How institutional investors changed governance mechanisms around the world

From passive funds to mergers and acquisitions, institutional investors are making their presence felt.

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Over the past two decades, the ownership structure of global corporations has undergone a

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marked transformation. Institutional investors, once background players in corporate governance, now exert growing influence over both the composition of boards and the strategic direction of firms. Their ascent has been steady and global.

The shift is most evident in the United States, where the “big three” asset managers — BlackRock, Vanguard and State Street — now rank among the top five shareholders in 90% of S&P 500 firms. Globally, ownership concentration among the top five investors per firm has risen steadily, creating more homogeneous shareholder bases, particularly among large firms.

Global patterns, local variations

The nature of ownership concentration varies by region. In the U.S., institutional ownership dominates, with universal investors — those holding diversified stakes across entire markets — playing an especially prominent role. In Europe, families are increasingly delegating wealth to institutional vehicles. The trend is toward diversification: from industrial to financial portfolios. In Asia, families and state actors still control large swaths of equity. Yet even there, the penetration of exchange-traded funds (ETFs) is on the rise.

The growth of passive investment, largely through ETFs, has been instrumental. These funds, which track indices rather than select stocks, now account for a significant share of capital flow. Their rise has contributed to ownership overlapping across economic sectors and geographies, centralizing influence and voting power among a handful of large institutional investors.

Passive funds’ impact on governance mechanisms

The growing presence of passive funds poses an interesting dilemma in the governance of firms where they invest. On the one hand, they are long-term holders without a clear exit option, and therefore should be incentivized to invest in governance. On the other hand, these funds are not rewarded for “beating the index,” they put pressure on fees and they might provide weak incentives for deep monitoring.

Interestingly, there is ample academic evidence that passive investors do have governance impact as they enter large publicly traded firms:

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- Boards have a higher number of appointments of independent directors.
- There is greater opposition to anti-takeover provisions and dual-class structures.
- Disclosure becomes more forward-looking with earnings guidance and earlier filings.
- More analysts cover the firm, which reduces some asymmetry of information.
- From a capital allocation perspective, payouts to shareholders increase while capital expenditures decrease.

Mergers and acquisitions: consolidation over discipline

One of the more consequential channels of influence is in M&A activity. Our research shows that institutional investors — particularly universal owners — are supportive of consolidation. This stems from their incentive alignment across firms: while discipline might improve individual performance, consolidation can lift sector-wide margins.

This trend has broader implications. M&A is increasingly a tool for market power rather than corporate reform. Institutional support for such deals reflects a shift in governance logic away from disciplining managers to optimizing portfolio performance when those portfolios have strong positions in natural rivals.

Voting and monitoring

Institutional investors engage primarily through voting, both at annual shareholder meetings and in high-stakes contests. Their governance teams examine regulatory filings, proxy statements and proposals. This research discipline reduces inefficient investment. Yet the engagement is not uniform: large-cap firms receive disproportionate scrutiny, raising concerns about a two-tier governance regime.

In high-profile proxy battles, institutional votes often tip the balance. When activists win the support of passive giants, boards frequently settle. Conversely, lack of support from passive funds significantly weakens dissident campaigns. Their role is not merely procedural; it is pivotal.

Delegation and decentralization

As their influence grows, some asset managers are experimenting with decentralized voting

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models. Vanguard, for instance, is piloting delegated voting at the fund level.

The rationale: decentralization may increase legitimacy on contentious issues, especially in ESG votes. Early evidence suggests that decentralized voters are more supportive of environmental and social proposals, while remaining aligned on traditional management resolutions.

Still, delegation raises new questions:

- Will retail investors or fund managers have the bandwidth and expertise to vote responsibly?
- Will proxy advisors gain more sway in a fragmented voting model?

A glass half full

In aggregate, institutional investors have improved some governance mechanisms:

- Boards are more independent.
- Transparency has increased.
- Voting has become more informed and consequential.
- Anti-takeover measures have declined.
- Shareholder payouts have risen.

Yet there are persistent gaps. Executive compensation remains largely unchallenged. Oversight of smaller firms is thin. The influence of institutional ownership appears more effective when outcomes are observable, standardized and scalable, but less so when issues require judgment or sustained engagement.

What next?

Looking forward, several challenges loom. First, geographical limits remain. Evidence of governance influence is strongest in U.S. firms with domestic shareholders. Their influence in other jurisdictions might be weaker as U.S.-based passive investors might lack the focus and the incentives to monitor firms far away in Europe or Asia.

Second, and most important, the concentration and overlap of ownership across a few large institutional owners poses a fundamental question: What do these investors ultimately want? So far, the evidence points to a bias toward shareholder payouts, transparency and industry

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consolidation. Whether this aligns with long-term economic dynamism remains an open question.

For now, institutional investors are not just shareholders. They are governors — with the data, the votes and, increasingly, the last word.

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