

The Impact of Promoter Shareholding on Firm Value and Financial Performance: Empirical Evidence from Listed Firms in India

Dr. K T Vigneswara Rao

Senior Assistant Professor, MBA Department
Madanapalle Institute of Technology
and Science (MITS)
Kadiri Road, Angallu Village
MADANAPALLE

Prof. Parameshwar H.S.

Assistant Professor -
Finance, IFIM
Bangalore

Kotha Bhima Ajay

PGDM -Finance,
IFIM Bangalore

Aditya Yadav Aradhyula

PGDM -Finance,
IFIM Bangalore

Abstract

Corporate governance plays a vital role in the determination of value and performance of listed firms across the world. In India, majority of listed companies are owned and managed by promoters and their ownership holding makes an impact on the corporate value and performance. The focus of this study is to examine the impact of promoter shareholding on the firm value and performance by using a sample of NIFTY 500 Index non-finance companies during the financial year 2012 to 2016. We applied panel data regression method for empirical analysis to capture the dynamics and impact of both time series and cross-sectional dimension of data. The study results reveal a significant positive relationship between promoter shareholding and firm value of sampled firms. This study observed that the financial performance of sampled firms is negatively affected by AGE, GROW and LEV of the sampled firms. Further, the empirical results reveal no relationship between promoter shareholding and financial performance of sampled firms.

Keywords: Promoter Shareholding, Panel Data, Listed Firms, India

Introduction

The major lines of enquiry in the corporate finance literature are the impact of corporate governance on firm value and performance. In the academic literature there is a different strand which explains this phenomenon. In the case of India, majority of promoters own the majority shareholdings and manage the business affairs of companies. Promoter ownership is an important factor which can impact the corporate governance practices and thereby affect the financial performance, value and sustainability of a firm. According to Jensen and Meckling (1976) agency theory there is an inverse relationship between managerial ownership and agency costs, the performance of a firm increases with an increase in managerial holdings. Another dimension of this study is the effect of promoter ownership on firm value in the corporate finance literature, Denis & McConnell (2003). Previous studies have observed that managers' and shareholders' interests are not aligned, which creates agency problems that moderate the value of a firm. Thus, more managerial ownership can enhance the interests of owners, for better decision-making and higher value. The extant literature examined the relationship between promoter ownership, performance and value of firm. The primary

objective of this research paper is to examine the relationship between promoter shareholding and firm value and financial performance in the emerging economy like India, where the concentrated promoter ownership holding is higher and can create the agency problem of majority and minority shareholders. This problem is more relevant to Indian firms where promoters and founders control firms through majority shareholding and cross-holding (Claessens & Yurtoglu, 2013). Therefore, the Indian firms are prone to lower valuations because of the perceived expropriation by the majority shareholder (Villalonga & Amit, 2006).

The major contribution of present study to the literature includes the evaluation of impact of promoter shareholding on the firm value and performance in India by using the panel data regression method. The basic outline of this paper is structured into seven different sections. The section 2 provides an account of literature review related to the study. Section 3 discusses the data and sample selected for the study. Section 4 outlines methodology applied in this study. This is followed by a discussion on the results in Section 5. Section 6 provides the conclusion of the study. Finally, section 7 narrates the limitations and scope of future research.

Literature review

Himmelberg, Hubbard & Palia (1999) used panel data to explain the changes in ownership on the performance of a firm. The study results are consistent with the proposition that the firm should choose strategy to reduce the agency cost. Lemmon & Lins (2003) examined ownership effect on firm value during East Asian Financial Crisis and found that Tobin's Q ratios of those firms in which minority shareholders are possibly most subject to expropriation which had declined 12 percent more than Q ratios in other firms during the crisis period and ownership structure plays important role in deterring the incentive to minority shareholders during crisis. Lins (2003) investigated management and non-management ownership structure related to firm value by using sample data from 18 emerging countries and found that management control was surplus of its proportional ownership is negatively related to Tobin's Q while value is significantly more positive in low-protection countries.

