stewards are even stronger considering the high interest that millennials place on ESG issues. As Larry Fink, CEO of BlackRock, expressed in the 2019 Letter to CEOs:

> [M]illennial workers were asked what the primary purpose of businesses should be – 63 percent more of them said “improving society” than said “generating profit.” In the years to come, the sentiments of these generations will drive not only their decisions as employees but also as investors, with the world undergoing the largest transfer of wealth in history: $24 trillion from baby boomers to millennials. As wealth shifts and investing preferences change, environmental, social, and governance issues will be increasingly material to corporate valuations (Fink, 2019).

This same insight is witnessed by Barzuza et al. (2020: 102) who claim that index funds, and the Big Three for that matter, face intense competition to win the “soon-to-accumulate assets of the millennial generation”. As suggested by

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[1] For example, social media and ”cancel culture” play an increasingly influential part in today’s public discussions and debates. See Bakhtiari, K., 2020. Why Brands Need To Pay Attention To Cancel Culture. *Forbes,* 29 September. [online] Available at: <https://www.forbes.com/sites/kianbakhtiari/2020/09/29/why-brands-need-to-pay-attention-to-cancel-culture/?sh=77f75c33645e> or Thomas, Z., 2020. What is the cost of ‘cancel culture’? *BBC,* 8 October. [online] Available at <https://www.bbc.com/news/business-54374824>

the survey results from millennial workers in Fink's annual letter quote, millennials do indeed hold ESG issues in high regard. Therefore, demonstrating active stewardship that promotes ESG matters in portfolio companies presents a significant incentive for the Big Three to act as diligent stewards. As Barzuza et al. (2020) emphasise, the threat of losing the race of millennial asset migration is of more importance to index funds than the threat of management retaliation when it comes to ESG activism.

Another reason for the Big Three to recognise the relevance of ESG issues in corporate governance are the major risks related to these matters. Some academics argue that due to the broadly diversified nature of index fund investing, the Big Three should have the greatest incentives to reduce systemic and systematic risk (Coffee, 2021; Condon, 2020; Covington & Thamotheran, 2015; Gordon, 2021; Platt, 2019). To clarify the distinction between both terms, systemic risk refers to "the risk that … an economic shock such as market or institutional failure triggers … the failure of a chain of markets or institutions or … a chain of significant losses to financial institutions" (Schwarcz, 2008: 204). In turn, systematic risk is the ongoing, day-to-day, overall "market risk" that causes ordinary market swings and is affected by factors such as the economy, interest rates, geopolitical issues, inflation, and other causes (Nguyen, 2021; Schwarcz, 2008). Traditionally, systematic risk (market risk), is known as the undiversifiable risk that lingers in all investments, including broadly diversified index fund portfolios (Chen, 2021; Schwarcz, 2008). Therefore, index funds should be highly interested in mitigating systematic risk by promoting sustainable corporate governance and thus, ensuring sustainable positive returns. Similarly, as ultimate investors in entire industries and economies, index funds should have the largest incentives to reduce systemic risk as well, in order to reduce the risk of economic shocks that could affect their portfolios. The most prominent systemic and systematic risk factor at the moment seems to be climate change, which many authors believe should be one of the most pressing incentives for index funds to act as forceful stewards (Coffee, 2021; Condon, 2020; Covington & Thamoteram, 2015; Gordon, 2021).

4.1.5 Morals and fiduciary duty

Some elements of stewardship incentives that seem to somewhat enjoy a consensus among academics on both sides of the debate are the moral and fiduciary duties of asset managers to act in the best interests of their beneficial investors. This notion is mentioned, for instance, in the works of Bebchuk & Hirst (2019b), Fichtner et al. (2017), Jahnke (2019b), Mallow (2019), Bioy et al. (2017), Bogle (2009), Lund (2018), Fisch et al. (2020), and Elhauge (2016). There are different views, however, regarding to what extent fiduciary and moral duties affect asset managers' decisions. This largely depends on individual moral differences between asset managers, as some of them might have more profound and consistent moral principles than others. Moral principles and fiduciary duty can also have dimensions that are open to debate and personal interpretation. One such example is the dilemma of either diligently voting shares or lending them in exchange for extra revenues. As Hu et al. (2020) contend, incentives for lending shares instead of voting them have grown stronger among index funds ever since the SEC clarified funds' power to lend shares, for example to short sellers and activists. This can be explained by the fierce competition between index funds, along with their limited possibilities to differentiate from one another. Lending shares can produce extra revenues that could be decisive factors when potential clients compare competing funds and their returns to one another (Hu et al., 2020). Furthermore, customers of index funds also benefit from share lending, since the revenues from lending shares translate to better returns for their investments. Alternatively, these extra revenues can allow index funds to lower their fees, which also benefits their end investors (Hu et al., 2020). That said, as the dilemma suggests, abstaining from lending, and instead voting the shares, can produce desirable corporate governance reforms that promote long-term results, which are also beneficial for both index funds and their customers. Moreover, diligent voting also improves the asset manager's reputation as a good steward, which has added marketing value. Thus, when it comes to the lending-voting dilemma, the incentives for which option to choose are inconclusive, as several factors affect the decision -

one of these factors being the individual interpretations of moral and fiduciary duties, albeit financial incentives are at least as significant.

