

Analysis of the Relationship between Share Ownership Structure, Corporate Governance Structure, and Corporate Investment Efficiency, using GSE Market Data (2005-9)

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Operational efficiency must be at the heart of the activities of the 35 firms listed on the Ghana Stock Exchange (GSE), with regard to share ownership structure, governance structure, and corporate investment efficiency. With randomly selected sample data of seven listed companies from the GSE Fact Book, 2010s, financial performance analysis method was applied to the relevant data. Resulting findings are: that most of the listed companies have high ownership concentration in structure; that corporate governance structure is an important element in the investment strategies of these companies; and that the two findings appear to show some positive relationships with corporate investment efficiency. A major implication is that, GSE should step up their publicity campaign on the importance of effective corporate governance and the benefits of widely-dispersed share ownership structure among potential investors.

INTRODUCTION

Ghana's capital market has a pivotal role to play in her developmental efforts. Certainly Ghana Stock Exchange (GSE) constitutes an important component in these efforts to mobilize the needed capital for investment purposes. So far GSE has managed to list about 35 companies, all of which are doing brisk businesses in various sectors of the economy to further Ghana's developmental aspirations.

In all these attempts, operational efficiency must be at the heart of all aspects of the work of the listed companies, in connection with such forces as share ownership structure, governance structure, and corporate profitability. Relationships among some of these forces need to be highlighted so that informed decisions can be made available for potential beneficiaries like the government, investors, academia, and other players in the financial system. Studies specifically relating to Ghana appear to be rare, if non-existent, implying that this study will be a timely development.

The overall aim of the study is to examine and analyse the relationship between corporate share ownership structure, corporate governance structure, and investment efficiency in terms of profitability of selected organizations on the GSE. The study specifically seeks to respond to the objectives of:

- i. Examining the relationship between corporate share ownership structure, corporate governance structure, and corporate investment efficiency in terms of profitability; and
- ii. Analyse the forces behind the variables that constitute the related forces listed in (i).

The scope of the study is mainly limited to the secondary information provided mainly by GSE in their most recent Fact Book of 2010, and the 2009 Annual Reports of the listed selected companies and supplemented by interviews with GSE officials. Reliability and validity of the results of the study will of course be influenced by the extent to which the data being used for the study are free of biases that are

associated with the compilation of such data. But we can take consolation from the fact that financial information from the GSE has always won national and international acclaim. Nevertheless, the results of the study can be said to be limited to the environment it is meant to address, and cannot be taken to provide a universal policy menu.

The remainder of the study is organized into the following sections: Section 2 provides a review of related literature, followed by Data Organization and Processing in Section 3. Section 4 details the Analysis and Discussions of processed data. Section 5 ends the study with Conclusions and Recommendations.

LITERATURE REVIEW

This study is at the heart of agency problem which is the focus of agency theory, an important area in Finance theory. Agency theory is a theoretical concept used to explain and understand the conflict of interests between shareholders and managers. The argument by agency theorists is that conflict of interests arises because managers fail to bear the full wealth effects of their decisions, but shareholders do. It is therefore necessary to institute monitoring mechanisms to mitigate the conflict of interests.

According to agency theory, the takeover market or the market for corporate control is an important external mechanism capable of disciplining the corporate managements. This implies that if a firm's managers pursue inappropriate, opportunistic or ineffective strategies for a prolonged period, the firm is likely to be undervalued in the market, and such firms can be likely targets for prime takeover bids, that then enable new management team to displace the incumbent management and make subsequent changes in strategy.

The earlier works of Berle and Means (1932) hold the view that corporations with owners widely dispersed and each owning a small fraction of total outstanding shares tend to under-perform. Their study opened the doors for other useful contributors like Hull and Weiss (1967), Jensen and Meckling (1976), Fama and Jensen (1983), Demsetz (1983), Jensen (1986), Stulz (1990), Sundaramurthy and Lyon (1998), Joh (2001), Sorensen (2006), High Beam Research (2008), and Goliath (2009), in areas relating to various themes like share ownership concentration, share ownership dispersion, separation of ownership from control, and the role of corporate governance structure.

For example, Jensen (1986) and Stulz (1990) commented on the issue of weak governance as an indicator of high conflict of interests which is evident in inefficient company investment, high inefficient costs, and high depletion of cash reserves by self interested managers. This was done through the general theory of agency problems, which sees corporate governance as an essential tool for managing the agency problem or mitigate the negative effects of agency problem. Both contended that owners would attempt to limit managers' access to free cash flow to prevent abuse by managers in the context of agency conflicts. Further, Sundaramurthy and Lyon (1998) explored the conflict between internal and external shareholders by examining the impact of the percentage of stock owned by managers, employees and institutional investors on the level of three popular shareholders' proposals.

