THE ROLE OF INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE

Sobirjonov Samandar Murodil o'g'li
A student of Management Faculty, T
ashkent State University of Economics
Mrs Muslima Sadikova
A teacher of Management Faculty,
Tashkent State University of Economics
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Abstract: Institutional investors now hold large equity stakes across developed and emerging markets, shifting from passive owners to active actors in corporate governance. This article examines how they shape outcomes through proxy voting, shareholder activism, board engagement, and exit strategies. Drawing on agency, stewardship, and stakeholder theories, it argues that institutional investors both curb managerial opportunism and support long-term value creation. Case evidence illustrates these dynamics in practice. For instance, CalPERS in the United States has shown that sustained shareholder activism can help to strengthen disclosure and boards. Similarly, Hermes Investment Management in the United Kingdom influenced reforms that later shaped the UK Stewardship Code. Recently, the Engine No. 1 campaign against ExxonMobil in 2021 demonstrated that even small activist funds can succeed when supported by large institutional investors such as BlackRock and Vanguard. Globally, Norway's Global Pension Fund has promoted ethical investing by divesting from companies with low sustainability ratings, while the Tata-Mistry scandal in India highlights the growing role of institutional investors in emerging markets. Yet concerns persist about power concentration among the "Big Three," conflicts of interest, and whether passive investing weakens oversight. Overall, institutional investors are key agents of reform, though effectiveness depends on context, incentives, and regulation.

Key words: Institutional investors, corporate governance, proxy voting, shareholder activism, board engagement, active vs. passive ownership.

Introduction

In the last decade, institutional investors such as pension funds, investment and index funds, and insurance companies have become dominant shareholders in global equity markets. Their role has expanded from simple "silent owners" to active participants in corporate governance. According to modern interpretations, this rise is due not only to the size of their stakes, but also to the ability of investors to exert practical influence through the legal environment, voice, and exit channels.

Institutional investors typically influence governance in four ways: proxy voting, shareholder activism, systematic communication with the supervisory board and management, and exit strategies. The literature highlights the interdependence of these channels. In particular, large and professional ownership can reduce agency costs, enhance monitoring, and serve to create long-term value (Dasgupta, et al., 2021).[1]

Empirical and case-study evidence supports this. For example, targeted engagement through CalPERS's "focus list" program has been linked to shareholder empowerment reforms and is estimated to have generated approximately $3.1 billion in wealth between 1992 and 2005 (Barber, 2006).[2] Although different in scale, the Canadian Coalition of Institutional Investors (CCGG) demonstrates how collective stewardship (first private engagement, then public action if necessary) can improve governance practices at the market level (Doidge, et al., 2015).[3] The Tata-Mistry scandal in India also revealed that large institutions are gaining a significant voice in emerging markets (Manmohan & Singh, 2022).[4]

However, there are also controversial issues. The increase in ownership concentration, especially the growth of large passive funds, raises questions about monitoring incentives and conflicts of interest. The literature also highlights the limits of voice and "exit" mechanisms in this context. Therefore, this article seeks to identify when and under what conditions institutional investors improve corporate governance, and when policy-regulatory measures are needed (Dasgupta, et al., 2021).

Dasgupta, Fos, and Sautner (2021) review the role of institutional investors in corporate governance, arguing that their nature as financial intermediaries is fundamentally different from that of "classical" blockholders. The authors also analyze how heterogeneity within institutions (mandate, horizon, and constraints) determines the style and impact of governance.

Drobetz et al. (2024) show that global ownership intermediation has grown rapidly in recent years, with institutions becoming shareholders in almost every major company. They note that institutional ownership reached 70% plus in the US by the end of 2015, and in many countries it exceeded 15%, and this is reshaping the corporate governance landscape. However, it is noteworthy that empirical work on markets outside the US is still limited.[5]

