

CHAPTER 3: LITERATURE REVIEW: FIRM OWNERSHIP STRUCTURE AND PERFORMANCE

3.0 Introduction

The purpose of this chapter is to review the existing theoretical and empirical evidence concerning ownership structures and performance measurements. The first section discusses the performance measurements employed in previous studies relating to corporate ownership structures, especially in government linked companies. To measure performance, two areas were looked into –financial measurement and non-financial measurement. The second section compares the efficiency of state or government owned organisations with that of privately owned. This section discusses the performance of partially privatised organisations, i.e. government wholly owned companies that have been ‘privatised’ but which are still controlled by the government. The last section explains the empirical evidence on the relationship between ownership structure and performance and government ownership and performance. The relationship between partial privatisation and performance needs to be determined since the government or state in some countries still controls their public sector enterprises despite having them privatised.

3.1 Ownership Structure and Performance

The relationship between ownership structure and company performance has been an important research topic during recent decades, and produced ongoing debate in the literature of corporate finance. Theoretical and empirical research on the relationship between ownership structure and firm performance was originally motivated by the separation of ownership from control (Berle and Means, 1932) and followed by agency theory (Jensen and Meckling, 1976; Fama and Jensen, 1983). The major objective of the shareholders of company is to maximise value while managers prefer self-interested strategies that are far from maximising value, and in the absence of either appropriate incentives or sufficient monitoring, managers can exercise their discretion to the detriment of owners.

Certain literature discusses ownership and company performance. La Porta, Silanes and Shleifer (1999) in their first study on ownership investigate the ultimate control in company. They categorised five types of ultimate owners: (1) a family or an individual, (2) the State, (3) a widely held financial institution such as a bank or an insurance company, (4) a widely held corporation, and (5) miscellaneous, such as a corporative, a voting trust, or a group with no single controlling investor. State control is a separate category as it is a form of concentrated ownership by the State. These forms are used by the State to pursue political objectives, while the public pay for the losses (Shleifer et al., 1994).

Claessen, Djankov and Lang (2000) further improved on the study done by La Porta et al., (1999) and applied it to East Asia. They investigated the separation of ownership and control in 2,980 public companies in nine East Asian countries. Generally, their findings are that the

pyramid structure and cross holding firms enhance corporate control in all East Asian countries. Only in Singapore are about half of the sample companies controlled by the state. This was followed by research done by Lemmon and Lins (2005) who continued to discuss ownership structure, corporate governance, and firm value from 800 firms in eight East Asian countries. Their findings on cumulative stock returns show that the returns of firms in which managers and their families separate their control and cash flow rights through pyramid ownership structures were lower by 12 percentage points during the crisis period compared to those of other firms. They also found that during the pre-crisis period, there was no evidence that firms with a separation between cash flow rights and control rights exhibit changes in performance differently from firms with any such separation.

Fazlzadeh, Hendi and Mahboubi (2011) explored the effect of ownership structure of 137 listed firms on firm performance in Teheran Stock Exchange for the period 2001 to 2006. Their ownership structures consist of ownership concentration and institutional ownership. It's concluded that institutional ownership has positive relationship with firm performance, ROA and ROE but vice versa on concentration ownership which showed negative relationship. Gurunlu and Gursoy (2010) investigate the influence of foreign ownership on performance and capital structure of 143 non-financial firms in Istanbul Stock Exchange over the period from 2007 to 2008. They used a multivariate regression analysis for pooled data of 246 observation and found that foreign ownership has positive relationship with performances, Tobin's Q and ROE after controlling company specific characteristics such as size, leverage, growth, agency costs and industry.

Ghazali (2010) evaluated the performance of ownership structures and corporate governance in Malaysia after Asian financial crisis. The reason of his periods of study after financial crisis is because there was a new regulation introduced by Malaysian Government on corporate governance, recognizing the importance of restoring market confidence. Ownership structures consist director ownership, foreign ownership and government ownership, and corporate governance was proxied by board size and independence. By using data from the year 2001 annual reports of 87 non-financial listed companies, results indicated that government ownership and foreign ownership were statistically significantly associated with Tobin's Q. Meanwhile none of corporate governance mechanisms show significant at all.

Hu, Tam and Tan (2010) identified that corporate governance issue increasing from concentrated ownership in emerging economies have received growing attention. They employed structural equation modelling to evaluate the independent and interdependent effects of corporate governance mechanisms consists role of the board of directors, supervisory boards, role duality and board size. Their study covering 304 publicly listed companies over 3 year data set from 2003 until 2005. Results indicate that ownership concentration has the most significant governance effect and negative impact on firm performance. Meanwhile, role of board directors, role duality and supervisory boards have a positive relationship with performance and others mechanism didn't show any impact since not significant.

Abidin, Kamal and Jusoff (2009) studied on the association between board structures and performance, where value added (VA) efficiency is used as performance. Based on random sample of 75 companies listed in Bursa Malaysia for year of 2005, they finding indicate that

board composition and board size have a positive impact on firm performance. But directors' ownership and CEO duality on the VA efficiency of firm's total resources are not established.

