THE BEHAVIOR OF INSTITUTIONAL INVESTORS AND ITS INFLUENCE ON THE CORPORATE PERFORMANCE: A CASE OF LISTED COMPANIES IN THE CASABLANCA STOCK EXCHANGE

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Abstract:
The last two decades were marked by the rise of a new shareholder actor who now shapes corporate governance, and is actively involved in the global financial markets. This obviously is institutional investor. This phenomenon continues to grow, and characterizes almost all developed and emerging economies. Morocco, therefore, is no exception.

We present in this work, the different behaviors of institutional investors, and the factors explaining their attitude. Indeed, several environmental constraints, and strategic variables influence this group of shareholders and guide their actions, which differentiates consequently the management of their investments. This will lead us inevitably to explain the link between the presence of institutional investors in corporate ownership and performance obtained. We take for the empirical study, a sample from listed companies in the Casablanca Stock Exchange for the period 2005-2011.

Keywords: institutional investor's behavior, corporate performance, Moroccan stock exchange, foreign institutional investors

I. INTRODUCTION

The last two decades have seen appear a specific type of shareholders, which has developed and grown in a spectacular way, those obviously are institutional shareholders. Many researches have focused on this new actor and its role in corporate governance. Institutional investors began to intervene significantly on American financial markets since the early 1980s, and then expand their holdings and increase their influence on a global level. The phenomenon continues to grow and characterizes almost all developed and emerging economies. Morocco, as a result, is no exception.

To better understand this new reality and assimilate the ins and outs of institutional investors functioning and their impact on the corporate governance, we will summarize the existing international literature and bring a new contribution of distinguishing two groups within the same institutional investors according to their activism.

Indeed, the majority of identified studies dealing with the thematic of institutional investors considered them as a homogeneous group with the same goals and acting in the same way. However, several environmental constraints and strategic variables influence this group of shareholders and guide their actions, what differentiates therefore the management of their investments. This brings us to first establish a taxonomy of these investors according to their behavior, and then present the factors affecting their attitude, all of which explain their connection with the corporate performance.

II. THE DIFFERENT BEHAVIOR OF INSTITUTIONAL INVESTORS

1. The Institutional Investors Activism

Depending on their degree of involvement in corporate governance, there are two types of institutional investors, actives and passives.

One stream of researchers [Black (1990), Porter (1992), Bushee (1998), Dong, Ozkan (2007)] consider that there is no incentive for these players to get involved in management of companies they invest their funds. The intervention logic of institutional investors here, is a short term approach, and are mainly interested in their securities performance immediately.

The purpose of institutional investors is to take advantage of price movements of securities in the financial market. They are, therefore, prone to leave the capital of firms if they find they are managed inefficiently (*the Wall Street rule*[1]). This passivity in the behavior of these investors often assume that a visa "unconditional" is granted to executives even in default of their management.

Conversely, a second stream of researchers [Pound (1988), Smith (1996), Carleton et al. (1998), Hartzell, Starks (2003), Drobetz et al (2004), Alexander et al (2007), Cornett et al. (2008)] have shown through their studies activism of these investors and advocate for effective intervention of this class of shareholders in the management of firms.

Assessing the impact of the presence of institutional investors in certain mechanisms related to corporate governance in general, the levels of executive compensation or types of decisions made by the Boards of Directors was discussed thoroughly.

In this context Baysinger et al (1991), Kochhar, David (1996), Smith (1996), Ryan Shneider (2002), Almazan et al (2005), consider that institutional investors are encouraged to effectively control the corporate governance management, and promote the rights of shareholders by monitoring the officers actions, and this by exerting lobbying, if necessary, to align the objectives of different stakeholders in the company.

We therefore denote an optical divergence relative to the role played by institutional investors between activism and passivism. The empirical results are often mixed and do not provide conclusive final judgment as to the role. Choosing to exercise strict control, or not to get involved in the management of companies held in the portfolio are, as we have presented it, the two main behaviors of institutional investors, which is a source of differentiation between them. Consequently, we admit to ask the question of why this discrepancy. In other words, what are the main factors influencing the motivations of these firm actors and determine their orientation?

