

# DOES OWNERSHIP STRUCTURE INFLUENCE FIRM PERFORMANCE? EMPIRICAL INSIGHTS FROM AN EMERGING MARKET

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## Abstract

This paper examines empirically the question of whether ownership structure leads to improvements in firm performance in an emerging market like Nigeria. The institutional climate in Nigeria differs from that of many industrialized economies in several ways, including a weak corporate control market, a strong concentrated ownership and weak investor protection. We utilize data on 73 firms, allowing us to discriminate between alternative hypotheses and to answer causal research questions on the relationship between ownership structure and firm performance. The results for concentrated ownership structure suggest that concentrated ownership has negative and insignificant impact on firm performance, which lend some credence to the entrenchment effects. Overall, the evidence supports the view that foreign ownership can be an effective mechanism to impact and thus ameliorate performance and, moreover, highlights the importance of assessing firm performance across alternative governance structures.

**Key Words:** Corporate Governance, Emerging Market, Foreign Ownership, Ownership Concentration, Firm Performance, Nigeria

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## 1. Introduction

One of the consequences resulting from the pressures of globalization has been to make countries noted for their reluctance to accept global best governance practices to realize that closer adherence to corporate governance mechanisms are essential for their domestic firms if they are to unlock the investment opportunities their economies offer. This is particularly true for emerging markets noted for their weak firm-level corporate governance practices, in addition to weak legal enforcements, primarily as a result of the lack of political will to support adequate corporate governance developments relative to the level of corporate governance development commonly observed in OECD member countries and the US. An important question then is to consider how basic corporate governance mechanisms such as ownership structure influence firm performance. On this issue Jensen and Meckling (1996) note that ownership concentration has a positive influence on performance since it reduces the conflict of interest

between managers and owners of the firm. In turn, this has provided a body of very interesting literature which view concentrated ownership as a response to weak corporate governance and lack of commitment instruments and enforcement (La Porta *et al.* 1998). For example, Berglof and Claessens (1998) argue that in environments with weak enforcement, concentrated ownership tends to be the single most dominant corporate governance mechanism, and that alternative mechanisms are rarely effective. Within this literature, Shleifer and Vishny (1997) and La Porta *et al.* (1998, 1999), argues that poor investor protection is associated with extremely concentrated ownership, since large shareholdings can be viewed as a strategy by large investors to exercise power over entrenched managers. Thus, ownership concentration is projected as a good substitute for legal investor protection in weak investor protected countries.

Following previous work on this subject, it is assumed that ownership structure is a significant factor in determining the objective of firms, shareholder wealth and the discipline of managers.

On the issue of managerial discipline, Jensen (1993) suggest that managerial shareholdings is one way of helping to align the interests of shareholders and managers, for as the proportion of managerial equity ownership increases, then so too does firm performance. As explained by La Porta *et al.* (1999), most firms around the world have concentrated ownership structures, with such firms being controlled by a single large shareholder who, more often than not, exercises ultimate control despite only possessing minor cash flow rights. This separation between ultimate ownership and control provides shareholders with a large controlling interest with the incentive to derive personal private benefits at the expense of shareholders (see for a discussion, Shleifer and Vishny, 1997; and Bebchuck *et al.*, 2000). The fact that large shareholders can extract private benefits may appear to have value implications for controlling shareholders and firms (Claessens *et al.* 2000). On the other hand, it has been found that concentrated shareholder ownership can result in more proactive monitoring, thereby giving rise to better corporate governance. Weiss and Nikitin (2004), for example, point out that proactive monitoring effectively reduces the scope for management to expropriate shareholders' wealth.

There has been a fair amount of governance research devoted to examining the effects of ownership structure on firm performance, using data for countries with a long history of implementing initiatives designed to improve corporate governance practices, but overall there is no consensus judgment that ownership structure improves firm performance; selected examples include Demsetz (1983), Demsetz and Lehn (1985), Mehran (1985), Shleifer and Vishny (1986) Morck, *et al.* (1988), Wruck (1988), McConnell and Servaes (1990), Zingales (1994), Cho (1998), Himmelberg, *et al.* (1999), Ang, *et al.* (2000), Claessens, *et al.*, (2000), Lins (2003), Baek, *et al.* (2004), Bhagat, *et al.* (2004), and Lin, *et al.* (2011). In reviewing these studies, Demsetz (1983) suggested that there is no relationship between ownership and firm performance. As if to strengthen this view, Demsetz and Lehn (1985), from a sample of 511 US firms, found no significant relationship between profit and ownership structure, noting that the relation is spurious. Claessens, *et al.* (2000), based on a sample of 2980 firms from 9 East Asian countries provide evidence to suggest that the separation of ownership and control has a decided and negative influence on firm value. In addition, Lin (2003), drawing on a sample of 1433 firms from 18 emerging markets where markets for corporate control are rudimentary, find that ownership control has a negative effect on firm value and, moreover, that the negative effect is stronger in countries with weak shareholder protection. Bhagat, *et al.* (2004) find no supporting evidence regarding the positive relationship between ownership concentration and firm performance. In sharp contrast to these findings, Mehran (1985) finds

