

Abstract

INSTITUTIONAL OWNERSHIP, MANAGERIAL DECISIONS & FIRM PERFORMANCE

Institutional investors are becoming a potent force in emerging markets; they provide the much-needed liquidity in financial markets and are also becoming proficient at shareholder activism. Therefore, in recent times, there has been increasingly great interest by both regulators, policymakers and researchers to understand whether these investors monitor, discipline and influence corporate managers. This dissertation tries to understand whether they influence key managerial decisions such as dividend policy and corporate investments and also whether they improve firm performance. Additionally, we disaggregate institutional ownership into domestic and foreign investor categories to examine whether they differ in their impact on managerial decision making. Our empirical analysis is carried out on NSE listed firms during the period 2001 to 2016. The period is also important as it is marked by increasing institutional activism and significant regulatory reforms in the Indian market.

The dissertation is organised as three essays. The first essay examines the impact of institutional investor ownership on dividend payouts. We assume a dynamic relationship between institutional investor ownership and dividend payouts and use a GMM estimator to obtain valid estimates. Preliminary bi-variate tests on our sample show that there is an association between institutional investor holdings and payout policy; they are observed to have larger holdings in dividend-paying firms as compared to non-paying firms. However, we do not find evidence to support a causal relationship between total institutional ownership and dividend payout level. Across institutional investor categories, we find evidence that domestic institutional investors do improve payouts and that this relationship holds across large firms.

The second essay tries to understand whether institutional investors reduce distortions to corporate investment. We try to answer this question by examining the sensitivity of investment to cash flows in q model regressions and check whether the level of institutional ownership reduces the strength of this relationship. The investment-cash flow sensitivity has been a source of great debate in empirical finance, and extant research considers it to be indicative of sub-optimal investment. We find that institutional ownership reduces a firms

investment-cash flow sensitivity and that the reductions are more pronounced among firms with higher agency costs. The evidence is consistent with the monitoring role of institutional investors and their ability to minimise agency-related over-investments.

In the third essay, we examine the relationship between large changes in institutional ownership and firm performance. Our measures of performance include both accounting based measures and capital market-based measures. We use a treatment effect model to estimate the relationship as institutional ownership in a firm is unlikely to be random. We find a positive relationship between large increases in institutional ownership and operating performance. This result is significant across both domestic and foreign institutional investors. However, when we use firm value as a measure of firm performance, we observe that large increases (decreases) in institutional ownership results in subsequent decreases (increases) in firm value. The evidence is consistent with institutional investors being myopic. Their short-term focus could be argued to result in an excessive preference for short-term earnings at the cost of long-term value.

JEL classification: D21, M21, G14, G31, G32, G34, G35

Keywords: Institutional ownership; Payout policy; Foreign investors; Dividends; Investment; Investment cash flow sensitivity; Capital market imperfections; Agency problems; Monitoring; Performance