Stewardship in the age of the new permanent owners

The influence of the Big Three on the environmental social and governance structure of their investee companies

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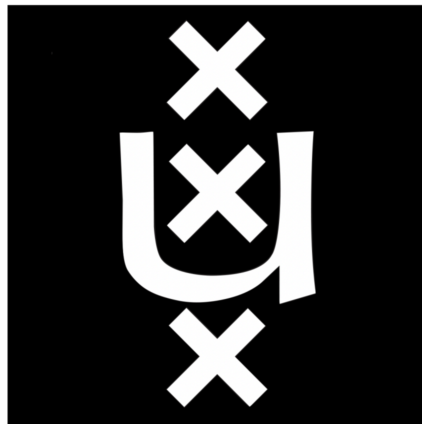

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Abstract

The rise of passive investing has led to the concentration of ownership in the hands of 'The Big Three', major asset managers that dominate the passive asset industry: BlackRock, Vanguard and State Street. This study analyses how the Big Three approach investment stewardship and what incentivises them to influence their investee companies to integrate the principles of environment, social and governance (ESG) responsibility. Based on expert interviews three central trends can be identified that contribute to an increase of the stewardship activities of the Big Three: increased investor appetite, growing regulation and the materialisation of ESG principles. Both private and public investors increasingly demand a growing ESG related stewardship role of the Big Three. Their inability to sell shares puts the Big Three in a 'partner position' with their investee companies, which contributes to the adoptation of an enhanced stewardship role. The stewardship strategy of the Big Three consists of three elements: monitoring, voting and engagement. Their engagement strategy can be characterised as event-driven with a focus on severe ESG underperformers. The Big Three are inclined to approach their investee companies based on a fundamentally positive thrust and adhere to a long-term perspective on the improvement of their ESG performance. However, the Big Three remain hesitant, potentially due to a fear for a regulatory backlash, to fully utilise their influential ownership position to push their investee companies to integrate ESG principles.

Keywords: The Big Three, ESG, stewardship, active ownership, engagement, ownership concentration

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1.Introduction

In the wake of the 2008 economic crisis, an immense global capital migration has occurred from active to passive asset strategies (Bogle, 2016; Fichtner, Heemskerk & Garcia-bernardo, 2017; Bioy, Bryan, Choy, Garcia-Zarate, & Johnson, 2017). Individual investors and large institutions historically used to invest predominantly in actively managed funds. Fund managers generated alpha by handpicking stocks with the aim of outperforming the market. Over the last decade, investors have started to shift to passive portfolio management, a strategy that replicates the performance of a particular benchmark market index. At present, passive asset management has grown to become a major force in the investing world. This study analyses how the rise of passive investing has altered the governance landscape, in particular the fund manager engagement with listed companies to push for corporate governance practices that integrate the principles of environmental, social and governance (ESG) responsibility. The focus of this study will be on the three major institutional investors that dominate the passive investing industry: Blackrock, Vanugard and State Street. To underline the magnitude of these firms, they will be referred to hereafter as 'the Big Three.' The study centers around the question: How do the Big Three approach investment stewardship and to what degree are there incentives for them to influence investee companies to integrate the principles of environmental, social and governance responsibility?

The shift to passive asset management is a global phenomenon driven by investors' growing cost-consciousness, their focus on diversification and active fund managers' difficulties in consistently outperforming their respective benchmarks (Fisch, Hamdani & Davidoff Solomon, 2017; Fichtner et al., 2017). Since the beginning of the century, the index mutual fund industry has grown almost five-fold, from $554 billion in 2004 to $2.6 trillion in 2016 (Reid, Collins, Holden & Steenstra, 2017:94). As a result of favourable market conditions and the rise of exchange-traded funds (ETF), mutual fund asset flows peaked at nearly $2 trillion worldwide in 2017 (Bioy et al. 2017). At present, passive index funds continue to enjoy strong inflows at the expense of their active counterparts (Johnson et al. 2018). In 2018, they pulled an impressive $301 billion from active funds (McDevitt & Schramm, 2018). Over the past decade, over 80% of all assets flowing into investment funds have gone to the Big Three (Bebchuk & Hirst, 2019). The index giants Vanguard and Blackrock/Ishares got the lion's share of these inflows while State Street suffered relative outflows (Johnson et al., 2018).

In contrast to the relatively dispersed actively managed funds industry, the passively managed fund industry is extremely concentrated (Fichtner et al., 2017). The exponential rise of passive investing has led to a re-concentration of corporate ownership in the hands of the Big Three (Idem:299). This concentration of corporate ownership is accompanied by a concentration of corporate power (Fichtner et al., 2017). As a result of their passive strategy, the Big Three obtained rather permanent and illiquid ownership positions (Idem: 298). The three index giants own an increasingly large share of publicly listed companies and corresponding corporate influence is expected to continue to accrue.

The growth of passive investing has coincided with a rising emphasis on investor stewardship. This paradigm change and the growing recognition of the power of the Big Three contributes to the expectation that large institutional investors will utilise their influence to ameliorate the governance of their portfolio companies (Bebchuk, Cohen & Hirst, 2017). Investment stewardship refers to the Big Three's engagement with public companies to endorse corporate governance practices that push for long-term value creation (Novick, B., Edkins, M., Clark, T., & Rosemblum, 2018). Over the last decade, the regulatory pressure on asset managers to provide conscious corporate oversight has accumulated (Bellinga & Segrestin 2018; Cheffins 2010; Davis, Lukomnik & Pitt-Watson 2009; Ivanova 2017). Public regulators from various viewpoints are promoting

institutional investor stewardship (European Commission 2010, European Commission 2011; Financial Reporting Council 2012; European Parliament 2017). As stewards, large institutional investors have the capability to engage with the management of their investee companies to ethically discipline management (Bellinga & Segrestin 2018:3). As dominant long-term shareholders and subsequent ‘permanent owners’ the Big Three have the instruments to substantially impact the governance structure and performance of publicly listed companies, thereby affecting the overall global economy. Through an engaged stewardship approach, they are able to steer corporates to integrate ESG principles. As the influence of the Big Three continues to rise around the world, the question of how they will carry out their stewardship roles is becoming all the more relevant.

Despite the rising acknowledgement of the potential power of the Big Three, the extent to which there are incentives for them to conduct stewardship-related engagement is contested. A paradoxical academic debate focusses on the extent to which the Big Three will be incentivised to actively exert their investment stewardship responsibilities. From one perspective, it can be argued that allocating resources to oversee investee companies is less of a priority for a passive fund manager as it is for an active fund manager. The Big Three compete on remuneration and their primary goal is to imitate the performance of a market index. Effective stewardship that increases the value of shares, will therefore not enhance their position relative to competing passive asset firms. This makes it tempting to assume that the Big Three are passive owners (Bioy et al., 2017).

On the contrary, unlike active managers, their passive strategy requires them to hold on to assets dictated by the underlying indexes and prudent portfolio management. In that regard, they are the ultimate long- term investors, which provides them with a strong position to encourage positive change through voting and engagement (Fichtner et al. 2017). Their inability to sell stocks might create an incentive for the Big Three to oversee managers to ameliorate the company’s performance. As permanent owners, the Big Three could be naturally incentivised to obtain a long-term perspective on corporate growth which could translate is an increased focus on the integration of ESG objectives.

In particular, this research seeks to make three contributions. First, an analytical framework is presented to understand the incentives of the Big Three to engage in ESG-related investor stewardship. Deriving from emerging literature, an analytical framework that disembogued into a testable hypothesis was constructed that formed a conceptual lens through which the interview data was anatomized.

Second, in this study, the incentives that shape the stewardship strategy of the Big are assessed from a Political Science perspective. Research on stewardship-related engagement is predominantly done from a finance perspective and primarily focusses on the quantification of voting-behaviour. In contrast to quantifying their ESG related voting behaviour, the nature of the stewardship strategy of the Big Three was evaluated on the basis of expert interviews.

Third, the empirical evidence reinforces the stewardship incentive problems that the analytical framework identifies. However, the empirical reality proves to be more complex and the Big Three are increasingly pushed into an ‘partner’ position with respect to their investee companies, which puts them in the position of a steward to promote long-term corporate governance practices. Nevertheless, it can be stated that the Big Three are far from fully utilising their ownership position to influence their investee companies to integrate ESG principles.

2. Theoretical Framework

2.1. Passive asset management vs. Active asset management.

Two leading investment strategies are utilised to achieve positive returns on investment: active asset management and passive asset management. Investors and asset managers who implement an active strategy aim to 'outperform the market' by building on various investing strategies. Active managers use their knowledge and skills to analyse the market and subsequently either buy assets which they believe are currently undervalued or future earning potential has been underestimated. They sell assets that have become overvalued and adjust their portfolios to minimise potential losses. The central objective of active asset management is to outperform a benchmark, usually indices like the AEX or S&P 500. The returns generated by an actively managed fund depends on the fees the fund charges. The managers ability to accurately predict the future value of assets will determine the attractiveness of the funds. In short: outperform the market, get more funds and make more fees.

In contrast, the objective of a passive asset strategy is to imitate the asset holdings of a specific benchmark index. Passive asset managers do not use investing strategies to predict the future value of their assets. Instead, they allocate a portfolio to replicate a market index. This results in a well-diversified portfolio with limited concentration risk: their portfolio equals a representative exemplification of the securities in this benchmark. Simultaneously, this investment strategy implies a lack of flexibility as fund managers will not be able to sell shares as a defensive measure if they conceive them as overvalued. As a result, the return on investment will mirror the performance of the market index. Index funds will deliver returns in line with the overall market or sector performance minus the operating expenses.

2.2 The rise of the Big Three

To adequately address the nexus between ownership and control, it is important to evaluate the historical rise and fall of the company as a social institution. Over de course of the twentieth century there have been three central periods that can be characterised as *finance capitalism (1900-1931), managerial capitalism (1932-1980)* and *new finance capitalism (1981-2008)* (Davis, 2009:62).

