

DOES OWNERSHIP STRUCTURE MATTER FOR ECONOMIC PROFIT? CASE OF TURKIYE

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ABSTRACT

Purpose- This study aims to analyze the effects of three different (institutional, insider and foreign) ownership structures on firm performance proxied by economic profit. Besides, any possible effects of leverage and firm size on firm performance are also tested.

Methodology- This study conducts a multiple regression analysis to the yearly data of firms traded in the Borsa Istanbul 30 (BIST-30) Index for the period of 2010-2022.

Findings- Empirical findings refer the existence of statistically significant and positive relationships among institutional ownership and insider (managerial) ownership on firm performance. However, not any evidence of statistically significant relationship between foreign ownership and firm performance has been found.

Other findings concerning the control variables included in the research model are that while leverage has negative effect on firm performance, firm size affects firm performance positively.

Conclusion- This study contributes to the literature on the relationship between ownership structure and firm performance by using data including BIST-30 listed firms in Türkiye as an emerging market. Besides, the research model includes “economic profit” variable that is so rarely referred in existing literature on firm performance evaluation.

Keywords: Institutional ownership, insider ownership, foreign ownership, firm performance, economic profit.

JEL Codes: G32, G38, L19.

1. INTRODUCTION

Since the early 1990s, researchers and corporate managers have begun to focus on the concept of modern corporation. The modern corporation concept has been described by Demsetz (1967) by a series of property right terms. First, Demsetz (1967) realizes the efficiency of the modern corporation by delegating effective ownership to the management. He also describes shareholders as essentially lenders of equity capital and according to him, the limited liability protection for shareholders relieves them of the need for examining both the assets of other shareholders and the corporations' liabilities (debtholders). The existence of multiple shareholders in modern corporations has led the emergence of the concept of ownership structure. In publicly-traded firms, the ownership structure can be defined as the distribution of equity regarding votes and capital, and the identity of the equity owners. The theory of Berle and Means (1932) on the foundations of corporate law in the United States on the rise of modern corporations emphasizes the separation of legal ownership and control. This separation can simply be defined as that those who are the owners of the corporation are different from those who control it. Berle and Means (1932) warn that the very separation of ownership may destroy shareholder value, as managers may act on their own behalf to extract rents. Besides, the emergence of other ownership-related concepts such as diluted ownership; increasing limitations on ownership rights and the rise of managerial hegemony in listed firms have also been other causes of increasing concern on the relationship between ownership structure and firm performance.

The effect of ownership structure on various firm policies, focusing particularly on firm performance, has been widely researched in previous studies. However, empirical results somehow differ. Earlier studies of Jensen and Meckling (1976), Lichtenberg and Pushner (1994), and Mehran (1995) claim the existence of a monotonic relationship between ownership structure and firm performance. On the contrary, Morck et al. (1988), McConnell and Servaes (1990) and, Short and Keasey

(1999) state that the relationship between two is non-monotonic. The common point of all these studies is the assumption that ownership structure is an exogenous variable that it is determined outside the model. However, Demsetz (1983) and Demsetz and Lehn (1985) consider ownership structure as an endogenous variable and suggest that it does not have a direct effect on firm performance. Some other studies [see, for instance, Farooque et al. (2007) and Boone et al. (2011)] provide further evidence that there exists a bidirectional relationship between ownership structure and firm performance. Another characteristic of the related literature is that -ignoring the emerging economies- most studies on ownership structure are carried out in advanced economies and concentrate on the conflict between dispersed owners and unmonitored managers. However, firms in emerging economies are mostly characterized by relatively concentrated ownership and the conflict is mostly between minority and majority shareholders (Din et al., 2022). Additionally, a notably higher share of relatively large firms in emerging markets are family businesses (56% in India, 54% in Southeast Asia, and 46% in Brazil as compared to 33% in Unites States and 40% in Europe) (Bhalla, 2016).

