

# PROMOTERS' OWNERSHIP AND PERFORMANCE OF COMPANIES IN INDIA

Anil Kumar<sup>1</sup>

*This paper examines the relationship between promoters' ownership and firm performance of Indian companies which are predominantly owned and controlled by the Indian business houses. The paper extends the primarily US based managerial ownership and firm performance based literature to India. The corporate governance system in India, different from the Anglo-Saxon system is promoter oriented who over the years have consolidated their shareholding. A series of reforms in corporate governance being undertaken in the past two decades has improved the corporate governance practices in the country.*

*Employing panel data regression models, results of the study show that after controlling for shareholding by the institutional investors (including foreign institutional investors) and firm specific factors, promoters' higher ownership stakes leads to higher accounting profits and enhanced firm value. It supports the conventional thinking that concentrated ownership is an incentive alignment tool and that it enhances firm performance.*

**Key words:** Corporate Governance, Promoters' Ownership, Firm Performance.

## 1. INTRODUCTION

Impact of promoters' ownership on firm performance is a relatively unexplored area in the corporate governance literature. The research on the issue has been primarily based on the developed countries which focus on managerial ownership as a mechanism to mitigate the conflict of interest between owners and managers on the presumption that managerial ownership promotes the incentive alignment (Jensen and Meckling, 1976; Shleifer and Vishny, 1986; Rajagopalan, 1997; Thomsen and Pedersen, 2000). Emerging economies marked by control of companies by a dominant group of shareholders who are usually promoters also, countenance a conflict known as principal-principal conflict arising due to exploitation of the interest of minority (non-controlling) shareholders by the controlling shareholders (La Porta, Lopez-de-Silanes, and Shleifer, 1999; Claessens, Djankov, and Lang, 2000; Dharwadkar, George, and Brandes, 2000). What needs empirical investigation in the context of these economies is the performance

<sup>1</sup> Associate Professor, Shri Ram College of Commerce, Delhi

effect of the ownership rights held by the promoters who are managers also, different from manager-owner system of the Anglo-Saxon countries where managers are offered shares as a post facto incentive to align with the interest of the owners.

India presents a unique setting of exploring the link between promoters' ownership and firm performance. The promoters of the companies in India who predominantly belong to the established 'business-houses' enjoy control rights independent of their holding of equity capital in the firm which at times is very low. This is accentuated by the pyramidal ownership structures formed through cross-holding of shares, passivity of financial institutions (mostly government owned) which hold a large block of shares, lack of activism of minority shareholders which are dispersed and unorganized, and lack of an active takeover market. Domination of the promoters is further reinforced in India by the historical factors and social ethos which accepts and associates companies belonging to the 'founding families' irrespective of their holding of ownership shares (RBI, 2001). Gradual increase in the stake of the promoters in the companies in India from merely 13 percent in 1965 to around 47 percent in 2007 raises important empirical question as to the impact of increasing shareholding of the promoters on firm performance and on firm value.

The purpose of this study is to examine the promoters' ownership- corporate performance linkage in the context of India. The earlier studies are on the impact of managerial ownership on firm performance and are primarily US based. Research of Morck et al. (1988) and McConnel and Servaes (1990) found non-linear relationship between managerial ownership and firm value- the value of firm first increases with increased managerial shareholding and then decreases as ownership gets concentrated in the hands of managers. Short and Keasey (1999) extended the US based analysis to the UK. A few Indian studies have also conducted investigation into the relationship between insider ownership and financial performance. Noteworthy among these are the studies of Khanna and Palepu (1999), and Sarkar and Sarkar (2000). Khanna and Palepu (1999) established that there is a positive linear relationship between insider ownership and performance of firms. The study based on a single year data of 1993, used both accounting (ROA) and market (Tobin's Q) performance measures to examine the relationship. Sarkar and Sarkar (2000) questioned the linear relationship assumption and show that the relationship between managerial ownership and performance is piecewise linear. These studies have used insider ownership as a control variable assuming that the relationship is similar to earlier studies in other countries, and secondly, the time frame of these studies is confined to a one year period which limits the scope of these studies.

This study examines longitudinal aspects of promoters' ownership-performance relationship to determine whether such relationship persists over time. The corporate governance framework in emerging economies is evolving over time. The transition in the Indian model of corporate governance is also taking place gradually with marginal adjustments on yearly basis. This study is based on a period of 7 years data which is long enough to track the dynamics of ownership and performance.

The paper is structured as follows. Section 2 outlines the promoters' ownership and corporate governance in India as evolved since the mid-nineteenth century when the corporate form of business was introduced in India. This provides a theoretical background for the development of hypotheses placed in Section 3 of the paper which also contains the data, variables of the model, and empirical methods for the empirical investigation. Section 4 presents empirical findings. Finally, Section 5 entails concluding remarks.