At the turn of the twentieth century, *finance capitalism,* a new kind of economic system, arose with the establishment of arguably the first modern industrial enterprises in the U.S. (Ibid:66,68). As a result of the emergence of large-scale production, and the concentration of industry due to the formation of trusts and cartels, the modern public corporation became dominant and replaced the traditional small, single-unit American business firms (Davis 2008:11, Davis 2009:68). The management of these corporations faced their origins: the bankers responsible for the creation of the new industrial system continued to serve on the boards of the corporations. The concentration of the financial industry brought about an oligopolistic predicament in which a small number of bankers essentially controlled the whole financial industry. Hilferding (1910) named this system in which corporations were interconnected through ownership ties *'finance capitalism'.* This new governance structure of the industry immediately received substantial political backlash, as many feared the concentration of economic and political power in the hands of a small banking elite (Davis 2008:12; Davis 2009:68). In response, the public relations officers of the giant companies aimed to establish the corporate imaginary of the 'soulful' company, to reassure that their largeness would not undermine American values or pose a threat to the democratic system (Marchand, 1998). Their campaigns to portray their companies as agents of public service were evidently successful (ibid).

The *finance capitalist* area in the U.S. was not long-lasting. Relying on retained earnings proved more convenient for corporations than relying on bank loans and bankers did not possess adequate operational knowledge to bring to the board table (Davis 2008:12). The stock market boom of the 1920's roped in millions of new investors while simultaneously the control of assets by the largest corporations became more concentrated (Davis 2009:71). The extensive public participation in the equity market sparked widely dispersed share ownership. Not political conditions but private ordering led to the appearance of dispersed ownership as many bankers aimed to maximise value by selling control (Coffee 2001).

In 1932, Berle and Means underlined the separation of ownership from control in large U.S. corporations in their classical work *'The Modern Corporation and Private Property'*. They concluded that capital in the U.S. had become highly concentrated and vested in a relatively small number of companies with immense power (Mizruchi, 2004). In contrast to the centripetal movement of corporate power, ownership became more centrifugal as stocks became increasingly dispersed among a large number of impuissant shareholders (Davis 2009:9). This dispersal resulted in a usurpation of power in the hands of a small number of managerial professionals in the control of most of the economic assets of the U.S. economy. This system, denoted as *managerialism*, can be characterised as *"a corporate system analogous to the medieval feudal system"* (Davis 2009:10). Berle and Means presumed that the interests of the managers, the new upper echelon, would not always be perpetually aligned with the interests of the shareholders (Mizruchi, 2004). The separation of ownership and control not only worried them because it would undermine managers' accountability of investors, they also stressed that it would erode managers' accountability to the broader society (Ibid).

In the two decades following the work of Berle and Means a consensus emerged among social theories regarding the nature of the new industrial order characterised by the principles of mass production (Davis, 2009:73; Drucker 1949). The managerialist enterprise was perceived as "*the representative, the decisive, industrial unit is the large, mass-production plant, managed by professionals without ownership-stake, employing thousands of people"* (Drucker, 1949:22). The shareholders of these new corporations discarded control and became less relevant to the managers of the firm, whom perceived themselves not only as responsible to shareholders, but also to the general public and their employees (Davis 2009:70). The corporate-industrial companies provided their employees with long-term employment contracts, sufficient retirement pensions and health-insurance (Davis 2009:90). By the 1950's the corporations had begun to live up to their own corporate soul branding, increasingly enacting social and environmental policies (Ibid).

The rise of the post-industrialist society posed severe challenges to the giant mass-production firms which fomented the end of the area of managerialism. The election of Ronald Reagan in 1981, whom sought economic revitalisation, became the catalyst of the crumbling of the managerialist area (Davis 2009:81). From Reagan's perspective, managerialism was unacceptable, as the primary objective of a business should be maximising profit, thereby optimising shareholder value. From this viewpoint, that quickly gained a broader societal and academic backing, the current system led to an inefficient allocation of resources (Ibid). The Reagan administration initiated several regulatory adjustments which led to a merger and takeover wave. In a period of only a few years, one third of the U.S. companies ceased to exist, which had substantial consequences for the structure of the national economy. Companies became more industrially focussed, and the perception of shareholder value maximisation as the sole purpose of corporations became the dominant consensus among management (Davis 2009:84,85). Furthermore, executive compensation completely rotated as company executives were increasingly rewarded with stocks and options in the company, which made their wealth dependent on stock price changes (Idem: 86,87). The new dominant view in the finance industry

towards shareholder value orientation freed the company of all sorts of social responsibilities to the general public or society.

Useem (1996) coins the term *investor capitalism* to refer to a new economic system in which institutional investors have become increasingly influential. He concludes that institutional share-owners have become international players that are better equipped to effectively exercise influence over the management of their investee companies. Large institutional investors are gaining power and are slowly becoming the agents of corporate control.

The dominant institutional investors Useem referred to were large public and private pension funds, non-profit organisations and investment and insurance companies. However, in the decades thereafter, the private profit-oriented institutional investor became the dominating force in the U.S. economy. During the 1980s and the 1990s, U.S. households substantially increased their participation on the equity market (Davis 2008:15). Mutual funds became the primary beneficiaries of flood of new investment (Ibid). Davis (2009) introduces the term *new-finance capitalism* which refers to the re-concentration of ownership in the hands of a few large actively managed mutual funds that own substantial shares in large publicly listed corporations. While the re-concentration has provided the large mutual funds with a position of corporate power, they choose to remain passive. The mutual funds oscillated frequently between investee companies which undermined the effectiveness of investment stewardship. Davis concludes that *"the new system of institutional ownership entails a surprising combination of concentration and liquidity"* (Davis, 2008:20). Rather than seeking control, the active mutual fund industry preferred to maintain their liquidity.

In the wake of the 2008 financial recession the investment sphere has experienced a reorientation from active to passive investment strategies. Active index funds have become under scrutiny for charging high fees to investors for moderate performance (Newlands & Marriage, 2016) and it became clear that it is not easy to select winning shares consistently over time (Cremers, Ferreira, Matos & Starks, 2016; Da & Shive, 2018). A wide range of literature demonstrates that in aggregate, active funds do in general not perform better and do not demonstrate higher return on investment than passive funds (Sushko & Turner, 2018). Passively managed funds increased from 1 percent of total fund assets in 1984 to 12.6 percent in 2006, and the move from active to passive funds has continued since then (French 2008). At present, the passive funds remain to grow at their active counterparts' expense. The gravitation from active to passive vehicles can be characterised as the most fundamental mass-money migration of the last decade. The main driver behind this capital migration is the below-average expense rate of passive investing strategies. Their clients do not have to pay for the labour of value- and growth managers and index funds are naturally tax-efficient: the act by active funds of continuously buying and selling assets tends to generate taxable profits, lowering post-tax returns. The first mover advantage and economies of scale have contributed to the re-concentration of ownership in the hands of the Big Three, which continues to provides them with a position of dominance in the index fund industry (Hirst & Bebchuk, 2018; Fichtner et al., 2017).

Fichtner et al. (2017) performed a network analysis on the current structure of corporate ownership and demonstrate an emerging concentration of corporate ownership in the hands of 'The Big Three': the large passive asset funds of Blackrock, Vanguard and State Street. The Big Three got the lion's share of the growth of passive investing and especially Blackrock and Vanguard continue to dominate new fund inflows (McDevitt & Schramm, 2019). Blackrock, State Street and Vanguard are American passive asset firms, which is not surprising given that ETF's are passive asset vehicles developed in the U.S. Their primary passive strategy makes them unable to sell shares which translates in their position as permanent and universal owners of hundreds of publicly listed companies (Fichtner et al. 2017). The magnitude of the Big

Three can barely be overstated: the asset under management of Blackrock alone exceeds the size of Germany's GDP. These large investment funds have assets under management of $6.3 trillion (Blackrock), $4.4 trillion (Vanguard), and $2.6 trillion (State street) (Bioy et al. 2017). The Big Three collectively manage $5 trillion of corporate equities in the U.S. but are expanding rapidly to other continents (Bebchuk & Hirst, 2019). Collectively, they vote about 20% of the shares in all S&P 500 companies and individually hold ownership positions of 5% or more in a vast number of investee companies (Ibid). Corporate ownership determines corporate control (Fichtner et al., 2017). The stewardship decisions of the Big Three can therefore be expected to have a profound impact on publicly listed companies and the economy overall. The Big Three are investing on behalf of both institutional and retail clients. These two client bases represent approximately half of the entire assets entrusted to the management of the Big Three.

2.3 Concentration of potential power in the hands of the Big Three

When discussing the power of the Big Three, we focus on their potential control over corporate governance and subsequently their ability to influence corporate decision-making processes (Ibid). There are three central ways through which the Big Three are able to influence investee companies to integrate the principles of environmental, social and environmental responsibilities.

- Proxy voting

Asset managers can engage in the decision-making process of their investee companies through the voting rights that are connected to their assets. Even though the Big Three are all conglomerates that consist of individual index funds, the voting power is harnessed by their parent asset firms. The Big Three dominate an accruing component of the shareholder base of listed corporations as they each manage in many cases 5% or more of the shares, collectively casting an average of 20% of the votes at S&P 500 companies (Bebchuk & Hirst 2019:2). However, only assessing the block holdings of the Big Three underestimates their voting power and the extent to which their voting impacts election outcomes. While their individual stakes usually not exceed the 7-9% range, their actual voting power lays substantially higher as many other, especially retail investors, do not vote their shares (Ibid). Fichtner et al. (2017) examined the historical voting behaviour of the Big Three and concluded that 90% of the votes sided with management. Moreover, they found that a large majority of the proposals on which the Big Three vote against are related to ESG. However, the voting strategy of the Big Three can be expected to change as they become increasingly influential shareholders.

- Private engagements

Engagement is a crucial element of the investment stewardship policies of the Big Three as engagement allows managers to maximise their full scale (Bioy et al. 2017:2). Because of the size of passive investors' holdings, corporate insiders are responsive to their requests for engagement (Fisch et al. 2018:24). Engagements often have the effect of persuading issuers to change their policies voluntarily. In the recent decade, mutual fund managers have increasingly made direct contact with the officers and directors of their portfolio companies (Idem:395).

- Structural power

In their position of permanent capital provider and significant shareholder of thousands of companies worldwide, the Big Three take up a core position within the global financial market. This position of prominence makes the global financial system dependent on their well-functioning which creates a position of structural power (Fichtner et al. 2017). The central position of the Big Three within the interconnected financial market allows them to exert 'disciplinary power' over company executives. This could make company executives prone to internalise their objectives (Ibid). In addition, the Big Three is situated in their position as advisors to governments and central banks to indirectly exert influence on policy and regulations. The Big Three increasingly engage in policy discussions with respect to a variety of issues beyond corporate governance (Eckstein 2018). They bring in their knowledge on specific issues which enables them to bring the interests of their investee companies to public decision makers (Fisch et al 2018:28).