This study primarily aims to fill this gap by examining the effect of ownership structure on firm performance for an emerging market (Türkiye) data. Compared to developed markets, emerging markets such as Türkiye have different political, economic, socio-cultural, and environmental structures. Besides, firms in these markets are mostly highly concentrated, family-owned firms and operate as affiliates of a group of companies owned by the same family or a group of families (Önder, 2003). The family members constitute the upper echelon of the management due to family ties and play a very central role in the decision-making processes of the firms. This situation creates a different kind agency problem unique to emerging markets' firms (Cheung et al., 2006; Panda and Bag, 2019). Another distinctive feature of this study is that it considers different dimensions of ownership structure as institutional, insider (or managerial) and foreign ownership structures.

The rest of the study is as follows. Sections 2 discusses the theoretical background and the empirical evidence, respectively. Section 3 is about the sample, data, variables, the research model and empirical findings. Finally, section 4 presents the findings and concludes the discussion.

2. THEORETICAL BACKGROUND AND EMPIRICAL EVIDENCE

Alchian and Demsetz (1972) and, Jensen and Meckling (1976) define firm as a series of contracts between production factors. However, these production factors mostly prioritize their own interests and are not aware that their success depends on the performance of the entire team and the competitive environment in which they operate (Fama, 1980). So, it can be concluded that a firm's (financial) performance is an output of its operations; and the primary objective of the firm's stakeholders is to maximize the firm's performance and so eventually their return that is positively correlated with the risk they undertake. The stakeholders' and especially the shareholders' risk and return phenomenon is tightly linked with their involvement in the firm and their potential in risk diversification (Laporsek et al., 2021).

The shareholders can reduce their risks through diversification by transferring their assets among firms with relatively low transaction costs. Unfortunately, excessive diversification of assets may sometimes cause excessive separation between ownership and control of firms. According to Demsetz (1983), though dispersed ownership reduces the shareholders' risks, it pressures their interest and attention in controlling the firm. Besides, monitoring firms with dispersed ownership may be a major cost-driver that lowers the required rate of return. On the contrary, concentrated ownership has also some benefits and costs. Concentrated ownership may reduce agency costs by increased monitoring of top management. However, it may also provide dominating owners with private benefits of control (Rose, 2019). Whether it is dispersed or concentrated, it is obvious that ownership structure is one basic determinant of the firm's (financial) performance. The possible effects of different ownership structures on performance have been subject to the agency and the resource dependence theories.

The agency theory of Jensen and Meckling (1976) is based on the proposition that there exists a separation between the management of firms (agent) and its owners (principal). This separation can potentially lead to agency conflicts (costs) between the managers and the shareholders of the firm such as excessive consumption of firm's resources on the behalf of the managers or false investment decisions. Moreover, it can also result in the dilution of shareholders' monitoring and this triggers managerial opportunism that has adverse effects on firm's performance (Berle and Means, 1932). These agency-related risks can be minimized by various mechanisms. Fama and Jensen (1983), and Fauzi and Locke (2012) offer setting up an effective board of directors; while Easterbrook (1984) suggests debt-financing and alternate dividend policies to minimize agency costs. Another mechanism is shaping a concentrated ownership by which the shareholders (in such situations, the blockholders) can discipline firm managers by utilizing their voting rights (Carney and Gedajlovic, 2001).

Another theory on the ownership structure and firm performance relationship is the resource dependence theory. This theory basically deals with how the external resources of a firm affect the behavior pattern of the firm. Though it is well-known that the external resources are vital for strategic, tactical and financial management of the firm, a theory on the consequences of this vitality has not been formalized till the study of Pfeffer and Salancik (1978) named "The External Control of Organizations: A Resource Dependence Perspective". Resource dependence theory deals with not only the optimal divisional structure of organizations, but also assignment of board members, selection of strategies, establishment of contract structures, and many other aspects of firm's organizational strategy. This theory assumes that resources provided by the others and the existence

of other firms are very necessary for a firm to achieve sustainable growth (Ulrich and Barney, 1984), as firms cannot be fully self-sufficient for survival (Boshnak, 2022). Later, Pfeffer and Salancik (1978) link their theory to corporate governance arguing that firms with constrained resources should strongly engage with their external environment through corporate governance. According to resource dependence theory, firm performance can be increased by reducing the level of dependence.

