The Effect of Institutional Investors Ownership on Stock Returns

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Abstract
Stock returns and affective factors on volatility of the important part of financial performance in businesses are topic of discussion in the field of financial research. On the one hand, the shareholders combination and the method of this combination with the company's management are factors that affect stock returns and some institutional investors are an important element of this combination that have a significant impact on decisions. This study tries to examine the relationship between the impact of institutional investor ownership and non-institutional investors on stock returns. For this reason, the percentage of ownership institutional investors is calculated using the total number of shares in hand of banks and insurance, holding and investment companies, pension funds, finance companies and investment funds, institutions and public companies divided by the company's total shares outstanding and stock returns was measured through dividends and share price total return. Also, the control variables were used such as firm size, firm growth, financial leverage, type of industry and year. This study utilizes data from the companies listed in Tehran Stock Exchange for a period of 5 years (2008-2012) and used Eviews software and regression method for analyzing variables. The results about first hypothesis suggest that there is a significant relationship Institutional Investors (independent variable) and return on stock (dependent variable) at level of 95% confidence. As well as there is significant relationship between the control variable such as size, financial leverage and firm growth and stock returns. Also, the results of second hypothesis suggest that there is significant relationship between stock returns as dependent variable and non-institutional ownership as independent variables.

Key words: Institutional ownership of stock, returns on stock

Introduction
Before the advent of very large firms in the late eighteenth century, the owners were manager and managers were owner. But with the separation of ownership and managers, the emergence of securities markets, groups of professional managers, a new approach was introduced as a social

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phenomenon with title of stock company. This leads to the emergence of a conflict of interest between managers and owners. Shareholder composition may vary in different countries. However, shareholders can have a major role in corporate governance system. Thus, different compounds can have different effects on the company performance, the methods of firm information reflect in markets and information asymmetry in firms. In this content the most attention is on the increasing presence of institutional investors in public companies owners circle, and the impact of active participation of these groups can have on organizations and their performance. Institutional investors have the potential influence on activities of managers directly and indirectly through its traded shares and the direct or indirect influence of institutional investors can be very important. On the other hand, the end product of accounting process is providing information to different users, including internal and external users of the company in the form of accounting reports. Included items in the financial statements have great influence on the decisions of users’ financial statements and have attracted much attention. One of the main groups of users of financial statements is shareholders. Among this, institutional investors (including large investors such as banks, insurance companies, investment companies, pension funds, etc.) have considerable influence in investee companies with respect to the ownership of a substantial portion of the shares and can be effective on their methods. On the other hand, these types of investors are professional stakeholders and have strong analysts who analyze accounting data and therefore have the ability to use this information. Institutional investors have several incentives to monitor the financial reporting and improve their companies’ performance. Among these drivers, it can be noted that the financial statements are an important source of information about the company, or that the investors are more capable than individual investors in analyzing accounting information. Therefore, we expect the logical relationship to exist between ownership of these groups of investors and firm performance.

