International Journal of Global Business and Competitiveness (2023) 18:70–79
https://doi.org/10.1007/s42943-022-00069-5

ORIGINAL RESEARCH

In What Contexts Institutional Investors Can Be Catalyst? The Moderating Role of Corporate Governance

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Received: 16 July 2022 / Accepted: 25 December 2022 / Published online: 26 January 2023

Abstract

The paper examines the role of institutional investors in improving firm-level financial competitiveness by enhancing corporate governance. We employ multiple case study methods to analyze the role of institutional investors in improving firm competitiveness. The study finds traces of institutional activism across different industries and their role in major corporate governance issues. Thus, the study suggests that institutional investors help in improving the corporate governance landscape of the firm, which in turn can impact the firm financial competitiveness. In India, the indicators of the principal–principal dilemma can be mitigated by implementing governance mechanisms such as empowering minority shareholders and increasing institutional investor engagement. Thus, the findings of this study propose changes in the legal framework that would empower institutional investors, primarily by reducing the expropriation of minority shareholders by majority shareholders (concentrated promoters), who could otherwise skew voting outcomes in favor of minority shareholders.

Keywords Firm financial competitiveness · Institutional investors · Shareholder activism · Corporate governance · Firm performance

JEL Classification G2 · G3 · G30 · G32 · G34 · G38 · M1

Introduction

The role of institutional investors in influencing corporate governance mechanisms and firm performance is equivocal. Institutional investors perform a practical monitoring function due to their consistent investment and responsibility, which positively impacts business performance (Elyasiani & Jia, 2010). The present study contributes to the nascent debate of such phenomenon which has lately been acknowledged in developing countries characterized by principal principle agency problems and concentrated ownership. Moreover, in Indian context, publically available data for institutional investors (such as domestic mutual funds) have been recently mandated by SEBI. Thus, due to the exploratory nature of the study phenomenon in developing markets, we adopt an interpretivism lens to understand their contribution toward competitiveness. Further details about the background and literature can be accessed in the supplementary file.

Research Questions

According to previous research, good corporate governance leads to improved business performance. (Bhagat & Bolton, 2019). Based on this assumption, firm performance can be a proxy for company competitiveness (measured by financial competitiveness) (Akben-Selcuk, 2016). "Understanding the competitiveness dynamics at the firm level is crucial for competitiveness (Ambastha & Momaya, 2004)". Firm competitiveness has previously been researched extensively using different approaches. For example, an organization's

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competitiveness can improve by focusing on the aspects: of assets, processes, and performance (Momaya, 2011). Competitiveness is a multidisciplinary topic with implications at all levels: national, industry, cluster, and enterprise (Shee & Momaya, 2001). Momaya (1998) further emphasized the role of strategic management practices in advancing the international competitiveness of key Indian industries. Corporate governance is an important part of strategic management practices, and therefore, good corporate governance can help firms attain competitiveness. However, lately sustaining export competitiveness and sustainability after the major disruption of the COVID-19 pandemic are being discussed (Momaya, 2020). Thus, research has examined firm competitiveness at various levels and across different industries and suggests that financial performance leads to competitiveness (Cetindamar & Kilitcioglu, 2013). Therefore, we propose that institutional investors' activism can help improve competitiveness through improvement in corporate governance. Thus, corporate governance mediates institutional investors' activism and firm financial competitiveness.

Corporate governance impacts firm-level competitiveness. Haldar et al., (2016) suggest that the knowledge-based industries displayed flexibility in their governance strategy and adapted the best international governance practices to compete internationally. Through case study analysis, we offer to examine the role of institutional investors' activism in firm financial competitiveness through corporate governance (Fig. 1).

Research Design

Case Study Method

We employ the case study method to comprehensively understand the role those institutional investors play in corporate governance with real-life examples of cases (see, for instance, supplementary file section case study method for details). There are two main reasons to use case study analysis for this study. First, it is challenging to get first-hand information from institutional investors and companies through primary data methods like questionnaires and interviews. Second, multiple case study research offers a more comprehensive understanding of difficulties related to the formation of decisions than would be attainable with a quantitative approach (Nordin, 2005). Many examples are required to understand variations in the examined phenomenon, particularly for configuration decisions, which allow for several alternatives for each choice (Eisenhardt, 1989).

