ROLE OF INSTITUTIONAL INVESTMENT INTERMEDIARIES IN CORPORATE CONTROL: A CRITICAL ANALYSIS

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ABSTRACT

Purpose: The study aims to critically analyse the role of institutional investment intermediaries in the corporate control of their investee companies in Anglo-Saxon jurisdictions.

Theoretical framework: Critical analysis of the role of institutional investment intermediaries derived out of the theoretical basis of classical theory of separation of ownership from management, agency theory, agency cost, stewardship theory and the modern corporate governance.

Method: This is theoretical research using the analogy of the different accepted theories of corporate law on corporate management and control into the underlying utility of emerging institutional investment intermediaries in corporate control.

Result and Conclusion: The result of the study shows major inferences that the suitable engagement in corporate control by institutional investment intermediaries is the stewardship relationship with its investee companies. However, their stewardship role can be converted to agency role to protect their private interests, which can also be resulted in the threat of corporate control monopolization as well as horizontal corporate control.

Research implications: The research indicates the need for prevention of stewardship relationship transposing to agency relationship for preventing corporate control monopolization as well as horizontal corporate control.

Originality/value: The current legal framework so far didn’t expect the possibility for transposition of stewardship relationship to agency relationship and its adverse impacts. Hence, corporate law and its allied laws shall take precautionary deterrence measures to avoid such transposition.

Keywords: Corporate Law, Corporate Management, Corporate Control, Agency Theory, Stewardship Theory, Corporate Governance, Institutional Investment Intermediaries.

PAPEL DOS INTERMEDIÁRIOS DE INVESTIMENTO INSTITUCIONAL NO CONTROLE CORPORATIVO: UMA ANÁLISE CRÍTICA

RESUMO

Objetivo: O estudo tem como objetivo analisar criticamente o papel dos intermediários de investimento institucionais no controle corporativo de suas empresas investidas nas jurisdições anglo-saxônicas.

Estrutura Teórica: Análise crítica do papel dos intermediários de investimento institucional derivada da base teórica da teoria clássica de Separação de Propriedade e Gestão, teoria da agência, custo de agência, teoria do mandato e governança corporativa moderna.

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Método: Esta é uma pesquisa teórica que utiliza a analogia das diferentes teorias aceitas de direito corporativo sobre gestão e controle corporativo na utilidade subjacente dos emergentes intermediários de investimento institucionais no controle corporativo.

Resultado e Conclusão: O resultado do estudo mostra inferências importantes de que o engajamento adequado no controle corporativo por meio de intermediários de investimento institucionais é o relacionamento de administração com suas empresas investidas. No entanto, seu papel de administração pode ser convertido em um papel de agência para proteger seus interesses privados, o que também pode resultar na ameaça de monopolização do controle corporativo, bem como no controle corporativo horizontal.

Implicações da pesquisa: A pesquisa indica a necessidade de prevenir que o relacionamento de administração se transforme em um relacionamento de agência para evitar a monopolização do controle corporativo, bem como o controle corporativo horizontal.

Originalidade/valor: O atual quadro legal até agora não esperava a possibilidade de transposição do relacionamento de administração para um relacionamento de agência e seus impactos adversos. Portanto, o direito corporativo e suas leis correlatas devem adotar medidas preventivas para evitar tal transposição.


1 INTRODUCTION

Control over the largest wealth-creating tool in history, the ‘modern business corporation’ is the ambition of many. David C. Bayne opined control entails a relationship between two which brings in responsibility of one over another and the finality or goal in the actions determines the means through which the same is achieved and which in turn determines the nature of the being (Bayne, 1963). So, the final objective of holding control determine the ways in which the control is being exercised. The same applies to the control exercised over corporate entities. The control over individuals or a physical thing is not the same as corporate control. It is the decision-making power of the controller that differentiates the corporate control from the other controls. The complete authority to exercise control on every matter of a company may not be concentrated in one entity. The ticket for corporate control is spread into multiple fractions of ownership by way of equity shares. Whoever possesses a large portion of such equity shares is bestowed with a significant amount of corporate control. Corporate control is considered to be a corporate asset that is transferable (Bayne, 1963). Equity is the risk capital as well as residuary. But it carries controlling traits in the form of voting rights. The modern corporate law witnessed the exponential growth of institutional investment intermediaries are the new equity holders with the controlling traits of voting rights. The list of Institutional Investment Intermediaries includes foreign as well as domestic business entities managing i.e., pension funds, insurance funds, sovereign funds, mutual funds, exchange traded funds, collective investment schemes, alternative investment funds, business trusts, etc. These investment management entities can be collectively called ‘institutional investment intermediaries’ as they invest the money raised from the public through their fund in the the portfolio companies and thus act as an intermediary between the investors and the investee portfolio companies. Gilson and Gordon rightly used the term ‘institutional investment intermediaries’ to collectively denote all of them (Gilson & Gordon, 2013). The holdings of these institutional investment intermediaries are substantially increasing, as the public tends to
channel their investments through institutional investment intermediaries. In the Netherlands, Switzerland, Denmark and the UK, the assets under management by institutional investors account for more than twice their GDP (Çelik & Isaksson, 2014). In such a scenario, it is inevitable to understand the implications and effects of gaining corporate control by the institutional investment intermediaries.