2.4 The capacity to change debate

They cannot act because they are so big, but they have to act because they are so big.

Will passive ownership of listed companies, through shareholder engagement and the use of voting rights, turn into an important tool for achieving environmental, social and governance (ESG) stewardship targets? To answer this question, we have to assess the willingness of the Big Three to conduct stewardship-related engagement. The resource allocation of the Big Three to conduct stewardship-related engagement is contested. A paradoxical debate will lie at the heart of the theoretical framework of this study that centers around the question: To what extent are there incentives for passive asset managers to actively influence the outcomes of corporate decision-making? The stewardship decisions of the Big Three can be analysed from an agency-costs theory of index fund incentives. In the literature two opposing perspectives stand to explain the nexus between passive investors and the exertion of active ownership. We refer to the first perspective as the 'passive ownership' hypothesis and to the second perspective as the 'active ownership' hypothesis.

2.4.1 The passive ownership hypothesis

This perspective states that passive investors are passive owners as there are little incentives for passive index funds to actively exert power to influence investee companies' corporate governance (Fichtner et al., 2017; Appel, Gormley & Keim, 2016; Bebchuk et al., 2017). From this perspective it can be argued that the Big Three lack both the resources and the motives to oversee their large and diverse portfolios. The rationale behind this perspective is fourfold: a cost-efficient business model, a collection action problem, their inability to exit and a potential regulatory backlash.

2.4.1.1. Cost-efficient business model

The exponential rise of passive index funds is largely the result of their low fees and expenses. Due to economies of scale, the magnitude of the Big Three allows them to charge lower fees, thereby becoming more attractive for investors (Reid et al. 2017:91). Stewardship is costly while the Big Three compete largely on fees. Increasing spending on stewardship would lead to increased fees which in turn would create incentives for investors to switch to rival funds. The pressure to preserve a cost-efficient business model seems to lead to the underinvestment of stewardship activities. Vanguard employs 15 staff members that vote at its 13,000 investee companies, State Street's 24 staff oversees 14,000 investee companies and Black Rock employs only 36 employees for stewardship at its 9,000 portfolio companies (Krouse et al. 2016). This underutilisation undermines the capabilities of the Big Three to undertake (ESG-related) stewardship activities.

2.4.1.2. Collective action problem

A substantial branch of literature (Gilson & Gordon, 2013; Lund, 2017; Bebchuk & Hirst, 2018) argues that the growth of passive index funds is due to the undervaluation of the financial returns to stewardship. Active ownership is not a pathway for increasing performance relative to competing funds. Improving the value of investee companies would not amplify performance relative to the index or relative to the performance of competing funds. A collective action problem occurs as rival funds tracking the same index would benefit from the generated value without additional expenditure on stewardship. The incentive to enhance relative performance would be alleviated by the ubiety of the company in the portfolios of competing passive index

funds (Bebchuk & Hirst, 2018). Therefore, spending resources to monitor investee companies is less of an objective of passive asset managers as it is for active asset managers.

2.4.1.3. Inability to exit

Hirschman (1970) made the classic distinction between alternative ways of reacting to dissatisfaction with corporations' performance: *exit, voice* and *loyalty.* His model sheds light on the different responses of shareholders to corporate governance. In this sense, exit, voice, and loyalty can be interpreted as different forms of shareholder activism. Shareholders can *exit,* withdraw from the relationship by selling their shares, which is considered the 'easy' option as it is the path of the least resistance (Bootsma 2013:113). Shareholders can also choose to *voice,* which entails an interaction process in which shareholders share their dissatisfaction with the management of their investee company in order to ameliorate their relationship. Finally, shareholders have the option of *loyalty*, which requires a relationship between management and shareholders built on trust. Loyalty entails that the shareholders do not undertake any action. They do not sell their shares (*exit*) nor enter a dialogue with the management of their investee company (*voice*) (Ibid:118). The notion of loyalty is built on *"the expectation that, over a period of time, the right turns will more than balance the wrong ones"* (Hirschmann, 1970:78).

However, the key investment vehicle of Big Three, index funds, requires the replication of specific benchmarks, which makes them unable to shell shares. They aim to minimise deviations from the underlying index weight and lack the traditional leverage used by active investors to put pressure on corporate government: the ability to exit or accumulate positions (Fichtner et al., 2017; Appel et al., 2016). They can only react to ESG underperformance by means of *voice* or *loyalty.* However, even if they choose to ventilate their concerns, there is not much they can do if firms do not take their engagement efforts seriously (Blitz & De Groot, 2019). The Big Three cannot shell shares in firms that only pay lip service to ESG, and therefore cannot translate their words into action (Ibid). The Big Three fail to carry their weight as stewards as they adopt a buy-and-hold strategy. They may more aptly be called 'permanent capital' as they buy assets with the intention to own it for the long term (Fichtner et al., 2017).

2.4.1.4. Regulatory backlash

Bebchuk and Hirst (2018) call a potential (regulatory) backlash *"perhaps the most significant risk"* (Bebchuk & Hirst, 2018:27) to the power of the Big Three. Historians (such as Davis, 2009) point at the resemblance between the current ownership predicament with a century ago in which a small banking elite yielded substantial power over the overall economy. The growing ownership concentration in the form of three giant passive asset managers also hasn't gone unnoticed by politicians and the wider public and is increasingly viewed as a potential antitrust issue (Walker, 2019a). The Big Three pose the risk of common ownership as it could impinge on competition. According to an OECD (2017) study at the common ownership position of institutional investors concluded that horizontal ownership could entail *"hidden social cost and reduced product competition"* (European Parliament 2019). In line with this theory, it can be argued that investee companies with the same shareholder are less incentivised to develop new products that could damage the market position of competing firms in the same sector with the same dominant shareholders (Azar, Schmalz & Tecu, 2015). As politicians are starting to feel at home with the argument, the potential of a regulatory backlash increases. This potentially could make the Big Three wary of pursuing an active stewardship approach, as utilising their power in any way that adversely impact corporate managers could incite a backlash (Bebchuk & Hirst, 2018).

2.4.2 The active ownership hypothesis

From a competing perspective it can be argued that passive investing does not align with passive ownership. The stewardship promises of the Big Three arise from their large stakes and their long commitment to their investee companies (Bebchuk & Hirst 2018). The active ownership hypothesis builds on the notion that the Big Three will use their power to influence the governance of investee corporations to realise substantial gains for their portfolios (Bebchuk 2017, Bebchuk & Hirst 2018). According to this line of thought, their inability to 'exit' and vote with their feet results in permanent ownership position that results in a long-time perspective on the growth of their companies. This long-term perspective will result in a strategy increasingly focussed on addressing ESG-related matters.

2.4.2.1. A long-term perspective arises from permanent ownership positions

It can be argued that the Big Three are permanent shareholders and are therefore naturally incentivised to oversee and influence asset managers to ameliorate corporations' performance. Their inability to 'exit' makes them able to exert more direct influence over corporate governance. The Big Three are long-term owners of their investee corporations which leads to a long-term perspective on their growth. If passive investors see themselves as long-term owners, they will be more inclined to focus on achieving long-term objectives, as opposed to short-term gain (Krosinksy & Robins 2012:43). The adaptation of a long-term perspective leads in turn to an increased focus on incorporating ESG factors into investment considerations. As a result, investors who are in it for the long run appear to place more emphasis on ESG objectives. In addition, investee companies might be more willing to engage in private engagements as they are its 'permanent owners'. Active engagement could therefore make them more inclined to internalise the main aims of the Big Three.

The Big Three openly express their commitment to responsible stewardship and proclaim that they perceive themselves as permanent owners. In his 2018 letter to CEO's Larry Fink states that *"index investors are the ultimate long-term investors"* (Blackrock 2018), and *"BlackRock cannot express its disapproval by selling the company's securities as long as that company remains in the relevant index. As a result, our responsibility to engage and vote is more important than ever."* (Ibid). On their website, State Street (2019) writes *"As one of the world's largest asset managers, we represent near-permanent capital and actively engage with our portfolio companies to promote long-term value of our clients' investments."* John Brennan, the former CEO of Vanguard outlines *"We're permanent long-term holders and, given that, we have the strongest interest in the best outcomes"* (Evans, Willmer, Baker & Kochkodin., 2017).

As long permanent owners, the Big Three could be viewed as providers of 'patient capital' to their investee companies. Braun (2015) states that *"an economy dominated by asset managers seeking low-cost exposure to the market portfolio may, in principle, open up the possibility for the internalisation of externalities, the formation of long-term orientations, and the provision of 'patient capital'"* (Braun, 2015:286). Empirical research has demonstrated the long-term positive consequences of integrating the principles of ESG on the market value of firms (e.g. Roberts, 2004; Fatemi, Glaum & Kaiser 2018; Malik 2015). *"Environmentally or socially motivated activities can improve the management team's capabilities and the firm's potential to attract qualified employees. Moreover, such activities can enhance the firm's reputation and strengthen its interactions with its stakeholders (Branco & Rodrigues, 2006)" (Fatemi et al. 2018:46).* The incorporation of ESG practices into an investment portfolio might improve their long-term performance. Investment managers owe fiduciary duties to clients and are ought to act first and foremost in the interest of its investors

(SEC). As long-term owners, it might therefore be in various cases in the best interest of the investors to push for the consideration of ESG objectives.

2.4.2.2. Paradigm shift: the increased emphasis on investment Stewardship

There is a growing acknowledgement of the potential power of the Big Three, and a growing assumption that they will employ their ascendancy to advance the governance of their investee corporations (Belinga & Segrestin, 2018; Cheffins 2010; Davis et al. 2009; Ivanova 2017). In response, the leaders of the Big Three repeatedly publicly underlined their devotion to investment stewardship and to ameliorating corporate governance structures (Bebchuk, 2017).

