OWNERSHIP CONCENTRATION IMPACT ON FINANCIAL PERFORMANCE: EVIDENCE FROM SERBIA

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Abstract: *Separation of ownership and management function in modern corporations resulted in the emergence of a conflict between principal (shareholders) and agent (top management). According to agency theory ownership concentration is a key mechanism that helps to mitigate principal-agent problem. As a result of the underdevelopment of the legal system and the corporate control market in transition economies and developing countries, the application of ownership concentration mechanism can lead to the emergence of a new conflict on the relationship between majority and minority shareholders. High ownership concentration allows the majority owner to use corporate resources in accordance with private goals, which negatively affects the value for minority shareholders and corporate performance. Accordingly, this research deals with the analysis of concentrated ownership impact on financial performance, measured by the Return on Asset (ROA) and Return on Equity (ROE). Empirical research was conducted for the period 2015-2017 on the sample of 70 non-financial companies, which shares are traded on the Belgrade Stock Exchange. The results of the applied statistical analysis methods show that ownership concentration greater than 55% has a negative impact on ROA and ROE.*

Key words: *Corporate Governance, Ownership Concentration, Agency Problem, Financial Performance, Transition Economies.*

JEL Classification: *G32, G34.*

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INTRODUCTION

Corporate governance can be defined as a set of clearly defined rules and procedures that regulate relationships between different stakeholders in and outside of the company, with the aim of creating adequate conditions for the proper function of a company and improving business performance. Corporate governance systematically regulates relationships between shareholders (principal) and management (agent) of the company, as well as between management, employees and all other internal and external stakeholders (Jensen & Meckling, 1976). This way, shareholders have the ability to carry out monitoring and controlling the management, which is the holder of the management function. A major contribution to the development of corporate governance has been given by the agency theory, which starts from the principal-agent problem, the cause of which is the separation of the management and ownership function. In order to alleviate the agency problem, different corporate governance mechanisms are applied (Babić, 2006). The effectiveness of corporate governance mechanisms are determined by two important factors. Firstly, the existence and implementation of laws and by-laws in the country that protect the ownership rights of shareholders. Secondly, the ownership structure, primarily the degree of ownership concentration as a percentage of shares held by majority shareholders. The agency problem is expressed in transition economies and developing countries, which are characterized by the underdevelopment of regulatory mechanisms of regulation, which further encourages managers to behave opportunistically. For this reason, it is resorted to a high ownership concentration, which is an internal, alternative mechanism for the regulation of managerial operations and the protection of shareholders' rights (La Porta, Lopez-de-slanes, Shleifer & Vishny, 1999).

The active role of the majority shareholders, which is manifested in the intensive supervision of top management activities, will reduce the ability of managerial manipulation of free cash flows, with most of the funds being channeled towards profitable projects. This improves the company's position on the market, which will reflect on the increase in shareholder value and the improvement of corporate performance.

A large number of empirical research about the effects of ownership concentration on financial performance show mixed results and conclusions about this corporate governance mechanism, which may be the result of different development phases in which the surveyed countries are located, as well as the applied model of corporate governance. Significant differences are present between developed European countries (EU) and transitional economies, which also include the Republic of Serbia.

The aim of this research is to examine the effects of ownership concentration on financial performance of the selected companies. Empirical research was conducted on the basis of data collected for the period 2015-2017. The sample for which this survey was conducted consists of 70 companies from the non-financial sector. Statistical data analysis was performed using descriptive statistics, correlation coefficient between independent and dependent variables, and multiple OLS regression analysis to determine the impact of independent variable on the dependent. Statistical data processing was performed using SPSS v.20 and MS Excel.

The results confirm that high ownership concentration has a negative influence on minority shareholders position and reduces efficiency of using corporate resources, which has negative impact on financial performance. The contribution of this paper is reflected in the expansion of existing knowledge in the field of corporate governance, because empirical research has confirmed previously defined research hypotheses. Relevant entities may use the presented facts in order to verify the legislation functionality in domain of protection minority shareholders rights. Another practical implication is raising awareness among minority shareholders about the potential misuse of funds by majority shareholders and the need to create appropriate

mechanisms through which minority shareholders will be involved in the decision-making process and monitoring top management behavior.

