Institutional Investments in India: A Review of the Literature

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This paper reviews the relevant literature on institutional investment and firm performance in India. It discusses the development of institutional investments in general under different segments like ownership and firm performance, role of large shareholders, and institutions as large shareholders in influencing corporate governance, reducing agency costs and affecting firm performance. It then discusses the monitoring role of institutional investors and the cost and benefits of monitoring. It also describes institutional investment in India and segments it into different groups of institutions and summarizes the extant studies in each category, i.e., mutual funds, banks and financial institutions, and foreign financial institutions. The paper shows that studies have reported divergent results in the context of developed economies. Although the history of institutional investment in India is short and the number of research in the Indian context is limited, they report evidence of monitoring. While the influence of mutual funds and banks is not clear, recent studies have argued that foreign institutional investors' shareholding has a positive influence on firm performance.

Introduction

Researchers have recorded that large shareholders have an advantage or incentive to influence firm's managers and their decisions. Large shareholders can be broadly classified as insiders and outsiders. As outsiders, when financial institutions control larger shareholding, they tend to monitor corporate management's policies and actions, thereby addressing the agency problems. This enhances corporate governance and influences firm performance.

Institutional monitoring activities affect different aspects of a firm such as the size of a corporate board, executive compensation, accounting policies and disclosures and investment decisions. Research studies, also, have discussed the impact of different categories of institutional investors. As there is resource heterogeneity among these institutions, their effects on firm's performance are divergent (Douma *et al*., 2006). Similarly their capacity to address agency problem and influence governance are also diverse.

In India, institutional investment activities have a short history. Before the economic reforms, only a few institutions were operating in the Indian market which were mostly government-

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owned. However, post economic reforms in 1991, the environment for institutional investors expanded. Government policies promoted private participation and foreign investments in Indian financial markets, and there has been a significant growth in institutional investment since then.

The present paper reviews the extant studies in the Indian context. It summarizes and discusses the role of institutional investment as a whole and then the sub-segments as per the role of different categories of institutions, viz., Mutual Funds (MFs), banks and financial institutions and Foreign Institutional Investors (FIIs), and their influence on firm performance.

Discussion

Ownership and Firm Performance

The debate on ownership structure and its impact on firm performance can be traced to the landmark study by Berle and Means (1932). They raised a question—'Who controls the modern corporation?'—and discussed the problems that occur in widely held corporations in which ownership is dispersed among small investor-shareholders, while the control is in the hands of the managers.

Several studies followed Berle and Means and looked at the role of managers in meeting the objectives of the shareholders (Jensen and Meckling, 1976; Fama and Jensen, 1983; Grossman and Hart, 1986; and Jensen 1993). They discussed that the potential conflict of interest and the agency problem among various stakeholders emerge from two important sources: (1) Different stakeholders have different goals and preferences to achieve, hence there is a conflict of goals; and (2) Stakeholders have inadequate information on each other's actions, hence a conflict arises among them as to 'who is responsible for the success or failure of a firm'. Roe (1990) argued that the diffused ownership structure does not provide any incentive to any one owner to engage in monitoring of managers' actions. If one shareholder takes up the monitoring activity, the cost is borne by that specific investor, while the benefits are enjoyed by all. This leads to a free-rider problem (Shleifer and Vishny, 1986).

Large Shareholders and Firm Performance

A large set of studies have discussed that agency problems can be addressed with the involvement of large shareholders. These shareholders can engage in monitoring activity, and hence can affect or have the potential to enhance firm performance (Shleifer and Vishny, 1986; Admati, *el al*., 1994; Maug, 1998; and Noe, 2002). These researchers have also argued that although the monitoring benefits occur to all shareholders, only the large shareholders have an incentive as they enjoy scale economies of monitoring cost and its benefits.

Bethel *et al.* (1998) provided empirical support on the large stakeholders' monitoring role. They reported that the performance of a firm is enhanced after an investor acquires a large block of equity. Such investors act as 'activist shareholders'. Kang and Shivdasani (1995), Kaplan and Minton (1994), and Parrino *et al*. (2003) reported the association of large shareholders and higher management (Chief Executive Officer, CEO) turnover, i.e., shareholders 'vote with their feet' for CEO actions and such monitoring forces the exit of ineffective and inefficient managers.

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Large shareholders also have an influence on the executive compensation. They participate in board decisions and scrutinize the compensation structure of the CEO and other senior managers. This leads to reducing agency costs or controlling of the agency problem (Bertrand and Mullainathan, 2001).

