Stockholm School of Economics
Bachelor of Science in Business and Economics
Degree Project in Accounting and Financial Management
Presented on 19th of May 2022

# TOO BIG TO BE PASSIVE?

*A study on how institutional investors work with corporate governance in their passive investments*

Jonny Jin (24665) & Cornelia Rathsman (24640)

**Abstract**

This thesis draws upon 12 in-depth interviews, with senior managers and investment professionals from 7 leading institutional investors in Sweden, to explore how they reason and work with corporate governance in their passive investments. Using Foucault's theory of disciplinary power as a theoretical framework, we found that institutional self-discipline complements earlier research in the area, mainly as a tool for explaining their incentives to engage in ownership. Like previous research, our interviews highlight resource limitation as an issue. However, opposed to earlier studies, the present thesis suggests that fiduciary norms, and the desire to do the right thing in according to normative regulation, have a significant impact on institutional behaviour in passive investing. Our interviews further revealed that passive investments appear to prioritize non-financial ownership governance, in particular ESG and sustainability, which can be a result of increasingly sophisticated performance measurement and evaluation systems, in accordance with Foucault's theory.

**Acknowledgements**

This paper has benefited from advice from our supervisor Johan Graaf. We are grateful for his, and our tutoring group's, dedication, feedback, and helpful comments on earlier drafts of this paper. We would also want to thank all the various managers and investment professionals, who gave their time to be interviewed, making this thesis possible.

**Key words:** Institutional investors, Passive investments, Corporate Governance, Shareholder Value, Incentives

**Table of content**


1. Introduction ..... 4
1.1 Background ..... 4
1.2 Problematization ..... 4
1.3 Research Question ..... 6
1.4 Study Contributions ..... 6
1.5 Delimitations and Limitations ..... 7
2. Literature Review ..... 7
2.1 Passive Investments ..... 7
2.1.1 Understanding Passive Investments ..... 7
2.1.2 The institutional investors' conceptualization of themselves ..... 8
2.2.1 Are Passive Investments Deemed to be Passive Owners? ..... 10
2.2.2 Passive Investing's Incentives to Engage ..... 11
2.3 Theoretical Framework ..... 13
2.3.1 Foucault's Theory of Disciplinary Power ..... 13
3. Methodology ..... 17
3.1 Research Design ..... 17
3.1.1 Research Approach ..... 17
3.1.2 Case Selections ..... 18
3.2 Data Collection ..... 18
3.2.1 Initial Contact & Interview Context ..... 18
3.2.2 Review of Interview Subjects ..... 19
3.3 Data Analysis ..... 20
3.4 Research Validity and Reliability ..... 21
4. Empirical Findings ..... 22
4.1 Passive Investments' Corporate Governance Work ..... 22
4.1.1 Passive Alone, but Active Together ..... 22
4.1.2 Active Ownership – Nothing but a Matter of Resource Priority ..... 22
4.1.3 The Exception of ESG ..... 23
4.1.4 Monitoring is a Two-Way Street ..... 25
4.1.5 External Influences from Social Norm and Legal Standards ..... 27
5. Analysis ..... 29
5.1 Passive Investments' Underlying Drivers and Incentives ..... 30
5.1.1 Economic & Political Regulation ..... 30
5.1.2 The Creation, Reformation, and Acceptance of the "Truth" ..... 31
5.1.3 Normative Regulation & Consensus Formation ..... 32
5.2 Passive Investments' Operative Governance Work ..... 34

5.2.1 Surveillance, External Pressures & Treatment ..... 34
5.2.2 Social Categorization & the Fear of Being the Worst ..... 37
5.2.3 Corrective Treatment & Categorization ..... 38
6. Conclusions and Summary ..... 39
6.1 Future Research ..... 41
6.2 Final Thoughts ..... 41
7. References ..... 42
8. Appendix. ..... 45
8.1 Appendix 1: Passive market share of total AUM in the US ..... 45
8.2 Appendix 2: Passive market share of total AUM in Sweden ..... 45
8.3 Appendix 3: Extract from Interview Guides ..... 46
8.4 Appendix 4: Review of Interview Sample ..... 47

# 1. Introduction

## 1.1 Background

Since the global financial crisis of 2008, the financial markets have experienced a massive shift from actively managed funds to cheap index funds (Fichtner et al., 2017), such as index mutual funds or exchange traded funds (ETFs), which we subsume under the term *passive funds*. In the US, passive funds own 55 percent of the domestic total Asset Under Management (AUM) today (Bloomberg L.P., 2022), an increase of 19 percentage points compared to 2014 (see Appendix 1). Similarly, in Sweden (see Appendix 2) the passive share has increased from 8 percent in 2010 to 17 percent in 2019 (Swedish Investment Fund Association, 2019). Consequently, as passive institutional investors obtain larger market share in the financial system, they will gain more corporate power and, thus, becoming an increasingly important stakeholder in the economic society.

The on-going shift towards increased passive institutional ownership raises concerns about the corporate ownership concentration and, more importantly, its implications for the portfolio firms' corporate governance. Current research is mainly based on the American market which discusses "the Big three", e.g., Blackrock, Vanguard and State Street, and its increasing power. Using data from December 2016, Blackrock alone holds approximately 37 percent market share in the ETF segment (Fichtner, et al., 2017). Corresponding market share for Vanguard and State Street are 18.5 percent respectively 15.5 percent (Fichtner, et al., 2017).

## 1.2 Problematization

As the existing studies in the field of institutions' passive investments governance work are dominated by quantitative method (Hshieh et al., 2021; Fu et al., 2021; Appel et al., 2016; Easley et al., 2020) and often based on American data, this paper responds to the call for more qualitative research to investigate nuances on how passive institutional investors work with corporate governance on other markets, which we consider to be the gap in the existing literature. Is it possible that previous findings, suggesting that passive investments are deemed to consciously be passive owners due to their lack of incentives to actively engage expressed by Strampelli (2018), Lund (2018) among others, possibly overlook social norms that cannot be ignored when passive investments grow large enough? In conjunction with the economical

society becoming more sophisticated in measuring data, used for constant performance evaluations, arguments from previous research (Lund, 2018; Strampelli, 2018; Bebchuk & Hirst 2019) suggesting that passive investments in governance work will not provide competitive advantage over peers, lack richness especially as non-financial incentives, and desire to do the right thing, are yet largely undiscovered (Bebchuk & Hirst, 2019; Kahan et al., 2021).

A quantitative method is usually used to explore whether passive funds vote differently compared to their active peers (Hshieh et al., 2021). However, since such approach is often based on American markets it leaves understanding for other markets, such as the European market, unexplored despite that an increasing portion of passive institutional ownership will have widespread effects and implications. Hence, in this paper, we will qualitatively examine how Swedish passive institutional investors conceptualize their responsibility and how they work with corporate governance. Although the current passive fund concentration is not as drastic in Sweden compared to the US (see Appendix 2), one can notice a similar growth pattern of passive funds in relation to active funds (Swedish Investment Fund Association, 2019), which makes it plausible to argue that the Swedish trend could continue in similar pattern to the American development in the coming years. It raises the question whether it is possible to be a passive owner when passive institutions manage an increasingly amount of substantial capital, especially as scholars, such as Strampelli (2018), refer to the concept of being "too big to be passive".

The Swedish market, Stockholm stock exchange (Mic: XSTO), is interesting for two main reasons. Firstly, it is the single largest capital market in the Nordic and Baltic area combined which, in turn, is the fourth largest market in Europe in terms of market capitalization. In such context, the Swedish market accounts for 68% alone (Statista, 2021). In other words, The Stockholm stock exchange is a major marketplace in Europe and, hence, a further exploration on how Swedish passive institutions approach their increasing power is a relevant question. Secondly, the Swedish corporate governance model differs fundamentally compared to the American model, distinctly by Sweden's offering of nomination committees. Through such nomination committees, shareholders gain influence over director elections, and the process becomes institutionalized and independent, which is also referred to as Shareholder Nomination Board (SNB). This Nordic selection model of board candidates is unique in any context (Arranz Aperte & Strand, 2022), since it allocates the ultimate power to the majority of the general meeting. It stands a stark contrast compared to the US corporate governance model which is

based on a one-tier structure, which often concentrate power by combining the position of Chair and CEO in a single individual (Arranz Aperte & Strand, 2022).

## 1.3 Research Question

With the identified gap in current literature, the purpose of the present thesis is to provide an in-depth understanding of the fundamental approach and reasoning of governance exercised by institutional ownership in their passive investments as their share of the market is growing. Thus, the research question is formulated as:

> *How do Swedish institutional owners work with corporate governance in their passive investments?*

The aim with the study is to explore underlying incentives and methods to how Swedish intuitional investors work with ownership today in their passive investments.

## 1.4 Study Contributions

This paper makes the following three contributions. Firstly, we contribute to existing quantitative dominated research, in the field of institutions' passive investments effect on corporate governance, by exploring passive funds' corporate governance work qualitatively bringing more nuances to area.

Secondly, our study reveals the largely overlooked non-financial incentives of fiduciary norms and their desire to be responsible owners to do 'the right thing'. In doing so, we find ESG and sustainability to be an area of corporate governance work where passive investors are indeed active. Earlier research has focused on passive funds' inability to raise fees in order to obtain necessary resources with active ownership engagement as an explanatory incompatibility for integrating ESG into a passive investment strategy (Blitz & de Groot, 2019). We show how other social powers, norms, and self-discipline, are significant enough to overpower monetary cost of engagement. Also, our empirics show that screening tools, and company specific analysis, are used for actively exclude certain companies, indicating a possibility for passive funds to threaten with exit. This, plus the use of Swedish nomination committees, voting and dialogues with portfolio companies' management, broaden the perspective outside the US.

Lastly, the study contributes to research performance measurement and business control in general, by providing a deeper understanding of passive ownership in corporate governance context.

## 1.5 Delimitations and Limitations

Two main delimitations have been contrived. Firstly, the research is delimited to the Swedish capital market. The rationale behind the geographical constraint is that regulations and legal systems, affecting institutional owners' ability to exercise corporate governance, can vary between countries. Secondly, the empirical study and set of interviews are delimited to institutional owners and does not include insights from their portfolio companies' point of view. This delimitation was set as a consequence of prioritizing the interview subjects expected to add most explanatory value to the process of answering the research question. Regarding limitations, the access to observe the institutional owners' daily operations in terms of dialogues with portfolio companies, internal meetings, and other internal processes, is limited. Thus, the institutional owners' work with corporate governance is not fully observed in practice but described through in-depth interviews supported by secondary data in form of corporate governance reports.

# 2. Literature Review

*This section contains a review of two blocks of literature relevant to the present study. The first block reviews previous literature on passive funds to offer a broad understanding of the topic. The second block presents prior research on mechanisms behind passive investors' corporate governance engagement.*

---

## 2.1 Passive Investments

### 2.1.1 Understanding Passive Investments

Passive investments are a type of investments that consistently track a predetermined market index, matching its risk and the return at all times. Common passive investments are mutual index funds and ETFs (ICI, 2022). By replicating a market portfolio, owning all the securities with equal weight proportion included in the benchmark, the investor will replicate the market

return. Hence, the goal of passive investments is to match the market performance rather than outperforming it (OIEA, 2022). Compared to an active managed fund, a passive investment strategy does not require the same level of engagement from the fund manager in terms of research analysis and frequent trading etc. Therefore, many institutions offer these passive products at low charge rate, offering customers an effective investment strategy at low cost (ICI, 2022). In Sweden, the average expense ratio for a passive index fund is about 0.12 percent, compared to an average fee of 0.62 percent for an actively managed fund (Morningstar, 2021.).