This research paper consists of three parts. The first part deals with the review of literature in the field of corporate governance, with a special emphasis on presenting existing theoretical knowledge about the effects of ownership concentration on financial performance. There is also a summary of the results of a current empirical studies in this area in developed and transition economies. The second part presents the methodology of measuring independent and dependent variables that are the subject of research in this paper. The third part of the paper contains the results of the correlation and regression analysis, based on which the relevant conclusions related to the tested research hypotheses were made.

LITERATURE REVIEW

Unlike traditional companies, where ownership and management functions have been consolidated, modern corporations have broken down. Holders of ownership function are shareholders/owners, while corporate governance is governed by professional managers (Hindley, 1969). Owners do not decide on how to use corporate resources over which they have proprietary rights. They just take the profit in form of dividends. On the other side, top management is responsible for making decisions about how to allocate corporate resources. Decisions made by managers should be in favour of satisfying the owners' interests, although this is often not the case. For this reason, there is a potential conflicts of interest between shareholders/principal and managers/agent, which explaine by the agency theory. The agency theory sees the common cause of the conflict on the principal-agent relationship in their divergent interests (Babić, 2006). What is in the owner's best interest is the maximization of profit, that is, the appropriation of the largest part of the free cash flow through dividends (Jensen & Ruback, 1983). Managers, however, seek to exploit the position they are in, so as to direct corporate resources towards the pursuit of private interests (Jensen & Meckling, 1976). In order to mitigate this problem, effective monitoring and control of the agents is necessary, which causes additional agency costs for the owners (Ross, Westerfield & Jaffe, 2002).

Problems of effective monitoring of management effort appear as a consequence of moral hazard (Eisenhardt, 1989; Babić, 2006). Moral hazard can be explained as a lack of interest and effort by managers, because managers know that they will not fully bear the consequences of their actions (Babić, 2010). Also, the problem arises when managers act more competitive than they really are. Candidates for management position can claim to have certain skills and abilities to perform a job, although they do not actually have them. The previous problems result in inefficient internal control mechanisms and a low level of management motivation, which, with inefficient external control mechanisms, produces high agency costs and reduces corporate performance and potential value, which is shared by shareholders through the dividend (Todorović, 2010).

Considering that the ownership structure of modern corporations consists of a large number of shareholders, the question arises as to which is the best and most effective mechanism for supervision and control of managers. The agency theory points out that a high degree of ownership concentration will contribute to the reduction of managerial opportunism, which will in the end have positive effects on the overall corporate performance. The gist is that a small number of major shareholders or one of the largest shareholders, in addition to appropriating profits, has been granted the right to participate in decision-making process and control of management behaviour. Large shareholders, unlike small ones, are more interested in monitoring and control managers activities. This is due to the fact that their shares in the share capital, and therefore the risk of efficient use of corporate resources, are significantly higher than shares and risk of minority shareholders. In addition, the major shareholder has full control over the work

of the Board of Directors (Babić & Nikolić, 2011). In this way, by intensive monitoring and control of the work of managers, large shareholders reduce the ability of managerial manipulation of free cash flows, which makes most of the funds available to profitable projects, which contributes to improving corporate performance and paying out larger dividends to shareholders.

Mitigate principal-agent conflict, using the ownership concentration mechanism, does not necessarily lead to improved corporate performance. The reason for this is that as a result of the elimination or control principal-agent conflict due to the increased concentration of ownership, a new problem arises on the relation principal-principal (Babić & Nikolić, 2011). The conflicting participants are the majority shareholders, who are in the role of business and management controllers, and minority shareholders, who are in an inferior position (Su, Xu & Phan, 2008). Principal-principal conflict is present in transitional economies and developing countries, characterized in general by the underdeveloped legal system, especially in the domain of the shareholders' rights protection. Thus, their rights become subject to expropriation, which is manifested in the form of control over the company by majority shareholders, whereby all forms of company resources is in their manipulative space, and disabling minority shareholders to collect returns from their share (Dharwadkar, George & Brandes, 2000).

A large number of empirical research on the effects of ownership concentration on financial performance show contradictory results and conclusions about this corporate governance mechanism. Divergent results in this field may be the result of the different development stages in which the surveyed countries are located, as well as the applied model of corporate governance. Significant differences are present between developed European countries (EU) and transitional economies, which also include the Republic of Serbia.

