The Great Re-Concentration and the Eclipse of Ownership
The Political Economy of American Asset Manager Capitalism

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Abstract
Who holds power in corporate America? Scholars have invariably answered this question in the language of ownership and control. This paper argues that tackling this question today requires a new language. Whereas the comparative political economy literature has long treated dispersed ownership and weak shareholders as core features of the American political economy, a century-long process of re-concentration has consolidated shareholdings in the hands of a few very large asset management companies. The hallmarks of this “asset manager capitalism” are shareholders that are both diversified and disinterested. The paper reconstructs the history of this institutional configuration and examines the conflicts of interest at the core of the new political economy of corporate governance.
1. Introduction

Who holds power in corporate America? Scholars have invariably answered this question in the language of ownership and control. This language was popularized by Berle and Means (1932), who observed that ownership in the United States was dispersed among shareholders, while a small class of corporate managers exercised control.\(^1\) This configuration was the consequence of Theodore Roosevelt’s trust-busting and the robber barons selling off their highly concentrated shareholdings, partly under the pressure of war-time taxation (Means 1931). 44 years later, Jensen and Meckling’s (1976) highly influential principal-agent theory further entrenched the idea – including in comparative political economy – that dispersed ownership and weak shareholder control were structural features of the US economy.

Another 44 years on, this pillar looks increasingly shaky. Stock ownership is more concentrated in the US today than at any point since the 1930s (Davis 2008). Although the largest shareholders – Vanguard, BlackRock, and State Street – fall well short of holding majority stakes, the size of their holdings casts serious doubt on the idea that control lies exclusively with management. The re-concentration of shareholdings does not, however, imply that ownership and control have been re-united. This is because share ownership has itself radically changed, in two ways.\(^2\) The first change concerns the structure of the portfolios of today’s dominant shareholders, who are fully diversified “universal owners” (Hawley and Williams 2000; Monks and Minow 1995). This opens up the possibility that universal owners internalize external effects arising from corporate conduct. It also, however, undercuts a central tenet of modern portfolio theory, which is baked into the law and economics approach to corporate governance: the idea that shareholders are risk-taking investors who seek outperformance (alpha) in a world in which market risk (beta) is independent from their own choices. The second change concerns the

\(^1\) Earlier discussions of ownership and control can be found, for instance, in Marx’ Capital, Vol. III (ch. 27) and in Veblen’s (1923) Absentee Ownership.

\(^2\) Lynn Stout (2012) exposed as a myth the view that corporations are owned by their shareholders. Taking the argument up where Stout left off, this paper asks what it means when shareholders are pure intermediaries.
position of today’s dominant shareholders in the investment chain. Berle and Means wrote in a world in which the only shareholders were natural or legal persons holding corporate stocks directly – a world without an investment chain. Since then, the investment chain has lengthened. Today, the majority of shares are owned asset managers. The returns yielded by their investments merely pass through these entities. Their business model rests entirely on the fees paid by the recipients of these returns. The ultimate beneficiaries of this investment chain are either institutional investors or households (see Figure 1). Thus, legal ownership of corporate stock has become divorced from the economic interest in the stock. The actors supposed to play the role of principals vis-à-vis economically disinterested corporate managers are themselves economically disinterested with regard to the corporation. This paper introduces the term asset manager capitalism to refer to this institutional configuration, which is without historical precedent.

**Figure 1:** The equity investment chain

Figure 1 depicts the investment chain connecting savers to the issuers of corporate equity. The complexity of this picture is a recent phenomenon. After World War II, there was no investment chain to speak of – virtually all corporate equity was held directly by households. The subsequent four decades saw the emergence and growth of public and private pension funds, whose direct equity holdings reached an all-time
high of 27 per cent in 1985 (Figure 2). Since then, pension funds have continued to grow, but so did the financial firms to which they increasingly delegated investment tasks. These asset management companies invest on behalf of both households and institutional investors via five main types of investment vehicles – mutual funds, exchange-traded, hedge, private equity, and venture capital funds. This paper focuses on the largest asset managers, i.e. the providers of mutual and exchange-traded funds. The asset management sector has achieved unprecedented size and concentration. The 500 largest companies manage USD 94 trillion globally, or 56 per cent of total financial assets held by households (Allianz 2018; Willis Towers Watson 2018, 8). By year-end 2017, the “Big Three” alone held more than 20 per cent of the shares of the average S&P 500 company, with BlackRock and Vanguard holding an average 7 and 9 per cent, respectively (Backus, Conlon, and Sinkinson 2019, 19; Fichtner, Heemskerk, and Garcia-Bernardo 2017).

Comparative political economy (CPE) has long conceptualized the US as a liberal market economy defined, in the sphere of corporate governance, by dispersed stock ownership and weak minority shareholders, and impatient capital (Aguilera and Jackson 2003; Gourevitch and Shinn 2005; Hall and Soskice 2001; Roe 1994). While a concentrated shareholder structure and strong minority shareholders were not foreseen by CPE theory, this is an problem that could be addressed within the existing paradigm. By contrast, the observations that shareholders are fully diversified and economically disinterested make asset manager capitalism a topsy-turvy corporate governance world in which neither Berle and Means nor Jensen and Meckling provide much useful guidance. The purpose of this paper is to map out this uncharted territory for students of American and comparative political economy. The narrow focus on stock ownership reflects a conscious choice, justified by the neglect of this question in CPE, which tends to abstract from the details of the

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3 In the following, the category “asset management company” comprises pure asset managers such as BlackRock, Vanguard, State Street, and Fidelity (the world’s four largest asset managers), as well as to the asset management arms of insurers (such as Allianz – the fifth-largest) and banks (such as J.P. Morgan Chase, the sixth-largest).

