PROMOTERS HOLDING VS FIRM VALUATION: EVIDENCE FROM NIFTY STOCKS

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ABSTRACT:

The value of a firm depends on several internal and external factors. Promoter’s holding and the type of promoter’s is one of the major internal factors to determine the value of a firm. In this research work the impact of promoters holding on firm value has been tried to found out for all the NSE listed firms for the period of 2006-07 to 2009-10 in India. Tobin’s Q has been used as a proxy to firm value to gauge the relationship. The relationship found to be non-linear where the firm value initially increases with increase in promoter’s ownership up to a certain level, then decreases, and finally when the ownership becomes very high the firm value starts increasing again. This shows the alignment, then entrenchment and finally alignment of the promoter’s interest with the firm value. Other factors such as revenue, R&D expense, selling intensity, asset turnover etc. also have significant impact on firm valuation apart from insider ownership. The research also confirms that the presence of foreign promoters leads to better performance and better valuation of Indian firms and thus concludes that for the promoter maintaining a good reputation to the investors is a key remain attractive to the long term investors.

Key words: NSE, Promoter, Tobin’s Q.
INTRODUCTION:

In India most of the business starts by a family or a group of friends who later comes to equity market in the form of IPO for the participation of common public in the venture and acquires capital for business expansion. The common patterns of Indian firms shareholding are Promoters (Family owned, Trustee owned and Foreign company owned) or Non-promoters (Common investor, Foreign institutional investor, Domestic institutional investors such as Mutual funds, Banks, Provident funds etc). Depending on the promoters type and their holding in the firm the investors assess the opportunity of a firm’s future performance and the valuation varies accordingly. There is no straight cut relation between promoters holding and firm performance but several studies have been conducted in abroad as well as in India. It widely varied from country to country but mostly it has been concluded that as the promoters holding increases initially the firm value/performance improves, after a certain point the relationship reverses because of reluctance of the promoters and lack of responsibility of the promoters. As the holding reaches substantial such as above 50% or 60%, the relationship reverses again and starts increasing with increase in promoters holding.

In recent developments in India corporate, the corporate affairs ministry has made a mandatory requirement of minimum 25% holding by public in all public listed company. This denotes a fact that a promoter (a person, family or corporate) can’t hold more than 75% share/voting rights in company. This will change the scenario of present holding cases of up to 99% of public listed companies by the promoters. Again in another move to promote public participation in public listed firm while listing for as IPO/FPO the highest regulatory body of financial market, SEBI, increased the limit of common public investment to 2 lacs from 1 lacs. This will also help the interested investors to get more chances to buy promising shares through IPO investment. The regulatory body is committed to protect the interest of common public investors from investment fraud taking place by few concentrated players in the financial market. It boosts the investor sentiment to invest in equity market. The more the common public participate in equity market the chances of proper price discovery is much higher leading to better firm valuation of the promising firm.

In this background it became an important area to do a research to find out the impact of promoters holding on the firm value. This research will help the investors to find out valuable firm for proper selection on investment.

MAJOR CONCEPT:

In this research work Tobin’s Q has been used as a proxy to the value of the firm. Tobin’s Q ratio is the most widely used variable as a proxy to firm value. It can be calculated as the ratio between market value of equity and debt to the replacement value of the assets or book value of assets. In the research work book value of assets is considered as the replacement value to calculate the Tobin’s Q ratio.

REVIEW OF LITERATURE:

STUDIES CONDUCTED ABROAD:
Ana Paula Matias Gama and Cecília de Jesus Cardoso Rodrigues (1986) in the paper titled “Corporate Governance and Performance in Public Listed, Family-Controlled Firms: An Empirical Evidence from Italian Corporate Sector” analyzed the governance-performance
relationships using multi-industry dataset of 208 firms listed on Milan Stock Exchange (MSE). The option to study Italian firms is sustained on the one hand in preliminary results provide by Faccio and Lang (2002:366), who found substantial discrepancy between ownership and control in Italy, a situation which potentially aggravate problems associated with a combination of principal-agent and principal-principal relationships. In this environment, complementarities between ownership and board related governance factors may be particularly important. On the other hand analyzing a single legal and institutional environment allows us to hold constant a number of important contextual factors [e.g. ownership may vary across countries depending on their legal systems (Shleifer and Wolfenzon (2002)). This strategy also avoids endogeneity problems between ownership structure and country-specific institutional characteristics (Demsetz and Lehn, 1985; Demsetz and Villalonga, 2001).

Mara Faccio and Meziane Lasfer (1999), in the paper titled “Managerial Ownership, Board Structure and Firm Value: The UK Evidence” finds a strong U-shaped relationship between the level of managerial ownership and the probability that the roles of chairman and CEO are split, that a non-executive director is appointed as chairman, and the proportion of non-executive directors on the board.

Laporta, R., Lopez-de-Silanes, F., Shleifer, A. (1999) in the paper titled “Corporate ownership around the world” finds that except in economies with very good shareholder protection, relatively few of these firms are widely-held, in contrast to the Berle and Means image of ownership of the modern corporation.

