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Impact of Ownership Concentration on the operating Performance of Pakistani Firms

Abstract

This study investigates the Impact of Ownership Concentration on the operating performance of Pakistani firms. Sample of 50 non-financial firms is selected from KSE-100 index of Karachi Stock Exchange of Pakistan. Descriptive analysis shows that there is an immense level of ownership concentration in Pakistani firms. Regression analysis suggested that there is a significant positive correlation among ownership concentration and firm's operating performance.

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Introduction

In this research, we scrutinize the affect of ownership structure on company performance. The relationship between ownership structure and performance has always been the area under discussion in the literature of corporate finance. The discussion on this area was started with the thesis of Berle and Means (1932). They argued that defuse ownership is inversely correlated with performance of a company. Most of the earlier studies found a positive relation among ownership concentration and firm's performance (Cubin and Leech 1983, Short 1994). Literature suggested that the Objective of the concentrated ownership is to enjoy the incentives of monitoring (Shleifer and Vishny, 1997). Therefore the firms that are related to high class technology based or involver intensive R&D have defused ownership structure because in these types of firms outside monitoring is very much difficult (Zeckhauser and Pound, 1990). According to Shleifer and Vishny (1997) there is a tradeoff when an investor invests a large share in one firm. On one side ownership concentration has the incentives of monitoring while on the other side it increases the portfolio risk so. On the same way Demsetz (1983) stated that ownership is an endogenous outcome of cost and benefits of ownership. In support of this Demsetz and Lehn (1985) empirically proved that there is no relation between ownership structure and firm's performance. In consistent with Demsetz and Lehn (1985), McConnell and Servaes (1990) found no impact of ownership concentration on firm's performance by taking Tobin's Q as a measure of performance but they empirically proved that institutional ownership is positively correlated with firm's performance. Lloyd, Hand and Modani(1987) examined that the companies with concentrated ownership have higher company market value to sales ratio. Nesbitt (1994), Smith (1996) also found the results consistent with McConnell and Servaes (1990) they found institutional ownership positively influence the firm performance. Aghion and Tirole (1997) showed the different picture they stated that concentrated ownership increases the monitoring which may reduces the manger's initiative. So in this way ownership could be adversely affect the firm's performance. On the same pattern Burkart et al. (1997) argued that excessive monitoring and interference by the share holder could be costly because it may decrease the manager's initiative. Another argument has been given by Shleifer and Vishny (1997) they stated that large share holder may try to serve their own interest instead of firm's performance. This conflict of interest could decrease the performance of the firm. Morck, Shleifer, and Vishny's (1988) found a U shape relationship among the managerial ownership concentration and returns of a firm. They proved returns are high at low level of concentration, low at moderate level of concentration and again high at high level of concentration. Lskavyan and Spatareanu (2006) stated that high level of ownership concentration leads to better corporate performance through monitoring of the managers.

Sample and Data Description

Our sample consists of 50 firms which are randomly selected from the non-financial firms of KSE-100 index of Karachi Stock Exchange of Pakistan. KSE-100 Index consists of 100 companies which cover more than 90% of the total market capitalization of the companies listed on the Karachi Stock Exchange. So our sample covers the gigantic companies of the Pakistan. Data is collected from annual reports of the companies for the year of 2009.

Variables of the study are as follow:

Return on Assets
Consistent with previous studies, we used Return on Assets (ROA) as a measure of performance in this study e.g. (Chen. et al., 2005). ROA is calculated by dividing net income after tax divided by total assets.

Ownership

Ownership (Own) is an independent variable in this study. To measure this variable we used Herfindahl index of the firm's ownership structure. Ownership concentration is calculated by taking the sum of squares of fraction of total equity held by each shareholder. Larger these fractions will result greater the value of (Own), so a company with greater result of (Own) having more ownership concentration. In consistent with earlier studies we are expecting a positive correlation among ownership and the performance of the firm (Cubin and Leech 1983, Short 1994).

Table 1 represents the descriptive statistics of the study variables, ownership and ROA. Result shows that ownership ranges from 0.013 to 0.89, with a mean value of 0.310, median 0.213 and std. Deviation of 0.240. These statistics suggested that there is an immense level of ownership concentration in Pakistani firms. ROA of the 45 companies' ranges from -0.172 to 0.360, with median 0.081, mean 0.91 and std. deviation 0.110

Descriptive Analysis

Table 1 Descriptive Statistics

	ROA	Own
N (Valid)	50	50
Mean	0.091	0.310
Median	0.081	0.213
Std. Deviation	0.110	0.240
Minimum	-0.172	0.013
Maximum	0.360	0.890

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Regression Analysis and Results

In order to find the impact of ownership on operating performance of the firm we used OLS regression method.

Table 2 shows the regression results of the study. Value of R square is suggesting that our independent variable ownership is explaining around 20% of the total variation in our dependent variable ROA. Further analysis represents that there is a positive correlation between ownership concentration and return on Assets. This relationship is statistically significant at 1% level of significant. This confirms our hypothesis that ownership concentration leads to better operating performance. These results are in agreement with earlier studies that empirically proved that ownership concentration leads to better operating performance e.g. (Cubin and Leech 1983, Short 1994).

Conclusion

In this study 50 non-financial firms from KSE-100 index of Karachi Stock exchange of Pakistan, are been analyzed. Results suggested that there is an intensive level of ownership concentration in Pakistani firms. Regression analysis shows a significant positive correlation among ownership concentration and firm's performance. Results confirms Lskavyan and Spatareanu (2006) who argue that large ownership leads to better monitoring of managers which tends to better operational performance.

Table 2 Regression Results

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		Std. Error	Beta		
(Constant)	0.034	0.026		1.322	0.193
Own	0.184	0.066	0.401	2.802	0.008
R Sruare		0.208			
Adj R squre		0.189			
F Stat		7.853			
Sig of F		0.008			

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