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When Financial Intermediaries are Corporate Owners: An Agency Model of Institutional Ownership

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Abstract. Increasingly, the equity investments of individual investors are being channeled through financial institutions. This article posits that the role of institutional owners as financial intermediaries, and the resulting complexity that institutions bring to ownership, distinguish institutional ownership from individual ownership. I develop a model of institutional ownership, referred to as *the nexus agency model (NAM)*, which reflects this complexity. The model provides a framework for identifying the potential additional agency costs to beneficial owners that are associated with owning via financial institutions. The degree to which owning via institutions benefits individual owners depends on the adequacy of the legal and regulatory environment and governance mechanisms in protecting individual owners' interests. The applicability of the nexus model to different institutional owner types is then demonstrated in a discussion of U.S. public and private pension plans and mutual funds, leading to the generation of a NAM-based research agenda for each type and across the types. The article ends with discussion of the model's applicability to non-U.S. institutional environments.

Key words: agency theory, governance, institutional ownership, mutual funds, pension plans

1. Introduction

One of the transformational changes affecting U.S. organizations is the tremendous growth of institutional ownership. In part due to the institutionalization of pension benefits and the appeal of professional fund management, individuals who previously invested primarily through bank accounts or individual investment accounts, now often channel their investments through financial institutions (O'Barr and Conley, 1992; Sellon, 1994). In 1980, financial institution types such as pension plans, mutual funds, insurance companies and bank trusts held about 38% of the U.S. equity market (Brancato and Gaughan, in O'Barr and Conley, 1992). More recently, their share has been estimated at 57% (Securities Industry Association, 1999).

While the growth of institutional ownership is noteworthy, what makes the change transformational is the effect of the growth, not the rate itself. Among the issues that have been the subject of debate and study are: (1) whether financial

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institutions promote myopia or a short-term performance perspective (Graves and Waddock, 1990; Hansen and Hill, 1991); (2) institutional concerns about corporate performance (Berenbeim, 1994); and (3) whether pressures for improved corporate governance and performance are effective in improving performance (Smith, 1996; Wahal, 1996). Institutional trading in financial markets is associated with increased price swings and market volatility (Norris, 1996; Schwartz, 1991; Wyatt, 1997a). Further, some institutional owners, particularly public pension plans and select mutual funds, have chosen to assert their newly-found owner power actively by influencing the strategy of targeted firms (Nesbitt, 1997; Useem Bowman Myatt and Irvine, 1993).

Much recent work focuses on institutional owners as corporate owners, or in agency theory terms (for example, Eisenhardt, 1989; Jensen and Meckling, 1976), as principals who have corporate managements as their agents. While such study is clearly important and insightful, it does not address the related research questions: *Is institutional ownership different from non-institutional (or individual) ownership; if so, how is it different; and how do the differences affect agency contract execution*? Institutional owner are indisputably the owners of record of a large segment of total corporate equity. However, much of this is not held for the institutions themselves; it is held by the institutions as financial intermediaries on behalf of the funds' beneficial owners. Institutional owners achieve their concentrated ownership positions through the aggregation of investments from the beneficial owners, investments previously made directly by individual investors without the use of intermediaries.

Being a financial intermediary entails fiduciary responsibilities, including the exercise of trust law regarding the duty of care to the beneficial owners who entrust their funds (Brizendine, 1992; Droms, 1992). However, I put forth that institutional ownership, involving equity agency contracts, is a unique type of financial intermediation, because it challenges existing theory of intermediation, which is largely based upon depository institutions and debt contracts (Allen and Santomero, 1998). I also suggest that, given the intermediary role that such financial institutions play, and the fiduciary obligations associated with the role, institutional ownership is a unique type of ownership. Thus, to gain a better understanding of institutional ownership, attention must be directed toward the institutions' intermediary role between beneficial owners and corporate management, and the institutions' concomitant responsibilities to beneficial owners. Just as agency theory addresses the question of the determinants of agents' performance for their principals, so too a framework of institutional ownership should address the research question: *What are the determinants of institutional ownership performance for beneficial owners*? There is need for a framework of institutional ownership to describe how it differs from non-institutional ownership, and to offer prediction concerning institutional owner performance from the perspective of beneficial owners.

This article uses agency theory as the theoretical frame to address the research questions that have been posed regarding institutional ownership. It starts with a

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review of theory regarding ownership and institutional ownership, and presents an analysis of the potential benefits and detriments that investing via institutions might bring to beneficial owners. The *nexus agency model* (NAM) of institutional ownership is then developed. NAM explicates the critical differences between institutional and non-institutional ownership: (1) the agency contract between beneficial and institutional owners is affected by law and regulation regarding financial intermediaries that do not apply to non-institutional, i.e. individual, ownership; and (2) institutional owners are complex organizations with their own goals apart from those of beneficial owners, and have stakeholders with their own respective goals for the institutions. These organizational and stakeholder goals may conflict with beneficial owner interests, and create additional sources of agency costs for beneficial owners. The degree to which owning via institutions is of benefit to individuals depends on the effectiveness of the legal and regulatory environment, and governance mechanisms, in protecting their interests. The article next applies NAM to three types of U.S. institutional owners – private and public pension plans and mutual funds – and then proposes a NAM-based research agenda. It ends with a discussion of the model's application to other countries' institutional contexts.

2. Corporate Ownership

Business owners have been categorized into *proprietors*, whose involvement in the firm includes working, as well as fixed, intangible, and human capital, and *investors*, who have no active role in the firm and whose contributions are limited to financial capital (Chamberlain and Gordon, 1991). As a result of rampant use of financial markets for capital expansion, ownership shifted from being largely composed of proprietors to being largely composed of investors. Owners became a fragmented, disjoint group with little involvement in the firms that they owned in terms of their own human capital. Thus, the evolution of the firm from being privately to publicly owned led to a split between ownership and control, which resulted in management control of the firm or 'managerialism' (Berle and Means, 1991/1932). As owners relinquished control of the firm, professional managers became empowered and were given great latitude with insufficient checks and balances. Berle and Means were among the first of the anti-managerialists who favored more government intervention in the corporate control process. Likewise, Herman (1981) noted the trend of diffusion of ownership, which resulted in increased management control and decreased family and financial institutional control of firms.

Much of the management field and related business disciplines developed during this era of 'managerial capitalism', when firms were management-controlled, ownership was unempowered, and the environment was relatively stable. This helps to explain why the management field has tended to focus on issues within the organization, whereas topics related to external control (including

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ownership) were neglected (Walsh and Seward, 1990). While there is no dominant theory of ownership in management, much of the field tends to adapt a stakeholder perspective. This is reflected in Penrose's (1959) early discussion of owners in management-controlled firm as providers of capital, who are remunerated like other providers of goods and services. Accordingly, under managerialism, owners had the attribute of legitimacy, but tended to lack the attributes of power and urgency (stakeholder attributes per Mitchell Agle and Wood, 1997).

Within the management field, ownership has been described by the dimension of concentration/dispersion (Berle and Means, 1991/1932; Herman, 1981; Mintzberg, 1983), with concentrated ownership being viewed as more powerful than dispersed ownership. Mintzberg's typology of ownership also includes the dimension of involvement, defined as "... distinguishing owners who play other roles in or around the organization from those who are detached – who are exclusively owners" (1983, p. 33). Involvement thus includes the owners' investment of their own human capital as well as their financial capital, making them somewhat akin to Chamberlain and Gordon's (1991) proprietor category of owners. According to current theories, generally the more involved and more concentrated ownership is, the greater its power.

