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A RELATIONSHIP BETWEEN INSIDER'S OWNERSHIP AND FIRM VALUE: A CASE OF PAKISTANI COMPANIES

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ABSTRACT

This research has examined the impact of insider's ownership on firm value. This research has used the data of 44 nonfinancial companies of KSE-100 Index for five years 2006-2010. In this research insider's ownership means the total shares held by directors (Executive/nonexecutives), CEO, Managers, their spouse and minor children. Insider's ownership is classified into three categories i.e. 0% to 25%, 25.1% to 50% and 50.1% and above. Tobin's Q ratio is used to measure the firm value. Two methods of analysis have been used, mean comparison and regression. Mean Q ratio of firms where insider's having 25% shares is greater than mean Q ratio of firms where insider's having 25.1% to 50% shares. And mean Q ratio of the later one is greater than mean Q ratio of firms where insider's having 50.1% and above shareholdings. As the insider's shareholding proportion increases the value of firm decreases, which shows negative correlation between insider's ownership and firm value. Regression analysis also proved negative correlation, but the relationship is weak. Regarding this research ideal percentage of shareholding for insider owners is 0 to 25%.

Key Words: INS-OWN, KSE, Q-Ratio

INTRODUCTION

Insiders' Ownership (INS-OWN) means that how much percentage of total shares is held by the management and directors of a corporation. If the management have more monetary stake in a corporation they will work more for betterment and prosperity of the corporation. Value of Firm

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(VOF) means that, the performance of a corporation in response to maximizing shareholders wealth.

It is the key feature of corporation that, control is separated from the ownership. Ownership is staggered among different shareholders. And control of the firm lies in the hands of management, which causes agency problem.

The agency theory suggests that the management is trying to achieve their own benefits rather than to work for achieving the shareholders benefits and objectives. It is quite possible that management will work for own interest at primary level and shareholders interest are kept at secondary level. Sometime management are taking steps/decisions which maximize the size of firm and in result their incentives are raised, rather than maximizing of shareholders wealth. In order to avoid agency problem it is proposed that management should have some stockholding in corporation.

Pattanayak (2008), quoted in his research the quotations of two Indian big giant chairmen, which reproduced below “TATA group chairman Mr. Ratan Tata said in press, “the steel industry is fragmented and considerably vulnerable. The only safeguard is to increase the founding family’s stake over time; the increase in stake is to ensure that management control remains with promoters”. And Bajaj Group chairman Mr. Rahul Bajaj held, “more than 75 percent of large listed Indian companies are family owned, in which a family has a significant shareholding in the company. Companies where management has little or no stake in the company constitute less than 5 percent of the large, listed companies. In a company managed by owners, there is a very strong motivation for managements to work for a long term share price increase.”

Management and shareholders are two separate parties in corporation having their own separate expectations and interests. Management wants to get maximum incentives and benefits and the shareholders want to maximize their wealth. To overcome this problem and make these interests parallel to each others, it is suggested by the researchers that management should have some stockholdings in a corporation.

When the management has some stockholding interest rather than their incentives and perks they will ultimately work for the betterment and growth of the corporation. And parallel to their incentives and benefits they will also think and work for maximizing of shareholders wealth. The INS-OWN is a base for alignment of interest of shareholders and management.

BACKGROUND OF THE STUDY

Berle and Means (1932), suggested in their book “separation of ownership from control” that there are many problems attached with the separation of ownership from control. So it is concluded that

greater the ownership, greater the interest. According to them the relation between ownership and firm performance is positive.

Jenson and Meckling (1976), presented the agency theory, which suggests that management is giving preference to fulfill their own interest rather than the interests of shareholders. As and when the ownership of management increases in a corporation then they are more concerned with the increase in shareholder's value and thus management ownership is positively correlated to VOF. If we apply Miller and Modigliani (1958), irrelevance theory to corporate ownership structure we can say that there is no relation between firm performance and ownership structure.

