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The Impact of Ownership Structure on the Performance ofPalestinian Listed Companies

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***Abstract:** -This study investigates the impact of institutional ownership, and foreign ownership in determining the Palestinian firm performance. This study is based on panel data of 200 observationsfrom non-financial firms listed on the Palestine Security Exchange (PSE) during the period from 2009 to 2016. The panel data regression result show that the institutional and foreign ownership hinder corporate performance. The result suggests that the firms which are held shares by institutions and foreigners have less performance.The study is timely given that the ownership structure plays pivotal roles in determining the performance. The previous studies in Palestine are very limited and the previous empirical studies in the developed country have provided mixed results on the relationship between ownership structure and firm performance. It, therefore, becomes a necessity to examine the impact of ownership structures on the performance of Palestinian Listed Companies.*
***Key words:**-Institutional ownership; foreign ownership; firm performance; Palestine*

I. Introduction

Early on Berle and Means (1932) studied the separation between ownership and management in big companies, and their thesis was that the ownership and control of public companies was separated and that owners replied on the board of directors to represent their interests. They believe that, over time, managers became so powerful that they had the final say. This, in turn, created the conflict between the shareholders and the managers.Berle and Means' (1932) view have been challenged in 1976, by Jensen and Meckling who formulated the agency theory. The agency theory focuses on the relationship between principal (shareholders) and agent (decision maker or manager), which suggests that the principal and agent are acknowledged as making the most of their own profits.

Up to now, the empirical studies about the relationship between the ownership and firm performance seem to have yielded conflicting results(Abdallah & Ismail, 2017), thus, the precise nature of the relationship remains inconclusive. This is may because most ownership structures' empirical research are limited mainly to the developed countries that feature similar institutions, attention to the ownership structure in developing countries is of utmost importance (Abbasi, Asadipour, &Pourkiyani, 2017).

InPalestine, the high degree of institutional ownership is considered a main factor.Harasheh and Nijim (2010) pointed out the conflict of interest between large and small shareholders due to the high degree of institutional ownership in the Palestinian listed companies. Furthermore, according to Dwaikat and Queiri (2014), the high degree of ownership in Palestine has a negative effect on the performance. Furthermore, Ijbara and Khoury (2009) noted that the high level of institutional owners in Palestine may lead to a conflict of interest between large and small shareholders. La Porta, Lopez-de-Silanes, Shleifer, and Shleifer (1998) claimed that the high degree of ownership may facilitate the extraction of private benefits by controlling shareholders at the expense of minority shareholders. For example, large shareholders may attempt to expropriate the assets of the company to the detriment of the minority shareholders' rights. These issues require an in-depth study in the context of Palestine to examine which type of ownership could enable companies to grow positively.

In addition, only few studies have examined the relationship between ownership and firm performance in the Palestinian context. For example, Daraghma and Alsinawi (2010), Dwaikat and Queiri (2014) and Ahmad

(2010) investigated insider ownership, Harasheh and Nijim (2010) and Hassan, Naser, and Hijazi (2016) examined the effect of institutional ownership. Moreover, Abdelkarim and Alawneh (2009) used only ownership concentration, Ahmad (2010) has examined foreign ownership, but this study measured foreign ownership as a dummy variable and targeted the banks performance in Palestine and the study period was before the application of the corporate governance code (i.e., before 2009).However, this study targeting the non-financial companies listed in Palestine and measuring by a percentage of the ordinary shares held by the foreign.

Therefore, this current study will fill the identified gaps in literature for Palestine by investigating the institutional and foreign ownership on firm performance measured by accounting-based measures of Return on Assets (ROA). The ROA is most favoured because the operating income used to compute ROA is not impacted by extraordinary charges and less susceptible to manipulation by managers.

This paper is organized in four sections, section one is the introduction, section two is the literature review related to the variables. The third section is dedicated to data and methodology, followed by the fourth section that provides a descriptive analysis. The fifth one presents the results. The last section provides a presentation and discussion of conclusions and recommendations for future avenues of research.

II. Literature Review and Hypothesis Development

2.1 Institutional Ownership

Roberts and Yuan (2006) described institutional ownership as the fraction of institutional investors (companies) who have bought shares of traded companies. Ownership structure has greater influence on a firm's governance structure and its performance (Moradi &Nezami, 2011). In Palestine, the financial reports of the non-financial companies in Palestine Security Exchange (PSE) indicate that the institutional ownership represents a significant control of the Palestinian listed companies, where institutional owners own about 40% of national companies.

