IMPACT OF CONCENTRATED OWNERSHIP ON FIRM PERFORMANCE (EVIDENCE FROM KARACHI STOCK EXCHANGE)

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Abstract

Does concentration ownership have any effect on firm performance? To answer this question or examine the in depth relationship between ownership structure and performance we used panel data of 100 non financial firms listed in Karachi stock exchange with a sample size of 600, from 2005 to 2010, and analyzed that ownership concentration doesn’t have any significant effect on firm performance. Concentrated ownership is negatively correlated with market performance and positively correlated with both the indicators of financial performance (return on assets & sale growth).

Keywords: Concentrated Ownership, Karachi Stock exchange, Financial Performance, Market Performance.
1. Introduction

In Pakistan the Capital markets are expand after the measures are taken by SECP (Security Exchange Commission of Pakistan) that increases the public confidence. Decisions about investment are more easily accessible due to the flow of information. Now a day corporations are more reliable on intangible assets such as intellectual property and skilled worker who are often awarded ownership.

Companies listed in Karachi Stock Exchange have uneven performance while working in the same market leads us to analyze relationship between ownership and performance i.e. market and financial performance of the firm. This research study measures the relationship between ownership structure i.e. Concentrated ownership (CO) with Share price growth (SPG) which shows market performance and with financial performance which contains Return on Asset (ROA) and Sales Growth (SG). It revealed that the fraction of state ownership, legal person ownership and the individual person ownership is irrelevant to the firm performance as all has the same effects.

This research study investigated the relationship of ownership structure, financial performance and market performance on companies listed in KSE (Karachi Stocks Exchange). The relationships between ownership structures, and firm performance had conflicts from the early days of corporate business but the objective of every relation was same; which is good performance of the business. This research study try “To find out the relationship, between Ownership structure, Financial and Market performance of firms in the Pakistani context”

2. Literature Review

Does the concentration of ownership affects the financial and market performance of companies? The literature has tried to answer this question. (Berle and Means, 1932) was the first who provided evidence about the relation of performance with ownership, farther more they examined a negative relation between ownership and firm performance.

In (Demsetz and Villalonga, 2001a) suggests that only large companies protect interest of well dispersed shareholder. So specific costs and benefits of concentrated ownership have begun to investigate. Most researchers focused on specific corporate decisions such as ownership structure and value creation.

(Akimova and Schwodiauer, 2004) found that share price level is positive association with value of the firm. Fernando, (Fernando et al., 2010) empirically proved that there is a positive correlation between ownership and share price of the firm.

(Akimova and Schwodiauer, 2004) examined the relationship between ownership structure on corporate governance and performance of firm. They measured ownership structure by the percentage of shares held by different share holders and measured performance by the unit sold by employee. They used Regression analysis to find out the positive relation between outside owner and performance, but they do not found significant effect of outside owner on performance.

(Kapopoulos and Lazaretou, 2007) tried to find out the relation between ownership structure and firm performance. They investigate it by hypothesis testing using sample of 175 Greek firms. They empirically found the impact of ownership structure on performance of the firm measured by profitability. They suggested that when a firm has high concentrated ownership, the profitability of that firm is also high.

(Uadiale, 2010) used a different technique to find out the relationship between ownership structure and firm performance. Using meta-analysis technique, they found no significant relationship between ownership structure and firm performance. They suggest that when a performance indicator use to control the endogeneity, that variable also moderate the effect of ownership on firm performance.

(Jelinek and Stuerke, 2009) examined that there is positive relation between managerial ownership and positively associated with return on asset but negatively associated with the expense ratio. The impact of ownership structure and corporate governance on capital structure there result revealed that the size of board and managerial shareholding is significantly negatively correlated with leverage (debt to equity ratio).
(Daraghma and Alsinawi, 2010) examined the effect of capital structure, board of directors and management ownership on the financial performance. They found that management ownership has a positive effect on the financial performance. (Uadiale, 2010) also try to explore the impact of corporate financial performance on board structure. He found that there is a strong positive association between board size and corporate financial performance; he further empirically proves that there is a positive relationship between financial performance and sitting outsider board directors.

