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ScienceDirect

Hospitality Management 26 (2007) 517–530

INTERNATIONAL JOURNAL OF Hospitality Management

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The relationship between institutional ownership and casino firm performance

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Abstract

This study examined the relationship between institutional ownership and firm performance in the casino industry from 1999–2003. Given the evidence of the endogeneity of institutional ownership in the casino industry, institutional ownership was found to be a significant and positive determinant of casino firm performance as measured by a proxy for Tobin's *Q* in a simultaneous equations system. This study reveals that investing institutionally in casino firms may help casino industry investors mitigate the agency problem caused by the separation of management from ownership. In addition, financial institutions tend to invest in larger casino firms with lower financial leverage.
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Keywords: Institutional ownership; Firm performance; Casino; Ownership endogeneity; Agency problem; Tobin's *Q*

1. Introduction

Institutional investors have become important players in today's financial markets. Their increasing importance in corporate governance in the United States (US) is observed from the growing volume of corporate equity they control. As of 2003, institutional investors were estimated to control 60% of all outstanding equity in the US (Hayashi, 2003), compared to 45% in 1990, 33% in 1980 and 8% in 1950 (Taylor, 1990). The

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doi:10.1016/j.ijhm.2006.02.003

observed increase in institutional ownership (IO) in the equity market has been attributed to the growth in pension funds (both public and private) and the passage of the Employee Retirement Income Security Act (ERISA) in 1974 (Graves and Waddock, 1990). Accompanying the growing volume of institutional shareholdings in the equity market, the role of institutional investors has changed dramatically from that of simply passive investors to active monitors.

Traditionally, institutional investors are not directly involved in corporate management decisions; instead, they simply follow the "Wall Street Rule" or an "exit policy" by selling their stakes when dissatisfied with the management or stock performance (Bathala et al., 1994; Graves and Waddock, 1990). With increasingly significant ownership of equity invested in a firm, it has become less costly and yet more powerful for institutions to "voice" disagreement with the management instead of following an "exit policy" by liquidating significant holdings at substantial discounts and, therefore, depressing the firm's stock price (Coffee, 1991; Pound, 1992). Institutional investors, compared to other non-institutional, are more likely to vote and engage in corporate management decisions due to their significant ownership of equity in the firms (Brickley et al., 1998) and attempt to influence top firm management to manage for the long-term interests of shareholders (Holderness and Sheehan, 1988). In other words, institutional investors may have assumed a more effective monitoring role with collective capacity in the corporate governance arena. As a result, they may further influence corporate management decisions and possibly, firm performance (Chaganti and Damanpour, 1991; Pound, 1991).

Since Berle and Means (1932) first commented on problems caused by the separation of ownership and control in corporations, the impact of ownership structure on firm performance has been a subject of debate. However, no consensus has been reached by previous researchers as to whether ownership structure influences firm performance. Also, the extent and directions of the impact, if any, of ownership structure on firm performance remain unclear (Agrawal and Knoeber, 1996; Chaganti and Damanpour, 1991; Clay, 2001; Craswell et al., 1997; Han and Suk, 1998; Loderer and Martin, 1997; McConnell and Servaes, 1990). Few scholars have studied how ownership structure may have influenced firm performance in the hospitality industry. To our best knowledge, while there have been studies on the influence of managerial stock holdings on firm performance in the restaurant industry (Gu and Kim, 2001) and the hotel industry (Gu and Qian, 1999), no studies have looked into the relationship between IO and firm performance for the hospitality industry including casino firms.

This study attempts to investigate the impact of IO on casino firm performance by testing the relationship between the two while controlling for other firm specific variables. Investors in the casino industry, like casino customers and operators, are important stakeholders. Frim performance, in terms of stock prices and other relevant measures (e.g., Tobin's *Q*), is of critical importance to the investors' vested interest in casino firms and therefore affects their desire to invest in the industry. From a casino firm management perspective, recognizing possible influence from institutional investors on firm performance may help direct the firm towards value maximization that is in the shareholders' best interests (Chatfield and Dalbor, 2005). The findings of this study should reveal whether investing in the casino industry institutionally would be a better form for casino investors to mitigate the agency problem caused by the separation of management from ownership, thus enhancing the value of casino firms in the equity market.

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