Significance of the Study

Performance of corporation is playing a vital role in promotion and demotion of a country economy. Role of corporation become more significant and its impact become more severe upon the emerging economy. Realizing the importance of corporation's performance researchers are studying every aspect which influencing the performance of a corporation.

Pakistan's economy is an emerging economy. Impact of corporation's performance is as significant on Pakistani economy as significant on other emerging economies. When the importance of corporation's performance in promotion and demotion of an economy is accepted, then it is very necessary to analyze every aspect, which influences corporate performance. Ownership structure has a significant impact upon corporate performance. Keeping the importance of corporate performance in mind and accepting the role of ownership structure and to analyze the relation between it through empirical study.

Relationship between insider owners and VOF is a debatable issue. Researchers have worked a lot to find the correlation between VOF and insider ownership. Researchers are not uniting on the single findings. Literature review consist the findings of previous researched relating INS-OWN and VOF.

Research Questions

- i. Do INS-OWN affect VOF?
- ii. Do insider owners work for maximizing of shareholders wealth?
- iii. Does there any difference between the performances of corporations where insider's stockholdings are more, as compare to firms where insider's stockholdings are low?
- iv. If the INS-OWN affect VOF, then in which direction (positive or negative) and what is its magnitude (low, strong or medium).

Research Objectives

Based on the above research questions the objectives of the research will be;

- i. To know about the direction of correlation between INS-OWN and VOF.
- ii. To know about the magnitude of correlation between INS-OWN and VOF.

LITERATURE REVIEW

Ownership structure and its relation to VOF is a multifaceted question, there is a vast literature review related to this relationship whether it is positive, negative or no relation. This research lists the results and conclusions of some researchers, conducted their research previously for investigating the relationship between INS-OWN and VOF. One group of researchers found that there is a positive relation between VOF and inside ownership, while the other group concluded that VOF is negatively correlated to INS-OWN. Another group of researchers found that this relation is curvilinear; they stated that VOF is positively then negatively and again positively correlated to INS-OWN as the ratio of management ownership increases.

For convenience here this research contains the literature of “relation between INS-OWN and VOF” in group of thoughts of different researchers.

Positive Relation between Vof and Insider Ownership

Selarka (2005), investigated through the relationship of VOF to insider ownership. In his research he examined this relation with groups and stand alone firms. He found that, there is a strong curvilinear U shaped relation exists between VOF and management ownership. He reported that when the INS-OWN is low (of the group) firm holding and (in standalone) firms the INS-OWN is much bigger when relation between VOF and management ownership is positive. He also reported that low and high outside block holding is positively correlated to VOF and this relation turn strongly negative at the moderate level of ownership by outside block holders (a group of shareholders having shares in blocks but they no involvement in the managerial matters of corporation).

Kaserer and Moldenhauer (2007) conducted their research and got evidences from German firms. They found that ownership structure is an exogenous variable at least in case of Germany. They report that the relation between ownership structure and VOF is positive. They also report that outside block shareholdings is positively correlated to VOF.

Kumar (2003), tested the hypothesis “Does ownership structure influence the value of firm”. For testing this hypothesis he took the sample of 2478 firms listed at BSE (India) for the period 1994 to 2000. He found that, there is no relation between the ratio of foreign shareholding in domestic firms and their performance. His study concluded that institutional investor influence VOF and its performance positively. He also concluded that INS-OWN effect VOF positively when it crossed beyond a certain level. He also suggested that ownership structure is not independent variable.

Demsetz and Villalonga (2001), conducted a study to investigate the relationship between VOF and management ownership. They constructed two equations, in first equation they took VOF as dependent variable and management ownership is as independent variable in a set of some other variables and in the second equation management ownership as a dependent variable and VOF as independent variable in a set of some other variable. For equation-1 they found that VOF is

dependent on management ownership and large block holders, but its relation to management ownership is positive and negative to large block holders. In support of equation-2 they stated that management ownership ratio is strongly affected by VOF. They also report that impact of VOF is more significant on INS-OWN than block holders.

