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OWNERSHIP STRUCTURE, RISK TAKING AND FIRM PERFORMANCE: A CASE FOR AN INTEGRATIVE FRAMEWORK

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Abstract

Studies on ownership structure and firm performance are inexhaustible. This is due to the growing contradictory, inconclusive and inconsistent empirical findings which give rise to growing concerns and suggestions for the integration of latent variables to best explain the observed unclear relationship. This would mean adopting more of an integrated (moderation or mediation) rather than direct research framework in an attempt to explain the relationship between ownership structure and firm's performance better. This paper thus examined the ownership structure and firm performance with risk-taking behaviour as a moderator. As conceptual paper, a review of agency and stewardship theories as well as prospect theory along with each dimension of ownership structure is conducted. From the extensive review, it was found that risk taking is an integral part of organizational life. Consequently, an integrative framework that incorporates risk-taking as a moderator in the relationship between ownership structure and firm performance is proposed. This paper concluded that

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the application of this framework would offer better explanation of the relationship between ownership structure and firm performance taking into account the risk preferences of the enterprise.

Keywords: Ownership structure, firm performance, risk taking, agency theory, stewardship theory, prospect theory

INTRODUCTION

In corporate finance literatures, the structure of ownership is identified as one of the central part of corporate governance (CG) mechanisms with imaginable outcome that can mar or build a healthy corporate performance. Being such an important mechanism, it has attracted the attention of both scholars and analysts in specific countries of developed and developing markets. This interest has grown, especially with the advent of globalization which has led to the emergent of regional economic integrations among seemingly homogenous but independent nations. Vroom & Mccann (2009) defined ownership structure as the relative amount of ownership claims bought and held by inside investors (i.e. the managers) and outside investors (i.e. shareholders who has no direct relationship with the management of the firm).

Theoretically, ownership structure is identified as one of the key determinant of the nature of agency relation in terms of where lies the dominant conflict: if it is among shareholders and managers or involving minor and major shareholders (Mang'unyi, 2011). Holderness (2009) suggested better ownership and management overlap as a strategy for minimizing such conflict and improving firm performance. Ownership structure can take the form of dispersion/concentration, managerial, government, foreign, institutional and family (Zheka, 2005). Each form presents unique problems and potentials for company's management. For instance, under a dispersed ownership structure, the dominant shareholder has both the incentive and the power to discipline management. In a concentrated ownership, there are conflicts of interest between owner-manager and outside shareholders as well as conflict between controlling and minority shareholders and these have been shown to influence firm performance negatively (Morck, Wolfenzon, & Yeung, 2005).

According to Klein, Shapiro, & Young (2005), a dispersed ownership structure is one measure of CG with increased expectations of a positive relationship with firm performance; other things being equal. The argument here is that such increased expectation presents a state of the "unknown" where any deviation from what is expected typifies a risky business situation. It follows therefore that a decision to or not to dilute ownership and the outcome of such decision

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points to the decision makers' preference for control and risk taking. Ownership structure (insider ownership) boosts risk taking of managers (Sullivan & Spong, 2007). Additionally, for sake of maintaining family legacy, family-owned firms seems to exhibit excessive risk aversion and forgo profitable expansion (Morck *et al*., 2000). Mangers are risk-averse and their interests are not aligned with those of the owners and this caused problem that result in reduced value and poor performance (Varcholova, & Beslerova, 2013).

Similarly, government owned banks were found to exhibits high risk taking and high performance, while institutional ownership was found to abandon *Code of Best Practices*, having weak and negative effect on firm value (Gursoy & Aydogan, 2002; Faccio & Lasfer, 2000). Foreign ownership was found to have the ability to diversify risk leading to high risk taking and high performance (Berger *et al*., 2005). The implication of the above is that, under each ownership structure, the level of firm risk taking is consequential of owners' risk preference, which by agency theory, is typically risk-seeking. By this theory, all stakeholders are homogenous and risk neutral group which usually prefer more risk to less, while managers with specific human capital skills and private control benefits prefers less to more risk-taking in anticipation of better performance (Jensen & Meckling, 1976; Demsetz & Lehn, 1985). This is a well known principal-agent problem which exists whenever the ownership of a firm is divorced from management (Zheka, 2005).