Hu & Zhou (2008) evaluated the effect of managerial ownership on firm performance by using a sample of unlisted Chinese firms for the period of 1998-2000. They found positive effect of managerial ownership on firm performance. Further, they concluded that relativity between company performance and managerial ownership is nonlinear, and if ownership exceeds above 50 percent the

modulation point turns it negatively. Margaritis & Psillaki (2010) investigated the relationship between efficiency, leverage and ownership structure with a sample of French technology manufacturing firms over the years from 2002 to 2005 by using non-parametric methods. Their study revealed that impact of efficiency on leverage found positive but significant to mid-leverage level.

Ruan, Tian & Ma (2011) examined the impact of managerial ownership on firm performance through the choices of capital structure, using a sample of listed Chinese firms between 2002 and 2007. Their study results conclude a nonlinear relationship between managerial ownership and firm value. Borgia & Newman (2012) explored the importance of owner characteristics in explaining the capital structure decisions of enterprises in emerging economies using a dataset of 1,539 Chinese SMEs and concluded that aversion to external control and propensity to take risk are the major determinants of capital structure decision. Extending their study, Isik & Soykan (2013) studied the impact of large shareholders on financial performance by using sample of 164 listed companies on Istanbul Stock Exchange for the period of 2003 to 2010. Their study concluded that large shareholders did not have the negative effect on firm performance.

Nureliana (2014) investigated the relationship between financial indicators of a firm such as profitability, firm size, asset tangibility, liquidity and capital structure and found a negative relationship between the portions of top five shareholdings and leverage ratio. His study concluded that focused firms hold minor debt than isolated ownership firms. Kodongo, Mokoaleli-Mokoteli & Maina (2015) examined the relationship between capital structure and firm performance with a sample of listed companies in Kenya and found that leverage negatively related to profitability. They also found assets tangibility had negative relation with firm value while sales growth and size firm are significant in the case of small sized firms. Shahar, Adzis & Baderi (2016) analyzed the relationship between ownership structure and firm specific features with capital structure of publicly listed firms in Malaysia, the authors have focused on ownership concentration and dispersion by using data of 38 middle-capital firm from 2008 to 2012. They found ownership emphasis possess negative relation with leverage ratio and capital structure, further it can reduce debt cost as well as agency cost, concluded that investors can able to understand capital structure while enhancing corporate governance.

Dharmapala & Khanna (2008) studied the relationship between Corporate Governance reforms, sanctions, enforcement and Firm value of Indian Listed Firms. The

sample size of 4000 Indian firms were considered for a period of 9 years: 1998-2006. The evidence they found that increase in Firm value significantly, and positively, capitalized the corporate governance reforms in the longer term. They had also observed Clause 49 was introduced for corporate governance reforms like greater board independence, enhancing disclosure requirements for affected firms.

Himmelberg, Hubbard & Palia (1999) examined the relationship between managerial ownership and firm performance during changes in the firm's contracting environment. The Authors have extended the results of Demsetz & Lehn (1985) and emphasized that in the firms contracting environment a large fraction of cross-sectional variation in managerial ownership is explained by unobserved firm heterogeneity. The finds of this study suggest that for both observed firm's characteristics and firm mixed effects it is difficult to conclude that changes in firm managerial ownership affect performance even we controlled.

Kumar (2004) evaluated the effect of ownership structure on the firm performance by using a sample of Indian corporate firms. The findings revealed a foreign shareholding pattern does not influence the firm performance significantly. Further they also conclude that for the stand-alone firms the effect of managerial shareholding and firm performance does not differ significantly across group. They had also observed the effect of interactions between corporate, foreign, institutional, and directorial ownership on firm performance and further results indicate that shareholding by institutional investors and managers affect firm performance non-linearly.

Lopez-Iturriaga & Rodriguez-Sanz (2001) analyzed the mutual relationship between the firm valuation, investment and ownership structure by using simultaneous equation approach. They have studied the sample of 140 Spanish listed companies for the 1991-1997 period. The findings were, ownership structure may also be influenced both by investment and value since both are determined by managerial ownership. Ganguli & Agrawal (2009) examined the relationship between performance and ownership structure by using CNX Midcap index 100 companies. The study revealed that concentration of promoters' shareholding is endogenous it's dependent on firms' performance. The study also found that even after 1992 economic reforms the promoter shareholding remains concentrated.

Jackling & Johl (2009) studied the relationship between corporate governance, performance and capital structure.

