

# Institutional Investors Ownership and Financial Performance: Examining the Nexus in Nigerian Deposit Money Banks

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Received: February 6, 2020

Accepted: August 17, 2020

Online Published: October 8, 2020

doi:10.5430/rwe.v11n6p177

URL: <https://doi.org/10.5430/rwe.v11n6p177>

## Abstract

The main aim of this paper is to examine the impact of institutional investor's ownership on the financial performance of deposit money banks listed on Nigerian stock exchange (NSE). The time frame for this study is 2011-2018. Data was generated from annual reports of 15 deposit money banks listed on NSE. The result of the panel data methodology shows a positive and significant relationship between institutional investor's ownership and banks financial performance. The study recommended that management of banks should give more attention to the large institutional shareholders due to their influence on the growth and survival of the company.

**Keywords:** banks, earnings, equity, corporate governance, institutional investors

**JEL Classification:** G34, M41

## 1. Introduction

Institutional investors are well-recognised bodies in financial markets. Their ever-growing functions in corporate governance are noticeable from the growing volume of equity they control in an organisation. After the financial predicament of 2008, there's been a focus on institutional investors, people seeing institutional investors as entities that make things happen in the market and normal investors are deficient as regards to capacity to compete with them. Institutional investors have progressed positively in the capital market's domestic space as opposed to the contribution by retail counterparts. The recent figure of contributions made by domestic institutional and retail investors provided by the Nigerian stock exchange (NSE) on a percentage basis for December 2015 showed a noticeable decline in the contribution by retail investors and an increase in institutional investor's shareholding (NSE, 2015)

The low dominance of institutional investors in Nigerian equities market relates to several determinants, most crucial of them is low confidence in Nigerian stock exchange because of the negative returns borne by investors in 2015 and start of the current year (Johnson, 2015). Such losses hamper confidence level of investors, and also more on retail investors because they possess little knowledge and perform profitably in the market as opposed to institutional investors. Since the increase of institutional investors in the capital market, their functions had moved from merely passive investors to active investors. Before 2015, institutional investors are usually not involved in management decisions (that is the day-to-day running of the organisation). They simply put their shares for sale when displeased with the stock operations. This is known as an exit policy as noted by (Bathala, Moon & Rao, 1994).

With progressively important control of equity in a firm, it is less expensive for an organisation to show disapproval against management rather than following an 'exit policy' and affecting the company's stock price (Coffee, 1991). Institutional investors in contrast to other non-institutional investors are highly probable to participate in firm's decisions as a result of their significant control in the organizations (Brickley, Coles & Terry, 1994) and thereby

affect top firm administration to control the investor's long-term interest (Holderness & Sheehan, 1988). Due to this, they positively affect top-managerial decisions and invariably affect firm performance as opined by (Chaganti & Damanpour, 1991; Loderer & Martin, 1997; Clay, 2001; Ozordi et al., 2019; 2020). This led to the issues arising from ownership separation and control. This arouses our interest in the effects of ownership structure on financial performance.

Institutional shareholders like pension funds, insurance companies in line with their extended nature of liabilities, embody a possibly crucial source of long-term funding. With an increased concern for emerging markets like Nigeria, inhabited by the short-termism in their stock markets along with structural and policy barriers like regulatory impediments, absence of suitable financing means, limited investment and risk governance expertise, low transparency, lack of relevant data and investment yardsticks for illiquid assets form the statement of the problem of this study.

Against this background, the main objective of this paper is to investigate the relationship that exists between institutional investor's ownership and financial performance of Nigeria deposit money banks. The remaining part of this article is structured as follows; the next section will discuss empirical and theoretical review on institutional ownership and financial performance. The section also further entails the development of a hypothesis statement based on the mixed results on literature. Section three will include the source of data collection, variables and model adopted by the study and method of data analysis. Section four will entail the presentation of results and discussion of findings. Lastly, section five is the concluding part of the study, which will include the recommendation and suggestions for further research.

## **2. Literature Review**

This section examines the conceptual review, theoretical review and empirical review concerning institutional investor's ownership and financial performance.

### *2.1 Institutional Ownership*

Agency theory is a significant theory that guides the separation of ownership and control of an enterprise. This theory involves the differences in the behaviour of principals and agents in light of separation between ownership and control. The principal is the shareholders, while agents are the managers. The main issue in agency theory can be explained when a conflict of interest exists between the principals and agents which is due to the reliance of shareholders on the work carried out by a manager (Jensen & Meckling, 1976; Eluyela et al., 2018a; 2018b). This conflict of interest will always lead to agency expenses.

