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A Literature Review of the Impact of Equity Concentration on Corporate Financial Performance

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Abstract: Equity structure is an important issue in modern corporate governance, and a reasonable equity structure can improve the efficiency of resource allocation, reduce enterprise operation risks, and balance the interest relationship between different economic entities. Equity concentration is an important indicator to measure the equity structure, which has an important impact on the financial performance of enterprises. Therefore, this paper sorts out the relevant literature on the impact of equity concentration on the financial performance of enterprises, and summarizes and looks forward, in order to provide certain references and references for enterprises to optimize their equity structure, enhance their competitive advantages, and improve their financial performance.

1. Related Concepts

1.1. Equity Concentration

The proportion of equity shares held by shareholders is different, making enterprises show a state of concentrated or decentralized equity. If the equity concentration is relatively high, it means that the equity of the enterprise is concentrated in the hands of a small number of large shareholders; If the equity concentration is low, it means that the equity is relatively balanced. At present, domestic and foreign scholars have different indicators for measuring equity concentration. Some scholars use the CR index to measure the concentration of equity in enterprises, such as CR_1 and CR_{10}, respectively, indicating the shareholding ratio of the largest shareholder, and the total shareholding ratio of the top ten shareholders. Some scholars express the level of equity concentration by the sum of squares of the proportion of equity held by the previous major shareholders. This indicator is treated quadratically, which widens the gap between the levels of shareholders' shareholding and better reflects the difference in the actual degree of control of shareholders over the operation of the enterprise.

1.2. Financial Performance

Financial performance is a comprehensive financial evaluation of an enterprise's operating results in a certain period of time from an intuitive internal and external perspective. It can be used to measure the implementation of an enterprise's performance objectives. The financial performance can be reflected by the profitability, operational ability, solvency and development ability of an enterprise in a certain period. It can comprehensively assess whether the enterprise has the ability of high-quality resource utilization, value acquisition, market development, capital raising ability, and whether it has sustainable development potential.

2. Related Theory

2.1. Principal-agent Theory

In the 1930s, Berle and Means put forward the Principal-agent theory. With the development of industrialization of human society, the scale of enterprises is becoming larger and larger, and the owners cannot manage all kinds of business of enterprises by themselves. At the same time, there are a large number of knowledgeable and competent professionals in the market. Entrusted by the owners of the enterprise, they collect a certain remuneration to manage the enterprise and pursue the maximization of the enterprise value. Therefore, the separation of ownership and management has become an important feature of modern companies. On the one hand, due to the difference in the goals of the business owners and the agents, the behavior done by the agents out of self-interest considerations may harm the owners' interests. On the other hand, the rights enjoyed by major shareholders and minority shareholders are different, and the interests of minority shareholders are easily infringed. When the equity is highly concentrated, the interests of the controlling shareholder and the enterprise tend to be the same, and its supervision over the management is strong, but this situation is easy to cause the phenomenon of large shareholders infringing on the interests of minority shareholders.

2.2. Stakeholder Theory

Stakeholders theory holds that enterprises should consider the balance between stakeholders, not just focus on the accumulation of shareholders wealth. Some shareholders have made long-term large investments in the enterprise, their shareholding ratio is higher, they pay more attention to the long-term development of the enterprise, and the supervision role of the enterprise management is stronger. However, some shareholders hold corporate stocks for a short period of time, the investment amount is small, and they have a "free rider" mentality for the company's future development, and lack corresponding supervision and management of the enterprise.

3. Impact of Equity Concentration on Corporate Financial Performance

3.1. Positive Correlation

He et al. believe that the improvement of the legal system restricts the encroachment of large shareholders on the interests of minority shareholders, and the cost of "hollowing out" by large shareholders is relatively high [1]. The highly concentrated shareholding structure enhances the motivation of major shareholders to participate in and supervise the operation and management of the enterprise, which can effectively improve the company's performance. The market competition in eastern China is fierce, and the protection of investors is relatively perfect, which has become an alternative mechanism for major shareholders to supervise management. Therefore, the positive effect of equity concentration on enterprise performance will be more significant in the western region of China [1]. Wang et al. research believes that in the case of highly concentrated equity, shareholders are often willing to supervise the performance of managers' work and responsibilities in order to protect their own interests [2], so that they can improve corporate performance with more scientific and reasonable business methods and investment decisions. Further research shows that R&D investment plays a part-mediating role in the impact of equity concentration on the financial performance of enterprises [2]. Vu conducted a study of 557 companies listed in Vietnam, explored the role of the board of directors in the financial performance of enterprises, and found that the increase in the concentration of equity in the board of directors is conducive to the role of board members in the strategic decision making of the company, and has a significant positive impact on the improvement of corporate financial performance [3]. Kao et al. conducted a study on different types of equity holders of Taiwanese listed enterprises and found that the increase in equity concentration can promote the growth of corporate financial performance. [4] A study by Puni and Anlesinya on Ghana-listed firms confirmed that increased equity concentration can reduce corporate agency costs, while diversification is detrimental to financial performance [5]. Geng and Guo found that the impact of equity concentration on enterprise performance is positive in promoting business performance, and that smaller asset scale and lower asset-liability ratio are conducive to strengthening the positive relationship between the two [6]. Cheng and Hu research on the media industry also confirmed the positive correlation between the shareholding ratio of the largest shareholder and the profitability of the company [7].