The empirical evidences on the ownership structure and firm performance relationship are rich but of diverse nature. Carlin and Mayer (2002) associate this diversity with differing institutional and cultural orientations across countries. Besides most studies on the subject investigate developed and developing countries [see, for instance, Morck et al. (1988); Dwivedi and Jain (2005); Elyasiani and Jia (2008); and Madiwe (2014)]. As this study reviews three different dimensions of ownership structure as institutional, insider (or managerial) and foreign ownership structures, the empirical findings of earlier studies is to be presented accordingly.

Theoretically, it is argued that institutional investors act as active monitors and struggle to maximize their investments. This phenomenon is reasonable as they also serve as catalyst for moderating the agency problems by lowering the adverse effects of unprofessional behavior of firm managers (Kang et al., 2007). This theoretical argument has empirically been supported by Smith (1996), Cornett et al. (2007), Elyasiani and Jia (2008), Alfaraih et al. (2012), Arouri et al. (2014), Abdallah and Ismail (2017), Lin and Fu (2017), Din et al. (2022) and Siddique et al. (2022), all providing a significant and positive relationship between institutional ownership and firm performance. However, some other studies observe a significant and weak or negative relationship [Dwivedi and Jain (2005); Elyasiani and Jia (2010); Ongore (2011); Arora and Sharma (2016); Al-Matari et al. (2017)]; or insignificant relationship [Agrawal and Knoeber (1996); Karpoff et al. (1996); Duggal and Millar (1999)] between institutional ownership and firm performance. Hussain et al. (2020) clarify this empirical finding on the reality that some institutional investors may have passive behavior patterns, so that they only try to compromise to protect their relationship with the firm. The hypothesis developed to address the relationship between institutional ownership and firm performance is as:

H1. There is a positive relationship between institutional ownership and firm performance.

Firm's top managers (or directors) as also shareholders may improve firm performance. The agency theory of Jensen and Meckling (1976) considers these managers as insider owners and as a mechanism that can reduce agency costs as they share a common interest along with the shareholders outside in the firm's success. Supporting this consideration, Kumar and Singh (2013) argue that in case of that the top managers own only a small portion of shares, the agency costs tend to increase, as these managers will prioritize and focus their own interests ignoring the shareholder value maximization goal of the firm. On the contrary, due to increase in shares held by the top managers, agency problems will relatively reduce and firm performance will increase. Palia and Lichtenberg (1999) also confirms this argument that insider ownership dilutes the adverse effects of myopic managerial behavior, enhancing firm performance. Likewise, Francis and Smith (1995), and Holthausen et al. (1995) state that insider ownership increases innovation and productivity, hence enhancing firm value. However, according to an opposite argument by Morck et al. (1988) and Denis and Denis (1994), insider ownership may tend to affect firm performance negatively, as it may weaken the efficiency of board and cause to lose internal control, especially in countries having poor corporate governance mechanisms and weak legal systems. Besides, Fama and Jensen (1983) see increasing insider ownership as a value-destroyer for minority shareholders.

Similar to the empirical literature concerning institutional ownership and firm performance, the literature on insider ownership and firm performance consists of varied empirical findings. Gugler et al. (2001), Iturralde et al. (2011), Talab et al. (2018), Al-Janadi (2021), Ivone and Shellen (2022), Iwasaki et al. (2022) provide certain and positive relationship between insider ownership and firm performance; while Al-Matari and Al-Arussi (2016), Alkurdi et al. (2021) posit opposite empirical findings. Finally, Shukeri et al. (2012) provide empirical evidence that relationship between insider ownership and firm performance is insignificant. Based on the literature given, the formulated hypothesis is as:

H2. There is a positive relationship between insider ownership and corporate financial performance.

