Shareholding Pattern and Its Impact on Corporate Performance

Shubhi Agarwal 1 and Dr. Archana Singh 2

PhD. Scholar, Economics Dept, Meerut College, Meerut, C.C.S. University, U.P. Pin code: 250002,

2 Associate Professor, Economics Dept., Meerut College, Meerut, C.C.S. University U.P., Pin code: 250002

Abstract- Corporate governance plays a vital role in establishing the relationship between shareholding patterns and corporate performance that ensures investment security. With this motivation in this paper, an empirical study has been conducted to examine the impact of institutional and non- institutional shareholding patterns on the associated corporate performance. This study focuses to examine the role of shareholding pattern on corporate performance. This study furnishes that how shareholding pattern helps in eliminating agency cost in a sample of 30 firms selected from “National Stock Exchange” and “Bombay Stock Exchange” during the period 2007-19. This study uses asset utilization ratio to measure agency costs. The independent variables in this study include Indian promoter, foreign promoter institutional ownership, non-institutional ownership and remuneration structure. The result findings showed that foreign promoter, institutional, non institutional ownership and incentive payments to agents make a positive impact on the corporate performance and contribute towards the reduction of agency cost but on the other hand shares held for custodian against which deposits receipts have been issued and Indian promoter ownership make an insignificant impact on corporate performance. (179 words)

Keywords: Agency cost, corporate, governance, performance and shareholding pattern.

JEL Classification- G 30, G 34

INTRODUCTION-

Adam Smith famously warned against the negligence and profusion of managers handling money other than their own (Smith 1776). Adam Smith’s warning makes a natural question “does ownership structure matter for firm performance? Ownership structure implies to both the share of managers in corporate firms and the distribution of the outsider claims whether there is a single or a small group of dominant owners. Jensen and Meckling (19876) built a model based on agency theory. It surveyed mainly the most essential and significant empirical literature of agency theory and corporate governance. Agency theory plays a key role in the corporate governance literature. It describes the conflict between self-interested managers and owners which ids fundamental in nature. The former i.e. agents or mangers have the control of the firm but the latter i.e. shareholders or principals bear most of the wealth effects. Jensen and Meckling (1976) original model illustrated this by describing how lower managerial stakes lead to increases in non-pecuniary spending by the managers as they do not fully internalize the costs. Agency problems of this kind generate agency costs. A key ingredient in their theory is that managers cannot be monitored and observed free or without incurring any costs by the outside shareholders. While the model makes many restricting assumptions, the results are applicable to a more general setting as shown by the numerous theoretical and empirical articles that have followed the work of Jensen and Meckling.

Institutional investors are important stakeholder of today’s financial market and appeared as integral force in equity market. They are major player not only in the developed market but also in the emerging markets of the world. In past, these investors were not directly involved in decision making and follow the exit policy by selling the shares held by them if they were not satisfied with management policies and decisions. But now due to increasing ownership of equity they have become more powerful to raise their voice in case of disagreement with management and hence are actively participating in the corporate decision making process through their voting right in company’s meetings and try to influence the firm top management to take care the long-term interest of shareholders. Institutional investors may be defined as specialized financial institutions, which manage savings collectively on behalf of other investors toward a specific objective in terms of acceptable risk, return maximization, and maturity of claims (Davis & Steil, 2001).Thus these institutional investors are playing very effective monitoring role and hence improving firm performance. Institutional investors take the form of: banks, insurance companies, pension funds and investment funds. Under normal circumstances, institutional investors tend to invest in large volumes. Due to the high stakes they hold, they are able to exercise controls on the action of the management making them be in tandem with the shareholder wealth maximization objective. Seifer et al. (2005) using samples of firms from United States, United Kingdom, Germany, and Japan find a significant relationship between institutional ownership and firms performance in these countries. It is widely acknowledged that institutional investor's possess the capability of boosting market performance by offering high level financing, experience and knowledge to the market in which they have invested (Gurunlu and Gursoy 2010).

