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Institutional Ownership and Firm Value: A Literature Review

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Abstract
Various research results show four different views on the relationship between institutional ownership and firm value: linear positive, negative linear, no relation, and an inverted U shape. This article aims to understand each relationship and develop future research on institutional ownership and firm value. Research articles investigating the relationship between institutional ownership and firm value were used as the data in this study. Several works of literature were collected using the database provided by Google Scholar and Scopus. This article proposes future research to add a moderating or mediating variable, using measures other than Tobin's Q. A similar study can be carried out in developing countries because of the low level of investor protection.
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1. Introduction

Company managers are obliged to increase the value of the company. Firm value is often related to a firm's stock value. A higher stock value tends to increase the firm's value due to rising investor wealth (Purbawangsa *et al*. 2019). A firm's stock values reflect the market expectation of manager performance in governing the firm. A well-performed manager will increase the investor's appreciation of the firm's performance, leading to an increase in the stock value. Meanwhile, the poor performance of the manager will lead to a decrease in stock value. The change in stock valuation affects firm value. However, not all managers have the same interests. Recent companies' fraud and scandals in Indonesia, such as PT Asuransi Jiwasraya and PT Asabri showed that managers have an agenda that does not align with shareholders' concerns.

Aligning the motives of managers and shareholders has been extensively discussed in the agency theory (Jensen & Meckling 1976). The agency problem lies in the manager's self-serving behavior. Self-serving behavior motivates managers to take actions that are not in line with shareholder goals. Shareholders will view this behavior as behavior that will increase agency costs so that the first agency problem arises: how to align the interests of managers and shareholders. The second agency problem stems from the first agency problem. If the manager owns a share of the company's shares, the manager tends to have the same goals as other shareholders. However, when there is asymmetric information, the manager is more likely to act in his own best interests. Asymmetric information makes it difficult for shareholders to assess a manager's performance. The second agency problem arises, which is monitoring agent behaviors (Bendickson *et al*. 2016).

Agency theory states that to ensure management acts following the interests of shareholders, one method that can be used is using a concentrated ownership structure. A concentrated ownership structure is characterized by a large number of shareholders who can control a company. The structure consists of: (1) family ownership, (2) government ownership, (3) ownership of financial institutions, (4) company ownership, and (5) ownership by shareholders with control rights (La Porta *et al*. 1999). A concentrated ownership structure allows shareholders to manage management by selecting directors and commissioners who can supervise and ensure management works according to the owner's expectations.

Previous studies have found inconsistent findings regarding the relationship between institutional ownership and firm value. There are at least four patterns of relationships found in previous research regarding the relationship between institutional ownership and firm values. The first relationship is linear positive (Khouri 2005; Panda & Leepsa 2017; Kao *et al*. 2018; Rap & Trinchera 2017; Buchanan *et al*. 2018; Thanatawee 2014; Lin *et al*. 2017; and Rashid 2020), the second relationship is negative linear (Musalam *et al*. 2018), the third relationship is no relation (Jennings 2015), and the fourth relationship is a non-linear (Liew & Devi 2020; Navissi & Naiker 2006; Santos *et al*. 2013 and Daryaei & Fatahi 2020). These relation patterns are puzzling and spark debates regarding the relationship between ownership structure and firm value.

Based on the explanation mentioned earlier, this study investigated the relationship between institutional ownership structure and firm value by conducting an in-depth analysis of the literature that studies the relationship between institutional ownership structure and firm value. The study was conducted on previous research related to the operational variable definition, methodology, place, and year of research based on the classification of the findings. The research results are expected to provide an overview of future research developments.

The results show that several things can be developed to investigate the relationship between institutional ownership and firm value. The variety of findings indicates that there is still a research gap between re-examining the effect of institutional ownership on firm value by adding a moderating or mediating variable. The subsequent possible development is related to the measurement of company value. Of the several studies reviewed, almost all of them use Tobin's Q value to measure firm value. Tobin's Q compares the stock's market value divided by the book value of the company's fixed assets. Mussalam *et al* (2018) suggested using other measures so that the results could be compared. Similar research can be carried out in developing countries because of the low level of investor protection. The low level of investor protection requires more significant institutional investor activity to ensure that institutional investors will get better prosperity.