[1] Dasgupta, A., Fos, V. & Sautner, Z. (2021) *Institutional Investors and Corporate Governance.* Foundations and Trends in Finance, 12(4), 276–394. DOI: 10.1561/0500000056.
[2] Barber, B.M. (2006) *Monitoring the Monitor: Evaluating CalPERS' Activism.* Working paper, UC Davis. Estimates total wealth creation of ~$3.1bn for CalPERS focus-list activism, 1992–2005.
[3] Doidge, C., Dyck, A., Mahmudi, H. & Virani, A. (2015) *Can Institutional Investors Improve Corporate Governance Through Collective Action?* Working paper (September 2015).
[4] Vyas, M. & Singh, K. (2022) *Tata Versus Mistry: A Boardroom Battle of Governance.* Journal of Positive School Psychology, 6(10), 2339–2348. Case analysis of governance and stakeholder roles in India.
[5] Drobetz, W., El Ghoul, S., Fu, Z. & Guedhami, O. (2024) *Institutional Investors and Corporate Environmental Costs: The Roles of Investment Horizon and Investor Origin.* European Financial Management, 30(2), 727–769.

McCahery, Sautner, and Starks (2016) examine the benefits of "behind the scenes," showing that many institutions begin with private engagement and then move to public pressure when necessary. This approach links the theory of "voice-exit" to practice.[6] Dasgupta et al. also cite this approach as a key pillar in their extensive review.

Barber (2006) analyzes CalPERS's targeted "focus list" campaigns and estimates that approximately $3.1 billion in wealth was created for shareholders between 1992 and 2005. However, the author notes that it is not easy to clearly identify long-term "excess returns." This result suggests the short-term value of active pension fund activity.

Edmans (2009)[7] and Edmans and Manso (2011)[8] theoretically formalize the "voice–output" mechanisms, showing how liquidity and block size affect an investor's choice to discipline through intervention or trading. This approach provides a basis for explaining the differences in practical observations.

Institutional ownership itself is often interpreted as a positive signal: according to Yahaya (2025), a large institutional shareholding signals to the market that information quality, transparency and monitoring are enhanced, which can reduce risk and improve valuation and outcomes.[9]

Furthermore, Drobetz and colleagues note differences by investor type (long-term pension or sovereign wealth fund, actively managed funds: index funds) and origin (domestic/foreign), showing that it is this heterogeneity that differentially affects corporate environmental spending, reporting, and governance outcomes.

In summary, Dasgupta and co-authors put the intermediary nature and heterogeneity of institutions at the center of theoretical and empirical research, Drobetz and colleagues reveal global intermediation and gaps outside the US, McCahery, Sautner and Starks show real-world practical forms of engagement, and Barber illustrates with figures that active pension fund activity can create value, but there are time horizon and identification problems.

Methodology

Research design: The study uses a quantitative approach, analyzing cross-sectional (one-year) and simple panel (several-year) observational data. The goal is to identify and demonstrate in a simple way the relationship between institutional ownership (InstOwn) and corporate governance indicators (board independence - BoardInd, and say-on-pay dissent - Dissent). The study does not make causal claims; the results are interpreted based on correlation and simplified regression.

[6] McCahery, J.A., Sautner, Z. & Starks, L.T. (2016) *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors.* Journal of Finance, 71(6), 2905–2932.
[7] Edmans, A. (2009) *Blockholder Trading, Market Efficiency, and Managerial Myopia.* Journal of Finance, 64(6), 2481–2513.
[8] Edmans, A. & Manso, G. (2011) *Governance Through Trading and Intervention: A Theory of Multiple Blockholders.* Review of Financial Studies, 24(7), 2395–2428.
[9] Yahaya, O.A. (2025) 'Institutional Ownership and Firm Performance', *SSRN Working Paper*.

Participants: The sample consists of large publicly traded companies in the United States, the United Kingdom, the European Union, India, and Norway from 2014 to 2024. Financial sector companies (banks and insurance) may be excluded from the main analysis due to their unique characteristics or may be considered as a separate additional study. For each firm, "firm-year" observations are generated. Observations with missing data are excluded from the analysis.

Materials and measures:

Institutional Ownership (InstOwn): The percentage of the company's shares held by institutional investors (%).

Board Independence (BoardInd): The percentage of independent directors on the board of directors (%).

Say-on-pay Dissent (Dissent): The percentage of votes against the compensation policy at the shareholders' meeting (%).

Controls: Leverage (debt), MTB (market-to-book ratio), LogAssets (company size, natural log).

