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THE DEGREE OF ATOMICITY OF THE OWNERSHIP AND THE FIRM'S FINANCIAL PERFORMANCE - EVIDENCE FROM ROMANIA

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Rezumat: *This paper examines the impact of the degree of concentration of the ownership on the firm's financial performance for a sample of 2,000 Romanian companies, in a time frame that range from 2009 to 2017. The effects of concentrated ownership on firm's performance is estimated using fixed effects model (FE), random effects model (RE) and a corrective model (PCSE) as methodology. The main results indicate the fact that between the financial performance, expressed by both indicators return on assets (ROA) and return on equity (ROE), and the variable which express the degree of ownership concentration is an inverse significant relationship. At the same time, other variables considered do not show significant differences in outcome: size, age, liquidity, leverage and tangibility negatively influence the financial performance of companies.*
Key words: *Concentrated ownership, financial performance, corporate governance, Romania.*
JEL Classification: *G32, G34, L25.*

1. Introduction

From a structural point of view, the capital of a company can be held by a number of shareholders, with different holding rates. For the most part, shareholders may be individuals, other companies, institutions or state administrations. Usually, a company's shareholders are not directly involved in its management system. However, they are involved in the appointment of managers or board of directors to monitor the overall performance of the company. Starting from the reference study by Berle and Means (1932), in which it was highlighted that, for the most part, the activity of the big American companies is not managed by the persons who holding their ownership, the researchers in the corporate finance field were concerned about the effects that could be obtained from the separation of ownership from control.

Over time, the international researchers' concerns about the relationship between the shareholder structure and the financial performance of the company have led to mixed conclusions. Thus, the main studies conducted show that, given the presence of diversity within the shareholder structure, which may develop a divergence in pursuit and achievement of objectives, companies' financial performance may differ.

In this context, the purpose of this paper is to identify and explore the links between company ownership thru its degree of concentration and their financial performance. The paper is divided as follows: the first part of this paper summarizes highlights the bibliographic study of the relationship between the degree of the ownership concentration and the financial performance of the companies; the next part presents the methodology of econometric models considered, as well as the structure of the used data; the following part deals with the empirical study of the paper, showing the main results obtained in the analysis, respectively their interpretations and, last but not least, the last part presents the conclusions and final remarks of the study.

2. Literature review

Making a foray into literature, it can be noticed that, both through theoretical and empirical studies, researchers have focused their attention on the conflict related to the separation of ownership from control. As it is also stated in agent theory, the degree of the concentration of ownership is the key mechanism of corporate governance that helps alleviate conflicts arising from the separation of the two parties (Shleifer and Vishny,

1986). The concentration of ownership is represented by the proportion of shares held by a majority shareholder (Sanda et al., 2005). In other words, the concentration of ownership is measured by the fraction of shares held by the most significant shareholders (Singh and Gaur, 2009; Obiyo and Lenee, 2011; Karaca and Ekşi, 2012).

In the studies found in the literature, the dominant hypothesis refers to a direct relationship between the concentration of the ownership and the performance of the company. This positive effect of ownership concentration can be supported by the effectiveness of monitoring decision-making, which gives to the major shareholders more powerful incentives and decision-making power at a low cost. Grossman and Hart (1986) argue that shareholders, who have a more consistent stake in the company, show willingness and availability in terms of their active involvement in monitoring decisions.

On the other hand, in some studies, the authors claim the opposite, showing a negative effect of the degree of concentration of the ownership on the performance of the company through the expropriation effect. As La Porta, Lopez-de-Silanes, and Shleifer (1999) argue, the nature of agent theory issues and their effect varies significantly between companies with a higher concentration of ownership than those with dispersed one. Thus, in the presence of concentrated ownership, the conflict presented in the agent theory related to shareholders - managers can turn into a conflict related to majority shareholders - minority shareholders (Young et al., 2008; Bebchuk and Weisbach, 2010). In this way, the presence of a high degree of concentration in the ownership structure may cause a conflict of interest between the controlling shareholders (the majority) involved in the monitoring of the decision-making process and the minority shareholders (Filatotchev et al., 2013).

Despite the fact that a higher degree of concentration of shareholders may lead to the conflict between majority shareholders - minority shareholders, most empirical studies confirm that concentrated ownership may positively influences the performance of the company. This is due to the majority shareholders, who, through active involvement and monitoring, contribute to increasing the quality of the decision-making process, which in turn leads to the growth and maximization of the company's performance (Babić, Nikolić and Erić, 2013). However, the high level of concentrated ownership could become inefficient due to the fact that the decision-making process pursued only one goal, namely to maximize the value of the company, neglecting other important issues (Sánchez-Ballesta and Garcia-Meca, 2007). This conclusion is confirmed by the ambiguous and contradictory results of empirical studies that analyze the effects of the concentration of ownership on corporate performance (Thomsen and Pedersen, 2000; Thomsen, Pedersen and Kvist, 2006; Cheung and Wei, 2006; Perrini, Rossi and Rovetta, 2008).