As a new generation of passive products is rising in the market, the distinction between active and passive investments is becoming less clear (Easley et al., 2021). Historically, the term "passive funds" have often referred to index mutual funds tracking an index solely based on geographical location, such as the OMXS30 for instance. Today, passive investments tracking an index based on different factors and characteristics, for example artificial intelligence or sustainability, are becoming increasingly more common. By constructing an index around specific factors, passive investments are becoming more active in their formation (Easley et al., 2021). However, once the index is set and the product is launched, the product has the same passive mechanisms, tracking their benchmark index systematically. Therefore, when referring to *passive funds* and *passive investments* in the present study, this includes both index mutual funds, index-tracking funds, and all kinds of ETFs.

### 2.1.2 The institutional investors' conceptualization of themselves

Institutional investors are often treated as shareholders without any peculiar attention drawn to their characteristics, instead they are distinguished by their share size holding (Hendry et al., 2006). Considering the institutional investors' role in the process of corporate governance, and their interaction with management, Hendry et al. (2006) review theoretical conceptualizations and present how these different conceptualizations are reflected in the fund managers' and company executives' perceptions of the actors concerned. The two most dominant conceptualizations cast investors and managers as (1) principles and agents and (2) as owners and fiduciaries (Hendry et al., 2006).

The first conceptualization of investors and managers, as principles and agents, is rooted in the economic literature. Here investors are characterized as economic actors (principles) who contract with management (agent) for the supply of risk capital (Fama, 1980). This relationship

is referred to as the principal-agent relationship (Jensen & Murphy 2010). Such economic conception makes no moral judgement, but rather assumes that both investors and managers are self-interested economic beings, looking to maximize one's economic utility. In other words, under this model management self-interest is rational. This conceptualization has been frequently used in previous research (Bebshuk & Hirst 2019; Eisenhardt, 1989; Fama, 1980; Ross, 1973; Jensen & Meckling, 1976) on passive investments and their incentives to engage with corporate governance. To bring new nuances to the field, the present study is focusing on the second conceptualization.

The second conceptualization of investors and managers as owners and fiduciaries, is rooted in literature on corporate law, and focuses on legal rights and duties of the respective parties involved in the company. Investors, typically characterized as owners, give them ownership rights such as to have the company managed primarily for their interest and benefit. The general presumption of such ownership is that there is some duty of care from the owners, even though the extent to which ownership carries responsibilities, as well as rights, is debatable (Hendry et al., 2006). However, here the underlying assumption is that managers have a moral obligation and *should* act as dutiful fiduciaries. Not doing so would be morally, as well as legally, wrong. In other words, in this model management's self-interest is considered to be immoral (Hendry et al., 2006).

Hendry et al. (2006) conducted a series of in-depth interviews with senior managers from institutional investors and listed corporations. The paper outlined that the dominating conceptualization of institutional investors was as traders, meaning the managers recognized that they were in the business to make money for the respective houses and their clients. They accomplished this by trading shares in accordance with portfolio constraints. The fund managers' main concern was to meet benchmarks, in addition to their obsession with relative performance compared to competitors or their index. Consequently, the fund managers might trade shares for a variety of reasons, many of which are unconnected to the company managers' performance.

## 2.2 Earlier Research on Passive Investments' Governance Work

### 2.2.1 Are Passive Investments Deemed to be Passive Owners?

Passive investments' can take different actions in order to influence their portfolio companies and existing literature refers to this stewardship as *monitoring*, *voting* and *engagement* (Bebchuk & Hirst, 2019) and earlier research presents contradictory theories whether passive funds act as active owners or not. Among the researchers defining passive investors as active owners, it also appears to be ambiguity whether the passive funds' influence have a positive or negative impact on firms' corporate governance and performance.

> " Although it is widely acknowledged that the rise of passive investing is beneficial for final investors – who benefit from greater diversification and lower costs - many institutions and corporate governance experts contend the 'ETF-ization' of listed company ownership has negative corporate governance implications because passive investors are deemed to be also passive owners, who are not interested in being actively involved in the corporate governance of investee companies."
>
> (Strampelli, 2018)

The majority of the current research on passive funds' corporate governance engagement is based on the three leading passive index fund institutions on the American market, referred to as '*The Big Three*'. The Big Three's voting and engagement statistics indicates that they are voting to a high extent at the shareholder meetings of their portfolio companies (Strampelli, 2018). However, an analysis of their *voting patterns* portraits them in a less active manner, since they appear to vote correspondingly in most cases in accordance with a centralized voting strategy (Strampelli, 2018). These patterns raise doubt regarding their ability to act as active owners. Similar arguments are disclosed by Lund (2018), who presents a case against passive shareholder voting, arguing that passive investors should not have the same voting rights as active funds. According to Lund (2018), passive funds apply a one-size-fits-all approach to corporate governance, since it is more costly for passive funds to generate firm-specific information, in comparison to their active peers who produce such information through analysis as a byproduct of investing. Strampelli (2018) supports this argument, stating that costs are the main disincentive for passive investments to engage in corporate governance.

The one-size-fits-all approach refers to a low-cost voting strategy where the passive funds are either voting 'yes' to all shareholder proposals meeting pre-determined criteria or strictly

following a proxy advisor's recommendation (Lund, 2018). This low-cost voting strategy is a consequence of the passive funds' lack of financial incentives to ensure that their portfolio companies are well run (Lund, 2018; Strampelli, 2018), which will be discussed further in following section *2.2.2.* Regarding dialogue and meetings with firm management, earlier research states that active fund analysts are the main drivers behind these events (Lund, 2018). Thus, the literature points to the risk of less effective investor engagement if the number of active fund analysts decreases as a result of the growing trend of passive investments (Lund, 2018).

However, several scholars are presenting signs of activeness, and frequently refer to the concept *'too big to be passive'* (Strampelli, 2018; Kahan et al., 2021; Fichtner et al., 2017). According to Kahan et al. (2021), the Big Three have incentives to be informed investors since well-thought-out voting decisions are likely to have a crucial impact on company performance due to their large scale and scope. Despite the low fee charged by passive funds, it lies within the Big Three's interest to use the magnitude of their holdings to improve corporate value and, thus, increase its financial performance and returns (Kahan et al., 2021). These arguments are supported by Strampelli (2018), who also addresses the reputational and regulatory pressure on leading passive institutions to actively engage with corporate governance. Although this argument has not been covered by earlier research, it is credible that reputational and regulatory factors would have an impact on passive funds' ability to attract customers (Strampelli, 2018)

## 2.2.2 Passive Investing's Incentives to Engage

### *2.2.2.1. Long-Term Investors*

> "The new index fund rule is that if you don't like the management, fix the management because you can't sell the stock"
>
> (Vanguard founder Jack Bogle interviewed by Benz, 2017)

The business model for passive index funds differs from actively managed funds in several aspects. One substantial difference is the possibility for actively managed investment funds to threaten to exit. According to Fu et al. (2021), exit is one of the best instruments to reduce agency costs and optimize shareholder value. Since index funds are designed to track a specific index, they do not have this option (Fu et al., 2021). Thus, they have incentives to improve the long-term performance of their portfolio companies (Bebchuk & Hirst, 2019). The CEO of

Blackrock, Laurance Fink (2018), states that their 'permanent' ownership constitute them as the ideal long-term investor:

> " 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. In this sense, index investors are the ultimate long-term investors — providing patient capital for companies to grow and prosper"

*2.2.2.2 Financial Incentives*

However, it is important to recognize the *free-rider problem* with this argument. Since there are several index funds tracking the same index, the resources put into voting, monitoring, and engaging with management can be considered a common good and will not provide for a competitive advantage since it benefits all index funds tracking the same index (Bebchuk & Hirst, 2019). This relates to a general economic insight, stating that agents who do not capture the total benefit generated by a certain activity, but only a fraction of it, tend to underinvest in this activity. Thus, the level of resources put into corporate governance by passive fund managers is expected to be below the optimal level from the beneficial investors and the overall economy's point of view (Bebchuk & Hirst, 2019).

Institutional investors compete directly with other competitors, regardless of if the fund is a passive index fund or an actively managed funds. However, passive fund managers have no *financial incentive* to invest in corporate governance of their portfolio companies (Lund, 2018; Bebchuk & Hirst, 2019; Strampelli, 2018). The argument goes that such corporate governance work will neither make one institution's passive funds more attractive compared to its competitors, nor will it provide for a competitive advantage over actively managed funds. Albeit active funds often come with higher fees than their passive equivalent, they also have the opportunity to outperform an index, generating a higher pay-off. Thus, even if passive institutional investors manage to increase the value of their portfolio companies by working with corporate governance, there will still be actively managed funds who succeed to outperform their benchmark index (Bebchuk & Hirst 2019).

*2.2.2.3 Fiduciary Norms*

Several scholars advert the *non-financial incentives* for passive institutional investors to be *perceived* as active owners (Bebchuk & Hirst, 2019; Kahan et. al 2021; Del Guercio &

Hawkins, 1999). Bebchuk and Hirst (2019) refers to the concept of *fiduciary norms*, defined as the desire to do the right thing. From such perspective, fund managers could be incentivized to invest in corporate governance to improve the institution's reputation. The extent to which fund managers are affected by fiduciary norms is yet to be discovered, but according to Bebchuk et al. (2019) the non-financial incentives are not significant enough to exceed the agency costs of engaging with corporate governance. Thus, fiduciary norms are expected to have a limited impact on the behavior of fund managers (Bebchuk & Hirst 2019). On the same topic, the increasing awareness of ESG issues is putting pressure on institutions to act as responsible investors (Eccles & Klimenko, 2019). However, it has been debated whether passive investing is compatible with an ESG philosophy or not (Blitz & de Groot, 2019). Blitz and de Groot argue that sustainability and passive investing are fundamentally incompatible with each other since sustainability integration requires active decisions. Additionally, Blitz and de Groot highlight passive index funds' incapability to raise fees to obtain the necessary resources to cover the required costs that such active decisions are associated with (Blitz & de Groot, 2019).

An ESG-investing strategy can be described by three processes: (1) exclusion, (2) inclusion, and (3) impact (OECD, 2020). Since index funds are tracking a specific index, they do not have the same possibilities to exclude nor include companies in order to make sure that their portfolio lives up to a certain ESG standard (OECD, 2020). The most momentous way for passive institutional investors to incorporate ESG, however, is through *impact.* Eccles et al. (2019) presents key factors driving the change towards increasing interest in ESG performance and how investors take actions in order to prepare for "the new era of sustainable investing" (Eccles & Klimenko, 2019). However, the importance of ESG investing is a relatively new topic on the agenda for both active and passive investors, and how passive investors incorporate ESG in their corporate governance work today remains an under researched area (Eccles & Klimenko, 2019).

## 2.3 Theoretical Framework

### 2.3.1 Foucault's Theory of Disciplinary Power

As a theoretical lens, we draw upon Michel Foucault's (1977) conception of power set out in Discipline and Punish. According to Foucault, attempts to control peoples' behavior is characterized by discipline and training, rather than older forms of physical force and violence described in sovereign power.

Disciplinary power operates by subjecting psychological strivings and motivations of individuals, and whole populations, to 'normative regulation' through methods corresponding to *mass surveillance*, *social categorization*, and *corrective treatment*. Here, Foucault (1977) describes how society has become increasingly more structured over time, where coordination and control over labor have both increased in complexity and become more technically sophisticated, which reenforces the disciplinary process. Thus, the individual's self-discipline and society's structuring are two sides of the same coin, where one presupposes the other (Blomberg, 2020).