4 This paper’s focus on ownership in listed companies excludes private equity and venture capital funds. Hedge funds, which do invest in listed companies, are small fry by comparison: the entire global hedge fund sector manages USD 3 trillion – BlackRock alone manages more than USD 6 trillion (BarclayHedge 2019).
investment chain in the context of broader stakeholder frameworks. In addition to opening up a new perspective on the American political economy, the paper also seeks to develop a language that can improve the scaffolding of such comparative frameworks.

The paper is divided into three parts. The second section recounts the transition from managerialism to shareholder value, including the crucial role played by principal-agent theory. The third section traces the growth of asset management companies. Only during the latest phase of this growth have these firms acquired the scale and the characteristics that obviate the conventional notion of stock ownership that has long underpinned the corporate governance literature. The fourth section discusses the hallmarks of asset manager capitalism – a concentrated ownership structure with strong minority shareholders that are, however, fully diversified and economically disinterested. It then lays out the promise of universal ownership, before discussing four conflicts of interest that may prevent asset managers from acting in the manner of a fully economically invested universal owner. The final section concludes with a brief discussion of the implications for American and comparative political economy.

2. Rise of the principals: From managerialism to shareholder value

Corporate governance is thick with ideology. While this is true for all economic institutions, corporate governance comes with a particularly solid superstructure. Mindful of the methodological challenge of distinguishing between the two – more relevant for political economy than for other disciplines – this account of the rise of asset manager capitalism considers both history and theory. It takes as its starting point the two central propositions of Berle and Means’ 1932 classic The Modern Corporation and Private Property. Berle and Means argued, first, that control over economic activity had become concentrated in the hands of the managers of increasingly large corporations. Second, ownership of corporate stocks had become

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5 For notable recent exceptions, see Davis (2008) and Deeg and Hardie (2016).
dispersed among many small shareholders. Berle and Means viewed these two features as mutually reinforcing, newly stable features of the US economy – ownership dispersion, “inherent in the corporate system” (ibid.: 47), the consolidation of the corporate landscape, and the empowerment of corporate managers all fed on each other. And yet, shareholders would not be subdued for very long. Before the next section zooms in on stock ownership, this section briefly recounts the history of the regime shift from managerialism to shareholder value.

Out of Berle and Means’ first proposition grew the sociology of the corporate elite, focused on the power of corporate managers and the network of interlocking directorates. While scholars debated the relative influence of the corporate versus the financial communities, a consensus emerged that an “inner circle” (Useem 1984) existed whose power was rooted not primarily in ownership but in a dense and stable interlock network (Davis, Yoo, and Baker 2003; Herman 1981; Mintz and Schwartz 1985; Mizruchi 1982; Zeitlin 1974). As did Berle and Means, this literature viewed the interlock network’s concentrated power and its lack of accountability to broader society as a potential threat to democracy. At the same time, precisely because the inner circle did not have to fear pressure from shareholders (while operating in a benign macroeconomic environment), it wielded its power pragmatically, accommodating organized labor and government regulation in the “mixed economy” (Hacker and Pierson 2016; Mizruchi 2013). The dismantling of these institutional counterparts in the 1970s and 1980s was the main internal factor in the fracturing of the corporate elite: “Having won the war, there was nothing left over which to fight” (Mizruchi 2013, 199).

Equally important was the external pressure exercised by corporate raiders, in close alliance with the highly influential law and economics movement. Established as an overtly political enterprise at the University of Chicago by Henry Simons, Aaron Director, Ronald Coase, and Richard Posner (Teles 2008), the movement’s academic work was popularized, among others, by Henry Manne (Ash, Chen, and Naidu 2019).

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6 For a discussion of how Parsons, Dahrendorf, Bell and others misappropriated Berle and Means to support the argument that American society had become more democratic, see Mizruchi and Hirschman (2009).
Manne helped pave the way for applying the core prescription of law and economics – protect property rights, then allow for them to be traded freely – to the field of corporate governance via the idea of a “market for corporate control” (Manne 1965). This idea provided a stepping stone to the most consequential article to come out of law and economics: Michael Jensen and William Meckling’s (1976) “Theory of the firm: Managerial behavior, agency costs and ownership structure”. The application of agency theory to the corporation built three axioms into the ideological infrastructure of corporate governance: a conflict of interest between weak outsiders (shareholders) and strong insiders (managers); the need, justified on efficiency grounds, to strengthen the rights of shareholders (as principals) vis-à-vis managers (as agents); and the elimination of workers from the analytical map. From these assumptions flowed three prescriptions for ‘good’ corporate governance (Fourcade and Khurana 2017, 355): monitoring of managerial performance by shareholders (requiring transparency and independent directors), aligning the incentives of managers with those of shareholders (requiring remuneration packages that include stock options), and a market for corporate control (requiring restrictions on takeover defense mechanisms). Thus, by the end of the 1970s, law and economics had collapsed the complex political question of how to organize the corporate system into the one-dimensional problem of protecting outside investors against “expropriation” by insiders (La Porta et al. 2000, 4).

Law and economics did not cause the restructuring of the American corporate landscape (Knafo and Dutta 2019). It did, however, provide the intellectual paradigm within which both the takeover wave of the 1980s and the corporate governance reforms of 1990s could be rationalized as part of the same movement towards greater economic efficiency (Zorn et al. 2005). In the 1980s, buyout firms (‘corporate raiders’) systematically dismantled the conglomerates managerialism had built (Fligstein 1990; Useem 1993). According to the efficiency argument, this “downsize and distribute” model created smaller, more focused corporate units that could be more easily monitored by and whose market value was therefore more transparent to outside investors (Lazonick and O’Sullivan 2000; Zuckerman 1999).
The rise of buyout firms coincided with the growth of public pension funds, whose share of listed corporate equity increased from one per cent of the total in 1970 to eight per cent in 1990 (see Figure 2). The largest fund, the California Public Employees’ Retirement System (CalPERS), began campaigning against firms that had implemented poison pills in 1987 (Smith 1996, 231) and, together with its peers, continued to campaign for independent directors, destaggered boards, and proxy voting (Webber 2018, 45-78). These corporate governance reforms significantly strengthened the power of shareholders, while helping to destroy the inner circle (Chu and Davis 2016, 750).7

