Fragmentation of Shareholder Power

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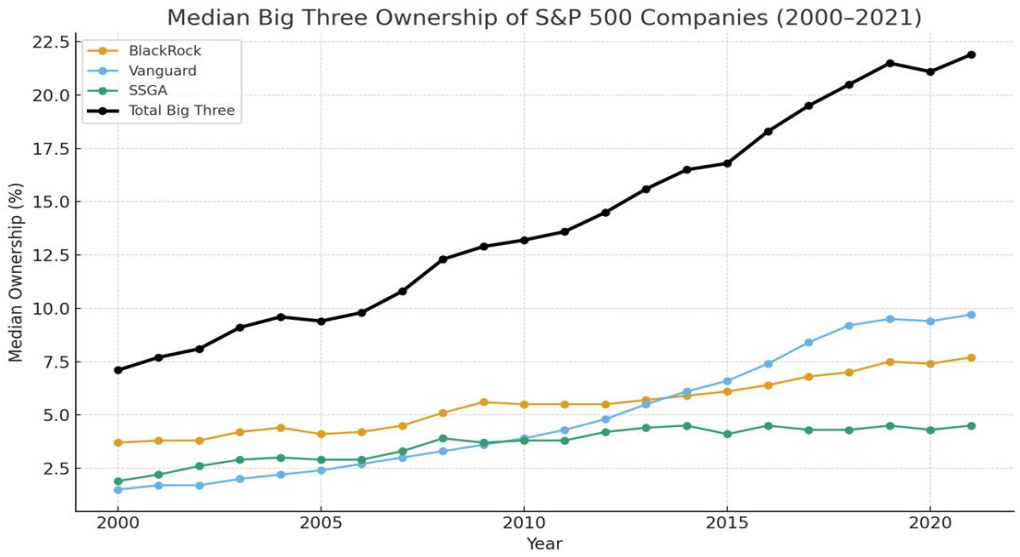
Corporate Governance Academic Forum
University of Toronto, Canada

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Motivation

Rise of **large** institutional investors ⇒ more concentrated ownership

Hartzell, Starks 2003; Dasgupta et al. 2021; Betermier et al. 2023; Brav et al. 2024; Lewellen, Lewellen 2025

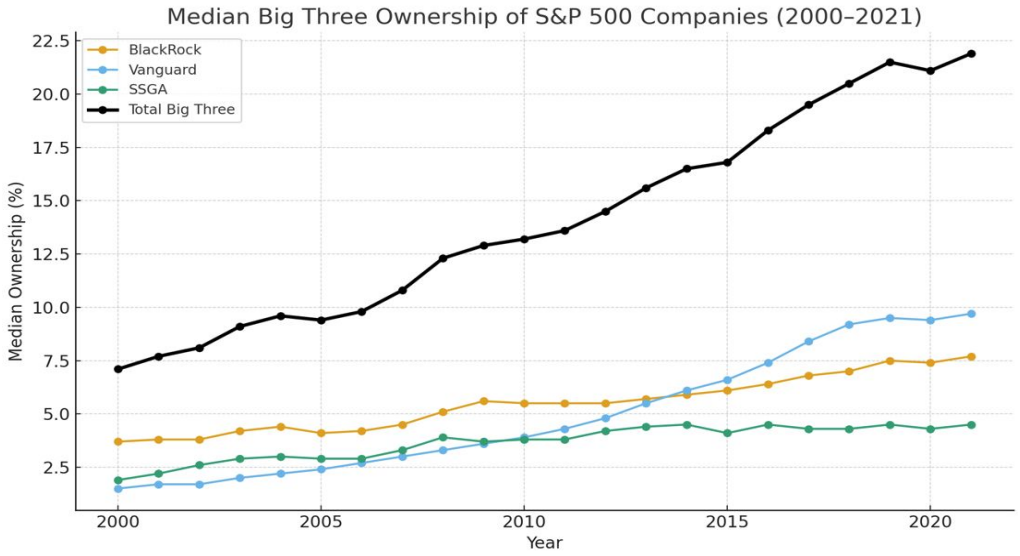


Bebchuk, Hirst (2022)

Motivation

Rise of **large** institutional investors ⇒ shareholder oversight & managerial accountability

Appel et al. 2019; Brav et al. 2024, 2025; Iliev, Lowry 2015; Iliev et al. 2021; Krueger et al. 2020; Lewellen and Lewellen 2022



Bebchuk, Hirst (2022)

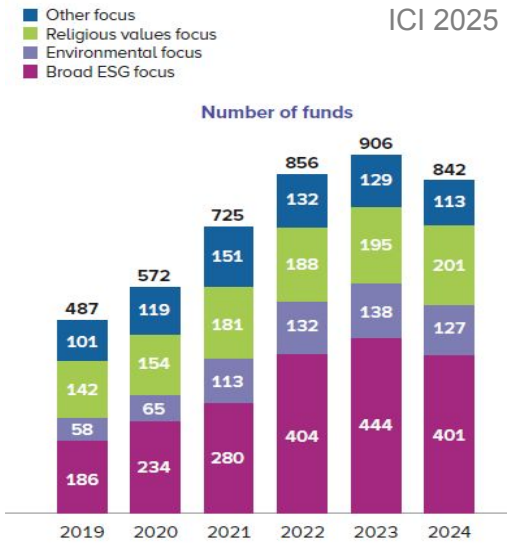
"When voting was dispersed among millions of individual investors, managers held little regard for shareholder views. Now, however, corporate leaders are extraordinarily responsive to institutional investor demands" (Fisch, Schwartz 2023)

Two developments in asset management

Fund proliferation

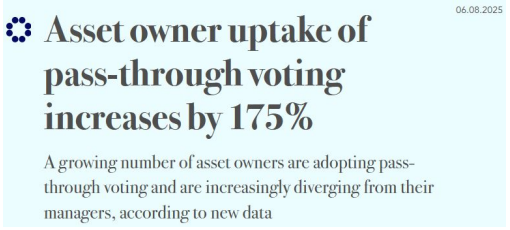
- Hundreds of funds launched annually
  - different styles, values, strategies
  - active and passive (e.g., niche ETFs)