**Table 1**

| | **Aims of power** | **Nature of power** | **Target & style of punishment** | **Methods & techniques of operations** |
|---|---|---|---|---|
| Sovereign power | Domination & submission | Centralized & processed, flows top-down | Physical body: Destruction & repression | Force & violence: torture, public execution |
| Disciplinary power | Economic & political regulation | Decentralized & relational flows bottom-up | The soul: Normative regulation | Discipline: *Surveillance, categorization, treatment* |

Table 1: Summary of respective characteristics, and method of operations, of disciplinary and sovereign power

*Aims of Power*

The theory of disciplinary power was shaped during the industrial revolution, as the government and organizations were subject to new challenges and opportunities as a consequence of the increased production and changing economic landscape. In contrast to Sovereign power, who aims for *domination and submission*, the shift to an industrial economy required new means and methods of power to achieve and maintain *economic and political regulation*, which is the aim of the disciplinary power put in an economical context (Barker, 1998).

*Nature of Power*

According to Foucault (1977), power is everywhere and is produced and reproduced through a network of institutions and authorities. Thus, the nature of disciplinary power could be described as *decentralized and relational*. Instead of being exercised by the state or centralized to a group of people, power is constituted and embodied in society by the acceptance of knowledge and "the regimes of truth" (Rabinow, 1991). The "truth", in turn, is constantly

redefined through the political and economic landscape, the media, educational systems, and institutions (Rabinow, 1991).

*Target & Style of Punishment*

In terms of target and style of punishment, the Foucauldian perspective targets the *soul* rather than the body (Foucault, 1977). The soul can be defined as the conciseness and personality of an individual, and through disciplinary power, this soul is affected by *normative regulation* (Ransom, 1997). Normative regulation is a collection of standards, values, and performance criteria (Ransom, 1997). According to Foucault (1977), normative regulations motivate people to compare and correct themselves against these norms, resulting in self-discipline. The theory of disciplinary power is thereby about making people want to *do something for themselves*, rather than making them do something that others force them to do (Allen, 1998).

*Methods & Techniques of Power*

As previously mentioned, Foucault (1977) specified normative regulation operation through three interrelated mechanisms: (i) Mass surveillance, (ii) Social categorization, and (iii) Corrective treatment.

Starting with (i) Mass surveillance, it is a form of internalized power by those who are being watched to govern their own behaviour according to the prevailing standards of normality. Foucault (1977) states that the power of surveillance is about its encouragement of self-regulation and self-discipline among people through a constant introspective self-evaluation and examination. The discipline is maintained by the knowing of possibility being seen constantly. From the information generated about the mass surveillance process, categorization systems can be formed to segment the description of collective facts into categories. Thus, (ii) Social categorization divides individuals into domains of value utility and segregates the market though description and characterization of collective facts (Foucault, 1977). Through social categories, recipes, guidelines, and boundaries people are continually remined to assess, observe and correct their attitudes and behaviour in relation to the norms of respective category. Thus, the individual self-discipline and society's structuring are two sides of the same coin as mentioned earlier. Through the creation of social categories, numerous of legitimate (iii) corrective treatment programs are designed to create certain boundaries, i.e., guidelines, recipes, and experiences, for people to fall within. These are designed to constantly remind

people, evaluate, observe, and correct attitudes and behaviors in accordance with the norms of respective category.

*Bentham's Panopticon Metaphor*

To demonstrate Foucault's point, philosophizer Jeremy Bentham's circular prison design is examined as a metaphor for how humans' self-discipline ourselves. The prison design places one watch tower in the middle, with prison cells set all around in a circle. Although the prison guard could see all the prisoners, the guard could not see all the prisoners at the same time. The prisoners, on the other hand, could not see the guard and therefore did not know when they were being watched. The theory states that inmates assumed they could be under surveillance, and that it was enough to make them act accordingly, eliminating the need for many, or any, prison guards. It was simply enough to make prisoners feel they were being monitored, than them actually being watched at all times, to make the prisoners discipline themselves.

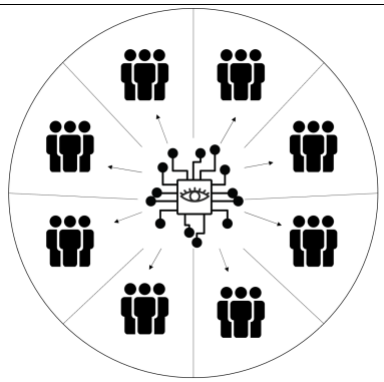


Figure 1: Bentham's Panopticon Metaphor

The Bentham's panopticon metaphor is the sort of self-governance that is the linchpin of Foucault's theory of modern power, as he argues that surveillance is being used in modern institutions as a key instrument to control and governance people. Foucault believes that every individual disciplines themselves, rather than that certain groups places themselves above other groups and interest. This means that even owners, senior executives and others are 'victims' of this historical and all-embracing process (Blomberg, 2020).

Foucault (1977) believes that the increased structuring of society is resulting in the introduction of more panopticon-like institutions and systems. As society measures everything more thoroughly, it can also increasingly identify and divide the market through social categorizations based on evaluation of performance. As performance management systems

become increasingly sophisticated, recorded by big data, and connected though IT and social media, all individuals become increasingly monitored. All these measurements, evaluation, and connections create constant self-discipline to act in accordance with what is important for the next evaluation. Not only are society accepting to be controlled and exposed to constant monitorization, but it actually demands to be evaluated to know what specific achievements is worth on a grading scale in accordance with pre-determined criteria. Hence, society becomes victim of its own "regime of truth" (Blomberg, 2020).

# 3. Methodology

*This section contains a description of how the empirical study has been designed and conducted. First it presents the chosen research approach and underlying reasoning behind the chosen methodology. This is followed by a thorough description of how the data was collected and analyzed.*

---

## 3.1 Research Design

### 3.1.1 Research Approach

Considering the nature of the present study, and the purpose to contribute with qualitative research to a currently quantitative-dominated field of research, the chosen methodology is a qualitative empirical study with an abductive approach. Depending on the objective of the research, case studies can be structured in different ways (Ryan, W. Scapens et al. 2002) and since the main objective of this study is to *describe* how institutions work with corporate governance in their passive investments, this case study is *descriptive* in its nature. The qualitative study will be performed as multiple-case study, consisting of several interviews. According to Yin (2003), interviews are one of the most distinguished and valuable sources of information when conducting a qualitative case study.

The rationale behind the abductive approach is the limited amount of previous qualitative research within the research area. Hence, to make sense of the empirical data, we are shifting between the data and literature studies/theory to interpret the empirical data and answer the research question.

In order to collect enough data and being able to draw general conclusions, a multiple-case study was chosen instead of studying a single case. Studying one single case can provide an even more in-depth understanding of the selected case but since different institutions have different organizational structure, niches, resources etc. a single case study would not be representative for the entire population of institutional actors on the Swedish capital market.

### 3.1.2 Case Selections

The case selections are based on several criteria. The geographical selection criterion is the Swedish market exclusively. The second criterion refers to the product offerings, and for the institution to be relevant, passive products must be included in their product offering. In terms of size, the focus is on leading assets owners. The emphasis on size is based on two reasonings. (1) The leading institutions have more resources to work with corporate governance and hold larger shares in their portfolio companies. Because of this, their work with corporate governance becomes more distinct and observable. (2) The study aims to cover as large share of the Swedish capital market as possible, and this is easiest done by focusing on the major players. Regarding the interviewees within the selected institutions, all senior managers and investment professionals, with sufficient knowledge about how the institution works with corporate governance in its passive investments, are considered to be relevant to include in the study. Thus, the title of the interviewees, as well as the number of interviewees within a specific institution, is allowed to vary since the study does not require perfect symmetry and comparability between the cases. The aim is to obtain as much in-sights and information as possible, rather than comparing the cases between each other.

## 3.2 Data Collection

### 3.2.1 Initial Contact & Interview Context

Once an institutional investor was selected based on the sample criteria, several senior managers and investment professionals within the given institution, were contacted through LinkedIn or email. The initial message included a short description and background of the present thesis and a request regarding participation in the empirical study. In total, 10 institutions/organizations were contacted and 8 of them (80%) replied and wanted to participate in the study. This resulted in 10 interviews with a total of 12 different individuals. Once the interviewee agreed to participate, the interview was scheduled. Four interviewees (33 %) asked

for interview questions in advance, but 8 of them (67 %) did not and entered the interviews with only a brief description of the topic. The interviewees were able to choose between a digital interview through Microsoft Teams or a physical meeting at their office. Three interviews (25 %) were conducted at the physical office of the institutional investor, while 9 of the interviewees (75 %) chose the digital format. A majority of the interviews were conducted individually, but in two of the interviews the institutions preferred to have two respondents present in the same interview.

The interviews were constructed using a *semi-structured technique.* Prior to the interviews, an interview template was constructed (see Appendix 3) and then constantly revised as the study went along and new discoveries were made. In order to gain a deep understanding of the corporate governance engagement of each institution, thorough research about the institution was made prior to the interviews. According to Ryan et. al (2002), it is beneficial to use various sources of information when conducting a case study and therefore secondary data was collected from the institutional investors' websites and corporate governance reports. However, these reports are not included in the reference list, in order for the institutions to remain anonymous. This resulted in a set of unique and individual interview questions to each institution, as well as additional follow-up questions, as a complement to the interview template. In all interviews except for one, two interviewers were present. This allowed one to focus on the pre-written questions while the other interviewer could listen more carefully and come up with appropriate follow-up questions. All interviews were recorded and lasted approximately 50 minutes. The fact that we were able to record all interviews made it possible for both interviewers to be active and ask questions during the interviews.

### 3.2.2 Review of Interview Subjects

Appendix 4 provides an overview of the participated interviews in the study, classified according to the institution or organization and role, sorted by the date of the interview. The study consists of 11 interviewees from investment institutions, complemented by one interviewee from a Swedish *Fund Association/investment union.* The rationale behind including a representative from a fund association is their overview of the Swedish capital market. The purpose was to include an unbiased party with an overall knowledge and insight into how the Swedish institutional owners work with corporate governance in their passive investments.

The 7 different institutional investors differ on several aspects in terms of size, product offerings, number of funds developed in-house versus outsourced funds through collaborations, and targeted customer groups. Regarding the titles of the interviewees, most of the interview subjects are executives and utmost responsible for the work with corporate governance within the institution. Some of the interviewees, that we were referred to when reaching out to the institutions, were also responsible for sustainability aspects.

## 3.3 Data Analysis

The data was analyzed in parallel to the interviews being held since the interviews were spread out during a period of three months and due to the semi-structured format of the interviews. Immediately after each interview an initial reflection was made, and potential new discoveries was noted. All interviews, both physical and digital meetings, were recorded and transcribed. After half of the interviews were conducted, five categories were identified and constructed, since categorizing is helpful to harmonize the answers (Taylor et al. 2016). The identified categories were (1) *signs of passiveness* (2) *signs of activeness* (3) *ESG – a special case?* (4) *additional ideas* and (5) *concrete examples*. These categories were based on our initial reflections from the interviews and which common denominators we could identify when looking at the interviews conducted so far. The transcripts were then thoroughly analyzed and relevant quotations were picked out and sorted under each category. As the interviews went along, and with the use of the theoretical framework, a new set of themes were identified. This is the result of the abductive research approach, where we continuously used the theoretical framework to make sense of the empirical data. The new themes identified was (1) *Passive alone but active together* (2) *Resource priorities* (3) *The exception of ESG* (4) *Monitoring* and (5) *External influences*.

