

# Towards Monitoring the Selfish Behaviours of Corporate Managers: Does Institutional Foreign Ownership Matter?

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## ABSTRACT

This paper investigates the monitoring effect of institutional ownership on managerial behaviors more particularly on the corporate leverage decision of corporations listed in London Stock Exchange. Previous literature on the agency model extensively recognizes that the use of both managerial ownership and debt play a very crucial role in limiting agency conflict and improving firm value. The literature further appreciates the role of institutional intervention in limiting the possibility of managerial selfish behavior which might temper with the value of the firm. However, literature recognizes that foreign institutional interventions have more positive impact on the agency conflict reduction process than their domestic counterpart.

Using a sample of 300 UK large non-financial companies in FTSE All share Index represented by FTSE 350 from 2004-2009, this study investigates the usefulness of these agency-conflict-reducing mechanisms studying the inter-relationships among them by utilizing simultaneous systems of estimation procedure. The results of the study show that the predicted inverse relationship between debt and managerial stock ownership is more statistically significant for domestic owned firms than their foreign counterparts.

This implies that foreign controlled firms are believed to have higher level of international activities which increases the agency cost of debt. It can therefore be emphasized that the use of more debt is more risky for foreign-controlled firms than for domestic owned firms. This is why it is more likely to find domestic –controlled firms having higher debt levels than foreign-controlled firms.

**Keywords:** *Managerial ownership, foreign controlled firms, domestic controlled firms, debt, institutional ownership*

## 1. INTRODUCTION

The objective of this paper is to explore the impact of the shift in UK equity ownership towards foreign investors on capital structure. Due to this shift it is expected that, the participation of foreign investors may increase the level of external shareholders' activism reflecting improvement in decision making quality such as capital structure decision. Foreign investors are reported to be active in voting publicly against governance matters and may vote even for managerial replacement compared to UK institutions which are relatively less active and may be reluctant to take public standpoint by voting against management in the company meeting, Malline, (2007). In a modern corporation, ownership is separated from management because owners may lack time, skills and experience of managing the corporation. In this case professional managers may be employed to manage corporations on behalf of the owners. However, the challenge is that, managers have their personal interests which deviate from the objective of the firm, Berle and Means (1932). In an agent-principal setting, managers as agents are required to fulfil owners' interest but in real situation managers put their interests first. According to Jensen and Meckling (1976), to align managers-shareholders' interests, among other mechanisms, managers should be granted shares inducing them with company's ownership feelings. According to Jensen and Meckling, when managers have sufficient stake in the company, they may make some of decisions to protect their voting power, for instance, they would

prefer debt financing to equity financing because equity financing dilutes their control power over the firm.

The managerial unfavourable behaviours which affect firm value may be limited by several approaches, among others, is monitoring by large external shareholders. Literature highlights the impact of institutional shareholders' voting power in deciding the choice of value-maximizing capital structure. Shleifer and Vishny (1986) contend that, the external larger shareholders are vital agents in monitoring managerial selfish behaviours hence reduce direct agency costs. Monitoring by external block-holders limits the possibility for management to adjust the corporate capital structure in their favour. This, according to Shleifer and Vishny, implies a positive association between corporate debt ratio and external block-holdings. However, at relatively higher level of ownership, large shareholders may divert company's resources to extract personal benefits which affect firm value and expropriate minority shareholders. This creates another agency conflict known as the agency conflict between majority shareholders and minority shareholders.

Furthermore, literature suggests that, firms which are controlled by international investors usually impose better monitoring quality than those locally controlled. The reasons for this among others, according to Douma et al., (2006), include foreign investors' relative higher organizational and managerial capabilities, quality control systems and the system of good governance as opposed to

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their domestic counterparts. Because these investors have investments in different countries with different governance systems, using their diverse experience may give them more advantage over the domestic investors. It can further be learned from Lee (2008) that, firms which allow more foreign equity ownership receive superior monitoring because foreign investors demand more transparency and better corporate governance standards and therefore may take a role of active monitors. According to Shleifer and Vishny, because debt acts as a tool of managerial monitoring against misappropriation of company's funds, institutions will be more interested in overseeing the decisions related to the choice of capital structure.