Betermier et al. 2023; Ben-David et al. 2023; Kostovetsky, Warner 2020

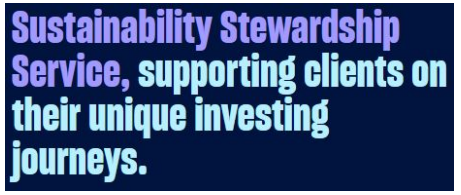


ICI 2025

At least 25% (~ $900 billion) of BlackRock's eligible institutional clients vote directly



State Street



This paper

- These developments align investment products with investor demands
- But also change ownership structures and fragment voting power

"A world of governance diffusion, by contrast, will upend this dynamic in unpredictable ways" (Brav et al. 2025)

This paper

What we do:

- Framework to understand these developments
- Investor heterogeneity □ structure of fund industry □ ownership and monitoring

Questions:

- What drives fund proliferation and decentralization?
  - which asset managers are more likely to adopt pass-through voting
- What these changes imply for:
  - shareholder oversight & firm value
  - welfare of fund investors, fund managers, initial asset owners

This paper

What we do:

- Framework to understand these developments
- Investor heterogeneity □ structure of fund industry □ ownership and monitoring

Forces and implications:

- Asset managers compete for investors, without internalizing governance externalities
  - catering to heterogeneous investors may lead to excessive decentralization
- The drivers of fund proliferation and the form of decentralization are central for governance outcomes

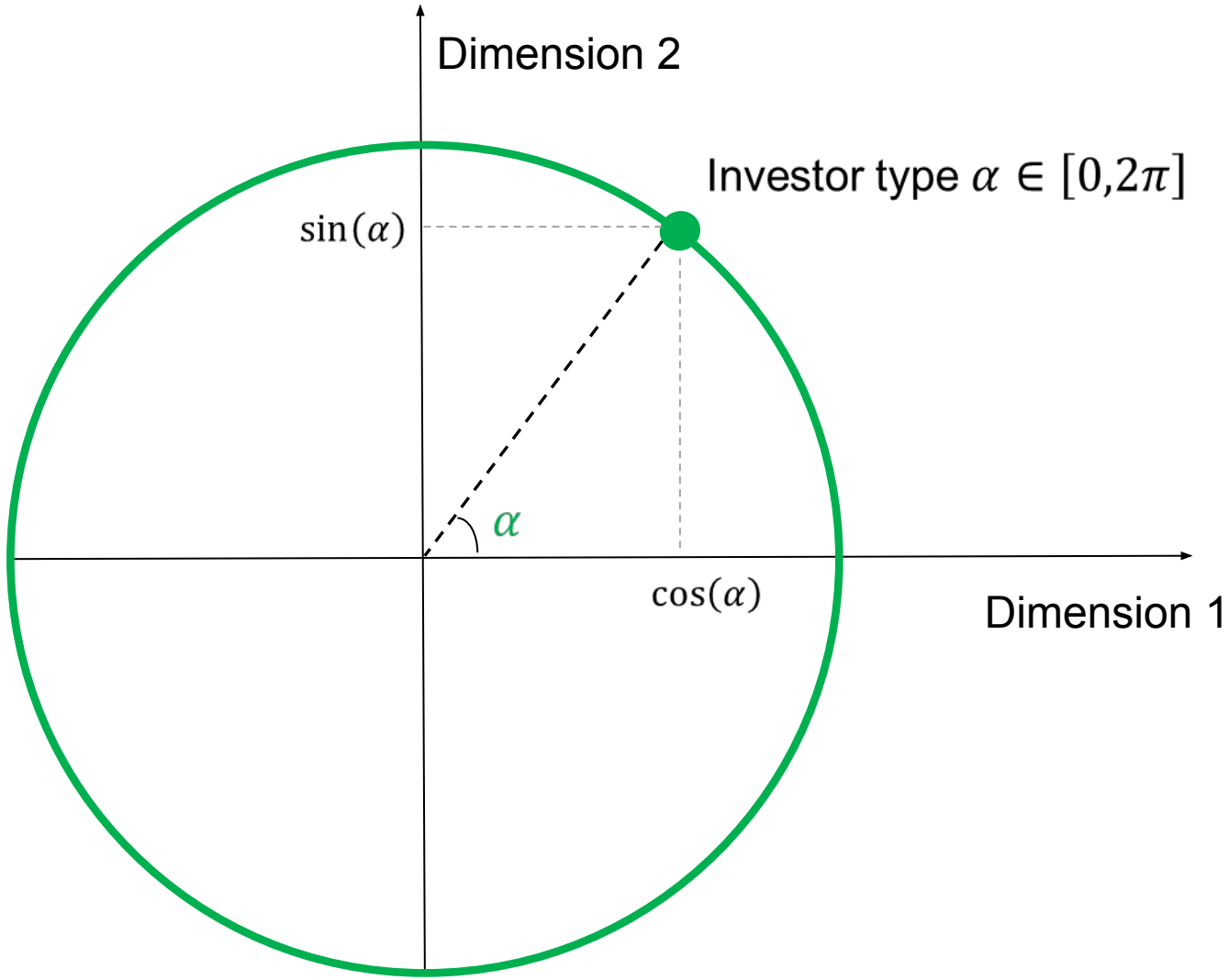
Model

Investors

Salop (1979)

