Impact of Institutional Investors' Ownership on Firm Performance of Public Companies in Sri Lanka

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Abstract: - The study's goal is to investigate the relationship between firm performance and ownership by institutional investors. The targeted goals and the necessary information were gathered from the annual reports and financial statements of 100 businesses from thirteen industries that were listed on the Colombo Stock Exchange in Sri Lanka between 2017 and 2019. The institutional investor's ownership has been investigated as an independent variable, along with company performance (Return on Assets and Return on Equity) and firm size (control variable). This investigation used correlation and regression, and the findings showed that a substantial positive relationship between firm size and firm performance whereas institutional investors' ownership has a significant negative association with financial performance of the company. According to the study's findings, it is advisable to support the corporate governance application principles in Sri Lankan public companies in order to encourage institutions to increase their investments and implement effective monitoring, which may enhance company performance.

Key Words: ***Institutional Investors' Ownership, Firm Performance, Return on Assets (ROA), Return on Equity (ROE).***

I. INTRODUCTION

Institutional investors have become important players and stakeholders in the financial industry of today. They have also become a major influence in the equity market. They have a substantial global presence in both established and developing markets. The growing amount of corporate equity they hold demonstrates their growing significance in corporate governance.

When making decisions in the past, these investors avoided direct involvement and instead used the exit strategy, selling their shares if they didn't like the decisions made by management (Bathalaal., 1994).

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They are more emboldened to speak up when they disagree with management since, they used their right to vote during company meetings, and as a result, they are actively taking part in corporate decision-making. They do this in an effort to persuade senior executives to consider the long-term interests of shareholders (Coffee, 1991). Institutional investor's ownership has emerged as a hot topic for debate in both industrialized and developing nations, including Sri Lanka. Sri Lanka has a growing economy that is nevertheless regarded as less developed. In recent years, financial literature has given Sri Lanka a lot of attention. In particular, as Sri Lanka enters the post-conflict recovery phase following the end of the domestic ethnic hostilities that raged there from 1970 to 2009, financial system reform has become crucial for boosting economic growth. Sri Lanka has lately begun implementing a number of economic changes, including processes of deregulation, infrastructural development, and promoting global integration. Long-term investment has so greatly risen.

Institutions control much of the stock market's ownership. According to Manawaduge (2008), institutional investors own a sizeable fraction of the shares listed on the Sri Lankan stock exchange. Domestic investors are reluctant to participate in

emerging nations with little corporate governance reform because of the immature equity market and inadequate investor protection, according to Lee (2010). This could be a factor in Sri Lanka's high rates of institutional foreign ownership. The expansion of institutional investor activity on the Sri Lankan stock market is a result of good governance practices.

To gain insight into governance procedures, it is crucial to take shareholder activism into consideration while reforming corporate governance (Daily et al., 2003). Institutional investors have thus far become a significant force in corporate oversight, acting as safeguards for the interests of minority shareholders. A significant and influential constituency that will play a crucial role in corporate governance has emerged because of the enormous growth in institutional investors' shareholdings. Corporate governance practices in Asian companies may be improved by institutional investors' equity participation, which would help to lessen problems connected to conflict between dominant owners and minority shareholders (Claessen and Fan, 2002).

Institutional investors with concentrated shareholdings are more likely to carefully monitor management's actions because they have the resources, expertise, and higher incentives to do so and to prevent managers from acting opportunistically (Wan Hussin and Ibrahim, 2003). Institutional investors are more driven to monitor businesses with significant free cash flow because it is challenging them to quickly sell their large shareholdings at market value (Chung et al., 2003). Mitra and Cready (2003) provide evidence that active investor monitoring from institutional investors also helps to prevent managerial opportunistic reporting behavior and improve the quality of governance in the financial reporting process, building on earlier studies that examine the role of internal governance mechanisms and earnings management.

The existence of substantial institutional owners clearly aids in the effective management of business performance, as shown by the aforementioned explanations. Therefore, it is difficult to determine how institutional investor's ownership affects business performance.

1.1 Problem Statement

Institutional investors are essential to improving business performance because they monitor management and reduce agency problems. Companies with low institutional investor's ownership are poorly run and have weak governance systems. Institutional investor ownership in Sri Lanka is still low despite efforts to raise it. This is a significant barrier to Sri Lanka and other developing nations' businesses performing better.

