



Ownership Concentration And Firms' Performance

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Abstract

Purpose: This paper aims at investigating ownership concentration and explore the nature of the relationship between ownership concentration and firms' performance in the Egyptian economy over 2014 -2018.

Design /methodology / approach: The required data are gathered from the annual financial statements of the interested companies. The primary sources that have been used to collect data are: The Egyptian Stock Exchange and the Co face Financial Yearbook over the period 2014-2018. The sample of the existing research includes the companies listed in EGX30 over the period 2014-2018. The researcher employs Ordinary least Square method (OLS) to estimate the impact of ownership structure on firms' performance measured ROA and ROE. Two regression models were employed in this research.

Findings: My results confirmed that the mean value of ownership concentration of the largest shareholder in this research sample is 18.3570%. This implies that largest shareholder in Egypt has a fairly ownership concentration. Additionally, ownership concentration owned by the largest shareholder in my sample ranges from 17% to 20%. More than half of the total percentage of shares is already in the largest five shareholders' hands. It also suggests that the largest five shareholders have a widely concentrated structure of ownership. Additionally, the ownership concentration by largest five shareholders ranges from 58% to 59%. Ownership concentration measured by shares owned by largest owner contributes positively in enhancing firm's financial performance measured by ROA. However, it decreases significantly returns on equity (ROE). In regards to ownership concentration measured by the percentage of shares owned by the largest five owners, conclusions revealed that this percentage increases significantly the measurements of profitability employed by current research (ROA, ROE).

Originality/ value: This article is one of the first to investigate whether ownership concentration explains the association between ownership concentration and firms' performance.

Keywords: Ownership concentration, the percentage of largest owner, the percentage of largest five owners, ROE, ROA, financial performance.

Introduction

Over the past decades, a number of rich and diverse studies have emerged on corporate governance and, more specifically, on the relationship between corporate governance and corporate financial performance. Many corporate governance issues arising from ownership and management separation have arisen. (Onder, Z., 2003), (Vu, M., Phan, T., Le, N., 2018).

The effectiveness of corporate governance is determined by two fundamental elements. First, the existence of law protecting ownership rights of shareholders. Second, the ownership structure and more specifically, the degree of concentration of ownership as a proportion of shares owned by majority shareholders (Vasilić, N., 2019).

Ownership structure plays a fundamental role in companies that perform well. When few people own a large number of shares, it can be argued that the ownership structure is concentrated while the ownership structure is dispersed when the majority of shareholders own the company stocks, and every one owns a small number of outstanding stocks (Yurtoglu, B., 2000; Weiss, C., and Hilger, S., 2012; Ulah, W., 2017; Simonti, M., et.al 2003). Previous studies have shown diverse conclusions on the impact of ownership structure on corporate financial performance (see for example: Shahrier, N., et.al 2020; Pivovarsky, A., 2000; Pedersen, T., and Thomsen, S., 2003; Kevin, J., et.al 2006). Some researchers have argued that the agency problem can be solved through a concentrated ownership structure. On the other hand, some researchers have suggested that the concentrated ownership structure may be a cause for the problem of agency between a majority and minority shareholders. Accordingly, a well-designed ownership structure could help reduce the agency problem and in this way increase the company's performance. (Holderness 2009; Ducassy and Montandrou 2015; Kumar & Zattoni, 2015). Based on this, the current research investigates the nature of the relationship between ownership concentration as a dimension of corporate governance and financial performance of corporations in Egypt.

Research problem, questions and objectives

One of the major research topics on the relationship between corporate governance and financial management that emerged from agency theory is the relationship between ownership structure and corporate performance. (Horobet, A., Belascu, L., Curea, S., Pentescu, A., 2019). Since the research introduced by Berle and Means (1932), ownership concentration has become an important research area in corporate governance (see Kumar & Zattoni, 2015). However, previous studies have shown less interest in the relationship between ownership and performance in the case of emerging economics. (Horobet, A., Belascu, L., Curea, S., Pentescu, A., 2019).

