THE CONCENTRATION OF CORPORATE OWNERSHIP: A MECHANISM FOR THE CONTROL OF CORPORATION

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By "Concentration of Corporate Ownership", we mean that the ownership of large-block stockholding in a corporation by a few individuals, families, groups and institutions. The greater the percentage of stock owned, greater the power to obtain representation on the board of directors, exercise of influence over the management team and overall control of the corporation.

Previous studies mostly considered the influence of the individual control mechanisms but the study by Agrawal and Knoeber [1996] considered seven mechanisms for the control of corporation. Those mechanisms were: outside representation on the board of directors, activity in the corporate control market, debt policy, managerial labor market, institutional stockholdings, insider stockholdings and large-block stockholdings. In this paper last mechanism has been discussed to understand the concentration of the corporate ownership as a mechanism for the control of corporation.

Various ratios, measuring the extent to which ownership in a corporation is concentrated, have been proposed and used in empirical analysis. Such measures also have considerable practicable importance. For example, ownership concentration indices play a key role in the implementation of anti-trust laws in the United States [Smyth, Boyes and Peseau, [1975]. Alternative concentration measures differ in their availability and ease of computation and researchers commonly opt for the simplest and most readily available measure. Support for this position has been provided by the evidence that different concentration indices are closely correlating.

A study of ownership concentration in very large 511 US corporations,

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Demsetz and Lehn [1988] explored that the five largest ownership interests, individual and institutional, controlled over 25 percent of stock. The five largest individual and family ownership interests controlled, on average, 09 percent of stock issued. Another finding of the study indicates that controlling stockholders bear even more firm-specific risk; ownership is more concentrated in firms exhibiting higher firm-specific risk.

In the corporate history, Berle and Means [1932], landmark book, "The Modern Corporation and Private Property", carried the first classical and credible study on the ownership concentration. They concluded that the 200 largest non-financial listed corporations in the United States in the year 1929 (less than 0.07 percent of all non-financial corporations) controlled nearly 50 percent of all corporate wealth [Steiner and Steiner, 1994]. They predicted that ownership concentration, with the passage of time, would increase with dangerous consequences.

By the passage of time, the data simply lend no support to the thesis of Berle and Means [1932], as the concentration of ownership has fallen [Steiner and Steiner, 1994]. By 1947, concentration of the ownership in the top 200 corporations of the United States had fallen to 46 percent. In the 1960s, it levelled off around 40 percent [Weston, 1982]. This declined to 38 percent in 1970; 36 percent by 1980; and 34 percent in 1984 [Golbe and White 1988:277].

An article in the Business Week, raised concerns about a dangerous concentration [Mandel, 1996]. The measure used the market value of top 50 corporations of the United States, in relation to the market value of Business Week 1000, corporations based on first quarter date for each year. The measure rose from 35 percent in 1986 to almost 37 percent in 1987 dropping slightly in 1988. In 1991, the measure reached almost 41 percent, dropped to 36 percent in 1994 and rose to 39 percent in 1996. However, Weston, Chung and Siu [1998] concluded at 35 percent in the year 1996.

Theorists although seldom interested in the concentration of ownership [Holderness & Sheehan, 1988], have identified several possible organizational roles for large-block stockholders. Some of which are likely to be value decreasing, while others are likely to have the opposite effect. For example, Fama and Jensen [1983] analyzed various ways in which managers that own enough stock to dominate the board of directors could expropriate or consume corporate wealth. A large-block stockholder could, for example, pay himself an excessive salary, negotiate, 'sweet heart', deals with other corporations he controls, invest in negative-net-present-value projects or simply withdraw corporate funds.

Stulz [1988] explains how concentration of ownership makes it easier for managers to keep their jobs, even if that means resisting a value increasing tender offer. Jensen and Meekling [1976], on other hand, explain how the interests of managers and stockholders increasingly aligned as the managers' percentage of ownership interest increases.

Morck, Shleifer and Vishny [1988] measured that as ownership concentration increased from 00-05 percent, performance improved. In the ownership range from 05-25 percent, performance deteriorated. As ownership concentration rose above 25 percent, performance improved, but slowly.

A simple explanation of this pattern is that in the 00-05 percent ranges the alignment of interest effect improved performance. In the above 05-25 percent range, management entrenchment influence may have a dampening effect on performance. The range over 25 percent, incremental entrenchment effects attenuated. But Morck et al [1988] questioned this simple interpretation. In the 00-05 percent range, they observed that the direction of causality might be reversed. High performance firms were more likely to give managers stock bonuses or make it profitable for them to exercise their stock options, resulting in large ownership percentages for management. They also referred to the point made by Demsetz and Lehn [1988] that firms with high performance may have substantial intangible assets that require greater ownership concentration to induce proper management of these assets. They agreed that it appeared plausible that above the 25 percent ownership concentration additional entrenchment effects would be small.