3. Data and methodology

The impact of concentrated ownership on the financial performances of the largest active companies from Romania is analysed within a panel data framework. The sample comprised 2,000 Romanian companies, with data for a period of 9 years (2009-2017). The source of data is AMADEUS, platform database of Bureau van Dijk (2019). The following table shows the types of companies considered in the sample, classified according to the economic activities in the European Union (according to the NACE codes - Nomenclature statistique des activités économiques dans la Communauté européenne), as well as their percentage in the sample.

Table 1. Classification and proportion of companies according to economic activities

Economic activities	Number of companies	Percentage
A. Agriculture, forestry and fishing	49	2.45 %
B. Mining and quarrying	20	1 %
C. Manufacturing	631	31.55 %
D. Electricity, gas, steam and air conditioning supply	73	3.65 %
E. Water supply; sewerage; waste managment and remediation activities	35	1.75 %
F. Construction	83	4.15 %
G. Wholesale and retail trade; repair of motor vehicles and motorcycles	701	35.05 %
H. Transporting and storage	132	6.6 %
I. Accommodation and food service activities	11	0.55 %
J. Information and communication	71	3.55 %
K. Financial and insurance activities	47	2.35 %
L. Real estate activities	18	0.9 %
M. Professional, scientific and technical activities	58	2.9 %
N. Administrative and support service activities	43	2.15 %
O. Public administration and defence; compulsory social security	1	0.05 %
Q. Human health and social work activities	10	0.5 %
R. Arts, entertainment and recreation	16	0.8 %
S. Other service activities	1	0.05 %
TOTAL	**2.000**	**100 %**

Source: Own processing

The dependent variable describes the financial performance. Past research identified a range of variables as potentially capturing firm performance. However, in this study, firm performance was measured by return on total assets (ROA) which represent the company's profitability related to its total assets and by return on equity (ROE) which denotes the return on the investment of the equity owners.

In order to capture the potential impact of concentrated ownership on financial performance, a dummy variable (CONC.3) was constructed. In line with most of the researchers, the variable takes the value 1 if the ownership of the companies is concentrated in the sense that the percentage holdings of the three largest shareholders (neglecting their identity) reach or exceed the threshold of 10% or the value 0 if the company's ownership is dispersed.

An appropriate set of control variables was introduced in the model, in line with the literature on financial performance determinants: firm size (SIZE) represents the annual absolute change of natural logarithm of total assets; firm age (AGE) defined as the natural logarithm of company age since establishment of the company until the certain year; liquidity (LIQID) measures the proportion of current assets to the company's current liabilities; leverage (LVRG) measures the proportion of funds provided by creditors to finance the firm’s assets and tangibility (TANG) shows the proportion of fixed assets (tangible assets) over total assets.

Based on the analysis of the literature on corporate financial performance determinants, it was assumed that firms have their own intrinsic characteristics which could influence the financial performance and, therefore it was estimated a fixed effects (FE) model. It was also estimated a random effects (RE) model which imply a random variation across firms, uncorrelated to the explanatory variables. In order to decide between fixed effects and random effects empirical specifications, a Hausman test was employed which showed that fixed effects estimator should be preferred. Tests results were reported in the lower part of the estimation tables. In addition, it is important to identify the autocorrelation issue before the standard errors of the estimated coefficients to be computed. Wooldridge test for autocorrelation pointed out that first order autocorrelation could not be rejected.

Given the evidence of strong cross-sectional dependence, the presence of heteroscedasticity and autocorrelation, Prais-Winsten PCSE procedure was used as the baseline scenario. The procedure fits linear models when the residuals are not independent and identically distributed, allowing correcting cross-sectional dependence, heteroskedasticity and autocorrelation.

$$Y_{i,t} = \beta_0 + \beta_k X_{i,t} + \varepsilon_{i,t} \quad (1)$$

where Y represents dependent variable (ROA, ROE), β_0 represents the constant, β_k represents the estimated coefficients, X represents the independent and the control variables, $\varepsilon_{i,t}$ is the random component of the error, i - the companies, t - the time.

4. Results

The following table presents the results of the regressive analysis of the relationship between the financial performance of companies, the independent variable represented by the concentrated ownership and the control variables.

