



## Foreign Ownership Structure And Corporate Performance: Empirical Evidence From India.

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### ABSTRACT

*The study on the relationship between the ownership and corporate performance has become an important task in modern firm theory (Berle and Means, 1932). The study examines whether differences in ownership structure across organizations can explain their differences in performance in developing economy like India. Using ownership structure of 425 Indian corporate firms over the period 2003-2009, the study provides answer to some of the questions raised like does ownership matter?, What is the comparative efficiency of domestic and foreign promoter ownership structure? This research also attempts to find out what is the preferred ownership structure for privately held firms? The relationship between ownership structure and firm performance was evaluated by examining firm performance over the years. Tobin's Q, Return on Asset and Return on Sales are used for measuring the performance of the firm. Statistical tools like Spearman correlation Test, Kruskal Wallis Test, Mann Whitney u test and Friedman ANOVA are used for analysis. It is found that the firms with foreign ownership are positively related with the performance.*

**Keywords : Ownership structure, corporate governance, Tobin's Q, foreign promoters**

### Introduction

The separation of ownership and control is an important feature of modern corporate firms. The study on the relationship between the ownership and corporate performance has become a front porch task in modern firm theory (Berle and Means, 1932). They further argue that the dispersal of company's stock right will weaken the shareholders control. The professional managers have a natural tendency to enrich themselves, to throw away the firm's assets in unproductive endeavors and inattentiveness, at the expense of the owners. Their view has been challenged by

Demsetz (1983), who argues that the ownership structure of a corporation should be thought of as an endogenous outcome of decisions that reflect the influence of shareholders and of trading on the market for shares.

Chibber and Majumdar (1999) examine the influence of foreign ownership on performance of firms operating in India using accounting measures of performance in cross sectional data analysis. Rather than capturing ownership variation through looking at categories such as domestic versus state ownership or joint ventures versus solely owned subsidiaries, they look only at ownership variations that have a legal basis in Indian Companies Act of 1956. They find foreign ownership to have a positive and significant influence on firm performance, but it does so, only when it crosses a certain threshold limit, which is defined by the property rights regime.

Douma, George, and Kabir (2003), examine how ownership structure, namely foreign individual investors and foreign corporate shareholders affect the firm performance, using Indian firm level data for 2002. They find foreign corporations attribute to positive effect on firm performance.

### Statement of problem

A firm's ownership structure influences its performance for several reasons. Firstly, the differences in identity,

concentration and resource endowments among owners determine their relative power, incentives and ability to monitor managers. Secondly, as owners have divergent goals, they have different influences on firm performance. This research examines whether the differences in ownership structure across firms can explain their performance differences in an emerging economy like India. In the light of the background described above the study raises the following questions.

- Does ownership structure have any impact on the corporate performance?
- Whether foreign ownership is more effective than domestic ownership in maximizing firm value?
- What is the comparative performance of different forms of ownership structure?
- What is the preferred ownership structure for privately held firms?

### Objectives of the Study

The study is undertaken with the following objectives:

- To study the relationship between Indian promoters' share holdings and the performance of the firms.
- To examine the effect of foreign promoters' share holdings on the performance of the firm.

### Methodology

#### Data and sources of data

This study utilizes large-scale firm level data of Indian listed corporations. By using the ownership structure of 425 Indian corporate firms over the period 2003-2009, the researcher study's the impact of ownership on the performance of firms. Data for this study has been sourced from the PROWESS database of CMIE. For the study, all the companies that are included in S&P CNX 500 index of National Stock Exchange of India (NSE) are considered.

The data relating to firms in the financial sector are excluded. This study covers a period of 7 years from 2003 to 2009. S&P CNX 500 is one of the broad based market indices in Indian capital market. It accounts for about 94% of total market capitalization and 98% of total turnover of NSE. The S&P CNX 500 include Indian firms from 78 different industries. After the exclusion of financial services firms our sample size comes down to 449. Non-availability of data for some of the firms decreases the sample size further to 425 companies.

The relationship between ownership structure and firm performance can also be evaluated by examining firm performance over the years. The variables taken for analysis are Indian promoters holding and foreign promoter holding.

Foreign promoter shareholders use their ownership stakes as a means to promote their strategic interests, like gaining access to new markets, location specific resources and low cost production facilities. Their foreign affiliations give them easy access to superior technical, managerial and financial resources.

Domestic promoters possess strategic interests because their ownership stakes are motivated by non-financial goals, such as obtaining control rights and developing sustainable competitive advantages and capabilities. However, their impact on firm performance is anticipated to be moderate because, in comparison to foreign shareholders, they have relatively inferior resource endowments and capabilities.

**Tools of analysis**

The data collected from various sources were analysed by using various tools and technique with a view to evaluate the performance of firms with different ownership pattern. The statistical tools like Spearman correlation Test, Kruskal Wallis Test, Mann Whitney u test, Friedman ANOVA were used in the study.