E.g., geography and ES score

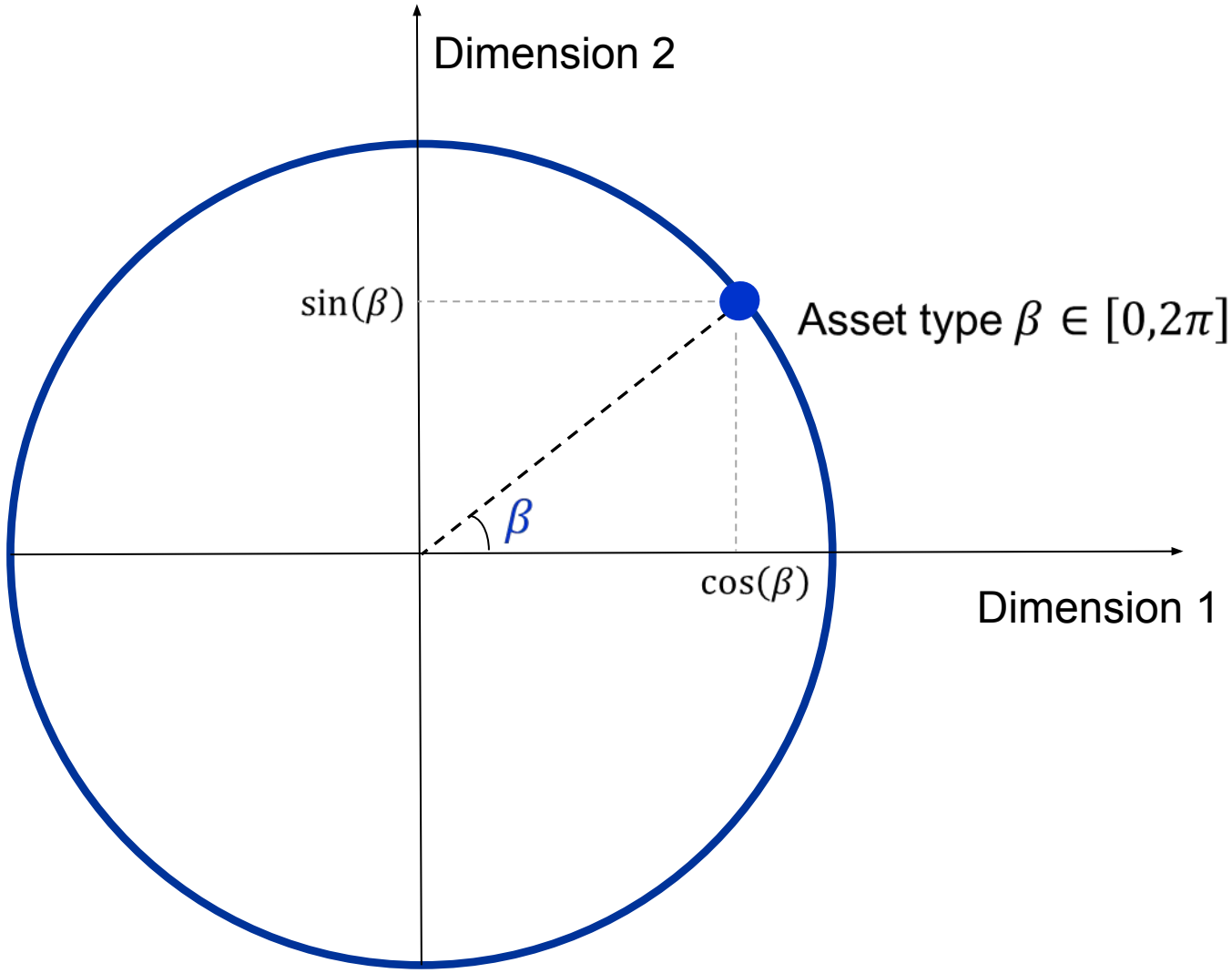
Investors: mass 1



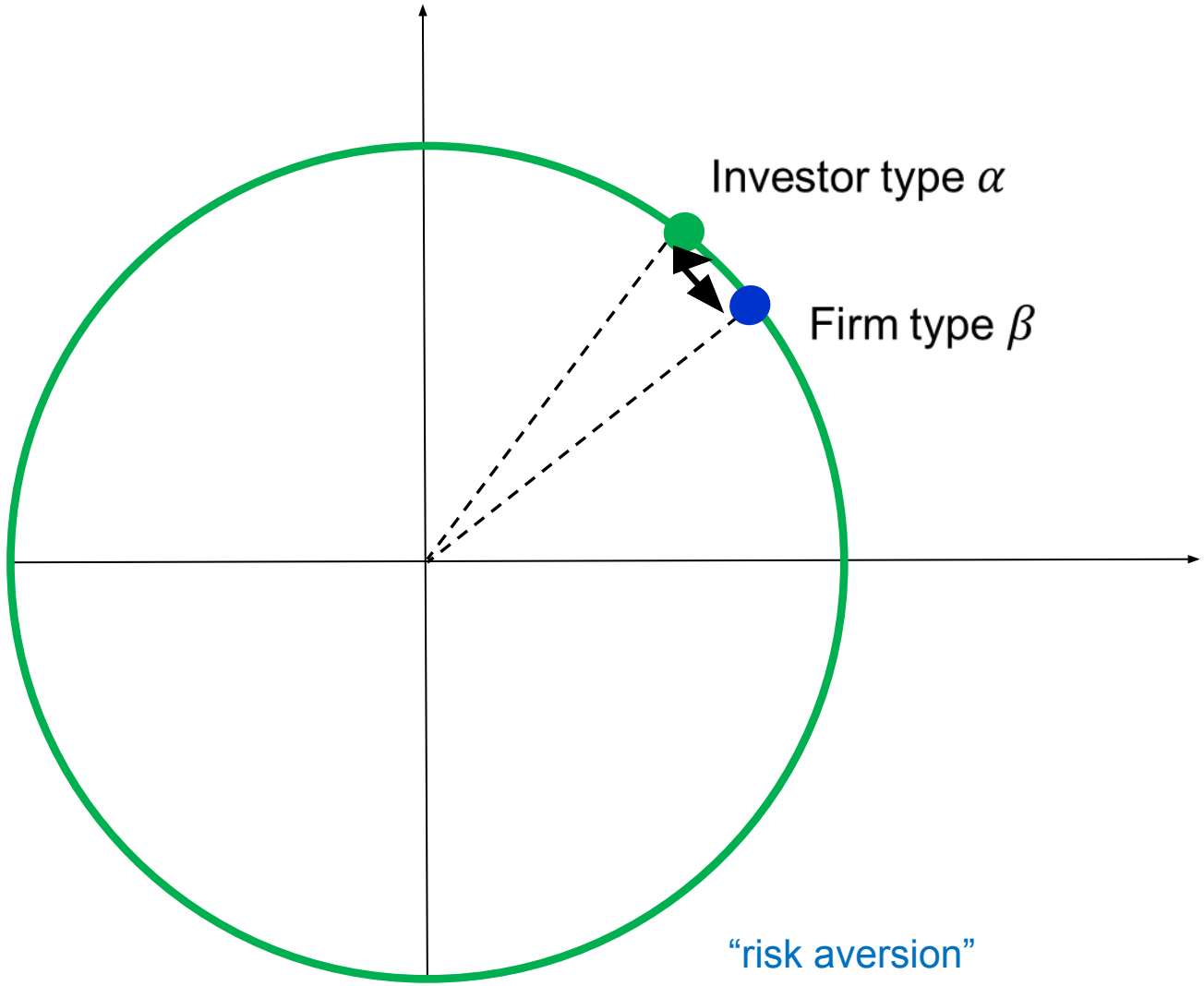
Investor α values dimension 1 at $\cos(\alpha)$ and dimension 2 at $\sin(\alpha)$