Institutional investors are essential factors in corporate governance mechanism. They are known to have the ability to monitor management and create an atmosphere of discipline in the organisation. Ping and Wing (2011) noted that institutional investors help in boosting corporate performance via creating an atmosphere of discipline and ability to monitor management effectively. Okere, Imeokparia, Ogunlowore and Isiaka (2018) also noted that institutional investors make rational decisions when determining various channels to distribute their funds. Institutional investors do not only have the power to monitor and discipline management but also the power to participate in the board meeting, influence board decisions, and active roles of ownership. If these functions are effectively and efficiently carried out, agency cost is reduced and have a positive influence on firm performance (Shleifer and Vishny, 1997; Rose, 2007).

However, Duggal and Millar (1999) oppose this claim and state that institutional investors do not effectively monitor management and hence firm performance is negatively affected. Gorton and Kahl (1999) also support the work of Duggal and Millar (1999) by documenting that the presence of institutional investor's ownership does not improve the performance of companies. This is due to the insignificant monitoring role of the institutional investors which arise from internal agency conflicts. Due to the argument above supported by evidence-based empirical research, there is still an uncertain relationship between institutional investors' ownership and firm performance (market and accounting based).

Strand of literature has discovered a significant and positive relationship between institutional investors and firm performance (Iturralde & Maseda, 2010; Gürbüz, Aybars & Kutlu, 2010; Lin & Fu, 2017). Also, some scholars' findings show a negative relationship (Haniffa & Hudaib, 2006; Rose, 2007). As documented by Gillan and Starks (2003), institutional investors are referred to as an essential control mechanism for corporate governance all over the world. They either do this directly via the ability to potentially influence management operations and decisions or indirectly by their shares trading ability. Based on the empirical findings above, we use institutional ownership as a measure of corporate governance tool.

## 2.2 Theoretical Review of Literature

This study examines the relationship between institutional investors ownership and financial performance of deposit money banks in Nigeria. The theoretical framework of this study is built on the agency theory (Eluyela et al., 2019a; 2019b). Agency theory postulates the relationship between the principal (shareholders) and agents (directors). The directors are employed by the shareholders to act in their best interest. The sole aim of every shareholder is the maximization of their wealth. In the quest of achieving this objective, directors are faced with the conflict of interest, which leads to the agency problem. These arise when the directors intend to pursue other goals and interest that differ from that of the principal. Duru and Tsitinidis (2013) observed that bank managers are always under pressure to provide high returns to institutional investors and get incentives for doing so. This might lead to the problem of earnings management and creative accounting where directors will report high profit even when the company made a loss for the financial year (Akintimehin et al., 2019; Otekunrin et al., 2019).

Chrisman, Chua, and Litz (2004) believe that agency conflict arises as a result of the divergence of interest and asymmetric information between the managers and shareholders. Sometimes managers pursue their selfish interest at the shareholders' expense, thus resulting in the agency problem. Grillian and Starks (2003) argue that concentrated shareholders provide extensive monitoring over the managers due to their stakes in the organization; thus, this excessive monitoring leads to the principal-agent problem. Edmans and Manso (2011) believe that once ownership is concentrated in the hand of institutional investors or shareholders, they can monitor the activities of managers to reduce agency problem. Chrisman et al. (2004) believe that agency conflict arises as a result of the divergence of interest and asymmetric information between the managers and shareholders. Sometimes managers pursue their selfish interest at the shareholders' expense, thus resulting in the agency problem.

## 2.3 Empirical Review

Strands of literature have examined the link between institutional investors' ownership and financial performance. However, there have been mixed results. In Japan, Mizuno (2010) examined 189 firms to know the impact of institutional investors ownership on financial performance. Their empirical result shows that there is a positive relationship. In Canada, Mahoney and Roberts (2007) assessed the effects of institutional ownership on corporate social performance and financial performance. Their findings revealed that a significant positive relationship exists between institutional ownership and corporate social performance and financial performance.