By the mid-2000s, the “revolt of the owners”, which had begun in the 1980s, was over (Useem 1993). So resounding was their victory that two legal scholars announced the “end of history for corporate law”, declaring that “[t]he triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured” (Hansmann and Kraakman 2001, 468).8

Despite this improved protection of outside shareholders and the associated weakening of management control, the assumption that outside shareholders were fundamentally weak remained unquestioned in the corporate governance literature, including in CPE. The most influential works of the period perceived the dispersed shareholder structure as a structural, durable feature of the US economy (Aguilera and Jackson 2003; Gourevitch and Shinn 2005; Hall and Soskice 2001; Roe 1994). And yet, it was precisely when the history of corporate governance seemed to have come to a standstill that the Great Re-Concentration accelerated dramatically.

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7 Students of interlock networks have since shifted their attention to the global level (Heemskerk and Takes 2016; Murray 2017; Vitali, Glattfelder, and Battiston 2011).

8 The victory of the shareholder value regime was not limited to the US, nor even to liberal market economies. Comparative research shows a global race to the top for minority shareholder protection, in which coordinated and emerging market economies have largely converged towards the benchmark set by US corporate law (Katelouzou and Siems 2015).
3. Rise of the intermediaries: The Great Re-Concentration

Why re-concentration? By the end of the 19th century, a significant share of corporate America was owned and controlled by a handful of corporations and banks, in turn owned and controlled by figures such as J.P. Morgan, Andrew Carnegie, and John D. Rockefeller (Chandler 1990 [1962]; Moody 1904). Several factors conspired to disperse this highly concentrated structure, including, in chronological order, the issuance of new shares by the acquisitive oligarchs of the Gilded Age, the anti-trust laws of the Progressive Era, robber barons under duress from war-related federal taxes, and the stock market boom of the Roaring Twenties, which turned millions into the stockholders (Means 1930; Ott 2011). The newly dispersed shareholder structure still prevailed in 1945, the first year for which data on sectoral holdings of corporate equity is available. As shown in Figure 2, 1945 was the moment of maximum ownership dispersion – households held 94 per cent of US corporate equity. The term Great Re-Concentration, then, refers to the seven-decade period since 1945 during which shareholdings shifted from households to institutional investment managers. Although public pension funds have played a role in this (Hawley and Williams 2000, 63-66), the remainder of this section focuses on the history of private pension plans, which has been more closely entangled with the fate of asset managers. During the first phase of the Great Re-Concentration, tax rules for mutual funds, retirement legislation, and financial regulation fed the steady growth of the overall asset management sector. The dominant dynamic over the last twenty years has been consolidation within that sector.

9 As Gourevitch and Shinn (2005, 243) have observed, this “blockholder trust model ... made the United States look rather like Germany at the turn of the last century”. What Morgan and Carnegie were to the former, Deutsche Bank and Allianz were to the latter (Windolf and Beyer 1996).

10 Household ownership of corporate equity can, of course, be equal or unequal. In the US (as virtually everywhere else), it is extremely skewed towards the top of the wealth distribution (Wolff 2017). Unless wealthy households hold highly concentrated portfolios, however, household ownership is synonymous with a dispersed ownership structure. Founder-controlled (Amazon, Facebook) or family-controlled (Walmart) companies are too few to change the bigger picture.
**Figure 2:** The structure of US corporate equity ownership, 1945 - 2018

![Graph showing the structure of US corporate equity ownership, 1945 - 2018.](image)

*Source:* Financial accounts of the United States (Z.1).

*Note:* Between 2000 and 2012, the share of corporate equity held by *hedge funds* rose from 2 per cent to 10 per cent (Cao et al. 2017, 88). In the financial accounts, holdings of shares issued by hedge funds show up as assets of the household sector (for domestic hedge funds) or of the rest of the world (for foreign hedge funds, including US funds registered in offshore jurisdictions). The expansion of the rest of the world and the stabilization of the household sector since 2000 thus reflect, to a large extent, the growth of hedge fund assets (see [www.federalreserve.gov/releases/Z1/z1_technical_qa.htm](http://www.federalreserve.gov/releases/Z1/z1_technical_qa.htm)).

**Phase I (1945 – 2000): Feeding the asset management sector growth**

Between the end of World War II and the turn of the 20th century, the share of corporate equity held directly by households declined steadily, falling below 40 per cent after the bursting of the dotcom bubble in 2000. This decline was the flipside of the proliferation and growth of collective investment vehicles – public and private pension funds, insurers, and mutual funds – which increased their share of equity holdings from virtually zero in 1945 to 42 per cent in 2000. While there is no lack of histories of this development, existing accounts often pay scant attention to the distinction between institutional investors such as pension funds and insurers on one hand, and ‘pure’ asset management companies on the other. Comparative political economists, focusing on the political coalitions between owners, managers, and workers, have largely treated the investment chain as a black box (Gourevitch and...
The following account focuses specifically on how and why the growth of retirement assets spurred the growth of asset management sector (as opposed to the banking or the insurance sector).

The big picture can be read off Figure 3. Total mutual fund assets (solid black line) have grown in lockstep with retirement assets since 1984. That growth accelerated when defined contribution (DC) plan and individual retirement account (IRA) assets took off in the mid-1990s. The share of retirement assets in total mutual fund assets doubled over the course of the 1990s, from 20 to 40 per cent (dotted red line). This share has recently plateaued at 45 per cent, whereas mutual fund assets have continued on their steep upward trajectory, indicating the growing importance of (non-retirement) household savings as well as foreign investment in US mutual fund shares.

