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Firm Performance, Institutional Ownership and Capital Structure: A Case of Malaysia

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Abstract

The paper aims to examine the significant relationship amongst institutional stockholdings and firms' performance as measured by ROA, ROE, PE, EPS and capital structure as measured by long term debt to capital ratio of companies listed on the Main Board of Bursa Malaysia. The results show that there is a significant relationship between the institutional stockholdings on the firms' performance measured by EPS and PE ratio of firms listed on the Main Board of BURSA. Moreover, it is revealed that there is no significant relationship between the institutional stockholdings on firms' capital structure.

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Keywords: Firm Performance; Institutional Ownership; Capital Structure; Financial Ratios, Malaysia.

1. Introduction:

Generally, all Malaysian firms strive to get listed in Bursa Malaysia Securities Berhad. The main intention behind this is to increase the number of projects that leads to raising funds. The other main reason for firms to be included in Bursa Malaysia is to enhance their liquidity by implementing strategic project. After get listed, the firms issue their shares through initial public offering (IPO) so that institutional or individual can buy the shares and that is the common source of raising the funds for firms. In view of this, the institution and individual that bought the shares not only for

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the investment or to raise fund of the issuing firm, but also referring to the true ownership of the firm. The buyer of the share have the ownership title in the firm that issued the shares. This type of ownership is known as outside ownership as well as institutional ownership. Aghion & Tirole, (1997).

Moreover, capital structure and ownership control plays an important role in influencing the firm's performance and for its growth. Shareholders are the real stakeholder's in the organization because of their holdings and that influence on major strategic decisions. Studies indicate that, the size of stockholdings of corporate executives, promoters, board of directors and other Top stakeholders influence to the firm's performance and capital structure. Thus, stockholding is an important indicator of firm's performance and firm's executive directors need to manage the capital structure strategically for stable growth and minimize all the negative consequences. This study mainly examines one type of ownership structure which is institutional ownership to know whether the size of institutional ownership measure by percent of stock held across firms can explain the firm's performance and capital structure or not. This is because of institutional ownership refers to the ownership stake in the firms that is held by large financial organizations, pension funds or endowments. Institutions generally purchase large blocks of a firm's outstanding shares and can exert considerable influence upon its management. Bennedsen & Wolfenzon, (2000);

The study used Institutional ownership of thirty Malaysian firms listed in the Main Board of BURSA over the periods of 2001 to 2005, this study also provides the answers of the research questions raised in this following section. Does ownership matter? If it does, then, whether institutional stockholdings are effective in improving firm performance? Do institutional stockholdings have an effect on firm's capital structure? Can institutional ownership be a tool to firm's performance and capital structure? These are some of the important questions, which researchers are trying to explore. In this context, the researcher investigate Malaysian firms from various industries in order to provide new evidence on how institutional ownership influence firm's performance and capital structure. This research is important to assist the managers to strengthen firm's performance and capital structure. The firm's managers enable them to identify the weaknesses of their firm's performance and capital structure. Additionally, this study also will give utmost benefits to all shareholders of the firm and know which firm will give higher return for strategic investment decisions. The result of this study will also be helpful for firm's management to upgrade their service facilities in order to improve the firm's relationship with outside institutional owners. (Huang, 1996)

The general purpose of the research is to look at the institutional ownership, capital structure and firm's performance of Malaysian firms. In defining the limitation of this study, the authors have identified the study areas to be addressed. To examine the relationship between institutional ownership and a firm's capital structure. To observe the relationship between institutional ownership and firm's performance.

The scope of study for this research only concentrated on firms that have institutional ownership. The thirty firms from various industry and covered the entire Malaysia will be the sample for this study. Besides, it focused on each firm's performance and capital structure by analyzing its five years financial ratios disclosed in the annual report.

This study tries to recognize whether the changes in percent of stock held by institutional stockholdings do affect or influenced the firm's performance and capital structure based on past literatures. Thus, this research contributes to the current literature by examining this said relationship to the developing market such as Malaysia. In addition to that, the findings of this study explains the trend institutional ownership of the Malaysian firms listed on the Main Board of BURSA on its performance and capital structure. This study, however, focuses on Malaysian firms belongs to various industries without specifying into industry on the effect of institutional stockholdings in firm's performance and capital structure. The quantitative approach is used in this study and descriptive statistics and multiple analysis of variance (MANOVA) test was employed. This particular model is used because it concerns on describing and evaluating the relationship between the dependent and independent variables. This study will look whether the independent variables will influence the firm's performance and capital structures of firms listed on the Main Board of BURSA or not.

