IMPACT OF MANAGERIAL OWNERSHIP ON FIRM PERFORMANCE OF PAKISTAN MANUFACTURING SECTOR

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Dedication

To My Beloved Parents

DECLARATION

I, **Adeel Karim** solemnly declare and affirm on oath that I myself have authored this MBA Thesis with my own work and means, and I have not used any further means except those I have mentioned in this document. All items copied from internet or other written sources have been properly mentioned in quotation marks and with a reference to the source of citation.

Adeel Karim

List of Abbreviations

KSE	Karachi Stock Exchange
SECP	Securities and Exchange Commission of Pakistan
CEO	Chief Executive Officer
ROA	Return on Assets
ROE	Return on Equity
SIZE	Firm Size
NI	Net Income
LEV	Leverage
DIV	Dividend
OLS	Ordinary Least Square
MSO	Managerial Ownership

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ABSTRACT

This study provides the evidence on the impact of managerial ownership on the firm's performance. It includes 140 non-financial firms of the manufacturing sector of Pakistan. For this purpose Pooled OLS technique is used. The impact of managerial ownership on the performance of the firms is undertaken. The study finds an evidence that managerial ownership exerts significant and positive influence on firm performance. The relationship revolves around the linear relationship of managerial ownership and firm performance by following convergence of interests (Incentive alignment theory). The results show that managerial ownership is an important instrument to reduce agency cost in case of manufacturing sector of Pakistan.

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Chapter 1

1. INTRODUCTION

Internal governance is measured by managerial ownership. It gives monitoring mechanism and align interest with shareholders, agency conflict is reduced and performance of the firm increased. There is a motivation for managers when they hold company's shares as such ownership provides managers to maximize the performance of the firm and also increase incentives. Another motivation consistent is that managers hold shares for its essential voting rights, e.g. to expand their effect on the top managerial staff and hence the general policies of the firm.

Agency relationship usually an interest conflict between the managers and shareholders. In financial terms agency cost arises when managers take decisions in different to their objectives but act on the behalf of shareholders. This conflict of interest result in weak decision of the firms leading to the agency theory which highlights that shareholder and manager's different goals and capacities influence the corporate behavior and outcome (Milgrom and Robert 1992).

Berle and Means (1932) argue that the shareholders are isolated to monitor managers so the main purpose isn't means that to maximize the shareholder's wealth but to satisfy manager's self-interest by using resources of the company to increase the firm performance.

Subsequently in 1990s, ownership structure and corporate governance of the firms have been the most challenging and consideration taking problems in a developing economy like Pakistan. In the past various researches have been accompanied, in the Asian

side economies, the ownership structure is significantly focused. Especially Indian side; gatherings for the most part control the commercial organizations. The case of Pakistan is not very distinctive, a bigger piece of the shareholder commercial structure in Pakistan takes centralization family ownership , and due to this the control take the standard stockholders, as well as involved in to management activities. As proposed in the meaning of ownership attention, control of ownership is under in the little amount people, elations, administrators, executives, holding organizations, groups and further nonfinancial partnerships. People or clusters are likewise called "managerials" as they frequently accomplish, controller otherwise confidently impact the process by an organization. Therefore, this concentrated ownership structures are stated as "managerial systems".

Several experts highlighted the conflicting situation between shareholders and managers; managerial level ownership has been proposed by easing the agency issue [Jensen and Meckling (1976)], though around adverse perspectives to given recommendation. To the extent the impact of the managerial ownership on performance of the firm is concerned a few studies recommend that expanding management equity stocks result in better arrangement of incentives related to monetary terms between managers and different shareholders (incentive alignment argument). Then again some studies reinforce entrenchment dispute which fights that association between managerial ownership and firm performance is negative [Demsetz (1983) and Fama and Jensen (1983)]. Being referred to between these two contradictions Morck, et al. (1988) joined contention and Stultz's (1990) incorporated hypothesis emerges. These conflicts are of the viewpoint that corporate performance is a non-repetitive reason for managerial ownership. Various view

furthermore have exhibited that there is no relationship between managerial ownership and firm performance (Natural Selection Argument).

Managerial ownership attempting to decrease the agency issue through merging back the ownership structure and control segment of the firm. Agrawal and Knoeber (1996) delineate the criticalness of ownership structure as control framework in agency issue. They inquire about firm performance and instrument to control agency issues and their discoveries is to reinforce managerial ownership as segment of control and impact firm performance. The relationship between shares held by administrators and firm performance is finding mixed. Two basic confirmations arise out of the observational writing. To begin with most of these studies give confirm that managerial ownership truly impact firm's performance. The outcome of managerial ownership on firm's performance is positive and it is clarified by the converging of interest theory, communicating that substantial value shares of managerial should be joined where market valuation is higher in light of lower agency costs. On the other hand, a negative relationship can be explained by the entrenchment theory, establishing that managerial ownership over a breaking point will have impact over some limit as a result of the crucial clash between substantial shareholders (for this circumstance the administration) and the distributed stockholders.

There is inadequate study to this matter of firm's performance and managerial ownership. There are more extensive space particularly on account of developing countries like Pakistan, in light of the fact that the greater part of the study done depends on the information from developed countries.