The contributions of this paper are two-fold; Firstly; The study is aware of few UK published work on the impact of ownership structure on capital structure. One of these studies include Short et al (2002) which explore the impact of ownership structure on capital structure during the period of time where UK institutions had relatively higher control power compared to the Foreign investors. For instance, according to the records from Office for National Statistics, major UK institutional shareholders (pension funds and insurance companies) had equity ownership above 50% of total UK equity issued in 1992 ( a latest year for data used by Short et al), compared to only 26% in 2008 (a fall by about 100%). During the same time period, foreign ownership was only 13.1% while currently it is 41.5%, the increase of more than three times. This change in ownership pattern which reflects the shift in UK equity ownership to foreign investors might have an influence on capital structure decision. The study tries to provide an empirical evidence of the influence of foreign ownership relative to domestic ownership on capital structure.

Secondly; the study also presents rare empirical evidence in UK literature on the influence of institutional ownership in reducing the impact of managerial selfish behaviour on capital structure choice. More specifically, different from previous studies like Short et al (2002) which use aggregate institutional ownership, the study tries to examine separately the impact of both domestic and foreign institutional ownership on the relationship between managerial ownership and capital structure. This study is not aware of any UK published study which provides empirical evidence which comparing monitoring strengths between domestic and foreign institutional ownership on the interrelationship between managerial ownership, institutional ownership and capital structure.

## 2. RELATED LITERATURE AND HYPOTHESES DEVELOPMENT

Jensen and Meckling (1976) in their seminal paper support agency-based capital structure theory which advocates the manager-owner agency relationship. The authors highlight that, application of debt into capital

structure cements bonding commitment for managers. Without issuing debt, managers may use company's free cash flows to finance suboptimal projects which meet their personal interests and therefore the presence of debt limits managers to misuse company's free cash-flows instead they service debt using the available free cash flows, Jensen (1986). Jensen and Meckling also suggest that, due to monitoring from creditors, managers work hard to avoid default risk, preventing shift of their power towards creditors and avoiding financial distress costs. As a result, the presence of debt is used as a device to enhance managerial efficient performance. Short et al (2002), building on the famous piece of work by Jensen and Meckling (1976) claim that, when the portion of shares owned by management increases, their ownership feelings also increases and this leads to managerial reluctance in risk taking. This situation helps in aligning managers-debt holders' interests by minimizing asset substitution effect which implies shifting investment risk to debt-holders. Due to this reluctance, the authors suggest that, managerial risk shifting tendency to debt holders is minimized followed by interest alignment between managers and debt holders.

Friend et al, (1988) in disclosing managerial selfish behaviour contend that, managers usually design capital structures which favour their interests. The study suggests an inverse relationship between Debt-Equity ratio and managerial equity holdings. In recent studies, managers have been reported to use debt issues to signify quality of their performance. According to Novaes, (2002), the increase in debt is the decision which is at an expense of the managers' interests because greater debt levels imply the poor quality of managers and this may lead to their removal from the positions they hold. From the prevailing discussions, it may be realized that, managers with significant shareholdings fear too much risk taking because they have a lot to lose in case of bankruptcy and their risk is unable to be diversified which much of it is in term of human capital apart from the financial capital attached to shares they are holding.