We use firm-level resolution data, as well as shareholder voting patterns for these resolutions, as these are required to analyze the impact of the participation of the institutional investors on the resolution outcomes and the overall corporate governance mechanism of a firm. The study's exploratory nature necessitates a study approach that includes case studies to offer extensive descriptions of the process of shareholder activism.

Sample Selection

We choose these five cases for our study primarily for two reasons: first, they are well-known cases from various industries where institutional investors safeguarded minority shareholder interests. Second, these incidents greatly influenced the governance of the companies in the sample. The other two cases focus on the reluctant part of institutional investors where their activism negatively impacts the firm's governance. Furthermore, these incidents drew a lot of attention from the media and other publicity outlets, drawing the attention of regulatory agencies and other stakeholders.

Data Collection

The data were sourced through multiple secondary databases mined from financial sources filed by the companies in the sample and formal news announcements published in reputed financial publications (Lavassani & Movahedi, 2021). We collected additional information regarding the cases in the sample through media reports, company websites, company annual reports, and proxy advisory websites.

Analysis

Table 1 provides information about the company profile, governance issues, year, institutional investor holdings and responses, and final decision of the companies in each case.

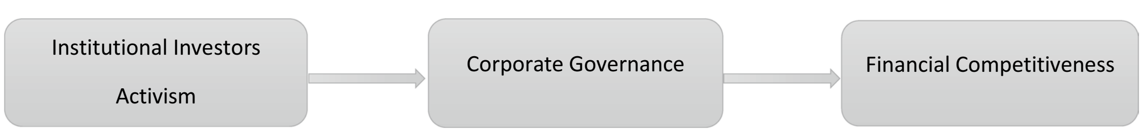

Fig. 1 Simplified conceptual framework of the linkages among key constructs in the study

Table 1 Company demographics of select comparative case companies

Company	Fortis Healthcare	Eicher Motors	Jindal Power and Steel	HDFC Bank	Reliance Industries
Background					
Ownership	Publicly listed	Publicly listed	Publicly listed	Publicly listed	Publicly listed
No. of employees	23,000	23,000	4899	120,093	236,560
Revenue	US$26 billion	US$1.5 billion	US$4.9 billion	US$16 billion	US$64 billion
Business type	Health care	Automobiles	Steel and power	Banking	Conglomerate
Example of a key issue					
Governance controversy	Proposal to remove four directors from company board due to poor governance and handling of ongoing takeover bids	Reappointment of MD with a proportionally high salary hike	Undervalued related-party transaction	Mr. Deepak Parekh's appointment as a non-executive director due to his busyness	Appointment of Yasir Othman H. Al Rumayyan as an Independent Director, Because of his stake in different Reliance Industries subsidiaries, he cannot be elected as an independent director
Year	2018	2021	2021	2018	2019
Institutional holding in the corresponding quarter	27.28%	39%	25.64%	60.75%	35.58%
Major institutional shareholders	Yes Bank 15% IFC 6.76% WF Asian 4.21%	SBI Mutual Fund 1.34% UTI 1.23% LIC 1.94% Amansa Holdings 1.9% Stichting Depositary APG 1.02%	NA	Jp Morgan Chase Bank 22.80% SBI Mutual Fund 3.87% ICICI Prudential 1.35% UTI 1.31%	SBI Mutual Fund 1.15% LIC India 6.54% Europacific Growth Fund 3.25% Govt of Singapore 1.29%
Institutional vote	Against	Against	Against	Majority against	Majority supported
Proxy firms recommendation	Recommended against	Recommended against	Recommended against	The majority recommended against, especially foreign proxy firms	Recommended against
Company decision	At least four board members were removed and a few resigned, and the proposed deal was approved with the best bid	The company declared the reappointment of MD with a cut on the proposed pay hike and got approval from the majority of the shareholders	The firm withdrew the EGM notice to ratify the sale process after strong backlash from shareholders and proxy advisory firms, which later altered the offer	The resolution was passed with a quarter of shareholders voting against it	The resolution was passed

