From exit to control: The structural power of finance under asset manager capitalism

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Abstract

Political economists have theorized the structural power of financial actors as a function of their capacity to (threaten) exit. This paper presents evidence to make the argument that the dependence of non-financial firms on outside financing have declined, and thus the exit options of wealth owners and their financial intermediaries. Presenting an alternative theory, this paper argues that financial-sector power is increasingly based not on financing and exit but on control. The argument is developed through an analysis of asset manager capitalism as a historically distinct corporate governance regime. Whereas the control-based dominance of finance capital during the early 20th century was characterized by credit-debt relationships between banks and corporations, today asset managers' equity holdings dominate; and whereas the shareholder capitalism of the late 20th century was characterized by impatient investors wielding the threat of exit, the power of asset managers in corporate governance is based on their large and illiquid, yet fully diversified shareholdings. Recent evidence suggests that the structural power wielded by asset managers determines corporate governance outcomes on environmental and social issues, influences product market competition, and shifts the macroeconomic policy preferences of the financial sector.

Keywords: Financialization, finance capital, rate of return on capital, rentier, shareholder value, corporate governance

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Introduction

Since the 1970s, the financial sector has greatly increased in size. At the same time, the owners and intermediaries of financial capital have become more powerful vis-à-vis other sectors. The political economy literature theorizes these trends as two sides of the same coin, conceptualizing the financial sector as providing a scarce resource to non-financial borrowers. From this perspective, the structural power of finance is a function of its ability to threaten to *exit* firms, sectors, or entire countries. This logic is epitomized by the figure of the "impatient" institutional investor that, in the 1990s, came to dominate corporate governance in the United States and the UK (Harmes, 1998). This theory of structural power runs into trouble, however, at a time when companies are less dependent on external financing and when financiers' exit options are diminished. Rather than two sides of the same coin, the persistent structural power of finance constitutes a puzzle.

This paper presents an alternative theory of the structural power of wealth owners and their financial intermediaries. It argues that "finance capital" is back (Hilferding, 1985), and that financial-sector power is increasingly based not on financing and exit but on (diversified) ownership and control. The argument has a structural, or macroeconomic, component and an agential component. Structurally, the financial system is shape-shifting, over the course of long economic cycles, between the functions of financing and wealth preservation. During periods of economic dynamism and growth – think late 19th-century United States or post-war Europe – financial intermediation is driven by demand for financial capital from the non-financial sector. By contrast, during periods of secular stagnation, "the preservation of wealth is an increasingly important function of the financial system" (Gennaioli et al., 2014, p. 1253), and financial intermediation is driven by institutional capital pools in search of scarce investment opportunities. Depending on which of these structural conditions prevails, different types of financial intermediaries dominate the scene – this is the agential component. Under conditions of financial capital scarcity, the dominant intermediaries are banks. By contrast, under conditions of financial capital abundance, the dominant financial institutions are asset managers – financial firms that pool and invest "other people's money."

The central concepts of my analysis are control and diversification – goals whose pursuit by investors has long been a driving force of financial history. When capitalists shift profits accumulated from commercial or industrial activity into financial assets, financial intermediaries must find profitable investments, which invariably requires lending to, or investing in, non-financial endeavors. Whether the borrowers are warring states – as in the cases of Genoese, Venetian, and Dutch bankers lending to Spanish, Dutch, and British sovereigns, respectively – or private businesses – as in the case of British bankers investing in US railroad bonds – these investments force financial-sector creditors to devise techniques to control the policies and activities of non-financial borrowers. Control alone is not, however, enough to shield investors from mishaps befalling their creditors. Genoese wealth owners and their bankers no doubt benefitted from bankrolling the Spanish crown, but their dependence on extending non-tradable loans to this fiscally unreliable "borrower from hell" certainly limited their structural power (Drelichman & Voth, 2011). By contrast, in late 19th-century Britain, landed gentry and industrialists in search of financial investment opportunities were in a much better position. Not only could they choose between government debt and domestic equities – they could easily gain exposure to a broad range of foreign bonds and securities by buying shares issued by the Foreign & Colonial Investment Trust, the world's "first global emerging markets investor" (Chambers & Esteves, 2014). Three centuries of financial innovation had greatly improved the intermediaries, instruments, and infrastructures of financial capital.

This development has since continued. The hallmark of today's asset manager capitalism is the financial sector's ability to combine diversification and control, on behalf of owners of financial wealth. This combination is unprecedented in financial history and amounts to wealth owners having their cake and eating it, too. Supported by a broader "wealth defence industry" of lawyers and accountants (Ajdacic et al., 2020; Winters, 2017), asset management companies constantly reorganize economic activity so as to better serve the remuneration of financial wealth. Under this configuration, finance operates not so much as "a system for the allocation of resources" than as "a weapon by which the claims of wealth holders are asserted against the rest of society" (Jayadev et al., 2018, p. 360). How this weapon is wielded varies across time and space. During the 1980s and 1990s, financialization along the *intensive margin* prevailed, namely in the form of the shareholder value revolution, which was geared towards increasing the "rentier share" of corporate profits (Henwood, 1997, p. 73). In the sphere of publicly listed corporations, this "corporate financialization regime Mark I" has since given way to a "Mark II" regime, under which asset managers keep the rentier share high, while various forces push the corporate economy towards monopolistic market structures organized around intellectual property rights (Auvray et al., 2021; Schwartz, 2021). As a corporate governance regime, asset manager capitalism is at its most developed in the U.S. and UK corporate sectors, its footprint growing in other countries, too (Braun, 2021). An equally important shift, however, has occurred outside the realm of listed corporations, where financialization along the *extensive margin* has greatly accelerated. Through processes of "capitalization" or "assetization", extensive-margin financialization renders new areas of economic activity amenable to financial investment (Birch & Muniesa, 2020; Langley, 2020; Leyshon & Thrift, 2007; Nitzan & Bichler, 2009). Alternative asset managers are key actors in the "minting" of capital (Pistor, 2019), turning unlisted corporate equity (Benquet & Bourgeron, 2021; Eaton, 2020), startup companies (Cooiman, 2021), residential real estate (Christophers, 2021a, 2021b), infrastructure (Gabor, 2021), and even farm land (Ouma, 2020) into asset classes accessible to institutional capital pools.