Credit was given to Berle and Means (1932) for the first pioneering empirical tests on ownership performance and ownership concentration. Berle and Means (1932) investigated the hypothesis of negative correlation between diffuseness of shareholdings and firm performance. Contrary to Berle and Means (1932), Jensen and Meckling (1976) furnished that there is a positive relationship between the institutional ownership and firm performance. Most of the existing studies regarding the relationship between ownership structure and firm performance are from matured and developed countries with high investor protection. Hence, the recent target by researchers in emerging countries is to explore and empirically prove the relationship between institutional ownership and firm performance. This paper is organized as follows Section 2 explains literature review which also depicts Transaction Cost Theory and Corporate Governance Theory, Section 3 presents the data and research methodology, Section 4 depicts analysis and results and Section 5 gives conclusion, limitations of the study and suggested future research.

LITERATURE REVIEW-

The following part will review literatures related to the relationship between shareholding patterns and corporate performance.

Duggel and Miller (1999) used standard event study methodology on S&P 500 index over the period of 1985-1990. The study investigated the relationship between institutional investors and corporate performance. The study employed OLS regression model. The result findings found that there was a positive but insignificant relationship between stock-holding scale of institutional investors and firm performance.

Lopez Iturriaga and Rodriguez Sanz (2001) used the sample of 140 Spanish listed companies for the 1991-1997 periods. The study investigated the relationship between ownership structure and firm valuation and investment. This study used simultaneous equation approach for analysing the results. The results findings depicted that there was a significant and positive relationship between ownership structure and firm valuation and investment since both are determined by managerial ownership.

Tsai and Gu (2007) conducted a study to investigate the link between institutional investors and corporate performance of casino's firm. The study used a sample of 24 casino firms over the period of 1999-2003. The study used proxy of Tobin Q to measure the corporate performance. The study applied simultaneous equation model for analysing the results. The result findings found positive and significant relationship between institutional investors and casino's performance. It can also be concluded by findings that institutional shareholders increase managerial monitoring and help in improving firm performance.

Hu and Zhou (2008) used a sample of unlisted Chinese firms for the time period of 1998-2000. The study analysed the relationship between managerial ownership and firm performance. The result findings found that there was a positive effect of managerial ownership on firm performance. It is also concluded in research results that relativity between company performances and managerial ownership is non- linear and if ownership exceeds above 50%, the modulation point will be turned towards negative.

Ferreira and Matos (2008) studied the link between institutional shareholders and firm performance. The study used the broad data set of equity holding from 27 countries. This research study employed three stage least square regressions model for analysis of results. The result findings found that there was a positive relationship between institutional ownership and firm performance and also concluded that the firms with higher institutional investors have higher firm valuation and better operating performance.

Ganguli and Agrawal (2009) examined the relationship between firm performance and ownership structure. The study used a sample of CNX Midcap Index 100 companies. The result findings revealed that concentration of promoters' shareholding is endogenous and dependent on firm performance. The study also found that even after 1992 economic reforms the promoter shareholding remains concentrated.

Elyasiani and Jia (2010) used a sample of 1532 corporate firms over the time period of 1992-2004. The study investigated the link between firm performance and level and stability of institutional investors of non-financial firms. The study employed the simultaneous equation model to make analysis of results. The result findings found there is a positive and significant relationship between long term institutional ownership and firm performance. The result also concluded that both shareholding proportion and the shareholding stability are essential for the effectiveness of monitoring of the institutional investor

Margaritis and Psillaki (2010) investigated the relationship between efficiency, leverage and ownership structure. The study used a sample of French technology manufacturing firms over the years from 2002 to 2005. The study used non- parametric methods. The result findings revealed that there was a positive relationship between efficiency, leverage and ownership structure but significant to mid- leverage level.

Charfeddine and Elmarzougui (2010) investigated the relationship between institutional ownership and firm performance. The study used a sample of 35 firms listed in Paris stock exchange and CAC 40 index consisting of 140 observations for the time period from 2002 to 2005. The study used simultaneous equation model for result analysis. The result findings found that there was a significant relationship between institutional shareholding and firm performance but it's having negative effect on firm performance.

Kumar and Singh (2013) examined the relationship between corporate board size, promoter ownership and firm value. The study used a sample of 176 Indian firms listed on Bombay Stock Exchange (BSE). The study used regression model for result analysis. The result findings found that there is extensively negative relationship between corporate board size and firm value whereas there is a positive relationship between promoter ownership and firm value. The empirical results also suggested that there was a positive link between firm value and ownership structure if ownership level exceeds to 40 percent. Ultimately promoter ownership helps in aligning the interest of shareholders with agents and increases firm performance.

