REASONS FOR AND IMPLICATIONS OF THE PRESENCE OF INSTITUTIONAL INVESTORS IN THE OWNERSHIP STRUCTURE OF BRAZILIAN COMPANIES

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Abstract

Using 3,057 observations from 2000 to 2012, we found the risk of expropriation of minority shareholders by controlling shareholders is positively associated with participation of institutional investors in equity funding. There is no evidence that these investors increase the likelihood of substituting the chief executive officer or increase the company's value or its financial performance. However, the presence of institutional investors is associated with higher company debt. This study suggests that institutional investors assume a function not fully explained by agency theory, such as enabling greater access to debt markets, but accentuate the agency conflict between controlling and minority shareholders. The main results show that the presence of institutional investors mitigates agency conflicts between shareholders and creditors, but increases the risk of expropriation of minority shareholders.

Keywords: Corporate Governance, Institutional Investor, Firm Value, Brazilian Stock Market

1. INTRODUCTION

The presence of institutional investors is usually considered a positive factor for improving the quality of corporate governance practices within companies. However, the evidence is still inconclusive about the effectiveness of these investors at mitigating conflict among controlling and minority shareholders, which is the main agency problem in markets with high ownership concentration. Therefore, the objective of this study was to identify and verify the reasons for and implications of the presence of institutional investors, such as banks or investment funds, in Brazilian companies.

From a theoretical point of view, there are different perspectives in the literature on the importance of participation of large investors in a company's capital. Grossman and Hart (1980), for example, highlighted that the presence of a large investor may solve problems related to free riders, which are found in companies with dispersed ownership structures. Jensen and Meckling (1976) shared this view, arguing that the presence of a large investor is sufficient to ensure the monitoring of a chief executive officer (CEO) on behalf of all shareholders. However, Shleifer and Vishny (1986) argued that even in the presence of a major investor, low monitoring would continue, because the investor has an incentive to protect only the rights of its shares, and its efforts providing greater legal protection to all investors would be reduced. In this sense, the arguments of Jensen and Meckling (1976) and Grossman and Hart (1980) seem to accept the premise that there is a need for strong legal protection.

While these theoretical perspectives point out the costs and benefits of the presence of a large investor in a company's capital, to the best of our knowledge, there is no theory that explains why institutional investors, such as banks or pension funds, do not take advantage of the benefits of diversification, and allocate their resources to companies that have concentrated control structures and high risk of expropriation of minority shareholders.

Our results fill this gap by suggesting that the development of corporate governance practices could depend on the controlling shareholder interest, which is able to find alternatives to make its preference for entrenchment effective and to protect against hostile takeovers. This occurs even when the controller signals to the market that it has been engaged in improving the quality of corporate governance within the company, by attracting institutional investors as holders of ordinary shares.

From an empirical viewpoint, the evidence for a positive relationship between the presence of institutional investors and their activism to monitor the decisions of the controlling shareholder and/or the CEO against the risk of expropriation of minority shareholders appears to depend on the level of legal

protection within the country. This argument is based on evidence found by Li et al. (2006) in a study conducted in 45 countries. In addition, the activism of institutional investors appears to depend on the influence of foreign investors, especially from countries with strong legal protection, as evidenced by Aggarwal et al. (2011) in a survey conducted in 23 countries. The evidence and the arguments in favor of activism of institutional investors were also found in Gillan and Starcks (2003), Parrino et al. (2003), Ferreira and Matos (2008), McCahery et al. (2010), Chung and Zhang (2011), and Iliev et al. (2015). Another interesting point is that in markets dominated by banks, as major institutional investors, the evidence points to the costs and benefits of such a structure. For example, Morck et al. (2000), studying the Japanese market, found that a company's value tends to increase linearly with the participation of non-financial investors in the capital because banks have different objectives to maximize the company's value compared with the interests of other shareholders.

However, in markets with high risk of expropriation of minority shareholders by the controlling shareholder, there is a lack of empirical evidence to explain whether institutional investors are effective at practicing activism. Even in these markets, the literature indicates that institutional investors choose to allocate their resources to companies with the best corporate governance practices, as identified by Giannetti and Simonov (2006), in the Swedish market, and Leuz et al. (2009) in 29 emerging economies.

In the Brazilian market, Punsulvo et al. (2007) found a negative relationship between the presence of pension funds in a company's capital and the quality of governance measured by a broad index, suggesting a trade-off between the participation of pension funds and the quality of corporate governance. The evidence in Brazil found by Punsulvo et al. (2007) contrasts with that found in the US market by Chung and Zhang (2011), who found that the effectiveness of institutional investors depends on better quality of corporate governance practiced by the company. In that case, the US results suggest that the presence of institutional investors and the quality of corporate governance within the company are complementary.

Although there is a trend toward greater participation of institutional investors in companies' capital, in the Brazilian market, domestic institutional investors, such as funds or public and private banks, are still prevalent. Lazzarini (2007)

suggested there is a small world among owners of Brazilian public companies, in a study conducted from 1995 to 2003. According to Lazzarini (2007), these owners are business groups and the government itself, through public pension funds and state-owned enterprises. Recently, Claessens et al. (2008) argued that because the main Brazilian banks are state-owned, companies that contribute to financing of political campaigns are later favored with greater access to financing debt capital.

The remainder of this paper is organized as follows. Section 2 presents a brief description of the Brazilian regulatory environment of which corporate governance is a part. Section 3 presents the methodology, specifically, the sample description, definition of variables, and development of the empirical research models. Subsequently, Section 4 presents the data analysis and main results. Finally, the main conclusions of the study and suggestions for future research are presented in Section 5.

2. CORPORATE GOVERNANCE IN THE BRAZILIAN MARKET

The Brazilian market is an interesting case study because of its complexity, providing challenges for its regulators to mitigate the risk of expropriation of companies' minority shareholders.