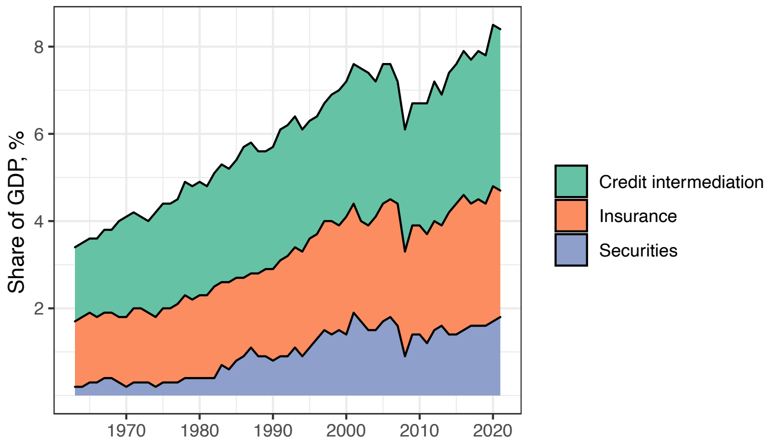
Extensive-margin financialization is both a driver and a consequence of widening wealth inequality. Indeed, in addition to contributing to the literature on the political economy of finance, this paper also hopes to contribute to the literature on wealth and wealth inequality. Sociologists have been calling for a return to the study of (wealth) elites and of the mechanisms through which they gain and perpetuate their wealth (Beckert, forthc.; Savage, 2021). Recent empirical work has shed much-needed light on household wealth and its composition (Goldstein & Tian, 2020; Hansen & Toft, 2021; Pfeffer & Waitkus, 2021). However, this literature has barely broached the question of the single most important determinant of top-1% wealth – the rate of return on capital. Not only has this rate remained stubbornly high in the aggregate (Jordà et al., 2019; Piketty, 2014), there is also overwhelming evidence for the "Matthew effect", whereby those households with the highest net wealth achieve the highest rates of return (Bach et al., 2020; Ederer et al., 2020). To date, most explanations of how wealthy rentiers avoid the "euthanasia" predicted by Keynes have focused on their use of the tax-evading or tax-minimizing offerings of the offshore world (Alstadsæter et al., 2019; Seabrooke & Wigan, forthc.). By contrast, scholars have paid less attention to the "investment chain" – the institutions and practices through which the wealthy invest and earn returns (Arjaliès et al., 2017; Harrington, 2016). Here, the emergence and consolidation of the asset management sector, and its sub-division into firms specializing in various “alternative” or “private” asset classes, have been game-changing developments. In order to explain persistently high returns to wealth, we need to put front and center the investment intermediaries who exercise structural power, both vis-à-vis the issuers of financial instruments and vis-à-vis regulators and tax authorities.

The paper proceeds as follows. The next section places financialization in a macroeconomic context. Focusing on the United States, it presents data on corporate finance to support the argument that investors’ exit options have declined. Section two sketches a theory of structural financial-sector power under conditions of financial capital abundance centered on the concepts of control and diversification. Section three illustrates that theory by tracing the return of control and the perfection of diversification in the US shareholder structure – that is, the rise of asset manager capitalism as a corporate governance regime. The final section concludes.

1. Macroeconomic perspectives on financial capital abundance

Figure 1 shows the value-added share of GDP of the three segments of the US financial sector since 1963. Whereas credit intermediation (i.e., banking) and insurance have doubled their share, the share of the securities segment (i.e., investment banking and asset management) has increased more than eightfold. Macroeconomic problems feature prominently in Greta Krippner’s explanation of financialization, and the macroeconomic considerations and policies that drove financial deregulation and liberalization are, today, well documented (Krippner, 2011; Özgöde, 2021; Walter & Wansleben, 2020). By contrast, the literature on contemporary financialization tends to neglect its macroeconomic dimension. Instead, the focus has been on how households (Chwieroth & Walter, 2019; Goldstein & Tian, 2020; Pagliari et al., 2020), corporations (L. E. Davis, 2016; Karwowski, 2018; Klinge et al., 2021), and states turn to finance for investment or borrowing purposes (Hardie, 2012; Schwan et al., 2021)Hardie, 2012; Schwan et al., 2020). From a macroeconomic perspective, there are two problems with this literature. Firstly, disaggregating corporate balance sheets leads to a rejection of the corporate financialization hypothesis – financial speculation has not become a major source of corporate profits.[1] Secondly, the focus on non-financial actors' demand for credit obfuscates the 'supply side' of the investment chain – the growth of pools of institutional financial capital. The growth of finance reflects not (only) the increased demand for credit but the accumulation of institutional pools of financial capital in search of long-term, yet liquid, financial assets.

Figure 1: Financial services, value added share of US GDP, 1963-2021



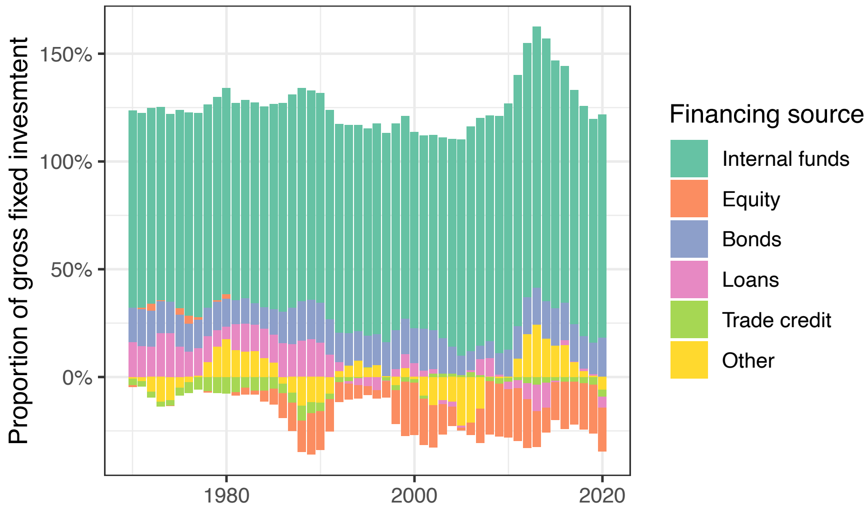
Data: Bureau of Economic Analysis (BEA). "Securities" includes the category "Funds, trusts, and other financial vehicles" (never more than 0.2% of GDP), listed separately by the BEA.

Using data on corporate borrowing and bank lending, this section argues that the growth of finance in recent decades has little to do with increased demand for credit from non-financial corporations, which have largely become financially self-sufficient. The upshot is that in such a world, the exit-based theory of the structural power of finance looses much of its appeal. The data presented focuses on the United States, homeland of financialization and the world's asset manager (Oatley & Petrova, 2020). It is necessarily selective, and should be read in the context of various recent attempts in mainstream macroeconomics to theorize the puzzling relationship between financial sector growth and the declining borrowing needs of non-financial corporations.[2]

[1] This result is obtained when the analysis of financial *assets* distinguishes between financial assets proper and (often offshoring-related) foreign direct investment; and when the analysis of financial *income* focuses on net – rather than gross – financial income (Ergen et al., 2021; Fiebiger, 2016; Rabinovich, 2019).

[2] Bernanke's (2005) "savings glut" conceptualizes financial capital abundance in the US as the result of excess savings in the export-driven Northern European and East Asian economies. Summers' (2014) revival

Figure 2: Financing of gross fixed investment, US non-financial corporations, 1970-2020



Source: Federal Reserve, US Financial Accounts.