In retrospect, it can be argued that risk-taking is part of an organizational life and firms could gain from it if assumed following a reasonable calculation and analysis. It should be noted however, that risk taking is not a choice for firms but the degree to which a firm decides to go in taking risk is a choice, hence we have firms that are high risk taker (or risk seeking, risk lovers etc) as well as firms that are low risk takers (or risk haters, risk averse etc). Either preference is a product of adequate risk management. It follows therefore that an organization's attitude toward risk taking depicts risk behaviour of that firm. And such behaviour is dependent on the types of ownership of the firm. In this regard, it is imperative to provide empirical evidence on the mechanics of how profitable or otherwise risk-takers and risk-averters can gain or loss using adequate research model and framework. Such framework must consider ownership structure, risk taking and performance interactively rather than exclusively as hitherto have been the case in most empirical studies.

In this paper we propose an integrative research framework, nay, moderation research framework by which firm managers, policy makers and researchers can use to analyze both the direct and interaction effect of ownership structure on firm performance with risk taking as a moderator. The framework suggests that in the real world of business, direct effect of one factor on another is improbably not illusionary. Therefore, to evaluate the association between such

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phenomenon, it would be inappropriate not to consider other latent factors that associate literally with the phenomenon, especially where such latent factors have been found to be theoretically, empirically or logically relevant. This being so implies that the validity and reliance on any empirical outcome must also be judged from the perspective of the framework and model applied. The proposed framework can thus be applied to conduct researches that seek to examine the relationship between ownership structure and firm performance as well as the moderating role of risk taking in the relationship between ownership structure and firm performance. The rest of the paper is presented in the following sequence: Literature review, integrative framework of Ownership-Risk-Performance: Debates and Configuration and conclusions.

LITERATURE REVIEW

To offer theoretical and conceptual support to the propositions and justifications for the proposed integrative framework, it is imperative to review some relevant theories and key concepts.

Theoretical framework

In corporate governance literatures to which ownership structure is a variable, there have been array of theories adopted to explain the nexus among CG variables such as: "the configuration of the board of directors, audit committee, independence of managers, the role of top management and their social relations beyond the legal regulatory framework" (Nicolae, & Violeta, 2013). These theories include agency theory, stewardship theory, stakeholder theory, resource dependency theory, political theory, legitimacy theory and social contract theory amongst others (Yusoff, & Alhaji, 2012). Nicolae, & Violeta, (2013) have suggested that effective corporate governance requires applying a combination of all theories, but since this study focuses on one CG variable, only few relevant theories are considered relevant. These include agency theory and stewardship theory while prospect theory is adopted to explain the behavioural aspect of the model – risk-taking.

Agency theory

Agency theory is one the oldest theory in finance that have been used to explained principal-agent relationship. Lately, the theory has also been use in explaining the role of risk in the relationship between ownership and firm performance, especially in the financial (banking) sector of many economies. An explicit analogy of the agency theory within the context of ownership structure, risk taking and firm performance is illustrated in Fig 1. As shown below, the

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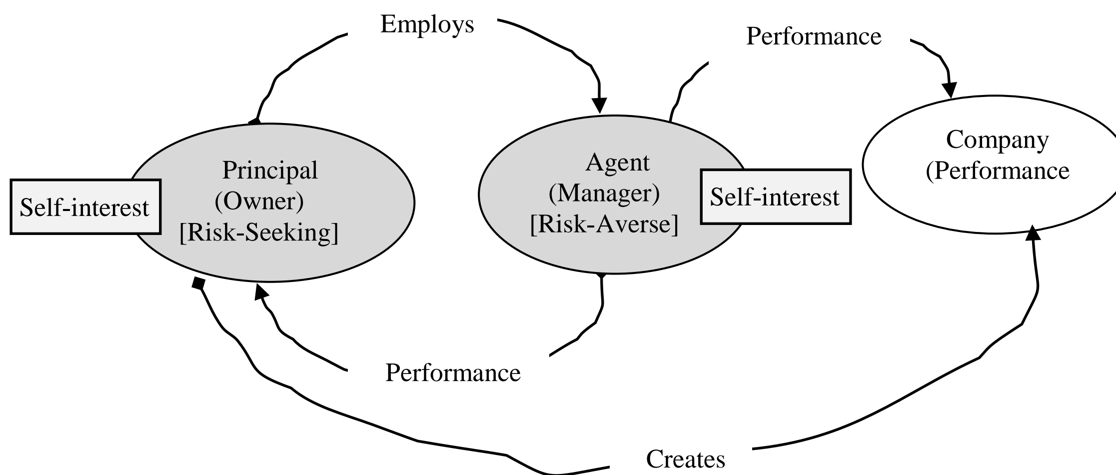
theory opens the black box of firms revealing the contract among factors of production in relation to actual production (performance), with each factor motivated by its self interest (Jensen & Meckling, 1976). The principal area of immense contribution of the agency theory is on how employee motivation is used to reconcile each stakeholder's self-interest while pursuing corporate interest (which is performance) amidst each group's differing risk preferences (Perrow, 1986). Therefore, the interrelationships among dimensions of ownership structure as explained in this study confined to exploring the self-interest of the stakeholder as a measure to enhance the performance of firms.