RESEARCH METHODOLOGY-

This section depicts the research methodology, the research design, sample design, data collection method and diagnostic test used in this study. This section further presents the study model, how it is estimated and how it can be used to project the relationship between agency costs and shareholding pattern.

Research Design: The study has empirical research design.

Sample Design: Random sampling is used while selecting the nature of corporate firms i.e. IT companies. The selection of IT companies included under study based on convenience sampling.

Target Population: The target population is all the listed IT companies in NSE and BSE.

Study Period: 2007-19. In number they are 360 listed companies.

Data Collection Method: This study uses secondary data. It is collected from annual reports through companies' websites. Panel data is used in this research work.

Diagnostic Test: Correlation and regression model is used. Multiple variate regression is used. STATA software is used for analyzing the results.

Dependent Variable: This study considers agency cost as its dependent variable which is measured by asset utilization ratio. I use this as proxy because it measures the ability of management to employ assets efficiently by agents. As we know there is a clash of interests between principals and agents. Principals are the financers and owners of company and agents are appointed and hired by principals to perform all functions efficiently and utilize all the assets of company in the best interest to increasing shareholders' value and attainment of organizational objectives. A higher asset utilization ratio indicates that companies are efficient in using their assets and higher shareholder value creation whereas a low asset utilization ratio indicates poor asset management and has more agency conflicts. It is defined as: **Asset utilization ratio = total revenue/total assets.**

Independent Variables: There are six independent variables which are used for measuring agent of agency cost: **Promoter:** A person who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or. A person who is in agreement with whose advice, directions or instructions the Board of Directors of the company is accustomed to Act. There are two types of promoter broadly classified as- **A)Indian Promoter:** Indian promoter includes individual/ HUF, central government, state government, bodies corporate, banks/ financial institutions and any others. **B) Foreign Promoter**; **Institutional Ownership:** It is determined as the total percentage shareholding of all institutional shareholders; **Non- Institutional Ownership:** It is the sum of all individual non-institutional and non-director shareholdings; **Shares held for custodian against which depository receipts have been issued; Remuneration Structure:** This variable is measured by taking natural log of the sum of total annual benefits paid to all members of the board.

Hypothesis: H1: Higher the Indian promoter ownership, lower will be the agency cost. **H2:** Higher the foreign promoter ownership, lower will be the agency cost. **H3:** Higher the institutional ownership, lower will be its agency cost. **H4:** Higher the non- institutional ownership, lower will be the agency cost. **H5:** Higher the shares held for custodian against which depository receipts have been issued, lower will be agency costs. **H6:** Increasing pay and bonuses of management reduces agency cost.

Model: This study tries to examine the link between agency cost and shareholding pattern and remuneration structure with multivariate regression analysis. The model is explained as follows: **Agency cost (aur) = α + β1 (IP aur) + β2 (FP aur) + β3 (IO aur) + β4 (NIO aur) + β5 (S aur) + β6 (NLDR aur) + e aur** where: Agency cost aur = the **dependent variable** of the study, aur represent asset utilization ratio for firm i at period t, α = the intercept; **Independent variables** include **IP** represents Indian promoter, **FP** depicts foreign promoter, **IO** represents institutional ownership, **NIO** depicts non- institutional ownership, **S** depicts shares held for custodian against which depository receipts have been issued, **NLDR** depicts natural log of director's remuneration and **e** aur = error term.