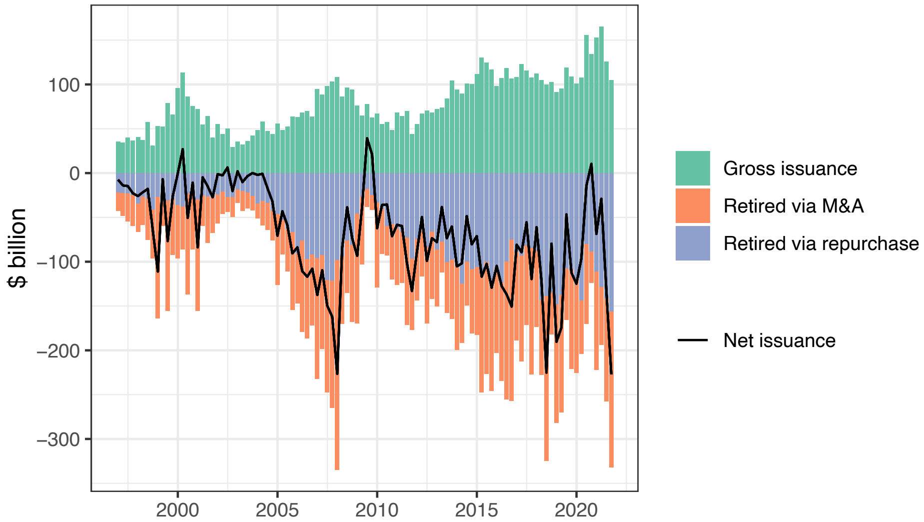
Note: Author's calculations based on Corbett and Jenkins (1997) and van Treeck (2009). Sums do not add up to 100% due to the approximate nature of both the method and the underlying data.

The most direct way of measuring the non-financial corporate sector's dependence on finance is look at the extent to which capital formation is financed by external funds. Figure 2 shows results obtained by using the methodology proposed by Corbett and Jenkins (1997) and further explained by van Treeck (2009). It shows, first, that the vast majority of corporate investment is financed from internal funds, that is, retained profits. Second, while the stock market had not been a source of net financing for the corporate sector since 1970, its contribution turned negative in the 1980s, meaning the stock market has helped ferret capital *out* of the corporate sector (Mason, 2015), at the expense of workers and investment (L. E. Davis, 2018; Palladino, 2020). Third, and most remarkably, even traditional loans have made a negative contribution since 1990.[3]

of the idea of a "secular stagnation" emphasizes deficient aggregate demand and real interest rates failing to fall to sufficiently negative levels. Caballero, Farhi, and Gourinchas (2017) postulate a "safe asset shortage", whereby the demand from investors with a preference for safety over yield outstrips the rate at which states (and other actors) issue high-quality bonds (see also Ahnert & Perotti, 2021). Mian, Straub, and Sufi (2021) argue that the decline in the natural rate of interest is driven by increasing inequality.

[3] These findings are compatible with high corporate debt levels (a gross measure; see Baines & Hager, 2021) and with rising corporate saving (a net measure; see Chen et al., 2017).

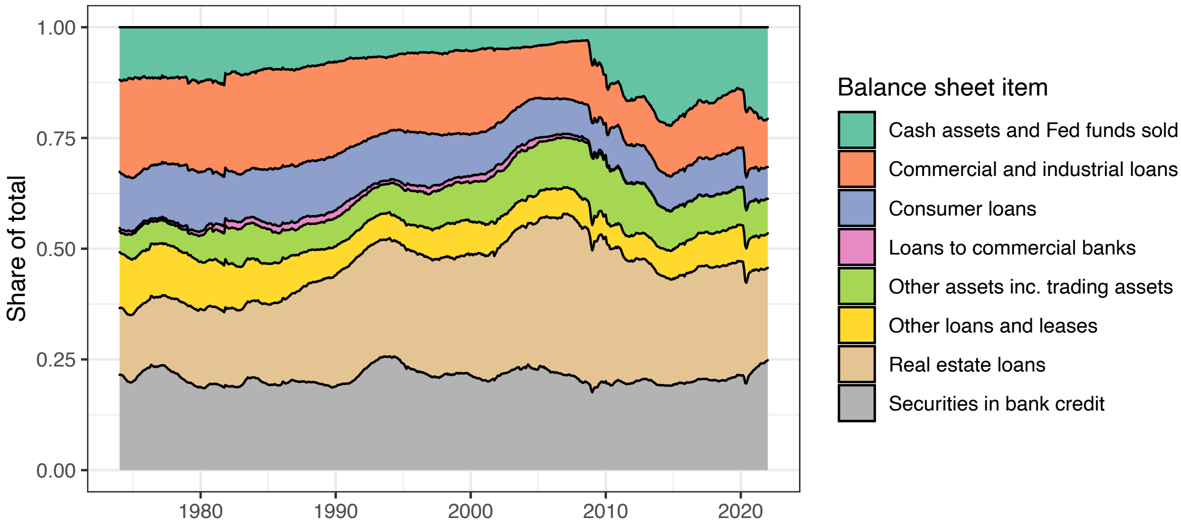
Figure 3: Net corporate equity issuance, United States, 1996-2021



Data: Federal Reserve, US Financial Accounts.

We can drill down further into the equity and loan categories. Figure 3 shows why net issuance of corporate equity in the US has been negative since 1996. Although gross issuance has followed an upward trend, that growth has – until the beginning of the Covid-19 pandemic – been eclipsed by the retiring of shares via stock buybacks and mergers and acquisitions. Lending to non-financial corporations has also turned negative. Since the category "loans" also includes government loans and loans from non-bank financial institutions, shedding light on *bank* lending to non-financial corporations requires data on commercial bank assets, displayed in Figure 4. We see that commercial and industrial loans (orange) have seen the largest decline in total bank assets, whereas real estate loans (light brown) have seen the largest increase. At the same time, loans to non-depository financial institutions, such as private equity and hedge funds (not shown in Figure 4), have more than doubled in absolute terms since 2015, fueling leverage in the global shadow banking system (Bezemer, 2014; Thiemann, 2018). This "debt shift" from business lending to mortgage lending and intra-finance lending has been documented for a large number of countries (Bezemer et al., 2020; Jordà et al., 2016).

Figure 4: Assets held by US commercial banks, 1974-2021

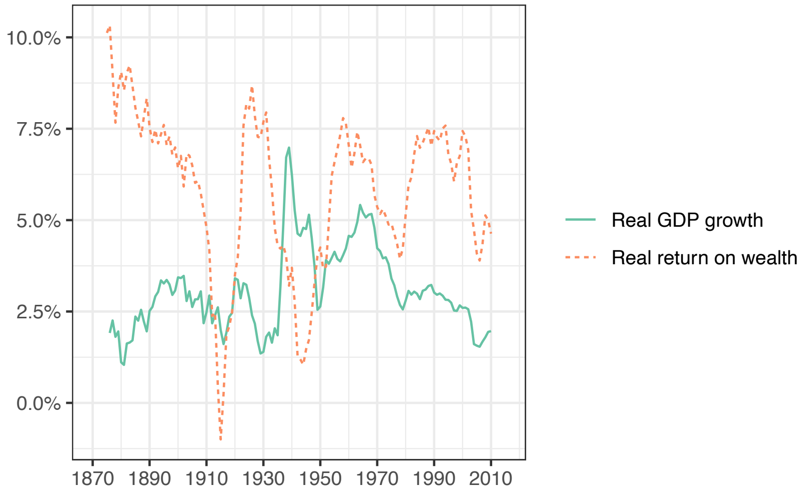


Data: Federal Reserve, US Financial Accounts, H8, Table 2.