Orden and Garmendia (2005) examined the relationship between ownership structure and corporate performance in Spanish companies. Ownership structure has been analysed in terms of concentration of control and the type of investor exerting control. In their study, return on assets (ROA) and return on equity (ROE) were used as company performance indicators. One of the hypothesized findings is that companies under government control showed negative impact and had worse performance results than other ownership structures. Zeitun and Tian (2007) examined the impact of ownership structure mix on company performance and the default risk of a sample of 59 publicly listed firms in Jordan from 1989 to 2002. The main findings suggest that ownership structure has significant effects on the accounting based measurement, return on assets (ROA) whereby government shares are significantly negatively related to the company's performance ROA and ROE (return on equity) although positively related to market performance, Tobin's Q.

In a related study, Gursoy and Aydogan (2000) described in their paper the main characteristics of ownership structure of the Turkish non-financial companies listed on the Istanbul Stock Exchange (ISE) and examined the impact of ownership structure on the performance and risk-taking behaviour of the Turkish companies. Specifically, they were interested as to whether foreign ownership (FRGN), government ownership (GOV), cross ownership (CROSS), family ownership (FAM) and affiliation to a conglomerate (CONG) have any impact on performance. The results indicated that government ownership has a negative, significant correlation with

accounting measurements (ROA and ROE) when controlling for leverage and size, as well as with market measurement (share price to EPS, P/E).

The understanding concerning the empirical differences in corporate control, particularly on government involvement, has advanced recently. However, research has been largely limited in the Malaysian capital market to ascertain whether the involvement of government in corporate control systems provides additional explanation for firm value. A number of studies explain these phenomena. Theoretically, shareholders and managers have different objectives. As shareholders, their intention to invest their monies in a company is to maximise company value or profit, however, managers have a different view. To maintain the performance of their company in future, managers prefer self-interest strategies and try to avoid any discretion of decision making from owners.

Corporate governance in general and board independence in particular, are the important subjects that attracted many researchers. For example, in the US, in relation to Enron, WorldCom and other scandals, the Sarbanes-Oxley Act mandates extensive changes in the governance of publicly traded-firms; and the New York Stock Exchange has strengthened its governance-related listing rules, including requiring all listed firms to have a majority of independent directors. Internationally, weak corporate governance has been cited as a driver of East Asian and other financial crises (Johnson, Boorne, Breach and Friedman, 2000). The World Bank and the OECD have launched major corporate governance codes that have been proliferating around the world.

In this context, various corporate governance mechanisms, such as ownership structure, are proposed to solve this divergence-of-interest problem and to mitigate the costs associated with the conflict. Berle (1932) suggested the existence of a positive linear relationship between ownership concentration and firm value. This was later supported by Shleifer and Vishnu (1998) who contended that block shareholders play an important role in monitoring management activities that lead to higher performance. There are five key features that clarify the different corporate governance systems around the world – legal protection of investors, the level of ownership concentration, the development of capital markets, the market for corporate control, and the effectiveness of board of directors.

There is extensive literature discussing how corporate governance affects firms' market value, but almost all of this literature focuses on developed countries and on particular aspects of governance, including board composition, shareholder activism, executive compensation, share ownership, and takeover defences. In developed countries, even careful studies rarely find economically important effects of particular governance elements. For example, Millstein and MacAvoy (1998), and Bhagat and Black (2002) investigated board composition and other board characteristics. Karpoff, Malatesta, and Walking (1996) and Carleton, Nelson, and Weisbach (1998) investigated shareholder activism. Bhagat, Carey, and Elson (1999) studied outside director pay. Sundaramurthy, Mahoney, and Mahoney (1997) studied takeover defences. Himmelberg, Hubbard and Palia (1999), Morck, Shleifer and Vishny (1998), and Palia (2001) studied inside ownership, while Chang (2003) studied inside ownership in pre-Asian-crisis Korea.

There are two studies that have been identified as limited control variables with no endogeneity control in their findings. First, Black (2000) only used 21 large firms in Russia, and found that there is a strong correlation between governance index and share price. Second, Gompers, Ishii and Metrick (2003) studied an array of takeover defences for US firms, and their evidence shows that the deciles of firms with the strongest takeover defences have lower share prices than deciles with the weakest defences.

Meanwhile, Durnev and Kim (2003) and Klapper and Love (2003) in their working paper focus on the factors that predict corporate governance in emerging economies and briefly address whether governance choices predict firms' market value. Durnev and Kim (2003) found higher scores on both the CLSA corporate governance index and the S&P disclosure index, which predict higher Tobin's Q for a sample of 859 large firms in 27 countries. Similar to previous studies, they used limited variables (their results significant at p values of 0.04 to 0.06 depending on the governance index), and they did not conduct robustness checks with other firm value variables or alternate definitions of the governance index. They also assumed that an industry does not affect governance. Contrary to Black, Jang, and Kim (2003) and Gillian, Hartzell, and Starks (2003) found that industry does affect governance. Durnev and Kim also assumed that a firm's market-model α and β value do not affect Tobin's Q.

In developed markets, Gillan, Hartzell and Starks (2003) investigated whether Tobin's Q predicts the overall governance of US firms and found no significant effect. Drobetz, Schillhofer & Zimmerman (2003) found a correlation between corporate governance index and the market value of German values. They have limited control variables, no endogeneity or signalling

control, rely on responses to a voluntary survey, and do not specify how their governance index was constructed.

