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The impact of ownership structure on the performance of non-financial firms: Evidence from Pakistan

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Abstract. The existence of separation of ownership and control create conflict of interest between shareholder and manager, which can intensively effect the firm Performance as result Corporate governance mechanisms are demanded. One possible ownership structure that can alleviate agency problem is ownership structure included managerial ownership and concentrated ownership. The Concentrated owner enhance Performance of their client firms. A probable reason could be that block holders have both the abilities and incentive to monitor the activities of their agent, in order to operate the firm for the benefit of shareholders. This study investigates the association of OS and FP for non-financial firms listed at Pakistan stock exchange (PSX) from 2010-2019.Ownership structure is represented by concentrated ownership and Managerial ownership. ROA and ROE is used as proxy for FP. Panel data techniques are used to investigate the association of OS and FP. Results demonstrate that CO has significant positive association with FP However the study do not find significant association between MO and FP.

Keywords: Corporate Governance, Ownership Structure, Concentrated Ownership, Managerial Ownership, Firm Performance

I. INTRODUCTION

In traditional neoclassical theory of firm, a firm is considered as homogeneous entity which aims to maximize its total value and the present value of its expected future cash flow. Jensen and Mecking (1976) defines a firm as legal entity that build a set of contracting relationship among parties (managers, shareholders, suppliers and customers). Today in the present global world the corporation started to raise the funds by selling the bonds and stocks to anonymous individual investors in the security markets. The investors who bought these corporate securities are more in numbers and their shareholding were dispersed as result, those shareholders lost control on their firms and most of the firms businesses transfer to the hands of manager and managers have more opportunities to take their own interest at the expense of shareholders (Jensen & Mecking, 1976). This separation of ownership and control creates the agency problem as well as information asymmetry problem (Berle & Means, 1932; Fama & Jensen 1983), that made it difficult for the shareholders to ensure that their resources are not expropriated by the manager and they are well managed in profitable projects which will generate appropriate return to them. Thus, in this regard it has been recommended that good corporate Governance system and its mechanism can aligned the interest of shareholders and managers (Shilfer & Vishny, 1997). These Governance mechanisms will also enhance and improve the efficiency of corporate culture.

Prior literature is reviewed and reports that firm's market value is not only based on its investment projects but on other factors as well such as financial structure, dividend policy and its governance / control and ownership structure (managerial & concentrated ownership) also adds value to the firms. The literature also reports positive relationship between ownership concentration and firm performance, because ownership concentration influence firm's ability to solve agency problem and enforce the manager to run the firm in the interest of shareholders (Mosen et al, 1968; Radice, 1971; Steer & Cable, 1978; Albe et al., 1998; Xu & Wang, 1999). While some other studies find no evidence to support the significance of this relationship (Demsetz & Lehnu, 1983; Jensen & Meking, 1976; Kim et al, 1988).

In term of managerial ownership and firm performance, a number of studies report positive relationship between them (Jensen & Macking, 1997; Kensen, 1987; Kim et al, 1988; Hudsun et al, 1992). However, other studies such as (Morecl et al, 1988; MCconnel & Servales, 1990; Han & Suk, 1998; Short & Keasy, 1999) report no linear relationship because when in a corporation there is excessive managerial ownership, managers tend to entrench the controlling power of management in a firm and operate firm's business for their own benefit. Craswell et al (1997) investigates that there is no relationship between managerial ownership and firm performance.

Most of the empirical studies covers the data related to developed countries (United Kingdom and United States). While evidence from the developing countries on the relationship of ownership structure and Firm performance is not investigated in the perspective of corporate governance mechanism. Therefore, the above conflicting results provide a setting to investigate the relationship a of ownership structure and firm performance in a developing country such as Pakistan. Pakistan is being a common law country which must show the characteristics of strong investor protection, however, this characteristic is contrary to the observed phenomenon that Pakistan provides strong IP. It is also in observation that most of the listed companies in Pakistan are family owned and/or having highly concentrated ownership. Furthermore, Pakistan's capital market shows weak legal enforcement and more political interference (Kaufman, Koehler & Butler, 2006; Laporta, Lopez-de-Silanes; Shleifer & Vishny, 1998). This leads to weak Corporate Governance in Pakistan. Thus, the objective of this study is to investigate the relationship of ownership structure and firm performance in a weak CG system, volatile capital market and a high concentrated ownership capital market

The rest of the paper proceeds as follow: Section 2 provides review of the extant literature. Section 3 demonstrates methodology of the study. Empirical results are discussed in section 4. Section 5 provides conclusion of the study.

