Conceptual Paper

The Impacts of Ownership Structure on Firm Performance

SitiSuziyati Suman
School of Accounting and Business
Management FTMS College, Malaysia
Siti.suman@student.anglia.ac.uk

Abdul Basit
School of Accounting and Business
Management FTMS College, Malaysia
Abdulbasit9037@gmail.com

Sahibzada Muhammad Hamza
School of Accounting and Business
Management FTMS College, Malaysia
Sahibzadahamza6@gmail.com

Abstract

The purpose of this study is to examine the impacts of ownership structures on firm performance in India in term of textiles, oil marketing and distribution and movies and entertainment industries registered in Bombay stock exchange. The research is done on 50 companies listed under Bombay Stock exchange covering the period of 2011-2015 with total observations of 250; panel data will be implied with an implementation of convenience sampling. Based on the review of previous literature there are very limited research done to examine the impact of ownership structure on firms’ performances especially in these 3 major sectors. Numerous researches have been implemented to examine and identify the trend of ownership structure and its consequences towards company's performance. Based on the literature most common variables that used to measure the company performance are ROA, ROI, Tobin's Q and ROE. Thus Managerial, Concentrate, Institutional and Foreign ownership were applied as the independent variables and ROA as the dependent variable in this research. This research employed Pearson correlation coefficient and multiple linear regressions analysis. Thus we can conclude that ownership structure quietly influence the level of firms performances. Also this study will eventually benefit the textiles, oil marketing and distribution and movies and entertainment sectors sector and help the company Board of Director to deal with their ownership structure in future. It also helps to guide them in determining the costs, improving the relationship in organization within the firms and make a good understanding on how the ownership structure would bring influence on the firm performance.
1.0 Introduction

The research is conducted to examining the impacts of ownership structures on firm performance in India in term of textiles, oil marketing and distribution and movies and entertainment industries.

Numerous research has been done in examining the trend of ownership structure impacts on firm performances around the world. Ownership structure is an important factor which affects a firm’s movement especially its health (Zeitun and Tian, 2007).

Previous studies in India has been done by Singh and Gaur (2009) did on corporate sector, Srivastava (2011) on actively listed company constitute the bulk of trading and Nazir and Malhotra (2016) on corporate governance. While in globally the studies in this topic done by Gedajlovic and Shapiro (2002) on financial performance of Japanese corporations; Grant and Kirchmaier (2004) in Europe corporate governance industry; Karaca and Ekşi (2012) in manufacturing industry on the Istanbul stock exchange. Mostly researchers has been done in corporate governance sector and the common variables used are ROI, ROE and ROA (Kaur and Gill, 2008; Srivastava, 2011; Nazir and Malhotra, 2016). Based on their studies most of them are using pooled data, time series and panel data. Thus this research applied a panel data from the year of 2011-2015.

The rational of this research is because of the conflict of interest between a firm’s managers and owners can influence the decision made by themselves which leave an impacts on company performances. Moreover, the issue of ownership structure on firm performance within any company has become a serious discussion in corporate governance for decades (Srivastava, 2011).

The issue that being investigated in this research is whether the trend of ownership structures determining the firm performance(profitability) of listed companies in textiles, oil marketing and distribution and movies and entertainment industries in India. Moreover, many research have been conducted in order to investigate the relationship between ownership structure and firm performance in developed and developing countries.

In India, only a few researches have been implemented in different industries where most of the research done on corporate governance sector, cement industries and most of them are constitute the bulk of trading companies, no specific sectors. Therefore, the findings in previous studies cannot represent overall determinants of ownership structure impacts on firm performances. As textiles, oil and marketing and distribution and movies and entertainment industries are quietly interesting, thus this research can create a new knowledge on those sectors and fulfil the existing gap.

1.1 Research Objectives

- To identify and examine the impact of institutional ownership on ROA
- To identify and examine the impact of managerial ownership on ROA
- To identify and examine the impact of concentrated ownership on ROA
- To identify and examine the impact of foreign ownership on ROA

2.0 Literature Review
Jensen and Meckling (1976) defined ownership structure as capital commitments, which involves inside investors (director or manager) and outside investors (debt and equity holder). Abel and Okafor (2010) defines ownership structure as the percentage of share held by managers (managerial ownership), institutions (institutional ownership), government (state ownership), foreign investors (foreign ownership), and family (family ownership). While recent definition has been added by Bansal (2005) that ownership structure is the committee of investors and shareholders (proprietors) is made up of individual peoples, groups and institutions whose have different goals, interests, investment horizons and capabilities.

