



OWNERSHIP STRUCTURE AND ITS IMPACT ON FIRM PERFORMANCE: A REVIEW OF LITERATURE

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Abstract

The objective of the paper is to survey the theoretical basis for and empirical evidences on the impact of ownership structure on firm performance. The relationship between the various aspects of Ownership structure namely Ownership concentration, Managerial Ownership, Directors' Shareholding, Institutional Shareholding, Promoters Shareholding, Foreign Ownership and firm performance is reviewed. Ownership structure is considered as an important corporate governance mechanism to resolve the conflict arising between the managers and shareholders. Extensive theoretical and empirical work on this topic was done over the last two decades. However, there are inconsistencies in the results and the impact of ownership structure on firm performance was found positive, negative and insignificant. The probable reasons for the inconsistencies include corporate governance environment, endogeneity of ownership structure and measures of firm performance used.

Keywords: Corporate Governance, Ownership Structure, Firm Performance, Endogeneity, Tobin's Q.

JEL Codes: G32.

1.0 INTRODUCTION

The issue of Corporate Governance have received considerable attention after plethora of corporate scandals and scams of the major giants across the world. The failure of several leading companies in India and abroad emphasized the importance of corporate governance issues in last two decades. Corporate governance mechanisms include board parameters and ownership structure. Ownership structure is considered as an important corporate governance mechanism to resolve the conflict arising between the managers and shareholders.

How ownership structure affects the firm performance is one of the major issue of concern for the policy makers, economists and that of a company as well. The fundamental insight into this issue was given by Berle and Means (1932) who believed the diffusion of ownership results in decrease in firm performance. They argued that the separation of ownership and control reduces management's incentives to maximise the corporate efficiency of modern corporations. Jensen and Meckling (1976) further developed their concern in the form of Agency Theory which provided the framework for ownership and firm performance studies worldwide. This theory is based on Principal-Agent relationship, according to which the agents (managers) perform their functions which are not in line with the interest of the shareholders (principals) and thereby reduces their wealth. On the other hand Klein *et al.* (2005) stated, "presence of dispersed ownership increases expectation of a positive relationship between measures of corporate governance and firm performance, other things being equal."

Corporate governance literature has evolved with a great deal of attention towards the ownership structure of the companies. Extensive theoretical and empirical work on this topic was done over the last two decades. However, the impact of ownership structure on firm performance was widely studied in developed countries. The impact is discussed very recently in emerging markets like India. Thus an attempt has been made here to bridge the gap by focusing on the studies on emerging economy as well. Ownership studies throughout the world have focussed on the different aspects of ownership structure and their impact on corporate performance.

2.0 OBJECTIVE

The objective of the paper is to provide a comprehensive review of the findings of the studies based on the relationship between ownership structure and firm performance. Along with findings, the methodology used to derive impact of ownership structure and the various aspects of ownership structure viz. promoter shareholding, institutional shareholding, directors shareholding, foreign ownership etc. on firm performance is presented. The remainder of this paper is organized as follows: section 2 briefly provides the review of existing literature encompassing the methodological aspects and main findings. Section 3 presents the probable reasons for the inconsistency in the research findings. Section 4 gives the directions for future research and section 5 concludes.

3.0. LITERATURE SHOWING RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND FIRM PERFORMANCE

The onset of the separation of ownership and control in the modern organizations emphasized the need to study the effect of ownership parameter on the firm performance. Researchers have been trying to identify the optimal ownership structure and



its impact on the subsequent firm's financial performance. The impact of ownership structure on firm performance is twofold. On the one hand, concentrated ownership can provide for better control of management, as the size of ownership stake and the incentive to monitor are positively correlated which in turn should improve firm performance and equally benefit minority shareholders. On the other hand, it can come with costs for minority shareholders as the controlling owners might try to expropriate from them.

Mc Connel and Servaes (1990) investigated the relation between Tobin's Q as a proxy for firm performance and the structure of equity ownership for a sample of 1,173 firms for 1976 and 1,093 firms for 1986. They found a significant curvilinear relation between Tobin's Q and insiders' shareholding. The results showed that the curve slopes upward until insider ownership reaches approximately 40% to 50% and then slopes slightly downward. They also found that a significant positive relation exists between Tobin's Q and the institutional investors' shareholding.

Demsetz and Villalonga (2001) argued in contrast to Berle and Means thesis. Using Tobin's Q as firm performance measure, they analysed the relationship on cross-sectional data of 223 US corporations for a period of 5 years from 1976-1980. They proposed that ownership structures, whether concentrated or diffused, emerge from the interplay of market forces that maximize shareholder expected returns. Ownership concentration is considered as an endogenous variable and the two dimensions of ownership structure are considered viz. insider ownership and ownership concentration. Insider shareholding is measured as the fraction of shares owned by management and the fraction of shares owned by the five largest shareholding interests denoted Ownership Concentration. Both OLS and 2SLS estimates are used to generate the results. Using OLS estimates they found that Tobin's Q is in significant relationship with ownership concentration. However, using the 2SLS estimates they found that there is no significant impact of ownership structure on firm performance. Their results were consistent with the view that ownership structure is chosen so as to maximize firm performance, and that greater diffuseness in ownership offers competitive advantage and thus increase firm performance.

Kumar and Singh (2013) analysed promoter ownership of 176 companies listed on the BSE for the period 2008-2009 using linear regression analysis to find the effect of promoter ownership on the firm value. Firm value is measured using Tobin's Q. The results of the analysis revealed that there exists a significant positive relationship between firm value and promoter ownership. The regression results suggested that firms with high ownership concentration of promoters have high market valuations (Tobin's Q).

Chen et. al. (2003) studied the relation between managerial ownership and Tobin's Q for 123 Japanese firms from 1987 to 1995. The results of the analysis using Ordinary Least Squares (OLS) regression model depicted a negative (positive) relation between Tobin's Q and managerial ownership at low (high) levels of ownership. However, after controlling for firm fixed effects, the results showed that Tobin's Q increases monotonically with managerial ownership. The findings concluded that as ownership increases, there is a greater alignment of managerial interests with those of stockholders. The conclusion remained same even when both managerial ownership and Tobin's Q were treated as endogenous variables in a simultaneous equation system.

Pathak and Pradhan (2012) examined manufacturing firms of seven industries for the years 2001 and 2009 with the objective of finding out whether shareholding has any effect on firm performance. The shareholders are divided into three board categories-promoter's holding, institutional holding and individual holding. Return on Assets (ROA) was used as performance measure. Dummy variable multiple regression analysis was employed to detect the effect of change in ownership structure on firm performance with the passage of time. The results revealed that the model used was significant. The findings showed that promoters do not have a significant impact on firm performance. Institutional shareholding has negative impact on firm performance which means higher the institutional shareholding, the lower is the return, however, individual holding was also found to be insignificant.

Morck et. al. (1988) analysed the relationship between management ownership and market valuation of the firm, as measured by Tobin's Q for a cross-sectional sample of 371 fortune 500 firms in year 1980. They found a significant non-monotonic relationship between the managerial ownership and Tobin's Q. The study concluded that Tobin's Q first increases, then declines, and finally raises slightly as ownership by the board of directors increases.

Dwivedi & Jain (2005) analyzed the panel data of 340 large listed firms for the year 1997-2001 spreaded across 24 industry groups in order to investigate the relationship between directors' shareholding, institutional and foreign shareholding & firm performance. A simultaneous equation regression model was employed with dependent variable (Tobin's Q, as a measure of financial performance) and other variables, while controlling for the industry effects and other non-governance parameters.



The analysis provided evidence that a higher proportion of foreign shareholding is associated with increase in market value of the firm, while Indian institutional shareholders' association was not statistically significant. Directors' shareholding has a non-linear negative relationship with firm value, while the public shareholding has a linear negative association.

Himmelberg et. al. (1999) analysed a panel data of 600 Compustat firms from 1982-1984 using Fixed Effects panel data model and Instrumental Variables to control for various possible unobserved heterogeneities in order to study the relationship between ownership structure and firm performance. Ownership structure is measured as percentage insiders' shareholdings (officers and directors). Performance was measured by using both market based measure Tobin's Q and accounting based measure Return on Assets. Controlling for various variable like capital-to-sales, advertising expenses-to-sales, R&D expenses-to-sales and operating income-to-sales ratios and fixed firm effects, they found that changes in ownership holdings have no significant impact on firm performance measures (Tobin's Q and ROA). They used instrumental variables to control for endogeneity of ownership and found a quadratic form of the effect of ownership on firm performance.