The conflict between management and shareholders has been concentrated broadly by analysts trying to understand the way of the firm Berle and Means (1932). Corporate

resources can be utilized for the advantage of managers instead of for increasing wealth of shareholder at the point when shareholders are excessively diffuse, making it impossible to see managers. It is surely understood that an answer for this issue is to provide administrators a value stake in the firm.

Firm's ownership is conducted to affect the firm's performance. (Reddy, 2010). Definite firms attributes are linked through firm's great enactment which contain size (Love and Rachinsky, 2007), growth, dividends, rate, liquidity (Gurbuz et al., 2010). Substantial firms draw in better managers and laborers who increases to the performance of the firm.

The convergence of interest hypothesis discuss about the firm performance and managerial ownership. Interest convergence model give contentions and clarification that whenever there is higher rate of managerial ownership in the firm, then there is better firm performance because of less agency issues and problems between managers and owners of the firm.

Whenever managerial ownership is discussed then there are two types of effects which are involved in it. One is alignment effect and the other is entrenchment effect. The alignment effect concludes that when there exist a higher level of managerial ownership then in respect of this the higher ratio of managers aligned towards the goals and objectives of the firms. On the other hand, entrenchment effect discuss that the greater managerial ownership level, the higher ratio of managers entrenched towards their personal goals and personal gain achievements. The present study concentrate the part of the ownership managerial besides agency costs is control and growing performance of the firm.

1.2. Research Questions:

- Does managerial ownership influence firm performance in Pakistan?

1.3. Objective of the Study:

This study focuses on the effect of managerial ownership on firm’s performance of manufacturing area of Pakistan. Following are the main objectives of this study:

- To examine the effect of managerial ownership on firm performance.

1.4. Significance of the Study:

To understand the effect of managerial ownership on firm performance is important as in Pakistan there are large number of family firms where managers are owners. They have incentive to increase the value of the firm. This study increase the understanding. It is useful for individual investors, family owners, researchers and academics.

1.5. Plan of the Study:

The plan of the study is as follows. After the introduction, chapter 2 reviews the literature on the issue; chapter 3 model specification, methodology data and variable description use in the study, chapter 4 present the empirical findings of the study, last chapter offers conclusion, policy implications, limitations of the study.

Chapter 2

2. LITERATURE REVIEW

There is larger body on literature which explains relationship between managerial ownership and firm performance.

Jensen and Meckling in 1976 proposed agency model, that shows the division of management and ownership now a days offers conflict between the two partners. Managers frequently take part in those work to maximize their own interest instead of that firm on the grounds that they get the full repayment of such activity and didn't focus on firm's performance. Those managers are treated as a developer to reveal awareness into the part of managerial in deciding firm performance. Managerial ownership is a tool to adjust the interests of managers and shareholders as discussed by Jensen and Meckling (1976). There is a positive relationship between managerial ownership and firm performance (interest convergence theory).

Jensen (1984) shows that firm performance and managerial ownership has negative association. Moreover different specialists recognized a relationship among various procedures of firms centrality *i.e* Tobin's Q and Managerial ownership; changed "mound molded" or "U formed" association between the managerial ownership and Tobin's Q .

Jensen, Ruan, et al. (2006) take given reasonable proposal on the "interest convergence" and also "entrenchment" impacts of managerial ownership, and establish that the relationship is non-linear between managerial ownership and the firm's performance. Managerial ownership enterprises the influence of a non-linear shape. Possible outcomes

of study has proposed that initially it’s a managerial ownership that effects influence, and in this way influences the company's performance. Firm performance is an expansions as the level of managerial ownership is arises as of 0% to 18 %, and later it declines till then it comes to 64%. Mostly once managerial ownership is in the degree of 17.8% to 46.4%, then this shows a positive relationship between leverage ratio and managerial ownership and negative connection else. The study influence is also joined to check its effect on company’s (Q degree) yet the outcomes have wound up being unimportant. Though capital structure is affected by managerial ownership and the capital structure is impact firms’ esteem.

Pant and Pattanayak (2007) state that at first firm esteem rises by contributing on it and the stock ownership by manager. Increase in worth might happen by quality of the way that at first manager don't get improved in as business section controls force them to search for after quality expanding purposes they comparably need to demonstrate their performance with the target and might not get balanced through more significant association for appropriation. In research while ownership exceeds 20 percent it persuades the chance to be enough sensible for them to search for after quality non-developing objectives except some weakening in the firm in their position. Rise in the ownership above 49% there advantage scope of firms with those as they take raised enthusiasm for the firm in light of the way that they ought toward standing occurrence of every money rout in firm esteem. in ownership some spot around 0% and 20% every one rate point develop prompts gather firm respect by a standard 0.005 and for each 1% growth in proprietorship from 20 for each percent to 49%, firms esteem reduces by 0.007 focuses.

Mueller and Oener (2001) another significant study which has concentrated on the impact of ownership on performance furthermore attempt to inspect the elements of managerial ownership for small and large size private associations. The present study has utilized 1300 firms acting as a part of the German business related association division for year 1997 to 2000. Examination discovers a profitable consequence of the managerial ownership which is around 80% share on firm performance and 80% if there should be an occurrence of managerial ownership and this impact turns into the negative. Those organizations who are altogether possessed by the supervisors there performance is make strides. The study has neglected to report any point of preference as an aftereffect of checking done by untouchables. To the degree factors is concerned, the managerial ownership influence in a non-straight way.