Developed European countries apply a continental model of corporate governance which are characterized by the presence of a small number of major shareholders in their companies, an insufficiently developed corporate control and foreign ownership markets (Ooghe & Langhe, 2002). The ownership structure of the company is made up of a small number of major shareholders who take over the role of controllers over the activities of management. The concentration of ownership in these countries prevents the emergence principal-agent problem, but the increase in ownership concentration above a certain level can lead to the emergence of the aforementioned problem in relation to majority-minority shareholders (Babić & Nikolić, 2011). It is therefore important to improve the efficiency of legal regulations and to stimulate the development of capital markets. Hamdouni (2010) was examined the effects of concentrated ownership on financial performance over a sample of 106 companies in France. High concentration of ownership has a negative effects on ROA, and positive effects on ROE. The results of the survey carried out by Alimehmeti & Paletta (2012) over listed companies in Italy confirm the positive implications of ownership concentration on ROA. The effects of concentrated ownership on financial performance measured by ROA and ROE in the Netherlands show the existence of a positive correlation (Scholten, 2014; Boerkamp, 2016). In a research conducted by Arosa, Iturralde & Maseda (2007) for over 586 unlisted companies in Spain, there are positive effects of ownership concentration on financial performance. In the same country, the research conducted by Cabeza & Gomez (2011) confirms the positive effects. Kapopoulos & Lazaretou (2006), by researching over 175 listed companies in Greece, confirms the positive impact of concentration of ownership on financial performance. The results of conducted empirical studies show that ownership concentration has a positive effects on financial performance of companies in the EU developed countries.

In addition to the developed economies, the issue of concentration of ownership is particularly significant in transition economies, where the process of transformation of state and social into

private ownership has led to significant changes in the ownership structure. The applied privatization methods differed from country to country, but mainly resulted in a concentration of ownership. Transition economies have implemented the reform process without a predefined plan, expecting that any change in ownership structure, leading to increased private ownership, will have a positive effect on corporate performance (Foo & Dorota, 2011). In addition to this underdeveloped legal system, which should be the basis for the implementation of structural changes, it further reduced the effects of privatization that did not have a strategic character. High level of corruption and excessive bureaucracy, as well as the fact that countries in transition were at an exceptionally low level of development compared to developed European economies, are additional arguments that can justify the weak or negative effects of concentration of ownership. The capital and labor markets, due to underdevelopment, could not be used as an effective mechanisms for disciplining and controlling the efficiency of management. For transition economies, a unified model of corporate governance has not yet been adopted, and the application of the continental or Anglo-Saxon model in their original form is not possible. Numerous authors agree that for the needs of transition economies it is necessary to develop a special hybrid model composed of an adequate combination of components, which are immanent for Continental and Anglo-American model of corporate governance in accordance with the socio-economic and historical specificities of transition countries (Błaszczyk, Hashi, Radygin & Woodward , 2003; Babić & Nikolić, 2016).

The results of the research carried out in transition economies are mixed. Mueller, Dietl & Peev (2004) were examined the effects of ownership concentration on ROA of 518 non-financial companies during the transitional period in Bulgaria. The results show that high concentration of ownership has a negative impact on ROA. The negative effects of ownership concentration on company performance are also found in the research of Lskavyan & Spatareanu (2006) carried out in Poland and the Czech Republic during the transitional period. Stančić, Čupić & Obradović (2014) analyzed the effects of ownership concentration on the profitability of the 74 commercial banks in Serbia, Macedonia, Bosnia and Herzegovina, and Croatia. The results show that the increase in the concentration of ownership has a negative, but a weak effect on the banks profitability. Pervan, Pervan & Todoric (2012) conclude that the high ownership concentration has a negative effect on financial performance in Croatia in the period 2003-2010. Leković & Marić (2015) did not find a significant correlation between different levels of ownership concentration and financial performance on a sample of 228 companies in Serbia. Similarly, Nikolić, Babić & Erić (2013) report on the absence of significant differences in the impact of concentration of different ownership types on profitability of 146 companies in Serbia.

A research which was conducted in over 60 privatized companies in Macedonia shows that ROA (Abazi-Alili, 2013) increases with the increase in ownership concentration. In the paper Balsmeier & Czarnitzki (2010), the effects of concentrated ownership on financial performance in 29 transition economies for the period 2002-2009 were tested. The results show that there is a U-shaped relationship between ownership concentration and performance, which indicates that the increase in ownership concentration to a certain limit of 55% positively affects financial performance. When ownership concentration exceeds 55%, financial performance deteriorates.