Although fiduciary and moral duties are valid incentives for the Big Three to act as diligent stewards, it is unclear how big a role these incentives play. Furthermore, due to the individual differences of fund managers, it is difficult to measure the influence of moral and fiduciary duties on stewardship activity. Conversely, it can also be difficult to identify the incentives behind different stewardship actions. For example, a recent article in the *Financial Times* by MacKenzie & Mooney (2021) reports that BlackRock will give direct voting rights for large pension funds and certain “sophisticated” institutional investors. As it is a significant step towards a more “democratic” corporate governance regime, it could be argued that this decision was made purely in the best interests of BlackRock’s end investors. However, if viewed through the lens of the “Agency costs view” of Bebchuk & Hirst (2019b), it could also be argued that letting investors vote directly alleviates the efforts of intelligent voting for BlackRock. BlackRock explained that despite this change, it would still cast proxy votes for those investors who are eligible to vote but prefer BlackRock to vote on their behalf (MacKenzie & Mooney, 2021). However, if this new voting alternative is widely adopted by eligible voters, it could mean a significant relief on BlackRock’s voting efforts, as this new decision will apply to approximately 40% of BlackRock’s current USD 4.8 trillion of index equity assets under management (MacKenzie & Mooney, 2021). This news has likely also positive marketing effects for BlackRock as the first large asset manager to empower their clients to vote directly.

4.2 Review of empirical evidence

4.2.1 Investment

Investment in stewardship could be argued to be one of the key metrics in determining how much value the Big Three place on stewardship activities. Stewardship investment amounts are easily quantifiable and quite accurately

reflect the relative weight of importance of stewardship to index funds. For instance, investment in stewardship determines the number of resources that can be allocated to stewardship activities such as monitoring, engagement with portfolio companies, acquiring information, intelligent voting, publishing stewardship reports, press and media engagement, and pursuing litigation. These activities require a sufficient number of staff, which is also determined by how much index funds invest in their stewardship teams. The larger the budget for stewardship, the larger, more competent, and more resourceful the stewardship team is, which in turn increases the success of stewardship activities.

One of the most influential and comprehensive research articles regarding the stewardship activities of the Big Three is by Lucian Bebchuk and Scott Hirst (2019b) in which they cover a wide variety of stewardship activities of the Big Three through an empirical setting. According to Bebchuk and Hirst (2019b: 2077), as of 2019, BlackRock had a stewardship team of 45 employees, Vanguard’s stewardship personnel size was 21 employees, and SSGA’s stewardship staff consisted of 12 employees. The authors highlight the small size of stewardship teams by contrasting it against the vast amount of portfolio companies that each of the Big Three had in their portfolios at that time. Respectively, BlackRock oversaw an estimated 11,246 portfolio companies worldwide (3,765 in the U.S. alone), Vanguard 13,225 companies worldwide (3,672 in the U.S.), and SSGA 12,191 portfolio companies worldwide (3,117 in the U.S.). This means that, for instance, BlackRock, having the largest stewardship staff of 45 employees and the least amount of portfolio companies worldwide (est. 11,246), would appoint on average nearly 250 companies to one stewardship employee to oversee. Based on the number of staff members of each stewardship team, Bebchuk & Hirst (2019b: 2078) further estimate that calculating with an average yearly salary of USD 300,000 per stewardship employee, the respective yearly budgets for stewardship personnel are thus USD 13.5 million for BlackRock, USD 6.3 million for Vanguard, and USD 3.6 million for SSGA (as of 2019). When comparing these stewardship investment amounts to the estimated total fee incomes that the Big Three charge for their

equity assets management services, the stewardship costs of the Big Three do seem relatively insignificant. To illustrate, as of 2019, Bebchuk & Hirst (2019b: 2078) estimate that BlackRock received approximately USD 9.11 billion from equity management fees, Vanguard received USD 3.47 billion, and SSGA USD 2.63 billion, respectively. By dividing the equity management fee incomes by the estimated stewardship budgets, the evidence suggests that the Big Three invest less than 0.2% of their fee incomes in their investment stewardship teams (Bebchuk & Hirst, 2019b: 2077). It can therefore be argued that the relative investment amounts in stewardship personnel compared to the presented management fee incomes do not correlate with the strong praise that the Big Three generally place on stewardship.[2] However, a paper by Filali (2019) suggests that even though index funds have limited resources to monitor companies (invest in stewardship), they tend to allocate these resources "optimally" in a way that the most pivotal and value-enhancing actions are paid more attention, for example, in terms of pivotal proposals and proxy votes.

A review of the latest 2021 and 2020 stewardship reports of the Big Three suggests that their stewardship teams have grown to some extent from the numbers presented in Bebchuk & Hirst's (2019b) calculations. For instance, BlackRock reports its stewardship team to consist of nearly 70 professionals, Vanguard reports its team to have more than 35 professionals, and SSGA discloses having 20 full-time employees dedicated to ESG and asset stewardship activities and 11 stewardship professionals around the world (Blackrock, 2021: 7; Vanguard, 2021: 8; State Street Global Advisors, 2020: 17. It is unclear whether SSGA's team consists of 31 stewardship professionals in total, or if some of the same employees were counted in these two different groups. Given that SSGA's stewardship team has 31 members in total, the budgets for each of the Big Three's stewardship staffs using the same formula as above would be as follows: BlackRock USD 21 million, Vanguard USD 10.5 million, and SSGA USD 9.3 million, approximately. When comparing these

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[2] See section 5.1.3 Advocacy, page 28. It describes in more detail the high praise that the Big Three place on stewardship.

budgets with the estimated equity management fee revenues presented by Bebchuk & Hirst (2019b), the portions devoted for stewardship costs would be 0.23% for BlackRock, 0.3% for Vanguard, and 0.35% for SSGA. Although better, these figures are not compared to current revenues and are therefore likely to be slightly inflated. Even so, these amounts still seem relatively small compared to the Big Three's revenues, or their portfolio sizes.