The study also found support to agency theory when board consists of more outside directors it has improved financial performance. The study also revealed that neither agency theory nor resource dependency theory have explained the connection between corporate governance and performance. Eisenberg et.al (1998) study on small and midsize of Finland found that there is a significant negative correlation between board size and financial performance. The ideal board size differs with the size of the firm. Black, Jang & Kim, (2006) has studied about the corporate governance relation with firm market value. The study found that with higher corporate governance share price will be higher. Kumar & Singh (2013) examined the effect of corporate board size and promoter ownership on firm value. They have studied the sample of 176 Indian firms listed on Bombay Stock Exchange (BSE) & the regression result was extensively negative relationship between corporate board size and firm value and whereas positive relationship between promoter ownership and firm value. Further, the empirical results suggest that positive effect on firm value raised if above critical ownership level of 40 percent and promoter's interest become aligned with that of the company.

The extant literature used various empirical methods, such as Ordinary Least Square (OLS) regression method to examination the cross section of firm. However, the number of studies which employed panel data method to explain the impact of promoter shareholding on the firm performance and value is void in the context of India; hence this study attempts to provide empirical evidence based on the panel data regression method. The empirical results can be compared with empirical results documented in previous literature for evaluating the applicability of existing models discussed in literature to an emerging economy like India.

Data and Sample

The study sample consists of NIFTY 500 Index companies during the financial year 2012 to 2016. For the fiscal year ending on 31st March 2016, this Index indicates a clear majority portion free float market capitalization of listed firms on NSE. After excluding financial and investment companies, final sample includes 378 firms covering 1890 firm years unbalanced panel data. The data were sourced from CMIE Prowess database.

Methodology

This study has employed panel data regression method for the estimation of impact of promoter shareholding on the performance of a firm. The major advantages involved under this empirical method such as variability of data because the same cross-sectional items were observed

over a period, low probability of collinearity and higher degree of freedom (Baltagi, 2008). The basic model of this method can be written as: $Y_{it} = \alpha + \beta X_{it} + \mu_{it}$ with the subscript "i" represent the cross-sectional dimension; "t" signifies the time series dimension. While "Y_{it}" represents dependent variable (Return on Assets (ROA) financial performance, TOBINQ (firm value). "X_{it}" represents a set of independent variables used for the prediction of dependent variable. The independent variable is promoter

shareholding in percentage (PHLD) While control variables includes age of the firm (AGE) measured by the number of years since the incorporation of a company, market risk (BETA), size of the firm (SIZE) measured by natural logarithm of total assets of a firm; ratio of R&D expenses to total sales (GROW), ratio of total debt to total assets (LEV), current ratio (CR) is the ratio of current assets to current liabilities. The following equations have been used for empirical analysis.

$$TOBINQ_{it} = \beta_0 + \beta_1 AGE_{it} + \beta_2 BETA_{it} + \beta_3 \frac{R\&D_{it}}{SALES_{it}} + \beta_4 CR_{it} + \beta_5 SIZE_{it} + \beta_7 PHLD_{it} + \beta_8 GROW_{it} + \beta_9 LEV_{it} + \mu_{it}$$

$$ROA_{it} = \beta_0 + \beta_1 AGE_{it} + \beta_2 BETA_{it} + \beta_3 \frac{R\&D_{it}}{SALES_{it}} + \beta_4 CR_{it} + \beta_5 SIZE_{it} + \beta_7 PHLD_{it} + \beta_8 GROW_{it} + \beta_9 LEV_{it} + \mu_{it}$$

Results and Discussion

Table1: Descriptive statistics of variables

Variable	Mean	Median	Minimum	Maximum	Std. Dev.	C.V.	Skewness	Ex. kurtosis	IQ range
AGE	38.48	30.00	1.00	153.00	24.00	0.62	1.28	1.76	32.00
TOBINQ	2.61	1.67	0.00	69.85	3.06	1.17	8.32	140.17	1.86
BETA	1.05	1.02	0.00	2.90	0.44	0.42	0.65	0.53	0.57
PHLD	56.63	56.99	0.00	99.59	16.19	0.29	-0.29	-0.26	24.60
GROW	0.01	0.00	0.00	3.43	0.10	8.23	26.08	820.27	0.00
SIZE	10.47	10.37	0.00	15.34	1.47	0.14	0.17	2.02	1.86
ROA	7.33	6.10	-73.75	115.83	8.62	1.18	0.96	18.82	8.99
LEV	0.49	0.46	0.00	3.30	0.30	0.61	1.11	5.54	0.44
CR	1.67	1.26	0.00	148.23	3.79	2.27	31.98	1200.10	0.90