Foreign ownership refers to the ownership of a portion of a firm's assets by individuals who are not citizens of that country or by a firm (or firms) whose headquarter(s) is (are) not in that country. Compared to the literature on institutional/insider ownership structures on firm performance, the literature concerning foreign ownership and firm structure relationship is quite limited with mixed results, and the related studies are outnumbered. Besides, the literature focuses mainly on developed economies and majority of the empirical findings posits a positive relationship between foreign ownership and corporate performance [Wei and Varela (2003); Douma et al. (2006); Hussain et al. (2020); Din et al. (2022); Ahmed et al. (2022)]. Pfeffer and Salancik (1978) and, Benfratello and Alessandro (2002) associate these findings with resource dependence theory. According to them, foreign ownership serves as a source of capital and allows access to technological resources which eventually increases firm performance. Contrary to this, Barbosa and Louri (2005) mount an argument that the unfamiliarity of foreign owners with a different investment environment may decrease firm performance. Elghuweel et al. (2017), and Amin and Hamdan (2018) provide evidence on the existence of negative relationship between foreign ownership and firm performance. Based on these arguments, the following hypothesis is as:

H3. There is a positive relationship between foreign ownership and firm performance.

3. METHODOLOGY

3.1. Sample and Data

This study aims to investigate the possible effects of ownership structures on firm performance and conducts a multiple regression analysis to the yearly data of firms traded in the Borsa Istanbul 30 (BIST-30) Index for the period of 2010-2022. The financial data concerning the sample is derived using a software by Finnet's *Financial Analyst* software.

3.2. Variables

3.2.1. Dependent Variable

The dependent variable included in the research model is economic profit as a proxy for firm performance. Main references to economic profit can be attributed to the free cash flow and capital structure theories of Modigliani and Miller (1958; 1961). After the theoretical foundations of economic profit has been laid by Kaplan and Zingales (1997), and Cleary (2002); some attempts have been made to measure the wealth of shareholders practically from 1970s to present, including Rappaport (1979), Stewart (1991), Stern et al. (1995), Grant (1996), and Uyemura et al. (1996). The common point of these attempts has been mostly relating free cash flow approach to the concept of value added.

Economic profit, in brief, can be said to be a variant of economic value added which is built on the concept of "excess return". Economic value added, economic profit or any other variant share the same basic idea that the value is created by generating excess returns on investments (Damodaran, 2005). The only difference among these variants is about to how these returns are calculated. The excess return calculation in economic profit is made from shareholders' perspective. So, the focus is on net income and cost of equity, rather than operating income and cost of capital.

3.2.2. Independent and Control Variables

The independent variables included in the research model are institutional ownership, insider ownership and foreign ownership. Besides, leverage and firm size are included in the model as control variables, proxied by total debt to total assets ratio and natural logarithm of firm's total assets, respectively. Definitions and descriptions of the variables in the research model are given in Table 1.

Table 1: Variables in the Research Model

Dependent Variable	Symbol	Calculation
Economic Profit	EP	Natural Logarithm of [Net Income – Cost of Equity* x Book Value of Equity]
Independent Variables		
Institutional Ownership	INSTOWN	Percentage of Shares Held by Institutional Owners to Total Number of Outstanding Shares
Insider Ownership	INSIOWN	Percentage of Shares Held by Board Members to Total Number of Outstanding Shares
Foreign Ownership	FOREOWN	Percentage of Shares Held by the Foreign Owners to Total Number of Outstanding Shares
Control Variables		
Leverage	LEV	Total Debt to Total Assets
Size	SIZE	Natural Logarithm of Total Assets

* Cost of equity is calculated by Capital Asset Pricing Model developed by Sharpe (1964) and Lintner (1965a, 1965b).

3.3. The Research Model

The relationships among EP, INSTOWN, INSIOWN, FOREOWN, LEV and SIZE are tested by the multiple regression equation as given below:

$$EP_t = \alpha_0 + \beta_1 INSTOWN_{it} + \beta_2 INSIOWN_{it} + \beta_3 FOREOWN_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + \varepsilon_{it}$$

where; i , t and ε are firm identifier, year identifier and the error term, respectively.

3.4. Empirical Findings

3.4.1. Descriptive Statistics

The descriptive statistics for the research model variables are given in Table 2. The mean of the dependent variable (economic profit in natural logarithm) is 15.90 and ranges from around 14.00 to 19.45. The mean values for the independent variables, i.e. institutional, insider and foreign ownerships are 32.30%, 18.90% and 9.70%, respectively. The descriptive statistics of the sample show that institutional investors own 32.30% of outstanding shares, while 18.90% and 9.70% of outstanding shares are held by insider and foreign investors, respectively. The remaining 39.10% of outstanding shares are held by other types of investors.