Institutions as Large Shareholders

With the growth in institutional investment in equity markets around the world, financial institutions have become the largest investor group in many countries, and are observed mostly in countries with stronger regulatory and governance structure (Li *et al.*, 2006). Admati *et al.* (1994), Maug (1998), and Noe (2002) showed that institutions (as large shareholders) become actively involved in resolving the problems associated with diffused ownership. They become vigilant and the fiduciary responsibility encourages them to be affecting and improving managerial efficiency and performance (Pozen, 1994). When institutional investors are not large enough, higher transaction costs coupled with smaller benefits of monitoring hinder them from engaging in any kind of activism and influencing firm performance (Webb *et al*., 2003).

Different financial institutions, viz., mutual funds, banks, insurance companies, pension funds and foreign institutions, have different investment objectives. Depending on their investment objectives and the regulatory environment, their influence on firm performance is dissimilar. For example, while there are regulatory restrictions on banks on investing in a firm's equity in the US, they are the largest shareholders in Germany and Japan, and also have a significant participation in management's actions (Johnson *et al.*, 2010). In Germany, due to larger representation in a firm's board and active participation in decisions, banks control a significant portion of voting rights than earnings or cash flows (Boehmer, 1999) and provide a check on agency costs. Similar to banks' role in Germany, Prowse (1990), Kaplan and Minton (1994), and Morck and Nakamura (1999) showed that banks play a very important role in corporate governance and in addressing agency problem in Japan. The activism role of pension funds has been well documented in the US. The studies in US have found mixed evidence on the role of pension funds in affecting firm performance.

The role of foreign institutions is another interesting area of study. The nature of high possible returns has attracted foreign investments into the emerging markets (Frenkel and Menkhoff, 2004). Many authors (Falkenstein, 1996; Kang and Stulz, 1997; Dahlquist and Robertson, 2001; and Douma *et al.,* 2006) have studied different markets and have reported mixed results on foreign investors as effective monitors. Bhattacharyya and Rao (2005) and Sahu and Chakraborty (2012 and 2013) reported FIIs to be effective monitors in India. Liu *et al*. (2010) compared the investment behavior of domestic and foreign institutions in China and reported that foreign institutions look for better governance indicators in their portfolio companies. Vo (2010) studied the Vietnam market and concluded that foreign institutional investors prefer corporates which have high disclosures or less information asymmetry.

Institutional Investors as Monitors and Decision Influencers

The monitoring role of institutions has been observed since long. For example, Gillan and Starks (2007) report that in the US, financial institutions participated in corporate governance activities

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since the early 1990s but, activism by these investors was observed only after the mid-1990s. The impact of bankruptcy and governance scandals motivated the market regulators in different countries to look for solutions. They felt the need for promoting institutions as external monitors of corporate managers. Rule 14a-8 of SEC in the US, the Cadbury Committee in the UK, the CII[1] Committee in India and similarly in other countries advocate a monitoring role by institutions. Institutional investors should use their influence, with their aggregated holdings and voting power, to ensure that the companies in which they invest comply with the governance code and conduct.

Since institutional investors have emerged as majority equity holders in several countries, viz., Australia, the US and the UK, many researchers have studied the monitoring role of institutional investors. Some of the earliest researches were done by Shleifer and Vishny (1986), Brickley *et al.* (1988), Coffee (1991), and Black (1998). Studies have argued that the incentive to monitor and influence the management decisions varies for different types of institutions. While Brickley *et al.* (1988) classified them into pressure-sensitive and pressure-insensitive institutions, Karpoff (2001) presented three different views: (1) Institutions take up monitoring of firm's management, and using their relationship, make efforts to directly or indirectly influence organizational changes; (2) They play the role of an active investor and interfere in management decisions; and (3) Institutional investors focus more on short-term performance for quick gains than wait for long-term returns. Elyasiani and Jia (2010) summarized the three different roles played by financial institutions: (1) active monitoring, (2) passive monitoring, and (3) siding with managers to exploit small retail investors.