The relative neglect of the topic of ownership within the management field contrasts with its position in financial economics. In general, the field of financial economics shares a paradigm that a firm's legitimacy rests on ownership; the firm is a vehicle for its owners (for example, Jensen and Meckling, 1976). Financial economics focuses on the maximization of shareholder value as the obligation that management/agents have to owners, generally interpreted as the maximization of stock price and dividend stream (for example, Koshal and Pejovich, 1992). Accordingly, firm internal control mechanisms, such as executive compensation systems, should be designed to support shareholder value maximization. The literature indicates that equity ownership among managers helps to align managers with owners (Chaganti and Damanpour, 1991), and thus reduces agency costs and improves firm performance (Fama, 1980; Fama and Jensen, 1983; Jensen and Murphy, 1990; Oswald and Jahera, 1991). But agency problems may become so significant that internal controls are ineffective. When this occurs, external control of the firm is necessary. Equity markets then become 'markets for corporate control' (Manne, 1965) with takeover battles as the means by which control is won.

3. Agency Theory Treatment of Ownership and Institutional Ownership

The elegance and simplicity of the agency framework is derived from defining organizational behavior in terms of two factors: an agent's contractual obligation to the principal, and the agent's self-interest (Eisenhardt, 1989). Agents may tend to engage in self-serving behavior, which may be shielded from the principal's detection due to adverse selection (pre-contract incomplete information) or moral hazard (post-contract hidden action or hidden information) (Rasmusen, 1989).

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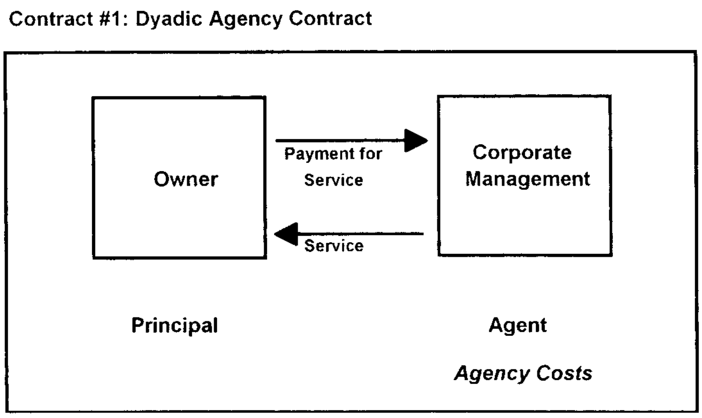

Figure 1. A general agency model of ownership.

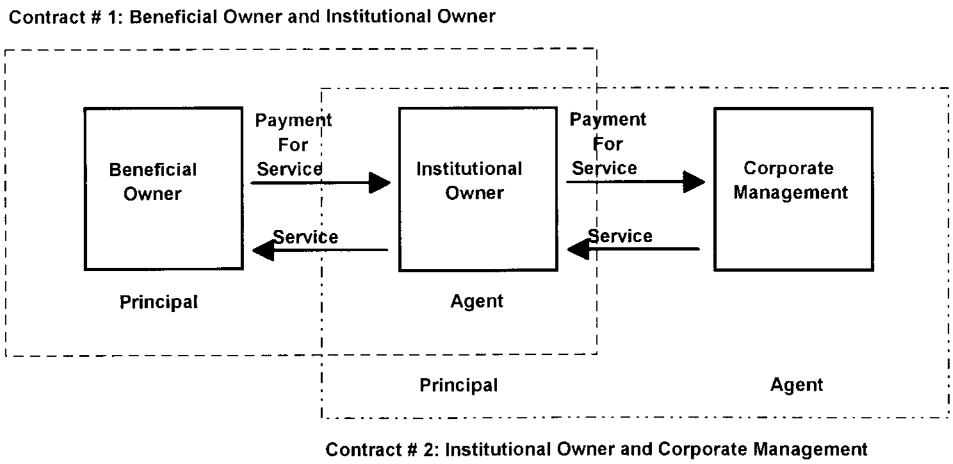

Figure 2. A two-party agency contract approach to institutional ownership.

These behaviors result in agency costs to the principal. Principals minimize agency costs by monitoring agents and by creating incentive systems to align the agents' interests with those of the principals (Pratt and Zeckhauser, 1985). Total agency costs consist of both the costs of self-serving behavior and the costs of monitoring and incentives implemented to curtail this behavior. The principal's goal is to reach the optimal point at which the sum of these costs is minimized.

The traditional principal/owner – agent/manager contract is depicted in Figure 1, labeled *a general agency model of ownership*. According to Jensen and associates' rendering of agency theory (Fama and Jensen, 1983; Jensen and Meckling, 1976), any multi-party system or organization is divisible into a series of two-party agency contracts, so that it is a 'nexus of contracts'. Following the Jensen and Meckling model, institutional ownership can be viewed as a series of dyadic contracts, as depicted in Figure 2. The institutional investor is an agent

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to the beneficial owner/principal in Contract 1, and a principal to the corporate management/agent in Contract 2. Agency theory includes professional contracts, which are characterized by great information asymmetry between the two parties, as in Contract 1, where the principal relies upon the professionalism of the agent to perform the contracted duties (Sharma, 1997).

Despite its elegance and parsimony, agency theory is not without its critics. The theory's application to organizational phenomena has been criticized for shortcomings in acknowledging uncertainty (Nilakant and Rao, 1994), failure to acknowledge other stakeholders (Hill and Jones, 1992), and problematic treatment of social phenomena (Noorderhaven, 1992). Accordingly, agency theory excludes organizational phenomena involving social and economic relationships that face organizational and environmental uncertainty.

Stakeholder theory (Evan and Freeman, 1988; Freeman and Reed, 1983) overcomes some of these criticisms by conceptualizing the firm as a nexus of various groups and their respective interests, and focusing on the ethics of negotiating across the diverse interests (Boatright, 1992; Clarkson, 1995). While stakeholder theory succeeds in recognizing the many parties that constitute the firm, it has not yet acknowledged the primacy of the profit obligation to owners. Sufficient profit for owners is necessary for firm survival. Without it, there is no firm, and no stakeholder interest can be fulfilled. This is not to say that stakeholder theory treats all stakeholders as equal; rather, it treats owners as one of several critical stakeholder groups, but fails to recognize that owners provide the foundation of the firm for all of its stakeholders.

Agency theory is important in developing a model of institutional ownership, because such a model should reflect both the primacy of ownership claims on the firm and the information asymmetries that may exist between beneficial owners and institutional owners. The former consideration is recognized in agency theory's general application to ownership, and the latter in the application of agency theory to professional contracts (Sharma, 1997). However, an agency-based model of institutional ownership must also address whether institutional ownership is critically different from non-institutional ownership, and if so, how the differences influence agency contract execution. As financial intermediaries, institutional owners exist within a legal framework that is unique to them, and this aspect of their institutional environment must be explicated to gain understanding of their agent role with beneficial owners. Further, while institutional owners bring professional expertise and norms to the contract, they are complex organizations, or political systems of competing interests (Mintzberg, 1983; Pfeffer, 1981; Pfeffer and Salancik, 1978). Accordingly, institutional owners have their own goals, separate from the goals of their beneficial owners (Garten, 1992), and face a myriad of stakeholder groups who may be influential in contract execution.