There are certain consequences for the company performance when considering the ownership effects of institutional investors on the firm performance of public companies in Sri Lanka. Additionally, in many nations, the general public and investors lack the necessary information and awareness when dealing with investing activities. Therefore, it is important to make sure that everyone is aware of how ownership by institutional investors affects company performance.

When taking into account the ownership effects of institutional investors on the firm performance of public companies in Sri Lanka, there are specific repercussions for company performance.

1.2 Research Objectives

To investigate how institutional investors' ownership affects the performance of Sri Lankan public companies.

1.3 Research Questions

Does institutional investors' ownership have an impact on the financial performance of public companies in Sri Lanka?

II. LITERATURE REVIEW

Institutional investors hardly ever engaged in corporate management in the outset. They only sold their stock when they were dissatisfied, which had a negligible impact on the company's success. Institutional investors now have more stock options, which gives them two methods to let the corporate management know they're not happy. First off, institutional investors hold more equities, have greater voting power, and actually have more backing for their judgments than individual stockholders do (Gillan and Starks, 2000).

Different companies have a variety of stockholder combinations. Every business has a few small stockholders and natural persons. To monitor management performance, these individuals mostly rely on information that is made publicly accessible, such as published financial accounts. In contrast, some other significant professional stockholders in every firm have access to useful internal knowledge regarding future perspectives, business strategies, and so on through direct interaction with the management (Nouravesh & Ebrahimi, 2003). It is generally believed that the existence of institutional stockholders could alter how other investors behave (Bushee, 1998).

The monitoring function of institutional investors in addition to their informational advantage would lead to a favorable link between ownership and firm performance. Institutional

investors have an incentive to watch a company's performance as well because they stand to gain more from it than smaller shareholders and can encourage remedial action if necessary thanks to their increased voting power (Shleifer and Vishny, 1986; Bhojraj and Sengupta, 2003). This is in line with the idea that institutional investors should take all reasonable precautions to protect the value of their assets, including keeping an eye on how the businesses they invest in are doing (Monks and Minow, 2001).

In major corporate organizations and enterprises, a partnership known as an agency relationship—in which shareholders act as the principle and management acts as their agent—is typical. When corporate corporations grew to be very large and owners recruited business managers as their agents to operate their enterprises, agency problems emerged as a result of the division of ownership and management. (Smith, 1776; Berle and Means, 1932; Ross, 1973; Jensen and Meckling, 1976; Agrawal, 1996; Shleifer and Vishny, 1997) investigated the agency problem and attempted to address problems resulting from managers and shareholders' conflicting interests.

Davis et al. (1997) developed stewardship theory in response to agency costs theory. The proprietors of an organization have embraced a focused leadership philosophy. A steward who improves organizational performance often satisfies the demands of the majority of the stakeholder group since the interests of the majority of stakeholders are linked with organizational performance. Managers that play the steward role will act in the organization's best interests and offer collective solutions rather than individual ones.

The steward managers optimize the business's financial success while minimizing agency conflict. According to Hofstede and Hofstede (2004), developed and developing economies have distinct perspectives on the usefulness and implementation of management theories. An ideal "steward" position is difficult to discover in the Sri Lankan environment due to lax norms and regulations, weak organizational and institutional environments, and lax institutional environments. On the other hand, family firms make up more than 64% of listed companies in Sri Lankan (Masulis et al., 2009). As a result, it is possible for the CEO and management to act in a "stewardship" capacity. According to institutional theory, organizations, organizational fields, and nations are social and cultural systems in addition to being systems for providing products and services (Judge et al., 2008). Institutions can be managed by laws, customs, understandings, and routes, or by social patterns, which are identified by a predetermined sequence of interactions, claim March and Olsen (1989). (Jepperson & Meyer, 1991). With the growth of MNCs and their subsidiaries in the late 1990s, institutional theory gained prominence and popularity. Institutional theory is varied, nevertheless, and its central idea has to do with organizations and how they adopt the institutional context (Scott, 2001).

Institutional investors are particularly good at monitoring a company's performance, which enhances business performance. Corporate governance has a considerable impact on a company's performance. Additionally, corporate governance increases investment, helps the company make the most of its resources, and strengthens its foundation, all of which will support the predicted rise in firm performance. To put it another way, sound corporate governance protects against potential financial hazards and promotes spectacular growth, which is why it is essential to the growth of a company's performance. Currently, research has been done on how corporate governance affects a company's overall success (Ehikioya, 2009).