In terms of control variables, leverage and firm size expressed in percentage and natural log forms have the mean values of 49.80% and 15.43. They range from 0.30% to 89.40% and from 14.00 to 20.57 with standard deviations of 25.70% and 1.324, respectively.

Table 2: Descriptive Statistics

Variables	Number of Observations	Mean	Minimum	Maximum	Standard Deviation
Dependent Variable					
EP	374	14.895	13.998	19.452	1.745
Independent Variables					
INSTOWN	374	0.323	0.000	0.921	0.282
INSIOWN	374	0.189	0.000	0.884	0.259
FOREOWN	374	0.097	0.000	0.958	0.261
Control Variables					
LEV	374	0.498	0.003	0.894	0.257
SIZE	374	15.426	14.001	20.568	1.324

3.4.2. Regression Analysis

The ownership structure is one of the most important determinants of firm performance due to the existence and a very nature of agency conflicts among the shareholders and firm managers. The research model of the study aims to analyze the possible effects of three different ownership structures including institutional, insider and foreign ownership structures on firm performance proxied by economic profit.

The results of multiple regression analysis from Table 3 indicate a statistically significant and positive relationship between institutional ownership and firm performance at 1% significance level. The related coefficient also implies that 1% increase in institutional ownership will increase economic profit by 5.05%. The empirical results also point the same (and even higher) effect of insider (managerial) ownership on firm performance with a coefficient of 10.28%. However, not any evidence of statistically significant relationship between foreign ownership and firm performance has been found.

The empirical findings concerning control variables, leverage and firm size indicate that while leverage has statistically negative effect on firm performance; firm size affects firm performance positively. The coefficient of leverage is -0.29 for economic profit indicating that a 1% increase in leverage will decrease firm performance by 0.29%. however, the coefficient concerning firm size is 0.07 and this means that 1% increase in firm size will increase firm performance by 0.07%.

Table 3: Regression Analysis

Dependent Variable: Economic Profit		
Variables	Coefficient	t-Value
INSTOWN	5.052***	5.21
INSIOWN	10.281***	3.60
FOREOWN	0.151	1.01
LEV	-0.287***	-10.36
SIZE	0.071*	8.43
R^2	0.384	
Adjusted R^2	0.352	
F Statistics	0.000	
Durbin-Watson	2.084	
N	374	

* and *** denote significance levels at 1% and 10%, respectively.

4. CONCLUSION

This study analyses the relationships among different ownership structures and firm performance. To the best of our knowledge, this is one of the pioneering studies that conducts an analysis to the data of Türkiye as a promising emerging market. The empirical findings are expected to fill the gap in existing literature on emerging markets and guide investors and firm managers.

The empirical findings indicate a statistically significant and positive relationship between institutional ownership and firm performance. This provides evidence that institutional investors have an effective role in mitigating adverse and value-destroying effects caused by the information asymmetries and agency problems observed in almost all firms. Besides, this finding is also an indicator of that institutional shareholders in Türkiye consider metrics concerning firm performance such as earning per share (EPS), market share, market price and economic profit etc., and actively monitor and try to control firm managers. This finding is in line with Pound (1988) and Cornett et al. (2007).

Another finding is the existence of a statistically significant and positive relationship between insider or managerial ownership and firm performance. This can be clarified that the combination of institutional and insider (managerial) ownership structures forces firm managers to pursue the primary financial goals of the firm rather than their personal goals. This finding also supports an agency theory prediction of that the concentration level of insider ownership is an instrument to improve firm performance. This finding is also supported by Zahra et al. (2018), Cheung and Wei (2006), and Shyu (2013).

Regarding the control variables, firm size is found to have a positive and significant effect on firm performance. This implies that with the expansion of firm size, firm performance increases. Besides, leverage has a significant and negative effect on firm performance. This implies that increase in leverage reduces firm performance due to increase in financial risk cost of capital.

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