4.2.2 Litigation

The Big Three can engage in stewardship activities in various ways, such as advocating sustainable values, engaging with managers directly, or voting in proxy meetings. Whenever these tools fail to work and a portfolio company severely misbehaves, index funds have the option to pursue litigation to deter further misconduct and to claim possible compensations in the form of settlements (Bebchuk & Hirst, 2019b). Relevant articles covering the litigation aspect of stewardship activity evidence include Griffith & Lund (2020), Platt (2019), and Bebchuk & Hirst (2019b). All of these studies empirically demonstrate that the Big Three show little eagerness to participate, let alone, lead, lawsuits targeting a single portfolio company. For example, Bebchuk & Hirst (2019b: 2113) argue that as active and forceful stewards of entrusted assets, it would make sense for the Big Three to "play the role of lead plaintiffs in significant securities class actions", since by assuming the lead role in litigation processes the Big Three could best serve and protect the interests of their investors. However, as their paper highlights, none of the Big Three have ever assumed the role of lead plaintiff in any of the significant cases studied during the period of 2007 through 2018. Griffith & Lund (2020) also documented similarly low levels of litigation activity by the Big Three, when they recorded the participation of mutual funds in shareholder suits during 2009-2018. Their study consisted of the ten largest U.S. equity asset managers as of December 2018, of which the Big Three placed in the top three accordingly. It is worth emphasising that this study examined *participation* in shareholder suits, instead of focusing solely on occasions where asset managers *lead* the litigation process, as in Bebchuk's and Hirst's paper. The result of Griffith & Lund's

(2020) study was that from 2009 to 2018, the ten largest mutual funds of the US with combined assets under management (AUM) of USD 24 trillion had filed only eleven traditional shareholder suits, that were based on only six different, distinct occasions of portfolio company misconduct.[3] In contrast, similar securities class actions filed from 2008 to 2017 amounted to 1,620 in total, of which the above recorded eleven suits constitute less than 1% of total suits (Griffith & Lund, 2020: 1193).

Platt (2019) agrees with previous studies in that the Big Three have indeed demonstrated quite little activity in terms of enforcing stewardship guidelines by litigation. However, in response to Bebchuk & Hirst (2019b), Platt points out that the Big Three are not alone in avoiding the role of the lead plaintiff, but in fact, all mutual funds along with other private investors do so. The reason being, that the Private Securities Litigation Reform Act, or "PSLRA", apparently disincentivises private sector funds to pursue the leading plaintiff role due to associated economical disadvantages (Silver & Dinkin, 2008: 472). Furthermore, Platt argues that, although scarce, these occasions of index funds' participation in shareholder lawsuits demonstrate their will to take an active and forceful role of stewardship, when the situation requires it. In light of several grand scandals, the Big Three have pursued litigation and managed to recover dozens, sometimes hundreds of millions of dollars on behalf of its investors in settlements. For instance, Platt notes that Vanguard recovered USD 73 million from a suit against Brazilian oil company Petrobras in 2017, and USD 90 million from another suit against American real-estate company VEREIT. Similarly, BlackRock has recovered dozens of millions from settlements of suits against Tyco, Countrywide, and VEREIT. Furthermore, BlackRock has filed lawsuits against financial institutions for mortgage underwriting and servicing practice

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[3] Griffith & Lund (2020: 1181) make a distinction between all shareholder suits filed and traditional suits filed. Their definition of this distinction is that "a traditional securities suit involves an investor suing a corporate issuer for misconduct or misinformation. In [some of the documented] suits investors sued the banks that packaged and securitized their mortgage loans. Because these suits do not involve a corporate issuer as the defendant, we treat them as distinct from traditional shareholder suits".

misconducts during the 2008 financial crisis, recovering more than USD 14 billion for its investors (Platt, 2019: 147-150).

4.2.3 Advocacy

Advocacy refers to general stewardship principles, values, and guidelines that the Big Three express publicly. By examining what the Big Three advocate in terms of stewardship, one can then compare the “noise” they make, to their actions, and see if they match. Evidence of what the Big Three advocate is gathered not only by reviewing relevant academic literature but also relevant annual reports and letters authored by the Big Three. For instance, one of Vanguard’s three main pillars of investment stewardship is advocacy, along with engagement and voting. As Vanguard puts it:

> We are tireless advocates for the highest standards of corporate governance worldwide and the sustainable, long-term value of our shareholders’ investments. We promote a long-term view in both corporate governance and investment practices through public forums and published materials (Vanguard, 2020: 4).

Or BlackRock, in its 2020 Investment Stewardship Annual Report: “We advocate for robust corporate governance and the sound and sustainable business practices core to long-term value creation for our clients” (BlackRock, 2020: 2). Similarly, SSGA’s Global Chief Investment Officer Rick LaCaille expresses that:

> As long-term stewards of capital we have a fiduciary duty to effectively manage the ESG risks of our portfolio companies. Through our engagement with boards on issues that can drive long-term value creation and by using our proxy voting power to reinforce this perspective, we rigorously advocate for our clients’ interests (State Street Global Advisors, 2020: 2).

The stewardship annual reports of each of the Big Three contain numerous comments voicing the importance and priority of stewardship activities to promote sustainable corporate governance. Common trends and terms in these remarks include ESG investing, long-term value creation, fiduciary duty to engage in stewardship, and sustainability, to name a few (BlackRock, 2020; State Street Global Advisors, 2020; Vanguard, 2020). Overall, the message that the Big Three quite loudly communicate is that they place a high value on

stewardship and are therefore responsible long-term asset managers. This message is also witnessed by numerous academics, including Caleb Griffin who gathered the promises made by each of the Big Three on environmental and social shareholder proposals (Griffin, 2020a: 10-14), Lucian Bebchuk & Scott Hirst who quoted Big Three senior officers on their stewardship comments (Bebchuk & Hirst, 2019b: 2034), and Jan Fichtner & Eelke Heemskerk who also pinpointed remarks made by the CEOs of BlackRock and SSGA (Fichtner & Heemskerk, 2020: 499-500), to name a few.