Literature has revealed two competing points of view: the substitution effect and the expropriation effect. According to substitution effect, more power in the hands of controlling shareholders, leading to more follow-on action by the controlling shareholders, thus maximizing the organization's performance. (Kuzentsov, A., et.al 2008; Kaser, C., Moldenhauer, B., 2007) However, according to expropriation effect, more power in hands of dominant shareholders would create the risk of expropriation for minority shareholders

(Jentsch, V., 2019; Hassan et.al 2016; Fedenia, M., and Hirschey 1999) Expropriation risk is supposed to be higher when one shareholder has a range of 5% to 25%. In this case, the opaque structure and weak control expected to be achieved by dominant shareholder to facilitate the expropriation of minority rights. Moreover, the risk of expropriation may increase when the organization breaks one share-one vote rule. (Bozec, Y., Bozec, R., 2007).

Based on the previous discussion, Literature revealed the following gaps that the current research tries to fill. First, few number of researches in emerging economics have shed light on investigating the relationship between ownership structure and performance (Horobet, A., Belascu, L., Curea, S., Pentescu, A., 2019). Based on this, my current research is one of the first researches that tries to investigate the relationship between ownership structure and financial performance of firms in Egyptian context. Second, Literature has introduced two contradictory points of view on the relationship between firms' performance and ownership structure based on the kind of ownership structure (Kuzentsov, A., et.al 2008; Kaser, C., Moldenhauer, B., 2007; Jentsch, V., 2019; Hassan et.al 2016; Fedenia, M., and Hirschey 1999; Bozec, Y., Bozec, R., 2007). In this regards, this research investigates whether ownership structure in Egypt improves financial performance or decrease it.

Based on the previous discussion, the current research tries to answer the following questions: what is the ownership structure in Egypt? What is the impact of ownership concentration on financial performance of firms in Egypt?

In the light of research questions, the research objectives can be determined as follows: (1) Determine ownership structure in Egypt. (2) Determine the influence of ownership structure on financial performance.

Literature review and hypotheses

A. substitution effect

Since the 1980s, the problem of agency between shareholders and managers has been a major concern in previous studies on corporate governance (Dwivedi, N., and Jain, A., 2005; Busta, I., et.al 2014). According to agency theory, the conflict between managers' goals and shareholders may rise from differences in their preferences for management efforts, their preferences for risk. Unlike shareholders, managers prefer to expand their companies for more power, prestige and incentives. Many control mechanisms have emerged unify the interests of shareholders and managers (Bozec, Y., Bozec, R., 2007; Barontini and Bozzi, S., 2011).

The concentrated ownership structure was widely accepted by researchers in terms of its ability to reduce the problem of agency and thereby improve the performance of the company. This positive influence of concentrated ownership structure can be explained by efficient pursuit, which means that the

concentrated ownership structure gives the large shareholders strong incentives and greater authority to monitor management at low cost. (Hu, Y., Izumida, S., (2008; Abradi, L., Rondi, L., 2020)

Agency theory suggested that the presence of a high degree of ownership concentration would contribute to a reduction in opportunistic management behaviour, which would have a positive effect on the performance of the company as a whole. Moreover, the presence of a small number of large stakeholders gives them the right to participate in decision-making process and control management behaviour. Large stockholders are more interested in monitoring the activities of managers. This means that through constant monitoring of managers, large shareholders reduce the opportunities for management fraud, resulting in improved corporate performance as whole. (Vasilić, N., 2019; Kuzentsov, A., et.al 2008; Fedenia, M., and Hirschey 1999).

B. Expropriation effect

Since the late of 1990's, the struggle between majority and minority shareholders has received considerable academic attention. Under a concentrated ownership structure, a hierarchical control structure, voting rights for major shareholders have given the right to controlling shareholders to ensure control over managers (Vasilic, N., 2019; Nakabayashi, M., 2019; Wang, B., 2017). On the other hand, the spread of ownership could create another problem which is large shareholders may confiscate the wealth of minority shareholders. Small shareholders fear that their rights will be expropriated by their large shareholders, resulting in higher capital costs for companies, which means inefficient investment (Hu, Y., Izumida, S., 2008; Chen, M, et.al 2017; Benamoraoui, M., et.al 2019). In fact it can be argued that the greater the risk of minority expropriation, the greater the incentive for controlling shareholders to maintain opaque structure and weak monitoring that will facilitate minority expropriation. (Bozec, Y., Bozec , R., 2007).

The risk of expropriation arises for several reasons. First, having a manager who is at the same time a controlling shareholder is an established manager who cannot be discarded even if his performance is unsatisfactory. Second, if the manager is a controlling shareholder, he will cancel any attempt at hostile acquisition. In this case, the risk of expropriation takes the form of agency costs that affect the performance of the company. (Bozec, Y., Bozec, R., 2007; Roseetto, S., and Staglino, R., 2007; Hedge, S., et.al 2020; Hu, Y., Izumida, S.,2008).

In the light of the previous discussion of the two contradictory points of view, numerous amount of research papers have been introduced to investigate the relationship between ownership concentration and corporations' performance. In Japan Hu, Y., and Izumida, S., (2008) aim at examining the causation relationship between firms' performance and ownership

concentration. This research showed positive impact of ownership concentration and firms' performance from 1980 to 2005. Busta, I., Sinani, E., Thomsen, S., (2014) depended on all publicly commercial banks from 17 western economics during 1993-2005. It finds that the effect of ownership concentration on banks value differs across the institutional setting. The impact is negative for countries belonging to Germany. However, the effect remains positive for countries under Scandinavian legal tradition. Authors argue that the differences in the impact of ownership concentration on bank performance may be due to the differences in shareholders protection across different legal families and identity of predominant block holders. In India, Dwivedi, N., Jain, A., (2005) confirmed that a high proportion of foreign shareholding is associated with an increase in the market value of firms. In Malaysia, Hassan, S., Karim, N., Salamuddin, N., (2016) confirmed that the relationship between ownership concentration and firms value is not nonlinear relation. Firm's value is measured using Tobin's Q while ownership concentration is measured by total percentage of ordinary shares owned by a firm's largest shareholder and the largest five shareholders. Heugens, P., Essen, M., Oosterhout, J., (2009) introduced a research on the relation between financial performance and ownership concentration in Asia, their conclusion confirms positive association between the two variables. In Pakistan, Abdallah, M., Safraz, M., Qun, W., and Chandhary, M., (2019) concluded that ownership concentration has a significant negative impact on ROA and Tobin's Q.

In Switzerland, Jentsch, V., (2019) confirmed that the presence of a controlling shareholder decreases firms' value. In Germany, Kaserer, C., and Moldenhauer, B.,(2008) find an evidence for a positive and significant relationship between corporate performance—as measured by stock price performance, market-to-book ratio and return on assets—and insider ownership over a 5 year period. Overall, the results indicate that ownership structure might be an important variable explaining the long term value creation in the corporate sector.

Based on the previous discussion the hypotheses of the current research can be formulated as follows:

H1: Ownership concentration has a positive impact on ROA

.H2: Ownership concentration has a positive impact on ROE.

Data and methodology:

Data and sample :

This section discusses the data used and the methodology implemented in the study. I collected data from Egyptian stock exchange (the companies included in EGX 30).

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Variables measurements

The current research identifies the meaning of ownership concentration as the percentage of shares held by shareholders (Shahrier, et.al 2020). Based on this, to measure ownership concentration variable, I used the total percentage of ordinary shares owned by a firm's largest shareholder (OC1) and the largest five shareholders (OC5).

The current research considers the accounting rate of return on assets (ROA) and accounting rate of return on equity (ROE). According to Fedenia and Hirschey (1999), ROA is the best available indicator of management use of assets. This actually is attributed to a reason which is ROA is not affected by reporting errors tied to leverage or recapitalization tied to share repurchases. ROA is the ratio of net income to total assets, while ROE is the ratio of net income to total equity capital. These two variables indicate management accomplishment given available assets (ROA) and shareholder's equity (ROE) (Shahrier, et.al 2020). It is worth to mention that instead of depending on only one variable (ROA) as a measurement of profitability, it is better to include another measurement of profitability which is (ROE). The inclusion of another measurement increases the robustness of the research investigation.

Current research considers some control variables: Some of control variables are employed to reveal the influence of other variables on financial performance.

Debt: This variable is measured by book value of total debt scaled by book value to total assets. Literature reveals two contradictory points of view on the relationship between debt and financial performance. Some researchers such as (Haiyan, et.al 2009; Hassan, et.al 2016) indicated that debt has a positive influence on financial performance as it reduces the expropriation effect. Also, it plays as a monitoring tool. On the other hand, debt may have a negative influence on financial performance if it is seen to increase the agency costs of debt. (Jensen 1986).

Firm size: Measured by the natural log of book value of total assets. Firms' size might have a negative influence on financial performance indicators. When firms become very large it might have excess agency costs which might constraint the ability of firms to increase its profitability (Himmelberg et.al 1999).

Methodology:

Two models were employed to test this research hypotheses:

Model (1)

$$ROA_{i,t} = \alpha_0 + \alpha OC1_{it} + \alpha OC5_{it} + \alpha TD_{it} + \alpha \text{Log assets } I_{i,t} + \mu_{i,t}$$

Model (2)

$$ROE_{i,t} = \alpha_0 + \alpha OC1_{it} + \alpha OC5_{it} + \alpha TD_{it} + \alpha \text{Log assets } I_{i,t} + \mu_{i,t}$$

Where I, t denote firm and year respectively. The dependant variable in the first equation is ROA which is returns on assets and dependant variable in the second equation is ROE which is return on equity. The independent variables in the both models are $OC_{i,t}$ which is total percentage of ordinary shares owned by firm's largest shareholder, and $OC5_{it}$ which is the ordinary shares owned by firm's largest five owners. The rest of the variables in the equation are control variables which are TD (total debt), (log assets) firms' size and $\mu_{i,t}$ refers to error term.

Empirical analysis and discussions:

A-Descriptive analysis

Table (1)

	ROA	ROE	OC1	OC5	Debt	Size
Mean	0.005522	0.028429	18.53750	58.58938	0.190577	7.308011
Median	0.005788	0.029529	18.10000	58.80000	0.188890	7.323582
Maximum	0.009924	0.052559	20.00000	59.00000	0.210664	7.431140
Minimum	-0.006001	-0.033004	17.30000	58.00000	0.177396	7.162666
Std. Dev.	0.003490	0.018947	1.117565	0.430905	0.010317	0.090153
Skewness	-2.023657	-1.870607	0.355156	-0.468092	0.640549	-0.129884
Kurtosis	7.774227	7.285202	1.326870	1.431496	2.274492	1.646151
Jarque-Bera	496.2039	409.8888	41.84948	42.26417	27.45593	24.07156
Probability	0.000000	0.000000	0.000000	0.000000	0.000001	0.000006
Sum	1.678694	8.642360	5635.400	17811.17	57.93553	2221.635
Sum Sq. Dev.	0.003691	0.108778	378.4325	56.26078	0.032252	2.462638
Observations	304	304	304	304	304	304

Table (1) reveals the descriptive analysis of the variables in the current research. Table (1) indicates that the mean ROA for the sample is lower than the mean ROE for the same sample. Since the first is 0.005522 and the second

is 0.028429. As can be seen in the table, the mean value of ownership concentration of the largest shareholder in this research sample is 18.3570%. This implies that largest shareholder in Egypt has a fairly ownership concentration. According to Setia-Atmaja LY (2009) ownership concentration is defined by distinguishing between two groups of firms. The first group is closely held when firms have at least shareholder who owns 20%.The second group is widely held, and we can see this form of ownership when a firm has shareholder who owns more than 20%. Additionally, ownership concentration owned by the largest shareholder in my sample ranges from 17% to 20%.

With regard to ownership concentration of largest five shareholders, the mean value of this variable is 58.59%. This means that more than half of the total percentage of shares is already in the largest five shareholders' hands. It also suggests that the largest five shareholders have a widely concentrated structure of ownership. Additionally, the ownership concentration by largest five shareholders ranges from 58% to 59%.

It seems clearly from this table that the sample depends on debt as the average debt ratio of the sample is 19.0577%.Regarding normality test, it seems that data do not follow normal distribution.