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Table I. Evaluation of potential benefits and detriments brought by institutional owners to the agency contract

Potential benefits	Evaluation
Portfolio diversification	Yes, it is a benefit
Record management	Yes, it is a benefit
Superior returns	Generally not a benefit; institutions tend to under-perform relevant indices
Fiduciary responsibility	It is a benefit to the degree it is exercised
Concentration of ownership	Depends of alignment of interests between beneficial owners and the influence exerted on corporations by the institutions
Reduction in participation costs	Yes, it is a benefit
Potential detriments	**Evaluation**
Institutions are an additional source of agency costs	Yes, it is a detriment
Other parties to the agency contract are an additional source of agency cost	Yes, it is a detriment

4. Institutional Ownership Agency Contract Execution

In this section, I describe and analyze the complexity of institutional ownership by focusing on how institutional ownership influences ownership contract execution, and then present the nexus model that captures this complexity.

4.1. Potential Benefits and Detriments of Institutional Ownership

The effects of institutional ownership on ownership agency contract execution are presented through the evaluation of a series of potential benefits and detriments that may accrue to beneficial owners. A synopsis of this section is presented as Table I.

Beneficial owners engage institutional owners in ownership contract execution to gain the potential benefits of portfolio diversification to lower investment risk, professional services such as investment record keeping, and superior financial returns (Kolb, 1994). These factors are among the key reasons that individuals choose to invest through institutions such as mutual funds rather than investing on their own (Capon Fitzsimons and Prince, 1996). Investors purchase shares in a basket of securities, which generally exceeds the level of diversification that an individual investor could obtain for a given investment amount. Professional service is evidenced through accurate record keeping and tax reporting to investors.

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But the third potential benefit of superior returns (Kolb, 1994) is not evidenced in empirical research. Two seminal studies (Jensen, 1968; Sharpe, 1966) conclude that, in general, mutual funds under-perform common market indices or benchmarks. Recent studies likewise indicate that mutual funds do not earn superior returns (Ippolito, 1993), and that internally-managed private pension funds earn less than mutual funds, even when risk and return are held constant (Berkowitz Finney and Logue, 1988). Research on public pension plans indicates that such plans also tend to under-perform the market (Randall, 1995). Thus, while diversification and record keeping are real benefits of investing through institutions, empirical studies indicate that increased return is not.

Individual investors often lack the expertise to self-manage their investments, and therefore rely on institutions' financial acumen in contract execution. In this regard, institutions engaged in ownership contract execution have a fiduciary responsibility to their beneficial owners, which is outlined in trust law (Brizendine, 1992; Droms, 1992). Fiduciaries, including but not limited to institutional owners, must use professional, objective judgment as to what is best for beneficiaries, act on their behalf, and avoid conflicts between their own interests and those of beneficiaries (Monks, 1997). The requirement for institutions to act as fiduciaries is a benefit to beneficial owners to the degree that it is exercised. It allows individuals with little knowledge of finance to utilize professional financial management for their personal investments. But a breach in fiduciary obligation, in which the institution acts on its own behalf or engages in conflicts of interest, is a potential detriment to the beneficial owner. For example, beneficial owners may be subjected to investments with a greater level of risk, and greater associated volatility in return than expected (Wyatt, 1996). Beneficial owners who lack financial savvy are clearly vulnerable to breaches in fiduciary responsibility, and must rely on the professionalism of institutional owners in upholding their fiduciary obligations and minimizing agency costs.

Since institutional owners are financial intermediaries, any theory of institutional ownership must rightfully reflect theory of financial intermediation. According to this theory, intermediaries emerge when there is value in producing, processing, and packing information, and re-bundling securities, due to market incompleteness and information asymmetry (Draper and Hoage, 1978). For example, recent research indicates that institutional owners have informational advantages over individual shareholders in two-tier takeover bidding offers (Sundaramurthy and Rechner, 1997). In the intermediation process, intermediaries serve as delegated monitors for their principals. This delegated monitoring may create incentive alignment problems that result in *delegation costs* to the principals (Diamond, 1984, 1996). Although Diamond introduces the notion of delegated monitoring, he concludes that, based on diversification within the financial intermediary, delegation costs do not materialize. Instead, intermediaries allow for better

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contracts and Pareto superior allocations under the optimal contract of debt. Thus, debt is optimal because it minimizes monitoring costs (Krasa and Villamil, 1992).

Financial intermediation theorists have focused on studying the optimal debt contract, rather than studying the range of intermediation contracts. Accordingly, the theory is indeterminate regarding the effects of the delegated monitoring associated with non-optimal contracts such as equity, the topic of this article. Allen and Santomero (1998) contend that current theory of intermediation is limited in its ability to explain non-traditional, or non-debt, intermediation, and note that this is a particular shortcoming given the burgeoning use of non-debt intermediation and the emergence of non-traditional intermediation on the part of depository institutions. In this regard, Allen and Santomero introduce the notion of *participation costs*, or the costs to an individual investor of participating in a financial market. Participation costs transcend information asymmetry as the basis for intermediation; here, there is a sense of the experience, judgment, and wisdom that is perceived by the beneficiary as necessary for informed investing in a financial market such as equity securities. The concept of participation costs offers an explanation for equity intermediary contracts. Such contracts allow principals to enter markets that they would otherwise tend to avoid due to high participation costs. Thus, intermediaries benefit principals by offering reduced participation costs, and by increasing the principals' propensity to participate in equity markets. (Table I). However, as will be explained below, I offer that, while intermediaries offer beneficial owners reduced participation costs for equity contracts, this benefit may be concomitant with increased agency costs to the beneficial owners.

A key dimension of ownership is concentration, or its opposite, dispersion (Berle and Means, 1991/1932; Herman, 1981; Mintzberg, 1983; Shleifer and Vishny, 1986). Ownership concentration is not a new phenomenon; it has, for example, included family ownership of public firms (Shleifer and Vishny, 1986). Large or concentrated shareholders have traditionally played an active role in corporate governance in many countries (Shleifer and Vishy, 1997). However, Useem (1993, 1995) demonstrates that the new era of 'investor capitalism' is associated with increased ownership concentration brought about by institutional ownership. I propose that whether this concentration of ownership, achieved through institutional aggregation of stock holdings, is a benefit or a detriment to beneficial owners depends on the alignment between their interests and the influence asserted on corporations by the institutions. If there is significant alignment of interests, institutions will serve to reduce corporate management's tendency to be self-serving, and reduce this source of agency costs. If alignment is weak, institutional involvement may be a detriment to the fulfillment of beneficial owners' interests and might therefore increase agency costs.

As previously stated, financial intermediaries are complex organizations with their own goals. I propose that the use of financial intermediaries or third parties introduces an additional source of agency costs to ownership contract execution;

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there are now agency costs associated with financial intermediary management, as well as agency costs associated with corporate management. This is a detrimental complication to contract execution, and may result in agency problems more difficult than those involving management of the public corporation (Gordon, 1994). For example, mutual funds may adopt policies that favor the growth of fund revenues attained by attracting new investors rather than maximize after-tax return to current investors (Barclay Pearson and Weisbach, 1995). There are also governance issues regarding mutual funds, focusing on whether board members who are categorized as independent (SEC law requires that 40% are not employed by the fund management company) function as such for fund investors, given the interlocking nature of these positions and the significant compensation that board members receive (Gould, 1997).