II. LITERATURE REVIEW

Barle and Mean (1932) present the issue on the separation of ownership and control, it leads two significant problems, asymmetric and agency and problem. Mayer and Maljuf (1984) argued that separation of ownership and control is one of the major cause of asymmetric information problem. The problem are arises because the manager who hired to operate firms business will know more about the firm than the shareholders. Manger wants to use these hidden information about the firm for their own interest (Gitman & Madura, 2000). When shareholders are dispersed there are large information asymmetry between the shareholders and mangers, thus small shareholders have lack expertise and incentive to overcome this gape and monitor managers to act for their benefit.

Mayer and Majulif (1984) report that information asymmetry problems mostly experience when issuing new equity is announced, because when the manager control the firm they want to finance the firm by issuing new securities first rather than financing from external sources, such as banks because such borrowing will discipline the manager, as if the manager will not take the payment according to debt contract that will create a problem for him, like for example the bank may force the firm for liquidation or restructuring the firm (Haris & Ravi,1990). On the other hand Wiwattanakuntung (2002) report that if manager issue new equity in financing firm projects they can delay paying dividend to equity holders when the firm facing financial distress.

Jensen and Meckling (1976) came up with the agency theory argued that because of the distinction of ratio of assertion of investment of managers and shareholders in the firm the conflict of interest arises between the shareholders and managers. The shareholders suppose that the investments made by managers is less as compared to shareholders so it is likely to occur that they may misuse their investment and shift this investment for their own interests . These kinds of conflicts of interest generate the agency costs and agency troubles.

The main question in agency theory is "how let the manager act in the best interest of shareholders" and how can investor be sure that their funds are well invested and not expropriated by managers? ((Jensen & Meckling, 1976; Shilfer & Vishny, 1997). In extension to the literature, different authors highlighted mixed feelings about concentrated ownership and firm performance. Stano (1976) investigate the impact of ownership structure on firm performance and his study shows that concentrated ownership firms significantly provide higher rate of return on the other side managerial control firms are associated with higher leverage and more volatile stock return.

Alba et al (1988) conduct a comprehensive research study to examine the association between ownership concentration and firm profitability of firms listed on Thailand Stock Exchange. The researcher result demonstrate that with the raise in the concentration ownership higher level of profitability is observed, the results explain that ownership concentrated firms enhance firm profitability in short term while low firm profitability will be observed in future. The reason could be that higher concentrated firms have less possibility to change its Corporate Governance system according to new economic environment.

Chen (2001) investigates the relationship between ownership structure and firm value, take the sample 434 companies listed on the Shangal and Shenzhen stock exchange in 1997 and measured the firm performance by Tobin The main ownership structure was divided into three groups State shareholders, Domestic intuition shareholders and Managerial ownership and he find a positive and significant association between domestic intuition ownership and firm value.

Wiwattanakatung (2001) examines the impact of ownership structure and firm performance of Thailand non-financial firms listed on the Thailand stock exchange, measured the firm performance by the return on assets, sales to asst and firm value (Tobin Q) and his study shows that there is no evidence found to support that the controlling shareholders takeout the firm assets for their own benefits and his findings shows that firms with controlling shareholders have a higher profitability (ROA, S/A) than those with no controlling shareholders.

However, there are some studies argued that concentrated ownership has no relationship to firm performance .Holderness and Sheehan (1998) examines the effect of concentrated shareholders on the accounting and firm value and their study was based on comparative analysis of the firms with concentrated ownership and those with the dispersed ownership and findings shows that the firm performance is not significantly different between these both. Demsetz and Lehn (1985) examines the effect of ownership concentration on firm performance he classified the ownership concentration into three groups all investors, family and individual investors and institutional investors and the results show that there is no significant relationship between ownership concentration and firm performance.

Based on the above discussion and empirical evidence, the following hypothesis can be examined:
Hypothesis 1: There is a significant relationship between concentrated ownership and firm performance.

Similarly, managerial ownership acts as control device which can be used to direct the internal control system of a firm, and hence can be used as a proxy to monitor all the actions and decisions which may in turn help in reducing and solving the agency problems (Shah, et al. 2015). Kensen (1987) has study ownership of board of directors and firm performance. The researcher has choose the following firm performance variables, profit margin, ROA, ROE, stock market performance and total return to shareholders, take the sample of 250 companies. The result of researcher show that proportion of shares held by board of directors has positive and significant related to profit margin and ROE. Vance (1964) use same firm performance measures and the results report that managerial ownership is positive and significant related to only profit margin while Pfeffer (1972) observe the positive and significant relationship between managerial ownership, profit margin and ROE. Kim et al. (1988) study the relationship between managerial ownership and market return of 270 firms from 1975 ~ 1978. The researcher demonstrate that because of existence of managerial ownership lead to less effect of agency cost on firm`s stock prices, positive relationship between managerial ownership and stock return is observed. Jahera (1991) examines the relationship between managerial ownership and firm performance in term of both market base and accounting base measures, takes the sample of 645 firm listed on the New York stock exchange and American stock exchange between 1982 and 1987 and their results shows that higher the managerial ownership higher the market return as well as accounting returns (ROA, ROE) and their findings also shows that higher level of managerial ownership improves the decision making of the manager and thus also increases the firm performance.

The research conducted by Yebon Duah (1993) examine the affiliation among managerial ownership and market return. The sample period used the study exist over the period from 1984 to 1991 and the data is collected through 200 companies listed on Kula lampur stock exchange. The result report positive and significant relationship between managerial ownership and excessive market return.

Moreck et al. (1988) review the effect of managerial ownership on firm performance, researcher select market return and account return as firm performance measure for 450 of fortune 500 firms in 1980, they categorize managerial ownership into three level at 0 to 5%, 5 to 25% and above 25%. The result of study indicate that market return is positive related to managerial ownership at 0 to 5%, negative related to 5 to 25% and then again positive related to above 25%. This is because at 0 to 5% there is alignment of interest between owner and manager and after that at 5 to 25% there is entrenchment of managerial shareholder`s power i.e. with adequate power of control in the firm managerial expropriation of funds can take place, but beyond 25% manager and shareholder interest again aligned and hence firm performance increase.

Wong and Yek (1991) also examines the non-liner relationship between managerial ownership and firm performance between 1982 to 1987, measured the firm performance by market value of firm and stock excess return and results shows that nonlinear relationship between managerial ownership and market value, their findings shows the firm managerial ownership is positively related to firm performance in the 0_20% range, negatively related to 25_45% range and again positively related beyond 45% range. Craswell et al (1997) investigates the relationship between managerial ownership and firm performance and take the sample of 349 public traded Australian firms from 1986 to 1989.The firm performance is measured by market value and there is no relationship between managerial ownership and firm performance. Previous researchers came up with both significant positive and negative impact of managerial ownership on firm performance. Therefore, the following hypothesis can be formed on the basis of previous discussions:
Hypothesis:2 There is a significant relationship between managerial ownership and firm performance.

III. METHODS

In this section, the effect of ownership structure and other control variable on firm performance are explain. Source of data, sample size, model and variable description are discussed in the section.

3.1 Data and sample size

The main sources of data for this study comprise the annual reports of non financial firms listed on Pakistan Stock Exchange from 2010 to 2019.The annual reports of all the listed companies of Pakistan stock exchange are available on the State Bank books. This source is considered as one of the authoritative sources of data on Pakistani corporate sector. For sampling purpose only the non-financial firms listed on Pakistan stock exchange is taken for statistical data gathering the banks, insurance companies, investment companies, leasing, business services and other service sectors excluded from the sample. We collected the firms that made a list for all the years that is from 2010 to 2019 This made our sample relatively more balanced. Following this procedure, we collected the data for 75 firms for 10 years The data for majority of the sample firms are available for 10 years. Therefore, the minimum benchmark for including a firm in the sample is 10 years. However, for the missing observations, this study uses median value computed from the available 10 years data.

3.2 Model and Variable Description

This section contains the model and definitions of variables. In this study we use quantitative method of research and implies the econometric model. The data used in this study is panel date, having the characteristics of both cross sectional and time series. Panel data is used to control heteroscedasticity in data and to provide more reliable estimates of coefficients. We adopted the following model to assess our hypothesis regarding the relationship between ownership structure and firm performance following by some prior studies (Klein,et al. 2005; Naveed et al. 2018). (Abdelsalam, Masry &Elsegini, 2008) We developed two equations based on two firm performance measures, ROA and ROE. Equation (1) uses ROA as the dependent variable used by (McConaughy, et al. 1999; Favero et al 2006; Cui & Mak, 2002) McConnell and Servaes (1990), and equation (2) applies returns on assets ROE as the dependent variable). The equations are given as below.

$$ROA_{it} = \alpha_i + \beta_1 (CO)_{it} + \beta_2 (MO)_{it} + \beta_3 (Size)_{it} + \beta_4 (LEV)_{it} + \beta_5 (BS)_{it} + \mu_{it} \quad ...(1)$$

$$ROE_{it} = \alpha_i + \beta_1 (CO)_{it} + \beta_2 (MO)_{it} + \beta_3 (Size)_{it} + \beta_4 (LEV)_{it} + \beta_5 (BS)_{it} + \mu_{it} \quad ....(2)$$

Return on asst (ROA), Return on equity (ROE), α_i intercept of equation , i number of firms, t time period, μ_{it} error term.

a) Firm Performance We use return on asst (ROA), return on equity (ROE) as firm performance measures.

b) The explanatory variable: Managerial ownership and concentrated ownership are the main explanatorily variables use for this study.

c) The control variables: Managerial ownership, Concentrated ownership is not the sole determinant of firm's efficiency . Hence the literature identifies various other factors affecting the performance of the firm. The effect of these factors is, therefore, important to isolate. Following Cui and Ma (2002), we control for the effects of firm size, leverage, and board size.

All variable are defined in Table 1 below

Table1. Discerption of Variables

Dependent variable	
Return on Assets (ROA).	Net income divided by total assets
Return on Assets (ROA).	Net income divided by total equity
Explanatory variable	
Managerial Ownership (MO).	% of shares owned by directors CEO
Concentrated ownership (CO).	% of share owned by top 5 share holder
Control Variables	

Size of Firm.	Natural log of assets
Leverage (LEV)	Total debt to total assets
Board size (BS).	Number of board of directors

IV. RESULTS

This section discusses the findings of research. Regression model is used in this study to measure the association between ownership structure and firm performance. The descriptive statistics for the dependent and in depend variables are discussed in the sub section 4.1; sub section 4.2 describe correlation results for the given variables while the last section present regression analysis results.

4.1. Descriptive statistics

The table 2 shows the descriptive statistics for the dependent and independent variables. The mean and median for ROA are 0.0867 and 0.06532 respectively with standard deviation of 0.1156. The median for ROE is 0.1317 while mean is 0.1621. The standard deviation for ROE is 0.2185. The median of MO 0.2105 and its mean is 0.2016 with standard deviation of 0.2185. The median for CO is 0.6869 with mean of 0.6648 and the standard deviation of 0.1955.

The table further indicates that mean and median for FS is approximately the same (9.72 and 9.71 respectively) with a relatively high standard deviation of 0.8882 as compared to other variables which is evident from its minimum and maximum values (4.99155 and 11.464 respectively) that describes the change in firm size with time. The median for leverage is 0.4930 while mean is 0.5047. The standard deviation for leverage is 0.4346. The median of BOD is 8.000 and its mean is 8.336 with standard deviation of 2.071. The skewness and kurtosis of all the independent, dependent variables and control variables show that the data is fairly distributed.

Table 2. Descriptive statistics for dependent and independent variables

VVariables	Mean	Median	St. Dev	Min	Max	Skewness	Kurtosis
ROA	0.087	0.065	0.116	-0.518	0.701	0.39	5.8
ROE	0.162	0.132	0.219	-0.747	0.978	0.62	3.5
MO	0.202	0.211	0.219	0.0000	1.750	1.46	2.26
CO	0.665	0.687	0.196	0.008	0.994	-0.37	-0.63
FS	9.72	9.710	0.888	4.991	11.46	-1.05	2.8
LEVG	0.505	0.493	0.434	0.000	7.561	2.5	6.8
BOD	8.336	8.000	2.071	5.000	15.00	1.18	1.10

Table 2 reports the descriptive statistics for independent and dependent variables. First column represents dependent and independent variables ROA is represented by return on asst and measured as net income/total asst, ROE represented by return on shareholder equity and net income/shareholder equity is use to measure the value of variable,. CO is represented by concentrated ownership and peroxide by percentage of shares owned by top five shareholders, MO represent managerial ownership that is measured as percentage of shares held by directors, CEO, Executives, FS shows firm size and is peroxide by log of total assets of a firm, LEVG shows leverage or total debt of the firm and is measured as total debt/total asst. BOD shows the of board of directors and is peroxide by total number of board of director working in a firm.

4.2 Correlation Analysis

Table 3 provides the correlation coefficients for the dependent ,independent variables and control variables. The results shows positive and significant association between ROA and ROE with (p-value ≤ 0.05). A positive and statically significant association is observed between ownership concentration and firm performance as peroxide by (ROA, ROE). The positive association exists between the variables because block holders have both the abilities and incentive to monitor the activities of their agent in order to operate the firm for the benefit of shareholders. These results are in consistent with the findings of (Mosen et al, 1968; Radice, 1971; Steer & Cable, 1978; Albe et al., 1998; Xu & Wang, 1999).

Table 3. Correlation matrix

	ROA	ROE	CO	MO	FS	LEV
ROA	0.784***					
ROE	0.011***	0.112***				
CO	0.0119**	0.112**				
MO	-0.22***	0.130***	0.043*			
FS	0.228***	0.283***	0.073*	-0.215**		
LEV	-0.161***	-0.181*	-0.034***	0.150***		
BS	0.167***	0.178***	0.041***	-0.19***	0.363***	0.161**

Table 3 reports correlation results for the dependent, independent and control variables. ROA indicates as return on assets, ROE shows return on equity. CO indicates concentrated ownership and is peroxide by % of share by top 5 shareholders, MO shows managerial ownership and is peroxide by % of shares held by CEO, Directors, Executives etc and rest of variables FS shows firm size, leverage is firm total debt/total assets and BS shows board size. The first row for each variable represents the correlation coefficients while the second row indicates their level of significance (p-value) indicate their level of significance as. *p < 0.1; **p < 0.05 ***p < 0.01

4.3 Regression Analysis, Fixed effect Model

Since the data is panel in nature, therefore we estimate panel data regression models. Following the standards procedure for panel data analyses, the applied diagnostic tests reveal that the fixed effect model is the suitable technique for estimating the regression model. The Hausman test results show that fixed effect model is suitable for this study. The Hausman test result is given in the following table.

Table 4. Hausman Test

Test Summary.	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob
Cross-section random	52.648872	8	0.000

Table 5 and 6 reports the regression result for the dependent and independent variables. The regression model in this study is built on the supposition that the ownership structure affects the performance of firms (Craswell, Taylor & Saywell, 1997; Han & Suk, 1998) Following the prior studies, this research proposes a model to investigate whether ownership structure constrains firm performance in Pakistan.

The results are reported in Table 5 and 6 respectively. The main explanatory variable of interest in the regression for our study is managerial ownership (MO) and Concentrated ownership (CO). Return on assts (ROA) and Return on equity(ROE) are use to measure firm performance for this study. Tobin's Q is used as the main proxy for firm efficiency, and in second the ROA is the dependent variable The fixed effect model are run to test the hypothesis.

Outcomes of the fixed effect model show that the managerial ownership is having insignificant negative relationship with ROE having t value (-0.99) and p value is 0.325 also negative and insignificant relationship with ROA having t (-1.19) with p value is 0.235, which is inconsistent with the findings that higher proportion of managerial ownership enhance the performance of firms .(Jensen & Meckling, 1976). The outcomes are empirically similar to those found in earlier studies (Porta et al., 2002). However, our results in the fixed effect model indicate that this relationship is negative and insignificant consistent with Demsetz and Villalonga (2001) and Chang (2003).

According to the regression analysis concentrated ownership is positively and significant correlated with ROE having t value 2.13 with p value 0.034 also positive and significant relationship with ROA having t 2.39 having p value is 0.021 value. The relationship is positive and significant because Wiwwatantung (2001) argue outside investor perceived controlling ownership will not transfer corporate assets from the firm, on the contrary they will try to maximize firm performance.