## **2. PROMOTERS OWNERSHIP AND CORPORATE GOVERNANCE IN INDIA**

The model of corporate governance in India in earlier years (when the first Indian Companies Act was enacted in 1850) was the 'managing agency' model. Managing agents promoted most of the companies, supplied the initial risk capital, provided managerial talent (which was scarce at that time), and since money and capital markets were in their rudimentary stage of evolution they also financed these companies. Managing agents served as the nucleus of corporate control in the companies promoted by them, many of which did not have the board of directors. Later when the Companies Act of 1913 provided for the constitution of board of directors in companies, most of the directors on the boards were appointed by the managing agents from amongst its own personnel and the boards tended to be more of a fiction than reality as they were composed of friends or business associates of managing agents. In the initial years, the managing agency system was evolved and dominated by the British merchants. After the year 1920, quite a few Indian business houses established their own managing agencies<sup>2</sup>. The managing agency contracts, deferred shares with disproportionate voting rights, inter-corporate investments and interlocking (multiple) directorships were the instruments through which the promoters gained unlimited power over the companies and ample scope for misgovernance.

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<sup>2</sup> Some of the leading Indian managing agencies in the early 1930s were: Tata Sons & Co. Ltd., Cowasji Jehangir & Co. Ltd., Birla Bros. & Co., Morarji Gokuldas & Co., Nourajee Wadia & Sons.

After independence, a new Companies Act, 1956 was enacted with the object of achieving a minimum standard of good behaviour and conduct by the company managements. A substantive law for corporate business in India, the Act provides a legal framework for regulating the corporate activities including governance and administration of companies, rights of shareholders and creditors, disclosures etc. The Act contains provisions with regard to the issues such as right of shareholders to make decisions on number of policies of the company, to appoint and remove the directors, to appoint and remove the auditors, to take recourse against corporate abuses including mismanagement of the company. The Act lays down certain disclosure norms and makes it mandatory for a company to maintain books and records. These in principle serve to protect the interest of the shareholders and creditors.

The dominance of the promoters over the companies continued even with the abolition of the 'managing agency' system after the independence. The leading managing agents who had established themselves as large industrial houses<sup>3</sup> by amassing wealth dominated the Indian corporate sector. Mannerism of functioning of industrial houses was the same as prevailed during the managing agency era. Corporate control continued to remain with the controlling families who appointed themselves as managing directors or whole-time directors and the board of directors of the companies comprised of their family members or relatives or associates.

In the wake of liberalisation and globalisation process as part of the structural adjustment programme unleashed in India in 1991, the key tenets of the Anglo-American model of corporate governance were adopted. The Indian Companies Act, 1956 which was already in line largely with the basic Anglo-American model was revamped (by making amendments) to reduce its complexity and bureaucratic interferences. The Capital Issues Control Act, 1947 was scrapped removing the control of the government over the issue of securities. The Securities and Exchange Board of India (SEBI) was set up in 1992 as an independent market regulator to bring in a new regime of greater disclosure and transparency. The gradual empowerment of the SEBI since then has played a crucial role in establishing the basic rules of corporate governance in the country. The regulations and guidelines issued by the SEBI from time to time are aimed at achieving better governance of companies and in developing an efficient capital market.

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<sup>3</sup> The prominent business houses being Tata, Birla, Kirloskar, Godrej, Shriram, Mafatlal, Bajaj, Thapar, Singhania Goenka, Dalmia, Mahindra.

India has adopted the key tenets of the Anglo-American model of corporate governance. This was facilitated also on account of historical ties with the United Kingdom and the Indian corporate laws being based on the British company law. Most of the recommendations of the three committees on corporate governance - the Kumar Mangalam Birla Committee (1999), Narayan Murthy Committee (2003) both set up by SEBI, and Govt. of India's Naresh Chandra Committee (2002) are remarkably similar to and have drawn inspiration from Cadbury Committee of the U.K. (1992) and Sarbanes-Oxley Act (2002) of the U.S.A.. The reforms suggested by these committees and the subsequent legislative actions taken (amendment to the Companies Act, Clause 49, revised Clause 49) have driven the Indian corporate system towards the Anglo-American model. For strengthening the board of directors (already a single tiered body), the reforms are centered on Anglo-American practice of a greater role of non-executive directors and the curtailment of inter-locking directorates<sup>4</sup> (reduced from 20 to 15 by the Companies Amendment Act, 2000).

In actual practice, however governance of Indian companies varies from the rules on books. The separation of ownership and control is observed in large number of companies on paper only. In reality, it seems, the control lies with the promoter owners/controlling group. The corporate vision is that of the promoter-owner and the professional managers have to follow the 'diktats' of the family members. The family dominance, in fact, has negated the separation of ownership and control in India. Nearly one third of the publicly listed companies in India are promoted, controlled and managed by the 'Industrial families' even at present. The Indian Household Investors survey (2005) conducted by the Society for Capital Market Research and Development also opine that the typical Indian listed company is family controlled.

The structure of ownership pattern in the corporate sector is strikingly different from the Anglo-American model. Over the years a changing pattern of shareholding of business houses is discernible. In the intervening period (1956-1991), many large private sector companies were being controlled by the business houses in spite of having small shareholdings due to the support extended by public financial institutions (Gupta, 1989; Rao and Guha, 2006). The average promoters' shareholding (including directors) in those companies was merely 13 percent in 1965 which rose to 21 percent in 1989 and the shareholding of financial institutions was substantially high at 28 percent in 1978 which decreased to the level of 23 percent in 1989 (Panchali, 1999).

