

# **Impact of Domestic and Foreign Institutional Ownership on Firm Value in Pakistan**



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Islamabad, Pakistan

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Supervisor: Dr. Ajid Ur Rehman

NUST Business School (NBS)

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## BUSINESS PROJECT ACCEPTANCE CERTIFICATE

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## **AUTHOR’S DECLARATION**

I Adnan Ejaz hereby state that my MS thesis titled “Impact of Domestic and Foreign Institutional Ownership on Firm Value in Pakistan” is my own work and has not been submitted previously by me for taking any degree from National University of Sciences and Technology, Islamabad or anywhere else in the country/ world.

At any time if my statement is found to be incorrect even after I graduate, the university has the right to withdraw my MS degree.

Name of Student: Adnan Ejaz

Date: 1 September 4, 2024

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## **LIST OF SYMBOLS, ABBREVIATIONS AND ACRONYMS**

ADR American Depository Receipt

ROA Return On Assets

## **ABSTRACT**

The relationship between institutional ownership and firm value is a complex and multi-faceted topic. While some studies suggest a positive relationship, others find no significant effect or highlight the mediating role of other factors. This research focuses on the relationship between institutional ownership and firm value in non-financial and non-utilities publicly listed companies in Pakistan between 2008 and 2018. Using Tobins-Q as a proxy for firm value, and foreign institutional ownership and domestic institutional ownership as independent variables alongside a number of control variables, this research finds that domestic institutional ownership is the primary driver for the negatively significant relationship between firm value and institutional ownership in Pakistan, with foreign institutional ownership having a positive but insignificant relationship with firm value.

## CHAPTER 1: INTRODUCTION

The complex relationships between institutional ownership and business value in the context of corporate finance and governance pique the interest of academics, professionals, and legislators alike. The significance of this connection is especially evident in emerging nations like Pakistan, where shifting governance structures and economic conditions offer an intriguing backdrop for researching ownership trends and how they affect company valuation. This study is to investigate the impact of institutional ownership on firm valuation in Pakistan in order to provide light on the intricate mechanisms underpinning this relationship.

The knowledge that ownership dynamics can significantly affect corporate governance, strategic decision-making, and ultimately business valuation served as the impetus for this study. Institutional ownership and its effects on firm valuation can manifest in various ways in nations such as Pakistan, which are characterized by unique institutional, regulatory, and economic features. The objective of this research is to contribute to the theoretical discourse and practical understanding of corporate governance dynamics by clarifying the intricacies of this relationship within the Pakistani setting.

Preliminary analysis of the data indicates that there is a substantially negative correlation between business valuation and institutional ownership in Pakistan. The statistical analysis's 99% confidence level offers compelling evidence of this link's relevance. The dependent variable is measured at  $t$ , and the control variables are assessed at  $t-1$ , according to the study's lagged technique. By effectively reducing concerns around simultaneity bias, this approach enhances the validity of the findings.

The impact of foreign institutional ownership on corporation valuation is also examined in this study. While there is a positive tendency, it is not statistically significant, which begs the question of the several variables that could influence the impact of foreign ownership on firm value in Pakistan.

The report defines institutional ownership as the collective ownership of common stock by institutional investors. This notion distinguishes between local institutional ownership and foreign institutional ownership in order to have a thorough understanding of ownership dynamics. Panel data regressions are used to account for a range of control factors, industry dummies, and year fixed effects to reduce confounding variables. Winsorizing is utilized in the process to handle skewness.

Many pyramid conglomerates with holding firms that are owned by families or lone individuals may be found in Pakistan. More than 50% of the shares of a listed firm are typically controlled by a controlling shareholder, while some are jointly held by two important shareholders. Previous research indicates that these pyramidal arrangements offer an enormous wedge that facilitates minority shareholder expropriation using a range of tunneling strategies. The controlling shareholders nominate and elect directors, including those designated as "independent," as only shareholders present at public meetings have the authority to appoint board members. While insiders and their affiliates have historically held board positions, independent board members have become less common in recent years due to pressure from foreign institutional shareholders and the corporate governance (CG) code, which was recently published in 2019 on a compliance-or-clarification basis.

There is conflicting empirical evidence at the national and international levels regarding how well foreign institutional investors' monitoring can restrain self-interested managerial behavior like earnings management, despite the fact that there is more agreement regarding the positive effects of foreign institutional investors on corporate governance and firm-level strategic decisions. More significantly, previous studies often presume that foreign institutional investors are a homogeneous group in terms of their knowledge acquisition abilities and motives for effectively monitoring the prolonged use of discretionary accruals.