evidence of a positive relation between equity ownership and firm performance. Further empirical evidence of strong positive relation between ownership concentration and firm performance is offered by Shleifer and Vishny (1986), Wruck (1988), McConnell and Servaes (1990), and Zingales (1994) for firms in the US and other industrialized economies.

The aim of this paper is to enrich the literature by testing hypotheses concerning the relationship between ownership dimensions: concentrated ownership, foreign ownership, and firm performance in an emerging economy, Nigeria. We focus our analysis on the Nigerian experience due to several reasons. Research on the relationship between ownership structure and firm performance has focused, almost exclusively, on the US and OECD countries due, primarily, to the paucity of data for developing and emerging markets on corporate governance practices. Despite the fact that the corporate sectors in these economies suffer from a short history of active governance practices, to date there has been little evidence documented for developing and emerging markets. Nigeria is an ideal case in this context given that the government has, since 1999, undertaken active reforms of the legislation governing the ownership of enterprises, including reforms of the legislation that governs securities, and the Companies and Allied Matters Act in 2004, which increased director accountability. These initiatives were intended to strengthen internal controls so as to better align the interest of managers and shareholders and, therefore, potentially could have an impact on the relationship between insider ownership and firm value. In addition, there are domestic points of view that doubt the effectiveness of concentrated shareholdings as a corporate governance mechanism for an emerging economy like Nigeria. This is due to the corporate sector's long history of poor firm-level governance practices, lacklustre company performance and the problems previously encountered with transforming Nigeria's indurate economy. The main reasons here are to be found in market inefficiencies associated with weak investor protections as compared to OECD member countries and the US (La Porta *et al.* 1998); the level of information asymmetry which is high and thereby escalates the disconnection between managers and owners of the firm, weak legal enforcement and the persistence of high agency costs.

By analyzing the ownership structure-firm performance relationship, the econometric findings of this study can be related to the prevailing institutional structure, and therefore help to inform academic and policy debate on corporate governance practices, as well as to enlighten international investors who would expect the corporate governance practices of Nigerian firms to be broadly compatible with international standards.

The remainder of the paper is organized as follows. The next section briefly surveys the literature pertaining to ownership structure as a corporate governance mechanism and specifies the hypotheses of the study. Section 3 describes the research procedure used to conduct the empirical analysis. Section 4 presents the main results and the discussion of the empirical investigation. Section 5 concludes.

## **2. Literature review and Hypotheses Development**

The corporate governance literature has firmly established that the separation of ownership and control necessitates the need for corporate governance, which includes a myriad of mechanisms, both institutional and market-based, designed to achieve corporate control and thereby lessen the agency problems espoused by Jensen and Meckling (1976) and Jensen (2000). Controlling owners, defined as the largest single owner, either in terms of equity or in vote, are investors that can be inspired by various incentives. Being closely involved in the control of the firm in which they have the largest ownership stake, it can be assumed that they are not only concerned about the profitability of the firm, but also of the opportunity to obtain perks and other relevant benefits. Such an assumption is justified by the fact that they usually belong to the type of investors that have the power to enforce firm actions as well as to profit from other than value-maximizing use of the firm's resources. And even though they can directly enforce value-maximizing behaviour, it is not readily apparent that value-maximizing behaviour is always their most important objective. In recognition of this, Mueller (2003), for example, noted that such owners might have many other objectives than profit or shareholder-value maximization. To limit the effects of this, it is envisioned that mechanisms such as ownership structure which, as an internal control mechanism, is significant a factor in determining firms' objectives, shareholder wealth and the level of managerial discipline. Within this strand of the literature, ownership structure has focused principally on two specific dimensions, namely: ownership concentration (Demsetz and Lehn (1985), Shleifer and Vishny (1986), McConnell and Savaes (1990), Leech and Leahy (1991), and Morck et al. 2000), and insider ownership as Faccio and Lasfer (1999), McConnell and Savaes (1990), Morck et al. (1988), and Stulz (1988). In the light of this, one strategy that has been advanced to help overcome the agency problem is to concentrate ownership in the hands of fewer shareholders. According to this view, a high degree of ownership concentration ensures effective monitoring of management by shareholders and, should it be necessary, uses their controlling power to intervene to correct management's policies.

