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Skill or effort?
Institutional ownership and managerial efficiency

Ghasan A. Baghdadi, Ishaq M. Bhatti, Lily H.G. Nguyen, Edward J. Podolski·

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Abstract

Using a sample of U.S. firms during the 1989–2015 period, we study whether the efficiency with which managers generate revenue is sensitive to monitoring by institutional shareholders. We find that institutional ownership is positively related to managerial efficiency. Our identification relies on a discontinuity in ownership around the Russell 1000/2000 Index threshold and suggests that the positive effect of institutional ownership on managerial efficiency is causal. Furthermore, we find consistent results after excluding from our sample forced CEO turnovers, suggesting that institutional shareholders force incumbent managers to exert greater effort rather than influence the replacement of less efficient CEOs. Finally, we document that monitoring by institutions helps improve managerial efficiency, and that an exogenous increase in institutional ownership leads to higher pay-for-performance sensitivity. Taken together, our findings highlight the important role played by institutional shareholders in getting the most out of corporate executives.

JEL classifications: G23; G30; M12

Keywords: managerial efficiency; managerial ability; institutional investors; agency conflict

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