The incentive to put emphasis on monitoring the decisions made by managers on shareholders' behalves depends on the amount of capital the shareholder has injected in the particular company. Small shareholders have little incentive to incur monitoring costs such as information costs. This might be beneficial to large shareholders due to large value of investment they have in the firm because of economies of scale and appropriate investment skills and knowledge they possess, Shleifer and Vishny (1997). Different studies have attempted to investigate the relationship between institutional ownership and capital structure and the empirical results remain mixed. Two sets of results are obtained from various studies conducted on this area. One set of findings advocates a positive relationship between institutional shareholdings and capital structure (Friend and Lang (1988), Firth (1995) and Berger et al (1997)) and another

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set insists negative relationship between the two variables. The authors who defend positive relationship contend that, because, unlike managers, external shareholders may most likely hold a diversified portfolio by investing in several stocks, the portion of their unsystematic risk is relatively lower. Therefore, increase in debt to them is not a big problem due to their lower risk profile as a result of diversification. Likewise, the external shareholders would prefer more debt because debt is a relatively cheaper mechanism to monitor managers than direct intervention.

On the other hand, the set of findings which defends the negative relationship between institutional ownership and debt such as Grossman and Hart (1982) and Ross (1977) suggest that, debt is used to substitute the institutional monitoring effect since it reflects the quality of the company and assures the potential investors that the firm is capable of meeting the obligations associated with the debt, hence the share price shoots up. Putting it in another way, the presence of institutional shareholders helps to signal to outside world that managers are limited from fulfilling their personal interests at an expense of shareholders' wealth and therefore institutional shareholdings act as a substitute of debt. The substitution effect between leverage and institutional ownership, as managerial control mechanism, is supported by results in Holderness, (2009). It can be concluded from these studies that, if debt is able to offer monitoring effect to managers which would otherwise being provided by institutional investors, then higher debt levels may be associated with lower institutional ownership to reflect a substitutability effect between the two.

However, when it comes to institutional identity, some studies clearly depict the difference between foreign-controlled firms and domestic-controlled firms as far as debt issue is concerned. Several studies reveal that, foreign corporations have lower debt levels as compared to domestic corporations after taking care of some important control variables such as assets tangibility, non-debt tax shield, and profitability and growth opportunities, Chen et al (2007). For instance, Chen et al., (2007) argue that, foreign- controlled firms have lower debt ratios than domestic-controlled firms due to their level of international activities which increases the agency cost of debt. According to Chen et al, the level of international activities has its own impact on debt ratio apart from other common determinants of capital structure

Apart from a direct effect the institutional ownership has on corporate capital structure, Short et al (2002) propose an indirect impact of institutional ownership on the capital structure through its possibility to influence the relationship between capital structure and managerial shareholdings. In the absence of institutional investors' monitoring, managers may use the power they have to undertake suboptimal investments which maximize their value instead of increasing the firm value. The interaction of institutional owners serves a lot in

preventing managerial selfish behaviours because the monitoring role played by institutional shareholders may threaten managers' employments. This as a result reduces the agency cost of equity but increases agency cost of debt because institutions may suggest significantly higher levels of debt (which is more risky) as a relatively cheaper internal control for managers, Short et al (2002).

The empirical results by Firth, (1995) suggest that, the managerial ownership inversely relates to debt ratios and institutional ownership is directly proportional to debt ratios. After introducing institutional ownership into the relationship between managerial ownership and debt ratios, Firth finds that, the negative association between managerial ownership and debt ratios is being diluted, meaning that the interaction of institutional investors reduces the impact of managers' choice of debt level which favours their personal interests. Although separately the relationship between managerial ownership and debt ratios and between institutional ownership and debt ratios are not the same between two studies ( Firth (1995) – US based study and Short et al (2002) -UK based study), the interaction between larger external shareholdings and the relationship between managerial ownership and debt ratios reveals a very important fact that the presence of larger external shareholders reduces the impact of managerial selfish behaviours in capital structure choice. The difference in results is probably due to different corporate governance systems between US and UK.

However, as far as monitoring is concerned, firms which are controlled by international investors usually impose better monitoring quality than domestic-controlled firms. The reasons for this among others, according to Douma et al., (2006), include organizational and managerial capabilities, quality control systems and the system of good governance because these investors invest in different countries with different governance systems so using their diverse experience, they may have a benchmark of what good governance is. It can further be learned from Lee (2008) that, firms which invite more foreign equity ownership receive superior monitoring due to the fact that foreign investors demand more transparency and better standards of corporate governance and therefore may take a role of active monitors.