Extant studies have reported different factors to be responsible for the varied nature of institutions' monitoring role. Institutional investors become active to ensure that the directors of a company consider and respect shareholders' interests. Bushee and Noe (2000), Chung *et al*. (2002), McCahery *et al*. (2010), and Chung and Zhang (2011) reported that institutional investors choose companies with better corporate governance practices. Bhide (1994), Badrinath *et al*. (1996), Falkenstein (1996), Almazan *et al*. (2005), and Huang (2009) associated institutional investments to liquidity of stocks. Gompers and Metrick (2001) related the large size of the company with companies paying dividends (Grinstein and Michaely, 2005) and managerial performance (Parrino *et al.,* 2003). Almazan *et al.* (2005) and Smith and Swan (2007) provided proof that institutional investors monitor executive compensation and reported that compensation is closely related to firm performance. Chung *et al*. (2002) argued that institutional investors put pressure on firms to adopt better accounting policies and practices. Interestingly, Holmström and Tirole (1993) considered the stock market to be the most reliable monitor as stock prices reflect a variety of information including the future performance of a company.

Contrastingly, another set of researchers have documented that institutional investors are passive and do not take up monitoring seriously. Kochhar and David (1996), David *et al*. (1998), and Almazan *et al.* (2005) argued that the pressure-sensitive institutions, viz., banks, insurance

[1] The Confederation of Indian Industries (CII) is a leading industry association in India and works to build an effective ecosystem which will support the growth and development of Indian industry and the economy.

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companies, and non-bank trusts, do not act against managers to preserve their business relationship with the companies. Pound (1993) reported that institutional shareholders empathize with the entrenched managers and vote for them. Pozen (1994) argued that legal and regulatory constraints restrict institutions from accumulating large ownership and use this to control corporate managers. Duggal and Millar (1999) studied the role of institutional investors in the context of a takeover market and showed that they do not play any significant role.

Costs and Benefits of Monitoring

Institutional investors, unlike other investors, have a unique set of monitoring costs and benefits. They face a cost-benefit trade-off in taking up monitoring activity. Institutions as shareholders will be 'active' only if the expected benefits exceed the cost of activism (Pozen, 1994; and Smith, 1996). Pozen (1994) also described that the benefits are wide ranging, direct in the form of affecting market value to establishing procedural changes in corporate governance. If there is a mismatch between the costs incurred by institutions and benefits of it, the institutions may not engage in activism. Chidambaran and John (2000) argued that for monitoring to be credible, investors need to hold enough shares and over a longer period. The cost of monitoring depends on the tools using which institutions exercise influence, and this varies across institutional investors (Li *et al*., 2006) and hence the monitoring efforts of only independent long-term institutions generate positive externalities. For small and atomistic shareholders, the costs are higher than benefits (McConnell and Henri, 1990) and only large shareholders have a monitoring incentive (Admati *et al.,* 1994; Gillan and Starks, 2003; and Dharwadkar *et al.*, 2008). The cost is higher when institutions get involved in a fight of proxy voting and low for holding informal meeting with managers (Pozen, 1994).

Coffee (1991), Bhide (1994), Maug (1998), and Almazan *et al.* (2005) showed that institutional preference of liquidity helps cover the cost of monitoring by using short information and engaging in trading benefits. Bushee and Noe (2000) argued that higher information quality reduces monitoring cost and hence institutional investors prefer firms with better information disclosure practices. Chen *et al.* (2007) showed that monitoring benefits increase with the size of shareholding,[2] independence of the institutions, and the length of period for which the institution has been investing in the firm. Existing knowledge on the portfolio company and processing of any new information about the firm is better with a longer term association. They further argued that some institutions, afraid of damaging the relationship with firms and losing existing or potential business, face a high cost of monitoring, e.g., banks and insurance companies in this category (Gallagher *et al.*, 2009).

Large institutional investors exploit the economies of scale (Opler and Sokobin, 1998; and Gallagher *et al.,* 2009) since there is a fixed component involved in the cost of acquiring information and there is a larger cost in having to sell (Dharwadkar *et al.*, 2008). Such actions might induce lower stock prices (Kochhar and David, 1996). Further, Chen *et al.* (2007) showed that with block holdings, it becomes easier to access the management. Institutional investors also create a budget for their annual activism program (Del Guercio and Hawkins, 1999).

[2] Also supported by Gallagher *et al.* (2009).

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Institutional Investors and Corporate Value

Apart from studying the activism role, researchers have also looked into the direct influence of institutional ownership on firm performance. The argument of institutional effect on firm value (Shleifer and Vishny, 1986) was extended by McConnell and Henri (1990), Black (1998) and later by Woidtke[3] (2002) who observed a strong and positive relationship between institutional ownership and performance (using Tobin's *q*). Other researchers, viz., Smith (1996), Anderson and Reeb (2003), Bhagat *et al.* (2004), Chen *et al*. (2007), Cornett *et al.* (2007), and Elyasiani and Jia (2010) also made similar observations using different measures of firm performance.

