

# The Relationship Between Ownership Structure and Role of Board

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**ABSTRACT:** *This paper develops a theoretical model to better understand how the priorities of the board of directors are influenced by the ownership structure and how that affects firm performance. Most corporate governance research focuses on a universal link between corporate governance practices (board structure, shareholder) and performance outcomes. This study suggest that the ownership structure has an important influence on the priorities set by the board and that these priorities will determine the optimal composition of the board of directors. We provide a framework on the interaction between ownership, corporate boards and firm performance.*

**INTRODUCTION:** Ownership structure is the most important factor in determining the firm's goals and the shareholders' wealth. The distribution of equity with regard to

votes and capital but also by the identity of equity owners is termed as ownership. Today in this globally integrated era, ownership structure plays an important role in the effecting company's performance. For a company, owners are an important source of capital. But there is remarkable difference between the different style, type or profile of owners. It can be defined by their preference in money decisions, such as: deciding between short term trading or long term holdings. Whether they are allergic or refrain to risk. Performance of a company critically depends on managerial ownership. Due to increase in managerial shareholding agency problem arise, which affect the performance of company ultimately. Value of a company depends on internal shareholder's share and company performance by dividing shareholders in to

internal investors with management rights and external shareholder who are investors without ballot right. The agency theory indicates that the management is trying to attain their own benefits rather than to work for achieving the shareholders benefits and objectives. Within of this outcome is the agency problem due to the conflict of interest between the owners of the company and those who manage the company. Fama (1980) argues that the composition of board structure is an important mechanism because the presence of non- executive directors represents a mean of monitoring the actions of the executive directors and of ensuring that the executive directors are pursuing policies consistent with shareholders interests. to safeguarding the interest of shareholders, board of directors is appointed through the election in the annual general meeting. The board of director is the agent to the shareholders in ensuring the transparent financial reporting the reflect the real financial position of the companies. Thus the role of the board of director is imperative to counter “managerial opportunistic” behaviour, which includes taking action for their own personal interests at the expense of the shareholders’ interests (Donaldson & Davis, 1991).

## REVIEW OF LITERATURE:

Mohamed (2008) In this empirical study “board of directors, size and performance in banking” found a different result from the previous researches with samples from wide industries. This study examined the correlation between board size and firm performance only in banking industry. Its sample is composed by 174 banks from 1995-2002. The study got a positive correlation between board size and firm performance.

Perrini, Rossi and Rovetta (2008) investigated the relationship between ownership structure and firm performance from Italian market since 2000-2003. Used panel data and two ownership dimensions, result showed that ownership concentration of five largest shareholders is profitable to firm valuation and managerial ownership is profitable only in non- concentrated firm. It suggested that the controlling owner may use his position in the firm to extract private benefits at the expense of the other shareholder by appointing managers that represent its own interest.

Jamal Abu- Serdaneh, Majdy .  
Zuriekat, Imad Al- Sheikh (2010) studied

the effect of ownership structure on firm performance for a five year panel data of 56 Jordanian manufacturing companies. Apply a multiple regression model. ROA and Tobin's q are indicators for evaluating the performance of a company. When ROA indicator applied, then concentration ownership is negative and institutional ownership is positive. When Tobin's q indicator is applied, the result show that no significant relationship between profitability all ownership structure. The result suggested that profitability decrease with high concentration ownership and increase with high portion of equity owned by institutional investors.

Xuan Quang and Wu Zhong Xin (2014) investigated the impact of ownership structure and capital structure on firms' financial performance. Sample of 134 non-financial companies was selected from 2009-2012. The result found that capital structure has negative impact with statistical significance on financial performance. Statistical significance of the impact of managerial ownership on financial performance has not been found. While for state-owned enterprises, there is negative

relation between managerial ownership and financial performance measured by ROE.

**OBJECTIVE OF THE STUDY:** The objective of the study is to develop a theoretical model to better understand the priorities of the board of directors are influenced by the ownership structure and how they affect firm performance.

**RESEARCH METHODOLOGY:** The paper is based on the empirical study of the role of the board directors and their influence on the firm performance.

**ANALYSIS AND INTERPRETATION:** The influence of board and relationship among the firm performance can be traced with the help of the following aspects of study.

**ROLE OF THE BOARD OF DIRECTOR:** Board of directors also plays the role of monitoring and controlling. "due to its monitoring role, the board of directors is an important tool to reduce agency cost and hence it has a direct impact on corporate performance through its main dimensions such as : structure , size. The board of directors is playing a role as a trustee of shareholders to represent the interest of shareholders. Molz (2007) defined the role

of board of director as “a body entrusted with power to make economic decisions affecting the well being of investors, capital, employees, security, communities, economic health and executives, power and perquisites”. Board of directors is the highest managing group of an organization, it was elected by shareholders. They are the representatives of shareholders, so their main responsibility is to make sure that agents will be on behalf of and maximize the shareholders’ interest. When business of companies is growing, the development of the companies needs professionals to fit the requirement of management. “the board reduces agency conflicts by separating the management and control aspects of the decision making process....”(panasian 2003). The demand for monitoring is expected to be influenced by the distribution of power amongst the stakeholders and their individual incentives. The agency literature suggests that some control mechanism may be substitutable so that there could be a trade-off among various sources of control available to individual stakeholders (Jensen and Meckling 1976).

**(1).Concentration ownership – none or low managerial ownership:** The degree of

ownership concentration in a firm is a determinant of the power distribution between managers and shareholders. These shareholders have adequate control rights (through their voting rights or through representation on the board of directors) to influence the management including the way the firm’s resources are allocated. They are also able to exert their influence over management by obtaining representation on the board from their voting rights at shareholders’ meetings (Prowse, 1994). Empirical prior studies which are related to the effect of ownership concentration on corporate performance found negative results, for example: some studies found that concentrated structure firms have significant better performance (Joh 2002; Severin 2001, Xu and Wang 1997). Small shareholders do not have incentive to monitor individually, collectively all shareholder benefit from the monitoring effort by the board of directors.

**(2).Concentration ownership – some managerial ownership:** Managerial stock ownership contributes to reducing agency cost (Jensen and Meckling 1976). If managerial ownership is increased their interest will be balanced to the interest of shareholders leading to possible remarkable

reduction of conflicts between managers and shareholders, gradual solution to agency problem and as a result, improvement of firms, financial performance. The board of directors remains the main instrument of monitoring of shareholders but the agency problem may be less severe when managers hold relative important shareholder positions.

**(3).Controlled ownership – none or low managerial ownership:** Useem (1996) large shareholder typically has some ability to influence proxy voting and may also receive special attention from management. Shleifer and Vishny (1986) argue that large shareholders have a strong incentive to monitor managers. The board of directors reflects to a high degree of the shareholder structure of the company. Large shareholders are typically directly or indirectly represented on the board of directors. Minority shareholders have less influence on the board composition compared to large shareholders.

**(4).Controlled ownership – some managerial ownership:** Casson (1999) suggests that firms controlled by family – ownership can invest more efficiently than those controlled by non-family ownership. When the

controlling shareholders are also actively involved in the management of the company, the agency problem related to the dispersion of ownership and control is dissolved. Previous studies suggest that family owners may have superior monitoring abilities relative to diffused shareholders, especially when family ownership is combined with family control over management and the board (Anderson and Reeb, 2004). However families like managers in a widely held company can abuse their power and use corporate resources to their own advantage.

**BOARD OF DIRECTOR'S OPTIMAL SIZE:** Previous literature has studied the relationship between the number of directors sitting on the board and firm performance. Different and opposing theoretical arguments are presented in the literature to support either large or small board size. Large board size is argued to benefit corporate performance as a result of enhancing the ability of the firm to establish external links with the environment, securing more rare resources and bringing more exceptional qualified counsel (Dalton 1999). There has been relatively little empirical research directly focused on the

impact of board size on performance that could help determine the validity of these two perspectives. Yermack (1996), Bohren and Odegarrd (2001) and Postma, Van Ees and Sterken (2003) found firms with smaller boards have a better performance.

**CONCLUSION:** This paper develops a theoretical model to better understand how the priorities of the board of directors are influenced by the ownership structure and how that affects firm performance. Most corporate governance research focuses on a universal link between corporate governance practices (e.g., board structure, shareholders) and performance outcomes. Furthermore, the corporate governance reforms focus strongly on improving the monitoring ability of the board of directors. This study suggest that the ownership structure has an important influence on the priorities set by the board and that these priorities will determine the optimal composition of the board of directors.

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