**Figure 3**: Retirement assets and their share of mutual fund assets, USD trillion

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11 As a result of this black boxing, comparative political economists interpreted the sell-off of European (and Japanese) blockholdings to Anglo-American investors in terms of Europe moving towards the liberal-market-economy model of dispersed ownership (Beyer and Höpner 2003; Deeg 2009). This interpretation obscured the countervailing trend of growing ownership concentration even in liberal market economies, above all in the US.
The impressive growth of mutual fund assets was not preordained. Mutual funds – like any financial instrument – are legal constructs, enabled by tax rules, retirement legislation, and regulatory statutes (Pistor 2019). The history of the legal construction of the contemporary asset management sector is complex, but recent insider accounts and historical research allow for the puzzle to be pieced together. The first piece was the *Revenue Act* of 1936, which granted conduit tax treatment to mutual funds. This exemption of mutual funds from tax on dividends – which mutual funds pass on, minus management fees, to their investors – meant that fund shareholders were treated the same as direct stock investors (Fink 2008, 28). To prevent mutual funds from acquiring control in their portfolio companies, the *Revenue Act* made this tax privilege conditional on funds owning no more than 10 per cent of the voting stock of any corporation (Fink 2008, 28). Fund size continued to be key issue in the run-up to the *Investment Company Act* of 1940. While mutual funds supported the idea of legislation, they vigorously opposed certain provisions in the original bill, which had been drafted by the Securities and Exchange Commission (SEC). Arguing that investment companies selling large quantities of securities into a falling market had been one of the sources of the 1929 crash, the SEC warned against “runs” on mutual funds and proposed to limit their size to USD 150 million. Rejecting this analogy to a bank run scenario, mutual funds strongly opposed the size limitation and succeeded in having it excluded from the final version of the bill (Fink 2008, 39). Section 14(b), which authorized the SEC to re-examine future increases in fund size, was never activated.

The *Revenue Act* and the *Investment Company Act* established the legal foundation for the existence of mutual funds without, however, channeling any savings towards them. Defined benefit plans, which did not invest in mutual funds, prevailed in the corporate retirement market, while the small market for defined contribution plans was dominated by banks and insurers (Fink 2008, 113).

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12 This rule applies at the level of the individual fund. That the consolidated holdings of the BlackRock and Vanguard fund families are approaching this threshold for most S&P500 companies falls within the letter of the 1940 *Revenue Act* provision, although it may conflict with its spirit.

13 Defined benefit plans, which did not invest in mutual funds, prevailed in the corporate retirement market, while the small market for defined contribution plans was dominated by banks and insurers (Fink 2008, 113).
(1947), ERISA (1974), the 401(k) provision (1978), and universal IRAs (1981). Long before Peter Drucker warned of “pension fund socialism” coming to America (Drucker 1976), the anti-labor Taft-Hartley Act of 1947 prohibited employers from contributing to union-controlled pension funds (McCarthy 2017, 95-100). Congress did not hide its intentions. In its comment on the bill, the House Committee on Education and Labor stated that it was “not in the national interest for union leaders to control these great, unregulated, untaxed funds derived from exactions upon employers” (ibid.: 100). By wresting control over the board of trustees, and thus over retirement assets, from unions and handing it to corporate management, Taft-Hartley severely limited the ability of labor to make strategic investment decisions for capital that, by the early 1970s, was flowing into more than 500,000 employer-sponsored pension plans (ibid.: 101). The Employment Retirement Income Security Act (ERISA) of 1974, which brought the riskiness of private pension promises—hitherto negotiated between employers, unions, and employees—under federal government regulation (Wooten 2004, 3), further weakened labor control over the investment of retirement assets. It did so by making more stringent a fiduciary requirement originally introduced by Taft-Hartley. Taft Hartley had merely stipulated that pension assets be invested to the “exclusive benefit” of plan beneficiaries. Drawing on rules developed by the New York State legislature during the 1950s, ERISA’s “prudent person rule” provided that fiduciaries must act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use” (McCarthy 2017, 110-11). In 1979, the Department of Labor issued a regulation specifying that prudence was a matter not of individual securities but of portfolio construction, thus explicitly tying fiduciary duty to the prescriptions of modern portfolio theory (Montagne 2013, 53). By effectively narrowing the prudent person rule down to prevailing ‘best practice’, ERISA created a strong incentive for plan managers to share fiduciary responsibility with professional, external asset managers
To the extent labor has re-learned how to wield this “last best weapon” via public pension funds (Webber 2018), it has done so in an uphill battle against the rules and investment norms instituted by these laws. The main impact of ERISA, however, was that by imposing much more stringent regulations on defined benefit plan managers, it set in motion a massive shift to defined contribution plans (Fink 2008, 124). For all the legislative victories of the mutual fund industry, its growth had stalled in the 1970s bear market (Clowes 2000, 192). The turning points for the industry came in the form of the introduction of section 401(k) into the Internal Revenue Code in 1978, and the 1981 Economic Recovery Tax Act, which allowed annual tax-deductible contributions of up to USD 2000 to an IRA. While the mutual fund industry had not lobbied for the 401(k) provision (the DC-plan implications of which were ‘discovered’ only in 1980 by Ted Benna), the idea for a “universal IRA” had originated with the ICI, which conducted a lobbying campaign and managed to get banks and insurers on board for their proposal (Fink 2008, 125). Since the early 1980s, IRA and DC assets have been the fastest-growing part of the retirement market. Together, these two categories account for almost two thirds of all retirement assets today, and for an even larger share of retirement assets that are invested in mutual fund and ETF shares.

To sum up, the first phase of the Great Re-Concentration brought a series of tax rules, retirement laws, and financial regulations that had two main effects: the rapid growth of retirement assets, and the growing reliance of private pension plan trustees on external asset managers. The consequence was a significant re-concentration of corporate ownership. Still, in the late 1990s, even the largest holdings of the largest public pension funds and asset managers barely reached 1 per cent of a corporation’s market capitalization (Tirole 2010, 40). The rise of institutional investors notwithstanding, share ownership remained dispersed.