B- Correlation matrix

Table (2)

Covariance Analysis: Ordinary						
Date: 01/06/21 Time: 13:26						
Sample: 2015Q1 2018Q4						
Included observations: 304						
Correlation						
Probability	ROA	ROE	OC1	OC5	Debt	Size
ROA	1.000000					

ROE	0.997001	1.000000				
	0.0000	-----				
OC1	-0.102073	-0.161476	1.000000			
	0.0756	0.0048	-----			
OC5	-0.064278	-0.014043	-0.587215	1.000000		
	0.2639	0.8074	0.0000	-----		
Debt	0.044242	-0.030959	0.830924	-0.697522	1.000000	
	0.4421	0.5908	0.0000	0.0000	-----	
Size	-0.061473	0.003412	-0.846996	0.755832	-0.897375	1.000000
	0.2853	0.9528	0.0000	0.0000	0.0000	-----

Table (2) shows that there is negative association between the ownership concentration of the largest owner and ROA at a confidence level of 90% (significance level is 8%). Also, results confirm that there is a significant negative association at confidence level of 99% between the ownership concentration of largest owner and ROE. Regarding the ownership of largest five owners, results confirm that there is no significant association with ROA and ROE. Additionally, it seems from the previous table that the correlation coefficients are very high between some variables. For example, the correlation coefficient between total debt and firms' size is 0.897375. Also, the correlation coefficient between firms' size and total assets is 99.66%. This implies that estimating regressions depending on the highly correlated variables will create

multicollinearity problem. Consequently, I should perform unit root test for all the variables included in my regression models.

C- Unit root test

In this stage I will test stationarity of time series included in my research.

Table (3)

Variables	Values and probabilities of Levin, Lin & Chu t before calculating the first difference	Values and probabilities of Levin, Lin & Chu t after calculating the first difference
ROA	18.6362 (1.000)	-6.629*** (0.000)
ROE	16.1057 (1.000)	-5.99223*** (0.000)
OC1	-4.48214*** (0.000)	
OC5	26.7282 (0.9147)	-13.1352*** (0.000)
Size	-4.99695*** (0.0000)	
Total debt	4.10613 (1.000)	-2.44459*** (0.0073)

*** Significant at 99%.

Table (3) displays the results of unit root test. According to table (3), it seems clearly that ROA time series is non-stationary time series. Because P. value exceeds 0.05, so we should reject the null hypothesis and accept the alternative hypothesis states that ROA series is a non-stationary time series. In order to transform ROA series from non-stationary to stationary we should calculate the first difference of ROA. Table (3) also displays the ROA after calculating the first difference and it shows that ROA has been transformed to be stationary time series after calculating the first difference.

Regarding the second dependant variable which is ROE, Table (3) shows that ROE time series is also non-stationary which means we should calculate the first difference of ROE in order to transform this time series into stationary time series and this has been confirmed in the second part of table (3).

Stationarity of independent variables has also been tested. In table (3) I tested the ownership concentration by the largest owner (OC1) and as it seems from this table that P. value of Levin, Lin & Chu t test is 0.000 which is less than 0.05 which means I should accept the null hypothesis states that the times series is stationary. Table (3) displays the largest five owners' variable (OC5) and it seems that this time series is non-stationary as P. value of Levin, Lin & Chu t exceeds 0.05 so I should reject the null hypothesis and accept the alternative hypothesis states that the time series is non-stationary. In order to transform this time series in to stationary time series I calculated the first

Table (4) reveals strong significant association between the ownership concentration of the percentage of largest owner (OC1) and return on assets (ROA). Also results confirm that the ownership concentration by largest five owners (OC5) has strong and significant impact on ROA. This implies that ownership concentration measured by the percentage of shares owned by only one owner or owned by the largest five owners increases the profitability of firms and this conclusion is statistically significant at 90% confidence level. This implies that when ownership is concentrated then coordination between managers and shareholders become easier. It is also much easier to request information from managers to assess their performance and all of these factors have an influence on financial performance.