ANALYSIS AND RESULTS-

Descriptive Statistics- (Table1)

	Mean	Median	Standard Deviation	Minimum	Maximum
AUR	1.484	1.188	1.375	0.3020	11.450
IP	38.496	38.863	24.557	0	98.82
FP	11.461	0	22.685	0	81.02
IO	21.868	20.487	17.200	0	58.64
NIO	27.453	27.064	14.839	1.14	90.76
S	0.7135	0	3.216	0	19.17
NLDR	1.115	1.238	1.706	-6.684	5.680

The **table 1** above provides descriptive statistical results on the dependent and independent variables that were used in the empirical analysis of this study. The findings depict that on average Indian Promoter ownership in the Indian IT companies are 38.496 with maximum of 98.82 and minimum of 0, standard deviation and median are 24.557 and 38.863 respectively. The mean value of foreign promoter ownership is 11.461 with minimum of 0 and maximum of 81.02, its median is 0 and standard deviation is 22.685. The findings indicate that on average institutional ownership in the Indian IT companies are 21.868 with maximum of 58.64 and minimum of 0, standard deviation and median are 17.200 and 20.487 respectively. The mean value of non-institutional ownership is 27.453 with minimum of 1.14 and maximum of 90.76, its median is 27.064 and standard deviation is 14.839. The average of shares held for custodian against which depository receipts have been issued is 0.7135 with minimum of 0 and maximum of 19.17, its median is 1.238 and its standard deviation is 3.216. The average of natural log of director's remuneration is 1.115 with minimum of -6.684 and maximum of 5.680, having 1.706 standard deviation and 1.238 as median. The agency cost is measured by asset utilization ratio having average value, median, standard deviation 1.484, 1.188, 1.375 respectively with minimum of 0.3020 and maximum of 11.450.

Correlation Matrix- (Table2)

	AUR	IP	FP	IO	NIO	S	NLDR
AUR	**1**						
IP	-0.0681	**1**					
FP	- 0.0106	-0.6215	**1**				
IO	0.1283	-0.4147	-0.1969	**1**			
NIO	-0.0064	-0.1874	-0.2507	-0.2353	**1**		
S	-0.0739	-0.1670	-0.1124	0.3160	-0.1346	**1**	
NLDR	0.0709	-0.0368	-0.0917	0.3841	-0.3005	0.2758	**1**

As per the **table 2**, there is negligible degree of relationship among asset utilization ratio (agency cost) and Indian promoter ownership, foreign promoter ownership, non- institutional ownership, shares held for custodian against which DR have been issued and natural log of director's remuneration. It is depicted in the above mentioned table that there is very low degree of positive relationship between asset utilization ratio (agency cost) and institutional ownership. Except institutional ownership, all other variables have no or little relationship with dependent variable that is asset utilization ratio.

(Table3)

Multiple R	R Square	Adjusted R Square	Standard Error
0.7444	0.5541	0.5449	1.3616

The results of multivariate regression analysis are presented in **table 3,** with asset utilization ratio as the dependent variable and Indian promoter ownership, foreign promoter ownership, institutional ownership, non-institutional ownership, shares held for custodian against which DR have been issued and natural log of director's remuneration as independent variables. This model depicts that there is a high degree of positive correlation between asset utilization ratio (dependent variable) and all independent variables as multiple R is 0.7444. The model as a whole is significant in explaining variation in the dependent variable. R-square is 0.5541 which means that the six independent variables explain 55 % variation in the dependent variable asset utilization ratio. As per results depicted there is positive correlation among them. Increase in all independent variable impacts positively to the asset utilization ratio up to 55 percent.