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<sup>4</sup> For details refer to Machold, S and A.K. Vasudevan (2004). 'Corporate Governance Models in Emerging Markets: The case of India', *International Journal of Business Governance and Ethics*, Vol. 1 No. 1

After liberalisation of the economy since 1991, the Indian promoters faced with a severe threat of losing control, especially to foreign companies, started increasing their stakes. This was facilitated by the relaxation of limits on inter-corporate investments, permitting companies to buy-back shares after 1999, allowing promoters creeping acquisition of shares, and withdrawing option to the financial institutions to convert a portion of their loans into equity. Table 1 depicts the changes in the shareholding pattern of 4812 Bombay Stock Exchange listed companies from 2001-2007. The table shows that the ownership by promoters has risen to 47.65 percent in 2007 from 21 percent in 1989. Shareholding of top 50 business houses (Panel A, Table 1) was above 50 percent in 2007. The other noticeable trend is a decline in the proportion of shareholding by financial institutions which came down to 13.22 percent in 2007 in the companies of top 50 business houses (Panel A), and merely 6.26 percent for the Indian private sector companies as a whole (Panel D, Table 1) from as high as 28 percent in 1978.

In conclusion, the present Indian model of corporate governance is predominantly family based corporate system which has undergone a series of reforms on the lines of the Anglo-American model. The concentrated ownership by the promoters-managers presents the governance issues strikingly different from manager-owner orientation of the US and UK.

### 3. HYPOTHESES DEVELOPMENT, DATA, VARIABLES AND MODEL

#### *Hypotheses*

Various studies have examined the impact of ownership structure on corporate performance. While the early analysis considered linear relationship between ownership and performance (Demsetz and Lehn, 1985), the studies of Morck et al. (1988), McConnell and Servaes (1990), Short and Keasey (1999), and Sarkar and Sarkar, (2000) followed non-linear approach to the performance effect on the notion of alignment of interest up to a certain level of ownership and 'expropriation' effect at high concentration of ownership. However, an Indian study for examining the impact of promoters' holding may not be in consonance with these studies. Of late, the promoters in India hold a substantial proportion of equity in the companies (evident from Table 1) and control the boards of directors. Intuitively, behavior of the promoters-owners-managers would be driven by the considerations of amassing the wealth and transfer it to the next generation (at least in case of family owned companies). The net worth of nearly 2500 companies belonging to 90 business houses of India was ₹ 15268 billion on 31.12.2001 which

increased by 265 percent on 31.12.2007 ( ₹ 40492 billion) and 460 percent on 31.12.2009<sup>5</sup>. It is, thus conceived that promoters' ownership has a linear positive effect on the performance of companies. Several studies (Kang and Shivadasani, 1995; Thomsen and Pedersen, 2000) also reported a positive linear linkage of concentrated ownership on firm performance.

Although 'tunneling' which is transferring resources from firms in which a controlling family has less cash flow rights to ones in which it has substantial cash flow rights (Bertrand, Mehta and Mullainathan, 2002) cannot be ruled out while exploring the relationship between ownership and performance. Study of Bertrand et al. (2002) also showed evidence of tunneling in India. However, 'tunneling' effect may take place in case of small holding by the promoters. In India the promoters have consolidated their holding over the years as shown in the earlier section. Further, expropriation of value from the minority shareholders may be easier in countries where there are weak minority laws (La Porta et al., 2000). With the advent of the SEBI in 1992 as an independent market regulator and regulatory measures undertaken in India after 1992, there is a marked improvement in corporate governance practices of the Indian companies. This is exemplified by the L.C.Gupta Survey (2005) and Moody's Investor Services & ICRA Survey (2007).

Consistent with these, Hypothesis 1 of the study is formulated:

*Hypothesis 1: Higher promoters' ownership leads to higher firm performance in terms of the accounting profits.*

An increase in promoters' shareholding may have a favourable impact on firm value due to the positive signal to the market about the future profitability. The study of Shleifer and Vishny (1986) also showed an increase in price of the shares consequent to rise in proportion of shares held by the large shareholder. Promoters may communicate their optimism to the shareholders by a signal that glues promoters' wealth to the shareholders' value and reduce information asymmetry (Sanders and Carpenter, 2003). Hypothesis 2 of this study focuses on the effect of promoters' shareholding on the market value of the equity.

*Hypothesis 2: Higher promoters' ownership leads to higher firm value.*

Reverse causality in the analysis of ownership and performance is an issue which has received attention in the empirical work. Chang (2003) suggests that ownership

<sup>5</sup> Author's calculation based on Prowess Database of the CMIE

variables not only influence firm-level factors but the firm-level factors influence aspects of organizational ownership. Demsetz (1983) also argued that the ownership structure of a corporation should be thought of 'endogenous'. But in the Indian context there has been a tradition of equity ownership by promoters and change in the proportionate shareholding by the promoters have come albeit slowly over the years (as shown in Table 1) This has come in response to threat of losing control with the introduction of the SEBI's revised take-over code and free transferability of securities in 1997 which dismantled the legal hurdles to the mergers and acquisitions. Promoters' ownership in India may, thus be taken as an exogenous variable in firm performance exposition.