2 THEORETICAL BASIS

The theoretical basis of this paper is emerging from the well-established concepts of corporate law such as separation of ownership from management, agency theory, agency cost, corporate governance, stewardship theory and the inter-connection with institutional investment intermediaries. Historically, when shareholdings were dispersed into multiple hands, especially in liberal economies of Anglo-Saxon, corporate control was also separated from ownership and handed over to the board of directors and managers (Adolf A Berle & Gardiner C Means, 1932). Corporate control under corporate law is primarily exercised by those who hold dominating voting power in shareholder’s meetings. However, in Anglo-Saxon jurisdictions, the shareholding turned out to be dispersed without having any controlling shareholders with majority voting rights. In the absence of control by shareholders, the directors and corporate managers became very powerful and fearless as they were not worried about a corrective action from the much-dispersed shareholders of the company. In this scenario, a type I agency problem emerged for making the directors and managers (agents) responsible for the shareholders and the company rather than their private interests (Huu Nguyen et al., 2020). Corporate law scholars are constantly in search of the magic wand for resolving agency problem and are presently focusing their attention on institutional investment intermediaries (Rock, 2015). The agency problems can be resolved only by ensuring that the agents act in the best interest of the principal and not for their interest and there shall exist a stewardship relationship between them. Various corporate governance mechanisms are introduced in different jurisdictions to cause deterrence to agency problem. The corporate governance mechanisms are also facing challenges in addressing agency problem due to changes happening in the sphere of corporate control. In the transience era, the dispersed shareholding in Anglo-Saxon jurisdictions gradually shifted towards consolidation through institutional investment intermediaries. Corporate law adopted the corporate governance norms to redress this agency problem and to reduce the agency cost. Shareholder activism and empowerment is one such measure of corporate governance towards this objective. In modern corporations, institutional intermediaries are emerging as their major shareholders. Institutional Investment Intermediaries (III) emerged by aggregating the investments of a large number of individual investors into massive securities portfolios by purchasing the securities of different public companies, predominantly by investing in equity (Anabtawi & Stout, 2008). The fundamental objective of institutional investment intermediaries is to maximize the returns subjected to acceptable associated risks (Asher, 1998). Their growing presence also raised major concerns in corporate ownership and management. The corporate governance mechanisms are now focusing upon the role of institutional investment intermediaries as stewards through Stewardship Codes to address the agency problem. Christian Anguita Oyarzún argues that the implementation of preventive governance with the aid of institutional investment intermediaries is the finest method to address the agency problem (Oyarzun, 2011).

The stewardship theory of corporate governance postulates the absence of conflict and the existence of alignment of interest between the owners and managers and the formulation of a governance structure for bringing coordination between them (Donaldson, 1990). Stewardship theory is based on the sociological and psychological traits of parties in their relationship (Davis et al., 1997). The Stewardship theory suggests a model man as a steward
opposite to an agent under agency theory with high utility in cooperative behavior and highly motivated with the expectation of intrinsic rewards like collective growth, recognition, achievements, etc. than any personal rewards (Pastoriza et al., 2008). However, this theory originally focuses on the mutual stewardship position of corporate managers and their principal *i.e.*, the company as it focuses on corporate governance. In this scenario, the party that chooses to remain as a steward is sometimes subjected to betrayal from the other party choosing opportunism and agency benefits. It resulted in the breakdown of trust between the parties involved. Thus, the stewardship theory can be successfully effectuated only when both parties are following ethnically valued and morally principled mutual relationship or else it will automatically transition into agency theory (Pastoriza et al., 2008). The same analogy of the original stewardship theory can be applied to the changed scenario of overarching growth of institutional investment intermediaries and their engagement in the corporate control of investee portfolio companies. The major reason for extending stewardship obligations on institutional investment intermediaries is their substantial stake which is growing day by day outweighs the direct investment of retail investors and promoters in many investee portfolio companies. By applying the same rationale of the original stewardship theory, institutional investment intermediaries are expected to exercise governance control as large shareholder stewards by reducing conflicts and bringing in coordination with the management of investee companies through the application of Stewardship Codes. However, the awful aspect of bestowing this stewardship obligation on institutional investment intermediaries is the betrayal of one party and the consequent application of the agency theory and accrual of private benefits.

