

Institutional ownership stability and BHC performance[☆]

Elyas Elyasiani^{a,*}, Jingyi Jane Jia^{b,1}

^a *Department of Finance, Fox School of Business and Management, Temple University, Philadelphia, PA 19122, United States*

^b *Department of Economics and Finance, School of Business, Southern Illinois University Edwardsville, Edwardsville, IL 62026-1102, United States*

Received 5 March 2007; accepted 5 December 2007

Available online 23 December 2007

Abstract

In this study, the association between performance of BHCs and institutional ownership stability is investigated and contrasted to those found for the less regulated utility and industrial firms in order to determine whether regulation displaces owner monitoring. We employ a simultaneous equations model treating firm performance and institutional ownership stability as endogenous variables. Several results are obtained. First, BHC performance is positively associated with institutional ownership stability. Second, this association is weaker for BHCs than for comparable utility and industrial firms, possibly because of the substitution of regulation for owner monitoring in banking. Third, this association is stronger in the recent deregulated years and for BHCs with lower likelihood of regulatory intervention.

© 2007 Elsevier B.V. All rights reserved.

JEL classification: G21; G32

Keywords: BHC performance; Institutional ownership stability; Regulation; Market discipline

1. Introduction

In the recent decades, shares owned by individuals have been increasingly held by institutional investors through vehicles such as mutual and pension funds, making institutional investors the largest shareholders of publicly traded firms. This trend has raised some interesting questions regarding the monitoring influence of institutional ownership on corporate governance and firm performance (Karpoff, 2001; Gillan and Starks, 2003).

Given that different institutional investors have different investment agenda and investment horizons (Woidtke, 2002; Del Guercio, 1996), some choose to monitor the firms and exert influence on the management, while others focus on information gathering and short-term trading profits. The choice between these two strategies is likely to be dependent on shareholding stability. Stable (long-term) institutional investors are more likely to engage in monitoring because they have a longer horizon to learn about the firms and also more opportunities to influence the management (Chen et al., 2007). In contrast, unstable (short-term) institutional investors tend to be involved in frequent trading based on information (Yan and Zhang, *in press*).

Several studies have documented that institutional investors do indeed monitor, show activism, and advance firm performance. For example, Smith (1996) finds that activist moves by CalPERS (California Public Employees' Retirement System; a pension fund) were associated with significant positive stock price reactions. These moves included creation of a shareholder advisory committee,

[☆] Earlier versions of this paper were presented at the Financial Management Association meetings of 2006, in Salt Lake City, and the Mid-Atlantic Research Conference in Finance (MARC) of 2006, in Philadelphia. This paper was reviewed and accepted while Prof. Giorgio Szego was the Managing Editor of The Journal of Banking and Finance and by the past Editorial Board.

* Corresponding author. Tel.: +1 215 204 5881; fax: +1 215 204 1697.
E-mail addresses: elyas@temple.edu (E. Elyasiani), jjia@siue.edu (J.J. Jia).

¹ Tel.: +1 618 650 2980; fax: +1 618 650 3047.

changing the composition of the board of directors and reducing executive compensation. Brav et al. (2006) also report that hedge fund activism is associated with an abnormal stock return of 5–7%, as well as advancement in firm performance (returns on assets and equity), in the following year. Cornett et al. (2007) show that there is a significant relation between the firms' cash flow returns and both the shareholding size and the number of institutional investors for those investors less likely to do business with the firms they invest in.

Stable institutional investors can improve firm performance through three channels. First, given their close connection to capital market and monitoring activity, stable institutional investors can reduce agency and information asymmetry problems, both of which can induce under-investment and inferior performance (Jensen and Meckling, 1976; Myers and Majluf, 1984; Ajinkya et al., 1999). As evidence of agency cost reduction by institutional investors, Qiu (2003) finds that public pension funds can reduce harmful excessive mergers and acquisitions in low growth and cash rich firms, which are associated with more agency conflicts, to a larger extent than in other firms. Similarly, Gine and Moussawi (2006) report that in firms with more managerial entrenchment, measured by number of anti-takeover provisions, institutional activists are more aggressive in voting on proposals to remove an existing poison pill or to adopt a policy that mandates the board to put any future pills to shareholder vote.

