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FIRM PERFORMANCE: DOES CLOSELY-HELD OWNERSHIP STRUCTURE PROVES TO BE ADVANTAGEOUS IN AN EMERGING ECONOMY? (PAKISTAN CASE STUDY)

Corporate governance is a prerequisite for the development and growth of economies as well as firms. In order to be most effective, organizations need to foster the development of an efficient corporate governance structure. The shortest way to cover the distance from effectiveness to efficiency is the choice of the appropriate corporate governance strategy. The most widely recognized mechanism of corporate governance is ownership structure. This study endows with helpful evidence concerning the momentous role played by ownership concentration in non-financial firms of Pakistani capital market. The total of 125 firms listed at Karachi Stock Exchange (KSE) are taken as a sample and the panel data methodology is applied. Performance is measured from both perspectives; ROA for accounting performance and Tobin's Q for market performance. The results reveal a positive and significant effect of ownership concentration on firm performance. Hence this study proves ownership concentration is the most appropriate corporate governance strategy.

Keywords: *corporate governance, ownership structure, firm performance, Karachi Stock Exchange, ownership concentration.*

Міан Саїд Назір, Сумайра Асгар Батт, Мухаммад Мусаррат Наваз

ЕФЕКТИВНІСТЬ ФІРМИ: ЧИ Є ЗАКРИТА ФОРМА ВЛАСНОСТІ ПЕРЕВАГОЮ В УМОВАХ ЕКОНОМІКИ, ЩО РОЗВИВАЄТЬСЯ? (ЗА ДАНИМИ ПАКИСТАНУ)

У статті показано, що для досягнення максимальної ефективності фірми необхідний вибір найбільш придатної стратегії корпоративного управління. Найбільш широко визнаний механізм корпоративного управління - структура власності. Досліджено роль концентрації власності в нефінансових компаніях пакистанського ринку капіталу за даними 125 фірм, зареєстрованих на Фондовій біржі Карачі (KSE), із застосуванням методології панельних даних. Фінансові результати діяльності оцінюються за ROA (рентабельністю активів) і Q-коефіцієнтом Тобіна для ринкових показників. Результати показують істотний позитивний вплив концентрації власності на діяльність компаній. Доведено перевагу концентрації власності як стратегії корпоративного управління.

Ключові слова: *корпоративне управління, структура власності, ефективність фірми, Фондова біржа Карачі, концентрація власності.*

Таб. 2. Літ. 24.

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ЭФФЕКТИВНОСТЬ ФИРМЫ: ЯВЛЯЕТСЯ ЛИ ЗАКРЫТАЯ ФОРМА СОБСТВЕННОСТИ ПРЕИМУЩЕСТВОМ В УСЛОВИЯХ РАЗВИВАЮЩЕЙСЯ ЭКОНОМИКИ? (ПО ДАННЫМ ПАКИСТАНА)

В статье показано, что для достижения максимальной эффективности фирмы необходим выбор наиболее подходящей стратегии корпоративного управления. Наиболее

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широко признанный механизм корпоративного управления — структура собственности. Исследована роль концентрации собственности в нефинансовых компаниях пакистанского рынка капитала по данным 125 фирм, зарегистрированных на Фондовой биржи Карачи (KSE), с применением методологии панельных данных. Финансовые результаты деятельности оцениваются по ROA (рентабельности активов) и Q-коэффициенту Тобина для рыночных показателей. Результаты показывают существенное положительное влияние концентрации собственности на деятельность компаний. Доказано преимущество концентрации собственности как стратегии корпоративного управления.

Ключевые слова: *корпоративное управление, структура собственности, эффективность фирмы, Фондовая биржа Карачи, концентрация собственности.*

1. Introduction. The origin from where the need for corporate governance stems is the well-known agency problem (separation of ownership and control) which was first discussed by Berle and Means (1932). Managers not having any stake in organization take such actions which expropriate company value, lower down investors' returns, make company position dangerous by taking excessive risk, spoil firm's reputation and deceive shareholders through manipulated reports. Such situation arises the need for "corporate governance". Corporate governance mechanisms are various successful ways by which fundamental issues such as agency problem can be resolved. These mechanisms are employed to govern and control managers' activities and give surety of satisfactory returns to investors. Among all "ownership structure" is the most indispensable corporate governance mechanism and the bottom line is that sound ownership structure is crucial for successful functioning of corporations.