The prevailing paradigm related to who is responsible for the overall governance structure and economic performance of a company is evolving. In the past decade, the common understanding of the relationship between corporate governance and the ownership structure has undergone a process of reorientation. The appropriate role for institutional shareholders in corporate governance is the subject of a continuing debate and is moving in the direction of shareholder empowerment. Shareholder empowerment can be defined as "*a shift in the allocation of power from corporate officers and directors to shareholders, implemented directly via shareholder participation in corporate decision making and advisory votes or indirectly via shareholders' ability to hold corporate executives and boards of directors accountable"* (Goranova & Verstegen Ryan, 2015:3). The concept of shareholder empowerment builds on the agency theory, which argues that as the owners of the corporations, shareholders must constrain corporate executives by engagement and monitoring. Shareholders should therefore have the adequate means to protect their ownership stakes and should be in the position to exert influence on corporate executives to take their interest and opinions into account (Bebchuk, 2013).

The 2008 financial crisis further ignited the notion of investor stewardship as many contributed the crisis partly to a lack of institutional monitoring (Belinga & Segrestin, 2018; Birkmose, 2014). The notion that board accountability is fundamental to strong corporate governance has been fuelled by the perception that institutional investors failed to perform engaged corporate oversight in the build up to the financial crisis. As a result, the voice that calls in favour of investor 'stewardship' of institutional investors, is becoming louder (Belinga & Segrestin, 2018; Ivanova, 2017; McNulty & Nordberg, 2015). The growing enhancement of the notion of stakeholder empowerment has been accompanied by a trend of increasing the accountability of corporate executives to their firms' shareholders (Goranova and Verstegen Ryan, 2015). CREATE-research (2019) recently surveyed 127 pension funds and revealed that a majority of the pension funds are not content with the current stewardship practices of passive asset firms. 23 percent of the pension funds stated that passive asset managers were only meeting their stewardship goals to a limited extent while 27 percent stated that they were not meeting their goals at all. 84 per cent consider stewardship essential to improve the quality of beta. The authors conclude: *"To them, passive ownership should not mean passive owners"* (Thompson 2019). Especially in the European context, pension funds are the most prominent institutional clients of The Big Three. The paradigm shift could contribute to institutional client demand for investor stewardship.

2.4.2.3. ESG integration into regulatory frameworks

International regulators and governmental institutions are showing slightly more interest in the implementation of ESG into the investment industry and are slowly starting to embed ESG into regulatory frameworks. The EU is at the vanguard of this process, while US regulators remain more hesitant to be outspoken on the subject. Regulatory bodies could contribute to the integration of ESG within the policies of

the Big Three through three central ways: by enforcing transparency, by addressing conceptual confusion and contributing to the expanding notion of their fiduciary duty.

First, they could contribute by addressing the conceptual confusion around the concept of ESG, which could lead to improved ESG data. At present, the European Union is in the act of developing a unified taxonomy in the form of an EU green bond standard. Furthermore, the European Parliament and EU member states have recently reached a political agreement that requires institutional investors to disclose the procedures they have in place to integrate ESG risks and the degree to which these risks are integrated into strategies, risk-assessments and the overall climate-impact of their portfolio's. This agreement will take a more concrete form as it will be transposed into national EU member-states' law. The EU is also working on a classification system for sustainable activities which will address conceptual confusion and facilitate the process towards more high-quality data sources. The growing focus on investor stewardship also contributed to the formulation of several amendments to the EU Shareholder Rights Directive (SRD II). In the light of the growing long-term investment objective, these amendments were initiated to strengthen the rights of shareholders. With these amendments the EU enforces transparency of institutional investors and their proxy advisors regarding their engagement policies which makes is easier to hold them accountable for the integration of ESG in their investment decisions and asses the effectiveness of their engagement policies. In contrast to Europe, US regulators are more hesitant: The SEC recently argues that, despite the rising pressure from variety of investors for ESG disclosure requirements, the market is not ready yet for a standardised ESG disclosure regime and leaves the process of ESG conceptualisation to the investment industry itself.

Second, the conceptualisation of the fiduciary duty of the Big Three is essential. The Big Three function as intermediaries, holding assets for their clients, and subsequently are expected to act as prudent investors. To protect the interest of the beneficiaries the Big Three are constraint by their fiduciary duty that is ought to prevent them from acting in accordance with their own interests. The legal interpretation of prudent investors is subject to developing investment and financial theories, which implies that the prudent investor standard is dependent on prevailing investing norms and values (Gary, 2019). The prudent investor standard is ought to align with the constantly changing industry norms. Institutional regulators and governmental institutions are corresponding to the changing norms among investors that increasingly value ESG and a growing body of research that indicates that ESG integration could result in better financial risk profiles of companies. While the incorporation of ESG considerations into the fiduciary duty of investment managers has not yet formed part of legislative proposals, there are small steps taken into this direction (Ibid). The US department of Labour elaborated by means of several interpretive bulletins on the concept by stating that ESG integration might yield better financial results than other investment strategies and that a prudent investor may want to consider ESG factors (Ibid).

In addition to enhancing transparency, regulatory bodies are increasingly focussed on providing institutional investors the legal framework to effectively monitor and engage with investee companies. To purport the development of shareholder stewardship on the part of institutional shareholders, the excessive terms of office have been set at the policy-making agenda with the aim of increasing board accountability. This has resulted in the development of codes of behaviour that, aimed at increasing demand for more effective stewardship, strengthen the grip of the Big Three on their investee companies. The adaptation of the 2010 UK Stewardship Code, designed to pressurise institutional investors to become more active and socially responsible shareholders, has been very influential (Lu, Christensen, Hollindale & Routledge, 2018).
After the UK became the first jurisdiction to adopt a stewardship code, a significant amount of countries followed their example, initiating stewardship codes that include a set of principles on how institutional investors should act as engaged shareholders of the companies in which they invest. A recently proposed

revision to the UK Stewardship code by its initiator, the UK Financial Reporting Council, sets a higher standard for investor stewardship policy and practice and includes that fund managers take ESG factors into account when overseeing the companies in which they invest (Walker, 2019b).

3. Methodology

3.1 Qualitative research methods

The main aim of this study is to obtain a holistic understanding of how the Big Three approach investment stewardship. Additionally, it seeks to better understand to what degree there are incentives for the Big Three to influence investee companies to integrate the principles of ESG responsibility. In order to examine these central themes, a qualitative research methodology was be utilised for two central reasons. First, the study asks a 'how' question, and implicitly a 'why' question. Essentially, the study is aimed at formulating a coherent view on the ESG stewardship approach of the Big Three and the incentives that continue to influence their approach. This are questions concerning processes emerging in a 'real life' context which are best analysed from a qualitative perspective (Boomsma, 2013:5). Second, a qualitative approach is suitable given the focus on the exertion of 'hidden power' by the Big Three. As outlined above, the Big Three are capable of exerting power through four channels: via proxy voting, private engagements, as an adviser to governmental institutions and because shareholder companies could internalise the objectives of the Big Three. Apart from voting, these potential avenues of power exertion can be characterised as structural power. The Big Three *"wield structural power by virtue of their control over key economic resources and the investment and credit processes on which businesses and wider society depends"* (Bell & Hindmoor, 2017:104). Given their size, the Big Three have a clear preference for one-to-one engagements, ideally behind closed doors (Bioy et al., 2017). Voting could come at the end of the engagement processes with investee corporations. Only if companies do not adhere to the perspective of the Big Three, which will be made clear through private engagements, they will vote against management directors. Primarily focussing on the quantification of the voting-behaviour of the Big Three on ESG- proposals would draw a distorted picture of the Big Three's approach to stewardship. Therefore, to adequately grasp the extent to which structural power is exerted on investee companies by the Big Three to influence ESG ambitions, stakeholder perceptions will be analysed.

3.2 Data: Expert interviews

In this study, expert interviews were utilised that were conducted between February 2019 and June 2019. The term expert refers to the specific role of the interviewee as a source of specific knowledge. Expert interviews are the methodological tools to get to this knowledge (Glaser & Laudel, 2010). This qualitative empirical research method is adapted as it is best equipped to generate knowledge essential for answering the central research question. Through expert interviews it becomes possible to assess the privileged professional knowledge of experts. An individual can be characterised as an expert if he or she holds an *"institutionalised authority to construct reality"* (Hitzler et al., 1994 in Meuser & Nagel, 2009:19). An expert has the capability *"to become hegemonial in a certain organisational and functional context within a field of practice"* and as a result *"becomes influential in structuring the conditions of action for other actors [....] in a relevant way"* (Bogner & Menz, 2002:46 in Meuser & Nagel, 2009:19). The expert is responsible for *"the development, implementation or control of solutions, strategies or policies"* and subsequently has *"privileged access to information"* about groups or persons in the decision-making process (Meuser & Nagel 2009:85&83). The expert is not interviewed as an individual, but as part of an organisational context. Experts are highly educated professionals who are aware of their status, capable of handling inquisitive situations and able to elaborate on complex contexts (Abels & Berens 2009:140). With the central research objective in mind, experts will be identified based on their extensive professional experience in the field of passive asset management and stewardship. Some experts were selected based on the presumption that they occupy key positions within the organisational structure of

State Street, Vanguard or Blackrock and have obtained advanced insights in their stewardship decision-making processes. Other experts were selected based on their professional positions at large institutional clients of the Big Three, civil society organisations or governmental institutions focussed on the investment industry.

For this study, ten interviews were conducted and six short conversations where held in informal settings. The interviewees include: a former director at Blackrock, a director at Vanguard, a director of a representative body of institutional investors, a director of a competition active investment firm, a senior project manager at the Dutch Association of Investors for Sustainable Development, the head of ESG at Morningstar, a head investor relations officer at a major AEX company and one of the Big Three's investee companies, several representatives of institutional clients of the Big Three (predominantly pension funds) and regulatory bodies focussed on the financial industry. Prior to the interview, the respondents would receive a broad overview of the study and the confidentiality of the interview and their anonymity was discussed and reassured.

Six out of ten respondents were selected using the 'snowball' technique. Snowballing is a meaningful sampling strategy that entails asking respondents in the first stage of the data-collection process to refer to other valuable respondents that meet the eligible research criteria (Flick 2006; Silverman 2000). As there was no *"clearly defined pool of experts"* on the central issue from which a representative sample could be drawn (Littig, 2009:102), it was difficult to determine beforehand which individuals were knowledgeable regarding the central research theme. In addition, various barriers can be distinguished that prevent access to high-level experts in the financial industry. After gaining initial access, one expert can be able to identify other valuable experts in his or her network (Ibid). The snowball strategy proved to be very valuable in gaining access to knowledgeable experts on the topic of investment stewardship.