The rest of this paper is organized as follows: The first section is the introduction. The second section describes the theory underlying and the development of the topic. The third section contains the data collection methodology. The fourth section discusses each piece of literature, and the fifth section presents the conclusion and development for future research.

2. Agency Theory

Agency theory originating from economics has been used as a theoretical basis in various disciplines, including organizational behaviour, law, marketing, health, and accounting. The approach offered by agency theory is often used to explain conflicts between shareholders and managers. Agency theory also describes the governance mechanism as a mechanism to reduce agency costs.

Agency theory arose from an economic view of risk-sharing between two groups, shareholders and managers, where each group may have a different approach to solving the problem. The desire to share shareholder risk becomes important since the shareholders assign responsibility to managers to achieve predetermined goals. This collaboration is expected to produce results according to the interests of the shareholders.

The essence of agency problems lies in the manager's self-serving behaviour, which encourages managers to take actions that are not in accordance with shareholder goals. Shareholders will assess this behaviour as something that will increase agency costs so that the first agency problem arises, namely a shift in risk-sharing (Bendickson *et al*. 2016).

Providing compensation to managers can reduce the tendency of managers to take actions that are not in accordance with the interests of shareholders. Compensation is based on the manager's performance. The manager's performance is shown through the financial measures listed in the company's financial statements. Fama (1980) states that managers' success in achieving organizational goals in the labour market will guarantee their future earnings. Therefore, without giving compensation in the form of bonuses, managers will try to improve company performance. Managers will seek to demonstrate their performance through the company's financial measures and provide signals to the labour market regarding their performance to maintain their future earnings. Risk also affects manager performance. Managers who face high business risks (such as bankruptcy) will try to make good decisions to demonstrate their performance.

The misalignment of objectives between management and shareholders cannot be resolved through a contract because contract implementation requires a monitoring process that will create a second agency problem. The second agency problem arises from the first agency problem. If the manager owns a share of the company's shares, the tendency is that the manager will have the same goals as other shareholders, but when there is asymmetric information, the manager has a tendency to take actions that benefit himself.

The mechanism for monitoring agent behaviour can be carried out by separating ownership and control rights (Fama & Jensen 1983). Concentrated ownership can reduce agency costs, or the greater the concentrated ownership, the smaller the agency costs (Ang *et al*. 2000). The more widespread the ownership structure will cause free-rider problems. The free-rider problem will reduce the motivation of minority shareholders to monitor managers. Concentrated ownership can mitigate conflict of interest between shareholders and managers because concentrated ownership has the incentive to monitor managers. Concentrated ownership can cause new agency problems. It can use its control rights to gain profits at the expense of the interests of minority shareholders (Villalonga & Amit 2006). The implementation of good governance can reduce the expropriation of prosperity by the majority shareholder against the minority shareholder.

There are four different views on the relationship between institutional ownership and firm value. Lin *et al*. (2017) stated that there are three different views, namely the view of active monitoring, the view of passive monitoring, and exploitation. The fourth view emerges from the non-linear, an inverted u-shaped relationship found by Liew & Devi (2020), Navissi & Naiker (2006), and Daryaei & Fatahi (2020).

According to the active monitoring view, institutional investors actively monitor how the company managed, reducing information asymmetry. This behaviour will reduce agency problems, which in turn will increase firm value. Institutional investors use their managerial skills, knowledge, and voting rights to discipline managers, including critical corporate decisions. In addition, institutional investors can assist companies when they need funds through internal sources owned by institutional investors or through institutional investor relations with third parties who have funds.

The passive monitoring view considers institutional investors to be interested only in short-term speculative gains. Institutional investors only seek profit because they have more information. Institutional investors also consider only diversifying their stock portfolios. This behaviour causes no relationship between institutional ownership and firm value.

The exploitation view holds that institutional investors can cooperate with company managers to exploit minority shareholders. Institutional investors will ignore or not using their disciplining rights to company managers when company managers commit fraud, or manager behaviour also will benefit institutional investors. This institutional investor behaviour can reduce the value of the company.

