OWNERSHIP CONCENTRATION AND CORPORATE PERFORMANCE ON THE GHANA STOCK EXCHANGE: A PANEL DATA ANALYSIS

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Abstract

Corporate governance is linked to corporate performance. The study examines the effect of ownership concentration on corporate performance on the Ghana Stock Exchange. Panel data covering a period from 2001 to 2006 for 28 firms were analyzed within the framework of both the fixed and random effects techniques. The results indicate that the effect of ownership concentration on corporate performance varies with the performance measurement variable. The results indicate a significant positive relationship between ownership concentration and return on assets and Tobin's Q, whilst there is negative insignificant relationship with return on equity. We also document that insider system of corporate governance is practiced on the Ghana stock exchange as shareholding is highly concentrated in the hands of a few individuals or institutional investors. Other governance features such as board size, board composition and CEO duality are all essential in predicting corporate performance. The results of the study generally support existing literature on the impact of ownership concentration on corporate performance.

Keywords: Ownership Concentration, Corporate Governance, Performance, Ghana.

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1. Introduction

Firm performance is affected by a myriad of factors. These factors may be endogenous or exogenous. Firm level characteristics such as corporate governance and its associated features have been identified as one of the endogenous factors affecting corporate performance. The importance of corporate governance cannot be overemphasized given the fact that shareholders typically face the problem of adverse selection and moral hazard in the face of separation of ownership and control ((Berle and Means, 1932).

Corporate governance has traditionally been associated with the principal-agent or agency problem. Indeed, it has been concerned with the resolution of collective action problems among widely dispersed stakeholders and the reconciliation of conflicts of interest between various corporate claimholders (Becht *et al*, 2003). Another important dimension to corporate governance worth noting is its characteristic- whether it is characterized by insider system (concentrated ownership) or outsider system (widely dispersed ownership structure). A distinguishing feature of the insider system of corporate governance is that it is characterized by a highly concentrated ownership structure (Maher and Andersson 1999). This system of corporate governance is common in Europe (except UK), Japan and Korea. The outsider system of corporate governance on the other hand is characterized by

relatively widely dispersed share ownership. This can be found in US and UK (Ibid).

According to Consolandi *et al.* (2006), a system of corporate governance can be defined as a more or less country-specific framework of legal, institutional and cultural factors shaping the patterns of influence that stakeholders exert on managerial decision-making. Thus, four divisions of corporate governance were identified namely Anglo-Saxon countries (the USA, the UK, Canada and Australia), Germanic countries (Germany, Netherlands, Sweden, Switzerland, Austria, Norway, Denmark and Finland), Latin countries (France, Italy, Spain and Belgium) and Japan. The popularity of corporate governance in re-aligning the interest of managers and owners has been well documented in the developed countries. The possible impact of ownership concentration on corporate performance has been a central question in research on corporate governance, but evidence on the nature of the relationship has been decidedly mixed (Earle *et al*. 2005). Neither theory nor empirical studies seem to agree to what effect is more likely to emerge or under what conditions large shareholders are beneficial or not to the firm's other stakeholders concludes Consolandi *et al.* (2006).

Demsetz and Lehn (1985) argue that if dispersed ownership were bad, it wouldn't exist in a rational world but they acknowledged the role of ownership concentration in terms of monitoring. They concluded that this role varies across firms in a way consistent with value maximization. It is then possible evidence

could be mixed depending on the firms under consideration. Most empirical studies of corporate governance practices and value creation pertain to the industrial countries, and empirical evidence for emerging markets appears to be undeveloped (Kyereboah-Coleman *et al.* 2005). But the issue of corporate governance has been gaining grounds in Ghana in recent times following moves by the Ghana Institute of Directors (IOD-Ghana-2000), in collaboration with the Commonwealth Association of Corporate Governance with the basic aim of addressing corporate governance in Ghana. A review of the following articles: Kyereboah-Coleman *et al.* 2005; Kyereboah-Coleman and Biekpe, 2006a, 2006b, 2006c 2007; Kyereboah-Coleman 2006 and Kyereboah-Coleman and Amidu, 2007, indicates that in the context of Ghana, the issue of ownership concentration and the additional risk it presents investors has received very limited empirical evidence. This article is unique in the sense that it provides a scientific insight into how concentrated shareholding structure is in Ghana and how it impacts on the performance of firms given the fact that the country is positioning itself as the next investment frontier. This article therefore reports the findings on ownership concentration and the additional risks it presents and their impact on company performance focusing on companies listed on the Ghana Stock Exchange. The rest of the paper is divided into four sections. Section two considers the literature review; section three discusses data used in the study and also details the model specifications used for the empirical analysis. Section four contains the discussion of the results and section five summarizes and concludes the paper.