Ownership structure, whether concentrated or dispersed, plays very significant role for firm performance. Ownership is concentrated when the majority of shares are in the custody of a small number of shareholders while ownership is dispersed when company has majority of shareholders each owning a small fraction of shares outstanding. Closely held ownership structure gives shareholders the right to obtain necessary information for effective monitoring process which positively influences performance. Simply large shareholders are the "monitors of the monitors", that's why continuity of this chain and strong connection between large shareholders, board of directors and management takes company performance in a positive direction. In contrast, as ownership moves towards widely held structure, the incentive to shareholders decreases and they have less power to hold control on managerial activities hence it badly affects performance. That's why this study attempts to explore the association between ownership concentration and firm performance in Pakistani corporate sector. This research paper is a step forward in corporate governance research. This study comes out with useful results which will lessen the gap in corporate governance literature. Thoroughly examining the prior literature revealed the fact that very few and old researches are available on different ranges of ownership concentration and its relation with firm performance. This study attempts to investigate firm performance at different levels of ownership concentration by setting unique levels. In addition to this, the current study will be among the pioneers in using such levels.

2. Literature review. Ample research is available, carried out taking ownership concentration as independent and firm performance as dependant variable and interestingly, taking an overall look they all present a mix plate of results. First of all, Jensen and Meckling (1976) set the basis for ownership structure has an influence on firm performance. This study provided evidence for positive relation between ownership concentration and firm performance as it helps in reducing conflicting interests between managers and owners. Demsetz (1983) was the first to prove ownership structure as endogenous through his research. Taking Fortune-500 firms as sample it was found that ownership structure whether concentrated or dispersed is affected by the decisions made by shareholders. Whatever the ownership structure of organization is, it has no relation with performance. Afterwards Demsetz and Lehn (1985) gave more detailed view of endogenity of ownership structure. Regression equations measure the fraction of shares in possession of top 5 and top 20 shareholders. Summary statistics revealed that firm performance does not move with ownership structure which means that no significant relation is present between these two. Similar findings were founded by Holderness and Sheehan (1988).

For the first time, Morck et al. (1988) introduced a very interesting relationship between ownership concentration and firm performance. Regression model proved that non-monotonic relationship exist between ownership concentration by managers and firm value. Performance found to move in U-shaped direction with the movement in managerial ownership. Similar results were also proved by Stulz (1988). After that Shleifer and Vishny's (1997) survey on corporate governance is very helpful in this regard as the results are drawn from a very large sample, the data was collected taking 1196 firms from all over the world. The survey revealed that concentration of ownership and firm performance positively relates to each other. Then comes the work of Claessens and Djankov (1999), concentration was measured as percentage of shares held by top 5 shareholders and performance was measured through profitability and labor productivity. The empirical analysis revealed a more significant and positive relation between these variables.

Afterwards Sarkar and Sarkar (2000) took India for their research. Total 1567 firms for the period of 1995-1996 were taken and the results provide rationale for "convergence of interest" hypothesis which implies that when ownership is concentrated in few hands then their interest align with companies interest hence resulted in improved firm performance. Subsequently, Chen (2001) studied the same phenomena for another Asian economy, China. The sample was 434 firms and strong linear and positive relationship is proved. Mitton (2002) sought to investigate the level of firm performance with the degree of concentration during the East Asian financial crisis and came out with the finding that the level of firm performance increases as the degree of concentration increases. A very useful study conducted in emerging economy Pakistan was by Afza and Slahudin (2009) taking 100 publically listed firms as a sample. Significant positive linear relationship between performance and ownership concentrated was found.

Recently, Alipour and Amjadi (2011) investigated Iranian firms taking the sample of 68 firms. The results indicated negative relationship between "largest shareholder and firm performance" and positive relationship between top 5 shareholders and firm performance. Another recent study by Foroughi and Fooladi (2011) took the sample of 45 public listed companies in the fiscal years 2002-2004. The statistical tests disclosed the fact that concentrated ownership has a significantly negative relation with performance. Moreover, Bajwa et al. (2011) investigated the impact of ownership structure as closely held on firm financial performance on the sample of 200 firms. The findings disclosed that no significant relation was found. Most recently, Parvan and Todoric (2012) considered Croatian firms for the period 2003-2010. The empirical analysis section of this paper explored that firms with disperse owners exhibit superior level performance than firms with concentrated owners, which means that no significant relation was found between concentrated ownership and firm performance. In contradiction to these results, Awunyo-Vitor and Baah (2012) study Ghana market taking the sample of listed firms for the period 1999 to 2008. Significant positive relation of ownership concentration with Tobin's Q and ROA was identified. Another very important study conducted in this regard by Shah et al. (2012). The results reveal that ownership concentration with single largest shareholder has positive effect on firm performance while in the case of top 5 largest shareholder the results are opposite, it has a negative relation with performance.