Figure 1. Conceptualized circle of interest and risk preferences based on agency theory



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From above figure, it can be deduced that the possible problem arising from ownership of firms relates to self-interest contributing to organizational performance. This assertion is based on the concept introduced by Eisenhardt (1989) and has been adopted and used in various studies to: a) determine financial performance of firms (Albassam, 2014); b) determine the effectiveness of the mechanisms of corporate governance (Al-Janadi *et al*., 2013); c) define ownership concentration structure of firms (Al-Fayoumi *et al.* 2010); and, assess corporate social responsibility of firms (Block & Wagner, 2014), among others.

Stewardship theory

The stewardship theory of CG contrasts agency. Its precepts as presented in Fig. 2 focus on an alternative management model where managers are seen as good stewards of the organization. It is defined to mean that a "steward protects and maximizes shareholders wealth through firm

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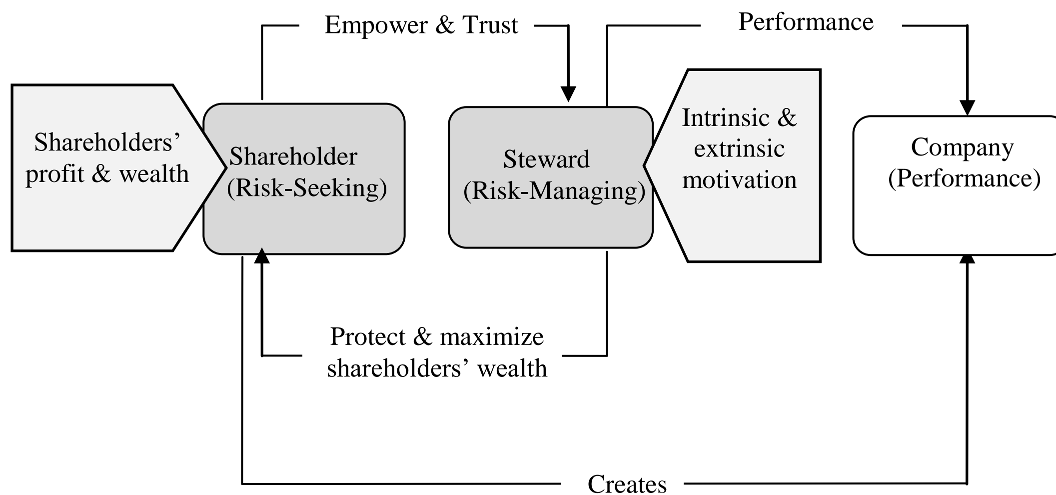
performance, because by so doing, the steward's utility functions are maximized" (Abdullah & Valentine, 2009, p. 90).From this perspective, managers and top executives of the organization act and work in the best interest of the owners rather than serving their self-interests (Yusoff & Alhaji, 2012).