Stakeholders of the financial intermediary/institutional owner may also press for their own self-interest, which introduces another source of agency costs to the agency model. For example, private pension plans may be subject to pressure from their corporate sponsors and other business interests regarding proxy voting. The majority of private plans allow outside money managers or trustees to vote their proxies, as "…insulation from pressure by peer companies and others to vote for management positions" (Davey, 1991, p. 12). Institutional isomorphism (DiMaggio and Powell, 1983) among mutual funds is evidenced in a rigid fee structure. With rare exceptions, fees are a function of assets under management, with little linkage to mutual fund performance (Grinold and Rudd, 1987) or fund scale (Wyatt, 1997b). Thus, industry norms cause beneficial owners to pay comparable fees, regardless of fund performance. Public pension plans are particularly subject to a myriad of interests and political pressures on funding and investment, which tend to negatively influence fund performance (Mitchell and Smith, 1994; Romano, 1993).

4.2. THE NEXUS AGENCY MODEL (NAM)

Institutional owners function as owner/principals to corporate managements, and as 'agents monitoring other agents' (Varian, 1990) in their intermediary role monitoring corporate managements for beneficial owners. The multiple dyadic contract agency approach depicted in Figure 2 does not provide a framework for addressing either the critical role of institutional owners as financial intermediaries between beneficial owners/principals and corporate managements/agents, or the effects that such intermediaries have on contract execution. An alternative characterization of institutional ownership as a multiple-agent contract appears in legal literature, where Black (1992) describes institutional owners as 'agents watching agents'. In accounting literature, Baiman (1982) has noted that there are no conceptual problems in expanding the agency contract to include more parties. Indeed, as depicted in Figure 3, a three-party agency model of institutional ownership has recently

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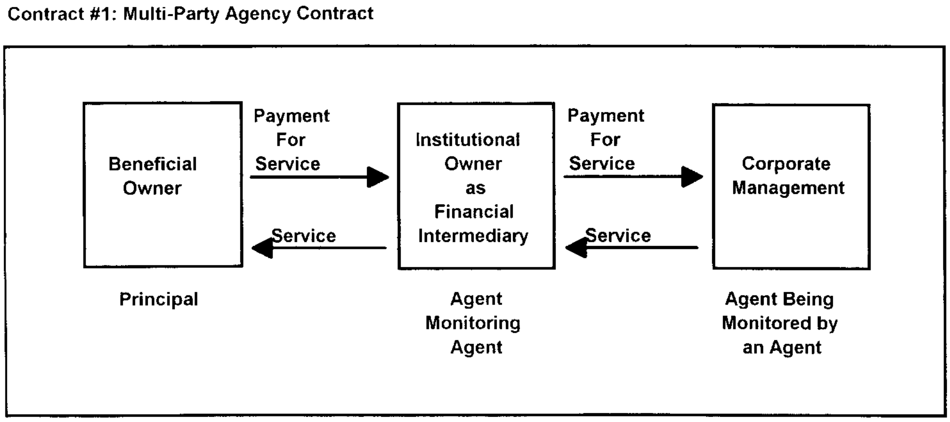

Figure 3. Application of agency theory to institutional ownership.

been developed and is a basis for the empirical study of mutual fund performance (Chandar, 1996). Therefore, the alternative conceptualization of multiple agents to a single contract, as opposed to the multiple dyadic contract approach, is evidenced in Varian's (1990) work in institutional economics as well as research in law and accounting regarding institutional ownership.

The nexus agency model (NAM) builds upon the 'agents monitoring other agents' heuristic, and expands to include the institutional owner's stakeholders into the ownership agency contract. Institutional owners face multiple roles, or sets of expectations, about behavior in a social structure (Rizzo House and Lirtzman, 1970) in their capacity as financial intermediaries. In role-set theory, the role-taking process becomes increasingly complex when several roles are to be enacted by the same person, and may result in role conflict, defined as "...the simultaneous occurrence of two or more role expectations such that compliance with one would make compliance with the other more difficult" (Katz and Kahn, 1978, p. 204). Boundary-spanning roles, in which expectations arise from role senders located in separate social systems (i.e. organizations), are particularly prone to role conflict (Van Sell Brief and Schuler, 1981; Wall and Adams, 1980). Institutional owners are depicted in Figure 4 as being at a nexus of roles. They face role expectations from various parties in different social systems, a situation which will tend to be wrought with role conflict.

NAM explicates the influence of securities industry regulation and general fiduciary law on contract execution involving financial intermediaries as institutional owners. For example, it has been demonstrated that "prudent man" laws within the U.S. affect institutional owner types differently, with the result that bank managers favor portfolio composition toward more prudent stocks than do mutual fund managers (Del Guercio, 1996). Through the outer rectangle labeled *legal and regulatory environment of the institutional owner type*, NAM acknowledges

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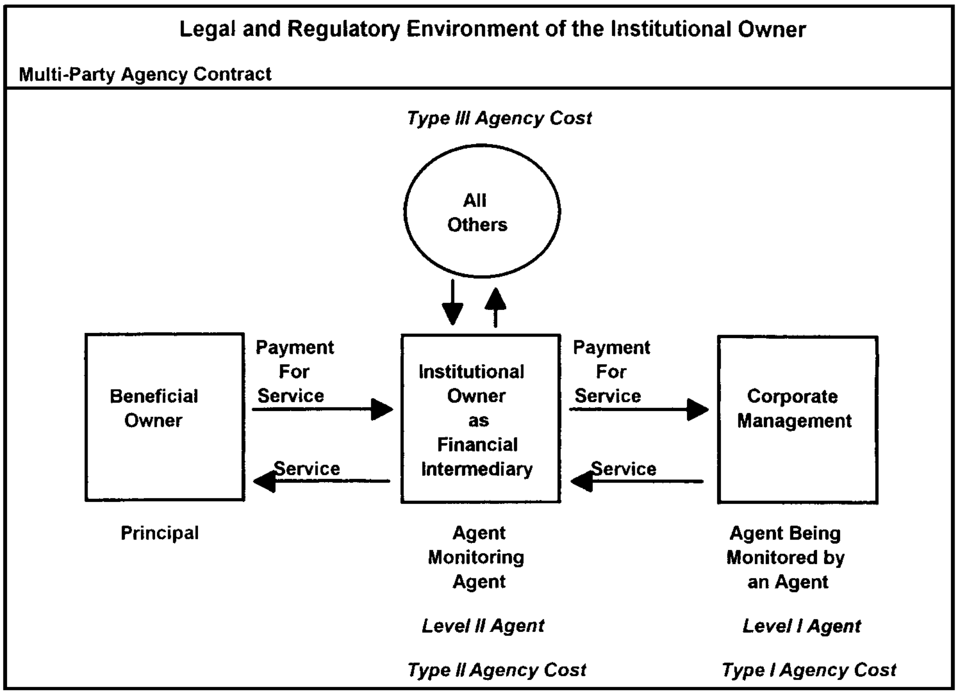

Figure 4. A nexus agency model of institutional ownership.

that the institutional owner agency contract is embedded within an institutional environment that affects contract execution.