Klapper, Leora F. Love, Inessa (2002), in the paper titled “Corporate governance, investor protection, and performance in emerging markets” in their empirical tests shown that better corporate governance is highly correlated with better operating performance, and market valuation.

Sabri Boubaker, (2003) in the paper titled “Ownership-Control Discrepancy and Firm Value: Evidence from France” shown that large controlling shareholders maintaining grip on control while holding only small fraction of cash flow rights are inclined to expropriate minority shareholders, which in turn detrimentally affects the firm’s valuation.

Beni Lauterbach and Efrat Tolkowsky (2004), in their paper titled “Market Value Maximizing Ownership Structure when Investor Protection is Weak” find that Tobin's Q is maximized when control group vote reaches 67%. This evidence is strong when ownership structure is treated as exogenous and weak when it is considered endogenous. Other ownership structure variables do not appear to have a significant valuation effect.

Ying-Jiuan Wong and Shao-Chi Chang (2005), in the paper titled “Does a Family-controlled Firm Perform Better in Corporate Venturing?” find that businesses in Taiwan experienced more negative market valuation of venturing announcements and the empirical results further indicated that the divergence of cash flow and voting rights was strongly and negatively associated with stock market reactions, suggesting that market participants may perceive family-controlled businesses as using corporate venturing to pursue self-interest at the expense of other shareholders.


Vincent Molly, Eddy Laveren and Marc Deloof (2005), in the paper titled “Transfer of family businesses and its impact on a firm's debt and growth rate” find that a transfer from the first-
to the second generation negatively influences the debt rate of the company, where in successions between later generations this effect is being reversed.

Ajay Khorana, Henri Servaes and Lei Wedge (2006), in the paper titled “Portfolio Manager Ownership and Fund Performance” find that fund manager ownership is higher in funds with better past performance, lower front-end loads, smaller size, funds affiliated with smaller families, and where the manager has been in charge for a longer period of time.

Clifford G. Holderness (2006), in the paper titled “A Contrarian View of Ownership Concentration in the United States and Around the World” offers evidence on the ownership concentration at a representative sample of U.S. firms. The ownership of U.S. firms is at least as concentrated, and by some measures more concentrated, than the ownership of firms in other countries. Such concentrated ownership is consistent with a fundamental property right of a market economy, which is that owners are active.

André Carvalhal-da-Silva and Ricardo Leal (2007) in the paper titled “Corporate Governance, Market Valuation and Dividend Policy in Brazil” investigates the effects of the corporate governance structure on market valuation and dividend payout of Brazilian companies. The empirical results indicate a high degree of ownership and control concentration. We can also note a significant difference between the voting and total capital owned by the largest shareholders, mainly through the existence of non-voting shares, pyramidal structures, and shareholding agreements.

Markus Petersen (2007) in the Paper titled “Retained inside ownership, signalling, and the valuation of initial public offerings – Evidence from Germany”, tests and confirms the Leland and Pyle (1977) signalling hypothesis of retained inside ownership. The ownership change at the IPO divestment) is found to have a negative impact on Tobin’s Q, while the absolute level of retained inside ownership has a nonlinear impact in OLS estimation. This impact turns into a linear positive impact in a simultaneous estimation of IPO valuation and the divestment of insiders.

Luis H. Gutierrez (2007) in the paper titled “Corporate Governance and Firm Valuation in Colombia” finds that voting rights are greater than cash flow rights because of indirect ownership across firms and large block holders were found to exert a positive influence upon a firm’s valuation and performance, which validates the positive monitoring approach of large shareholders, but this relationship is not monotonic.

Rim Zabbar (2008), in the paper titled “Stock Price Response to Mandatory Disclosure of Ownership Changes: Evidence from France” finds that While announcements of increases in ownership concentration do not trigger a significant market response, there is a negative impact of decreases in ownership concentration on stock price

James Lau and Hai Wu (2008) in the paper titled “Founding Family Ownership and Dividend Smoothing” finds that the degree of dividend smoothing engaged in by the family firms are much less than the on family firms and the source of the difference arises from the family firms’ willingness to increase their dividends, rather than their willingness to cut dividends in response to significant earnings changes.

Paul A. Gompers, Joy Ishii, Andrew Metrick (2008) in the paper titled “Dual-Class Firms in the United States” finds a strong evidence that firm value is increasing in insiders’ cash-flow rights and decreasing in insider voting rights.

Gwinyai Utete (2008) in the paper titled “Institutional Investor Preferences and Firm Value” finds that transient institutional investors (those that trade frequently with a view to maximizing short term gains) possess superior information to other market participants and actively seek out situations in which they can exploit this informational advantage.

Ying-Jiuan Wong and Shao-Chi Chang (2009), in the paper titled “Does a Family-Controlled Firm Perform Better in Corporate Venturing?” find that family-controlled business in Taiwan
experienced more negative market valuation of venturing announcements and also indicates that the divergence of cash flow and voting rights was strongly and negatively associated with stock market reactions, suggesting that market participants may perceive family-controlled businesses as using corporate venturing to pursue self-interest at the expense of other shareholders.