Source: Author's Compilation based on secondary sources

Institutional Investors as Enthusiastic Contributors

Fortis Health Care

Fortis's health care has been in the limelight for many years due to its governance issues. In 2011, it announced that it bought the overseas healthcare business prompted by its owners, Shivinder Singh and Malvinder Singh. Many analysts cited concerns over this related parted deal owing to unfair pricing of the deal amounting to 20% of premium without any rationale.

Similarly, in the first quarter of 2018, many firms like Manipal Hospitals, IHH Healthcare, and Munjal and Burman were keen to buy Fortis Health Care. Hence, the shareholders of Fortis were not happy with the overall sale process based on the present proposal. The key concern that was evident from the process was the Fortis board approved the bid of Munjan-Burman, sidelining Manipal and IHH. Manipal and IHH both specialize in the healthcare sector, while Munjal-Burman does not have any specialization in the industry. On April 28, three Fortis shareholders, East Bridge Capital Master Fund, East Bridge Capital Master Fund I, and National Westminster Bank Plc (Trustee of the Jupiter India Fund), requested an extraordinary general meeting to remove three directors, Brian Tempest, Harpal Singh, Sabina Vaisoha, and Tejinder Shergill. Tempest's expulsion as a firm director received the required majority of votes, with 87.91% in favor. Other institutional investors also supported the demand to remove at least four directors. After the removal and resignation of many board members of Fortis Healthcare and multiple bids and counter-bids, IHH acquired the hospital chain in November 2018. However, the deal has since been in a legal struggle over the additional stake purchase by IHH Healthcare from the open market. In 2018, the IHH group bought 31% of Fortis, triggering an obligatory open offer to buy another 26% of the company from the market. Due to ongoing legal procedures, the Supreme Court of India halted the open offer.

Eicher Motors

The firm management submitted a resolution to reappoint Siddhartha Lal as Managing Director for 5 years beginning May 1, 2021, and establish his annual pay not exceeding 3% of earnings at the 39th annual general meeting (AGM) on August 17, 2021.

Proxy advice company Institutional Investor Advisory Services (IIAS) anticipated that his proposed remuneration in FY22 would be 23.23 crore, with 32% variable pay, compared to 21.2 crores in FY21, based on the preceding fiscal year's pattern. If the shareholders had approved the proposal, Lal's salary for the current fiscal year would have been Rs 23.23 crore, well ahead of other managing directors in the sector such as Maruti Suzuki's Kenichi Ayukawa (Rs 4.7 crore), M&M's Anish Shah (Rs 9.41 crore), and Ashok Leyland's Vipin Sondhi (Rs 9.41 crore) (Rs 2.2 crore). Siddharth Lal's overall compensation climbed by almost 130% from Rs 9.2 crore in 2016–2017 to Rs 21.12 crore in 2020–2021. Only Bajaj Auto's Rajiv Bajaj, who receives a compensation package of Rs 40.6 crore, gets a bigger deal than Mr. Lal. Surprisingly, only Mr. Bajaj and Mr. Lal are the company's promoters in the industry.

Many shareholders, along with major Institutional shareholders, opposed this proposal for reappointment of Mr. Lal bundled with the salary rise; the investors did not seem to have any problem with his reappointment as a Managing Director but rather the 10% rise in his compensation aiming the slowdown of company revenues with ongoing pandemic and sales still to return to pre-COVID levels. The resolution failed to pass the required threshold as 73.05% of shareholders favored the resolution. Similarly, shareholders previously rejected wage rise requests from former Tata Motors CEO Guenter Butschek and Apollo Tyres CEO Neeraj Kanwar.

After the resolution failed to pass the shareholder vote in the AGM, the company later unanimously declared the reappointment of Mr. Lal as Managing Director of Eicher Motors with cut in proposed salary hike. The new resolution got the endorsement from Shareholders through a postal ballot with 99.42% shareholder support.