Corporate governance addresses the agency problems that are induced by the separation of ownership and control in modern corporations including those in developed countries. Agency problems continue to be sources of large costs to shareholders. For example, in developed countries, such as the US and UK, firms are generally characterised by dispersed shareholdings; however, in most continental European companies ownership is much more concentrated (Franks and Mayer, 1997 and Faccio and Lang, 2000). This was supported by a study done by La Porta, Lopez-de Silanes and Shleifer (1999) in which they report that 85% of firms have a controlling shareholder, in contrast to only 10% in the UK or 20% in the US.

Additionally, there are differences in the significance concerning the role played by boards of directors in different corporate governance systems. Meanwhile, Anglo-Saxon boards have been generally considered a competent control mechanism because of their independence of management (Denis and McConnell, 2002); a substantial body of evidence addresses the effectiveness with which UK boards and US protect shareholders' interests (Hermalin and Weisbach, 1988). In other cases, the lack of regulation on the role of boards of directors in most continental European countries has been questioned. For example, the implementation of Codes of Best Practices in several countries following the Cadbury reports issued in the UK in 1992 indicated that the greater presence there of controlling shareholders makes the compliance of these voluntary requirements difficult (Lannoo, K 1999). Meanwhile in Spain, boards of directors

do not exercise complete control due to their lack of information (Orden et al., 2005) and their lack of freedom to make decisions (Ricart, Alvarez and Gallo, 1999).

The level of development of capital markets has also been taken into account in order to establish institutional differences across countries. Rajan and Zingales (1995) proposed the dichotomy bank - versus market oriented to classify G7 countries such as Japan, Germany, France and Italy - are characterised by the importance of the banking sector in financing firms and, with the exception of Japan (Mayer and Sussman, 2001), have very small financial markets. Then followed by the US, UK and Canada, which have well-capitalised stock and bond markets. According to Kaplan (1997), Anglo-Saxon markets are much more liquid than the German ones. In Germany and France, the number of quoted companies and the market capitalisation are much lower than the US and UK. In addition, although the banking sector is of superior importance in financing Spanish firms the Spanish capital market was classified as one of the less developed both in capitalisation value and in volume of shares traded (Demirguc-Kunt and Maksimovic,2008).

Next, there are different roles played by the market for corporate control across countries. Hostile takeovers in the US and UK are a common event, and this activism of the market for corporate control compensates the lack of other internal control mechanisms (Pagano and Volpin, 2001). It is different in Japan and continental Europe where the high concentration of firm ownership constitutes not only an essential control mechanism, but also one of the main structural barriers to hostile takeovers (Moerland, 1995). It is similar in Spain, where the percentage of hostile takeovers registered in the Spanish market, which is 4%,is not comparable

with that in the major markets such as in the US about 47%, or the UK of 25% (Ocana, Pena and Robles, 1997).

Two examples on governance standards and company value are included, as follows. The first study, which was done by La Porta (2001), investigated the differences in governance standards among 27 countries. The evidence shows that firms incorporated in countries with better governance standards tend to have a higher valuation. Meanwhile, a second type of study on inter-firm variation within one country was carried out by Drobetz (2003) for Germany, Gompers et al. (2003) for the US, de Jong et al. (2002) for the Netherlands and Black (2001) for Russia. It is concluded that these studies generally found a positive relationship between governance standards and company value.

No matter which definition of corporate governance we refer to, the core issue of corporate governance is the agency problem. The agency problem or conflict arises when managers' interests are not congruent with the shareholders. Shleifer and Vishny (1997) suggested that expropriation of shareholders wealth by managers can take many forms including building empires, enjoying perks, stealing and transferring money from the firms, insider trading, inappropriate investment due to management incompetence and management entrenchment. Jensen and Meckling (1976) define the expropriation as agency costs.

Agency problems arise because of the separation of ownership and control (Berle and Means, 1932). The primary reason for having a corporate governance structure is to reduce the agency

problem associated with separation of ownership and control of a firm. Most studies have outlined two potential agency problems associated with ownership structures. The first is the management-shareholders conflict, which arises when shareholders are so numerous and dispersed that no one is able or willing to monitor the management, leaving the management relatively unconstrained to pursue their own interests. The second agency problem arises when one shareholder has absolute control of the firm and, thus, can take actions that benefit him/her at the expense of the non-controlling or minority shareholders. In this regard, Agrawal et al. (1996) examined seven mechanisms to control agency problems between managers and shareholders. These are shareholdings of insiders, institutions, and large block shareholders, use of outside directors, debt policy, managerial labour market, and market for corporate control. The findings show a significant relationship between firm performance and the four factors cited above.

This was later examined by Scoutt and Rosenstein (1998) who examined the relationship between governance mechanisms like board composition, managerial ownership, and firm's performance. The evidence suggests that there was a curvilinear relationship between managerial ownership and performance. In addition, Rechner and Dalton (1991) examined the relation between CEO duality and organisational performance and the result was found to be significant.

Subsequently, this study discusses government ownership and firm value. Government-controlled companies may respond to signals from the government to enhance national welfare or other non-profit considerations, which may not relate well to the goal of value maximisation (Vernon, 1979). A government corporation or government-owned corporation is a legal entity

created by a government to exercise some of the powers of the government. It may resemble a not-for-profit corporation, as it has no need or goal of satisfying the shareholders with a return on their investment through price increase or dividends. Its sole goal is to provide some kind of good or service to the public.