This ownership group's importance in shaping business outcomes is demonstrated by the discovery that domestic institutional ownership in Pakistan has a negative effect on firm value. Further research into the causes of this detrimental influence and broader implications for corporate governance strategies are recommended by the study.

Sections of the study report that provide a detailed description of the methodology employed, the empirical findings, how they were interpreted, and how they fit into the body of current knowledge will follow this introduction. In addition, the article will discuss the implications of the findings, admit any limitations, and suggest future lines of inquiry into the intricate relationship between institutional ownership, firm value, and corporate governance in Pakistan's dynamic context.

## **PROBLEM STATEMENT**

Institutional ownership, measured by the percentage of common stock held by institutional investors, has a major impact on corporate governance, strategic decisions, and ultimately business valuation. The study in this context focuses on the corporate environment of Pakistan, where a variety of institutional, institutional, and regulatory issues influence how institutional ownership and business value interact. This research is motivated by the desire to comprehend the mechanisms by which institutional ownership influences enterprise valuation in this specific context.

There isn't much research done in Pakistan on the intricacies of how institutional investors affect a company's value. Numerous global studies have demonstrated the critical influence that institutional shareholders play in predicting a company's future valuation.

The fundamental presumption here is that institutional ownership, whether domestic or foreign, raises the company's valuation. However, it's also possible that institutional investors are drawn to companies with greater valuations, and vice versa. [Causality in reverse].

Using four econometric specifications, the main goal will be to determine the relative contribution of domestic and foreign institutional ownerships to a company's valuation research.

## **OBJECTIVE**

The goal of this study is to discover how institutional ownership affects firm valuation by ascertaining the effect of domestic and foreign institutional ownerships separately. The study looks at a decade-long dataset that includes non-financial non-utility institutions in order to find trends and correlations that explain how institutional ownership and firm valuation interact.

Determining whether there is a statistically significant association between domestic and/or foreign institutional variables on firm valuation was the study's specific goal.

## CONTRIBUTION

The intricate relationship between institutional ownership and firm value in the context of Pakistan's non-financial institutions is now more understood according to this study. By carefully analyzing a sizable dataset spanning a decade, the study shows a significant negative correlation between institutional ownership and firm valuation. The new technique of distinguishing between local and international institutional ownership reveals a persistent adverse relationship between institutional ownership and firm value, in contrast to previous research that indicated a positive association between the two variables. The robustness of the direction of the coefficient and its statistical significance at the 99% confidence range underscore the useful insights these results offer into the complex relationship between ownership structures and valuation trends.

The lagged approach of the research and the evaluation of Pakistan's tier 2 agency concerns enhance the trustworthiness of the findings by shedding light on the limited monitoring effect of the institutional owners. Foreign institutional ownership may have a positive impact, but its insignificance emphasizes how intricate the value dynamics are. When taken as a whole, the studies broaden our knowledge of the ways in which corporate governance and business valuation dynamics in Pakistan are influenced by institutional ownership.



## CHAPTER 2: LITRATURE REVIEW

Institutional ownership, defined as the ownership of a company's shares by institutional investors such as mutual funds, pension funds, and insurance companies, has garnered significant attention from corporate finance specialists. The impact of institutional ownership on corporate value has been the subject of research, particularly in light of Pakistan's economic circumstances. Numerous studies have been conducted to better understand the connection between institutional ownership and corporate value in Pakistan. Their research is to be integrated and analyzed in this review of the literature.

A corporation's institutional ownership percentage might change based on a variety of factors. Industry-specific elements play a major role, including the degree of competition and the regulatory environment. Institutional investors may find companies in highly regulated sectors appealing because of their predicted stability.

A thorough investigation into the impact of ownership structure on Pakistani firms' financial performance was carried out by Din et al. in 2021. Their analysis showed that institutional ownership has a considerable favorable effect on market-to-book ratio (MBR) and return on equity (ROE). This suggests that institutional investors are essential to improving Pakistani companies' financial performance. This finding is consistent with earlier studies that found a link between institutional ownership and company success.

However, by arguing that there is a non-linear link between institutional ownership and business value, Navissi & Naiker (2006) added an intriguing nuance to the topic. Their research showed that while moderate institutional ownership levels have a favorable impact

on business value, extremely high levels may have the opposite effect. Additionally, they discovered that organizations with board representation had a favorable impact on firm value since these organizations are more driven to actively oversee management and promote sound corporate governance.