2. Literature Review

A system of corporate governance may be characterized by concentrated share ownership or widely dispersed ownership structure. Corporate governance could be characterized by insider systems or outsider systems and this could in one way or the other impact on the performance of the firm. The firm's predisposition towards risk could also be affected by whether it is insider-dominated or outsider-dominated. According to Maher and Andersson (1999) the outsider system of corporate governance typical of US and UK is characterized by relatively widely dispersed share ownership and high turnover and turn to foster open and equitable distribution of information and places a strong emphasize on the protection of shareholders right especially minority shareholders. The insider system of corporate governance typical of Japan and Germany is characterized by concentrated ownership and multiplicity of inter firm – relationships and tend to overcome the problems with the monitoring of management that are associated with dispersed ownership (ibid). This is true because cash flow rights and control rights are aligned. According to Lskavyan

and Spatareanu (2006), there is a significant empirical literature investigating the relationship between ownership concentration and firm performance (see also Gibbs, 1993, Hoskisson *et al.*, 1994, Jensen and Warner, 1998 and Jiang, 2004) but in the view of Earle *et al.* (2005), these empirical studies of the firm performance-ownership concentration relationship have produced mixed results.

According to Estrin and Rosevear (1999), insider-dominated firms in Ukraine actually perform better than outsider-dominated firms. As early as 1932 Berle and Means predicted that firm performance should deteriorate (improve) as ownership become more diffused (concentrated). Later studies by Claessens and Djankov *et al.* (1999), Gorton and Schmid (2000) and Mitton (2002) found a positive relationship between ownership concentration and firm performance. This could be coming from the fact that when cash flow rights and control rights are aligned, majority shareholders now have the incentives and the power to monitor management. Information asymmetry leading to adverse selection and moral hazard is reduced to the barest minimum. The presence of a higher ownership concentration can lead to a higher level of corporate social performance as a result of mitigation of agency costs. Pivovarsky (2003) also documented a positive relationship between ownership concentration and enterprise performance in Ukraine. When financial performance is strong, the presence of major shareholders may prevent management from attempting the opportunity to 'cash in' by reducing social expenditures in order to take advantage of the opportunity to increase their own short term private gains (Conolandi *et al.* 2006).

According to Shleifer and Vishny (1986) ownership concentration may improve performance by increasing monitoring and alleviating the free-rider problem in takeovers. Wruck (1989) also found a positive relationship between private sale of block shares associated with increasing concentration and performance. Kapopoulos and Lazaretou (2006) examining the issue for 175 Greek listed firms found that, a more concentrated ownership structure positively relates with higher firm profitability and that higher firm profitability require less diffused ownership.

But Demsetz and Lehn (1985) argue that if dispersed ownership were bad, it wouldn't exist in a rational world. They reported no relationship between ownership concentrated and performance (accounting profit). McConnell and Servaes (1990) also found no relationship or effect on the ratio of market value to replacement costs of assets (Tobin's Q). Demsetz and Villalonga (2000) found a negative relationship using ordinary least squares estimation. Others have argued this negative relationship from the point of view that high concentration of ownership might also have costs. Burkart et al (1997) have postulated that even if tight control by shareholders is ex post efficient, ex ante, it constitutes an expropriation threat which

reduces managerial initiative and non-contractible investments. Kocenda (2003) also found no significant relationship between ownership concentration and performance. Demsetz and Villalonga (2001) again found no statistically significant relationship between managerial shareholding, outside blockholder shareholding, and Tobin's Q, once controlling for endogeneity of ownership. In the same direction, Himmelberg *et al*, (1999) found that changes in ownership have no significant impact on performance. Lskavyan and Spatareanu (2005) noted that concentration is insignificant in explaining performance both in the transition countries, where market monitoring is supposedly weak and in the UK where market monitoring is supposedly strong Thus, it is obvious corporate governance practices depend among other variables on the size of the capital markets, the characteristics of their regulation and ownership structure of firms.

3. Research Methodology

The research is based on the official data published by the cross-sectional firms for the various years covering a period from 2001-2006. Ownership data is from the data base of the Ghana Stock Exchange and firms annual reports and financial statements. Ownership is defined as any direct blockholding possessing more than five percent of the company's shares at the reporting time. No distinction is made whether these shares are held by managers or not or whether they are held by foreigners or nationals of this country. The companies selected ranges from old to newly formed ones and some companies were de-listed during the study period. In order to gain the maximum possible observations, pooled panel crossed-section regression data are used. Panel data analysis involves analysis with a spatial and temporal dimension and facilitates identification of effects that are simply not detectable in pure cross-section or pure time series studies. Thus, degrees of freedom are increased and collinearity among the explanatory variables is reduced and the efficiency of economic estimates is improved. The empirical model follows that used by Earle *et al.* (2005 check) given as:

$$Performance_{it} = \alpha + \lambda O_{it} + \delta G_{it} + \chi C_{it} + \varepsilon_{it}$$

(1)

Where

$Performance_{it}$ is a measure of performance for firm i in time t. Various measures of performance were used including return on assets is defined as earnings before interest and tax divided by total assets of the firm, return on equity and TobinsQ.

O_{it} Is a vector of ownership concentration for firm i in time t. The first measure of ownership

concentration is the percentage of shares held by the largest block holder (C_{it}), we also sum the second and the largest holding for each firm for the various years ($C2_{it}$) and finally we cumulate the three largest block holders ($C3_{it}$).

G_{it} Is a vector of corporate governance variables namely board size (a measure of the numerical strength of the firm), board composition (a measure of the blend of executive and non-executive directors) and board duality for firm i in time t.

C_{it} Represents a vector of control variables for firm i at time t namely; firm size (a natural log asset base, turnover and age of the firm). ε_{it} is the error term

The general form of the panel regression model is stated as:

$$Y_{it} = \alpha + X'_{it}\beta + \mu_{it} \quad (2)$$

With the assumption that μ_{it} follow a one-way error component model

and $\mu_{it} = \mu_i + \nu_{it}$; $\qquad\qquad$ (3)

where μ_i is time-invariant that accounts for any unobservable individual-specific effect that is not included in the regression model. The term ν_{it} represents the remaining disturbance, and varies with the individual firms and time. The choice of the model estimation whether random effects or fixed effects, will depend on the underlying assumptions. In a random effect model, μ_i and ν_{it} are random with known disturbances. In a fixed effects mi, the country-specific effects, and μ_i, a random term, are fixed parameters and are estimated together with the other parameters. In resolving this dilemma, we use Hausman (1978) specification test in choosing the appropriate model. The hausman test is a test of orthogonality of the random effects and the regressors and the test will be based on a contrast vector H:

$$H = [b^{GLS} - b^w]'[V(b^w) - V(b^{GLS})]^{-1}[b^{GLS} - b^w]$$

(4)

Where H is approximately chi-squared distributed with k degrees of freedom. Where k is the number of regressors in X_{it} excluding the constant. We test the hypothesis that there is no correlation between individual effects and the explanatory variables using our baseline model. We report the results of the Hausman specification test in Table 2.

4. Empirical Results

4.1 Descriptive Statistics

Table 1 presents the descriptive statistics of the dependent and independent variables in the sample of firms over the period. The sample covers 28 firms listed on the Ghana Stock Exchange over a six-year period, 2001-2006. It reports the mean and standard deviation for overall, between and within of all the variables used in the study as well as the number of firm-year observations over the sample period. The mean score for return on assets, a measure of the overall earnings power is 0.17. This implies that on the average across the sample firms ROA registers 0.17. There is however variation in this variable across the firms over the time period and also between firms and within firms over the period with a minimum and maximum ROA of -0.70 and 13.18 respectively. Thus, some firms reported negative earnings in the period covered. Return on shareholders' equity registers on the average 0.23 over the overall sample and also exhibits variation but not as widespread as ROA as revealed by the standard deviation. Tobin's Q also has a mean score of 0.61.