3. Research Methodology and Hypothesis Development. The total of 652 firms are listed at KSE for the time period tested and the market capitalization is 2,945,784.51. Only non-financial firms were considered in this for sample. First of all, KSE-100 list was downloaded on 31 December, 2011 and all the firms were taken at the first hand. The final sample data set consist of 150 companies. First, 75 companies were chosen to be included in the final sample. Further, it is decided to enter 54 Shariah compliant firms in the existing sample. At the last step more 21 non-financial firms were randomly extracted from the All-share index based on their good reputation and recognition and added in the sample, making the final sample consisting of 150 firms. While collecting the data 25 more companies are excluded from the sample due to non-availability of the required data and the finale sample consists of 125 firms. The data for this study is gathered from the annual reports (secondary source). Panel data technique is used with 6-year time period and collection of data starts with 2005 and ends with 2011 fiscal year. Through panel data results can be more generalized which is not possible in the case of cross sectional or time series data.

3.3 The Model. An empirical model is designed to explore the relation between ownership variables and firm performance. General structure of regression equation:

$$Performance = f\,(Ownership\ concentration,\ Control\ variables), \qquad (1)$$

where *Performance* is a function of ROA and Tobin's Q; OC_t = Fraction of shares held by top 5 largest shareholders measured by Herfindahl index, and *Control variables* are Size and Leverage of Firm.

4. Empirical Analysis and Discussion. Table 1 reports the descriptive statistics including mean, median, skewness, Kurtosis and maximum-minimum values for dependant, independent and control variables. The total assets are on average Rs. 16.536 bln with the standard deviation of Rs. 32.752 bln. Skewness is about 3.896; it makes right tailed distribution with very few high values on the right tail. The smallest amount for assets in the given sample is Rs. 0.065 bln and the greatest amount is Rs. 262.673 bln. Shareholders equity is Rs. 6.710 bln with dispersion of Rs. 16.947 bln. The mean value for net profit is Rs. 1.171 bln with standard deviation of Rs. 5.710 bln. The mean values for dependant variables ROA and Tobin's Q are as follows: 7% (ROA) and 1.4735 (Tobin's Q). ROA with 10% standard deviation which shows the data is clustered around the means and Tobin's Q with standard deviation of 2.4675 which is higher than mean and shows the spread of data points. These results also point out towards the skeweness of data as it is clear from Table 1 that ROA is negatively skewed, which shows that most ROA values are negative and Tobin's Q is highly skewed (13.56) with most of the values are positive. Leverage with 54% mean and standard deviation of 23%, this shows that in more than half of the sample companies the leverage is 54%. In Pakistan on average concentration is 47%, it means that majority of the shares are in custody of top 5 shareholders. This shows that in Pakistani non-financial firms ownership is highly concentrated as almost half of the total number of shares is in the hands of few shareholders. Cheema et al. (2003), Iqbal (2006) and La Porta et al. (1999) also provide evidence for ownership structure as concentrated in Pakistan. The mean value is true representation for the level of concentration in Pakistan as variation of data points from mean is 24%, it implies that data points are not so far from the mean. Distribution is positively skewed and bulk of the values lie on the right side of the distribution. The lowest level of concentration in the sample firms is 0.19% and the highest level of concentration by top 5 is 99.43%.

Table 1. **Descriptive Statistics**

	Mean	*Med*	*Std. Dev*	*Skew-ness*	*Kurtosis*	*Min*	*Maximum*
Assets (bln Rs.)	16.536	4.389	32.752	3.896	18.111	0.065	262.673
Equity (bln Rs.)	6.710	1.960	16.947	5.295	41.832	-78.099	201.565
Profit (bln Rs.)	1.171	0.168	5.710	5.465	54.716	-36.139	63.527
ROA (%)	6.8218	5.9843	10.0316	-2.141	30.633	-121.39	44.25
Tobin's Q	1.4735	1.0879	2.4675	13.601	210.087	0.1303	43.6216
Levg	0.5410	0.5517	0.2300	0.321	0.813	0.0059	1.6158
OC	0.4747	0.4652	0.2399	0.185	-0.903	0.0019	0.9943

4.3. Regression Analysis. OLS regression model is run to determine the relationships between ownership concentration and firm performance. The foremost thesis in this regard (Berle and Means, 1932) inferred that disperse ownership structure adversely affects while concentrated ownership structure positively affects firm performance. The present study attempts to test the hypothesis by testing the relation between ownership concentration and firm performance. Concentration is checked taking top 5 shareholders as a proxy for ownership concentration and no specific cut off point is used for entering into top 5 shareholder category.