In order to find similarities and contradictions between the respective institutions and their corporate governance work, we constructed a table with identified corporate governance mechanisms, illustrated in Table 3. According to O'Dwyer (2004), this way of organizing the data requires a deep understanding of the transcript. Therefore, the data is analyzed in conjunction with the processing and organization of the empirical data.

**Table 2**

| Interview | | | Fund offering | | Factors in how Corporate governance (CG) work is designed | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Intv. | Insti. | Position | P | A | CG/B | CG/PB | CG/P | CG/E | CG/N | CG/AN | CG/M | CG/R | CG/CO | CG/ME |
| 1 | 1 | Fund Manager | x | | | x | x | x | x | | | x | x | x |
| 2 | 1 | Fund Manager & Head of Sustainability | x | | | x | x | x | x | | | x | x | x |
| 3 | 1 | Chief Executive Officer (CEO) | x | | | x | x | x | x | | | x | x | x |
| 5 | 2 | Fund Manager & Head of Sustainability | x | x | x | x | | x | x | x | x | x | x | x |
| 6 | 3 | Head of Corporate Governance (CG) | x | x | x | x | | x | x | x | x | x | x | x |
| 7 | 2 | Fund Manager & Head of Sustainability | x | x | x | x | | x | x | x | x | x | x | x |
| 8 | 2 | Head of Corporate Governance (CG) | x | x | x | x | | x | x | x | x | x | x | x |
| 9 | 4 | Head of Corporate Governance (CG) | x | x | x | x | | x | x | x | x | x | x | x |
| 10 | 5 | Portfolio and CG analyst | x | x | x | x | | x | x | x | x | x | x | x |
| 11 | 6 | Head of Corporate Governance (CG) | x | x | x | x | | x | x | x | x | x | x | x |
| 12 | 7 | Head of passive investments | x | x | x | x | x | x | x | x | x | x | x | x |
| Unique no. | 7 | | 7 | 6 | 6 | 7 | 2 | 7 | 7 | 6 | 6 | 7 | 7 | 7 |
| % | 100% | | 100% | 86% | 86% | 100% | 29% | 100% | 100% | 86% | 86% | 100% | 100% | 100% |

P = offer in-house passive fund(s)
A = offer in-house active fund(s)
CG/B = combines passive and active share to one block
CG/P = passive inv take stand-alone CG initiatives
CG/PB = believes active ownership can be paired w passive inv
CG/E = passive inv make ESG index adjustments
CG/N = highlights Nomination Committee as a important tool
CG/AN = is participating in at least one Nomination Committee
CG/M = have meetings w/ holdings both proactively and in case of incident
CG/R = highlights the resource and cost aspect of active ownership
CG/CO = makes surveys and value customers' opinion in prioritized CG topics
CG/ME = experience some sort of communicative challanges w/ media

Table 2: Extract from the mapping process of interviews.

Note! Here interview 4, with CEO of organization 1, is being excluded due to its different nature of operations since it does not have any operative asset management.

## 3.4 Research Validity and Reliability

Ryan et al (2002) points to the importance of *procedural reliability* when conducting qualitative research, meaning that the study has a comprehensive research plan and full transparency of the case analysis (Ryan et al., 2002). Since a large share of the leading investment institutions in Sweden has been included in the study, we do believe that this provides enough evidence in order to draw general conclusions about how Swedish passive investments work with corporate governance. However, it is important to recognize that the study is based on a sample, and it is possible that some institutional owners, who has not been covered, might work in different ways. Furthermore, when conducting case studies, especially using a semi-structed interview technique, it is important to be aware of potential response bias and subjectivity. For instance, there is a risk that respondents want to be perceived as more active in their corporate governance work, then they are in reality. However, the anonymity minimizes this risk since the institutional owners will not be named and have nothing to gain by presenting themselves in a more positive manner. Regarding subjectivity, the conclusions drawn from qualitative data can depend on who is analyzing and presenting it. The subjectivity is being diminished however with the use of our theoretical framework and the fact that we have been two people interpreting the data in the same way. All things considered, we believe that the reliability of the present study is considered strong and that the study would be able to be recomposed with the same results.

# 4. Empirical Findings

*In this section we will present the empirical findings from the conducted interviews, investigating how institutional owners work with corporate governance. The section is structured in accordance with our identified themes.*

---

## 4.1 Passive Investments' Corporate Governance Work

### 4.1.1 Passive Alone, but Active Together

Of total 12 interviews, 11 interviewees represented 7 different institutions offering asset management to customers. Of these 7 fund institutions the majority, 6/7 (86%), offered both passive and active asset management in their fund catalogue. In all of these cases, corporate governance took form by combining all of the institutions' shares in a company, from both their passive and active funds, into one combined block and, thereby, impact companies' management. Doing so, the total fund institution can have a larger shareholder impact, for instance when voting at the annual meetings. Although, such corporate governance work benefit both passive and active fund management, it was almost exclusively the active fund managers who took dialogues with company's management discussing operative financial performance:

> "You get what you pay for, active asset management comes with higher fees but active returns as well. For passive funds you pay almost no fee at all, so one cannot expect the same level of activity".
>
> (Portfolio and CG analyst, institution 5)

However, passive managers did participate occasionally in company dialogues both proactively and reactively although, in these cases, the meetings had a non-financial characteristic.

### 4.1.2 Active Ownership – Nothing but a Matter of Resource Priority

There was a strong shared conviction among all the interviewees that passive funds are fully capable, in theory at least, to practice active ownership:

> "Passive investors can absolutely be active owners since they do not have any worse fundamental circumstances to practice active ownership than their active fund equivalents. However, in the end it all boils down to a question of resource priority, and whether the institutions are prepared to take the costs that a more active ownership implies".
>
> (CEO, Organization 1)

When asked to elaborate their reasoning, the respondents frequently described customers' expectations of retaining low fees on passive funds as a constraint to increasing general corporate governance engagement:

> "We must highlight the price difference between an active and passive managed fund. An active fund's fee is more expensive than a passive one. Consequently, the customer gets more engagement, active stock picking and dialogue when buying an active fund. You get what you pay for. That said, we always weigh the benefits against the costs when making decisions for our passive funds as well".
>
> (Head of CG, Institution 3)

These arguments were often repeated during our study, pointing that excessive resource requirements associated with governance engagement is the main disincentive for passive funds to act as active owners. However, it should also be mentioned that respondents emphasized that activeness is a question of resources rather than the fund type. All else equal, passive funds' fundamental ability to engage is the same, indicating that if the perceived benefits to engage exceeds the costs, passive investments could engage in active ownership.

### 4.1.3 The Exception of ESG

Non-financial aspects of corporate governance stood out regarding passive funds' activeness, particularly sustainability aspects, i.e., environmental, social and governance (ESG). Here, all respondents were very keen to underline their active ESG integration into their passive portfolios as they believe it was important in order to stay competative. As sustainability was brought up, the discussion of passive funds' resource ability to engage in ownership took a different turn, indicating benefits to be perceived large enough:

> "We are expected to take responsibility for all our portfolio holdings, regardless of it being an active or passive managed fund. We cannot simply tell media or our customers that we ignore certain companies only because they are smaller holdings included in a passive portfolio. We are expected to take responsibility for these companies just as in the companies we have a larger ownership stake in".
>
> (Fund Manager & Head of Sustainability, Institution 2)

It should be noted that such ambitions of corporate governance add new nuances to previous reasonings in section 4.1.2, where passive funds' low fees were described as a hindrance to actively engage in corporate governance. During our discissions, several ways to influence corporate governance was mentioned:

> "Despite us not being among the largest owners today, we can still have a large influence on companies. The most important thing for us is not to vote at an annual meeting, but rather to actually ask questions to companies' top management and meet them. This shows that we, even as a 'passive' owner, constantly monitor top management, which will have an influence on their work. In reality, however, we do not need to formally analyze them, but the important thing is to ask questions regularly. That will push companies in the right direction".
>
> (CEO, Institution 1)

In line with such ambitions, and unlike previous arguments about passive funds not being among the largest shareholders in a company, this argument shows that all funds, passive funds included, can have an active impact on corporate governance just by showing they are monitoring their holdings:

> "By signal to our holdings' management that we constantly monitor their actions, and by asking relevant questions in dialogues with management, we will have a greater impact and influence on corporate governance, compared to solely own a larger shareholder stake in the company".
>
> (Head of CG, institution 4)

In line with institutional passive investments' ESG related governance work, were the aspect and ability to customize their tracking indexes. Commonly among all institutions, they offered

sustainability adjusted indexes to their passive funds, excluding certain shares in norm-based unsustainable companies, despite the increased cost associated with such index customization:

> "The benefit with an index-tracking fund is that we can adjust, and exclude, certain companies from the tracking index if they act badly. Although unusual, it has happened that we have excluded a company after certain incidents have happened".
>
> (Fund Manager & Head of Sustainability, Institution 2)

In other words, the passive funds actively choose to discuss with their index supplier to tailor their tracking index. Note that the notation of the passive fund changes from an 'index-fund' to an 'index-tracking fund' after such tailoring. These types of index adjustments can be done continuously, which suggest that passive funds, in fact, have the ability to exclude companies from their index. Although some variation existed, inevitably, this illustrates the passive funds' ability to 'threaten to exit' if a company is misbehaving. Hence, to a certain degree, even passive funds can be active in the way they wish to invest their money.

However, in case of an incident, exclusion was expressed to be a rare option. Communicated by the interviewees, if one of their holding companies would misbehave the common approach was to at first stick with the company and guide them, rather than excluding them immediately:

> "At first, we try to stay with the company and understand what has happened. Is the management open to what we have to say? If we believe that there is a way for us to 'turn the ship around', that is what we are going to do".
>
> (Head of CG, Institution 6)

### 4.1.4 Monitoring is a Two-Way Street

As the above quotes indicate, solely passive investors' ability to monitor portfolio holdings will influence the companies' management. However, simultaneously the institutions are being monitored by customers and media, making them a subject for stakeholder influence as well:

> "Institutions do not want to take any risk of receiving bad publicity by supporting, or owning, the 'wrong stocks' and companies that go against social norms. Everyone wants to brand themselves as an 'active ESG contributor'. Hence, active

> ESG work is important for funds' brand image, and ultimately for staying competitive since it is a very prioritized question for customers today".
>
> (CEO, organization 1)

In similar vein, increased regulatory requirements, mostly regarding sustainability standards and reporting, was repeatedly brought as another driver for passive funds to prioritize active ESG work, despite the associated increased costs with such governance:

> "Regulatory requirements decide what, and how, we should report certain metrics. During the last years, we have seen increased regulatory requirements trying to harmonize the sustainability reporting. Inevitably, this makes it more expensive for passive funds to operate due to increased ESG reporting".
>
> (Fund Manager & Head of Sustainability, Institution 2)

Although all respondents welcomed such regulations in an effort to harmonize ESG accounting standards, there was simultaneously a fear that nuances could be lost along the development:

> "It is certainly a good thing that ESG regulations exist, but like always with regulations, there is some fuzziness to it and a risk of losing nuances".
>
> (Head of CG, Institution 6)

On this topic, however, all respondents expressed some sort of communicative challenges towards media and customer, in particular regarding ESG-related governance topics:

> "We definitely experience communicative challenges, particularly in sustainability related topics, like investing in green conversion cases. In some ESG work the perception is that 'you are damned if you do, and damned if you do not'. I think it is good that we are being reviewed, but it becomes a very 'black or white' question when nothing is that simple in reality."
>
> (Portfolio and CG analyst, Institution 5)

### 4.1.5 External Influences from Social Norm and Legal Standards

Building on the findings in section 4.1.3, we found that passive institutions were being pressured, by customers and social norms, to act in a certain way regarding how they exercise corporate governance work. Frequently, the respondents mentioned that the relevance for sustainability related questions have increased during the last decade, and that ESG related questions have received more attention among both regulators and customers. Thus, the respondents expressed that their passive investments have responded accordingly and prioritized more allocation of resources to these types of ESG related corporate governance work, in an effort to adapt to new standards.

