An Empirical Study of the Impact of Institutional Investors on Corporate Governance and Corporate Performance, Base on Samples of Familial Listed Companies in China

Yingzhao Li, Min Huang
School of Business Administration South China University of Technology, Guangdong, China, 510640;
Email:mia_huang@qq.com

Abstract: Using Panel Data methods, this paper examines the impact of institutional investors on corporate governance and corporate performance, based on samples of familial listed companies in China from 2006 to 2008. The research shows that after investing in familial listed companies, institutional investors would play an important role to improve corporate governance. Simultaneously, the proportion of institutional investors' shareholding was positively correlated with corporate performance of familial listed companies. The participation of institutional investors would improve corporate performance.

Keywords: Institutional Investors; Corporate Governance; Corporate Performance

1 Introduction

Currently, according to some foreign scholars, researches of familial companies' corporate governance structure and business performance mainly focus on the specialties of governance structure, contract- relationship theory of familial companies' governance structure, board of directors, outside directors and Trust Mechanism. Some researchers believe that, with the expertise of outside directors, decision-making system in companies would become more objective and independent, which can consequently improve the quality and efficiency of decision-making process (Schwartz & Barnes, 1991). On the other hand, Johannisson and Huse (2000) agree that the functions of outside directors in family business would change in different period. As the development of China's stock market, China's institutional investors play an important role in capital markets and have gained development in terms of quantity, forms of organization and shareholding. Institutional investors have the advantages of professional, information and financial superior involved in corporate governance, improving corporate governance through Internal Mechanism and external mechanism (Li, W.A. and Li, B., 2008) [1]. As the number of institutional investors and an increasing proportion of the market value and the motivation of participating in corporate governance, influences on corporate performance are accordingly increasing.

So, how important have the institutional investors played in the current China's capital market? Is it true that the participations of institutional investors have great impacts on corporate governance and performance? This paper will illustrate the empirical research about institutional investors' impacts on corporate governance and performance in familial listed companies with panel data model。

2 Literature review and theoretical assumptions

With the development of institutional investors, more scholars are concerned about the impact on corporate performance and governance and carried out extensive and in-depth study.

Hartzell and Starks (2000) suggest that institutional investors play an effective supervisory role on the payment contracts of managers. They found that concentration of institutional investors were positively correlated with Performance Pay Sensitivity in Managerial Compensation, and negatively correlated with Managerial abnormal return [2]. Bertrand and Mullainathan (2001) state institutional investors can actively participate and play a key role in corporate governance [3]. According to research by Dong M and Ozkan A (2007), in British capital market, there is a significant positive correlation between active institutional investors and corporate governance [4]. Considering the impact on corporate performance, Changanti and Damanpour (1991) found that there is a positive correlation between institutional ownership and the return of equity (ROE) [5].

However, there are some scholars insist the opposite opinion. Webb (2003) disagree that the role of institutional investors playing in improving corporate governance structure [6]. After reviewing the articles about institutional investors involving in corporate governance, Romano (2001) found an apparent contradiction that although the critics maintain a positive evaluation to active

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shareholders, empirical studies have shown that the impact on corporate performance is negligible [7].

Based on China's samples, a large number of research have been done by Chinese scholars. With studies about the proportion of institutional shareholding and the latter independent directors, Wu and Jiang (2006) found that there was a positive correlation between these two issues, concluding that institutional investors play an important role in improving independent director system [8].Wang and Dong (2009) agree that while institutional investors are holding more shares, they would consider the balance of costs and benefits, and then become active institutional investors involving in corporate governance [9]. Based on CCGI^{NK}, Li, W. and Li, B. (2008) suggest that institutional investors can improve the level of corporate governance. Besides, there is a positive correlation between the proportion of institutional shareholding and corporate performance, marketing value [1]. On the other hand, Xu (2009) states that institutional investors have certain impacts on the stock value of listed companies in China, but influencing little on corporate governance and business performance. In a word, institutional investors in China still stay in the early stages of development [10].

Seen from the literature review above, it did not reach the same conclusion about the institutional investors' impacts on corporate governance and performance, and so far neither focusing on familial listed companies. For this reason, this paper will illustrate the impacts from institutional shareholdings on corporate governance and performance of familial listed companies, with the assumptions showing below:

H1. The involvement of institutional shareholders in familial listed companies can be effective in improving the governance level, namely, institutional investor shareholding proportion was positively correlated with corporate governance of familial listed companies.

H2. The involvement of institutional investors is an effective way to improve corporate performance, that is, institutional investor shareholding proportion was positively correlated with corporate performance of familial listed companies.