Abdallah and Ismail (2016) carried out a study on corporate governance practices, ownership structure and corporate performance in golf cooperative council (GCC) countries. The results show that there is a positive relationship between governance quality and firm performance. Arosa, Iturralde and Maseda (2010) provide new evidence as regards how ownership concentration influences the performance of non-listed firms in Spain. The sample size for the study is 586 non-listed firms. They focused on the conflict arising between majority and minority shareholders and differentiating between the behaviour of family and non-family firms. Empirical evidence from their work shows that for family firms, there is a positive relationship between ownership structure and firm performance. Bhattacharya and Graham (2009) studied the relationship between institutional ownership and performance of 116 listed firms in Finland. They adopted a system approach in investigating the potential two-way causality between the two variables. Results show that an equal distribution of the voting power among the largest institutional stakeholder may exert positive effects on firm performances.

Cornett, Marcus, Saunders and Tehranian (2007) examined the relationship between institutional investor involvement and operating performance of large firms included in the S&P 100. They find a significant relationship between the firms operating cash flow returns and percentage of institutional stock ownership. Elyasiani and Jia (2010) investigated the association between corporate firm performance and the level and stability of institutional ownership within a simultaneous equation model. Findings reveal that there is a positive relationship between firm performance and institutional ownership stability, accounting for the shareholding proportion.

Kang and Kim (2012) employed a new classification of ownership identity to assess the impact of ownership structure on enterprise performance in China. They used both fixed-effects model and generalised methods of moments (GMM), they find out that marketized state-owned enterprises performed better than firms controlled by the government. This indicates that firms owned by institutional investors have better performance. Lin and Fu (2017) further investigated the role institutional investor play in increasing corporate performance of Chinese listed firms from 2004-2014. The results show that institutional ownership positively affects firm performance. This is in line with the work of Kang and Kim (2012).

Rashid (2018) examines the influence of board independence on the performance of firms listed in Bangladesh. The study observed 135 listed firms on Dhaka stock exchange by using market and accounting measures of performance. Discussion of results from the survey shows there is no positive influence between board independence and firm economic performance. Further findings reveal that Bangladesh has imitated the requirement of having outside directors sit on the corporate board to make board independent and accountable.

#### 2.4 Hypothesis Development

Based on the mixed result in the empirical findings above, the hypothesis stated below will be tested in a later section of this study;

H<sub>0</sub>: Institutional investor's ownership is positively related to the financial performance of deposit money banks in Nigeria.

H<sub>1</sub>: Institutional investor's ownership is negatively related to the financial performance of deposit money banks in Nigeria.

### 3. Methodology

The research was conducted by confirming and testing the relationship between variables and by testing hypotheses using a well-structured equation (Popoola, Asaleye, Eluyela, 2018; Ademola et al., 2020a; 2020b). The data used in this study was obtained from a sample comprising 15 publicly listed banks in the Nigerian Stock Exchange looking at a period of 2011 to 2018. The study used secondary data generated from the annual report of the sampled banks. Panel regression analysis was used in the study to analyse the relationship between institutional investors equity and firms' performance. Panel data involves both cross-sectional and time-series method (Adegboyegun et al., 2020; Lawal, Babajide, Nwanji & Eluyela, 2018; Oladipo et al., 2019a; 2019b). Hence, this study adopts this method because the data gathered were both time-series and cross-sectional data (see Nwanji et al., 2020). Correlation analysis was carried out to observe the relationship between the independent and dependent variables (Adetula, Eluyela, Akomolafe, Ilogho and Adubi, 2016; Oladipo et al., 2019c). Also, test for multicollinearity was carried out in section four of this study.

#### 3.1 Variables and Research Model

To test for the relevance of the hypotheses, this study employed a modified version of the econometric model of Harasheh and Nijim (2010). The Econometric model of Harasheh and Nijim (2010) is therefore seen below as;

$$Q = \alpha + \beta_1 \text{debt} + \beta_2 \text{NIG} + \beta_3 \text{IR} + \beta_4 \text{NII} + e \quad (1)$$

Where  $\alpha$  is the vertical intercept,  $\beta$  is the regression coefficients and  $e$  is the error term.

Based on the fact that the study employed different proxies, the above model is therefore adapted by developing a simple definitional model to guide our analysis (Umukoro et al., 2020). This model is as follows

$$Y = \beta_0 + \beta_1 x_{i-t} + \mu_{i-t} \quad (2)$$

Equation 1 can be defined as:

$$\text{ROA} = f(\text{INTINV}, \text{FS}) + c\mu \quad (3)$$

ROA = f (Institutional investors share, Firm size)

Therefore, the Regression Equation is:

$$\text{ROA}_{1-t} = \beta_0 + \beta_1 \text{INTINV}_{1-t} + \beta_2 \text{FS}_{1-t} + \mu \quad (4)$$

Where; Institutional investors share (INTINV): total shares of firm  $i$  in year  $t$  belonged to banks divided by the total number of shares outstanding.