3. Methodology

This research study is based on the data, published by listed companies of KSE in their financial reports as well as the data published by State Bank of Pakistan as “Balance Sheet Analysis” of Joint Stock Companies Listed on the Karachi Stock Exchange published by SBP (State Bank of Pakistan) on www.sbp.org.pk. For this research study 100 firms whose published data was available from almost each sector. Initially the work is started on 150 firms, the firms with incomplete data and the firms with consecutive three year losses was screened out and was left with 100 firms with six year data. In this research study 600 sample size is used for panel data analysis.

3.1. Sales Growth (SG) (Dependent Variable)

For the measurement of sales growth the difference of two years sales as a percentage of previous year's sales is taken, as given by the Balance sheet analysis published by state bank of Pakistan

(Attiya and Iqbal, 2006) measured Sale growth as an average of last three years sale (Gompers et al., 2003) and (Chiang et al., 2011) used sales growth variable as the indicator of performance.

(Brown et al., 2004) consider Sales Growth as Performance measures variable and argued that sales growth is negatively but significantly associated with ownership (Bebchuk et al., 2004).

3.2. Return on Asset (ROA) (Dependent Variable)

Return on assets is an indicator of how profitability of a firm is related to its total assets. ROA provides a platform to check that how efficient management use the assets of a firm to generate earnings. (Fazlzadeh et al., 2011) measured ROA by two different ways: net income after interest and tax divided by total assets ratio and income before interest and tax divided by total assets ratio. In this research study ROA is calculated by dividing, company annual earnings before tax to its total assets.

3.3. Share Price Growth (Dependent Variable)

Share price growth is measured by difference of two years average share prices as a percentage of previous year average prices. (Joskow and Nancy L. Rose, 1994) and (Buck et al., 2008) also used change in share price (Share Price Growth) as a measure of market performance. (Jelinek and Stuerke, 2009) argued that share price is a good indicator of firm performance; they further argued that investor may earn capital gain due to an increase in share price.

3.4. Leverage (D/E) (Control Variables)

Leverage is measured as percentage of debt to equity (Shah and Hijazi, 2004) and (Frank and Goyal, 2003) calculated leverage as a percentage of debt to debt plus market value of equity.
(Myers and Majluf, 1984) predict a negative Relationship between leverage and performance. According to Pecking order theory relationship between leverage past profitability should be a negative one.

3.5. Company Size (TS) (Control Variable)

It is measured by taking the total assets of a firm at the closing date. To make values as comparable natural log is taken (Fazlzadeh et al., 2011).

(Josef et al., 1994) argued that there is positive relation between efficiency and size of the firm. While some researchers suggested that performance that is measured by return on asset is positively associated with firm size, this relation is also confirmed by (Leech et al., 1991).

3.6. Liquidity (LIQ) (Control Variable)

Liquidity refers to company's ability to pay off its short-terms debts. In this research study liquidity is measured as a percentage of current assets to current liability (John, 1993).

(Su and Vo, 2010) found that there is insignificant relation between liquidity and performance (ROE). (Kim et al., 1998) found a positive relationship between liquidity and return on equity; they also found that free cash flow is positively correlated with liquidity, however (Baskin, 1988) found that liquidity is negatively associated with return on asset.

3.7. Concentrated Ownership (CO) (Independent variable)

The concentrated ownership refers to the portion of shares held by top share holders. In different studies different concentrations are used. A 5, A10 and A20 are mostly used .In this research Study we use top 10 shareholder for the concentrated ownership (A10). In 1998 Porta et al. argued that the top 10 shareholders used to determines concentrated ownership (Porta et al., 1998a). On the other hand some researchers argue that top 20 shareholders might reflect better concentrated ownership (Demsetz and Lehn, 1985). When the shareholder holds 50% or more shares it not only become the dominated share holder but also has a legal right to control it (Faccio et al., 2002).

Main Hypothesis: Concentration ownership is irrelevant as far as the performance of firm is concerned.

Sub Hypothesis: 1) Concentration ownership is irrelevant as far as the Market performance of firm is concerned

2) Concentration ownership is irrelevant as far as the financial performance of firm is concerned

(Demsetz and Villalonga, 2001b) argued that there is no association between ownership and performance. (McMahon, 2007) also argued that there is no significant relation between ownership and business growth.