Similar to the original stewardship theory of corporate governance, a shortcoming or failure of following values, ethics and mutual trust from any party will result in the collapse of the stewardship relationship between the institutional investment intermediaries and investee companies and the rise of agency relationship among them. Walker Committee of UK identified such agency problems originated from the gap between the owner (the shareholders) and manager (the board) and the potential for misalignment of interest between them (Walker, 2009). The misalignment of interests between controlling institutional investment intermediaries and the corporate managers of investee companies creates agency problems (Pastoriza et al., 2008). The institutional investment intermediaries hold real fiduciary duties only towards their end beneficiaries that is their clients (EU High-Level Expert Group on Sustainable Finance, 2017). Their prime focus is to satisfy such beneficial investors and not the investee company or other shareholders or stakeholders of the investee company (Bebchuk et al., 2017). Because of the patent legal mandate, stewardship could be a short-term characterization for the institutional investment intermediaries in a drawn-out play. As highlighted earlier, due to misalignment of interest, the permanent approach of institutional investment intermediaries is more of agency rather than stewards. The major reasons for formulating this assumption over institutional investment intermediaries are a) while bearing the full cost of stewardship obligations, the returns for them are only a fraction of the benefits available to all (Kirkpatrick et al., 2011); b) the interests of the investee company are not converged with the interest of beneficial investors of the institutional investment intermediaries as well as the investment managers; c) the personal goals of the sponsors of institutional investment intermediaries are contrary to the larger interests of the investee companies; d) long term perspective actions of the investee companies may affect the current CAGR of the investment funds managed by institutional investment intermediaries and which will result in questioning the ability of fund managers to increase the short term fund returns. The Report of the High-Level Expert Group on Sustainable Finance also identified that “many large publicly-listed firms complain that asset managers pressure them on short-term results even if they have long-term mandates” (EU High-Level Expert Group on Sustainable Finance, 2017); e) institutional investment intermediaries are not investing their money but investing the money
of public investors and there also exists an agency relationship between the fund managers and beneficial investors. However, here the agent’s (fund manager) performance is assessed by looking at the CAGR of the fund which is aligned with the interest of beneficial investors. Hence, this agency problem is not so fatal. In order to cover up this intrinsic agency problem, the fund manager’s emphasis was always on enhancing CAGR and not establishing a cordial steward relation with the management of the company; f) the existence of multi-fold conflicts of interest among the parties like the fund manager with the fund house, fund manager and investee company, investment beneficiary with the fund manager, etc.; g) the decision to vote against the board decision will negatively affect the stock price and which is also detrimental to the interest of fund manager, where they may give preference to the private interest than the interest of the company; and h) accrual of the private benefits including pecuniary benefits like excessive salary for their nominee directors, intervening in the production for the advantage of their sponsor, etc., and the non-pecuniary benefits including usage of amenities from the investee companies (Holderness, 2001). Hence, the agency objectives of fund managers are having the paramount interest above their socially and legally inflicted stewardship obligations. Such agency behavior of institutional investment intermediaries is described as asset owners engaging with investee companies to cater to the private interest of the fund manager, fund house and business group to which they belong rather than that of their beneficial investors.

Hence, under the behest of fulfilling the stewardship obligations, the institutional investment intermediaries are allowed and expected to interfere in the corporate management and control which is identified as legitimate and legal. Corporate control thus becomes dynamic, diverse and the active engagement of institutional investment intermediaries which turned out to be inevitable. However, the stewardship role of institutional investment intermediaries is susceptible to shortcomings and also subjected to criticism that it eventually results in agency problems between the investment intermediaries and the corporate management of the investee companies. Taking into account of all the above, this paper aims to study the adverse impacts of corporate control by the institutional investment intermediaries.