In addition, it has also been argued by Faccio and Lasfer (2000) and Crespi-Cladera and Renneboog

(2000) that the ability of shareholders to monitor management largely depends on the type, size and ability of a particular shareholding and that each type of shareholding has different monitoring capabilities. It is widely acknowledged in the literature that having sufficiently large shareholdings allows the holders to control or monitor the performance of the firm, which is in their own best interest if they are to minimize the potential free rider problem. On this issue, the literature notes the existence of a positive alignment effect that is related to concentrated ownership, as increasing the controlling owner's cash flow rights improves the alignment of interest between the owners and the minority owners which, in the process, lessens the negative effects associated with the degree of entrenchment created by the controlling owner (Classes and Fan, 2002).

As well as the potential benefits alluded to, it is acknowledged that high ownership concentration can activate other problems with corporate governance resulting in other types of costs (Bolton and Von Thadden, 1988; Maug, 1998; La Porta et al., 1999; Holdness and Sheehan, 2002; Claessens et al., 2002; Claessens and Fan, 2003; Carlin and Mayer, 2003). First, large shareholders may attempt to expropriate private gains at the expense of small shareholders or of other stakeholder groups. Thus, for example, high managerial ownership of the firm may result in the entrenchment effect, whereby the goal of management becomes one of maximizing their own private benefits. This effect could also occur in the case of an entrenched controlling owner, such as an institutional who may deprive minority shareholders of their right. Second, related to the entrenchment effect, the considerable control enjoyed by large shareholders may also provide them with intangible benefits, such as status and political influence, which in the literature is classified as private benefits of control (Morck et al., 2005). The possible maximization of these benefits may be in conflict with the goal of achieving optimal control of the firm. Third, large shareholders bear excessive risk on their investment by concentrating them in a limited number of companies, although it has been demonstrated that the existence of large shareholders exists, small shareholders may shirk their monitoring responsibilities even more and engage completely in free-riding behavior.

As earlier noted, the empirical evidence of the effect of ownership structures on firm performance is somewhat mixed owing to the simultaneous presence of both the positive incentive and alignment effects and the negative entrenchment and private benefit effects, and related endogeneity problems. While several studies have reported evidence of the existence of a relationship between ownership structure and firm performance, other studies cast doubt on the effectiveness of large shareholders in being effective agents of corporate governance. On a collective level, they argue that there is no cogent and

significant evidence that there is a relationship between ownership structure and firm performance, and that owner-controlled firms tend to perform much better than management-controlled firms (Demsetz and Lehn, 1985; Holderness and Sheehan, Himmelberg et al., 1999; Demsetz and Villalonga, 2001). All these arguments, coupled with the mixed direct empirical evidence, lead us to predict a negative relationship between ownership concentration and firm performance, resulting in the following hypothesis:

*Hypothesis 1: Ownership concentration via dominant shareholders is negatively related to performance at high levels of ownership.*

This hypothesized performance effect of ownership concentration is however open to the critique advanced by Demsetz (1983), who theoretically contends that the ownership structure of the firm is 'an endogenous outcome of competitive selection in which various cost advantages and disadvantages are balanced' (Demsetz, 1983: 384). Therefore, we conjecture that while ownership concentration allows shareholders to preserve their interests directly, it may also have different effects on firm performance. And although arguments against ownership concentration are few, one view against it is that it offers the largest shareholders too much discretionary powers to deploy firm resources in ways that advance their own self interest at the expense of other shareholders (Bai et al. 2005). Thus ownership concentration enables controlling shareholders to exert more control at minimal capital expense, thereby making tunnelling much easier (Johnson et al., 2000). Here, the plausibility of tunnelling by controlling shareholders thus renders ownership concentration as a double-edged sword. These arguments alone suggest that ownership concentration may have no positive economic consequences, and so we expect domestic firms with strong or dominant ownership concentration to be less profitable than foreign owned ones.