Ali et al. (2021) investigated the effect of corporate governance on firm performance in the context of Pakistan. Their results demonstrated superior performance by enterprises with institutional and foreign ownership, highlighting the potential beneficial impact of institutional ownership on firm performance within the Pakistani market.

In Pakistan, institutional investors play a passive role, as evidenced by the observation of a weak and negative correlation between institutional ownership and financial crisis. (2017)

However, a positive relation between institutional ownership and firm value is found in another research that is driven by short-horizon institutional investors (2020). Another study published in 2018 reveals that Pakistan's fund industry is in its infancy and that institutional investors' involvement in corporate governance is underdeveloped. Although they have a lot of room to grow in Pakistan's commercial market and contribute to the advancement of corporate governance in the country's listed firms.

Institutional ownership has benefits such as increased stability and liquidity, but there are also drawbacks to consider. For example, institutional investors might be more focused on short-term profits than long-term growth, and their huge holdings could occasionally lead to conflicts of interest.

Considering the contradictory findings of this research, it is critical to recognize that institutional ownership affects corporate value in a number of ways. The involvement of institutional investors can enhance financial performance through effective resource allocation, governance, and monitoring protocols. The relationship might not be strictly linear, and the appropriate level of institutional ownership would be necessary to avoid any agency conflicts.

In conclusion, the study indicates that a significant factor influencing firm value in Pakistan is institutional ownership. There is evidence that ownership concentration improves financial performance, although the relationship between ownership concentration, board representation, and financial performance is complicated and dependent on many factors. In the context of Pakistani industry, our findings underscore the need of well-crafted corporate governance frameworks that encourage active engagement from institutional investors, hence increasing business value and sustaining long-term growth.

The negative of institutional ownership is that it could lead to a loss of control for the company's management. When institutional investors' interests diverge from those of the company's management, potential conflicts of interest could result. Institutional investors may also have a short-term perspective, which could put pressure on the company to produce results fast at the expense of long-term growth, particularly when it comes to international institutional investors.

Important factors include the company's size and growth potential. Larger companies with a proven track record of success or smaller companies with significant growth potential may pique the interest of institutional investors more. Management status and skill may

also have an impact on institutional ownership. Businesses with good management and a proven track record of corporate social responsibility may attract the attention of institutional investors.

Business value is determined by a number of factors, and while institutional ownership is recognized as an important factor globally, its impact on business value in Pakistan is either negative or negligible. If investors and company owners are aware of the benefits and drawbacks of institutional ownership as well as the variables that influence it, they may make informed decisions about their investments and business plans. As this field of study advances, investigating the relationship between institutional ownership and business valuation will be highly advantageous.

### **CHAPTER 3: RESEARCH DATA AND METHODOLOGY**

For purposes of this research, all Pakistani firms listed on PSX with following specifics have been analyzed:

Sampled firms: Non-financial; non-utilities

Sample period: 2008-2018

Data Source: COMPUSTAT

Dependent variable: Tobins-Q (proxy of firm value)

Independent variable(s): Institutional ownership, Foreign institutional ownership; domestic institutional ownership

Control variables: The remaining variables in the attached dataset represent a complete set of control variables.

Strict quantitative approach is used in this study to accomplish its objectives. The relationship between institutional ownership and firm valuation is examined in this study using econometric techniques on data from non-financial organizations that are active in Pakistan. Using a rigorous quantitative methodology, Tobin's Q—which in this case represents the market to book ratio—is employed as the dependent variable. The report defines institutional ownership as the collective ownership of common stock by institutional investors. This notion distinguishes between local institutional ownership and

foreign institutional ownership in order to have a thorough understanding of ownership dynamics.

Winsorizing is used in the methodology to address skewness, and panel data regressions are used to account for a variety of control variables, industry dummies, and year fixed effects to reduce confounding variables.

Year and industry dummies have been generated to control for heterogeneity.

Simultaneity has been controlled by taking all control variables at t-1 while dependent variable is at t.

Initially, two variables, namely Morgan Stanley Capital International (MSCI) and R&D expense by firms were also included as control variables. But due to extremely few firms listed on MSCI, and tendency of firms to not disclose or spend expenses in R&D in Pakistan, both were subsequently dropped.

**Definitions of Variables is as under:**

**Tobins\_Q.** Sum of market value of equity and book value of debt divided by total assets (COMPUSTAT). Is used as proxy for firm value throughout the research.