3 METHODOLOGY

This research is a theoretical research with deductive reasoning. Deductive reasoning approach is used for making logical inferences and specific conclusions as to the role of institutional investment intermediaries in corporate control and its ill effects by a detailed analysis of the established theories and principles of corporate law and corporate governance.

4 RESULTS

This paper analytically presents two major concepts i.e., the role of institutional investment intermediaries as stewards and their engagement with investee companies, and the transformation of such stewardship engagement into agency relationship and consequent control concentration. The role of institutional investment intermediaries in corporate control as stewards subsequently results in an agency relationship between institutional investment intermediaries and investee companies. Due to the reasons elaborately discussed, the institutional investment intermediaries will engage in agency relationship with their investee companies and will strive to protect their private interests rather than the interests of the investee companies, other shareholders or stakeholders. Such probability of private benefits also raised serious competition concerns that once they gained a majority stake in a company with the intention to gain private benefits, they will engage in active corporate control by influencing the price mechanism, production and output, technological developments, selection and appointment of directors and senior management of the company and can also influence the
board and managerial decision making. Gradually, these investment intermediaries are increasing their stake in different companies across all sectors and are in the process of becoming majority shareholders in many listed companies. Further, joint and several holdings of the various investment intermediaries together in investee portfolio companies are gaining corporate control monopolization of investee companies. This is eventually causing the reverse trend of dispersed ownership stipulated by Berle and Means into concentrated shareholding which can lead to a serious competition concern of horizontal corporate control over the business sector similar to the traditional US trust companies (Table 1).

### Table 1. Transformation of corporate control of the Institutional investment intermediaries

<table>
<thead>
<tr>
<th>Stewardship relationship</th>
<th>Agency relationship</th>
<th>Corporate control Monopolization</th>
<th>Horizontal corporate control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional investment intermediaries are legally expected to meaningfully engage in the corporate management of the investee companies under stewardship obligations</td>
<td>Stewardship engagement of institutional investment intermediaries with investee companies are transposed into agency relationship upon betrayal and attempt to safeguard the private benefits</td>
<td>Agency relationship and desire to maximise private benefits push the institutional investment intermediaries further to use their controlling stake to dictate corporate management of investee companies</td>
<td>Corporate control monopolization over all the major companies of a business sector will enable the institutional investment intermediaries to collectively control the business activities in that sector at large equivalent to the US trust companies</td>
</tr>
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</table>

Source: Authors (2024).

However, the current legal approach considering institutional investment intermediaries as stewards is not for restricting or mitigating such corporate control monopolization, but demanding more engagement of institutional investment intermediaries in corporate governance. The corporate governance norms and stewardship code shall effectively address this issue and cause deterrence to the conversion of stewardship to agency relationship. Because such conversion results in the apprehended corporate control monopolization in many companies as well as horizontal corporate control monopolization at a sector level. Their horizontal corporate control of multiple companies of similar industries shall be viewed seriously by the competition law as well as the corporate law. Otherwise, there will be a replica of the power concentration enjoined by the archaic trust companies into the hands of modern institutional investment intermediaries. The same was highlighted by Schmalz and pointed out that there is a necessity to act urgently to address anti-competitive effects deriving from parallel holdings (Corradi & Nowag, 2023). Rock Rubinfeld even doubted the existence of a connection of common ownership with the overall price hike in the US (Corradi & Nowag, 2023). Hence, the corporate control monopolization over investee companies in a sector shall be restricted by the corporate law and securities law. The corporate law can prevent the nomination of institutional directors into the board of investee companies, restrict certain general meeting resolutions from the side of institutional investment intermediaries that intend to monopolize their control, mandate their stewardship obligations through a proper regulatory body, mandate directors appointed to make a declaration of their relationship with institutional investment intermediaries, etc. Similarly, the securities law can also play a vital role in the prevention and mitigation of corporate control monopolization by restricting as well as preventing the investments of institutional investment intermediaries above a reasonable threshold, mandating
the institutional investment intermediaries to make periodic declarations about the level of their corporate control over investee companies, etc. Such a reasonable investment threshold can be set by the securities market regulatory body after due consultation with the competition regulatory body which shall be different for companies based on their market capitalization, promoter’s stake and the size of the sector engaged. There can be a maximum threshold above which the investment by institutional investment intermediaries shall be prohibited. However, it is not feasible to restrict the investment of institutional investment intermediaries to 1% as recommended for preventing corporate control monopolization (Posner et al., 2017). Even after the existence of substantial stake of institutional investment intermediaries in portfolio companies, the independence of the board of directors of such investee companies shall be ensured by the corporate law. Corporate law must draw a proper balance between corporate control monopolization and stewardship obligations of institutional investment intermediaries to prevent the reappearance of archaic trust utility into the arena of modern corporations. Furthermore, the Competition law shall step in to restrict the horizontal corporate control of institutional investment intermediaries akin to the US Trust companies. The intersection of regulating factors of corporate control such as corporate law, competition law along with the support of securities law can play a vital role as a preventive mechanism of such horizontal corporate control (Figure 1).