Theoretical Basis
There are different perspectives regarding the impact of institutional investors on corporate performance. Under the hypothesis of active surveillance because of the amount invested wealth, institutions may actively manage their investments. Based on this attitude of institutional investors, shareholders are experts who have comparative advantage in collecting and processing information. In general, the researches confirm the hypothesis. In conclusion, according to this argument there is a positive relationship between the level of institutional ownership and firm performance. Also, this statement assumes only an investment relationship between institutional investors and company (Bushee, 1998). In this study, the impact of institutional ownership on stock returns is reviewed. As defined by Bush big investors are such as banks, insurance companies, investment companies, pension institutions, etc. This is generally thought that the presence of institutional investors may lead to change in firm behavioral (Velury et al., 2006). Volatility of stock returns is one of the most controversial issues in financial issue that is in attention of stock market researchers in recent years in emerging markets. The reason of this tendency refers to the relationship between price volatility and consequently its impact on the performance of financial sector and total of economy. On the other hand, the usefulness of stock returns volatility to the investors is that they consider the stock returns volatility as a measure of risk. Also, the policies makers in capital markets can use this measures as a means to measure the vulnerability of the stock market. Hence, the study of factors affecting the stock returns volatility can be useful in making many decisions in the capital market. Its result can be used for activists in exchange stock, including financial institutions, corporate executives and economic systems executives. On the other hand, the role of institutional investors in the capital market as intermediaries to transfer
funds and savings and management of financial resources in financial markets is more important. So that, increase in institutional investors trading in global stock markets since the late 1980s leads to increased financial researchers to investigate the effect of these institutions on changes in stock prices. So that, the institutional investors can be considered as a group of shareholders of the company that can be effective on price changes and subsequent stock returns volatility. There is different theoretical regarding the relationship between institutional investors and volatility of stock returns. Some researchers believe that institutional investors might be have mass and tend to use positive feedback trading strategies. Therefore their performance can lead to auto correlation and volatility of stock price. So, despite this type of investment, stock return volatility is visible. This approach is justified on the basis of the convergence of interests. It means that institutional investors be along with managers due to common interest, and cause instability in stock prices. In contrast, others argue that institutional investors are aware investors that adjust stock prices with new and timely information, and reduce the volatility of stock returns. So, existence of these investors makes market more efficient. The researchers also believe that two factors affecting the stock price are the amount of available information and type of shareholders' answer in order to transfer the information to financial markets or to the other stockholders. In this regard, Bohl et al argue that institutional investors are one of the key players in the capital market that their use of their abilities is a function of how investment. Therefore, the level of institutional ownership can be associated with the volatility of stock returns. Thus, the researchers suggest institutional investors increase transparency of information with corporate governance implement and reduce information asymmetry. This action will reinforce the efficiency of the capital market. So that it is expected the stock return volatility decreases and causes an attractive and safe market for new investment. They also stated that the existence of institutional investors would provide good profit opportunities for investors and has expand in market depth and liquidity and price transparency and ultimately increase productivity and improve social welfare. Whatever ownership concentrated, the likelihood of large shareholders to access the private information becomes more. In such circumstances, large shareholders may be less willing to encourage management to improve performance. Also institutional investors inevitable move towards management in voting with consider the profitable trade (useful) with investee companies. For example, an insurance company may hold substantial shares in the company and meanwhile be the principal underwriter of that company and may have an important impact on trade relations with the company, and perhaps other to disagree with management. Therefore, according to this hypothesis, managers and institutional owners have a mutual benefit cooperation. Overall, this cooperative decreases the beneficial effects of monitoring by large shareholders on firm performance (Bushee, 1998). If that is true, the hypothesis of personal interest claim negative relationship between institutional ownership and corporate performance. Despite of strong evidence, the relationship between firm performance and institutional ownership is relatively obscure and unknown. In terms of theory institutions may have incentives for proactive monitoring on management to improve performance (Pound, 1998; Shleifer et al., 1997).

Research Background
Mcconnell et al, 1990 believe that Institutional shareholders have a negligible effect on the stock returns. But if we have the ownership stock by management involve significant effect on returns. The results Brous et al., 1994 study indicate that there is a positive relationship between stock price, profitability, and improvement in operation and institutional ownership.
Mehran . H,1995 did not find a significant relationship between returns of American companies and institutional investors, including individuals, institutions and corporations.

According to Pound, 1998 regarding to efficiently monitor hypothesis there is a positive relationship between the performance and more investment by institutional investors.

Black and Bernard, 2001 on research in Russia by using time series analysis regression found that there is a strong relationship between institutional investor sand shareholder returns.

Parrino et al, 2003 concluded that if institutional investors feel threatened, rather than have effects on management sell their investment and believe long-term returns are not significant.

In general Holderness, 2003 concluded that evidence on the relationship between institutional investors and shareholder returns in the United States shows that this relationship is sometimes positive and sometimes negative.

Dlugoze etl, 2004, Sung. J et al, 2004, Black, Bernard, 2006, concluded that better management leads to better corporate governance and considering its stakeholders and shareholder returns with corporate governance that institutional ownership is one of its criteria negatively correlated.