### ***Data and Sample***

The data used in this study pertains to the listed companies included in 'Group A' of the Bombay Stock Exchange as on January 1, 2000. On that date 139 companies were included in the Group A. Companies in the public sector and banking companies are excluded from the study on account of different control structure and capital structure in these companies. On account of non-availability of data for a few companies for all the years of the study, the sample size of the companies is reduced to 85. These companies belong to various sectors of the economy and represent about 45 percent of the market capitalization as of March 31, 2001. The final sample yielded a balanced panel data set consisting of 595 firm-year observations.

The period selected for the study is 1999-2005 i.e. 7 years. Panel data for 7 years from 1999 through 2005 is constructed for each of the companies included in the sample. Researches in management study frequently rely on panel data sets from 5 to 7 years. The data for the study is retrieved from the Prowess database of the Centre for Monitoring Indian Economy (CMIE) and annual reports of sample companies.

### ***Model***

Panel data is used in this study to investigate the impact of promoters' ownership on firm performance. Most prior corporate governance studies have used the cross-sectional analysis implicitly assuming that all firms in the sample are equal. Probably the most important advantage of the panel data concerns the control of firm heterogeneity (Baltagi, 2005), thus rendering the test of hypothesis more robust. Panel data sets are increasingly used in applied work, especially for policy analysis (Wooldridge, 2003). The previous research adopted a static approach being based on the cross-sectional data.



The corporate governance framework in the emerging economies is evolving over time. The increase in promoters' shareholding in India is gradual over a period of time, hence panel data regression models have been relied upon in this study. Khanna and Palepu (2000), Chang (2003), and Kedia et al. (2006) have also examined the performance effect of ownership over a longitudinal time period.

The following base model is developed to test the hypothesis 1 and 2 of the study:

$$\text{Performance}_{it} = \alpha + \beta_1 X_{it1} + \dots + \beta_k X_{itk} + \delta_1 \partial_1 + \dots + \delta_{t-1} \partial_{t-1} + \epsilon_{it}$$

$X_{itk}$	-	Explanatory and control variables
$\partial$	-	Year dummies
$t$	-	1,2 ---- T
$i$	-	1,2 ---- n
$\epsilon$	-	Error term

The variables of the model are identified on the basis of the prior empirical studies in corporate governance and firm performance. The identified variables are subjected to the Principal Component Analysis. The model with accounting and market based measures of performance (ROA and P-TQ) as dependent variables employs fixed effects estimators and random effects estimators. The validity of the estimators is then determined by applying F- test, Wald test, Breuch – Pagan Lagrange Multiplier (LM) test and the Hausman (1978) test.

### Variables

The key variables of the study are measures of performance of firms, promoters' ownership (i.e. shareholding) and other ownerships by the financial institutions and foreign entities. Further, corporate governance related and other firm specific control variables are used to avoid any spurious relation between performance and promoters' ownership. A summary of the variables of the study is presented in Table 2.

The dependent variable of the study is corporate performance. Researches on corporate governance and performance have used both accounting and market valuations to measure corporate performance. The current study employs both accounting and market based measures of performance of companies. In line with prior researches (for example, Dahya and McConnel, 2003; Bhagat and Black, 2001; Klein, 1998; Khanna and Palepu, 1999), *Return on Assets* (ROA) as the accounting measure of performance is used in this study which is earnings before depreciation, interest and taxes divided by the

beginning-of-the-year total assets. ROA is most widely used and is considered to be the most appropriate measure (out of the other two accounting measures viz. Return on Equity (ROE) and Return on Capital Employed) to quantify the overall operating performance of the firm.

In most US based corporate governance studies, Tobin's Q is used to measure the market performance and firm value. In the Indian context, calculation of Tobin's Q is difficult as a large chunk of debt is institutional debt, not being actively traded (Sarkar and Sarkar, 2000). Further, most companies report asset values at historical values not at the replacement costs. Thus, Tobin's Q is replaced by 'Proxy to Tobin's Q (P-TQ)' for the study which is obtained by dividing total of market value of equity and book value of debt to the book value of assets. P-TQ is used for developing country's study, for example, by Khanna and Palepu (1999), and Sarkar and Sarkar (2000) as an alternative to Tobin's Q. P-TQ is directly observable and is more aligned to the objective of the shareholders.