Regarding control variables, debt and log assets (size of firms) have a significant impact on ROA Table (4) also shows that the explanatory variables explain 78.5% of the ROA changes. The previously indicated results confirm that ownership concentration by only largest owner or by largest five owners enhance the profitability of firms and this result has confirmed statistically and economically. The research evidence that ownership concentration is positively associated with firms' profitability meets my expectations and consequently I should accept the first hypothesis states that "Ownership concentration has a positive impact on ROA". This conclusion totally conform to some previous researches (See for example: Hu, Y., Izumida, S., (2008); Busta, I., Sinani, E., Thomsen, S., (2014); Dwivedi, N., Jain, A., (2005); Hassan, S., Karim, N., Salamuddin, N., (2016); Heugens, P., Essen, M., Oosterhout, J.,(2009); Kaserer, C., and Moldenhauer, B.,(2008). However, few research papers indicated that the relationship between ownership concentration and ROA is a negative association such as Jentsch, V., (2019).

statistically at 90 % confidence level. Also this result conforms to the theoretical model introduced by Castaneda (2006) which confirms that negative association between ownership concentration and performance might arise from weak legal institutions to protect minority shareholders, inefficiency in financial markets meaning that controlling owners will chose low productive projects.

Regression analysis revealed that ownership concentration by largest five shareholders increases significantly the returns on equity. This conclusion motivate the researcher to partially accept the second hypothesis states that "Ownership concentration has a positive impact on ROE". This conclusion totally conform to some previous researches (See for example: Hu, Y., Izumida, S., (2008); Busta, I., Sinani, E., Thomsen, S., (2014); Dwivedi, N., Jain, A., (2005); Hassan, S., Karim, N., Salamuddin, N., (2016); Heugens, P., Essen, M., Oosterhout, J.,(2009); Kaserer, C., and Moldenhauer, B.,(2008). However, few research papers indicated that the relationship between ownership concentration and ROA is a negative association such as Jentsch, V., (2019).

5- Conclusions, implications and future research:

It has been confirmed by different research papers that ownership concentration enhances financial performance of different firms. However very few number of researches has tested this result in Egypt. The current research paper has tried to add to literature by testing the relationship between ownership concentration and financial performance of firms. My results confirmed that the mean value of ownership concentration of the largest shareholder in this research sample is 18.3570%. This implies that largest shareholders in Egypt has a fairly ownership concentration. Additionally, ownership concentration owned by the largest shareholder in my sample ranges from 17% to 20%. More than half of the total percentage of shares is already in the largest five shareholders' hands. It also suggests that the largest five shareholders have a widely concentrated structure of ownership. Additionally, the ownership concentration by largest five shareholders ranges from 58% to 59%. Ownership concentration measured by shares owned by largest owner contributes positively in enhancing firm's financial performance measured by ROA. However, it decreases significantly returns on equity (ROE). In regards to ownership concentration measured by the percentage of shares owned by the largest five owners, conclusions revealed that this percentage increases significantly measurements of profitability employed by current research (ROA, ROE).

The empirical evidence introduced by the current research does not identify all the channels through which ownership concentration affects financial performance of corporations. Several other channels could affect financial performance. Based on this, future research could examine the role of

board of directors (BOD) in explaining the relationship between financial performance and ownership concentration. Also, other measurements could be used in the future to measure financial performance instead of ROA and ROE. For example, depending on Tobin's Q measurement could lead to different conclusions. Also, my research depends only on one independent variable concentration of ownership. It would be better to include other dimensions of ownership structure such as the rights of minority, institutional ownership and insider ownership.

The current research has managerial and theoretical implications. Firstly, the current research extends literature on the relationship between ownership concentration and financial performance of corporations. The analysis reveals that ownership concentration explains around 79% of financial performance behaviour in two econometric models. Second, results revealed that ownership is fairly concentrated at hands of the largest shareholders in corporations. Also, ownership is widely concentrated at hands of largest five shareholders. Improving financial performance through ownership concentration should attracted practitioners' attention to ownership concentration as an important corporate governance mechanism. Presence of a high degree of ownership concentration would contribute to a reduction in opportunistic management behaviour, which would have a positive effect on the performance of the company as a whole.

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