Bhattacharya et al., 2007 in their research concluded likely the level of institutional ownership that is correlated with investee companies in trade and investment, has negative effect on firm performance.

Ditmar, Smit. M, 2007 by examining two criteria of corporate governance (institutional shareholders and board of directors) and its relationship with shareholders returns found that in firms with weak governance, each dollar change in cash lead to change in market value of 0.42 to 0.88 (return on equity). While this amount is doubled at companies with good governance.

Tsaia&Gu 2007 studied the relationship between firm performance and institutional ownership in the casino industry for the years 1999 to 2003. Institutional ownership is percentage of shares from whole capital stock held by state-owned companies. These companies include insurance companies, financial institutions, banks, public companies and other parts of the state. They showed that institutional investors in the casino industry may help investors in it that decrease agency problem from separation of ownership from management.

Cornett et al., 2007 in their study divided institutional ownership in two categories: sensitive to pressure (those who are less inclined to challenge with management) and non-sensitive to pressure (those who have more incentives to monitor and control by management) and studied their relationship with firm performance. They concluded. They concluded that the level of institutional ownership insensitive (observer) is positively associated with firm performance and sensitive ownership has not relationship with firm performance.

Kaniele et al., 2008 investigated dynamic relation between individual investor net trading and short-horizon returns for a large section of dividends in New York Stock Exchange. Their findings show that individual investors are more capable of institutional investors in stock selection.

San, G. 2007 used from institutional investor data and volume of trading for all stocks on the New York Stock Exchange from 1986 to 2001 and test whether trading by institutional investors are more profitable than individual investors.. Individual investors receive higher profits by selling and that their business monthly is more profitable about 2% than institutional investors in price bubble of the late 1990’s. He also provided the opportunity to explain the poor performance of institutional investors.

Grinblatt et al., 2000 simultaneous analyzed investment behavior and performance of various types of investors and found that foreign investors, mostly institutional investors, seems to have
better performance than internal stakeholders. Even after controlling for differences in behavior, it has been shown that foreign investors tend to be active investors and internal investors tend to be dissatisfied.

Kang, et al., 1997 studied stock ownership in Japanese firms by non-Japanese investors from 1975 to 1991. They found that foreign investors, mainly institutional investors, have better performance than internal investors in Japan.

Fakhariand Taheri(2009) examined the relationship between institutional investors and volatility of stock returns of listed companies in Tehran Stock Exchange by using cross-sectional data from 121 participants in the 2008. Their findings indicate that the presence of institutional investors has increased monitoring the performance of managers and decreases information asymmetry and ultimately by increasing the percentage ownership of share holders, the stock return volatility decreases.

Noraveshand Ebrahimi Kordlor (2005) studied the relationship between institutional ownership and information asymmetry. The results indicated in firms with more institutional ownership in comparison to firms with less institutional ownership, stock price data encompasses more future profits. They linked this relationship to Professionalism of institutional investors who has the ability and comparative advantage in processing information. Therefore, the stock prices of firms with institutional ownership should reflect a greater part of future profits.

Hosseini(2007) examined the relationship between corporate governance and share holder returns. The results showed that while institutional ownership is high in listed firms on Tehran exchange stock. However, there was no significant relationship between institutional ownership and returns. However, based on results from studies in other countries, the relationship is positive or even negative.

Marfoo (2008) examine the effect of institutional investors and non-executive managers in board members on prediction of corporate earnings (accuracy, bias, timeliness and frequency of review). The results showed weak role of institutional ownership on be effective on prediction of corporate earnings. However, about institutional investors, they showed significant direct correlation between about firms that their percentage of institutional ownership is more than fifty percent. Also, the results indicate a lack of effective non-executive in board members and institutional investors in reducing forecast errors.