Selarka E. (2005) found a significant curvilinear relationship between firm value and the fraction of voting rights owned by insiders for a cross sectional sample of 1397 manufacturing firms traded on the Bombay Stock Exchange for the year 2001. Using OLS regression, the firm value as measured by market to book value ratio first decreases and then increases as the ownership is concentrated in the hands of insiders. The market signaled a negative relation between inside ownership and firm value until a significant high level of ownership is reached. Therefore the results showed that corporate insiders expropriate corporate assets at lower level of their ownership, hence resulting in lower firm value in the capital market.

4.0.REASONS FOR INCONSISTENCY IN RELATIONSHIP BETWEEN OWNERSHIP STRUCTURE AND FIRM PERFORMANCE STUDIES

A number of studies had been done focussing on the relationship between ownership structure and firm performance relationship worldwide. However there are inconsistencies in the results and the impact of firm performance on ownership structure varied from positive to negative and to insignificant. The possible reasons could be:

- i. The different corporate governance environment- legal, political, economic, social, communities, cultures and ideologies, and the financial markets is one of the most important reason of the diverse relationship between the ownership structure and firm performance relationship. A specific corporate governance environment may determine that whether the relationship between ownership and firm performance is positive, negative and insignificant.
- ii. The model specification and the estimation method used may also lead to different conclusion on ownership-firm performance studies. Endogeneity of the ownership structure could be the probable reasons as a general trend is to determine the ownership structure exogenously. A single equation estimation model will produce biased results if ownership is endogenously determined. In such case simultaneous equation models and instrumental variable techniques would produce better estimates.
- iii. The firm performance measure used can also produce different results. In exiting literature firm performance is measured using both the market based measures and accounting based measures. Tobin's Q, the ratio of market value of firm to its replacement costs, as a proxy of firm performance is used extensively in ownership studies. Though different scholars have modified the formula due to unavailability of data on the replacement costs of assets and used book value of assets as denominator. Thus the different proxies of Tobin's Q may result in different estimates. Also the accounting based measures which are based on the past performance of the company like Return on Assets, Return on Capital Employed (ROE), Return on Equity (ROE) etc may invariably produce inconsistent estimates due to the fact that they reflects only the short term profitability of the company' operations and can be easily manipulated by the managers (insiders) and are also affected by the accounting practices used.

5.0 SCOPE FOR FURTHER RESEARCH

This paper discusses the literature on ownership structure and firm performance relationship .While much has been learned about the ownership and firm performance relation, there are certain issues that can studied in future research. Most of the studies on ownership structure and firm performance relationship are performed in developed economies and very few focused on the developing markets. Thus there is need for more studies considering various aspects of ownership structure in emerging economies especially in light of recent changing environment. Another avenue for future research is to examine the endogenous issues. It requires careful design of the empirical test and careful interpretation of the results. Studies generally focused on the direct relationship between the ownership structure and firm performance relation, thus there is also potential for evaluating the indirect relationship between the ownership structure and firm performance relationship via other corporate governance mechanisms. Ownership structure can influence the corporate strategy like financing decisions, investment decisions, compensation and pay performance, dividend policy, mergers and acquisitions etc. which in turn can influence firm performance. Finally evaluating the ownership- firm performance relationship across countries in different corporate



governance environment will involve a more comprehensive perspective of impact of ownership structure on firm performance.

6.0 CONCLUSION

The purpose of this paper is to shed light on the existing literature analyzing the impact of ownership structure on firm performance. The review of the existing studies concludes that the impact of Ownership Structure on firm performance is inconsistent. While some studies reported a positive relationship between the two, other found the relationship negative and some studies concluded that there is insignificant relationship between ownership structure and firm performance. The paper found that the reasons for inconsistencies in the results include the corporate governance environment, endogeneity of ownership structure and firm performance measures used. Further studies in this area can be conducted considering cross country analysis of ownership - firm performance relationship in different corporate governance environment.

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