2.*Factors Explaining the Behavior of Institutional Investors*

The adoption of a passive or active behavior by institutional investors is really just the result of different factors. The literature of corporate finance and organizational management identifies three main influential factors on the behavior of institutional investors.

The first differentiating factor in the behavior of institutional investors is their investment horizon, which can vary from short to long term. Thus, investors with short-term horizons, commonly called 'myopic' investors [Porter (1992), Bushee (1998), Dong and Ozkan (2007)] have a passive role in the governance of firms to which they belong. While institutional investors, with a long-term horizon, adopt rather active behavior and participate effectively in the management of the company [Hansen, Hill (1991), Kochhar, David (1996), Chen et al (2007)].

Both findings were empirically supported through the results obtained by different researchers Graves (1988), Demirag (1995) to institutional myopia, and Wahl, Mcconnell (2000), Gaspar et al (2005) to their activism. This therefore justifies the need to consider other explanatory variables to better understand the nature of the behaviors of this class of shareholders.

The second factor explaining the behavior of institutional investors is their percentage ownership in the capital of companies.

In fact, and in light of empirical results obtained in different contexts [Waal (1996), Maug (1998) Duggal, Millar (1999), Del guercio, Hawkins (1999), Khan et al (2005), Cornett et al. (2008)], the more the shareholding of institutional investors is dispersed, the more they adopt passive actions. Conversely, the concentration of institutional investors' ownership promotes active behavior.

The last factor used by the current literature refers to the nature of the relationship built between institutional investors and firms owned in their portfolio. Indeed, there are two scenarios in economic reality:

- Unique investment relationship,
- A relationship of investment and business.

In this second case, the investor is both a shareholder and supplier of the owned company. The risk arises if the business relationship prevails that in investment. Thus the investor will tend to tacitly accept the decisions of managers to keep intact the business relationship. However, this approval may involve inappropriate and not optimal decisions for the firm owned. The researches by Brickley et al (1988), David et al (1998), Chen et al (2007), lead us to make the following proposals:

-the institutional shareholders who maintain only an investment relationship with portfolio companies are more active and involved in the management and strategy of these firms.

-the institutional shareholders who develop both investment and business relations adopt a rather passive.attitude.

We can say that these three factors may act together to determine the type of action to be taken by institutional investors, so therefore influence the corporate performance.

The possibilities offered to our economy are more.

III.THE IMPACT OF INSTITUTIONAL INVESTORS' OWNERSHIP ON CORPORATE PERFORMANCE

This is to evaluate the influence of the institutional investors' behavior on the corporate performance and the creation of shareholder wealth, and check the alignment of their objectives with those of other stakeholders. It therefore seems useful to position first, the various theoretical and empirical debates raised in the literature about the possible impact of the presence of institutional investors on performance. Then, we discuss the possible existence of a bilateral relationship between institutional investors and performance.

1. The Theoretical Framework of the Link Between Institutional Investors and Corporate Performance

According to various studies conducted in various contexts, four major trends regarding the influence of the presence of institutional investors on the corporate performance. We distinguish between:

- Hypothesis of activism and effective control [Pound (1988), McConnell (1990), Smith (1996)] that combines the presence of institutional investors with improvement of corporate performance. In this case, institutional investors are involved especially to reduce conflicts of interest between managers and other shareholders. We retain here especially the positive impact of their presence because of their expertise, skills and experience in project management. Their ability to exercise effective control over the management of firms at lower costs is a major asset. These features are even more apparent when it comes to foreign institutional investors. They undertake in investments in various environments, this allows them to a greater understanding of the economic realities of the countries.

Since the first empirical work of Mcconnell, Servaes (1990 and 1995), Grawal, Mandelker (1990), who corroborated the positive link between the presence of institutional investors and corporate performance, more recent studies such as those of Alexander et al. (2007), Cornett et al. (2008), Elyasiani, Jia (2008) confirmed this relation.

