

Institutional Investment in Mid-Cap BFSI Firms: Examining the Interplay of Promoter Ownership, Governance Mechanisms, and Regulatory Change

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ABSTRACT

Institutional investors significantly shape capital markets by fostering long-term value creation, enhancing transparency, and improving market efficiency. Their investment decisions often reflect confidence in a company's fundamentals and influence broader market sentiment. While institutional investments in large-cap firms are well-documented, India's mid-cap Banking, Financial Services, and Insurance (BFSI) sector remains understudied, despite its rapid growth, evolving governance frameworks, and increasing appeal to institutional investors. Mid-cap BFSI firms represent a critical segment of India's financial landscape, combining growth potential with ongoing governance improvements. This study analyzes 14 mid-cap BFSI companies listed on Indian stock exchanges, using a balanced panel dataset from 2018 to 2024. It investigates how promoter ownership, board composition, and regulatory changes affect institutional shareholding. Additionally, Granger causality tests assess the lead-lag relationship between Foreign Institutional Investors (FIIs) and Domestic Institutional Investors (DIIs).

Key findings indicate that higher promoter ownership attracts institutional investors, likely due to perceived stability and commitment. However, board independence does not significantly influence institutional investment patterns. Notably, FIIs appear to lead investment trends, with DIIs following their movements. Regulatory changes during the study period had limited impact on institutional investment behavior. These insights provide valuable implications for investors, policymakers, and corporate governance practitioners in India's expanding mid-cap BFSI sector.

Keywords: *Institutional Investment, Mid-cap BFSI Firms, Corporate Governance, Promoter Ownership, Board Composition, Regulatory Impact, Indian Financial Sector.*

INTRODUCTION

In emerging economies like India, Mid-cap companies act as a bridge between the stability of large-cap firms and the growth potential of small cap firms, crucial for economic development, and with its strong growth potential, they attract substantial Institutional Investments (FIIs –DFIs, MFs etc.). They actually act as **Catalysts** for Capital Market Deepening in India.

The Mid-Cap in India, though less studied, represents a fast-growing segment that balances strong growth potential with evolving governance maturity—making it increasingly attractive to institutional investors. Within BFSI, mid-cap firms include rising NBFCs, Small finance banks (SFBs), fintech-driven insurers—sectors crucial to **India's \$5 trillion economy vision**. As of March 2025, the market cap of mid-cap companies stood at ~₹45 lakh crore, with BFSI as a dominant contributor (SEBI/CMIE estimates).

The Securities and Exchange Board of India (SEBI) categorizes companies into three market capitalization (market cap) categories in India: **Large cap, Mid cap, and Small cap**

- **Large Cap:** Companies ranked 1st to 100th in terms of market cap and their market cap generally is greater than ₹20,000 crores. These companies are often sector leaders with a proven track record and are generally considered more stable and safer investments.
- **Mid Cap:** Companies ranked 101st to 250th in terms of market cap and their market cap generally ranges from ₹5,000 to ₹20,000 crores. Mid cap stocks are considered to have moderate stability and growth potential.
- **Small Cap:** Companies ranked 251st onwards in terms of market cap and their market cap is below ₹5,000 crores. Small cap stocks are considered to

have higher risk but also the potential for significant growth.

Institutional investors like FII's, DFI, mutual funds and Banks etc. influences not just market direction , but corporate governance too.

Mid-cap firms often face scrutiny over governance practices, despite rapid financial growth. Issues like Board Independence, Board Diversity and response to Regulatory Changes become critical differentiators for attracting or deterring investors

This study fills these gaps by analyzing a carefully selected sample of 14 Indian mid-cap BFSI firms during this dynamically changing period. Our research provides three key contributions:

Contextual Novelty: By focusing on mid-cap BFSI firms—a niche but economically significant segment—we uncover how ownership and governance dynamics diverge from those in large-cap or non-financial firms.

Policy Relevance: The 2018–2024 era serves as a case study for how regulatory changes can reshape institutional investment patterns, offering insights for policymakers in similar emerging economies.

Methodological Rigor: Despite a focused sample size, our firm-level longitudinal analysis (7 years × 14 firms) reveals nuanced interactions often overlooked in broader, large-N studies.

This research not only advances academic understanding of institutional investment but also offers practical insights for investors evaluating mid-cap financial stocks, promoters adapting to governance reforms, and regulators crafting sector-specific policies.

LITERATURE REVIEW

1. PROMOTER OWNERSHIP AS STRATEGIC SIGNALING:

The relationship between promoter shareholding and institutional investment is influenced by two opposite views: Agency theory (Jensen & Meckling, 1976) tells us that concentrated ownership can lead to power concentration and weaker governance oversight (Morck et al., 1988), while Signaling theory (Spence, 1973) argues that higher promoter stakes can convey skin in the game - commitment and stability (Connelly et al., 2011). Evidence from emerging markets, especially in financial sectors, shows this balance is nuanced. For example, Singh and Gaur (2021) found that promoter ownership between 25–45% tends to reassure investors without raising governance concerns, while Sarkar and Sarkar (2020) observed that Indian institutions often become cautious when promoter holdings exceed 50%. Supporting this, Lins et al. (2017) highlighted a global U-shaped effect, where both low and excessively high promoter stakes can deter institutional investment, though the thresholds vary by context.

2. INSTITUTIONAL INTERPRETATION FRAMEWORKS:

Investor responses to ownership signals are mediated by three key factors:

- *Disclosure quality:* Post-SEBI reforms reduced reliance on ownership patterns alone (Chakrabarti et al., 2022)
- *Investor origin:* DIIs show greater comfort with promoter-led firms than FIIs (Khanna & Palepu, 2005; Ferreira & Matos, 2021)
- *Regulatory climate:* Post-crisis reforms signal credibility (Bushman et al., 2018), with RBI & SEBI guidelines increasing trust in regulated entities (Sarkar et al., 2023)

3. INDEPENDENT DIRECTORS: EVOLVING EVIDENCE:

The impact of board independence continues to be debated. While Fama and Jensen (1983) argued that independent directors help strengthen oversight, evidence from emerging markets suggests the reality is more complex. Johnson et al. (2021) showed that during times of crisis, the effectiveness of independent boards often depends on the directors' expertise and independence. In India, regulatory changes have gradually improved boards' ability to monitor management (Sarkar & Sarkar, 2022), yet the gaps highlighted by Khanna and Palepu's (2004) idea of "institutional voids" still linger. Recent studies also stress that it's not just about having independent directors, but about having the *right* ones—Bennett et al. (2019) and Chen et al. (2020) both highlight how industry-specific knowledge is especially valuable for boards in the financial sector.

REGULATORY COMPLIANCE DYNAMICS :

The compliance-investment dynamics operates through dual channels:

1. *Credibility enhancement* via reduced information asymmetry (La Porta et al., 2000; Ferrell et al., 2021)
2. *Cost thresholds* where excessive compliance burdens deter investment (Aggarwal et al., 2019; Chen et al., 2020)

This aligns with Coffee's (2007) "optimal regulation" framework, particularly relevant for mid-cap firms balancing transparency needs with resource constraints.

INSTITUTIONAL OWNERSHIP & VALUATION LINKAGES :

Tobin's Q are widely used to measure how institutional ownership affects firm value (Tobin, 1969). While early work by Morck et al. (1988) laid the groundwork by linking institutional holdings and valuation. For instance, Raghunandan and Rajgopal (2019) found that in India, the quality of corporate governance plays a key role in how institutional stakes translate into higher valuations. At the same time, Porter's (1992) well-known critique of investor short-termism still holds weight—he argued that too much institutional influence can actually hurt long-term growth, as it is considered hot money , pointing to a possible inverted-U effect. This ongoing tension highlights why finding the right level of institutional ownership is not one-size-fits-all but must be tailored to the sector and context.

Key Theoretical Contributions

This synthesis advances three conceptual frameworks:

1. *Regulatory Signal Theory*: How policy changes alter ownership signal interpretation
2. *Contextual Ownership Thresholds*: Sector-specific optimal promoter stakes
3. *Compliance Cost Calculus*: Institutional investors' cost-benefit analysis of governance reforms

Theoretical Underpinnings

1. **Regulatory Signal Theory**: This idea shows how policy changes can reshape what ownership patterns signal to investors. When regulations are becoming stricter—institutions are looking beyond just promoter shareholding and pay closer attention to how well a firm complies with rules and how transparently it discloses information. This helps explain why the same ownership structure might send different signals under different regulatory conditions.
2. **Contextual Ownership Thresholds**: It show that Industry specific dynamics like —like how much capital a sector needs, its risk exposure, and how closely it's regulated—shape what level of promoter stake is acceptable to institutional investors. For mid-cap BFSI companies, this comfortable range often falls between 25% and 45%, while in sectors like manufacturing, higher promoter holdings may still be seen as reasonable.
3. **Agency Theory (Jensen & Meckling, 1976)** : Agency theory describes the complexity that can arise when the goals of shareholders and managers are not fully align, leading to decision that hurt a firm's performance. Institutional investors help bridge this gap by keeping a close watch on management and pushing for decisions that protect shareholder value. That said, Shleifer and Vishny (1997) caution that too much oversight hang can be counterproductive by discouraging managers from taking innovative risks.