Thomsen & Pedersen (1999) study the firms in EU 12 nations going after the year (1990 & 1993). Performance has negative relationship with ownership focus by utilizing return on value to gauge performance results, regardless isn't an important. Tobin's Q diminishes when performance is measured with ownership by (5 or 20) biggest stockholders record however outcome were inconsequential. A substitute way to deal with oversee assesses the envisioned by managerial ownership is gotten by Zhou and Hu (2007). Study examines the performance of firms having managerial ownership with those not having managerial offer proprietorship. Utilizing coordinating example examinations research finds that associations having an essential managerial ownership succeed to perform superior to anything firms having no managerial stock ownership. There is a positive outcomes of managerial ownership and that outcome is capable and strong.

In their findings Abdullah, et al. (2011) explored the impact of corporate ownership structure on firm performance. Using an outline of 183 KSE recorded firms for the period 2003-2008. They use OLS and 2SLS backslide models. Business section based measure Tobin's Q and accounting based measures ROA and ROE of firm performance both used and related to be conflictingly related to the ownership's share of the managers. Resources unmistakable quality and nature of interest and change opportunities prompts amplify Tobin's Q, while it diminishes with firm size. Their outcomes demonstrate that where the rate ownership of related ownership and square property is over their particular 50th percentiles then Tobin's Q is in a by and large higher in firms. Large firms have expanded the value of Tobin's Q which implies that the performance is similarly increases with size. Also, the test result demonstrates that the piece holding decrease the organization costs, and makes positive failing impact.

It has been concentrated on the period 1976 to 1984 with US affiliations. This investigates the relationship of corporate significance and ownership structure. It just concentrates only on those organizations having net yearly trades more significant instead to the 500 small firms in a time to an examination. By evaluating, Tobin's Q corporate value is utilized. May be those variables that are distinctive, they influencing firms esteem on the other side the ownership configuration are joined the impact level, size of the firm, promoting and R&D usages and further industrial particular variable are additionally used dependent variables to take out the dissimilarity. The outcomes discover that in a general sense managerial ownership relies upon corporate value. The Q-ratio of the firm rises when the managerial ownership is point out in between 0% and 5% to 7%. In other case, its declines when the ownership level rice upto 10% to 12%. The conclusions reveals that

managerial ownership with low level is joined positively with firm performance. Chan, et al. (1993)

Javid and Iqbal (2008) examine ownership and it is association with company performance. A sample of fifty firms were taken as test from Pakistan for the time of (2003 to 2008). Organizations have more connected with ownership which might be an immediate result of weak legal environment in Pakistan. Firms build benefit and performance when they prompts ownership concentration. There is a negative association with managerial ownership concentration that has openness and statements in corporate management study. The exploration demonstrates that some firm particular variables in addition influence ownership focus e.g. more theory open gateways goes about as enthusiasm for leaders to develop social affair of their ownership. Firm size has inverse impact and lead misconception of ownership.

Bathala,et, al.(1994) have concentrated a relationship between managerial ownership, institutional ownership and firms' leverage level and they accept that the organized ownership are contrarily joined with level of influence and managerial shareholding in organizations. Mathematical statement framework is utilized all the while and two stage minimum square philosophy (2SLS) is utilized to consolidate the issue of indignity. Gained results reinforce that institutional financial specialists' go about as watching operators adequately which encourages reasonable office cost. Research and development costs and headway are additionally then again identified with debt ratio. The check that institutional having a place has negative effect on managerial value ownership is particularly weak. This concentrate additionally demonstrates the levels of leverage and managerial share ownership are related oppositely. This proposal encourage agency theory

wishes as increases in managerial ownership level and seen to remain joined with greater measure of change and R&D that prescribe the higher agency costs.

Kaserer & Moldenhaure (2008) choose 648 German recorded firms sample of covering the years 2003-2007 has attempted to search the effect of firm performance with managerial ownership. Between the two variables observational confirmation support the vicinity of positively and uncommonly huge relationship. The corporate performance is calculate using distinctive intermediaries' i.e stock quality, market to book ratio and return on assets (ROA). There are using two system for estimations. First, to control the agency cost as corporate management framework of managerial ownership, pooled OLS technique is utilized. Second, as the relationship between firm performance and managerial ownership is endogenous, focus advance contemporary mathematical statement framework to control the issue of indignity in the set of the data. These outcomes are strong because all the performance measures as it holds used as a part of the concentrate yet when stock expenses are used to evaluate performance the verification get the chance to be more grounded when appeared differently in relation to once used to ROA and market to book ratio. Outcomes of the study shows the managerial ownership level stays constant ultimately and the positively impacts firm performance. Outcomes show that ownership centralization of any kind whether it's managerial or some other structure prompts improve the performances of the firm. According to this study the basic variable in choosing estimation of the firm is ownership.

Lim,et al.(2007) have researched the association between the managerial ownership and firm's performance. Illustration comprised of 155 listed firms on Shanghai stock exchange China and Shenzhen stock exchange. The managerial ownership is selected as

number of shares held by the director of firm as rate of aggregate number of shares. There are three methods that are utilized to assess firm performance these are return on assets, normalized real profits and the return on sales and the four variables which are utilized to control the organization impact are age, leverage, firm size, and CEO duality. The study is going utilize a fake variable that partners 0 if the firm is listed in the Shenzhen stock exchange and 1 if the firm is listed in Shanghai stock exchange. According to the outcomes there is a favorable position associated with the managerial ownership, and high level measure of managerial shareholdings in the firm for better the advancement of total assets regarding the growth of profit.