Firms

Firms: supply mass s (supplied by initial asset owners)



Investor's utility



"risk aversion"

payoff price

$$\int_0^{2\pi} \left(x_\beta \left(v_\beta - p_\beta + r \cos(\beta - \alpha) \right) - \frac{\eta x_\beta^2}{2} \right) d\beta$$

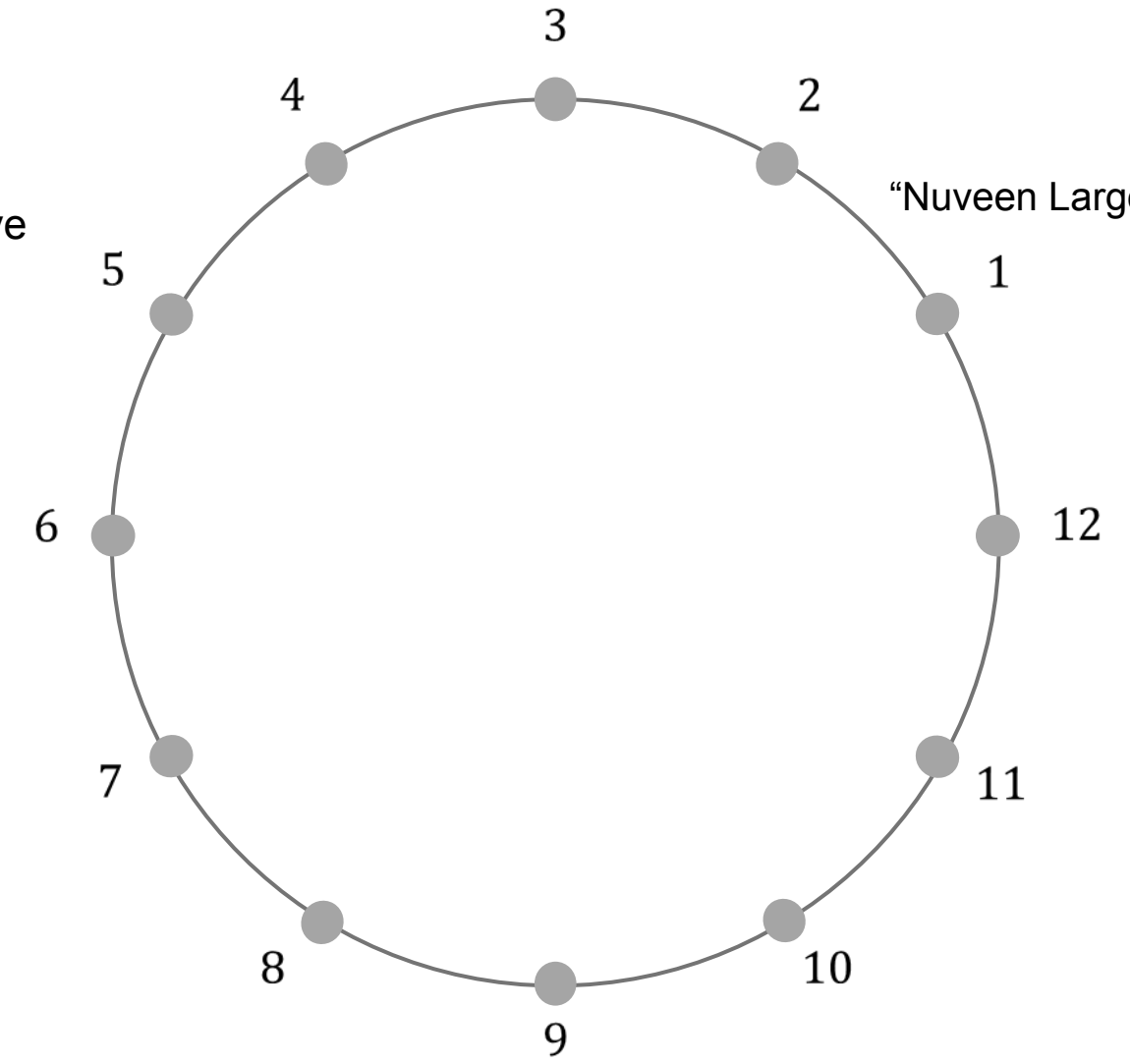
position

utility from characteristics

Funds

K funds

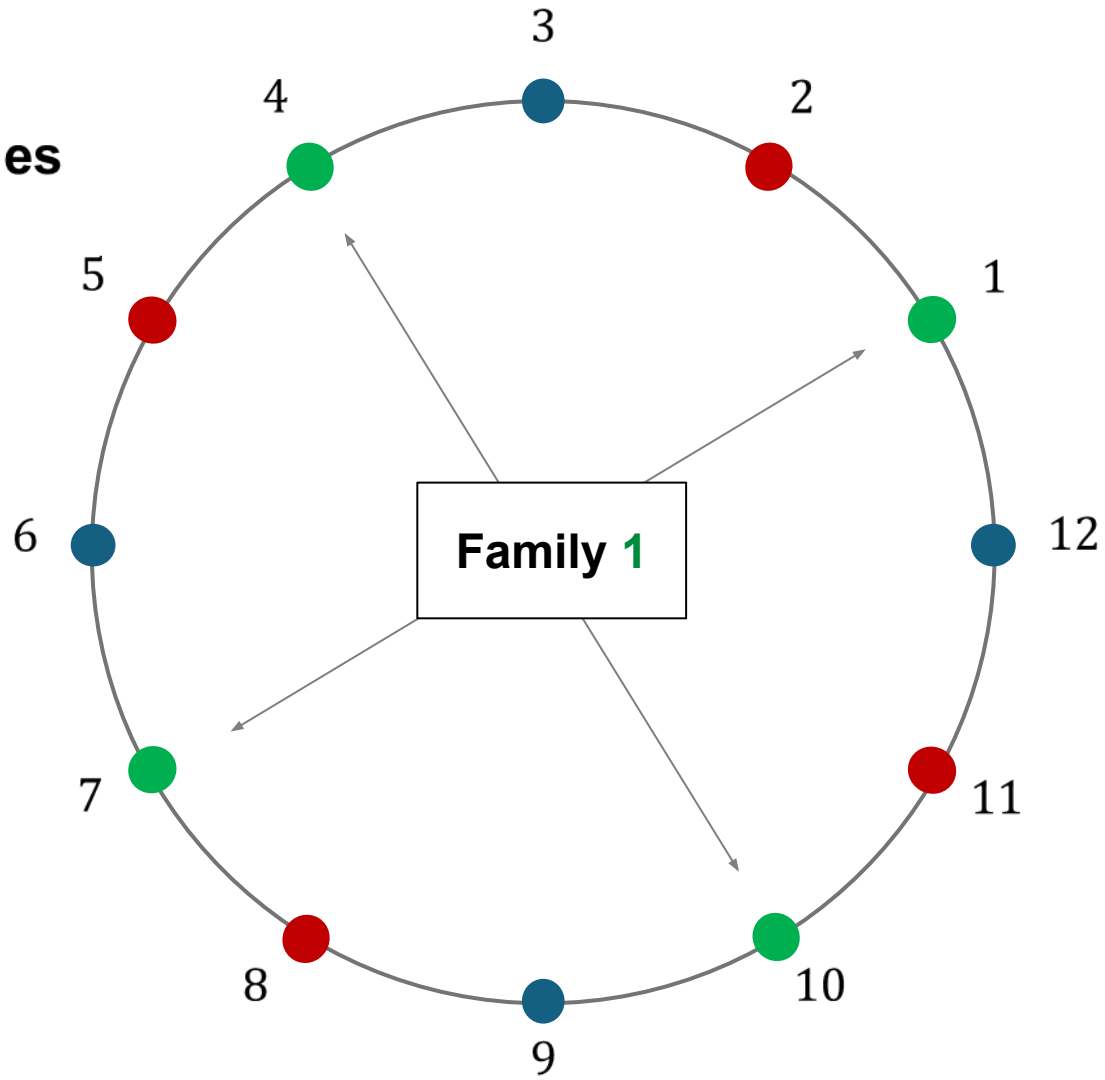
- active or passive



"Nuveen Large Cap Responsible Equity" fund

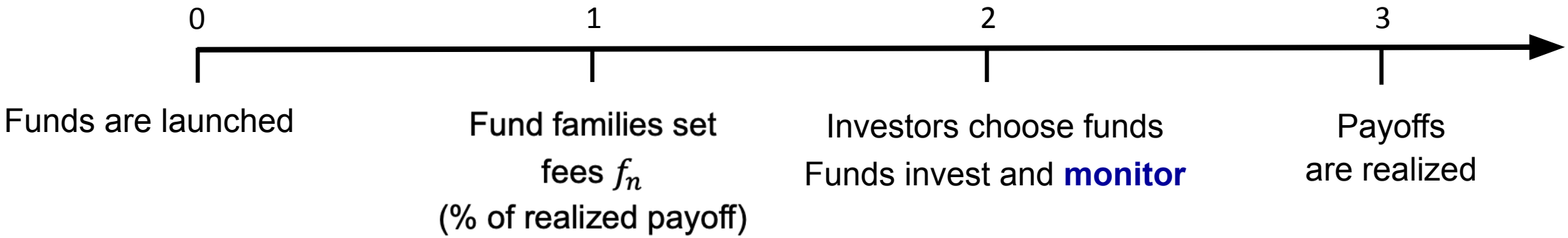
Fund mandate $\alpha_k \equiv$ fund k offers optimal portfolio for investor type α_k

Fund families