One dimension of advocacy evidence includes different initiatives and principles, of which the Big Three have become signatories and therefore commit to support and follow these actions. For example, all of the Big Three are signatories of the Principles for Responsible Investors (PRI), which is a network of investors supported by the United Nations, providing six principles that incorporate ESG and stewardship values to investment practices (PRI, 2021b; PRI, 2021b; BlackRock, 2020; State Street Global Advisors, 2020). BlackRock and SSGA are also both signatories of the Climate Action 100+ initiative, which seeks to ensure that the largest corporate greenhouse gas emitters in the world take action to combat climate change. Vanguard, however, is not a signatory of this initiative. (Climate Action 100+, 2021). Nonetheless, Vanguard is one of the 128 signatories, along with BlackRock and SSGA, of the Net Zero Asset Managers initiative, which aims to limit global warming to 1.5 degrees Celsius and to support the goal of net zero greenhouse gas emissions by 2050, or sooner (Net Zero Asset Managers, 2021).

4.2.4 Monitoring

The activity of monitoring appears to have two slightly different meanings depending on the literature that is reviewed. Some authors, such as Filali (2019), Heath et al. (2021), Mullins (2014), and Lakkis (2021) seem to use the term “monitoring” in a broader sense that would incorporate activities such as engagement and voting, almost as if it would be a synonym for stewardship itself. For example, Heath et al. (2021: 5) write that “index funds could possibly

monitor through other channels. For example, index funds could either publicly or privately engage with managers and then vote in support of the management proposals they negotiated beforehand”. This use of the word is slightly distinct from the definition used, for example, by Bebchuk & Hirst (2019b), Booraem (2019), Coates (2018), and all of the Big Three in their 2020 annual reports, in which “monitoring” refers to the activity of overseeing, keeping track, following, supervising, analysing, and/or evaluating portfolio companies. For example, Bebchuk & Hirst (2019b: 2045) define “monitoring” as the activity of “evaluating the operations, performance, practices, and compensation and governance decisions of portfolio companies. It provides the informational basis for the voting and engagement decisions of index funds”. To clarify, this paper interprets and uses “monitoring” as Bebchuk and Hirst define it, since the broader definition of “monitoring” is already used in this paper as “stewardship”, under which activities such as engagement and voting fall. Based on the definition of Bebchuk and Hirst, monitoring is thus a stewardship activity that is hard to measure or track, because it is essentially an internal activity. It provides the basis for decision-making of outward stewardship activities such as engagement and voting but monitoring in itself does not leave records or evidence to gather and analyse. Although the effects of monitoring can be seen in voting and engagement outcomes, monitoring in itself can only be estimated by the quality of engagement and voting decisions. Moreover, it can only be measured by quantifying the stewardship resources available to practice it, which is already covered in the “Investment” paragraph of this chapter. Therefore, evidence of monitoring activities is not reviewed in this thesis as no significant evidence could be found due to the internal and invisible nature of monitoring activities.

4.2.5 Engagement

The engagement evidence of the Big Three refers to all recorded interactions between the Big Three and their portfolio companies, other than voting and litigation. These interactions can be public or private, pro-active or reactive (reaching out or responding), and usually involves contact with portfolio

company managers, directors, or other relevant staff (Bebchuk & Hirst, 2019b). The Big Three tend to report engagement records and numbers in their stewardship reports, which is what many research papers have used as a basis for evidence of engagement activity, or the lack thereof. For example, Heath et al. (2021) and Bebchuk & Hirst (2019b) have both studied the engagement numbers of the Big Three using either disclosed information from the Big Three's annual stewardship reports or outsider public databases. While Bebchuk and Hirst examined The Big Three's private engagements with portfolio companies during 2017-2019, Heath et al. focused on the effect that private engagements have on index funds siding with management on shareholder or management proposals. Bebchuk & Hirst (2019b: 2087) found that, on average, during a three-year period of 2017-2019 the Big Three engaged with only 5.2% of their portfolio companies a single time, and only 2.3% multiple times. Therefore, 92.5% of their portfolio companies were not engaged with for the three-year period studied. Furthermore, the findings of Heath et al. (2021) suggest that private engagement does not seem to be as effective of a tool as perhaps thought.

Both Bebchuk & Hirst (2019b) and Heath et al. (2021) also examined the Big Three's public engagement through their activity in filing Schedule 13D vs Schedule 13G forms. When shareholders hold more than 5% of a stock, the Securities and Exchange Commission (SEC) requires filing one of these forms (Code of Federal Regulations, 2021). Form 13D is more extensive and is required when the shareholder plans to influence the control of the company, such as influencing the composition of the board of directors. Alternatively, one can file a shorter and less comprehensive version, Schedule 13G, if the shareholder meets certain criteria for this exemption (Code of Federal Regulations, 2021). As Bebchuk & Hirst (2019b) argue, the Big Three should have greater incentives to influence the identities of directors when they hold substantial blocks in portfolio companies (5% or more). However, Bebchuk & Hirst (2019b: 2099) found that from 2007 to 2018, the Big Three filed only nine Schedule 13D forms, of which seven were not specifically related to influencing the composition of the board. Similarly, Heath et al. (2021: 30-31) noticed that

none of index funds' filings since 2004 were under Schedule 13D. Both studies, therefore, indicate little desire on behalf of the Big Three to influence the identity of directors in portfolio companies, even when their shareholdings are significant (5% or more). Bebchuk & Hirst (2019b) also point out that in the last decade or so, the Big Three have not issued shareholder proposals of their own, despite them being a significant and powerful tool for improving governance in public companies.