Figure 1. Methods of preventing adverse impacts of corporate control of the institutional investment intermediaries at different levels
Source: Authors (2024).

Hence, the cordial relationship between institutional investment intermediaries with investee companies shall always be restricted and limited to stewardship which shall be ensured by the corporate governance norms along with the stewardship code.

5 DISCUSSIONS

This study critically analyses the role of institutional investment intermediaries in the corporate control as significant shareholders following stewardship codes. However, by applying the analogy of the stewardship and agency theories of corporate governance, on betrayal of either party there is high chance of conversion of the stewardship role of institutional
investment intermediaries to agency relationship. The aftermath of securing private benefits through agency relationship is identified as corporate control monopolization and horizontal corporate control in the hands of institutional investment intermediaries. The following discussions elaborated these key perspectives.

5.1 Growth Of Institutional Investment Intermediaries

The US Securities market witnessed the domination of institutional investment intermediaries through ownership concentration in many companies (Coffee, 2021). Over a span of 50 years, household investment in the US had been significantly reduced from 80% to 38% whereas it flowed from household to institutional investors and became the majority shareholder in many US public corporations (Dasgupta et al., 2021). Presently, institutional investors are the largest shareholders of UK-listed companies (Suren Gomtsian et al., 2020). They owned 43% of the global market capitalization of listed companies, equivalent to almost USD 44 trillion (Fukami et al., 2022). In Australia, the total managed fund reaches $6.4 Billion by September 2023. A study shows that there is a substantial increase in equity investments in Australia and the UK compared to interest-bearing bonds or debentures by institutional investment intermediaries (Varzaly, 2023). The major factor that led to their development is the legal privilege to deal with the public fund and also the fear and reluctance of retail investors to invest directly in securities due to a lack of knowledge of fundamental and technical aspects of specific securities and less time to engage in stock research and stock selection. This resulted in choosing indirect investment through institutional investment intermediaries by only holding either units or certificates of investment from such investment channels managed by the investment intermediaries. These intermediaries can act as the actual record owners and hold equity as fiduciaries for their investee beneficiaries. There are multifarious factors considered by the investment intermediaries before choosing any stocks for investment for ensuring good returns like the size of the company, market liquidity and lower return volatility, better disclosures, probability of cash dividends and share repurchase, better managerial performance, etc. (Chung & Zhang, 2011). Such institutional investment intermediaries gained enormous power over the public companies in the US as well as over the US economy (Strine, 2021). As their collective holdings in many companies are substantially increasing, the law shall also be forced to recognize their inevitable role in corporate control. The institutional investment intermediaries engage with the investee portfolio companies in three different patterns of behavior such as agency, trusteeship and ownership (Johnston et al., 2022). Among these, they will take the safest route of channeling their control mandate under trusteeship as a bulwark for protecting the interest of the company, other stakeholders, and their investee beneficiaries.