Performance measurement is the transformation of the intricate reality of performance into structured symbols that may be connected to and communicated in the same context (Lebas, 1993).

Quantification and accounting are regarded to serve a less significant role in current corporate management than performance measurement (Koufopoulos et all 2008). This is in line with the definition of performance management provided by Bititci, Carrie, and McDevitt (1997), who defined it as a process wherein the organization manages its performance to be in line with its corporate and functional strategies and objectives.

Wellalage & Locke looked at the connection between ownership structure and financial performance for Sri Lanka listed firms from 2004 to 2009 in their paper from 2014. They used ROA and Tobin's Q as dependent variables and ownership structure as an independent variable to assess the firm's financial success. The results of the data's regression analysis showed that investors have a negative impact on the financial performance of Sri Lankan businesses.

Research by Tahir, Saleem and Arshad (2013) examines the connection among institutional investor’s ownership and business performance for 126 companies listed on the Karachi Stock Exchange (KSE) from 2008 to 2013. Institutional investor’s ownership was employed as an independent variable, and ROA and ROE were used as dependent factors. They discovered that institutional investor’s ownership, an endogenous variable, was revealed to be strongly and favorably

associated to company performance by utilizing the OLS, 2SLS regression model.

III. METHODOLOGY

3.1 Sample and Data Collection

100 publicly traded companies from the three years of 2017 to 2019 made up the sample for this study. Data for the sample period were collected from 2017 to 2019 according to the study's method of data collection. The Colombo Stock Exchange Handbook and Colombo Stock Exchange Annual Report will be used as secondary sources in this project to collect data.

3.2 Data Analysis

To determine the relationship between institutional investor ownership and company performance, financial ratios will be generated. The data is processed using SPSS (version 16.0), a program designed specifically for statistical processing. Here, data are analyzed using descriptive statistical tables, correlations, and regressions.

3.3 Research Model

$$ROA_{i,t} = a + \beta_0 INST_{i,t} + \beta_1 SIZE_{i,t} + \varepsilon$$
$$ROE_{i,t} = a + \beta_0 INST_{i,t} + \beta_1 SIZE_{i,t} + \varepsilon$$
$$INST_{i,t} = a + \beta_0 ROA_{i,t} + \beta_1 SIZE_{i,t} + \varepsilon$$
$$INST_{i,t} = a + \beta_0 ROE_{i,t} + \beta_1 SIZE_{i,t} + \varepsilon$$

Where,
$ROA_{i,t}$ = Return on Assets of company "i" for the period "t"
$ROE_{i,t}$ = Return on Equity of company "i" for the period "t"
$INST_{i,t}$ = Institutional investor's ownership of company "i" for the period "t"
β_0 = the constant
β_1 = the coefficient for control variable
ε= the error term

3.4 Definitions of Key Terms

3.4.1 Institutional investor's ownership

A measure of institutional ownership is the number of outstanding shares held by them at the conclusion of the fiscal year; the shareholding patterns of the companies are published in their annual reports.

$$\text{Institutional investor's ownership} = \frac{\text{Number of shares in hand}}{\text{Company's total shares outstanding}} \times 100$$

3.4.2 Return on Equity (ROE)

The ROE is the ratio of a company's financial year-end net income to its shareholders' equity, measuring net income as a percentage of shareholder equity.

$$ROE = \frac{\text{Net Income}}{\text{Shareholder's Equity}} \times 100$$

3.4.3 Return on Assets (ROA)

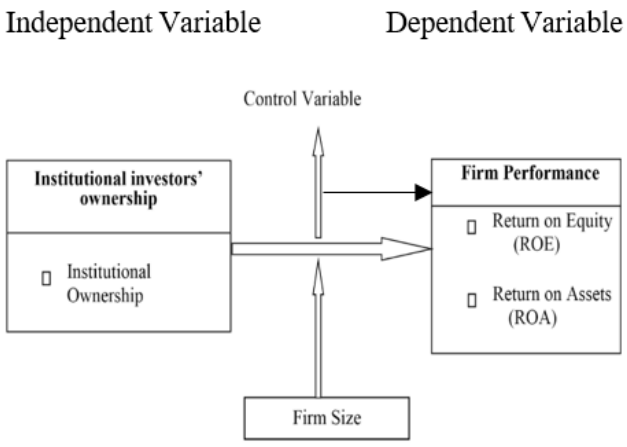
The ratio of a company's annual net income to its total assets, or ROA, is used in this study as an accounting measure of firm success.