Figure 2. Conceptualized block of interest and risk preferences based on stewardship theory



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Stewardship theory draws its basic fundamentals from social psychology (or sociology and psychology) which focus on the behaviour of organization's executive. The steward's (or manager's) behaviour is pro-enterprise, collectivists and is considered as being dovetailed rather than depart from the interest of the enterprise. It is also adjudged to have more utility than individualistic self-serving behaviour because the steward seeks to achieve corporate objectives instead of personal objectives (Davis, Schoorman & Donaldson 1997). Unlike agency theory which views an employee or workforce as economic beings that stifles an individual's egoistic desires in an organization, stewardship theory advocates for vital structures that sanction or enable the steward and cede maximum sovereignty built on trust to the stewards. It emphasizes on employees' or executives' position to act more autonomously to maximize shareholders' wealth since such independency can help in minimizing the costs monitoring and controlling their behaviour (Abdullah & Valentine, 2009; Donaldson & Davis, 1991).

Prospect theory

Prospect theory was first developed and applied in the field of decision science as a behavioural decision theory. It was propounded by Kahneman and Tversky in 1979 to explain the role of top

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management in selecting investment portfolio. As explained by Shimizu (2007), the theory says that top management are more likely to keep a particular portfolio that perform poorly if the loss from such portfolio and the attendant effect on overall corporate performance is small and insignificant, otherwise (i.e. if such loss is large and significant), the top management will drop such portfolio and embark on alternatives risky investment with hope of improved and better performance. Fiegenbaum (1990) was one of the first scholars that applied prospect theory in investigating risk-return association.

After Fiegenbaum, prospect theory has continued to enjoy significant application in the fields of management sciences, economic and psychology. According to Holmes *et al* (2011), many studies in management sciences have adopted prospect theory especially when examining the risk taking behaviour of organizations. It is on the bases of the popularity enjoyed by this theory that we proposed also that prospect theory should be used to explain the moderating role of risk taking behaviour in the relationship between ownership structure and firm performance

Conceptual review

Although the concepts used in this study are not strange, defining them would make proper a clearer understanding of the proposed interrelationships in the framework. However, it is not without doubt that as simple as the concepts appear, there may still be some misconceptions of the concept of ownership structure, risk-taking behaviour among other concepts. For this purpose, these two concepts and their various dimensions are discussed.

Firm performance

Firm, or organizational, or corporate, or enterprise performance is a complex terminology that encompasses many facets of organizational existential purposes. The complex nature of the term sometimes makes it somewhat difficult to explain with simple straight forward words and terms. However, in corporate literature, performance is often categorized into two broad measures of financial and non financial. The preference for either measure depends on the congruency of the research objective with the interest of a particular group who are interested in it (Bhagat & Bolton, 2008). In other words, the decision to adopt either financial or non financial measures is often guided by research purpose and the interested group to which the performance measures matters most, while at the same time acknowledging the limitation of exclusivity of other performance measures.

Popular measure that have been in use include return on assets (ROA), return on equity (ROE), operating profit (OP), return on investment (ROI), earnings per share (EPS), Tobin's q

among other (Akpan, 2017a; Ayako, Githui & Kungu, 2015). In either measure, the bottom-line is the ability of the firm to manage resources in such a way that guarantees competitive advantage (Iswatia, & Anshoria, 2007). This definition resonates well with past scholars because it captures the very essence of business enterprise development (Almajali, Alamro, & Al-Soub, 2012). Every firm is interested in superior level of performance for a number of reasons which include but not limited to tax, investment, return, industry growth and contribution to social and economic wellbeing of a nation (Almajali *et al.,* (2012). This has attracted intense research interest on the subject with a view to finding a better, most efficient and effective way to attain it. And ownership structure and form have been identified as one of the determinant firm performance as discussed in the section that follows.

Ownership structure

The term ownership structure is often misconstrued and used synonymously with ownership concentration as found in many empirical studies (see Al-Saidi, & Al-Shammari, 2015). Abdulsamad, & Yusoff (2016) and Vroom & Mccann (2009) defined ownership structure as "the relative amount of ownership claims held by insiders (managers) and outsiders (investors with no direct relationship with the management of the firm)". This definition categorizes all potential claimants only as being either an insider or an outsider. However, a broader understanding of the concept of ownership structure can be achieved by looking at the various measures used as its proxies as presented in Table 1.