5.2 Stewardship Role Of Institutional Investment Intermediaries In Corporate Control

Lord Mayner’s criticism of the growing presence of institutional investment intermediaries with respect to investee portfolio companies as ‘absentee landlords’ as well as ‘ownerless corporations’ pointed towards their relentless corporate governance obligation vested on them as major shareholders of many companies (Cheffins, 2010). Their active role in corporate control as stewards is the expectation of the law and legal machinery. Responsible ownership is considered to be a public good (EU High-Level Expert Group on Sustainable Finance, 2017). OECD and many countries around the world recognized their inevitable role as stewards to monitor the performance of the investee portfolio companies continuously since they are acting as a trustee of their investors (Kirkpatrick et al., 2011). The UK Stewardship Code 2020 and The Australian Asset Owner Stewardship Code 2020 sets high stewardship standards for institutional investment intermediaries in the UK and Australia. Thus, they have
a special responsibility to undertake a major role in corporate governance as they can effectively utilize their voting powers to impact the standards of corporate governance followed by the company (Çelik & Isaksson, 2014). The institutional investment intermediaries are exercising their stewardship functions in many ways: a) by voting at shareholder meetings on director elections and management; b) by placing shareholders’ resolutions and proposals in the general meetings; c) by calling extraordinary general meetings; d) by bringing a class action and derivative action suits; e) collectively acting as per the instructions of advisory firms; e) constantly interacting directly with the management, etc. Stewardship theory works on values, ethics and mutual trust between corporate managers and institutional investment intermediaries. According to Professor Bernard Black, the probability of shareholder activism and collective action is increased due to the presence of institutional investment intermediaries who are capable of initiating such actions and also able to connect with peers for collective initiatives (Black, 1992). OECD asserted the growing demand of institutional investors to recognize their involvement in corporate governance (OECD, 2004). It also necessitated the active role of institutional investors for the efficacy and integrity of the corporate governance system and the effective surveillance of the company. Such entities are in an advantageous position to monitor and even influence corporate decisions, and initiate legal battles and proxy solicitations as they can collectively engage as a force impelling over various matters before the key managerial personnel and board of directors of investee companies including sustainable business strategies (Holderness, 2001). In the US, the institutional investment intermediaries are unanimously undertaking the voting strategy through the support and advice of Institutional Shareholders Services (ISS). The Activist hedge funds in the US are vehemently trying to exercise corporate control by shifting away the balance of power from the board of directors to achieve their objectives (Holderness, 2001). This approach is based on the shift of the focus from mere shareholders’ value maximization to enlightened shareholder value (ESV) enhancement. Enlightened shareholders’ value refers to the growth of the long-term market value of the company by considering and recognizing the vital role played by all the stakeholders (Jensen, 2001). Here, the institutional investment intermediaries are expected to step in to ensure corporate governance in a way that encapsulates the interests of all stakeholders.

On the other hand, the argument of shareholders’ empowerment and their stewardship in corporate governance stands to be a failure because of the short-term objectives of ordinary shareholders rather than of the institutional investors (Talbot, 2013). Still, the major reason that prevents active stewardship engagement of institutional investment intermediaries is that they are more likely to remain passive in corporate management. To ensure institutional investors’ activism in corporate control, it is necessary to make it statutorily mandatory for them to engage in the voting process (Iliev et al., 2015). Recommendation 19 of Walker’s report of the UK provides that the fund managers who invest on behalf of unit holders shall voluntarily undertake a stewardship obligation including monitoring of the board, or explain why they were unwilling to make such a commitment (Walker, 2009). Whereas the recommendation 22 set out for the collective engagement of institutional investment intermediaries and fund managers to enhance their ownership influence for promoting sustainable growth of the company (Walker, 2009). The report also recommended ratification of the UK Institutional Shareholders Committee’s Code on the Responsibilities of Institutional Investors, 2009 by FRC (UK Institutional Shareholders Committee, 2009). As a result, the UK Stewardship Code, 2010 was adopted by which the corporate Governance in the UK made a paradigm shift from board board-centric approach to shareholders engagement and empowerment. The Code was introduced to strengthen shareholder engagement in corporate governance and clearly articulated the best practices for institutional investment intermediaries. On the other hand, institutional investment intermediaries are also found to be the solution for redressing the agency problem by addressing the shortcomings of monitoring of the board. The Stewardship Code mandated the investment
intermediaries to publish their policies for undertaking stewardship responsibilities, to carefully monitor investee companies and not to blindly support the board of directors (Cheffins, 2010). Such stewardship policy shall include the manner of monitoring, internal arrangement for excising stewardship obligation as part of their ordinary business, the strategy used for intervention whenever required, and voting strategies including the usage of advisory services or proxy. The Code was revised and a subsequent edition was published by the Financial Reporting Council (FRC) in the year 2020 (The UK Stewardship Code, 2020). It provides ‘twelve principles for asset owners and asset managers and ‘six’ principles for service providers and expected reporting on each principle with apply or explain approach. The Code is set as voluntary as it provides standards that are higher than the minimum UK regulatory requirements. These stewardship obligations are primarily cast upon them as a part of shouldering their greater responsibility towards their clients or investment beneficiaries by active monitoring of the investee companies. This is a restricted approach, in reality, stewardship obligations are cast upon them by the state because of the existence of larger public good imbibed in the responsible corporate ownership than the limited stewardship obligation towards their investment beneficiaries.