Numerous theoretical models and framework have been developed in order to identify the relationship and the impacts of ownership structures trend towards firm performances. Berle and Mean (1932) is the topic pioneers of ownership structure which is done in United State corporate law where they hypothesize that an inverse correlation should be observed between the diffuseness of shareholdings and firm performance.

Most common theoretical adopted was the Agency Theory which is created by Jensen and Meckling (1976). This theory emphasises on the separation of firm management and ownership. The theory was born as the consequences of conflict of interest between agents (shareholders and managers) and due to problem in separation of firm management and ownership (Abdul Jamal et al, 2013). There are two conflicts which are conflict between shareholders and managers and conflict between shareholders and bondholders (Jensen and Meckling, 1976). The separation of ownership and management lead to the costs associated with resolving conflict between the owner and agents (Berle & Means, 1932; Jensen & Meckling, 1976; Eisenhardt, 1989).

Stewardship theory was introduced by Donaldson and Davis (1991) to understand the existing relationships between ownership and management of the company. This theory arises as an important counterweight to Agency Theory (Pastoriza, 2008). Managers determine to the firm and it excite to personalisation of the success or failure of firm (Davis, Schoorman and Donaldson, 1997). Bathula (2008) expressed the stewardship perspective view a directors and managers as stewards of firm. As an expert decision maker, managers and directors protect their reputation, by that they operate the firm in a manner which maximises financial performance especially shareholder returns as firm performance directly impacts perception about managers’ individual performance (Bathula, 2008).

While Transaction cost theory was initiated by Cyert and March (1963) to discuss how the costs of engaging in an action by an organization affect its behavior. Modern corporations generally have easy access to finance; but their shareholders are more dependent on the managers (Volonte, 2012). Coase (1937) contended that the integration of exchange within the firm happens if the transaction costs utilizing the market are higher than the costs utilizing an internal organization. The issues in a corporate finance and corporate governance can be examined through the transaction cost economy theory (Williamson 1988, 1996). Saravia and Chen (2008) support that transaction cost theory brings to the study of corporate governance which provides a robust framework to explore contracting problems that happen between the firm and its shareholders.

Then the Principal Agent Theory is emphasises the conflict between shareholders and management. The conflict is led by the different agendas of shareholders and managers, more specifically, the divergence between the control right and cash flow right (Chen, 2012). Williamson (1963) stated that emolument such as perquisite doesn't have productivity, and then discretionary profit is a staff expansion expenditure, physical and equipment. According to Chen (2012) the profit maximization is the principal priority and the utility maximization is referring to agent preference where certain conflict can arise among them.

2.1 Empirical research on ownership structure

Various researches were carried out to examine the impacts of ownership structure impacts on firm performance in globally such as Demsetz and Villalonga (2001) conduct a research to
investigate the relation between the ownership structure and the performance of corporations if ownership is made multi-dimensional and treated as an endogenous variable. They examines the roles played by two aspects of ownership structure, the fraction of shares owned by the five largest shareholding interests and the fraction of shares owned by management. They used 223 firm random subsample from Demsetz and Lehn (1985) previous research with a period of 1976-1980 and 1980-1981 (5 years). The dependent variable of firm performance measured by Tobin’s Q, profit rate, advertising-to-sales ratio, R&D to sales ratio, fixed assets-to-sales ratio, market risk, firm-specific risk, ownership concentration, managerial shareholdings, assets, debt-to-assets ratio and industry managerial. Then followed by the second dependent variable of Fraction of shares owned by management; Firm performance, Market risk of stock, Firm-specific risk, Firm size (book value of assets), The value of debt as a fraction of the book value of assets. They found that no statistically significant relation between ownership structure and firm performance.

Grant and Kirchmaier (2004) study about the relationship of Corporate Ownership Structure and Performance in Europe by using sample of 100 firms in five major European economies by included a controlling for industry and country effects, liquidity and the owner types. Ownership data describes the ownership status at that point in time, and performance data covers a period of 10 years prior to that date. They also make a different by using a Hedrick-Prescott Filter methodology as indicators of the governance quality. Ownership structures vary considerably across Europe and that ownership has a significant impact on firm performance. They also observe that ownership structures in Europe are not consistent with value maximisation principles. The finding implies that dominant shareholders destroy value where it contrary to similar research made on US.

Lazaretou and Kapopoulos (2006) conduct a study to investigate whether there is strong evidence to support the notion that variation across firms in observed ownership structures impacts in systematic variations in observed firm performance. The investigation made by assessing the impact of the structure of ownership on corporate performance, measured by profitability along with data on year 2000 from 175 of Greek listed firms which it's covers all sectors of Greek economy. In this study they also model the ownership structure from the previous study of Demsetz and Villalonga (2001) by using endogenous variable and two different measures of ownership structure which reflect on different group of shareholders with conflicting interests. The findings suggest that a more concentrated ownership structure positively relates to higher firm profitability. They also find out that higher firm profitability requires a less diffused ownership.

Chen (2012) makes a research to investigate the effect of ownership structure on firm performance with evidence from Non-financial Listed Companies in Scandinavian. He investigated the effect by testing dependent variable like valuation, profitability, growth and risk; and independent variable of Tobin’s Q, Return on Equity (ROE), growth in total asset and Beta. The methodology was used the linearity versus non-linearity and endogenous vs. exogenous from 20 largest non-financial listed firms in each of the Scandinavian countries with period from 2008-2010. The finding concluded that ownership concentration has a positive effect on firm profitability and growth, and a negative effect on firm valuation and risk. While divergence between voting right and capital right has positive impact where it influence on firm valuation and owner identities do influence firm performance especially in terms of profitability and growth. Low ownership concentration may imply higher risk (Larner, 1966). Furthermore, Radice (1971) prove that owner-controlled firms tend to have higher profit rates and growth rates.

Wei et al., (2014) make a research to determine the relationship between ownership structure and firm performance in Malaysia in trading and services sector. They conduct the research by testing dependent variables like firm age, firm size, leverage, return on assets (ROA), return on equity (ROE) and Tobin’s Q; and independent variable which are managerial ownership structure and Non-managerial ownership structure. This study test 70 companies from trading and services sector company listed in Bursa Malaysia from 2008-2012 (5 years). The finding
concludes that the firm size, leverage and Tobin's Q have significant relationship with ownership structure of the company.

Zakaria, Purhanudin and Pallanimally (2014) conduct a study to examine the impact of ownership structure on firm performance of the Malaysian listed Trading and Services firms by using samples of 73 companies and obtained the data for ownership within span of five years (2005-2010), by testing dependent variable in term of profitability, valuation, growth and risk such as ROA, leverage, firm size and investment opportunities; and independent variable Concentrated Ownership, Managerial ownership, Government ownership and Foreign ownership. Their study revealed that firm performance which measures through return on asset, leverage, firm size and investment opportunities has two relationships with the ownership structure. First, concentrated and managerial ownership show that it can enhance the firm performance and the second is it inversely occurs in government ownership firms. In addition, the Trading and Services firms have no effect by ownership structure under pre crisis period. Then the significant effect only can be seen in concentrated firm during crisis, post crisis periods and for foreign ownership firms in post crisis period.

<table>
<thead>
<tr>
<th>Authors</th>
<th>Proposal</th>
<th>Measures</th>
</tr>
</thead>
</table>
-ROE  
-Price-Earnings Ratio (P/E)  
-Price to Book Value (P/BV)  
-Free Floated shares (FF)  
-Debt to Equity ratio (D/E)  
-concentrate ownership |
2{return on equity (ROE)  
3. Managerial shareholding  
4. Institutional shareholding |
- ownership concentration  
-foreign ownership  
-institutional ownership |
-return on equity (ROE)  
-market-to-book-value ratio (MBR)  
-Proxy TQ  
- ownership concentration |
-Return on Assets (ROA)  
-Stock Return  
-Tobin's Q  
-concentrate ownership |
Return on Equity (ROE)  
Dividend Yield (DY)  
-concentrate ownership  
-managerial ownership  
-foreign ownership |
Based on the various research conducted, the managerial, concentrate, institutional and foreign ownership have been adopted as independent variables and ROA as the dependent variable since it always been used in previous researches such as Pathirawasam (2013); Hu and Zhou (2006); Kortelainen (2007); MohdSaat and Kallamu (2014); Raji (2012); Andersson, Nordwall and Salomonsson (2005); Manawaduge De Zoysa (2013); Lee (2008); Srivastava (2011); Gugong, Arugu and Dandago (2014).