Bernard S. Black et al. (2010) in the Paper titled “How Corporate Governance Affects Firm Value: Evidence on Channels from Korea” provides evidence of an association between corporate governance and firm market value (based on the trading prices of minority shares), more limited evidence of a causal relationship, but very little evidence on the channels through which governance may affect firm behaviour and therefore market value, and whether governance affects only the value of minority shares or also affects overall firm value. For overall firm value the research find that for better-governed firms (i) capital expenditures and sales growth are lower, but investment is more sensitive to profitability; (ii) profitability is more sensitive to growth opportunities; (iii) dividends are higher, controlling for profits, and are more sensitive to profits.

**STUDIES CONDUCTED IN INDIA:**

Agarwal, Anup and Charles R. Knoeber (1996), in the paper titled “Firm performance and mechanism to control agency problem between managers and shareholders” shows that director’s holding has no significant impact on firm value is more revealing in Indian context. Chhibber, Pradip K. and Sumit K. Majumdar, (1998), in the paper titled “State as investor and state as owner, consequences for firm performance in India, the study finds pre-reform foreign ownership holdings has no effect on firm’s profitability. However, once the maximum limit of foreign ownership is raised to 51% post-reform, it shows a positive association with firm profitability proxied by return on assets (ROA) and return on sales (ROS).

Sarkar, Jayanti and Subrata Sarkar (1999) in the paper titled “The Governance of Indian Corporates” shows a non-linear relation with fir value- i.e. it first decreases upto 25 percent and increases thereafter. In case of corporate body’s shareholding, beyond 15 percent Q-ratio shows a positive association with firm value. In a subsequent study Sarkar and Sarkar (2000) revisited the above issues in a more technical way. Instead of relying on graphical and tabular interpretation, they have employed a piecewise linear regression method to study the non-linear relation between share ownership and firm value. For managerial shareholding, they find the firm value to decline till 25 percent of share ownership and to increase thereafter. However, once other block holders shareholding enter into equation, the negative impact at lower level of managerial holdings cease to be significant. Sarkar and Sarkar (2005) provide evidence that promoter shareholding ah has no impact on firm value in case of low growth firms while is has positive impact on on firm value for high growth firms.

Chhibber, Pradip K. and Sumit K. Majumdar (1999) in the paper titled “Foreign ownership and profitability, property rights, control and the performance of firms in Indian industry” find that insider ownership has positive and significant impact on firm value while director’s holding has no perceptible impact. Khanna and Pelepu (1999) also supported the same.

Deb, Saikat Sovan, and Chakrapani Chaturvedula (2004) in the paper titled “Ownership Structure and Firm Value: Empirical study on Corporate Governance System on Indian Firms” published by Director’s shareholding shows a non-linear relation with fir value- i.e. it first decreases upto 25 percent and increases thereafter.

Sarkar, Raja and Jayanti Sarkar (2005) in the paper titled “Diversification, Propping and Monitoring Business groups, Firm Performance and the Indian Economic Transition” find that the firm value to decline till 25 percent of share ownership and to increase thereafter.
However, once other block holders shareholding enter into equation, the negative impact at lower level of managerial holdings cease to be significant.

Kole, Stacey r. (2005) in the paper titled “Measuring Managerial Equity Ownership: A Comparison of Sources of Data” find that asset utilization and employee productivity is more with higher insider stake and in case of cost efficient and return on assets, the result is not identical across sectors or periods.

Pattanayak Mr. Manoranjan (2006) in the paper titled “Insider Ownership and Firm Value: Evidence from Indian Corporate Sector” find that the firm value to decline till 25 percent of share ownership and to increase thereafter. However, once other block holders shareholding enter into equation, the negative impact at lower level of managerial holdings cease to be significant.

RESEARCH METHODOLOGY:

STATEMENT OF PROBLEM

As the empirical and theoretical literature suggests, the relationship between managerial/insider ownership and firm value is non linear in nature. This non-linearity is the leading path to determine the hypothesis for the present study. When the shareholding of the insider is very low, the entrenchment effect is non-operational due to lower control over the decision making process of the firm. As MSV (1988) suggests the positive relation of insider shareholding and firm value at very low level of shareholding can be seen as a promise of insiders to perform well with the increase in their share ownership. Thus, it reflects their incentive to maximize firm value when their stake rises in the firm. However once they gain controlling authority in the firm, they can entrench themselves or pursue non-value maximizing activities. As per entrenchment hypothesis, more equity ownership by manager/insider may lead to lower financial performance. The reason being, with larger ownership stake they may be so powerful that they do not have to consider other stakeholders interest. Being wealthy due to large amounts of holding, they no longer need to maximize profit rather try to maximize their personal utility (like building personal empire, increasing market share or consume at office). But with majority ownership (>50%), their interest is better aligned with the interest of the firm. They have to bear 50% loss of each penny forgone. Convergence of interest sets in at such a high amount of ownership in the firm. It may be noted that, incentive effects operates positively at all levels of ownership. Each increment in shareholding includes the manager/insider to perform. However, it is the dominance of entrenchment effect over incentives effect at medium level of ownership that drives the value of firm downwards. Considering the above arguments, the test for any non-linearity in the relationship between insider ownership and market value is to be tested.

