

IMPACT OF OWNERSHIP STRUCTURE AND DIVERSIFICATION ON FIRM VALUE: EVIDENCE FROM THE SHARIAH AND NON-SHARIAH COMPLIANT REITS COMPANIES

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ABSTRACT

Firm value is affected by many factors among them are management itself, ownership structure of the company, and diversification strategy adopted by the company. Therefore, this study attempts to investigate and compare the impact of ownership structure and diversification on firm value between Shariah and non-Shariah compliant REITs companies in Malaysia. The study uses annual data that cover the period of 2006 until 2013. Empirical evidences indicate that all ownership structure measures; namely, insider ownership, institutional ownership, foreign ownership, shareholder dispersion have significant and positive impact on firm value. Furthermore, results suggest that diversified Shariah and non-Shariah compliant REITs have higher performance relative to those that do not diversified.

Keywords: *Ownership Structure; Diversification; Firm Value; Shariah Compliant REITs; Non- Shariah Compliant REITs; Tobin-Q.*

INTRODUCTION

A foremost and crucial goal of company is to enhance its value by maximizing the profit earned by the company. Nonetheless, a conflict of interest or also known as an agency conflict between the owner of the company and the management is one of the serious problems in the company that might destroy the firm value. This arises when the owner or principal of the company sells some portion of his share to outside investors or the agent. Nevertheless, no such conflict appears if the owner solely manages and owns all shares in the company (Masdupi, 2013).

An agency conflict might happen due to the act of managers or agents that is primarily based on their own self-interest rather than taking into considerations the shareholder's interests. Managers are hired to manage the company effectively and efficiently and should act based upon the owner's interest. Yet, in reality, managers are more likely to act and make decisions according to his own interest than the shareholder's interest predominantly on the issues of diversification of business activities that could affect the firm value.

Poor decision made on business diversification would either create or destroy the firm value as suggested by Masdupi (2013). Failure of the company to exploit all benefits of diversification in terms of cost savings, better efficiency and synergy among divisions, raising debt capacity, greater economies of scale and others could jeopardize the diversification. Eventually it can reduce the firm value. Hurst (2012) also supported that a more diversified companies produced a superior flow of cash as a result of wider prospect set as well as diversified companies will operate and trade above their forecasted values.

LITERATURE REVIEW

Ownership Structure

Defined as the distribution of shares held by individuals or institutions in a company, ownership structure can be one of the strategies in order to moderate agency conflict because there is separation between control and ownership in the company and the performance or value of the company is frequently driven by ownership structure (Masdupi, 2013). Agency theory developed by Jensen and Meckling (1976) suggests that in order to solve such conflict, companies should look for the ownership structure which permits managers to become more conscious towards the full potential of the assets of the company and to act upon shareholder's interest rather than their own self-interest. Empirical evidences by Hatzell, Sun and Titman (2012) reported that ownership structure helps to reduce agency cost.

Diversification

Diversification of business on the other hand, is the number of business segments owned by the companies. A diversified company is classified as company that owns more than one business segment while a focused company is a company that has only one business segment (Hurst et al., 2012). The authors also argued that diversification too is predicted to have an effect on the performance or value of the companies. Agency theory explains that diversifications are primarily motivated by managers' self-interests such as employment risk-reduction, power, prestige and high reward (Jensen & Meckling, 1976). Masdupi (2013) added that, theoretically, when managers diversify business activities according to the shareholder's interest, it helps to enhance shareholder's wealth and therefore will directly increase the firm value. Nonetheless, such ideal situation may not exist when managers tend to put their self-interests before the shareholder's interests. Previous research done by Lang and Stulz (1994) found that negative relationship between diversification and firm performance whereby diversified firms have lower Tobin Q as compared to pure-play firms.

All those previous studies examine the effect of ownership and diversification on only non-Shariah compliant companies or while others failed to segregate the sample between non-Shariah and Shariah compliant companies. It is important to separate these two groups of companies and compare whether these factors identified could have different influence on firm value since they operate under different regulatory frameworks. Shariah compliant companies are not only obligated to operate according to the Shariah principles but the Shariah advisory board is also governing them. Hence, it would be interesting to discover if such requirements could have made a difference on performance of these two groups.

In an attempt to investigate the impact of ownership structure and diversification on firm value, only two (2) Shariah compliant REITs companies and thirteen (13) non-Shariah compliant REITs companies were selected as samples after taking into consideration the availability of data needed. The numbers of present Islamic REITs and Conventional REITs companies are provided in Table II.

REITs Industry in Malaysia

No. of REITs	End-Sept 14	End-Nov 13
Islamic REITs	3	4
Conventional REITs	13	13

Source: Securities Commission Malaysia (2014)

The independent variables used for this paper consist of ownership structure and diversification measures (refer Table II). These factors are identified to have potential impact on firm value (Hurst et al., 2012; Lang & Stulz, 1994).