To concretize the social norm pressure, one example was brought up by institution 5 when discussing its exclusion criteria for the investment strategy. The initial standpoint was to exclude all non-controversial weapons for the majority of its funds, passive funds included. However, coincide with the development of the Russia-Ukraine war (UNRIC, 2022), the institution officially changed its standpoint to now accept inclusion of non-controversial weapons for all its funds, passive funds included:

> "ESG related questions can be linked to moral ethics, which makes it tricky. In this particular case, we have noticed increased interest among our customers to include military, non-controversial weapons, for some time. After close consideration, we have chosen to now accept non-controversial weapons as an investment possibility for all our funds. However, this principal change was a co-occurrence, and a coincidence in time, with the war".
>
> (Portfolio and CG analyst, Institution 5)

On the aspect of moral ethics, several of the respondents explicitly pointed out this to be an important factor to consider in the institutions' governance work, especially when reasoning for exclusion criteria:

> "What sectors to exclude falls in line with our principles for responsible investments. However, it also falls very much in line with one's values and ethic, which is deeply rooted in our society and is constantly in formation".
>
> (Head of CG, Institution 3)

Simultaneously, the respondent emphasizes the on-going change in political and economic landscape, in particular within ESG and sustainability accounting standards. Most frequently mentioned was EU's Sustainable Finance Action Plan (SFAP), and its key component the Sustainable Finance Disclosure Regulation (SFDR). It aims to direct money into sustainable investments and increase the transparency for sustainable investments (Morningstar, 2021). The SFDR provides with a specific and collective framework, requiring all investment funds to fully disclose their offering from a sustainability point of view by classifying funds as 'Article 6, 8 or 9'. In other words, the SFDR distinguish funds that takes sustainability factors into consideration in their investment decisions, from the ones that do not.

The 'Article 9' funds are those which as an objective have a direct positive impact on the environment and society and do not significantly harm other sustainable objectives. The level below, called 'Article 8' funds, promotes environmental and social efforts, or excludes assets that do not comply with the sustainable development principles. All other funds, that do not classify as 'article 9 or 8', are categorized as 'article 6' funds, doing non or only baseline sustainability assessment. This way, funds can be categorized based on their sustainability performance, making it easier for customers to compare and allowing for side-by-side comparisons of competing investment offering when it comes to the level of sustainability (Morningstar, 2021). Following consequences by such categorization, and constant monitoring from regulations, media and customers, fund institutions appear to integrate sustainability to protect their own branding:

> "Ever since all funds need to report on how they integrate and work with sustainability there are clearly new incentives to work with governance questions today compared to a few years ago since nobody want to be an 'article 6' fund".
>
> (Fund Manager & Head of Sustainability, Institution 1)

Further, it could also be noted that prioritized ESG questions in the institutions' governance work was influenced by customers' values:

> "We construct a customer survey every year where we ask which of UN's global goals, they believe are most important. Then we take these results into consideration when determining our ESG strategy regarding our impact dialogues with portfolio companies"

(Portfolio and CG analyst, Institution 5)

In addition, every interviewee that represented an institution which received invitations to participate in the companies' nomination committees accepted the offer and expressed that it was a very valuable and important channel for influencing the corporate governance work. Even the institution which did not receive any invitations today stated that they would accept the invitation if they got one:

> "Nomination committees are absolutely a large opportunity for us to have an impact and influence a company. For instance, by working for appointing an ESG competent person into the board we could plausibly influence the whole company's ESG work".
>
> (Fund Manager & Head of Sustainability, Institution 2)

Lastly, all respondents stated that they used their passive investment to actively vote at the annual meeting. Albeit all institution outsourced recommendations from external analysis on how to vote, the final decision was based on an internal assessment. Hence, the respondents revealed that proxy advisor recommendations were used as a tool rather than following it strictly, since the institutions want to fully ensure that they can stand by the voting decision taken. It was also mentioned that the general willingness for collaboration between institutions was larger in ESG-related governance. Such collaboration can take form through sharing ideas in a group meeting with a holding's top management, different external initiatives, or even agree upon how to vote on the annual meeting so that the institutional shares are combined between institutional boarders to have a greater shareholder impact.

# 5. Analysis

*In this part, an analysis of the empirical findings will be carried out with the intention to answer our research question. The analysis will be structured in accordance with our theoretical framework and will consist of two parts. The first part will investigate Swedish institutors' underlying reasonings, incentives and drivers behind their corporate governance work. Thereafter, we will address how the corporate governance work is reflected in the passive investments' operations.*

## 5.1 Passive Investments' Underlying Drivers and Incentives

In order to grasp the full picture to answer the question, *how* Swedish institutional owners work with corporate governance within their passive investments, one must first understand the underlying reasonings behind their actions. From there, one can recognize how it is reflected in the institutional owners' corporate governance work within their passive investments.

### 5.1.1 Economic & Political Regulation

Foucault (1977) suggests that *the aim* of disciplinary power, in an economical context, is to achieve, and maintain, economic and political regulation. Relating to our empirical findings it suggests that the increase in new regulations and legal frameworks within the general European fund market and accounting standards, notably within ESG and sustainability, have imposed constant new adaption of new working requirements and methods among all types of funds (Morningstar, 2021). For instance, this can be illustrated by EU's action plan on sustainable finance, requiring investors to use SFDR/EU Taxonomy aligned data from companies to screen portfolios, and then generate regulatory disclosure reports, as well as proactively manage the sustainability impact of the investments (Morningstar, 2021). As indicated by the respondents, such adaption is labor intensive and requires additional resources, especially since all data is not yet available nor reported among the portfolio companies.

Although all respondents emphasized the increased cost aspect associated with the regulatory adaption, institutions offering both actively and passively managed funds saw synergies between the funds, where the shares held in index-tracking funds could be used to increase the total equity share for the institution. The higher fees associated with active funds could then be used to satisfy the increasing resource requirement, which complements Blitz et al. (2019) argument of passive funds' need for additional resources to integrate ESG into a passive investment strategy. Adding to the reasoning by Blitz et. al (2019), passive investments can realize synergies with its active managed equivalent's governance work, indicating that a combination of actively and passively managed funds enables passive investments to act as active owners. However, since the new regulations applies for all types of funds, the legal framework is just as relevant for passive funds independently. On this side end, for an institution offering solely passive index-tracking funds in-house, the respondents believed that the adaption would be more challenging, especially from a resource and profitability aspect, where

benefits need to be weighed against costs. This supports earlier research to some extent, suggesting that resource limitations are one of the main disincentives to engage in corporate governance (Strampelli, 2018). However, here the acknowledgment of nuances is vital to consider since the balance between benefits and cost differs depending on the characteristic of governance work. Interestingly enough, despite the resource intensive requirements associated with the correction, all the institutions underwent measures in order to correct themselves, providing additional value to Strampelli's (2018) research, which will be elaborated on in section 5.2.

### 5.1.2 The Creation, Reformation, and Acceptance of the "Truth"

Foucault (1977) described *the nature* of power as embodied in society by the acceptance of knowledge and "the regimes of truth" which, in turn, is constantly redefined through media, normative regulations, and by the political and economic landscape (Rabinow, 1991). Such nature and acceptance of a "truth" can be reflected in how passive funds' corporate governance work is influenced. The respondents revealed that this can be illustrated by several examples, many of which however, relating to sustainability and ESG aspects of corporate governance.

The strong ESG-focus is plausibly a consequence of medias' increasingly focus on sustainability (Eccles & Klimenko 2019), in addition to a changed political and economic landscape driven by new legal frameworks and accounting standards as described above. Combined, media and the political landscape form normative regulations that all institutions need to correct themselves to because, otherwise, their 'soul' will be punished through bad publicity, damaged brand image, reduced fund inflows and ultimately, weakened competitiveness. This was confirmed by all respondents as they believed active and integrated ESG corporate governance work to be essential for sustaining future competitiveness. This finding adds new insights to the concept of fiduciary norms discussed in earlier research (Bebchuk & Hirst, 2019; Kahan et al., 2021; Hendry et al., 2006), stating fiduciary norms to have the potential, yet limited impact, on institutional owners' corporate governance work. In contrast to this finding however, our study reveals that fiduciary norms appear to have a significant impact on passive investment's governance work, particularly within ESG, as a consequence of strong normative regulations. Following such perception of ownership, institutional owners can be conceptualized as 'owners and fiduciaries' in accordance with Hendry et al (2006). It presumes duty of care and responsibility towards its investments, as well

as acting dutiful towards the institutions' customers as fiduciaries. Not doing so would be morally wrong by the institutions, falling in line with Hendry's et al. (2006) conceptualization.

### 5.1.3 Normative Regulation & Consensus Formation

In accordance with Foucault (1977), the described process of knowledge and truth acceptance forms a consensus which establish a normative regulation. Nonetheless, such consensus is constantly evolving and is in formation, whereof the institutions self-discipline themselves to adapt and correct their behavior accordingly. Otherwise, if they do not, punishments are targeted on the institutions' soul, i.e., their brand damage, hence the institutions want to do the actions for themselves, rather than being forced. Our empirical findings suggests that all institutions performed continuous forms of scanning of the market based on norms, for instance by having regular customer surveys, to identify the evolvement of consensus. Based on this information the institutions could gain new knowledge and adjust their behaviour in their corporate governance work correspondingly. The most obvious example in our empirics can be illustrated by institution 5's change in its exclusion criteria in conjunction with the Russia-Ukraine war (UNRIC, 2022).

Using institution 5 as an illustration, initially it excluded the military defense industry in its investment strategy, however, soon after the outbreak of the Russia-Ukraine war, institution 5 updated its view on military defense industry and allowed it to be included in several of its funds. Albeit not verbally confirmed by institution 5 that the change was a pure result due to the outbreak of the war, the timing of execution is clearly noticeable. However, it was confirmed that institution 5 had notice a changed attitude among its customers towards defense weapons, and that the demand for investment exposure to the military defense sector had increased. Although this particular change primarily affected the active managed funds it would also imply that, had a defense weapons company been originally included in an index for its index-tracking funds, it might no longer be excluded post this change. Using Foucault's framework (1977), institution 5's corrective actions would be an illustration of normative regulation to not violate the norm.

At the same time, one must not forget that normative regulation is a subject of constant reformation through not only the economic landscape and media, but also the institutions themselves. This implies that the institutions also constantly gain new knowledge and

acceptance from their operations and dialogues with companies. That said, this can create communicative challenges if the normative 'truth' is not aligned between media and institutions, which is illustrated by the dashed horizontal arrow in Figure 2. Further, illustrated by the vertical dashed lines in Figure 2, such new knowledge can also create a redefined truth acceptance which, in turn, potentially also influence future regulations. A concreate example mentioned among our respondents was regarding portfolio companies aiming to convert their current business to become a more environmental aligned business in the future. For instance, an old oil company aiming to rebuild its business toward greener renewable solutions. Here, our empirics confirm that they experience communicative challenges, in particular with media and customers, since it might look like that they invest in harmful companies when they in fact are trying to support the company's conversion towards sustainable solutions. Further, it appears that competing institutions collaborated to a greater extent both with each other, but also with organizations representing the Swedish fund institutions, in an effort to influence the regulators to adjust legal standards if needed.

