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OWNERSHIP STRUCTURE AND COMPANY PERFORMANCE – RESEARCH AND LITERATURE REVIEW

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Abstract The aim of this article is to summarize the results of published researches conducted in the area of influence of ownership forms on companies and financial performance and to highlight the specifics of these relations in the environment of transition economies. Several authors have documented greater efficiency of private companies compared to state-owned. According to different studies, an alternative option for transition economies is foreign ownership. Recent studies show that the effect of ownership forms on companies and financial performance is more significant in Eastern European countries compared to developed countries. However, study results are often contradictory, therefore they require additional research.

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Introduction

At a time of unprecedented global competition, increasing performance is an important objective of every company. In this context, identification of financial performance determinants represents a current research question and the large amount of work devoted to this topic shows an active interest of experts to find the answer to this question. The effects of ownership forms on financial performance of enterprises[3] have been of particular research interest in the literature of corporate finance. Generally we meet with the statements that interests of managers and shareholders are not aligned, which causes problems that reduce a firm's value and financial performance. After 1990, this issue has become current also for post-communist countries. Analyses are even more difficult and challenging as they are done in the environment of economic transformation with extensive privatization processes, which are also accompanied by many negative social phenomena. The aim of this article is to summarize published results of important researches on the topic of the influence of company ownership forms on financial performance and to point out the problematic aspects of this relationship in the environment of transition economies.

Ownership forms and support for privatization theories

The term corporate governance has a number of various meanings. The World Bank states that it represents "organization and rules that affect expectations about the exercise of control of resources in firms" (World Bank Development Report, 2002, p. 68). Another interpretation states "corporate governance issues arise in an organization whenever two conditions are present. First, there is an agency problem, or conflict of interest, involving members of the organization – these might be owners, managers, workers or consumers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract" (Hart, 1995, p. 678). It is also mentioned that "corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected" (John & Senbet, 1998, p. 372). All the stated interpretations have something in common. Each of them points out that corporate governance difficulties exist; there is a necessity for systems to handle and limit the arising conflicts.

The effect of ownership forms or structure of the share capital on the financial outcomes of enterprises has been the topic of scientific conversations for more than 80 years. It began at the moment of publication of the classic research of Berle and Means, The Modern Corporation and Private Property. At the end of the 1990s the topic of impact had actually become popular also in post-communist nations. It was right after they had found the important role of the private sector in development of the economy. Presently in those countries they differentiate three kinds of enterprises in regard to ownership: state, private and those with foreign ownership.

The major facet of ownership structure is associated with a company´s shares and their concentration. If a high percentage of shares is held by a relatively few owners, according to Citak (2007, p. 231) a company´s ownership is considered to be highly concentrated. Although every study examines various periods and different groups of countries and companies, the majority of the papers find a positive relationship between ownership structure and company performance measured by return on assets (ROA), return on equity (ROE), market to book value of equity (MBV) and more.

State – owned enterprises (SOEs) also known as government-owned corporations are defined as a legal entity that is created by the government in order to take part in activities on the government's behalf. Governments may either wholly or partially own a state-owned enterprise. In terms of state ownership, we meet with bigger diversity in points of view and opinions in academic circles. Based on De Alessi (1980) and his statement, state-owned enterprises are political firms with the public as a collective owner. A specific feature of these companies is that individuals have no direct claim on their residual income and are unable to transfer their property rights. Lately this has been considered inefficient and bureaucratic. One of the most unprecedented global functions in the last quarter of the twentieth century has been privatization. During the above-mentioned period, governments around the world introduced different forms of privatization regardless of their economic backgrounds, political orientations and ideological positions (Haque, 2000, p. 227). Since than many researchers have claimed that SOEs should be privatized and while supporters of privatization argue that privatization is the only way to bring about changes in managerial goals and lead towards a competitive environment, others argue that it can be accomplished by more gradual approaches. Public sector inefficiency is sometimes seen as a 'stylized fact', it appears from the empirical evidence that a change in ownership from public to private is not necessarily a cure for an under-performing organization.

There are three theories that support privatization of State – owned enterprises (SOEs):

1) property rights,
2) public choice,
3) agency theory.