A major Brazilian market characteristic is the fact that this market has undergone changes in the legal and institutional environment, starting in early 2000. For example, the main corporate law has been reformulated, and differentiated levels of listing segments for corporate governance have been created, such as level 1, level 2, and *Novo Mercado* (New Market), which are encouraged by the main stock exchange, the BM&FBOVESPA. Table 1 shows the characteristics of these levels compared to the traditional market, especially with regard to the type of shares issued, percentage of free float, share dilution, tag-along concession, and composition of the board.

Black et al. (2014) found a positive impact of changes in the Brazilian institutional environment on companies' quality of corporate governance and on the market value of these companies. According to the authors, the evolution of corporate governance practices is due to two reasons: first, the adherence of companies to Level 2 and New Market; and second, and the improvement of corporate governance practices when a company decides to migrate to a listing segment with higher standards.

Table 1. Differentiated levels of corporate governance and the traditional market

	New Market	*Level 2*	*Level 1*	*Traditional market*
Characteristics of shares issued	Only shares with voting rights (ON)	Allows non-voting shares (PN) with additional rights.	Allows ordinary and preference shares (according to law)	
Minimum percentage of outstanding shares (*free float*)	Minimum 25%			No rule
Public distribution of shares	Share dilution efforts			No rule
Tag-along Concession	100% for ordinary shares	100% for ordinary and preference shares; 80% for PN (up to 09/05/2011)	80% for ordinary shares (according to law)	
Annual public meeting and corporate event calendar	Mandatory			Optional
Composition of the board of directors	Minimum of five members; 20% must be independent		Minimum of three members (according to law)	
Stopping the accumulation of positions (from 10/05/2011)	Chairperson and CEO is the same person (grace period of 3 years from accession)			There is no rule

Source: Adapted from BM&FBOVESPA (2014)

On the other hand, Gorga (2009) argued that the changes in the corporate law were below expectations. One of these arguments is that although the new legislation (Law n. 10303 / 01) has reduced the limit of the proportion of preference shares from 66.67%, based on previous legislation up to 2001, to 50% of the company's total capital, this change applies only to companies that went public after the 2001 law change. According to the Brazilian Institute of Corporate Governance (IBGC, 2014), despite the deepening of the debate on corporate governance and increasing pressure for the advancement of good governance practices in companies, Brazilian companies are still characterized by high concentration of shares in the hands of controlling shareholders. The low effectiveness of boards of directors and the overlap between ownership and management suggests that even after taking into account possible evolution, there are still weaknesses in corporate governance practiced by companies.

3. METHODOLOGY

3.1. Sample and data collection

Our study considered a 13-year period from 2000 to 2012. The rationale for choosing this period was the possibility of including the most possible data after major changes in the legal and institutional environment, such as the creation of the *Novo Mercado* in the early 2000s. To form the sample of studied companies, we excluded financial institutions, as these have different financial statements and peculiar characteristics that prevent comparison with other sectors. In order to avoid inflationary effects, the figures were adjusted for inflation, using the variation of the general price index on December 31, 2012. We considered valid observations from companies that presented sufficient information on variables to develop the objective proposed in this study.

The source for financial indicators was Economatica. Meanwhile, to collect information regarding ownership structures and boards of directors, we used the website of the Brazilian Securities Commission (*Comissão de Valores Mobiliários*). After the data collection, companies that did not have all the necessary information for the research were excluded. Thus, our database comprised unbalanced panel data for 462 companies with 1 to 13 observations per company, making 3,057 observations.

3.2. Development of empirical models and definition of variables

The broad classification of an institutional investor covers any type of investor that is not an individual. However, as highlighted by Aggarwal et al. (2011) and Chung and Zhang (2011), institutional investors, such as banks, insurance companies, and pension funds, have strong fiduciary responsibilities that characterize them as more likely to improve the corporate governance of a company. Thus, to identify the companies with institutional investors in the Brazilian market, we used a dummy variable (DLarg) that takes a value of 1 if at least one of the major shareholders of the company is clearly termed a bank or investment fund, either public or private, and is set to 0 otherwise. A complete description of the variables used in this study is provided in Table 2.

Table 2. Description of variables

N	Variable	Measure
1	Tobins' Q	Ratio of the market value of the company to the book value of total assets.
2	ROA	Ratio between the operating result and the total asset at the end of period *t*.
3	CEO-Turnover	Variable equal to one (1) if the CEO of company *i* was replaced at time *t* compared to *t-1*, and zero (0) otherwise.
4	DLarg	Binary variable equal to one (1) if the company has at least one institutional investor, such as a bank or investment fund, as capital shareholder, and zero (0) otherwise.
5	GrD/TA	Ratio of gross debt to total asset value.
6	Cont1; Cont5	Percentage of ordinary shares held by the largest shareholder (Cont1) and the five largest shareholders (Cont5).
7	Wedg1; Wedg5	Excess voting power by the largest shareholder (Wedg1) and five largest shareholders (Wedg5). These variables were calculated by the following equation: Wedge = [(Con / Own) -1], which was applied to the largest and five largest shareholders.
8	Dual	Binary variable equal to one (1) if the company has two classes of shares, and zero (0) otherwise.
9	AA	Binary variable equal to one (1) if the company has a shareholder's agreement, and zero (0) otherwise.
10	Pyr	Binary variable equal to one (1) if the company has indirect ownership or pyramid control, and zero (0) otherwise.
11	Fam	Binary variable equal to one (1) when the controlling shareholder is family, and zero (0) otherwise. We considered family control cases when at least one of the five largest investors is an individual person.
12	CGI	Binary variable equal to one (1) if the company has shares listed on the CGI, and zero (0) otherwise.
13	NM	Binary variable equal to one (1) if the company has shares listed on the New Market (*Novo Mercado*) (NM), and zero (0) otherwise.
14	SizeBoard	Number of members belonging to the board of directors.
15	Out	Percentage of outside directors to the total number of board members.
16	CEOdu	Binary variable equal to one (1) if the CEO concurrently holds the position of chairperson of the board of directors, and zero (0) otherwise.
17	CEOb	Binary variable equal to one (1) if the CEO simultaneously occupies the position of regular board member at the same company, and zero (0) otherwise.
18	Ln TA	Natural logarithm of the total value of assets.
19	ST Debt	Ratio of short-term debt to total debt of the company.
20	Sector	Sector of economic activity in which the company belongs, according to Economatica's classification.
21	Liquidity	Liquidity of shares on the stock exchange (BM&FBovespa).