An example of recorded firms of US and managerial ownership and company's worth to investigate the affiliation is picked by Fahlenbrach and Stulz (2008). The variables measured are changes by Q on lagged ownership and which impact the fixes regression model. In the managerial ownership firm’s director and officers is measure to incorporate the ownership of the share of the firms. There are independent variables which are property, plants and equipment as ratio to the total assets and book value of assets, Research and Development use unpredictability, free income and Dummy variable which breaks even with 1 if the firm doesn't make any Research& Development costs and o generally, change of CEO and capital consumption. The study inferred that supervisors fundamentally bring their ownership level up in the firm when financial condition of the firms are not stable and to diminish their ownership level when the firm's shares are performing better in the business sector. The outcome additionally demonstrates that when there is a major change in firm’s performance then there is a major increase in company's Tobin's Q ratio. So there

is no tasteful result found that huge decrease in ownership goes to unfavorable impact of the value of the firm.

Wruck (1989) shows that there is a non-direct relationship between firm's performance and the managerial ownerships. There is an opposite relationship between firm performance and managerial ownership as stated by Berle and Means (1932). There is an adversely relationship between the managerial ownership and agency cost and positive relationship between firm's performance and managerial ownership (Jensen and Meckling) (1976). According to the convergence of interest theory, because of lower agency cost there is a positive relationship between performance of firm and managerial ownership. Whereas a negative relationship in between firms' performance and managerial ownership is suggested by the "entrenchment theory". In the firm when there is a higher level of managerial ownership it encourages the managers to accomplish their goals and objectives. The manager who holds an extensive number of shares in the organizations has held the results of managerial activity that either make or destroy the company's performance. The organizations ought to perform better and high managerial ownership when managers work hard and take good investment decisions.

Jensen and Meckling (1976) while investigating diverse ownership design managerial ownership seems to be the most unclear on the grounds that it has uncertain effects on firm performance. Then again, it is measured to be an instrument for relationship of managerial interest with those of shareholders. Managerial ownership gives money incentives to their managers to enlarge the benefit and because of this present organization's performance is expansion. Morck et al (1988) and Stultz (1988) However, managerial

ownership is advances entrenchment of the managers which is particularly excessive when they have low skills or like to carry on with a simple life.

Fama and Jensen (1983) and Deserts (1983) test convergence of interest theory. It is stated that managerial share ownership helps in adjusting in the between of management and shareholders and can be diminished managerial motivations to extend perquisites, and dispossess wealth of the shareholders and participate in other non-maximizing conduct. The managerial share ownership might have an opposing impact on agency conflict in the middle of shareholders and management just because of the costs of huge share managerial ownership. As opposed to decreasing managerial motivating forces issue, managerial share ownership may set up in the workplace management group, promoting an increase in managerial advantage.

As showed by Fama (1980), to control the managerial team members there are different perks and privileges for the managers. From one viewpoint, conflict is being arises among the upper level of managerial ownership to succeed the most elevated and most impressive positions in association. The current opposition encourages checking among directors, subsequently non quality improving the practices of various people from the managerial group and might provide few purpose of preference, whatever is left in the managers to finish upper positions. Then again, the managers work business area supervise managers to administer one another's activities. Non quality expanding exercises by an individual from the managerial group can negatively affect the association equally estimated value, in managerial work market the estimation of the entire group of managers is diminish. The manager's capacity is to perform shared checking depends on the

scattering of managerially power, when a reasonable grouping force is controlling by a single managers then the observing framework is being more hard to set up.

Higher managerial ownership in the firm is to allow the managers' that they take over the bid and can diminish the firm value; (Fernandez and Arrondo (2005) and Stultz (1988). The firm performance is rise with lower level and fall with higher level of managerial ownership; Mork el al. (1988); McConnell and Servaes (1990, 1995); Hermalin and Weisbch (1991); and Holderness et al. (1999). Entrenchment theory and interest convergence hypothesis shows that there is a curve-linear relationship firm performance and managerial ownership. According to Morck,et al. (1988), McConnell and Serves (1990) and McConnell and Serves (1995) finds that there is no straight connection between firm performance and managerial ownership. The following studies specify that because of interest convergence theory, firm performance increases at low levels of managerial ownership.

Kaserer and Moldenhaure (2007) contend that external piece of ownership furthermore more concentrate on managerial ownership and corporate performance have positive outcome in the event of German firms. Khanna (2007) report the managerial ownership has an important relationship with performance of the firm and have significant effect. Firm performance is affected by the managerial ownership over the manager's activities of high work cost. Fahlenbrack & Stulz (2008) discover that the managers will probably diminish their ownership when their organizations are performing great and more likely to expand their ownership when their organizations turn out to be financially debt. The outcomes is likewise recommend that there is huge increase in the Tobin's Q and managerial ownership, and not discover any verification of the extensive reduction in the

ownership have unfavorable impacts on firms' performance. Li et al, (2007) discover that the organizations where there is higher level of managerial ownership seems to govern their asset, advancement extra precisely due to association with their benefits improvement, thus the entry of assets shows a lower decrease in respect of various organizations.