Other literature on the Big Three's engagement activities discovers several trends, such as the increase of public engagement through annual letters to CEOs (Jahnke, 2019a; Bioy et al., 2017), eagerness to engage with portfolio companies after corporate scandals (Platt, 2019), larger companies expressing more satisfaction with the level of engagement than smaller companies (Jahnke, 2019a), and a preference of the Big Three on private one-on-one engagements behind closed doors (Bioy et al., 2017). Jahnke's (2019a) findings were gathered by conducting more than 50 interviews with institutional investors and stock market-listed companies. Among his findings of increased CEO letter writing and increased engagement satisfaction among large companies, Jahnke also finds that most engagements occur domestically (in the U.S.) and that interviewees did not experience a significant increase in the number of engagements in recent years (Jahnke, 2019a: 329). This is somewhat contradictory to the results of Bioy et al. (2017: 16), who surveyed 12 large index fund providers and noticed an increase in the number of disclosed engagements during 2014-2016, especially concerning Vanguard and BlackRock. However, this difference in results is possibly explained by different time periods of examination. Surveys also suggest that index funds are willing to reach more portfolio companies in the future and improve the quality of their interactions (Bioy et al., 2017: 15).

The findings of Bebchuk & Hirst (2019b), Heath et al. (2021), Jahnke (2019a), Bioy et al. (2017), and Platt (2019) are in line with the information available from the stewardship annual reports of the Big Three, as the latest reports (from 2020 and 2021) seem to suggest modest improvement of engagement efforts

from the Big Three, except for BlackRock, which seems to have improved its number of engagements from 2019 to 2020. In Table 2, the numbers of engagements of the Big Three were gathered from their investment stewardship annual reports from 2018 through 2021. Although the figures suggest little improvements compared to the literature reviewed in this sub-section, the data between the Big Three's reports are inconsistent and fragmented, which makes interpreting the data more difficult.

Table 2. Number of Engagements of the Big Three from 2018 to first half of 2021.

Number of Engagements of the Big Three from 2018 to 2021 (H1)				
		BlackRock	Vanguard	SSGA
2018				
	Total Engagements	2 049	721*	1533*
2019				
	Total Engagements	2 050	868*	1434 (H1)
	Environmental	316	-	-
	Social	353	-	-
	Governance	1 931	-	-
2020				
	Total Engagements	3 043	655	1721*
	Environmental	1 260	-	-
	Social	956	-	-
	Governance	2 882	-	-
H1 2021				
	Total Engagements	-	734	555
	Environmental	-	-	161
	Social	-	-	271
	Governance	-	-	411
*Number of companies engaged with, and not total number of engagements				
Sources: Blackrock (2018; 2019; 2020), Vanguard (2018; 2019; 2020; 2021), State Street Global Advisors (2019; 2020; 2021).				

For instance, the Big Three might disclose slightly different types of information such as the number of engagements versus the number of companies engaged with. As Table 2 notes, BlackRock discloses engagement numbers as the total amount of engagements, whereas Vanguard and SSGA switch between companies engaged with and the total amount of engagements. In the 2021

stewardship annual report of BlackRock (2021), engagement numbers were disclosed by five different engagement topics, but a total amount was not disclosed. Since various topics can be discussed during a single engagement, these figures do not represent a reliable and definite picture of how many engagements BlackRock had in total, nor does it inform with how many companies they engaged with. Furthermore, report periods of the Big Three vary between 1st January – 31st December and 1st of July to 30th of June. Vanguard and SSGA use the former, whereas BlackRock adopts the latter. That said, SSGA's 2018 stewardship report consisted of the whole of 2018 and the first half of 2019. As the next stewardship report of SSGA was that of 2020, H2 of 2019 seems to have gone without notice. These inconsistencies and fragmented information between the Big Three make it harder to compare them to one another, and therefore harder to determine which of the three are making the best (worst) progress.

4.2.6 Voting

Voting is one of the most influential stewardship activities available for asset managers to enhance corporate governance in portfolio companies. Index funds, and the Big Three for that matter, have a fiduciary duty to their clients to act in the best interests of their investors, including the duty to vote at proxy meetings (BlackRock, 2020; Bogle, 2009; Lund, 2018; Bebchuk & Hirst, 2019b; Employee Benefits Security Administration, 2016). As long-term passive funds, this translates to acting in the pursuit of sustainable corporate governance, which improves long-term value creation for their portfolio companies, and therefore, provides desirable long-term results for their investors. Given the critical nature of voting activities, numerous academic papers have empirically examined the voting patterns of the Big Three to conclude of the level of forceful stewardship that they exhibit. For example, studies by Bebchuk & Hirst (2019b), Fichtner et al. (2017), Heath et al. (2021), and Bioy et al. (2017) all investigated index funds' voting records to determine to which degree do index funds vote with, or against, management of portfolio companies. Results of all four papers suggest that index funds, or just the Big Three in some of the papers, tend to

vote excessively with management most of the time. For instance, Bebchuk & Hirst (2019b: 2093) find that the Big Three vote on average only roughly 3% of votes against S&P 500 say-on-pay proposals, which is three times less compared to the votes of active managers on such proposals. Although say-on-pay voting is only one dimension of voting decisions, it reflects the interests of managers as the vote concerns their compensations. Therefore, minimal voting against say-on-pay proposals indicates excessive deference to management, although does not definitely prove it (Bebchuk & Hirst, 2019b). Similarly, Bioy et al. (2017: 13) report in their findings that the Big Three have voted against management approximately 10% of the recorded votes from 2014 to 2017. These votes are not exclusively related to say-on-pay, but all the votes in general. Results by Fichtner et al. (2017) and Heath et al. (2021) are consistent with those of Bioy et al. (2017). However, Fichtner et al. (2017) and Barzuza et al. (2020) report that regarding director re-elections, the Big Three are not that deferential to management. For example, in 2017, SSGA voted against the re-election of directors in 400 companies due to their failure to appoint more females as board members (Bioy et al., 2017; Barzuza et al., 2020). In fact, Barzuza et al. (2020) suggest that in respect to salient ESG issues the Big Three boldly challenge management. In light of corporate scandals and misconduct, Platt (2019) notes that there are differences among how the Big Three vote against directors after corporate scandals. The margin of votes against management on such occasions lies between 5% to 20% among the Big Three, which seems quite low considering these are votes against managers and directors that have been accused of corporate misconduct (Platt, 2019).