Note: Includes US branches and agencies of foreign banks.

Given these developments, how have wealth owners fared? Other things equal, the corporate sector's declining demand for financing should put downward pressure on corporate bond and equity yields. However, other things have not remained equal. The best measure to illustrate this Piketty's (2014) r - g, the gap between the rate of return on capital (r) and the rate of economic growth (g), which recent work has shown to have proven remarkably resilient (Jordà et al., 2019). Reproduced in Figure 5, the data collected by Jordà et al. on real returns on wealth indicate a larger r-g gap for the four decades since 1980 than during any comparable period since the late 19th century. Why, during this period of growing financial capital abundance, has the r - g gap not declined?

Figure 5: Real return on wealth and real GDP growth rate



Data: Jordà et al. (2019), The Rate of Return on Everything.

Note: Data for 16 advanced economies (United States, Japan, and 14 European countries), weighted by real GDP. Decadal moving averages. Rates of return reflect relative portfolio weights of different asset classes (bonds, bills, equity, housing).

3. Finance capital is back: Structural power and institutional capital pools

Keynes (1936, p. 334) famously predicted that the "cumulative oppressive power of the capitalist to exploit the scarcity-value of capital" would decline over time, leading to the "euthanasia of the rentier". Whereas Keynes' primary concern was with loan and bond financing, other observers of the emerging mixed economy derived their predictions of the end of financial-sector power on their analysis of equity markets. Thus, Berle and Means (1932) argued that the dispersion of formerly concentrated shareholdings in the United States had separated ownership from control, thus shifting power from shareholders to corporate managers. Burnham went further still by arguing that the idea of a separation of ownership and control was without meaning because "[o]wnership means control; if there is no control, then there is no ownership" (Burnham, 1941, p. 87). For Burnham, as for Keynes, shareholders had already become "functionless investors."

These predictions of the end of the structural power of finance fared well throughout the post-war period. However, with the deregulation of domestic financial systems and the liberalization of the global financial system, structural power made a return. My central argument is that the mechanisms underpinning the structural power of finance evolve alongside financial expansion. Specifically, the early phase of the latest financialization cycle brought an increase in the capacity of financial actors to threaten exit. This mechanism of structural power is the subject of a large and sophisticated literature. However, the concentration of financial capital in the form of giant institutional capital pools has reduced the latter's exit options, while increasing their capacity to exercise not only voice, but outright control.

The ability of capitalists to hold back investment or to permanently move capital elsewhere is the subject of a large literature on the structural power of business (Block, 1977; Culpepper, 2015; Fairfield, 2015; Lindblom, 1977). The literature on the structural power of *finance* is more explicitly focused on exit. It emphasizes financiers' ability to (threaten to) withdraw credit or portfolio investment from firms, sectors, or entire countries (Strange, 1988), both in the Global South (Dafe, 2019; Naqvi, 2019; Roos, 2019) and in the Global North (Bell & Hindmoor, 2015; Culpepper & Reinke, 2014; Woll, 2014). Subject to certain scope conditions – such as issue salience, regulatory capacity, and intra-finance disunity (James & Quaglia, 2019; Kalaitzake, 2020; Massoc, 2020, 2021) – exit-based structural power allows financial actors to "influence the policy choices of corporate and sovereign borrowers" (Harmes, 1998, p. 99).

In recent decades, however, the growth of institutional capital pools has strengthened the *control-based* power of finance. The structural part of this argument draws on Rudolf Hilferding's analysis of early 20th century "finance capital", the relevance of which for early 21st-century financialization has long been emphasized by Marxist and post-Keynesian scholars (Chesnais, 2016; Palley, 2016; Windolf, 2005). Taking his cue from Marx and anticipating the arguments of Braudel and Arrighi, Hilferding viewed finance capital as the outcome of an extended period of capitalist accumulation, during which a "steadily increasing proportion of capital in industry does not belong to the industrialists who employ it" but instead belongs to the banking sector, which in turn "is forced to keep an increasing share of its funds engaged in industry." This "capital in money form which is … transformed into industrial capital" is what Hilferding called finance capital (Hilferding, 1985, p. 283). The hallmarks of finance capitalism were the dominance of the financial sector – as opposed to states, families or individuals – among the creditors and shareholders of corporations; and the high degree of control the financial sector exercised in corporate governance.

Hilferding saw in finance not just a source of financing but also a means of (re-)organizing industry. Capitalists whose profits exceeded what they could, or wished to, re-invest deposited their money with the banking system, thus causing them to increase their lending, as well as their purchases of debt and equity securities. Thus acquiring “a permanent interest” in corporations, banks faced the problem of *control* – corporations now had to be “closely watched … and so far as possible controlled by the bank in order to make the latter’s profitable financial transaction secure” (Hilferding, 1985, p. 120). Although historians of corporate governance regimes around 1900 tend to reach more nuanced conclusions about the power of “Morgan’s men” (DeLong, 1991; Fohlin, 2007; O’Sullivan, 2016), Hilferding’s point stands that both in the US and in Germany, banks’ role in corporate governance was geared towards minimizing competition, maximizing profits, and thus the ability of corporations to service their debts and pay out dividends.