Jindal Power

In May 2021, Jindal Steel and Electricity Ltd (JSPL) proposed selling its 96.42% ownership share in Jindal Power Ltd, the company's power division, to World One Private Ltd (World one) for Rs 3015 crore. The initial disclosure of the deal was met with resistance by proxy advisory firms (such as Mumbai-based IiAS and Bengaluru-based InGovern Research). The rationale for this is that World one is a member of the promoter group, and the transaction is a related-party transaction. Surprisingly, Naveen Jindal, Shallu Jindal, and Arti Jindal own Worldone, with Naveen Jindal controlling the bulk of the shares.

The proxy advisory companies advised JSPL shareholders to vote against the proposal, believing that the sale was not fair for a fully functioning power plant having a capacity of 3400 MW and that the transaction should be priced at roughly Rs 10,000–12,000 crore. InGovern contended that the firm had not disclosed its valuation report to shareholders and had converted advances and inter-corporate deposits (ICDs) made by JPL to JSPL to acquire captive power plans to loans. The firm withdrew the EGM notice to ratify the sale process after strong backlash from shareholders and proxy advisory firms, which later altered the offer. Finally, InGovern advised that shareholders vote in favor of the amended agreement in late August. Even though three proxy advice companies advised shareholders to vote in favor of the merger, IiAS advised investors to vote against it. According to the firm, the revised plan received a 96% vote.

Institutional Investors as Reluctant Activists

HDFC Bank

HDFC Bank Ltd is one of India's leading banks. It is a new-generation private sector bank headquartered in Mumbai that offers a wide range of banking services, including commercial and investment banking on the wholesale side, as well as transactional/branch banking on the retail side.

In July 2018, institutional investors (almost a quarter of HDFC shareholders) opposed a special resolution to prolong Deepak Parekh's appointment as a non-executive director of HDFC Ltd. beyond October 2019. Glass, Lewis & Co, and Institutional Shareholder Services, both based in the United States, along with domestic advisory firms, have urged investors to vote against Parekh's directorship and the company's board's independence. The explanation given by ISS is that Parekh is on the board of over six public businesses, while Glass Lewis believes that the board of HDFC is not "sufficiently independent." According to The Economic Times, significant foreign funds have been unhappy with Parekh's performance and voted against his reappointment. Foreign institutional investors own over 72% of the mortgage lending firm. Aberdeen Asset Management, Oppenheimer Funds, and GIC Singapore were among HDFC's significant investors. Two thousand nine hundred seven members voted in favor of the motion, accounting for 77.36% of the votes. However, 572 members voted against Parekh's reappointment as a director of the corporation, accounting for 22.64% of the total votes cast.

The above case signifies when institutional investors work as dabbler activists and try to achieve interests that are not in the interest of ordinary shareholders and the firm. In this case, many foreign institutional investors worked on the recommendations of US-based proxy advisory firms, citing his appointment to multiple boards without proper justification and reasoning for opposition to Mr. Parekh's reappointment. Though there is mixed evidence of board busyness and firm productivity, the relationship between board activity and firm productivity is contingent on monitoring/advising requirements and regulatory control (Bazrafshan & Hesarzadeh, 2021).

Reliance Industries Ltd.

In July 2019, Reliance Industries requested shareholder approval to appoint Saudi Aramco chairman Yasir Othman H Al Rumayyan as an independent director. He is the Governor of the Saudi Arabian Public Investment Fund (PIF). He is also the Chairman of the Saudi Arabian Oil Company's Non-Executive Board (Aramco). He has worked in Saudi Arabian financial institutions for almost 25 years. PIF has invested Rs. 113.7 billion in Jio Platforms Limited for a 2.32% share and Rs. 95.6 billion in Reliance Retail Ventures Limited for a 2.04% stake (on a fully diluted basis). Aramco, on the other hand, is in talks with RIL about forming a strategic collaboration in the latter's O2C sector.