Second, stable institutional ownership alleviates the managerial myopia problem as it allows the managers to invest in longer-term profitable projects (Bushee, 1998, 2001; Edmans, 2007; Cherkas et al., in press). Bushee (1998) argues that high turnover trading by institutional investors encourages myopic investment while low turnover trading by these investors reduces the pressure on managers for myopic investment behavior. He shows that shareholding proportion of short-term investors is positively related to the probability that managers reduce R&D to reverse an earning decline. Wahal and McConnell (2000) also find that shareholding proportion of low turnover institutional investors is positively related to corporate expenditures for property, plant and equipment and R&D investment (long-term investment). Bushee (2001) reports that the shareholding proportion of short-term institutional investors is negatively related to long-run firm value. Third, as suggested by Hartzell and Starks (2003), stable institutional shareholding better aligns the interests of the managers with those of the shareholders, by increasing the proportion of the incentive–compensation of the managers in the total, and, thereby, advances firm performance.

Most corporate finance studies exclude the banking industry because of its unique asset composition, high leverage, and highly regulated character. However, the unique features of this industry make it an important and interesting case for investigating the incentives of institutional investors for monitoring and its effect on firm performance. In particular, we are interested in the substitutive

effect of regulation on institutional investor monitoring. It is proposed here that stable shareholding by institutional investors motivates them to monitor the banking firms owned, but the extent and/or effectiveness of monitoring will be weaker in banking than in non-financial industries, as detailed in the next section.

Measures of institutional ownership used in the existing studies include the aggregate proportion of the company shares held by all institutional investors, the disaggregate proportions held by each institutional investor-type (banks, insurance companies, investment companies, investor advisors, and others), and the number of institutional investors (McConnell and Servaes, 1990; Bennett et al., 2003; Cornett et al., 2007). It is notable that when institutional investors are information traders, they tend to move in and out of the stocks, based on the most recent information available, without playing an active monitoring role. In this case, it is possible that while the identities of the institutional shareholders change frequently, the total (aggregate) institutional shareholding proportion remains constant. This renders the aggregate ownership proportion untenable as a measure of monitoring by institutional investors since it masks the fact that institutional investors who have no intention to stay with the firm will be unlikely to monitor the management.

A reliable measure of institutional ownership influence must account for the stability of shareholding. In this study, we use three institutional ownership stability measures to proxy the monitoring incentives of the institutional investors, and examine their association with firm performance. The first measure is institutional ownership persistence (IOP), defined as the mean ownership proportion standardized by its standard deviation over a five-year rolling sample period. This measure captures both the level and the volatility (stability) of institutional ownership in describing the monitoring incentives of the investors and can be considered the reciprocal of the coefficient of variation (the standard deviation scaled by the mean), used by Minton and Schrand (1999) to measure the cash flow volatility.

The second and third measures are based on the institutional ownership stability indicators introduced by Bohren et al. (2005). The *non-zero-points duration* is the number of time points (quarters) that an investor is holding a non-zero stake. The *maintain-stake-points duration* is the time points when an investor maintains its stake. The assumption is that the longer the institutional investors hold a non-zero stake, and/or maintain their ownership stake, the more likely they are to monitor the management. In order to illustrate the incremental influence of institutional stability, we control for the effect of the shareholding proportion and the number of institutional investors on firm performance. Firm performance is measured by return on assets (ROA), Tobin's Q and the ratio of earnings before interest and taxes (EBIT) to total assets.

Three results are obtained. First, bank holding company (BHC) performance is directly related to institutional own-

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات