

WHY DOES ANY FIRM HAVE SEVERAL OWNERS?

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Abstract

The paper considers the owners of the firms as normal investors who want to optimise the return from their investments in accordance with their wealth constraint and the risk of their investment in the firm. The paper tests this theory on a representative sample of Danish companies including small firms. Concerning the wealth constraint for owners, the study finds evidence of more dispersed ownership in larger and more capital-demanding firms. According to the investors' risk aspect, firms operating on foreign markets are more likely to have more than one owner. Concerning the domestic markets the owner structure is more dispersed in industries with a volatile business cycle.

Keywords: corporate governance, ownership structures

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1. Introduction

The interest in different aspects of corporate governance is growing with the spread of performance-related pay of firm executives and the very high allowances paid out to some of these executives. Some of the empirical studies in this area have therefore focused on the relation between payment of the managements and performance of the firm, while other studies have examined the relationship between firm performance and the board and owner structure of the firm. However, only a few papers have examined which factors determine the number of owners of the company. This paper contributes to an answer of this question by presenting empirical evidence from Danish companies concerning concentrations of owners, characteristics of the companies and their environment. Large public companies with a highly diffuse ownership structure may have a weak owner control with a less efficient management of the firm as top executives pursue other priorities than shareholder values, the so-called Berle-Means thesis (Berle and Means, 1933). However, as shown by La Porta et al. (1999), the large company with a highly diffuse ownership control is actually non-existing. Even among the 20 largest companies in each country studied, they found only one or a few big blockholders controlling the firms in all 46 countries except for the USA and the UK. For all smaller non-

traded companies a few controlling blockholders are common also in the USA and the UK.

Despite the fact that a company with only a few blockholders is the normal picture of the ownership structure, most of the available empirical evidence on the governance-performance link is based on data sets with large companies from the USA and the UK. This also applies to the few empirical studies looking at factors determining the number of owners of the company. The advantage of this paper is that it uses a representative sample of Danish companies in the empirical part, which contrary to the earlier studies in this area includes smaller firms and companies not listed on the stock exchange.

The next section discusses the different theories and the hypothesis put forward to explain the dispersion of firm ownership. Section 3 presents the cross-section data set of 1,200 Danish firms, Section 4 presents the empirical findings and Section 5 concludes the paper.

2. Theoretical background

The Berle-Means thesis predicts that in firms with weak owners the managers are tempted to pursue other goals than long-run profit. A typical example is the substitution of short-run profits for R&D investments in order to secure their own salary and job position. The probability of pursuing other goals is expected to increase if manager salaries depend on

the actual performance of the firms and if the period over which managers are evaluated by the board is shorter than the pay-off period from R&D. However, it has not been possible to verify the thesis in the empirical literature. It has been documented that firms with dispersed ownership perform worse than closely held firms due to the agency problem. However, there seems to be no simple linear relationship between the profitability of companies and the concentration of their ownership, and concerning a nonlinear relationship the studies are simply not consistent. For a survey of the literature, see e.g. Shleifer and Vishny (1997), Morck, Wolfenzon and Yeung (2005), Tirole (2006) and Miwa and Ramseyer (2003).

As already pointed out by Demsetz and Lehn (1985), this theory behind the Berle-Means thesis cannot explain that companies normally have more than one owner. The theory is founded on the presumption that the incentive to shirking or free riding increases when the number of owners in the company increases. However, from this point of view the optimal number of owners is always one because in that situation the whole return from the efforts put into monitoring the management belongs to the owner himself and should not be shared with other owners. Therefore, to explain the fact that most companies have more than one owner other factors may be included in the owners' decisions about the optimal number of owners.

Demsetz and Lehn mention in their article two other factors which are working in the other direction and increasing firm performance as the owner concentration decreases. The first factor is the disciplinary effect of the *corporate control market*, which works most efficiently when the ownership is dispersed so that a hostile takeover is possible by buying shares. This effect is even stronger in companies with a highly dispersed ownership, as a new owner can control the company with a share of the company fare below 50%. The other factor is *capital market advantages* for listed companies with a highly dispersed ownership. This is due to the liquidity effect in the share market where the share prices are higher for companies with a large proportion of their shares traded and thereby reducing the price of equity finance for the company.

These factors point to a more complicated relationship between firm performance and the concentration of ownership. One possibility is a U-relationship with high performance in firms with a concentrated ownership structure but also in firms with a highly dispersed ownership structure. The empirical studies show some evidence for this relationship.

However, Demsetz (1983) and Demsetz and Lehn (1985) argue that the ownership structure are endogenous to the performance of the companies so the empirical studies not taking care of this may be misspecified. The endogeneity emerge as investors will search the best return on their investment, and

the market competition will then equalize the return across companies with different ownership structures. Therefore, the ownership structure will be firm-specific and if the capital market is in equilibrium, there will be no relationship between firm performance and ownership structure. Empirical studies taking this endogeneity into account by using instrumental-variables, simultaneous-equation models or panel data find no significant relation between ownership structure and performance, see e.g. Hermalin and Weisbach (1991), Cho (1998) and Himmelberg et al. (1999).

Miwa and Ramseyer (2003) examined the equilibrium hypothesis on a Japanese data set with about 700 firms in the years 1953 and 1958. The US-run occupation of Japan after the Second World War removed the shareholders from many of the most successful companies and then the acquired stock was resold. This operation reduced the ownership concentration of the companies and the firm-specific ownership structure may be in more disequilibrium after this operation compared to the structure before the war. As a reaction to this disequilibrium the ownership concentration increases during the following years, and as expected Miwa and Ramseyer find a significant relation between ownership concentration and firm profitabilities in 1953, but no significant relation in 1958 where the equilibrium structure has been re-established.

The Japanese experiment suggests that the ownership structures are dynamic and adapt to the different factors influencing the profitability of the company. To explain the equilibrium ownership structure of the companies, Demsetz and Lehn (1985) suggests a kind of portfolio explanation from the owner's point of view, who wants to maximize the return on their total wealth for a given risk or alternatively minimize the risk for a given return. From this portfolio perspective at least two factors are important for the investors' decisions about the size of the share to invest in a given firm.

The first factor is that owners are *wealth-constrained*, so under some circumstances they have to invite equity capital from outside. The lack of capital could occur when the founder of the company has several lawful successors and none of them individually could raise the full equity capital of the firm. In this situation, the successor may share the company or invite external ownership from outside the family. Therefore as a result of this natural development, older firms are expected to have more owners than younger firms. The size of a company is an important determinant of the capital requirement to run the business. Larger companies have a higher demand for capital and are expected to have a more dispersed ownership structure due to the wealth constraint of the individual owner.

Furthermore, for larger companies with a highly dispersed ownership structure an investor can gain full control of the company if he is in position of just a small fraction of the shares. This effect further

strengthens the dispersion of ownership with increasing firm size. Due to cultural barriers and lack of information, the foreign investor's co-operation with domestic investors is difficult and he therefore typically wants to be in possession of all the shares of a firm in order to control the firm effectively. Therefore, the existence of foreign owners among the blockowners is expected to affect the number of owners negatively.

The same line of reasoning can be used concerning the number of bank connections. Thus, the number of bank connections is expected to affect the number of blockholders positively because in the initial phase of the firm's life, growth needs more funding and as noted above the cheapest way to fund new projects is probably to invite new equity capital. However, before reaching that point the firm needs a reputation in order to increase the number of shares. Therefore, the firm has to expand using other credit sources, i.e. they have more than one bank connection, which will probably last for a certain period. For that reason bank loan and new equity capital could be viewed as substitute in financing firm's activities. But also the developments in the company itself can demand external equity capital if the actual owners do not have deep pockets. Thus a high capital intensity is expected to increase the demand for capital and therefore the number of blockowners. As the firms may face an increasing supply curve for funds they may want to finance new investments by attracting new equity capital, i.e. increasing the number of owners. Naturally, the strength of this argument increases with a longer payback period and with a larger risk in connection with the investment. The same is likely to happen for companies with high growth and/or with a low profitability and therefore low-retained earning. Furthermore, firms with a high solvency rate are less

wealth-constrained and therefore expected to have fewer owners.

Risk is another factor leading to more owners as the individual investor or family may want to diversify their portfolio on more than one firm in order to reduce the risk of their total wealth. From this portfolio perspective one would expect the ownership to be more dispersed in firms where earnings are highly volatile. This may be the case in industries where demand fluctuates due to the business cycle or frequent shifts in consumer preferences. The high tech industries may have a high risk for technological reasons as the innovations goes fast in these industries. The risk may also be higher for internationally oriented firms. Compared to domestic markets the costs of collecting market formation in foreign countries are higher and therefore the level of market knowledge is lower increasing the risk for transaction in foreign countries. Consequently if the firm belongs to an industry with high export intensity, the probability of more than one owner is higher than usual. However, operating in several market could reduce the risk on firms return associated with the business cycle as long as the cycles are different across markets.

3. Data

The data used in this study is based on public information on accounts of Danish firms over the period 1990 to 1999. The data source is from a private company (Købmandsstandens Oplysningsbureau A/S), who collects firm-specific information derived from each Danish firm's legal obligation to submit accounts reports to the Danish authorities. In principle, all Danish firms are included in the database that takes the form of an unbalanced longitudinal data set.

Table 1. Descriptive statistics for the sample of Danish firms, 1997

Variable	Number of obs.	Mean	Standard deviation
One owner (dummy)	1217	0.6491	0.4774
One owner concentration	1057	0.8137	0.3001
Two owner concentration	1018	0.8989	0.2230
Three owner concentration	973	0.9348	0.1775
Turnover (log)	1217	16.7621	0.9884
Capital labour ratio (log)	1217	10.2694	1.5926
Age (log)	1217	3.0974	0.8575
Number of banks	1214	1.2306	0.5066
Solvency	1217	0.3063	0.2667
Foreign-owned (dummy)	1217	0.2629	0.4404
Personally owned (dummy)	1201	0.2622	0.4401
Parent company (dummy)	1217	0.3706	0.4832
Listed company (dummy)	1217	0.0567	0.2313
Cycle industries	1217	92224	323473
Growth industries	1214	3.5626	19.611
Concentration	1217	0.1842	0.2016
Manufacturing (dummy)	1217	0.4009	0.4902
High tech industry (dummy)	1217	0.0213	0.1446
Internationalisation	1216	0.2648	0.2237

Table 2. Some ownership characteristics related to firm size.

	Number of firms	Only one owner	Parent company	Foreignowned
Number of employed				
0 – 20	78	0.718	0.538	0.308
21 – 50	207	0.715	0.435	0.329
51- 250	684	0.643	0.341	0.244
251 – 500	150	0.667	0.327	0.280
501 +	98	0.469	0.378	0.194
Total	1217	0.649	0.371	0.263

The sample used in this paper relates to one year, 1997, and the account data has for the larger firms been supplemented with information concerning their ownership structure. Data on ownership has been collected from various issues of the yearly publication Greens – “Børsens håndbog om dansk erhvervsliv”. The firms included in Greens either have more than 50 employees or a turnover exceeding DKK 50 million in 1994 prices.

A summary description of the data used in the estimations is given in Table 1. The ownership variables take account of the different distribution of the shares among the owners at least for the three largest owners.

The one owner dummy variable equals 1 when the firm has one owner and zero elsewhere and most of the firms (65%) have only one owner. The concentration indexes for one, two and three owners are calculated as their shares in the ownership of the firm.

The average value of these indexes shows that the ownership is highly concentrated on a few owners for the majority of firms, as only 7 percent of the firms have more than 3 owners.

The definition of turnover, capital labour ratio, age, number of banks and dummies for foreign-owned firms, personally owned firms, parent company, listed company and manufacturing is straightforward. Solvency is defined as the equity capital share of the total balance, and the variable for internationalisation is the export share of the industry. In addition, a dummy variable for the high tech industries is included in order to control for technological opportunities and risks across industries. To take account of the risk of the business cycle the standard deviation of the industrial turnover from 1990 to 1997 are measured by the variable: Cycle industries. Market growth is measured by the increase in industrial turnover from 1990 to 1997. To highlight the impact of firm size, Table 2 shows the share of one owner, the share of parent company and the share of foreign-owned firms for different firm size categories. On average the share of firms with one owner is rather constant up to a firm size of 500 employed where the largest companies have a substantially lower share of one owner as expected. The share of parent companies

falls with firm size in the beginning and then increases for the largest firms. This implies that normally subsidiaries are median sized. The share of foreign-owned firms is rather constant across firm size except for the largest firms where the share is significantly smaller.

4. Empirical results

The data sample used in this study is representative of Danish firms with a turnover above 50 mill kroner and therefore the data include 65% firms with only one owner. To analyse the owner structure of firms and the effects from factors determining the number of owners, we therefore first estimate the probability that a firm has more than one owner by a logit model and the results are listed in Table 3. Next, we move on to use more of the owner information for the 35% firms with more than one owner by explaining the variation in owner concentration ratios. Table 4 present the estimation results of 3 different owner concentration ratios using a Tobit model. Assuming a logistic probability function, the probability that a firm has more than one owner can be written as:

$$L(w) = \frac{e^w}{1 + e^w} \quad (1)$$

$$w = x' \beta + \varepsilon \quad (2)$$

Where x is a column vector of explanatory variables, β is a column vector of the explanatory variables' parameters and finally ε is the error term (Amemiya, 1981). Table 3 presents the estimated parameters from 3 different experiments using the standard logit estimation form. The estimated models have a high fit as they explain where the firms has more than one owner in more than 82 percent of the firms.

Furthermore, the estimated models are highly stable as the estimated coefficients are stable across the different models. Model 1 includes some important characteristics of the firms together with variables for the turnover and the capital labour ratio to indicate the company's demand for equity capital. Companies owned by foreigners have a significantly lower probability of more than one owner compared to domestic firms. This effect is in accordance with the theoretical discussion above where the foreign investors want to control the firm due to cultural barriers between a foreign owner and a domestic owner, which make a co-operation as owners more difficult.

Table 3. Logit models of the probability of a firm having more than one owner

	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>
Intercept	-8.0545** (1.3236)	-8.0428** (1.3385)	-8.2151** (1.3646)
Foreign-owned (dummy)	-2.0928** (0.2615)	-2.0873** (0.2669)	-2.1537** (0.2718)
Personally owned (dummy)	1.2686** (0.1603)	1.2878** (0.1619)	1.2524** (0.1654)
Parent company (dummy)	1.3002** (0.1497)	1.3168** (0.1523)	1.3730** (0.1546)
Listed company (dummy)	0.7566** (0.3096)	0.7306** (0.3175)	1.0704** (0.3890)
Turnover (log)	0.3270** (0.0766)	0.3075** (0.0784)	0.3058** (0.0802)
Capital labour ratio (log)	0.0710 (0.0463)	0.0438 (0.0482)	0.0521 (0.0493)
Age (log)	0.1845* (0.0830)	0.1469 (0.0838)	0.1624 (0.0846)
Solvency		1.0836** (0.3657)	0.8636* (0.3755)
Number of banks		0.2840 (0.1482)	0.2269 (0.1504)
High tech industry			0.2736 (0.3730)
Cycle industry			-4.3E-7 (2.9E-7)
Growth industry			-0.0064 (0.0075)
Internationalisation			0.0086** (0.0033)
Log likelihood	383.56	396.29	406.45
Concordance	82.2	82.7	83.0
Number of observations	1201	1198	1194

Notes: Numbers in brackets are standard errors of the estimated parameters. * indicates that the estimated parameter differs significantly from zero at the 5% level of significance and ** at the 1% level.

Personally owned firms and parent companies have a more dispersed owner structure and the effect is highly significant. For personally owned firms this could be a result of a more tight wealth constraint for persons compared to a foundation or another company who could rise capital among its own owners. The higher dispersion for a parent company compared to a subsidiary firm may be connected to the business relation for a subsidiary. The parent one owner. Of course this result is expected as no listed company could have only one owner by definition.