The last view is non-linear. The non-linear approach combines both the active monitoring view and the exploitation view. This view states that when the number of shareholdings by institutional investors is low, institutional investors will actively monitor the company's manager, discipline managers and assist in making appropriate managerial decisions. As the institutional investor's ownerships share increases, the likelihood of exploitation by institutional investors of minority shareholders increases. Therefore, the non-linear relation will be forming between institutional ownership and firm value

3. Method

This study used research articles that investigated the relationship between institutional ownership and firm value. The literature was collected using the world wide web through websites that archive research results such as Google Scholar. The keywords used in this search were institutional ownership and firm value. When using google scholar, the selection of search years is limited to the last ten years. After the search results showed, the next step was analysing the article's publisher, whether the publisher is reputable or not. If it is published in a reputable journal, it will proceed to the next process. Unqualified articles were excluded.

The next step was scanning the abstract. The criterion is the suitability of the research variables (institutional ownership and company value) and the results (positive, negative, unrelated, or non-linear), resulting in nine articles used as the mains reference. From these nine articles, a backward search was conducted on the references used to gather more articles that investigate the relationship between institutional ownership and the firm value

After the articles were collected, the next step was coding the review articles using Microsoft Excel. The table prepared contained the research title, author, year, operational definition, research variables, and research results. Code was given to group the articles based on four predefined relationship criteria, namely positive, negative, no relationship, or non-linear

4. Results and Discussion

This section discussed the results from the previous studies. They are categorized based on the research findings and divided into four categories of the relationship between institutional ownership and firm value. The four categories include (1) active monitoring, (2) passive monitoring, (3) no effect, and (4) inverted U shape relation.

4.1 The Active Monitoring

The view of active monitoring is based on the agency theory, particularly the segregation of ownership and control rights. The presence of a concentrated shareholder can reduce agency problems and increase company value (Panda & Lepsa 2017). Shleifer & Vishny (1986) argued that the presence of a concentrated shareholder has an active monitoring function. The active monitoring function occurs because institutional shareholders will actively participate in the company through monitoring corporate governance to maximize their returns. Institutional shareholders have control rights; they can supervise managers at a lower cost. Several researchers who found a positive relationship between institutional ownership and firm value are Khouri (2005); Panda & Leepsa (2017); Kao *et al*. (2018); Rap & Trinchera (2017); Buchanan *et al*. (2018); Thanatawee (2014); Lin *et al*. (2017); and Rashid, (2020). The explanation for each study is as follows.

Khouri (2005) examined the role of block holders defined as institutional ownership that has no representation on the board of directors; institutional ownership with representatives on the board of directors; and ownership by the board of directors of company value. Firm value was measured using Tobin's Q. A significant positive relationship was found between institutional ownership of above 25 percent for the ones that have no representation on the board of directors, institutional ownership with representatives on the board of directors, ownership by the board of directors, and Tobin's Q. There is no significant relationship between institutional ownership of below 25 percent for institutional ownership that has no representation on the board of directors, institutional ownership with representatives on the board of directors, ownership by the board of directors, and Tobin's Q.

Panda & Leepsa (2017) investigated how the institutional ownership by pressure-resistant and pressure-sensitive institutions influences foreign institutional ownership and company performance. Pressure-sensitive institutions consist of banks, insurance companies, and non-bank trusts, while pressure-resistant ones consist of pension funds, mutual funds, and endowment funds. Company performance is measured using three measures, namely Return on Assets (ROA), Net Profit Margin (NPM), and Return on Equity (ROE). Institutional ownership was measured using the percentage of shares by pressure-resistant institutions (pension funds, mutual funds, and endowment funds), pressure-sensitive institutions (banks, insurance companies, and non-bank trusts), and foreign ownership percentage institutions. It is found that institutional ownership by institutions that are immune to pressure and foreign institutions significantly affects company performance. Institutional ownership by pressure-sensitive institutions harms the company's performance.

Kao *et al*. (2018) examined the relationship between ownership structure and board characteristics on firm value. The ownership structure is defined according to block holder ownership, institutional ownership, foreign ownership, and family ownership. Block holder ownership was measured based on the percentage of shares owned by the ten largest external shareholders or shareholders with five percent of the company's total outstanding shares. Meanwhile, institutional ownership was measured using the percentage of ownership by institutions, including ownership by financial institutions, both local and foreign. The percentage of shares owned by foreign individuals or institutions were used to measure foreign ownership. Family ownership is calculated using the percentage of shares by the family. On the other hand, ROA, ROE, Tobin's Q, and market to book value of equity were used to measure firm value. The results show that block holder ownership, institutional ownership, foreign ownership, and family ownership are positively related to firm value.