Even though Yasir Othman H. Al Rumayyan is a successful businessman in his own right, he would offer expertise and skills to the organization that would be advantageous, particularly in the New Energy and Materials sector. His appointment complies with the Companies Act and the SEBI Listing Obligations and Disclosure Requirements (LODR). Given PIF and Aramco's ties to RIL, we believe that his appointment as a non-independent non-executive director will compromise the board's independence. Many proxy advisory firms also recommended against this resolution; despite all this, 98.03% of shareholders (with the support of 43 institutional investors voted in favor of his nomination, while 1.96% (only 14 institutional investors) voted against it. The direct support of institutional investors, in this case, raises an important question regarding the role of institutional investors in enhancing the board's independence of their investee company—the non-independent non-executive director.

Table 2 provides the findings from each case based on the role those institutional investors play in corporate governance through activism. Finally, Table 3 provides the findings based on the impact of institutional investors' activism had on corporate governance and the financial performance of the firm.

Findings and Conclusion

The study's findings demonstrate the role institutional investors play in strengthening a firm's corporate governance. Improving corporate governance contributes to the firm performance and hence increases a firm's competitiveness.

In a country like India, where concentrated ownership with majority shareholders is the norm, agency problems are more visible. The growing participation of minority shareholders such as institutions has accelerated the road to reducing agency problem conflicts. Given their resources and access to information, institutional investors have greater financial and informational clout than

Table 2 Role played by institutional investors in corporate governance

Cases findings	Explanation
Monitoring role	Institutional investors, as seen in the example of Eicher Motors, act as a "watchdog" to ensure that management incentives align with the interests of shareholders
Stewardship role	Institutional investors as stewards of the organization's mission to keep the organization focused on its purpose and to ensure that all organizational actions and resources advance the task, as evident from the cases of Fortis Healthcare and Jindal power
Accountability role	The instances of Eicher Motors, HDFC Bank, and Vedanta exemplify the need of institutional investors to hold corporate governance boards accountable for acts that depart from planned objectives and shareholder interests
Transparency role	The case of Fortis Health Care illustrates the importance of institutional investors' transparency when they have concerns about a company's governance structure. Boards of directors should maintain this transparency about their business operations, such as who makes decisions, when, and how, and communicate relevant information with members and other stakeholders who may be interested in the matter
Reluctant activism	The case findings from Reliance Industries and HDFC bank show the reluctant side of the institutional investors. These incidents signify the dabbler activist role that Institutional investors play in some instances, which impacts the governance mechanism of the companies negatively

other minority shareholders like retail investors. Hence, their involvement with the company is unavoidable, and as a result, they must act in the interests of other minority shareholders and defend their rights.

Though shareholder activism is not new in India, in the last 4 years, institutional investors have increased their involvement in business decisions through quality participation in meetings and proxy voting. Institutional investors have also significantly benefited from proxy consulting services; with the help of their voting recommendations, institutional investors have made informed decisions on crucial company matters. Despite having diversified shareholding on paper, many Indian corporations are promoter-driven, and this concentrated promoter ownership is the reason for some cases getting approval even after strong opposition from institutional investors, as in the case of HDFC bank. Institutional investors, on the other hand, have been at the forefront of monitoring and gaining access to the anticipated consequences of critical corporate choices. The most common decisions made at the company level include director appointments, salary, related-party transactions, capital structure modifications, and so on, all of which are crucial for the business's long-term existence and success. Institutional investors assure scrutiny of these vital decisions by ongoing monitoring and activity. Thus, they do their utmost to fight actions that might otherwise stifle business growth and firm performance.

The findings suggest that corporate governance boosts the company's performance. The primary purpose of good corporate governance is to maximize long-term value for shareholders and stakeholders, and no company can accomplish that unless it focuses on improvement in business performance through improvement in corporate governance. Therefore, it makes institutional investor activism a critical factor in the financial markets.