A non-straight relationship between the managerial share ownership and the firm's market value, as explored by Mrock et al. in 1988, and concluded that the managerial ownerships rises from 0 to 5% as the business sector estimation of the firm rises, then again, as the company's reasonable worth decline than the managerial ownerships increase from 5%-25. Finally, firm's market value reduce 25% as managerial ownership expanded. This result gives a confirmation of managerial entrenchment. While there is a lower agency cost because of holding the lower and higher levels of managerial ownership. Welch (2003) & Khan et al. (2007) build a non-linear general classic in light of the investigation of Mrock,et,al. (1988), yet they neglect toward find some important connection. Craswell et al. (1997) found immense curvilinear relationship only for huge organizations through a defining moment of the approx. 50% of managerial ownership. Chen et al. (1993) discover that they are steady at a low level of managerial ownership, i.e. inside and outside aspects of control management, have a positive association between managerial ownership and firm esteem. Short & Kaesey (1999) discover the certain basic effect of director ownership and cubic ownership however have a negative effect of aligned ownership. Huge control variables are size and development and the polynomials achieve its most extreme at 16% and its minimum level at 42% ownership.

Jensen and Meckling (1976), state the firm's agency model, the present day company association is liable to the agency clashes emerging apart of management in the firms and ownership. In this setting, managers have an opportunity to expand his own wealth instead of the maximizing shareholders' wealth. Agency theory proposes a few systems to diminish agency issue, and three studies are important to reduce agency issue. Jensen and Meckling (1976) proposed another system is to enlarge the ownership structure of directors in the firm, and compelling managers to tolerate an investment outcomes to their activities. Subsequently, managerial ownership can work as control instrument because of external shareholders' while adjusting their interest of managers. Sundaramurathy and Lewis (2003) underlined that managerial advantage in the firm is controlling by the managerial ownership. What's more, Vo and Phan (2013) found that the increase in managerial ownership will enhance the performance of firms in Vietnam. In any case, when managers has a huge part of the company's capital, then there is rising in ownership and managers didn't take an improper decisions.

The discussion in going before research concerning the part of managerial as a motivation, incentive and support, techniques and methods and the shareholders feel secure and solid association with different shareholders in order to improve the firm performance and also that solid relationship will have positive effects on the performance of the firm too and then will have additionally extremely concentrate on the agency issues and their control and screen and supervise the managers furthermore on the division of firm ownership and control (Berle and Means, 1932).

Sheilfer and Vishney (1997) study firm ownership and market evaluation of 370 diverse firms. The finding of this study concluded that firm performance first increase

when the ownership with managers reaches up to 5%, then suddenly the firm performance decrease as managerial ownership reaches from 5% to 25%, and then there is a slight increase in the performance of the firm when mangers have ownership increases to 25% or more.

Cosh and huges (1987) study that diffused and indirect ownership give a control, influence and power to the managerial ownership, and owed to the separating and distinctive interests and advantages of little and fundamental shareholders the quality, worth and performance of the firm not expanded but rather going on the lower side, because of that different and separating advantages, interests and preferences furthermore then the corporate assets at all times not use for a definitive objective of the firm which is to maximize the shareholder's wealth and increase the firm performance.

There is nonlinear connection between managerial ownership and performance, (Morck, Shleifer & Vishny 1988), yet on one side when the managerial firm ownership support to make parallel the inclinations of the specialists, central and ownership, by controlling misuse and spending of additional remittances and bundles given by the shareholder, as a consequence of agreement and assertion that the destinations and objectives of the firm ought to be accomplished. Despite the fact that have on the other side managers have tendency to make insufficient effort, aggregate the classified compensation and dig in or set up the top management ownership at all levels, make weaker the relationship between the top level management and firm performance (idea of entrenching the preference of the managers with the interest of shareholder).

(Jensen and Meckling, 1976; Fama, 1980; Jensen, 1993) state that managers are engage in increasing their personal wealth and while shareholders are ken interested in

increasing their profit. This will bring about an irreconcilable circumstance in managers and shareholders. There are three different ways of expropriation: interest in activities that advantage the managers as opposed to the interests of organization, management entrenchment and price transferring. Hypothetically, interest alignment theory have proposed as a component to be utilized to adjust the interest between shareholders & managers. From agency theory with respect to the interest alignment. Sappington (1991) proposes that keeping in mind the interest of shareholders with managers it's an important benefit for managers to rise their value and wealth. Jensen & Meckling (1976) discuss that managerial ownership required to produce the complete surplus to motivate the agents, on the basis that as the level of managerial ownership expands then the managers and shareholders' interest is to be more aligned, in this manner the opportunistic behavior is decrease. On the other side, when managers have more hold in the firm *e.g. share ownership*, then they acquire more expenses for not increasing shareholders wealth. Subsequently, adjusting the interests in between of agents and principals determines for the agency issue and accomplishes the fundamental objective of the shareholders, which is to be maximize the value, therefore there is a positively effect on firm's performance. Shleifer & Vishny (1997) & Becht et al.(2003) expressed that managers isn't interested just to maintaining a strategic distance from the agency issue, but rather are inspired by different reasons, for example, their profession development and their standing. It is surely understood that managers ought to consider the significance of their status and their picture to secure it all together for any further chances to work later on.