Rap & Trinchera (2017) studied the relationship between shareholder protection of institutional ownership and firm value. This research was conducted through four stages. The first stage examined the relationship between investor protection and ownership concentration. The results found a significant negative relationship. In other words, the higher the investor protection, the lower the concentration of ownership. The second step is to separate the types of shareholders, namely strategic investors and institutional investors. Strategic investors make investments for strategic reasons, while institutional investors buy and sell shares based on financial considerations. The results show that the higher the investor protection, the lower the strategic ownership type. The higher the investor protection, the higher the institutional investor ownership type. The third stage was carried out by separating institutional ownership into independent institutions and grey institutions. The results show a positive relationship between investor protection and independent institutional ownership, and ownership of grey institutions is higher in countries with low investor protection. The fourth step was analysing the relationship between the ownership of different shareholder groups on company value. The results show that strategic ownership has a negative effect on firm value, while independent institutional ownership positively affects firm value. This effect is evident in countries with low investor protection.

Research conducted by Buchanan *et al*. (2018) investigated the effect of institutional ownership on the relationship between Corporate Social Responsibility and firm value using the background of the 2008 global crisis. Firm value was measured using Tobin's Q. Institutional ownership was measured using three measures, and block holder ownership was measured using the percentage of shares owned by investors, which is greater than 5 percent. The top five institutional ownership refers to the average percentage of company shares owned by the five largest institutional investors. Long-term institutional ownership is measured by the percentage of shares held by long-term institutional investors. The test results on the effect of institutional ownership on the relationship between CSR and firm value found that the relationship between CSR and firm value was positive in companies with low institutional ownership before the crisis. However, this effect was found to be significantly lower in firms with high institutional ownership. The test results after the crisis shows the opposite. Companies with large institutional ownership have a positive impact on the relationship between CSR and firm value. It was concluded that institutional ownership could be a value-enhancing mechanism, especially during times of economic recession.

Thanatawee (2014) examined the relationship between institutional ownership and firm value in Thailand using 323 non-financial companies listed on the Stock Exchange of Thailand (SET) from 2007 to 2011. Firm value was measured using Tobin's Q. Institutional ownership was calculated based on the majority shareholder's share ownership. There were three measures used, namely institutional ownership, which was measured from institutional ownership including banks, insurance, finance companies, funds, and unit trusts; domestic institutional ownership, which was measured based on local institutional ownership; and foreign institutional ownership, which was calculated using the percentage of share ownership by foreign institutions. Control rights were measured using a dummy variable, 1 if institutional shareholders have control rights, 0 otherwise. Control rights were defined as shareholders who own at least 25 percent of the company's shares. The results showed that companies with large institutional ownership showed better company value. The existence of institutional investors, especially domestic investors, has an important influence on firm value. Other results show that institutional investors tend to invest in large companies with high retained earnings.

Lin *et al*. (2017) studied the effect of institutional ownership on firm value, using big data obtained from Chinese companies registered from 2004 to 2014. Company performance was measured using Tobin's Q and ROA. Institutional ownership is the proportion of shares owned by institutional investors. Meanwhile, the test results found that institutional ownership has a positive effect on company performance. Another finding is that not all institutional investors apply active monitoring and increase firm value. Foreign institutional ownership that is immune to government pressure and large institutional shareholders has a more significant positive effect on company performance than small domestic shareholders who are not resistant to pressure.

Research conducted by Rashid (2020) examined the mediating effect of company board characteristics on the relationship of ownership structure to company performance in companies listed on the Bangladesh stock exchange. The independent variable in this study is ownership structure which was measured using three measures: sponsorship and director ownership which defined the percentage of shares owned by sponsors and directors; institutional ownership measured using the percentage of shares owned by the institution; and foreign ownership determined by the percentage of ownership of shares by foreign institutions. The dependent variable is accounting performance measured using ROA and ROE, while market performance uses Tobin's Q and market to book ratio. The results showed a positive and significant direct effect of foreign institutional ownership on accounting performance and corporate market performance. The impact of institutional ownership is only significantly positively related to ROA, and ownership of sponsors and directors is only considerably related positively to ROA, Tobin's Q, and market to book.