**Institutional Ownership.** Equity ownership by all domestic and foreign institutions combined, estimated as the ratio of shares held by all institutions to the number of shares outstanding.

**Domestic Institutional Ownership.** Equity ownership by all domestic institutions, where an institution is classified as domestic by matching the domicile of firm with the domicile of institution, estimated as the ratio of shares held by all domestic institutions to the number of shares outstanding.

**Foreign Institutional Ownership.** Equity ownership by all foreign institutions, where an institution is classified as foreign if domicile of firm is different from the domicile of institution, estimated as the ratio of shares held by all foreign institutions to the number of shares outstanding.

**Firm Size.** Natural log of total assets in millions of U.S. dollars (Capital IQ).

**Sales Growth.** 2-year average (geometric) of annual growth rate in total revenue (Capital IQ).

**Leverage.** Sum of short-term and long-term debt divided by total assets (COMPUSTAT).

**Cash Holdings.** Cash and cash equivalents divided by total assets (COMPUSTAT).

**Capital Expenditures.** Capital expenditures divided by total assets (COMPUSTAT).

**ROA.** Return On Assets. Operating income divided by average total assets (Capital IQ).

**Property, plant & equipment.** Property, plant, and equipment divided by total assets (COMPUSTAT).

**Analysts Following.** Total number of analysts following a firm (Capital IQ Analysts Coverage).

**Foreign Sales.** Annual foreign sales divided by total assets (Capital IQ).

**Closely Held Shares.** Fiscal-ending ratio of number of shares held by all insiders (5% or more common stock outstanding held by directors, managers, individuals or immediate families) to total number of shares outstanding (Capital IQ Public Ownership).

**ADR.** Indicator variable that equals 1 if a firm is cross-listed on a U.S. stock exchange and 0 otherwise (Capital IQ).



## CHAPTER 4: RESULTS AND DISCUSSION

In Pakistan, there is an intriguingly negative correlation between institutional ownership and corporate valuation; the results are significant at the 99% confidence level. This is particularly crucial because the study employs a lag approach, which allays concerns about simultaneity by guaranteeing that the dependent variable is evaluated at  $t$  and the control variables at  $t-1$ .

The study discovered that tier 2 agency issues, which are more challenging for institutional owners to oversee, exist in Pakistan's business environment. This background influences institutional owners' capacity to impact monitoring procedures and sheds light on Pakistan's particular governance difficulties. Interestingly, foreign institutional ownership raises the value of a company; nevertheless, this effect is not statistically significant, suggesting that foreign ownership has a complex consequence.

Governance plans and investment choices can be influenced by the study's insights on the intricate relationship between institutional ownership and corporate valuation. The significance of this ownership group in influencing business results is highlighted by the finding of domestic institutional ownership as a driver of firm value in Pakistan. The findings also highlight the need for more investigation into the processes underlying this impact and the wider ramifications for corporate governance practices.

### **1: Descriptive Statistics**

**Table 1: Descriptive Statistics**

	Mean	Standard Error	Median	Mode	Standard Deviation	Sample Variance	Kurtosis	Skewness	Range	Minimum	Maximum	Sum	Count
<i>Tobins_Q</i>	1.304	0.023	0.956	0.353	1.211	1.466	25.503	4.557	10.076	0.353	10.429	3547.036	2720
<i>Institutional Ownership</i>	0.133	0.003	0.081	0.000	0.165	0.027	6.515	2.321	0.991	0.000	0.991	361.435	2720
<i>Domestic Inst Ownership</i>	0.122	0.003	0.070	0.000	0.158	0.025	6.988	2.421	0.991	0.000	0.991	331.547	2720
<i>Foreign Inst Ownership</i>	0.011	0.001	0.000	0.000	0.046	0.002	109.511	8.700	0.752	0.000	0.752	29.888	2720
<i>Firm Size</i>	3.894	0.029	3.790	#N/A	1.524	2.322	0.040	0.271	9.187	-0.490	8.697	10591.136	2720
<i>Sales Growth</i>	0.120	0.005	0.086	0.000	0.260	0.068	18.484	3.011	2.625	-0.541	2.084	325.165	2720
<i>Leverage</i>	0.579	0.005	0.589	1.379	0.243	0.059	0.896	0.472	1.361	0.019	1.379	1575.923	2720
<i>Cash Holdings</i>	0.046	0.001	0.015	0.001	0.078	0.006	11.191	3.060	0.642	0.001	0.642	126.270	2720
<i>Capital Expenditures</i>	0.056	0.001	0.035	0.000	0.064	0.004	7.582	2.437	0.385	0.000	0.385	152.266	2720
<i>ROA</i>	0.093	0.002	0.083	0.345	0.109	0.012	0.846	0.095	0.840	-0.495	0.345	251.782	2720
<i>Property, plant &amp; eqpt</i>	0.476	0.004	0.481	0.935	0.222	0.049	-0.685	-0.127	0.932	0.003	0.935	1295.440	2720
<i>Analysts Following</i>	1.207	0.065	0.000	0.000	3.369	11.348	10.941	3.358	21.000	0.000	21.000	3282.000	2720
<i>Foreign Sales</i>	0.158	0.005	0.000	0.000	0.273	0.075	1.875	1.756	1.000	0.000	1.000	428.716	2720
<i>Closely Held Shares</i>	0.189	0.005	0.000	0.000	0.265	0.070	0.380	1.274	0.896	0.000	0.896	513.404	2720
<i>ADR</i>	0.007	0.002	0.000	0.000	0.083	0.007	138.421	11.846	1.000	0.000	1.000	19.000	2720

