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OWNERSHIP STRUCTURE AND FIRM VALUE OF TOP CAPITALIZED COMPANIES IN SRI LANKA

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Abstract

The purpose of this paper is to empirically examine the impact which Ownership Structure has had on firm performance of the Sri Lankan firms which are listed in Colombo Stock Exchange (CSE). This study used Descriptive Statistics, Univariate Analysis, and Ordinary Least Squared Multi Regression Model as techniques and these techniques were applied on 60 top Capitalized companies which are listed in CSE. Annual Reports in 2015/16 Financial year are used to collect data on Ownership Structure and Firm Value. Insider (Managerial) Ownership, Institutional Ownership, Foreign Ownership were used as independent variables. To define the Firm Value Tobin's Q ratio is used as performance measurement. Firm Age and Size of the Board are used as control variables. The empirical regression results of the study indicate that the Ownership Structure has no significant relationship with Firm Value except Foreign Ownership.

Key Words: Ownership Structure, Firm Value, Top Capitalized Companies in CSE.

1. INTRODUCTION

Background of the problem

Ownership structure is analyzed in terms of insider ownership percentage (holdings of equity shares by big level executives and directors of the company), Institutional ownership and, Foreign ownership and firm performance is measured by Tobin's Q. Directors of a company manage the company on behalf of the shareholders (stewardship) and shareholders are owners of

the company thus this theory points out that the separation of ownership and management functions lead to principal-agent conflicts as the managers may pursue their own interest at the expense of the principals (Mustapha & Ahmad, 2011). According to Samarakoon (1999) in Sri Lanka, highly concentrated insider ownership is present in many listed companies and research backs this up.

Ownership structure of a company has an impact on agency problem. When small number of shareholders holds a large portion of the equity and large number of shareholders own small portion of the company's equity then there can be income smoothing and window dressing. When equity shares are owned by the big level executives and directors of the company then also there is a chance to mislead the minority shareholders of the company regarding wealth of the company. Therefore, this study focused on studying the relationship between Ownership Structure and Firm Value of top capitalized companies in Sri Lanka.

Problem statement

This study survey and discuss both the traditional Corporate Governance theories and theoretical and empirical analysis conducted by earlier researchers on various Corporate Governance mechanisms of Sri Lanka's listed firms in Colombo stock exchange. Hence the problem statement addressed in the present study is; *is there a significant relationship and influence between ownership structure and value of top capitalized companies which are listed in CSE.*

Research Questions and Objective of the study

The overall objective of the study is to identify whether there is a *significant relationship and significant influence between ownership structure and value of top capitalized companies which are listed in CSE.* It is further divided to three objectives as;

- i. To identify whether there is a significant relationship and significant influence between insider (managerial) ownership and firm value.
- ii. To identify whether there is a significant relationship and significant influence between Institutional Ownership and firm value.
- iii. To identify whether there is a significant relationship and significant influence between Foreign Ownership and firm value.

Based on objectives, the primary Research question is developed as;

Is there a significant relationship and significant influence between ownership structure and value of top capitalized companies which are listed in CSE.

The main research question was addressed in this research study through follow mentioned three sub questions.

- i. Is there a significant relationship and significant influence between insider (managerial) ownership and firm value of top capitalized companies which are listed in CSE?

- ii. Is there a significant relationship and significant influence between institutional ownership and firm value of top capitalized companies which are listed in CSE?
- iii. Is there a significant relationship between foreign ownership and firm value of top capitalized companies which are listed in Colombo Stock Exchange?

2. LITERATURE REVIEW

Corporate governance is the system by which companies are directed and controlled. This corporate governance codes are introduced to minimize the agency problem of the companies. As per the definition given in Wikipedia, Corporate Governance refers to the system of structures, rights, duties, and obligations by which corporations are directed and controlled. The Governance structure specifies the distribution of rights and responsibilities among different participants in the firm such as the board of directors, managers, shareholders, creditors, auditors, regulators and other stake holders and specifies the rules and procedures for making decision in corporate affairs. Agency costs result from the separation of ownership and control within an organization and are characterized by opportunistic behavior such as investing in negative net present value projects, shirking, and consuming perquisites.

Al-Najjar (2010) pointed out that institutional owners may affect the management performance and activities directly through their ownership and indirectly through their ability to trade their shares. In addition, the key role they are playing in monitoring their firms transmitting information to other shareholders.

Managerial ownership is the way in which a firm is owned and managed. As per the findings of Bokpin (2011), there is a positive relationship between insider ownership and firm value in the Ghana Stock Exchange.