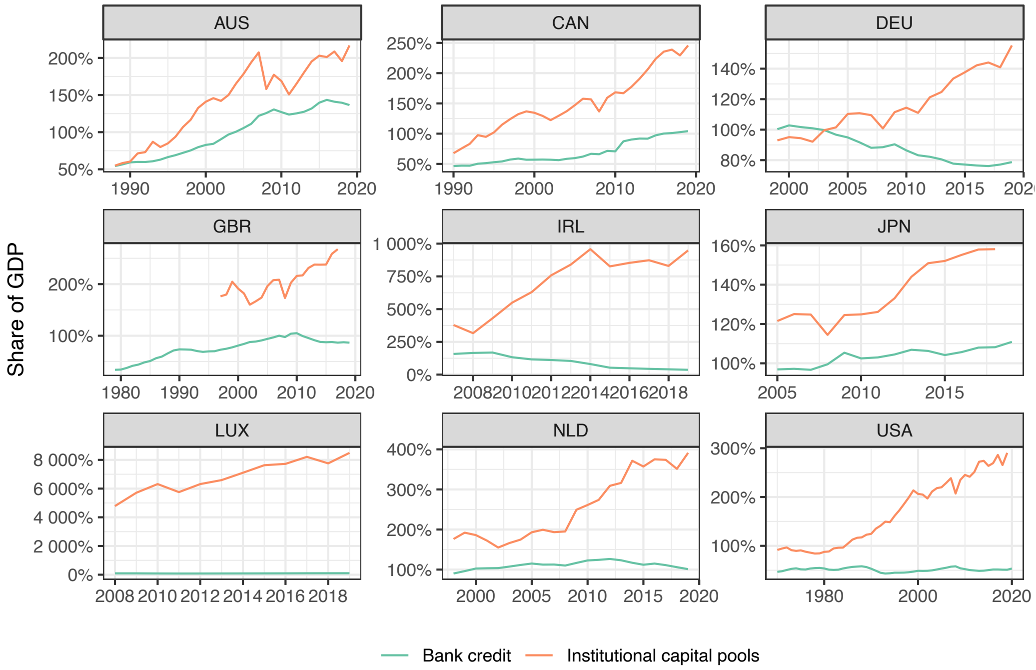
This control-based understanding of the power of finance capital was largely forgotten in the political economy literature. It lived on, however, in two separate subfields – the sociology of the corporate elite and the French regulation school. The former focused on the power of corporate managers and the network of interlocking directorates, especially in the United States. While scholars debated the relative influence of the corporate versus the financial communities, a consensus emerged that an “inner circle” existed whose power was rooted *not primarily in ownership* but in a dense and stable interlock network (Herman, 1981; Mintz & Schwartz, 1985; Useem, 1984). Hilferding’s ideas also continued to inform Marxist political economy scholarship, especially in the French regulation school. Taking his cue from Baran and Sweezy, Michel Aglietta diagnosed a strong tendency towards “capital concentration” for US capitalism. Finance capital constitutes “the ultimate mode of capital centralization” that took “concrete form in financial groups” whose economic importance consisted in their ability to foster “the cohesion of finance capital” – that is, to act as aggregators and coordinators of the interests of wealth owners (Aglietta, 1979, pp. 253, 266).

Although the re-emergence of finance capital can thus be attributed to the structural dynamics of capitalism, there is, nevertheless, the question of agency. Who are the agents of finance capital today? When Aglietta asked this question based on data for 1968, he found that banks still dominated the landscape of financial intermediaries. Since then, however, banks have been joined, and then increasingly overshadowed, by what Aglietta called institutions of "contractual saving", and what this paper refers to as "institutional capital pools." This diverse group comprises asset owners – pension funds, insurers, endowments, sovereign wealth funds, and the family offices of the super-rich – and their asset managers.[4] Funded pension systems have been the most important driver of the rise of institutional capital pools, and the chief source of growth for asset management companies (Scharfstein, 2018).

Asset managers are intermediaries who invest other people's money for a fee. Just like pension funds pool the savings of many households, asset managers pool the capital of many institutional investors (as well as households). The asset management sector comprises, first and foremost, mutual funds and exchange-traded funds, as well as less regulated and more leveraged institutions, namely hedge funds, private equity funds, and venture capital funds. As indicated by the eightfold increase of the securities segment in Figure 1 above, the asset management sector has seen exceptional growth over the past half century. What is more, since the global financial crisis of 2008, most global banks have greatly expanded their asset management arms, as have many insurers. On the list of the world's top-10 asset managers, the "Big-Three" (BlackRock, Vanguard, and State Street Global Advisors) are closely followed by the asset management arms of Goldman Sachs, Allianz, and the like. Figure 6 charts the global rise of institutional capital pools, here defined as the sum of investment funds, pension funds, and insurers, for a selection of advanced economies. The purpose of including three offshore financial centers is to illustrate why national-level data understates the volume of assets controlled by asset managers, many of which operate from offshore jurisdictions.

[4] The former group comprises both not-for-profit institutions (such as pension or sovereign wealth funds) and for-profit financial business, notably insurers. Institutional asset owners differ by legal form, social purpose, asset-liability structure, and regulatory regime (Deeg & Hardie, 2016). See McCarthy et al. (2016) on pension funds, Kohl and van der Heide (forthc.) on insurers, Chambers et al. (2020) on university endowments, and Babic et al. (2020) on sovereign wealth funds.

Figure 6: Assets held by institutional capital pools vs. bank credit, share of GDP, selected countries, various dates - 2020



Data: OECD (investment funds, pension funds, insurance corporations, GDP), Bank for International Settlements (bank credit to the private non-financial sector).

Note: "Institutional capital pools" is calculated as the sum of investment funds, pension funds, and insurers.

The growth of institutional capital pools in general, and of the asset management sector in particular, have reshaped the structure of financial markets and of financial asset ownership. This is most visible in the area corporate governance, where share ownership concentration made a comeback through the backdoor of the retirement-asset-fueled lengthening of the investment chain. However, the consequences reverberate across various other institutional spheres in which financial firms play a key role in the "minting" of capital – the production of financial claims on ever new areas of economic activity (Pistor, 2019). In particular, finance has moved into private – that is, not publicly listed – assets. As their assets under management have increased from near zero in 1970 to $2.4 trillion in 2010, and to $4.1 trillion today, private equity firms have expanded their activities (McKinsey, 2021b). In the corporate sector, they have complemented the traditional buy–one–firm–and–restructure strategy with a buy–many–firms–and–merge strategy (Eaton, 2020). The chief battle ground of the "asset economy", however, has been housing (Adkins et al., 2020; Ansell, 2019). While the "petit rentier" class has been shrinking in most countries (Goldstein & Tian, 2020), institutional capital pools have played a key part in the transformation of residential real estate into an asset class (Gabor & Kohl, forthc.; Wijburg et al., 2018). Private equity firms in particular have moved into housing on a massive scale (Christophers, 2021a, 2021b).

A comprehensive discussion of the control- and diversification-based theory of structural financial-sector power would need to consider all major asset classes, including listed and unlisted corporate equity, corporate, household, and government debt, as well as real estate. Due to space constraints, the remainder of this paper will focus on listed equity only, and thus on corporate governance.

4. Asset manager capitalism: Control *and* diversification

Key to the following is the "Berle-Means-Jensen-Meckling ontology" (Braun, 2021, p. 271). Until recently, the corporate governance literature assumed shareholdings in the United States to be highly dispersed among atomistic, weak shareholders (the Berle-Means component) who are, nevertheless, the only stakeholders with a long-term interest in the economic performance of the corporation, whose governance they should, therefore, dominate (the Jensen-Meckling component). The main power resource of these individually weak shareholders was their ability to exit by selling their shares, thereby pushing down the share price and exposing corporate managers to the dangers of the market for corporate control. This framework underpinned the comparative political economy literature on corporate governance, which equated institutional investors in liberal market economies with "impatient" capital, in contrast to the "patient" capital provided by banks and other strategic blockholders in coordinated market economies (Gourevitch & Shinn, 2005; Hall & Soskice, 2001). The Berle-Means-Jensen-Meckling ontology does not, however, map onto the new landscape of asset manager capitalism.[5]

Table 1 presents a stylized overview of the evolution of U.S. corporate equity ownership and corporate governance since 1900. Each of the four columns represents a distinct corporate governance regime, classified according to four criteria. The hallmarks of

[5] For a paradigmatic formulation of the "strong managers, weak owners" view of U.S. corporate governance, see Roe (1994). For an early and prescient discussion of re-unification of ownership and control in the hands of institutional investors, see Hawley and Williams (2000, p. 43)

finance capitalism were a high concentration of share ownership, substantial control exercised by shareholders, poorly diversified portfolios, and therefore a strong shareholder interest in the performance of individual firms. This regime gave way under the early-20th-century diffusion of share ownership, which brought about the separation of ownership and control and ushered in managerialism. Driven by the growth of institutional capital pools, the post-World War II decades then brought a "Great Re-concentration" of shareholdings, weakening shareholders' exit options while strengthening their control. Today, the United States is no longer the dispersed ownership society that scholars across disciplines and across generations – from Berle and Means, to Jensen and Meckling, to Hall and Soskice – took for granted. This section traces the emergence of the historically unprecedented control-and-diversification configuration, focusing on the corporate governance regime shifts from managerialism to shareholder primacy, and from shareholder primacy to asset manager capitalism.