The size of the firm is also very importance for the dispersion of the ownership. The probability of having more than one owner is significantly higher for firms with a large turnover. According to the discussion above this result is not surprising as large firms are expected to demand more equity capital from their owners and the result indicates a capital constraint among investors. The capital labour ratio has a positive effect on the probability of a firm having more than one owner as expected. However, the effect is not significant.

The age of the firm also has an effect on the owner structure where older firms are significantly more likely to have more than one owner. This is not a surprising result as many new and young firms are

company may be owned only for the investment return from a portfolio perspective. However, for a subsidiary the parent company may have a direct business relation with the subsidiary that adds value to its investment. It may therefore have a higher return from the subsidiary than other investors and for that reason take a larger share of the subsidiary. Companies listed on the stock exchange also have a significantly higher probability of having more than set up by an entrepreneur who may be the only owner for the first part of the life of the firm. As the firm and the founder grow older, the firm may be handed over to the founder's relatives or outside owners and a more dispersed ownership is likely as discussed above.

Model 2 includes variables indicating the firm's access to capital. The estimated parameter of the solvency variable is positive and significant. Solvent firms are more likely to have more than one owner; this indicates that firms with several owners do not seem to be capital-constrained in the same way as firms with only one owner. The number of banks is also positively correlated with the number of owners. However, this effect is not significant.

Model 3 introduces four variables to control for different industrial environments. Concerning the type of industries, we introduce a dummy for the

high tech industries to study where the high risks in these industries lead to a more dispersed owner structure. This is the case as the coefficient is positive; however, the estimated parameter is not significant.

To further pick up the risk aspect for the owners, a variable of the standard variation of the industrial turnover from 1990 to 1997 has been included.

However, the estimated parameter is not significant and it has the wrong sign. Market growth is measured by the increase in industrial turnover from 1990 to 1997 and there seems to be a weak negative effect on the probability of a firm having more than one owner in high growth markets.

As introduced in the theoretical discussion, the degree of internationalisation of the firm is measured at the industrial level with the export share of the industries. Firms operating in exporting industries are more likely to have a dispersed ownership structure.

This may be the result of the additional risk of loss from lack of market information, changes in exchange rates, trade barriers etc. associated with operations on foreign markets compared to the home market.

The logit estimates presented in Table 3 only use information where a firm has one or more owners. However, the survey contains information on the share of the three largest owners for a smaller part of the sample. To make use of this information, concentration indexes for the largest owners have been constructed. As a lot of firms have only one owner, these indexes take the value of 1 for a large part of the sample. Consequently, ordinary least square regression is not the optimal estimation technique and therefore a single-censored Tobit model has been applied. The standard Tobit model can be written as:

$$\begin{aligned} y_i^* &= x_i\beta + u_i, \quad i = 1, 2, \dots, n, \\ y_i &= y_i^* \text{ if } y_i^* < 1, \\ &= 1 \text{ if } y_i^* \geq 1, \end{aligned} \quad (3)$$

where y corresponds to the owner concentration and the error term u_i is assumed to be normal distributed with zero mean. The likelihood function of (3) becomes

$$L = [1 - \Phi(x_i\beta/\sigma)]\sigma^{-1} \prod [(y_i - x_i\beta)/\sigma] \quad (4)$$

where Φ and ϕ are the cumulative distribution and density function of the standard normal variable. Finally, the model is estimated using maximum likelihood regression analysis.

Table 4 presents the estimation results for the share of the largest owner, the two largest owners and the three largest owners. The table presents model results with the same explanatory variables as in Table 3, and generally the models perform best for the one owner index as the Log likelihood for that model takes the lowest value.

All estimated parameters take the opposite sign of the estimated value in the logit estimation in Table 3. This is expected as an increase in the probability of a firm having more than one owner may reduce the share of the largest owner.