Firm size (FS): is the natural logarithm of selected firm's total assets which serves as a control variable for the independent variable

$\beta$  = coefficient of parameter

$_{1-t}$  = time coefficient this is the time frame been considered in the study

$\mu$  = error term

The a priori is such that:  $\beta_1, \beta_2 > 0$ . The implication of this is that a positive relationship is expected between explanatory variables ( $\beta_1 \text{INTINV}$ ,  $\beta_2 \text{FS}$ ) and the dependent variable. The size of the coefficient of correlation will help us explain various levels of relationship between the explanatory variables.

#### 4. Data Analysis and Discussion of Findings

Table 1. Correlation Coefficients Matrix

	ROA	INTINV	FS
ROA	1.000000	0.372943	-0.134344
INTINV	0.372943	1.000000	0.189447
FS	-0.134344	0.189447	1.000000

Source: Authors' computation (2019)

Table 1 present the correlation matrix of the independent and dependent variables used in this study. It reflects the relative strength of the linear relationship between the explanatory variables. According to Okere, Isiaka and Ogunlowore, (2018), multicollinearity could only be a problem if the pair-wise correlation coefficient among regressors is above 0.80. Therefore, based on this outcome, the problem of multicollinearity is absent among the independent variables.

##### 4.1 Regression Analysis

In this section, the study employed panel data regression analysis to investigate the relationship between institutional investor's ownership and financial performance of money deposit banks in Nigeria.

Table 2. Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTINV	6.313540	1.024595	6.161983	0.0000
FS	-0.643253	0.283707	-2.267316	0.0263
C	7.600114	3.324899	2.285818	0.0252
R-squared	0.769141	Mean dependent var		5.331376
Adjusted R-squared	0.718542	S.D. dependent var		5.687878
S.E. of regression	2.283400	Sum squared resid		380.6157
F-statistic	15.20065	Durbin-Watson stat		1.769897
Prob(F-statistic)	0.000000			

Source: Authors' computation (2019)

The result in table 2 shows the estimation of the relationship between institutional investor's ownership and financial performance. The result indicates that  $R^2 = 0.77$  (77%) and adjusted  $R^2$  is 0.72 (72%) this shows that 72% of the total variation in the dependent variable (ROA) is explained by the independent variable (Institutional Investors Share). The p-value of the F statistics is 0.0000. The Durbin Watson is 1.77, which falls within the acceptable region and shows the presence of low auto-serial correlation which is common in time-series data. Therefore, the model indicates that there is a significant relationship between institutional investors equity and firms performance variables. The result further indicates that there is a positive relationship with a correlation coefficient value of 6.313540 and p-value of 0.0000 this implies that a unit increase in institutional investors equity will lead to 6.3% increase in the performance of the sampled banks. This result shows that there is a direct and meaningful relationship between the institutional investor's level and the company's performance. This result is mostly consistent with the findings of (Elyasiani & Jia, 2010; Kang & Kim, 2012; Lin & Fu, 2017).

#### 5. Conclusion and Recommendations

The study examined the relationship between institutional ownership and firm performance. In line with the previous research (Elyasiani and Jia, 2010), institutional ownership was measured by investor's shareholdings, and firm performance was measured by Return on Assets (ROA). The  $R^2$  and adjusted  $R^2$  from the regression analysis was used to explain the relationship between the dependent and the independent variable. The empirical findings showed

a positive relationship between equity shareholdings of investors and bank performance, thus indicating that a unit increase in institutional investors equity capital will lead to an increase in bank performance. Therefore, high institutional investor's participation in banks will boost the firm's performance, and this will increase the investment in shares of banks. Also, prompt implementation of proper prudential guidelines should be adequate to avert grave volatility in a financial system progressively moulded by the presence of institutional investors.

Our study is not without limitations. Our dataset is based on the banking sector in the Nigerian economy. This provides a suggestion for further research that sectors like consumer goods, industrial goods, agricultural and others listed on the Nigeria stock exchange can be considered. Also, we only examined the relationship between the dependent and independent variables. Subsequent studies can look at this relationship both in the short and long run by examining the causal relationship between these variables.

### Acknowledgements

The authors will like to appreciate the management of Landmark University for funding the article processing fee (APC).

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