

# OWNERSHIP STRUCTURES AND CORPORATE PERFORMANCE: A LITERATURE REVIEW

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## Abstract

In the last decades, the phenomenon of separation between ownership and control has attracted the most attention from researchers and professionals. Indeed, proprietary concentration can play an asymmetrical role in helping to influence corporate performance, whereby large shareholders can use their power both to expropriate wealth due to minority shareholders and to benefit minority shareholders, controlling the discretion of the management. However, there is still a lack of research that has integrated and systematized the empirical research carried out on the relationship between proprietary concentration and company performance given that there is still no convergence of results regarding the sign and the form of this relationship. Therefore, the purpose of this work is to present the results of a systematic review of the literature on the subject, proposing a possible innovative interpretation of the relationship mentioned above that takes into account additional interaction variables linked to the institutional structures of the countries in which the investigated companies operate.

## 1. INTRODUCTION

The study of the relationship between ownership and control has always been of great interest to the analysis of corporate governance (CG) (Berle & Means, 1932). Scholars have focused their attention on the effectiveness of CG mechanisms, investigating the relationship between ownership structure and performance in the perspective of agency theory issues (Arrow, 1974; Fama, 1980; Fama & Jensen, 1983; Walsh & Seward, 1990; La Porta et al., 1997, 2000, 2002; de Miguel et al., 2004; Maury & Pajuste, 2005; Dalton et al., 2007; Dahya et al., 2008). The academic research on these topics derives from studies of different matrixes (accounting, financial, economic, managerial, strategic, organizational, legal, etc.) (Bushee, 2001; Demsetz & Villalonga, 2001; Gompers & Metrick, 2001; Hoskisson et al., 2002; Bainbridge, 2003).

Agency theory issues are related to conflicts of interest between the management and the controlling shareholders (JaraBertin et al., 2008; Setia-Atmaja, 2009; Garcia-Meca & Sánchez-Ballesta, 2010). However, in countries where ownership is typically concentrated in the hands of a few large shareholders, the most important agency problems relate to conflicts of interest between majority shareholders and minority shareholders (Bebchuk-Kraakman & Triantis, 2000; Davies, 2000).

Normally, large shareholders can play a dual role. On the one hand, using their power, they can extract private benefits, expropriating the wealth of minority shareholders. Indeed, ownership concentration beyond certain levels can reduce the efficiency of the governance mechanisms imposed to protect shareholders' rights (Shleifer & Vishny, 1997). Consequently, the hypothesis of expropriation or entrenchment supports the existence of a negative relationship between the company performance and the ownership concentration. On the other hand, however, large shareholders can improve the corporate performance and thus protect the interests of minority shareholders by controlling the discretion of the managers or that of the controlling shareholder (Demsetz, 1983; Shleifer & Vishny, 1986, 1997; Maury & Pajuste, 2005; Li et al., 2008).

Thus, ownership concentration can play an asymmetric role in helping to influence business performance (Selznick, 1957; Barclay & Holderness, 1989; Winton, 1993; Ocasio, 1994; Zwiebel, 1995; Bolton & Von Thadden, 1998; Pagano & Röell, 1998; Thornton & Ocasio, 1999; Bennedsen & Wolfenzon, 2000; Block & Hege, 2001; Pedersen & Thomsen, 2003; Gomes & Novaes, 2005; Connelly et al., 2010; Bebchuk, 1999; Burkart et al., 2003; Li et al., 2008; Minichilli et al., 2009).

The aim of this paper is to analyse the main contributions of the literature on the form and the sign of this relationship from the perspective of the institutional-based-view. Therefore, this document is structured as follows. Section 2 provides the methodology used. Section 3 contains the results of the literature review. Section 4 examines the case of family businesses and the role of the institutional-based-view. Section 5 concludes the essay with a discussion on the limitations of

studies on CG, offering a possible innovative interpretation for future research.

## **2. METHODOLOGY**

To achieve the aim of this paper, we conducted a literature review about the ownership structure, CG and performance issues. In particular, the review consisted of two phases. Through the two major freely accessible web search engines, specifically the ISI Web of Science (WoS) and Google Scholar (GS), we researched the academic publications in the literature to highlight and systematize the main research orientations of scholars. The research was developed using the following keywords: corporate governance, ownership structure, performance, expropriation hypothesis, monitoring hypothesis and institutional-based view.

The articles published were selected following some criteria that we describe below. First, we included exclusively the most important articles published in academic journals relevant to the subject. Second, we selected only the articles published in the English language and containing at least one of the selected words and terms directly or indirectly in their titles. Third, the papers included the keywords specified above.