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}} \times 100$$

3.4.4 Firm Size

Size refers to the size of the business and is calculated using the logarithm of the total assets at the conclusion of the fiscal year. Performance and ownership by institutional investors may be impacted by a company's size.
Size = Logarithm of Total Assets

3.5 Theoretical Framework



IV. RESULTS AND DISCUSSIONS

4.1 Descriptive Statistics

Table.1. Descriptive Statistics of All Study Variables

Variable	N	Minimum	Maximum	Mean	Std. Deviation
ROA	300	-50.360	72.20	5.178	12.625
ROE	300	-202.00	89	5.092	26.256
IOWN	300	.104	99.946	74.989	24.577
FIRM SIZE	300	12.225	24.463	18.659	3.125
Valid N	300				

The standard deviation of ROA is 12.625%, and the mean is 5.178%. This indicates that the profitability value can deviate by 12.625% on either side of the mean. The maximum ROA for a corporation in a year is 72.20%, while the minimum is -50.36%.

The standard deviation of ROE is 26.256%, and the mean is 5.092%. This indicates that the profitability value can deviate by 26.256% on either side of the mean. In a year, a company's ROE might reach a maximum of 89% and a minimum of -202%.

The standard deviation of IOWN is 24.577%, and the mean value is 74.989%. This indicates that the profitability value can deviate by 24.577% on either side of the mean. The maximum IOWN value for a corporation in a year is 99.946%, while the least is 0.104%.

The standard deviation is 3.125% and the mean value of SIZE is 18.659%. This indicates that the profitability value may deviate by 3.125% on either side of the mean. The greatest SIZE value for a corporation in a year is 24.463%, and the least value is 12.225%.

4.2 Correlation Analysis

The correlation between IOWN and ROA shows a positive link (r = 0.012, p = 0.830> 0.01) between the two variables. The ROA will rise by 1 degree if the IOWN rises by 0.012, on average. 0.830 is the important level. It exceeds the 0.01 error value. The outcome does not demonstrate the model's strong position.

Table.2. Correlation Analysis

		IOWN	ROA	ROE	SIZE
ROA	Pearson Correlation	.012	1		
	Sig. (2-tailed)	.830			
ROE	Pearson Correlation	-.020	.678**	1	
	Sig. (2-tailed)	.730	.000		
SIZE	Pearson Correlation	-.185**	-.158**	-0.017	
	Sig. (2-tailed)	.001	.006	.764	

**. Correlation is significant at the 0.01 level (2 tailed)

The correlation coefficient between IOWN and ROA, which is -0.020, describes the inverse relationship between institutional investor ownership and business performance. IOWN would fall by 0.020 if ROE increased by one. The significance level is 0.730. That goes over the 0.01 error limit. The results do not support the model's robust position.

SIZE and ROA's association shows that there is a negative correlation between them (r = -0.158, p = 0.006–0.01). Consequently, SIZE would drop by 0.327 if ROA increased by 1. The important value is 0.006. It has a lower error value than 0.01 the outcome demonstrates the model is solid standing.

A -0.017 Correlation coefficient between SIZE and ROE shows a weak relationship between institutional investor ownership and company success. In other words, SIZE would decrease by 0.017 if ROE increased by one. There is a 0.764 level of significance. It has an error value larger than 0.01. The results do not support the model's robust position.

4.3 Multiple Regression Analysis

4.3.1 Normality Test

Table.3. Normality Test

Variables	N	Skewness	Kurtosis
	Statistic	Statistic	Statistic
ROA	300	1.488	9.061
ROE	300	-3.174	21.739
INSTITUTIONAL OWNERSHIP	300	-1.628	1.937
FIRM SIZE	300	-.074	-1.465

Analyses of skewness and kurtosis are performed to determine whether the data distribution is normal. The earlier study (Coakes & Steed, 2003) showed data normality with output values between three, and the subsequent analysis (kurtosis analysis) showed data normality with output values between three. (Kline, 1998).