Table 2. **Ownership Concentration and Firm Performance**

Variables	**Performance Variables**			
	ROA		**Tobin's Q**	
Intercept	***β coefficient***	***t-value***	***β coefficient***	***t-value***
	0.046	(1.657)	2.807	(3.760)***
Independent Variables				
Concentration (OC)	0.087	(2.914)***	0.270	(8.250)***
Control Variables				
Size	0.132	(4.397)***	-0.087	(-2.626)***
Levg	-0.491	(-16.612)***	-0.117	(-3.599)***
R	**0.502**		**0.297**	
R square	**0.252**		**0.088**	
Adjusted R2	**0.249**		**0.085**	
D-W	**1.086**		**1.470**	
F-Value	**97.668*** **		**28.130*** **	

*** Significant at the 0.01 level ** Significant at the 0.05 level * Significant at the 0.10 level.

Positive and highly significant relation is identified. This shows that shareholders holding major part of the equity could control managerial activities more effectively, which results in excellent work at managerial level and ultimately results in superior performance by firms. While on the other hand in case of dispersed ownership, managers are free to do anything of their own choice, they intentionally do not act in the best interest of shareholders and do not put their best efforts to enhance firm performance. Moreover, they put company performance at risk by investing in such projects which are only beneficial for them and not for the company.

The reason is that there is no controlling authority above them; small shareholders have little control over managers, as they hold an insufficient amount of shares and they are widely dispersed, so they are not in a position to keep close eye on managerial activities or obstruct them from taking any biased action. On the other hand, shareholders holding major block of equity are in a better position to make the management answerable for their ambiguous activities. One more important finding is the favorable effect from market, market prefer firms with concentrated ownership then firms with disperse ownership structure. From the market viewpoint major shareholders protect their investment and ensure suitable returns on it. Concentration proved to be highly significant with positive coefficient which implies that ownership in the hands of few shareholders positively affects firm's market performance which ultimately leads to significant increase in share price. Awunyo-Vitor and Baah (2012) study recently provided support for the findings of this paper. It can be infer from these results that closely held firms perform better than diffusely held firms in Pakistan. The above results are in agreement with many previous studies, as can be seen in the literature (Berle and Means, 1932; Shleifer and Vishny, 1997; Classens et al., 2000; Sarkar and Sarkar, 2000; Mitton, 2002; Afza and Slahudin, 2009; Alipour and Amjadi, 2011). While control variables size positively and leverage negatively affects firm's financial performance and this effect is highly significant. While in case of Tobin's Q both control variables negatively influence firm's market performance and this effect is highly significant. Adjusted R2 is 25% which means 25% variation in ROA is explained by concentration while in the case of Tobin's Q it is 9%. The values of D/W provide indication of no autocorrelation among error terms of different years. Which is a good sign as presence of autocorrelation causes the regressors to become inefficient. F-value tells about the fitness of model and here F-values are highly significant at 1%. This shows that OLS model best explains the relation between the variables.

5. Conclusion. The present study hignlights the relationship between ownership structure and corporate performance. Ownership structure is the most prominent corporate governance mechanism and the bottom line is that sound ownership structure is crucial for successful functioning of corporations. Emerging economies like Pakistan are in ominous need of such research studies which shed light on the true conditions prevailing in corporate sector regarding ownership structure and what role it plays in influencing firm performance. Since developed countries already have considerable amount of researches on ownership-performance relation and the work is still ongoing. Many studies around the world found to be consistent with our results but at the same time much more studies contradict our results. Concentration by the largest 5 shareholders significantly and positively increases firm performance. Both accounting and market measure (ROA, Tobin's Q) endow with similar results. When majority shareholding is acquired by only 5 shareholders, they become the controlling shareholders. In disperse ownership structure with majority of small shareholders free-ride by managers adversely affects performance (Berle and Means, 1932). Further the levels of concentration among top 5 shareholders are investigated to know the limit above which concentration is injurious for firm. 3 limits are applied and the middle level is proved to be the best for firm profitability and market performance. Highly significant results tell us that in Pakistan ownership between 40-80% is a key to success. At lower limit (40%) its role is not very significant but it doesn't drop down firm performance. At extreme height level (> 80%) it decreases financial performance but still market consider it as good. The findings of this research will be beneficial particularly for economies not only developed but also developing, researchers, policy makers, entrepreneurs and in general wider community. This paper is limited to the concentration by top 5 shareholders; future researchers can investigate concentration by top-10, top-15 even top-20 shareholders. Another very important suggestion is that, the identity of owners with major block of shares can also be investigated. In addition to this, future research can include financial sector firms in the sample and can cover an even more long duration (time period) to generalize the results more.

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