Negative Correlation between Vof and Insider Ownership

Farooq, Zijl, Dunstan and Karim (2007), investigated the relationship between VOF and ownership structure through getting evidences from Bangladesh firms. In their research they illustrated that INS-OWN is not independent, but it is dependent on some other variable like VOF and firm performance. They found that ownership structure has no significant impact on VOF but VOF (Tobin's Q) influence ownership structure negatively significantly. After examining the relation between ownership structure, INST-OWN and firm performance they found that, INST-OWN and firm performance is positively correlated to each other. They also found that non executive directors have no influence on firm performance.

Lins and Lemon (2001), investigated the relationship between management ownership and VOF during the crises of Asian Market in 1997. They took Tobin's Q as a metric of valuation. In their research they found that when the INS-OWN is more than 26% then the Q ratio of those firms showed more decrease as compare to the pre-crisis year than the firms where INS-OWN is less than 26%. Their findings show that, the relationship of INS-OWN is negative to VOF and stock return.

Hassan and Butt (2009), examined the relation between ownership structure and corporate governance on capital structure on Pakistan listed companies at Karachi Stock Exchange, by taking the data for the period from 2002 to 2005 for 58 randomly chosen non-financial companies. Their research findings were that correlation between CEO/Chair duality and INS-OWN is negative to profitability as well as the INS-OWN ratio is negatively correlated with debt to equity ratio. But the Institutional Ownership is positively correlated to debt-to-equity ratio which is statistically insignificant. And when they examined the size and profitability with debt-to-equity, they found that profitability is negatively correlated with debt-to-equity ratio whether size of the firm is positively correlated to debt-to-equity ratio. After studying this research paper it is concluded that there is an inverse relation between VOF and insiders ownership, because with the introducing of debt into firm capital structure VOF can be increased. Their research paper stated that the "*On the other hand managerial ownership with debt-to-equity ratio indicating that concentration of ownership induces the managers to lower the gearing level*".

No Relation between Vof and Ins-Own Fraction

Shahid (2003), examine the relationship of management ownership to the VOF and stock market performance by using the data from Egypt. Accounting measures of performance are used as a proxy for VOF i.e. ROA and ROE. The researcher found that there is no significant relation between management ownership and ROA/ROE of the firm. It found that there is no relation

between stock market performance and insider ownership. The author suggested that there must be some other economic factors which affects share price.

Positive Relation at Low Level and High Level and Negative Relation at Moderate Level of Ins-Own

Lopez-Iturriaga and Rodriguez-Sanz (2001), investigate through the relation between INS-OWN and VOF, and the effect of INS-OWN on investment, by using the data of Spanish firms. They found that relation between management ownership and VOF is not unidirectional. This relation is positive at low level ownership of managers and at a very high level of INS-OWN and the same relation turn to negative at a moderate level of insider ownership. They also find no relation between firm investment and INS-OWN.

Deb and Chaturvedula (2004), examined the impact of ownership structure on the VOF. The study was based on Indian economy and their research findings were, VOF is positively correlated to INS-OWN, when INS-OWN below 30% and above 60%. And this relation become negative, when INS-OWN crossed 30% and not yet reached 60%. Their research illustrated that as the percentage of INS-OWN increases, VOF first increase, then decrease and it again increase when INS-OWN exceed 60%.

Pattanayak (2008) examined the relationship between management ownership and VOF by taking evidences from Indian corporate sector. He got the data for the period from 2000-01 to 2003-04, by using Bombay Stock Exchange listed firms. His sample size was 1833 firms. His study concluded that, at the initial relationship between VOF and management ownership is positive. And when the INS-OWN crossed the 20% level then its impact on the VOF becomes negative. He further report that as and when the insider stake goes beyond 49% then this relation turn again positive. He also examined the relation between foreign ownership ratios in home firms and found that, foreign ownership is positively correlated to VOF and improving firm performance.