3.3 Data-collection

The study utilises semi-structured interviews. This approach allows for an in-depth examination through open-ended questions which encourages meaningful answers and leaves room for flexibility (Patton, 2002). Prior to the interviews, an interview guide was produced to enable a specific focus during the course of the interview. The interview guide contained themes and open-ended questions which were established in advance and were explored during the interview. Using a flexible interview guide allows for probing to generate further explanations from respondents. This interview guide was developed prior to the first interview but was reviewed an adjusted during the data-collection process by including key topics addressed by respondents. The questions asked during the interviews were fully based on the analytical framework as outlined in the theory section. Both the passive and the active hypothesis were tested during the interviews. First, the respondents were asked to broadly describe the stewardship activities conducted by the Big Three and the extent to which ESG is becoming a central element of their stewardship approach. After that, they were asked to share their perspective on which possible incentives contribute to their current stewardship strategy. After an elaboration on the incentives, we would ask their perception on the individual potential incentives that constitute both hypotheses, if they weren't mentioned by the respondents themselves beforehand. Finally, we would ask respondents to expatiate on the way that they perceived these incentives to have a profound impact on the stewardship activities of the Big Three. This provided me with an informed view on the perception of the experts on impact of the individual elements that constitute the active and the passive ownership hypothesis on the ESG stewardship strategy of the Big Three

3.4 Data-analysis

The analysis of the interview-data was conducted in three subprocesses: (1) data reduction, (2) data display and (3) data interpretation (O'Dwyer, 2004). Atlas.ti, a Computer Assisted Qualitative Data Analysis (CAQDAS) package, will be utilised as this program allows to subject inductive data to assiduous computer- assisted *"comparative analysis that successively moves from studying concrete realities to rendering a conceptual understanding of the data"* (Charmaz & Belgrave, 2012:347). Atlas.ti offers a broad variety of tools that assist by exploring data systematically (Boomsma, 2013:69).
The first step entailed the transcription of the interviews. Next, the full interview data was coded based on the concepts that emerged from precious research and new concepts that were derived from the interview data. The full transcribed data will be reduced to the data relevant to answer the central research question. "*Intuitive open coding schemes"* will be developed to identify the central themes that emerged out of the data (Boomsma, 2013:70). The process of coding interview transcripts can be characterised *"as a process of classifying units of data to identify passages of text representing some more general phenomena"* (Boomsma, 2013:71)
The second subprocess of data display involves the identification of key themes by displaying the reduced data through comprehensive matrices that grasp the central themes and unfolding patterns (Ibid). Rather than summarising the open interview codes into a reduced amount of main codes, Atlas.ti will be used for grouping codes to connect them to central themes (Ibid).
The final step in the analysis is 'data interpretation' which involves the exegesis of the reduced data sets (O'Dwyer, 2004). The matrices and overviews created in the previous steps were examined in detail and emerging central themes were critically assessed. As a result, a comprehensive description of the research results led to an 'overarching view' that includes the answer to the central research question.

3.5 Reflection

Important to note is that ESG is a sensitive topic in the investment industry, even more so than we initially expected it to be. While ESG might not seem a specifically sensitive topic at first glance, as it does not involve disclosing the personal life-world of participants, respondents were hesitant to discuss specific matters and details. In some of the interviews, we noted that experts provided evasive answers because of the sensitive nature of some of the questions posed. An important explanation for the sensitivity surrounding ESG was the fear for naming and shaming, an assumption that several respondents underlined. As one respondent highlighted: 'you do not want to be the person in the organisation that causes your company public harm'.

I recorded all interviews, but during those interviews respondents often stated that they were willing to share specific information 'off the radar'. The sensitivity surrounding the topic of ESG became also clear when reaching out to respondents. I contacted some experts that were initially eager to participate in the study, but after an elaboration on the topic, decided not to participate. Mentioning the central themes of the study, seemingly caused distress among especially employees of the Big Three. The sensitivity around the topic made it essential to establish a trusting connection with respondents, before they were wholeheartedly willing to share their perceptions on the issue. I was able to schedule several interviews with employees of two Big Three firms, that were called off minutes after each other, which could suggest that they exchanged thoughts on the interview, and collectively decided not to participate.
The ability of a researcher to gain access to potential respondents is shaped by the personal characteristics of the researcher (Denzin & Lincoln, 2011). I am confident that next to be extremely clear on the central

aims of the study, being a starting female researcher helped gaining access to respondents as this made me appear ‘less threatening’.

I felt that the sensitivity surrounding the topic was partly due to the fact that ESG is currently a hotly debated topic, both in the media and within the investment industry. This undoubtedly contributed to the quality of the interviews, as all respondents had elusive, well-thought-out perspectives on the questions asked. The central topic of ESG related stewardship is at centre of debate within their firms, which made individual respondents well-aware of their own perspective, doubts and questions related to the central stewardship theme of this study. All in all, the sensitivity surrounding the topic introduced me to the iterative nature of fieldwork and made the data-collection both more challenging and interesting.

4. Results

4.1 Three dominant incentives

Based on the expert interviews a relatively clear picture can be constituted regarding the contested capability of the Big Three for conducting stewardship related engagement and the nature of this engagement. It can be concluded that, with regards to ESG related stewardship, the passive investment strategy of the Big Three does not entail passive ownership. BlackRock, Vanguard, and State Street are increasingly taking up an active role in overseeing and monitoring their investee companies. The passive investment strategy of the Big Three is limited to their investment vehicle, and does not imply passive ownership. Especially on the subject of ESG, the Big Three are taking up a growing stewardship responsibility. Their investor stewardship strategy is becoming a vital segment within their overall strategy and they are expanding their investor stewardship activities on the topic of ESG integration. The expansion of their stewardship activities includes the expansion of their own ESG teams, as well as an increased reliance on local partners and independent data-providers.

However, this conclusion does not imply a full refutement of the passive ownership hypothesis. While the central claim that a passive investing strategy leads to passive ownership can be repudiated, the qualitative findings yield substantial empirical evidence for the threefold rationale behind this hypothesis. All the three sub-rationales find empirical backing and form important barriers for the integration of ESG factors in their stewardship approach. The passive buy-and-hold strategy does limit their leverage over their investee companies and their cost-efficient business model limits the financial room for stewardship. Simultaneously, the collective-action dilemma forms a barrier on spending resources to monitor investee companies as this will not bolster their own performance compared to competitors. However, these barriers have not proven strong enough to result in a full abdication of their stewardship responsibilities.

Three central incentives can be distilled from the qualitative interviews that usher the Big Three in becoming increasingly active owners in terms of their ESG stewardship approach. First and most importantly, there is a growing demand from the clients of the Big Three to take up a more active stewardship role in terms of both engagement and voting behaviour. The Big Three face a rising pressure from a variety of stakeholders to demonstrate their commitment to push for positive change and increase their current level of engagement with their investee companies. Second, regulatory bodies are increasingly embedding ESG into regulatory frameworks, which helps to address the conceptual confusion and helps to materialise ESG risks. Finally, the Big Three are acknowledging that ESG disclosure can provide valuable insights into the underlying drivers of corporate financial performance and value. As a result, they are increasingly embedding ESG factors into the risk assessments of investments which paves the way for sustainable enhanced indexes that tailor to their client's needs.

First, I will elaborate on the three primary incentives that fuel the adaptation of an increasingly active ESG stewardship approach by the Big Three. Next, I will discuss how these incentives result in a stewardship approach that is focussed on incident-driven, private engagements.

4.1.1 Growing client demand

The investment industry is in the midst of a fundamental paradigm shift. All respondents underline the fundamental importance of a shift in the perceptions of clients, that increasingly value the extent to which ESG considerations are taken into account within their investments. Both institutional clients and retail clients are gradually becoming more critical and outspoken on the subject and are increasingly holding the Big Three accountable for the extent to which they push for the integration of ESG principles within the governance structure of their investee companies. Two central paradigm shifts have contributed to this increasing 'ESG liability' that is placed on the shoulders of the Big Three.

ESG is increasingly valued as important by both private and retail clients of the Big Three for multiple reasons. First, in the investment industry, a growing chorus of voices problematises a perceived short-termerism that only focusses on quarterly records and is thought to impede returns in the long run. The overall perception that the pressure to generate strong short-term results should be alleviated and replaced by a perspective centred around long-term value creation, that takes into account the financial, social and environmental value of the company in the long run, is gaining ground. Both institutional investors and retail investors are increasingly inclined to perceive ESG as aligned with a long-term perspective on economic growth. Simultaneously, building on a substantial body of research, they are becoming more convinced that a portfolio's improved social and environment impacts doesn't have to result in reduced returns or could even enhance performance in the long run, enhancing long-term returns. The prevailing conviction that societal objectives and optimal financial returns are incompatible which has dominated discourse over the past century is losing ground.

Furthermore, it is important to underline that the clients of the Big Three are not operating in a social vacuum. Particularly in Europe, the view that as long companies act ethically within legal boundaries, they do not have to be concerned with larger social goals is firmly challenged by a perspective that emphasises the role of a business in society. Social norms request ethical leadership, corporate social responsibility and highlight the role of the business in contributing to sustainable development. Especially institutional clients, such as European pension funds are well-resourced actors for which investment strategy is not only influenced by their constituency, but also by media coverage, NGO's and other civil society organisations that have proven to be very effective in urging them in the direction of ESG integration. To illustrate, the impact of 'responsible investment benchmarks' that assess the socially responsible investment strategy of pension funds, or documentaries that evaluate the nature of the companies these pension funds are invested in, should not be underestimated.