- Hypothesis of conflicts of interest and expropriation of minority shareholders [Pound (1988), Brickley et al (1988), Chen et al (2007), Young et al (2008)] calling for a weakening of the corporate performance due to the presence of institutional investors.

Indeed, as we have previously reported, in addition to investment relationships with portfolio companies, institutional investors can also develop profitable client relationships with those companies. This will have as result to put institutional investors in a contradictory and ambivalent situation. On one hand, their obligation as controlling shareholder and strategic makers forces them to effectively monitor the management of portfolio companies, while their business relationships encourage them to align with the managers in the sense not to oppose or contradict their decisions.

This conflict of interest situation is usually associated with exercise of less control by institutional investors, and therefore their presence has a negative effect on performance.

In parallel, according to the hypothesis of the expropriation of minority shareholders, institutional investors can align with managers to meet their common goals at the expense of the remaining shareholders. This strategic arrangement reduces the value of organizational fit created and promotes the expropriation of small shareholders [Barclay (1989), Burkart et al (2000), Lemmon, Lins (2003), Wang, Albuquerue (2008)]. This negative relationship between the presence of institutional investors and corporate performance has been corroborated empirically by the work of Alexander, Paquerot (2000) for the French case, Woidtke (2000) for the American hedge funds, Khanna , Palepu (1999) for the India case.

- Hypothesis of neutrality [Demsetz (1983), Demsetz, Lehn (1985), Agrawal, Knoeber (1996), Himmelberg et al (1999)], which puts forward the idea of a lack of influence of institutional shareholding on corporate performance. This hypothesis explains the maximization of the firm value by factors other than the ownership structure, including the characteristics of the environment, requirements and characteristics of its market and its own operating conditions.

It is considered here that the ownership structure that enables the company to achieve its objectives and strategies while minimizing the costs of monitoring and private benefits result rather from a choice of investors. Empirical studies supporting the thesis of neutrality of institutional shareholding on performance has been shown, among others, in the work of Mehran (1995), Wahl (1996), Faccio, Lasfer (2000), Chen et al (2003) and Miguez-Vera, Martin-ugedo (2007).

- Hypothesis of non-linearity of the relationship between institutional ownership and corporate performance. This hypothesis has its foundations in the work of Morck et al (1988), McConnell, Servaes (1990), Himmelberg et al. (1999), De Miguel (2004).

The focus on the presence of institutional investors in ownership and their influence on the financial corporate performance is becoming increasingly internationalized, particularly because of the key role they play in structuring economic investment and the development of countries. The Moroccan economy is no exception, and there has been a rise of domestic and foreign institutional investors power. However, as just explained, the influence of this class of shareholders on corporate performance differs from an economic and legal context to another.

We resume in the following table the main assumptions about the nature of the link between the presence of institutional investors and corporate performance.

Table 1. Summary of Assumptions on the Presence of Institutional Investors and Corporate Performance

Hypotheses	*Effect on Performance*	*Argument*	*Reference Authors*
Effective control	Positive	-Institutional investors improve corporate performance thanks to the expertise and the financial resources at their disposal that allow them to effectively monitor the management team and reduce conflicts of interest. -Institutional investors are active and ensure the smooth running of the firm.	-SCHLEIFER, VISHNY (1986) -POUND (1988) -MCCONNELL, SERVAES (1990) -CHEN et al (2007) -CORNETT et al (2008)
Conflicts of Interest and expropriation	Negative	- Institutional investors maintain business relationships with the companies they own and are not motivated to control managers. -They can also cooperate with managers to gain private benefits particularly for major share ownership levels (phenomenon of expropriation). - Institutional investors are passive and prefer short-term gains. Thus, they are not interested in management control.	-POUND (1988) -BRICKLEY et al (1988) -COFFEE (1991) -BUSHEE (1998) -YOUNG et al (2008) -ALBEQUERUE, WANG (2008)
Neutrality	Neutral	-Ownership structures do not influence the performance. -Each firm is able to determine the optimal structure of ownership that minimizes costs of agency. -The endogeneity of the ownership structure and performance.	-DEMSETZ (1983) -DEMSETZ, LEHN (1985) -WAHAL (1996) -SMITH (1996) -HIMMELBERG et al (1999) -DEMSETZ, VILLALONGA (2001)
Non linearity	Positive and negative	-according typology and institutional investors behavior, the relationship with the performance may be nonlinear. - Effect of institutional investors on performance	-MORCK et al (1988) -MCCONNELL, SERVAES (1990, 2008) -DAVIES et al (2005)