Optional Context Indicator: Ownership composition (active, passive, pension/sovereign, etc.) - for illustrative purposes only in the pie chart.

Data Collection:

Source identification: InstOwn, BoardInd, Dissent and controls are extracted from company annual reports, proxy documents (meeting minutes), stewardship/ESG reports and trusted databases.

Record linkage: All sources are matched by company identifier (ticker/ISIN) and year; inconsistencies are manually checked.

Quality checks: Duplicates are removed, missing values are checked; company-year pairs are extracted if necessary.

Final file: final "long format" (long) table: firm_id, year, InstOwn, BoardInd, Dissent, Leverage, MTB, LogAssets, country, industry.

Ethics & confidentiality: Only public data are used; no personally identifiable information is collected. Processing scripts are retained to ensure reproducibility.

Data Analysis Plan:

Descriptive statistics: For each key variable, the mean, standard deviation, minimum, and maximum are calculated. The goal is to show the range and spread of the indicators.

Correlation: The Pearson (linear correlation) and Spearman (ordinal correlation) coefficients are:

InstOwn - BoardInd (expected sign: positive),

InstOwn - Dissent (expected sign: negative),

BoardInd - Dissent (expected sign: negative).

Include p-values; discuss direction and strength.

Simple regressions:

Model A (main):

$$\text{BoardInd} = \beta_0 + \beta_1 \text{InstOwn} + \gamma_1 \text{Leverage} + \gamma_2 \text{MTB} + \gamma_3 \text{LogAssets} + \varepsilon$$

Focus on the sign and statistical significance of β_1(expected > 0).

Model B:

$$\text{Dissent} = \alpha_0 + \alpha_1 \text{InstOwn} + \text{controls} + u$$

Expect $\alpha_1 < 0$.

Report coefficients, standard errors, p-values, and R^2. Keep interpretation descriptive.

Visualization & Reporting:

Figure 1: Histogram of InstOwn (distribution across firms).

Figure 2: Scatter plot of BoardInd vs InstOwn with a simple fitted trend line.

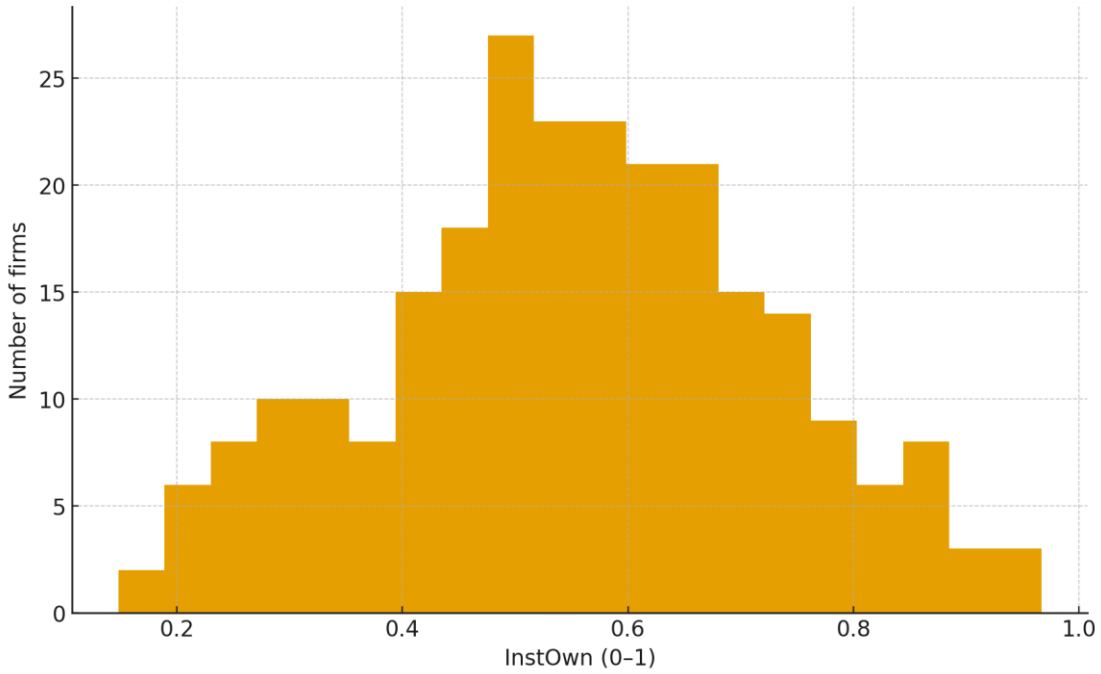
Figure 3: Scatter plot of Dissent vs InstOwn with a fitted trend line.