Joh (2001) investigated how ownership structure and existence of conflicts of interests among shareholders operating within a poor governance system, impacted on company profitability. His paper, using panel data and regression models, concluded that firms with low ownership concentration showed low firm profitability. This stand was buttressed by Sorensen (2006) who examined the effects of ownership dispersion on cost efficiency, using empirical evidence, and concluded that corporate governance failure suggested that dispersion and indirect ownership weakened incentives to control the company, leading to agency losses and inferior performance. The study presented an empirical analysis that suggested that fragmented ownership induced cost-inefficiency relative to companies owned by a single entity.

The study by High Beam Research (2008) appears to contradict the above stand by looking at the determinants of ownership concentration and the effects of ownership concentration on the firm's performance, using panel data of firms from different manufacturing sectors of the Pakistan's economy during 2003-08. The results suggested that firms with high ownership concentration did not adopt better governance practices and disclosed less, even though board composition had positive and significant role,

thus confirming the stand by Fama and Jensen (1983) who maintained that dispersed ownership was advantageous because efficiency gains outweigh the agency costs. These imply that ownership concentration was an endogenous response of poor legal protection of the investors which seemed to have significant effect on corporate performance. Adopting a multiple regression approach, Goliath (2009) also found that the size of Board members positively correlated with share value, but there was lack of any significant relationship between inside ownership and share value.

What the foregoing review seems to reveal is that shareholder structure (whether highly concentrated ownership or widely dispersed ownership) can influence investment efficiency (profitability) of the firm through endogenous corporate governance. This revelation tends to emphasize the significance of operating an effective corporate governance to mitigate potential agency problems and related costs, which the above two opposing views attempt to deal with to secure investment efficiency.

Corporate investment efficiency (profitability) is defined using measures by Hasan and Butt, 2009; Farooque, 2007; Bradley, Myers & Allen, 2008; and Helfert, 2000. For purposes of this study, our focus will be on the shareholders who technically own the business, even though Helfert (2000) discusses other two considerations of performance financial analysis: the viewpoints of management and lenders (creditors). Our emphasis on the shareholders is because they have special interests in the current and long-term returns on their equity investment concerning growing earnings, cash flows and dividends which, in total, would result in the economic value of their venture. The two measures of investment efficiency for our purposes are Return on Equity (ROE) often in percentage terms, and Earnings per Share (EPS) always in monetary values, like the GHc. ROE is the most common ratio for evaluating the return on the shareholder's investment, and it measures the relationship between the business Net Profit and total shareholders' investment, calculated as: $ROE = \text{Net Profit} / \text{Shareholders' investment} (\%)$.

The use of this measure is subject to some caution arising from the definition of net profits, which in our case, is the result of operations belonging wholly to the holders of common and preferred equity shares. But Average Equity is used to allow for the reasoning that profitable operations build up equity during the year which implies that the annual profit should relate to the mid-point of the buildup. The measure is thus adapted to become: $\text{Return on Average Equity} = \text{Net Profit} / \text{Average Shareholders' Investment} (\%)$.

The second measure is Earnings per Share, that is $EPS = \text{Net Profit to common stock} / \text{Average number of shares (GHc per share)}$. A great deal of attention is paid to this ratio by both shareholders and management, and it is used widely in the valuation of common stock. But we should note that its use is not problem-free. For example, fluctuations in the number of shares outstanding during the year due to new stock offerings, dividends paid, etc, require retroactive adjustments in past data to ensure comparability. Another caution is to ensure that fluctuations and trends in actual performance are compared to the projections and watched closely for signals of strength and weaknesses, especially because analysts tend to focus attention on past EPS levels.

Another measure of corporate profitability, Tobin's Q, is dealt with in Aluchna et al, 2007 and Farooque et al, 2007. We should, however, note that all these tools have their own strengths and weaknesses.

In this paper we define corporate governance as the means by which shareholder value is facilitated by effectively managing corporate affairs so as to ensure the protection of the individual and collective interest of all stakeholders, (Hasan and Butt, 2009; Farooque et al, 2007). The ingredients of good corporate governance practices include the board size and composition, skills of members, CEO/Chair duality role, board compensation, etc, all of which have association with agency problems and agency costs, and can be used to assess the effectiveness of a listed company.

