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A Study on Ownership Concentration by Family Members and Financial Performance: Evidence from India

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Abstract

Ownership concentration is stated by the number of large-block shareholders and if the percentage of firm's shares owned by the family members then that makes them as Family owned firms. They form the backbone of Indian economies, as they contribute towards GDP of country. Therefore, family business management is an emerging area of academic interest. In this regard, this empirical research deals with the analysis of relationship between concentrated ownership by the family members and its impact on financial performance, measured by the Return on Asset (ROA) and Return on Equity (ROE). The present study analyses the performance of Indian family businesses for firms listed on BSE 500 Index for a period of 2016-2018. An equity ownership above 20% by family members, also the family member as a chairman of the board and multiple generations or multiple members actively involved in business has been identified as family owned business. Using a representative sample of 375 Indian family owned businesses out of BSE 500 Index. Statistical analysis of collected data includes descriptive statistics, determination of the correlation coefficient between ownership concentration and financial performance, multiple OLS regression analysis to determine the impact of ownership concentration on financial performance. The results show that there is a U-shaped relationship between ownership concentration and performance, which indicates that the increase in ownership concentration to a certain limit of 55% positively affects financial performance. When ownership concentration exceeds 55%, financial performance deteriorates.

Keywords: *Ownership Concentration, Family owned Business, Corporate Governance, Shareholders, Equity and Financial Performance.*

Introduction

Ownership concentration is the ownership share (votes) of the largest owner in percentage (Pathirawasam, 2013). Hill and Snell (1998) found good relationship between ownership structure and firm performance which is measured by using profitability.

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"A Business is Family-owned Business when it is an enterprise growing out of needs, built on a family's abilities, guided by its moral values, sustained by the family's commitment and passed down to its sons & daughters as a legacy as precious as the family's name."

Conducting business in India has never been more exciting and daunting at the same time. Paradigm shifts on the regulatory, operational and technological fronts are driving business heads to continuously innovate their products or services and become more perceptive and agile in order to stay relevant.

Amidst all the change taking place within and across borders, there is one segment to which markets remain attractive – family businesses.

The contribution of family businesses to wealth creation, wealth preservation and wealth distribution in the nation is commendable, and their unique approach of looking at their businesses over generations and as an investment for the future ensures a long-term perspective with respect to decision making and provides stability to the economy.

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The obvious importance of Family Business in India is the Indian Economy is majorly driven by entrepreneurial capitalism.

The list of 50 most lucrative family-owned businesses in Asia was made up of 12 Indian Listed Companies. A significant portion of public listed firms in India are Family-owned, thus the performance of such Family-owned Business has direct relevance for financial market efficiency.

Identification of family-owned business

Identifies a firm as family firm if the first condition of significant ownership is met and any one of the other two conditions are met

a) An Equity ownership above 20% by family members as on date (2018) or the last shareholding data available.

b) Family member as a Chairman of the Board, or two or more family members in the Board of the firm.

Once it was established that a Family has more than 20% shareholding in a company, it was determined if the family also exerts management control on the company. Wherever the Chairman of the Board, the Chief Executive Officer (CEO), the Managing Director, or a person in the board of directors was also a promoter and member of the family holding more than 20% stake in the company, that company is considered to be a Family Business.

a) Multiple Generations or multiple members of same generations, actively involved in business.

The above criteria have been primarily used to classify companies into Family and Non-Family Businesses. The aim of this research is to examine the effects of ownership concentration on financial performance of selected companies. Empirical Research is conducted on the basis of data collected for the period of 2016-2018.

Statistical data analysis was performed using descriptive statistics, correlation coefficient between independent and dependent variables, and multiple OLS regression analysis to determine the impact of independent variable on the dependent. Statistical data processing was performed using SPSS and MS Excel.

Literature review and hypothesis development

Ownership concentration

With substantial ownership concentration by family members has both the potential benefits as well as potential costs involved.

Large concentrated shareholders however, may derive greater benefits from pursuing objectives such as firm growth, form survival and enhancing shareholder's value. Barclay and Holderness (1989) note that large ownership stakes also reduce the profitability of bidding by other agents, thereby reducing the value of the firm.

Shleifer and Vishny (1997) suggest that one of the greatest costs that large shareholders can impose is remaining active in management even if they are no longer competent or qualified to run the firm.

But there were some researches who found benefits for concentrated ownership by family members in Business. Demsetz and lehn (1985) note that concentrated investors have substantial economic incentives to diminish agency conflicts and maximize firm value. Stein (1988, 1989) shows that firms that have shareholders with longer investment horizons suffer less managerial myopia and are therefore less likely to forgo good investments to boost current earnings.

James (1999) demonstrates how family ownership provides incentives to invest according to the market rule and suggests that family firms invest more efficiently than non-family firms because the family intends to pass the firm onto succeeding generations.

In sum, large, concentrated ownership by family members in firm have substantial economic incentives to maximize firm performance and the influence and power to cause it to happen.

Considering that the ownership structure of modern corporations consists of a large number of shareholders, the question arises as to which is the best and most effective mechanism for supervision and control of managers.

