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Changes Of Productive Returns Against Ownership Structure

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Abstract

Ownership structure has been a prime variable in corporate governance literature. The structure of the ownership of corporate governance, influence the value of the firm. As proposed by agency theory, different ownership structure leads to varied level of managers' motivation and engagement, which in turn leads to value creation. Using panel data for period 2011-2022 for a sample of listed firms in India, the study attempts to see a how the varied ownership structure influences the productivity of a firm - measured in terms of accounting performance measures while taking firm size, firm age, and leverage as control variable. Being multidimensional variable, the ownership is being analysed along the dimensions such as shareholders' concentration, identity among others for its effects on the performance.

Keywords: Corporate governance, agency theory, ownership structure, Productive Returns

Introduction

The discussion on ownership structure and returns has been there in much research from earlier periods (Jensen and Meckling, 1976). Some researchers suggest that ownership changes do not affect the returns for the company (Hart 1995). While much of the research and studies are of the opinion that returns of a company, especially ROA and ROCE, are affected due to the ownership structure with increased participation of retail investors in the stock markets of India, the question of profitability to ownership structure becomes important.

The relationship between ownership structure and profitability has been discussed historically as agency problems for the business (Mitnick 1996). The concept of this paper is to identify the relevance of ownership structure in the Indian markets, keeping in mind the securities listed in the stock exchanges. General conception states that as ownership increases profitability is bound to increase as owners have more stake and will do more for the organization to increase its profits. Difference between ownership structure has also been made on the aspect of Indian promoters and foreign promoters. The basic idea of this differentiation is to find the variation that happens when we companre the ownership styles of Indian and Foreign promoters, and how their leadership styles affect the profitability of the organization. The paper covers literature review in the next segment, followed by data collection and methodology, which is followed by results, discussions, and conclusion.

Literature Review

Ownership Structure (OS) is a major constituent of corporate governance among others such as Board of Directors composition and leadership duality (Shleifer and Vishny, 1997), which results in sub-optimal returns for the organization.

Corporate Governance, through its various constituents have significant influence on corporate performance (Lemmon & Lins, 2003; Ganguli & Guha, 2016), this effect may be positive or negative, but has a leading effect on the returns of the organizations.

Being a major constituent Organizational Structure (OS) fairly influence the firms' operating and market-based performance (Yasser and Mamun, 2016), this was proved using pooled OLS technique on publicly listed companies.

Promoter ownership, through close monitoring, diminishes the agency costs and therefore have a higher firm performance (Isakov and Weisskopf, 2014), hence enhancing the profits of the organizations.

Presence of institutional investors is believed to be positive as they tend to monitor the activities of the managers in an efficient manner (Elyasiani and Jia, 2010), institutional investors have experience to negate the agency problem and to extract maximum possible revenues from the management.

X Xu and Wang, 1999 discussed the positive effects of increased ownership to the profits of the organization. Abdullah and Ismail, 2017, noted the same point stating the positive environment on the management of the organization where ownership stake is high.

Whereas Lepore, Pisano et al. 2019, established that good governance of high promoter ownership is a myth and has no significant effect on the profitability of the organization. Similar observations were made by Kao and Hodgkinson, 2019 stating that ownership stunts organizations performance. Udin, Khan and Javid, 2017 discussed financial disturbances and its relationship with ownership structure.

Feng, Hassan and Elamer, 2020 discussed the relevance of positive ownership of chinese real estate companies on their profitability. Rashid, 2020, discussed how ownership structure complements the profitability of the organization. Comison-Zozoza and Fores-Julin, 2020 commented on the favourable growth of profits where ownership controls the governance of the organization.

The literature for the relationship between ownership structure and profitability is quite rich. Many researchers have tried to find out the relationship in various contexts, be it public private ownership or profitability in communistic and capitalistic environments. ***Though***, much research has tried to explore the effect of ownership on profitability, some positive and some negative, most of them have not studied the relationship in the Indian context, also none of the research took such longer time for the study as well as the sample collected was also not that comprehensive. This paper collected the data for the decade and for all the companies listed in the exchange.

Research Methodology:

The data was extracted using CMIE Prowess. The data was collected for the period between 2011-2022. The basic idea to take this time frame was to consider data beyond the sub-prime crisis. There were 1145 companies that were traded between 2011-2022 at the NSE and continue to trade. Data from all these companies was collected. Companies with ROE greater than +100% and less than -100% were excluded from the study as outliers.