4.2. Passive Monitoring

Passive institutional ownership might engage in simple and costless governance activities such as taking vote, but might not engage in complex governance activities that requires continuous monitoring such as corporation merger and acquisition (Schmidt and Fahlenbrach, 2016). The view of passive monitoring is based on the premise that institutional owners do not actively participate in decision making, are not interested in improving performance and corporate governance mechanisms, and are more concerned with short-term returns on capital gains. This view suspects that there is no relationship between ownership structure and firm value (Lin *et al*. 2017; Panda & Leepsa 2017; David & Kochhar 1996)

Jennings (2005) stated that institutional ownership has no relationship with manager performance improvement. Jennings explained that the results of his research did not get evidence that the institution was monitoring management which would improve the quality and valuation of the company. Institutions conduct monitoring depending on the incentives they get from the monitoring process. There are several reasons put forward why institutional investors do not monitor. First, the institution is defined as a myopic owner who will not hesitate to sell their share if the company's short-term performance is terrible. Second, political costs, as a result, arise from parties who reject the concentration of financial power that the institution must bear. Third, the emergence of other agency problems such as free riders. All stakeholders enjoy the benefits derived from the institutional activity, but the institution bears the cost. Fourth, conglomerates behind the institution may have different incentives, which will hinder the institution's activity in carrying out its monitoring function. Finally, the institution may not have the skills necessary to carry out the monitoring process.

4.3. Exploitation View of Institutional Ownership

Institutional investors can exploit minority shareholders. Institutional investors can cooperate with managers or at least ignore manager behaviour and exploit minority shareholders (Lin *et al*. 2017). The exploitation behaviour of institutional investors will reduce the value of the company.

Research conducted by Mussalam *et al*. (2018) investigated the effect of family and institutional ownership on company performance in Indonesia. This study uses 139 non-financial companies listed on the Indonesia Stock Exchange from 2009 to 2013. This study uses the independent variables of family ownership and institutional ownership. Family and institutional ownership are measured using the percentage of share ownership by families and institutions in the company in a specific year. Company performance was measured using Tobin's Q. The results found that family ownership was significantly positively related to company performance, institutional ownership had a negative effect on company performance. Hidayat et al. (2020) found that institutional ownership has a negatively significant effect on firm value. The institutional ownership did not perform their monitoring duties and thus did not increase the company value

4.4. Monitoring and Exploiting View of Institutional Ownership

According to the monitoring and exploitation viewpoint, when institutional investors' share ownership is low, institutional investors will apply active monitoring of manager performance, discipline managers, and corporate decision-making. When institutional ownership is low, the firm value will increase. As institutional investors increase ownership of the company, it will increase the control rights held by institutional investors. The increasing control rights of institutional investors lead to exploitation by institutional investors of other shareholders.

Navissi & Naiker (2006) investigated the linear relationship between the firm value of 134 companies listed in New Zealand. Institutional ownership is proxied as insider ownership, institutional ownership with representatives on the board, and institutional ownership without representation on the board. Firm value is measured using market value to book value of equity. The test results show that small amounts of share ownership by institutions with representatives on the board positively affect firm value. However, this effect becomes negative as the institutional ownership increases.

Research conducted by Liew *et al*. (2020) investigated whether companies in Malaysia, whether family-owned or not, exploit loans and their effect on firm value. This study used independent variables, namely the banks that have a relationship with the company. The dependent variable is the firm value measured using Tobin's Q and market value to book equity, ROE, and ROA. Moderating variables, namely ownership concentration measured using low ownership and high ownership, were used in this study. The results found a negative relationship between the number of banks involved with the company and firm value. There was no difference in the relationship between the number of banks involved in family firms or not on firm value. It was found that there was a positive moderating effect of concentrated ownership on this relationship in companies with a low number of family ownership. The positive moderating effect turns negative as the number of family ownership increases.

Santos *et al*. (2013) investigated whether the presence of the largest shareholder, identity, and the right to cash flow influence corporate governance, whether certain types of investors (family or institutional) impact firm value. This study also looked at the moderating effect of the legal setting and institutional ownership of concentrated ownership. This study measured firm value using Tobin's Q. The results show that countries with low legal protection systems for investors tend to have an inverted u-shaped relationship pattern. In countries that have good investor protection systems, an almost linear positive relationship was found. The effect of a block holder depends on the identity of the block holder. Family ownership can overcome agency problems and increase the value of the company. Institutional ownership has a negative effect on firm value. The cut-off of family ownership that can overcome agency problems is in the range of 30-50 percent. Below or above this number, family ownership is unable to increase the value of the company.