Not many researchers conduct their research specifically on government ownership and firm value. For Singapore, through Temasek Holdings, Ang and Ding (2005) compared the financial and market performance of Government Linked Companies (GLC) with non-GLCs, which have a different governance structure with the key difference being government ownership. Their study found that, on average, GLCs exhibit higher valuations than non-GLCs, even after controlling for firm specific factors such as profitability, leverage, firm size, industry and foreign ownership. Majumdar (1998) compared the financial performance of state owned, private owned, and mixed state-private ownership firms in India from 1973 to 1989. His analysis suggests that the most profitable firms were the private owned followed by mixed ownership. State owned enterprises had the worst performance. The majority of other studies in India and abroad drew similar conclusions (Ramaswamy, 2001; Shleifer and Vishny, 1997; Shleifer, 1998).

Meanwhile, in China, Tian and Estrin (2005) found that government ownership reduces corporate value due to political intervention. In addition, other papers done by Xu, Pan, Wu, and Yim (2005) found that government enterprises perform worse in profitability than non-government. Dean et al. (2005) examined the performance of domestic Chinese firms in various ownership categories versus foreign-invested enterprises (FIEs) based on two nationwide surveys conducted by the National Bureau of Statistics in 1998 and 2002. The results show that both

domestic non-state-owned firms and foreign-invested enterprises performed better than state-owned enterprises. However, three categories of Chinese companies – privately owned, collectively owned, and with shareholding – had higher performance levels than the foreign invested enterprises. In Europe, especially Germany, companies under Treuhand (the government privatisation agency) and Management KGs (government ownership organisation) performed better than before privatisation (Dyck and Wruck, 1998).

In general, and in conclusion, the majority of studies show negative results when looking at government ownership and performance or firm valuation. There could be many reasons for the poor performance or financial results by government-owned companies. First, the main target of government companies is social welfare not profit motive. Second, the government is only the agent of the real owners who are the citizens. The main problem for government companies implementing corporate governance is the bureaucracy. There is no personal interest for the bureaucrats to ensure that an organisation is run efficiently or governed well since they do not gain any additional benefit to enforce good governance.

According Lopez-de-Salines et al.(1997), bureaucrats and the government respond to various interest groups (e.g. trade unions) as part of their social agenda. Any social or non-social benefits are likely to be so diffused among the voters who are the citizens that it is unlikely that there will be much of an incentive to exercise any governance over the organisation to ensure it performs effectively (Andrews and Dowling, 1998). Due to poor financial performance of government companies, the government has started the process of privatisation. However, the progress has been extremely slow. Many vested interests – employees, unions, bureaucrats, and

other political realities impede the process of privatisation. Therefore, the government still controlled and owned companies even though the company was going public, which is called partial privatisation.

3.2 Partial Privatisation Performance

Widespread privatisation in recent decades has generated considerable empirical literature concerning the effect of ownership on company performance. Most studies found that privatisation has a positive impact on the profitability and efficiency of companies. For example, Megginson and Netter (2001) studied the impact of shares issue privatisation with transfer of management control included Boubakri and Cosset (1998), who found significant improvement following privatisation in the operating performance of 79 companies from 21 countries. In contrast, using cross-country panel data on 500 large companies, Dewenter and Malatesta (2001) found that earnings improve following privatisation but decline subsequently. The companies in these studies have a majority of the assets privatised and control rights have been transferred from the government to private owners.

The impact of partial privatisation is important because most privatisation transactions of significant size are through the partial sale of equity on the stock market. For example, Jones et al. (1999), in their study, using a sample of share-issue from 59 countries found that only 11.5% of the companies sold all of their capital and less than 30% sold more than half of their capital in the initial public offering. In relation to practical importance, partial privatisation is just theoretical because government owned companies still perform poorly even though government

companies going public.⁹ The political view argues that governments practise objectives that consider citizen social welfare and which are in conflict with profit maximisation, and that this political intervention can distort the objectives and constraints faced by managers (Shielfer and Vishny (1994)). Therefore, to overcome this problem, only the transfer of management control to private owners is likely to deal with inefficiencies in state-owned enterprises.

From a managerial view based on the agency theory, state-owned companies have complexity in controlling and monitoring managers. This is because there is neither an individual owner with a strong incentive to monitor managers nor a public share price to provide information about manager actions, as judged by stock market participants (Latffont and Tirole,1993). Other difficulties include the fact that the management have a limited incentive contract if they do not have information from the stock market (Holmstrom and Tirole (1993) and Tirole (2001)), managers lack an important public signal of their skills for the executive job market (Fama, 1980), and also limited takeover opportunities (Scharfstein (1988) and Stein (1988)).

It is difficult for government owned companies to become fully privatised because of the difference between the political motive and the managerial perspective. This is because both ownership and control shift to the private sector at the same time. This is different in partial privatisation, in which the shares of the firm are traded on the stock market while the firm remains under government control and is subject to political intervention. One example is India's

⁹*While focussing on the impact of privatisation, there is also a well-developed literature on the political economy of privatisation strategies, including partial privatisation. For example, Perotti (1995) argues that governments may retain a passive stake in companies in order to signal to investors that their commitment is not to implement policies adverse to the companies.*

experience. India has a well-established stock market that long predates privatisation, and in the period we consider, privatisation consists solely of the sale of minority equity stakes.