Bozec, et al. (2002) summarized each theory. Based on agency theory, managers attempt to maximize their very own advantage or profit rather than that of a business owner or company itself. However, managers in private firms are disciplined by a variety of outside control systems, such as the market for managers, and also by inner control mechanisms, such as compensation and rewards incentives (Cuervo & Villalonga, 2000). The property rights theorists argue that under state ownership property rights are poorly determined (Ramamurti, 2000). They concentrate on the marketability of property rights, threat of bankruptcy, and avoidance by the managers the searching for their own conveniences. These kinds of control do not restrict managers in SOEs; as a result it is highlighted that they are less likely to maximize profits. Another approach emphasizes the issues in the functioning of government. Managers of these SOEs are more concerned with maximizing their own power, their prestige, and the amount of resources under their control (as cited in Kim & Chung, 2007).

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3 In this article are used terms such as state-owned enterprise and private company. The selected terms are closely explained in the following text.

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Performance of a private company vs. state-owned enterprises

A private company is a company whose ownership is private. In the literature it is specified that it is expected that private ownership guarantee superior corporate governance through the role of external owners in monitoring managerial performance and in ensuring a single-minded focus on profitability as the objective of the firm (Estrin, 2002).

Specifically, we raise the question of whether private enterprises perform better than state-owned and whether post-privatization ownership structures cause improvement in performance over a certain period. There is a question posed by Peltzman (1971), "If a privately owned firm is socialized, and nothing else happens, how the ownership alone will affect the firm's behavior." Review of the literature points out that the difference in ownership structure among companies may affect their financial performance. Some analysts reviewing the performance differences between private and state-owned enterprises have offered various outcomes, yet generally these researches recommend that privatization of state-owned enterprises leads to better financial performance. Among those authors we can name Andrews and Dowling (1998) and Parker (1997). The analysis discovered a significant positive influence of private ownership, which is an essential condition of utilization of potential positive effects of the corporate legal form of ownership. Better financial performance of the private companies and non-significant differences in the performance of public companies of both legal forms of ownership verify these conclusions. In this paper we use the term "privatized firms" meaning previously state-controlled companies where private owners presently have control and the level of state ownership is reduced. By the term "state-owned enterprises" (SOEs) we mean those companies where state ownership is greater. It is important to state that corporate governance mechanisms vary around the world and can produce different ownership effects on performance of companies. Shleifer and Vishny (1997) have defined at least three kinds of mechanisms in the world economies. In Europe and Japan, there is much less reliance on elaborate legal protections, and more dependence on large investors and banks. In the United States and the UK, firms substantially count on the legal protection of investors, and the ownership structure is dispersed. In the rest of the world, ownership is typically heavily concentrated in families, in which the legal protection is weaker compared to the other types of ownership. As a result of such differences between certain corporate governance systems we can anticipate various relationships between ownership and firm efficiency and value. Empirical researches mentioned in this paper can be divided into three groups:

1) studies that compare the relative performance of private and public firms,
2) studies that compare domestically-owned and foreign companies,
3) studies that compare the performance of the companies in transition economies.

Kim and Chung (2007) reviewed these studies well. After assessing existing literature on the relative performance of private and public firms, they concluded that efficiency of private companies is considerably better than that of state-owned enterprises and partially privatized enterprises. These previous studies employed various sample data sets: from one country, from one industrial sector or from many countries. In spite of the difference in the information set, the outcome is incredibly robust and enough to generalize that state-owned enterprises usually tend to perform worse than private companies. Examination of the efficiency of state ownership forms ends up with fewer disputes in scholastic circles. Recently, SOEs have actually been traditionally criticized as ineffective. For example, De Alessi (1980) mentions that the certain feature of such a business is that a citizen does not have a direct right to receive residual income.

Ehrlich, Gallais-Hamonno, Liu and Lutter (1994) have given proof on productivity differences between state-owned and privately owned firms. They used data of 23 international airline companies of different (and in some cases changing) ownership categories over the period 1973-1983. They developed a model of endogenous, firm-specific productivity growth. The authors found a significant link between ownership and firm-specific rates of productivity growth. Their results reveal that private ownership leads to higher rates of productivity growth and reducing expenses in the long run and these differences are not affected by the degree of market competition or regulation. Their outcomes show that the change from complete state ownership to private ownership would increase productivity growth by 1.6 to 2 percent a year and costs would decline by 1.7 to 1.9 percent.