The leftmost rectangle identifies the beneficial owner as the principal. The rightmost rectangle consists of corporate management, the ‘agent being monitored by an agent’. Corporate management is labeled a *level I agent* in the model. Agency costs associated with corporate managements are referred to as *type I agency costs*.

The institutional owner or financial intermediary occupies the middle rectangle described as ‘agent monitoring another agent’. The intermediary is labeled a *level II agent* in the model. Agency costs associated with the financial intermediary or level II agent self-interest are referred to as *type II agency costs*. Intermediation contracts involving equity are uniquely laden with the potential for reduced participation costs (Allen and Santomero, 1998), and concomitantly, I posit, the potential for increased agency costs for the involved beneficiaries. Just as the relative financial naiveté of beneficiaries in equity markets allows for the participation cost reduction brought about by intermediaries, it also allows for an increase in opportunistic behavior by intermediaries, which will tend to be undetectable by the beneficiaries. Thus, the delegated monitoring performed by institutional owners brings about a reduction in participation costs while generating a new source of agency costs for beneficial owners.

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In addition to the three inner rectangles in Figure 4, an oval above the level II agent rectangle depicts *others* or stakeholders of the intermediary, including pension plan sponsors and organizations that have a business interest with the sponsor (in the case of pension plans), and other mutual funds (in the case of mutual funds). Agency costs associated with others are labeled *type III agency costs* in the nexus model.

NAM contributes by explicitly acknowledging that the institutional owner agency contract exists within law and regulation affecting contract execution, and by establishing three distinct potential sources of agency costs to the beneficial owner: costs emanating from corporate management or level I agent (type I agency costs), from the intermediary or level II agent (type II agency costs), and from other stakeholders of the intermediary (type III agency costs). Accordingly, the critical difference between institutional ownership and individual ownership is that the latter is associated only with type I agency costs emanating from corporate management, whereas the former is associated with all three types of agency costs and with a regulatory environment not germane to individual ownership. For the individual investor who may either own directly or own via institutions, institutional ownership brings forth the potential for two other sources of agency costs (the institution and its stakeholders) in addition to the single source present via either type of ownership (corporate management). Given that institutional ownership results in two new potential sources of agency costs to beneficial owners, and is embedded in law and regulation governing the institutions' transactions and behaviors, are beneficial owners better off investing as individuals, or investing through institutions?

The potential benefits associated with investing via institutions, as outlined in Table I, include portfolio diversification and fiduciary responsibility as established in law. Through their corporate monitoring function, the institutions may serve to reduce type I agency costs emanating from corporations. Thus, the benefits may indeed outweigh the additional potential agency costs, in which case it is worthwhile for individuals to invest through financial intermediaries. However, the additional type II and III agency costs may outweigh the benefits, in which case, beneficial owners would be better off investing on their own account as individuals. Prediction regarding the benefits to beneficial owners of investing via institutions depends on the efficacy of regulatory and governance mechanisms:

Proposition I: The greater the degree to which law and regulation regarding financial institutions reflect the interests of beneficial owners to control agency costs, the greater will be the benefit of owning via financial institutions.

Proposition II: The greater the degree to which institutional ownership functions as a corporate governance mechanism to control type I agency costs, the greater will be the benefit of owning via financial institutions.

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Proposition III: The greater the degree to which the governance of institutional ownership functions to control type II and III agency costs, the greater will be the benefit of owning via financial institutions.

NAM makes no assumption as to which party to the contract dominates in the role conflict, which ensues, even though the beneficial owner is the principal in the contract. Rather, the nexus model presents institutional ownership as a political system of competing interests, in which beneficial owners will dominate only to the degree that the multiple sources of potential agency costs are adequately controlled.

5. Empirical Implications

The contribution of NAM is not limited to its conceptualization of institutional ownership; indeed, both the relationships outlined in the model (with its dependent variable of performance) and the associated propositions provoke empirical study. In this regard, Section 5.1 presents a description and analysis of three types of institutions – U.S. private and public pension plans and mutual funds – in terms of the model's components. It summarizes each institutional owner type's respective beneficial owners, management, legal and regulatory environment, and critical stakeholder groups, and includes a discussion of the type's general role in corporate governance and reduction of potential type I agency costs. A synopsis of the section is presented in Table II. Section 5.2 then discusses the largely neglected topic of the governance of institutional owners, a curious neglect given the institutions' impetus in bringing the subject of corporate governance to the forefront. After the NAM-based review of the three types of institutional owners and their governance mechanisms, Section 5.3 outlines a proposed research agenda regarding the efficacy of law and regulation, and institutional owner governance, in controlling potential type II and III agency costs within and across the institutional owner types. The remaining section outlines other potential applications of NAM.

Before delineating the differences between the institutional owner types, some commonalties must be noted. All three types of institutions face fiduciary responsibilities as are defined in U.S. law. However, as will be explained, the three types face quite different regulatory environments, which affect their respective rights and responsibilities to beneficial owners. In addition, private and public pension plans share some characteristics. Both are financial institutions that have a legal obligation to provide income to participants during their retirements (Kidwell Peterson and Blackwell, 1993), granted by pension sponsors to attract, retain, and motivate employees (Bodie and Papke, 1992). Pension plans have significantly predictable time horizons for their outflows to beneficial owners. This presents them with the opportunity to develop a long-term perspective regarding their investments (Brown, 1998; Monks and Minnow, 1996). Many pension plans outsource at least part of their investment function to mutual funds (Brancato, 1997). As of year-end 1997, the most recent year for which information is available, private

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Table II. NAM application to private and public pension plans and mutual funds

Institutional owner Type	Beneficial owners	Management (*Type II Costs*)	Legal/Regulatory environment	Critical stakeholders (*Type III Costs*)	Role in corporate governance (*Type I Costs*)
Private pension plans	– Private sector employees	– The trustee that is appointed by the plan sponsor; often, such trustees are employees of the sponsor	– ERISA – Movement from DB to DC plans	– Firms engaged in business relationships with the sponsor	Passive: – business community norms – legal/regulatory environment – manager background
Public pension plans	– Public sector civil service employees	– Generally, are employees of the sponsor – May be employees of the plan itself if the plan is an autonomous unit	– Idiosyncratic – Local and social investing statutes – Ceilings on asset allocation – Remain DB plans	– Plan member labor unions – Taxpayers – Elected officials	Activist: – independence from the private sector – manager background
Mutual funds	– Mutual fund shareholders	– “Wall Street” money managers	– Various SEC regulations over time	– Other mutual funds via industry norms	Somewhat passive to activist: – variation within type

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plans totaled $1,765 billion or 24.1% of U.S. institutional ownership; public plans were $1,306 or 17.7%; and mutual funds, $2,206 or 27.6% of the $5,625 billion in equity owned by institutions (Securities Industry Association, 1999).

5.1.A. Private pension plans

Private pension plans are the retirement funds of corporate employees. Private trustee plans, including defined benefit and defined contribution types, are managed by a trustee appointed by the plan sponsor. While the trustee may be a bank or trust company, it may be an employee of the sponsor (Brancato, 1991; O'Barr and Conley, 1992). I put forth that private plan trustees who are also employees of the sponsor will tend to face potential conflicts of interest in the performance of their dual roles, a potential source of type II agency costs.