"Over time, the strategy of filling up the style grid has led to few families with large, granular, and similar fund offerings" Betermier et al. 2023

Timeline



Family n: monitoring effort $e_{\beta,n}$ in firm β at cost $\frac{\gamma}{2} e_{\beta,n}^2$

Centralized monitoring

- informed voting; engagement; supporting an activist

$$v_\beta = u + \left(\sum_n e_{\beta,n}^2 \right)^{1/2}$$

Prices and fund portfolios

Demand of fund k:

$$x_{\beta,k} = \frac{1}{\eta}\left(v_\beta - p_\beta + r\cos(\beta - \alpha_k)\right)$$

payoff price portfolio tilt

Prices and fund portfolios

Prices of assets:

$$p_\beta = v_\beta - \eta s$$

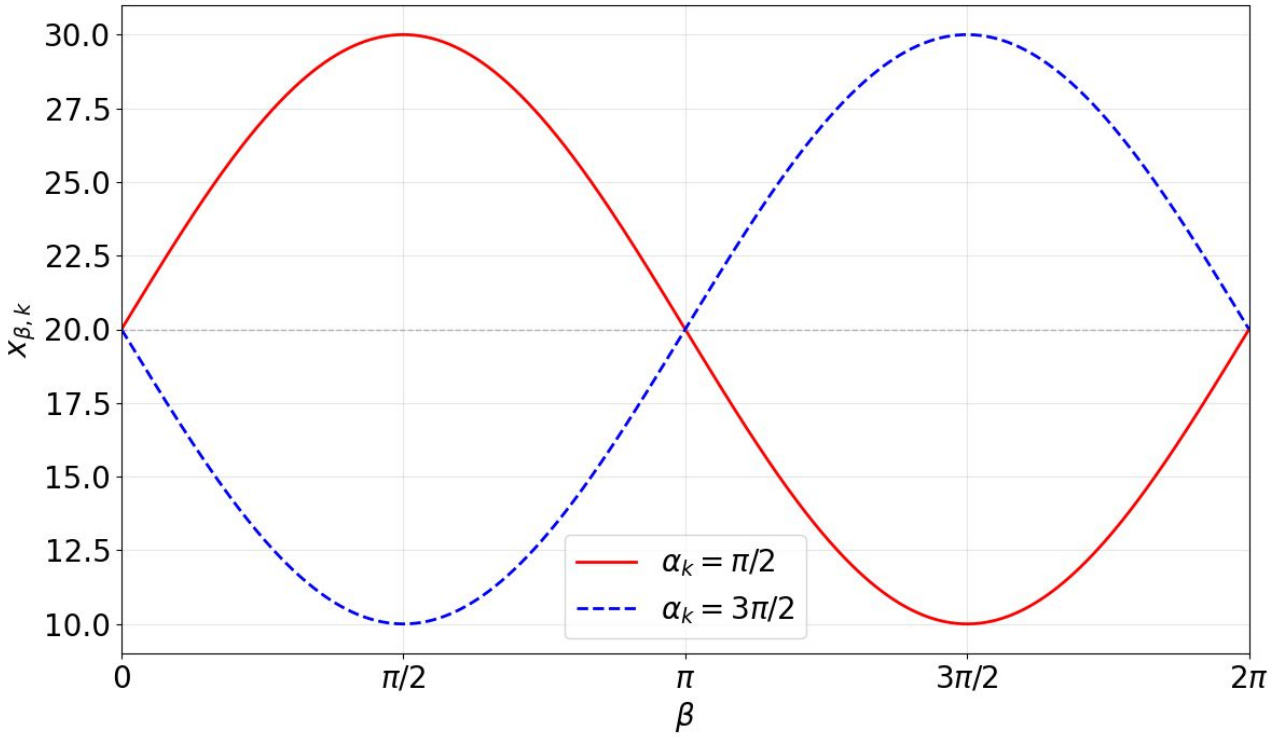
Fund portfolios:

$$x_{\beta,k} = s + \frac{r}{\eta}\cos(\beta - \alpha_k)$$

Fund family portfolios:

$$\bar{x}_{\beta,n} = s$$

portfolio tilts toward mandates



Implications

Drivers of fund proliferation

- Fund proliferation: **supply** vs. **demand** factors
  - regulatory easing (e.g., 2019 “ETF Rule”) vs. stronger preferences (e.g., polarization)
  - both encourage entry, but have **different governance implications**
- Stronger investor preferences ⇒ shareholder oversight can improve despite ownership fragmentation

Monitoring incentives: $\frac{f_n \cdot \alpha_{\beta,n}}{\gamma}$ (fee, stake)

Lewellen and Lewellen (JF 2022)

Drivers of fund proliferation

Number of funds grows if

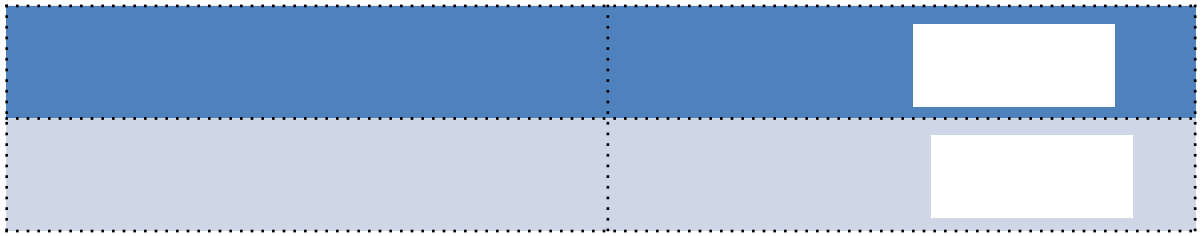
- C ↘ supply factors
- r ↗ demand factors

⇒ **incentives to engage**

Intuition:

fees family's stake

- C ↘
- r ↗



Drivers of fund proliferation

Number of funds grows if

- C ↘ supply factors
- r ↗ demand factors

⇒ **incentives to engage**

Intuition:

	fees	family's stake
C ↘	↘	↘ or
r ↗	↗	↘ or

Ben-David et al. 2023; Heeb et al. 2023

Family entry

Drivers of fund proliferation

Number of funds grows if

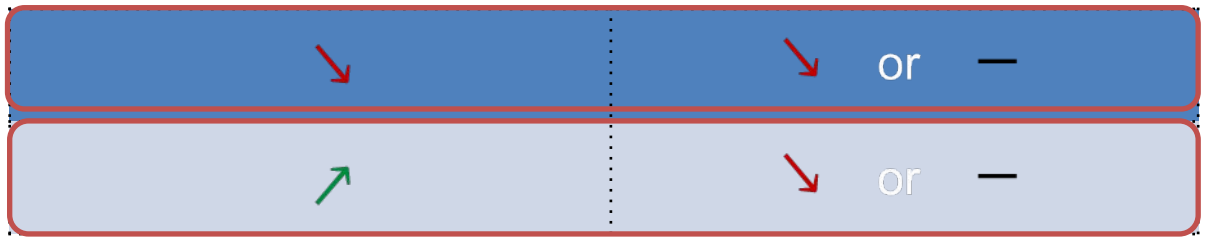
- C ↘ supply factors
- r ↗ demand factors

Effect on governance:

weakens monitoring

can strengthen monitoring

Intuition:



Ben-David et al. 2023; Heeb et al. 2023

Family entry vs. Expansion of incumbents to deter entry

Betermier et al. 2023

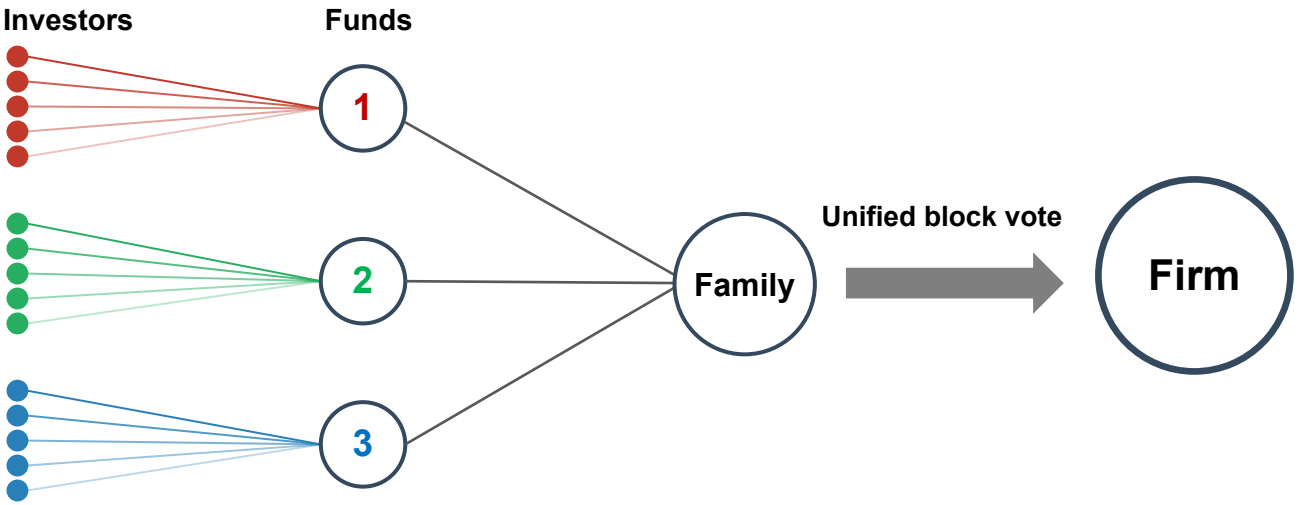
Investor preferences and competition

- Monitoring can ↗ if driven by strong investor preferences
  - especially if new funds are launched by incumbents
  - centralized monitoring ⇒ no fragmentation + stronger incentives via fees