Li and Sun (2014) defined managerial ownership as the ratio of equity owned by directors. The new structure adapted in today's modern corporation suggests the detachment of ownership from its control; thus, it causes a conflict of different interests within the management. This leads to various consequences which affects the overall firms' performance (Berle and Means, 1932).

**H1: Managerial ownership has a positive significant impact on ROA**

Ownership concentration is the ownership share (votes) of the largest owner in percentage (Pathirawasam, 2013). Hill and Snell (1998) found good relationship between ownership structure and firm performance which is measured by using profitability. Concentrated firms will encourage innovation as a strategy to increase firm value rather than diversification strategy because it will make the manager tied along with the interest objective (Zakaria, Purhanudin and Palanimally, 2014).

**H2: Concentrate ownership has a positive significant impact on ROA.**

Investors are large institutional investors such as banks, insurance companies, investment companies (Bush, 1998). The institutional ownership is gauged through the ratio of shareholding held by institutions to the total number of shares (Fazlzadeh et al., 2011; Nuryanah & Islam, 2011). Cornett et al (2003) found that large stockholders and institutional investors have become increasingly active in corporate governance, especially in
underperforming firms. Bethel et al. (1998) find that block share purchases by institutional investors are most likely in highly diversified firms with poor profitability.

**H3: institutional ownership has a positive significant impact on ROA.**

Foreign ownership is found in the increasing output, employment and wages of target firms in respect to residential procured firms (Wang and Wang, 2014). Along with this it directly can influence the company performance. Barbosa, Natalia & Louri (2003) state no evidence shows that multinational corporations are performing well than the domestic corporations in Greece and Portugal which is measured by ROA.

**H4: Foreign ownership has a positive significant impact on ROA.**

### 2.2 Conceptual framework

![Diagram of Concentrate Ownership, Institutional Ownership, Foreign Ownership, Managerial Ownership, and ROA]

### 3.0 METHODOLOGY

To examine the hypotheses, companies from three sectors (textiles, oil marketing and distribution; movies and entertainment) which are publicly listed in Bombay Stock Exchange has been chosen within the time span of 2011-2015. 50 total companies were selected for the sample by using convenient sampling technique. The companies were chosen based on the availability of financial data in annual reports. While the accessibility of the data can be explained based on Barton, Bradbrook & Broome (2015) where they defined accessibility as a process where people are able to use information and documents of technology products and services easily by visiting with the website or application and software such as e-books, PDFs and so on. Thus the study would take data from the published annual reports which are accessible in the company's official website. This research has employed E-views software to analyze the Correlation analysis and the Multiple Regression analysis data.

### 4.0 Conclusion

Ownership structure and firm performance are regarded as important fundamental issues in corporate governance. The literature on the effect of ownership structure has devoted much attention on firm performance. The discussion of agency theory, stewardship theory, transaction cost theory and principal agent theory addresses the cause and effect of variables such as managerial ownership and the impacts on firm performance. It means ownership is quietly matters in India. The empirical findings emphasizes on the role of ownership structure in firm performance.
Most studies on ownership concentration and firm performance have often found a higher rate of return in companies with concentrated ownership. Different managerial ownership has always found to be controversial because its overall effect depends on the relative strength of the incentive alignment and entrenchment effects; while foreign ownership and institutional ownership was discussed moderately.

However, it is important to note that even if various research have been done in developed countries or developing countries there is a limited empirical research done to examine the impacts of ownership structure on firm performances in India. Since the ownership structure leaves consequences on firm performance, continual studies should be conducted in future with a robust framework.

5.0 References