The main explanatory variable of the study is promoters' ownership which is the fraction of equity shares held by the promoters including persons acting in concert with the promoters. It is captured by a variable denoted by PS which is measured on a 0.0-1.0 continuous scale. Literature suggests that institutional investors improve managerial efficiency of a company by investing in information, monitoring managers and reducing the conflict of interest between owners and managers (Shliefer and Vishny, 1997). To neutralize the possible impact of domestic financial institutions shareholding, variable IIS for the fraction of shares held by the domestic institutional investors including banks is taken in the empirical models. A foreign owned company has the advantage of access to advanced technology and brings in professionalism in the management. The entry of foreign financial institutions (FIIs) in India after 1991 in the equity market has two implications: FIIs have higher incentive to monitor corporate managers to ensure returns on their investment, and secondly, these institutions possess more efficient tools for monitoring managers (Khanna and Palepu, 1999). The studies of Chhibber and Majumdar (1999), and Sarkar and Sarkar (2000) showed a non-linear relationship between foreign ownership and performance of Indian companies. Consistent with prior studies, shareholding by foreign entities (i.e. by foreign corporations as well as by foreign institutional investors) is included as ownership related control variable which is denoted by FES.

Board of directors is viewed as the primary mechanism to monitor the opportunism of

the management and ensure corporate decisions in the best interest of the shareholders (Fama and Jensen, 1983; Waldo, 1985; Fleischer, Hazard and Klipper, 1988). Empirical studies linking board of directors with performance focus on three main aspects: the composition of board of directors (proportion of independent directors), board leadership structure (separation or combining of the positions of the chairman of the board and CEO of the company i.e. duality), and size of the board. Although the results of the studies on these aspects are not conclusive, this study incorporates the three variables in the models to ferret out its possible impact on firm performance. These are: a continuous variable FID which is fraction of independent directors on the board of each company; binary variable 'Duality' as a proxy for CEO duality which takes the value of one in case of the duality and zero otherwise; and count variable BS which equals the total number of directors.

Consistent with the corporate governance literature, additional variables are included in the performance regression models to account for other potential influences on the performance of firms. These are: firm size (Sz) which is natural logarithm of book value of assets of firms; growth (Gw) obtained by current year's sales divided by previous year's sales; debt (Db) defined as book value of total debts divided by book value of assets; and advertisement (adv) obtained by advertisement expenses divided by total assets.

#### 4. EMPIRICAL RESULTS AND ANALYSIS

Table 3 presents descriptive statistics (mean and standard deviation) of the variables. The average promoter's shareholding in the sample companies is above 40 percent. The striking feature is the maximum shareholding of the promoters which is as high as 89 percent. The promoters of these companies will have to off-load their shareholding to keep a minimum public float of 25 percent as per the latest SEBI guidelines. Domestic institutional investors' presence is quite significant in the Indian corporate sector evident from the average ownership of around 15 percent over the period 1999-2005 in the companies under study. Statistics of foreign entities' ownership is not surprising since it includes shareholding by the foreign entity as collaborator also.

The descriptive statistics indicate that the proportion of independent directors in the boards of the companies in the sample is more than 50 percent which suggests that these companies have adopted the SEBI Code as far board composition is concerned. The CEOs of nearly 42 percent of the sample companies simultaneously act as chairpersons of the boards. In fact, the CEO duality has been around this figure over the period 1999-

2005. This indicates that generally the CEO duality status remained unchanged over the period in spite of the requirement of a higher proportion of independent directors on the boards of companies with duality by the SEBI code of corporate governance applicable to these companies with effect from 30-03-2001. The world trend, on the contrary tends to decouple the two roles. The average board size of companies in the sample is 10 directors. This is close to the average board size of 12 in the U.S.A. and UK for the large non-financial firms (Andres et. al., 2005). The descriptive statistics of other variables is self explanatory.

To test the main hypotheses of the study, the performance model with Return on Assets and Proxy to Tobin's Q is estimated by the Ordinary Least Squares (OLS), Within Groups (Fixed Effects), and Between Groups (Random Effects) estimators with full set of year dummies.

Table 4 contains the results of the OLS, Fixed Effects, and Random Effects estimators for the return on assets as the dependent variable.

The F-test for the ROA model (9.33, Prob.>F=0.00) rejects the null hypothesis of no fixed effects, indicating the superiority of fixed effects estimators over the pooled regression. The Breuch-Pagan Lagrange Multiplier (LM) test establishes the appropriateness of the random effects model as against the OLS (Prob.>ch2=0.00). Additionally, the Wald test of joint significance of the independent variables (121.33, Prob.>chi2=0.00) provides evidence of the correctness of the model. The Hausman Specification test is then applied under the null hypothesis of which both random effects and fixed effects estimators are consistent. The result of the test (Prob.>chi2=0.00) rejects the null hypothesis indicating thus that preferred model is fixed effects (Greene, 2003).

The results of the estimators on the model of the study taking market measure of performance (i.e. Proxy to Tobin's Q) as the regressand are given in Table 5.

The required econometric tests are conducted to establish the appropriateness of the estimators with P- TQ as the dependent variable. The F-test (3.19, prob.>F=0.00); the L-M test (Prob.ch2=0.00); and the Hausman test (Prob.>chi2=0.00) supports the fixed effects model.

Having established validity of the models, the attention is now focused on the main hypotheses of the study and also a brief analyses of the other variables used in the models of the study.