The abstract of each paper was read to evidence the relationship with the issues investigated in this research. To conduct the analysis of the articles collected, all the authors contributed directly to this phase of the literature review process. All the authors worked separately in this phase, examining each article with attention, thus highlighting the critical aspects that were useful for the aim of this research. Subsequently, the authors compared their results and then processed the sections dedicated to the literature review.

## **3. LITERATURE REVIEW**

Several studies have empirically supported the monitoring hypothesis proposed by Demsetz (1983) and Shleifer and Vishny (1986), proving the existence of a positive and significant relationship between ownership concentration and performance (Agrawal & Mandelker, 1990; Kaplan & Minton, 1994; Xu & Wang, 1997; Gorton & Schmidt, 2000; Wu & Wu, 2005; Li et al., 2008). These results show that large shareholders play an important role in monitoring and discipline.

Kaplan and Minton (1994), for example, verified that large shareholders play an important monitoring and regulatory role for Japanese companies. Agrawal and Mandelker (1990) obtained the same result, which is consistent with the monitoring hypothesis.

Similar results were also obtained by Gorton and Schmidt (2000). They proved that performance improves to the extent that control rights are concentrated. Similarly, Xu and Wang (1997) stated that, for Chinese listed companies, the relationship between ownership concentration and performance is significantly positive. In a later empirical study, Wu and

Wu (2005) achieved the same result. Li et al. (2008) showed that large shareholders could have incentives to monitor the management, thus preventing the company financial distress.

Other studies, instead, have reinforced the expropriation hypothesis, supporting the existence of a negative and significant relationship between ownership concentration and performance (Leech & Leahy, 1991; Mudambi & Nicosia, 1998; Lehmann & Weigand, 2000). For example, Leech and Leahy (1991), analysing the effects of proprietary structures on the performance of large companies in the UK, noted that greater ownership dispersion implies higher valuations and wider profit margins. Similarly, Mudambi and Nicosia (1998), analysing data on UK financial companies, found that the increase in concentration is inversely related to company performance.

Using a data set on German mining and industrial companies from 1991 to 1996, Lehmann and Weigand (2000) hypothesized a positive relationship between proprietary concentration and performance. They based their hypothesis on the consideration that concentration reduces information asymmetries between owners and managers as well as between companies and external investors. Contrary to what has been argued, the authors found a significantly negative impact of concentration on profitability. In particular, the results show that concentration has a negative and significant effect on the Return On Assets. Unlike previous studies, the results obtained by de Miguel et al. (2004) with reference to Spanish companies showed the existence of a non-linear relationship but a quadratic one between concentration and value, confirming the effects not only of monitoring but also of expropriation (Busta et al., 2014).

The empirical and theoretical research that set the objective of identifying the reasons for the diametrically opposite results found in the various countries understudy has focused on two different categories of factors: firm-specific variables and macro-economic or institutional variables. With regard to the first category of variables, some scholars (Maury & Pajuste, 2005; Li et al., 2008) have pointed out that the counterweight power, that is, the power that other large shareholders – other than the first – can exercise to counterbalance the power of the majority shareholder, plays an important role that cannot be ignored in the analysis of the relationship between capital structure and performance (Pagano & Röell, 1998; La Porta et al., 1999; Bennedsen & Wolfenzon, 2000). Similar conclusions have been drawn from them regarding the identity of the shareholders who make up the command coalition. The fact that this coalition consists of financial institutions, families, other companies and so on means that it is not indifferent to the determination of performance. Some studies, for example, have analysed the role of family property (Anderson & Reeb, 2003; Villalonga & Amit, 2006; Giovannini, 2010). For example, according to Anderson and Reeb (2003) and Maury (2006), an expansion of family ownership helps to reduce the agency conflicts resulting from the relationship between shareholders and managers, thus improving performance.

Another group of scholars, however, has focused more closely on the role that institutional contexts can play in explaining the divergence of results. The same group has argued that some deficiencies in the institutional structures of the countries, from which insufficient protection of the shareholders derives, could be filled by internal governance mechanisms, such as the concentration of ownership or family ownership and control. In this way, internal and external governance mechanisms act as substitutes in providing companies with efficient governance (La Porta et al., 2002; Boubakri et al., 2005; Dahya et al., 2008; Anderson & Gupta, 2009; Jiang & Peng, 2011a; Peng et al., 2017).