OBJECTIVES OF THE STUDY

Following are the objective of the research work:

1) To establish a relationship between promoters holding and firm valuation

2) To analyse the investors perception on promoters holding while investing in equity market.

3) To analyse and find out the major factors influencing firm valuation (Tobin’s Q)

4) To find out the impact of foreign promoters on firm’s performance
VARIABLES

INDEPENDENT VARIABLE
INS: The fraction of equity shares held by insiders/Promoters, INSSQ and INSCU are the square and cube of insider share respectively. Promoters share reflects direct insider holding in the firm. In Indian context it the family holding of the firm or the holding trusts holding.

DEPENDENT VARIABLE
Sales or ln(Sales): Firm size is measured using natural logarithm of sales revenue for each year. Firm size influence performance of firms,, but it is difficult to predict the sign of the co-efficient a priori. The economies of scale and scope of argument attributes a positive relationship of firm size and performance. However, organizational inefficiency may arise when the firms grow large. This is a likely situation in large firms as monitoring becomes difficult.
Leverage or LEV: Leverage is defined as the ratio of long term debt to total assets. In a Modigliani-Miller framework, the market value of any firm is independent of its capital structure. However, if tax shields are precious, then firm value should increase with the amount of leverage. Theoretically, more efficient managers prefer fixed payments. On the other hand, if debt covenants are too much restrictive, then it constraints the manager’s ability to make value enhancing investment which may negatively affect firm value.
Age or ln(age): Age is defined as the number of years between the observation year and the firm’s corporation year. Age has an ambiguous effect on firm performance. Mature firm has the reputational advantage vis-à-vis new firm. The prolonged period of learning experience and absence of the liabilities of newness augur well for old firm. However older firms are prone to inertia and bureaucratic rigidities. They may be less able to cope with new invention and late in adopting new technologies.
Operating Income Y/S: Operating income is a measure of profitability and measured as the ratio of cash profits to sales. Higher profit rate should be associated with higher firm value. It is indirect measure of firm free cash flow or market power. If the discretionary expenditure out of firms free cash flow in the firm is high, firm value will be low and vice versa. On the other hand, if the firms face high growth opportunities, their free cash flow can be reinvested in profitavle venture which will enhance firm value.
Capital Expenditure or I/K: This is the capital expenditure or new fixed assets creation in the firm. It is the ratio of newly acquired fixed assets to gross fixed assets. It helps in growth opportunities of the firm.
Research and Development Intensity R&D/K: It is measured as the ratio of R & D expenditure to capital. Firms with higher R&D/K ratio are expected to perform better as they are more foresighted and have higher scope for new innovation.
Selling Intensity or ADV/K: This is defined as the ratio of advertising and promotional expenditures to capital. It captures the effect of intangible assets along with R&D expense. These variables control for upward biases in Q-ratio that result from the use of book value of total assets in the denominator which hardly measures intangible capital. High advertising expenditure may help in building brand name and customer loyalty.
Capital Intensity or K/S: This is the ratio of gross fixed assets to sales. Tangible investments in fixed capital are observable and easy to monitor, thus reduces the scope for managerial moral hazard. Firms whose capital is less tangible may be subject to higher agency cost and lower Q- ratio. On the other hand firms operating with higher proportions of intangible assets may adopt strict governance structures to signal investors that they want to prevent the future misuse of these resources.
Liquidity: Turnover rate is used as a proxy for liquidity. Turnover is measured as the annual average number of shares trades over total number of shares. Liquidity is a particular concern of investors in emerging markets like India. Investors prefer those stocks which are actively traded in the market. This in turn exerts upward pressure on share price.

BSE 500: A dummy variable is generated to distinguish between BSE 500 firms and others. In terms of quality and size, these firms are the leaders in their respective sectors. It is expected that market will value these firms more in comparison to other firms.

HYPOTHESIS

PRIMARY HYPOTHESIS

- H₀: Firm performance is a non-monotonic function of share ownership by insider, i.e. firm value first increases, then decreases and thereafter increases with insider ownership.

SECONDARY HYPOTHESIS:

- H₀: Firms with foreign promoter perform better than firms with only domestic promoters
- H₀: Firms with promoters holding higher than 51 percent performs better than the firms having promoters holding less than 51 percent
- H₀: Higher Promoters holding and better promoter’s reputation leads to better valuation of the firm.

LIMITATIONS OF THE STUDY

The limitations during the project were:

- Only NSE listed firms has been considered for the study to limit the no of firms. Considering all firms may lead to change in conclusion.
- The data for last four years (2007-2010) has been analysed during the project.
- Many firms complete information were not available which has been filtered to make the research more reliable, but at the same time it causes loss in total no of firms in consideration.