Hassas Yeganeh et al (2008) in a study examined the relationship between institutional investors and firm value. The results showed that there is a positive significant relationship between institutional investors and firm value that this confirms the effective oversight hypothesis. However, the results revealed no significant association between institutional ownership concentration and firm value. Therefore, the convergence interest hypothesis is not confirmed. In summary it can be said that institutional investors have incentives to improve performance. In addition, they have ability to punish manager that does not move toward their interests. Experimental evidence for this hypothesis is mainly defended.

Namaziand Kerman(2008) investigated the effect of ownership structure on the performance of companies listed on Tehran Stock Exchange. The results showed a significant and negative relationship between "institutional ownership" and firm performance and positive and significant relationship between "firm ownership" and firm performance.
Statistic Population
The population is listed companies in Tehran exchange stock during 2007 to 2011. Also the sample is determined using delete method and considering following criteria:
1. Necessary information is reliable, complete and available to obtain the variables.
2. Companies are accepted in Tehran Stock Exchange by the end of 2006.
3. Their fiscal year ended at 29 March and the fiscal year have not been changed.
4. Throughout all study period its shares were traded at least once in the four-month that the end of year to obtain the market value of each stock at the end of year.

According to above conditions 50 firms are selected to use in this study that its data is obtained using the site of Tehran Stock Exchange and Rahavard Novin software.

Research hypothesis
There is significant relationship between return on stock and the amount of institutional investor ownership.

The research model
\[ \text{Return} = B_0 + B_1 \text{Ins inv} + B_2 \text{Size} + B_3 \text{Growth} + B_4 \text{Lev} + B_5 \text{Dummy year} \]
\[ \text{Return} = B_0 + B_1 \text{Ind inv} + B_2 \text{Size} + B_3 \text{Growth} + B_4 \text{Lev} + B_5 \text{Dummy year} \]

The research variables
Dependent variables
Return: the sum of return and dividend ratio

Independent variables
Ins inv is equal to the amount of institutional investor ownership that the total shares held by banks and insurance, holding and investment companies, pension funds, finance companies and investment funds, organizations, institutions, companies, government divide by the total outstanding shares to calculate it that ratio or the amount of institutional ownership is obtained.
Ind inv is equal to the amount of non-institutional ownership that is calculated using following formulation:
Total of firm stock: stock owned by institutional owners

Control variables
Size: is equal to natural logarithm book value of total assets
Growth: sale value and percentage of its increasing (decreasing) are used for calculating of it.
Lev: financial leverage of firm that is calculated using firm debt divided by firm assets.
Year: for controlling the year that firm was active in it
Research finding

Descriptive statistic

<table>
<thead>
<tr>
<th>Variable</th>
<th>Elongation</th>
<th>Skewness</th>
<th>Var</th>
<th>S.D</th>
<th>Mean</th>
<th>Numerous</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on stock</td>
<td>26.233</td>
<td>-4.149</td>
<td>0.625</td>
<td>0.79027</td>
<td>0.04995</td>
<td>250</td>
</tr>
<tr>
<td>Institutional Ownership</td>
<td>60.144</td>
<td>7.318</td>
<td>0.732</td>
<td>0.8558262</td>
<td>0.5348</td>
<td>250</td>
</tr>
<tr>
<td>Non-institutional</td>
<td>10.235</td>
<td>6.125</td>
<td>0.2741</td>
<td>0.52364</td>
<td>0.15238</td>
<td>250</td>
</tr>
<tr>
<td>Ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Firm Size</td>
<td>1.269</td>
<td>0.700</td>
<td>2.306</td>
<td>1.5186</td>
<td>13.5938</td>
<td>250</td>
</tr>
<tr>
<td>Financial Leverage</td>
<td>1.124</td>
<td>0.2452</td>
<td>1.5240</td>
<td>1.23452</td>
<td>1.1242</td>
<td>250</td>
</tr>
<tr>
<td>Firm Growth</td>
<td>0.4521</td>
<td>0.2536</td>
<td>0.2944</td>
<td>0.54263</td>
<td>10.536</td>
<td>250</td>
</tr>
</tbody>
</table>

According to above table the mean of institutional ownership is equal to 0.5348 and S.D is equal to 0.855 and about non-institutional ownership is equal to 0.1523 and 0.5236. Also the mean of return on stock and firm size is equal to 0.49950 and 13.5938 respectively and their S.D is equal to 0.79027 and 1.5986. Review of descriptive statistics showed that selected sample has versatility and thus we can generalize sample results to the population.

