Corporate Ownership Structure and Firm Performance: A Brief Review

Yiwen Fang[1, a, *]

[1]*School of Economics, Finance and Marketing, RMIT University, Melbourne, VIC 3000, Australia;*
*a. *yvonnefang98@hotmail.com*

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Abstract: The correlation between ownership structure and corporate performance has been studied extensively in the corporate finance literature. The relevant literature suggests that ownership structure is one of the main corporate governance mechanisms affecting the manager behavior and behavioral tendency of shareholders, which in turn affects the firm value. This paper gives a brief review on the relationship between firm performance and different dimensions of ownership structure (with special attention to ownership concentration and insiders ownership). The results of existing literature regarding the value-ownership relationship have not been conclusive, thus the probable reasons of the discrepancy are discussed. And several avenues for future research are also provided in the end of this paper.

1. Introduction

The relationship between ownership structure and corporate performance has been a trending topic since Berle and Means proposed the proposition of 'the separation of the control and ownership' in *The modern corporation and private property* [1]. Since then, many scholars have conducted extensive researches on the role of ownership structure in corporate governance. In fact, the ownership structure is generating considerable attention also due to its nonnegligible effect on corporate performance. The ownership structure in the real world is related to the company's residual control rights and residual claims that affect the manager behavior and behavioral tendency of shareholders, which in turn affect the firm value. Therefore, to clarify the relationship between ownership structure and company performance is of great significance to promote the optimization of corporate governance structure and improve the firm value.

Prior literature on the value-ownership can be basically separated into two stands. The first stand group of scholars tend to analyze the exogenous nature of the ownership variable. In this respect, most studies focus on the correlations between firm performance and two aspects of ownership structure, ownership concentration and insiders ownership. In contrast, the other stand is led by Demsetz (1983) who suggests an endogeneity of ownership, believing that there is no systematic correlation between ownership structure and corporate performance [2].

Based on existing theoretical and empirical results, next two sections of this paper largely focus on a literature review on different dimensions of ownership structure, with special attention to the

role of ownership concentration and of insiders ownership in firm performance. Then section 4 discusses the endogeneity of ownership structure from both static and dynamic perspectives. And the final section concludes this paper by identifying the future research agenda on issues of value-ownership relationship.

2. The relationship between ownership concentration and firm performance

Based on the theory of 'the separation of ownership and management', Grossman and Hart (1980) argued that in a company with a diffuse ownership structure, each shareholder is too small and has less incentive to devote resources to ensuring that directors of the corporation are acting in the shareholders' interest, instead, shareholders with a large block of shares are more likely to monitor management because they partially internalize the benefits of the monitoring effort [3]. Shleifer and Vishny (1986) also pointed out a certain degree of ownership concentration is necessary to improve the firm performance because large shareholders in this case have restrictions on mangers to avoid them from sacrificing the interests of shareholders and seeking their own interests [4].

A vast group of empirical studies are in favor of this positive correlation prediction. Claessens et al. (1999) evaluated a sample of 706 cross-section Czech firms between 1992 and 1997, arguing that the more concentrated ownership, the higher firm profitability [5]. Similarly, Mandaci and Gumus (2011) measured the value of non-financial firms listed on the Istanbul stock exchange by ROA and Tobin's Q and found a positive effect of ownership concentration on firm value [6].

In contrast to other studies, Svejnar and Kocenda (2002) examined the effect of ownership concentration on post-privatization performance in Czech, found that firms with dispersed ownership structure have better financial performance than more concentrated firms [7].

In short, a positive correlation between ownership concentration and firm performance is empirically supported by many researches. It can be expected that the existence of shareholders of large blocks of shares is conducive to reducing the cost of separation of ownership and control, as large shareholders have the power and incentive to participate in corporate management and thus reduce the 'free-rider' phenomenon whereby enhance the corporate performance. On the other hand, with a higher degree of ownership concentration, the controlling shareholders are more capable of seeking private benefit of control and also have the power to expropriate the minority shareholders [8]. Moreover, the controlling shareholders are more likely to transfer assets and profits out of firms for their own interests, which is referred to as 'tunneling effect' [9].

3 The relationship between insider ownership and firm performance

The seminal work of Jensen and Meckling (1976) highlighted that firm value depends on the proportion of shareholdings held by internal shareholders [10]. Considering the existence of agency costs, they argued that by increasing the shareholdings held by insiders, the agency costs can be reduced, and it aligns the interests of the managers and the shareholders, thus improving the company performance. Therefore, an increase in insider ownership may increase the firm value due to the 'convergence-of-interest' effect.

McConnell and Servaes (1990) [11] and Morck, Shleifer & Vishny (1988) [12] were in favor of 'managerial entrenchment effect', believing that managerial ownership can be inversely related to the corporate performance because manager with a large block of shares becomes more entrenched, therefore has tendency to pursue personal interests at the expense of small shareholders, which in turn may offset the 'convergence-of-interest' effect.

Stulz (1988) developed a theoretical model that shows a concave relationship between managerial ownership and firm value [13]. He assumed that the only reason for the conflict of interest between managers and shareholders is that a successful takeover may be beneficial to shareholders, but it will

hurt managers. An increase in managerial ownership will increase the premium offered and decrease the probability of a successful tender offer, on the other hand, as management holdings gradually increase, managers facing less takeover threat may be relatively slack and adversely affect the company's performance. In his view, a certain extent of the managerial ownership are advantages while managerial ownership may be negatively correlated with firm performance beyond some level.