Many papers also look at different aspects of institutional investors' influence. Merton (1987) reported that the investor base of a firm influences the market value as a larger investor base increases the share price. Hence with value in their mind, institutional investors make investment decisions. Gompers and Metrick (2001) reported that institutional investors prefer large companies. Grinstein and Michaely (2005) reported preference for firms that pay cash dividends or repurchase shares. Badrinath *et al*. (1996), Falkenstein (1996), and Huang (2009) showed market liquidity and return volatility as important reasons. In contrast, a set of studies reported not much significant relationship, e.g., Agarwal and Knober (1998), Karpoff *et al.* (1996), Karpoff (2001), Duggal and Millar (1999), and Rose[4] (2005).

Institutional Investors and the Structure of Corporate Boards

The activism role of institutional investors also affects companies' board in terms of structure, size and functions. Such institutions, if dissatisfied with the board's performance, have three choices, i.e., exit[5] – sell their shares; voice – hold their investment and express dissatisfaction; and remain loyal – hold their share and do nothing (Hirschman, 1971). Whidbee (1997) reported that board independence increases when institutional shareholding increases. Parrino *et al*. (2003) found that institutional investors could influence the decisions by the board of directors and affect CEO turnover. Hence, boards care about the portfolio adjustments taken up by institutional ownership (Gillan and Starks, 2003). In a recent study, Chung and Zhang (2011) showed that governance provisions in terms of composition and operation of board are effective in attracting institutional investors.

Institutional Investments in India

The number of empirical studies in the Indian context is limited. An initial set of research (Verma, 1997; and Khanna and Krishna, 2000) reports that institutional investors played a passive role in monitoring the managers or influencing the corporate governance and performance of Indian corporates. A study by the World Bank (2005), a survey involving institutional investors, companies and market participants, found that the domestic mutual

[3] The study focused on ownership of public and private pension funds. It reported positive influence by private and negative influence by public pension funds on firm performance.

[4] The study is based on Danish market and showed that ownership by institutional investors does not influence firm performance.

[5] Webb *et al*. (2003) argued that as long as the cost of exit is cheaper as compared to the cost of monitoring, institutions will be more likely to exit than attempt to reform a company.

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funds take up only a passive role in monitoring the management's actions in their portfolio companies. The study also found that FIIs become active and exercise their ownership rights signalling satisfaction or dissatisfaction. A recent work using an event study of corporate governance scandals showed that institutional holding has a salutary effect (Chakrabarti and Sarkar, 2010).

On the other hand, Sarkar and Sarkar (2000) observed a passive role played by the Development Financial Institutions[6] (DFIs) in the corporate governance system of companies in India. However, Kumar (2004) and Mohanty (2002) presented contrasting views. While Kumar argued of a positive effect on firm performance by institutional investors, mainly the DFIs,[7] Mohanty presented that DFIs take part in active governance of companies through a format of 'nominee directors' on the board, and participate in key decisions.

Deb and Chakrapani (2004) in a cross-sectional study of 443 companies showed a positive relationship between institutional holding and firm value. Mukherjee and Ghosh (2004) found that among the institutional investors, FIIs show consistency in stock picking as compared to DFIs who are sporadic and volatile. Sehgal and Mulraj (2008) argued that although institutional investors hold a major share in several companies, they have been passive investors. They hardly raise a voice of disagreement at board meetings or Annual General Meetings (AGMs).

Expert committees[8] set up to study corporate governance structures in India have emphasized that institutional investors have a bigger role to play. The CII report was a first such report. This was followed by the Kumarmangalam Birla Committee and the Narayana Murthy Committee. All these reports have described the implication of the institutional shareholders and their role in the corporate governance of a company and stressed that institutional investors should make good use of their voting power to enhance governance. Discussing the Satyam case, Srinivas (2011) argued for a proactive role of institutional investors. They should seek information on major resolutions of firms and reject any decisions which reduce value. A summary of different Indian studies is presented in Table 1.

Mutual Funds and Firm Performance

Extant studies on the role of mutual funds influencing firm performance found contrasting results. In the developed economies context, mutual funds have been active monitors. Wermers (2000) reported that mutual funds exhibit selective ability in the US market. Cornett *et al*. (2007) showed that mutual funds, as pressure-insensitive investor, have a positive impact on firm performance in the US. In contrast, Charkham[9] (1994) argued that the way mutual funds are established and managed, it discourages the fund managers from being actively involved in the corporate governance activities. Hence, they do not influence firm performance.