Furthermore, partial privatisation cannot escape from agency problems because of the separation of ownership and control. Some literature considers the role of financial markets as information providers and monitors of management (see, for example Grossman and Stiglitz (1980), Fama (1908), Holmstron and Tirole (1993) and Tirole (2001). The stock market provides incentives to investors to assemble information that is reflected in share prices, and this information can improve managerial incentives in a number of ways. For example, Holmstron and Tirole (1993) and Tirole (2001) illustrated that the share price can be used to create more effective incentive schemes to improve performance. A share price can also have a beneficial impact on incentives because it serves as a signal of ability in the managerial labour market (Fama, 1980). Moreover, financial markets facilitate corporate control through takeovers, which can impose managerial discipline (Scharfstein (1988), and Stein (1988)). However, public listings may also have an adverse impact on company performance in private companies if there are substantial agency costs associated with the increased dilution of ownership.

3.3 Government Ownership and Performance

Results from previous studies concerning the performance of companies under government or state control have been inconsistent (Majumdar (1998), Tian and Estrin (2005), Ang and Ding (2005), Black et al. (2000). These studies also looked at companies after privatisation but still under government control (called partial privatisation by some studies). Here, examples given

are from countries where government involvement or intervention is on company decision-making as the government, or state has a larger shareholding stake in those companies.

In Malaysia, there are two objectives for companies under government control – going public or privatization (also called partial privatization by other countries such as the UK, European countries, and Mexico). First, the privatisation policy would quickly achieve the NEP's goal of providing more avenues for Bumiputra businessmen to participate in the economic activities, thereby enabling the Bumiputra to manage and own at least 30% of the country's commercial wealth (Haniffa, 1999). Second, privatisation provides additional funds while at the same time reducing the government's burden in providing essential services to the public (for example, road construction, health services, energy and power).

As such, if these services were privatised to Bumiputra private companies, which had the right expertise and resources (Hamid, 2008) it would reduce the government burden and at the same time provide more time and funds to focus efforts on other much more important tasks. Under the government support, these privatised companies thrived and were expected to become more successful. Most of the companies were corporatised through the issuing of a portion of their shares on Bursa Malaysia. As the government maintained substantial ownership in these companies, these corporatised entities have come to be known as Government Linked Companies or GLCs (also on Government Linked Investment Companies (GLICs) (Treasury Circular, Ministry of Finance, 1993).

These factors, including the absence of a bankruptcy constraint, are predicted to lead to lower efficiency in state owned firms than privately owned ones. For example, in Malaysia three privatised government companies, namely, Malaysia Airline System (MAS), Tenaga Nasional Berhad (TNB)(power company) and Telekom Malaysia (telecommunication company) have borrowed an estimated US22 billion from abroad due to the 1997 currency crisis (Jomo, 2001). Empirical evidence strongly supports this contention. For example, Megginson and Netter (2001) conclude, “[the weight of empirical research] is now decisively in favour of the proposition that privately owned firms is more efficient and more profitable than otherwise comparable state owned firms”.

Below, is some of the empirical evidence concerning the relationship between ownership structure and performance, government ownership and performance, and partial privatisation and performance.

(i) Malaysia

Razak , Ahmad and Aliahahmed (2008) studied the performance of government ownership in Malaysia for the period of 1996 until 2005. Their study examines the impact of an alternative ownership/control structure of corporate governance on firm performance among government linked companies (GLCs) and non-GLCs in Malaysia. It is believed that government ownership serves as a monitoring device that leads to better company performance after controlling for company specific characteristics. They used Tobin’s Q as the market performance measure while ROA is to determine accounting performance measure. This study is based on a sample of 210 firms over a period from 1995 to 2005. This study used the panel based regression approach to

determine the impact of ownership mechanism on firm's performance. The findings appear to suggest that there is a significant impact of government ownership on company performance after controlling for company specific characteristics such as company size, non-duality, leverage and growth.

Meanwhile, another study, conducted by Hamid (2008), examines the corporate governance structure of GLCs and non-GLCs and performance in Malaysia. He used a sample of 92 companies listed in Malaysia and divided them into GLCs and non-GLCs for the period of 2001 until 2003. One of his findings indicated that the poor performance of GLCs in Malaysia being due to government influence on the board structures such as the appointment of Bumiputra, senior government officers and politicians as directors (POL) was basically unfounded because these variables have no statistically significant adverse impact on performance.

(ii) Singapore

One of the studies on government ownership and performance was done by Ang and Ding (2005). They studied the ownership/control structure of Singaporean GLCs (government linked companies) in which the government, through a holding company, Temasek Holdings, owns large cash flow rights but disproportional control rights. They also investigated the level of corporate governance displayed by the GLCs and compared it to a control sample of listed non-GLCs on the Singapore Exchange over an 11-year-period from 1990 to 2000. For a company to be considered as a GLC it must meet certain criteria. First, Temasek, a government agency that owned companies, must hold an effective ownership interest of around 20% or more in a listed company, where the effective holdings are determined up to the second tier companies in the

group structure of Temasek Holdings. They also include second-tier companies in the Singapore Technologies Group, a wholly owned Temasek subsidiary. Second, the identified GLCs must be listed on the main board of the Singapore Exchange starting 31 December 1990 or later, up until 2000. Then they used Tobin's Q as a measurement to determine firm value in relation to government involvement and corporate governance.

