3

Theoretical Background and Hypotheses

3.1 General Remarks

Already the origin of the separation of ownership and control, the legal reforms, was controversially judged. While their aim was to increase the efficiency in corporate governance, many critics already saw the potential problems caused by the loss of control by shareholders. The following academic discussion also broached the issue of these potential problems and the resulting effects of ownership and performance. However, the discussion has yielded in controversial and partially contradicting effects and reached no consensus on the relation of ownership and performance.

The following chapter introduces the key hypotheses of this academic discussion.[1] After introducing to the chapter and adding some general remarks, the second section briefly explains the agency theory and the shareholder-management conflict as the theoretical background of the hypotheses. Subsequently, the hypotheses of the relation of performance and ownership concentration, of performance and insider ownership and finally of performance and institutional ownership are explained. Each section consists of three subsections, with the first considering the assumed effects of the ownership variable on performance and the second the reverse effect. The last subsection summarizes the hypotheses and their effects. After the examination of the relation of ownership and performance Section 3.6 addresses the interactions of the three ownership variables. Finally, the chapter is recapitulated by Section 3.7.

All effects explained in the following are assumed to be monotonous, i.e., having a constantly positive or negative effect.[2] This, however, does not necessarily imply linearity, the stability of the effect strength. Actually many

[1] For an overview of selected studies and their findings see Table A.9 in Appendix A.5, p. 231.

[2] Exceptions are the combined effect by Mørck et al. [1988] and the integrated argument by Stulz [1988]. These are combinations of before explained effects and are mentioned due to their importance and frequent use in literature.

studies assume nonlinear effects with increasing marginal values.[3] Furthermore, based on the general concept of decreasing marginal values, it is likely that the function saturates for higher values. For example, a 1% increase in ownership will have a stronger effect at an ownership level of 5% than at 80%. Considering both increasing marginal values and a later saturation of the effect results in a function with the shape of a logit distribution:[4]

$$f(x) = \frac{e^{x\beta}}{(e^{x\beta} + \alpha)} \, .$$

However, since α and β are not fixed to a value of one as they are in the simple logit distribution of $f(x) = e^x/(e^x + 1)$, the function can form a wide range of shapes. Table 3.1 shows the function after adjustments of α and/or β.[5] The consideration of these potentially different shapes of the effect is important, since then a combination of effects must not yield in a constant dominance of one effect but the prevalence of the effect can change at different levels of the exogenous variable. An example of such a combination with changing dominance is also given in Table 3.1.

The studies performed later distinguish control and cash flow rights, where the control rights are used as the main ownership variable and the regressions are controlled by a ratio of voting and cash flow rights.[6] Hence, also a separate consideration of their theoretic effects is necessary. Accordingly, the effects are explained on the basis of the control rights. Furthermore, a possible effect mediation through the divergence of control and cash flow rights is examined.

3.2 Theoretical Background

Most of the hypotheses formulated in the following are based on the economic principal-agent theory, where a positive effect stems from the amelioration of the shareholder-management conflict, e.g., by disciplining the management. Analogously, an aggravation of the conflict results in a negative effect.

The principal-agent theory is part of the new institutional economics, which developed as extension of the neoclassicism. It abandons the assumption of a complete market by allowing informational asymmetries and trans-

[3] See Chen et al. [1993], Cho [1998], Cleary [2000], Cui/Mak [2002], Gugler et al. [2003b], Hermalin/Weisbach [1991], Holderness et al. [1999], Hubbard/-Palia [1995], Kole [1996], McConnell/Servaes [1990, 1995], Monsen et al. [1968], Mørck et al. [1988], Short/Keasey [1999], Short et al. [2002a, 1994], Stulz [1988], Welch [2003], and Wruck [1989].

[4] Such functions were already found by Mørck et al. [1988] and Stulz [1988]. See Figure 3.3 and Figure 3.4, p. 51 and p. 53.

[5] A change in α moves the graph to the left or right and hence alters the saturation point and the increase of the gradient for low values. β adjusts the gradient and its difference in the course of the function.

[6] See Section 4.4.2, p. 89.