NEXUS BETWEEN OWNERSHIP STRUCTURE AND FIRM PERFORMANCE - EVIDENCE FROM INDIAN SERVICE SECTOR

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ABSTRACT

Shareholding pattern of an organization determines the management control and decision making climate. Empirical researches have proved relationship among the type of shareholdings, managerial efficiency and stock returns in manufacturing sectors. This study investigates the relationship between the organizational shareholding pattern and financial performance of select services sector companies taking sample from listed financial services and Information technology firms from CNX500 Index for a period of five years. The study emphasizes on the significance of categorical distinctions among ownership and evaluating its influence on firm performance for investment decisions. Both accounting and market based approach of Firm performance has been considered using Tobin Q ratio and Return on Capital Employed as proxy. The results show that there is Insider owner’s dominance in services sector. A higher percentage of aggregate promoter and promoter’s group holdings are documented in services sector. The study also documents a positive and significant relationship between the firm performance as measured by market model and the percentage of shares held by promoters and Institutional bodies. In contrast, there is negative and insignificant influence of promoter’s holdings on the firm performance. However, Institutional shareholdings have a positive and significant influence. Dominant insider’s ownership enhances management efficiency through excessive control for wealth maximization.

Keywords: Ownership structure, firm performance, Tobin Q, inside owners, JEL category: G23, G21

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1. INTRODUCTION

Financial performance of an organization is predisposed by internal and external factors. In recent years the internal factors like corporate governance, board structure and shareholding pattern is gaining importance in research to find the influence of these factors on the firm performance, specifically the shareholding pattern. The category of shareholding, determines the management control, decision-making climate, and performance. Though, firm performance is subjective to other uncontrollable external factors, evidences have shown that the managerial control has linkage with the firm performance.

The category of shareholders is an important factor for economic performance as per the economic theory and public policy. As per the principal-agent model, the shareholders who are the real owners (Principal) of the company, delegate the powers to manage the day-to-day operations to the management (Agent). The primary role of owners is monitoring the performance of the company from time to time. The delegation of powers to agent also depends on the category of owners. It may include the Inside and Outside owners. Inside owners largely constitute the promoters or promoter group holdings that in principal have access to sensitive information about the firm and have power to make changes in decisions inside the firm. Promoters also may include the sub-divisions like Indian and Foreign investors whose degree of involvement in key decision-making, day-to-day supervision, and access to information is dissimilar. Principally, Indian listed firms are family owned and promoter centric, thou regulatory authority in India insists for at least 25 percentage holdings by the public shareholders. In fundamental analysis, understanding the shareholding pattern and the changes in the shareholding pattern from time to time is crucial for both present and prospective investors.

This study shows how shares of services sector companies are divided among the different class of investors who represent ownership and influence the firm performance. Shareholding pattern data is released on quarterly basis by all the listed companies in India as per the format prescribed by the SEBI. It is quite imperative to understand the rules to evaluate the shareholding pattern and its likely relationship with firm performance. It is observed that increased promoter’s holding is perceived as positive signal to the market as it shows the confidence of the promoters in the company’s business. Increase in promoter stake considered positive because promoters commit additional fund when they are optimistic about future growth of their company. A lower promoter stake could draw a negative signal to other investors due to lack of promoter confidence in their own business.

2. LITERATURE SURVEY

Jensen, M. C., & Meckling, W. H. (1976) developed a theory on ownership structure of the firm deriving its linkages with the agency cost theory and property rights theory and finds relationship between agency cost and separation of management. Mudambi, R., & Nicosia, Ca. (1998) found that an increased control vested with the large shareholders have the positive influence on firm performance. Lauterbach, B., & Vaninsky, A. (1999) found that firms owned by family and managed by family itself perform relatively worst as compared to those managed by others. It concludes that firm performance is better in modern organizations, which has dispersed ownership and non-owner managers.

found negative relationship between the number of independent directors on board and firm performance. It also asserts that the degree of negative relationship reduces as the number of internal director’s ratio increases. Fang, Noe and Tice (2009) found liquidity increases the information content and it is not driving factor of firm performance.