According to the analysis, all skewness values are contained within the ranges of three. As evidenced by kurtosis statistical values greater than +3 and -3, ROE, ROA, size, foreigners, Arabs, GCC, company size, leverage, and composition are all regularly distributed. According to Hair (2010), this value is acknowledged, and as a result, the data in this study consider ownership as the kurtosis analysis result is typical regardless of the skewness analysis.

4.3.2 Multicollinearity Test

a. Dependent Variable: ROA, ROE

When the VIF is more than 10, multicollinearity is problematic since there is a strong connection between the independent variables (Silver, 1997).

Table.4. Multicollinearity Test

Model	Collinearity Test	
	Tolerance	VIF
INSTITUTIONAL OWNERSHIP	.966	1.035
FIRM SIZE	.966	1.035

This is the rationale behind selecting the multicollinearity diagnostics with VIF when examining multiple regression models. There are smaller correlations between the independent variables in this situation since institutional investor's ownership and company size both imply the same tolerance (0.966 and 1.035, respectively), which is less than 10.

4.3.3 Regression Analysis

4.3.3.1 Regression Analysis between ROA and Institutional Investors' Ownership

Table.5. Regression Analysis between ROA and Institutional Investors' Ownership

Statistics	**IOWN**	**SIZE**
ß-Coefficient	-0.009	-0.653
t- Statistics	-0.299	-2.773
p. value	0.765	0.006
Std.Error	0.030	0.235
R^2	0.025	
Adjusted R^2	0.019	
SE of regression	12.5056	
F- Statistics	3.868	
Probability (F-Statistics)	0.022	

The given results indicate that institutional investor's ownership and business size account for just 2.5% of the variability of the ROA, with the value of R2 being at 0.025. Only 2.5% of ROA is, on average, explained by institutional investor's ownership and firm size, with the remaining 97.5% being explained by other factors in Sri Lankan public enterprises. The regression model's F-statistics value is 3.868 and is significant at the 95% level of confidence (P = 0.022–0.05), supporting the

model's general validity. After adjusting for size, it is discovered that there is no correlation between institutional investor's ownership and ROA (P = 0.765 > 0.05).

4.3.3.2 Regression Analysis between ROE and Institutional Investors' Ownership

Table.6. Regression Analysis between ROE and Institutional Investors' Ownership

Statistics	**IOWN**	**SIZE**
ß-Coefficient	-0.026	-0.183
t- Statistics	-0.407	-0.370
p. value	0.684	0.712
Std.Error	0.063	0.496
R^2	0.001	
Adjusted R^2	-0.006	
SE of regression	26.333	

F- Statistics	0.128
Probability (F-Statistics)	0.880

The F-statistics value for the regression model is 0.128, and it is significant at the 5% level (P = 0.880 > 0.05), demonstrating the general validity of the model. According to R2, which has a value of 0.001, the ownership of institutional investors and the size of the business barely contribute 0.1% to the variability of ROE. It means that institutional investor's ownership and company size only account for 0.1% of ROE, with the remaining 99.9% of ROE in Sri Lankan public enterprises being explained by several other factors. After adjusting for size, there is no detectable correlation between institutional investor ownership and ROE (P = 0.684 > 0.05).

4.4 Summary Of Interpretation and Findings

According to the correlation approach, there is a slight but positive link between institutional investor ownership and ROA (r = 0.012, P = 0.830 > 0.01). The correlation coefficients between ROA and SIZE are significantly and negatively correlated (r = -0.158, P = 0.006 0.01), however.

The relationship between the return on equity ratio and institutional investor's ownership is also negatively and insignificantly correlated (r = -0.20, P = 0.730 > 0.01) with institutional investor's ownership. The negative and negligible correlation between ROA and SIZE is shown by the following values: r = -0.017, P = 0.764 > 0.01.

According to the given regression results, SIZE has a substantial link with ROA whereas the

independent variable institutional investor's ownership has an insignificant relationship with ROA. According to the relatively weak coefficient of determination (R2) of 0.025, only 2.5% of the variance in ROA can be explained by the independent variables (IOWN and SIZE), and the remaining 97.5% of the variation in ROA may be explained by other variables.

According to the regression analysis's findings, there is little to no correlation between institutional investor's ownership and ROE, and there is also no correlation between ROE and SIZE.