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6 This was observed when the combined holding by DFIs was less than 25%.

7 This was observed once the total shareholding by all DFIs crossed 15%.

8 Such committees are constituted by the Government of India to examine important issues which affect economic growth and development.

9 Charkham (1994) termed mutual funds as 'Type B' institutions which treat investment in equity shares as of investment in commodities with no fundamental difference in qualities other than that of being tradable instrument or financial asset.

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Table 1: Summary of Indian Studies on Institutional Investment		
Author	**Institutional Holding Included**	**Observation**
Khanna and Krishna (2000)	Divided institutional holding into domestic financial institutions and foreign institutional investors.	Domestic institutions are aggregate of all state-run financial intermediaries, including banks, government-owned insurance firms, and government-owned MFs. Foreign institutional ownership is aggregate of ownership by foreign corporations and foreign financial intermediaries.
Sarkar and Sarkar (2000)	Studied the impact of institutional investors on firm value. Institutional investors constitute both government-owned insurance companies and government sponsored MFs. DFIs as government-owned developmental institutions include banks and state financial corporations.	Considered shareholding by foreign entities, which include foreign corporations and foreign institutional investors.
Mohanty (2002)	Studied the institutional investors role in corporate governance and firm performance.	Studied only mutual funds and DFIs, but did not include FIIs.
Mukherjee and Ghosh (2004)	Included different categories of institutions MFs, financial institutions, and FIIs in their study.	Industry-wise sample of only four was considered. Hence, a small sample.
Kumar (2004)	Combined government and DFIs, which include banks, MFs, insurance companies, financial institutions, central and state government firms, state financial corporations and other government bodies.	Under 'foreign ownership', FII holdings were clubbed together with promoter and non-promoter shareholding.
Douma *et al.* (2006)	Studied the impact at broad level of foreign shareholders and domestic shareholders. Divided foreign ownership into foreign corporations and FIIs, and domestic ownership into domestic corporations and domestic financial institutions.	Domestic financial institutions consist of banks, DFIs, insurance companies, and MFs.
Patibandla (2006)	Distinguished large investors into public financial institutions and foreign investors.	Public financial institutions include the government institutions, IFCI, IDBI, and ICICI.

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Table 1 (Cont.)

Author	Institutional Holding Included	Observation
Kaur and Gill (2009)	Studied the impact of Institutional holding along with Indian promoters, Foreign promoters, and non-institutional holding.	Holding by institutions include MFs, UTI, banks, financial institutions, insurance companies and FIIs.
Sehgal and Tripathy (2009)	Examined the trading practices of Development Financial Institutional Investors (DFIIs) and FIIs.	MF investment was used as a proxy to represent DFIs.
Chakrabarti and Sarkar (2010)	Examined the impact of institutional ownership divided into FIIs, MFs and banks and financial institutions.	Analyzed cross-sectional variation of two corporate governance events (scandals) and study on stock returns.
Patnaik and Shah (2013)	Studied investment made by domestic institutional investors and FIIs in obtaining superior returns.	Domestic institutional investors include banks, MFs and insurance companies.

No evidence of monitoring by mutual funds in India was reported by Sarkar and Sarkar (2000). In a recent study, Zabiulla (2013) showed that fund managers exhibit poor stock selection as they fail to incorporate the relevant economic information while investing in stocks. However, Mohanty (2002) and Sahu and Chakraborty (2013) reported a positive relationship between mutual fund holding and performance of companies that have better corporate governance record. Kumar (2004) found that when the ownership crosses a threshold limit, the mutual funds are able to influence firm performance.

Banks, Financial Institutions and Insurance Companies and Firm Performance

Banks play the role of lenders apart from investing in equity. As lenders they have an advantage over other institutions due to their access to insider information. Banks' role in the US was influenced by regulatory restrictions, but in Germany and Japan, they have played a leading role in monitoring managers' actions. Brickley *et al.* (1988) classified banks as pressure-sensitive and passive investors. Payne *et al.* (1996) argued that banks are likely to have business relationship with companies in which they invest and hence have a tendency to vote against or counter the proposals of managers. Van Nuys (1993) studied the voting exercise role of institutional shareholder during a proxy battle at Honeywell Inc. and provided evidence that banks and insurance companies support the decisions of managers and concluded that such institutions collude with management. In a recent study, Elyasini and Jia (2010) found that ownership by banks and insurance companies do perform some monitoring and have positive impact on firm performance.