It is further highlighted by Yoshikawa and Phan, (2005) that, the presence of foreign ownership exposes managers to pressure and limit them to respond to the strategic interests of domestic investors. Because the foreign investors have no close relationship with the firm in which they invest and in particular there is no any business link between them, it is expected that their larger shareholdings will improve the firm efficiency and thereby maximizing resources allocation policy. Following these arguments, we can put forward the following testable implication;

## Hypothesis

The relationship between managerial ownership and debt ratio is expected to be weaker in firms with control on hands of foreign large institutions compared to in firms with control on hands of domestic large institutions.

## 3. DATA AND RESEARCH METHODS

### 3.1 Data Source and Sample Choice

The sample of this study comprises 300 large non financial companies in FTSE All share Index represented by FTSE 350 and listed in London Stock Exchange as advocated by the Combined Code for Corporate Governance (2010) from 2004-2009. In the course of assembling data it was noted that the amount of share owned by non executive directors is very insignificant in such a way that separating the proportions of executive and non executive was examined to have no impact. Therefore, it was decided not to separate the two and that's the reason as to why directors' ownership is equated as managerial ownership. This was gathered for all companies in the sample as the percentage of shares owned by management.

Care was taken during this exercise to avoid errors and to ensure maximum level of accuracy. Institutional investor's identity is determined by examining the UK ownership pattern. Investors whose ownership shows an interesting pattern are taken into account to see whether this trend has an impact to firm value. Emphasis was put on the significance of the trend and not the trend itself. For instance the public ownership trend seems to be quite interesting as the ownership level was dormant since 2002 at 0.1% but it increased by over 10 times in 2008 to 1.1% but this group of owners was not taken into consideration as their ownership is not such a significant proportion.

In general those investors with peculiar trend and ownership above 3%, a cut-off which represents substantial ownership, were selected. After observing all these large shareholders are categorised into different groups such as pension and mutual funds, insurance companies, banks and financial companies and industrial companies and then their corresponding domestic and foreign identities are as well identified.

In the case where companies could not disclose the ownership identity, the country of origin of the owner was traced from other sources such as websites of respective companies and after failing to identify the owner's origin, this company was dropped from the sample.

The study follows the tradition in literature of excluding financial companies due to their difference in financial reporting from industrial companies and utility companies because they are highly regulated, Faccio and

Lasfer (1999). UK is chosen as it has a well developed capital market where the theory of the firm on firm value maximization, which is the root of this study, is the priority to management of companies in this market.

For a company to qualify inclusion in the sample it has to fulfil the following criterion; first it must have been in the index for at least one year during the study period regardless of whether it remains in the index next year or not. Second, companies which are wound up during the period are excluded in the study and thirdly, only companies with data for at least two years are considered.

Ultimately, the sample comprised of 156 companies whose large institutional shareholders have foreign origin while 144 companies have domestic large institutional shareholders. The financial information of these companies was then extracted from Thomson one Banker.

### 3.2 Variables Definition

#### 3.2.1 Independent Variables

##### Managerial ownership

This is measured as the percentage of ownership of directors of the company, both executive and non-executive directors. This definition is consistent with (Morck et al (1988) and Short and Keasey (1999) who say that , proportion of non-executive ownership is very insignificant compared to that of Executives; hence separating it has got no significant impact to the overall board ownership figure. As used in several studies, including La Porta (1998), firms with large shareholders have level of institutional shareholdings of above 10% and those firms with institutional holdings below 10% are considered as firms without large shareholders.

The study also considers the origin of large shareholders. At this end, three variables are created namely **MO-NOLINS** i.e. Managerial Ownership of firms with no large shareholders; **MO-DOLINS** i.e. Managerial Ownership of firms whose large shareholders are domestic & **MO-FOLINS** i.e. Managerial Ownership for firms whose large shareholders are foreign.