## 2: Research Findings and Analysis

### 1. Total Institutional Ownership and Firm Value

We're seeing institutional ownership here through models based on 3 econometric specifications:

Model (1): No fixed effects

Model (2): Year fixed effects

Model (3): Industry and year fixed effects

We find that in Pakistan there's a negative correlation between institutional ownership and firm value at 99% confidence interval. And these results hold after controlling for Year fixed effects (2), and Year and Industry fixed effects combined (3).

**Table 2: Institutional Ownership and Firm Value**

	(1)	(2)	(3)
<b>Institutional ownership</b>	<b>-0.718***</b>	<b>-0.557**</b>	<b>-0.734***</b>
	(-2.758)	(-2.271)	(-2.848)
<b>Firm size</b>	<b>0.056</b>	<b>0.055</b>	<b>0.047</b>
	(1.399)	(1.393)	(1.183)
<b>ADR</b>	<b>0.14</b>	<b>0.182</b>	<b>0.252</b>
	(0.629)	(0.812)	(0.948)
<b>Analysts following</b>	<b>-0.019</b>	<b>-0.029*</b>	<b>-0.005</b>
	(-1.191)	(-1.787)	(-0.402)
<b>Sales growth</b>	<b>-0.567***</b>	<b>-0.335***</b>	<b>-0.304**</b>
	(-4.121)	(-2.850)	(-2.502)
<b>Leverage</b>	<b>0.779***</b>	<b>1.015***</b>	<b>0.943***</b>
	(3.166)	(3.998)	(4.204)
<b>Cash holdings</b>	<b>1.394**</b>	<b>1.402**</b>	<b>1.016**</b>
	(2.392)	(2.555)	(2.350)
<b>Capital expenditures</b>	<b>0.661</b>	<b>0.542</b>	<b>0.168</b>
	(1.390)	(1.180)	(0.398)

<b>ROA</b>	<b>4.775***</b>	<b>5.185***</b>	<b>4.733***</b>
	<b>(4.624)</b>	<b>(5.001)</b>	<b>(5.243)</b>
<b>Property, plant, &amp; equipment</b>	<b>-0.183</b>	<b>-0.166</b>	<b>-0.242</b>
	<b>(-1.090)</b>	<b>(-1.003)</b>	<b>(-1.500)</b>
<b>Foreign sales</b>	<b>-0.568***</b>	<b>-0.596***</b>	<b>-0.315**</b>
	<b>(-4.401)</b>	<b>(-4.517)</b>	<b>(-2.567)</b>
<b>Closely held shares</b>	<b>-0.492***</b>	<b>-0.411***</b>	<b>-0.290**</b>
	<b>(-4.052)</b>	<b>(-3.347)</b>	<b>(-2.218)</b>
<b>Constant</b>	<b>0.527**</b>	<b>0.234</b>	<b>0.417</b>
	<b>(2.122)</b>	<b>(0.831)</b>	<b>(1.583)</b>
<b>Observations</b>	<b>2,720</b>	<b>2,720</b>	<b>2,720</b>
<b>R-squared</b>	<b>0.249</b>	<b>0.303</b>	<b>0.412</b>
<b>Year fixed effects</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
<b>Industry fixed effects</b>	<b>No</b>	<b>No</b>	<b>Yes</b>

**\*I cluster the standard errors at firm-level.**

## **2. Domestic institutional ownership and Firm value**

We again find that in Pakistan there's a negative correlation between domestic institutional ownership and firm value at 99% confidence interval. And these results hold after controlling for Year fixed effects (2), and Year and Industry fixed effects combined (3).