Table 1: Hallmarks of shareholder power under four corporate governance regimes

Main shareholders	**Robber barons**	**Households**	**Pension funds**	**Asset managers**
Concentration of ownership	High	Low	Medium	High
Power of shareholders	Strong: control	Weak: exit	Medium: exit and voice	Strong: Approaching control, no exit
Portfolio **diversification**	Low	Low	Medium	High (indexed)
Interest in firms	High	High	Medium	Low
Corp gov regime	**Finance capitalism**	**Managerialism**	**Shareholder primacy**	**Asset manager capitalism**

Source: B. Braun, 'Asset manager capitalism as a corporate governance regime.'

Shareholder primacy: Exit plus voice

Among the drivers of the transition from managerialism to the shareholder primacy regime, the rise of the law and economics movement and the growth of institutional investors stand out.[6] Law and economics took the corporate governance field by storm via the idea of a "market for corporate control", which redefined the economic function of capital markets (Manne, 1965). Manne's idea underpinned Jensen and Meckling's agency theory of the corporation, which built three axioms into the ideological infrastructure of corporate governance: a conflict of interest between weak outsiders (shareholders) and strong insiders (managers); the need, justified on efficiency grounds, to strengthen the rights of shareholders vis-à-vis managers; and the elimination of workers from the analytical map. By the end of the 1970s, law and economics had reduced the complex political question of how to organize the corporate system to protecting outside investors against "expropriation" by insiders (La Porta et al., 2000, p. 4). Law and economics was a highly effective intellectual movement that paved the ideological ground for the regime shift towards shareholder primacy (Jung & Dobbin, 2015; Lazonick & O'Sullivan, 2000; Robé, 2012). It would have been unlikely to succeed, however, had it not been for the rise of institutional capital pools.

Two developments related to institutional capital pools tipped the balance in favor of shareholders – the takeover wave led by private equity firms, and the rise of pension funds pushing for governance reforms. The 1980s saw the emergence and rapid growth of private equity funds (Appelbaum & Batt, 2014). Specializing in leveraged buyouts of listed firms, these "corporate raiders" systematically dismantled the conglomerates managerialism had built (Fligstein, 1990; Useem, 1993). From a structural power perspective, the significance of the creation of a market for corporate control was that it weaponized the exit option. While shareholders had always had the option to sell their holdings in a corporation, managers did not need to worry too much about the resulting downward pressure on the share price. The emergence of institutional capital pools with a business model centered on hostile takeovers and asset stripping fundamentally changed the managerial calculus regarding the price of their company's stock.

The rise of buyout firms coincided with an explosion in the growth of pension funds, whose direct holdings of total corporate equity (listed and unlisted) reached an all-time

[6] The fracturing of the corporate elite was, arguably, both a cause and a symptom of the financialization of corporate governance (Mizruchi, 2013).

high of 27 percent in 1985 (Braun, 2021, p. 276). What made U.S. institutional investors such a revolutionary force was their unique “capacity to unite liquidity and control” (Coffee, 1991, pp. 1284–1285; see Table 1 above). Public pension funds’ equity stakes – approaching but rarely exceeding one per cent – were small enough to make exit a credible threat and, at the same time, large enough for their voice to carry weight within the newly shareholder-friendly corporate governance system (G. F. Davis, 2008). Indeed, public pension funds emerged as the driving force of the corporate governance reforms of the 1990s and early 2000s, successfully campaigning against poison pills, and for independent directors, de-staggered boards, and proxy voting (Webber, 2018, pp. 45–78). At the same time, these funds, despite holding diversified portfolios, were generally still active stock pickers and traders. An asset-weighted turnover rate of between 60 and 80 per cent in the early 1980s certainly justified their reputation, in the comparative political economy literature, as “impatient” investors (Ippolito & Turner, 1987, p. 19).

By the mid-2000s, the “revolt of the owners” was over (Useem, 1993). Not only in the United States and the UK, but across many advanced economies, CEO remuneration was now tied to stock market performance (Linsi et al., 2021), minority shareholder rights were highly protected (Katelouzou & Siems, 2015), and private equity and hedge funds enforced the rules of the game via the (newly) liberalized market for corporate control (Callaghan, 2018; Goyer, 2011). Such was the success of the owners’ revolt that two legal scholars declared the “end of history for corporate law”(Hansmann & Kraakman, 2001, p. 468). Their declaration could hardly have been timed more poorly.

Asset manager capitalism: De-facto control plus diversification

If pension fund growth in the 1980s and 1990s dramatically reshaped the landscape of corporate ownership, the recent growth of asset managers amounts to a magnitude 9 earthquake. Simply put, whereas pension funds pool the retirement assets of households, asset managers pool the assets of households, pension funds, insurers, and others. As a result, they are *much* larger.[7] Indeed, the success of just a few asset managers in growing

[7] Retirement assets have provided the fuel for the growth of the asset management sector (Braun, 2022). Congress played a crucial part: The Employment Retirement Income Security Act (ERISA, 1974) pushed