Phung, & Hoang. (2013) documents that state ownership has an inverted U-shaped relationship with firm performance whereas foreign ownership has a U-shaped relationship with firm performance. It means that when ownership is concentrated in the hands of state ownership, the firm performance will decline and foreign ownership improves firm performance.

Kim, H. (2014) finds a positive relationship between the common factors and the firm performance. Khamis, R., Hamdan, A M., & Elali W., (2015) positive relationship is found between institutional ownership and firm performance. Contradictorily, there was no significant effect of managerial ownership on company performance. It also states that the on retreating of managerial ownership the firm performance improvises.

3. PURPOSE OF THE STUDY
This study attempts to find the shareholding pattern in the service sector firms and linkages between the category of ownership and firm performance.

4. METHODOLOGY
The data samples have been derived from the CNX500 index for a period between 2010 to 2015 on the two major segments of services sector i.e. Financial Services (74) and Information Technology (26). There are different methods used to measure the firm performance. However, the widely used methods of measure of firm performance are Tobin’s Q ratio and Return on Capital Employed. Tobin’s Q ratio is also called Q ratio. It is the market measure of firm performance and it is computed as follows.

\[ Q_{t,i} = \frac{(\text{Equity Market Value} + \text{Liabilities Market Value})}{(\text{Equity Book Value} + \text{Liabilities Book Value})} \]  \[ \text{(1)} \]

Return on capital Employed (ROCE) is also widely used as an accounting measure of firm performance. It is computed by taking the ratio between net operating profit and firm capital employed.

\[ \text{ROCE}_{t,i} = \frac{\text{NOPAT}_{t,i}}{\text{CE}_{t,i}} \]  \[ \text{(2)} \]

In this study, both have been used to check the robustness of the results. The following OLS model has been adopted to verify the impact of category of ownership on firm performance. In this study Tobin Q, and Return on Capital Employed (ROCE) has been used as the proxies for financial performance of the sample company. Ownership category is considered at its aggregate level of promoters, public, institutional and non-institutional holdings.

\[ Q_{a} = \alpha_{0} + \beta_{1} \text{Pr}_{a} + \beta_{2} \text{Pub}_{a} + \beta_{3} \text{Inst}_{a} + \beta_{4} \text{Nonist}_{a} + \varepsilon_{a} \]  \[ \text{(1)} \]

\[ \text{ROCE}_{a} = \alpha_{0} + \beta_{1} \text{Pr}_{a} + \beta_{2} \text{Pub}_{a} + \beta_{3} \text{Inst}_{a} + \beta_{4} \text{Nonist}_{a} + \varepsilon_{a} \]  \[ \text{(2)} \]

Where, ‘Q’ is the Tobin Q measure of Financial Performance and Return on Capital Employed (ROCE), which are the dependent variables. Based on the review of literature, it is observed that the firm performance is studied at its aggregate level of holdings by Promoters.
shareholdings (Pro), Public shareholdings (Pub), Institutional shareholdings (Inst) and Non-Institutional shareholdings (Noninst). Therefore, these categories of shareholdings have been considered as Independent variables.

5. EMPIRICAL RESULTS AND DISCUSSIONS

**Table 1** Descriptive statistics of ownership structure and firm performance indicators

<table>
<thead>
<tr>
<th></th>
<th>Financial Services</th>
<th>IT Services</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
<td>Mean</td>
</tr>
<tr>
<td>Tobin Q</td>
<td>1480</td>
<td>1.4448</td>
</tr>
<tr>
<td>ROCE</td>
<td>1480</td>
<td>10.3329</td>
</tr>
<tr>
<td>Pro</td>
<td>1480</td>
<td>46.584</td>
</tr>
<tr>
<td>Inst</td>
<td>1480</td>
<td>30.093</td>
</tr>
<tr>
<td>Noninst</td>
<td>1480</td>
<td>23.270</td>
</tr>
<tr>
<td>Pub</td>
<td>1480</td>
<td>53.364</td>
</tr>
</tbody>
</table>

The above table shows the descriptive statistics of the sample companies firm performance indicators and ownership structure. It is observed that financial services companies mean of Tobin Q measure is 1.44 with minimum of .7 and maximum of 7.91. A Q ratio of below one means that the stock is undervalued and cost to replace a firm's assets is greater than the value of its stock. On the other hand, a Q ratio of more than one implies that a firm's stock is more expensive than the replacement cost of its assets, which implies that the stock is overvalued. This measure of stock valuation is the driving factor behind investment decisions in Tobin's model.