Ang et al. (2005) discovered that, on average, GLCs show higher valuations than those of the non-GLCs, even after controlling for firm specific factors such as profitability, leverage, firm size, industry effect, and foreign ownership. Specifically, GLCs provide superior returns (on both assets and equity), and are valued more highly, through their better management of expenses than non-GLCs. Since GLCs are generally correlated with better governance practices, the results support the view that investors in the Singaporean market do value the higher standards of corporate governance found in the GLCs.

Ramirez and Tan (2004) also found evidence that the capital market value of GLCs is higher than that of non-GLCs. They compared 17 Singaporean GLCs with 92 non-GLCs during the period between 1992 and 1998. In summary, they found that the positive and significant relation between the government link and Q is robust to the inclusion of other variables such as industry effects, size and monopoly power, profitability and bankruptcy risk, which might affect firm value and thereby Q. They explain that besides performance measurement, the capital markets seem to substantially reward the very fact that a company is linked to the government. This positive market perception is hard to pin down. It could simply reflect a form of brand recognition (much like how consumers are willing to pay more for goods bearing a well-known

label than for similar or even identical goods without such a label). They also suggest that investors believe that GLCs are backed by government, which will let them fail in times of trouble.

(iii) China

Tian and Estrin (2005) explore the effects of different levels of government shareholding on corporate value by using a large sample of Chinese PLCs containing 2,660 firm-year observations. They show that the overall impact of state shareholding on corporate values in China is found to be negative, which is consistent with the Western literature. However, firms with diffused shareholding structures were found to have the worst performance compared to other structures such as private and state owned firms. Their main result concerns the relation between corporate value and the size of government shareholdings in that firms with a lower level of state ownership have a high level of corporate value compared to those with a higher level of state ownership. That is, when the size of government shareholding is sufficiently large, the effect of government shareholding on corporate performance is marginally positive relative to situations where private and state ownership are more equally balanced. Their finding is robust, including to questions of reverse causality, and is consistent with the findings from previous work on China in that reforms have managed to provide incentives for private agents and the government, which lead both to act in ways that enhance efficiency. Their study is an extension of the search done by Tian (2000). Tian (2000) explored the relationship between state shareholding and corporate performance of 825 publicly traded Chinese companies in 1998; 413 of these had some government ownership, 312 had none. The study found the performance of “private” enterprises to be significantly superior to that of “mixed” enterprises. It was also found

that corporate value generally declines with state ownership, but then increases after the state share passes 45%.

Paskelian (2006), in his thesis, studied government ownership, firm value and the choice of Chinese SOE methods for 400 announcements of seasoned equity offerings by companies listed on either the Shanghai Stock exchange or Shenzhen Stock Exchange from 1993 through 1998. His study found that companies with higher government ownership underperform relative to those with lower government ownership and that issuing rights offerings are preferred. The market reaction to the rights offering is lower than to the public offering. In his second study, he identified that: (i) companies with higher government ownership still have lower performance than companies with lower government ownership; (ii) companies with higher government ownership still use rights offerings as the equity issue method; (iii) companies with lowest government ownership issue equity use private placements; (iv) the market reaction to the announcement of private placement is positive; and (v) the monitoring action provided by the placement buyer has a positive effect on the long-term performance of the companies issuing private placements. He concludes that privatised companies with high government ownership do not necessary maximise company value; instead, the managers are more aligned with the political and social agenda of the government.

(iv) India

In India, according to the Ministry of Labour in 2000: as of 1999, the public sector employed more than twice the number employed in the private sector (within the organised sector) in 1999. This situation continued in 2005 when state owned enterprises were the major and significant

player in the Indian economy (Khanna and Palepu, 2005). Unfortunately, the financial performance of these units has not been good. Arun Shourie, India's Minister for Disinvestment, pointed out that of the 210 central government and 8,000 public enterprises at the state level, half are not profitable. He mentioned that despite efforts to improve these enterprises (involving Rs400 billion or \$8,516 million over nine years) none of these enterprises improved their performance. Moreover, those that made profits did so due to the monopoly positions that they occupied (Asia Money, 2005). The average rate of return, when the monopolies are excluded, was 24 percent (including monopolies it was 3.9 percent).

There are several research studies concerning the performance ownership structure in India. One of them is by Majumdar (1998), who compared the financial performance of state owned, private owned, and mixed state-private ownership firms in India from 1973 to 1989. His analysis suggests that the most profitable firms were the private owned followed by mixed ownership. State owned enterprises had the worst performance. The majority of other studies in India and abroad draw similar conclusions (Ramaswamy, 2001; Shleifer and Vishny, 1997; Shleifer, 1998).

Ahuja G and Majumdar, S K (1998) examined the determinants of performance of 68 Indian state-owned enterprises in the manufacturing sector for a five-year period from 1987 to 1991. The manufacturing sector is the major player in the Indian industrial sector. They identified a low level of efficiency in resource utilisation, on average, less than 0.35 on a scale of 0 to 1. Even though the result only applies to 68 firms, as these firms are major players in the Indian industrial scene there is significant potential to improve economic performance even with the

resources available. The low performance of this sector, and the accompanying waste of resources that is indicated, casts a new light on the urgency of the problems of Indian state-owned firms. Industrial progress is a function of both the level of investment in resources, as well as the efficiency with which they have been utilised. Given estimates of the size of the state-owned sector in India, if national industrial capabilities are encapsulated in firms, the performance of firms that they studied have probably led to a significant holding back, or perhaps even retrogression, of Indian industrial performance.