In 1974, The Employee Retirement Income Security Act (ERISA) was created as federal regulation governing private plans, for the then-ubiquitous defined benefit (DB) pension plan (Institutional Investor, 1994). However, the corporate sector is moving away from DB plans, which guarantee beneficiaries a stated amount, to defined contribution (DC) and hybrid plans, in which the sponsor makes a stated contribution, but investment risk is shifted to the beneficiary (Andrews and Hurd, 1992; Bodie Marcus and Merton, 1988; Bodie and Papke, 1992). DC plans are much more flexible and portable than DB plans, and therefore bring beneficial owners the benefit of lower portability losses upon job change (Bodie Marcus and Merton, 1988; Andrew and Hurd, 1992). It has been noted that a benefit of the conversion from DB to DC status to plan sponsors is avoidance of ERISA (Blair, 1995). Therefore, the movement toward DC plans is partly based on risk shift and portability considerations, and partly due to intentional avoidance of ERISA on the part of private plan sponsors.

It has been suggested that a conflict of interest may arise when firms engaged in a business relationship have pension plans that invest in each other (David and Kochhar, 1996; Montgomery and Leighton, 1993). Accordingly, type III agency costs may arise among firms whose pension plans reflect a degree of interlocking corporate ownership.

In general, there is a noted lack of involvement by private plans in corporate governance (Useem Bowman Myatt and Irvine, 1993), manifested in the delegation of proxy voting to money managers or trustees (Davey, 1991). Private pension plans tend to remain silent in corporate performance and governance matters, exercising 'exit' or sell strategies when dissatisfied with a corporation (Brancato, 1997; Pomeranz, 1998; Useem et al., 1993). A norm of 'mutual forbearance' has emerged between private plans and their corporate colleagues, promoting silenced voices (Brown, 1998). Mutual forbearance causes private plans to behave passively with corporate managements for fear of retaliation. In addition, the stringency of ERISA encourages passivity. Under ERISA a pension plan could lose its tax-exempt status if it tried to exercise control over a company (Blair, 1995). Further,

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it is well possible that the background of private plan managers influences their plans' role in corporate governance and reduction of type I agency costs. While the public service background of public managers may predispose them toward activism, private managers' corporate backgrounds may predispose them away from it (Demb and Richey, 1994). As private plans are inactive in corporate governance, this institutional type appears to be ineffective in controlling type I agency costs.

5.1.B. Public pension plans

Public pension plans are the retirement funds of public sector employees; specifically those employed by states, counties, and municipalities. Pension plans of federal employees are generally excluded from this category, as many of them are not investment portfolios but are instead invested almost exclusively in non-marketable, special issue Treasury securities. Further, six of the thirty-four federal plans pay for retirement benefits from current year appropriations, i.e., they are "pay as you go" plans with no accrual policy (U.S. General Accounting Office, 1996).

Although some public plans are administered by autonomous units, separate from the plan sponsor, the large majority is administered by the plan sponsor (Zorn, 1997b). Thus, many public pension plan managers are employees of the plan sponsor. In addition, public pension plan managers tend to have backgrounds in public administration, not business administration (O'Barr and Conley, 1992). Thus, plan administrators may tend to be aligned with the interests of the local government unit that is the plan sponsor, so that public pension plans are potentially subject to the influence of political interests (Romano, 1993). This results in potential type II agency costs.

As public organizations, public plans are subject to a wide variety of political interests, which tends to result in greater goal ambiguity than in private sector organizations (Perry and Rainey, 1988; Ring and Perry, 1985). Although ERISA governs private pension plans, public plans instead face a wide variety of state legal environments, as there is no federal-level financial regulation regarding them (Martin, 1990; J.O. Woods, 1996). While some public pension plan legal environments are ERISA-like, others are less stringent (Clark, 1991; Greenwich Associates, 1996; Romano, 1993) leading to variation in plan governance. For example, most public plans are governed by a board of trustees, but a minority is not (Zorn, 1997b). The investment policy of public plans may reflect legal statutes to improve the local economy, or to affect social change (Kieschnick, 1979; Litvak, 1983). It may also reflect legal ceilings on portfolio allocation to riskier asset classes, which forces conservative investment. This means that such plans have earned less return than they could have (Randall, 1995), contributing to plan under-funding.

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Public pension plans reflect their civil service environment (O'Barr and Conley, 1992), resulting in a mutual expectation of long-term employment. A distinctive characteristic of public plans is the presence of members' labor unions, as unions have a much higher penetration rate in the public sector compared to industry (Feuille, 1991; Fiorito and Stepina, 1996). Member labor unions are thus a critical stakeholder of public pension plans. Reflecting the employment longevity of their civil service, unionized workforce, the vast majority of public pension plans remain DB plans (Zorn, 1997a), despite the change toward DC plans in the private sector.

Employer contributions to public pension plans are funded by tax dollars, and politicians overseeing the plans are sensitive to issues affecting their re-election. Thus, taxpayer interests may influence pension plan management, particularly in states experiencing economic stress and high taxation. There are significant equity issues regarding public pension plans and taxpayer interests. Of the individual taxpayers who fund such plans, only about one-half of those employed in the private sector have any pension plan other than social security (Radcliffe, 1990; Twinney, 1997), whereas three-quarters of civilian government employees have a pension plan (Radcliffe, 1990). In addition, given the relatively low-paying civil service environment, many public employers offer pension plans to attract employees (Zorn, 1994). Taxpayers may oppose the retirement packages of public sector employees, coupled with the relatively low retirement age associated with the packages. Thus, taxpayers and elected officials are stakeholders who represent sources of potential type III agency costs in the form of inadequate plan funding.

While the public nature of public plans creates some pressures on funding and investment policy, it also frees the plans of most dependence on, and interference from, the private sector (Blair, 1995). In addition, the background of public plan managers may predispose them toward activism (Demb and Richey, 1994). Some plans, most notably CalPERS, are clearly at the forefront of owner activism, although the efficacy of the activism in terms of improvement in corporate performance is unclear (Del Guercio and Hawkins, 1999; Smith, 1996; Wahal, 1996). Thus, public pension plans are active in corporate governance and attempts to reduce type I agency costs, but research is inconclusive regarding the effectiveness of the activism.

5.1.C. Mutual funds

A mutual fund is an open-ended investment company whose investors purchase ownership interest in a diversified portfolio of securities (Johnson, 1993). Mutual funds are categorized based upon their investment philosophy, which determines the level of risk of the fund and the types of financial assets in which it invests. Those that invest in equity securities are classified as institutional owners. The investment company earns its income through management fees charged to shareholders, which, depending on the fund, may be charged when shares are purchased, redeemed, and/or annually (Fredman and Wiles, 1998; Livingston and O'Neal,

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1998). Because mutual fund shares are redeemable by investors at any time, the liquidity of investments is of great concern to fund management (Levinthal and Myatt, 1994). Mutual fund "Wall Street" money managers must be able to liquefy or sell their position in a financial asset at any point, in contrast to pension plans that face a more predictable, long-term investment timeframe. This promotes a tendency toward short-term thinking, which, coupled with competitive pressures on performance, result in higher portfolio turnover than occurs with pension plans (Brancato, 1995). Thus, a tendency among mutual fund managers toward short-term thinking may generate relatively high transaction costs to their beneficial owners, a type II agency cost to the owners.