As per the findings of Bokpin (2011), performance has significant and positive relationship with ownership structure. They specifically find out that foreign share ownership predicts corporate cash holding in Ghana Stock Exchange. Ongore & K'Obonyo (2011) state that the positive and significant relationship between foreign ownership and firm performance appears to have gained universal acceptance across the globe due to a number of factors. Research findings of Imam & Malik (2007) suggest that in Bangladesh, the ownership structure and firm performance has a relationship. They conclude that foreign ownership and firm value (Tobin's Q) positively related and the relation is nonlinear monotonic one.

As per the Pattanayak (2007), Age is defined as the number of years between the observation year and the firm's incorporation year. Age, a priori, has an ambiguous effect on firm performance. Mature firm has the reputational advantage vis-à-vis new firm. Lappalainen & Niskanen (2012) have taken firm age as a controlling variable. Morck (1988) indicate that for older firms, there is evidence that Tobin's Q is lower, when the firm is run by a member of the founding family than when it is run by an officer unrelated to the founder.

3. METHODOLOGY

The study considers all the companies which are listed in the CSE as the population. And out of them 60 top capitalized companies were selected based on turnover more than 50 million. To determine the ownership structure and firm value by each company, it is examined the annual reports of the financial year 2015/2016.

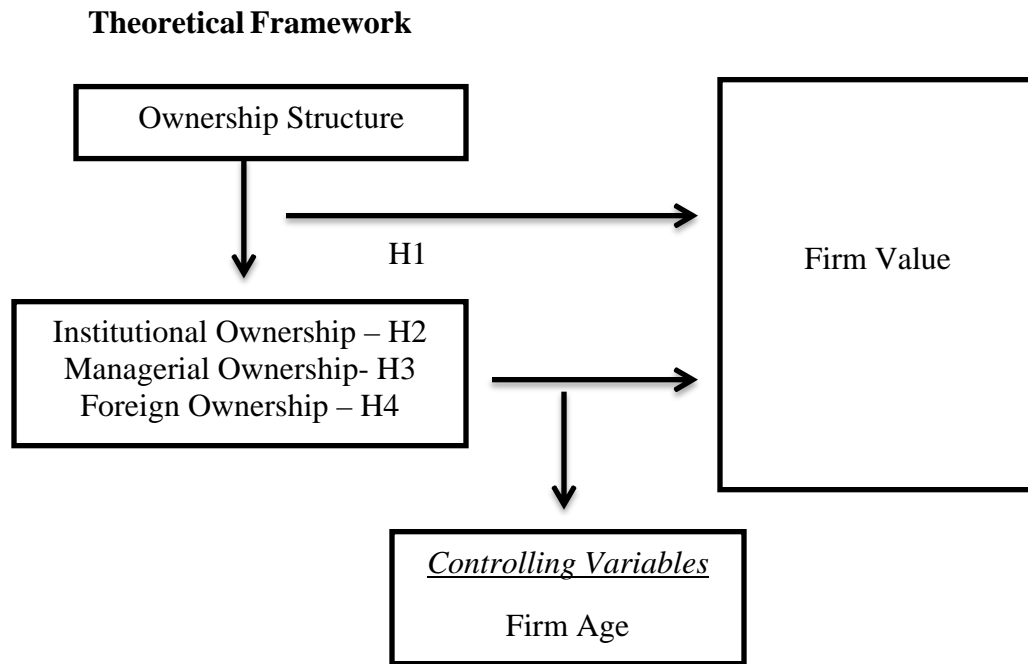


Figure 01 – Conceptual Frame work

Accordingly following Hypothesis were developed,

- H₁ - There is significant relationship between Ownership Structure and Firm Value.
- H₂ - There is a significant relationship between Institutional Ownership and Firm Value.
- H₃ - There is a significant relationship between Managerial Ownership and Firm Value.
- H₄ - There is a significant relationship between Foreign Ownership and Firm Value.

Research Model

The relationship between ownership structure and firm value can be obtained by running an independent model representing independent and controlling variable dimensions. The model was tested is shown below.

Model

$$\text{Firm Value} = \beta_0 + \beta_1\text{INO} + \beta_2\text{MNO} + \beta_3\text{FRO} + \beta_4\text{FAGE} + \beta_5\text{BSIZE}$$

Firm Value	is Tobin's Q ratio of the company	
β_0	is the Intercept coefficient	
INO	is the Institutional Ownership percentage	
MNO	is the Managerial Ownership percentage	
FRO	is the Foreign Ownership percentage	
FAGE	is the Firm Age*	
BSIZE	is the director Board Size*	*controlling variables

Data analysis tools

Data was analyzed using Descriptive statistics which explored the data collected and then Correlation analysis was used to identify the relationship between the variables. In order to predict the dependent variable, multiple regression analysis was applied.

