Ownership structure and the financial performance of listed conglomerate firms in Nigeria

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Corporate Governance, Financial Performance and Conglomerate firms.

Abstract

This study assesses the impact of ownership structure on the financial performance, using listed conglomerate firms in Nigeria. The main objective of the study is to ascertain the level to which ownership structures influences the performance of Nigerian conglomerates firms. The methodology employed is the use of secondary data and the ex-post facto research design. The population of the study is all the conglomerates firms listed on the Nigerian Stock Exchange as at 31st December, 2013. The study used regression as a tool of analysis. Findings show that managerial and foreign ownership has negatively impacted the performance of listed conglomerate firms within the sturdy period, while firm size positively impacted the firm performance. The study recommends among others that managerial ownership should not control up to 50% or more of shares allotted in the company which helps in reducing their control over other shareholders which may be responsible for poor performance, less room should be given to the foreign investors to own shares which though would help in monitoring the activities of the firm, expropriation of the firms wealth to foreign economy may be experience.

Introduction

This study provides additional evidence regarding the way in which ownership structure influences quoted Conglomerate Company's performance in Nigeria focusing on the conflict emanating on incentives due to managerial and foreign ownership participation on corporate Governance structure and their impact on the firm's performance.

There is a general perception that ownership concentration in a company may actually improve its performance as having a large controlling shareholder (with majority voting) would ultimately decrease the company's monitoring costs. There is also an assumption that managers are imperfect agents of shareholders, as they could attempt to pursue their own goals rather than work on optimizing the shareholders' wealth. This is the reason why many families tend to entrust their business operations to family members who are also co-owners.

Performance is crucial to any business organisation survival and continues patronage by investors, potential investors, potential investors, creditors, and other stakeholders in the business world. Every business organisation has an important decision of making returns. This decision is important since the ability of a firm to make returns in this competitive environment determines to a larger extend its ability to survive in the future. On the other hand, ownership structure of any company has been a serious agenda for corporate governance and that of firm's performance. The influences on the firm value by managerial ownership and foreign ownership have been issues that researchers have undertaken to investigate for decades. This has been widely tackled in developed climes and more recently in emerging markets, but was less discussed before in Nigeria in recent changing environment. Notable exceptions include Adenikinju &Ayorinde(2001), Estrin et al (2001) and Sanda, Mikailu & Garba (2005), Barako & Tower (2006),Farooque et al (2007). and Javed & Iqbal (2007).

Modern organizations emphasize the divorce of management and ownership; in practice, the interest of group managing the company can differ from the interest of those that supply the capital to the firm. This study assumes from the outset that a conflict of interests between shareholders and managers of a company is one of the main reasons for a company's poor performance. One approach that may control this conflict, applied by many successful companies around the globe, is to increase the equity ownership of managers, therefore encouraging executives to work more efficiently to maximize their wealth as shareholders. However, such an approach may also work in the opposite direction, as large manager shareholders may use their influence and increased control to achieve private benefits. For this reason there has been a surge in many jurisdictions around the world in the drive to strengthen corporate governance regimes in an attempt to ensure protection to small shareholders whilst optimizing corporate performance. "Corporate Governance" as defined by the International Finance Corporation (IFC), refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders, and other stakeholders. Good corporate governance, IFC adds, contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The agency theory is being used to explain the role of ownership structure in balancing this conflict of interest. A greater concentration of managerial ownership may bring the monitoring and expropriation hypotheses into play, indicating that firms with a greater spread of ownership, the classic owner-manager conflict is mitigated due to the large shareholder's greater incentives to monitor the manager. However, a second type of conflict appears. The large shareholder may use its controlling position in the firm to extract private benefits at the expense of the small shareholders.
The major objective of the study is to evaluate the level to which ownership structure influences the performance of Nigerian conglomerate firms. The specific objectives of the studies are:
i). To examine the impact of managerial ownership (MGROWN) on performance of Nigeria conglomerates firms.
ii).To determines the contribution of foreign ownerships (FRNOWN) on performance of Nigerian Conglomerate firms.
The following null hypotheses were formulated in accordance with the above set out specific objectives of the study to test the influence of ownership structures on performance of Nigerian conglomerate firms.
Ho1 Managerial Ownership has no significant impact on the performance of Nigeria conglomerates firms'
Ho2 Foreign Ownership has no significant contribution on performance of Nigerian conglomerate firms.
The rest of the paper is divided into four sections covering discussion on the literature review and theoretical framework, the research method and model specification, results and discussion, conclusion and recommendation.