\footnote{The case of fiduciary duty under ERISA shows that new legislation did not always benefit the mutual fund sector. On the basis of diversification rules under the Investment Company Act, ERISA provided that mutual funds did not automatically become fiduciaries when retirement plans invested with them. While advantageous for mutual funds in the first analysis, it turned out that trustees of smaller DB pension plans wanted to share their fiduciary responsibility with their asset managers and therefore avoided mutual funds (Clowes 2000, 192).}
**Phase II (2000 – present): Consolidation within the asset management sector**

Since the dotcom crash, and especially since the 2008 financial crisis, the *Great Re-Concentration* has continued apace. The aggregate numbers in Figure 2 indicate very little change over the last twenty years, bar a modest expansion of foreign ownership, continued growth of mutual funds, and the emergence of ETFs. In reality, these seemingly modest changes have greatly accelerated the re-concentration of the shareholder structure, pushing the holdings of the largest asset managers in individual companies far above five per cent.

The aggregate share of institutional ownership has increased more than Figure 2 would suggest. One reason is that the share of corporate equity held by hedge funds rose from 2 per cent to 10 per cent between 2000 and 2012 (Cao et al. 2017, 88). Including these holdings, which in Figure 2 are hidden in the categories ‘rest of the world’ and ‘households’, as well as the holdings of foreign institutional investors, raises institutional ownership to well above 50 per cent of the total. Data from 13(f) forms, filed with the SEC by investment firms managing more than USD 100 million (including non-financial corporations and foreign investors), reveals an institutional ownership share in S&P 500 companies of 80 per cent, up from 60 per cent in 2000 (Backus, Conlon, and Sinkinson 2019, 15).

Thus, while overall growth of the sector has continued, at the very top this second wave of concentration of the shareholder structure reflects consolidation and concentration trends *within* the asset management sector. A small number of asset managers have attracted retirement and retail capital on an unprecedented scale. Unlike the slow, legislation-driven development growth during phase I, phase-II growth has been explosive and driven – although legislation played a role – mainly by the contingency of the 2008 financial crisis, as well as by technology and financial innovation.

Shining a spotlight on the profitability of the financial sector, the global financial crisis increased retail and institutional investors’ awareness of the cost of investment. Index funds, which track an index rather than try to ‘beat the market’, are significantly cheaper than actively managed funds. The first index fund was
commissioned by the pension fund of Samsonite, and launched by Wells Fargo in 1971 (MacKenzie 2006, 85). Although Paul Samuelson argued already then “that most portfolio decision makers should go out of business” (Samuelson 1974: 18), it was only with the introduction of exchange-traded funds (ETFs) at the turn of the century that index funds became transformative for the asset management sector (Braun 2016a; 2016b). A low-margin business, ETFs increased the premium on scale in the asset management sector. Indeed, ETFs can be understood as the core element of what Haberly et al. have called “digital asset management platforms”: “vertically integrated set[s] of services ranging from index fund and ETF provision, to robo-advising, to third-party analytics and trading support” (Haberly et al. 2018, 3). By this account, financial technologies and services often described as “fin-tech”, rather than being decentralizing forces, have created massive economies of scale in the asset management sector – much like in other parts of the economy driven by information technology (Kenney and Zysman 2016; Thelen and Rahman 2018).

**Figure 4:** Active equity funds versus index equity funds (incl. ETFs), 1993 – 2017

![Active vs Index Equity Funds](source: Investment Company Institute)

Winning the competition for the ETF market has made the “Big Three” – BlackRock, Vanguard, and State Street, who control a collective ETF market share of 80 per cent – the largest asset managers in the world (Fichtner, Heemskerk, and
This consolidation has increased concentration within the asset management sector on a global scale: Within the group of the world’s 500 largest asset managers, the top-20 have increased their share of total assets under management from 38 to 43 per cent between 2008 and 2017. The majority of those top-20 being US asset managers, this increased concentration at the top is reflected in a counter-intuitive – given the very rapid accumulation of financial wealth elsewhere, notably in China and India (Willis Towers Watson 2018, 12) – increase in the US share in global assets under management, up from 41.5 per cent in 2007 to 53 per cent in 2017 (Willis Towers Watson 2018). To put things in perspective: At year-end 2017, the 14 largest US asset managers controlled USD 32.5 trillion – enough to own the entire US stock market. The world’s four largest asset managers – BlackRock, Vanguard, State Street, and Fidelity – controlled USD 16.5 trillion – enough to own the entire stock market of the euro area, twice over (World Bank 2019; Willis Towers Watson 2018). Such comparisons provide more than vivid imagery – they are relevant because large pools of capital have few places to go besides corporate equity, which in the largest developed economies accounts for one fourth of total investable assets (Jordà et al. 2019, 8). Diversification can prevent the building up of large ownership stakes only up to a certain size threshold – once an asset manager is fully diversified, every additional dollar flowing into its equity funds will increase an existing ownership stake. Crucially, both the size their portfolios and the dominance of indexed investments therein mean that (the threat of) exit is unavailable to the Big Three. If they are to influence management, it is through voice, be it through voting or behind-the-scenes engagement (Appel, Gormley, and Keim 2016).

The evidence for shareholder concentration is overwhelming. While 20 per cent – Berle and Means’ threshold for control – remain out of reach for individual asset managers, the Big Three as a group now own more than 20 per cent of the stock of

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15 The fraction of assets under management the largest asset managers invest in equity is typically higher: 53 per cent for BlackRock in 2017, 63 for State Street (source: annual reports; no annual reports available for Vanguard). Much of the rest is invested in bonds, including corporate bonds. For many listed companies, the largest asset managers are therefore both shareholders and creditors.
the average S&P 500 company, with Vanguard and BlackRock owning an average 9 and 7 per cent, respectively (Backus, Conlon, and Sinkinson 2019, 19). While their holdings are somewhat smaller for listed firms outside the S&P 500, BlackRock and Vanguard are nevertheless often the largest minority owners. Table 1 shows the number of listed firms in which the Big Three own 5 per cent or more. BlackRock holds such stakes in more than half of all listed US companies.