Torre, Hidalgo and Pindado (2003), their research was based on the hypothesis "*Value of firm first rises, then falls and finally continues to rise as insider's ownership increases*". Their findings related to this hypothesis were, INS-OWN ranging from Zero percent to 35% is positively correlated to VOF and this relation turn negatively when INS-OWN exceeds 35% and remain same up to 70% and finally this relation again turn to positive as and when INS-OWN exceeds 70%. They also found that size of firm is negatively correlated to VOF.

Positive Correlation at Low Level and Negative at High Level of Ins-Own Proportion

Han (2004), examined the effect of INS-OWN on the VOF by using the data related to REIT (Real Asset Investment Trust) and UPREIT (Umbrella Partnership Real Asset Investment Trust) for the period from 1994 to 2000 of 156 firms mostly listed at NYSE, used Tobin's Q as the metric for comparison of VOF. He concluded that, the relationship between Tobin's Q (VOF) and percentage

of INS-OWN is significant and nonlinear. Its relation is positively correlated at low level and become negative as and when the INS-OWN ratio goes up.

Negative Correlation at Low Level and Positive at High Level of Ins-Own Proportion

Lins and Lemmon (2001), examined the relationship between management ownership and VOF in emerging markets. He investigated to a sample of 1433 firms from 18 emerging markets. In his research he found that management control less than 20% is negatively correlated to the VOF. And large inside management share-holding is positively correlated to VOF. His research also indicates that if there are non-management block-holders, then its relation is positively correlated to VOF, in such firms where INS-OWN are less than 20%. He also examined the level of protection for shareholders in a country, he found that if level of protection is low then the large proportion of inside-ownership exploit the small shareholders and the VOF is low. Here high proportion of inside-ownership is negatively correlated to VOF. And large non-management block holdings are positively affecting the VOF in countries where small shareholding protection level is low.

The literature of INS-OWN and VOF tells us that researchers are not united on a single conclusion regarding its relation whether it is positive, negative or no relation. This research report is testing the impact of INS-OWN on performance of corporations by using the data of Pakistani corporation listed at Karachi Stock Exchange.

RESEARCH METHODOLOGY

Data

This research analyzes the effect of INS-OWN fraction and its impact on performance of corporations. For this purpose this paper using five year data from 2005-06 to 2009-10. Total sample size consists of 44 non financial companies of KSE 100 index. All companies selected at a reference date of 31 June 2010.

Variables of Interest

As already mentioned INS-OWN means that, the percentage of shares held by directors (executives and non executives), CEO, managers and their spouse and minor children. For this purpose this paper categorized INS-OWN into three categories and assigning label to each variable which represent insider ownership.

- i. INS-1= Where the total fraction of shares held by directors (executive and non executive), CEO, managers and their spouse and minor children, ranging from zero percent to 25%.
- ii. INS-2= Where the total fraction of shares ranging from 25.1% to 50%.
- iii. INS-3= Where the total fraction of shares are more than 50%.

Metric of Performance

There is no specific metric for measuring the performance of firm. Hence different scholars have used different metrics as performance measurement. In consistency to Pattanayak (2008), Lins and Lemmon (2001) and Torre, Hidalgo and Pindado (2003), this research is also using *Tobin's Q* ratio as a metric for measuring performance of corporations. Tobin's Q ratio is, multiplying market price of shares into total numbers of shares and divided by total assets value.

METHODS

Following Pattanayak (2008), Lins and Lemmon (2001) and Torre, Hidalgo and Pindado (2003), this research also used mean comparison method of analysis. To confines the relation between INS-OWN fraction and VOF through Tobin's Q ratio and the impact of INS-OWN on Tobin's Q ratio. This will enable us to know about the correlation between VOF and INS-OWN fractions. In mean comparison analysis the greater the mean the better it is. For mean comparison ANOVA test has been used. In consistent to Farooq, Zijl, Dunstan and Karim (2007) regression is also used to analyze the correlation between INS-OWN concentration and firm performance.