As a result of the evolving concept of investor stewardship, the Big Three have become under renewed pressure to consider the environmental, social or governance impact of their holdings. Both retail and institutional investors are not only increasingly considering the impact of their investment choices in response to a broader societal quest, they are also increasingly holding the Big Three partially accountable for the actions of their holdings, as they expect them to exert influence on their corporate governance practices. This responsibility placed on the shoulders of the Big Three became clear when discussing their stewardship capabilities with the institutional clients of the Big Three. A senior director at a Dutch pension fund states; 'the time that passive asset firms could sit back and deny their responsibility has passed. We [Pension funds] have to act, but they also have to act; A stewardship officer at a different Dutch pension funds outlined: 'After ESG related scandals, I will look at their [Blackrock's] recent voting behaviour at that firm, and address the proposals we would vote different on during our conversations'. An investor relations officer at one the Big Three's investee companies stated that after an ESG related

scandal Blackrock initiated an engagement process: 'Yeah, well, after that [the ESG scandal] they want a meeting, discuss the recent events, they need to act because their clients ask for it. They need to have a story for when they get back to their clients'.

In the recent decade, both retail clients and institutional clients have become more vocal on the topic of ESG, which is a process that started by asking questions and is slowly moving towards demanding strong corporate oversight centred around ESG. Investors are increasingly holding the Big Three accountable for the social behaviour of their invested companies. Retail clients in general increasingly value ESG and a new investor generation is emerging: both millennial and female investors aim to include ESG considerations alongside financial ones. Large institutional clients, such as pension funds, sovereign wealth and insurance funds are shifting to passive portfolio's and simultaneously aim for full ESG-integration, which fuels the pressure on the Big Three to actively integrate ESG within their corporate strategy. The evolving investor appetite towards ESG has resulted in a growing pressure on the Big Three to start monitoring their investee companies enabling them to substantiate their answers to ESG-related questions from their clients. The growing proportion of shares that the Big Three own in publicly listed companies worldwide is steadily growing and the stewardship decisions of the index fund managers can therefore be expected to have a profound impact on the performance of its investee companies. Their clients are knowledgeable of the potential power of the Big Three and are subsequently asking them to use this power in order to generate greater ESG integration within the governance structure of their holding. Simultaneously, they are increasingly convinced that the Big Three are capable of realising long-term investment returns through engagement with their investee companies. The rising client pressure has created a context in which passive ownerism is not an accepted strategy anymore. The Big Three have expressed their awareness of the changing landscape and corresponding investor appetite, publicly recognising that action from their side is needed. They are expected to demonstrate their commitment to push for positive change and increase both the quality and quantity of the current level of engagement with their investee companies.

An important aspect of the rising client pressure on the Big Three is the cooperation between institutional clients. Large institutional clients are increasingly focused on collaboration, knowledge-sharing and form coalitions before entering ESG related conversations with the Big Three. The stewardship teams of institutional clients are growing, both in absolute terms and in importance within their organisation, and are increasingly working together. Through coalition formation, they jointly represent more substantial assets under management, which enhances their leverage in the conversation with the Big Three. This creates more serious pressure on the Big Three to move towards a specific direction.

The majority of the respondents strongly underline the importance of this bottom-up movement: without the pressure from clients some expect that the Big Three would have most likely be more reluctant in enhancing their investment stewardship practices on ESG. The movement towards ESG integration and increased stewardship is therefore predominantly fuelled by client's pressure, that has urged the Big Three into their current direction. As clients start to view stewardship as a central differentiator it will become a pivotal point of competition for the Big Three.

4.1.2. The materialisation of ESG principles

ESG principles are increasingly embedded within asset owners and managers' activities. The Big Three have begun to recognise that high-quality ESG disclosure can provide valuable insights into the underlying drivers of corporate financial performance and value. A growing body of academic knowledge suggests that higher ESG rated companies demonstrate lower idiosyncratic tail risk, which increases the present value of expected cash flows, thereby generating value for investors. The Big Three have adopted this conviction, which has created an incentive for them to focus on developing their access to ESG data and corresponding analysis.

The translation of ESG principles, that are by nature non-financial, into metrics and reporting frameworks is perceived as crucial by all respondents. If ESG will be translated into concrete metrics, the principles can be integrated in the performance assessment of asset managers, and in the risk-assessments of corporations. A former director of a Big Three firm underlines the importance of materialisation by stating that if ESG is not measurable, it won't be implemented into risk assessments and will not create the wanted results. An investor relations officer of one of the Big Three's investee companies proclaims that the people in the industry heavily value the concrete measurability of ESG. Without the translation of the vague ESG principles into quantifiable, comparable measures it won't be used to track and assess status of a specific KPI's. Therefore, without the translation of ESG principles into a detailed taxonomy, the concept of ESG will not be accepted by mainstream financial analysts and investors. At present, the investment industry is in the process of translating ESG factors into metrics that can be integrated in financial analyses and become KPI's that reflect the operational strength, efficiency, and management quality of a company.

An important driver in the quantification process of ESG principles is the growing quality of the data that ESG data providers develop. ESG rating proved agencies emerged in response to the demands for reliable data on the social and sustainable performance of firms. They have grown to become important actors in the financial industry that provide datasets that the Big Three heavily rely on for their sustainable analyses. MSCI, one the most prominent data providers used by the Big Three, is described by a former director from Blackrock as a previous 'data dump'. However, he acknowledges that the quality of their data is improving which he considers an important development that facilitates the materialisation of ESG. Independent data providers are increasingly developing data specifically designed to identify material ESG risks at the portfolio and security level. They offer data that aims to capture the extent to which a company is exposed to industry-specific material risks and assess how well a company is equipped to manage those risks. Their data is becoming increasingly valuable in informing investment process as the growing quality of the factors makes it possible to use them as drivers of portfolio risk and return. As a result, the factors based on ESG principles will be increasingly implemented into the risk profile of investments by the Big Three to reduce risk and increase diversification.

The increased materialisation of ESG allows for the development of financial products that respect the passive index-tracking investment strategy and simultaneously allows for the integration of ESG principles. The overall trend towards both passive investing and ESG investing creates natural incentives for the Big Three and other index and fund providers to meet investor demand and focus on developing new index-tracking products (Bioy, 2018:2). The growth of the global landscape of sustainable index-tracking funds across regions has not been uniform: Europe remains at the forefront, accounting for 85% of the total global assets under management accommodated sustainable index mutual funds and exchange-traded funds (Ibid). The U.S. shows the most substantial growth rate as the collective U.S.

assets have quadruped over the recent five years (Ibid). The universe of sustainable index-tracking funds shows a broad variety of approaches to address various investment and sustainability objectives (Ibid). The approaches differentiate in how they evaluate ESG performance and how closely they structure the portfolio to meet a standard benchmark (Ibid). At present, passive funds account for 24% of the overall fund market, while the passive sustainable fund industry accounts for only 12% of the global sustainable fund landscape, which indicates a large growth potential (Ibid).

4.1.3. ESG integration into regulatory frameworks

International regulators and governmental institutions are slowly starting to embed ESG into regulatory frameworks. Regulatory bodies contribute to the integration of ESG within the policies of the Big Three by addressing conceptual confusion around the concept of ESG, enforcing transparency and contributing to the expanding notion of their fiduciary duty. By addressing conceptual confusion and requiring transparency, regulators create a level playing field, fuel research for high-quality ESG data, reduce 'greenwashing' in the investment industry, and make the engagement practices of the Big Three more pellucid for their clients. While all regulatory adaptations are still in an initial development phase, they already have quite substantial disciplinary effects. The expectations of potential events are affecting the corporate decision-making process of the Big Three on stewardship strategy. A former director at Blackrock highlights: 'they [Blackrock] are aware that ESG regulation will come and they know they already have to start adjusting their strategy accordingly.'

Especially the expectation that upcoming regulation will demand an increase in transparency is expected to have a strong disciplinary effect. At present, the engagement and stewardship activities of the Big Three are still very opaque to both retail and institutional clients. If the transparency of the engagement processes of the Big Three increases, this will foster competition on stewardship as a key differentiator between passive asset management firms. Especially institutional clients have started to value ESG and if transparency increases, they will be better equipped to gain an informed perspective on the stewardship activities of the individual Big Three firms. This knowledge will undoubtedly affect the decisions of a broad subset of institutional investors, and especially pension funds, on which passive asset firm they will choose to work with. Therefore, if transparency grows, stewardship will increasingly become a key element on which the Big Three will have to compete. While the regulatory demand for transparency is still in an initial development phase, this already has an impact on the stewardship strategy of the Big Three as this urges them in the direction of an enhanced stewardship strategy.

Furthermore, the efforts by European Union to develop a clear ESG taxonomy will fuel ESG data development. With only one exception, all respondents underline the importance of data that adequately measures ESG principles. At present, ESG data is largely incomplete, self-reported and not always comparable. Several respondents illustrated the incoherency of the ESG landscape by pointing at the low correlation between the ratings of ESG data information provider agencies that assess the corporate sustainability performance of companies. The inconsistency between ratings of the large third-party ESG data providers (most notably Sustainalytics and MSCI), on which the stewardship teams of the Big Three rely heavily, underlines the limitations and conceptual confusion around the concept of ESG. The lack of transparency, standardisation and scoring methodologies in ESG data providers' collection poses a central challenge for the integration of ESG principles. According to various respondents, the investment industry is structured around quantification. The approximation of the subjective nature of ESG principles into numbers to make is measurable is very much valued by individuals working in the industry. The establishment of a structured and systematic framework for ESG consideration is therefore crucial as this facilitates the materialisation and measurability of ESG principles. High-quality ESG data is the lifeblood of ESG investment analyses and the advancement of the data by addressing the conceptual confusion is therefore crucial. Regulatory bodies are taking up an increasingly supervisory role by contributing to the development of a clear ESG taxonomy. Subsequently, they are instrumental to the standardisation and materialisation of the ESG principles from non-financial information to credit-relevant key performance indicators (KPI's).

Next to addressing conceptual confusion and enforcing transparency, the small regulatory steps taken into the direction of expanding the legal understanding of the fiduciary duty of institutional investors are influential. Several respondents highlight that regulators are responding to evolving societal norm by slowly moving towards the expansion of the fiduciary duties of obedience, loyalty, impartially and prudence to allow for the integration of ESG within these principles. Especially the initiation of the UK stewardship code is valued by respondents as central to infusing shareholder empowerment. Initiated with the aim of curbing managerial myopia, stewardship codes highlight that the prevailing notion that fiduciary duties block a fiduciary investor from considering ESG principles is eroding. The stewardship codes clearly outline a responsibility for the Big Three as responsible stewards, partially responsible for the ethical behaviour of their investee companies. A passive ownership strategy is not maintainable for the Big Three in the light of the objectives prescribed by the stewardship codes.