Pooled OLS was used for the selected 11450 data points. As the model assumes that economic environment affects the returns of all the organizations in an equal way. There were three hypotheses used for the study:

H1: Higher the level of promoters' shareholding better the firm performance

H2: Higher the level of shareholding of the non-promoter foreign shareholder better the firm performance

H3: Higher the level of shareholding of the institutional shareholders better the firm performance

For study of these hypothesis the following models were used:

$$\text{M1: } \log(ROE) = \beta_1 PromPer + \beta_2 FrpPer + \beta_3 Insper + \beta_4 MC + \beta_5 Beta + \epsilon$$

Where,

- PromPert - Indian Promoter ownership (Percentage)
- FrpPer - Foreign Promoter ownership (Percentage)
- InsPer - Institutional Investor ownership (Percentage)
- MC - Market Capitalization (Control Variable)
- Beta - risk of the investor (Control Variable)
- RoE: Return on Equity (YoY)

Market Capitalization was converted into a dummy variable into large cap, small cap and middle cap companies. For ease of understanding, SEBI's standard of categorising large cap, to small cap companies was used.

Results and Discussions:

Coefficients:	**Estimate**	**Std. Error**	**t value**	**Pr(>|t|)**
Ppercent	-6.86E+00	7.46E-02	-92.06	<2e-16
Fpercent	-5.95E+00	1.50E-01	-39.54	<2e-16
Insper	-7.27E+00	2.19E-01	-33.23	<2e-16
MC	7.05E-01	3.17E-02	22.21	<2e-16
Beta	-6.00E-06	2.06E-07	-29.14	<2e-16

Table 1: Showing results of Model M1, where market capitalization was used as figures (Adj R^2-0.7037)

Coefficients:	**Estimate**	**Std. Error**	**t value**	**Pr(>|t|)**
Ppercent	-8.12E-01	1.57E-01	-5.174	2.33E-07
Fpercent	-9.36E-01	1.81E-01	-5.165	2.45E-07
Insper	-4.92E+00	2.33E-01	-21.132	< 2e-16

CategoryMID	-6.37E-01	1.48E-01	-4.295	1.77E-05
CategorySMALL	-4.24E+00	9.57E-02	-44.269	< 2e-16
Beta	-7.08E-06	1.78E-07	-39.7	< 2e-16

Table 2: Showing results of Model M1, where market capitalization was used as dummy variable (Adj R^2- 0.7786)

Pooled OLS was performed on log of ROE as dependent variable and Indian Promoter%, foreign promoter% and Institutional Investors as independent variables. Market Capitalisation and Beta was taken as control variables. It was observed that promoters have a negative impact on ROE.

It is observed that large cap companies are stable and therefore, non-institutional investors are confident about these companies and therefore they remain unaffected by the change in ownership. Whereas the same was seen with Mid cap companies. But for small cap companies non institutional investors are sceptic about the developments in the company and hence depend on the owners to identify the profitability of the company, since if promoters share is less than non-institutional investors do not invest in these companies and therefore, returns are low.

Since pooled OLS ignores heterogeneity amongst groups, to negate this effect we performed fixed effects panel model on log ROE, taking the same variables, clustering market capitalisation in three categories Large cap, mid cap and small cap. Random effects panel was not used ROE was found to be time invariant over a period of 10 years. On fixed effects panel it was observed that big corporations have no effect of ownership percentage on ROE whereas small and mid-cap companies have a negative effect on ROE. Concentration is Inversely proportional to the size of organization when it comes to ROE.

Conclusion

The research implication of this study states that ownership structure, with high concentration hinders the ROE of the organization. The effect which is seen to be high in the Institutional percentage, which aligned with agency theory. Promoters' percentage also has a negative effect signifying ineffective leadership active participation in the organization.

This research has some managerial implications as we see that MID cap companies have higher negative impact on the profitability when compared with ownership. So, organizations can plan, their ownership structure, with respect to the market capitalisation and the risk they carry.

The paper sets tone for retail investors to see that not always high concentration of ownership structure, leads to profitability, so investment must be made sensibly, keeping this fact in mind. However, the data used in the paper is quite extensive, limitations of the study is that many few companies in the study are highly leveraged and should be studied separately. Future studies can use debt-equity ratio also as a control variable, since R2 is still at 0.70 and 0.77, which clearly can incorporate one more control variable.

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