Agency theory posited that corporate investors can better monitor and control corporate policy (Jensen &Meckling, 1976).Several scholars have emphasized the positive impacts of institutional ownership of a firm. Ping and Wing (2011) believed that institutional investors were a vital mechanism of corporate governance helping to enhance firm performance. Besides, in Jordan, Dana (2015) found that institutional investors have the power to influence managerial decisions to avoid risks, which, in turn, will affect firm performance.Arouri,HossainandBadrulMuttakin (2015) argued that the institutional owners have great financial resources, knowledge, and experience that could enhance the monitoring role.
However, some researchers have found the opposite, for example, Crane and Koch (2014) noted that large institutional shareholders might engage in self-serving behaviour to use the resources of the firm to finance their own businesses or associated business. Furthermore, Barry,Lepetit, andTarazi(2011) found that institutional owners imposed the riskiest strategies when their ownership is concentrated, a concentration that can shape corporate risk-taking.Accordingly, the hypothesis is posited as:

H1: There is a significant relationship between institutional ownership and firm performance of non-financial companies listed on PSE.

2.2Foreign Ownership

Foreign ownership is defined as the state of being possessed by an individual or company from abroad. According to agency theory, larger foreign ownership is more aligned towards performing an effective monitoring task (Jensen &Meckling, 1976); therefore, foreign ownership affects firm performance positively. Nonetheless, ambivalent results have been reported in the studies of the relationship between the foreign ownership and firm performance. Masdupi (2010) stated that foreign ownership may help to monitor expertise in a newly formed market, and foreign owners are commonly able to control managerial decision making; therefore, a manager will make any decision more cautiously. Moreover, Wang and Wang (2015) mentioned that employment, wages, and outputs are improved in companies with foreign ownership.

Nonetheless, negative relationships between foreign ownership and firm performance have been found. For example, Rahman and Reja(2015) argued that an increase foreign ownership also has the possibility of complicity and conspiracy among foreign investors and managers against the bests interests of other shareholders if foreign ownership is at high levels. Besides, in a sample of Malaysian listed companies, Fauzi and Musallam (2015) have shown a negative relationship between foreign ownership and the performance of a firm.

H2: There is a significant relationship between foreign ownership and firm performance of non-financial companies listed on PSE.

III. Data and Methods

In the present study, secondary data was obtained from annual reports and Data Stream for an 8-year span (2009-2016). The study gathered data specifically for non-financial listed firms comprising of 25 companies, with 12 categorized under the service sector and the remaining (13 firms) from the industrial sector. The following model is estimated to examine the effects of lack thereof of the board characteristics on the performance of the companies,

$FP_{it}= \beta_0 + \beta_1 INSTITOWN_{it} + \beta_2 FOREIGNOWN_{it} + \beta_3 EXAQ_{it}+ \beta_4 INDUSTRY_{it} +\varepsilon_{it}$.

Where *i*refers to company, *t* refers to year and

FP : Firm Performance represented by return on assets (ROA).

E : Error term.

INSTITOWN : Percentage of the ordinary shares held by the institutional, such as financial institutions and banks, domestic private institutional investors, pension funds, insurance companies, and mutual funds to reflect institutional ownership in Palestinian listed companies.

FOREIGNOWN: Percentage of the ordinary shares held by the foreign.

Control Variables:

EXAQ : External audit quality = 1 if the firms use Big 4 and 0 for non-Big 4 firms. The big 4 companies are Deloitte, KPMG, PricewaterhouseCoopers and Ernst & Young.

INDUSTRY : It can be measured by a dummy variable; 1 if the firm is an industry and 0 for others.

IV. Descriptive Analysis

Table 1

Summary Statistics

Variable	Observations	Mean	Min	Max	Std. Dev
ROA	200	0.03	-0.14	0.17	0.08
INSTITOWN	200	0.40	0.00	0.91	0.34
FOREIGNOWN	200	0.03	0.00	0.57	0.11
EXAQ	200	0.68	0.00	1.00	0.47
INDUSTRY	200	0.52	0.00	1.00	0.50

ROA = Return on Assets,INSTITOWN= Institutional Ownership, FOREIGNOWN= Foreign Ownership,EAQTY = External Audit Quality, and INDUSTRUY= Firm Industry.

Table 1 presents the summary statistics of the research variables.The mean, minimum, maximum, and standard deviation for the financial performance as proxied by ROA are 0.03, -0.14, 0.17 and 0.08respectively. This indicates that firms listed on PSE have an average ROA of 3% across the study period. This average return is considered low compared to the average performance of companies listed on other emerging markets; for example, Said, Crowther, andAmran (2014) had an average of 7% in Malaysia.As for the institutional ownership (INSTITOWN), the descriptive statistics reveal a mean of .40, a minimum of 0.00, a maximum of 0.91, and a standard deviation of 0.34. This value (40%) of the institutional ownership is similar to that other studies which examined institutional ownership in Palestine. For example, Ijbara and Khoury (2009) find that the institutional ownership is 42.17% whileHarasheh and Nijim (2010) find 42%.