5.3 Corporate Control By Institutional Investment Intermediaries And Its Adverse Impacts

Institutional investment intermediaries engaged in corporate control through voting rights, dialogues and proper assessment of disclosures of the company. They used the preventive governance method through active interaction and constant discussions with the top management. They can gain the necessary understanding of the manner of undertaking corporate governance obligations by the corporate management of the investee companies through this active monitoring. Such interaction cannot be neglected by the management because of the existence of collective voting power of institutional investment intermediaries, their right to bring derivative as well as class action suits and the right to call extraordinary general meetings and authority to bring in shareholders’ resolutions. The institutional investment intermediaries can collectively exercise their voting rights unanimously for the same objectives, by following the recommendations of proxy advisory firms. This is resulting in the emergence of institutional investment intermediaries as the new masters of the board of directors and of senior management for guidance on their crucial decision-making process. The legal compulsion to cast votes on every resolution in general meetings and other stewardship obligation makes them so powerful, that the companies need to convince them to pass resolutions especially special resolutions that requires 3/4th majority approval. Applying the agency relationship and mis-alignment of interest, the voting rights can be exercised by them to fulfill the personal interests of the fund managers or fund house or the sponsors than the interest of the investment beneficiaries. However, such agency problem within the investment intermediaries between the fund managers and unit holders is not yet foreseen and assimilated by the current regulatory framework of corporate governance across the world.

Thus, it is high time for the corporate governance mechanism to undertake a shift in its approach. It shall recognize and strengthen the stewardship role of institutional investment intermediaries by reducing the probability of actuating the agency relationship. The ever-growing corporate control of institutional investment intermediaries will eventually result in the dissemination of specific directions in corporate governance to investee companies and the nomination of directors to the board of directors of investee companies. Sooner or later, institutional investment intermediaries together may make influencing remarks over the corporate governance of the companies in Anglo-Saxon jurisdictions. The control not being exercised currently doesn’t imply that the control cannot be exercised in the future. They may
be acting as a soldier in ambush waiting for the right time to take coercive action. This could lead to the control monopolization over a company by the institutional investment intermediaries. However, once such corporate control monopolization spreads across the companies in an industry, it will be catastrophic like the horizontal corporate control exercised by the archaic US trust companies.

Since there is an ever-growing trend of less participation of retail investors in corporate democracy, it can turn out to be necessary to impart the institutional investment intermediary’s active participation in corporate democracy and governance including appointing nominee directors as institutional directors into the board (García-Meca et al., 2017). As Matt Levine, while discussing the growing control concentration by a small group of index fund managers over many public companies, rightly observed that “there is another government... consisting of a handful of gigantic institutional asset managers... who own (on behalf of their customers) most of the stocks of most of the public companies, and can, in some loose sense, tell those companies how to behave. They are not chosen democratically, exactly, but they are representative; millions of people give their money to those institutions and trust them to make decisions for them” (Levine, 2020). It has been also argued that the power to influence corporate management by institutional investors can be used effectively to reduce carbon emissions, combat climate change, address lack of ethnic and racial diversity, ensure gender equality and make businesses more environmentally and socially responsible and compliant to help in the attainment of sustainable development (Lafarre et al., 2022). This was made possible mainly because of the non-fidelity of institutional investment intermediaries towards the corporate managers of the company. They also project themselves as supporters of corporate sustainability to attract investor customers. Their social responsibility obligations are legally recognized in major developed countries. On the contrary, once they effectuate the agency relationship and started to hold a controlling stake in a company, they might start influencing the price mechanism, production and output, technological developments, selection and appointment of directors and senior management of the company and can also influence the board and managerial decision making.