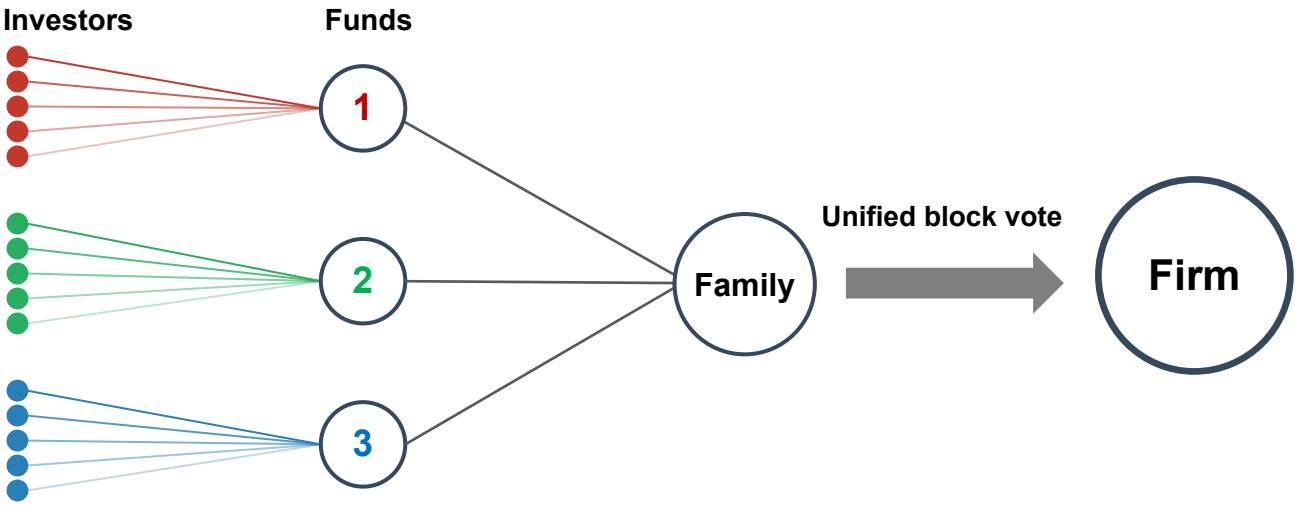
- However, strong investor preferences can induce competition to decentralize
  - investors value not only investment-alignment but also vote-alignment