Just 0.1% of the variance in ROE can be described by the independent variables (IOWN and SIZE), and the rest 99.9% of the variation in ROE may be explained by other variables, according to the Coefficient of determination (R2) of 0.001, which is regarded as being very weak.

Table.7. Results Summary of Hypothesis Testing

In between	**Significant level**	**significant**
IOWN and ROA	0.765	Insignificant
SIZE and ROA	0.006	Significant
IOWN and ROA	0.684	Insignificant
SIZE and ROA	0.712	Insignificant

Given that the computed significant value is greater than the table significant value when institutional investor ownership is taken into account (P=0.765>0.05), the null hypothesis (H0) should be accepted and the alternative hypothesis (H1) should be rejected. The null hypothesis was accepted, proving that there is no connection between institution ownership and ROA. When testing a hypothesis using SIZE, the null hypothesis (H0) should be rejected and the alternative hypothesis (H1) accepted because the estimated significant value is less than the table significant value (P=0.0060.05). When the alternative hypothesis was accepted, a strong relationship between SIZE and ROA was discovered.

In a hypothesis test where institutional investor ownership is utilized, the null hypothesis (H0) should be accepted and the alternative hypothesis (H1) should be rejected because the calculated significant value is greater than the table significant value (P=0.684>0.05). The acceptance of null states that there is "no meaningful association between Institutional Investor's ownership and ROE."

When testing hypotheses using SIZE, the null hypothesis (H0) should be accepted and the alternative hypothesis (H1) should be rejected because the computed significant value is smaller than the table significant value (P=0.712>0.05). The alternate hypothesis was adopted, and the results showed a "significant association between SIZE and ROE.

If hypotheses are taken into account, IOWN does not significantly affect the performance of public corporations' firms. As a result, we accept the null hypothesis and reject the alternative. In this case, the company's performance is strongly associated with its SIZE. As a result, we accept the alternative and reject the null hypothesis.

V. CONCLUSION

Theoretically, given the supposed effect institutional investor's ownership has over how management runs the company and, consequently, how it creates value for shareholders, there should be a strong correlation between institutional investor's ownership and firm performance. Because they have the means, knowledge, and higher incentives to do so and to stop managers from acting opportunistically, institutional investors with concentrated shareholdings are more likely to carefully scrutinize management's actions (Wan Hussin and Ibrahim, 2003). Sadly, empirical investigation of this theoretical premise came up empty.

The developed hypothesis states that the ownership of institutional investors, as suggested by Pound (1988) for pressure-sensitive institutional owners, has a negative association with business performances. The findings of Charfeddine and Elmarzougui (2011) for the Paris Stock Exchange and Sabien (2009) for a sample of Indian industrial enterprises can be harmonized with this result. The fact that Sri Lanka is still developing and has weak institutions, as well as the fact that family-controlled businesses dominate the country's public companies, may be the cause of this unfavorable relationship. Also, local institutional investors are hesitant to engage in developing nations with poor corporate governance due to the immature equity market and lack of investor protection (Lee 2010).

5.1 RECOMMENDATION

To develop this research study, 100 Sri Lankan public enterprises were consulted. The majority of businesses differ in their primary business. Throughout the inquiry, the researcher carefully examined each company's annual report. The public corporations can greatly benefit from a shared quality. According to this report, institutional investor's ownership made up the ownership structure. But occasionally, things can alter. The ownership structure might also incorporate other kinds of owners. as a block owner and foreign owner, etc. The ownership structure should therefore be carefully taken into account in any further research on this subject.

The primary goal of every research project is to make recommendations. If there is an issue, a suggestion to lessen it will be made.Assist in the creation of policies by policymakers that not only promote institutional investor's ownership but also enhance governance and business performance. You must help the business management comprehend how institutional investor's ownership can enhance firm performance. Assist institutional investors in acquiring more stock in Sri Lankan public companies to boost company performance. The majority of publicly traded companies experience losses; thus, management must take this into account.

5.2 LIMITATIONS

The Colombo stock exchange has been the primary source of information for the data set. Therefore, the findings from this study solely apply to Sri Lankan public firms. Performance is mostly assessed using accounting data. Data needed may contain statistical inaccuracy. Only 100 publicly traded firms are included in this analysis, and due to time constraints, the data collected for this study only includes statistical data for the most recent three years, from 2017 to 2019. These numbers were collected from the CSE handbook and annual report (only secondary data).

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