Summarized Results of Hypothesis

<table>
<thead>
<tr>
<th>Variables</th>
<th>Level of significance</th>
<th>T</th>
<th>S.D</th>
<th>coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\beta_0$</td>
<td>0.001</td>
<td>-3.237</td>
<td>.613</td>
<td>-1.986</td>
</tr>
<tr>
<td>Institutional Ownership</td>
<td>0.0124</td>
<td>-1.459</td>
<td>0.070</td>
<td>-0.102</td>
</tr>
<tr>
<td>Firm size</td>
<td>0.0121</td>
<td>1.875</td>
<td>0.041</td>
<td>0.077</td>
</tr>
<tr>
<td>Financial Leverage</td>
<td>0.000</td>
<td>0.124</td>
<td>1.1142</td>
<td>0.0425</td>
</tr>
<tr>
<td>Firm Growth</td>
<td>0.000</td>
<td>0.452</td>
<td>1.5635</td>
<td>0.05241</td>
</tr>
<tr>
<td>Coefficient of Determination</td>
<td>0.195</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted Coefficient of Determination</td>
<td>0.181</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F</td>
<td>2.960</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson</td>
<td>1.90</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Model Significance</td>
<td>0.006</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The hypothesis examined in different industry. According above table we concluded the model is significant in level of 95%. In this test there is significant relationship between return on stock as dependent variable and institutional ownership. Also there is significant relationship between control variables such as size, financial leverage and firm growth.
### Variables and Coefficients

<table>
<thead>
<tr>
<th>Variables</th>
<th>Level of significance</th>
<th>T</th>
<th>S.D</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\beta_0$</td>
<td>0.001</td>
<td>0.5236</td>
<td>0.624</td>
<td>-2.547</td>
</tr>
<tr>
<td>Institutional Ownership</td>
<td>0.0124</td>
<td>0.2314</td>
<td>0.874</td>
<td>1.520</td>
</tr>
<tr>
<td>Firm size</td>
<td>0.0121</td>
<td>4.025</td>
<td>0.964</td>
<td>0.87</td>
</tr>
<tr>
<td>Financial leverage</td>
<td>0.000</td>
<td>1.6325</td>
<td>3.9524</td>
<td>0.972</td>
</tr>
<tr>
<td>Firm Growth</td>
<td>0.000</td>
<td>2.0142</td>
<td>0.9325</td>
<td>0.9325</td>
</tr>
</tbody>
</table>

**Coefficient of Determination**: 0.1512

**Adjusted Coefficient of Determination**: 0.1427

**F**: 1.935

**Durbin-Watson**: 2.254

**Model significance**: 0.000

The hypothesis examined in different industry. According above table we concluded the model is significant in level of 95%. In this test there is significant relationship between return on stock as dependent variable and institutional ownership. Also there is significant relationship between control variables such as size, financial leverage and firm growth.

### Limitations

1. Political, economic, cultural, and emotional environment of the Tehran Stock Exchange and the awareness of participants in the capital market affected on the supply and demand, trading volume and market boom or recession, and effect on the research variables and it is worthy pay attention to this important matter in future research.
2. Limitations on sampling in the total activities.
3. Limitations on research period
4. The effect of macroeconomic variables (such as inflation) on the stock returns were not considered. It is clear that such variables can have an impact on the findings.

### Recommendations

Since the sum of capital increase through the issue of shares and the debt is equal to the increase in the total assets and asset increase refer to firm size, so we can calculate firm size through other methods such as sale ratio. According to research results we should consider the amount of investor ownership in the stock selection. Also, for future research we can examine the effects of private and state ownership and ownership concentration on the return stock and it is recommended this research conduct using other methods such as combination data analysis.
References
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