(Daraghma and Alsinawi, 2010) examined ownership has positive effect on the financial performance. It was also concluded that the debt financing has no influence on the profitability of Palestinian corporations. (Uadiale, 2010) also examined a strong positive association between board size, concentrated ownership and corporate financial performance. Also it was concluded that a positive association between outside directors corporate financial performance.
3.8. Specification of the Model

In this research study panel data regression analysis is use. This panel data regression analysis helps in analyzing cross-sectional and time series data. In this research study, pooled regression is used (Shah and Hijazi, 2004).

4. Results

4.1. Correlation

To check multi-co-linearity among independent variables, I have used Pearson’s co-efficient of correlation. (Shah and Hijazi, 2004) and (Tariq and Hijazi, 2006). All of them used correlation matrix to check multi-co-linearity.

Insert Table 1

With the help of Table-1, multi-co-linearity among independent variables is not found. The table found no sever problem of multi-co-linearity among variables.

4.2. Regression Analysis

Insert Table 2

Share Price growth = -0.246 - 0.0334 Concentrated Ownership + 0.0451 Company Size + 0.136 Liquidity - 0.00129 Leverage
Sale Growth = -0.165 + 0.0268 Concentrated Ownership + 0.0095 Company Size + 0.138 Liquidity - 0.00168 Leverage
Return on Asset = -0.218 + 0.0581 Concentrated Ownership + 0.0188 Company Size + 0.130 Liquidity - 0.000162 Leverage

R Square show goodness of fit of the models, it also show the dependency which is covered by independent variable. R Square covers 60.2% variation in model 3, 59% variation is covered by model 1 and 50.6% variation is covered by model 2 which is slightly lower than model 1 and 3.

Concentrated ownership is negatively associated with market performance and positively associated with financial performance. Company size and liquidity is positively associated with performance where as leverage is negatively associated with performance. The positive and negative signs with value of coefficient show their positive and negative relation.

P-value explains significance of the relation. Concentrated Ownership and leverage show insignificant results at 1% and 5% level. Liquidity show significant results in all models at 1% and 5%, but Leverage show mix result, significant in model 1 at 1% as well as 5% but insignificant in model 2 and 3 at both 1% and 5% level.

Insert Table 3

Insert Table 4

Concentrated Ownership is positively correlated with both the indicator of financial performance but negatively correlated with market performance. The impact is insignificant with both indicators of performance market and
financial performance. This insignificant result of this study supports the hypothesis of this research study. *Concentration ownership is irrelevant as far as the performance of firm is concerned. Sub Hypothesis: 1) Concentration ownership is irrelevant as far as the Market performance of firm is concerned. 2) Concentration ownership is irrelevant as far as the financial performance of firm is concerned.* Therefore we accepted all the hypothesis of this study. Result of this research study supports the studies of (Fama and French, 1998) and (Xu and Wang, 1997) explored the insignificant relationship between ownership structure and performance of the firm.

5. **Conclusion and Recommendation**

5.1. Conclusion

The possible relation between ownership structure and performance is the main point of this research study. Previous evidence show mix relationship between ownership structure and performance. Some studies investigated that ownership structure affects the performance; while some studies investigate that the ownership is irrelevant to the performance.

The empirical evidence provided by this study answer the question .Does the concentration ownership and ownership mix has any effect on firm performance? To answer this question, 100 non financial listed firms with 6 year data from 2004 to 2010 was analyzed and concluded that ownership concentration and ownership mix doesn’t have any significant effect on firm performance.

The empirical evidence shows that concentration ownership does not play an important role in the performance of the firm. Concentrated ownership is negatively correlated with market performance and positively correlated with the both indicators of financial performance. Both the indicators of firm performance show insignificant result so concentrated ownership are irrelevant of firm performance.

5.2. Recommendations

The findings of the study are very important because as there is no evidence of a strong positive or strong negative relationship between firm performance and ownership structure and provide the evidence against the myth that actually owners of the firms exercise their rights in pushing the management to perform better.

5.3. Dimensions for future research

This research study covers 60 % variation, so it is suggested that to cover more variation new variables may used in future that are not used in this research study like net profit margin and earnings per share.
References


Table 1
Correlation among Independent Variables

<table>
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<tr>
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<th>Liquidity</th>
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Table 2
Regression Model

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Table 3
Expected Results

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<td>Return on Asset</td>
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## Table 4

### Actual Results

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