		can combine other assumptions according to participation levels in capital of these actors and conditions that can vary their incentives to control.	

IV. INSTITUTIONAL INVESTORS AND CORPORATE PERFORMANCE OF LISTED COMPANIES IN THE CASABLANCA STOCK EXCHANGE

1. Brief presentation of Casablanca Stock Exchange

The Casablanca Stock Exchange was established as long ago as 1929. At that time, it was known as the Office for Clearing of Transferable Securities.

The growing importance of the securities market and the introduction of foreign exchange controls prompted the authorities at that time to improve and regulate the Stock Exchange's organisation and operations.

The market's organisational shortcomings hindered however its attractiveness at a time when domestic investors showed a growing interest in stock market investment. To overcome such shortcomings, reforms were undertaken in 1967, providing Morocco's financial markets with a well-organised legal and technical framework.

Following these reforms, in 1986, Morocco embarked on a Structural Adjustment Programme which was completed ten years later. This Programme enabled Morocco to consolidate its fundamentals and successfully bring under control its high level of debt and inflation. Seven years later, in 1993, another major set of market reforms was undertaken to complement and enhance previous measures.

In order to increase market transparency, the obligation to publish accounting and financial statements for listed companies went into force in 1993. The refusal of ten companies to comply with these new measures resulted in their de-listing.

In January 1997, further improvements were made to stock market organisation by the enactment of law Number 34-96, revising and complementing the Royal Decree establishing Law Number 1-93-211 relating to the Casablanca Stock Exchange. Maroclear, the central securities depositary, was established in **October 1998,** by the enactment of Law Number 35-96.

Since then, the Casablanca Stock Exchange has been rejuvenated. In 2000, the Société de la Bourse des Valeurs de Casablanca or "SBVC" has changed name to become the Casablanca Stock Exchange, a joint stock company with a Board of Directors and a Supervisory Board.

In January 2007, the Casablanca Stock Exchange redesigned its visual identity with a wish to support its change in size.

We remind that the companies listed on the Casablanca Stock Exchange, are considered by as a natural and representative sample of the national economy. Moreover, the market capitalization represents 85% of GDP (2011), which makes this stock exchange in the same level of the most developed stock exchanges regarding the percentage of market capitalization in GDP.

2. Data and Model Specification

2.1. Sample

The sample used in this study consists of 48 firms listed in Casablanca stock exchange from all sectors of the Moroccan economy for which there were data about ownership and accounting variables for the period 2005–2011.

Table 2. Distribution of Selected Companies in the Study Sample by Business Segment

CODE	*BUSINESS SEGMENT*	*NUMBER OF FIRMS*
01	Food/Production	**5**
02	Insurance	**2**
03	Banking	**6**
04	Constructions and Construction Materials	**6**
05	Beverage	**2**
06	Chemistry	**2**
07	Distributors	**3**
08	Electrical and electronic equipment	**1**
09	Real Estate	**1**
10	Pharmaceutical industry	**2**
11	Hardware Software and IT Services	**1**
12	Mining	**3**
13	Oil and Gas	**2**
14	Services to local municipalities	**1**
15	Financing Companies and Other Activities	**7**
16	Portfolio companies / Holdings	**1**
17	Forestry and Paper	**1**
18	Telecommunications	**1**
19	Transport	**1**
	TOTAL	**48**

2.2. Variables and Model Specification

Our regressive econometric model has firm performance as the dependent variable. The second has fraction of shares owned by management as the dependent variable. The variables of the model are calculated as averages of 7 years of annual data, from 2005 to 2011.
The equation is as follows:
- The dependent variable: Firm performance. This is measured by ROE and ROA.
- The explanatory variable: Percentage of shares owned by institutional investors.