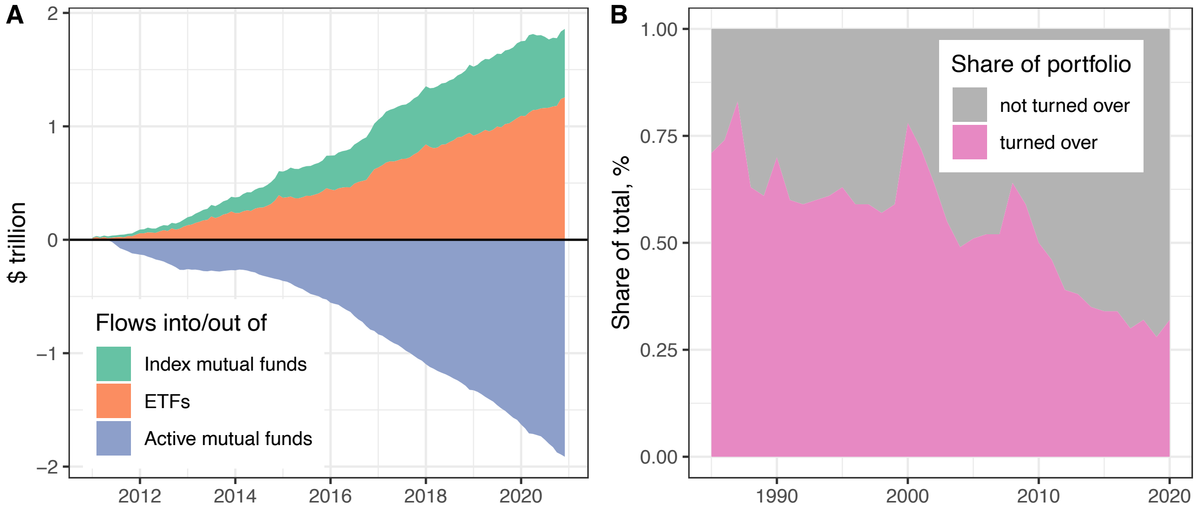
their assets under management has, single-handedly, shifted U.S. stock ownership from dispersed to concentrated. This scenario was not anticipated and caught most corporate governance scholars by surprise. In 2009, the very first sentence of an article published by leading finance scholars in a leading finance journal still described dispersed ownership in the United States as "[o]ne of the best established stylized facts about corporate ownership" (Franks et al., 2009, p. 4009). At that point, however, BlackRock's *average* equity stake in S&P 500 companies had already surpassed 5 per cent.

The implications of the Great Re-concentration for the structural power of wealth owners and their financial intermediaries are not straightforward. Consider, first, the question of *exit*. In their quest for scale, large asset managers have essentially relinquished the option to exit individual investments (Condon, 2020; Fichtner & Heemskerk, 2020; Jahnke, 2019). This is a consequence, first, of the size of their stakes in individual companies, which even in a liquid market cannot be sold without causing a major drop in the share price. Indeed, as shown in Figure 7, Panel B, the turnover rate in mutual fund equity portfolios has continuously declined over the past four decades, from around 70 per cent in the late 1980s to around 30 per cent in recent years. Second, the loss of exit is a feature of the index-tracking investment strategies pursued by the majority of funds offered by the Big-Three asset managers. Figure 7, Panel A, shows that investors have re-allocated almost $2 trillion from actively managed domestic mutual funds to index-tracking equity funds over the past decade. These data points should be seen in the context of the evidence, cited above, of the declining dependence of the corporate sector on outside financing. In addition to corporations borrowing less from banks and capital markets, they also have less to fear from the trading of their outstanding equity liabilities on the stock market. Exit-based theories would predict the structural power of large asset managers to be weakened by this decline of exit options.[8]

public pension funds towards delegating to outside asset managers; other legislation paved the way for the growth of individual retirement plans, notably 401(k) plans (1978) and universal IRAs (1981).

[8] Falling portfolio turnover rates coexists with the rise of high-frequency trading and other quantitative trading strategies. However, these appear to have relatively little impact on corporate governance.

Figure 7: Indicators of declining exit-options for U.S. domestic equity funds



Data: Investment Company Institute Factbook 2021.

Note: Panel A: Showing domestic equity funds. Mutual fund data include net new cash flow and reinvested dividends; ETF data for net share issuance include reinvested dividends. Panel B shows asset-weighted averages for mutual equity funds.

However, exit was, and is, a relatively weak mechanism to enforce shareholder power. Where there's a seller, there's also always a buyer. Unless the volume of shares sold is very large, the impact on the share price tends to be negligible. Even the combination of exit and voice – the hallmark of the shareholder primacy regime – was often insufficient for even large institutional investors to prevail in conflicts with corporate management.[9] Today, however, managers of S&P 500 managers face a highly concentrated ownership landscape in which the joint holdings of the "big two" asset managers, BlackRock and Vanguard, are approaching 20 per cent (Backus et al., 2020, p. 19). 20 per cent is the threshold commonly used in the comparative corporate ownership literature to identify controlling shareholders (Aminadav & Papaioannou, 2020). In other words, although the largest shareholders have lost the option to exit individual portfolio companies, they have gained a considerable degree of *control*. How do they wield this control-based power?

Any attempt to tackle this question needs to start from a consideration of the fact that today's dominant investors are *fully diversified* holders of the market portfolio. It is the

[9] Roe recounts an instructive episode in 1990, in which "two of General Motor's largest institutional shareholders" were rebuffed by GM's management, which "could get away with that rebuff because each [shareholder] owned less than 1 percent of GM's stock" (Roe, 1994, p. xiii).

combination of control *and* full diversification that marks asset manager capitalism as a historically distinct corporate governance regime (see Table 1). Pension funds, in order to achieve reasonably high diversification, could only hold relatively small stakes in individual companies, which limited the effectiveness of their voice in corporate governance. The explosive growth of asset managers eliminated this temporary bottleneck. Large institutional capital pools (pension funds) could now pool their investments in even larger institutional capital pools (asset managers). Contrary to the previous dynamic, pension funds' quest for diversification now actively contributes to the strengthening of shareholder control, exercised by asset managers. As a result, for the first time in the history of publicly listed corporations, shareholder control and full shareholder diversification are not mutually exclusive anymore.

The implications of diversification for how today's dominant shareholders wield their control-based power are dramatic. As corporate governance scholars pointed out already in the 1990s, the behavior of "universal owners" should strongly differ from that of investors who bet on the performance of only a hand-picked selection of companies (Hawley & Williams, 2000; Monks & Minow, 1995). The promise of universal ownership is that instead of pushing corporations to do whatever it takes to maximize profits, fully diversified shareholders internalize negative external effects from the conduct of individual portfolio companies. The largest asset managers have embraced this narrative enthusiastically. They thus present themselves as quintessential long-term shareholders and as champions of environmental, social, and governance (ESG) objectives (Jahnke, 2019). The theoretical and legal case for diversified asset managers to wield their structural power so as to minimize negative externalities at the portfolio level is compelling (Condon, 2020). In practice, however, this logic is counteracted by a host of "agency problems", ranging from the fact that stewardship teams are also a cost factor to the risk of alienating the corporate managers who control the allocation of retirement plan assets to competing asset managers (Bebchuk et al., 2017).

How, then, do the largest, most diversified asset managers wield their control-based structural power? To date, the empirical evidence in support of the "forceful stewardship" hypothesis has been mixed (Fichtner & Heemskerk, 2020, p. 509). Index funds are less likely than other funds to engage with portfolio firms (Heath et al., 2021). Crucially, however, non-engagement is not the same as not exercising power. Thus, a study of 146 shareholder resolutions related to environmental and social issues, from the 2021 proxy season, has shown that the world's six largest asset managers are more likely than almost all their peers to vote against those resolutions (ShareAction, 2021). All six supported fewer resolutions than recommended by the two leading proxy advisory firms, ISS and Glass Lewis. For a significant number of resolutions, the lack of support from the largest asset managers proved decisive. While 30 out 146 resolutions passed, 18 more resolutions would have passed had one or more of the big three voted yes. In other words, the voting power that comes with large shareholdings effectively makes BlackRock, Vanguard, and State Street the decisive swing vote on controversial shareholder resolutions. To date, they have used that power to shield corporations from the environmental and social demands tabled by activist shareholders.