DATA ANALYSIS

DESCRIPTIVE

The ownership structure of a firm decides the way the firm organizes itself and runs the economic activity. It is accepted that the success and continuance of any form of ownership organization depends upon its performance i.e. real or perceived. In Table – 1, Shows the comparison of performance of firms when the insider or promoters are the majority shareholder and otherwise. In Indian perspective, when a shareholder holds more than 51 percent of share in a firm, he/she has strategic control power over the firm such as adoption of annual accounts, matters relating to alteration of the capital structure of the company, issues relating to the appointments of the auditors, and their recommendation, appointment and termination of its directors, directors remuneration, and issues related to the voluntary winding up of the company. Thus, it is useful to examine the performance of firms when property rights are fully devolved to the insiders vis-a-vis firms where ownership is widely diversified.
Table 1: Comparison of firms having insider ownership more than/equal to 51% and less than 51%
Source: Prowess Data base

In the total observations of 3120 almost half or 1550 observations were found where the promoters’ holding is higher than or equal to 51 percent. In the table above in Panel A, various parameters of the firms whose promoters shareholding is less than 51 percent is shown. Panel B shows the parameters about the firms which has promoters holding is more than or equal to 51 percent. There are three kinds of performance parameters –
  a) Market related Such as Tobin’s Q, Mktbook, Mbvr, Mtbe, Metba, MVA
  b) Accounting ratio related such as ROA, ROE, EPS and
  c) Agency cost related like operating expenses, asset turnover
Tobin’s Q i.e. the ratio between market value of equity and debt to the book value of assets of the firm is higher for the firms in panel A than in Panel B. The mean for panel A is .96 as against .63 in Panel B. All other market related parameters shows similar results except Metba i.e. the ratio of market value of equity to book value of assets. This may lead to think that firms having promoters holding less than 51 percent are more comfortable with debt rather than equity. It shows the confidence of the promoters on their firm’s performance. ROA of the firms in panel A is quiet low compared to Panel B, but in contrast ROE is much higher for the firms in Panel A (5.90%).

Table 4.2 presents the descriptive statistics of the variables used in our empirical model. It gives the mean, median, coefficient of variation, 75th percentile and 25th percentile values of all variables. The shareholding of the insider in the sample has a mean and median both of
Table 2: Comparison of major variables used in valuation
Source: Prowess Data base

.53 a CV of .32 and 75th percentile and 25th percentile values are at 0.64 and 0.41. Size of the firm has been measured by natural logarithm of sales for which the mean is 6.13 and median is 6.16. The operating income (Y/S) median is .11 which shows that lot many firms are running business with profit.

Leverage is measures as the ratio of long term borrowings to total assets. The sample has a mean of leverage of .29 which suggests proportion of long term debt in total assets is quite good. The average R&D intensity is found to be .01, which means Indian firms spends only 1 percent of their capital as R&D expenses. The advertising expenses or promotional expenses have a mean of .03 and a median of .01. The expenditures on acquiring new fixed assets (I/K) is found to be negative that shows that in that time period the sample firms has sold their fixed assets rather than purchase. Capital intensity is measured as the ratio of gross fixed assets to sales. It has a mean 3.01 and a median of .63. The high difference in mean and median shows that few firms has very high capital turnover ratio whereas others are low in this. Liquidity is measured in terms of daily turnover ratio, for which the variable shows very small value with a mean of .0048 and a median of .0009. The age of the firms were taken as natural logarithm form to neutralize the effect of long existence and reputation.

ANALYSIS BASED ON USING THE RELEVANT TEST

PRIMARY HYPOTHESIS (H0): Firm performance is a non-monotonic function of share ownership by insider. In other words, firm value first increases, then decreases and thereafter increases with insider ownership.

In Table 3, the result of multiple regression has been shown which gives the value of coefficients for the result of insider ownership and firm performance. Here in this model only ownership variables i.e. insider ownership (INS), insider ownership squared (INSSQ) and insider ownership cubed (INSCU) has been used against firm performance or Tobin’s Q.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>1.485</td>
<td>.213</td>
<td>6.983</td>
</tr>
<tr>
<td></td>
<td>INS</td>
<td>3.554</td>
<td>1.369</td>
<td>-.473</td>
</tr>
<tr>
<td></td>
<td>INSSQ</td>
<td>-6.859</td>
<td>2.859</td>
<td>.974</td>
</tr>
<tr>
<td></td>
<td>INSCU</td>
<td>3.427</td>
<td>1.859</td>
<td>-.448</td>
</tr>
</tbody>
</table>

Table 3: Coefficient of multiple regression analysis for model 1

The result from the model confirms our hypothesis that the relationship between the performance of firms and insider ownership is cubic in form. The coefficient on the variables
INS and INS\(^3\) are positive while for the variable INS\(^2\) it is negative. These results provide support for the general functional form of relationship between firm value and insider ownership suggested by previous studies; that is the management move from alignment, to entrenchment, to alignment as their ownership stake in the firm increases.