Table 1: Big Three positions of 5% or more, all listed US firms

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<th>BlackRock</th>
<th>Vanguard</th>
<th>State Street</th>
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<td>1,175</td>
<td>31</td>
<td>83</td>
<td>1,289</td>
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<td>1,383</td>
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<td>71</td>
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</tr>
<tr>
<td>2016</td>
<td>2,281</td>
<td>1,631</td>
<td>200</td>
<td>4,112</td>
</tr>
<tr>
<td>2017</td>
<td>2,454</td>
<td>1,839</td>
<td>221</td>
<td>4,514</td>
</tr>
</tbody>
</table>

Source: Bebchuk and Hirst (2019, 45).

In sum, the second phase of the Great Re-Concentration has transformed the US from a dispersed-ownership liberal market economy into a concentrated-ownership liberal market economy – a configuration not foreseen in the comparative political economy literature. The Great Re-Concentration also poses a conundrum for the corporate finance literature, which has long held that “one of the best established stylized facts about corporate ownership is that ownership of large listed companies is dispersed [...] in the U.S. and concentrated in most other countries” (Franks, Mayer, and Rossi (2008, 4009), quoted in Holderness (2007, 1377)). The historical novelty of American asset manager capitalism, however, runs even deeper. For unlike Morgan, Carnegie, and Rockefeller in the late 19th century, BlackRock, Vanguard, and State Street are fully diversified and largely disinterested shareholders – with far reaching consequences for corporate governance.
4. Diversified and disinterested: eclipse of ownership?

Having charted the rise of asset managers, this section turns to the consequences of the Great Re-Concentration for the political economy of corporate governance. The key dimensions of the analysis are listed in the first column of Table 2: the concentration of the shareholder structure; the strength of the dominant shareholders; the degree of diversification in their portfolios, and their economic interest in their portfolio companies. Columns two to four depict the evolution of the US investment chain since the 1930s: individual ownership dominated through the 1960s, pension fund ownership loomed large from the 1970s through the 1990s. Since then, the hallmarks of asset manager capitalism have clearly emerged: concentrated ownership; strong minority shareholders (albeit largely deprived of the option to exit); fully diversified portfolios; and low economic interest in portfolio companies. While this configuration shows similarity to the ‘money trust’ and ‘Germany, Inc.’ configurations – depicted in the final column – with respect to concentration and shareholder strength, the fact that asset managers are diversified and disinterested sets asset manager capitalism apart.

Table 2: The hallmarks of asset manager capitalism

<table>
<thead>
<tr>
<th>Shareholder...</th>
<th>Evolution of the US investment chain</th>
<th>Comparison</th>
</tr>
</thead>
<tbody>
<tr>
<td>concentration</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>strength</td>
<td>Weak: exit</td>
<td>Weak: exit</td>
</tr>
<tr>
<td>diversification</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>interest</td>
<td>High</td>
<td>Medium</td>
</tr>
</tbody>
</table>

*Diversified: The promise of universal ownership*

Concentrated ownership by strong owners characterized both the US ‘money trust’ and ‘Germany, Inc.’. Asset manager capitalism is unique, however, in that today’s dominant shareholders, by virtue of their size and investment strategies, hold fully diversified portfolios – they are quintessential “universal owners” (Hawley and Williams 2000; Monks and Minow 1995). As truly universal owners, the largest asset
managers occupy a position not foreseen in the financial paradigm underpinning the shareholder value model: modern portfolio theory.

Modern portfolio theory fundamentally changed the way investors thought about risk, and therefore how they constructed portfolios and traded securities. The theory, as developed by Harry Markowitz and William Sharpe, among others, stated that the expected return on any asset was a linear function of its beta, that is, “the extent of its sensitivity to the return on an optimal portfolio” (MacKenzie 2006, 54).\textsuperscript{16} Crucially, the theory assumes that the beta is exogenous to investing. The search for alpha, or above-market return – the bread and butter of the active fund manager – does not affect beta (Hawley and Lukomnik 2018, 4). Crucially, this assumption that the negative externalities from the behavior of portfolio firm A on non-portfolio firms B and C do not concern the fund manager rests on the further assumption that the fund manager \emph{is not invested in B and C.}

Under asset manager capitalism, this assumption no longer holds. As a consequence of both their size and their dominant investment strategy, the largest asset managers today are invested in the full universe of listed companies. The Big Three hold 84 per cent of their equity investments via index funds, the majority of which track broad indices such as the S&P 500 (Fichtner, Heemskerk, and Garcia-Bernardo 2017, 304). While actively managed funds dominate at other large asset managers, their sheer size means that their investments, too, are highly – if not fully – diversified.\textsuperscript{17} The consequence is that negative externalities from any and all of these companies impact the asset manager’s portfolio, effectively collapsing the alpha/beta distinction (Hawley and Lukomnik 2018). This, then, is the \textit{promise of asset manager capitalism:} Today’s dominant shareholders are truly universal owners who should, in principle,

\textsuperscript{16} The interconnections between modern financial economics and law and economics remain underexplored. Michael Jensen’s work and career was unique in that it spanned both schools: His PhD thesis presented empirical evidence on the underperformance, after fees, of investment managers, which fed directly into Eugene Fama’s (Jensen’s PhD supervisor) formulation of the efficient markets hypothesis (MacKenzie 2006, 78-79). The idea that securities are priced efficiently by the stock market is firmly built into the theoretical foundation of the law-and-economics approach to corporate governance.

\textsuperscript{17} In the US, the average active mutual fund holds 116 stocks (Heath et al. 2019, 2). In many cases, these funds are, to a greater or lesser extent, “closet indexers” – nominally active funds whose portfolios closely resemble the benchmark index (Coates 2018; Cremers et al. 2016).
take the long view and consider negative externalities arising from activities of listed companies. And since they are strong owners, they would, in theory, have the power to prompt portfolio companies to curb the externality-generating activities. In practice, however, asset manager capitalism has rendered the term “ownership” largely meaningless.