Holderness and Sheehan [1988] studied 114 listed corporations with ownership concentration more than 50 percent but less than 100 percent. Among the 114 firms, 27 became majority stockholder firms. But only 13 ceased to be such firms during the same period. Thus, there is little net outflow from majority ownership. This result also confirmed for a much larger base of publicly traded firms. It appears that majority ownership is surviving as a viable organizational form. In the sample, the majority stockholders approximately equally divided between individuals and corporations. Firms with individual majority stockholders are slightly larger than the typical New York Stock Exchange firms are.

The average majority stockholding is 64 percent for all firms in the sample, which is substantially more than the minimum 50 percent that assures voting control. The evidence appears inconsistent with the proposition that majority blocks held to expropriate minority stockholders. Expropriation oriented majority stockholders might want to hold above 55 percent because of super majority voting provisions in the firm's bylaws or articles of incorporation. However, only 36 percent of the sample firms involve blocks above 66 percent, the typical supermajority requirement and for these firms the authors find no case in which the requirement mentioned in proxy statements.

When majority-stockholder firms compared to firms with relatively diffuse stockownership. Holderness and Sheehan [1988] found no statistical difference in investment expenditures, frequency of control changes, accounting rate of return and Tobin's q. However, there was evidence that individual majority-stockholder firms under performed their comparison firms in terms of q-ratios and accounting rate of return, whereas, corporate majority-stockholder firms did not.[1]

The corporate literature points out, that international comparisons expose the weaknesses of historical explanations of the development of corporations based on structural rather than behavioral factors. Family firms in different cultures have been shown to adopt different strategies because differing cultural environments prompted divergent assumptions, aspirations and the adoption of criteria by owners and managers nurtured within different societies. These findings include the highlighting of the continuing importance of family stockholders and the influence they can exert even in corporations where they do not have control.

Scott [1979] demonstrates that the development of corporations in all countries examined has been radically different from the picture painted by the managerialists. Frank and Mayer [1997] adopt a contingency view about the suitability of insider and outsider mechanisms of the control of corporations and its governance. Insider systems such as stereotypical Germanic/Latin/Japanese approaches, may be appropriate in cases with longer-term payoffs, but may be slow in undertaking corrective action. Outsiders systems such as the stereotypical Anglo-American system may be more appropriate where risk is important but may not provide necessary close monitoring and corrective action may be taken prematurely through exit.

The conflict between the interests of debt and equity providers in the bank-dominated Germanic and Japanese system may lead to a high level of

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[1] *See also Barclay and Holderness [1991].*

risk aversion and adverse effects on the development of capital market [Macey and Miller, 1997].

Recent evidence has shown that the Anglo-American systems are developing more active investors and that Germanic /Latin /Japanese systems are witnessing a growth in hostile takenovers and corporate restructuring has stimulated a debate about the possible convergence of mechanisms of the control of corporation [Macey and Miller, 1997]. The extent to which these developments represent a convergence of the control of corporation and its governance mechanisms in the face of globalization or a fragmentation of system within individual countries.

Roe [1997] argues for the development of competing governance mechanisms within a given economy. Corporations with more effective system of governance in a given environment are likely to outperform other firms and thereby put pressure on them for a change. Alike, Franks and Mayer [1997] adopt a contingency view about the suitability of insider and outsider mechanisms for the control of corporation and its governance. Insider systems, such as stereotypical Germanic/Japanese/Franco approaches may be appropriate in cases with longer-term pay-off, but may be slow in undertaking corrective action. Outsider system, such as the stereotypical Anglo-American system, may be more appropriate, where risk is important but may not provide necessary close monitoring and corrective action may be prematurely through exit.

The concentration of corporate ownership measures has also been calculating for individual industries. Historically, the most widely used measure has been the share of the four largest firms of industry sales, assets, employment or the value added in manufacturing. It is argued that when four firm concentration ratios exceed 40 percent, the competition in the industry was too anemic. However, this view has also been disputed both on theoretical and empirical grounds [Weston, Chung and Siu, 1998]. The degree of concentration varies widely among individual industries.

In nutshell, we can conclude that the corporations, are artificial creatures by law of the land: the most efficient combination of land, labor, capital and management / organization. Government should have the capacity to make sure that corporations act in the most compelling terms, that corporations act in the best interest of public. But we have been shown in the most compelling terms that they do not. Other factors than the law-national culture (as in Japan), concentrated stock ownership (as in Germany) and centralization (as in France) have been moderately successful in assuring the good citizenship of a corporation. In the USA and UK these factors do not exist.

Similar issues are also raised in the context of transitional economies. Where, there may be a need to promote competition as a means of breaking down the problems resulting from entrenched managers of monopolistic firms with their network of contracts from the ancient regime.

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