In comparison to the findings of Fichtner et al. (2017), Bioy et al. (2017), Heath et al. (2021), and Bebchuk & Hirst (2019b), the latest annual stewardship reports of the Big Three suggest similar voting behaviour regarding votes against management. Table 3 below combines voting data from the annual stewardship reports of the Big Three from 2019 and 2020. The data supports the notion that the Big Three tend to vote excessively with management, as a vast majority of management proposals are supported, and roughly only 10% of

proposals are voted against management recommendations. Interestingly, the voting reports of the Big Three are once again somewhat inconsistent with one another, as each of them reports slightly different numbers in slightly different ways. They are therefore difficult to compare to one another, as different metrics are presented somewhat differently.

Table 3. Voting by the Big Three in 2019 and 2020.

Voting by the Big Three in 2019 and 2020			
	BlackRock	SSGA	Vanguard
2019			
Total number of proposals voted	155 131	157 517	168 409
Management Proposals	151 230	154 087	163 048
Shareholder Proposals	3 901	3 430	5 361
% of Proposals Voted Against Management	8,0 %	11,0 %	-
% of Management Proposals Supported	89,2 %	<u>66,0 %</u>	93,2 %
% of Shareholder Proposals Supported	11,7%*	<u>76%**</u>	55,8 %
2020			
Total number of proposals voted	153 001	181 370	176 834
Management Proposals	149 073	176 680	170 982
Shareholder Proposals	3 928	4 690	5 852
% of Proposals Voted Against Management	9,0 %	11,4 %	-
% of Management Proposals Supported	88,2 %	<u>65,0 %</u>	93,6 %
% of Shareholder Proposals Supported	10%*	<u>75%**</u>	52,4 %
* BlackRock only discloses % support for ESG proposals, and not for "Other" proposals outside of ESG matters. BlackRock also reports these numbers including abstentions.			
** SSGA reports these numbers as % of shareholder proposals voted with Management			
<u>The underlined figures</u> are rough estimates (± 5 percent units) based on bar charts that SSGA presented in their reports instead of numbers.			
Sources: BlackRock (2020), State Street Global Advisors (2019; 2020), Vanguard (2020)			

Caleb Griffin contributes to the literature of ESG voting by the Big Three with two papers, in which he focuses specifically on voting records on environmental and social (E&S) proposals. Griffin (2020b: 2) suggests that the Big Three "already possess sufficient voting power to determine the outcome of a majority

of shareholder proposals”, and that this includes the power to determine the outcomes of approximately 50% of E&S proposals and roughly 65% of governance proposals. Furthermore, Griffin (2020a: 1) finds that despite significant marketing efforts on behalf of the Big Three on E&S issues, their overall support for such proposals was as low as between 7% and 22% in the proxy season of 2018-2019. These findings somewhat contradict the conclusions of Barzuza et al. (2020), who argue that on ESG issues, the Big Three challenge management “boldly”. However, this difference could be explained by the fact that Barzuza et al. (2020) seem to focus only on social issues, and specifically on board diversity, whereas Griffin (2020a) examines E&S proposals more generally.

Another concern regarding the voting activities of the Big Three is their possibility to lend shares for profit instead of voting them. Hu, Mitts & Sylvester (2020: 1) noted that after the SEC loosened restrictions on institutional investors to be able to lend shares instead of voting them, a surge of 58% was noticed in terms of shares supplied for lending prior to shareholder meetings. Furthermore, this change seemed to be most prominent in companies with higher index fund ownership (Hu et al., 2020). Filali (2019), also acknowledges the concern of index funds’ share lending, although she points out that index funds prefer to vote their shares in “sensitive” and pivotal proposals, instead of lending them. As Hu et al. (2020) encapsulate it, lending shares is somewhat of a dilemma, since on one hand, index funds have a fiduciary duty to act as forceful stewards and vote their shares to improve corporate governance, but on the other hand, lending shares also generates additional returns for index investors, which benefits index funds in terms of marketing purposes.

A recent article in the *Financial Times* by MacKenzie & Mooney (2021) reports quite significant steps towards a more democratic corporate governance environment, as BlackRock announced giving their clients the right to vote directly on proxy meetings, starting in 2022. This change will affect only large pension funds and “sophisticated institutional clients” but will apply to approximately USD 2.4 trillion of index equity assets – nearly half of

BlackRock’s current index equity assets under management (MacKenzie & Mooney, 2021). As the first major asset manager to announce such a change that empowers the ultimate owners of votes to voice their will directly, BlackRock sends a strong message to the world. As it relates to this research, the message could be interpreted as evidence of BlackRock’s willingness to promote sustainable corporate governance by giving a direct voice to those who are most concerned with sustainable results – its end investors. However, as the theory review suggests, BlackRock’s incentives for such a change can be more complex than merely the benefit of its clients. Viewing this recent news from the perspective of the “Agency-costs view”, it could also be interpreted as evidence of an attempt to reduce stewardship costs, while enjoying positive publicity. Moreover, it could be interpreted as evidence of BlackRock (willingly) reducing the agency costs related to their position as a proxy by eliminating their intermediary role altogether.