The mean, minimum, maximum, and standard deviation of foreign ownership (FOREIGNOWN) are 0.03, 0.00, 0.57, and 0.11 respectively. These values signify weak foreign ownership in the companies listed on PSE. This can be attributed to the turbulence environment in which the listed PSE companies operate making it an unattractive marketplace in which to invest.External audit quality (EAQTY) has a mean of 0.68, minimum of 0.00, maximum of 1.00, and standard deviation of 0.47. The mean of 0.68 indicates that most PSE listed companies are audited by big-4 auditing firms which imply high reporting quality.

V. Correlation Analysis and Parametric Regression Assumptions

The correlation between the study variables was tested by using univariate analysis and the results from the analysis revealed the absence of severe multicollinearity issues, with all of the variables significant correlation not exceeding 0.70. Moreover, the variance inflation factors (VIF) obtained did not exceed 10. Meanwhile, heteroscedasticity was tested for the variance behaves using the Breausch-Pagan/Cook-Weisberg test. The results showed the absence of heteroscedasticity in data (chi2 (1) = 0.06, prob> chi2 =0.88). The entire variables were winsorized at 1% from top to bottom to mitigate the extreme values bias.

VI. Regression Analysis

A panel data regression analysis based on OLS pooled model which is chosen by using Breusch-Pagan Lagrangian Multiplier (LM) tests.Table 2 shows the results of the regression.

Table 2

Results of the Regression (N = 200)

Variables	**Coef.**	**Z**	**P>|z|**
INSTITOWN	-.0786	-3.68	0.000***
FOREIGNOWN	-.1614	-3.47	0.001***
EXAQ	.0501	3.25	0.001***
INDUSTRY	.0369	3.60	0.000***
Constant	.0117	1.14	0.257
R2			0.2019

ROA = Return on Assets, INSTITOWN = Institutional Ownership, FOREIGNOWN = Foreign Ownership, EAQTY = External Audit Quality, and INDUSTRUY= Firm Industry. Note: ***, **, * indicate that the parameter estimate was statistically significant at 1%, 5% and 10%, respectively.

Table 2 presents the results of the panel data regression. The model tested the direct relationship between institutional ownership, foreign ownership. the external audit quality and the firm industry are control variables. The R^2 of the model is 20% for the factor that influence the firm performance. Hypothesis 1 predicts significant relationship between INSTITOWN and firm performance of Palestinian listed companies. The result support the hypothesis which indicates negative relationship between INSTITOWN and firm performance. A possible reason for the significant negative relationship between institutional ownership and firm financial performance can be related to the high level of institutional investors on short-term profitability of a firm. This is in line with Ijbara and Khoury (2009) who noted that the high level of institutional owners in Palestine may lead to a conflict of interest between large and small shareholders. The result is consistent with the findings of Barry et al. (2011), and Crane and Koch (2014) that large institutional shareholders might engage in self-serving behaviour to use the resources of the firm to finance their own businesses or associated business.

Hypothesis 2 predicts significant relationship between FOREIGNOWN and firm performance of Palestinian listed companies.The result support the hypothesis which indicates negative relationship between FOREIGNOWN and firm performance at 1% level (p-value =0.001). These results suggest that the higher the foreign ownership, the lower the performance of the firm. This result does not support the agency theory that the existence of foreign ownership in a firm is associated with better firm performance.A possible explanation for this result that may the Palestinian political situation can be an obstacle for foreign investors to affect companies in positive fashion. Another possible explanation for the negative result is the mean of foreign ownership in this study was 0.03, which is a low percentage to control the decisions of local investors, as the domestic investors could protect their rights through their connections, and different techniques can be used against foreign investors such as losing voting records or declaring their shares illegal (Zheka, 2005).

As for the control variables, the indicate that the external audit quality affect the performance in positive way. The rational justification for this results that the intention of PSE to select Big 4 companies is to improve external mechanisms which will in turn improve the profitability of the company. Besides, Table 2 reveals that the industry sector was found to be positive to ROA.This mean that the performance outcomes of Palestinian listed companies are influenced positively by industry.

VII. Conclusion

This studyexplains the relationship between the ownership structures and firm performance in Palestine. The results found that there is a negative relationship between institutional, foreign ownership with the Palestinian firm's performance. Accordingly, the result of this study is inconsistent with the agency theory, as well as consistent with the results of previous studies which show that the institutional and the foreigner shareholders might engage in self-serving behaviour to use the resources of the firm to finance their own businesses or associated business.Future research can focus on a larger sample so that the results are more comprehensive. Second, this study uses a few variables from the ownership structures. It is possible that other types of ownership such as director ownership, insider ownership, CEO ownership, managerial ownership, and family ownership that are not considered in this study influence the performance of Palestinian firms.The findings have important implications for practitioners and policymakers for future research with respects to the ownership structures to examine which type of ownership could enable companies to grow positively.

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