On the issue of foreign ownership, it is generally conceded, especially in developing and emerging market economies, that the diffusion of foreign ownership has positive influence on firm performance. Such a view, however, is predicated on a strong assumption that the influx of foreign investment, usually in the form of subsidiaries of Multinational Corporations (MNCs), is the channel through which the propagation of firm-specific assets such as technology, managerial ability, access to network links with foreign markets, access to new technologies and various intangibles and global best corporate governance practices, can promote efficiency and, thus lead to the development of efficient forms of control (Boardman et al., 1997; Majumdar, 1997).

Affirmative side effects of foreign ownership are supported by Kimura and Kiyota (2004) who observe that once foreign firms establish a certain

level of ownership in the equities of a firm they acquire the power of control over the management of the firm and become more receptive in transferring their firm-specific assets. Likewise, Pfaffermayr and Bellak (2000) note that the positive effects of participating in a foreign multinational's network can mainly be found in productivity and profitability, while Khanna and Palepu (2000) and Sarkar and Sarkar (2000) assert that foreign investors are usually active monitors of management. In support of these views, Laing and Weir (1999) argue that firms managed by dynamic foreign chief executives (CEOs) tend to perform better than other categories of firms, while Estrin et al. (2001), using Bulgarian data, found evidence to support the hypothesis that foreign firms perform better than private domestic firms. This is in line with Shleifer and Vishny's (1986) theoretical predictions of a positive effect of foreign investment on corporate governance. Here, foreign investment results not only in foreigners becoming outside blockholders with the ability and the incentive to monitor incumbent management but to also force changes in behaviour that are in the interest of outsider shareholders as a class. This perspective of a positive impact of foreign ownership on performance is also acknowledged by Dahlquist and Robertson (2001) who note that foreign investors can complement the inefficient monitoring of domestic institutions.

A further distinction between purely domestic firms and their foreign-owned counterparts is anchored on the fact that both the latter's prosperity and superiority derives from gains of MNC networks rather than from ownership *per se*. However, ownership matters on governance practices, since control system due to the ownership commonly leads to improvement in firm performance. Hence, the main source of a superior performance of one group over the other is derived from the implementation of better control structures. In so far as foreign corporate practices are superior to those prevailing in the domestic economy, foreign ownership may provide information and encourages the adoption of superior practices in areas such as information disclosure, internal checks and balances, and accounting standards (OECD, 2002). But the question which has been so often posed is whether foreign firms always act in the best interest of outsider shareholders. Naturally, if they acquire a controlling stake in a domestic firm, they may well have the same incentive as other insiders to exploit minority shareholders. In fact, the same sizeable ownership stake that motivates foreign owners to monitor management can also provide the incentive to oppose governance reforms that undermine the position of the dominant shareholder. Furthermore, since foreign owners attain management control when they invest in developing and emerging market economies, it is conceivable that this effect could be rife.

The theoretical literature on this issue does, however, cast some doubt on the existence of a positive relationship between foreign ownership and good corporate governance. In particular, the entrenchment thesis of Morck et al (1988) suggests that more equity ownership by the manager will only worsen financial performance since managers with large ownership stakes may be so powerful that they need not consider the interest of other stakeholders. This situation may also apply to foreign owners, since they usually participate in the management of the firm. In a similar vein, the theory of private benefits of control (Bebchuk and Roe, 1999) explains why foreign insider shareholders may not have an incentive to improve corporate governance. Taking these points of view together, it may be presumed that given their position as large shareholders this in itself provides them with potential benefits that they can enjoy with relative ease, especially if the extant corporate governance is anaemic. Overall, it seems reasonable to predict that ownership matters on governance practices are important for foreign firms, leading us to propose the following hypothesis for empirical testing:

*Hypothesis 2: The shareholding of foreign ownership is expected to have a significant influence on firm performance.*

Hypothesis 2 is proposed on the assumption that foreign owners are more single-mindedly focused on the intrinsic value of the firm than perhaps other owner categories. Therefore, the hypothesised performance effect of foreign ownership provides reasonable grounds for believing H<sub>2</sub> as it is at least conceivable that controlling owners, defined as the largest single owner either in terms of equity or voting rights, are investors that may be influenced by different incentives. Being more closely involved in the control of the firm in which they have the largest ownership stake, they may not only be concerned about firm performance, but also with the opportunity to derive perks and other paraphernalia of ownership for the reasons noted above. This position is founded on the commonly held view that consequent upon the superior corporate governance practices of foreign firms, vis-à-vis their domestic counterparts, foreign ownership may not only promote global best corporate governance practices in their operations, but may also leverage on their ownership and internalization advantages - such as technology, capital, managerial skills, production techniques and branding and other intangibles - to propel greater efficiency in firm performance. However, given weak corporate governance practices in Nigeria, it may be conjectured that foreign ownership may help alleviate two perceived problems prevalent in Nigeria, namely: lack of effective monitoring and the preponderance of relational practices; problems which are all too common in developing and emerging market economies due to weak corporate governance and

legal systems that are typified by ownership concentration.