2. Literature review & theoritical framework

This section discusses the related and relevant literature of the study. The items covered includes conceptualisation of the theoretical and empirical review of managerial ownership and foreign ownership and performance.

2.1 Introduction

Ownership Structure, Corporate Governance & Company Performance

Corporate governance finds or implements a system to monitor and control the Company's management in order to ensure value maximization in the interest of shareholders. Finally, it also helps in resolving the "conflict of interest" dilemma between controlling shareholders and other shareholders of the company. Such perspective on corporate governance implies the existence of an intrinsic relationship between corporate performance and the ownership structure (managerial & foreign ownership and others) in a single company. Good corporate governance, therefore, consists of a set of various mechanisms; however it is important to determine the most suitable model and whether the governance system should be market-based (like in the US or in the UK) or control-based (as applied in Japan, continental Europe and emerging economies)? The market-based model relies mainly on independent corporate boards, dispersed share ownership, transparent information disclosure and on active take-over markets. The control-based system, on the other hand, emphasizes the values of insider corporate board, concentrated share ownership structure, limited disclosure, reliance on family finance and access to other sources of funding (banks, financial institutions). The resolution of conflict between owners and managers relies on internal mechanisms such as ownership structure, executive compensation, board of directors, financial disclosure, and the implementation of good corporate governance rules. On the other hand, the resolution of conflict between controlling shareholders and minority shareholders seeks remedies outside the company, like finding an external counter balance (through take-over or buy out), or relying on the available legal infrastructure to provide protection to minority shareholders. Recent studies of corporate governance systems have revealed that (i) geographical location, (ii) tax systems, (iii) industrial development and (iv) cultural characteristics; are four key factors in determining the ownership structure of a company which in turn impacts the company's performance. Besides market or economic condition, one of the main reasons for a company's bad performance, distress or even bankruptcy lies in its poor management. The inefficiency that might lead companies to failure or to poor performance could be well rooted in the existence of a conflict of interest or a divergence in priorities between the Company's managers and its shareholders.

However, these companies could be negatively affected by an important corporate governance problem: securing the control of key shareholders over managerial discretion while ensuring that management are not biased or influenced by the private interests of a particular group of shareholders. One solution to this corporate governance dilemma is provided by a well-regulated and functioning capital market which would force both management and shareholders to abide by a well defined set of corporate governance rules that would ultimately enhance corporate performance while safeguarding shareholders' rights.

2.2 Theoretical Framework & Empirical Studies

What ultimately matters for companies, policy makers and economists alike is whether ownership structure affects corporate performance, and if so, how. The fundamental insight into the issues dates back to Berle and Means (1932),who argue that the separation of ownership and control of modern corporations naturally reduces management incentives to maximize corporate efficiency. Their concerns were later developed by Jensen and Meckling (1976) into that has subsequently become known as "agency theory", which has been characterized as "a theory of the corporate ownership structure" and the guiding framework for ownership-performance studies. The central premise of the theory is that self-interested managers (controllers or agents) can engage in decision making and behaviours that may be inconsistent with maximizing value of shareholders (owners or principals). They proposed that there are two kinds of agency costs – agency costs of equity and debt. The conflicts between managers and shareholders leads to agency cost of equity, and the conflicts between shareholders and debt – holders leads to agency cost of debt. Usually, managers are interested in accomplishing their own targets which may differ from the firm value. The owners may try to monitor and control the managers' behaviours. These monitoring and control actions results in agency costs of equity. When lenders provide money to a firm, the interest rate is based on

the risk of the firm, managers might be tempted to transfer value from creditors to shareholders. These monitoring and control actions results in agency cost of debt.

The trade-off theory indicates the exposure of the firm to bankruptcy and agency cost against tax benefits associated with debt use.

Bankruptcy cost is a cost directly incurred when the perceived probability that the firm will default on financing is greater than zero.one of the bankruptcy costs is liquidation cost, which represents the loss of value as a result of liquidating the net assets of the firm. Another bankruptcy cost is distress cost, which is the cost a firm incurs if stakeholders believe that the firm will discontinue. According to trade off theory, companies are expected to look for a target debt ratio (Jalilvand and Harris, 1984). Ownership structure is often thought as an important instrument for corporate governance to resolve the conflict of interests between shareholders and managers. The past 30 years have witnessed the rapidly growing literature on this topic. Early work was largely descriptive. The empirical research appeared in the mid-1980s and has gotten a lot of attention recently.

The purpose of this review is to survey the theory and evidence on the relationship between ownership structure and corporate performance. Generally speaking, theoretical and empirical researches supplement each other. Since the ownership-performance relation is subject to controversy in theory, empirical research becomes more important to examine which of the logically possible explanations is the most probable.

2.2.2 Managerial ownership and performance

Efficacy of managerial ownership: alignment vs. entrenchment

Some shareholders may be entirely passive investors, whereas others are more active and do perform an important monitoring service. Various motivations and abilities of different types of shareholders may result in their distinctive effectiveness to influence major corporate decisions and value. Managerial ownership (insider ownership) is the most popular topic that has been extensively studied. Jensen and Meckling (1976) formalize the relation between managerial ownership and corporate value. They propose **the convergence-of-interest hypothesis** to explain the positive effect of managerial ownership. That is, a sufficiently high level of managerial ownership helps align the interests of managers and shareholders resulting in superior performance. A manager's claim on the performance outcomes and burden on the costs associated with non-value maximizing behavior increase with his fraction of the equity. Thus, a high level of managerial ownership increases the probability that the manager devotes significant effort to creative activities and immunizes himself from misappropriating the corporate resources. The manager will act to maximize firm/shareholder value due to his own interests.

However, Demsetz (1983) and Fama and Jensen (1983) propound offsetting costs of significant management ownership**– the managerial entrenchment hypothesis**. According to this hypothesis, the firm will be less valuable when managers with a significant equity have enough voting power to ensure their position inside the firm or to allow their free from outside checks. A manager held smaller shares can be disciplined toward firm value maximization by the market forces, while a manager controlling a substantial equity can entrench himself from the market restriction, such as the takeover threat or the managerial labour market. Consistent with this, Stulz (1988) develops a model of firm valuation to explain how large shareholdings help managers to be entrenched and decrease the monitoring of external control mechanisms.

The impact of managerial ownership on performance therefore is a double-edged sword.

2.4 Empirical evidence

Managerial ownership as a function of performance Morck et al. (1988) examine the relationship between management ownership, as measured by the combined stake of all board members, and market value of the firm, as measured by Tobin's Q, for a 1980 cross-section of 371

Fortune 500 (Ayorinde, 2000).To test two hypotheses of the convergence-of-interest and entrenchment, they estimate piecewise linear regressions allowing for slopes to change at two turning points, 5 and 25 per cent. The results show that in some ranges of ownership (below 5 per cent and over 25 per cent), Tobin's Q is positively related to board ownership, but in others, a negative relation is found.