⇒ Differentiation along a new dimension: investor control

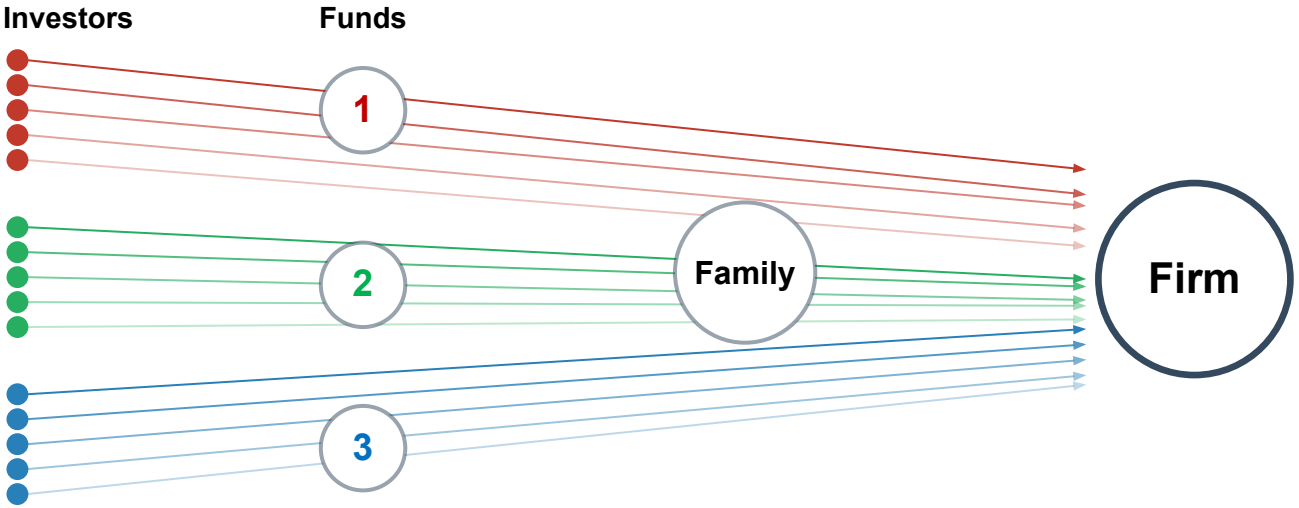
Decentralization



Centralized stewardship

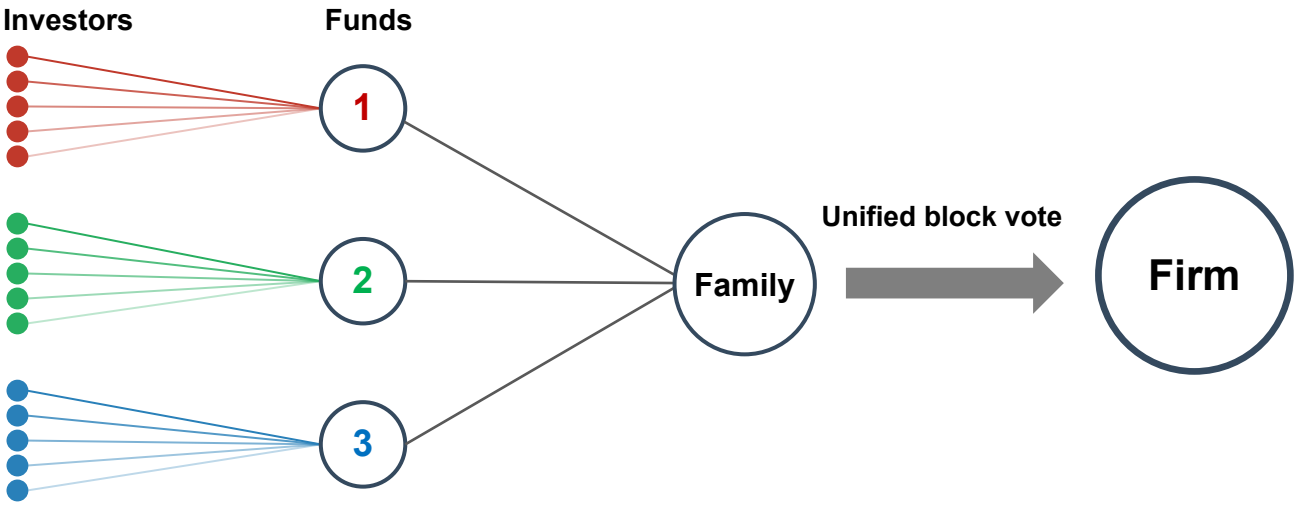


Centralized stewardship

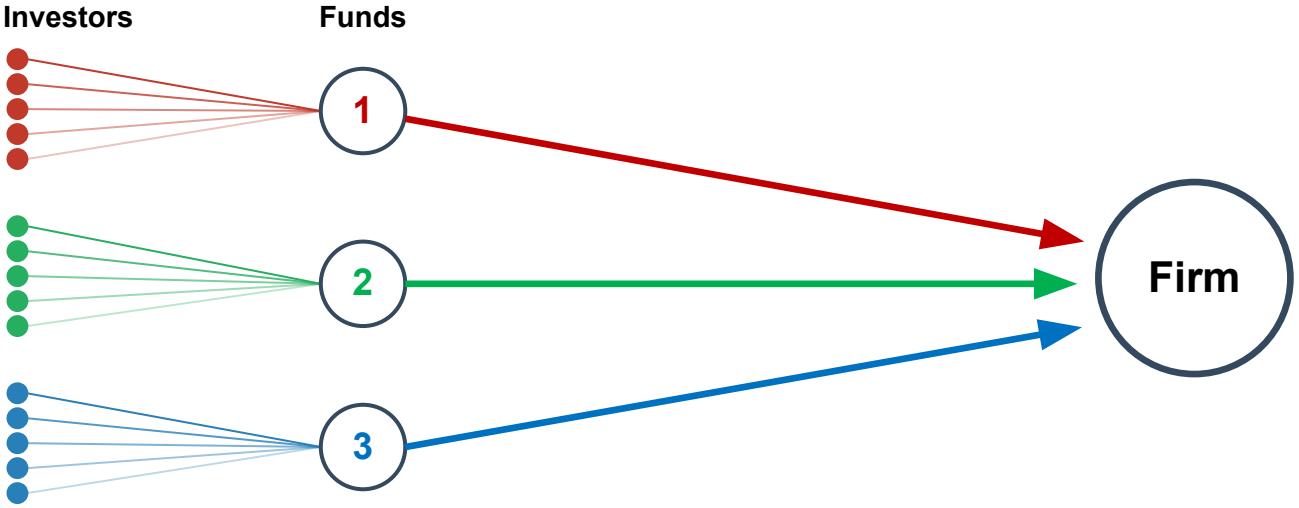


Decentralization

Pass-through voting to fund investors



Centralized stewardship



Decentralization

Delegation to fund managers

Pass-through voting

Shareholders take two sets of actions:

1. Monitoring ~ voting on governance proposals; engagement ← all investors benefit
2. Voting on ideological proposals (e.g., ES) ← investors disagree
   - investor gets warm-glow B if his vote is aligned with his "type"

Centralized stewardship
monitoring
misaligned voting

Decentralization via pass-through voting
no monitoring
value-aligned voting

Incentives to decentralize

	All families centralize stewardship
	All families adopt pass-through voting

Asset manager's trade-off:

- If other asset managers don't offer PTV, wants to be the first to adopt it
  - investors switch to get value-aligned voting (B), don't internalize the negative governance effect

  ⇒ **AUM** and/or **fees increase**

- Downside: **loss in fee revenue** due to lower valuations

Decentralization is excessive

Asset managers excessively adopt pass-through voting

- Social trade-off: Preference representation vs. weaker monitoring

⇒ PTV is **socially optimal** when warm-glow benefits B exceed net gains from monitoring

- Asset manager that is the first to adopt PTV can fully capture B
- Yet, it only captures f of monitoring gains ⇒ **excessive adoption**

Who benefits from pass-through voting

Utility (compared to centralized stewardship)

Fund investors	Asset managers	Initial asset owners
↑ warm-glow	↑ higher profits	↓ lower asset prices

Asset managers draw a clear line between what pass-through voting means "from a commercial perspective"… and its impact "from a stewardship and governance perspective"

"admitted that they either offer or would offer it if considered a commercial imperative, for example to retain or win a large enough client"

Gomtsian, Gosling 2026: interviews with asset managers

Delegation to fund managers

Centralized stewardship	Delegation to funds	Pass-through voting
monitoring	**some** monitoring	no monitoring
misaligned voting	**partially** value-aligned voting	value-aligned voting

Delegation to fund managers **can strengthen monitoring** relative to centralization

- despite the fragmentation of voting power
- fund has a more **concentrated** position in the firm ⇒ stronger incentives
- fund managers may have a **more efficient monitoring** technology

Delegation to fund managers

Centralized stewardship	Delegation to funds	Pass-through voting
monitoring	**some** monitoring	no monitoring
misaligned voting	**partially** value-aligned voting	value-aligned voting

- Delegation to funds is more efficient than pass-through voting if B is small enough
- But fund investor utility and fund manager profits are higher under PTV

Conclusion

- Industry trends: **fund proliferation** and **decentralization**
  - reflecting heterogeneous investor demands

- These trends may **fragment shareholder power**
  - asset managers compete for investors, without internalizing governance externalities
  - the drivers of fund proliferation and the form of decentralization are central for governance outcomes