The Impact of Ownership Structure on Firm Performance: Evidence from Pakistan

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ABSTRACT

The connection between ownership structure and firm performance has attracted much attention, especially in emerging markets, yet yielded many inconsistent empirical results. This paper presents an analysis of the association between eight categories of ownership, HHI Index, GINI index and firm performance in Pakistan. Some researchers argue that ownership concentration can improve firm performance by making the owners more willing or able to monitor agents. In contrast, others argue that in the presence of efficient markets, market monitoring will discipline the managers. The author’s results show that there is significant positive association with ownership structure and market based performance measure and economic profit. The ownership proportion of the institutional shareholding and foreign shareholding are also positively associated with firm performance.

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KEYWORDS:
Corporate Governance, Firm Performance, Ownership Structure

1. INTRODUCTION

The relationship between ownership structure and corporation performance is one that has received considerable attention in finance literature (Jiang, 2004). For a few decades, considerable energy has been devoted to trying to explain differing corporate ownership structures in different countries and its effect on financial performance. La Porta et al. (1999) and Durnev and Kim (2006) find that the quality of legal protection of shareholders help to determine ownership concentration, in countries with relatively poor legal protection of investors; publicly listed companies are likely to have large blockholders. Roe (2000) puts a counter argument to explain ownership differences in terms of politics. In particular, those publicly listed companies in emerging democracies are more likely to have concentrated ownership than their counterparts in the developed countries.

The effective control of the large shareholding enables them to influence the key decision making regarding how companies are run and also decisions on corporate policies. However, as stated by Holderness (2003), the role of large shareholders is not well developed in the ownership literature, especially the role of the largest shareholder. The largest shareholder is a unique group of shareholder, as their holding can be associated with benefits and costs, especially the under investment costs (Claessens et al., 2002; Truong and Heaney, 2007).

Conversely, studies on the relationship among ownership blockholding (top 1, 2, 3, 5, and 10), institutional ownership, associated company ownership and foreign ownership and firm performance
are largely conducted in developed countries and a few emerging economies. However, the relationship may be different in different countries (Konijn, Kräussl and Lucas, 2011). This means that these relationships in emerging markets may not only differ with those in developed markets, but also among emerging markets. Besides, corporate ownership in emerging market becomes an interesting issue in recent years (Borisova et al., 2012).

Ownership structure has two implications; i.e. the structure of ownership (share per cents of state, legal or institutional, domestic individual holders) and ownership concentration (share per cents of top one, two three, five or ten shareholders). The typical achievers among ownership structure and firm performance researches are the results of Jensen and Meckling (1976), who divided shareholders into internal (investors with management right) and external shareholders (investors without ballot right). The conclusion of their research was that the value of a firm depends on the internal shareholder’s share, which is called ownership structure.

Theoretically, the more the internal shareholder’s share the higher the firm value. The researchers also defined firm value as a function of ownership structure. Because the ownership structure has links to corporate governance, it can have both positive and negative effects on corporate governance (Jiang, 2004).

Since the 90s, careful observation of ownership structures across the world showed that dispersed shareholdings are much less frequent than expected and we observe instead a high degree of ownership concentration (La Porta et al., 1999; Becht and Roell, 1999). Consequently, the potential expropriation of the minority investors by the controlling owners became the main concern (Johnson et al., 2000; Lehman and Weigand, 2000; Faccio et al., 2001). It was recognized that large shareholders may be costly because they have other objectives than small shareholders and may expropriate the latter.

Douma, George and Kabir (2006) state that ownership structure affects firm performance because there are different owners with different objectives. Klein, Shapiro and Young (2005) documented that due to difference in ownership concentration across countries the relationships in governance-performance also vary. Pakistan, where a large share holdings are common (La Porta et al., 1999; Cheema et al. 2003), it seems more interesting to explore the link between the concentration of ownership and its identity with performance.

2. LITERATURE REVIEW

A number of studies have dealt with and discussed the relationship between concentrated ownership and firm performance, the impact of ownership structure on the performance and the relationship between stockholders and executives.

2.1. Ownership Literature

Leech and Leahy (1991) argue that ownership structure fundamentally constrains managerial diversion from shareholder interests by determining the distribution of voting power and the control among shareholders. Moreover, Thomsen and Pedersen (2000) argue that ownership concentration measures the power of shareholders (Principals) to influence the managers (Agents). These indicate that it has a positive relationship with firm value. However, Denis and McConnell (2003) stated that concentrated ownership has a positive relationship with firm value most often. The contrasting view is that the increase in ownership concentration has the danger of entrenched block shareholders that may lead to decrease in firm value.

However, Thomsen and Pedersen (2000) find a non-linear relationship between ownership concentration and firm performance in a sample of largest European firms, ownership concentration
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