ANALYSIS AND DISCUSSIONS

Mean Comparison Analysis: Following the methodology of Pattanayak (2008), Lins and Lemmon (2001) and Torre, Hidalgo and Pindado (2003), results of this research is also based upon mean comparison.

Table-1. Correlations Results

		INS	Qratio
INS	Pearson Correlation	1	-.151
	Sig. (2-tailed)		.025
	N	220	220
Qratio	Pearson Correlation	-.151	1
	Sig. (2-tailed)	.025	
	N	220	220

In order to test the relationship of INS-OWN with the VOF, Pearson correlation test has been used as shown in table-1. Test results of -0.151 illustrates that value of firm is negatively and significantly affected by the shares of the insider owner as evident by the p value of 0.025. Pearson correlation test does not tell about the direction and magnitude. For knowing the magnitude of correlation, this research has also used regression analysis. Results of regression analysis are displayed in table-4, table-5 and table-6 of this research.

Table-2. ANOVA Results Of Mean Comparison Analysis Qratio

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	2.595	2	1.298	3.222	.042
Within Groups	87.413	217	.403		
Total	90.009	219			

In order to compare the mean Tobin's Q ratio of all three categories of INS-OWN, ANOVA test has been used. Test results are significant indicated by the significance level of 0.042 and the F value, which shows that mean Tobin's Q ratio of all three categories is not equal. In order to check that, which insiders shareholding category's mean Tobin's Q ratio is greater. To know about the mean Tobin's Q ratio category wise. The Post-Hoc estimation is used. In this research for multiple mean comparison among each category of insider's shareholding "Tukey" test has been used. Results of which are displayed in table-3b.

Table-3a. Mean Q ratio of all Categories

INS	Qratio
INS-1	.686805
INS-2	.630536
INS-3	.303655

Table-3b. Multiple Mean Comparisons

Qratio Tukey HSD						
(I) INS	(J) INS	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
					Lower Bound	Upper Bound
INS-1	INS-2	.0562687	.1036437	.850	-.188321	.300858
	INS-3	.3831497*	.1510854	.032	.026602	.739697
INS-2	INS-1	-.0562687	.1036437	.850	-.300858	.188321
	INS-3	.3268810	.1679220	.128	-.069400	.723162
INS-3	INS-1	-.3831497*	.1510854	.032	-.739697	-.026602
	INS-2	-.3268810	.1679220	.128	-.723162	.069400

*. The mean difference is significant at the 0.05 level.

Table 3a shows mean Q ratio of INS-1, INS-2 and INS-3 are 0.6868, 0.6305 and 0.3036 respectively, which demonstrated that the mean of the first category is greater than the other two categories. Similarly the mean of the second category is greater than the third. Table 3b shows mean comparison among all three categories of insider's shareholding. Mean Q ratio of INS-2 is greater than mean Q ratio of INS-3 but its difference is statistically insignificant evident by the p value of 0.128. Similarly mean Q ratio of INS-1 is greater than mean Q ratio of INS-2, but the p

value of 0.85 shows that its difference is also statistically insignificant. The Mean Q ratio of INS-1 is greater than Mean Q ratio of INS-3 and the difference is statistically significant illustrated by the significance level of 0.032.

Regression Analysis

Regression analysis is used to analyze the impact of ownership structure (INS-OWN) on firm performance (VOF).

Table-4. Model Summary of Regression Analysis

Model	R	R Square	Adjusted Square	R Std. Error of the Estimate	Durban Watson
1	.151 ^a	.023	.018	.6351661	1.08

a. Predictors: (Constant), INS

Classification of correlation's magnitude i.e. R:

R value ranging from 0-0.2 is termed as weak.