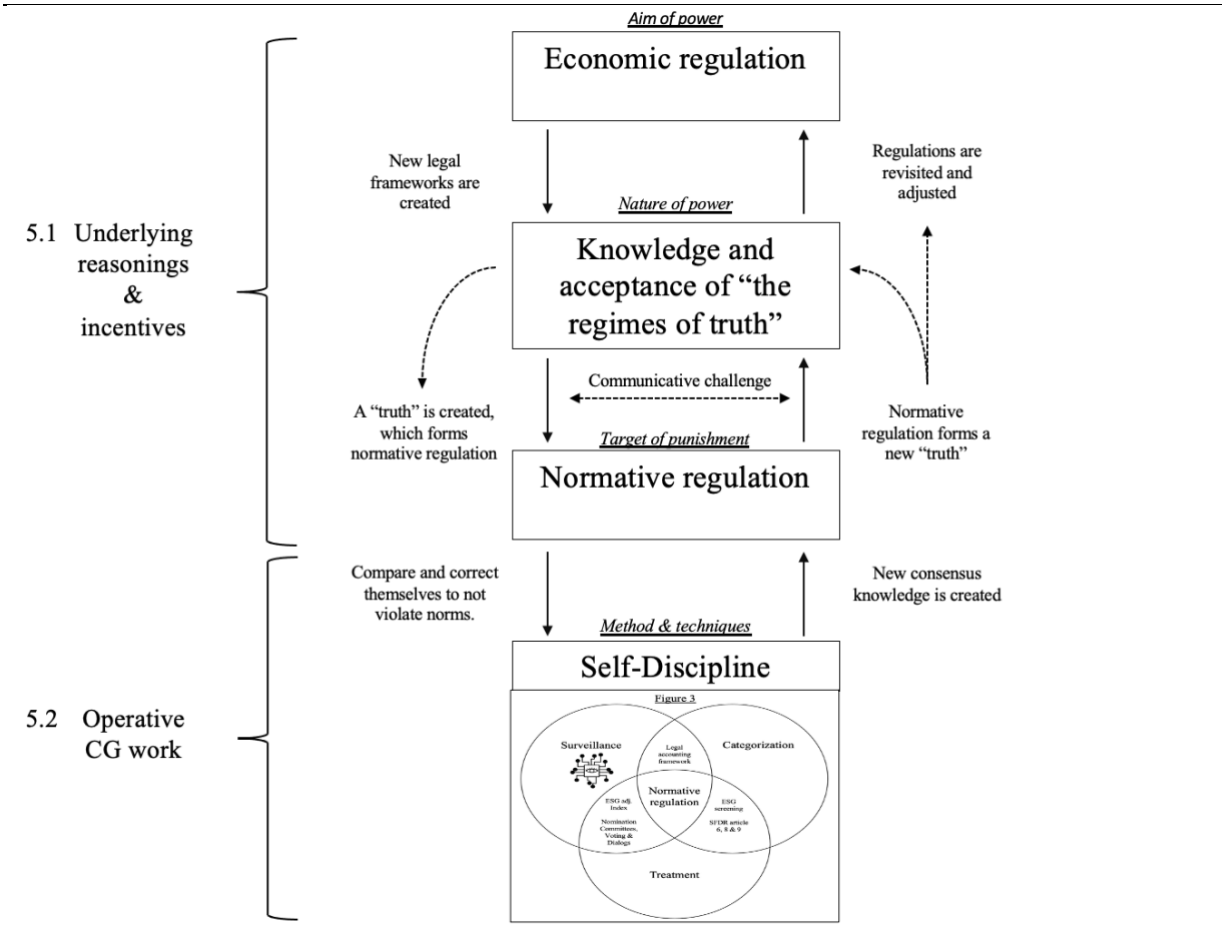



Figure 2: Summarized analysis using Foucault (1977) on how Swedish institutional owners work with corporate governance in their passive investments

## 5.2 Passive Investments' Operative Governance Work

Foucault (1977) explains power to be carried out as methods of surveillance, categorization, and corrective treatment, and our thesis illustrates how this is reflected in the operative corporate governance work of passive investments.

### 5.2.1 Surveillance, External Pressures & Treatment

Drawing upon Foucault's disciplinary power as theoretical framework, institutions are regulating self-discipline driven by the knowing of the possibility of constantly being watched. In the case of institutional ownership and responsibility, the norm appears to expect all funds, actively or passively managed, to be responsible owners and supporting the 'right' type of companies through its investments. Assimilated with Bentham's panopticon metaphor, institutions play two roles. In the first role, institutions are equated as the 'prisoners', while media, regulators and customers are sitting in the 'guard tower'. In other words, just the knowing that an actor could possibly be watching at all times self-disciplines institutional owners to correct their behavior in all portfolios, passive funds included. In the second role, the institutions sit in the 'guard tower' watching over its portfolio holdings represented by the 'prisoner cells', which will influence how institutional investors work with governance.

#### *5.2.1.1 Panopticon Metaphor 1: 'Passive Institutions as Prisoners'*

For passive investments specifically, self-discipline and corrective treatment could be demonstrated in several areas in our empirical findings. For instance, all institutions underwent some sort of ESG index adjustments for their index-tracking funds, which is based upon a screening process entrenched on 'international norms'. Despite initial reasonings of passive funds' being shallow on resources due to low fees, these types of ESG adjustments appeared to always be prioritized in all institutions, despite them being costly actions due to index tailoring with the supplier. Thus, our empirics bring new insights to previous research by Bebchuk, Hirst (2019) and Strampelli (2018) among others, as it suggests that even though resources and fees are shallow, the institutions appear to discipline themselves and correcting their behaviour as a consequence of them being constantly surveilled by media, customers, and regulators. The other end of the argument implicates that if an institution does not correct its behaviour according to the norm, for instance by not making any ESG index adjustments, they will be subjects to norm violation and punishments will be carried out through the soul. In this case, the soul of an institution is the brand perception and image.

However, as Foucault (1977) states, the formation of the truth is constantly redefined through both the political and economic landscape, as well as through institutions. In our case, this means that situations can arise where institutions learn new knowledge from their portfolio companies that stand in contrast with the current 'truth' in the normative regulation. As indicated by the respondents, every institution experiences some sorts of communicative challenges, in particular with media, regarding their corporate governance. As previously mentioned, our empirical findings suggest that media have lately been heavily ESG-focused which influence how institutions work with corporate governance. Using the same conversion example from earlier, the institution's 'truth' might be that emission heavy companies need capital to support the conversion of the current emission heavy production towards a greener environmental production in the future. However, until the 'truth' is broadly harmonized, it creates a risk that media surveillance just sees the current emissions and, thus, classify the portfolio to break environmental norms, creating communicative challenge in situations where the knowledge and acceptance of the truth is not yet harmonized in one consensus.

#### *5.2.1.2. Panopticon Metaphor 2: 'Passive Institutions as Guards'*

When discussing institutional passive investments as 'guards' in the panopticon metaphor, their function shifts to monitor the portfolio holdings performance. However, unlike active fund managers, passive funds' financial return is not being quarterly evaluated compared to a relative index or peers since the nature of the product is to solely track a pre-determined index (ICI, 2022). Thus, our empirics find that the surveillance of the holdings in passive investments will be dominated by a non-financial characteristic, which carry on earlier research from Bebchuk, Hirst (2019) and Kahan et. al (2021). In the present study, the respondents commonly emphasized the importance of nomination committees, selecting the most appropriate people to the board, as well as sustainability aspects. These channels appeared to be important for the institutional investors to both influencing governance and for monitoring executives. The nomination committee was particular highlighted among the respondents, arguably due to the monitoring nature that the board has over company executives, which is appointed by the nomination committee. Additionally, passive investment was keen on using their share to actively vote at the annual meetings. Albeit all institution indeed outsourced recommendations from external analysis sources on how to vote, the final decision was always based on a company specific internal assessment. This stands in contrast to earlier research on the 'Big three's' voting, as well as adds new nuances to Lund's (2018) argument of passive investments'

low-cost proxy strategy and ‘one-size-fits-all approach’, especially as governance work appear to be ESG dominated, and where every company has specific ESG risks.

Further, many institutions stated they have proactive dialogues with the index-tracking portfolio companies on regular basis, which illustrates surveillance according to Foucault (1977). Consequently, positive governance outcomes can realize due to self-disciplinary behaviors by just the knowing that the portfolio companies are being monitored by their passive institutional owners. However, for institutions with both actively and passively managed funds, it was more rarely passive managers participated in these meetings, even though it did happen occasionally. Interestingly however, in the dialogues where passive managers participated the focus appeared to always be on non-financial metrics, such as sustainability development for the company, adding further support for non-financial incentives to have significant influence on passive fund managers, in contrast to Bebchuk’s and Hirst’s (2019) research.

An additional illustration of passive investments’ self-discipline can be recognized when an index-portfolio company find itself in a crisis, often ESG-related such as some sort of scandal, corruption or similar. In these types of situations, the institutions act as ‘guards’ in the Bentham’s panopticon, while the portfolio companies are ‘prisoners in the cells’. If a holding company violates rules or the social norms, it will be categorized as a company that breaks guidelines, in which the institutions are expected to take actions and treat the behavior. Our empirics show that every institutional owner indent to use their passive shares in their index-tracking portfolios in order to meet and have a dialogue with the company’s top management and hear the situation out. This is a firsthand measure in an effort to influence the company which will, if needed, be followed up with voting on the annual meeting, supporting Bogle’s statement (Benz, 2017) to ‘fix management’. However, if the situation escalates and is assessed to be bad enough, even the index-tracking funds could potentially threaten to exit the company. This is done by tailoring the index through its supplier, so that the company no longer will be included in index and, thus, will be sold off from the index-tracking portfolio. This adds a new dimension of potentially threaten to exit contrasting earlier literature by Bebchuk and Hirst (2019) among others.

On the subject of influencing the portfolio companies, our empirics show another interesting aspect of how institutions approach corporate governance work in their passive investments. Compliant with passive investments’ focus on non-financial metrics, compared to active funds’

focus on quarterly financial performance, ESG-related questions are, yet again, increasing in relevance. Interestingly enough, our empirics show that in these types of governance, investors seem more willing to collaborate between competing institution houses. Consequently, such openness and willingness for collaboration can be a result of them wanting to do the right thing, associated with moral ethics in ESG related governance, adding support for Fiduciary Norms (Bebchuk & Hirst, 2019), and is a unique feature for passive investments in how they work with corporate governance. This brings an aspect which is, until now, unexplored in existing research. Compared to active fund managers' low willingness to cooperate between competing institutions, where meetings with management tend to have a more operative financial core and, thus, often at one-on-one basis in order to find the best performers for coming quarter, passive managers' non-financial focus led to a higher degree of cooperation.

### 5.2.2 Social Categorization & the Fear of Being the Worst

Since the relevance for sustainability has increased during the last decade, classifications of funds based on their ESG performance have been formed. Currently, regulators in the EU develop and release new accounting standards, such as the Sustainable Finance Disclosure Regulation's (SFDR) articles, classifying funds in an effort to segment the market based on how sustainable the product is. In accordance with Foucault (1977), this will create a social structure of categorization to segment the market.