Diverse study (e.g. Krivogorsky, 2006; Palia and Lichtenberg 1999; Weir et al., 2002; Kapopoulos and Lazaretou, 2007; Bhagat and Bolton, 2008; Mangena and

Tauringana, 2007; Owusu-Ansah, 1998; described that firm performance positively impact the managerial ownership. Owusu Ansah (1998) investigate by taking 49 sample, listed firms Zimbabwean in 1994 establish the positive effects on director ownership. Similarly, The association between managerial ownership and firm performance calculated through Tobin's Q & ROA by taking sample of 72 listed firms in Zimbabwe from 2002-2004. They described that the relationship is positive. Findings also shows that when there is a rise in managerial ownership then the managers and shareholders' interest turn out to be more aligned, hence agency problem will be fixed and it may affect the firm performance positively. Mangena and Tauringana (2007).

However, a few findings (e.g. Ho and Williams, 2003; Lin, 2002; Haniffa and Hudaib, 2006; Sanda et al., 2005); De Angelo and De Angelo 1985; establish that the there is negative effect between managerial ownership and firm ownership. Lins (2000) gave confirmation to an association between firms' performance and managerial ownership through 18 developing markets. Their outcomes shows that in countries having low protection of the shareholders has negative impact between managerial ownership and control. Sheu and Yang (2005) & Dalton et al. (2003) stated, no relationship is found between managerial ownership and firm performance, and the managerial ownership doesn't influence the performance of the firm.

2.1 Conclusion and Research Gap:

The review of literature suggests that managerial ownership can affect the firm performance positively or negatively. This study tries to explore this relationship in case of Pakistan manufacturing firm listed at KSE.

Chapter 3

3. METHODOLOGY AND DATA

3.1 Methods

This study examines the impact of managerial ownership on firm performance. The managerial ownership reduces the conflict between the shareholders and managers as described by Agency cost theory. This alignment of interest of managerial and shareholder leads the management to choose those project which increase value of the firm. There is expected to have positive impact of firm performance and managerial ownership. ROA and ROE is a tool through which the firm performance is measured. [(Jensen & Meckling (1976)].

3.1.1 Model Specification:

The following model is estimated to examine the relationship between managerial ownership and firm performance, where the firm performance is measured by ROA and ROE.

$$ROA_{it} = \alpha_o + \alpha_1 MSO_{it} + \alpha 2\ LEV_{it} + \alpha 3\ DIVit + \alpha 4\ SIZEit + \alpha 5NI + \varepsilon it \quad \dots \quad \dots \quad (1)$$

$$ROE_{it} = \beta o + \beta 1\ MSO_{it} + \beta 2\ LEVit + \beta 3\ DIVit + \beta 4\ SIZEit + \beta 5NI + \varepsilon it \quad \dots \quad \dots \quad \dots . \quad (2)$$

Where:

$t = 2003\text{-}2011$ $\qquad$ $i = 1 \ldots\ldots 140$

ROA = Return on Assets $\qquad$ DIV= Dividend

ROE = Return on Equity

MSO = Managerial ownership

LEV= Leverage

SIZE = Firm Size

NI = Net income

ε = Error

3.1.2 Variables Definitions:

Return on Asset (ROA)

The return on assets ratio measures how adequately a company can earn in assets by its investment. As it is, ROA indicates how proficiently a company can covert the money used to buy assets into profits or net income. The higher ratio is better to investors because it shows that company is more active to manage its assets and also to produce a large amount net income. ROA is calculated by:

$$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$$

Return on Equity (ROE)

ROE is obtained as net pay partitioned by the equity. The ratio is exercised as utilized by Yasser (2011) for organizations of Pakistan to obtain profitability of organization.

$$ROE = \frac{\text{Net Income}}{\text{Shareholder's equity}}$$

Size

Size is calculated through logarithm of total assets. Large companies have better opportunities to increase the performance of firm to utilize the resources of investment by reducing the risk of financial distress. A few studies report that when profit of the firm diminish it restricts the borrowing capacity. Firms of small size have prefer low leverage

level and large size firm can decrease financial distress because they are more diversified and have higher debt ratio. Pecking order theory, a conservative methodology recommends negative connection between debt ratio and firm size. Firms of large size and great position in business sector desire equity issuance for financing so there is a negative relationship. In Pakistan's case have the positive relationship between debt and firm size.

$$\text{Size} = \text{LOG (Total Assets)}$$

Dividend Yield

Dividend is measured as Dividend per share (DPS) over Earning per Share (EPS). There is distinction in the information level of managers and outsider investors about income distribution of the firm. This information asymmetry prompts more debt financing and high dividend and shows a positive sign to the outside investor while agency theory contend that when firm pay high dividend and firm require external financing there will be a declining in money inflow of dividend per share (DPS) and earning per share (EPS).

$$\text{Dividend yield} = \frac{\text{Annual dividend per share}}{\text{Price per Share}}$$

Leverage

Leverage is measure through debt to equity ratio. The financial leverage ratios measures that how much a company have total debt and then compare it with the company's assets or equity. This shows that how much assets of the company hold by the shareholders instead of creditors. The company is in less leveraged position whenever shareholders own a majority of the assets. On the other hand, the company is considered to be a highly leveraged when creditors own a majority of company's assets. These all are the measurements which investors understand that how risky is the capital structure of a company.

$$\text{Leverage} = \text{Debt / Equity}$$

Managerial Ownership

MO is calculated as percentage of shares possessed by managers and executives of the firm as utilized by Din and Javid (2011), Lim et al. (2007) and Fahlenbrach and Stulz (2008).