Disinterested: The separation of legal and economic ownership

When it comes to the social function of asset managers in general, and the Big Three in particular, the elephant in the room is the concept of ownership. Indeed, the second unique hallmark of asset manager capitalism is the separation of legal ownership and economic interest.

Berle and Means’ (1932, 119) defined ownership as “having interests in an enterprise” and control as “having power over it”. The separation of the two, they noted, reduced “the position of the owner ... to that of having a set of legal and factual interests in the enterprise”. Subsequently principal-agent theory sought to re-unite ownership and control by strengthening shareholder protection and by aligning the incentives of managers with those of owners. The causal influence of the theory notwithstanding, the shareholder value regime successfully merged the class position and interests of the two groups by giving managers “interests in the enterprise” via stock options and other forms of incentive pay.

Since then, the Great Re-Concentration has further increased the strength of the dominant shareholders, thus seemingly perfecting the re-unification of ownership and control. However, the rise of asset management companies has brought about a different separation – the separation of the “legal interest” and the “factual interest” in the enterprise. Neither Berle and Means nor the principal-agent theorists could imagine a shareholder that holds the legal title (shares and the attached voting rights) but not the economic interest.18 A pure asset manager, of course, is precisely

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18 In their Separation of ownership and control, Fama and Jensen (1983, 301) studied “the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions,” implying that the wealth effect was born by the shareholders.
such an entity whose interest as a business is not the return from its investments but the fee income it collects from its clients. It is these clients who, as beneficial owners, bear the factual economic interest. In the common case of the client being a pension fund acting as a fiduciary, the beneficial owner is even further removed. Put differently, the actor that is supposed to be the principal in the shareholder-manager relationship, is itself the merely the agent of its own chain of principals, namely its clients and beneficial owners (Bebchuk, Cohen, and Hirst 2017). In short, whereas Jensen (1989) predicted the “eclipse of the public corporation”, what has actually been eclipsed is principal-agent theory’s foundational concept of ownership.\footnote{While not essential for the present argument, it is important to note that, in another manifestation of the separation of legal and economic interest, hedge funds in particular use hedging strategies and other means to separate the legal title from the risk of the underlying asset (Ringe 2016).}

**The political economy of asset manager capitalism: Four conflicts of interest**

Losing both Berle and Means and Jensen and Meckling as guides to the political economy of corporate governance is certainly disorienting. Fortunately, the question of what could replace them is easily answered. Asset managers may not be the same as capitalists, but they are businesses. In order to understand their interests, power, and limitations, political economists need to study their business models (Arjaliès et al. 2017; Bebchuk, Cohen, and Hirst 2017; Kay 2012). Drawing on burgeoning literatures in law and in economics, the remainder of this section discusses four conflicts of interest that afflict large mutual and, especially, index fund providers. The first two conflicts of interest derive directly from these asset managers’ position in the investment chain, where they operate as pure intermediaries. Conflicts three and four arise at the sectoral and at the macroeconomic level, respectively.

First, asset managers lack incentives to invest in active engagement with portfolio companies, which is a cost for them. In addition, index funds, which merely track the market, have little to gain from increasing returns through engagement. At worst, performance gains achieved through index fund engagement with individual companies are reaped by active funds invested in those companies (Lund 2017).
Those advocating a benign view of this conflict invariably invoke the market mechanism and a principal-agent argument: asset managers compete for investors, and investors demand good stewardship from their agents (Fisch, Hamdani, and Solomon 2019; Jahnke 2019). If asset managers fail to act in the interest of their principals – i.e., use exit and voice as if they had an economic interest in their portfolio companies, their investors will exit the fund and take their business to a competitor. Moreover, there may be cost-effective ways for index funds to impress their preferences on portfolio companies, notably through litigation (Platt forthc.).

On balance, however, the evidence seems to support the skeptics. One simply metric is the headcount of stewardship teams. Even the largest asset managers have only very recently formed such teams, which in the medium double digits remain far too small to monitor thousands of portfolio companies (Marriage 2017). Even if competition among asset managers creates incentives to engage, these numbers indicate that such engagement serves a signaling purposes in that competition rather than a substantive economic function vis-à-vis portfolio companies. In the same vein, out of almost 4000 shareholder proposals submitted to companies in the Russell 3000 index between 2008 and 2017, not a single one came from one of the big-three asset managers (Bebchuk, Cohen, and Hirst 2017, 48). A comprehensive analysis of voting and other data has shown that index funds are less likely than other funds to engage with firms (Heath et al. 2019). Whether this justifies Heath et al.’s conclusion that index fund passivity shifts power from shareholders to managers, however, is a different question. Equally plausible is the argument that power shifts to other types of investors. The initiative for engagements with individual companies now often comes from activist hedge funds, whose first phone calls routinely go to the Big Three (Appel, Gormley, and Keim 2016). Regulators and policymakers have identified weak engagement by the strongest shareholders as a potential problem for corporate governance. The EU’s new Shareholder Rights Directive, for instance is partly a shareholder obligations directive. The rapid worldwide spread of private-sector led “Stewardship Codes” indicates that asset managers are eager to pre-empt legislative action on the issue (Hill 2017). A policy proposal that would rattle the
sector is to prohibit voting by index funds altogether in order to preserve the influence of more active, focused, and informed investors (Lund 2017).