Table 1. Summary of empirical measurement of ownership structure

Authors & Year	**Nos.**	**Constituent measures**
Namazi & Kerman (2013)	4	institutional investors, corporate shareholding, managerial shareholding and foreign shareholders
Alves, 2012	3	managerial, concentration and institutional ownership
Nor *et al.* (2010)	6	concentration, management shareholders, state firms, individuals, nominees, and corporate shareholder
Dinga, Dixon & Stratling, (2009)	8	managerial, institutional, non-financials, family or individuals, governments, banks, foreign, and all largest ownership
Ma & Tian (2009)	2	10 largest shareholders and state ownership
Ali *et al.* (2007)	3	ownership by manager, block, and foreigners

Table 1...

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Lee (2008)	3	concentration, foreign, and other firms
Haniffa & Hudaib (2006)	2	5 largest shareholders and managerial shareholdings
Abdullah, (2006)	2	management and foreign block-holders
Arshad et al. (2011)	1	government and family ownership
Yatim (2011); Fauzi & Locke (2012); Marn & Romuald (2012); Kassim, Ishak & Abdul (2012); Shukeri, Shin & Shaari (2012)	1	managerial ownership
Kim, Rasiah & Tasnim (2012)	3	government, foreign and institutional ownership
Taufil-Mohd, Md-Rus & Musallam (2013)	3	government, foreign and institutional ownership

From the table, five predominantly mutually exclusive measures can be identified. These include ownership concentration, managerial ownership, government ownership, institutional ownership and family ownership. Each of these dimensions represents how ownership structure can be understood. Brief discussions on each of the dimensions would further enhance our understanding of this concept.

Ownership concentration – This is the proportion of an organisation's shares that are owned by a number of the major shareholders (Sanda et al., 2005). Implicitly, ownership concentration is considered to be a reaction to the different levels of legal protection of minority shareholders of a firm in a particular country (Azam et al., 2011). In terms of measurement, past scholar such as Karaca & Ekşi, (2012), Obiyo & Lenee (2011), among others measured it as a fraction of share owned by the five largest shareholders or by the significant shareholders.

Government ownership - Otherwise known as state ownership, this form of ownership structure is identified as one of the most prevalent among firms in GCC. It is defined mathematically in many empirical studies as the ratio of shares owned by the state in a firm (NurulAfzan & Rashidah, 2011; NazliAnum, 2010; Irina & Nadezhda, 2009). Government ownership typically takes the form of an organization set up for the purpose of holding shares and other securities on behalf of investors.

Managerial ownership - sometimes known as insider ownership; it is "proportion of shares owned in the firm by insiders and members of the board of directors (BODs) …" (Wahla et al., 2012; Liang et al., 2011; Mandacı & Gumus, 2010). It is often given as incentives to dissuade management from pursuing personal interest at the detriment of corporate interest.

Family ownership - Family ownership has grown to assume the status of a globally ubiquitous and economically important organizational form of business ownership (Carney *et al.*, 2015). It

is said to be predominant in emerging market as members of the family usually prefers to hold a high percentage of company values.

Foreign ownership - It is the proportion of shares owned by foreign investors in a firm that is domicile in another country. This type of ownership can be by an alien as individual investors or by foreign institution. They are said to be another best way to boosting a firm's market performance by providing a high level financing and by transferring both their experience and knowledge to the institution and market where they have invested (Gurunlu & Gursoy, 2010).

Intuitional ownership - These includes investors such as pension funds, insurance firms, other companies or corporate investors like one bank buying and holding a share of another bank or firm among others. By buying and holding such shares, they can play a significant role in influencing the operations and performance of the issuing or selling firm due to their depth of knowledge and wealth of experience (Almudehki & Zeitun, 2013).

Risk taking Behviour

Technically, risk taking is a firm's attitude of accepting to venture whereas, risk behaviour can be describes as an act of a firm which could be seen as being risk taking or risk averse. Defined as a conscious decision making among alternative results under probabilistic uncertainty situation (Dan-Jumbo, 2016; Berglund, 2007), risk taking is very important to organizational performance. Also, risk taking refers to the propensity to involve in activities that have equally potential benefits and harmful outcome simultaneously (Mehdi & Hamid, 2011). According to Fazelina, Gary, Fauziah, & Ramayah (2013) and Hamid, Rangel, Taib, & Thurasamy (2014), risk taking is concerned with the commitment of significant resources to activities that have both significant possibilities for failure and success, with the purposes of reaping potential high benefits.