Although they dominate asset managers' public discourse about engagement and stewardship, ESG issues are by no means the only empirical benchmark for the extent to which they wield their power. Perhaps most interestingly, legal scholars and economists have examined whether common ownership – the same small group of asset managers holding significant stakes in all competing firms in a given sector – is associated with anti-competitive behavior by portfolio firms (Elhauge, 2016). Common ownership can be understood as the evil twin of universal ownership (Azar, 2020). Whereas the latter postulates the internalization of negative environmental or social externalities at the level of the entire portfolio, the former postulates, for the sectoral level, the internalization of the negative externalities competition has on profits. The agenda-setting studies in this field have found evidence that when competing firms in the same sector – notably, airlines and banks – have the same dominant shareholders, anti-competitive collusion becomes more likely (Azar et al., 2018, 2021). The hypothesized causal mechanisms range from shareholder passivity, to large shareholders payouts reducing investment and thus product market competition, to shareholders actively discouraging price competition.

The elephant in the room: Aggregate asset prices

These are important observations that suggest that asset managers are, in one way or another, already shaping the corporate strategies and behaviors. However, arguments regarding the preferences of asset managers with regard to individual portfolio companies need to be taken with a grain of salt. At issue is the very concept of ownership, which forms the bedrock of the Berle-Means-Jensen-Meckling ontology. Berle and Means (1932, p. 119) defined ownership as "having interests in an enterprise". Similarly, the entire edifice of agency theory hinges on the assumption that shareholders have more skin in the game than either managers or workers (Fama & Jensen, 1983, p. 301). Yet precisely this assumption has become very difficult to defend. That U.S. corporate law does not assign ownership rights to shareholders, has been known for some time (Stout, 2012). Recently, however, even "share ownership" has fragmented along the investment chain. Asset managers, who hold shares and control the associated voting rights, have a fiduciary duty to asset owners (e.g., pension funds), who have a fiduciary duty to the individual savers who are the ultimate beneficiaries of this investment chain. In other words, the separation of ownership and control has been joined by the "separation of ownership from ownership" (Strine Jr, 2007, p. 7). Herein lies the ultimate irony of asset manager capitalism: Whereas the shareholder primacy regime was geared towards increasing the control-power of unproblematic owners, under asset manager capitalism regime the dominant shareholders exercise unprecedented control-power, yet as pure intermediaries, have only the most tenuous claim to ownership.

This separation of ownership from ownership does not mean, of course, that asset managers have no economic interests. However, rather seeking to maximize returns – which in the case of mutual funds and ETFs are reinvested or passed on to asset owners – asset managers' overriding economic interest is in maximizing their fee revenue, and thus their assets under management. For this, returns matter, but only indirectly, and to the extent that they cause asset owners to move their money to or from competitors. Instead, the variable of the greatest interest to asset managers are *aggregate* asset prices. This is because the fees they charge are calculated as a percentage of the current value of a client's assets. Across a large asset manager's portfolio of funds, the impact of individual fund performance on the growth of assets under management is far less than the impact of aggregate asset price developments. Thus, in 2020, net inflows of new money into the asset management sector contributed $5 billion towards the sector's gross revenue increase, whereas the aggregate rise in asset prices contributed $29 billion (McKinsey, 2021a). Hence BlackRock's preference for macroeconomic policies that sustain high asset prices, powerfully illustrated by its strategic and persistent lobbying for expansionary monetary policy (Braun, 2021, p. 291). Indeed, for BlackRock's bottom line, proxy fights and board room battles are a side show. Far more consequential are the actions of regulators, legislators and, above all, central banks.

Conclusion

The growth of finance has coincided with a declining dependence of non-financial corporations on outside financing. At the same time, the growth of institutional capital pools has made their equity stakes less liquid. Both developments reduce the capacity of financial actors to sell their investments in individual firms.[10] This erosion of the exit option constitutes a problem for the political economy literature, which has long posited exit as the key mechanism underpinning the structural power of finance in general, and of impatient institutional investors in particular.

Seeking to address this problem, I have argued that under asset manager capitalism, the structural power of wealth owners and their financial intermediaries is based on the latter's sheer size, which allows them to achieve substantial control at the firm-level, while maintaining full diversification at the portfolio level. Whereas financial-sector control over industry was the essence of Hilferding's "finance capital" and thus is not new, asset managers have only recently reached the scale needed to insulate investors from the success or failure of any individual components of their portfolios. Whether through holdings of the liabilities of listed and, increasingly, unlisted corporations, or through their holdings of real estate and infrastructure assets, asset managers exercise unprecedented control over non-financial actors and sectors, while compensating for the loss of the exit option through diversification.

[10] Emerging market economies do, of course, remain vulnerable to capital flight (Bonizzi et al., 2020).

The preceding discussion points towards three promising avenues for future research on the structural power of finance. The first concerns the politics of corporate ownership and corporate governance. As old debates about how to democratize corporate ownership and governance are being re-opened (Block, 2014; Buller & Lawrence, forthc.; McCarthy, 2019; Palladino, 2021), a firm grasp of the historical uniqueness of asset manager capitalism can help make the case that the ideological defense of the shareholder primacy is bankrupt even on its own terms. With the fragmentation of what the law-and-economics tradition called "ownership", and the breakdown of the Berle-Means-Jensen-Meckling ontology, the structural power wielded by asset managers appears to rest on shaky ideological ground.

The second use case concerns research on the political economy of inequality. The rate of return on capital is determined by technology as well as by government policies on labor markets, taxation and financial regulation. Whereas in the past the distribution of power between capital and labor may have sufficed to explain policy outcomes in those areas, the growth and financialization of household wealth have complicated the picture (Adkins et al., 2020; Pagliari et al., 2020; Pfeffer & Waitkus, 2021). Today, even middle-class households have a stake in the rate of return on capital, and thus "great expectations" of governments to protect their wealth (Chwieroth & Walter, 2019). In this context, studying the mechanisms through which financial intermediaries wield structural power in order to defend the claims of wealth owners against competing claims promises to shed new light on the sociology and political economy of inequality.

Finally, more research is needed on what asset managers want. Whereas the corporate governance preferences of asset managers are the subject of a burgeoning field, their preferences for *macroeconomic* governance are poorly understood. There are good reasons to assume that here, too, dramatic change is underfoot. Simply put, banks – the core of the late-20th century "deflationary bloc" (Feygin, 2021) – benefits from stable growth rates and positive real interest rates, regardless of whether interest income derives mainly from business lending or from mortgage and consumer lending (Posen, 1995). By contrast, asset managers' overriding preference is macroeconomic policies that sustain high asset prices, notably an expansionary monetary policy stance. Whereas banks are certified monetary policy hawks, asset managers seem to be doves.

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