Proxies for Ownership Structure and Diversification Impact on Firm Value

Variables	Measurement	Predict ed Sign
Ownership structure variables:		
Insider ownership	$\frac{\text{No. of shares held by managers and directors}}{\text{No. of common shares outstanding}}$	+
Institutional ownership	$\frac{\text{No. of shares held by institutions}}{\text{No. of common shares outstanding}}$	+
Foreign ownership	$\frac{\text{No. of shares held by foreigners}}{\text{No. of common shares outstanding}}$	+
Shareholder Dispersion	$\frac{\text{No. of shares held by public investors}}{\text{No. of common shares outstanding}}$	+
Diversification variable:		
Herfindahl index by	$\sum_{i=1}^n \text{Fraction of Asset of segment } i^2$	-

asset		
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The theoretical framework for this study is developed after reviewing and analysing all past literature pertaining to ownership structure and diversification influence on firm value (Figure 1).

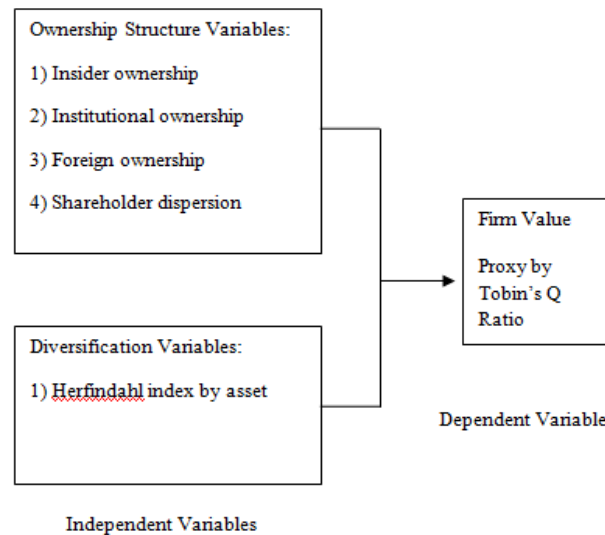


Fig. 1. Conceptual framework of ownership structure and diversification impact on firm value

RESEARCH METHODOLOGY

The research methodology starts with the research design. This study adopts a causal research design because the researcher wanted to know the relationship and impact of several independent variables namely insider ownership, institutional ownership, foreign ownership, shareholder dispersion and diversification toward the dependent variable which is Tobin's Q ratio as proxy for firm value. The data collection method that was applied in the study is secondary data whereby all data were collected from annual reports of both Shariah and non-Shariah compliant REITs companies for the period between 2006 until 2013. Initially three Shariah compliant REITs companies and thirteen non-Shariah compliant REITs companies were identified. However, due the incompleteness of data, this study had narrowed down the sample to only two (2) Shariah compliant REITs companies and 13 non-Shariah compliant REITs companies. A Pooled Ordinary Least Square (POLS) regression was used to achieve the objective of the study. The dependent variable and independent variables were identified after reviewing previous literature related to the study. Hence, the regression model for the firm value is formulated as given below.

$$TQR_{it} = \beta_0 + \beta_1 IO_{it} + \beta_2 INO_{it} + \beta_3 FO_{it} + \beta_4 SD_{it} + \beta_5 HIA_{it} + \varepsilon_{it} \quad (1)$$

Where the variables in equation 1 are:

TQR_{it} = the Tobin's Q Ratio (Proxy for Firm Value)

β_0 = Constant

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = the slope of regression

IO_{it} = Insider Ownership

INO_{it} = Institutional Ownership

FO_{it} = Foreign Ownership

SD_{it} = Shareholder Dispersion

HIA_{it} = Herfindahl Index by Asset

ε_{it} = Error Term

RESULTS AND DISCUSSIONS

Table III displays the estimated results of the impact of ownership structure (IO, INO, FO and SD) and diversification (HIA) on firm value (TQR). Generally, ownership structure has direct relationship with firm value for both Shariah compliant and non-Shariah compliant REITs companies. Specifically, factors such as insider ownership, institutional ownership, foreign ownership and shareholder dispersion will increase the value of the companies.

Firm value of Shariah REITs increases as managers and directors increase their control on the companies relative to the firm value of non-Shariah REITs. However, the coefficient magnitudes of ownership structure for Shariah REITs appear to be greater than non-Shariah REITs. This implies that for Shariah REITs compliant companies, greater governance and monitoring by IO, INO, FO and SD led to high firm value. In fact, insider ownership has higher coefficient relative to the other types of ownerships. As a conclusion, the result of this study is following the agency theory prediction of positive relationship between ownership structure and firm value. Similar empirical results were found by previous studies of Kamangue and Ngugi (2013), Rashid (2011), Chen, Blenman and Chen (2008) and Wei, Xie and Zhang (2005).