On ownership concentration on the Ghana Stock Exchange, it can be said that shareholding structure is highly concentrated given a mean score of 51.02%. It could also be said that the system of corporate governance on the Ghana Stock Exchange is characterized by insider systems typical of Europe (except UK), Japan and Korea (see Maher and Andersson 1999). There is however variation in this variable as reported by the standard deviation but the least block holder on the exchange is 14.81%. This meets the minimum threshold for block holding which is 5% (see Earle *et al.* 2005). The largest blockholder on the exchange has 90.24%. Considering C2 and C3 confirm the fact that shareholding is in the hands of some few individuals or institutions. The mean board size for the sample is approximately nine. There are however wide variations in this between the cross-sections and over time. All companies on the exchange thus meet the minimum Companies Code provision on the number of directors a company must have at all times and SEC Guidelines even though the SEC recommends a board size of between 8 and 16.

For board composition the mean ratio is 72.68% implying the use of more outside directors on the board in the overall sample, however there is some amount of variation in this ratio across the cross-section of firms as seen in the standard deviation (15.09) between the cross-sections. It can therefore be said that most boards on the exchange are independent. This is in line with standard finance literature as Fama and Jensen (1983) and other experts also support this view that boards must be independent as much as possible. The mean score for CEO duality suggests some companies on the stock exchange operate the one-tier system of corporate governance where the CEO is the same as the board chairperson. However, majority of the firms operate the two-tier system of corporate governance. The mean age of the sampled firms is approximately 35 years. There is however large variation in this variable as shown by the standard deviation (21.92). There are wide variations also between firms and within firms. The least age considered for this sample is three years and with some firms as old as 110 years.

Table 1. Descriptive summary statistics

Variable		Mean	Std. Dev.	Min	Max	Obs.
ROA	overall	0.17	1.08	-0.70	13.87	N = 168
	between		0.46	0.09	2.47	n = 28
	within		0.98	-2.23	11.57	T-bar = 6
ROE	overall	0.23	0.25	-0.51	1.04	N = 168
	between		0.18	-0.08	0.65	n = 28
	within		0.18	-0.39	0.96	T-bar = 6
Tobin's Q	overall	0.61	0.43	-1.65	1.94	N = 168
	between		0.34	0.14	1.38	n = 28
	within		0.24	-1.18	1.22	T-bar = 6
C1	overall	51.02	20.09	14.81	90.24	N = 168
	between		19.71	14.81	90.24	n = 28
	within		5.14	25.84	69.27	T-bar = 6
C2	overall	65.59	18.28	27.96	93.37	N = 168
	between		17.74	28.84	93.37	n = 28
	within		5.36	49.06	8821	T-bar = 6
C3	overall	72.75	16.92	32.87	98.45	N = 168
	Between		16.37	32.96	93.87	n = 28
	within		5.15	54.98	89.29	T-bar = 6
Board size	overall	8.68	2.02	5	14	N = 168
	between		1.98	5	13	n = 28
	within		0.51	6.85	11.18	T-bar = 6
Board composition overall		72.68	15.09	20	90.91	N = 168
	between		2.84	68.89	74.89	n = 28

	within		14.87	22.33	94.69	T-bar = 6
CEO Duality	overall	0.63	0.49	0.00	1	N = 168
	between		0.48	0.00	1	n = 28
	within		0.09	-0.04	0.96	T-bar = 6
Age	overall	34.93	21.92	3.00	110.00	N = 168
	between		22.19	5.50	107.50	n = 28
	within		1.71	32.43	37.43	T-bar = 6
Turnover	overall	11.68	1.92	7.34	17.34	N = 168
	between		1.82	7.75	15.64	n = 28
	within		0.88	8.32	16.80	T-bar = 6
Total Assets	overall	12.04	2.00	8.06	16.53	N = 168
	between		1.88	8.78	15.56	n = 28
	within		0.84	8.94	16.86	T-bar = 6

Note: N refers to overall panel observations (nXT), n is the cross-sectional observations (firms), T-bar is the time frame. C1 stands for first blockholder, C2 first largest and second largest blockholder and C3 the commulative three largest blockholders

4.2   Regression Results

Both fixed and random effects specifications of the model were estimated. After which the Hausman test was conducted to determine the appropriate specification. We report the results of the Hausman test in Table 3. The test statistics are all significant at 1%, except for return on assets implying that the fixed effects model is preferred over the random effects results. The Hausman specification test suggests we reject the null hypothesis that the difference in coefficients is not systematic. But for return on assets, we choose the random effects over the fixed effects results implying acceptance of the null hypothesis.