DATA ORGANISATION AND PROCESSING

Data for the study is mainly secondary; the major source is the GSE Fact Book (2010) and the Annual Reports of the selected companies, specifically the financial data on their Balance sheets and Income

statements for the years 2005 to 2009, the study period when data availability posed no challenge. The results of the researcher's interviews with GSE officials were used to supplement our secondary data.

A random sample of 7 listed companies among a total of 35 currently listed on the GSE was decided on. The list applies to companies that have been very active during the study period.

Issues of share ownership structure, corporate governance structure, and those of corporate investment efficiency were considered using the GSE Fact Book and the Annual Reports of selected companies. The method to enable achievement of our objectives consisted of the use of financial performance analysis employing financial ratios and other financial measures over the specified period. Collected data was processed into three major groups of Share-Ownership Structure; Corporate Governance Structure; and Corporate Investment Efficiency (profitability).

1. Share-ownership structure: according to whether Concentration Ratio is High, or Low (Low implying widely dispersed ownership structure), using the Herfindahl Index of Ownership Concentration (Sorensen, 2008)
2. Whether Corporate Governance structure is good (that is satisfying the above list of good corporate governance practice) or weak (that is, the opposite being the case).
3. Corporate Investment Efficiency (profitability), using financial ratios of Return on Equity/Investment (ROE); and Earnings per Share (EPS). (Helfert, 2000; Bradley Stewart and Allen, 2008; Farooque et al, 2007; Aluchna, 2007).

Tables 1, 2 and 3 provide relevant statistics on the three groupings.

ANALYSIS AND DISCUSSIONS

Tables 1 and 2 provide statistics on share-ownership structure and corporate governance structure respectively of the 7 firms. Table 1 indicates that the companies have high owner concentration ratios of above 0.6, constituted by about 4 firms, using Herfindahl Index of owner concentration (Sorensen, 2006). Dispersed ownership appears to be rare among the listed firms. This fact necessitates keeping a large number of Board of Directors to provide an effective governance structure. Majority of Board members must be of Non-Executive status, and must be independent of management and free from any constraints likely to materially interfere with the exercise of their independent judgment. Our interview with GSE officials indicated that they insist that 25% of Board must be Non-executive; no compromise on CEO/Chair duality role; and no decision on size of membership.

Table 2 provides some information on the ratio of Non-Executive members to total Board members. The ratios for the companies appear high, except Mechanical Lloyd with very low ratio, probably implying weak corporate governance structure, and also Aryton Drug Manufacturing Firm and Camelot Ltd that need to beef up their governance structure. In the case of Enterprise Insurance Ltd, the ratio is fairly high, but then it appears two Board members come from the same institution, a situation likely to lead to opportunistic tendencies that could even compromise on some critical corporate objectives. Besides, only the Ghana Commercial Bank retains two Independent Non-Executive members, which appears to be an improvement over the others. To this end, other companies need to learn from such best practices. GSE should continue to ensure that their education and publicity campaigns are given greater boost. Nevertheless, we can discern that positive relationship exists among the share-ownership structure, corporate governance structure, and corporate profitability. Table 3 indicates that ROEs and EPS for the companies over the study period have been positive, though with some variations. These results may have been the outcomes of the relationships identified in the earlier paragraphs.

**TABLE 1
SHARE OWNERSHIP STRUCTURE**

GHANA COM BANK				FAN MILK LTD				MECH. LLOYD LTD				ENTERPRISE INSUR			
Holder	Share s (mill)	%	Cum %	Holder	Share s (mill)	%	Cum %	Holder	Shares (mill)	%	Cu m %	Holder	Share s (mill)	%	Cu m %
SSNIT	79.0	29.8	29.8	Fan Milk Internati onall	10.97	55.5	55.5	T.R. Darko	10.98	21.9	21.9	Ventures & Acquisitio ns	12.83	48.9	48.9
GOVT	56.6	21.4	51.2	Ent Ins Ltd	1.59	8.0	63.5	SSNIT	8.83	17.6	39.6	Ghana-Re	1.64	6.0	54.9
BBG	17.4	6.6	57.8	BBg/JP Morgn	0.99	5.0	68.5	BBG	4.72	9.4	49.0	SSNIT	1.57	6.0	60.9
Daniel Ofori	7.20	2.7	60.5	BBG Re Epk	0.67	3.4	71.5	M.O. Darko	1.83	3.6	52.6	BBG. Epak Inv	0.88	3.3	64.2
Large st 20 Holde rs			<u>72</u>	Large st 20 Holders			<u>78</u>	Large st 20 Holders			<u>76</u>	Large st 20 Holders			<u>78</u>