In accordance with the result of Table 3, the foreign owners have a higher share of the company than the domestic owners. In personally owned firms, parent companies and listed companies on the other hand, the coefficient is negative so the largest owners have a significantly lower share of the firm as these firms have a more dispersed ownership structure.

The size of the company and the capital labour ratio reduce the owner concentration due to the capital constraint owner. However, only the size effect for the one owner concentration is significant. Older companies have a significantly lower owner concentration even when the size of the company has been taken into account. This once more verifies the entrepreneur theory where the founder of the firm also own the firm but have to hand it over to his successors or invite more outside capital as time pass by. More banks reduce the owner concentration of the largest owners significantly. So banks are a substitute to large owners of a company.

Companies operating in risky environments have a significantly lower owner concentration for the largest owner. This is due to firms belonging to industries with a volatile business cycle or firms within the exporting industries facing uncertain foreign markets. Also firms in high tech industries have a lower owner concentration. However, this effect is not significant.

4. Conclusions

From an efficiency point of view the firms could have different ownership concentration depending on their history and the market they operate in.

To explain the individual firm's ownership structure, the paper considers the owners of the firms as normal investors who want to optimise the return from their investments in accordance with the risk involved.

As the owners are wealth-constrained and want to diversify their portfolio of investment, it is expected that firms have more owners if they have a

high demand for capital or operate in risky environments. The paper tests these theories on a representative sample of about 1,200 Danish companies including small firms.

Concerning the wealth-constraint for owners, the study finds evidence of more dispersed ownership in larger firms which require more capital. Also capital incentive companies are more likely to have dispersed ownership.

However, this effect is not significant. There is a significantly positive relation between the solvency of a firm and the probability that it has more than

one owner. The interpretation of this finding could be that firms with more than one owner have better access to equity capital.

According to the investors' risk aspects, the study finds that firms operating on foreign markets are more likely to have more than one owner and the

share of the largest owner is significantly smaller compared to owners of firms operating in the domestic markets.

Concerning the domestic market, the owner concentration is significantly lower in industries with a volatile business cycle.

Table 4. Estimates of Tobit models for various owner concentrations

	One owner concentration	Two owner concentration	Three owner concentration
Intercept	267.52** (36.61)	269.44** (41.44)	292.72** (47.143)
Foreign-owned (dummy)	62.333** (6.7838)	70.076** (9.9321)	86.774** (16.409)
Personally owned (dummy)	-30.858** (4.9823)	-25.696** (5.4445)	-26.973** (5.7129)
Parent company (dummy)	-44.335** (4.4818)	-40.197** (5.1014)	-36.803** (5.7129)
Listed company (dummy)	-44.575** (8.2534)	-55.351** (8.3175)	-55.159** (9.638)
Turnover (log)	-4.4269* (2.1600)	-3.2724 (2.4618)	-4.1423 (2.7599)
Capital labour ratio (log)	-2.3988 (1.3752)	-1.8136 (1.5444)	-2.6640 (1.6504)
Age (log)	-6.2880** (2.4026)	-7.4324** (2.7288)	-5.3378 (3.0061)
Solvency	-11.066 (10.447)	-13.238 (12.589)	-15.154 (13.725)
Number of banks	-6.6407 (3.9137)	-9.5932* (4.1614)	-9.2278* (4.4617)
High tech industry	-7.2531 (9.9835)	-17.751 (10.646)	-17.725 (11.415)
Cycle industry	-0.0001* (0.0001)	-0.0000 (0.0000)	-0.0000 (0.0000)
Growth industry	0.2289 (0.2313)	0.0612 (0.2310)	-0.0650 (0.2130)
Internationalisation	-0.2149* (0.0936)	-0.1416 (0.1063)	-0.0672 (0.1158)
Normal scale parameter	51.602** (2.2393)	49.938** (2.7577)	47.698** (3.0730)
Log likelihood	-2128.8	-1390.5	-1030.9
Number of observations	1048	1009	965
Number of firms with a concentration of 1	702	789	803

Notes: Numbers in brackets are standard errors of the estimated parameters.

* indicates that the estimated parameter differs significantly from zero at the 5% level of significance and ** at the 1% level.

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