Research Gap

Existing researches on how institutional investment shapes firm value still leaves several important gaps. First, although Morck et al. (1988) laid the foundation by linking Tobin's Q to investment decisions, more recent studies rarely test whether this relationship holds true for mid-cap financial companies in emerging markets like India . Second, much of the governance literature—like the work by Raghunandan and Rajgopal (2019)—tends to focus on board structures alone, often overlooking how changing regulation and regulatory flags shape the influence that institutions can exert. Third, traditional linear models of the ownership–valuation link (Jensen & Meckling, 1976) fall short in explaining the threshold effects seen in developing economies, where the impact of concentrated ownership can vary widely depending on the regulatory context.

Practical Significance

The study offers actionable guidance for:

- Investors: Identifying ownership ranges that maximize value
- Regulators: Tailoring policies for mid-cap financial firms
- Firms: Designing governance frameworks that attract stable institutional capital

This research not only addresses critical gaps but also provides a nuanced understanding of institutional investment dynamics in emerging market financial sectors.

Data and Methodology

The main aim of this study is to understand how promoter ownership, governance practices, and regulatory changes together shape both the level and stability of institutional shareholding in India's mid-cap companies. By doing so, the research seeks to identify patterns and causal links that will give insight on what drives institutional investors' decisions and how they influence the future strategic direction of these firms . Covering the period from 2018 to 2024, the study focuses on mid-cap firms, which hold a important place in the Indian economy. Specifically, the analysis looks at 14 mid-cap BFSI firms listed on the NSE's Nifty Midcap 150 Index, including 8 banks, 3 NBFCs, 2 insurance firms, and 1 asset management company.

The study uses Tobin's Q as a proxy for firm value. This value is estimated as :

$$\text{Tobin's } Q_{it} = \frac{(M \text{ Cap}_{it} + BVL_{it})}{RCA_{it}}$$

Where “i” and “t” denote the sample firm and year, respectively. M Cap_{it} represents the market Capitalisation for each of the firms. BVL_{it} represents the book value firm, and RCA_{it} represents the total replacement cost of the aseets. These values are estimated for each firm for each of the years from 2018 – 2024.

The study uses **Panel data regression** as it allows for the simultaneous capture of both cross-sectional heterogeneity and time-series dynamics. It is ideal for studying the evolution and stability of institutional shareholding, allowing us to see how Promoter Ownership and governance influence investment decisions over time, not just at one point.

The Granger causality test was applied to find out whether the variables in the study have any influence on each other . To see how a sudden change in one factor affects the others over time, impulse response functions were used to map the effect of a single shock on the present and future values of all variables in the system. Additionally, Forecast Error Variance Decomposition (FEVD) was carried out to break down how much of each variable's forecast error can be traced back to shocks in other variables (including its own) across different time frames. Together, these methods help show which factors matter most in explaining changes in institutional shareholding.

Table No 1: Variables under the study

Variables	Description
Tobin's Q	A proxy for firm value, Tobin's Q is calculated as the market value of a firm divided by the replacement cost of its assets, reflecting investor perception of a firm's future growth prospects.
Institutional Shareholding	Represents the percentage of a company's equity held by institutional investors, indicating external confidence and oversight in corporate governance and performance.
Gender Diversity	Measured by the presence of female directors on the board, this variable captures diversity in leadership and its potential influence on decision-making and firm performance.
Regulatory Flag	A binary variable indicating whether the company has been flagged for regulatory concerns (e.g., SEBI observations or compliance issues), reflecting perceived governance risk.
Promoters Shareholding	The percentage of equity held by promoters, reflecting the extent of founder or insider control, can influence both governance and strategic direction.
Independent Director	Measured by the proportion of independent directors on the board, this variable assesses the board's autonomy and its ability to protect minority shareholder interests.
FII & DII Shareholding	Captures the holdings of Foreign Institutional Investors (FIIs) and Domestic Institutional Investors (DIIs), representing different investor outlooks and confidence levels in the firm.