3. Results of the Study

Companies whose majority shareholder is an institutional investor have a positive relationship with performance measures adopted. This finding supports the hypothesis of activism and effective control which combines the presence of institutional investors with improved firm performance. Institutional investors are involved in particular to reduce conflicts of interest between management and other shareholders. We retain particularly the positive impact of their presence because of their expertise, skills and experience in project management. However, the weakness of the link requires a setback of interpretation at this stage.

Table 3. Relationship Between Corporate Performance and the Presence of Institutional Shareholders

	ROE		ROA	
R-Squared	0,754		0,768	
Adjusted R-Squared	0,710		0,707	
Durbin-Watson	2,572		2,172	
	Coefficient	Student's t (α=2,5%)	Coefficient	Student's t (α=2,5%)
Institutional Investors	0,492	2,373	0,339	1,096

Particular attention was paid to the differentiation between domestic and foreign institutional investors.

Table 4. List of Companies whose Principal Shareholder is Institutional Investor

	Company	Business segment/Category	Compartment
Foreign Institutional Investors	AXA CREDIT	Financing Companies and Other Activities	Market of Growth
	BMCI	Banking	Main Market
	REBAB COMPANY	Mining	Market of Growth
	EQDOM	Financing Companies and Other Activities	Main Market
	ZELLIDJA S.A	Portfolio companies / Holdings	Market of Growth
	NEXANS MAROC	Electrical and Electronic Equipment	Main Market
Domestic Institutional Investors	MED PAPER	Forestry and Paper	Main Market
	CIH	Banking	Main Market
	SOFAC	Financing Companies and Other Activities	Market of Growth

Returning descriptive statistics of these two sub-samples, we note, against all odds, that performance realized by companies controlled by domestic institutional investors exceeds that of companies controlled by foreign institutional investors. Therefore the assumption that foreign institutional have more skills and expertise, and often transfer their know-how to firms they control, so their performance is higher, is not quite true, at least for the companies of our study sample.

Table 5. Statistics of Domestic and Foreign Institutional Investors

	Domestic Institutional Investors		Foreign Institutional Investors	
	ROE	ROA	ROE	ROA
Average	23,27%	- 0,27%	12,18%	4,63%
Standard deviation	54,40%	2,37%	3,78%	3,42%

On the other hand, and to better elucidate the relationship that may exist between such shareholders and the companies in which they sit, as they adopt behavior (active or passive), we take in the table below a list of firms controlled by institutional investors and the type of relationship they maintain with them.
We recall that institutional investors can only develop investment relationships with portfolio companies, which normally promotes their active behavior. Or maintain a duality of business and investment relations, which negatively impacts the performance of the companies in question.

Table 6. Types of Relations Between the Shareholders of Control and Controlled Companies[2]