Source: Prepared by the authors

For the first empirical model tested in this work, we considered the contributions of Giannetti and Simonov (2006), Li et al. (2006), and Leuz et al. (2009), who argued that institutional investors choose companies with lower risks of expropriation of minority shareholders to allocate their resources.

$$DL\arg_{i_t} = \beta_0 + \beta_1 Cont1_{it} + \beta_2 Wedg1_{it} + \beta_3 AA_{it} + \beta_4 Pyr_{it} + \beta_5 Z_{it} + u_i + \eta_t + \varepsilon_{it} \qquad (1)$$

Where *Cont*1 refers to ownership concentration, *Wedg*1 to excess voting power of the largest shareholder, *AA* to the existence of a shareholder's agreement, and *Pyr* to the pyramid control structure. These are considered the main independent variables of interest, which aim to verify that the risk of expropriation of minority shareholders is an important aspect that explains the presence of institutional investors in Brazilian companies' capital. The aim is to test, using equation 1, and the validity of the following Hypothesis 1.

Hypothesis 1. The practice of mechanisms to leverage the voting power of the controlling shareholder in the Brazilian market is negatively associated with the participation of institutional investors, such as banks and pension funds, in the capital of Brazilian companies.

For the reasoning of the second empirical model tested in this work, we took into account the contributions developed by Parrino et al. (2003), DeFond and Hung (2004), Giannetti and Simonov (2006), Li et al. (2006), Leuz et al. (2009), Aggarwal et al. (2011), Chung and Zhang (2011), and Iliev et al. (2015). They argued that the presence of institutional investors has a positive influence on monitoring of activities by insiders and, consequently, there is better financial performance and the shareholders are more likely to replace the CEO, as described in equation 2,

$$Perf_{i_t} = \beta_0 + \beta_1 DL\arg_{it} + \beta_2 PE_{it} + \beta_3 PE * DL\arg_{it} + \beta_4 Out_{it} + \beta_5 Out_{it} * DL\arg_{it} + \beta_6 Z_{it} + u_i + \eta_t + \varepsilon_{it} \qquad (2)$$

$$Turn_{i_t} = \beta_0 + \beta_1 Perf_{it-1} + \beta_2 DL\arg_{it} + \beta_3 PE_{it} + \beta_4 PE * DL\arg_{it} + \beta_5 Out_{it} + \beta_6 Out * DL\arg_{it} + \beta_7 Z_{it} + u_i + \eta_t + \varepsilon_{it} \qquad (3)$$

in which the dependent variables $Perf_{it}$ represents the financial performance of company *i* at time *t*, and $Turn_{it}$ represents the turnover, which is a binary variable that takes a value of 1 if the CEO of company *i* was replaced in periods *t* to *t-1*, and 0 otherwise.

It is noteworthy that, in equations 2 and 3, the main independent variables are almost the same. Thus, *DLarg* is a dummy variable that takes a value of 1 if firm *i* has in its ownership structure at least one institutional investor in time *t*, and 0 otherwise. *PE* is a set of variables related to the company's ownership structure, especially equity concentration, such as the percentage of votes of the largest and five largest shareholders (*Cont1*) and (*Cont5*), respectively; the excess voting power of those shareholders (*Wedg1*) and (*Wedg5*), respectively, or the family nature of the controlling shareholder (*Fam*). The variable (*Out*) represents the percentage of outside directors on the board and the variable (*Out * DLarg*) is the interaction term between the percentage of outside directors and the presence of institutional investors. The purpose of including the variables related to the board is to separate the possible effects that the presence of foreign investors has on the dependent variables highlighted in equations 1 and 2, either directly or through the independence of directors.

In equation 3, we added a variable related to financial performance with one lagged period (*Perf_{t-1}*), which aims to verify the sensitivity of CEO turnover before a poor financial performance.

The development of equations 2 and 3 aims to testing Hypotheses 2 and 3, respectively, as described below.

Hypothesis 2. The participation of institutional investors, such as banks and pension funds, in the capital of Brazilian companies is positively associated with their value/financial performance.

Hypothesis 3. The participation of institutional investors, such as banks and pension funds, in the capital of Brazilian companies is positively associated with the replacement of the CEO of the company.

Finally, the reasoning for the fourth empirical model took into account the possibility of the presence of the institutional investor being relevant for mitigating the potential agency conflict between shareholders and creditors in the Brazilian market.

$$GrD/TA_{i_t} = \beta_0 + \beta_1 DL\arg_{it} + \beta_2 PE_{it} + \beta_3 PE * DL\arg_{it} + \beta_4 Out_{it} + \beta_5 Out_{it} * DL\arg_{it} + \beta_6 Z_{it} + u_i + \eta_t + \varepsilon_{it} \qquad (4)$$

In equation 4, the dependent variable is represented by the amount of debt, which is measured by the percentage of gross debt in relation to the total value of assets (*GrD / TA*) of firm *i* at time *t*. Just as in equations 2 and 3, the reason for including variables related to the board of directors is to separate the possible effects that the presence of foreign investors has on the dependent variable highlighted in equation 4, either directly or via the independence of directors. The other control variables, placed in equations 1–4, are represented by the vector Z_{it}, which is a set of exogenous variables, such as the observable characteristics of companies, while u_i, η_t, ε_{it} are the unobserved heterogeneity and time-invariant, the time fixed effects, and the random error term, respectively.