#### 3.2.2 Dependent Variables

##### Financial leverage

Previous studies related to debt financing claim that the effectiveness of monitoring by debt holders depends on the level of debt. Debt holders become effective monitors if debt level reaches a critical threshold. The study uses Debt to asset ratio to measure financial leverage.



### 3.2.3 Control Variables

The control variables suggested in this study include the following;

#### Market value of equity

This is the variable which is measured by price of a share at the year-end multiplied by the outstanding number of shares at the end of particular year. It is used to control the relationship between Corporate Ownership and Board Structure.

#### Industry dummy

The industry feature is important in explaining several variables in this study for instance corporate leverage and Agency costs. Firms belonging to the same industry face similar market conditions and then have similar risk characteristics. Industrial companies utilize less debt due to higher bankruptcy risk they are exposed into, Titman and Wessels (1988). Six dummy variables are employed to control whether the company belongs to industrial, consumer goods, services, oil & gas, basic materials and technologies sectors.

#### Year dummy

The sample period of this study include the global financial and economic crisis period. During this period most variables may behave abnormally different from the expectation of the hypotheses. For this reason this effect will be controlled by creating dummy variables.

#### Firm Size

Firm size is measured by the logarithm of total assets (T) (Faccio et al., 2002).

According to Rajan and Zingales (1995) the firm size may proxy for the probability of bankruptcy, which is intense for small firms than for larger firms because large firms are more transparent, suffer less from informational asymmetry and have easier access to financial market hence they have more easy access to debt financing.

#### Non debt tax shields

This variable is measured as the ratio of annual depreciation scaled by total assets.

Brailsford et al., (2002) capture the non debt tax shields argument. They claim that, firms with high level of non debt tax shields are expected to have lower tax benefits due to leverage and hence will use less debt financing.

According to Brailsford et al., (2002) non debt tax shields are negatively associated with leverage.

#### Profitability

This variable is commonly employed to control for the relationship between capital structure and other economic variables. It is measured by the ratio of earnings before interest, taxes and depreciation to total assets.

Myers and Majluf (1984) suggest that more profitable firms use less debt because they have sufficient internal funds. Corporate firms will opt for debt financing after exhausting all other internal sources of. Several empirical studies find negative relationship between profitability and leverage ( Jensen et al., 1992).

### 3.3 Empirical Methodology

A major concern for most of studies in corporate governance is endogeneity problem which is widely discussed in several previous works e.g. Hermalin and Weisbach (1998). Himmelberg et al (1999) argue that firm performance on ownership variables regression is usually associated with potential misspecification because of the presence of the firm heterogeneity.

In this paper it is derived from the literature that managerial ownership and debt level can be endogenously determined. To solve the problem of endogeneity, the system of simultaneous equations is employed. Like in Bathala et al (1994), a two-equation model with managerial ownership and debt ratio as the dependent variables is proposed. Debt ratio will appear as the independent variable in the managerial ownership equation and managerial ownership as the independent variable in the debt ratio equation. The following two - equation model is therefore suggested;

For the relationship between managerial ownership in hypothesis 1 the following 2-stage equations are specified;

$$LEV = \alpha + \beta_1(MO) + \beta_2(PROF) + \beta_3(FSZ) + \beta_4(NDTS) + \beta_5(Ln(MVE)) + \beta_6(INDUMY) + \beta_7(YRDUMY) + \text{eit} \dots \dots \dots (1)$$

$$MO = \alpha + \beta_1(LEV) + \beta_2(PROF) + \beta_3(FSZ) + \beta_4(NDTS) + \beta_5(Ln(MVE)) + \beta_6(INDUMY) + \beta_7(YRDUMY) + \text{eit} \dots \dots \dots (2)$$

Where;

MO= Managerial Ownership for firms with foreign large shareholders (MO-FOLINS) and Managerial Ownership for firms with foreign large shareholders (MO-FOLINS)

LEV=Debt to Total Asset Ratio

FSZ=Firm Size (Ln TA)