### 3. Data and methodology

The evaluation of the hypothesized relationships just outlined is based on the empirical investigation of the effectiveness of ownership structure on firm performance. The data set consists of a sample of 201 firms listed on the Nigerian Stock Exchange (NSE) for the period 2001 to 2007. From the list of 201 firms data could be collected on a consistent basis for 73 firms matched by whether such firms were publicly traded on the NSE prior to 2001, and were in continuous operation over the whole sample period. Two aspects of ownership structure are investigated in the study. First, the level of control and concentration of ownership displayed by domestic firms and, the largest shareholding as reflected in foreign ownership. To measure these two ownership structures as an internal control mechanism, we use the ownership concentration variable (COWN) which is defined as the minimum/largest number of shareholders that can jointly exercise control over the firm. This is a fairly good measure of ownership structure in Nigerian companies because of the generally high level of concentrated ownership. As for foreign ownership (FOWN), we use the percentage of shares in the hands of foreign investors.

As a control measure, we use two firm-specific variables: firm size (FSIZE) and leverage (LEV). Here, we should mention briefly that Carter et al. (2003) observed that that the size variable can influence the relationship between ownership and performance. Larger firms are hindered by operational inefficiencies which could be the result of a myriad of factors such as lack of focus or a lesser degree of transparency in managerial actions. Thus they are likely to have elevated levels of agency conflict. On the other hand, Short and Keasey (1999) found that firm size has a significantly positive effect on firm performance, since larger firms have the potential to access funds with greater ease, both internally and externally. They also argue that the presence of economies of scale allows larger firms to create barriers to entry. Thus, to allow for either of these effects, we include firm size as a control variable. Size is defined as the total assets of the firm. In the spirit of Mork et al. (1988), McConnell and Servaes (1990), and Short and Keasey (1999), we utilize a control variable (LEV) to proxy for the level of firm indebtedness, because, as noted by Demsetz and Lehn (1985), ownership structure may influence firm financial structure. Lastly, firm performance is captured by a measure for market price per share (MPS) and earnings per share (EPS). As for the relationship between leverage and firm value, while stressing the importance of debt in restricting managerial discretion over the use of free cash flow, Stultz (1988) suggests an inverse relationship

between leverage and value. Myers (1977) argues that the presence of debt in the capital structure is more likely than not to prevent a firm from investing in profitable projects. On the other hand, Stultz (1988) argues that leverage concentrates insider ownership and thus reduces the likelihood of a takeover bid succeeding. In addition, Billett (1996) documents that

leverage can reduce the probability of a firm being acquired through the increased co-insurance potential of target debt. Based on these arguments we include leverage as a control variable, defined as total long term debt divided by issued equity. Table 1 shows the frequency distribution by industry.

**Table 1.** Frequency Distribution

Industry	No.	(%)
Agriculture	1	1.35
Automobile and Tyre	3	4.11
Breweries	3	4.11
Building materials	4	5.48
Chemicals and Paints	5	6.85
Conglomerates	8	10.96
Commerical/Services	1	1.37
Computer & office equipment	2	2.74
Construction	3	4.11
Engineering technology	1	1.37
Food/beverages/tobacco	5	6.85
Industrial/domestic	7	9.59
Insurance	9	12.33
Machinery (marketing)	1	1.37
Packaging	3	4.11
Petroleum products (marketing)	6	8.22
Healthcare	6	8.22
Printing and Publishing	3	4.11
Real estate	1	1.37
Emerging markets	1	1.37

We use the NSE classification system, which divides firms into nonfinancial categories according to the contribution of each industry's net sales. We observe the largest number of firms in our sample classified as insurance, conglomerates, industrial/domestic products, healthcare, and petroleum products, with only minimal representation of firms in the agriculture, commercial/services, engineering technology, machinery, real estate and emerging market sectors. The minimal representation of firms in these sectors may be explained by the lack of foreign involvement in these sectors. It is perhaps noteworthy to also mention that the lower representation of industries with assets deemed difficult to monitor is to be expected in markets where expropriation by insiders is a common occurrence.

The objective of the present study is to evaluate the effectiveness of governance mechanisms on firm performance. To delve deeper into the issue, we estimate, on the basis of the hypotheses stated above, for each ownership type three models based on the

OLS regression procedure, to determine the relationship between ownership structure and firm performance:

$$FPER_i = \beta_0 + \beta_1 COWN + \beta_2 FOWN + \mu_i \quad (1)$$

Where: **FPER** denotes firm performance, **COWN** is concentrated ownership as earlier defined, and **FOWN** denotes foreign ownership. The subscript

*i* is used to denote individual firms and  $\mu_i$  denotes a standard i.i.d disturbance or stochastic term. Estimates of the relationship between firm performance and ownership structure can be found

through  $\beta$ , while  $\beta_0$  refers to the firm-specific effects, which capture all time-in variant unobserved firm specific effects. These are features that are idiosyncratic to a particular firm (e.g. firms may differ due to unobservable firm specific capabilities). We employ the same technique applied to equation (1), with the notable difference that we control for

size by substituting an appropriate measure into Eq. (1), as shown in Equation (2)

$$FPER_i = \beta_0 + \beta_1 COWN + \beta_2 FOWN + \beta_3 FSIZE + \mu_i \quad (2)$$

Following theory and the wealth of empirical evidence, we employ the next model (controlling for leverage) to capture the relationship between ownership structure and firm performance by substituting an appropriate measure into Eq. (2) as follows:

$$FPER_i = \beta_0 + \beta_1 COWN_i + \beta_2 FOWN_i + \beta_3 FSIZE + \beta_4 LEV_i + \mu_i \quad (3)$$

In the models, the dependent variables represent the measures of firm performance that are likely to be affected by corporate ownership structures. Although studies, such as Demsetz and Lehn (1985), and Shleifer and Vishny (1986), have used share price, Tobin's Q ratio and profits as measures of performance, the present study employs firm

performance measures which utilize share price and profits, instead of Tobin's Q. This is because information on replacement cost, which is required for the computation of Tobin's Q, is not available for the firms included in our sample. Furthermore, since Tobin's Q is the ratio of valuation of shareholders to the market value of the firm's assets, at the margin, the shareholders' valuation is expected to approximate to, and so will be captured by, the firm's share price.

#### 4. Empirical Results and Discussion

Table 2 presents the summary statistics of our sample of 73 listed firms in Nigeria from 2001 to 2007. The mean, minimum and maximum of each independent variable are provided. Panel A shows that ownership concentration ranges from 1 to 411, with a mean of 24. Most notably, foreign shareholders own on average 31.99 percent of the outstanding shares with a range of 0 to 85.

**Table 2.** Descriptive statistics for the sample

Variables of interest	Mean	Minimum	Maximum	Std. dev.	<i>n</i>
<b>Panel A: Variables</b>					
COWN	24.00	1.00	411.00	70.00	73
FOWN	31.99	0.00	84.70	26.72	73
LEV	3.55	0.00	25.44	5.40	73
FSIZE	10,264.00	80.00	74,702.00	15,520.00	73
<b>Panel B: Pairwise correlations between variables</b>					
	COWN	FOWN	LEV	FSIZE	VIF
COWN	1.00				1.619
FOWN	-0.0562	1.000			1.888
LEV	0.042	0.319	1.000	0.545	1.517
FSIZE	-0.001	0.348		1.000	1.522

Notes: COWN is concentrated ownership. FOWN is foreign ownership. LEV is leverage. FSIZE is the size of the firm.

For the control variables, the average firm size in the sample is N10,264.00 million, while leverage is 3.55, suggesting that Nigerian firms make little use of debt in their capital structure, presumably to avoid potential agency problems related to underinvestment. The simple correlation matrix, shown in Panel B, indicates that the independent variables are not highly correlated. In fact, all correlation coefficients are below 0.8. The findings here are further supported by the variance inflation factors (VIF).

The primary OLS regression results are presented in Table 3, Panels A, B, and C, where the dependent variables are market price per share (MPS) and earnings per share (EPS). The independent

variables are concentrated ownership (COWN) and foreign ownership (FOWN). Although the model expressed in Eq. (2) is far less powerful than the model in Eq. (3), it is however still relatively strong. The F-statistic is significant to the 0.05 level or better. In the first regression, we examine the linear impact of concentrated ownership on the profitability of firms (Panel A). The overall model is significant for both measures of firm performance. Our results indicate that the ownership concentration (COWN) coefficient shows a positive influence on the firm performance measures, suggesting that once dominant shareholders have a sufficient ownership level for unchallenged control, the profitability of firms improves and vice versa. The results here also

indicate that ownership concentration is inversely related to firm value. We also observe a positive association between foreign ownership and the profitability of firms, which is significant at the 1% level. This suggests that the profitability of firms is sensitive to this variable. The results here were expected and supported the hypothesized performance effect of foreign ownership.

Panel B reports the results of the effect of ownership structure on market price per share (MPS) and earnings per share (EPS), while controlling for

firm size. Taken together, a positive coefficient is found between ownership concentration and the profitability of firms, but the relationship is not significant. This lack of significance leads us to conclude that there is effectively no relationship between the variables of ownership concentration and firm performance, and Hypothesis 1 is supported. What this tells us is that the Nigerian ownership structure with its characteristics of dominant controlling owners suffers from some deficiency.

**Table 3.** Regression models with different performance measures

<b>Panel A:</b> $FPER_i = \beta_0 + \beta_1 COWN + \beta_2 FOWN + \mu_i$						
Variables	MPS			EPS		
	Beta coef.	t-values	P-values	Beta coef.	t-values	P-values
OWN	0.160	1.162	0.249	0.150	1.102	0.274
FWON	0.371	2.699***	0.009	0.404	2.976***	0.004
Adj R <sup>2</sup>	0.071			0.092		
F.Statistics	3.737**		0.029	4.667**		0.013

  

<b>Panel B:</b> $FPER_i = \beta_0 + \gamma_1 COWN + \beta_2 FOWN + \beta_3 FSIZE + \mu_i$						
Variables	MPS			EPS		
	Beta coef.	t-values	P-values	Beta coef.	t-values	P-values
OWN	-0.049	-0.476	0.635	-0.020	-0.175	0.861
FOWN	-0.001	-0.006	0.995	0.101	0.821	0.414
FSIZE	0.732	8.120***	0.000	0.597	5.865***	0.000
Adj R <sup>2</sup>	0.518			0.386		
F.Statistics	26.781***		0.000	16.061***		0.000

  

<b>Panel C:</b> $FPER_i = \beta_0 + \lambda_1 COWN_i + \beta_2 FOWN_i + \beta_3 FSIZE + \beta_4 LEV_i + \mu_i$						
Variables	MPS			EPS		
	Beta coef.	t-values	P-values	Beta coef.	t-values	P-values
OWN	-0.134	-1.491	0.141	-0.091	-0.837	0.405
FOWN	-0.119	-1.229	0.223	0.002	0.016	0.987
FSIZE	0.536	6.169***	0.000	0.433	4.084***	0.000
LEV	0.435	5.009***	0.000	0.365	3.447***	0.000
Adj R <sup>2</sup>	0.643			0.469		
F.Statistics	33.369***		0.000	16.917***		0.000

\*Significant at 10% level; \*\*Significant at 5% level; \*\*\*Significant at 1% level

In line with this reasoning, it seems that ownership concentration in the hands of dominant shareholders impairs firm performance. Also, the presence of dominant shareholders in our sample firms can potentially result in agency problems between controlling and minority shareholders as noted by Shleifer and Vishny (1997). This is because

dominant controlling owners may actively choose investments that align with their personal interests rather than those of the other shareholders; thus, their immediate predilection is to choose investments that do not necessarily redound to the benefit of the remaining shareholders.



If we compare the behavior of foreign-owned firms, the results also showed a significant negative relationship. However,  $\beta_4$  which reflects the relationship between firm size and the profitability of firms indicates a significant and positive association which suggests that there are improvements that accrue from foreign ownership. This supports Hypothesis 2. This is not particularly surprising given that foreign-owned firms tend to have more resources and greater access to external markets. These are significant ownership and internalization advantages that give them (foreign firms) competitive edge in corporate governance and performance respects and, in the process over their domestic rival firms. The significant negative impact of foreign ownership could suggest that these firms with greater tendency to probe more profoundly than domestic firms might also incentivise their managers to embrace best global governance practices. In addition, the joining of autonomy with greater incentive to discipline management further compels managers of foreign-owned firms to act optimally and to avoid the related set of human factors (such as opportunism, bounded rationality attributes of decision making, corruption, etc.) which together with a set of host country specific factors create conflict of interest on the one hand, and impede the assessment and organization of economic activities, on the other hand. These human and domestic environmental factors that impede economic activities manifest themselves somewhat differently within domestic firms. A symmetrical analysis of corporate governance practices thus requires that we acknowledge the transactional limits of domestic firms as well as their sources of organizational failure, mainly because of lack of bounded rationality attributes/skills of good corporate governance decision makers or managers of domestic firms are indifferent to the quality of corporate governance required to enhance firm value, perhaps as a result of the entrenched corruption, cronyism and associated moral hazards. There is a preponderance of domestic ownership of firms in Nigeria, as opposed to foreign ownership, and they are mostly directly involved in the day-to-day management of the firms; as such, the result on concentration ownership coincides with the entrenchment effect of large shareholdings as suggested by Morck, et al. (1988), Shleifer and Vishny (1986s), and Claessens, et al. (2002). This interpretively reflects the adverse (moral hazard) effects of owners using their controlling position to expropriate benefits for themselves at the expense of minority shareholders. As a result, resources may be diverted to activities that benefit the dominant owners themselves rather than to those which prospectively enhance long term, firm performance. On account of this prospect, Shleifer and Vishny (1986) note that large investors can be so powerful that they may pursue their own interests which need not correspond with those of other (small) investors or employees in the firm. Thus, it may be