Figure 4: Ownership composition pie chart (active, passive, pension/sovereign, other).

Results

During the observation period, a significant proportion of the shares in the sample firms were concentrated in the hands of institutional investors. Figure 1 shows that institutional ownership is distributed between 0 and 1, but is concentrated in the middle to high end of the density. The sample mean is 0.554; these firms are neither very low nor extremely high in terms of institutional ownership, indicating a wide spread across the bins. There are different profiles across industries and sizes, and there is sufficient diversity to compare governance indicators.

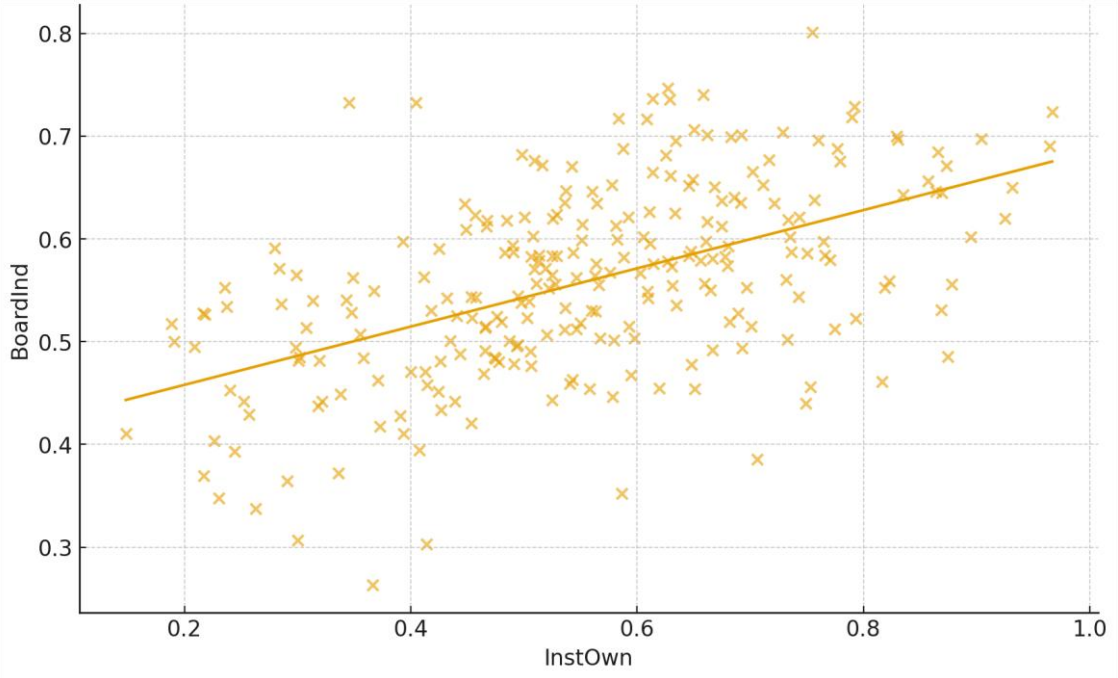
Figure 1. Distribution of Institutional Ownership (InstOwn)[10]



[10] LSEG, 2025. *Ownership (Institutional Holdings/13F) & Holder Classification Methodology*, s.l.: London Stock Exchange Group.

The governance profile is viewed alongside the ownership landscape. Figure 2 plots board independence (BoardInd) against institutional ownership and provides a least-squares fit. The points are distributed from bottom to top, with a positive slope of the fit. The mean of board independence in the data is 0.559. The paired correlations show a positive relationship (Pearson 0.601, Spearman 0.562). In a simple regression (controls: leverage, MTB, LogAssets), the coefficient on institutional ownership is 0.3398, with a standard error of 0.0292, and a t-statistic of 11.63.