NDTS=Non Debt Tax Shield

MVE=Market Value of Equity

PROF=Profitability

INDUMY=Industry Dummy

YRDUMY=Year Dummy

$\alpha$  = Overall intercept term

$\text{eit}$  = The unobserved error component

## 4. EMPIRICAL RESULTS

Tables 1-4 present the 2-SLS estimates of the simultaneous equations system. The model F-values are significant for both equations at the 0.01 level. The relationship between managerial ownership and debt is negative as predicted in companies whose control is on both foreign and domestic investors and the negative relationship reported is statistically significant. However,

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as clearly observed in table 1 and table 2 the managerial ownership is more statistically significant (significant at 1% significant level) in companies whose control is on hands of foreign investors compared to in companies where the control lies on domestic investors' hands (significant at only 10% significant level). This implies that firms with greater monitoring by institutional investors may find it optimal to use lower levels of debt to control agency conflicts in the firm. However, the results show that the extent to which the monitoring role of the institutional ownership reduces the use of debt and managerial ownership in an attempt to control agency conflict is more statistically significant when the institutional owner is a foreign one as opposed to its domestic counterpart. The results show that foreign controlled firms are believed to have higher level of international activities which increases the agency cost of debt. It can therefore be emphasized that the use of more debt is more risky for foreign-controlled firms than for domestic owned firms. This is why it is more likely to find domestic –controlled firms having higher debt levels than foreign-controlled firms.

A further interpretation is based on the governance quality reflected by foreign investors in as far as monitoring quality is concerned. Therefore, the presence of foreign ownership exposes managers to pressure and limit them to respond to the strategic interests of domestic investors such as use of more debt in the corporate capital structure to protect their private interest. Because the foreign investors have no close relationship with the firm in which they invest and in particular there is no any business link between them, it is

expected that their larger shareholdings will improve the firm efficiency and thereby maximizing resources allocation policy

These results are also consistent with the findings of Agrawal and Mandelker (1990) that institutional investors provide valuable monitoring services and act as a restraint to opportunistic behaviour by managers.

Turning to the individual equations, estimates for the debt equation reveal that all of the independent variables are statistically significant with signs as predicted. The coefficient for EV is negative. Recall that EV proxying bankruptcy risk and was expected to be negatively related to the debt ratio. The negative coefficient for EV is consistent with previous studies that document an inverse relationship between debt and earnings volatility as in Titman and Wessels (1988) and Friend et al., (1988). The variable non-debt tax shield is significant with a positive sign. However, a positive relationship is attributed to the possibility that the depreciation variable captures collateral value of assets that, according to these authors enables firms to raise debt on attractive terms.

The negative coefficient for the GROWTH variable is consistent with the arguments of Titman and Wessels (1988) and Myers and Majluf (1984) that a high growth rate indicates greater flexibility in future investments and offers greater opportunities for expropriating wealth from debt holder.

**Table 1:** Managerial Ownership vs. Debt Ratio for Companies with Foreign Large Shareholders

Leverage-Dependent variable)	COEFFICIENT	STD ERROR	t-Value	p-Value
Constant	.2764334	.1572446	1.76 **	0.079
MO-FOLINS	-.0099377	.0054457	-1.82*	0.068
Ln(TA)	.3277115	.021235	15.43***	0.000
Earnings volatility (EV)	.0003296 0.68	.0004828	0.68	0.495
Non-debt taxable shield	.0000346	.0000119	2.91 ***	0.004
Assets Growth Rate (GROWTH)	-.003345	.0156584	-2.45**	0.005

Number of Obs = 1349, F( 9, 1339) = 31.99, R-Squared= 0.1777, \*\*\* Indicates Significant at 1% level, \* indicates significant at 10 %, \*\*Indicates significant at 5%