Consequently, in the case of passive institutional ownership, the mass surveillance argument will be reinforced and sustained since intuitions now can be evaluated in accordance with a harmonized prevailing standard of normality as, for instance, the SFDR regulation entails. As our empirical findings support, this creates a fear among institutional owners of being the worst performer called 'article 6' funds and, hence, they will adjust accordingly insensitive of the cost since every institutional owner wants to brand themselves as an ESG contributor. Put differently, as long as institutional owners have the knowing that they are being governed and evaluated on a particular aspect, and that the potential consequences are material enough for the soul if they fail, the institution will adjust to the correct behaviour, nonetheless the resource requirement. According to Foucault (1977), the benefits of investing in adequate corporate governance engagement will outweigh the monetary cost when the punishment on the soul becomes material. That is, when the pressure from mass surveillance, i.e., customers, media, regulators, is large enough. Combined with increasingly sophisticated methods for measurable

performance, in conjunction with new legal accounting standards building social categorization, the self-discipline will correct behaviors in accordance with normative regulations. Thus, in contrast to Bebchuk and Hirst (2019), governance work could actually make one institution's passive funds more attractive compared to its competitors and provide for a competitive advantage, since one's ESG performance will be reflected in its categorization. Furthermore, unlike Bebchuk and Hirst (2019), our empirics expect fiduciary norms to have a great impact on the fund managers' behavior. Continuing on the 'benefit against cost' argument above, the ongoing implementation of new sustainability accounting standards can allegedly explain why ESG is a special case in how institutions work with corporate governance within their passive investments today.

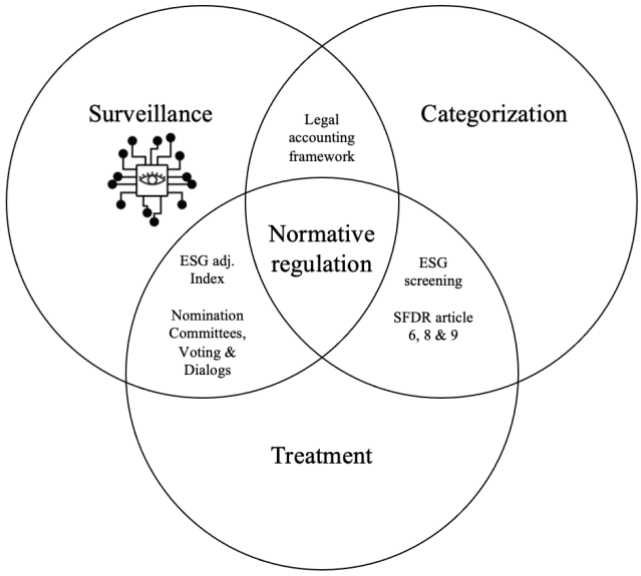



Figure 3: Swedish institutions' self-discipline and operative governance work in their passive investments

### 5.2.3 Corrective Treatment & Categorization

As previously mentioned, if a portfolio company within a tracking-index violates social norms, the institutions will monitor the situation and intend to undertake dialogues with the company at firsthand. If, however, a company is not able to correct its behavior according to the norm, the respondents indicated that the institution would use its screening tool in order to categorize the company as 'unsustainable' and, thus, exclude the company from the tracking index through customization with its index supplier, adding new light to passive funds' ability to threaten to exit (Fu et al., 2021). The company would then be treated as other companies that is normative classified as unsustainable. These types of corrective actions in passive portfolios from the

institutions is, in turn, a self-disciplinary action in order to not violate social norms on being a responsible institutional owner or risking bad publicity of being categorized as a poor institutional investor.

# 6. Conclusions and Summary

*In this section, we will firstly summarize and discuss the current thesis' findings and conclusions, followed by a comment on some suggestions for future research. Lastly, we share our final thoughts.*

---

Our aim with the study was to examine how Swedish institutions work with corporate governance in their passive investments. The analysis suggests that earlier research on passive investments' corporate governance work, and their incentives to engage, does not fully capture all nuances to the question.

Like previous research (Lund, 2018; Bebchuk et al., 2019; Strampelli, 2018), we found that the low fees associated with passive investments limit their resource availability, suggesting that passive investing have low financial incentives to engage in company specific analysis. While the argument goes that such company specific engagement will not provide competitive advantage, our findings suggest otherwise. All respondents indicated that they, as large institutions, are expected to take company specific responsibility and that such engagement is necessary to stay competitive, adding new insights to previous research. This desire to do the 'right thing' refers to the concept of fiduciary norms (Bebchuk & Hirst, 2019). Thus, unlike Bebchuk's and Hirst's (2019) expectation that these fiduciary norms have a limited impact on the fund managers' behavior, our empirics find them to be vital.

We expect fiduciary norms, behaving as a responsible owner in accordance with normative regulations, to be significant enough and overweigh associated costs with increased governance engagement. This can be explained using Foucault's theory of disciplinary power, where increasingly sophisticated panopticon-like surveillance systems for evaluation, leads to categorization which self-disciplines institutions to correct their behaviour in their passive investments.

On closer examination, daily operative financial governance appeared not to be prioritized for passive investors. Since passive investments' goal is not to outperforming the market (OIEA, 2022), passive funds are not evaluated on such aspects. From such perspective, no financial incentive to invest in corporate governance exists, backing Lund (2018), Bebchuk and Hirst (2019) and Strampelli (2018). However, one particular aspect of institutional passive investors' corporate governance work stood out clearly, namely ESG related governance, shedding new light to earlier research. As seen in our empirics, adding such point of view suggests that passive funds indeed can become more attractive over competitors if invested in corporate governance. This finding is plausibly a result of sustainability's increasing relevance in society, pressuring institutions to act as responsible investors (Eccles & Klimenko, 2019). This forms both a new economic landscape, knowledge, truth, and norms, making institutions self-disciplined in these types of questions. Thus, unlike Blitz and de Groot (2019), sustainability appears to be integrated with passive investments due to incentives driven by fiduciary norms and self-discipline which overrules resources limitations from the low fees.

Passive investments' ESG incorporation takes place by not only introducing excluding strategies when formatting the tracking index, implying that passive funds indeed can threaten to exit on contrary to previous research (Fu et al., 2021; Bebchuk & Hirst 2019), but also when passive funds signal to their holdings that they are constantly being monitored. Thus, making the portfolio companies self-disciplined to behave accordingly. Additionally, in few cases passive fund managers have shown direct active corporate governance engagement in company specific ESG governance, in particular in situations where a portfolio company violates the normative regulation. Such findings support that institutions are, in fact, active owners in their passive investments today, especially in areas where they are being evaluated and monitored by regulations, media and customers. Currently, such areas are mainly ESG focused which creates incentive for fund institutions to integrate sustainability into their passive investments to protect their own brand and stay competitive. This complements earlier research (Bebchuk et al., 2019), assuming corporate governance engagement not providing competitive advantage for passive investments. Additional findings are the use of the Nordic phenomenon of nomination committees as a channel to influence governance, as well as the overall willingness to collaborate between competing institutions in ESG relating governance specifically.

In summary, we believe that the present study both confirms and complements existing literature on how passive institutions work with corporate governance. As the current trend for

passive investments has grown in popularity in last decade (Fichtner et al., 2017), it is of importance for investors to recognize how these passive investments reason and work with ownership to understand its implications for value creation and performance. Likewise, it is important for companies to realize how passive investments behave as shareholder owners.

## 6.1 Future Research

We have detected two additional aspects that we believe can be used to investigate the field wider and differently. Firstly, since our study is based on the institutional investors' perspective only, we believe it would be of interest to also interview the portfolio companies to gain new perspective on how they experience passive investors' work with governance. Secondly, it would be interesting to see whether similar or dissimilar pattens, in terms of incentives and normative regulations, to our findings can be seen on other Nordic or European markets.

## 6.2 Final Thoughts

All things considered, the present qualitative study brings more nuances to current quantitative dominated research, as well as new insights to how Swedish institutional investors work with corporate governance in their passive investments today. As discovered in this study, passive investments have indeed solid fundamental conditions to practice active ownership albeit restricted resources, due to their low fees, making it a question of priority. Despite that, however, institutional passive investments practice several active governance activities today beyond the simplest voting on annual meetings. Not only is such voting decision based on company specific research, but also screening processes for index adjustments, and where applicable, participation in nomination committees. We see this activeness, however, to be focused on non-financial metrics purely, and in particular dominated by ESG and sustainability related governance. In such case, fiduciary norms, and institutional self-discipline driven by surveillance, categorization, and corrective treatment, form normative regulation. This, in turn, creates a desire to do the normative right thing among the investment institutions, making them want to act as responsible owners despite their limited resources from their low fees. In consistent with passive investments' accelerating market share growth, more attention and surveillance are being drawn towards them. Therefore, today major institutional investors appear to have grown to a size where they simply are too big to be passive.

# 7. References


Allen, B. (1998). "Foucault and Modern Political Philosophy", In: *The Later Foucault.* (Ed.) Moss, Jeremy (London) Sage, pp. 164-198.

Appel, I., Gormley, T., Keim, D. (2016). Passive investors, not passive owners. *Journal of financial economics,* (1), 111-141.

Arranz Aperte, L., Strand, T. (2022). The Nordic nomination committee, and board tenure: an empirical investigation. *Spanish Journal of Finance and Accounting,* 1-27.

Barker, P. (1998). *Michel Foucault: An introduction.* Edinburgh University Press.

Bebchuk, L., Hirst, S., (2019). Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy. *Columbia Law review, 119*(8), 2029-2145

Benz, C. (2017). *Bogle: Index Funds the Best Hope for Corporate Governance.* Morningstar. https://www.morningstar.com/articles/830770/bogle-index-funds-the-best-hope-for-corporate-governance

Boffo, R., Patalano, R. (2020). *ESG Investing: Practices, Progress and Challenges*. OECD Paris. www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf

Blomberg, J. (2020). *Organizational Theory*. SAGE Publications Ltd.

Bloomberg Finance L.P. (n.d.). [.BIATPDE G Index (US Passive Dom Equity AUM($MM))] Retrieved 2022, January 18 from Bloomberg Terminal

Blitz, D., de Groot, W. (2019). Passive Investing and ESG are incompatible. *Robeco The Investment Engineers.* https://www.robeco.com/media/3/7/3/373d6ef6896087e59ad0e622b92b5464_201901-passive-investing-is-incompatible-with-sustainability-investing_tcm17-16805.pdf

Del Guercio, D., Hawkins, J., 1999. The motivation and impact of pension fund activism. *Journal of Financial Economics* (52), 293–340.

Easley, D., Michayluk, D., O'Hara, M. Putnins, T.J. (2021). The Active World of Passive Investing. *Review of Finance.* 1433-1471.

Eccles, R., Klimenko, S. (2019). The Investor Revolution. *Harvard Business Review, May-June 2019,* 106-116.

Eisenhardt, K.M. Agency theory: An assessment and review. *Academy of Management Review*, 1989, *14*, 57–74.

Fama, E. (2008). Agency problems and the theory of the firm. *The Journal of Political Economy, 88*(2) 288-307

Fichtner, J., Heemskerk, E.M., Garcia Bernardo, J. (2017). Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk. *Business and politics, 19*(2), 298-326.

Fink, L. (January 17, 2018). *A Sense of Purpose.* Harvard Law School Forum on Corporate Governance. https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose/

Foucault, M. (1977). *Discipline & Punish: The Birth of the Prison* (2nd ed.). Random House Inc.