3. Research design

3.1 Data sources and sample selection

This paper selected listed companies which have become privatization by 2006 in Shanghai Stock Market and Shenzhen Stock Market, during the period from 2006 to 2008. In accordance with the following criteria on initial samples removed: first removed some companies in a non-normal trading status, such as ST, PT. Secondly, referring to the familial companies in this paper are mainly defined as that the actual controller of company was natural person and his family. In accordance with this standard, this paper selected the companies whose shares are holding by family as the ultimate object of study. Then, this paper excluded the financial insurance companies and the presence of incomplete data or data outliers to the enterprise, eventually to be 688 samples of observations. Data of corporate governance and finance in this paper is from CCER database, and the data of ownership structure is from JuYuan database.

3.2 Variable Selection and Model Design

This paper mainly study taxation's impacts on corporate debt financing and investment at different periods. Two models are built as follows.

Model 1: Institutional investor shareholding proportion impacts on corporate governance

$$X_{i,t} = \alpha_0 + \alpha_1 IIS_{i,t-1} + \alpha_2 SSP_{i,t} + \alpha_3 HF10_{i,t} + \alpha_4 CSP_{i,t} + \alpha_5 SIZE_{i,t} + \varepsilon_{i,t}$$

(In this case, $AGMAR_{i,t}$、$IDF_{i,t}$ and $SER_{i,t}$ are chosen as explained variables $X_{i,t}$ to measure the level of corporate governance of listed companies.)

Attendance rates of annual general meeting(AGMAR), proportion of independent directors(IDP)and remuneration of senior executives(SER)are the proxy variable to measure the level of corporate governance and to examine the relationship between the percentage of institutional shareholdings and corporate governance. Investors, who maintain investment philosophy, can participate actively in the company's shareholder meeting, understand the company's operating condition and on the company's major business decisions, develop strategies to express their views and help to improve corporate governance. Therefore, AGMAR reflects the level of corporate governance. Wu and Jiang (2006) conclude that institutional investors play an important role in improving independent director system [8]. Wang, et al (2009) insists that institutional investors often have a natural sensitivity on executives [9]. Generally speaking, the higher level of corporate governance, the higher payment for senior managers. Therefore, attendance rates of annual general meeting(AGMAR), proportion of independent directors(IDP)and Remuneration of senior Executives(SER)are considered as explained variables, institutional investor shareholding proportion(IIS)as an explanatory variable, to measure the level of institutional investment in this paper. The following variables are selected as control variables: (1) state-owned shareholding proportion (SSP); (2) Ownership Concentration (HF10), Herman (1981) state that the more concentrated the Ownership is, the more powerful and effective to influence managers and directors [11]. (3) Proportion of circulating shares (CSP); (4) company size (SIZE).

Model 2: Institutional investor shareholding proportion impacts on corporate performance

$$Y_{i,t} = \beta_0 + \beta_1 IIS_{i,t-1} + \beta_2 SSP_{i,t} + \beta_3 HF10_{i,t} + \beta_4 CSP_{i,t} + \beta_5 CASH_{i,t} + \beta_6 LEV_{i,t} + \beta_7 ATR + \beta_8 SIZE_{i,t} + \varepsilon_{i,t}$$

(In this case, $TOBINQ_{i,t}$、$EPS_{i,t}$ and $ROE_{i,t}$ are chosen as explained variables $Y_{i,t}$ to measure corporate performanc e of listed companies.)

Participation of institutional investors in corporate governance would lead to higher level of corporate governance, reduction of agency costs and improvement of corporate performance. Chaganti and Damanpour (1991) found that there is a significant positive correlation between institutional shareholding and return of equity (ROE) [5]. McConnell and Servaes (2003) also suggest that there is a significant positive correlation between institutional shareholding and TobinQ. In this case, Tobin Q、EPS and ROE are chosen as the elements reflecting the ability of listed companies' benefits to study institutional investors' impact on performance of listed companies. Institutional investor shareholding proportion (IIS) is defined as an explanatory variable to measure the level of institutional investment. Other elements are also considered as controlled variable in this paper, such as state-owned shareholding proportion (SSP), Ownership Concentration (HF10), proportion of circulating shares (CSP), level of cash flow (CASH), asset-liability ratio(LEV), turnover ratio of assets(ATR)and company size(SIZE).

Table 1 variables and explanations of model

Symbol	Name	Definition
IIS	institutional investor shareholding proportion	number of the listed company's institutional investors shareholding proportion
AGMAR	attendance rates of annual general meeting	attendance of annual general meeting / total shareholders
IDP	proportion of independent directors	Number of independent directors/ total board directors
SER	remuneration of senior executives	logarithm of senior executives remuneration
Tobin Q	tobin 'Q	The total market value of corporate capital/total assets
EPS	earnings per share	profit/ total shares
ROE	return of equity	net profit/ average net assets
SSP	state-owned shareholding proportion	the proportion of largest shareholder's stake in listed companies
HF10	ownership concentration	the squares of top ten shareholders proportion
CSP	proportion of circulating shares	numbers of circulating shares / total shares
CASH	level of cash flow	net cash flow from operating activities/ total assets of last year
LEV	asset-liability ratio	total liability / total asset
ATR	turnover ratio of assets	net sales/average total assets
SIZE	company size	twice logarithm of total assets

4 Analysis and results

4.1 Descriptive statistics

688 samples are analyzed with statistical software SPAA13.0. It is can be found from the sample descriptive statistics:

(1)The average percentage of institutional shareholdings in listed companies is merely 4.29%, which is far away behind European and American institutional investors. It is related to equity structure of listed companies and the slow development of institutional investors.