R value ranging from 0.21-0.5 is termed as moderate.

R value ranging from 0.51-1.00 is termed as high.

Table-4 is about model summary of regression analysis. According to above criteria of R value, the value of R=0.151 demonstrates the weak correlation between INS-OWN and VOF. R-Square 0.023 reveals that 2.3% variation in Q ratio is caused by INS-OWN concentration. This result indicates that there are other variables which affect the VOF. Similarly the value 1.080 of Durban Watson statistic point out that there exists a moderate autocorrelation.

Table-5. ANOVA Results of Regression Analysis

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	2.060	1	2.060	5.105	.025 ^a
Residual	87.949	218	.403		
Total	90.009	219			

a. Predictors: (Constant), INS

b. Dependent Variable: Qratio

In regression analysis ANOVA is used to check the fitness of regression model. Table -5 consists of ANOVA results of regression analysis. Results of ANOVA are significant indicated by the p and F value of 0.025 and 5.105 respectively, which means that the model is fit. Fitness of model reveals that the variables selected in regression model are relevant. The SSE value of 2.060 exemplify that most of the variation is due to some other variable not included in the regression.

Table-6. Coefficients Results of Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.849	.102		8.310	.000
INS	-.149	.066	-.151	-2.259	.025

a. Dependent Variable: Qratio

Table-6 consists of coefficients results of regression analysis. Its results showing that, relation is significant. Sign of beta value is negative, which is the proof of negative correlation between VOF and INS-OWN fraction. The relation is negative and significant as evident by the t value of -2.259 and p value of 0.025.

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSION

Results of this research are addition to the existing literature of “*INS-OWN and VOF*”. This research investigated through the correlation between INS-OWN fractions and VOF through empirical data and analysis. Data of this research paper based on Pakistani firms listed at Karachi stock exchange.

Mean comparison analysis shows that mean Q ratio of firms in which insider owners have up to 25% shareholding is greater than the Q ratio of firms where INS-OWN is ranging from 25.1% to 50%. And mean Q ratio of firms in which insiders have ownership stake ranging from 25.1% to 50% is higher than the mean Q ratio of firms where insiders have ownership rights 50.1% and above. After studying the mean comparison analysis it is concluded that, as the INS-OWN stockholding increases the mean Q ratio decreases, which is a sign of negative correlation. Negative correlation between INS-OWN and VOF reveals that as the insider owner’s stockholding appreciates VOF depreciates. This is because at the low level of insider owner’s stockholding the sword of takeover and replacement is hanging upon their heads. Due to the fear of takeover and replacement they are using corporate resources more efficiently.

Results of regression analysis are also showing a negative correlation between INS-OWN and VOF, as the sign of the beta value is negative. Furthermore this correlation is weak, as R value is less than 0.20.

RECOMMENDATIONS

Recommendations for Policy Makers

According to this research ideal proportion of INS-OWN is up to 25%. As the ratio of INS-OWN goes up threat of takeover and replacement slashed. Then they are using corporate resource for their own benefits rather than corporate benefits. And the individual shareholders are exploited. Keeping this in view there should be strong amplifications of rules and new rules may be implemented to protect small shareholders. So the policy makers make it sure that INS-OWN ratio do not exceed the ideal position of INS-OWN as mentioned in this research.

Recommendations for Futuristic Research

Value of R squared shows that 2.3% change in VOF is due to INS-OWN which is a low amount. Furthermore the correlation is also weak. So it is concluded that VOF is not affected only by INS-OWN but there are some other variables which affect VOF. It is suggested that affect of INS-OWN may be tested with an addition of some other variables. The INS-OWN blocks made in this research having excessive intervals .i.e. 0-25%, 25.1%-50% and 50.1% and above. It is recommended that for futuristic research intervals in INS-OWN blocks may be reduced. Because with the more of INS-OWN blocks, the more accurate results regarding ideal proportion of insider's stockholding will be obtained.

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