Mutual funds exist within a regulatory environment, largely under the domain of the Securities and Exchange Commission (SEC), which has adapted over time in response to problems emerging from investment trends. Securities regulation extends to the review of a fund's registration statement and prospectus, redemption of shares, and fairness of management fees (Johnson, 1993). Under current regulation, shareholders elect a board of directors responsible for investment policies. The board also either appoints officers to manage the fund's operations, or delegates the operations function to a management company (Investment Company Institute, 1996).

The mutual fund industry is characterized by the presence of thousands of funds, low switching costs to investors, much rivalry, and a great degree of public information available to investors regarding the funds' relative performance (Brancato, 1997; Fredman and Wiles, 1998). Some advance the position that mutual fund industry dynamics serve to curb agency costs. Accordingly, regulation is necessary only when competition fails to ensure that transactions are executed fairly and efficiently; further, it is thought that the liquidity mandate faced by the funds reduces the chances for fiduciary abuse (Baumol Goldfeld Gordon and Koehn, 1990). But, it is possible that the industry's competitive forces may also lead to type II and III agency costs. Mutual funds may favor attracting new investors to maximize fund revenues rather than maximize after-tax return to current investors (Barclay et al., 1995), a form of type II costs to current investors. In the clamor to top the ratings lists by earning the greatest return within a fund category, mutual funds may take on a greater level of risk than is conveyed to beneficial owners by investing in some assets that are riskier than is implied to investors (Wyatt, 1996), resulting in a type II agency cost to beneficial owners who wish to avoid higher risk levels. And, despite the high level of rivalry and growth of the industry, industry fees tend to remain constant, as a function of assets under management (Wyatt, 1997b). I put forth that the norm among industry members supporting a rigid fee structure creates a potential type III agency cost to beneficial owners. Akin to the "Prisoners' Dilemma" game theory classic, each individual firm would be better off reducing fees and thereby generating more business, but the industry is better off by maintaining a high fee structure.

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Mutual funds' liquidity requirement does limit their ability to engage in long-term or relational investing in corporations. While this may seem to have a negative effect of the funds' role in corporate governance, and indeed often does, mutual funds evidence significant differences in their role in corporate governance. Many review proposals on proxy statements, and sometimes contact management (Useem, 1993). Some fund managers, such as Monks and Minnow of Lens (Lux, 1995) and Price of Franklin Mutual Advisors (Reed, 1998) have been among the most activist and effective of all institutional investors in pressing for corporate strategic change in under-performing companies. Thus, the role of mutual funds in activism toward controlling type I agency costs varies widely, as does the effectiveness of the activism.

5.2. THE GOVERNANCE OF INSTITUTIONAL OWNERS

As has been illustrated regarding institutional ownership, agency contracts are embedded within the institutional forces of law/regulation and governance. But rather than being independent forces, many governance mechanisms such as boards of directors are legally mandated requirements for public corporations. Governance mechanisms thus reflect the larger socio-political-economic system of which the firm is part, and vary significantly across countries (Charkham, 1994). While the subject of corporate governance is becoming well established across several disciplines, the subject of institutional governance, i.e. the governance of institutional owners as complex organizations, has received little inquiry. In this section, I discuss the mechanisms of corporate governance, and then employ this discussion as the basic for exploration of the subject of institutional owner governance.

Corporate governance mechanisms include ownership concentration, organizational structure, boards of directors, executive compensation, and the market for corporate control (Hitt Ireland and Hoskisson, 1999). Type I agency costs associated with managerialism can be reduced through the implementation of an organizational reporting structure that minimizes the opportunity for managerial self-serving behavior to develop. The board of directors is charged to function as a check on management in ensuring representation of shareholder, and to a degree, other stakeholder, interests, and has the responsibility to replace management if it manifests managerialist tendencies. Executive compensation may serve as a governance mechanism to reduce managerialist tendencies by aligning managerial and owner interests. And should the internal mechanisms of ownership, structure, the board of directors, and executive compensation fail, the external mechanism of the market for corporate control may displace managerialist executives through corporate takeover, though there may be agency costs associated with takeovers (Shleifer and Vishny, 1997).

In the U.S., the era of institutional ownership has been associated with an improvement in corporate governance, through more empowered ownership; less bureaucratic structures; more aligned executive compensation systems; and

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stronger, more involved boards. Regarding the market for corporate control, institutional owners have functioned as critical parties in corporate takeover battles (Davis and Stout, 1992; Shleifer and Vishny, 1986). But, given the fairly newly found power of the institutions, and given the potential type II and III agency costs emanating from agency contracts involving institutions as financial intermediaries, questions arise as to whether there is adequate governance of institutional owners. Specifically, what are the mechanisms of institutional owner governance, and what is their effectiveness?

A starting point toward development of tentative answers is analysis of institutional governance in terms of the five established corporate governance mechanisms listed above. While corporate ownership is become more concentrated (in large part due to institutional ownership), in general the ownership of the institutions is dispersed and unempowered, consisting of a myriad of beneficial owners. Issues related to organizational structure, the second governance mechanism, vary by institutional type, and appear to be complex. Private pension plan-trustee structural relationships; the effects of whether public plans are, or are not, administered by autonomous units instead of the plan sponsor; and mutual fund relationships with their larger investment company (e.g. Fidelity or Merrill Lynch) are examples of institutional governance issues regarding structure that have been largely unexplored. The efficacy of pension plan and mutual fund boards as representatives of beneficial owner interests is largely unaddressed, though there is indication that the independence of board members has been questioned (Gould, 1997; Romano, 1993). The use of compensation as an institutional governance mechanism to align management and beneficial owner interests is also an unaddressed, promising area of research.

The final governance mechanism, the market for corporate control, is, upon initial analysis, largely irrelevant for institutional owners. There is no market per se for pension plans ownership. (For example, a member of G.M.'s pension plan cannot liquidate that position and join Ford's pension plan without a change in employment and adherence to complex pension rollover regulations.) Mutual funds may tend to have more of a market governance mechanism, so that the continued existence of under-performing funds might come into question. But ascertaining the degree to which under-performing funds become takeover targets of well-performing funds requires empirical study. It appears that the subject of institutional governance is currently severely under-researched, and is worthy of a significant research effort given the power and influence of institutional owners and the potential agency costs associated with them.

5.3. Proposed research agenda

I advance a NAM-based research agenda that calls for the development, and testing, of hypotheses derived from the model and its propositions presented in an earlier part of the paper. The propositions outline anticipated relationships between insti-

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tutional owner law and regulation, and governance mechanisms, and agency costs to beneficial owners. Much of the existing literature on institutional owners is related to Proposition II, testing the efficacy of institutional owners as a corporate governance mechanism in controlling corporate (type I) agency costs (for example, Del Guerico and Hawkins, 1999; Smith, 1996; Wahal, 1996). While further study of this topic is clearly in order, the largely unaddressed issues regarding institutional ownership are the degree to which law and regulation faced by institutional owners controls the three types of agency costs, and the degree to which institutional owner governance mechanisms control type II and III agency costs, as outlined in Propositions I and III, respectively.