Ownership concentration (first blockholder) has a positive and statistically significant relationship with return on assets. There is also a positive relationship between first blockholder and the Tobin's Q and it is statistically significant as well. It could be inferred that highly concentrated shareholding could overcome the problems with the monitoring of management that are associated with dispersed ownership and this will result in positive gains. According to Maher and Andersson (1999), when cash flow rights and control rights are aligned, majority shareholders now have both the incentive and the power to monitor management. Shleifer and Vishny (1986) argued that ownership concentration may improve performance by increasing monitoring and alleviating the free-rider problem in takeovers (see also Wruck 1989 and Kapopoulos and Lazaretou 2006). But there is a negative and insignificant relationship between ownership concentration (first blockholder) and return on equity. It could be argued therefore that high concentration is associated with increased cost and this will negatively impact on performance. Demsetz and Villalonga (2000) found a negative relationship between ownership concentration and performance (see also Burkart et al 1997).

There is no statistically significant relationship between C2 (first and second largest blockholder) and any of the performance measurement indicators.

Whilst there is a positive relationship with return on assets and Tobin's Q, there is rather a negative relationship with return on equity. Probably the advantages expected of highly concentrated ownership does not translate to the bottomline. Demsetz and Villalonga (2001) find no statistically significant relationship between managerial shareholding, outside blockholder shareholding, and Tobin's Q, once controlling for endogeneity of ownership (Lskavyan and Spatareanu 2005)

There is also insignificant relationship between C3 (first, second and third largest blockholders) and return on assets and return on equity. Whilst there is a positive relationship with return on assets, there is still a negative relationship with return on equity. One could argue for return on assets that ownership concentration increases performance at a decreasing rate or probably too many cooks spoils the goulash. But C3 has a positive and statistically significant relationship withTobin's Q. It could be said that highly concentrated ownership structure increases managerial initiative and non-contractible investment. Firms with highly concentrated shareholding structure have a lot of growth options to be exploited.

Board size has a positive and significant relationship with all the performance measures except for return on equity. Thus the board's role in exercising good faith and forming sound judgment on decisions relating to the corporation and its business has positive effects on company's performance. Kyereboah-Coleman *et al*. (2005) document a positive relationship between board size and performance.

For board compostion, there is an insignificant relationship with return on assets and return on equity but there is a negative and statistically significant relationship between board composition and Tobin's Q. The findings of the research support the evidence of Fama and Jensen (1983), Weisbach (1988), Rosenstein and Wyatt (1990), Byrd and Hickman (1992), Kyereboah-Coleman *et al* (2005) and at variance with the findings of Hermalin and Weisback (1991), Mehran (1995), Yermack (1996), Bhagat and Black (2002), who concluded that a higher proportion

of outsiders on the board is not associated with
superior firm performance

Table 2. Panel Regression Results: Ownership and Corporate Performance

	Rerun on Assets	Return on Equity	Tobin's Q
	(Random Effects)	(Fixed Effects)	(Fixed Effects)
First Blockholder (C1)	0.0071	-0.0046	0.0059
	(2.96)***	(1.52)	(1.68)*
First and second blockholder (C2)	0.0122	-0.0045	0.0022
	(1.60)	(1.46)	(0.65)
First, Second and Third blockholder (C3)	0.0108	-0.0034	0.0047
	(1.33)	(1.05)	(1.75)*
Board Size	0.3807	0.5424	0.0737
	(2.46)**	(1.59)	(2.38)**
Board Composition	0.5656	0.0502	-0.5775
	(0.62)	(0.35)	(2.29)**
CEO Duality	0.4545	-0.0108	-0.0305
	(1.52)	(0.05)	(0.17)
Age	-0.0456	0.7323	0.0167
	(0.22)	(2.29)**	(0.16)
Turnover	-0.0155	-0.0146	-0.0311
	(0.14)	(0.63)	(0.93)
Total Assets	0.0559	0.0183	-0.0071
	(0.49)	(0.74)	(0.18)
Constant	84.5400	2.8691	0.1247
	(7.04)***	(3.47)***	(0.31)
R-squared	0.1553	0.1803	0.1652
Prob > F	0.0000	0.0012	0.0002
Hausman test, chi^2(5)	0.9929	0.0209	0.0071