AYRTON DRUG MANFACT				CAMELOT LTD				GOIL LTD			
Holder	Shares (mill)	%	Cum %	Holder	Shares (mill)	%	Cum %	Holder	Shares (mill)	%	Cum %
Samuel Adjepong	70.24	33.0	33.0	West Africa Data Services	2.90	44.3	44.3	Ghana Govt	107.4	51.1	51.1
SSNIT	55.90	26.0	59.0	Strategic Initiatives Ltd	1.30	19.9	64.2	SSNIT	38.9	18.5	69.6
BBG/SSB	23.00	10.7	70.0	Akyea-Djamson	0.56	8.5	72.7	GOIL Employee Plan	9.3	4.4	74.0
BBG/Bar clay Capt	20.90	9.7	80.0	P. K. Nduom	0.24	3.6	76.3	BBG	1.9	0.9	75
Large st 20 Holders			<u>96</u>	Large st 20 Holders	5.97		<u>91</u>	Large st 20 Holders	166.9		<u>79</u>

Source: GSE Fact Book (2010) and 2009 Annual Reports for the selected 7 companies

TABLE 2
CORPORATE GOVERNANCE STRUCTURE – MEMBERS OF BOARD OF DIRECTORS

Members as at 31/12/09	GCB Ltd	FAN Milk Ltd	Mechanical Lloyd Ltd	Enterprise Ins Ltd	Aryton Drug Man	Camelot Gh Ltd	GOIL Ltd
Chairman	1	1	1	1	1	1	1
Executive Director	3	1	4	1	2	2	1
Non-Executive Director	7	5	2	6	4	3	7
Independent Non-Executive Director	2	0	0	0	0	0	0
Total no. of Members	13	7	7	8	7	6	9
Non-Executive/ Board members Ratio	69%	71%	29%	75%	57%	50%	78%

Source: GSE Fact Book (2010) and 2009 Annual Reports of the selected 7 companies

TABLE 3
CORPORATE INVESTMENT EFFICIENCY:
(ROE; EPS for the 7 companies Years: 2005-9)

Company	2009		2008		2007		2006		2005	
	ROE %	EPS GHc	ROE %	EPS GHc	ROE %	EPS GHc	ROE %	EPS * Cedis	ROE %	EPS * cedis
GCB Ltd	9.3	0.071	18.1	0.141	18.6	0.124	28.3	1577	17.8	782
Fan Milk Ltd	43.2	0.766	32.9	0.357	28.1	0.220	29.8	1656	40.8	1781
Mechanical Lloyd Ltd	7.2	0.020	11.0	0.030	13.1	0.030	9.1	149.9	10.4	159.2
Enterprise Insurance Ltd	4.2	0.087	10.0	0.173	12.6	0.116	11.6	712.0	15.6	722.0
Aryton Drug Manufact. Ltd	24.3	0.013	19.1	0.008	18.9	0.007	16.3	48.08	25.4	42.16
Camelot Ghana Ltd	7.90	0.009	25.53	0.020	2.49	0.001	8.72	48.70	3.73	20.23
Ghana Oil Co. Ltd	18.16	0.025	16.60	0.020	18.30	0.019	25.46	1132.0	16.12	651.01

Source: GSE Fact Book (2010); and 2009 Annual Reports of the 7 selected listed companies
The local currency was the cedi, before re-denomination.

CONCLUSIONS AND RECOMMENDATIONS

The first conclusion of this study is that majority of the listed companies on the GSE have high ownership concentration, which goes to buttress Farooque et al (2007). Secondly, a number of companies also operate relatively effective corporate governance structure without which the positive ROE and EPS

measures reported would not have been achieved. The third conclusion is that there exist some positive relationships among the three forces of share ownership structure, corporate governance structure, and corporate investment efficiency, even though some researchers like Aluchna, et al (2007) and High Beam Research (2008) seem to differ on the direction of the link. The resulting implications of the study are that GSE must step up their activities in the area of public education and campaign to attract further investment capital through the launch of the benefits of wider share-ownership structure as an alternative to the currently more popular high share-ownership concentration. Furthermore, existing companies must also be encouraged to adopt a more effective and stronger governance structure to be able to achieve greater efficiency of their investments. In all these, the GSE obviously needs the support of the government that must continue to provide the very much needed enabling environment to achieve effective mobilization of long-term capital for investment and national development.

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