The above discussion leads

to the formulation of the following Null hypotheses of the study:

H₁: There is no significant impact of Promoter shareholding on institutional shareholding.

H₂: There is no significant influence of Independent directors on institutional shareholding.

H_{3a}: FIIs do not significantly influence DIIs.

H_{3b}: DIIs do not significantly influence FIIs.

H₄: There is no significant impact of regulatory changes on DIIs.

H₅: There is no significant impact of regulatory changes on FIIs.

Empirical Analysis, Results, and Discussion

Table 2 captures the descriptive statistics of the selected variables for the period from 2018 – 2024. A Tobin Q's value greater than 1 implies that the market value of assets surpasses the book value of its assets.

Table 2 details the descriptive statistics

for the variables used in the study.

Table No 2: Descriptive Statistics (2018-2024)

Variable	Obs	Mean	Std. Dev.	Min	Max
Institutional Shareholding (%)	98	42.61	18.55	11.8	87.6
Recent Regulatory Flag (0/1)	98	0.21	0.41	0	1
Board Strength (No. of Members)	98	10.41	1.13	8	12
Women Directors (Count)	98	2.72	0.73	1	5
Independent Directors(%)	98	7.15	6.10	4	7
Company ID	98	7.50	4.05	1	66
Market Cap (Cr)	98	48,497.58	56,830.13	4,441.2	335,090
Market Value of Debt (Cr)	98	10,162.17	8,018.67	120	41,000

Variable	Obs	Mean	Std. Dev.	Min	Max
Book Value (Cr)	98	7,046.68	12,565.51	306.7	70,149
Replacement Cost (Cr)	98	20,655.43	29,466.87	6,500	180,543
Tobin's Q	98	3.75	3.78	0.72	24.97

Table No 3: Hypothesis Testing

Hypothesis	Dependent Variable	Independent Variable	Coefficient	P-value	Result
H1: Promoter shareholding significantly impacts institutional shareholding.	Institutional Shareholding	Promoter Holding (0 = No, 1 = Yes)	10.895	0.007	Significant
H2: Independent directors positively influence institutional shareholding.	Institutional Shareholding	Independent Director (%)	0.038	0.764	Insignificant
H3a: FIIs do not significantly influence DIIs.	DIIs	Lagged FIIs	FIIs → DIIs: IRF = -1.25		FIIs → DIIs: Significant ;
H3b: DIIs do not significantly influence FIIs.	FIIs	DIIs	(Step 1), FEVD = 17% →		DIIs → FIIs: Insignificant
H4: Regulatory changes impact DIIs.	DIIs	Recent Regulatory Flag PCAS	0.599	0.685	Insignificant
H5: Regulatory changes impact FIIs.	FIIs	Recent Regulatory Flag PCAS	0.225	0.794	Insignificant

The study investigates key determinants of institutional shareholding and firm value in midcap BFSI firms using fixed-effects panel regressions and impulse response analysis.

The findings reveal that firm value (measured via Tobin's Q) does not significantly influence institutional shareholding. Board gender diversity shows a marginally significant positive effect on institutional shareholding, suggesting some institutional preference for gender-diverse boards. Promoter shareholding has a strong and statistically significant positive impact on institutional

shareholding, possibly indicating higher ownership and commitment . Contrary to expectations, independent directors and recent regulatory flags do not significantly affect institutional interest. Furthermore, dynamic interaction analysis between FIIs and DIIs suggests asymmetric behaviour—FIIs significantly crowd out DIIs, but DIIs have little influence on FIIs. Lastly, recent regulatory actions appear to have no significant effect on either domestic or foreign institutional investment levels.

Table no 4: Regression Equations by Hypothesis

Hypothesis	Regression Equation
H ₁ :	$InstiShareholding_it = \alpha_i + \beta_1 * Promotor0noIyes_it + u_it$
H ₂ :	$InstiShareholding_it = \alpha_i + \beta_1 * IndependentDirector_it + u_it$
H _{3a/3b} :	$DIIs_t = \alpha + \sum(\beta_k * FIIs_t-k) + \varepsilon_t$
	$FIIs_t = \alpha + \sum(\beta_k * DIIs_t-k) + \varepsilon_t$
H ₄ :	$DIIs_it = \alpha_i + \beta_1 * RecentRegulatoryFlagPCAS_it + u_it$
H ₅ :	$FIIs_it = \alpha_i + \beta_1 * RecentRegulatoryFlagPCAS_it + u_it$