Daryaei & Fattahi (2020) examined the relationship between ownership structure and company performance in Iran. This study shows that there is a non-linear relationship between ownership structure and company performance. At institutional ownership levels below 28.5 percent for ROA, and 43.5 percent for Tobin's Q, company performance improved as institutional ownership increased. At the level of institutional ownership above 28.5 percent for ROA, and 43.5 percent for Tobin's Q, company performance decreased as institutional ownership increased. Institutional ownership of between 4.2 percent and 14.1 percent has a positive relationship to ROE. This study used institutional ownership as an independent variable measured from the level of institutional ownership. The dependent variable was company performance measured using ROA, ROE, and Tobin's Q.

5. Conclusion

Institutional ownership can be used to limit or reduce managerial ownership in the company. Restrictions on managerial ownership may reduce management control over the company so that concentrated ownership is considered to have monitoring capabilities and a disciplinary mechanism for managers. Monitoring and disciplinary mechanisms will work if institutional investors are willing to implement an active monitoring mechanism. An increase in the shares owned by institutional investors will increase the control rights that institutional investors have. The greater the control rights held by institutional investors, the possibility that institutional investors who were active in monitoring will turn into exploitation of minority shareholders, which will reduce the value of the company.

Institutional investors may have different incentives. Not all institutional investors are attracted to dividends. Some may prefer capital gains. Institutional investors who have a capital gain motive will not monitor or try to discipline managers because supervising managers will cause institutional investors to incur additional costs, reducing the profits obtained. Institutional investors who have a capital gain motive will prefer to sell their ownership when the manager's performance is lacking rather than paying additional costs to monitor or discipline managers. The free-rider problem also reduces the institution's intention to supervise and monitor manager performance.

To increase the activism of institutional investor, one methods that can be use is by increasing the number of stock hold by institutional investor in other word increase the institutional ownership (Dogan 2020). Institutional investor with small ownership might not engage in the monitoring process, since it would cost them. Institutional investor with small ownership might sell their stock if they dissagree with company performance, while institutional investor with large ownership, the incentive to monitor the behaviour of management will benefit them since exit strategy will cost them more. The size of institutional ownership might solving the agency problem's of monitoring the behaviour of manager.

Increasing the number of ownership will gives investor more control of the company. Increased controling right will lead to another conflict, wich is between the majority and minority share holder, thus creating agency problem type three. The majority share holder can exploited the wealth of the minority share holder by controlling the manager decission to benefit the majority share holder interest, for example vote not to distribute dividend and uses the excess cash in investment that benefit the institutional investor. To address this problem, regulator needed to intervere by imposing and uphold strict regulation to make sure the institutional investor action did not exploit the minority investor, Based on signaling theory (Spence, 1973), there are slightly different perspectives on how ownership concentration affects firm value. Depending on how the information is interpreted, ownership concentration may have either a positive or negative effect on a firm's value. A positive effect occurs when investors believe that institutional ownership will improve the monitoring process, which will signal good news and will increase the firm's value. A negative effect occurs when investors believe that institutional ownership will expropriate their wealth because of the controlling rights possessed by the institutional owner, which will signal bad news and further decrease firm value. There is a third possibility that institutional ownership might not affect a firm's value because investors only consider capital gains, which are short-term goal.

From the explanation of the literature review, several things can be developed for research that investigates the relationship between institutional ownership and firm value. The variety of findings shows that there is still a research gap between re-examining the effect of institutional ownership on firm value by adding a moderating or mediating variable. The next possible development is related to the measurement of company value. Of the several studies reviewed, almost all of them use Tobin's Q value to measure firm value. Tobin's Q shows the comparison between the stock's market value divided by the book value of the company's fixed assets. Mussalam et al. (2018) suggested the use of other measures so that the results can be compared. Similar research can be carried out in developing countries because of the low level of investor protection. The low level of investor protection might make minority investor not to invest in company with large institutional ownership thus decrease the value of the company it self.

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