2. Institutional Ownership & Capital Structure

Institutional ownership and capital structure researched extensively in different context. Chen, Guo, and Mande (2003) document that managerial shareholding has a linear significant impact on Japanese firm performance, even after controlling for firm fixed effects. However, they find that the fixed effect is significant. They found that institutional shareholders including the government (institutional) and in some cases directors are the group of owners,

which influence firm performance significantly after controlling for firm specific fixed effects and some observed firm-specific factors that may also influence firm's economic performance.

According to Douma, George, and Kabir (2003), the firms with higher level of debt, cost of capital would be higher. In such scenario firm will have to perform better than it would have been otherwise. Both the institutional investors' and directors' holding have significant impact on firm performance even after controlling for unobserved firm heterogeneity. The impact is also non-linear in nature (the square of director (*director*2) and that of institutional investors (*institutional*2) is significant. The estimated threshold point occurs at around 15% for the institutional investors while for directors' it occurs at 24%. This implies that ROA declines as institutional's (director's) share increases by 1% starting from 0 to 15% (24%) and then increases. The significant negative coefficient of debt intensity is consistent with the argument that the financial risk reduces firm value. Chen et al. (2003) for Japanese firms and Qi et al. (2000) for Chinese firms, also find similar results. The negative coefficients may also elect the fact that the firms with higher debt intensity had heavier interest burdens and their profitability was eroded by the higher interest payments.

McConnell and Servaes (1995) argued that firm value and capital structure could be closely correlated. This is further clarified in Berger and di Patti (2003). On the one hand, high leverage may reduce the agency costs of outside equity, and increase firm value by encouraging managers to act more in the interests of shareholders. Furthermore, they also suggest that more efficient firms may also choose higher equity capital ratios, all else equal, to protect the rents or franchise value associated with high efficiency from the possibility of liquidation. If leverage is relatively high, further increases may generate significant costs including bankruptcy cost and thus may lower firm value.

Morck *et al* (1988) examined that theoretical and empirical findings on the effect of institutional ownership on firm's performance vary. Stulz (1988) formalized a concave relationship between institutional ownership and firm valuation: an increase in institutional ownership and control will first increase firm value; but at a higher level of institutional ownership, firm value will decrease because of entrenchment effects. Jensen and Meckling (1976) argue that firm performance increases with increase in institutional ownership. Shleifer *et al* (1988) have found a curvilinear relationship between institutional ownership and firm's performance. In his study, performance first increases, then declines and finally rises slightly as institutional ownership increases.

Barnea, Haugen, and Senbet (1985) suggest that some, but not all of the prior studies did not take ownership structure into account. Under virtually, any theory of agency costs, ownership structure is important, since it is the separation of ownership and control that creates agency costs. For example, the greater insider shares may reduce agency costs, although the effect may be reversed at very high levels of insider holdings. As well, outside block ownership or institutional holdings tend to mitigate agency costs by creating a relatively efficient monitor of the managers. They also suggest that exclusion of the ownership variables may bias the test results because the ownership variables maybe correlated with the dependent variable in the agency cost equation (performance) and with the key exogenous variable (leverage) through the reverse causality hypotheses noted above.

H^0: Significant relationship does not exist between institutional ownership and a firm's capital structure.
H^1: Significant relationship does exist between institutional ownership and a firm's capital structure. It can be statistically presented as: **$H^1: \rho \neq 0$**
H^0: There is no significant relationship between institutional ownership and a firm's performance.
H^1: There is significant relationship between institutional ownership and a firm's performance. It can be statistically articulated as: **$H^1: \rho \neq 0$**

3. Method

The research method involves a series of rational decision-making choices with regard to issues relating to the purpose of the study, its location, the type it should conform to, the extent to which it is manipulated and controlled by the researcher, its historical aspects and the level at which the data will be analysed. This study engages in hypothesis testing as it tries to explain the nature of certain relationships among the said variables. It is a correlational study that attempts to identify the crucial factors associated with the problem and is conducted in non-contrived settings with minimal interference from the researcher with the natural work settings. There are six main variables

used in this research. The variables used are percent of stock held by institutional shareholders, percent of return on assets (ROA), percent of return on equity (ROE), earning per share (EPS), price earning (PE) ratio and long term debt as a percent of the firm's total capital and using yearly data starting from 2001 to 2005.