5 Discussion

5.1 Answers to research questions

This research was conducted with two research questions in mind, namely, *why* would the Big Three engage (or not engage) in forceful stewardship, and *how* do the Big Three demonstrate this in practice. The first research question is more theory-oriented, whereas the second research question is based on empirical evidence. Therefore, the first research question is answered with a thorough literature review covering several different arguments and points of view. The key findings of the theory review show that most of the theories and arguments fall under either the value-maximisation view or the agency-costs view. Due to the strong dichotomy of these arguments and views, the theory review of stewardship incentives does not lead to any conclusive answers to the first research question since many valid arguments for and against forceful stewardship were found. The second research question is also answered with a comprehensive review of published empirical studies, with the aim of proving or disproving theories presented in the theory review, or at least test them. The

overall findings of the second research question suggest a somewhat weak demonstration of forceful and active stewardship by the Big Three, thus supporting the arguments under the agency-costs view more than those under the value-maximisation view.

5.2 Interpretation of findings

Most of the theories and arguments presented in the theory review were categorised either under the value-maximisation view or under the agency-costs view. Those that fell under the value-maximisation view, were interpreted as presenting arguments that index funds, or the Big Three, do have incentives to engage in stewardship diligently and act as forceful stewards. As the value-maximisation view suggests, these views argue that forceful stewardship is in the best interest of the Big Three in order to improve and ensure long-term value creation in their portfolios, which is the fundamental purpose of index investing. Accordingly, those arguments and theories that fell under the agency-costs view, were interpreted as presenting arguments that there are significant incentives not to engage in active and forceful stewardship, usually because of disadvantages that it would present to index funds. These disadvantages concern particularly asset managers, and not their end investors, which creates misaligned interests between index funds and their clients. In other words, arguments that were classified under the agency-costs view suggest that the misalignment of interests between the Big Three and their end investors creates stronger incentives not to act as forceful stewards than to engage actively in stewardship. Both the value-maximisation view and the agency-costs view had several relevant and valid academic papers that present incentives that index funds have to either act or not act as forceful and diligent stewards. Due to the significant dichotomy between arguments under both views, conclusive remarks concerning which theory is more valid could not be made by merely discussing the arguments and theories back and forth. Therefore, a review of the evidence was in place to test these arguments and theories.

The evidence chapter defined and examined six different dimensions of stewardship and presented the evidence accordingly. The findings of the Big Three's investments in stewardship suggest that stewardship plays a relatively small role in the Big Three's priorities, at least based on investment amounts. As the calculations suggest, only 0.2% - 0.3% of equity index asset management fees are invested in stewardship personnel (Bebchuk & Hirst, 2019b). Also, the number of employees in the Big Three's stewardship teams seems to be insufficient compared to the vast number of portfolio companies they each hold. Therefore, the findings from investments in stewardship were interpreted to support weaker, rather than active, stewardship. It is, however, unclear what could be considered a respectable or sufficient amount of investment in stewardship in order to conclude it as evidence of strong and active stewardship, as there is no baseline for it.

In terms of litigation, the findings suggest little eagerness by the Big Three to lead or participate in lawsuits against portfolio companies. However, in some rare, more salient cases, the Big Three have demonstrated more ambition to pursuit litigation and recover investors' money in settlement payments. Overall, the litigation evidence also suggests weak stewardship, especially considering the minimal number of lawsuits that the Big Three have led, or participated in, against culpable portfolio companies following corporate misconduct.

Concerning advocacy of stewardship, evidence shows that the Big Three advocate for diligent stewardship loudly and hold it in high regard. Furthermore, the Big Three are signatories of significant ESG related initiatives and guidelines that further support their advocacy of stewardship. Therefore, in terms of advocacy, the Big Three do show active stewardship.

Regarding monitoring by the Big Three, although an important aspect of stewardship, meaningful evidence was not found due to the "invisible" nature of internal monitoring activities. As explained in the monitoring chapter, there seemed to be two different definitions of monitoring used in the literature, and according to the definition as interpreted in this research, no such monitoring

evidence was found nor reviewed. The effects of monitoring are of course seen in engagement and voting activities, which are reviewed in their own chapters.

The evidence of engagements indicates little private engagement on behalf of the Big Three, as well as very few shareholder proposals issued by them. Also, little evidence was found of efforts influencing board composition, both by formally nominating directors and informally suggesting nominees. Engagements seem to concentrate more on larger companies, and geographically in North America. However, public engagements, such as annual letters to portfolio companies' CEOs, have become more common among the Big Three. The recent reports of the Big Three support the engagement evidence, albeit the reports were found to be slightly inconsistent with each other and therefore hard to interpret and compare. Considering all of these factors, the Big Three show relatively modest engagement efforts compared to their size and breadth of portfolio companies, although it is again unclear exactly what amount of engagement could be considered "enough".

Lastly, the voting evidence shows that the Big Three do quite excessively side with management and oppose shareholder proposals, except in some salient ESG cases such as gender diversity. Overall support for E&S issues was found to be low, despite the Big Three having pivotal power in nearly a half of ESG votes and strongly advocating for ESG matters. Recent voting reports by the Big Three showed slight inconsistencies with one another, making it hard to interpret and compare the reports, as they were sometimes even almost misleading. Therefore, the voting evidence suggests quite feeble voting efforts from the Big Three. All combined, the review of the available empirical evidence suggests rather modest and weak stewardship efforts by the Big Three, thus indicating arguments under the agency-costs view to have more merit.

5.3 Theoretical and practical implications

The review of different theories and arguments in light of the evidence suggests that the findings are more in accordance with the agency-costs view than the

value-maximisation view. Therefore, the findings suggest that the Big Three seem to have more incentives to abstain from excessive stewardship efforts than to act as forceful stewards. This finding thus supports the views of Bebchuk & Hirst (2019b; 2021), Heath et al. (2021), and Griffin (2020a; 2020b), which contend that the Big Three do little in terms of stewardship, although it would be beneficial if they contributed more. However, comparing the findings of this research with the findings of the studies reviewed in this research is somewhat invalid because this research was conducted as a literature review of dozens of different studies, neither using primary data nor producing "primary" results. Therefore, the findings of this research are only suggestive and reflective "macro-level" conclusions of the overall existing literature, whereas the reviewed studies themselves use primary data to produce original micro-level findings that contribute to the grand discussion.