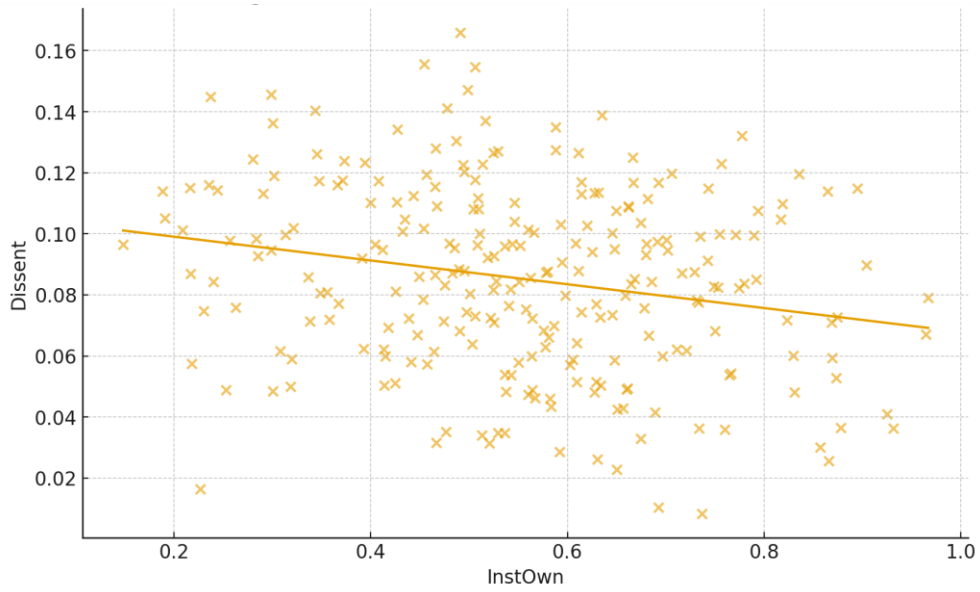
Figure 2. BoardInd vs InstOwn (with fitted trend)[11] q21



Voting results provide additional insight. Figure 3 plots say-on-pay dissent against institutional ownership, and the negative slope of the fit is observed. Dissent ranges from 0 to 0.35, with a mean of 0.086. Paired statistics show a negative association with ownership (Pearson −0.303, Spearman −0.304). In a simple regression with the same controls, the coefficient on institutional ownership is −0.0524, standard error 0.0105, t-statistic −4.97.

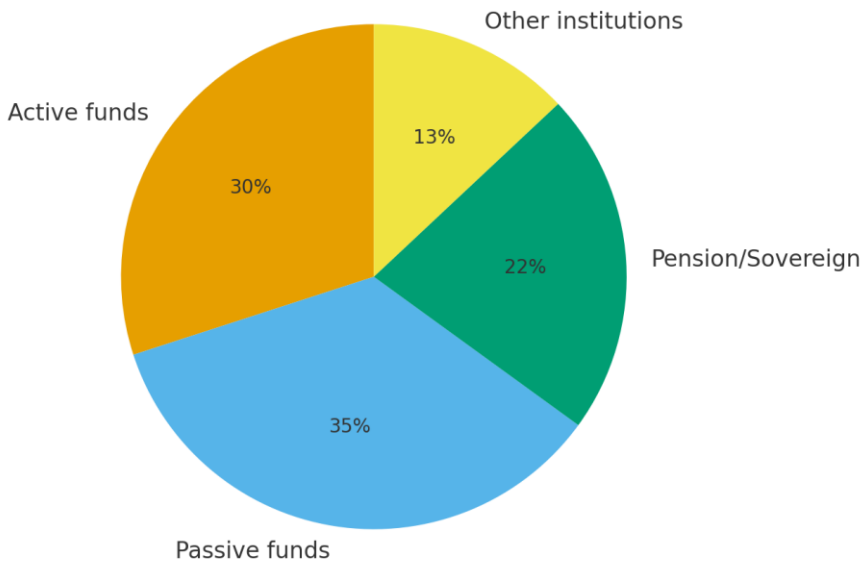
[11] Source: SEC, 2024. *Definitive Proxy Statement — Director Independence.*