From the above coefficients following polynomial equation on the relationship can be deduced:

\[
\text{Tobin’s Q} = 3.554 \times \text{INS} - 6.859 \times \text{INS}^2 + 3.427 \times \text{INS}^3 + 1.485
\]

Fig. 1: Relationship between Tobin’s Q and Insider Ownership

In the graph, the predicted value of Tobin’s Q and insider share has been plotted from the pooled data. It shows that corporate value increases with insider ownership but begins to decline at higher levels of insider ownership. Finally, firm value increases at very high level of insider ownership. This finding is consistent with convergence of interest and entrenchment effects of increasing effects on increase levels of insider ownership. Also,
higher promoter ownership induces them to monitor the activities with other constituents of the firm which results in higher market value.

In the second model several other variables were used. In this model too the sign and significance of insider ownership variables remain same.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>1.527</td>
<td>.260</td>
<td>.5870</td>
</tr>
<tr>
<td></td>
<td>INS</td>
<td>2.216</td>
<td>1.356</td>
<td>-2.95</td>
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<td></td>
<td>INSSQ</td>
<td>-4.056</td>
<td>2.834</td>
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<td></td>
<td>INSCU</td>
<td>1.856</td>
<td>1.845</td>
<td>-2.42</td>
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<td></td>
<td>LN S</td>
<td>-.065</td>
<td>.047</td>
<td>.094</td>
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<td></td>
<td>LN SSQ</td>
<td>.002</td>
<td>.004</td>
<td>.030</td>
</tr>
<tr>
<td></td>
<td>Y S</td>
<td>.000</td>
<td>.001</td>
<td>.011</td>
</tr>
<tr>
<td></td>
<td>LEV</td>
<td>2.929</td>
<td>.358</td>
<td>-.471</td>
</tr>
<tr>
<td></td>
<td>LEVSQ</td>
<td>3.289</td>
<td>.522</td>
<td>.359</td>
</tr>
<tr>
<td></td>
<td>R D K</td>
<td>2.511</td>
<td>1.093</td>
<td>.043</td>
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<td></td>
<td>ADV K</td>
<td>-.203</td>
<td>.337</td>
<td>-.011</td>
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<tr>
<td></td>
<td>I K</td>
<td>.720</td>
<td>.163</td>
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<tr>
<td></td>
<td>K S</td>
<td>.000</td>
<td>.001</td>
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<td>LN AGE</td>
<td>-.105</td>
<td>.036</td>
<td>-.056</td>
</tr>
<tr>
<td></td>
<td>Liquidity</td>
<td>-.517</td>
<td>.762</td>
<td>-.013</td>
</tr>
</tbody>
</table>

Table 4: Coefficients of multiple regression analysis for model 2

From the above table taking the coefficients we derive the following model for value of the firms:

\[
\text{Performance (Tobin's } Q) = \alpha + \beta_1 \cdot (INS) + \beta_2 \cdot (INS^2) + \beta_3 \cdot (LN(S)) + \gamma_1 \cdot LN(S) + \gamma_2 \cdot LN(S^2) + \gamma_3 \cdot (Y/S) + \gamma_4 \cdot (LEV) + \gamma_5 \cdot (LEV^2) + \gamma_6 \cdot (R&D/K) + \gamma_7 \cdot (ADV/K) + \gamma_8 \cdot (I/K) + \gamma_9 \cdot (K/S) + \gamma_{10} \cdot (LN(Age)) + \gamma_{11} \cdot (Liquidity)
\]

Where the value of the coefficients and constant are as follows:

\[
\alpha = 1.527, \quad \beta_1 = 2.216, \quad \beta_2 = -4.056, \quad \beta_3 = 1.856, \quad \gamma_1 = -.065, \quad \gamma_2 = .002, \quad \gamma_3 = .000, \quad \gamma_4 = 2.929, \quad \gamma_5 = 3.289, \quad \gamma_6 = 2.511, \quad \gamma_7 = -.203, \quad \gamma_8 = .720, \quad \gamma_9 = .000, \quad \gamma_{10} = -.105, \quad \gamma_{11} = -.517
\]

It indicates a convex non-linear relationship of firm size (sales) to firm value. Firm value first increases and then decreases with log of sales. Leverage or debt intensity is positive with a value 2.9 and with high statistical significance. A high commitment of fixed payments helps in alleviating cash flow issues and enhances firm value. The coefficient of R&D intensity is positive and statistically significant. It means higher R&D leads to higher Q ratio which suggests that high R&D firms are innovative and profitable. Advertising expenses coefficient is negative which shows that the impact of high advertising cost does not add firm value like R&D expenses. Current expenditures in fixed capital (I/K) is found to be positive and significant. Higher expenditure in fixed assets creation is perceived by market as a promise for future growth.
opportunities. Either such firms are willing to take long term investment or foresee strategic opportunities for which they are readjusting their capital assets.

For the variable age of the firm the coefficient is found to be negative. This shows that younger firms create better value than older firms. Older firms are subject to bureaucratic control and inertia. Though older firms in India are more productive but they are less profitable. This may be due to lack in initiative to diversify or failing to provide innovative products that satisfies changing customer needs.