Figure 1: Forecast Error Variance Decomposition (FEVD)

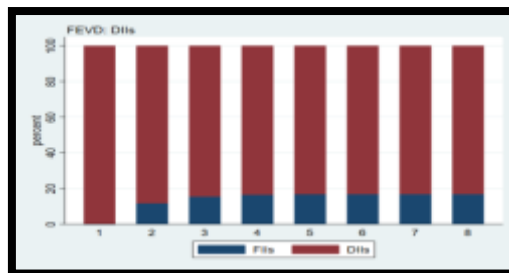


Figure 2: Forecast Error Variance Decomposition (FEVD)

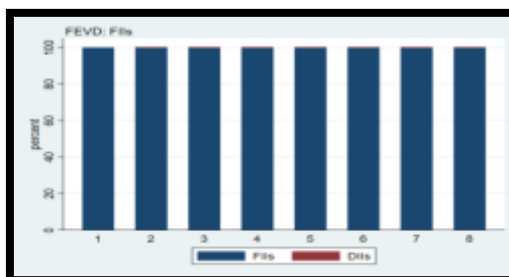


Figure 3: Impulse Response Function

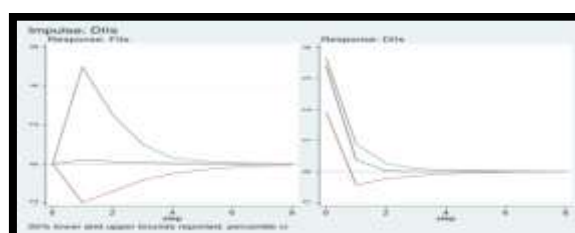
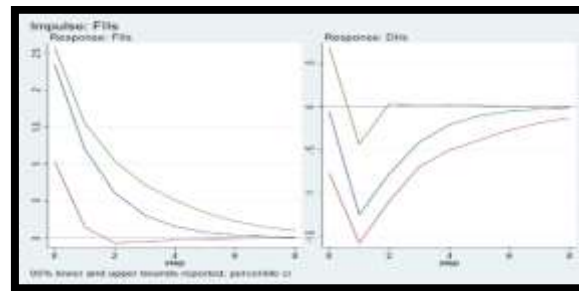


Figure 4: Impulse Response Function



The IRF and FEVD analyses reveal a notable asymmetry in the dynamic relationship between Foreign Institutional Investors (FIIs) and Domestic Institutional Investors (DIIs) in midcap BFSI firms. From the FEVD results, it is evident that DIIs are largely influenced by their own past behaviors, with over 80% of the forecast error variance attributed to internal shocks. However, the influence of FIIs on DIIs gradually increases over time, accounting for approximately 17–20% of the variance by the eighth step. In contrast, FIIs remain highly self-driven, with over 98% of their forecast error variance explained by their own past values, and minimal impact from DIIs. This suggests that while FIIs can influence DIIs, the reverse is not true, highlighting an asymmetric relationship.

The impulse response analysis further supports this asymmetry. When FIIs experience a shock, there is an immediate and significant negative effect on DIIs, particularly at step one, indicating a crowding-out effect where FIIs may displace domestic investors. However, this effect gradually diminishes, suggesting short-lived interdependence. On the other hand, shocks to DIIs do not elicit a significant response from FIIs, underscoring the limited influence DIIs have on foreign investors. Additionally, FIIs demonstrate a persistent response to their shocks over multiple periods, while the effects of DII shocks are strong but short-lived. Overall, the evidence points to FIIs playing a dominant and proactive role in shaping investment behaviour, while DIIs appear more reactive and internally driven.

Limitations of the Study

This study, while insightful, is subject to certain limitations. The sample is limited to 14 mid-cap BFSI firms in India from 2018–2024, which may restrict generalizability. The reliance on secondary data omits qualitative aspects such as boardroom dynamics and investor sentiment. Additionally, using Tobin's Q as a proxy for firm value, though standard, may not fully reflect sector-specific nuances or market fluctuations. Finally, the study is observational, limiting causal inferences between governance variables and institutional ownership.

Scope Of further studies

Future research could address the above gaps by expanding the dataset by including larger numbers of firms, a longer time horizon and incorporating qualitative insights, or applying advanced econometric models.

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