INTEGRATIVE FRAMEWORK OF OWNERSHIP-RISK-PERFORMANCE: DEBATES AND CONFIGURATION

The rationale behind the proposition of an integrative framework for analyzing ownership structure and firm performance in the presence of risk taking behaviour is best argued from theoretical and empirical inferences as well as "common sense dictum". Theoretically, earlier discourse on relevant theories presented above reveal that each dimension of ownership structure entails an attributes of risk taking preferences of corporate stakeholders. Agency theory says business owners are risk lovers; believing in high risk higher return paradox, they would encourage managers through incentives to invest in high risk project, a position that the managers are less likely to take unless, the associated risk-incentive problems are apparently

resolved by the principals. Given this scenario, a firm's risk taking propensity would thus depend on shareholders ability to manage the associated risk-related incentive problems. One of such problem is having a risk-averse manager to pass up positive but risky projects with attractive net present value which shareholders would like to undertake (Lamy, 2012) in the interest of shareholders against their interest. This way, it may be right to say that the principal reason for the emergent of conflict among various stakeholders in an organization is preference for risk taking. This being so would imply that risk-ting is a critical factor in how the ownership of a firm is structured in relation to its performance.

Empirically, some studies on ownership structure have examined how different types of ownership structure have different implications for risk taking. For instance, it was argued that institutional investors, though they suffer from under-diversification and extended liability problems, the organization in which they have stake in tended to perform better due to the fact that they have strong preference for risk taking (Barry *et al.*, 2011). In other words, institutional ownership and risk taking are considered to be highly correlated, meaning that firms with high institutional ownership (or investors) are more likely to be associated with high risk taking. This proposition was also contended in Hartzell & Starks (2003) and in Cheng, Hong & Scheinkman (2010) where a positive correlation between institutional ownership and risk taking could be inferred. Another form of ownership structure that we can draw inference on its relationship with risk taking is individual and family ownership. It was shown earlier that in organizations where individual or family stakeholder with no controlling stake in the firm diversifies their portfolio and would prefer taking more risk. Although they may suffer from coordination problems and lean capacity to influence executive compensation, they (family ownership) appears to have a reverse correlation with risk taking excepting the condition that such firm is thickly family-dominated enterprise. With such condition, a positive direct association may exist between family ownership and risk taking and performance may well be positively influenced.

As Hoyt & Liebenberg (2011) explained, risk management nay risk taking behaviour involves identifying and evaluating collective organizational risk to minimize failure and maximize firm value for all stakeholders. And most importantly, risk taking is one of the key issues in strategic management, decision making and strategic change (Shimizu, 2007). Abdulsamad, & Yusoff, (2016), and Liu (2011) are of the opinion that in the present day, businesses firms use risk management as a method or strategy for risk reduction in order to attain preset goals and objective. This is done in the believe that the stronger the risk management which facilitate risk taking propemnsity, the better the competitive advantage for the firm. In literature, it is argued in relation to firm performance that risk management as well as

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risk taking enhance a firm's ability to achieve competitive advantage and expected returns. Inefficient risk management and risk taking can ruin corporate existence.

Managed and assumed properly, a higher risk taking will result in higher returns; therefore, taking risk is critical on account of the increase in globalization (Abdulsamad, & Yusoff, 2016). The authors further explained that managers of firms are today focusing more on achieving risky projects for purposes of increasing organizational profitability. Also firms manage risk and take risk differently in an attempt to minimize its effect on performance. One of the ways is to manage operating and financial leverage, the later being linked to systematic risk that can affect firm performance (Nimalathasan & Pratheepkanth, 2012).

Also, we can pitch another argument for the integrative framework based on "common sense dictum" which appeals to rational judgment favourig risk taking as an organizational strategy. On this reasoning, the idea that risk exist everywhere (Akpan, 2017a) suffices, and so does the contention that that the volatility and dynamism that characterized real life business world bring to fore the concept of risk as an important factor that must be considered in any investigation involving business operations and its performance. It is therefore, commonsensical to consider risk taking as an integral part of an organizational life and the foundation for success only if recognized and managed as such (Dan-Jumbo, 2016).