The Fixed effects model with the accounting measure of performance (ROA) as the dependent variable supports the Hypothesis 1 of the study that promoters' ownership leads higher firm performance in terms of the accounting profits. The coefficient of promoters' shareholding is positive and significant (Table 4, Fixed Effects Model:  $\beta = 0.172$ ,  $p < .01$ ). The ownership by the promoters, evidently is sustaining superior performance in India relegating the accusation of corporate mis-governance leading to the industrial sickness to the background. It also refutes the 'tunneling' of resources by the promoters in India established in the study of Bertrand et al. (2002). The results confirm the conventional belief that ownership concentration mitigates the agency problems and improves firm performance (La Porta et al., 1999).

Further, the analysis shows that promoters' shareholding has a positive impact on firm value (Table 5, column 3) which upholds Hypothesis 2 of the study. The beta coefficient value of 8.007 at more than 95 percent confidence level indicates shareholders' wealth creation by the promoters. This gives support to the conventional wisdom that the promoters (who are in the commanding position in India) would not like to destroy the value of companies in which they have invested substantial money by way of equity capital. The listed companies in India are required to disclose the changes in the promoters' holding to the stock exchanges by way of corporate filings. An increase in promoters' shareholding emanates signal to the market of insiders' optimism about the company resulting in positive impact on share prices. The quantifiable and observable signals have a strong influence on the Indian markets (Gupta, Jain and Kumar, 2006). The finding of the study is also consistent with Sarkar and Sarkar (2000) who provided empirical evidence of statistically significant positive relationship between shareholding and company value beyond the threshold of 25 percent shareholding, although the study of Sarkar and Sarkar (2000) is based on cross-sectional data of the year 1995-96.

Of the other ownership variables, Fixed-Effects estimators for ROA and P-TQ as dependent variables do not reveal a significant relationship between shareholding by institutional investors including by foreign entities, and firm performance. This indicates the 'apathetic' attitude of institutional investors (including foreign institutional investors) even with an average shareholding of more than 15 percent and maximum shareholding going up to 40 percent (for the sample companies). This finds support with the conclusion of the study of Sarkar and Sarkar (2000), and Khanna and Palepu (1999). However, it contradicts the finding of Patibandla (2006) whose empirical analysis based on firm level panel data for 12 Indian industries covering the period from 1989 to 2000

reported a significant positive relationship of foreign equity ownership with the profits. However, the estimator used and the time-frame in Patibandla's study were different from the present study.

The Fixed effects model with the market based measure of performance (P-TQ) as dependent variable reveals that the proportion of independent directors to the total directors is significantly related with the P-TQ, coefficient estimate of 1.521 at  $p < .05$  being quite significant (Table 5, column 3). This indicates positive performance effects of composition of boards in terms of percentage of independent directors on the market based performance measure. It can, thus be inferred that the market gives premium to good corporate governance practices. Component of independent directors being a well accepted and proclaimed good corporate governance practice. This also tends empirical support to the McKinsey Survey (2002) which link good corporate governance practices with high price to book values.

In contrast are the results when market measure of performance is replaced by the ROA as dependent variable. The absence of effect of the board composition on the accounting profits is intriguing (Table 4, column 3). Notwithstanding that this is consistent with the result of several studies (Baysinger and Hoskisson, 1990; Andres, Azofra and Lopez, 2005) including a meta analysis study conducted by Dalton et. al. in 1998, it needs to be analysed in the context of 'independent directors' and the board practices in India. The board composition and practices are regulated in India by the SEBI code. The structure and rules alone cannot raise the standards of corporate governance as corporate governance extends beyond regulations. 'Sadly (in India), there is a wide gap between prescription and practice' (Naresh Chandra Committee Report, 2002). The former employees of the companies, long time friends, associates, partners of consulting firms to the companies are inducted as independent directors on the boards of many companies to meet the code requirement. Naresh Chandra Committee (2002) also admitted that the promoters usually pack the board of directors with their cronies. The 'nomination committee' for making recommendation regarding appointment of independent directors, the best of international practices, is missing in Indian companies barring a few exceptions (some of the Indian companies having nomination committee are Infosys, Wipro, Dr Reddy, Dabur, L&T). 'The independent directors are nominated by the controlling group' (Gupta, 2007) and are dependent on the management for their continuation. How can they be termed as independent directors? Survey conducted by Moody's Investor Service and ICRA (2007) also noted that despite regulations regarding independent directors, the Indian business houses retain significant control over listed companies.

It seems that the independent directors have been adopted by many Indian companies for the sake of compliance with the code and in many cases to lend an ornamental value to the boards. This may have a positive reflection on the market prices of the shares but certainly has not improved the board processes. The Satyam scandal clearly demonstrated the passive role of highly acclaimed independent directors even when the promoters were diverting the funds of the company for their family concern. In such a scenario, it should not be expected that 'independent directors' on the boards of the companies in India would have positive impact on the financial performance of firms.

Separation or duality of the CEO has not yet established as a preferred corporate governance practice in India. The SEBI code on corporate governance is also ambivalent. Not surprising, it has no impact on firm performance which is clear from the results of the models of the study. The empirical analysis does not support the link of the board size with the performance. The coefficient estimate is close to zero with ROA as the dependent variable, and insignificant statistically when P-TQ is employed as the dependent variable in the model. The prior Indian studies on the issue provide contrary results (Kathuria and Dash, 1999; Ghosh, 2006). Among the other controlling variables, results on expected lines, suggest that advertisement is highly associated with the accounting performance of companies. An interesting result of the analysis is the significant negative relation of size of the firm in terms of assets with the P-TQ suggesting that small sized firms are performing better in terms of return to the market.