SECONDARY HYPOTHESIS 1:

(H₀): Firms with foreign promoter perform similar to the firms with only domestic promoters or there is no difference in performance of the firms due to presence of foreign promoters.

<table>
<thead>
<tr>
<th>Tobin’s Q</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group 1</td>
<td>1827</td>
<td>1.070869</td>
<td>1.3071749</td>
</tr>
<tr>
<td>Group 2</td>
<td>730</td>
<td>1.350731</td>
<td>1.3677527</td>
</tr>
<tr>
<td>Total</td>
<td>2557</td>
<td>1.150767</td>
<td>1.3305025</td>
</tr>
</tbody>
</table>

Table 5: Comparison of means for the presence of foreign promoters

<table>
<thead>
<tr>
<th>ANOVA (Tobins Q)</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Groups</td>
<td>40.853</td>
<td>1</td>
<td>40.853</td>
<td>23.279</td>
<td>.000</td>
</tr>
<tr>
<td>Within Groups</td>
<td>4483.873</td>
<td>2555</td>
<td>1.755</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>4524.725</td>
<td>2556</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 6: ANOVA test for the presence of foreign promoters

From the above tables we can see the impact of foreign promoters on the performance of firms. Group one are the firms without any foreign promoters whereas group 2 is the firms having foreign promoters. Comparing the means of Tobin’s Q for both the category we find that there is difference in value. The mean of Tobin’s Q for domestic holding firms is 1.07 whereas for foreign promoters the value is 1.35. To check the significance of this difference we have done One–way ANOVA test and the F value for the test is 23.3 for degree of freedom 1. The table value is for the same degree of freedom at 90% significance level is 39.86. As the observed value is lower than the table value null hypothesis gets rejected. This shows that both group of firms performance is not similar, significant difference is present in the performance of both the groups. As the firms with foreign promoters holding has higher mean value it can be concluded that firms with foreign promoters perform better than firms with domestic promoters.

SECONDARY HYPOTHESIS 2:

(H₀): Firms with promoters holding higher than 51 percent performs similar to the firms having promoters holding less than 51 percent i.e. there is no significant difference in performance because of shareholding pattern at more than or equal to 51 percent and less than 51 percent.

To prove this hypothesis we have used T Test. The following are the findings from the test:
Group Statistics

<table>
<thead>
<tr>
<th>Group</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Std. Error Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin’s Q</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 (&gt;=51%)</td>
<td>1547</td>
<td>1.134940</td>
<td>1.3757991</td>
<td>.0349792</td>
</tr>
<tr>
<td>2 (&lt;51%)</td>
<td>1253</td>
<td>.958395</td>
<td>1.1467250</td>
<td>.0323954</td>
</tr>
</tbody>
</table>

Table 7: T Test for majority and non-majority holding-mean comparison

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>Sig.</th>
<th>t</th>
<th>df</th>
<th>Sig. (2-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin’s Q</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equal variances assumed</td>
<td>39.017</td>
<td>.000</td>
<td>3.634</td>
<td>2798</td>
<td>.000</td>
</tr>
<tr>
<td>Equal variances not assumed</td>
<td>3.703</td>
<td>2795.7</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 8: T Test for majority and non-majority holding

For the two groups defined as promoters holding more than or equal to 51 percent and less than 51 percent the means are 1.13 and .96 respectively. This means are different but to check the difference whether it is significant or not Independent two tail test has been done. The value of t-test for both the cases (assuming equal variances and not assuming equal variances) comes 3.6 and 3.7 respectively. The t-test value at 95 percent significance level for two tailed test from the t-table is 1.96 which is lower than the observed value. From this value comparison it can be said that as the table value for t-test is lower than the observed value the null hypothesis gets rejected i.e. there is significant difference in performances of firms between the two groups. As the mean value of the first group (more than or equal to 51%) is higher than the second group (less than 51%), we can conclude that firms with more than or equal to 51 percent of promoters holding performs better than the firms with promoters holding less than 51 percent.

SECONDARY HYPOTHESIS 3:

(H0): Higher Promoters holding and better promoter’s reputation leads to better valuation of the firm.

This hypothesis has been proved using chi-square test. To see the impact of each independent parameter on firm value chi-square test has been done for each parameter. Following table shows the parameters along with corresponding chi-square value.

<table>
<thead>
<tr>
<th>Parameters</th>
<th>Degree of freedom</th>
<th>Observed Chi-Square Value</th>
<th>Chi-Square value from table</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm_Value vs Reputation_promoter</td>
<td>2</td>
<td>14.295</td>
<td>5.9915</td>
</tr>
<tr>
<td>Firm_Value vs Holding_promoter</td>
<td>2</td>
<td>10.737</td>
<td>5.9915</td>
</tr>
<tr>
<td>Firm_Value vs R_D_Investment</td>
<td>4</td>
<td>0.94</td>
<td>9.4877</td>
</tr>
<tr>
<td>Firm_Value vs Capital_Expenditure</td>
<td>4</td>
<td>5.513</td>
<td>9.4877</td>
</tr>
<tr>
<td>Firm_Value vs Firm_Age</td>
<td>4</td>
<td>9.203</td>
<td>9.4877</td>
</tr>
<tr>
<td>Firm_Value vs Leverage</td>
<td>4</td>
<td>5.18</td>
<td>9.4877</td>
</tr>
<tr>
<td>Firm_Value vs Liquidity</td>
<td>4</td>
<td>1.481</td>
<td>9.4877</td>
</tr>
<tr>
<td>Firm_Value vs Adv_expenses</td>
<td>4</td>
<td>4.424</td>
<td>9.4877</td>
</tr>
<tr>
<td>Firm_Value vs BSE_TOP</td>
<td>4</td>
<td>3.626</td>
<td>9.4877</td>
</tr>
</tbody>
</table>