Hypothesis 1 predicts an insignificant association between Indian promoter ownership and company performance, the coefficient is positive and insignificant at $\beta = .05$, $p < .096$. This result shows that the hypothesis is rejected. **Hypothesis 2** states that there is a significant relationship between foreign promoter ownership and company performance. The regression result shows $\beta = .18$, $p < .003$, explains that there is a significant relationship between foreign promoter ownership and company performance. This implies that foreign promoters equip themselves with knowledge, experience and better managerial and administrative skills in the conduct of the company`s affairs. The results also confirms with Ogega (2014) that showed a strong positive relationship between ownership structure and profitability of commercial banks in Kenya. This study also used multiple regression analysis. The results depicted that a unit increase in foreign ownership would result in the greater financial performance of Kenyan commercial banks. The study established that domestic ownership of the bank significantly affects the financial performance of banks in Kenya. Foreign investors can employ an investment strategy by taking the position of block shareholders directly and effectively monitor management actions or to enable a long investment horizon that encourages strong ties between the firm and outside providers of capital (Ellul et al., 2007). If foreign shareholders are block shareholders, they could be viewed as informed traders. Since block shareholders are believed to have access to private, value-relevant information via their roles as monitors of corporate operations (e.g. Barclay and Holderness, 1991), it is likely that foreign block shareholders may wish to exploit their information advantages. Increased ownership concentration may then lead to greater entrenchment of managers, who are subject to less monitoring by boards of directors and less scrutiny by the market (Morck et al., 1988). Therefore, this indicates the higher the foreign investors in the company, the higher the possibility of business survival and good corporate performance. **Hypothesis 3** states that there is a significant relationship between institutional ownership and company performance. The regression result shows $\beta=0.19$, $p < .002$, explains that there is a significant relationship between institutional ownership and company performance. Institutional investors are efficiently monitoring the decision making function and it contributes towards the better firm performance. Effective monitoring also helps to align the interests of principals with that of agents that ultimately leads and brings reduction in agency cost. The incentives for large shareholders to monitor management increase if there is an increase in concentrated ownership (Douma et al., 2006). (Cornett et al., 2007) also furnished the same fact as previous research paper that institutional owners possess more experience, talent, skills and incentives to monitor management and it will ultimately lead to close monitoring on management activities. Hence, managers will act in the best interest of shareholder that can lead to elimination of agency cost to a great extent. **Hypothesis 4** hypothesizes that non- institutional ownership significantly influences company performance. The regression results shows $\beta=0.15$, $p < 0.004$, explains that there is a direct association and significant relation between non institutional ownership and company performance. This indicates that the agency problem can eliminated by increasing the share of non-institutional ownership. **Hypothesis 5** states that there is an insignificant relationship between shares held for custodian against which depository receipts have been issued and company performance. The result shows positive and insignificant ($\beta = 0.06$, $p < 0.169$). The hypothesis is rejected. These shares bear very insignificant part in total ownership so it is not able to make any influence on company performance and hence reduction in agency cost. **Hypothesis 6** states that there is a significant relationship between director's remuneration and company performance. The regression result shows $\beta = .13$, $p < .005$, explains that there is a significant relationship between director's remuneration (including bonus and percent of profit and stock option) and company performance. Though agents are appointed by shareholder's consent and as per their qualification and abilities but as there is no special incentive as per law for those who are efficient and honest agents, so it is clearly depicted through results if certain remuneration is assigned may be in the form of bonuses or increasing pay, agency cost will be removed. Efficient directors are paid as per their ability, efficiency, talents then they will work in the best of organizational goals and take prompt decisions and furnish reasonable return oriented project investments. It helps in increasing corporate performance and reducing agency cost. It also brings in welfare as it eliminates the conflict between principal and agents.

CONCLUSION-

This research study focuses on the relationship between shareholding pattern and corporate performance. This study tries to show how shareholding pattern can help in reducing agency cost. The results show that agency cost is eliminated by increasing the foreign promoter ownership, institutional ownership, non institutional ownership and rising bonuses and pay to directors of the corporate firms. Two independent variables i.e. Indian promoter ownership and shares held for custodian against which depository receipts have been issued don't make any impact on reducing agency cost. The result findings showed that stock returns are high where foreign ownership is more as compared to those where there is a low foreign ownership. The study found a significant correlation between foreign ownership and R&D and therefore firm performance. This is, according to them, mainly due to the capacity of foreign investors to provide experience, expertise and resources that are lacking domestic enterprises (Huang & Shiu, 2009). Harris & Robinson (2003) using the Generalized Method of Moments found that in general, FDI enhance productivity. But in some occasions, it might hinder the performance. One of the problems occurring is a huge culture barrier which will create agency problems. It also makes an impact on the overall productivity of the corporate firm.

Limitations of the Study: This research work includes secondary data that do not carter for current information. Many changes may have occurred during the period of data collection that was unexplained by the study which may have affected the results of the study. Availability of data is limited as accessibility of annual reports consistently is difficult.