The research agenda is both specific to each institutional owner type and proposes comparison of agency contract execution across institutional types. First, it is necessary to further develop the description and analysis of the three institutional owner types, their unique legal and regulatory environments, and critical stakeholders that is provided in Section 5.1 and Table II. This would facilitate the identification of potential sources of agency costs associated with the institutional type's management (type II agency costs) and stakeholders (type III agency costs). Some NAM-related research questions regarding type II agency costs generated from the description and analysis in Section 5.1 include the performance effects of designation of an employee of the sponsor as the private pension plan trustee, vis-à-vis the other options of use of a bank or trust company; the degree to which managers' civil service backgrounds influence public pension plan investment policies and performance; and the frequency to which mutual funds that are top-performing in their category extend asset allocation to assets that are riskier than is conveyed to beneficial owners. Questions regarding type III agency costs include the propensity for the sponsors' business relationships to affect private pension plans' investment and corporate governance policies; the tendency for elected officials to lessen the adequacy of public plan funding to appease taxpayers; and the degree to which mutual fund industry norms affect industry rivalry and the policies of individual funds.

Next, there is need for additional specification of the governance mechanisms of the respective institutional types that is provided in Section 5.2. There may be other governance mechanisms, undetected in the analysis conducted regarding the applicability of corporate governance mechanisms to institutional owners, which could be identified with further study.

Hypotheses could then be developed that would reflect the three propositions, stated in terms of the effectiveness of the specific legal and regulatory environment and governance mechanisms of the institutional type in controlling the potential type II and III agency costs associated with the type. Appropriate measures of performance for both pension plans and mutual funds include plan investment returns, earned from investment of the plan's portfolio of financial assets (Berkowitz Finney and Logue, 1988; Useem and Mitchell, 1998), and, for pension plans, plan funding, the actuarial estimation of how well the plan is able to meet

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its current and future retirement payment obligations (Bodie and Papke, 1992; Ippolito, 1986; Mitchell and Hsing, 1995). Hypotheses can be developed for other institutional owner types, such as bank trusts and life insurance companies, to identify their particular type II and III agency costs and the efficacy of the type's respective regulation and governance mechanisms in controlling the costs.

Testing to be conducted across institutional owner types might provide insight into their differences in performance, as measured by return on investment. Research indicates that internally managed pension plans under-perform mutual funds, even when controlling for risk (Berkowitz Finney and Logue, 1988). Some possible causes of the performance differential are legal environment, in which pension plan managers are held to a more conservative "prudent man" standard than are bank managers (Del Guercio, 1996), and internal organization and structure, which lead to public pension plan administrative inefficiency (Hsin and Mitchell, 1997). NAM-based research offers to provide more explanation of the differences in performance.

5.4. Other potential nexus applications

As previously discussed, institutional ownership increases owner concentration. A result is that the ownership pattern in the U.S. is becoming more similar to the rest of the world, where concentrated holdings, frequently by banks and families, is often the norm (Shleifer and Vishny, 1997). However, despite the tendency toward concentration, significant differences in ownership across countries warrant attention. This paper has presented institutional and individual ownership as the relevant typology in the U.S. Outside of the U.S., a broader range of ownership categories must be considered (Gedajlovic, 1993; Pedersen and Thomsen, 1997), including cooperatives and government ownership, as well as the greater influence of personal/family ownership. In addition, the typology of institutional owners must be adjusted based upon legal environment. For example, ownership by banks has been prohibited in the U.S., whereas banks play a dominant ownership role in some countries (Charkham, 1994). Another consideration is the 'nation effect' due to institutional factors such as relative stock market size and prevalence of dual class shares (Pedersen and Thomsen, 1997), as well as institutionalized behaviors based on national norms and values (Demb and Richey, 1994). Finally, ownership is generally much more concentrated in other countries. For example, data indicate that 85% of German firms had at least one shareholder that held more than a quarter of their equity (J. E. Woods, 1996).

Factors that differentiate U.S. ownership from ownership in other countries might possibly affect the applicability of NAM to non-U.S. settings. I suggest that two key features of the nexus model, the positioning of institutions as intermediaries with their own self-interests, and the influence of other stakeholders on them, are sufficiently context-free that the model can be applied to a host of national settings. However, non-U.S. application of the nexus model would

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require an understanding of the unique socio-economic settings of the involved countries. Different levels of ownership concentration, legal and regulatory environments, institutionalized behaviors, and other factors must be considered in the development of appropriate research questions and hypotheses.

Although it is outside the scope of this article, I offer that the nexus model, develop here to apply to institutional ownership, has the potential additional benefit of being pertinent to a much wider array of socio-economic activities. It could be applied to any market where transactions between a buyer and seller are routinely mediated by an intermediary or broker, creating multiple layers of agents who monitor each other. An example is the insurance business, in which the market consists of insurance companies, independent agents serving as intermediaries, and those interested in purchasing insurance. Nexus explicates the self-interests of the intermediary party, and the resulting complexity they affect on the transaction.

6. Conclusion

Useem's research (1993, 1995) confirms that earlier projections regarding the potential growth and impact of institutional owners (Berle, 1959; Drucker, 1976; Harbrecht, 1959; Herman, 1981) have come to fruition. Institutional ownership has brought about a new 'organizational logic' of maximizing shareholder value (Useem, 1995), resulting in a "... contemporary brand of hard-edged, shareholder value-oriented corporatism" (Brown, 1998, p. 803) and an unprecedented amount of organizational restructuring and downscoping (Hoskisson and Hitt, 1994). But, as the nexus model shows, despite the emphasis on shareholders, institutional owners may be serving themselves and the interests of others at the expense of their obligation to beneficial owners. They may also be directed by their legal and regulatory environments toward specific investment and corporate governance policies that affect the institutions' obligation to beneficial owners.

Controls implemented to reduce agency costs generally take the form of incentives, which serve to align agents' interests with those of principals, and mechanisms that allow principals to monitor agents. These controls may be inadequate to reduce type II and III agency costs due to power asymmetries among the parties, as professional agency contracts are characterized by a tendency for the agent to be more powerful than the principal (Sharma, 1997). For example, some concentrated, powerful institutional ownership may press for quick growth in corporate earnings, most easily achieved by 'denominator management' cost-cutting rather than long-term growth (Hamel and Prahalad, 1994). Mutual funds, whose revenue is a function of assets under management, may engage in investment policies that attract new investors in order to maximize assets under management, rather than policies that service existing investors through tax-minimizing investing strategies (Barclay et al., 1995). Despite the abundance of public information on mutual fund performance, this tactic may be virtually undetectable to the majority

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of fund investors who lack detailed knowledge of the after-tax implications of investment decisions.

Within the last few decades, institutional owners have developed into organizations of significant socio-economic importance. With the retirement of the oldest baby boomers now hovering in the not-to-distant future, adequate funding of both public and private pension plans, whether managed by the plan sponsor or outsourced to mutual fund managers, is of paramount concern, not simply to retirees but to society as well (Davis, 1995; Lynn, 1983). Studying institutional owners from the perspective of beneficial owners serves to complement existing research regarding the effects of institutions on corporate governance and performance. This article has developed an agency-based framework of institutional ownership, and has proposed a research agenda utilizing the framework. Perhaps it will spark further interest in the study of the transforming socio-economic phenomena known as institutional ownership.

Note

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