With reference to the firm-specific variables, Maury and Pajuste (2005) and Li et al. (2008) showed that the counterbalancing power of other major shareholders can create a mechanism to regulate and monitor the controlling shareholder and the top management, consequently reducing the expropriation of wealth to the detriment of minorities. Maury and Pajuste (2005) empirically proved that a more equitable distribution of ownership and therefore of voting rights among the large shareholders of Finnish listed companies has a positive effect on performance: the contestability of the power of the largest shareholder, measured using several variables, has a positive effect on the Tobin's Q of the companies. Similarly, Lehman and Weigand (2000) reported that the presence of a second majority shareholder capable of influencing decisions improves the profitability of German listed companies.

In the same direction, Li et al. (2008) also underlined that the counterbalancing power plays an important role in determining corporate performance, reducing the likelihood of financial distress. Again, Santos et al. (2014) analysed the distribution of power in the command coalition and discovered that the presence of a second and a third large shareholder has a significant and positive impact on the leverage ratio. Faccio et al. (2001), studying the effect on dividends, affirmed that the presence of several large shareholders reduces the expropriation in European countries while producing opposite effects in Asian countries. Volpin (2002) also supported the positive effects of a greater distribution of power in the coalition of command, affirming that, for Italian companies, the evaluation is greater when the control is contestable, for example when a voting union controls the company.

In summary, these studies have shown that the distribution of power in the command coalition conditions the analysis of the relationship between capital structure and performance. Moreover, as pointed out extensively in the literature, such analyses cannot disregard the consideration of the identity of the controlling shareholders. Maury and Pajuste (2005), in fact, empirically verified that, in family-owned businesses, an increase in the control quota of another family is negatively correlated with the company performance while an increase in the control quota of another non-family owner, for example, a financial institution, is positively related to performance. Similar results were

found by Lepore et al. (2018). Consistent with the developed model, these results suggest that the incentive to collude with the majority shareholder (expropriation hypothesis) or to monitor the same (monitoring hypothesis) are greatly influenced by the type of blockholder.

In principle, therefore, coalitions with similar shareholder identities, supporting a marginal cost of the more modest expropriation, facilitate free riding. At the same time, other coalitions, made up of shareholders with different identities, pay higher expropriation costs and therefore limit opportunistic behaviour.

With regard to the macro variables that can play a role in explaining the asymmetric results about the relationship between ownership structure and performance, much of the literature has focused on the role of investor protection deriving from the institutional structures of the countries (La Porta et al., 1997, 1998, 2000). The protection of investors' rights is fundamental in a system of good governance, as the investment choices of shareholders are closely linked to the quality of law and its enforcement (La Porta et al., 1997, 1998, 2000; Boubakri et al., 2005). The more a country system is able to protect investors adequately from the expropriation of wealth, the greater the propensity to invest in companies' risk capital. However, even today, CG systems in many countries, both in development and in advanced economies, lack mechanisms for effective legal protection for investors.

#### **4. FAMILY FIRMS AND THE ROLE OF THE INSTITUTIONAL-BASED VIEW**

For family firms or for companies owned by the state or by other public administrations, today there is homogeneous evidence showing that the concentration of ownership is always positively or negatively correlated with the corporate value. Even in this case, numerous studies have examined the effect of institutional variables to explain the divergent results that empirical analyses have produced regarding the sign and intensity of the relationship between proprietary concentration and performance.

For example, investigating the asymmetric role that family ownership concentration can play in protecting shareholder rights, the research has not defined a single opinion (Jiang & Peng, 2011a, p. 36). Also, in this case, both positive and negative relationships, as well as the absence of significant relationships, have been verified. In this regard, Jiang and Peng (2011a, p. 36) affirmed that "the effect of family ownership and control systematically depends on the differences in the legal and regulatory institutions that protect (minority) shareholders in various countries". Therefore, they suggested that institutional contexts can provide an explanation for why the study of the relationship between capital structure and performance has led to such different results in the various contexts investigated. The authors affirmed that a fundamental issue to be addressed could be to establish under which institutional

conditions and with which legal and regulatory regime family businesses perform better than non-family ones.<sup>1</sup>

According to some of the pioneers of CG studies (Berle & Means, 1932; Jensen & Meckling, 1976), the growing size of family businesses should result in an inevitable separation between ownership and control. In other words, an increase in the size and complexity of the company should generate a substitution effect between family members and external professional managers. However, several scholars have pointed out that many large companies often continue to have family ownership and control (La Porta et al., 1998; Morck et al., 2005). In these situations, a conflict of interest is created between the shareholders of the family of command and the unfamiliar minority shareholders, which the literature has called principal–principal agency conflict (Young et al., 2008; Jiang & Peng, 2011b; Sauerwald & Peng 2013).