In detail, they found that a significant variation in the efficiency performance of the firms exists. They found that firm-specific characteristics –age, size, and market status; generic environmental factors –increasing competitive intensity, as well as institutional characteristics, all affect the performance of state-owned enterprises. One of the results suggests that the government must provide public policy to solve public enterprise problems for the heterogeneity of firms within the state-owned sector. Policies and actions, such as privatisation and closure, can be tailored to specific contexts keeping in mind these micro firm-level factors.

Further attention needs to be given to developing a schedule of priorities in terms of the enterprises to be targeted for remedial action, especially for smaller and older firms in the manufacturing sector.

(v) Europe

Grant and Kirchmaier (2004), in their research, compared three distinct ownership structures of firms –widely held, de-facto (government) control, and legal control –and quantified the

differences, relating them to the trend component of share prices. For this study, they used a new and unique data set of uniform ownership data for the largest 110 firms in the five major European economies (Germany, the UK, France, Italy, and Spain) over 10 periods of study (1993 – 2002). To measure performance, they employed a filtering technique that is commonly used in macroeconomics to decompose GDP data into a trend and cyclical component. For the first time, they applied this technique to isolate the long-term share price trend from other effects.

In France, the dominant form of ownership is legal control, while the best performing category is de-facto control, with an ownership block between 33.3% and 50% of the voting shares. The performance differences between de facto control and widely held firms as well as firms under legal control are significant at the 1% level for both the risk adjusted and un-adjusted returns. In Germany, the dominant form of ownership is also legal control. However, the best performing companies are widely held. Companies under de facto control are the next best performing group and legal control are the worst performing. The performance effect is statistically significant for all groups at the 1% level, except between the widely held and de facto control group. After adjusting for risk, widely held firms remain the best performing group, followed again by the de-facto control group. The performance differences remain significant between the widely held and legal control group, and become significant between the de-facto and legal control group at the percentage level. This result is similar to a Spanish study in which the results indicate that the best performing ownership structure is the widely held category even though the dominant form of ownership is legal control. Meanwhile, in the UK, widely held firms predominate, providing investors with little in choice terms of control structure. Only 4% of firms in the FTSE 100 fall under the de facto control heading, and 3% under legal control. Finally, the Italian data

illustrates the out-performance in the Italian equities markets of companies that have a single, legal controlling shareholder or group with a block over 50% of the voting shares.

From the sample, there is a heavy bias towards legal control as the dominant ownership structure, with 65% of companies in this category. The de-facto control group is the next best performing control group; meanwhile widely held companies are the worst performers for most of the period. In addition, for the widely held sample, 16% of firms are dominated by banks, which often have a unique ownership and regulatory structure, are controlled by foundations with special control rights, and cannot be treated as standard public companies (Galbraith, 2002). However, only the performance differences between widely held firms and firms with legal control are statistically significant at the 5% level, however, the generalisability of the results is limited. After controlling for risk, the performance differences between those two groups remained significant at the 5% level, the differences between the legal and de-facto control group became significant at the 10% level.

Meanwhile in Poland, Pinto, Belka and Krajewski (1993) tested whether privatisation is required to improve the performance of SOEs by examining how the Polish state sector responded in the three years following the “Big Bang” reforms of January 1990. These liberalised prices, tightened fiscal and monetary policy and introduced competition – but did not include privatisation. Results documented that there is a significant performance improvement due to macroeconomic stabilisation package, even without privatisation. Improvements were mostly due to the imposition of hard budget constraints, tight bank lending policies, and enhanced credibility about the government’s “no bailout” pledge.

In conclusion, they discovered that in a number of major European economies, the dominant form of ownership is not the most efficient one. Across Continental Europe, legal control by a large shareholder, or coalition of shareholders who control the board, is the dominant ownership category. The study documented that for Germany and Spain widely held firms significantly outperform those under legal control. In contrast, the United Kingdom is almost exclusively widely held and legal control is the dominant structure. The predominance of legal control is puzzling, as from a wealth maximisation perspective, the dominant block holder(s) would benefit from holding a more diversified portfolio of assets. Corporate owners would serve their shareholders better by investing in internal projects with higher paybacks or returning money to shareholders via share buybacks.

They summarise that current European ownership structures, especially state control or de-facto, are a function of the complex interaction of historic national regulations, tax codes, strength of institutional investors and individual/family wealth preferences, constraints and psychology. The balancing of these interests through the political process at country level has been a prime determinant of current corporate structures. However, as demonstrated, these structures are far from efficient for society in aggregate, and Europe would benefit from changing its ownership structure.