MO = Shares held by managers and directors / Number of outstanding common shares.

Net Income

Net income is measured by earning after tax over sales through balance sheet analysis. Net income shows that after paid off all expenses how much revenues will be left. This is the amount through which company pay off their debt, new investments, or distribute to shareholders.

$$NI = EAT/Sales$$

3.2. Estimation Technique:

Pooled ordinary least squares method (OLS) is used as we have data from 2003-2011 of 140 firms

3.2.1. Pooled Ordinary-Least Squares (OLS):

In this study pooled ordinary least square method (OLS) is used as proposed by Milekov, Poulsen and Wintoki, (2014). OLS is the regression analysis technique which demonstrates the direction of relationship among variables. This technique shows that which variable depends on another.

$$Yt = \alpha + \beta X1 + \mu t$$

Necessary possibility here if there should be an occurrence of OLS is that the zero error of correlation in terms of µt and regressors of the model. This shows that the independent variables of system are pre-determined. Empirical literature and theory on account gives prove that managerial ownership, dividend and leverage are not decided outside the model i.e. are endogenous to the framework. In the event that we apply Pooled OLS to acquire the appraisals of parameters it will give one-sided and conflicting result. Though, to analyze the effect of managerial ownership on firm performance, ordinary least squares (OLS) and pooled sample regression model is used.

3.3. Sample

The present study pointed is to analyze the relationship between firm performance and managerial ownership. Furthermore see a components and variables that assume critical part in deciding the firm performance, for investigating the present relationship the information of 140 non-financial firms recorded at Karachi stock exchange beginning from 2003 to December 2011 is acquired. The sample is started from 2003 as managerial ownership is actualized in Pakistan. Test of 140 non-financial firms, oil and gas sector, chemical sector, fertilizer sector, textile sector weaving, spinning, tobacco, food producing sector, automobiles and engineering sector, construction, cement and material sector, pharmaceutical sector, electricity sector, test is confined to 140 firms. The firm size, net income, dividend and leverage are used as independent variables. ROA & ROE is the dependent variable and control variable is size. These variables are utilized to explore the impact of managerial ownership on firm performance and the variables and element which

are decided in managerial ownership. The data is acquired from Balance sheet analysis which is circulated by State Bank of Pakistan. The data of managerial ownership is taken from annual reports of the firm.

Chapter 4

4. Empirical Results & Discussion

This chapter discuss the empirical results and their explanation of 140 non-financial firms for the period of nine years; i.e 2003-2011. This study analyze the impact of managerial ownership on firm performance.

A. Regarding the firm performance:

The following hypothesis are constructed:

H_1: There is a significant relationship between managerial ownership and firm performance, other things remaining the same.

H0: There is no significant relationship between managerial ownership and firm performance.

In order to test the hypothesis of the relationship between managerial ownership and firm performance, the given study is taking two unrelated proxies of firm performance, i.e. return on equity (ROE), return on assets (ROA), Other than dividend (DIV), managerial ownership (MSO) and leverage (LEV) the control variables are, firm size (SIZE) and net income (NI).

$$FP = \delta_\circ + \delta_1 MSO_{it} + \delta_2 SIZE_{it} + \delta_3 DIV_{it} + \delta_4 LEV_{it} + \delta_6 NI_{it} + \varepsilon_{it} \qquad (1)$$

Where FP is financial performance and it is measured by ROA and ROE

$$ROA_{it} = \alpha_o + \alpha_1 MSO_{it} + \alpha 2\ LEV_{it} + \alpha 3\ DIVit + \alpha 4\ SIZEit + \alpha 5NI + \varepsilon it \quad ..... \qquad (1)$$

$$ROE_{it} = \beta o + \beta 1\ MSO_{it} + \beta 2\ LEVit + \beta 3\ DIVit + \beta 4\ SIZEit + \beta 5NI + \varepsilon it \quad .... \qquad (2)$$

Table 4.1

Descriptive Statistics

	DIV	LEV	MSO	NI	ROA	ROE	SIZE
Mean	4.93757	4.950099	22.54343	5.423756	7.353255	-0.06798	8.016465
Std. Dev.	2.053982	1.114158	2.559007	2.180548	2.357328	9.678582	1.969057

The mean value and standard deviation is presented in Table 4.1. The highest standard deviation is for ROE and lowest standard deviation is for size of firm.

Table 4.2

Correlation Matrix

Variables	DIV	LEV	SIZE	MSO	NI	ROE
DIV	1	-0.059	0.200	-0.078	0.193	0.018
LEV	-0.059	1	-0.016	0.133	-0.263	-0.232
SIZE	0.200	-0.016	1	0.063	0.086	0.043
MSO	-0.078	0.133	0.063	1	-0.177	0.018
NI	0.193	-0.263	0.086	-0.177	1	0.172
ROE	0.018	-0.232	0.043	0.018	0.172	1

The result presented in Table 4.2 shows that the correlation is not high. Therefore, there is no problem of multi-collinearity.