Corporate governance

Corporate Governance systematically regulates relationships between management, employees and all other internal and external stakeholders (Jensen & Meckling, 1976). Corporate Governance can be defined as a set of clearly defined rules and procedures that regulate relationships between different stakeholders in and outside of the company, with the aim of creating adequate conditions for the proper function of a company and improving business performance.

The effectiveness of corporate governance mechanisms are determined by two important factors. Firstly, the existence and implementation of laws and by-laws in the country that protect the ownership rights of shareholders. Secondly, the ownership structure, primarily the degree of ownership concentration as a percentage of shares held by majority shareholders.

Performance of family businesses

Families often value activities and products, such as firm value, profits, equity or asset returns (Adams et al., 2004; Chua et al., 2003).

Extant performance research has considered only financial metrics. Empirical studies on publicly listed firms, however, have yielded mixed results. Some studies find that family influence is an effective form of control providing greater financial performance of family businesses (Anderson & Reeb, 2003; Lee, 2004; Maury, 2006). On the other hand, there is empirical evidence pointing negative effects of family influence in terms of nepotism, entrenchment and expropriation of minority shareholders leading to lower performance of family businesses (Miller, Le Breton-Miller, Lester, & Cannella, 2007).

The ownership structure of the company is made up of a small number of major shareholders who take over the role of controllers over the activities of management. The concentration of ownership in these countries prevents the emergence principal-agent problem, but the increase in ownership concentration above a certain level can lead to the emergence of the aforementioned problem in relation to majority-minority shareholders (Babić & Nikolić, 2011). Hamdouni (2010) was examined the effects of concentrated ownership on financial performance over a sample of 106 companies in France.

High concentration of ownership has a negative effect on ROA, and positive effects on ROE. The results of the survey carried out by Alimehmeti & Paletta (2012) over listed companies in Italy confirm the positive implications of ownership concentration on ROA. The effects of concentrated ownership on financial performance measured by ROA and ROE in the Netherlands show the existence of a positive correlation (Scholten, 2014; Boerkamp, 2016). In a research conducted by Arosa, Iturralde & Maseda (2007) for over 586 unlisted companies in Spain, there are positive effects of ownership concentration on financial performance. In the same country, the research conducted by Cabeza & Gomez (2011) confirms the positive effects. Kapopoulos & Lazaretou (2006), by researching over 175 listed companies in Greece, confirms the positive impact of concentration of ownership on financial performance. The results of conducted empirical studies show that ownership concentration has positive effects on financial performance of companies in the EU developed countries.

A research which was conducted in over 60 privatized companies in Macedonia shows that ROA (Abazi-Alili, 2013) increases with the increase in ownership concentration. In the paper Balsmeier & Czarnitzki (2010), the effects of concentrated ownership on financial performance in 29 transition economies for the period 2002-2009 were tested.

The findings indicate that there is a U-shaped connection between concentration of ownership and performance, indicating that the rise in concentration of ownership to a certain 55 percent limit has a positive effect on economic performance. When the concentration of ownership exceeds 55%, financial performance deteriorates.

Hypothesis

Ha. High ownership concentration has a negative impact on ROA.
Hb. High ownership concentration has a negative impact on ROE.

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Research methodology

In family business management research, two branches of studies are common. One branch studies the different performance of family and non-family companies and the second branch studies the particular features of family companies that affect the output of the business.

This Research basically focuses on second branch of study in detail.

Sample and statistical methods

Empirical research was conducted on the database for 2016-2018. In the context of the importance of shareholding pattern to the strategic choices and processes of a firm, it studies the shareholding pattern of top 500 firms listed on the Bombay Stock Exchange (BSE 500) of India. This study presents and analyses the trends in equity ownership by various classes of shareholders for the period of 2016-2018 across different ownership categories. Firms listed on BSE 500 into family and non-family on the basis of a minimum of 20% equity shares by the family members and management control or succession/business continuity.

Our sample comprised of BSE 500 with around 75% of them being family firms. Of this representative sample of 375 family-owned companies, 90 family-owned companies are more than 55% owned. Rest receiving less than 55 percent concentration of family members ' ownership of the firm's equity.

All data necessary for statistical analysis were collected from secondary sources. The data on shareholding is submitted by the companies to the exchanges and is compiled by Prowess database, Centre for Monitoring Indian Economy (CMIE). For the calculation of ROA and ROE, the data contained in the financial reports are available on the website of the Bombay Stock Exchange.

Statistical analysis of collected data includes descriptive statistics, determination of the correlation coefficient between ownership concentration and financial performance, multiple OLS regression analysis to determine the impact of ownership concentration on financial performance. The entire statistical data processing was performed in the software SPSS and MS Excel.

Independent and dependent variables

Independent variable: ownership concentration. Degree of ownership concentration is measured as a percent of shares owned by largest shareholders, who own more than 55% of total shares.

Dependent variable: financial performance. Financial performance have many indicators but in this research, two financial indicators have taken as dependent variable that is ROA (Return on Assets) and ROE (Return on Equity).