Interacting with corporate management is not directly profitable for the business of such institutional investment intermediaries as it also requires further study, assessments and time and effort. However, an argument in support of exercising such stewardship obligation by institutional investment intermediary is that the capital appreciation for their investment will occur only if the investee company performs well. This is a paradigm shift from passive shareholders to active shareholders with stewardship obligations with the mandate of exercising voting rights on every resolution in the general meeting. The attraction of the private benefits over corporate control is also incentivizing the institutional investment intermediaries to engage in active corporate control monopolization. Such immense horizontal control exercised by institutional investment intermediaries over in the corporate decision-making process of many companies in the same sector will be akin to that of the monopoly control exercised by the traditional trust corporations of 19th century United States over US corporations. Gilson and Gordon clearly articulated that the archaic dispersed equity ownership pattern in the US stipulated by Berle and Means had been shifted towards the concentrated shareholding in the hands of such institutional investment Intermediaries, which is expected to happen in other countries too (Gilson & Gordon, 2013). The day by day increasing corpus fund will enable the institutional investment intermediaries to gain majority shareholding in many companies. Increased voting power makes them hold sway in the corporate managerial decision-making process. On this behest of increasing shareholding of institutional investment intermediaries, there are hue and cry for strengthening corporate governance by providing a significant role to investment intermediaries in corporate control in order to reduce the agency cost. The supporters argued that it is essential to meet their increasing need of corporate
disclosures from the invested companies, to properly form their views on meeting resolutions. It will be a necessity to make more detailed disclosures than the normal public disclosures to the investment intermediaries holding 5% or more of shares in the respective company. In such a scenario, it will be essential to change the ‘shareholder primacy model’ for corporate disclosure towards the ‘institutional investor primacy model’ of corporate disclosure (Geltner, 2013). However, this shift if happens will also result in the concentration of control over major companies in the same industry into the hands of a few institutional investment intermediaries. They will be able to favorably dictate the board of the investee companies. This paradigm shift of dispersed ownership in Anglo-Saxon jurisdiction towards concentrated ownership through the active engagement of institutional intermediaries will result in their active engagement in corporate control and novel challenges to corporate governance frameworks. As the corporate governance needs to make proper bounds to such corporate control to balance the interests of other shareholders, stakeholders and corporate managers. This concentrated ownership could also result in ultimate horizontal corporate control spreading over the major companies in the same sector. Such horizontal corporate control is the extreme version of corporate control that can be exercised by institutional investment intermediaries raising serious competition concerns. Thus, the siren for such an alarming appreciable adverse effect on competition ahead shall be recognized very early to effectuate adequate counter-legal measures. For example, the procurement of major equity stakes of different competing rivals in the airline and other similar sectors by the major institutional investors like Berkshire Hathaway, Vanguard, etc. was alleged to follow a pattern as they can have an incentive to persuade the competitor to compete less (Geltner, 2013). Such kind of horizontal corporate control over a sector at large was exercised in the past by conventional US trust companies. Trust companies during their relatively short existence, proved as an effective tool for a combined control of the market, even though unanimously declared as illegal by modern Anti-Trust laws around the world, still may re-emerge under disguise. Thus, the current corporate governance framework and stewardship Codes shall encapsulate and regulate the corporate control exercise by the institutional investment intermediaries under their stewardship obligations and shall cause deterrence to the subsequent agency relations to avoid the existence of corporate control monopolization and horizontal corporate control by the institutional investment intermediaries.

6 CONCLUSION

The study focuses on the changing scenarios of corporate control under the modern corporate governance framework of Anglo-Saxon Jurisdictions. The emergence of institutional investment intermediaries as the powerful class of shareholders is changing the structure of corporate ownership and transforming the corporate governance standards through stewardship codes. Strengthening of stewardship obligations of institutional investment intermediaries and insistence on their active engagement in corporate management are novel measures of corporate governance for corporate sustainability. Stewardship Codes legitimated and recognized their interventions in corporate management intending to strengthen corporate governance and reduce the agency cost. On the other side, the conversion of stewardship relationship to an agency relationship for securing private benefits is catastrophic and shall be prevented. A failure of such prevention will result in corporate control monopolization over investee companies by the institutional investment intermediaries and eventual horizontal corporate control over the major companies at the sectoral level. Such control will enable them to increase the profit percentage of all the companies under their control in the sector through the same they can increase the net profit of the companies and improve the CAGR of their fund and which in turn will cause consumer price hikes and inflation in the economy. A combined action of corporate law, securities law and competition law can only prevent the effectuation of such horizontal
corporate control which was akin to the overarching corporate control exercised by the US trust companies. On the behest of increasing shareholding of institutional investment intermediaries and their corporate control, it is necessary to strengthening corporate governance by providing a significant role to investment intermediaries in corporate control in order to reduce the agency cost. But the same corporate governance norms shall be reformulated to encapsulate the preventive measures of corporate control monopolization and horizontal corporate control. Thus, it is high time for the corporate governance mechanism to undertake a shift in its approach. It shall recognize and strengthen the stewardship role of institutional investment intermediaries by reducing the probability of actuating the agency relationship.

REFERENCES