(vi) Jordan

Rami Zeitun and Gary Gan Tian, (2002) examined the impact that ownership structure has on the performance of firms and the default risk found in Jordan. The data used in this study included

59 publicly listed companies on the Amman Stock Exchange (ASE), consisting of different industrial sectors: manufacturing, trade, steel and mining, utility, and real estate (excluding banking and insurance sectors), over the periods 1989-2002. Their findings indicate: (1) Ownership structure has a significant effect on the accounting measure of performance return on assets (ROE); (2) Government shares are negatively related to the firm's performance ROE; (3) Defaulted firms have a higher concentration of ownership than non-defaulted firms, and firms with a higher proportion of foreign ownership have a low incidence of default; (4) Government ownership is negatively related to the firm's probability of default; and (5) Both mixed and concentration ownership structure data can be used to predict the probability of default, as the largest five shareholders (C5), and the government ownership fraction (FGO) is negatively correlated with the probability of default. These results further suggest that reducing government ownership can increase a firm's performance, but will also cause some firms to go bankrupt, at least in the short term.

(vii) Turkey

Guyson and Aydogan (2002) examine 194 firms listed on the Istanbul Stock Exchange (ISE) (1992-1998) and divide types of ownership into Government ownership, family ownership, foreign ownership, and affiliation to conglomerate. Performance was based on ROA (Accounting measurement) and PE, and ratio stock return as average monthly stock return in 24 months (market measurement). Their results indicate that: (i) Concentrated ownership firms have higher PE ratios and higher average returns; (ii) Affiliated firms (conglomerate and government) have higher returns and higher earnings; (iii) Government firms have lower accounting but higher market performance with higher risk.

(viii) MINA countries

Bolbol A, Fatheldin A, Omran MM(2005) studied the performance of companies with government involvement in MINA countries. A sample of 304 firms from different sectors of the economy from a representative group of Arab countries (Egypt, Jordan, Oman, and Tunisia) was gathered for the period 2000-2002. Their study was to determine the effect of ownership concentration on firms' performance and market measures, after controlling for the endogeneity of ownership concentration. They found that Government ownership consists of 34% of ownership structure in Egypt, Tunisia 20%, Jordan 9% and Oman 6% (for Pool – 19% of 889 observations). Meanwhile for pool regression, Government ownership has a positive significant relationship with ROE and Tobin's Q (positive and not significant for ROA).

(ix) Russia

Kuznetsov P., Muravyev A. (2005) investigated the impact of ownership concentration on the performance of 101 Russian non-financial privatised enterprises that constitute the group of "blue chips" of the country's stock market for the period of study from 1995 to 1997. No link was found between concentration of ownership in the hands of private owners and company profitability. However, when considering the case of majority ownership by the state, the regression analysis showed that the concentration of private ownership is negatively related to profitability if the state-related entities do not have a controlling block of shares. Generally, the results indicate that performance of companies under state control will be poor when compared to other ownership concentrations.

There is considerable awareness about the poor financial performance of government owned enterprises and the government, and, in recent years, this has started the process of privatisation. However, the progress has been extremely slow. Many vested interests – employees, unions, bureaucrats and other political realities – impede the process of privatisation.

There are many reasons as to why government ownership results in poor financial performance in various countries. First, the government is tied with social, which may not be in line with the profit motive. Second, the government is only the agent but not the ultimate owner who are the citizens. Specifically, it is not the real owners who exercise governance, but the bureaucrats. There is no personal interest for bureaucrats to ensure that an organisation is run efficiently or governed well since they do not gain additional benefits from enforcing good governance. Bureaucrats and governments respond to various interest groups (e.g. trade unions) as part of their social agenda (Lopez-de-Salines et al., 1997). Finally, even if the public can exercise control directly, it is unlikely to be effective because of the extreme dispersion of the principal. Any social or non-social benefits are likely to be so diffused among the electorate that it is unlikely that there will be much of an incentive to exercise any governance over the organisation to ensure it performs effectively (Andrews and Dowling, 1998).

Even though there are studies on government involvement and company performance, there is still a lack of research concentrating on government owned companies or government linked companies (GLCs), except for Singapore. However, the research in Singapore only compared between GLCs and non-GLCs and the criteria comparing these two was loose and unbalanced. For example, Ang et al. (2005) compared 30 GLCs and 117 non-GLCs, and Ramirez (2004) compared 17 GLCs with 92 non-GLCs. Consequently, their results may not show the actual and

accurate results, as when comparing between two samples, the study needs to match one sample with the other sample. Therefore, this current study uses the matching method by taking into consideration the size of the company and industry between two samples. The other gap is that there is no study comparing two countries that have similar corporate governance policies but different status. For example, Malaysia, which is a developing country, can learn from its neighbour, Singapore, as a developed country. As mentioned in an earlier chapter, Singaporean GLCs control more than 50% of the Singaporean market and are a major contributor to the Singaporean economy. Therefore, this study will compare and explore the performance of these two GLCs (Malaysia and Singapore) after taking into consideration firm special characteristics including corporate governance.

3.4 Chapter Summary

This chapter reviews the existing theoretical and empirical evidence concerning ownership structures and performance measurements. The first section discusses the performance measurements employed in previous studies concerning corporate ownership structures, especially government involvement in companies, and identifies two types of measurement—financial measurement and non-financial measurement. The following three sections explain some empirical evidence concerning the relationship between ownership structure and performance, government ownership and performance, and partial privatisation and performance. The main reason for identifying the relationship between partial privatisation and performance is that, in some countries, the government or state still controls public sector enterprises even though these enterprises have been privatised.