In addition, Herfindahl index of Shariah compliant REITs companies reflects a negative and significant relationship with firm value. This means that when companies become more diversified, the firm value decreases for both group of companies. However, the magnitude of HIA coefficient of non-Shariah REITs is lesser than those Shariah REITs. The results of this study concur with Dadbeh, Bagherabadi, Abednazari and Talaei (2013), Kang, Lee, Choi and Lee (2012) and Fukui and Ushijima (2007). These authors argued that firm value decreases due to the over investment by managers that supported the agency theory. In addition, Table III shows that the adjusted R^2 value for Shariah compliant REITs companies is 0.9650 which indicates a high value. This is based on the common rule of good adjusted R^2 of higher than 0.6. A 0.9650 of adjusted R^2 value reflects that the dependent variable which is firm value is explained by all independent variables as much as 96.51% while the remaining of 3.49% will be explained by other variables that are not taken into consideration in this study. Meanwhile, the value of adjusted R^2 for non-Shariah compliant REITs companies is 0.8877. This shows that 88.78% of the independent variables identified in this study are able to explain firm value as measured by Tobin's Q. The p-values of the F-statistics for both models are statistically significant. This suggests that both models are well specified.

Generally, it can be concluded that even though Shariah compliant companies are required to operate within the Shariah laws and principles, however, results of the study indicate that

there are many similarities between these two groups of companies when ownership structure determinants are concerned. Hence, for investors who are seeking ethical investment, they should consider investing in Shariah compliant REIT companies since these companies' performances are as good as the conventional companies. As Muslim investors, investing in Shariah compliant REIT companies could enable them to achieve the five objectives of Maqasid Shariah which are the protection of religion, self, mind, lineage and lastly wealth (Dusuki, 2012). Furthermore, according to Islamic legal maxim as suggested by Hatta and Dien (2014), all haram elements in our daily life activities including investment activities should be removed. It is known among Muslim that Allah S.W.T prohibits non halal activities for many reasons. For instance, consuming riba' will suppress the poor and make the poor becomes poorer and the rich becomes richer.

TABLE III.
Estimated Results of Pooled Ordinary Least Squared (POLS) Method

Independent Variables	Dependent Variable: TQR	
	Shariah Compliant REITs Companies	Non-Shariah Compliant REITs Companies
	Coefficient (p-value)	Coefficient (p-value)
Constant	0.2930 (0.3465)	0.6962 (0.0000)
IO	1.854 (0.0025)**	0.0333 (0.0386)**
INO	0.0782 (0.0051)**	0.0319 (0.0070)**
FO	0.1839 (0.0179)**	0.0687 (0.0049)**
SD	0.0116 (0.0346)**	0.0002 (0.0234)**
HIA	-1.0391 (0.0126)**	-0.1374 (0.0086)**
AR(1)	1.0902 (0.0000)***	0.7116 (0.0000)***
Adjusted R-Squared	0.9650	0.8877
F-Stat	41.6706 (0.0002)***	13.0625 (0.0000)***
Durbin Watson	2.0545	2.2173

Notes: ***Significant at 1% level, ** Significant at 5% level, * Significant at 10% level & NA- Not Applicable

CONCLUSION AND RECOMMENDATIONS

As a conclusion, this research aims to investigate the impact of ownership structure and diversification on firm value as well as to examine whether there are differences in ownership structure and diversification mechanism impact between Shariah and non-Shariah compliant REITs companies.

Empirical evidences from this study imply that the ownership structure and diversification do affect firm value as what have been predicted in the agency theory by Jensen and Meckling

(1976). The results for both Shariah and non-Shariah compliant REITs companies show positive and significant relationship between ownership structure and firm value as well as negative and significant relationship between diversification and firm value. This means that ownership structure mechanism is effectively in place to mitigate agency conflict between the shareholders and managers in the company. In addition, manager's decision on diversification strategy of the company that is based on own interest will give adverse impact to the company since it can diminish firm value.

Furthermore, there is no difference in relationship between ownership structure and diversification on firm value for both Shariah and non-Shariah compliant REITs companies. This shows that apart from several differences that are mainly from the compliancy issues, there are also some similarities between Shariah and non-Shariah compliant REITs companies' practices. The findings have important implication to Muslim investors who are interested to invest in property sectors. Perhaps the advantage of investing in Shariah-compliant REITs companies is that not only are these companies conducting their businesses according to Shariah tenets but they also have similar firm value relative to non-Shariah compliant companies. The ownership structure of Shariah-compliant REITs companies tends to have more influence on the firm value. Finally, yet importantly, irrespective if the REITs companies are Shariah or non-Shariah compliant, managers who are over investing could cause the firm value to decline.

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