Jiang and Peng (2011a) highlighted the existence in the literature of three diametrically opposed positions regarding the association between family ownership/control and performance in large family firms. The first group of scholars has argued that there is a positive effect on performance deriving from family ownership concentration, which is based on the greater capacity for monitoring recognized in this category of shareholders (Anderson & Reeb, 2003). The second group of researchers, instead, has underlined the inefficiencies that could emerge from the family ownership concentration, for example conservatism that leads to the rejection of the investment opportunities characterized by the best cost/benefit ratios (Schulze et al., 2003; Gomez-Mejia et al., 2010) or the family conflicts that can arise and lead the enterprise to dissolve (Eddelston & Kellermanns, 2007). The third group has argued that family ownership and control are irrelevant to company performance (Daily & Dalton, 1992; Miller et al., 2007, 2013), which would be influenced by other variables instead.

Regarding state-owned enterprises and those presenting a financial institution in the position of the dominant shareholder, for example a bank, a pension fund or another institutional investor, the literature has shown that these shareholders can play an important role in the containment of opportunism, because they are subjected to wider activity of public scrutiny and regulation. Therefore, they should work in the direction of aligning the interests of the various parties involved, improving governance and limiting expropriation actions (Boubakri et al., 2005; Omran, 2009).

Consequently, the companies controlled by these shareholders could have a greater incentive to operate more transparently and in the interest of all shareholders, for example having wider disclosure duties towards the financial markets than companies controlled by other entities, from family businesses, for example, or from industrial companies. In other words, the presence of certain categories of

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<sup>1</sup> For further information, see Jiang and Peng (2011a, 2011b); Chua et al. (2012); Gedajlovic et al. (2012); Lepore et al. (2017, 2018); Peng et al. (2017).

controlling shareholders should improve governance, preventing or at least limiting profit diversion actions (Bianchi et al., 2011).

It must be emphasized that the presence of the state in business ownership is typically justified by the relevance of the activity carried out for the purpose of the welfare of the community. Due to the importance of the activity carried out, the greater extent of regulation and the fact that the activities are financed by taxation, that is to say, the resources are provided compulsorily by the citizens, state enterprises should be subjected to greater public control; for example, they have duties to disclose more information about the community than companies controlled by other entities. As a result, companies controlled by public entities could have a greater incentive to operate transparently and in the interest of all the shareholders.

With reference to state-owned enterprises, the consideration mentioned above presupposes the assumption of the perfect functioning of the internal control mechanisms on the management as well as the external one of the community on the elected bodies. The evolution over time has, however, made it clear in several countries that such forms of control are often inadequate to ensure that public companies are governed in the collective interest. Therefore, it is necessary to understand which are the best governance rules and systems to adopt.

To understand the reason for the divergent results regarding the relationship between capital structure and performance,<sup>2</sup> the research conducted over the last twenty years has also focused on the effects of legal protection and other external CG mechanisms created to protect minorities. These are mechanisms that are linked to the institutional structures of the countries that host companies, such as the characteristics of the market for corporate control, competitive environments, the market-oriented or bank-oriented characterization of financial markets, the nature of the legal system, the efficiency of judicial systems and the law enforcement.

Many studies have examined in particular the mitigation effect that such mechanisms can exert on the problems deriving from the conflict of interests for the control of companies: agency problems that imply conflicts between management and property (the type I agency problem) and conflicts between large shareholders and minority shareholders, in companies characterized by broader levels of ownership concentration (the type II agency problem).<sup>3</sup> The latter type is more important in countries where ownership is typically concentrated in the hands of a few large shareholders (Zattoni, 1999; Zattoni & Minichilli, 2009).

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<sup>2</sup> For further information, see Demsetz (1983); Shleifer and Vishny (1986); Agrawal and Mandelker (1990); Leech and Leahy (1991); Kaplan and Minton (1994); Xu and Wang (1997); Mudambi and Nicosia (1998); Gorton and Schmidt (2000); Lehmann and Weigand (2000); de Miguel et al. (2004); Wu and Wu (2005); Li et al. (2008).

<sup>3</sup> For further information, see La Porta et al. (1997, 1998, 2002); Bushee (2001); Demsetz and Villalonga (2001); Gompers and Metrick (2001); Hoskisson et al. (2002); Bainbridge (2003); de Miguel et al. (2004); Maury and Pajuste (2005); Jara-Bertin et al. (2008); Connelly et al. (2010); Boubaker et al. (2014); Courteau et al. (2017); Wang (2017); Zhong et al. (2017).