**Data Analysis and Interpretation**

The analysis is done as two sections. Section I deals with the cross sectional analysis and Section two deals with Time series analysis. The Section I is divided into two major sub sections. Sub section I presents the correlation results of the performance measures. Sub section II presents the results of the ownership structure and the performance measures. The section II deals with the performance trend analysis. First, the performance measures are analysed for significant changes across years. When found significant, the study intends to analyse the potential determinant for variation across years. To achieve this objective, performance variables are represented by the Y intercept and Slope of the performance trend.

**Cross sectional analysis of performance metrics**

The main aim of this study is to find out the performance variation of companies with different ownership structures taking one year at a time. High accounting profit rates are usually accompanied by high stock prices, whereas the denominator of Tobin's Q, is measured by the book value of tangible assets rather than by replacement cost, is much like that used by accountants when estimating the firm's capital investment. Hence, the researcher expects the accounting profit rate and Tobin's Q to be correlated. Highly correlated variables are eliminated for further analysis.

**Correlations of performance measures**

The Spearman Rank Correlation has been used to determine whether there is any evidence of a statistically significant association between the performances measures considered in the study.

Table 1: Spearman Correlations of performance measures.

Performance Measures	Return on Asset	Tobin's Q	Return on sales	Return of Equity
Return on Asset	1.000	.601	.217	.619**
Tobin's Q	.601	1.000	.250	.555
Return on sales	.217	.250	1.000	.294
Return of Equity	.619**	.555	.294	1.000

Since the association between Return on Equity and other performance variable high, Return on Equity is eliminated from further analysis.

**Analysis of ownership structure**

The study primarily aims at analysing the effect of the ownership structure of the firm on the performance of the firm. Examination of the ownership structure of the sample firms gives some interesting insights. On an average 42 percent of the equity of these firms is owned by Indian promoters, with a maximum value of 98 percent. The mean value of the foreign promoter shareholding of the sample is 10.5 % and the maximum is found to be 91%.

Major categories of shareholdings in India have remained relatively stable over time. Unlike several other emerging markets, firms in India, typically maintain their shareholding pattern over the period of study (Patibandla, 2002), making it possible to identify the ownership affiliation of each sample firm with clarity. Hence the researcher has used shareholding pattern of the year 2007 to categorize the companies. The ownership variables are split into 4 categories (0, 0.1% -25%, 25.1%-50% and greater than 50%) and then based on these categories they are grouped as follows:

Foreign promoter holding	Indian Promoter holding			
	0	0.1-25%	25.1%- 50%	>50%
0	Group 1	Group 2	Group 3	Group 4
0.1-25%		Group 5	Group 6	Group 7
25.1%- 50%	Group 8			
>50%	Group 9			

Table 2: Ownership Structure and Tobin's Q: Results of Kruskal Wallis Test.

Year		2003	2004	2005	2006	2007	2008	2009
Tobin's Q	KW Test	60.852	53.347	51.392	51.906	12.425	28.416	57.987
	Asymp. Sig.	.000	.000	.000	.000	.190	.001	.000
ROS	KW Test	7.741	7.793	7.918	3.848	9.591	7.048	7.786
	Asymp. Sig.	.560	.555	.542	.921	.385	.632	.481
ROA	KW Test	39.712	46.121	47.867	52.671	9.690	35.449	40.142
	Asymp. Sig.	.000	.000	.000	.000	.376	.000	.000

The results of the above analysis suggest that ownership structure has significant impact on Tobin's Q and Return on assets. This necessitates the application of post hoc tests using Mann Whitney U Test. Since there is a significant impact of ownership structure and the firm performance, this research further attempt to study which ownership group has a significant impact. For this Mann Whitney U test has been used to test the ownership patterns in pairs.

**Mann Whitney Test Statistics For Ownership Structure**

% Of Shareholding	Performance Measures	Significance	2003	2004	2005	2006	2007	2008	2009
<b>Indian Promoter Shareholding Structure</b>									
Less than 25% & 25% to 50 %	Tobin Q	No	.462	.483	.695	.826	.530	.614	.663
	ROA	No	.066	.131	.435	.237	.980	.633	.792
Less than 25 % & more than 50 %	Tobin Q	No	.921	.974	.338	.095	.839	.284	.134
	ROA	No	.935	.884	.712	.946	.908	.120	.132
25% to 50 % & more than 50 %	Tobin Q	No	.153	.308	.325	.005	.567	.340	.169
	ROA	YES	.001	.012	.012	.031	.725	.006	.003
Less than 50 % & more than 50 %	Tobin Q	NO	.200	.381	.259	.003	.656	.254	.173
	ROA	YES	.003	.032	.021	.056	.784	.005	.012
<b>Foreign Promoter Shareholding Structure</b>									
Less than 25% & 25% to 50 %	Tobin Q	YES	.003	.032	.005	.001	.218	.055	.038
	ROA	NO	.141	.014	.018	.011	.401	.004	.002
Less than 25 % & more than 50 %	Tobin Q	YES	.000	.000	.000	.000	.147	.010	.014
	ROA	YES	.001	.000	.000	.000	.153	.000	.000
25% to 50 % & more than 50 %	Tobin Q	NO	.137	.178	.284	.213	.557	.398	.327
	ROA	NO	.143	.191	.072	.019	.261	.463	.256
Foreign Promoter & No Foreign Promoter	Tobin Q	YES	.000	.000	.000	.001	.280	.002	.000
	ROA	YES	.019	.000	.007	.000	.154	.021	.000