Source: Author's own calculation

Descriptive statistics of the variables under consideration are presented in Table1. As per the results presented in Table 1, this study observed that the minimum and maximum TOBINQ of sampled firms ranges between 0 and 69.85. The mean of TOBINQ is 2.61 with a standard deviation of 3.06. While, mean value of ROA is 7.33 with a

standard deviation of 8.62. The median value of TOBINQ and ROA is 1.67 and 6.1 respectively. The value of skewness and kurtosis computed for the variables suggests that there is an asymmetry in the distribution of data. There problem of collinearity is absent based upon the variance inflation factor (VIF) test results.

Table 2: Fixed-effects regression method results

(Dependent variable is TOBINQ)

Variable	Coefficient	Std. Error	t-ratio	p-value	
const	- 11.50	1.81	- 6.36	0.00	***
BETA	0.50	0.25	2.01	0.04	**
AGE	0.23	0.03	6.71	0.00	***
PHLD	0.02	0.01	2.04	0.04	**
GROW	- 3.71	0.89	- 4.16	0.00	***
SIZE	0.38	0.16	2.42	0.02	**
CR	0.01	0.04	0.23	0.82	
LEV	- 1.24	0.39	- 3.14	0.00	***

and* indicates significance at the 5% and 1% level respectively

Mean dependent var	2.64	S.D. dependent var	3.12
Sum squared resid	4514.78	S.E. of regression	1.79
LSDV R-squared	0.74	Within R-squared	0.09
LSDV F(384, 1411)	10.51	P-value(F)	0.00
Log-likelihood	- 3376.19	Akaike criterion	7522.37
Schwarz criterion	9637.30	Hannan-Quinn	8303.16
rho	0.13	Durbin-Watson	1.51

Source: Author's own calculation.

The above table shows fixed effects regression results by using 1796 observations.

Test for differing group intercepts -Null hypothesis: The groups have a common intercept

Test statistic: $F(377, 1411) = 7.1962$, with p-value = $P(F(377, 1411) > 7.1962) = 0$

The above test for differing group intercepts shows that fixed effect method is appropriate for the estimation of given model in comparison with pooled OLS method.

Breusch-Pagan test statistic: $LM = 655.694$ with p-value = $\text{Prob}(\text{chi-square}(1) > 655.694) = 0$

The above test result shows that random effect method is suitable for the estimation of given model in comparison with pooled OLS method.

Hausman test statistic: $H = 324.661$ with p-value = $\text{Prob}(\text{chi-square}(7) > 324.661) = 0$

The above test statistics suggests that fixed effect method is suitable for the estimation of given model in comparison with random effects method.

Table 3: Fixed-effects regression method results

(Dependent variable is ROA)

Variable	Coefficient	Std. Error	t-ratio	p-value	
const	18.67	6.07	3.08	0.00	***
BETA	0.41	0.62	0.66	0.51	
AGE	- 0.29	0.10	- 2.78	0.01	***
PHLD	0.00	0.03	0.07	0.95	
GROW	- 19.46	2.19	- 8.88	0.00	***
SIZE	0.58	0.73	0.80	0.42	
CR	0.07	0.09	0.75	0.46	
LEV	- 13.34	0.97	- 13.75	0.00	***

and* indicates significance at the 5% and 1% level respectively

Mean dependent var	7.29	S.D. dependent var	8.65
Sum squared resid	27323.05	S.E. of regression	4.41
LSDV R-squared	0.80	Within R-squared	0.21
LSDV F(384, 1408)	14.32	P-value(F)	0.00
Log-likelihood	- 4986.08	Akaike criterion	10742.16
Schwarz criterion	12856.44	Hannan-Quinn	11522.78
rho	- 0.07	Durbin-Watson	1.70

Source: Author's own calculation.