The development of this empirical model took into account the evidence of Paligorova and Xu (2012) in a study conducted in the G7 countries; Faccio et al. (2010) in East Asia and Western Europe; Liu and Tian (2012) in China; and, Mendes-Da-Silva et al. (2007), Claessens et al. (2008), and Fernandes and Barros (2010) in the Brazilian market.

Thus, the formulation of equation 4 aims to test Hypothesis 4, as described below.

Hypothesis 4. The participation of institutional investors, such as banks and pension funds, in the capital of Brazilian companies is positively associated with a lower risk of expropriation of creditors by shareholders.

4. RESULTS

The data presented in Figure 1 show that the number of companies in which financial institutions were invested increased substantially (90.3%) from 2000 to 2012. In 2007, the highest number of investee companies (109 companies) was registered, representing an increase of 109.6% from 2000.

Figure 1. Number of companies invested by institutional investors from 2000 to 2012
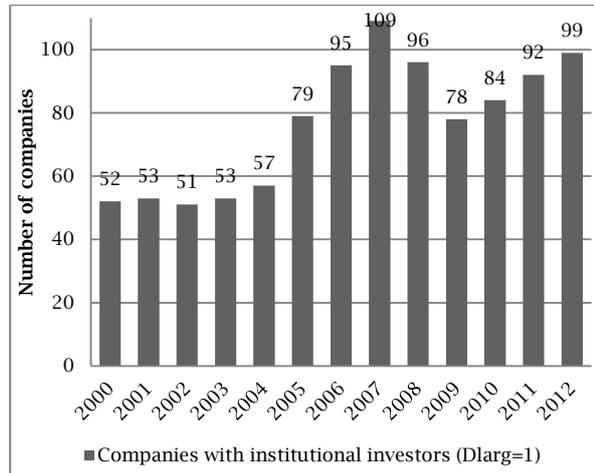
Source: Authors using research data

As Figure 1 shows, the total numbers of companies in which institutional investors were invested declined only in 2008 and 2009, possibly due to the 2008 financial crisis.

4.1. Regression analysis

In Table 3, we present the regression results for equation 1, the aim of which is to verify possible determinants of the presence of institutional investors in the capital of Brazilian companies.

Regarding corporate ownership structure, the data in Table 3 show that the voting power of the largest shareholder (*Cont1*) presented a negative likelihood ratio with the dependent variable, the presence of institutional investors (*DLarg*). This relationship was statistically significant in the regressions from 1–4. When analyzing the voting power of the five largest shareholders (*Cont5*), the relationship was not statistically significant, as shown in the regressions from 5–8. Thus, the high ownership concentration of the largest shareholder is a possible barrier to the company having institutional investors as the main shareholders. However, the excess voting power of the controlling shareholder (*Wedg1*) presented as a relevant aspect that positively influences the presence of institutional investors. The coefficient of *Wedg1* was statistically significant at the 1% level in regression 4, confirming the arguments in Section 3 that the institutional shareholders were more likely to undertake investment opportunities in preference shares, compared to investment opportunities in stocks that enable control of Brazilian companies. One possible explanation is that the largest shareholder was resistant to sell part of its controlling shares to institutional investors, due to the negative sign of the variable *Cont1*. However, when there was leverage of control by the largest shareholder (*Wedg1*), it increased the likelihood that the company had an institutional investor as a holder of ordinary shares.

Table 3. Determinants of the presence of institutional investors in companies' capital

Var. –DLarg	1	2	3	4	5	6	7	8
β_0 – Constant.	-6,84***	-6,96***	-6,47***	-6,00***	-7,31***	-7,32***	-6,60***	-7,93***
β_1 – Cont1	-0,04***	-0,04***	-0,03***	-0,04***	-	-	-	
β_2 – Wedg1	-	-	-	1,38***	-	-	-	
β_3 – Cont5	-	-	-	-	0,000	0,000	0,001	0,003
β_4 – Wedg5	-	-	-	-	-	-	-0,55**	-
β_5 – Dual	1,09***	1,30***	-	-	0,18	0,43	-	-
β_6 – AA	0,32	0,19	0,31	1,84	0,59***	0,47**	0,48***	0,55***
β_7 – Pyr	0,80**	0,90**	0,91***	1,00***	-0,09	0,01	0,06	0,02
β_8 – CGI	-	0,76**	-	-	-	087***	0,85***	-
β_9 – NM	-	-	-0,30	-	-	-	-	0,43
β_{10} – Ln TA	0,13	0,12	0,15	0,09	0,13	0,10	0,07	0,15
β_{11} – GrD/TA	0,03***	0,02***	0,02***	0,02***	0,03***	0,03***	0,03***	0,03***
β_{12} – Tobin's Q	-	-0,005	-0,03	-	-	0,09	-	-0,008
β_{13} – ROA	-	-0,04***	-0,04***	-	-	-0,04***	-	-0,04***
β_{14} – Sector	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
β_{15} – Natu	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
β_{16} – Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N (obs)	2997	2997	2997	2997	2997	2997	2997	2997
N (companies)	440	440	440	440	440	440	440	440
Prob (Chi²)	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Authors using research data
Notes: The table shows the results of a logit regression to identify the determinants of the presence of institutional investors, where DLarg is a dependent dummy variable that takes a value of 1 when institutional investors, such as banks or pension funds, have significant participation as shareholders. Several regressions were estimated using the random-effects model. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively

The opposite relationship was found when analyzing the excess voting power of the five largest shareholders (*Wedg5*), showing a negative and statistically significant relationship with the dependent variable (*DLarg*). In this way, the perception of institutional investors against the risk of expropriation is different when it results from excess voting power by the largest shareholder (*Wedg1*), and when it is due to leverage of the voting power practiced by the five largest shareholders (*Wedg5*).