Some more studies of private sector versus public sector performance, for example by Davies (1971, 1977), Boardman and Vining (1989), Galal, et al. (1994), Dewenter and Malatesta (1998) have reported higher efficiency in the private sector. On the other hand Caves and Christensen (1980), Millward (1988), Nelson and Primeaux (1988), Parker and Wu (1998), and others, have actually reported results more favorable to public ownership or no statistically significant differences. This variation in the results is caused mostly by the fact that the early studies had access to different and frequently somewhat limited data on firm ownership. We can conclude the main issues of early studies are that (Estrin, at al., 2007):

1) studies rely on short time periods with observations concentrated immediately before and after privatization,
2) studies use small and often unrepresentative samples of firms,
3) studies are frequently not able to determine accurately ownership because privatization is still ongoing or due to the fact that the constant post-privatization changes of ownership are hard to detect,
4) studies frequently combine panel data from various accounting systems.

Majumdar (1996) examines differences in efficiency between government-owned, mixed, and private sector firms in India. In his research he used industry survey records and found that SOEs owned by the government have performance scores on an average level with values of 0.658 and 0.638, combined enterprises have scores of 0.92 and private enterprises have scores of 0.975.

Megginson, Nash and Randenbourgh (1994) compared 61 companies from 18 countries in the period before and after privatization. The results of this study indicate that for most companies in the sample, there was an increase in profitability, efficiency, output, employment and payment of dividends. D'Souza and Megginson (1999) conducted similar research, but on a sample of 85 companies from 28 countries. Their results confirm previous claims except regarding increase in employment. Mohammed Omran (2002) evaluates the financial and operating performance of newly privatized Egyptian state-owned companies to see if the results vary among companies as a result of their new ownership structure. Egypt's privatization program offers a unique post-privatization data of different ownership structures. Since most studies do not distinguish between different types of ownership, this article provides a new perspective on the impact of post-privatization ownership structure on firm performance. The study includes 69 companies that were privatized between 1994 and 1998. For these newly privatized firms, the study documents show a significant increase in profitability, operating efficiency, capital expenditures and dividends. In contrast, there can be seen a significant decline in employment, debt and risk even if the output shows an insignificant decrease after privatization. Research by Ab Razak, Ahmad and Aliahmed (2008) on the relationship between ownership structure and performance of the company was the subject of interest among academics, investors and policy creators, because of the key factor in understanding the effectiveness of alternative control systems in which public ownership serves as a control mechanism. Accordingly, this article examines the impact of alternative ownership / structure of company control on business performance of individual companies in Malaysia directly associated with the government and those unrelated to the government. Generally, it is argued that government ownership or state ownership serves as a monitoring device, which leads to better business performance, monitoring the specific characteristics of the company. Tobin's Q is used as a measure of market performance, while ROA is to determine the extent of financial performance. This study is based on a sample of 210 companies during the period from 1995 to 2005. A regression model was used to determine the impact of ownership on the mechanisms of corporate performance. The findings show that there is a significant effect of state ownership on the performance of the company, after checking the specific characteristics of firms, such as size of the company, non-duality, leverage and growth. The findings are important for investors and policy creators, which will serve as a guide when making investment decisions.

Wu and Cui (as cited in Zeitum & Tian, 2007) study the effect of ownership structure on a firm's health. They found that there is a positive relation between ownership concentrations and accounting profits, indicated by return on assets (ROA) and return on equity (ROE), yet the relation with respect to the market value measured by the share price-earning ratio (P/E) and market price to book value ratio (M/B) is negative. Likewise, the contribution of government

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(state) and institutional ownership is significantly positive to company profit, while negative to the market value.