Based on the above findings and mixed results of empirical studies, the following research hypotheses will be set:

***H_1**: High ownership concentration has a negative impact on ROA.*

***H_2**: High ownership concentration has a negative impact on ROE.*

METHODOLOGY

Sample and statistical methods

Empirical research was conducted on the database for 2015-2017. The sample for this research was conducted consists of 70 companies from the non-financial sector (Open market and MTP Belex). All data necessary for statistical analysis were collected from secondary sources. For the calculation of ROA and ROE, the data contained in the financial reports are available on the website of the Belgrade Stock Exchange. Data on percentage shares of shareholders are available on the Central Securities Register website.

Statistical analysis of collected data includes descriptive statistics, determination of the correlation coefficient between ownership concentration and financial performance, multiple OLS regression analysis to determine the impact of ownership concentration on financial performance. The entire statistical data processing was performed in the software *IBM SPSS v.20* and *MS Excel*.

Independent and dependent variables

The independent variable in this paper is ownership concentration. Degree of ownership concentration is measured as a percent of shares owned by largest shareholders, who own more than 55% of total shares:

$$55\% \leq \text{percent of shares owned by largest shareholder} \leq 100\%.$$

The financial performance of companies, as dependent variables, were measured using ROA and ROE.

ROA is a profitability ratio coefficient that shows the ability of a company to create profit by using its assets. ROA is determined as the ratio between net profit and total assets

$$ROA = \text{Net profit} / \text{Total assets}.$$

ROE is a profitability ratio coefficient that measures company's ability to earn profits by engaging capital. ROE is determined as the ratio between net profit and total equity.

$$ROE = \text{Net profit} / \text{Total equity}.$$

Control variables

Although the aim of this research is focused on examining the impact of ownership concentration on financial performance, it is necessary to extract the appropriate control variables, because financial performance, can be determined by other factors. For these reasons, the analysis includes two control variables: companys` liquidity and activity. The companys` activity is an important profitable factor and is defined as the ratio between sales revenue and total assets. Increasing the activities of the company, ie sales turnover, has a positive impact on financial performance. Liquidity of the company, as the ability to execute maturity obligations, also contributes to improving financial performance. Low liquidity makes it difficult to carry out daily business activities, which can negatively affect financial performance. Liquidity of the company is determined as the ratio between current assets and short-term liabilities.

$$\text{Liquidity} = \text{Current assets} / \text{Short-term liabilities}.$$

$$\text{Activity} = \text{Sales revenue} / \text{Total assets}.$$

RESULTS AND DISCUSSION

The arithmetic mean, standard deviation, minimum and maximum values are shown in Table 1. The average value for ROA is -.096674, and for ROE = - .006063. The lowest ROA is -2.7298, while the maximum value is 3.0467. The minimum ROE value is -2.0937, and the maximum is 3.9585. Ownership concentration in the observed sample ranges from 55.18% to 100%, while the average value of concentrated ownership is 77.89%.

Table 1. Descriptive statistics

Variables	N	M	SD	Min	Max
Own_conc	70	77.89%	.1176869	55.18%	100%
Liquidity	70	5.151507	8.0134189	0.1474	56.6473
Activity	70	1.529326	1.8393983	0.0000	7.8781
ROA	70	-.096674	.6883132	-2.7298	3.0467
ROE	70	-.006063	.6906100	-2.0937	3.9585

Source: Author's calculation

In order to test the research hypotheses, a correlation analysis was first performed, which results are shown in Table 2. There is a significant and negative correlation between ownership concentration and ROA, with the coefficient of correlation -0.322 (sig < 0.01). The statistically significant, negative and weak link is present between ownership concentration and ROE, because the coefficient of correlation is -0.276 (sig < 0.05).

Table 2. Correlation matrix

Variables	*Own_conc*	*Liquidity*	*Activity*	*ROA*	*ROE*
Own_conc	1.000	-.116	-.103	**-.322****	**-.276***
Liquidity	-.116	1.000	-.031	.173	.067
Activity	-.103	-.031	1.000	-.044	.090
ROA	**-.322****	.173	-.044	1.000	**.671****
ROE	**-.276***	.067	.090	**.671****	1.000

** p<0.01, * p<0.05.
Source: Author's calculation

Significant results obtained by correlation analysis are the basis for conducting deeper statistical analysis using multiple OLS regression. Concentrated ownership has a significant and negative impact on ROA (**B = -.315**; **sig = 0.008**). Liquidity has an insignificant and positive impact on ROA (B = .149; sig = .201). Activity has an insignificant and negative impact on ROA (B = -.061; sig = .601). The determination coefficient for this model is **R^2 = .130**, which implies that only 13% of the ROA variability is determined by changes in the ownership concentration. This model does not have a problem with multicolinearity (VIF < 10).