## 5. CONCLUDING REMARKS

This paper investigated the relationship between promoters' ownership and firm performance for Indian companies which are predominantly owned and controlled by the Indian business houses. The results of the study, based on panel data analysis, show that after controlling for shareholding by the institutional investors (including foreign institutional investors) and firm specific factors, promoters' higher ownership stakes leads to higher accounting profits and enhanced firm value. It supports the conventional thinking that concentrated ownership is an incentive alignment tool and that it enhances firm performance.

The corporate governance in India is in transition with a series of reforms being undertaken in the past two decades. The scams and frauds of 1990s perpetrated by the promoters in India through preferential issues, price rigging, exorbitant pricing of the new issues, mis-utilisation of funds, accounting manipulations etc. have been pushed to

the background by the regulatory measures of the SEBI which have improved the regulatory framework and efficiency of the stock markets compared to the 1990s.

The results of the study should be of interest to the investors and policy-makers. The investors may benefit from knowing that increasing promoters' holding is a good signal for the market and it should have positive impact on share value. The policy-makers and regulators should find solace in the improvement in the corporate governance practices, although limited, brought in by the regulatory measures undertaken in the past two decades. However, there is no room for complacency. Issues like nomination committee for appointment of independent directors on the boards, professionalism of the directors require attention of the policy-makers to strengthen the board processes.

This paper has extended the primarily US based managerial ownership and firm performance based literature to India where there are important differences in corporate governance system. The Indian system is promoter oriented with dominance of 'business-groups' in the corporate sector. This study has examined the performance linkage of promoter-owner-manager different from manager-owner orientation of the US and UK. It is an effort to augment understanding of the Indian perspective. However, the findings of this research should be considered in the light of its limitations. While the sample for the study is composed of a cross-section of firms of different sizes operating in different industries, it is biased in favour of large capitalised companies. The low capitalised companies (with market capitalisation of less than ₹ 1.5 billion) are estimated to be in the range of 85-90 percent of the total number of listed companies in India. Since shares of large number of these companies are infrequently traded at the stock exchange, it becomes difficult to find out value of these firms based on market prices of the shares. These companies also pose a serious challenge to the governance of companies in India and have jeopardized the regulatory system by overburdening, thus encouraging stock market manipulations and insider trading. Further studies may investigate the performance effects of promoters' holding in these companies particularly differences in the performance effects of low capitalised companies and large capitalised companies.

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**Table 1**  
**Changing Pattern of Shareholding in Indian Corporate 2001-2007**

**Panel A: Top 50 Business Houses (Indian)** (Number of Companies 391)

Category/ Year	2001	2003	2005	2007
Promoters	48.07	50.16	50.22	50.32
Non-promoters Institutions	14.87	13.31	12.07	13.22
Non-promoters Corporate Bodies	9.59	9.22	10.70	8.85
Public and others	27.47	27.31	27.01	27.61
Total	100	100	100	100

**Panel B: Other Business Houses (Indian)** (Number of Companies 924)

Category/ Year	2001	2003	2005	2007
Promoters	48.18	50.15	50.10	49.68
Non-promoters Institutions	10.75	9.60	9.02	10.57
Non-promoters Corporate Bodies	11.43	10.94	11.63	9.72
Public and others	29.64	29.31	29.25	30.03
Total	100	100	100	100

**Panel C: Private Indian (Stand Alone)** (Number of Companies 3303)

Category/ Year	2001	2003	2005	2007
Promoters	44.40	46.13	46.62	45.76
Non-promoters Institutions	3.02	2.71	2.49	3.78
Public and others	39.69	39.27	38.52	39.53
Total	100	100	100	100

**Panel D: Total (Indian Private Sector)** (Total Number of Companies 4812)

Category/ Year	2001	2003	2005	2007
Promoters	46.17	47.91	48.38	47.65
Non-promoters Institutions	5.89	5.13	4.92	6.26
Non-promoters Corporate Bodies	12.18	11.39	11.87	10.29
Public and others	35.76	35.57	34.83	35.80
Total	100	100	100	100

Note: Data for 4812 Bombay Stock Exchange Listed Companies based on Prowess Database of CMIE and Capital Online.