	Company	Business segment/Category	Shareholders	% share	Type of relationship Shareholders / controlled company
Foreign Institutional Investors	AXA CREDIT	Financing Companies and Other Activities	AXA ASSURANCES MAROC	87,16%	Investment
			OTHER SHAREHOLDERS	11,40%	
			SOCIETE EPARGNE CROISSANCE	1,43%	
	BMCI	Banking	BNP PARIBAS BDDI PARTICIPATIONS	66,74%	Investment
			OTHER SHAREHOLDERS	15,55%	
			HOLMARCOM	8,78%	
			AXA ASSURANCE MAROC	8,55%	
			BMCI	0,38%	
	REBAB CO.	Mining	FONDS ABU DHABI	82,82%	Investment
			OTHER SHAREHOLDERS	9,26%	
			ZELLIDJA SA	4,50%	
			SOMED	3,42%	
	EQDOM	Financing Companies and Other Activities	SOCIETE GENERALE CONSUMER FINANCE	34,95%	Investment
			SGMB	18,77%	
			OTHER SHAREHOLDERS	17,02%	
			FIPAR HOLDING	9,35%	
			CIMR	6,02%	
			RCAR	5,00%	
			SOCIETE CENTRALE DE REASSURANCE	4,65%	
			CNIA SAADA ASSURANCE	4,24%	
	ZELLIDJA S.A	Portfolio companies/ Holdings	SOMED	69,50%	Investment
			AXA ASSURANCES MAROC	17,58%	
			AL HOCEINIA SA	5,01%	
			REBAB COMPANY	4,57%	
			DIVERS ACTIONNAIRES	3,33	
	NEXANS MAROC	Electrical and Electronic Equipment	NEXANS PARTICIPATIONS	83,59%	Business and Investment
			OTHER SHAREHOLDERS	14,63%	
			ATLANTA	1,78%	
Domestic Institutional Investors	MED PAPER	Forestry and Paper	CDG DEVELOPPEMENT	36,78%	Business and Investment
			SEFRIOUI MOHSIN	20,57%	
			SEFRIOUI MOHAMED	11,56%	
			BENNANI HABIBA	6,98%	
			OTHER SHAREHOLDERS	5,41%	
			SEFRIOUI AFIFA	5,23%	
			SEFRIOUI ILHAM	5,23%	
			SEFRIOUI AMINA	4,53%	
			SEFRIOUI DOUNIA	3,69%	
	CIH	Banking	MASSIRA CAPITAL MANAGEMENT	67,88%	Investment
			OTHER SHAREHOLDERS	18,16%	
			HOLMARCOM	5,97%	
			RMA WATANYA	4,31%	
	SOFAC	Financing Companies and Other Activities	CIH	59,84%	Investment
			BARID AL MAGHRIB	39,29%	
			OTHER SHAREHOLDERS	0,87%	

Among this group of companies controlled by institutional, whether domestic or foreign, investors, we retain two cases (Nexans Morocco and Med Paper) where, in addition to the investment relationship between the company controlling and the controlled company, is also have a business relationship. Indeed, the company controlling is also the supplier of the controlled company. In reviewing the performance achieved by these two firms, there is no significant negative impact on their financial results. Therefore, the idea that maintaining a dual business relationships and investment impacts negatively the performance of controlled companies is rejected. That said, it should be noted that the low number of cases with this dual relationship don't allow to generalize this finding.

Table 7: Types of Relations Between the Shareholders of Control and Controlled Companies-Bis

	COMPANY	ROE	ROA	Type of relationship Shareholders/ controlled company	% held by the shareholder of reference
FOREIGN INSTITUTIONAL INVESTORS	AXA CREDIT	0,156	0,020	Investment	87%
	BMCI	0,136	0,013	Investment	67%
	REBAB COMPANY	0,101	0,094	Investment	83%
	EQDOM	0,171	0,029	Investment	35%
	ZELLIDJA S.A	0,086	0,084	Investment	70%
	NEXANS MAROC	0,081	0,038	Business and Investment	84%
DOMESTIC INSTITUTIONAL INVESTORS	MED PAPER	0,795	-0,029	Business and Investment	37%
	CIH	0,194	0,017	Investment	68%
	SOFAC	-0,291	0,004	Investment	60%

V. CONCLUSION

We consider that the behavior of institutional investors within firms is explained by several factors varied in nature. From the empirical results of our study, we can say that the presence of institutional investors in the corporate ownership influences positively the performance. The hypothesis of activism and effective control that combines the presence of institutional investors with improvement of corporate performance is verified here. Consequently we support the findings of Schleifer and Vishny. On the other hand, there is no significant negative impact on the financial results of the companies maintaining dual relationships of business and investment with their institutional investors shareholders.

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