4. DATA ANALYSIS**Correlation Analysis**

According to the Correlation coefficients, institutional ownership and firm value (Tobin's Q) has positive insignificant relationship (the correlation between institutional ownership and firm value is $r=0.14$). But the managerial ownership and firm value (Tobin's Q) has negative insignificant relationship. Moreover, there was a strong positive and significant relationship between foreign ownership and firm value (Tobin's Q) (the correlation between foreign ownership and firm value is $r=0.50$).

The analysis indicates that the firm age and firm value has positive significant relationship. But board size and firm value has negative significant relationship which carries the correlation of -0.220.

Multi variant Analysis

According to the regression results, the Tobin's Q model was developed as follows,

$$\text{TOBIN'S Q} = -11.161 + .147\text{INO} + .075\text{MNO} + .473\text{FRO} + .149\text{FAGE} -$$

In this model -11.161 represent the value of Tobin's Q when all the independent and controlling variables are zero. And this value is constant. This model shows that all the independent and

controlling variables positively affect the Tobin's Q when one unit of Tobin's Q changes except board size. But only foreign ownerships significantly affect the firm value.

Table 01 - Interpretation of Overall Model summary

Model	R square	Adjusted R square	F Ratio
1	0.2870	0.265	12.958

The Correlation coefficient of the model is .287. It means that 28.7% of variance of Tobin's Q explained by independent variable. Further R² of .287 implies the independent variable is unable to explain 71.3% of the variance of the Tobin's Q.

And according to the findings the F ratio is 12.958 and its greater than one and the model has a good fitness. Therefore, F ratio in the model is significant and these results indicate that there is a significant relationship between independent variables and Tobin's Q and model is valid from the given predictors.

4.4 Hypothesis Testing

Table 02 – Hypothesis test results

Hypothesis	Expected results		Actual results		Accept/ Reject
	Positive	Significant	Positive	Significant	
H1 – There is a significant relationship between ownership structure and firm value	Yes	Yes	Yes	No	Reject
H2 – There is a significant relationship between institutional ownership and firm value	Yes	Yes	Yes	No	Reject
H3 – There is a significant relationship between managerial ownership and firm value	Yes	Yes	Yes	No	Reject
H4 – There is a significant relationship between foreign ownership and firm value	Yes	Yes	Yes	Yes	Accept

5. CONCLUSION

Coefficient value of institutional ownership is .147 and significance value is .082 which is not significant at 5% level of confidence. This shows institutional ownership is positively related to firm value but relationship is not significant. And Ongore & K 'Obonyo (2011), also stated that there is a positive relationship between ownership of corporations and firm performance. In contrast, findings of Al-Najjar B. (2010), shows that there is a negative relationship between institutional ownership and firm profitability.

Coefficient value of managerial ownership is .075 and significance value is .380, which indicates that managerial ownership is positively related to firm value but relationship is not significant. As per the findings of Bokpin (2011), there is a positive relationship between insider ownership and firm value in the Ghana Stock Exchange which is in line with the present study but the findings of the present study is not significant. As per the findings of Fauzi and Locke (2012), managerial ownership exhibits a positive and significant relationship with firm performance, and Wellagala and Locke (2011) confirm that in Sri Lanka, effect of insider ownership on firm performance is more positive and significant. But findings of the present study are positively related to firm value but not significant.

Coefficient value of foreign ownership is .473 and significance value is .000. Therefore, foreign ownership is positively and significantly related to firm value. As per the findings of Bokpin (2011), performance has significant and positive relationship with ownership structure and their findings are in line with the present study. Ongore & K'Obonyo (2011) also pointed out that the positive and significant relationship between foreign ownership and firm performance. Their findings are also in line with the present study. But in contrast, Kumara (2004), findings suggest that firm performance is not related to foreign ownership in the long run.

Empirical results suggest that there is a positive and insignificant relationship between ownership structure and firm value except foreign ownership. Results of this study suggest that institutions are holding more shareholding percentage. It shows the lower dispersion of ownership of the top capitalized firms in Sri Lanka. And as per the results, there is a positive and insignificant relationship institutional ownership and Tobin's Q. Manager Shareholdings are very low in Sri Lanka. Empirical results suggest that relationship between managerial ownership and Tobin's Q is positive but not significant. Foreign share- holders also hold low percentage of shares in top capitalized companies. But there is a strong positive and significant relationship between foreign ownership and Tobin's Q. Firm age and board size were taken as controlling variables. Firm age is significant and board size is not significantly related to firm value as per empirical results.

The regression results indicate that the ownership structure has no significant relationship with firm value except foreign ownership.

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