4. Analysis

4.1 Preliminary Analysis

Table 1.

	SH	ROA	ROE	EPS	PE	LTDC
Mean	9.3339	5.380	8.69	0.1472	14.4113	19.1743
Median	5.0800	4.3300	8.33	0.1000	10.8000	15.5600
Maximum	37.8200	28.3300	97.9400	1.6200	406.1200	70.2000
Minimum	0.0500	-15.3800	-140.4500	-0.6600	-108.9300	0.1000
Std. Dev.	9.9524	6.6587	20.4111	0.2913	39.0191	16.2234
Skewness	1.0548	0.3237	-1.8152	1.1849	6.6551	0.7763
Kurtosis	0.151	1.308	20.7279	5.5103	69.8080	-0.0573
Jarque-Bera	27.9404	11.9022	2583.413	209.9112	29002.90	15.1218
Probability	0.0000	0.0026	0.0000	0.0000	0.0000	0.0005
Observations	150	150	150	150	150	150
Cross sections	30	30	30	30	30	30

Table 1 reveals that the mean and median of institutional stockholdings level for the whole sample is 9.33 and 5.08 percent respectively. Institutional shareholder has an average value of 9.33 percent with a very high standard deviation of 9.96 percent. This mean level of holding is much lower than those of in Japanese firms which is 43.3 percent with a very small standard deviation of 1.42 as reported in Chen et al. (2003). Return on assets (ROA) with mean 5.380 percent varies between –15.38 to 28.33 percent with the median level at 4.33 percent and a standard deviation of 6.66. The mean and median on return on equity (ROE) is 8.69 and 8.33 percent respectively, with the maximum of 97.94 percent and a minimum of -140.45 and also with a standard deviation of 20.41. Furthermore, for earning per share (EPS), its mean which is RM0.15 vary between –RM0.66 to RM1.62 with the median level at RM0.10 and has a standard deviation of 0.29. Moreover, for the price earning (PE) ratio, it shows that the mean and median of 14.41 and 10.80 respectively that have the maximum of 406.12 and the minimum of –108.93 and also a standard deviation of 39.02. In addition, for the last variable this is long term debt as a percent of total capital has a mean and median of 19.17 and 15.56 percent respectively that vary between 0.10 percent to 70.20 percent with a standard deviation at a level of 16.22.

Moreover, as shown in the **Table 1,** all variables are significant, shows that the probability is lower than 0.05 ($p<0.05$). Furthermore, the average or mean result obtained for percent of stock held by institutional shareholders is 9.2536 when $p=.05$, it shows that 95% probability of the percent of stock held by institutional shareholders mean is in the range of 0.05 to 37.82. Skewness and Kurtosis refer to the shape of distribution, and are used with interval and ratio level data. Values for skewness and kurtosis are zero if the observed distribution is exactly normal. Positive values for skewness indicate a positive skew, while negative value for skewness indicate a negative skew, while

negative values for kurtosis indicate a distribution that is flatter. Under the Skewness, it shows that the percent of stock held by institutional shareholders (SH), return on asset (ROA), earning per share (EPS), price earnings ratio (PE), and long term debt to capital (LTDC) have a positive distribution which is 1.065, 0.327, 1.197, 6.723 and 0.784 respectively. However, the sudden move of the return on equity (ROE) has a negative direction of skewness of -1.834. The greater the number of skewness, the wider the sudden move of mean or distribution. Moreover, for kurtosis, all variables show the positive distributions that refer to the peaked distribution (leptokurtic) except for the long term debt to capital ratio (LTDC) that is negative value or known as flatter distribution.