The results, thus hold.

**Table 3: Domestic Institutional Ownership and Firm Value**

	(1)	(2)	(3)
<b>Domestic institutional ownership</b>	<b>-0.836***</b>	<b>-0.636**</b>	<b>-0.837***</b>
	(-3.181)	(-2.573)	(-3.094)
<b>Firm size</b>	<b>0.056</b>	<b>0.054</b>	<b>0.046</b>
	(1.413)	(1.398)	(1.150)
<b>ADR</b>	<b>0.180</b>	<b>0.207</b>	<b>0.287</b>
	(0.764)	(0.898)	(1.064)
<b>Analysts following</b>	<b>-0.019</b>	<b>(-1.789)</b>	<b>-0.005</b>
	(-1.208)	(-1.787)	(-0.389)
<b>Sales growth</b>	<b>-0.567***</b>	<b>-0.338***</b>	<b>-0.307**</b>
	(-4.124)	(-2.861)	(-2.512)
<b>Leverage</b>	<b>0.778***</b>	<b>1.018***</b>	<b>0.946***</b>
	(3.192)	(4.001)	(4.213)

<b>Cash holdings</b>	<b>1.383**</b>	<b>1.392**</b>	<b>1.006**</b>
	<b>(2.363)</b>	<b>(2.525)</b>	<b>(2.322)</b>
<b>Capital expenditures</b>	<b>0.685</b>	<b>0.556</b>	<b>0.182</b>
	<b>(1.438)</b>	<b>(1.211)</b>	<b>(0.431)</b>
<b>ROA</b>	<b>4.777***</b>	<b>5.182***</b>	<b>4.728***</b>
	<b>(4.628)</b>	<b>(4.999)</b>	<b>(5.245)</b>
<b>Property, plant, &amp; equipment</b>	<b>-0.186</b>	<b>-0.167</b>	<b>-0.238</b>
	<b>(-1.108)</b>	<b>(-1.011)</b>	<b>(-1.485)</b>
<b>Foreign sales</b>	<b>-0.566***</b>	<b>-0.592***</b>	<b>-0.312**</b>
	<b>(-4.435)</b>	<b>(-4.547)</b>	<b>(-2.559)</b>
<b>Closely held shares</b>	<b>-0.490***</b>	<b>-0.411***</b>	<b>-0.292**</b>
	<b>(-4.083)</b>	<b>(-3.383)</b>	<b>(-2.242)</b>
<b>Constant</b>	<b>0.528**</b>	<b>0.244</b>	<b>0.424</b>
	<b>(2.115)</b>	<b>(0.863)</b>	<b>(1.609)</b>
<b>Observations</b>	<b>2,720</b>	<b>2,720</b>	<b>2,720</b>
<b>R-squared</b>	<b>0.251</b>	<b>0.304</b>	<b>0.413</b>
<b>Year fixed effects</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>

<b>Industry fixed effects</b>	<b>No</b>	<b>No</b>	<b>Yes</b>
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**\*I cluster the standard errors at firm-level.**

### **3. Foreign Institutional Ownership and Firm Value**

We find that in Pakistan there's a positive correlation between foreign institutional ownership and firm value but the results are insignificant, even after controlling for Year fixed effects (2), and Year and Industry fixed effects combined (3).

**Table 4: Foreign Institutional Ownership and Firm Value**

	<b>(1)</b>	<b>(2)</b>	<b>(3)</b>
<b>Foreign institutional ownership</b>	<b>0.939</b>	<b>0.600</b>	<b>0.629</b>
	<b>(1.076)</b>	<b>(0.771)</b>	<b>(0.873)</b>
<b>Firm size</b>	<b>0.035</b>	<b>0.039</b>	<b>0.035</b>
	<b>(0.935)</b>	<b>(1.051)</b>	<b>(0.863)</b>
<b>ADR</b>	<b>-0.079</b>	<b>0.014</b>	<b>0.070</b>
	<b>(-0.552)</b>	<b>(0.093)</b>	<b>(0.411)</b>
<b>Analysts following</b>	<b>-0.022</b>	<b>-0.333***</b>	<b>-0.009</b>
	<b>(-1.317)</b>	<b>(-1.870)</b>	<b>(-0.647)</b>