Still on common sense analogy, we can argue that risk management concept and practice has become a rising phenomenon in the analysis of firm performance. This is moreso with current emphasis in financial research gradually shifting away from quantitative finance toward qualitative or behavioural finance. In the opinion of Akpan *et al.* (2017a, p. 59), "risk-taking vis-à-vis the entire field of risk management has received a rising attention in many fields not by choice but by design because of the inextricability of risk, not only from business but human existence". The purpose of risk management vis-à-vis risk taking behaviour is to enable the right decision to be made concerning which risk to take and to what extent such risk must be accepted by an organization.

Therefore, the role of risk taking in moderating the influence of ownership structure on firm performance seems largely unexplored explicitly in past studies probably due to the absence of appropriate analytical framework. Therefore, we proposed that the framework shown in Fig. 3 could serve as a template for analyzing firm performance in relation to ownership structure with risk taking behaviour as a latent variable with considerable potential moderation effect.

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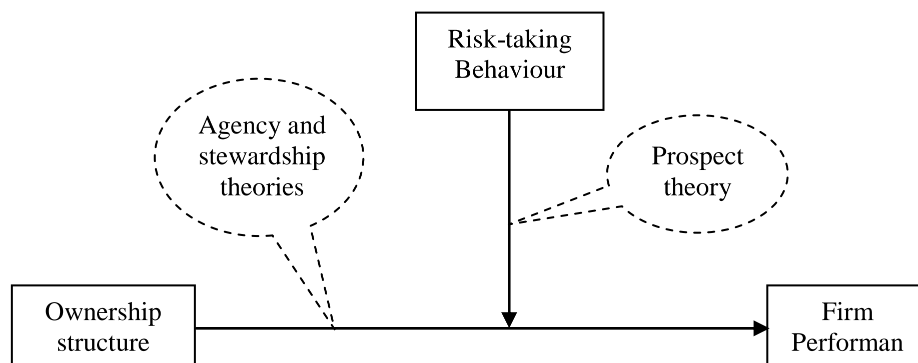
Figure 3. Proposed integrative framework for ownership-risk-performance



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The above framework provides relevant theories that could be applied in making arguments for the various relationships. This configuration follows contemporary authors that have applied similar framework in different context and phenomenal analysis. These include Akpan et al. (2017b&c) which applies similar framework in investigation capital structure and firm performance; Yung-Chien (2016) which also applied similar framework with corporate innovation activities (which represent risk-taking) as a moderator and Eikenhout (2015) which moderated enterprise risk management on financial crisis and insurance performance. In summary, these suggest that the era of uni-variate and bivariate relationship analysis is receiving less empirical attention as empirical outcomes remained contradictory over time; and; has given rise to multivariate and multidirectional investigations.

In summary, our propose framework provide in-depth analysis of some fundamental issues that have not been clear in past studies. The first issue is that ownership structure should be discussed inclusively with risk taking preferences; and second issue is that a robust analysis of the relationship between ownership structure and firm performance could also be more revealing by incorporating the level of risk an organization assumes.

CONCLUSIONS

In this paper, we presented succinct discussions in ownership structure, firm performance and risk taking behaviour as an independent construct. The purpose of this was to provide evidence explicitly and tacitly on how these constructs must be integrated to offer a more robust and comprehensive analysis of firm performance that may be associated with ownership structure. To do this, relevant literature on supporting theories and inferential empirical evidences have been reviewed. We found that both theory and the concept of ownership structure mentioned an inextricable role of risk taking as an essential part in almost all dimensions of ownership

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structure but a framework that integrate these risk taking with ownership structure while examining the effect of the later on firm performance is largely lacking. Therefore, this paper has demonstrated that in studies involving ownership structure and firm performance, risk taking preferences of the firm could play a moderating role in the relationship and thus offers more understanding of the relationship for practical and policy applications.

Consequent upon the above, the paper put forward an analytical framework, showing the architecture of ownership structure, risk taking and firm performance and other relevant configurations to aid empirical analysis of the interrelationships among these constructs. Also, we aver therefore that using the proposed framework could offer more explanation of the phenomenon and recommend that the framework should be adopted in future studies with focus on the direction and magnitude of the changes on the outcomes from which a clearer understanding of the relationship can be achieved by referring to outcomes from the predominating direct effect framework and models in past studies.

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