4.2 Decision Analysis

Table 2. Tests of Between-Subjects Effects

Source	Dependent Variable	Type III Sum of Squares	df	Mean Square	F	Sig.
Corrected Model	ROA	5817.931[a]	125	46.543	1.412	.164
	ROE	54200.084[b]	125	433.601	1.315	.221
	EPS	11.859[c]	125	.095	2.903	.002
	PE	216540.603[d]	125	1732.325	4.032	.000
	LTDC	35783.123[e]	125	286.265	2.001	.025
Intercept	ROA	4339.873	1	4339.873	131.677	.000
	ROE	9295.146	1	9295.146	28.194	.000
	EPS	3.453	1	3.453	105.662	.000
	PE	29270.521	1	29270.521	68.132	.000
	LTDC	49026.600	1	49026.600	342.694	.000
SH	ROA	5817.931	125	46.543	1.412	.164
	ROE	54200.084	125	433.601	1.315	.221
	EPS	11.859	125	.095	2.903	.002
	PE	216540.603	125	1732.325	4.032	.000
	LTDC	35783.123	125	286.265	2.001	.025
Error	ROA	791.000	24	32.958		
	ROE	7912.315	24	329.680		
	EPS	.784	24	.033		
	PE	10310.750	24	429.615		
	LTDC	3433.493	24	143.062		
Total	ROA	10950.505	150			
	ROE	73429.735	150			
	EPS	15.894	150			
	PE	258004.045	150			
	LTDC	94364.491	150			
Corrected Total	ROA	6608.931	149			
	ROE	62112.399	149			
	EPS	12.644	149			
	PE	226851.353	149			
	LTDC	39216.615	149			

a. R Squared = .880 (Adjusted R Squared = .257)

b. R Squared = .873 (Adjusted R Squared = .209)

c. R Squared = .938 (Adjusted R Squared = .615)

d. R Squared = .955 (Adjusted R Squared = .718)
e. R Squared = .912 (Adjusted R Squared = .456)

The F test appears in **Table 2** of MANOVA to answer the research question, "Is the model significant for each dependent?" F test is used to tests the null hypothesis that, there is no difference in the means of each dependent variable for the different groups formed by categories of the independent variables. Having obtained a significant multivariate effect for institutional shareholders that is, a significant of $F<0.05$, it indicates which individual dependent variables contribute to significant multivariate effect. In this study the adjusted alpha which is the critical value of F is equal to 0.01 (0.05/5). Using this alpha level, a significant univariate main effect is earning per share (EPS) and price earning (PE) ratio with $p<0.01$.

Hence, the institutional shareholder to influence on the firm performance is significantly influenced by earning per share (EPS), $F=2.903$, $p<0.01$ and price earning (PE) ratio, $F=4.032$, $p<0.01$. However, the institutional shareholder to influence on the firm performance is not significantly influenced by two dependent variables that measure firm's performance which are return on asset (ROA) and return on equity (ROE) because $p>0.01$. Furthermore, there is no significant main effects were found for the institutional shareholder to influence on firm's capital structure. This is because the researcher only study on the general view of the firm in Malaysia without specified into industry.

The aim of this research is to examine, whether there is a significant relationship between independent variable and dependent variables. Thus, it is concurrent with statistical test which is the multiple analysis of variance (MANOVA) that measure the relationship between independent variable and dependent variables. Furthermore, inspection of table 2 shows that the results obtained for ROA and ROE and long term debt to capital ratio is not significant because it influenced by the reliability of the data because different industry had different style of their performance and capital structure that may affect the data analysis. Thus, the EPS and PE which measure the firm performance has a significant effect towards the stock held by institutional shareholders, so it reject the null hypothesis. While for a percent of long-term debt to capital which measure the firm capital structure has no significant effect towards the stock held by institutional shareholders, so this study accept null hypothesis.

5. Conclusion

This study is conducted to know the effect of institutional ownership on firm's performance and capital structure of thirty listed companies on the Main Board of BURSA Malaysia for the period of 2001 to 2005.

There are several objectives that this study attempt to achieve. This includes, examining the relationship between institutional ownership with firm's capital structure and firm's performance measure by long term debt to capital ratio and returning on asset (ROA), return on equity (ROE), price earning (PE) ratio and earning per share (EPS) respectively from 2001 to 2005. Descriptive Statistics, it shows all variables are significant the probability is lower than 0.05 ($p<0.05$). Thus, it shows that there is strong relationship between the firm's performance and capital structure with institutional ownership.

MANOVA test it shows the institutional ownership to influence on the firm performance is significantly influenced by firm's performance measured by earning per share (EPS) and price earning (PE) ratio. However, the institutional ownership to influence on the firm performance is not significantly influenced firm's performance measure by return on asset (ROA) and return on equity (ROE). Furthermore, there is no significant main affects were found for the institutional ownership to influence on firm's capital structure measure by long term debt to capital ratio. This result contrast with the result in descriptive statistics and thus the researcher can say that Malaysian firms would prefer to finance a firm's needs from internally generated funds rather than external creditors. Thus, it is suggested for future studies to use the Pairwise Analysis and to compare within industry, since, this study have more than one dependent variables and author also can further look on which pair of dependent variable has significant correlation with independent variable.

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