Tian (as cited in Zeitum & Tian, 2007) offers another study carried out on 825 companies listed on the Shanghai Stock Exchange, out of which 513 are with mixed-ownership and 312 private firms. He discovered that private firms perform better than mixed ownership firms. D'Souza, Megginson and Nash (2005) evaluated performance of 129 privatized companies coming from 23 OECD countries, focusing on influence of ownership on relative change of ROS, sales and investments. The results show growth in profitability, productivity and investments after privatization. There is significant impact on performance of private and foreign ownership and level of capital market development. In the same period Boubakri, Cosset and Guedhami (2005) performed analysis of performance on 230 companies from 32 countries. They used regression analysis to measure the influence of macroeconomic factors, ownership and size of company on ROS, ROE and ROA change. Due to the reforms in selected countries there are differences in results among them, but as in other studies, results also show growth in profitability, investments and effectiveness after the privatization. The positive impact of transformation of 429 companies in China that were transformed from state-owned to Joint Stock Companies, were found in the research of Aivazian, Ge and Qiu (2005). Dong, Lanjoun and Lesink (2006) compared performance of 121 privatized companies before and after privatization with the use of regression analysis. They identified growth in profitability, sales and salary. They state that the main factor that influenced improvement was change in management and access to capital market. Hanousek, Kocenda and Svejnar (2007) analyze the effects of different types and concentration of ownership on performance using a large population of firms in the Czech Republic after mass privatization. Results indicate that the performance effects of privatization and different types of ownership are on the whole surprisingly limited and that many types of private owners do not generate performance that is different from that of firms with state ownership. The only improvement in performance was observed in companies with foreign owners. The authors also performed another study. Its main goal was to evaluate what economists have learned to date about the economic effects of privatization, focusing on the post-communist (transition) economies and China, with comparative references to other developing countries. The main reason why they focused on transition economies was the fact that those countries experienced major changes in the values of many relevant variables as they changed their economic system. It is stated that those countries carried out a major transformation that made the share of private sector in GDP increase from extremely low levels to between 60% and 90%.

Ongore and Vincent (2011) performed a study that investigated the effects of ownership structure on the performance of 42 listed companies in Kenya using agency theory as an analytical framework. Measures of performance were ROA, ROE and Dividend Yield. Using Pearson's product moment correlation and Logistic regression, the study found that ownership concentration and government ownership have significant negative relationships with firm performance. On the other hand, foreign ownership, diffuse ownership, corporation ownership, and manager ownership were found to have significant positive relationships with firm performance.

Similar evidence and researchers can be also found in the banking sector. Privatization of banks is part of many empirical studies on the topic of whether privatization improves performance of banks. Bonin, Hasan and Wachtel (2005) analyzed influence of ownership on performance and effectiveness of bank in selected countries. The results show that the most effective are foreign-owned banks and the least effective are state-owned banks. Baruník and Soták (2010) performed a research on Czech and Slovak banks using the stochastic frontier analysis. The authors tried to observe whether the statements that private firms perform better than state-owned can by applied also on banks and whether the cost-efficiency is influenced by bank ownership. They used data of 44 Czech and 21 Slovak banks between the period of 1996 to 2005. The main findings of the research are that the structural influences are significant for both countries. Foreign-owned banks are bit more cost efficient than domestic private banks, state-owned banks are significantly less cost efficient when compared to domestic private banks.

There have also been a number of studies on emerging markets. Daqing Qi, Woody Wu and Hua Zhang (2000) made a study of Chinese companies and found out that the most beneficial for corporate performance is legal-person ownership, while state ownership on the other hand dilutes the performance of listed companies. It was stated in the study that companies with legal ownership tend to be also more profitable based on ROE figures.

Ivashkovskaya and Stepanova (2010) came up with interesting findings - that the impact of ownership on the efficiency of enterprises is more significant in Russia and Eastern European countries compared to developed countries. In terms of this statement, Akimova and Schwodiauer (2004) performed research on 202 Ukrainian companies for the period 1998-2000. They concluded that insider ownership is found to have a significant non-linear effect on performance, while outside owners do not have a significant effect on performance. The impact of foreign ownership on performance is significantly non-linear; it means that its effect is positive only up to a level that falls short of majority ownership.

According to OECD principles of corporate governance it is incredibly crucial to make sure that in terms of state-owned enterprises there are well established clear and consistent ownership policy; governance is transparent with a certain level of professionalism and effectiveness. It is essential to acknowledge the rights of all shareholders and ensure access to all corporate information. In a number of countries state-owned enterprises represent an important part of GDP, employment and market capitalization. Their performance is essential to a great segment of the population and to the business sector and lays a role in overall economic efficiency. Overall corporate governance is additionally crucial for privatization as it makes ventures much more appealing to potential buyers.