(2)Different company has different return of equity; with standard deviation (0.665) which is nine times as the sample mean (0.073). This is one sight of varying quality of familial listed companies in China.

4.2 Analysis and results

Model 1 and Model 2 have been computed by SPSS13.0 statistical software with least square method。

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Table 2 Regression analysis [1]

Dependent variable / Independent variable	Model 1: Institutional investor shareholding proportion impacts on corporate governance					
	AGMAR		IDF		SER	
	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
IISt-1	3.130	8.121***	0.002	1.621	0.057	4.157***
FSA	-0.305	-5.645***	3.86E-005	0.294	-0.001	-0.622*
HF10	-5.627	-0.486	-0.15	-0.530	-0.531	-1.283*
CSA	-12.136	-1.936*	0.026	1.674*	0.495	2.204***
SIZE	-14.316	-0.654	-0.072	-1.344	5.205	6.640***
	AR =0.133		AR =0.007		AR =0.102	
	DW =2.053		DW=2.114		DW=1.997	
	F =22.087***		F =2.016*		F =16.528***	

Seen from Table 2, in Model 1, Regression Equation 1 and 3 were both statistically significant at 99% confidence level, Regression Equation 2 was statistically significant at 90% confidence level; pre-institutional investor shareholding proportion was positively correlated with both attendance rates of annual general meeting and Remuneration of senior Executives, statistically significant at 99% confidence level. This reflects the participation of institutional investors would raise the attendance rate shareholders and influence the payments of senior managers. Institutional investors play an important role in corporate governance and improve it. However, Equation 2 also shows that there was no significant correlation between the proportion of institutional ownership and the proportion of independent directors, which reflecting that, in familial listed companies; the independent directors are more controlled by actual controllers. Institutional investors cannot play a full role in the appointment of independent directors.

Table 3 Regression analysis 2

Dependent variable / Independent variable	Model 2: Institutional investor shareholding proportion impacts on corporate performance					
	EPS		ROE		Tobin Q	
	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
IIS_{t-1}	0.039	4.866***	0.019	1.810*	0.016	4.182***
FSA	-0.002	-1.900*	-9.8E-005	-0.066	0.000	0.022
HF10	-0.485	-2.025**	-0.160	-0.502	0.003	-0.264
CSA	-0.191	-1.457	-0.069	-0.398	-0.332	-5.326***
SIZE	3.189	6.886***	1.379	2.242**	0.390	1.773*
CASH	1.743	8.175***	0.578	2.043**	-0.054	-0.538
LEV	0.011	0.329	0.003	0.075	0.125	8.092***
ATR	1.972	5.721***	0.781	1.797*	-0.225	-1.450
	AR =0.225		AR =0.016		AR =0.152	
	DW=2.120		DW=2.016		DW=1.936	
	F =25.881***		F =2.413**		F =16.436***	

In Model 2 Tobin Q、EPS and ROE are chosen as the elements reflecting the performance of listed companies to study institutional investors impact on performance of listed companies. Showing from Equation 1 in Model 2, pre-institutional investor shareholding proportion was positively correlated with earnings per share (EPS) of listed companies, statistically significant at 99% confidence level, indicating institutional investors can im-

prove EPS. Results of Equation 2 show that pre- institutional investor shareholding proportion was positively correlated with the return of equity (ROE), statistically significant at 90% confidence level, indicating the involvement of institutional investors can increase

ROE of listed companies, but the effect is less obvious. Equation 3 shows the institutional investor shareholding proportion was positively correlated with Tobin Q of listed companies and statistically significant at 90% confidence level, which reflecting institutional investors can change the profit expectations of listed companies. After participations of institutional investors, the governance structure and system of listed companies would be changed, influencing operation to reach more benefit.

5. Conclusion

Based on samples of familial listed companies in China, this paper illustrates the relationship between institutional shareholding and corporate governance, performance. Depended on study Panel Date, it is found that Institutional Investors, affecting corporate governance as a positive element, will increase their quantity and value with the development of China's stock market. Involving in familial list companies, institutional investors will effectively improve corporate governance and raise its level. At the same time, the more shares institutional investors hold, the better performance familial listed companies will be, and institutional investor shareholding proportion was positively correlated with the return of equity (ROE) 、earnings per share and marketing value. In a word, institutional investors can improve corporate governance and performance of familial companies

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