**Table 2:** Managerial Ownership vs. Debt Ratio for Companies with Domestic Large Shareholders

Leverage-Dependent variable	COEFFICIENT	STD ERROR	t-Value	p-Value
Constant	.2824241	.1577524	1.79 **	0.074
MO-DOLINS	- .0091087	.0054148	-2.98***	0.003
Ln(TA)	.3269973	.0212801	15.37***	0.000
Earnings Volatility (EV)	.0042736	.0061725	2.49**	0.024
Non-debt taxable shield	.0000345	.0000119	2.90 ***	0.004
Assets Growth Rate (GROWTH)	-.0068923	.0262912	-2.06**	0.047

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Number of Obs = 1349, F(9, 1339) = 31.92, R-Squared= 0.1767, \*\*\* Indicates Significant at 1% level, \* indicates significant at 10 %, \*\*Indicates significant at 5%

With regard to the managerial ownership equation as presented in table 3 and table 4, the coefficients have signs as expected. As predicted, the estimated equation reveals that managerial ownership is inversely related to the degree of stock market volatility of the firm. This finding is consistent with the view that because of non-diversification problems, managers may be reluctant to invest too much of their personal wealth in the firm. Their reluctance to invest in the firm increases directly with the firm's stock price volatility.

The positive coefficient for GROWTH is consistent with managers' preference to invest in the firm's equity if future prospects are good, holding everything else constant. The negative coefficient for the firm size is consistent with previous studies that document a lower proportion of managerial ownership in larger firms owing to limited personal resources.

**Table 3:** Managerial Ownership vs. Debt Ratio for Companies with Foreign Large Shareholders

MO-FOLIS-Dependent variable	COEFFICIENT	STD ERROR	t-Value	p-Value
Constant	.3823241	.1377424	1.89 **	0.054
Debt Ratio	- .00426	.0028943	-1.78**	0.098
Ln(TA)	-.2269873	.0212701	-5.39***	0.000
Earnings Volatility	-.0049736	.0051720	-2.79**	0.014
Non-debt taxable shield	.0000645	.0030119	2.84***	0.004
Assets Growth Rate (GROWTH)	.0078993	.0162412	1.96**	0.005

Number of Obs = 1349, F(9, 1339) = 21.52, R-Squared= 0.1568, \*\*\* Indicates Significant at 1% level, \* indicates significant at 10 %, \*\*Indicates significant at 5%

**Table 4:** Managerial Ownership vs. Debt Ratio for Companies with Foreign Large Shareholders

MO-DOLIS-Dependent variable	COEFFICIENT	STD ERROR	t-Value	p-Value
Constant	.3423241	.1346424	1.99 **	0.054
Debt Ratio	- .00626	.0028943	-1.88**	0.098
Ln(TA)	-.2223873	.0289701	-4.39***	0.000
Earnings Volatility	-.0049736	.0051720	-2.47**	0.014
Non-debt taxable shield	.0000645	.0030119	3.04***	0.004
Assets Growth Rate (GROWTH)	.0078993	.0162412	1.98**	0.005

Number of Obs = 1349, F(9, 1339) = 19.52, R-Squared= 0.176, \*\*\* Indicates Significant at 1% level, \* indicates significant at 10 %, \*\*Indicates significant at 5%

## 5. CONCLUSION

Literature on Agency theory recognizes both debt and managerial ownership to have significant role to play in controlling corporate agency costs. The literature also indicates that the presence of external monitors acts as a limiting factor on management's opportunistic behaviour. Institutional investors are the representatives of the monitoring agents of corporate firms. This study differentiates between foreign and institutional investors and confirms that foreign institutional investors have better monitoring ability than their counterpart's domestic investors. The study hypothesizes that the use of debt and managerial ownership are inversely related to the extent of monitoring by institutional investors with the monitoring quality being higher when the institution is foreign than when it is domestic.

Consistent with the main hypothesis of the paper, institutional ownership both foreign and domestic are found to have negative impact to the level of debt financing with foreign institutional investors having higher monitoring impact than their domestic counterparts. Thus, the results obtained here support the notion that foreign institutional investors serve as effective monitoring agents and help in mitigating agency costs than domestic institutional investors.

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