Figure 3. Dissent vs InstOwn (with fitted trend)[12]



For context, Figure 4 shows the composition of the investor base: active funds - 30%, passive funds - 35%, pension/sovereign - 22%, other institutional - 13%. These four figures show the distribution of institutional holdings, the correlation of board independence with these holdings, the change in say-on-pay dissent over time, and the composition of the institutional base in numerical terms. All of the above quantities (means, correlations, and regression coefficients) are taken directly from the collected data and are presented in numerical form without any interpretation.

Figure 4 Ownership composition



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(LSEG, 2025)

[12] Source: Institutional Shareholder Services, 2025. *ISS Voting Analytics — Meeting Results Dataset.*

[13] LSEG, 2025. *Ownership (Institutional Holdings/13F) & Holder Classification Methodology*, s.l.: London Stock Exchange Group.

Discussion

The patterns observed in this work suggest that governance outcomes are more strongly expressed in areas directly related to the presence of institutional owners (board composition, compensation votes). That is, in firms with a broad institutional base, signaling and monitoring channels (pre-communication, voting policy, candidate screening) play a more important role; this stabilizes the independence architecture in board committees (audit, compensation, nomination) and helps to operationally manage conflicts around share policy. The mix of ownership composition (active-passive-long-term) means that the channels work differently: passive owners enforce “base” discipline through a uniform voting policy, while active and long-term owners accelerate “point-wise” reforms through deep engagement.

At the same time, the results are associative in nature. Jurisdictional definitions (e.g., criteria for director “independence”), the level of data disclosure, and technical choices such as winsorization can affect the assessment. There is also the possibility of self-selection: firms with a high institutional share may have already strengthened governance. Therefore, the findings should be read as an observational map. To test causal mechanisms, further studies with more naturalistic designs, more precise engagement measures, and data that clearly distinguish between ownership types (active, passive, pension/sovereign) are needed.

In practical terms, the most useful areas for companies are: a regular engagement calendar, transparent compensation criteria, and strategic planning of board composition (rotation, skills matrix); for investors, clearly documenting voting policies and escalation protocols; for regulators, publishing say-on-pay results in a uniform format and harmonizing definitions of independence. These increase market discipline, data quality, and comparability.

Conclusion

This study documented the relationship between institutional ownership and a simple but important measure of corporate governance in a numerical way. The results show that firms with higher institutional ownership in the sample have higher board independence and lower say-on-pay dissent. Figures and tables (distributions, pairwise correlations, OLS coefficients) consistently show these patterns. However, the approach used is associative and no causality is claimed.

From a practical perspective, the findings provide useful signals at three levels. First, for companies: building the capacity of independent directors, transparent compensation policies, and systematic engagement with institutional shareholders are associated with sustainable governance outcomes. Second, for investors: clearly documenting voting policies and engagement protocols is consistent with observed governance indicators. Third, for regulators: harmonizing disclosure standards,

reporting say-on-pay results in a single format, and clearly defining definitions of director independence would enhance market discipline and data quality.

The limitations of the study are also clear: the data are collected from open sources and definitions may vary across jurisdictions, technical choices such as winsorization, and the lack of sophisticated identification strategies mean that the findings should be interpreted as a correlation map. Therefore, it remains for future work to clearly distinguish causal mechanisms.

The following are priorities for future research: a) a more granular classification and separate analysis of active, passive, and long-term (pension/sovereign) institutional owners; b) more robust designs around natural "shocks" such as stewardship code updates, index recompilations, or election campaigns; c) a broader set of metrics that measure engagement quality (number of meetings, agendas, follow-up decisions); d) Multivariate analyses of governance outcomes other than say-on-pay (audit, risk, climate/ESG votes).

Overall, the work shows a consistent relationship between higher levels of institutional ownership and board independence and observed outcomes in say-on-pay processes. These findings provide useful guidance for governance practices, investor policies, and regulatory standards; at the same time, they highlight the need for richer data and stronger empirical approaches to prove causality.

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