3.2. Negative Correlation

Chen found that, on the one hand, concentrated equity enhanced the holding capacity of large shareholders, and its “hollow” motivation increased, which adversely affected the interests of small and medium shareholders and depositors. On the other hand, enterprises with low equity concentration face greater risk of being acquired. In order to avoid such incidents, corporate management often strives to improve the company's operating performance. Therefore, the increase in equity concentration has a significant negative impact on the business performance of enterprises. At the same time, the cross-regional operation strategy can reduce the related loans of major shareholders, thereby effectively curbing the damage of equity concentration to business performance [8]. The research of Li et al. draws a similar conclusion. Further research found that the improvement of the institutional environment can reduce the agency cost and weaken the negative correlation relationship between the two [9]. Research by Tan et al. showed that higher equity concentration hinders the improvement of bank performance [10]. Peng believed that there is a second kind of agency problem between large shareholders and small and medium shareholders. The excessive concentration of equity of major shareholders and the lack of effective supervision and balances affect the normal production and operation of enterprises [11]. Xu believed that the large shareholders in the state-owned enterprises had weak supervision ability to the managers, while the situation of “one large shareholder onyl” was difficult to effectively restrain the behaviors of the controlling shareholders, resulting in the decline of the performance of the state-owned enterprises, and the inefficient investment played a part of the intermediary role [12].

3.3. Nonlinear Correlation

Long and Wang believed that the equity concentration presents an inverted "U" correlation relationship with the enterprise performance. Moderate equity concentration strengthens the supervision of the controlling shareholders on the management. However, the excessive equity concentration makes the degree of check and balance of the enterprise to the low side, and the situation of “One person says counts” is not conducive to improving the financial performance of the enterprise. R&D investment of the enterprise plays an intermediary role in the impact of equity concentration on corporate financial performance [13]. Liang found that the equity concentration has supervision effect and infringement effect on the enterprise. The moderate increase of the shareholding ratio of the largest shareholder is beneficial to the increase of the financial performance of the enterprise. However, when the excessive concentration of the equity exceeds the critical point, the financial performance shows a downward trend. The increase of the shareholding ratio of other major shareholders will have a check and balance effect on the largest shareholder, thus reducing the “infringement effect” and promoting the recovery of financial performance [14]. Xiong and Huang believed that there is a U-shaped correlation relationship between equity concentration and company performance. When the shareholding ratio of the first largest shareholder is low, a "tunnel effect" occupies the dominant position, while the continuous increase of shareholding ratio makes it reduce the hollowing and infringement on the enterprise, and the enterprise performance shows an upward trend [15]. Research by Gu showed that there is an inverted U-shaped correlation relationship between the two. Although the increase of equity concentration is not conducive to the check and supervision between shareholders, moderate equity concentration can improve the decision-making efficiency of the enterprise, and thus improve the enterprise performance [16].

3.4. No Correlation

Ren and Zhang conducted research on 13 listed publishing companies, and found that there was no significant correlation between equity concentration and enterprise performance [17]. Guo and Chen found that when the largest shareholder has absolute control right over the enterprise, the equity governance mechanism is invalid, and there is no significant correlation relationship between the two. In order to improve the enterprise performance through equity governance, the “absolute control right” of the largest shareholder must be broken [18]. Xu found that in the competitive market, the performance of listed companies has nothing to do with the equity concentration. Only the enterprise occupying a dominant position in the competition market has good performance [19]. Liang and Huang found that the equity concentration of protective industries is stronger than that of non-protective industries. However, the impact of equity concentration in protective industries on enterprise performance is not significant [20].

4. Conclusion

Equity structure is the foundation of corporate governance. As one of the measurement indicators of corporate governance, equity concentration reflects the effectiveness of corporate governance. From the above literature, it can be concluded that most of the scholars' research believes that there is a correlation between equity concentration and enterprise performance. However, due to the differences in research objects, research perspectives, measurement indicators, macro environment, etc., the studies have not reached a consistent conclusion on the correlation between the two. Some studies have confirmed that some variables have intermediate and moderating effects between equity concentration and enterprise performance, and the mechanism of action between the two needs to be further explored. Therefore, in future research, scholars should introduce more mediating variables and moderating variables to explore the role mechanism of each variable in the relationship between equity concentration and corporate financial performance.

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