4.2. The investment stewardship strategy of the Big Three

Increased investor appetite, growing regulation and the potential for enhanced risk-adjusted returns in the context of an increased focus on shareholder stewardship form strong incentives for the Big Three to transform in increasingly active owners on the subject of ESG integration. ESG is becoming ubiquitous in especially Europe and is gaining more and more ground in the US and other continents. The Big Three are not immune to the evolving norms in the broader society and are ought to respond to this wider trend. Several important barriers, such as their inability to sell shares, are limiting their room for manoeuvre. Nevertheless, the three important incentives as highlighted above; regulation, client demand and the materialisation of ESG-principles, will lead to a stewardship approach adapted by the Big Three that combines monitoring, private engagement and informed voting. The strategy of the Big Three regarding their engagement approach is balancing on the middle ground between reactive and alpha engagement. Their investment stewardship strategy has become an integral part of their overall strategy as they are increasingly monitoring investee companies, more actively vote their shares and increasingly engage in dialogue with the management of their investee companies on the subject of ESG. The three central components of the stewardship approach of the Big Three will be discussed: monitoring, voting and engagement.

4.2.1 Monitoring

When it comes to monitoring, the Big Three are stepping up their game. Monitoring is essential for the Big Three as this enables them to directly respond to ESG related client demand. Their clients are increasingly asking for information related to the companies in the benchmark they are tracking. The Big Three partly rely on third party ESG data providers to generate data on the ESG status of their investee companies. Furthermore, they are also increasingly gathering data directly from their investee companies. Investee companies are ought to elaborate on their long-term strategic goals, how ESG risks are integrated into this strategy, the obstacles they might anticipate and the milestones that show advancement. As a former director at Blackrock noted: ESG is becoming mainstream as a broader segment of both institutional as private clients demand sustainable enhanced financial products. He underlines the importance of the increased materialisation of ESG principles as important driver behind the monitoring of investee companies. The quantification of ESG has made it possible to more adequately estimate the risks associated with ESG integration and contributed to the development of more advanced products fabricated to meet the individual ESG preferences of their clients. At present, this has especially translated into the rise of sustainable enhanced indexes that aim to deliver sustainable exposure, while offering returns equal to market performance. As the quality of the data on ESG grows, the Big Three will be better equipped to develop sustainable indexes that tailor the specific needs of individual clients.

4.2.2 Voting

Voting is a central element of the stewardship strategy of the Big Three. They consider voting at shareholder meetings an essential element of their fiduciary duty and therefore aim to effectively exercise their voting rights. As they are unable to vote with their feet, they can only utilise their shareholder power through engagement or voting, which makes voting pivotal to their stewardship approach. The inability of the Big Three to sell their shares, which translates in their position as permanent owners, contributes to their perception that a sustainable positive relationship with the management of their investee companies is essential. In their perception, their relationship with management is the central channel through which they are able to directly exercise influence over the strategy of their investee company. They consider

voting against management a 'last resort' measure. Dissatisfaction with the strategy of a company will not directly result in a vote against management. It is something that only after an extensive engagement process will be considered, and they will usually ought to avoid it. If dissatisfaction prevails after an engagement process that usually lasts several years, the Big Three will be inclined to use their voting power and vote against the reappointment of management. A director at local platform representing the interests of institutional investors called their ability to reject re-appointments the 'ultimate correction measure' of institutional investors.
However, this a stage they initially ought to avoid and they are always initially inclined to vote in line with the management directors they appointed themselves. This inclination is partly the result of a long-term orientation as they aim to establish a trusting relationship with the directors they appointed themselves. Furthermore, voting in line with management is perceived as a way of generating stability which they perceive as a central element of their fiduciary duty to maximise shareholder value. They are well-aware that if they vote against management in their position as dominant shareholders this could create friction.

4.2.3 Engagement

The nature of the engagement approach adopted by the Big Three can be characterised as event-driven with a focus on high-profile cases. The Big Three are not focussed on structurally engaging with a broad subset of their investee companies. According to an investor relations officers of one of their investee companies, they are less likely to participate in time-consuming road shows and other conferences. Instead, their approach is selective in evaluating the investee companies they choose to engage with to ameliorate the ESG integration within the governance of these companies. The Big Three rely on media, NGO's, but also on local partners to signal high-profile ESG cases, and subsequently aim to get into contact with these companies. Fundamental demerits in the governance structure or sustainability policies will be addressed during meetings with, depending on the local governance context, the supervisory board or board of directors.

The stewardship approach of the Big Three can, from one perspective, be interpreted as 'reactive engagement', which is associated with voting practices based on a set of generic, pre-defined criteria (Celik & Isaksson 2014:109). In most cases the Big Three are inclined to follow proxy advisor's voting recommendations when it comes to investee companies known as 'quality stocks'. These investee companies can be characterized by a stable growth rate, high return on equity and no known (media) history related to ESG scandals. These are the companies that, though latently monitored, the Big Three are less likely to focus on within their engagement strategy. Their contact with these companies will be less personal and will be mainly constituted by voting at shareholder meetings.

With regard to high-profile cases, the Big Three are more likely to take up an engagement approach known as 'Alpha engagement'. This form of engagement indicates an active ownership approach that seeks to support both short or long-term returns above market benchmarks (Celik & Isaksson 2014:109). In this perspective, ESG merits are interpreted as an alpha source, and companies usually get on the radar of the Big Three when they are excessively underperforming. When it comes to these companies, private engagement initiated by the Big Three are usually thematic and incident-driven (Dimson et a 2015, Bauer et al. 2014). The signalling of the high-profile cases occurs in the context of client-pressure, societal dissatisfaction but also the extent to which NGO's, media-outlets and other civil society organisations are focussing on the ESG performance of the specific company is an important determinator. These factors are central segments of a framework that the Big Three use to determine what companies will be central

in their engagement strategy. The Big Three only engages with a very small percentage of their portfolio companies: the excessive ESG underperformers.

In the Dutch context, companies as ING or Exxon Mobil are on their radar, while companies as Philips and Randstad are only latently monitored and are currently not perceived as high-profile cases within the adopted engagement strategy of the Big Three. A company as ING has become on the radar of the Big Three in the aftermath of a negative media storm as a result of a settlement with the Dutch Public Prosecution Service (DPPS) related to shortcomings in the execution of customer due diligence policies, and a proposed 50 percent pay hike for ING's CEO that angered both politicians and the public. The media coverage, which resulted in pressure from mainly institutional clients on the Big Three, to initiate a process of engagement. Exxon Mobil, the world largest publicly listed oil and gas company, caught the public eye after it became clear that they structurally lobbied to delay widespread climate change acceptance. After the company received substantial public backlash, their dominant shareholders, Vanguard and Blackrock, initiated an engagement process.
In contrast, Philips and Randstad are good growth, low-ESG risk companies: high performing quality stocks and no history of ESG related scandals. These companies will only be latently monitored, and the degree of personal contact between their investor relations office and the stewardship teams of the Big Three can be expected to be marginal.

The Big Three will enter engagement processes on account of a fundamentally positive thrust, and prior to or independent of a shareholder resolution. Their positive, proactive and constructive approach is partially prompted by their inability to sell their shares. This leads to their perception that constructive dialogue is the primary pathway to success. Their long-term perspective, which follows out of their inability to sell shares results in an engagement process with an extended timeline. Only after several years of private engagement without the anticipated outcome, the stewardship teams of the Big Three will seriously discuss the option to vote against specific proposals. Their inability to sell shares will therefore make voting their 'last resort', which is a stadium in the engagement processes that they usually ought to avoid. Engagement is perceived as a more efficient way to obtain the central objective, enhanced ESG policies. Moreover, voting against proposals can also result in increased media-attention, which they perceive as a potential risk for short-term stock prices, thereby not fulfilling their fiduciary duty.

When the Big Three decides to engage with a specific company to enhance its ESG performance, this will be organised as private, behind-the scenes dialogues. The private engagement process can be in-house, collaborative (with other investors or local partners) or service provider−led private engagements. The Big Three adopt an engagement-first approach, which indicates that, when they signal ethical problems, environmental concerns or other breaches of social norms they will first rely on private engagements to allay the perceived problems. Shareholder engagement is perceived as the pre-eminent way to advocate for attention to ESG issues. In most cases, the Big Three first require information from the company to construct an explanation of the current operations before formulating a perspective on the issue at hand, and deciding on their future steps within the engagement processes. In these engagement process, the role of local partners or platforms is becoming more important as they increasingly use these platforms to share perspectives and collaboratively reach out to investee companies.

Next to being 'locked-in' in their shares, their fiduciary duty stipulates the objective of long-term value creation for their clients. The respondents almost all underline the importance of the increasing integration of ESG factors in the universal understanding of their fiduciary duty. Engagement becomes increasingly factored into the overarching common understanding of how the Big Three are ought to

enhance and protect the value of assets entrusted to them. Delivering sustainable, long-term growth is gradually integrating in not only their own, but also their clients' perspective of what the Big Three 's responsibilities are towards them. The Big Three will have to respond to this still evolving objective by becoming increasingly transparent through reporting on the extent to which they engage with companies on ESG factors that are relevant to long-term economic performance. The Big Three are also responding to their client expectations by expanding their stewardship teams, to allow for increased monitoring, but especially incident-driven engagement.

The magnitude of the Big Three provides them with a privileged position, relative to other, smaller investors as the board members are usually inclined to be open for conversation and take their ESG concerns seriously. The Big Three are generally among the largest investors in their investee companies which puts them in a powerful position to demand change to benefit their shareholders and fulfil their newly expanded fiduciary obligation.

The Big Three are often prescribed as 'toothless tigers', for their inability to sell shares. This inability to exit makes them unable to vote with their feet which reflects in the nature of their engagement processes. Their obligation to hold on to shares translates in an imbroglio where the Big Three and investee company 'are in it together', both responding to outside pressure from their clients, media attention and regulatory bodies. This moves the Big Three more into a 'partner position' with their investee company, relative to their active counterparts, which creates the incentive for them to be more actively engaged in conversations to eliminate ESG related risks. This partner position is essential, as it puts the Big Three in the position of a steward: overseeing the performance of their investee company.