There are many empirical studies in this perspective worth discussing. Mehran (1995) conducted a study on sample of 153 randomly-selected firms in manufacturing industry during 1979-1980 and suggests that insider's ownership is positively related to the firm value [14]. Managers with high percentage of shareholding have incentive to work harder for the corporate in order to increase the value of stake held by themselves. Kaserer and Moldenhauer (2008) investigated the effect of insider ownership on corporate in 638 Germany firms between 1998 and 2003 using ROA, stock price performance measurement [15]. The study found that a more concentrated insider ownership has a positive effect on firm value and ownership structure, which is crucial in explaining the long-term value creation. Similarly, another study was conducted on a sample of 988 newly privatized firms in Czech by Makhija and Spiro also found a positive relationship between those two [16].

Taking convergence-of-interest effect and managerial entrenchment effect into consideration simultaneously, recent studies support a nonlinear relationship between insider ownership and firm performance. Morck, Shleife and Vishny(1988) investigated the relationship between managerial ownership and firm value on a sample of 371 cross-sectional fortune 500 firms in 1980, as measured by Tobin's Q [17]. Their study found that Tobin's Q increases as the managerial ownership rises within the 0-5% and beyond 25% level, Tobin's Q faces downward sloping when managerial ownership is between 5%-25%. McConnell and Servaes (1990) also advanced this prediction by using a sample of over 1000 firms that listed on either NYSE or AMEX in 1976 and 1986 and found a 'hump-shape' relation between Tobin's Q and fraction of share held by insiders [18].

The previous studies indicate that an agreement on the correlation of insider ownership on corporate performance is yet to come. However, most empirical evident suggest that insider ownership is a non-monotonic function of corporate performance, which is due to a combination of two competing effects. It can be predicted that the alignment effect will generally dominant entrenchment effect at low level of managerial ownership, as managerial ownership rises over a certain level, the entrenchment effect will take the lead.

4 Endogeneity concerns

4.1. Static perspective

Starting with Demsetz(1983), who contended that the ownership structure is the outcomes of a value-maximizing process, which can be further explained as the ownership structure is the equilibrium result of the rational decisions made by its shareholders [2]. Many studies confirmed that there is no significant relationship between ownership structure and firm value. Demsetz and Vilalonga(2001) confirmed this prediction by treating ownership structure as an endogenous variable [19]. Similarly, another study was conducted by Holdemess and Sheehan (1988) on a sample of 114 NYSE- or AMEX-listed firms, as measured by Tobin's Q and accounting return [20]. Their study claims that there is no significant difference in firm value between majority-owned firms and diffusely held firms. Cho (1998) examined a cross-section of fortune 500 manufacturing firms from 1993 to 1995 and found a significant non-monotonic relationship between corporate value and insider ownership [21]. However, estimating a simultaneous equation regression instead OLS, Cho found that corporate value can affect ownership structure, but not reverse. which is consistent with endogeneity of ownership hypothesis. Other studies also confirmed that ownership structure is endogenously determined, such as studies [22-24].

4.2 Dynamic perspective

With the endogenous problem has been widely discussed, some scholars came to realize the existence of lag effect. Hu and Izumida (2008) examined a panel of manufacturing firms listed on Tokyo stock exchange from 1980 to 2005 and found that ownership concentration has effect on contemporary and subsequent firm performance [25]. However, they failed to find that performance has a feedback effect on subsequent concentration. On the other hand, Cheung and Wei (2006) argued there is no significant relationship between insider ownership and corporate performance once adjustment cost is allowed, they also found that insider ownership and corporate performance can be explained by their respective lagged values [26].

5. Further discussion and future research agenda

According to the previous discussion, scholars over the world have done a lot of researches on the relationship between ownership structure and firm performance. Although the empirical approach and perspectives of researches are roughly the same, the results of value-ownership relationship are mixed. The following reasons may bring on these discrepancies: (1) The ownership structure of different types of companies in different countries is not always the same. Countries with different political regulations and economic environments may affect the firm value, which in turn cause a different empirical result. (2) The difference in the selection of measures of firm performance is one of the factors that may lead to the diversity of research conclusions. Many scholars tend to use the accounting profit rate, while others would rather use Tobin's Q ratio.

As can be seen from above, the following aspects should be considered in the future study of the relationship between ownership structure and firm performance: (1) The selection of variable measurement indicators should be considered comprehensively and appropriately, future studies should consider establishing an indicator system for comprehensively examining the corporate's performance, rather than drawing conclusions from a specific indicator. (2) Prior empirical studies on ownership-value relationship mainly focus on static perspective, lacking dynamic analysis on the effect of changes of ownership structure on subsequent firm performance and also the feedback effect of firm performance on subsequent ownership structure improvement. (3) The influence of industry characteristics on ownership structure and corporate performance is seldom considered. The relationship between ownership structure and firm performance in different industries may be different. In this case, it's necessary to involve dummy variables in an empirical model representing industry factors if the empirical study is conducted on a sample that across multiple industries.

As the economy is constantly developing, the ownership structure of a company is also constantly changing. Any theoretical or empirical research conclusion cannot adapt to a long-term development of modern companies. This also tells us that research to disentangle the relationship between ownership structure and corporate performance will never stop. And any research contribute to this area will give us a better approach in improving firm performance and optimizing ownership structure.

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