In addition, we found that an increased risk of expropriation of minority shareholders, especially due to the excess voting power of the largest shareholder, seems not to be a restriction for the presence of institutional investors in the companies' capital. This assertion was supported not only by the analysis carried out for the variable *Wedg1*, but also when analyzing the coefficients of the variables related to the issuance of two classes of shares, shareholders' agreement and pyramid control structure. The issuance of two classes of shares (*Dual*) showed a positive sign and was statistically significant in regressions 1 and 2; the shareholders' agreement (*AA*) coefficient showed a positive sign and was statistically significant in regressions 5–8, and pyramid structure control (*Pyr*) coefficient was positive and statistically significant in the regressions 1–4.

It is argued that this evidence supports the argument that the effort within the company to offer greater protection to minority shareholders, at least by not using mechanisms for leveraging voting power, is associated with lower likelihood ratios of the company to have an institutional investor. This result is consistent with the evidence of Punsulvo et al. (2007) in the Brazilian market, which suggests that the quality of corporate governance, when measured by a broad index, and the presence of institutional investors are substitutes.

The coefficients of *Dual* and *Pyr* were statistically significant only in the regressions that took into account the percentage of control by the largest shareholder (*Cont1*), while the variable (*AA*) was statistically significant only in the regressions that took into account the percentage of control by the five largest shareholders (*Cont5*). One possible interpretation of this evidence is that in the absence of the variable associated with the percentage of control by the largest shareholder (*Cont1*), the variable related to the shareholders' agreement (*AA*) already captures the risks of expropriation by the largest controlling shareholder. This risk could arise whether from the use of the issue of two classes of shares and/or the presence of pyramid control structure (*Pyr*), which are positively associated with the presence of institutional investors as holders of ordinary shares in Brazilian companies.

Regarding corporate governance practices, the variable related to the listing of the company's shares in the Corporate Governance Index (CGI) had a positive relationship with the odds ratio of the company having an institutional investor as a holder of ordinary shares. This relationship was statistically significant in regressions 2, 6, and 7. On the other hand, when analyzing the variable associated with the New Market (*NM*), there was no positive relationship with the analyzed dependent variable. When analyzing the characteristics of the companies, the size of the company *(ln TA)* did not influence the likelihood ratio of the company having

institutional investors, while there was a positive relationship with the company's debt (*GrD/TA*), which was statistically significant in all regressions with the dependent variable. Regarding the financial performance, the presence of institutional investors seems to be influenced by *Tobin's Q*, but companies with lower levels of operating profitability (*ROA*) were more likely to attract institutional investors to its shareholder structure. The coefficients of the binary variables associated with the sector of activity (*industry*), the nature of the controlling shareholder (*Natu*), and the time fixed effects were included in the regressions. The nature of the largest investor as well as the variables associated with the years from 2005 showed positive likelihood ratios and were statistically significant in all the analyzed regressions.

The regressions presented in Table 4 aimed to verify if there is a relationship between the presence of institutional investors (*DLarg*) and the market value of Brazilian companies, as measured by Tobin's *Q*. The coefficient of *DLarg* was not significant in any of the estimated regressions.

In Table 4, we observe that the percentage of outside directors on the board (*Out*) positively affects the company's Tobin's *Q*, as evidenced by the coefficient $\beta 11$, which was statistically significant in all analyzed regressions. However, this relationship between percentage of outside directors and company value does not seem to be influenced by whether the company has at least one institutional investor in its ownership structure, which is evidenced by the $\beta 10$ coefficient in regression 7, and although the coefficient has a positive value, it was not statistically significant.

These findings indicate that the presence of an institutional investor had little effect in positively influencing the company's Tobin's Q. Such evidence was found only when there is excess of voting power by the five largest shareholders. Under that condition, the presence of institutional investors mitigated the negative effect caused by excess voting power of the largest investors, as shown by the sum of the coefficients $\beta 5$ and $\beta 9$ in regression 6.

The evidence does not generate conclusions about whether the institutional investor itself practices leverage of voting power. However, from the previous results that suggest institutional investors are more likely to acquire shares without voting rights, we could infer that the leverage of voting power by the five largest shareholders would be *financed* through investments made by institutional investors. That is, in this case, institutional investors would have a greater chance of representing the interests of minority shareholders who are not part of the five largest investors, and of mitigating the risks of expropriation of the five largest investors, although at sub-optimal levels. Another possible explanation is that the largest shareholder tends to be able to attract resources from institutional investors that have different objectives to maximizing the company's value. It is argued that the estimates for the coefficients $\beta 6$ and $\beta 8$ support this statement, because they indicate the ineffectiveness of the presence of institutional investors to mitigate the risk of expropriation from the high ownership concentration of the largest shareholder (*Cont1*), or of their excess voting power (*Wedg1*).

Table 4. Effectiveness of institutional investors (*DLarg*) to increase the company's value

Var. – Tobin's Q	1	2	3	4	5	6	7
β_0 – Constant	3,03***	3,76***	3,09***	3,91***	3,07***	3,76***	3,05***
β_1 – Dlarg	0,03	-0,008	-0,08	-0,34	-0,003	-0,04	-0,05
β_2 – Cont1	0,0009	-	0,0003	-	0,0009	-	0,009
β_3 – Wedg1	-0,09**	-	-0,10***	-	-0,12***	-	-0,09***
β_4 – Cont5		-0,001		-0,002		-0,001	
β_5 – Wedg5		-0,24***		-0,24***		-0,26***	
β_6 – Cont1*DLarg			0,002	-			
β_7 – Cont5*DLarg				0,004			
β_8 – Wedg1*Dlarg					0,06	-	
β_9 – Wedg5*Dlarg						0,10*	
β_{10} – Out*Dlarg							0,10
β_{11} – Out	0,28*	0,23*	0,28*	0,22*	0,27*	0,23*	0,26*
β_{12} – CGI	0,27***	0,26***	0,27***	0,26***	0,27***	0,26***	0,27***
β_{13} – CEOb	0,05	0,05	0,05	0,05	0,05	0,05	0,05
β_{14} – SizeBoard	-0,007	-0,008	-0,007	-0,008	-0,007	-0,009	-0,008
β_{15} – Ln TA	-0,13**	-0,17***	-0,13**	-0,17***	-0,13***	-0,16***	-0,13***
β_{16} – GrD/TA	-0,005***	-0,005***	-0,005***	-0,005***	-0,005***	-0,005***	-0,005***
β_{17} – ROA	0,01***	0,01***	0,01***	0,01***	0,01***	0,01***	0,01
β_{18} – Liquidity	0,04	0,04	0,04	0,05	0,04	0,04	0,04
N (obs)	2747	2747	2747	2763	2747	2763	2747
N (companies)	409	409	409	410	409	410	409
Prob (Chi²)	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Authors using research data