Besides the direct costs of active engagement, asset managers face a second conflict of interest related to their respective business models. The asset management arms of large banks, for instance, tilt their equity investments towards their corporate clients of their parent banks, indicating a less-than-arms-length relationship with portfolio companies (Ferreira, Matos, and Pires 2018). For pure asset managers, competition for companies’ retirement plan assets and, increasingly, for corporate savings provides a clear incentive not to alienate corporate management (Bebchuk, Cohen, and Hirst 2017). Proxy voting data show that the largest asset managers overwhelmingly vote with management (Bubb and Catan 2019), including on the most controversial of agenda item, CEO pay (As You Sow 2019). Heath et al. (2019) confirm this finding for index funds and a broader set of controversial issues. Similar findings exist for negative externalities that according to the universal owner hypothesis the Big Three should curb, especially those related to climate change (Briere, Pouget, and Ureche 2019).

The third conflict of interest is a direct consequence of the concentration of corporate ownership among a small number of very large asset managers, which gives rise to the problem of “common ownership” (Azar, Schmalz, and Tecu 2018; Backus, Conlon, and Sinkinson 2019; Elhauge 2016). If the main competitors within a given sector have the same investors among their largest shareholders, the theory goes, these firms are incentivized to engage in anti-competitive behavior. The agenda-setting study on the issue has found evidence of a causal link between common ownership and consumer prices in the airline industry. The authors highlight four channels through which common owners can achieve such an outcome: “voice, incentives, and vote – as well as doing nothing, that is, simply not pushing for more aggressive competition” (Azar, Schmalz, and Tecu 2018, 1557). The theory that common ownership has anti-competitive effects has rapidly gained traction among national (Federal Trade Commission 2018) and international (OECD 2017) policymakers, and has been fiercely opposed by the asset management industry (Fox 2019). One policy proposal suggests enforcing of §7 of the 1914 Clayton Act, which
outlawed competition-reducing corporate mergers that had become the prevalent strategy to establish oligopolies in reaction to the 1890 Sherman Act. The authors suggest that investors should be prohibited from owning more than one percent in more than a single firm in oligopolistic industries, such as airlines or banking (Posner, Scott Morton, and Weyl 2017).

**Figure 5:** Distribution of equity and mutual fund holdings by wealth group, 1989 – 2018, USD trillion

![Distribution of equity and mutual fund holdings by wealth group](image)

*Source: Federal Reserve, US distributional financial accounts.*

While the first three conflicts of interest are being studied by legal scholars and financial economists, the fourth conflict, which arises from the highly unequal distribution of share ownership in the US, has not been widely discussed. The Fed’s recently published distributional financial accounts for the first time shed light on this issue (see, however, Wolff 2017). As illustrated in Figure 5, the top 1 per cent of the wealth distribution own 50 per cent of the corporate equity and mutual fund shares, while the top 10 per cent own 86 per cent. While the distribution is less unequal at the top for retirement assets – which are roughly of the same magnitude and are not included in Figure 5 – the issue remains. The massive concentration of share ownership at the top of the wealth distribution counteracts the benign logic of universal ownership – a negative externality for the poor can be a positive externality.
for the rich. A case in point is worker pay at the lower end of the wage scale. Low wages for the bottom 50 per cent of the wealth distribution certainly have negative externalities for other parts of the economy. It is far from certain however, whether those costs outweigh the benefits the top 50 per cent draw in the form of higher returns on their equity holdings.

**Conclusion**

Comparative political economy has conceptualized the US as a liberal market economy defined, in the sphere of corporate finance, by dispersed ownership, weak owners, and impatient capital (Aguilera and Jackson 2003; Gourevitch and Shinn 2005; Hall and Soskice 2001; Roe 1994). While in the early 2000s traditional ownership networks had already largely dissolved in coordinated market economies, which increasingly resembled the US system on that dimension, the latter was perceived as firmly anchored and durable. In recent decades, however, the Great Re-Concentration and the growth of asset managers have transformed the US into a *concentrated*-ownership liberal market economy with *strong* minority shareholders and a large amount of indexed, and thus patient, capital. These changes have largely been driven by developments within the investment chain rather than by the interaction between financial and non-financial institutions such as labor market, welfare, or training regimes. The spread of asset manager capitalism to other places, including prototypical coordinated market economies such as Germany, seems to support this interpretation.

At first blush, the new shareholder structure resembles that at the end of the 19th century: the equity of an increasingly concentrated corporate sector is increasingly concentrated in the hands of only a handful of financial firms. Two crucial features, however, distinguish the new asset manager capitalism from the Gilded Age money trust, as well as from corporatist Germany, Inc. prior to the 1990s. First, unlike their robber baron predecessors, today’s dominant owners are fully *diversified* across the entire stock market. In the case of the largest asset managers, which overwhelmingly are invested in corporate equity via index-tracking funds, this increasingly holds for the global stock market. Second, asset managers are *economically disinterested*
intermediaries, managing capital on behalf of their clients. Unlike the robber barons in the US (and to a significantly greater extent than Deutsche Bank and Allianz in Germany), their business model is to compete for capital from investors and to extract managements fees from them. The returns from their shareholdings are relevant in that competition, but the largest asset managers in particular only own the legal title, not the economic interest in the corporations whose stock they hold.

At closer inspection, therefore, asset manager capitalism is without historical precedent. Its four hallmarks are a concentrated ownership structure with strong minority shareholders that are fully diversified and economically disinterested. Whereas the first two features could potentially by reconciled within the existing ownership versus control dichotomy, diversification and disinterestedness are fundamentally at odds with both Berle and Means and Jensen and Meckling. If political economists are to adopt a more differentiated model of the role of shareholders in corporate governance, they will need to look elsewhere. This paper outlined a political economy of asset manager capitalism organized around the promise of universal ownership on the one hand, and the peril of conflicts of interest on the other. The combination of strong yet fully diversified shareholders holds the promise of truly universal ownership: The internalization of negative externalities, especially of the environmental kind, by the newly dominant actors within the investment chain. In practice, however, at least four conflicts of interest prevent asset manager capitalism from living up to that promise: a business model in which engagement with portfolio companies appears primarily as a cost; competition among asset managers for retirement plan assets and corporate savings; the anti-competitive implications of common ownership; and the extremely unequal distribution of equity holdings across the population.
References


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