The effect of foreign ownership

The effect of foreign ownership on firm performance has been an issue of interest to both academics and policymakers. Görg and Greenaway (2004) mentioned that the major challenging concern in the international business strategy is the outcome gained from foreign ownership of firms. The emphasis on firm-specific assets as the primary source of firms' heterogeneity with respect to conduct and performance has stimulated numerous studies that seek to investigate whether multinational firms (MNCs), or their subsidiaries, perform better than domestically controlled firms. Existing business literature states that the reason why companies invest abroad is that they possess firm-specific advantages, which are not accessible to domestic companies in the host country. Such benefits might compensate the expenses of operating abroad and therefore MNCs display remarkable performance (Dunning, 1993; Markusen, 1995; Caves, 1996).

It is mainly accepted that foreign ownership plays a crucial role in firm performance, particularly in developing and transition economies. Researchers (Aydin, Sayim & Yalama, 2007) have concluded that, on average, multi-national enterprises have performed better compared to the domestically owned firms. It is therefore not surprising that in the last two decades there was increase in foreign direct financial investments especially in developing nations. Two major explanations have been put forward to explain high performance associated with foreign ownership of firms. The very first reason is that foreign owners are more likely to have the capability to monitor managers, and offer them performance-based incentives, leading the managers to manage more seriously, and avoid behaviors and activities that threaten the wealth creation motivation of the firm owners. The second reason is the transmission of new technology and internationally tested management practices to the firm, which helps to enhance efficiency by reducing operating expenses and generating savings for the company.

There is an agreement among many authors that the foreign owner has positive impact on financial results of companies (Ivashkovskaya & Stepanova, 2010). Positive impact on a company´s performance is explained by tighter control of managers from the side of a foreign owner. There are two studies that distinguish between privatized SOEs and newly created private firms. Sabirianova, Svejnar and Terrell (as cited in Estrin, et al., 2007) performed a study on almost all industrial firms in the Czech Republic and Russia and found that foreign start-ups are less efficient than existing foreign owned firms, but more efficient than domestic start-ups, which are in turn more efficient than existing domestic firms. Therefore results proved the above-mentioned statement that foreign enterprises are more efficient than domestic. A second study was done by Commander and Svejnar (2007). They used data of 26 transition economies and based on their results stated that domestic start up firms are less efficient than foreign owned firms but not significantly different from domestic privatized or state-owned firms. Among emerging economies, Willmore (1986) analyzes a matched

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sample of foreign and domestic firms in Brazil and finds foreign firms have higher productivity and greater capital intensity. Studies that examine the dynamics of productive efficiency show that foreign-owned companies improved their efficiency faster than domestic state-owned and private enterprises. The reason can be that foreign owners brought about a sizable increase in efficiency in the period immediately after acquiring the local firms, but later on the rate of change in efficiency has been on average similar in all the principal types of ownership of firms. Petkova (as cited in Chari, Chen & Dominguez, 2009) conducted a study using Indian plant level data and concluded that foreign-owned plants experience improvements in productivity three years following foreign investment.

The reasons for this positive impact are various. One of them is that companies equipped with foreign corporate shareholdings are endowed with superior technical, organizational, and financial resources. For instance, Chibber and Majumdar (as cited in Douma, George & Kabir, 2006) found that the extent of a foreign firm's control over a domestic firm is positively associated with the degree of resource commitment to technology transfer. Djankov and Hoekman (as cited in Görg & Greenaway, 2004) wrote that foreign investment is associated with the provision of generic (management skills and quality systems) and specific knowledge. Boardman, Shapiro and Vining (as cited in Douma, George & Kabir, 2006) used a sample of Canadian firms and found significant performance differences among multinational enterprises or their subsidiaries and domestic firms. They attribute these differences to firm specific advantages (resource heterogeneity) and differences in agency costs among foreign and domestic firms owing to ownership concentration differences. Furthermore, Douma, et al (2006) presented another study conducted by Dhar on foreign-controlled companies in India which finds that most of these enterprises have business links beyond mere equity participation. They have technical collaborations, nominations of foreign directors on their boards, consultancy and marketing arrangements, trademarks, patent obligations, and managerial resource sharing. In addition to the agency cost and resource-based advantages, Wiwattanakantang finds that institutional factors such as investment promotion benefits lead to performance differences between foreign controlled firms and domestic firms.