Table 9: Results of Chi-square Test

From the above table we can see the chi-square value both observed value and table value for respective degree of freedom. The chi-square value for reputation of promoters and
promoters holding is higher than the table value which means null hypothesis is failed to reject. It shows that the reputation of promoters and promoters holding has significant impact on enhancement of firm value. For other factors/parameters the chi-square value is lower than table value which means they those factors does not have significant impact on firm valuation and firm performances.

**MAJOR FINDINGS**

The major findings from the research work are as follows:

- The relationship between the insider ownership and firm value is not found to be linear but it is non-monotonic function in nature as expected. The firm value initially increases with the increase in promoters holding till certain point at around 35-40%, in the next phase from 40% to 65%, the firm value declines and in the last phase i.e. above 60% till 100%, the firm value increases again.
- In India the FDI investment plays a crucial role in performance of firms. The same belief has been proved through hypothesis development and using statistical tools. It has been found that the presence of foreign promoters leads a firm to perform significantly better than the firm having only domestic promoters holding. Tobin’s Q ratio has been used as a proxy to performance of the firms and we find significant difference in mean of Tobin’s Q in between the two categories of firms.
- The firms having more than or equal to 51 percent holding performs better than the rest of the firms. It may be due the power of decision making by the promoters to grab the opportunities without much hurdle and accountability.
- The promoter’s reputation and promoters holding in the firm plays a crucial role in decision of investment in the potential investors mind. Along with other factors such as revenue, R&D expenses, advertising, age of the firm et al. promoters holding helps the investors to choose investment horizon. The primary research also reveals that majority of investors (57 percent) prefers to invest in the firms where promoters have 40 to 60 percent holding. 64 percent of the investors said that they will invest in the firms where the promoters have good reputation. A substantial no of respondents (60 percent) believes that promoters reputation and holding has impact on share prices of the firm, so it becomes essential to check the background of the promoters along with financial analysis on the while considering the investment decision.

**SUGGESTIONS AND RECOMMENDATION**

From the research work done the following suggestions and recommendations can be made:

- As the firms with promoters holding more than or equal to 51 percent have better performance than the rest, the investors should invest in those firms to get better return.
- The firms having foreign promoters have significantly better performance in the study period and believe to continue to perform better. This fact should be kept in mind while making investment decisions.
- Promoter’s reputation also came out to be one of the major factor for investment decisions for the potential investors. The promoters should not take any measure which may spoil their reputation and will hurt investor sentiment.

**CONCLUSION**

From the research work done on the relationship between promoters holding and firm valuation the existing thought on the relationship of non-monotonic function found to be prevailing. The results from the co-efficient of independent variables, it supports the general
functional form of relationship between firm value and insider ownership as suggested by MSV (1988), Short and Keansey (1999), Mudambi and Nicosia (1998), Faccio and Lasfer (2000); that is management move from alignment, to entrenchment, to alignment as their ownership stake in the firm increases. When the shareholding is very low, the entrenchment effect is non-operational due to lower control over the decision making process of the firm. In low level of promoters holding it can be seen as promise of insiders to perform with the increase in their share ownership. Thus, it reflects their incentive to maximize firm value when their stake rises in the firm. However, once they gain controlling authority in the firm, they can entrench themselves or pursue non-value maximising activities. At that level they don’t consider the other stakeholder interest. Being wealthy, the promoters no longer require maximizing profit rather they prefer to maximise on their wishes such as empire bidding, increase market share etc.

But with majority ownership (51 percent in case of India), their interest better aligned with maximising firm value. Because of higher stake as the firm value increases their wealth increase but at the same time if their performance becomes sub-standard they have to bear the loss due to fall in market prices. The insider ownership plays a crucial role in corporate governance in almost every country and its no exception for India. Firms having high promoters holding has experienced several fraud cases like accounting fraud, wrong information to the market etc. and that beats the firm value. In other case where the ownership is diversified having Board of Directors from different stakeholder their performance found to be better. In India a majority of large firms are Government controlled where Govt. of India has the power to appoint/remove its top management and directors the performance remains better.

Due to high commitment by the market regulator SEBI and Ministry of Corporate Affairs, the Indian corporate houses has to show a good proper accountability to the regulators and investors along with few unavoidable glitches. The research work result also shows that if the firms having low promoter’s holding does not perform on the basis of their promoters holding, they may be targeted by some other management groups for takeover.

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