There are a few studies in the Indian context with associate shareholding by banks, financial institutions, and insurance companies with firm performance. Khanna and Krishna (2000) and Sarkar and Sarkar (2000) report a negative relationship between domestic institutional

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ownership (which includes banks) and firm performance. Mohanty (2002) found a negative association between bank shareholding and financial performance of firms. Douma *et al*. (2006) reported an insignificant relationship between domestic financial institutions and firm performance. Patibandla (2006) reported that with higher shareholding by government financial institutions, there was lower profitability of corporates. He argued that large investors who are protected by the government tend to collude with corporate managers and divert funds for non-productive personal goals. Interestingly, Ramaswamay *et al*. (2002) found a positive relationship between the proportion of equity ownership by banks (and insurance companies) and performance of firms which have gone for unrelated diversification.

Foreign Institutions and Firm Performance

Equity ownership by foreign institutions has been of interest mainly in the emerging economies. Empirical studies have found mixed evidence on this. It is argued that the foreigners, with their expertise and experience in developed markets, may have an advantage over domestic investors. Seasholes (2000) conducted a comparative analysis in Taiwan and reported that foreign and domestic investors act in opposite directions, i.e., buy/sell ahead of good/bad earnings announcements respectively. Griffin *et al.* (2004) showed that the flow of investments from foreign economies has a significant impact on the expected future returns of Indian market. The foreign investors have the capability as 'elite information processors' (Kim and Verrecchia, 1994) which helps them to generate better returns in emerging markets as compared to their domestic competitors. Jiang and Kim (2004) and Dvorak (2006) supplemented this view and reported that FIIs leverage form expertise and experience (of international markets), better analytical skills and more resources for dedicated research. Kim and Yi (2006) studied a large sample of firms in the Korean market and found evidence that foreign investors look at firm-specific data in making investment decisions. In contrast, Chang (2010) argued that in emerging markets, the foreign investors may lack expertise in local environment which might lead to informational disadvantage.

In India, many studies have looked at the impact of FIIs, but mostly at aggregate level. Mukherjee *et al*. (2002) and Kumar (2007) find evidence that FIIs drive the domestic stock market. Sehgal and Tripathy (2009) documented that FIIs react faster as compared to DFIs in chasing stock market returns and also observed herding behavior by FIIs. Khanna and Krishna (2000) studied the impact of foreign holding in business group affiliated firms and found positive relationship to performance. Sarkar and Sarkar (2000) supplemented this and found that an increase in foreign holdings increases company value. However, both these studies had not separated foreign holdings into foreign corporates and foreign institutions.[10] Douma *et al.* (2006) disaggregated foreign ownership into ownership by foreign corporations and foreign institutions. They reported that the influence of FIIs on firm performance is not clear-cut.

A study by Patibandla (2006) showed a linear relationship between shareholding by foreign investor and the profitability of firms. Bhattacharyya and Rao (2005) studied the effect of FII

[10] A breakdown between equity holdings by foreign corporations and foreign institutions was not available in the CIMM (renamed as CMIE) database.

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equity holding on controlling the agency costs and showed that they help in reducing the agency costs or improving firm performance. In recent studies, Sahu and Chakraborty (2012 and 2013) disintegrated institutional holding into mutual funds, banks and financial institutions and FIIs and showed that while mutual funds and FIIs influence firm performance in a positive way, it is negative for banks and financial institutions.

Conclusion

The role of institutional investors in monitoring corporate managers and influencing firm performance has been a debatable issue in finance literature. While some argue that institutional investors take up monitoring activity which structures corporate governance and leads to better firm performance, others believe that these investors have a different investment objective. Those supporting the first argument describe that institutions invest in shares largely on behalf of the small retail investors. Hence, they have a fiduciary responsibility of generating enough returns to meet these small investors' expectations. With their larger weightage of shareholding, they can vote for changes and hence can play a big role in corporate governance. The other group argues that the investment objectives and the cost-benefit outcomes discourage their participation in monitoring activity. In India, earlier, the environment was not well developed and hence the monitoring activities were absent. Post-economic reforms, when institutional participation increased, there had been an increase in the institutional monitoring activities. While different studies have discussed the role of institutional investments as a whole, some studies have divided institutional holdings into different categories of institutions and have observed the divergent impact of domestic and foreign institutions. ❏

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