Following Morck et al. (1988), McConnell and Servaes (1990) and Holderness et al. (1999), among others, find significantly inverse U-shaped relationship in the similar way. The results suggest that the Convergence-of-interest effect is more important at both low levels and high levels of managerial ownership, but the entrenchment effect is dominant at the medium levels of shareholdings.

2.4 Foreign Ownership and Firm Performance

The effect of foreign ownership on firm performance has been an issue of interest to academics, researchers, and policy makers. As posited by Gorg and Greenaway (2004), the main challenging question in the international business strategy is the outcome gained from foreign ownership of firms. It is duly accepted that foreign ownership plays a crucial role in firm performance, particularly in developing and transitional economies, researchers such as Aydin et al. (2007) have concluded that, on average, multi-national enterprises have performed better than the domestically owned firms. It is therefore, not surprising that the last two decades have witnessed increased levels of foreign direct investments in the developing economies.

There are many theories in extant literatures that have been used to underpin research of this nature. The theories are stewardship theory, stakeholder theory and agency theory. The agency theory is the one this research work is hinged on. Therefore, the study is based on the proposition of agency theory, the theoretical framework most often used by researchers to understand the relationship between the ownership structure and performance. It involves a contract under which the principal (Owners) engages another party (Managers), called agent, to perform some services on their behalf, where some power of decision making are delegated to the agent (Jensen and Meckling, 1976). In the modern business world, the principal is the shareholders, who are the owners of the company, whereas the management of the company represents the agent.

As posited by Brennan (1995), agency problem may arise as the agent fails to act in the best interest of principal and the effect may be reflected in the company's share price. It specifically exists in the companies when the management has incentives to achieve their own interests at the expense of the shareholders (Agrawal & Knoeber, 1996) and will act in an opportunistic manner to maximize their rewards. As parties internal to the organization, management tends to have an information advantage over the principal due to the day-to-day information and the insider knowledge.

Because of the opportunistic behaviour of agents, organizations will try to put in place mechanisms that have to align the interests of the agents and principles or at least minimize the differences. One of the important mechanisms is through the establishment of board of directors. In addition, to safeguarding the interests of shareholders, board of directors is appointed through the election in the annual general meeting. The board of directors is the agent to the shareholders in ensuring the transparent financial reporting that reflect the real financial position of the companies. Thus, the role of the board of directors is imperative to counter "managerial opportunistic" behaviour, which includes taking action for their own personal interests at the expense of the shareholders' interests (Donaldson & Davis, 1991). In this sense, corporate governance framework in which board of directors is a part serves as an effective tool in meeting the expectations and needs of the shareholders. Board of directors may provide better monitoring of management, therefore, can lead to transparent and reliable reporting.

3. Research Methodology and Model Specification

The study adopted correlation research design to verify the relationship existing between the firm's performance and ownership structure. The population of the study is all conglomerates firms listed on the Nigeria stock exchange as at 31st December, 2013.The study used the entire population as sample adopting census sampling techniques The data of this study were obtained mainly from secondary sources extracted from the annual reports and accounts of the listed conglomerate firms in Nigeria for the period 2004 to 2013. A panel data multiple regression model is used for analysis of data. Penal data can control heterogeneity among the cross sections and can reduce multi-collinearity problem of the explanatory variables (Mira, 2005). This study use the regression analysis where ordinary lease square technic is employed. Multiple regressions were used for the analysis and SPSS 16 was used to run the regression. To evaluate the relationship between performance and some corporate governance characteristics, the following model was developed:

Pit =Bo +B1MGROWN it +B2FRNOWNit +B3FMSIZit +ἐit

Where:

Pit =Performance at time t for firm I (measured by earning per share)

MGROWNit =Managerial ownership at a time t for firm (measured by percentage of managers as equity shareholders)

FRNOWNit = Foreign Ownership at time t for firm i (measured by percentage of shares held by foreigners)

FMSIZit =Firm Size at time t for firm I (measured by log of total assets)

B0 = Constant or Intercept

B1 – B3 =Coefficient of explainatory variables

4. Results and Discussion

This segment presents the analysis of the data and tests of hypotheses formulated in section one of the work. First, descriptive statistics table is presented and analysed, followed by the correlation matrix table and the summary of Regression Result table, The policy implications and Recommendation are made and drawn from the findings of the study.