With regards to the cost-efficient element of the passive ownership hypothesis, that presumes that there are substantial financial incentives for the Big Three to heavily underinvest in stewardship, there is limited empirical backing in the interviews. Not one respondent mentioned the importance of a low-cost business model when discussing the capabilities of the Big Three for ESG-related stewardship, which could indicate that the financial incentive to underinvest is not as strong as the academic literature predicts it to be. After asking specifically about the nature of their low-cost business model, a director at a Big Three firm stated that his firm is fully capable of handling these costs. Other respondents do confirm that this is an issue, but do not perceive it to be a decisive factor that fully determines the ESG stewardship strategy of the Big Three.

The extent to which the Big Three aim to safeguard the private nature of their engagement process is remarkable. Even though it can be viewed as more beneficial to the engagement to keep it private during the course of the process, it could be expected that, after a successful engagement procedure, the Big Three would be publicly vocal on their successes. Other than releasing public records with annual engagement and voting statistics, the Big Three release no public information on the effectiveness of their engagement processes. Even though this would be highly effective in satisfying ESG demand from both retail and institutional investors, the Big Three collectively decided to keep their full engagement process under the radar as much as possible. There is limited empirical evidence in the interviews to explain their desire to keep the nature of the engagement processes private. A potential explanation could be that any media attention that highlights their use of corporate power could ignite a debate that focusses on the potential merit of so-called common ownership. Especially in the United States, the theory is gaining traction that the substantial stakes of the Big Three in several companies in one sector creates an incentive for them to constrain competition. According to this theory, horizontal ownership creates an anti-competitive playground as it erodes the incentive to invest in resource and development efforts that could

negatively impact the value of their stakes in competing firms. Building on research that underlines the perils of overlapping institutional ownership (Elhauge 2018 & Azar et al. 2018), regulators and politicians are increasingly debating whether the Big Three have become ‘too big’. The vision of an economy predominantly controlled by financial oligarchs in a recurrent controversy in U.S. culture (David 2009:68). The US Federal Trade commission is currently in the process of a regulatory investigation of the anticompetitive effects of horizontal shareholding and the EU has also acknowledged the potential risks of common ownership. In this governance context, it can be argued that it would not be sagacious for the Big Three to publicly demonstrate their influence over their investee companies. Flexing their muscles by pushing ESG integration on their investee companies could add fuel to the fire. Therefore, an important latent barrier to ESG integration could be the pressure that arises from a governance landscape that is increasingly critical towards horizontal ownership.

While the Big Three are taking up an increasingly active role with regards to their investment stewardship strategy related to ESG issues, it can be concluded that they are not at the forefront of the broader societal movement towards ESG integration. The interviews offer insufficient empirical backing to the perception that the Big Three are permanent shareholders and are therefore naturally incentivised to oversee and influence asset managers to ameliorate corporations’ performance. Instead, they seem to respond to the incentives created by a broader societal movement. As a result, most respondents indicate that their stewardship strategy is not likely to develop in the direction of shareholder activism. The incentives that the broader societal movement in the direction of enhanced stewardship and ESG integration are not strong enough in the context of their low-cost business-model, the financial risks, and the potential regulatory backlash that an increasingly activist approach will entail. Based on the expert interviews, it can be concluded that it is unlikely that in the near future, the engagement strategy of the Big Three will be expanded by activist efforts against management, initiating shareholder proposals or aiming for company board seats.

Nevertheless, it can be stated that the passiveness of the Big Three is only visible in their investment vehicles that offers diversified and low-fee portfolios. Their passive investment strategy does not imply a passive ownership strategy related to ESG related stewardship.

5. Conclusion

This study analysed how the Big Three approach investment stewardship and what incentivises them to influence their investee companies to integrate the principles of environmental, social and governance responsibility. Based on expert interviews three central trends can be identified: increased investor appetite, growing regulation and the materialisation of ESG principles.

Both institutional and retail clients increasingly emphasise ESG integration and demand that the Big Three are more engaged ownership, overseeing the implementation of ESG principles in the governance structure of their investee companies. Investing in companies characterised by social responsible corporate behaviour has become essential for a large segment of the, predominantly European, pension funds, insurance companies and individual investors. Subsequently, the Big Three are increasingly expected to take up an enhanced stewardship role. The materialisation of ESG principles and the growing role of international regulators and governmental institutions facilitates the integration of ESG into the overall stewardship strategy of the Big Three. European regulatory bodies address conceptual confusion, thereby facilitating the quantification of ESG. Furthermore, they aim to enforce transparency on the stewardship activities undertaken by the Big Three which facilitates competition on stewardship. The rapid development of high-quality ESG data also has an important impact of the integration of ESG principles in the stewardship strategy of the Big Three. The translation of ESG principles, that are by nature non-financial, into metrics and reporting frameworks enables the integration of ESG in the risk-assessments of corporations and in the performance assessment of asset managers.

The results provide evidence in favour of the active ownership hypothesis: passive investing does not align with passive ownership. The passive investment strategy of the Big Three is limited to their investment vehicle, and does not imply passive ownerism. However, the verification of the active-ownership hypothesis does not imply a full refutement of the individual elements that constitute the passive ownership hypothesis. In the context of an industry that competes on fees, a collective action problem and the inability of the Big Three to sell shares, the incentives to adopt an enhanced stewardship role are stronger. Especially the growing demand from both retail and institutional clients to adapt to an active stewardship role regarding the ESG integration among the governance of their investee companies has proven to be an important trigger for the Big Three to become increasingly active owners. The growing cooperation between institutional investors has fuelled the rising pressure on the Big Three as alike-minded institutional investors have started to form coalitions which are intended to obtain a stronger position when engaging with the Big Three. As the dominant shareholders of publicly listed companies, the Big Three are ought to take up control and become a steering force influencing the internal corporate decision making processes on ESG.

Both institutional and retail clients are increasingly holding the Big Three partially accountable for the implementation of ESG principles into the governance structure of their investee companies. As the Big Three are unable to sell shares of ESG under-performers, they are placed into a ‘partner position’ with their investee companies. This partner position makes the Big Three more inclined to internalise the objectives of ESG integration among their investee companies and will lead to the adoptation of an enhanced stewardship role. In this sense, a disciplinary mechanism occurs that seems to generate a greater ethical accountability of the investee company to the broader society. Therefore, it can be concluded that the concentration of ownership in the hands of the Big Three has resulted in an increased focus on the integration of ESG within the governance structure of publicly listed companies.

The Big Three adopt a stewardship strategy that consists of three central elements: monitoring, voting and engagement. Their investment stewardship strategy has become an integral part of their overall strategy as they are more precisely monitoring investee companies, actively vote their shares and increasingly engage in dialogue with the management of their investee companies to improve ESG integration. They prefer to initiate engagement processes if serious ESG related issues occur. Voting is interpreted as the 'ultimate measure', and will usually only be effectuated at the end of a failed engagement process. As continuity and the establishment of a trusting relationship between the Big Three and management is considered essential, the Big Three will primarily utilise their voting power to block reappointment of management positions. The engagement stewardship strategy of the Big Three can be characterised as event-driven and focusses predominantly on high-profile cases. Instead of engaging structurally with a large subset of investee companies, the Big Three choose to engage with only a small percentage of their investee companies that are excessively underperforming on the ESG spectrum. The investee companies that are adequately performing will only be latently monitored. Through engagement the Big Three respond to the demand of especially institutional investors that regard stewardship practices as pivotal to the quality of beta.

However, the extent to which the Big Three conduct stewardship related engagement should not be overestimated. They are far from utilising their permanent ownership positions to its full potential and remain rather hesitant to exercise their power to strongly push for ESG integration. They demonstrate a predilection for keeping their engagement endeavours private and under the radar. A strategy that could be explained as rational in the light of a public debate that is becoming increasingly antagonistic towards the horizontal ownership position of the Big Three. Publicly flexing their muscles by strongly pushing for ESG integration could result in a regulatory backlash.

Davis (2009) argued that the rise of the mutual fund industry has resulted in an investment industry characterised by a concentration of corporate ownership, reminiscent of the *finance capitalist* era a century ago. Based on this research, it can be argued that the increased focus on the investor stewardship responsibility of the Big Three has resulted in, what could be called the regeneration of the *'soulful'* corporation, a concept associated with the era of *managerialism.* With regards to stewardship enhancement, the current financial predicament seems to demonstrate more similarities with the managerialist era, in which the company as a social institution became dominant. Through a grassroots movement characterised by client demand, the Big Three are increasingly expected to live up to their self-portrayed long-term perspective on the sustainable growth of investee companies.

Based on this study, it can be concluded that the incentives for the Big Three to fulfil an active ownership role are stronger than what dominant academic literature on this topic suggests. Based on the empirical evidence it can be stated that several important incentives, most notably client demand, and their inability to exit, will urge the Big Three into partner-position with the management of the investee companies. In their newly acquired stewardship role, they will increasingly oversee, steer and correct where the management of the firms are slipping away.

6.1 Research limitations and recommendations

The results of this study must be interpreted in light of several limitations. First, in this study, the nature of the engagement processes remains largely a black-box. Further knowledge on the engagement process initiated by the Big Three would have enhanced the concluding remarks.
Furthermore, only ten in-depth interviews were conducted during the course of the study. While we believe that the richness and trustworthiness of the data was high and a level of knowledge-saturation was reached, we are confident that more interviews would have resulted in an enhanced perspective on the complexity of the central theme.
Since the potential of the Big Three to conduct ESG related stewardship activities is largely unexplored, there are numerous interesting potential avenues for future research. It would be very interesting to address the specific nature of the engagement processes of the Big Three with their investee companies in future studies as this could inform us on the effectiveness of their current stewardship strategy. For example, how and when are processes initiated, what communication channels are being used, which stakeholders are seated at the table, and the frequency of the engagements remain uncharted territory. Moreover, knowledge of the aspects on which the Big Three monitor their investee and how the framework is constituted on the basis of which they select the ESG under-performers to engage with would contribute to our overall understanding of the stewardship strategy of the Big three.
Furthermore, in future research, it would be interesting to further explore the perspective of institutional clients on the extent to which they consider the Big Three partially responsible for the ESG behaviour of their investee companies. In which situations do the Big Three have a certain responsibility and how are they expected to positively influence the assets they invest in to act as prudent fiduciary asset managers according to their clients.

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