Suggested Future Research- There are some suggestions that can be made for future research based on shortcomings and limitations this research is having. Future researches can take more years for extension of the study and add some more variables like firm size, firm growth, firm age, independent directors, non independent directors, women directors, risk and inflation for investigating the link between agency cost and these variables. The relationship between agency cost and governance variables are not limited to only IT corporate firms but for future researches, it can cover other corporate firms like pharmaceuticals companies, banking companies, real estate firms, hotel firms, and construction and manufacturing firms. Inclusion of vast fields can help to compare the relationship between agency costs and its potential indicators and can also reflect what type of corporate firms face lesser agency costs and agency problem.

REFERENCES-

1. Akerlof, G.A.1970, "The Market for "Lemons": Quality Uncertainty and the Market Mechanism", The Quarterly Journal of Economics, vol. 84, no. 3, pp. 488.
2. Barnea, A., Haugen, R.A. & Senbet, L.W.1981, "Market Imperfections, Agency Problems, and Capital Structure: A Review", Financial Management (pre-1986) - LA English, vol. 10, no. 3, pp. 7.
3. Berle, A.A.,Jr. & Means, G.C. 1932, The Modern Corporation and Private Property, the Macmillan Company, New York.
4. Charfeddine, L. and Elmarzougui, A. 2010, Institutional ownership and Firm performance: Evidence from France, The IUP Journal of Behavioral Finance, Vol. VII, No. 4, 2010.
5. Duggal, R. & Millar, J.A. 1999, "Institutional ownership and firm performance: The case of bidder returns", Journal of Corporate Finance, vol. 5, no. 2, pp. 103.
6. Elyasiani, E., and Jia, J, 2010, Distribution of Institutional Ownership and Corporate Firm Performance. Journal of Banking & Finance.34, pp. 606-620.
7. Furubotn, E. and Richter, R. 1998, Institutions and Economic Theory: The Contribution of New Institutional Economics, Ann Arbor, and University of Michigan Press.

8. Grossman, S.J. & Hart, O.D. 1986, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration", The Journal of Political Economy, vol. 94, no. 4, pp. 691.
9. Gurunlu, M. and Gursoy, G. 2010, ―The Influence of Foreign Ownership on Capital Structure of Non-Financial Firms: Evidence from Istanbul Stock Exchange, IUP Journal of Corporate Governance, Vol. 9 No. 4, pp. 21–29.
10. Han, K.C. & Suk, D.Y. 1998, "The Effect of Ownership Structure on Firm Performance: Additional Evidence", Review of Financial Economics, vol. 7, no. 2, pp. 143.
11. Hartzell, J.C. & Starks, L.T. 2003, "Institutional Investors and Executive Compensation", The Journal of Finance, vol. 58, no. 6, pp. 2351.
12. Himmelberg, C.P., Hubbard, R.G., and Palia, D. 1999, "Understanding the Determinants of Managerial Ownership and the Link between Ownership and Performance. Journal of Financial Economics, 53 (3), 353-384.
13. Hu, Y., and Zhou, X. 2008, The Performance Effect of Managerial Ownership: Evidence from China. Journal of Banking and Finance, 32 (10), 2099-2110.
14. Jensen, M.C. and Meckling, W.H. 1976, Theory of the firms: managerial behavior, agency costs and ownership structure, Journal of Financial Economics. 3(4): 305-60.
15. Margaritis, D., & Psillaki, M. 2010, Capital structure, equity ownership and firm performance. Journal of banking & finance, 34(3), 621-632.
16. McConnell, J.J., and Servaes, H. 1990, Additional evidence on equity ownership and corporate value. Journal of Financial Economics 27:595-612.
17. Singh, M. and W.N. Davidson III, 2003, Agency costs, ownership structure and corporate governance mechanisms, Journal of Banking and Finance. 27: 793-816.
18. Smith, A. 1776, An inquiry into the nature and causes of the wealth of nations, London.
19. Tsai, H. & Gu, Z. 2007, "INSTITUTIONAL OWNERSHIP AND FIRM PERFORMANCE: EMPIRICAL EVIDENCE FROM U.S.-BASED PUBLICLY TRADED RESTAURANT FIRMS", Journal of Hospitality & Tourism Research, vol. 31, no. 1, pp. 19.
20. Williamson, O.E. 1991, "Comparative Economic Organization: The Analysis of Discrete Structural Alternatives", Administrative Science Quarterly - LA English, vol. 36, no. 2, pp. 219.