concluded that the potential agency problem may lead to suboptimal allocation of resources that only serves to compromise firm performance.

Focusing further on the regression estimates, Panel C, based on Eq. (3), presents the regression results where market price per share (MPS) and earnings per share (EPS) are regressed on ownership structure, while controlling for firm size (FSIZE) and leverage (LEV). The control for firm size and leverage suggests that the latter (LEV) adversely affects performance of the firms in the sample, which supports the findings of Maury and Pajuste (2005) who reported similar effects of leverage on firm performance, while the size variable was also found to be negatively related to ownership concentration. Our results here appear to be broadly consistent with the results produced by Maury and Pajuste (2005) and Demsetz and Lehn (1985) and other studies noted in our introduction. The negative relationship implies that there is no relationship between the variable of concentrated ownership and profitability, further supporting  $H_1$ . A possible explanation for the negative relationship between concentrated ownership and firm performance is the possibility that the dominant controlling owners exploit minority investors by focusing instead on their *de facto* personal interests to the detriment of overall shareholder value-maximization. Therefore, the empirical evidence discussed in our introduction would seem to lend some credence to the entrenchment effects of ownership concentration. The finding of a significant relationship between foreign ownership and firm performance lends credence to the concession that foreign ownership is imbued with strong and effective corporate governance properties, as the results were largely unchanged even with the inclusion of both control variables.

## 5. Conclusion

This paper examined empirically the question of whether ownership structure leads to improvements in firm performance in an emerging economy with imperfect or undeveloped market for corporate control. We concentrated on the Nigerian economy which bears these characteristics. To test the hypotheses that (i) strong owner concentration has no influence on firm performance, and (ii) foreign ownership influences firm performance, we used a sample of 73 firms over the period 2001-2007. We provide empirical evidence regarding two measures of firm performance - market price per share (MPS) and earnings per share (EPS). Our findings shed light on the way these ownership structures influence firm performance in Nigeria and substantiate the findings of studies in economies with developed market for corporate control.

An important result is the negative, albeit, significant effect of concentrated ownership on firm performance, which indicates that the model of

corporate governance predominant among Nigerian-owned firms does not function decisively. We also found that foreign ownership has a significant influence on firm performance, which suggests better corporate governance practices in foreign-owned firms. Our findings are corroborated by DeAngelo and DeAngelo (1985) and Zingales (1994). The implications of these findings are that a government with a reform agenda should focus its attention on measures likely to secure improvements in the performance of corporate Nigeria, because, as indicated by the findings of this study, the emphasis on strong ownership concentration is misguided for it does not yield superior firm performance. Further, with the evidence of significant positive relationship between foreign ownership and firm performance, policy initiatives that promote inward foreign direct investment (FDI) are likely to have affirmative consequences.

Some caveats to our study will help to illuminate the scope for future research. First, Leuz *et al.*, (2003) aver that insiders in a weak corporate governance setting are more likely to under-report the true financial outcome of the firm so as to hide their private benefits, and that concentrated ownership acts as a substitute for missing country-level corporate governance mechanisms. We encourage corporate governance scholars to evaluate a firm-level test to ascertain whether a particular ownership structure can improve corporate governance practices and at the same time restrict private benefits of control, and reduce incentives to under-report financial situations. Second, we focus on corporate ownership and board monitoring, both of which are internal governance mechanisms. Further research is needed to examine board characteristics and cause and effect, using a much larger sample size, and including the financial sector that has undergone substantial reforms since 2005.

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