**Table 2**  
**VARIABLE DEFINITION AND SOURCE**

<b>Variable</b>	<b>Measurement</b>	<b>Source</b>
<b><i>Performance</i></b>		
Return on Assets (ROA)	Profit before depreciation, interest and taxes divided by total assets	Prowess Database
Proxy to Tobin's Q Ratio (P-TQ)	No. of Equity shares multiplied by the market price per equity share on the last day of the year plus book value of Debt divided by book value of assets on that day.	Prowess Database
<b><i>Ownership Variables</i></b>		
Promoters Shareholding (PS)	Fraction of equity shares held by the promoters	Annual Report
Institutional Investors Shareholding (IIS)	Fraction of equity shares held by the domestic institutional investors including banks	Annual Report
Foreign Entities Shareholding (FES)	Fraction of equity shares held by Foreign Entities including FIIs	Annual Report
<b><i>Board Related Variables</i></b>		
Proportion of Independent Directors (FID)	No. of independent directors divided by total number of directors	Annual Report
CEO Duality (Duality)	Variable equals 1 if the CEO is chairman also, otherwise 0	Annual Report
Board Size (BS)	Total number of Directors	Annual Report
<b><i>Firm Related Variables</i></b>		
Firm Size (SZ)	Logarithm of Book Value of Assets	Prowess Database
Growth (GW)	Current year sales divided by previous year sales	Prowess Database
Debt (Db)	Total debt divided by total assets	Prowess Database
Advertisement (Adv)	Advertisement expenses divided by total assets	Prowess Database

**Table 3**  
**DESCRIPTIVE STATISTICS**

<b>Variable</b>	<b>Observations</b>	<b>Min.</b>	<b>Max.</b>	<b>Mean</b>	<b>Std. Deviation</b>
<i>Performance Variables</i>					
Return on Assets (ROA)	595	-1.269	1.115	.1715	.1404
Proxy to Tobin's Q (P-TQ)	595	.0084	9.776	3.352	2.534
<i>Ownership Variables</i>					
Promoter's Shareholding (PS)	595	0	.89	.418	.186
Institutional Investors Shareholding (IIS)	595	0	.407	.159	.096
Foreign Entities Shareholding (FES)	595	0	.839	.252	.2335
<i>Board Related Variables</i>					
Proportion of Independent Directors (FID)	425	0	.92	.524	.145
CEO Duality (Duality)	595	0	1	.425	.494
Board Size (BS)	595	4	19	10.21	2.747
<i>Firm Related Variables</i>					
Growth (GW)	595	.1934	10.377	1.186	.6716
Size (SZ)	595	8.890	11.222	10.086	.477
Debt (Db)	595	0	1.541	.2333	.203
Advertisement (Adv)	595	0	.2804	.0233	.0397

**Table 4**  
**ESTIMATORS OF PERFORMANCE EQUATION**  
**Dependent Variable: Return on Assets (ROA)**

Independent Variables	OLS	Fixed Effects	Random Effects
PS	.031 (.0326)	.172** (.075)	.078 (.051)
IIS	-.210 (.064)	.124 (.094)	.0133 (.0798)
FES	.038 (.029)	.076 (.055)	.0407 (.038)
FID	.0251 (.0439)	.0568 (.0529)	.066 (.0397)
Duality	.076*** (.0102)	.0064 (.016)	.028* (.013)
Board Size	.006*** (.002)	.003 (.0028)	.005* (.002)
Size	.010 (.0136)	-.032 (.029)	-.00 (.019)
Growth	.022*** (.007)	.0131** (.005)	.016** (.005)
Debts	-.146*** (.028)	-.240*** (.033)	-.206*** (.021)
Adv.	.990*** (.134)	1.087*** (.322)	.992*** (.213)
Year Dummies	Yes	Yes	Yes
No. of Obs.	595	595	595

Notes: Each regression contains full set of year dummies

\*\*\*  $p < .001$ ; \*\*  $p < .01$ ; \*  $p < .05$

Standard errors are in parentheses

The estimated coefficients of the year dummies are not presented

Estimations using Stata 9.0 version.

**Table 5**  
**ESTIMATORS OF PERFORMANCE EQUATION**  
**Dependent Variable: Proxy to Tobin's Q (P-TQ)**

<b>Independent Variables</b>	<b>OLS</b>	<b>Fixed Effects</b>	<b>Random Effects</b>
<b>PS</b>	3.789** (1.335)	8.007* (3.963)	3.612* (1.813)
<b>IIS</b>	-4.263 (2.712)	4.81 (5.053)	-882 (3.346)
<b>FES</b>	-.922 (1.054)	-.756 (2.942)	-.858 (1.407)
<b>FID</b>	2.091 (.697)	1.521* (.9101)	1.990* (.879)
<b>Duality</b>	1.661*** (.421)	.552 (.870)	1.339** (.541)
<b>Board Size</b>	-.061 (.084)	-.086 (.153)	-.087 (.104)
<b>Size</b>	.689 (.509)	-7.289*** (1.568)	-.285 (.690)
<b>Growth</b>	.545 (.3103)	.311 (.293)	.399 (.292)
<b>Debts</b>	-5.546*** (1.156)	-1.909 (1.764)	-3.241** (1.349)
<b>Adv.</b>	13.037** (5.457)	22.769 (13.395)	15.429* (7.508)
<b>Year Dummies</b>	Yes	Yes	Yes
<b>Number of Obs.</b>	595	595	595

Notes: Each regression contains full set of year dummies

\*\*\*  $p < .001$ ; \*\*  $p < .01$ ; \*  $p < .05$

Standard errors are in parentheses

The estimated coefficients of the year dummies are not presented

Estimations using Stata 9.0 version.