Large Shareholders Impact Companies' Profitability, Policies

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Corporations can't choose their shareholders, but some might wish they could. A new study found that some large shareholders are associated with lower-than-average returns for the companies in which they invest, while other shareholders are linked to higher-than-average returns in their companies.

“Large shareholders come with different sets of skills and preferences when they invest in a company. And with the power these shareholders wield, their skills and preferences can have significant effects on corporate profitability,” said Henrik Cronqvist, co-author of the study and assistant professor of finance at Ohio State University's Fisher College of Business.

“This is the first study that has been able to show that individual shareholders matter, not only for corporate policies, but for firm performance as well,” Cronqvist said.

Cronqvist conducted the study with Rudiger Fahlenbrach, assistant professor of finance at Ohio State . Their results are available as a working paper at the Social Science Research Newtwork.

The researchers constructed a data set in which they were able to track all large shareholders – those that hold more than 5 percent of a company's stock – for large U.S. public corporations (essentially the Standard & Poor 1,500) from 1996 to 2001. In all, they identified and followed 1,642 large shareholders.

This is not the first study to examine the impact of large shareholders on corporations, Fahlenbrach said.

“But other studies have assumed, at least implicitly, that all large shareholders affect corporations in the same way, and to the same magnitude,” he said.

“But we show that individual shareholders make unique impacts, probably because of their different views and preferences concerning corporate policies.”

The results showed that some types of shareholders had more impact on corporate policies than others. As would be expected, activist shareholders, such as financier Warren Buffet, had strong effects on companies.

In addition, pension funds, corporations and private equity firms mattered a lot in shaping corporate policies and their bottom lines. But some large shareholders – including banks and trusts – seemed to have little impact on firm policies. Mutual funds, insurance companies, and money managers fell in the middle in terms of influence.

The results also showed that large shareholders had a wide range of effects on corporate profitability, as measured by return on assets (ROA).

The researchers ranked shareholder effects on ROA from worst (at the 0 percentile) to best (100 th percentile). The shareholder at the 25 th percentile was associated with 3 percentage points lower-than-average return in the companies in which it invested. The shareholder at the 75 th percentile was associated with 7 percentage points higher-than-average return for its companies. “That's a range of 10 percentage points, which is quite large,” Fahlenbrach said.

The study was also able to link specific policies pushed by shareholders with profitability in the companies they invested in.

For example, return on assets was higher in companies with shareholders associated with higher pay for CEOs, suggesting that, in general, higher CEO compensation was a good deal for corporations in this sample, Cronqvist said.

But ROA was lower in firms with shareholders linked to diversifying acquisitions.

Results also showed how large shareholders pushed different corporate policies depending on the goals they had for the companies they invested in.

For example, firms with shareholders who were associated with growth strategies – such as pursuing mergers and acquisitions – also seemed to pay their CEOs higher compensation.

"This result supports the idea that some shareholders play a role in shaping pay schemes to spur growth in the company," Cronqvist said.

One question may be whether large shareholders really do shape policies in the companies they invest in, or if they simply invest in companies in which they share similar values and policy preferences. With their multi-year data set, the researchers were able to examine company policies before individual shareholders invested in them, to determine whether these shareholders had an impact.

"We found that changes in policies we noted happened after the shareholder comes in, and not in the years before," Cronqvist said. "That indicates the shareholders had something to do with the policy changes."

Overall, the results show that large shareholders don't all think and act alike, according to Fahlenbrach. And these differences have real-world effects on companies' bottom lines.

“We found that the differences in shareholders' opinions, skills and preferences play a significant role in explaining corporate policies and even performance measures,” Fahlenbrach said.

Source: Ohio State University

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