Descriptive Statistics

The descriptive statistics for each of the variables were designed to show the Minimum, Maximum, Mean and Standard deviation, and skewness values. Descriptive statistics helps readers to understand the measures of central tendency, measures of variances associated with the variables of the study and the normality of the data used in the study.

Table4.1: Descriptive Statistics

Variable	Min	Max	Mean	Std. Dev.	Skewness
PERF	-70	456	58.65	103.328	2.06
MGO	0	0	.06	.091	2.773
FRNOWN	0	1	.25	.266	.187
FMSIZ	7	11	9.89	.910	-1.166

Extracted from SPSS 16 output file

From Table 4.1 above, the mean value for Performance is 58.65% for firms, while Managerial Ownership and Foreign Ownership are 6.0% and 25.0% respectively within the period of the study. The minimum value for Performance is -.70 while the maximum is 456. Managerial Ownership have a minimum value of 0.00, and a maximum value of 0.00. Foreign Ownership recorded a minimum value of 0.00, and a maximum value of 1.0. The zero (0) values recorded for both Managerial Ownership and Foreign Ownership indicates that in a certain year the firm do not have any amount of shares held within the observation. It is observed that among the independent variables, Managerial Ownership has the lowest standard deviation and therefore it shows that the Managerial Ownership has the least contribution to the endogenous variables. While on the other hand, Foreign

Ownership has highest standard deviation and it therefore shows its highest contribution to the stimulant of the study. The skewness values were all close to -2 and 2 except for Managerial Ownership implying higher than normal, else the data is considered to be tolerably mild and normally distributed. Therefore the result from the two normality test substantiates the validity of the regression result.

Correlation Matrix

The table below explains the association between the regressand and the regressors and also the association between the regressors themselves. The values were extracted from the Pearson correlation of two-tailed significance.

Table 4.2: Correlation Matrix

Variable	PERF	MGO	FORGN	FMSIZ
PERF	1	-0.236*	-0.360**	0.413**
MGO	-0.236*	1	-0.389**	-0.080
FORGN	-0.360**	-0.389	1	-0.075
FMSIZ	0.413**	-0.80	-0.075	1

Extracted from SPSS 15 output file

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Table 4.2 above shows that all the independent variables (MGO, and FORGN) are negatively related with Performance except (FMSIZ) that is positively associated with Performance. However, Managerial Ownership is significantly related with Performance at 5% level of significance indicating a strong relationship, while for Foreign Ownership and Performance is insignificantly related at 1% level of significance. Amongst the exogenous variables, the relationship was a not very weak as expected except for only two of the independent variables that were insignificantly related. All the independent variables among themselves were negatively related. The tolerance values and the variance inflation factor are two good measures of assessing multicolinearity between the independent variables in a study. The result shows that variance inflation factor were consistently smaller than ten (10) indicating complete absence of multicolinearity (e.g Neter et 'al; 1996 and Cassey et 'al; 1999). This shows the suitability of the study model been fit with the four independent variables. Also, the tolerance values were consistently smaller than 1.00, therefore extend the fact that there is complete absence of multicolinearity between the independent variables (Tobachmel and Fidell, 1996).

Summary of regression result

This table shows the regression result of the endogenous variable (PERF) and the exogenous variables of the study (MGO, and FRNO). The presentation is followed by the analysis of the relationship and contribution of all the independent variables to the dependent variable of the study and also the cumulative analysis.