Table 2. Results of regression analysis

	ROA			ROE		
VARIABLES	(1) FE	(2) RE	(3) **PCSE**	(4) FE	(5) RE	(6) **PCSE**
CONC.3	1.999*	1.949***	-1.263***	2.736***	3.249***	-3.095***
	(0.942)	(0.223)	(0.448)	(0.507)	(0.465)	(0.717)
SIZE	0.651***	-0.118***	-0.929***	-0.580***	-2.334***	-4.088***
	(0.101)	(0.063)	(0.224)	(0.211)	(0.167)	(0.485)
AGE	-1.136***	0.965***	-0.641***	2.412***	1.970***	-1.256***
	(0.187)	(0.157)	(0.163)	(0.392)	(0.326)	(0.386)
LIQID	-0.014***	0.016**	-0.029***	-0.032**	-0.036**	-0.0322**
	(0.002)	(0.007)	(0.011)	(0.016)	(0.017)	(0.016)
LVRG	-0.053***	-0.042***	-0.041***	0.001*	0.0008**	-0.0006*
	(0.005)	(0.004)	(0.005)	(0.0003)	(0.0003)	(0.0003)
TANG	-0.620***	-0.591***	-0.501***	-0.756***	-0.920***	-0.756***
	(0.074)	(0.067)	(0.063)	(0.140)	(0.161)	(0.140)
Constant	-4.555***	3.355***	12.39***	19.13***	37.01***	55.95***
	(1.011)	(0.837)	(2.730)	(2.113)	(1.738)	(5.599)
R-squared	0.017	0.013	0.019	0.004	0.006	0.060
Hausman test		223.92***			210.21***	
Pesaran CD test	24.82***			24.21***		

Wooldridge (F -test)	160.43***			287.26***		
Breusch-Pagan LM $\chi 2$		7746.75***			7230.61***	
Observations	18000	18000	18000	18000	18000	18000
Companies	2000	2000	2000	2000	2000	2000

Source: Author’s estimations

***, ** and * denote significance at 1%, 5% and 10% level of significance
Robust standard errors in parentheses

Analyzing the results synthesized in columns (3) and (6) of the table, it can be stated that there is a statistically significant negative relationship between the companies' concentrated ownership and their financial performance considering both financial performance measurement indicator, respectively the ROA and the ROE indicator. Few years ago, such a result was obtained by McConnell and Servaes (1990), Thomsen and Pedersen (2000), Welch (2003), Mahrt-Smith (2005), Shah and Hussain (2012), Tran et al. (2014), Wang and Shailer (2015) and Abdullah et al. (2019).

Thus, researchers support the fact that, in monitoring the determinants of financial performance, environmental influences are much more important than the structure / atomicity of ownership. Examining more closely these results, it can be noticed that the significance of the relationship between the concentration of the ownership and the performance of the companies leads to the conclusion that, under caeteris paribus condition, a change in the degree of atomicity of the companies' ownership is of considerable importance in the process of improvement of profitability. In other words, the financial performance of companies is influenced by the presence in the ownership structure of a small number of major shareholders or a larger number of minority shareholders. Regarding the Romanian economy, following the economic crisis, the ownership of the companies underwent changes in the sense that a tendency to disperse it appears. However, the changes mentioned in the shareholder structure have had a significant impact on the performance of the companies together with other factors in the low performances recorded in the post-crisis period.

Considering the control variables, it can be concluded that they are statistically significant at 1%. Thus, all of the control variables considered negatively affect the firm's financial performance. Overall, the model is statistically significant.

5. Conclusions

In conclusion, the ownership structure can influence the performance of the company in many ways. Differences in shareholder identity, different degrees of concentration, or unequal distribution of resources among shareholders affect their power and ability to control managers. Moreover, the wide range of shareholders and managers' objectives can influence the performance of the company in different ways.

The connection between the degree of ownership concentration and corporate performance has been the subject of an ongoing debate in the corporate finance literature, showing mixed results. The purpose of this study was to observe empirically whether the relationship between concentrated ownership and firm’s financial performance exists. In this regard, this research contributes to the expansion of the literature on the impact of corporate governance from the perspective of the concentrated ownership on the financial performance, considering a sample of 2,000 Romanian companies, in a time frame that range from 2009 to 2017. The main results indicate the fact that between these two variables is an inverse relationship. At the same time, control variables considered do not

show significant differences in outcome: size, age, liquidity, leverage and tangibility negatively influence the financial performance of companies

Therefore, considering both theoretical contributions and practical implications, this research could be developed by integrating into the sample a variable indicating the ownership structure. In this way, the results of the research could outline more pertinent conclusions regarding the influence of the atomization degree of the ownership structure on the financial performances of the Romanian companies.

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