ROA = Net Profit / Total Assets

ROA is a profitability ratio that shows the ability of a company to create profit by using its assets.

ROE = Net Profit / Total Equity

ROE is a profitability ratio that measures company’s ability to earn profits by engaging capital.

Control variables

This analysis includes three control variables: Company’s Liquidity, Activity and Financial Leverage.

Liquidity = Current Assets / Short-term Liabilities

Liquidity of the company, as the ability to execute maturity obligations, also contributes to improving financial performance.

Activity = Sales Revenue / Total Assets

The company’s Activity is an important profitable factor and is defined as the ratio between sales revenue and total assets.

Financial Leverage = Long-term Debt / Total Assets

Financial Leverage is the ratio that divides Long-term Debt by Total Assets.

Results and Discussion

Table 1. Descriptive Statistics

Variables	N	Mean	Standard Deviation	Minimum	Maximum
Ownership Concentration	90	67.69%	1075869	55.15	80.25
Liquidity	90	6.161608	8.1043179	0.3487	54.6879
Activity	90	1.418215	1.7282872	0.0000	8.8781
Financial Leverage	90	5.121408	7.1346250	0.2274	42.5478
ROA	90	-085574	6773132	-2.3549	3.0225
ROE	90	-007074	6705100	-2.0762	3.2257

The Arithmetic Mean, Standard Deviation, Minimum and Maximum values are shown in Table1. The Average Value for ROA is -.085574, for ROE = -.007074. The Lowest ROA is -2.3549, while the Maximum Value is 3.0225. The Minimum ROE Value is -2.0762 and the Maximum is 3.2257. Ownership Concentration in the observed sample ranges from 55.15% to 80.25%, while the average value of ownership concentration is 67.69%.

Table 2. Correlation Matrix

Variables	Ownership Concentration	Liquidity	Activity	Financial Leverage	ROA	ROE
Ownership Concentration	1.000	-112	-102	-075	-411**	-251*
Liquidity	-112	1.000	-025	451	225	057
Activity	-102	-025	1.000	347	-042	-078
Financial Leverage	-075	451	347	1.000	173	067
ROA	-411**	225	-042	173	1.000	552**
ROE	-251*	057	-078	067	552**	1.000

**p<0.01, *p<0.05.

In order to test the research hypothesis, a correlation analysis was first performed, results are shown in Table2. There is a significant and negative correlation between ownership concentration and ROA, with the coefficient of correlation -.411 (sig < 0.01). The statistically significant, negative association between ownership concentration and ROE, as the coefficient correlation is -.251 (sig < 0.05).

Table 3. Multiple OLS Regression (dependent variables: ROA and ROE)

Variables	ROA	ROA	ROA	ROA	ROE	ROE	ROE	ROE
	R Square	Sig	B	VIF	R Square	Sig	B	VIF
Ownership Concentration		007	-312**	1.010		035	-257*	1.010
Liquidity	0.130	311	159	1.006	0.084	657	055	1.006
Activity		620	-062	1.006		554	-067	1.006
Financial Leverage		557	032	1.021		345	020	1.021

**p<0.01, *p<0.05.

Significant Results obtained by correlation analysis are the basis for conducting statistical analysis using multiple OLS Regression. Concentrated Ownership has a significant and negative impact on ROA (B = -.312, Sig = .007).

Liquidity has an insignificant and positive impact on ROA (B = .159, Sig = .311).

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Activity has an insignificant and negative impact on ROA (B = -.062, Sig = .620).

Financial Leverage has an insignificant and positive impact on ROA (B = .032, Sig = .557).

The determination coefficient for this model is R Square = .130, which implies that only 13% of the ROA variability is determined by the changes in the ownership concentration. This model does not have a problem with multicolinearity (VIF <10).

Concentrated ownership has a significant and negative impact on ROE (B = -.257, Sig = .035).

Liquidity has an insignificant and positive impact on ROE (B = .055, Sig = .657).

Activity has an insignificant and negative impact on ROE (B = -.067, Sig = .554).

Financial Leverage also has an insignificant and positive impact on ROE (B = .020, Sig = .345).

This Model is fairly low quality, because ownership concentration explains only 8.4% (R Square = .084) changes in ROE. This Model also does not have a problem with muticolinearity (VIF <10).

Conclusions

Results of this research paper support the results obtained by Nikola Vasilic (2018), Mueller, Dietl & Peev (2004), Lskavyan & Spatareanu (2006), Pervan, Pervan & Todoric (2012), Stančić, Čupić & Obradović (2014).

Balsmeier & Czarnitzki (2010) report the existence of a U-shaped relationship between ownership concentration and financial performance, which is also in line with the results of this study. Therefore, a moderate ownership concentration will be in the function of improving financial performance, while the increase in the concentration of ownership above the level that is determined as moderate, will negatively reflect on the financial performance.

The results of the conducted research show that increasing the ownership concentration over 55% has a negative impact on financial performance. Concentrated ownership negatively affects ROA, which accepted the research hypothesis Ha. Concentrated ownership has significant and negative impact on ROE, which implies that the hypothesis Hb is accepted.

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