Table 5. Fixed Effect Model Results of ROA with MO, CO and Control Variables

Variables	**Coefficient**	**t- Statistic**	**Prob**
Constant	-0.2246	6.61	0.0011
MO	-0.0247	-1.19	0.235
CO	0.0631	2.39	0.021

FS	0.0252	3.71	0.000
LEV	0.0577	-4.30	0.000
BS	0.0068	2.39	0.017
R- Squred	0.1135		
Adjested R- Squred	0.1046		
F- Statistic	10.74		0.000

Table 5 reports the regression analysis using fixed effect model for dependent and independent. The dependent variable is return on assets (ROA). The explanatory variables are managerial ownership (MO) and concentrated ownership (CO). The regression control the effect of firm size (FS) leverage (LEV) and board size (BS).

Table 6. Fixed Effect Model Results of ROE with MO, CO and Control Variables

Variables	Coefficient	t- Statistic	Prob
Constant	-0.520	-4.30	0.000
MO	-0.0385	-0.99	0.325
CO	0.1085	2.13	0.034
FS	0.0564	4.41	0.000
LEV	0.00428	-1.70	0.090
BS	0.01078	2.00	0.046
R- Squred	0.996		
Adjested R- Squred	0.887		
F- Statistic	20.775		0.000

Table reports the regression analysis using fixed effect model for dependent and independent. The dependent variable is return on assets (ROA). The explanatory variables are managerial ownership (MO) and concentrated ownership (CO). ownership (MO) and concentrated ownership (CO). The regression control the effect of firm size (FS) leverage (LEV) and board size (BS)

Size of the company calculated by taking usual log of sales depicts substantial positive connection with ROE having a t value of 4.41 with p value and also positive connection among size and ROA having t value 3.71 with p value 0.000 showing the significant connection. The finding are according to Short and Keasy (1999) who suggest that large firms have more opportunities to generate internal funds as result they can avoid financial constrain situation and have great opportunity in profitable projects.

Leverage show a negative insignificant relationship with ROE having t value (-1.71) with p vale is 0.091 however negative but significant relationship is demonstrated between leverage and ROA having t value is (-4.30) with p value 0.000. The negative results comes between leverage and firm performance this is because as debt to asset ratio raises the cost associated with serving it also increases as result firms experience a decline in their performance.

V. DISCUSSION AND CONCLUSIONS

The present study investigates the impact of ownership structures on firm's performance of non-financial firms listed at Pakistan Stock Exchange. Panel data analysis are used for exploring effect of ownership structure on the performance of non-financial firms of Pakistan during 2010 to 2019. The results of the study show that managerial ownership is insignificantly and negatively correlated with firm performance. The findings are consistent with the findings of (Demstez & Villalonga, 2001). However, the result are inconsistent with the studies conducted by (Jansen & Meckin, 1976; Kim et al., 1988; Oswad & Jehera, 1991; Yobuach-Duah, 1993) who argued that managers ownership must be a significant factor of performance of firm and found a significant positive relationship. The findings may differ due to the country effects, market effects or by having restricted data time period etc. So, on the basis of results the researcher rejects the hypothesis (H1) because of the insignificant adverse relationship among firm performance and managerial ownership.

The results demonstrate that concentrated ownership is positively as well as significantly connected with firm performance. The findings are consistent with the findings of (Monsen et al., 1968; Radice, 1971; Steer & Cable, 1978; Levin & Levin, 1982; Alba et al., 1988; Xu & Wong, 1999) which show significant positive association between concentrated ownership and firm performance. The possible reason for significant relationship may be that when maximum numbers of shares are owned by small number of shareholders, they can effectively monitor manager´s and their discretion untimely firm performance increases. Therefore, the researcher confirms the validity of hypothesis (H2).

This study is limited to only two measures of ownership structure, managerial and concentrated ownership. However, there are other determinants of ownership structure such as institutional ownership, block ownership, family ownership which need to be investigated. Second, due to data availability constraints, we have considered only non-financial firms. Future studies should also consider financial sector. Future research may be conducted by keeping in view the capital structure and dividend policy along with the ownership structure. That will ensure more effective forecasting of the Firm Performance in Pakistani Stock Market.

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