**Analysis of Indian promoter shareholding**

Tobin's Q in general does not differ significantly for changes in Indian promoter's percentage of shareholding. Only in the year 2006, it is observed that Tobin's Q for companies having Indian promoter's percentage of shareholding in excess of 50% is significantly different when compared with percentage of shareholding in the range of 25% to 50 % and also 0 to 50% categories. With regard to Return on assets, the performance of companies where percentage of shareholding of Indian promoters is in excess of 50% is significantly different compared with companies having promoters' shareholding of 25% to 50% and 0 to 50%.

**Analysis of Foreign promoter shareholding**

Results of the analysis indicate that both Tobin's Q and Return on assets yield the same results. There are significant differences in performance when the foreign promoter shareholding is less than 25% and 25% to 50% as well as more than 25% but less than 50% category and more than 50% category. The mean rank foreign promoter shareholding increases with the increase in percentage shareholding. So it can be concluded that foreign promoter shareholding has a significant impact on the performance of the companies considered for the study.

**Performance trend analysis**

Each performance measures are tested for significant variation across years. Friedman ANOVA is used to test the difference in performance across years based on the ranked data

Table 4: Performance measures across years: Results of Friedman Test Statistics.

	Tobin's Q	Return on sales	Return on assets
Test statistics	669.591	12.994	79.385
Asymp. Sig.	.000	.023	.000

The Significance value 0.000 for Tobin's Q, 0.023 for Return on sales and 0.000 for Return on assets are well below the accepted significance level 0.05. The results of Friedman's ANOVA shows that all the performance measures taken for the study varies across years necessitating further analysis.

**Ownership structure and performance across years**

The significance of the ownership structure of the firm on the performance of the firm across the years using Intercept of the trend line and the Slope of the trend line is analyzed in this section.

Table 5: Performance measures across years between ownership Groups: Results of Kruskal Wallis Test Statistics.

	Tobin's Q		ROS		ROA	
	Slope	Intercept	Slope	Intercept	Slope	Intercept
Test Statistics	13.218	33.568	5.536	9.246	9.963	20.860
Asymp. Sig.	.153	.000	.785	.415	.354	.013

The test statistics values suggests that there is a significant impact of ownership structure on intercept of trend line but no significant impact of ownership structure on slope of the trend line measured by Tobin's Q and Return on assets. The Slope of the trend line which represents both the direction and magnitude, for both Tobin's Q and Return on assets vary significantly so it can be concluded that across year's ownership structure has no influence on the performance of the firm.

**Findings and Suggestions**

This study has investigated empirically the relationship between the ownership structure and firm performance using a panel of Indian corporate firms over 2003-2009, from a multi theoretic perspective. The findings are documented as

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follows:

**Indian promoter shareholding**

For Indian Corporate Firm's performance and domestic ownership is unrelated in the long run. It is been found that Tobin's Q in general does not differ significantly for changes in Indian promoter's percentage of shareholding. The results do not provide any evidence of the effects of domestic ownership on the performance. We conclude that the Indian promoter share-holding pattern does not influence the firm performance significantly, and the agency problem is solved by the optimal ownership pattern in the long run.

The results of similar studies on Indian data have produced contradictory results. It is possible that the contradictory results can be accounted for by differences in time periods studied and in research design. However, given the contradictory results produced by the current study and the prior Indian research, it is clear that there are many questions relating to the relationship between share holding pattern and performance of the firm, which remains unsolved.

**Foreign promoter holding**

Different categories of foreign ownership have varying impacts on firm's performance. Undoubtedly, there is a significant difference in performance between firms with foreign shareholding and without foreign shareholding. Both Tobin's Q and Return on Asset vary significantly with changes in foreign promoter shareholding.

The mean rank of the companies with more foreign shareholding are higher than the companies with less foreign promoter holdings and in the same way the mean rank of company with foreign shareholding are higher than the companies without foreign promoter holdings. The study shows that foreign ownership benefits positively on performance of firms. One reason might be the ability to monitor or control and give incentives to manage more effectively and by avoiding initiatives reducing corporate value. Another reason would be transformation of technology to domestic firms by foreign partners, thereby generating savings on operating expenses.

**Conclusion**

The researcher concludes that the Domestic promoter shareholding pattern does not influence the firm performance significantly. The Foreign ownership positively affects the firms' performance. This result is in line with other existing studies with respect to India and other developing countries, which find that foreign ownership, lead to higher performance. Before drawing implications for the modeling and practice of corporate governance in India, however a number of factors must be noted. Perhaps the most important one has to do with the measurement of ownership variables. The measure we use does not distinguish among different type of shareholders. For example, 'Foreign' includes foreign Individual investors and foreign corporate investors. A finer classification scheme might reveal a more important role of ownership categories. A second factor has to do with the sample characteristics. A more broad coverage in the sample in terms of cross-section and time-series might answer the question of significant change in ownership.