Globerman et al. (as cited in Barbosa & Louri, 2005) "report that once the effects of capital intensity and size are controlled for, MNCs operating in the Canadian market are not significantly more productive than Canadian-owned firms, emphasizing that better performance of MNCs is primarily due to the high capital intensity and large size that generally characterize them. Kim and Lyn (1990) also found that MNCs operating in the US market are less profitable than randomly selected domestically owned firms." Barbosa and Louri (2005) performed a study in Greece and Portugal. The results show that ownership does not make a significant difference for firms in Portugal, subsequently casting doubts on the hypothesis that MNCs perform better than domestic firms, probably because they have to compensate for their liability of being foreign. MNCs operating in Greece are significantly more profitable than Greek-owned firms, only if a specific measure of profitability (gross return on assets) is taken into account and only when firms in the upper quantiles are compared. When net profitability is used, ownership ties do not matter.

A study performed by Douma, George and Kabir (2006) has an interesting conclusion. Based on the results they stressed the necessity of disaggregating foreign ownership into foreign institutional and foreign corporate shareholding. According to the authors those two categories should be analyzed separately. The main dynamics governing the investments by institutions and corporations are different and impact of foreign institutional investors on company performance is not clear-cut. Their results show that the variable representing ownership by foreign corporations is positive and significant, while ownership by foreign financial institutions is not significant. The significant positive relationship of foreign institutions may indicate that these institutions are 'tracking' better-performing firms. They suggest that all future studies examining the role of foreign ownership in emerging economies should incorporate this distinction.

The effect of privatization in the transforming countries

The topic of privatization and impact of ownership on financial performance is currently discussed and analyzed in numerous researches. Specifically in the transforming countries there is a concern of whether private or state-owned companies have better performance. The transformation of the former communist countries from almost completely state-owned to primarily private is one of the most important events in recent economic history. Most policymakers expected privatization to result in improved economic performance and it all ended up in a deep recession period for the first three to eight years of the transition. Despite that, they belong to the fastest growing economies in the last ten to fifteen years.

The first studies concentrating on effects of ownership on performance date back to 1980, when authors Caves and Christensen discovered that private and state-owned Canadian railways perform equally efficiently. After 1990 studies have focused primarily on privatization and recent studies come up with results with different findings and numerous variations of outcomes from no significant effect of privatization on performance (Estrin, et al., 2007), to cautiously concluding that privatization tends to improve firm performance (Megginson & Netter, 2001), to being fairly confident that privatization improves performance (Shirley & Walsh, 2000; Djankov & Murrell, 2002). The view that privatization could also be pivotal in the transition process was strongly advocated by proponents of the so-called Washington Consensus, which emphasized fast transfer of ownership via privatization. They believed that private ownership together with market forces would ensure better and more efficient performance of the economy (Lipton & Sachs, 1990; Blanchard, et al, 1991).

Frydman, Gray, Hessel and Rapaczynski (1999) compared the performance of privatized and state firms in the transition economies of Central Europe, using data of 506 midsize manufacturing companies in 1994, comparing four measures of firm performance – sales revenues, employment, labor productivity and material costs per unit of revenue. The authors found that privatized firms perform better compared to the state owned enterprises. However, the performance improvement is concentrated in revenue improvement (not cost reduction) in firms privatized to outside owners.

Conclusions

The research and literature review of the influence of ownership structure on performance has shown varied results. Generally it can be stated, based on most of the research, that private companies show better performance than state-owned companies. Foreign ownership has a positive impact on companies and performance, which also applies in the banking sector. Even though there are numerous researchers considering this topic, there is still a lack of research based in Slovakia and in Slovak companies. Privatization in Slovakia was an important part of country development and the results could provide significant information for both academic and corporate sectors.

We consider it very important to further develop this kind of research by analyzing the differences in impact of forms of ownership on performance in the selected industries and also by more detailed examination of the structure of ownership within its defined forms. This also leaves space for research in the environment of transition economies.

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