Notes: The table shows regression results for equation 2, thereby verifying the effectiveness of the presence of institutional investors (DLarg), such as banks or pension funds, in increasing the company's value. The regressions were estimated using the fixed-effects model with White (1980) robust standard errors. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively

The coefficients of other characteristics of the board, such as the total number of members (*SizeBoard*) and the duality of the CEO functions, either as chairperson of the board of directors or as a regular board member (*CEOb*), were not statistically significant. On the other hand, the binary variable associated with adherence to the CGI presented a positive sign and was statistically significant in all analyzed regressions.

Still, in Table 4, it appears that the control variables related to firm size (*Ln TA*) and the volume of debt (*GrD/TA*) showed negative signs and were statistically significant in all regressions, while the variable related to operating performance to assets (*ROA*) presented a positive sign and was statistically significant in the analyzed regressions. Finally, the liquidity of the shares on the stock exchange (*Liquidity*) showed no statistically significant relationship with Tobin's *Q*.

A similar analysis, presented in Table 5, shows the regressions estimated considering the operating performance on assets (*ROA*) as the dependent variable. While the presence of institutional investors was not generally associated with Tobin's *Q* of the companies, except under restricted conditions, the presence of such investors in the capital of Brazilian companies was negatively associated with operating return on assets (*ROA*). The coefficient β1 had a negative sign and was statistically significant in almost all analyzed regressions.

Data in Table 5 show that concentration of the largest shareholder (*Cont1*) or the five largest shareholders (*Cont5*), as well as variables related to excess voting power of such investors, (*Wedg1*) and (*Wedg5*), respectively, were not statistically significant in establishing relationship with financial performance measured by variable *ROA*. When analyzing the interaction between those variables with *Dlarg*, the coefficients β6 to β9 did not show a statistically significant relationship with the company's financial performance. This evidence suggests that the presence of institutional investors negatively affected the company's operating performance, as measured by ROA. The same results were found when replacing the dependent variable (*ROA*) by other financial metrics, such as operating margin, the return on equity (*ROE*), or annual growth of company net revenue (*ΔRec*). In addition, we highlighted that the methodology did not take into account the simultaneous relationship between the variables *DLarg* and *ROA*, since the less profitable companies had greater probability of attracting institutional shareholders, as shown in Table 3.

The coefficient of the board of directors' characteristics, the percentage of outside directors (*out*), was positive and statistically significant in all analyzed regressions except regression 2, which included the variable related to the dual leadership exercised by the same person, in the positions of CEO and chairperson of the board of directors (*CEOdu*). In regression 2, both variables *Out* and *CEOdu* showed no statistically significant correlation with financial performance. In the other regressions, the β14 coefficient was positive, possibly by taking into account the possibility of the CEO as a director, but being a regular member and not just assuming the role of chairperson. The number of board members (*Sizeboard*) was not statistically significant in the analyzed regressions.

Among the other control variables, such as firm size (*Ln AT*) and volume of debt (*GrD/TA*), only debt had a negative and statistically significant relationship with the financial performance in all analyzed regressions.

Table 5. Effectiveness of institutional investors (*DLarg*) to increase the company's financial performance

Var. –ROA	1	2	3	4	5	6	7
β_0 – Constant	12,80	18,94***	12,83	11,08	12,58**	9,97***	13,45*
β_1 – Dlarg	-1,58***	-1,44**	-1,45	-4,35*	-1,38**	-1,71***	-3,85
β_2 – Cont1	-0,01	-0,01	-0,006		-0,01		-0,01
β_3 – Wedg1	0,38	0,35	0,17		0,54		0,38
β_4 – Cont5				-0,01		-0,007	
β_5 – Wedg5				0,84		0,58	
β_6 – Cont1*DLarg			-0,0009				
β_7 – Cont5*DLarg				0,03			
β_8 – Wedg1*Dlarg					-0,36		
β_9 – Wedg5*Dlarg						1,06	
β_{10} – Out*Dlarg							2,64
β_{11} – Out	4,80*	-0,13	4,71*	4,85*	4,84*	4,88*	4,27*
β_{12} – CGI	-0,72	-0,76	-0,66	-0,65	-0,72	-0,62	-0,76
β_{13} – CEOb	1,83***		1,79***	1,76**	1,82**	1,79**	1,88***
β_{14} – CEOdu		-0,52					
β_{15} – SizeBoard	-0,13	-0,09	-0,12	-0,12	-0,13	-0,13	-0,14
β_{16} – Ln TA	-0,35	-0,43	-0,37	-0,23	-0,34	-0,22	-0,36
β_{17} – GrD/TA	-0,09***	-0,09***	-0,09***	-0,09***	-0,09***	-0,09***	-0,09***
N (obs)	2747	2747	2747	2763	2747	2763	2763
N (companies)	409	409	409	409	409	409	409
Prob (Chi²)	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Authors using research data
Notes: The table presents the regression results to verify the effectiveness of the presence of institutional investors (DLarg), such as banks or pension funds, to increase the company's financial performance (ROA). The regressions were estimated using the fixed-effects model, and White (1980) robust standard errors. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively

After verifying a relationship between the presence of institutional investors and Tobin's *Q* or the operating profitability of company assets (*ROA*), we attempted to verify if the presence of such investors in the company's ownership structure increased the likelihood ratio of CEO turnover (equation 3). Specifically, the aim was to verify the effectiveness of institutional investors in practicing monitoring activity.