Fu, L., Pan, L., Wu, F. (2021). Does passive investment have a positive governance effect? Evidence from index funds ownership and corporate innovation. *International review of economics & finance*, (75), 524-545.

Hendry, J., Sanderson, P., Barker, R., Roberts, J. (2006). Owners or Traders? Conceptualizations of institutional investors and their relationship with corporate managers. *Human Relations, 59*(8) 1101-1132

Hshieh, S., Li, J. Tang, Y. (2020). How do passive funds act as active owners? Evidence from mutual fund voting records. *Journal of corporate finance,* (66), 1-16 https://doi.org/10.1016/j.jcorpfin.2020.101692

Investment Company Institute. (2022). *Trends in the Expenses and Fees of Funds, 2021* (ICI Research Perspective Vol. 28, NO 2). https://www.ici.org/system/files/2022-03/per28-02_2.pdf

Jensen, M.C., Meckling, W.H. (1976) Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, (3), 305-360.

Jensen, M.C., Murphy, K.J. (2010). CEO Incentives - It's Not How Much You Pay, But How. *Journal of Applied Corporate Finance, 22*(1), 64-76.

Kahan, M., Rock, E. (2020). Index funds and corporate governance: Let Shareholders be Shareholders. *Boston University Law Review, 100*, 1771-1815.

Lund, D. (2018). The Case Against Passive Shareholder Voting. *The Journal of Corporate Law, 43*(3) 102-144

Morningstar. (2021, August 25). *Morningstar finds Falling Fees Saved Investors $6.2 Billion in 2020.* Morningstar Inc. https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2021/Morningstar-Finds-Falling-Fees-Saved-Investors-6.2-Billion-in-2020/default.aspx

Morningstar. (2021). *Morningstar's Guide to the EU Action Plan.* Morningstar Inc.

Morningstar. (2021). *The EU Sustainable Finance Disclosure Regulation.* Morningstar Inc.

O'Dwyer, B. (2004). Qualitative Data Analysis: Illuminating a process for transforming a 'Messy' but 'Attractive' 'Nuisance'. In A. Humphrey, Lee (Ed.), *The Real Life Guide To Accounting Research* (1, p. 391-409)

PRI. (2020). *ESG & Passive Investments Strategies Consultation Results.* https://www.unpri.org/download?ac=10145

Rabinow, P. (1991). *The Foucault Reader: An introduction to Foucault's thought.* Random House Inc.

Ransom, J. (1997). *Foucault's Discipline: The politics of subjectivity.* Duke University Press

Roberts, J., Sanderson, P., Barker, R., Hendry, J. (2006). In the mirror of the market: The disciplinary effects of company/fund manager meetings. *Accounting, Organizations and Society,* (31), 277-294

Ross, S. The economic theory of agency: The principal's problem. *American Economic Review,* 1973, *63*, 134–9

Ryan, B., Scapens, R. and Theobald, M. (2002). *Research Method & Methodology in Finance & Accounting.* (2nd ed.). Thomson Learning.

SEC's Office of Investor Education and Advocacy [OIEA]. (n.d.). Index Funds. In *Glossary.* Retrieved May 2022 from https://www.investor.gov/introduction-investing/investing-basics/glossary/index-fund

Statista. (2021) *Largest Stock Exchanges in Europe as of January 2021, by domestic market capitalization.* https://www.statista.com/statistics/693587/stock-exchanges-market-capitalization-europe/?fbclid=IwAR0ojyCKzt8R1rpdb-L7Rs7jI1T7WRoapXn-EXNfT0PPa1u546p2O95rvtY

Strampelli, G. (2018). Are Passive Index Funds Active Owners? Corporate Governance Consequences of Passive Investing. *San Diego Law Review, 55*(803), 803-852

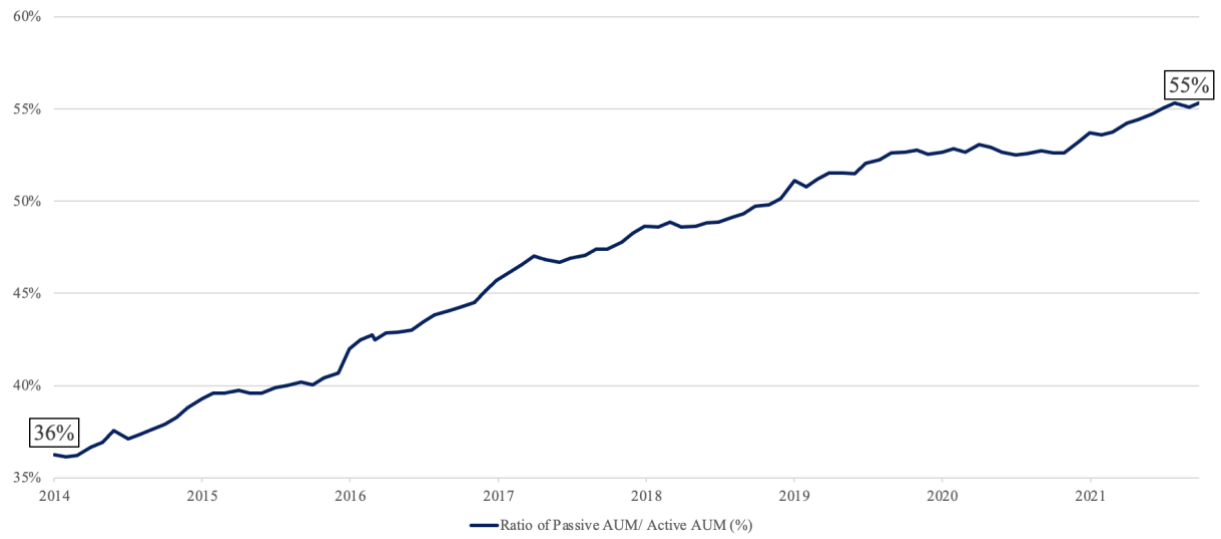
Swedish Investment Fund Association. (2019). *Fondmarknadens utveckling 1979–2019 – Så blev Sverige världsmästare i fondsparande.* https://www.fondbolagen.se/globalassets/faktaindex/studier-o-undersokningar/langtidsstudier/40_ars_studie.pdf

UNRIC. (2022, May 9). *The UN and the war in Ukraine: key information.* UN. https://unric.org/en/the-un-and-the-war-in-ukraine-key-information/

Yin, R. (2003). *Case Study Research: Design Methods* (3rd ed.). SAGE

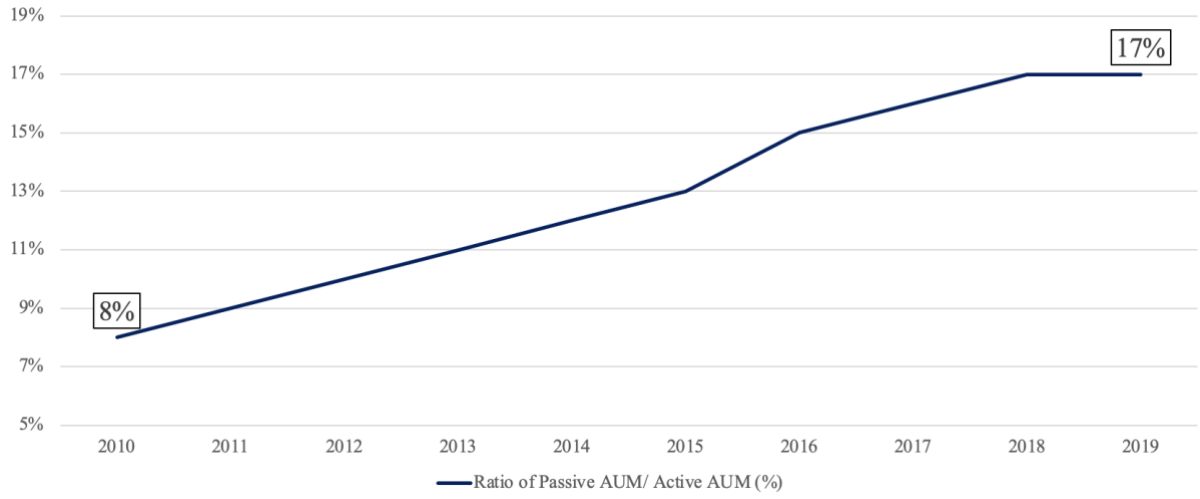
# 8. Appendix.

## 8.1 Appendix 1: Passive market share of total AUM in the US




(Bloomberg L.P., 2022)

## 8.2 Appendix 2: Passive market share of total AUM in Sweden




(Swedish Investment Fund Association, 2019)

## 8.3 Appendix 3: Extract from Interview Guides

**Formalities**

- Presenting the aim of the study.
- Asking if it is ok to record/ tape the conversation.
- Reminding of GDPR forum.

**Background**

- Respondents were asked for how long they have worked with capital markets and corporate governance questions.
- Asking about the institutions fund offering to confirm our own background check.

**Ownership and corporate governance work in their passive investments**

- As a major institutional investor in Sweden, what responsibility do you feel you have against companies, customers, and society?
- Do you believe it is possible to be an active owner despite being a passive investment? If so, why/ why not? In what way?
- How can such activeness be reflected in the passive asset management?
- How do you monitor/analyze your passive index-tracking portfolio?
- There have been discussions concerning passive funds' low fees and lack of resources as a challenge for increasing ownership engagement, what is your opinion on this?
- Based on the institutions' annual ownership report
    - how are 'prioritized topics' determined? Do you take any input from customers? If so, how?
    - Do you participate in any nomination committees? If so, what does this mean to you?
- How do you act, in firsthand, if a company violates your guidelines?
- Do you ever collaborate with other competing institutions in corporate governance questions? Why/ why not?
- How do you communicate with your stakeholders?
- We see several new legal accounting standards be implemented the last couple of years, and more to come. Do you welcome such development? What implications do such development entail?

- Can you, as a major institution, take part and influence such development of new accounting standards? If so, how? Can you name any concreate examples?

**The Interview End**

- Are there any additional issues or aspects you want mention that we have not yet discussed?

## 8.4 Appendix 4: Review of Interview Sample

| **Interviewee** | ***Description*** | ***Institution/ organization**** | ***Date of interview*** |
|---|---|---|---|
| Interviewee 1* | Fund Manager | Institution 1 | 2022-02-09 |
| Interviewee 2* | Fund Manager & Head of Sustainability | Institution 1 | 2022-02-09 |
| Interviewee 3 | Chief Executive Officer (CEO) | Institution 1 | 2022-02-18 |
| Interviewee 4 | Chief Executive Officer (CEO) | Organization 1 | 2022-02-22 |
| Interviewee 5 | Head of Corporate Governance (CG) | Institution 2 | 2022-02-24 |
| Interviewee 6 | Head of Corporate Governance (CG) | Institution 3 | 2022-04-08 |
| Interviewee 7* | Fund Manager & Head of Sustainability | Institution 2 | 2022-04-11 |
| Interviewee 8* | Corporate Governance (CG) analyst | Institution 2 | 2022-04-11 |
| Interviewee 9 | Corporate Governance (CG) analyst | Institution 4 | 2022-04-19 |
| Interviewee 10 | Portfolio and CG analyst | Institution 5 | 2022-04-20 |
| Interviewee 11 | Head of Corporate Governance (CG) | Institution 6 | 2022-04-27 |
| Interviewee 12 | Head of passive investments | Institution 7 | 2022-05-03 |

Appendix 4: Review of interview sample

* *The interviewees were interviewed at the same time during the same meeting.*

*** Institution = investment institution offering in-house passive and/or active funds, Organization = Fund association/ investment union*