Notes: All regressions include a constant. T-statistics are in parentheses. *** ** * means significant at 1, 5 and 10 percent level of significance; Return on assets is the net profit as a percentage of total assets; Return on equity is net profit as a percentage of equity; Tobin's Q is the ratio of market to book value of assets, board size is the numerical measure of the board strength.

Jensen (1993) recommends that the function of the CEO could be separated from the function of the board chairman. This ensures that there are checks and balances on the powers of the CEO. Organizational theories also suggest that CEO duality (CEO is also the board chairman) diminishes board control and promotes CEO entrenchment (Hambrick and Finkelstein 1987). The results suggest a positive relationship between CEO duality and return on assets but it also exhibit a negative relationship with return on equity and Tobin's Q. A test of significance however portrays that there is no significant statistical relationship between the variables

There is a negative relationship between age of the firm and return on assets even though it is not statistically significant. But there is a positive and statistically significant relationship between age of the firm and return on equity. For Tobin's Q, there is an insignificant positive relationship with age of the firm. It could be argued that, industry experience is gained with long establishment which go a long way to add value to shareholders wealth.

Turnover, a measure of the size of the firm, is negatively and statistically insignificant with all the performance measures. Thus, turnover is unimportant in explaining firm performance. Total assets also has a positive but insignificant relationship with return on assets and return on equity but has a negative and insignificant relationship with Tobin's Q.

5. Conclusions

Corporate governance has become an important framework condition affecting the industrial competitiveness of companies. It is now recognized as an important variable affecting the industrial competitiveness of firms and it affects the development and functioning of capital markets with a residual effect on resources allocation. However, there is no single model of corporate governance and each country (industry) has through time developed a wide variety of mechanisms to overcome the agency problems arising from the separation of ownership and control. As well, the impact of ownership concentration on firm performance has been neglected among the ongoing studies in corporate governance especially in Sub-Sharan Africa and Ghana for that matter. Given that the nation is positioning itself as the next investment destination in Africa, an understanding of shareholding structure and how its impacts on firm performance is not only an appropriate addition to the on-going debate for

formulating effective broad based corporate governance practices, but long over due. The study employed a panel data analysis covering 28 firms over a six year period from 2001-2006. It tested whether ownership concentration and other corporate governance variables were significant predictors of corporate financial performance. This study presents important and interesting evidence regarding the effects of ownership concentration on corporate performance. The results significantly show that the impact of ownership concentration depends on the performance measurement variable. Whilst ownership concentration significantly predicts performance for return on assets and Tobin's Q, it is insignificant for return on equity. We posit that ownership increases corporate performance at a decreasing rate.

Board size is significant in predicting firm performance. With the exception of Tobin's Q, board composition is irrelevant in explaining corporate performance. CEO duality is also irrelevant in explaining corporate performance in Ghana. Again, with the exception of Tobin's Q, age of the firm does not matter in explaining corporate performance. Firm size namely turnover and total assets were all insignificant in predicting corporate performance.

The current study thus suggests that ownership concentration influences corporate performance. The positive relationship indicates that when shareholding is highly concentrated it could overcome the problem with the monitoring of management that is associated with dispersed ownership and this will result in positive gains. As cash flow rights and control rights are aligned, this improves the bottom-line. Corporate governance together with its associated feature is not a matter of choice any more. It is part of the larger economic context in which firms operate. Ownership concentration has a role to play in explaining firm performance and all stakeholders including prospective investors must take corporate governance seriously in their decision making process. As a subsequent paper, we propose a more comprehensive view on the determinants of ownership concentration in Ghana and the impact of foreign ownership on corporate performance in Ghana.

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