The above table shows fixed effects regression results by using 1796 observations.

Test for differing group intercepts -Null hypothesis: The groups have a common intercept

Test statistic: $F(377, 1411) = 7.1962$, with $p\text{-value} = P(F(377, 1411) > 7.1962) = 0$

The above test for differing group intercepts shows that fixed effect method is appropriate for the estimation of given econometric model in comparison with pooled OLS method.

Breusch-Pagan test statistic: $LM = 1214.83$ with $p\text{-value} = \text{prob}(\text{chi-square}(1) > 1214.83) = 0$

The above test result shows that random effect method is suitable for the estimation of given econometric model in comparison with pooled OLS method.

Hausman test statistic: $H = 24.8778$ with $p\text{-value} = \text{prob}(\text{chi-square}(7) > 24.8778) = 0$.

The above test statistic suggests that fixed effect method is suitable for the estimation of given econometric model in comparison with random effects method.

We applied pooled ordinary least square regression (OLS) regression for estimating the given model. After that we have applied panel data diagnostic tests to check whether the pooled OLS method is appropriate for the estimation of given econometric model. Breusch-Pagan (1980) test statistic suggested the random effects model over the pooled OLS model. In addition, we tested for differing group intercepts, which suggested the use of fixed effects model over the pooled OLS model. All these test results recommended the use of panel data regression method over the pooled OLS method. Hence we applied panel data regression method for estimation of the impact of promoter shareholding both on firm value and performance.

To make a choice between fixed or random effects model, we have used Hausman (1978) test statistic. The test statistic

suggests that fixed effects method is appropriate for the estimation of econometric model. Therefore, we have used fixed effects regression method to estimate the model. Based on empirical results reported in Table 2, it is observed that the estimated model is statistically significant at 1% level in explaining the impact of promoter holding on the value of sampled firms with F-value of 10.51 ($p = 0$). The LSDV R-square value of 0.74 shows that about 74% of the variation in the value of sampled firms has been explained by the explanatory variables. We estimated the given model by using robust standard errors for controlling the heteroskedasticity and serial correlation. The t-ratios associated with independent variables BETA, AGE, PHLD, GROW; SIZE and LEV specify that they are statistically significant at conventional levels. On the basis of significant positive relationship between promoter shareholding and firm value, we can infer that one unit increase in the shareholding of promoter causes 0.02 unit increase in the firm value.

Based on empirical results reported in Table 3, it is inferred that the estimated model is statistically significant at 1% level in explaining the impact of promoter holding on performance of sampled firms with F-value of 14.32 ($p = 0$). The LSDV R-square value of 0.8 shows that about 80% of the variation in the financial performance of sampled firms has been explained by the explanatory variables. This model is also estimated by using robust standard errors for controlling the heteroskedasticity and serial correlation. The t-ratios associated with independent variables AGE, GROW and LEV specify that they are statistically significant at conventional levels. There is a significant negative relationship with AGE, GROW, LEV and ROA of sampled firms.

Conclusion

The purpose of this study is to estimate the impact of

promoter shareholding on the firm value and performance by using panel data regression method with a sample of NIFTY 500 Index non-finance companies during the financial year 2012 to 2016. At first, we used the ordinary least square regression (OLS) to estimate the model. We performed panel data diagnostic tests to determine whether to apply to OLS regression or panel regression method. These diagnostic tests suggested the use of panel data regression method for the estimation of given model. Further, Hausman (1978) test results suggested the application of fixed effects method over random effects. Hence, we estimated the panel data model by using fixed effects method in estimating the impact of promoter shareholding on both firm value and financial performance of sampled firms.

Our empirical results reveal a significant positive relationship between promoter shareholding and firm value of sampled firms. This study observed that the financial performance of sampled firms is negatively affected by AGE, GROW and LEV of the firms. This study has implications for the academicians, researchers, and finance professionals.

Limitations and future research

The sample of the study is limited to NIFTY 500 Index companies during the financial year 2012-2016. This study also excluded the endogeneity issues involved in the econometric model for the estimation of firm value and performance of sampled firms. Further studies can include ownership concentration, block shareholding and managerial ownership related variables, which may impact the performance and value of a firm.

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