In light of the findings which suggest index funds to have somewhat weak incentives to engage forcefully in stewardship, their incentives could perhaps be improved by appropriate policy changes and reforms introduced by relevant authorities. Alternatively, index funds' stewardship efforts could possibly be mandated to a certain degree, thus ensuring a minimum level of stewardship, whether it be in terms of stewardship team size, budget size, or other quantifiable stewardship measures. It is also worthwhile considering whether direct voting could and should be applied as an industry standard, following the example of Blackrock in giving certain investors direct voting rights. Therefore, policymakers should consider whether such policy reforms are justifiable, possible, and desirable. Index funds' stewardship incentives could also be increased by end-investors demanding more forceful and transparent stewardship. These demands could be expressed by communicating directly with index funds, starting campaigns supporting or opposing certain companies, or by investing in funds or with fund providers that seem to do better in stewardship while disinvesting from those whose stewardship efforts seem to be lagging.

5.4 Limitations of the research

Due to the nature and the circumstances of the research, there are some limitations of the research that should be addressed. Firstly, the research experienced some limitations in terms of the accessibility of data. The research consisted mainly of qualitative secondary data, most of which was academic literature published in journals and law reviews. However, some articles were behind a pay-wall, which was a limitation to this study, and therefore the selection of studies was not as ample as it could have been. Secondly, it is also highly possible that more relevant free-of-charge papers could have been found for this study, but for one reason or another, were missed by the author and therefore not included in the selection. As the subject of this research has been hotly debated in recent years, it is unreasonable to assume that every single relevant study was found and included in this review.

Thirdly, it is also possible that the Covid-19 pandemic affected or influenced some results of the study. For example, results of empirical studies published in 2021, or even the 2020 and 2021 reports of the Big Three, could have been impacted by the pandemic in a way that distorts the perceived progression that the Big Three have made in the last 20 months or so. In other words, the stewardship efforts of the Big Three since the pandemic hit, could have been different in one way or another had the pandemic not taken place. Therefore, comparing the years of 2020 and 2021 with previous years is not necessarily a completely reliable or valid comparison, and should be interpreted accordingly.

Lastly, as the research progressed, more information was found that could have complemented the overall arguments and discussion of the research. However, due to practical limitations concerning the length of this bachelor’s thesis, some limits had to be set in terms of the literature and arguments that were selected and discussed. Therefore, only the most relevant and prominent literature was selected, although there were other interesting arguments and dimensions that could have been suitable to introduce or could have been examined more carefully in the research.

5.5 Recommendations for future research

In light of this research and its limitations, there are a few recommendations for future research that could provide added value to the discussion. One of them would be to study in more detail the effects of the Covid-19 pandemic on the stewardship decisions of the Big Three, or index funds in general. It is unclear how much the pandemic impacted the stewardship advances of the Big Three since early 2020, and therefore, such research would be valuable to determine the validity of conclusions made from the Big Three's stewardship efforts during the pandemic.

Another relevant topic of further research could be related to the stewardship reporting practices of the Big Three in their stewardship reports. During this research, some issues and inconsistencies of stewardship reporting were noted, which made it more difficult to interpret the reports and compare them to one another. At times, these issues almost seemed to exist on purpose to hamper the investigation and comparison of reports. Therefore, research dedicated to investigating these reporting issues could be useful to determine whether the Big Three engage in crafty reporting practices that intentionally "drown" adverse information in the reports, or purposefully complicates finding, interpreting, and comparing sensitive material against rivals.

Lastly, future research should try to answer the question of what level of stewardship is deemed to be enough, acceptable, or desirable. While this research concluded that the evidence suggests a somewhat weak level of stewardship by the Big Three, it remains unclear exactly where the line of sufficient or preferable stewardship lies. Therefore, future research should tackle this important question in order to set more tangible benchmarks and goals for index fund stewardship in the years to come.

6 Conclusion

The rise of index funds during the last two decades has attracted attention from scholars in the fields of corporate governance, corporate law, and financial markets. The three largest index fund managers - BlackRock, Vanguard, and SSGA, known as the Big Three - have accumulated such large market shares that their power and their role as stewards of invested assets have been hotly debated both in corporate and academic circles. Among the largest asset managers in the world, the Big Three hold significant shares in such a large number of public companies that their influence on the economy is strong. However, whether the Big Three use this power to promote sustainable corporate governance in their portfolio companies is dependent on their incentives and capabilities to do so. Therefore, this research aimed to determine whether the Big Three have incentives to act as forceful stewards that promote sustainable corporate governance, and how do the Big Three demonstrate this in practice. The research was conducted as an extensive literature review, using relevant academic papers and reports as secondary qualitative data to answer the research questions. The data were sorted, categorised, analysed, synthesised, and reported in accordance with their relevance to the research questions. The first research question is more theory-oriented and was answered by reviewing existing theories of incentives. The review of theories and incentives showed that there are many valid incentives for and against active stewardship efforts on behalf of the Big Three. Due to the strong dichotomy of arguments, no final answers were concluded. The second research question was answered by reviewing existing empirical studies that present evidence of the Big Three's stewardship efforts, or the lack thereof. The stewardship efforts were divided into six different activities: investment, litigation, advocacy, monitoring, engagement, and voting. Overall, the review of the current evidence suggested a somewhat weak demonstration of forceful stewardship by the Big Three. Despite some signs of improvement that could warrant optimistic hopes for the future, insofar as the reviewed evidence suggests, the actions of the Big Three are more in accordance with the agency-costs view than the value-maximisation view.

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