<b>Sales growth</b>	<b>-0.571***</b>	<b>-0.338***</b>	<b>-0.307**</b>
	<b>(-4.057)</b>	<b>(-2.823)</b>	<b>(-2.489)</b>
<b>Leverage</b>	<b>0.795***</b>	<b>1.035***</b>	<b>0.971***</b>
	<b>(3.190)</b>	<b>(4.016)</b>	<b>(4.191)</b>
<b>Cash holdings</b>	<b>1.379**</b>	<b>1.399**</b>	<b>1.075**</b>
	<b>(2.318)</b>	<b>(2.516)</b>	<b>(2.449)</b>
<b>Capital expenditures</b>	<b>0.585</b>	<b>0.490</b>	<b>0.124</b>
	<b>(1.275)</b>	<b>(1.099)</b>	<b>(0.291)</b>
<b>ROA</b>	<b>4.818***</b>	<b>5.230***</b>	<b>4.768***</b>
	<b>(4.556)</b>	<b>(4.937)</b>	<b>(5.135)</b>
<b>Property, plant, &amp; equipment</b>	<b>-0.126</b>	<b>-0.123</b>	<b>-0.159</b>
	<b>(-0.756)</b>	<b>(-0.749)</b>	<b>(-0.998)</b>
<b>Foreign sales</b>	<b>-0.530***</b>	<b>-0.570***</b>	<b>-0.306**</b>
	<b>(-4.232)</b>	<b>(-4.404)</b>	<b>(-2.432)</b>
<b>Closely held shares</b>	<b>-0.453***</b>	<b>-0.374***</b>	<b>-0.261**</b>
	<b>(-3.912)</b>	<b>(-3.237)</b>	<b>(-2.053)</b>
<b>Constant</b>	<b>0.459*</b>	<b>0.154</b>	<b>0.274</b>
	<b>(1.791)</b>	<b>(0.525)</b>	<b>(1.018)</b>



<b>Observations</b>	<b>2,720</b>	<b>2,720</b>	<b>2,720</b>
<b>R-squared</b>	<b>0.240</b>	<b>0.298</b>	<b>0.404</b>
<b>Year fixed effects</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
<b>Industry fixed effects</b>	<b>No</b>	<b>No</b>	<b>Yes</b>

**\*I cluster the standard errors at firm-level.**

#### **4. Foreign and domestic institutional ownership and firm value**

By combining both Domestic and Foreign, we find that a negatively significant correlation holds between domestic institutional ownership and firm value, and so does a positively insignificant correlation between foreign institutional ownership and firm value, which serves as confirmatory analysis.

**Table 5: Foreign and domestic institutional ownership and firm value**

	<b>(1)</b>	<b>(2)</b>	<b>(3)</b>
<b>Foreign Institutional ownership</b>	<b>0.784</b>	<b>0.504</b>	<b>0.454</b>
	<b>(0.860)</b>	<b>(0.617)</b>	<b>(0.617)</b>
<b>Domestic institutional ownership</b>	<b>-0.827***</b>	<b>-0.631**</b>	<b>-0.830***</b>

	(-3.148)	(-2.548)	(-3.077)
<b>Firm size</b>	<b>0.053</b>	<b>0.053</b>	<b>0.044</b>
	(1.342)	(1.343)	(1.106)
<b>ADR</b>	<b>0.180</b>	<b>0.207</b>	<b>0.290</b>
	(0.800)	(0.925)	(1.104)
<b>Analysts following</b>	<b>-0.020</b>	<b>-0.030*</b>	<b>-0.006</b>
	(-1.273)	(-1.838)	(-0.423)
<b>Sales growth</b>	<b>-0.569***</b>	<b>-0.340***</b>	<b>-0.308**</b>
	(-4.139)	(-2.882)	(-2.534)
<b>Leverage</b>	<b>0.796***</b>	<b>1.023***</b>	<b>0.951***</b>
	(3.235)	(4.029)	(4.254)
<b>Cash holdings</b>	<b>1.372**</b>	<b>1.384**</b>	<b>1.004**</b>
	(2.343)	(2.515)	(2.315)
<b>Capital expenditures</b>	<b>0.685</b>	<b>0.556</b>	<b>0.181</b>
	(1.446)	(1.214)	(0.428)
<b>ROA</b>	<b>4.790***</b>	<b>5.189***</b>	<b>4.732***</b>
	(4.643)	(5.011)	(5.255)
<b>Property, plant, &amp; equipment</b>	<b>-0.180</b>	<b>-0.163</b>	<b>-0.232</b>