Discussion

The findings of this study indicate the role of institutional investors in improving corporate governance through their participation in essential company matters by utilizing their voting rights and other means. Consistent with (Aggarwal et al., 2015), our findings show that institutions place a high value on their involvement in influencing corporate governance of a performance, which ultimately leads to improvement in firm performance and hence makes the firm more competitive. Institutional investors value corporate governance, and many are eager to engage in shareholder activism through the proxy process (Lewellen & Lewellen, 2022; McCahery et al., 2016). Also, as concluded by (Iliev & Lowry, 2015), many types of institutional investors spend significant time and resources in researching both at the firm level as well as using services from proxy advisory firms to vote on critical firm matters related to corporate governance.

Practical Implications

The findings of this article have the following implications:

1. **Policy:** Policymakers can use the findings of this study to push for changes that would empower institutional investors, especially in the context of reducing the voting power of concentrated promoters, which could otherwise skew voting outcomes in favor of the majority shareholders, as happened in the case of HDFC bank. Second, higher regulatory criteria for institutional investors' activism are calibrated to protect the interests of all stakeholders in the firm, not just shareholders.

Table 3 Impact of institutional investors' activism on corporate governance and firm financial performance

Company	Issue	Corporate governance	Impact on financial performance
Fortis Healthcare	Deal for the acquisition of the concern	Many controversial directors with support from institutional investors were removed and the overall board of the company was restructured	The company revisited the bids and the best bid was selected based on the value and the acquirer's prior experience in the sector
Eicher Motors	Remuneration hike for the company's promoter director and MD	With resistance from the non-promotor shareholders, the proposed hike in remuneration was canceled	Positive impact on the company's bottom line
Jindal Steel and Power	Related party sale of ownership	The resistance from institutional investors forced the company to revise the deal price as it was believed to be undervalued and the valuation basis was not made available to the shareholders	Positive impact on the cash flow from investing activities
HDFC Bank	Reappointment of managing director	The majority of Institutional Investors resisted the reappointment of the MD on many grounds	This case did not have a direct impact on financial performance but the activism by institutional investors was a key incident for their active role in company governance
Reliance Industries	Director appointment	The appointment of an independent director having a stake in a group of companies of concern compromises the Board's Independence	As empirical evidence suggests that more board independence leads to increased firm performance, therefore any attempt to disapprove the board independence will hamper the firm performance

2. **Corporate Governance:** As in India, the indicators of the principal-agent dilemma are more visible; as a result, by empowering minority shareholders, this problem is mitigated to some extent, and by increasing institutional investor engagement, firm governance can become more effective.
3. The findings motivate managers to grasp the differences between management, promoters, and non-promoters on various forms of ordinary resolutions, with documented results, to close the gap and bring all parties on the same page.
4. **Social:** As members of society, institutional investors play an important role in the business sector, stressing, and opposing problems that are important to their investments as well as the investments of ordinary people (Retail Investors). Their active engagement protects retail investors' investing interests while boosting investor confidence.

Key Questions Reflect Applicability in Real Life

1. What role do institutional investors play in shaping corporate governance mechanisms?
2. How institutional investors' capability can safeguard minority shareholders' interests?
3. In what contexts the mechanism of institutional investors work in countries with concentrated ownership?
4. What role do proxy advisory companies play in assisting institutional investors in influencing critical corporate governance decisions?
5. How India's legislative reforms are allowing institutional investors to have a role in critical corporate decisions?

Supplementary Information The online version contains supplementary material available at https://doi.org/10.1007/s42943-022-00069-5.

Acknowledgements The authors would like to thank Dr. Kirankumar S. Momaya and two anonymous reviewers for their helpful comments that improved the manuscript.

Author Contributions All authors contributed to the study conception and design. Material preparation, data collection, and analysis were performed by IRG and AH. The first draft of the manuscript was written by IRG and all authors commented on previous versions of the manuscript. All authors read and approved the final manuscript.

Funding The authors did not receive support from any organization for the submitted work.

Data Availability The data that support the findings of this study are available from the corresponding author upon reasonable request.

Code Availability Not applicable.

Declarations

Conflict of Interest On behalf of all authors, the corresponding author states that there is no conflict of interest.

Ethics Approval Not applicable as the study has used publically available secondary data.

Consent Not applicable.

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