The data in Table 6 show that the presence of institutional investors had no significant relationship with the replacement of the company's CEO. On the contrary, the presence of such investors reduced the likelihood ratio of the turnover of the CEO when the company has high levels of concentration of voting power by the largest shareholder.

Those statements were established when analyzing the β2 coefficients of variable *DLarg*, which were not statistically significant in all regressions, and β10 of the interaction between *Cont1* and *DLarg*, which had a negative sign and was statistically significant in regression 5. The other interactions between *DLarg* and the variables associated with ownership concentration, such as *Cont5*, *Wedg1*, *Wedg5*, and *Fam*, were not statistically significant, indicating that the turnover of the CEO was not sensitive to the presence of institutional investors as shareholders of Brazilian companies during the sample period.

The percentage of outside directors (*Out*) increased the probability of CEO replacement, as identified by the coefficient β3, which was statistically significant in all regressions. However, there was no evidence that the effectiveness of the percentage of outside directors had an effect on the turnover of the CEO in companies with at least one

institutional investor in the group of the company's five largest shareholders.

The evidence presented in Table 6 suggests that the presence of institutional investors is not effective in preventing the possible practice of the entrenchment by the controlling shareholders. This is confirmed by negative and statistically significant relationships with the variables *Cont5* and *Fam*, which measure the percentage of voting power by the five largest shareholders and the family nature of the company's voting capital, respectively. In addition, a negative relationship that family nature assumes with the substitution of the CEO could be observed by the coefficient variable *CEOdu*, which refers to the dual functions of CEO and chairperson occupied by the same person.

Taken together, the results presented in Tables 4, 5, and 6, show little evidence that the presence of institutional investors add value to the company. On the contrary, the evidence allows the rejection of the hypothesis that the presence of institutional investors increases the chances of aligning the interests between controlling shareholders and minority shareholders, given its ineffectiveness in enhancing the operating profitability on assets and/or monitoring the CEO, and replacing it when needed.

Given such evidence and the fact that the institutional investor may be considered as a minority shareholder and in a better position than other minority shareholders to monitor the company's controlling shareholder, the question arises about what the benefit for the company is in attracting resources from institutional investors. Therefore, in Table 7, we analyze if the presence of institutional investors is associated with debt volume, measured as the ratio of gross debt to total assets (*GrD/TA*).

Table 6. Effectiveness of institutional investors (*DLarg*) in CEO *turnover*

Var. –Turnover	1	2	3	4	5	6	7
β_1 – L_1.Tobin's Q	-0,26*	-0,26*	-0,26*	-0,27*	-0,26*	-0,26*	-0,31***
β_2 – Dlarg	-0,10	-0,28	-0,39	-1,27	0,48	-0,35	-0,24
β_3 – Out	3,33***	3,16***	3,15***	2,99***	3,33***	3,16***	3,96***
β_4 – Out*Dlarg	-	-	-	1,14	-	-	
β_5 – Wedg1	0,23	-	-	0,10	0,19	-	
β_6 – Wedg1*Dlarg	-0,26	-	-	-	-	-	
β_7 – Wedg5	-	-0,35	-0,45	-	-	-0,36	
β_8 – Wedg5*Dlarg	-	-	0,31	-	-	-	
β_9 – Cont1	-0,001	-	-	-0,001	0,02	-	-0,004
β_{10} – Cont1*DLarg	-	-	-	-	-0,014*	-	
β_{11} – Cont5	-	-0,01*	-0,01*	-	-	-0,013*	
β_{12} – Cont5*DLarg	-	-	-	-	-	0,00	
β_{13} – Fam	-	-	-	-	-	-	-0,53*
β_{14} – Fam*Dlarg	-	-	-	-	-	-	0,23
β_{15} – CEOdu	-0,62**	-0,58**	-0,58**	-0,61**	-0,62**	-0,59**	-
β_{16} – SizeBoard	-0,10*	-0,12**	-0,12**	-0,11**	-0,11**	-0,12**	-0,11**
β_{17} – GCI	-0,16	-0,18	-0,17	-0,17	-0,16	-0,18	-0,07
β_{18} – Ln TA	0,36*	0,28	0,28	0,35*	0,35*	0,28	0,38*
β_{19} – ST Debt	0,00	0,00	0,00	0,00	0,00	0,00	0,00
N (obs)	1406	1416	1416	1406	1406	1406	1420
N (companies)	192	194	194	192	192	192	192
Prob (Chi²)	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Authors using research data
*Notes: The table shows the results of logit regressions to see if the presence of institutional investors (DLarg), such as banks or pension funds, is effective in promoting the replacement (turnover) of the CEO. The regressions were estimated using the fixed-effects model. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively*

Table 7. Effectiveness of institutional investors (*DLarg*) in increasing the indebtedness of the company

Var. –GrD/TA	1	2	3	4	5	6	7
β_0 – Constant	-81,57	-87,86***	-81,92***	-87,83***	-82,51**	-87,95**	-81,55**
β_1 – Dlarg	1,88*	2,44**	2,64	2,36	2,96**	3,30**	1,81
β_2 – Cont1	-0,05*		-0,05		-0,05*		-0,05*
β_3 – Wedg1	2,73**		2,80**		3,59***		2,73**
β_4 – Cont5		0,01		0,01		0,01*	
β_5 – Wedg5		1,83		1,83		2,46	
β_6 – Cont1*DLarg			-0,01				
β_7 – Cont5*DLarg				0,000			
β_8 – Wedg1*Dlarg					-1,97*		
β_9 – Wedg5*Dlarg						-2,64	
β_{10} – Out*Dlarg							0,07
β_{11} – Out	5,42	5,19	5,46	5,19	5,75	5,17	5,40
β_{12} – CGI	-4,99***	-4,61***	-4,99***	-4,61***	-4,99***	-4,66***	-5,00***
β_{13} – CEOb	0,74	0,62	0,73	0,62	0,66	0,59	0,74
β_{14} – SizeBoard	-0,20	-0,16	-0,21	-0,16	-0,21	-0,15	-0,20
β_{15} – Ln TAt	7,47***	7,66***	7,47***	7,66***	7,49***	7,64***	7,47***
β_{16} – ROA	-0,23***	-0,23***	-0,23***	-0,23***	-0,23***	-0,23***	-0,23***
N (obs)	2747	2747	2747	2763	2747	2763	2747
N (companies)	409	409	409	410	409	410	409
Prob (Chi²)	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Authors using research data
*Notes: The table presents regression results to verify if the presence of institutional investors (DLarg), such as banks or pension funds, is effective in attracting debt resources to the company. Regressions were estimated using the fixed-effects model with White (1980) robust standard errors. ***, **, and * represent significance at the 1%, 5%, and 10% levels, respectively*