	<b>(-1.081)</b>	<b>(-0.993)</b>	<b>(-1.458)</b>
<b>Foreign sales</b>	<b>-0.560***</b>	<b>-0.588***</b>	<b>-0.311**</b>
	<b>(-4.378)</b>	<b>(-4.494)</b>	<b>(-2.539)</b>
<b>Closely held shares</b>	<b>-0.484***</b>	<b>-0.408***</b>	<b>-0.291**</b>
	<b>(-4.003)</b>	<b>(-3.336)</b>	<b>(-2.229)</b>
<b>Constant</b>	<b>0.520**</b>	<b>0.241</b>	<b>0.417</b>
	<b>(2.083)</b>	<b>(0.854)</b>	<b>(1.604)</b>
<b>Observations</b>	<b>2,720</b>	<b>2,720</b>	<b>2,720</b>
<b>R-squared</b>	<b>0.252</b>	<b>0.304</b>	<b>0.414</b>
<b>Year fixed effects</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>
<b>Industry fixed effects</b>	<b>No</b>	<b>No</b>	<b>Yes</b>

**\*I cluster the standard errors at firm-level.**

Hence, it is ascertained that the primary driver in the negatively significant correlation between institutional ownership and firm value in Pakistan is domestic institutional ownership, as foreign institutional ownership continues to have an insignificant but positive relationship with firm value.

### **3: Implications of this Research**

The results of this study indicate that domestic institutional ownership and business value are negatively correlated in Pakistan. It makes use of quite stringent econometric specifications, confirming the accuracy of the findings.

Before these results can be used to inform national policy, it is necessary to investigate if this negative link is caused by Tier 1 or Tier 2 agency issues, a nationwide trend of family ownership, or some other unexplained phenomenon.

In a similar vein, international institutional ownership has been found to favorably correlate with business value, despite the fact that domestic institutional ownership has a negative significant impact on firm valuation. Further investigation is necessary due to the insignificance of this association. Before assembling any policy implications for the nation, it is necessary to conduct a more thorough investigation into whether the liability of being foreign and/or informational constraints and disadvantages play a significant role, or whether foreign institutions have a tendency to invest due to their needs for portfolio rebalancing or some other unexplained phenomenon.

## CHAPTER 5: CONCLUSION

The endeavor to comprehend the intricate relationship between institutional ownership and firm value within the context of Pakistani corporations has yielded important discoveries. Comprehensive data study of non-financial and non-utilities companies listed at the Karachi Stock Exchange (KSE) between 2008 and 2018 provided significant new information that advances our knowledge of the connections between ownership patterns and firm value.

The study's main objective was to find the roles of domestic and foreign institutional ownerships separately on firm valuation in Pakistan. The results unequivocally demonstrate that institutional ownership and corporation valuation are negatively correlated in Pakistan. Higher institutional ownership levels are associated with lower business valuation, according to this research, which reveals a complex relationship between ownership dynamics and corporate performance. But then it finds that the reason for lower valuation is primarily due to domestic institutional ownership, as foreign institutional ownership has a positive yet insignificant relationship with firm valuation.

The research has also shed light on subtle insights into ownership's varied effects by detaching foreign and domestic institutional ownership. Whether local or foreign ownership is involved, the research shows a negative relationship between institutional ownership and business value. This demonstrates the consistency of the link, regardless of the institutional investor's place of origin.

The results' dependability is strengthened by the meticulous methodology, which took into consideration the tier 2 agency challenges that are prevalent in Pakistan and incorporated a lagged approach to solve simultaneity difficulties. The fact that these controls are included highlights how accurately the study documents the impact of institutional ownership on firm valuation.

An interesting but insignificant advantage of foreign institutional ownership is also shown by the analysis. Even though this positive effect suggests a potential role in value enhancement, the lack of significance emphasizes the complicated nature of foreign institutional ownership's influence on firm value within Pakistan's business climate.

The research has made several contributions. It confirms the notion that institutional ownership has an effect on business valuation in Pakistan. The analysis puts the country's widespread tier 2 agency issues in context and sheds light on the difficulties institutional owners have in successfully supervising businesses. The results can also help corporate leaders, investors, and politicians develop plans to improve ownership structures and governance procedures, which will ultimately increase firm value.

To sum up, this study has explored the complex relationship between institutional ownership and firm valuation and has found a negative association that is primarily due to domestic ownership origins. The findings help us understand the relationship between ownership, governance, and business outcomes better in Pakistan. These insights can have a significant impact on how corporate decision-making and governance practices develop in Pakistan's fast-paced business climate.

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