Concentrated ownership has a significant and negative impact on ROE (**B = -.267**; **sig = 0.027**). Liquidity has an insignificant and positive impact on ROE (B = .051; sig = .668). Activity has an insignificant and negative impact on ROE (B = .073; sig = .538). This model is fairly low quality, because concentrated ownership explains only 8.4% (**R^2 = .084**) changes in ROE. This model also does not have a problem with multicolinearity (VIF < 10).

Table 3. Multiple OLS regression (dependent variables: ROA and ROE)

	ROA				*ROE*			
Variables	**R^2**	**Sig**	**B**	**VIF**	**R^2**	**Sig**	**B**	**VIF**
Own_conc	0.130	.008	**-.315****	1.010	0.084	.027	**-.267***	1.010
Liquidity		.201	.149	1.006		.668	.051	1.006
Activity		.601	-.061	1.006		.538	.073	1.006

** p<0.01, * p<0.05.
Source: Author's calculation

CONCLUSION AND RESEARCH LIMITATIONS

The results of the conducted research show that increasing the ownership concentration over 55% has a negative impact on financial performance. Concentrated ownership negatively affects ROA, which confirmed the research hypothesis **H1**. Concentrated ownership has significant and negative impact on ROE, which implies that the hypothesis **H2** is accepted.

Theoretical approaches emphasize the importance of ownership concentration to achieve better results of companies in developing countries and transition economies. However, increasing the concentration of ownership over a certain level provides the opportunity for the majority shareholder to make decisions in his own interest, or at the expense of minority shareholders and the whole company, due to the extraordinary rights he acquires in this way. Results of this research paper support the results obtained by Mueller, Dietl & Peev (2004), Lskavyan & Spatareanu (2006), Pervan, Pervan & Todoric (2012), Stančić, Čupić & Obradović (2014). Balsmeier & Czarnitzki (2010) report the existence of an U-shaped relationship between ownership concentration and financial performance, which is also in line with the results of this study. Therefore, a moderate ownership concentration will be in the function of improving financial performance, while the increase in the concentration of ownership above the level that is determined as moderate, will negatively reflect on the financial performance.

The results support the hypothesis about the expropriation of minority shareholders rights by majority owners. The reason for the absence of notable implications of concentrated ownership on financial performance is the presence of inadequate legal regulations in the area of protecting manority shareholders' rights, which has been confirmed by The Global Competitiveness report according to which Serbia has reached 138th place in category of the protecting minority shareholders for the year 2015. Serbia has improved when it reached 137th place out of 138 countries in 2017. In addition, transition economies are characterized by the underdevelopment of capital and labor markets, which makes these mechanisms less effective in disciplining management. For this reason, managers who can be shareholders at the same time have no real threat or danger that their position will be compromised, which encourages them to behave opportunistically.

Serbia has done a lot to improve its legislation in the area of protecting the minority shareholders' rights, primarily through the adoption harmonize its legislation with the legal system of the European Union. But the essential problem is in their inadequate implementation and non-compliance with them by relevant stakeholders (Đulić & Kuzman, 2012), which provided the opportunity for large shareholders (controllers) to direct the available resources of the company in order to achieve their own goals.

The results obtained make a good roadmap for further research in order to eliminate research constraints. First, only one independent variable concentration of ownership was used. It would be appropriate to include in the analysis and other important segments of the ownership structure, such as: the rights of minority shareholders, institutional ownership, family ownership, ownership of legal and natural persons, foreign ownership, insider ownership. Secondly, the research sees the concentration of ownership over 55%. In order to identify a U-shaped relationship between ownership concentration and financial performance, it is also necessary to analyze the effects of different levels of lower ownership concentration and compare them with different levels of higher ownership concentration. Thirdly, in order to identify the optimal level of ownership concentration, which can improve financial performance, different levels of ownership concentration on financial performance based on the model of Perrini, Rossi & Rovetta (2008) should be analyzed in the next research. Fourthly, for the purpose of measuring financial performance, only ROA and ROE were applied. In order to get the right idea of financial performance, it is necessary to take into account other indicators such as Return on

Investment (ROI), Return on Sales (ROS), net profit, revenue growth. Fifth, the analysis needs to include other control variables, such as company size, company age, leverage etc. to determine whether and to what extent other factors cause changes in financial performance.

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