To analyze the relationship among all the variables, Pearson Correlation Analysis is performed in this particular study. The above correlation table shows that Dividend per share has positive correlation ROE. Similarly Dividend per Share has positive correlation

with Firm Size and Net Income, while there is a negative correlation exists between the Dividend per Share with Leverage and Managerial Ownership.

The correlation between Leverage and all other variables i.e. Dividend per Share, Firm Size, Net Income, and ROE; is negative but have positive relationship with managerial ownership. Similarly the Managerial Ownership has negative co-relationship with Dividend per share and Net Income while positive correlation with Leverage, Size and ROE.

Similarly ROE has positive correlation with Dividend per Share, Firm Size, Managerial ownership and Net income while ROE is negatively correlated with Leverage.

Table 4.3

Results on the Impact of Managerial Ownership on Firm Performance
(Overall MSO)

	ROA		ROE	
Explanatory Variables	Coefficient	**t- value**	Coefficient	**t- value**
C	0.344***	9.414	0.677***	7.178
MSO	+0.01	0.377	0.011	0.647
SIZE	+0.074***	+15.389	+0.145***	+11.660
DIV	0.0140***	4.168	0.019**	2.245
LEV	-0.058***	-4.574	-0.074**	-2.237
NI	0.063***	18.879	0.131***	15.180
R^2	**0.525**		**0.425**	

Note: The ***, **, * is significant at 1%, 5%, 10% level respectively.

In Table 4.3 the section 1 & 3 shows that the result of accounting measures performance are return on assets (ROA) and return on equity (ROE),when managerial ownership and other control variables is regressed. Pooled OLS estimation technique is used.

For all the two performance measures, this study reports insignificant effect of managerial ownership on firm performance. In any case, this is reliable with Morck and Vishny (1988) prompting a way that the level of managerial ownership isn't a huge factor of firm performance in Pakistan. This outcome doesn't encourage the theory because managerial ownership positively influences the performance of firm. This is additionally reversing an expectations of the agency theory.

Now on the control variables, there is a negative coefficient of size with ROA and ROE exhibits that increase in size contributes debilitating the financial performance of the firms. In Pakistani manufacturing firms, increase in size my lead to the underutilization of assets. This outcome is as per the various investigates, for example, Mahadwartha (2004) and Din and Javid (2011).

Khan (2007) reported the results that there is a significant and positive relationship of dividend with ROE & ROA is reliable. It gives a sign in a way that dividend payment upgrades the firm's performance because reduces the conflict between managers and shareholders. Because of agency cost is decreasing, the firm performance is improved. The reason might more committed undertaking for the managers, subsequently conflict of interest diminished with the shareholders. The outcomes recommend that if resources used proficiently, then dividend payment is productive for firms intending to improve their quality and performance.

There is negative and critical relationship of leverage with ROA and ROE that shows a leverage negatively affect firm performance that might be a direct result of the overdependence on debt of Pakistani firms. Increase in the level of debt is reduces the accounting performance, proposes that it's not productive for the firms to build the extent of debt in their financing structure if there ought to emerge an occurrence of Pakistan. So

firms should use debt just as a last resort. It support the point of view that undertaking debt goes as a positive sign to financial experts as for firm's future cash flow, that in turns contributes in improvement of firm esteem. Moreover, net income have a significant and positive association with firm performance as expected in OLS. Whenever the earnings and growth of the firm increases it affects firm performance positively.

Chapter 5

5. CONCLUSION AND IMPLICATIONS

5.1. Conclusion

This study examines the association between firm performance and managerial ownership. A 140 non-financial firm's sample is taken for the time of 2003 to 2011. Out of two methods of performance ROA and ROE. It is inferred that confirmation with respect to the effect of managerial ownership on firm performance is insignificant. This is because of the way that in Pakistani corporate sector majority of firms are in family ownership and in the family ownership the members act as management, they neglect to assume any critical part in change of firm performance as they are not generally suitable for fulfill an obligations of successful management. Additionally, in family owned business the greater part of the management are normally not sufficiently qualified or prepared to take better decision with respect to firm performance. Then again, the above said family managers and directors have excessive impact on corporate decision making than the others.

It is comprehended that the listed firms in Pakistan, upto a moderate level the managerial ownership applies positive and important effect on the firm performance. There is likewise a strong evidence found of the nonlinear relationship between managerial ownership and firm performance. The nonlinear relationship represents that starting expansions in managerial ownership have increasing effect on firm performance yet when they secure a critical control of a firm they get settled in and start looking for after their own specific expectations. Again when managerial ownership comes to a great degree higher level then they begin carrying on a maximizing way and would not attempt non-

profit and risky choices as at this point they will need to carry significant adversity coming about because of non-optimal activities in light of the fact that their offer will be immense if there should be an occurrence of any conceivable adversity or improvement. It would directly affect their own-selves and at last will have to face the music.

5.2. Implications of the Study

- The performance is to some extent affected by managerial ownership, so it can play positive role in increasing the firm performance.

5.3. Limitations of the Study

- Due to inaccessibility of data on shareholding pattern of some firms sample stayed limited only to 140 firms.
- Role of many important aspects determining the level of managerial ownership remained unexplored in this study.
- Enclosure of corporate governance influences like board size, CEO/Chair duality and board composition etc. could have been much helpful in clarifying performance of Pakistani enterprises.

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