In the context of many studies, the emphasis has been shifted towards the variables relating to the institutional context. This turn has led to the flanking of the theories usually used in the background of studies (agency theory, transaction cost theory, resource-based view, stewardship theory, etc.) with the institutional-based view (Peng & Jiang, 2010; Jiang & Peng, 2011a; Van Essen, 2011; Banalieva et al., 2015). This is a theoretical approach that seems to be particularly suitable for explaining the effect on the performance of concentrated ownership and the way in which the institutional conditions influence any performance differences between companies (Gedajlovic et al., 2012, p. 1011; Peng et al., 2017). Furthermore, this theoretical approach can be extremely useful for clarifying further why family businesses are not evolving according to the hypothesis of Berle and Means (1932) (La Porta et al., 1998; Carney et al., 2009). When a country has weaker and less efficient legal and regulatory institutes, or more generally when the institutional structures of the countries in which the companies operate have gaps or deficiencies, companies tend to maintain a more concentrated ownership structure.

Family-owned businesses, for example, show a limited propensity to recruit external managers unless the managers have some form of family relationship with the owners (Burkart et al., 2003). More generally, according to the empirical evidence provided by La Porta et al. (1998), there is a mechanism of substitution between the institutional mechanisms of shareholder protection and the ownership concentration. In particular, the weaker the legal institutions and the formal regulatory schemes put in place to protect shareholders, the more the ownership and control rights are concentrated in the hands of a few large shareholders (Lepore, 2017, 2018).

La Porta et al. (1998) and Guillen and Capron (2016) underlined that shareholder protection may vary among countries due to differences in legal and regulatory institutions, which play an important external role in CG. Different levels of protection of minority shareholders deriving from institutional arrangements can play a crucial role in defining priorities in internal governance structures, thus helping to explain the positive or negative results highlighted by empirical research with reference to the different countries (Boubakri et al., 2005; Peng et al., 2017).

Anderson and Gupta (2009) explored the relationship between corporate performance and the overall quality of CG in a sample of about 1,700 companies operating in 22 countries. The authors verified empirically that the financial structure of a country (market-oriented or bank-oriented) and the legal system (common law or civil law) influence CG and market performance. The study addressed three relevant research questions. First, it wondered whether CG at the company level varies based on the different combinations of the financial structure and legal system of the countries under investigation and then whether the characterization of the financial market and the type of legal system of the host country, individually and jointly, influenced CG and

performance. Finally, it checked whether different CG mechanisms (board characteristics, anti-takeover provisions, executive and director compensation, qualitative factors, auditors and audit-related committee, charter/bylaws and director and management ownership) affect performance differently, depending on the combinations of financial market and legal system.

The results of the study highlighted the important role played by the institutional structures of the countries in influencing the effectiveness of the various CG mechanisms, the overall quality of the same and, therefore, the performance of the companies, in this way emphasizing how these variables cannot be neglected in studies that deal with the relationship between governance and performance. In fact, the study highlighted that CG at the company level varies based on the different combinations of financial structure and legal system, exerting different influences on the performance of companies in various countries. In practice, companies operating in countries with market-oriented financial systems and common-law legal systems tend to have better governance. Moreover, these companies show higher market valuations than companies with comparable CG but operating in countries characterized by a combination of bank orientation and civil law.

## **5. CONCLUSION**

This work shows that it is necessary to renew the studies on CG and on the role of ownership concentration as a mechanism to contain agency problems. In particular, the role of institutional contexts in the effectiveness of blockholding should be considered. The internal mechanisms of good governance cannot be developed and implemented in the societies of each country simply through isomorphic processes, without considering the context. Similarly, it seems anachronistic to think that legislators and other regulatory bodies can contribute to the genesis and development of external governance mechanisms by ignoring the other context variables.

From an experimental point of view, the simultaneous presence of empirical results that support the existence of both positive and negative relationships highlights that there are different interaction variables, deriving from the institutional environment, which can influence the sign and the intensity of the relationship. In this regard, La Rocca (2012, p. 38) argued that the relationship between ownership concentration and value can be configured in various ways precisely because, being potentially mediated or moderated by other governance variables, it can bring out the existence of a relationship of substitutability or complementarity between properties and other CG variables. Therefore, the same holds that to appreciate the influence of the property on the business value, it is necessary to evaluate the contribution of other CG tools to the downsizing of opportunistic problems, without neglecting the role of the institutional context.

The interaction variables related to the institutional structures of the countries could bring order to the results highlighted with reference to the various countries and allow research to reach managerial and political implications that are not linked to the historical period and to the investigated context.

The institutional vision and the consideration of the context variables are particularly useful in studies of business ownership and performance because considering the effect of institutional moderation or mediation variables could help to explain the non-convergent results on the relationship between concentration and performance.

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