Table 4.3: Summary of Regression Result

Variable	Beta Coefficient	t-values	Sig	Tolerance	VIF
Constant	-2.107	-2.107	0.40		
MGROWN	-0.398	-3.559	0.001	0.837	1.195
FORNOWN	-0.489	-4.370	0.000	0.838	1.194
FMSIZ	0.345	3.338	0.002	0.981	1.020
R					0.642
R2					0.413
Adj R2					0.381

F-Stat.					13.113
F-Sig					0.000
D/W					0.754

Extracted from SPSS 16 output file

PERF = -2.107 - 0.398MGROWN – 0.489FORNOWN + 0.345FMSIZ

The cumulative correlation between the endogenous variable and all the exogenous variables is 64.2% showing that the association between Performance and Ownership Structure used in the study is positively, moderately and statistically significant. This implies that for any changes in Ownership Structure of Nigerian conglomerates firms; their Performance will be directly affected.
The cumulative R2 (0.413) which is the multiple coefficient of determination gives the proportion of the total variation in the endogenous variable explained by the exogenous variables jointly. Hence, it signifies 41% of the total variation in Performance of Nigerian conglomerates firms is caused by their Managerial Ownership, Foreign Ownership and firm size. This indicates that the model of the study is fit and the exogenous variables are properly selected, combined and used. The Durbin Watson tests of first order auto-correlation which have a value of 0.754 indicates that errors are uncorrelated to each other indicating absence of serial correlation within the period of the study.

i. Managerial Ownership and Performance

From the table above, Managerial Ownership has a t-value of -3.559 and a beta value of -0.398 which is significant at 1%. This signifies that Managerial Ownership has negatively, strongly and significantly impacted on the Performance of Nigerian conglomerates firms. It therefore implies that for every 1% increase in the number of shares held by directors, the Performance of listed Conglomerates will decrease by N0.40. This may be as a result of the entrenchment hypothesis which state that managers may embark on self-serving interest rather than the shareholders interest which will have an adverse effect on the firm's performance.
This provides an evidence of rejecting null hypothesis one of the study which states that Managerial Ownership has no significant impact on Performance.

ii.Foreign Ownership and Performance

From the table above, Foreign Ownership has a t-value of -4.320 and a beta value of -0.489 which is significant at 1%. This signifies that Foreign Ownership is negatively, strongly and significantly influencing the Performance of Nigerian conglomerates firms. It therefore implies that for every 1% increase in the number of shares held by Foreigners in Nigerian conglomerates firms, the Performance will increase by fifty kobo (N0.50). This may be as a result of the expertise and the expropriation tendency of foreign investors.

ii. The foreign ownership is one of the identified ownership structure that has been proven empirically in our study, to serve as enhancing mechanism to improve the performance of the firms. Therefore, less of the foreigners should be allowed to have more investment and possibly be given less role to be part of the board because their presence only may serve as a discouragement for managers to perform in order to impress the foreign investors.

5. Conclusion and Recommendation

The negative effect of managerial ownership on performance may not be surprising as the managers may only be interested in short term gain rather than long term gain. Therefore, the study concluded that large managerial ownership be discourage in conglomerate firms.

The recommendations of this study are made based on variety of people/organizations that are involved directly or indirectly with ownership structure and performance processes in Nigeria.
The responsibility for monitoring the compliance of Corporate Governance practiced by listed companies in the Nigerian stock exchange is vested with the Nigerian Securities and Exchange Commission (SEC). Therefore, SEC should ensure as much as possible that:

i. The managers who are at the helm of affairs do not control majority shareholdings allotted in the company, as it gives them too much power and control over other shareholders which may be responsible for the poor performance in a bid to get short-term private gains.
ii. The foreign ownership is one of the identified ownership structure that has been proven empirically in our study, as not enhancing ownership mechanism to improve the performance of the firms. Therefore, the foreigners should not be allowed to have more investment than the indigenous investors and therefore be given less role to be part of the board because their presence may only serve as disincentives to manager's performances and would provide avenues for the expropriation of the firm values.

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