As it is found in the descriptive statistics, the ratio is above one it indicates that the financial sector firms are on an average overvalued. ROCE of the sector is 10.3329. Higher ROCE indicate better financial position. With regard to the Information services companies it is observed that the mean of Tobin Q measure is 3.35 with minimum .6 and maximum of 9. It means that on an average the sample firms have firm value of more than the cost of its assets. It is observed that the mean of ROCE measure of financial performance is 24.59 with minimum 5.18 and maximum of 37.8 Ownership structure has dominance presence from public and promoter shareholdings with mean of 54.70 and 45.29 respectively.

**Table 2** OLS results of firm performance of services sector companies and ownership structure

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Unstandardized Coefficients: Dependent Variables</th>
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<tbody>
<tr>
<td></td>
<td>Financial Services</td>
</tr>
<tr>
<td></td>
<td>Tobin Q</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.841</td>
</tr>
<tr>
<td>Pro</td>
<td>.193</td>
</tr>
<tr>
<td>Pub</td>
<td>.013</td>
</tr>
<tr>
<td>Inst</td>
<td>.903</td>
</tr>
<tr>
<td>Noninst</td>
<td>-.089</td>
</tr>
<tr>
<td>R²</td>
<td>0.519</td>
</tr>
<tr>
<td>DW stat</td>
<td>2.014</td>
</tr>
</tbody>
</table>

***P <0.01; ** P < 0.05; *P < 0.1.

The above table shows the OLS results between firm performance and category of ownership. Firm performance as measured by Tobin Q ratio and ROCE is taken as dependent variable and percentage of shareholdings by promoter, public, institutional, and Non-institutional entities as explanatory variables. In case of financial sector firm performance as measured by Tobin Q ratio it is observed that 51.9 percent of variations in Tobin Q ratio can
be explained by the categories of ownership. Percentage of shares held by promoters and Institutional bodies have positive and significant influence on the firm performance.

However, percentage of shares held by public has least insignificant influence and Non-institutional entities holdings have negative insignificant influence on firm performance. However, as per the accounting measure of firm performance it is observed that 16 percent of variations in ROCE can be explained by the categories of ownership. Percentage of shares held by promoters has negative and insignificant influence on the firm performance. However, percentage of Institutional shareholdings has positive and significant influence. Public and Non-institutional holdings have very least insignificant influencing variables in explaining the firm performance.

In case of information technology companies firm performance as measured by Tobin Q ratio it is observed that 35.7 percent of variations in Tobin Q ratio is explained by the categories of ownership. Percentage of shares held by promoters and public has positive and significant influence on the firm performance. However, percentage of shares held by institutions has least insignificant influence and Non-Institutional entities holdings have significant negative influence on firm performance.

In case of firm performance as measured by return on capital employed, it is observed that 14.7 percent of variations in ROCE can be explained by the categories of ownership. Percentage of shares held by public has positive and significant influence on the firm performance. However, percentage of Institutional, promoter and Non-institutional holdings has very least insignificantly influencing variables on firm performance.

6. CONCLUSIONS

Ownership pattern is key corporate Governance issue as it has bearing on the management control and efficiency of an organization. Agency problems are persistence as dependency on agents poses higher risk due to principle and agent goal disparity and insider’s supremacy on the firm performance. In this study, insider owner’s dominance found as the aggregate promoter and promoter’s group holdings being the highest in services sector. Thou, aggregate public shareholdings represent larger stake is dominated by the institutional investors. The results documents positive and significant relationship between the firm performance as measured by market model and the percentage of shares held by promoters and Institutional bodies. Contradicting results are found under accounting measures of firm performance wherein there is negative and insignificant influence of promoters holdings on the firm performance and Institutional shareholdings has positive and significant influence. Cross sectional studies have shown dissimilar directional influence of the variables and confirm the influence of ownership structure on firm performance.

REFERENCES


Nexus between Ownership Structure and Firm Performance - Evidence from Indian Service Sector