The data in Table 7 show that the presence of institutional investors (*DLarg*) positively affected the volume of debt contracted by the company, and the β1 coefficient was statistically significant in all regressions except regression 3.

Regarding the variables of ownership concentration, it appears that the highest percentage of control of the largest shareholder (*Cont1*) and the five largest shareholders (*Cont5*) had negative and positive effects, respectively, on volume of a company's debt. However, the magnitude of the parameters was relatively low, as shown in β2 parameters, but statistically significant in all regressions, except regression 3, while β4 was

statistically significant only in regression 6. When analyzing the excess voting power of the largest (*Wedg1*) and five largest shareholders (*Wedg5*), only the coefficient of *Wedg1* was positive and statistically significant in all regressions. This evidence suggests that excess voting power of the largest shareholder was not understood by company's creditors as a risk of expropriation, as understood by the minority shareholders. Another possible explanation is that lenders use collateral to protect themselves from the risk of expropriation, and excess voting power is a limiting factor for the company to attract funds in the stock market, which would increase the chances of debt being the main source of funding.

When analyzing the interaction between the presence of institutional investors and participation of the largest shareholder and five largest shareholders, we found that the interaction between *Wedg1* and *Dlarg* was statistically significant, with a negative effect, β_8. One explanation for this evidence is that the volume achieved with equity resulting from investments by institutional shareholders in the company reduces their need for new loans. The exchange of debt for equity from institutional investors could increase the discretionary power that the controlling shareholder would have to allocate these resources, especially when institutional investors do not display the activism expected by other minority shareholders.

Only three control variables showed statistically significant coefficients in all the regressions: adherence to the CGI (*CGI*), firm size (*Ln TA*), and operating return on assets (*ROA*). While most profitable companies and those with shares listed in the CGI tended to reduce the company's debt volume, possibly because of better opportunities to raise equity, the size of the company was a relevant aspect for the company to have higher debt (they had more assets for collateral). The variables related to the board of directors, such as the number of members (*SizeBoard*), the percentage of outside directors (*Out*), and the dual role of the CEO as a regular board member (*CEOb*), did not show significant coefficients in all analyzed regressions.

5. CONCLUSIONS

The objective of this study was to identify and verify the reasons for and implications of the presence of institutional investors, such as banks or investment funds, in Brazilian companies. No evidence was found that the presence of institutional investors mitigates the risk of expropriation of minority shareholders at Brazilian companies or that such investors mitigate this conflict. The presence of a bank or an investment fund in the ownership structure of Brazilian companies seems to be influenced by business characteristics that are associated with the practice of leverage of the voting power of the controlling shareholder. This is contrary to the evidence and arguments that such investors are more likely to avoid making investments in companies with poor quality of corporate governance, as identified by Giannetti and Simonov (2006), Li et al. (2006), and Leuz et al. (2009). Moreover, it turns out that, on the one hand, the presence of institutional investors is not

associated with increasing value of companies or with monitoring the CEO or controlling shareholder. On the other hand, the evidence suggests that the presence of institutional investors mitigates the agency conflicts between shareholders and creditors, but possibly at the expense of minority shareholders. Thus, we infer that the development of best corporate governance practices depends on the interest of the controlling shareholder, which is able to find alternatives to effect its preference for entrenchment and protect against hostile takeovers, even signaling to the market that it has been engaged in improving the quality of corporate governance within the company.

Finally, it appears that the presence of institutional investors in Brazilian companies' ownership structure plays an unforeseen role in agency theory, enabling greater leverage of the voting power of the largest shareholder of the company and in this way, accentuating the agency conflict between controlling shareholders and minority shareholders. Analyzed together, these findings contrast with those of McCahery et al. (2010) and Iliev et al. (2015), who argued that the presence of institutional investors was a possible solution for companies to improve their corporate governance systems. On the other hand, our results are consistent with those of Amaral et al. (2008) in Brazil, who found evidence that the presence of institutional investors, as well as excess voting power of the largest shareholder, were associated with longer delays in the disclosure of financial reports. It appears, therefore, that corporate governance development still lacks evidence for a better understanding of what the relevant aspects of ownership structure are for mitigating possible agency conflicts between controlling and minority shareholders in emerging markets.

The main limitation of this study is that it did not use alternative proxies associated with the characteristics of institutional investors. In this sense, future research could explore the divisions between banks and pension funds based on whether they are public or private, and domestic or foreign. In addition, future studies could verify the ownership of the institutional investor, with the aim of explaining why these investors fail to mitigate the agency conflict between controlling and minority shareholders. In addition, future studies could verify the diversification of institutional investors, since these characteristics may affect decision-making processes in companies, especially the risk level of investments, as argued Dhillon and Rossetto (2015). Finally, future work may seek to explain what makes the institutional investor engage in activism for corporate governance in Brazil. Parrino et al. (2003), McCahery et al. (2010), and Iliev et al. (2015), for example, provide possible starting points to meet this goal. Another suggestion for future research is verification of the relevance of political factors that motivate the choice of institutional investors, such as banks or pension funds, to invest in Brazilian companies, as developed by Claessens et al. (2008).

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