Role of management with diffuse ownership essay sample

• Diffuse stock ownership

– Limited liability public corporation

– Diffuse ownership of voting equity shares

– Large number of individual share owners

– Separation of ownership and control

• Operations of firm are conducted and controlled by managers without major stock ownerships

• Conflicts of interest arise between owners and managers

OWNERSHIP CONCENTRATION:

• Equity ownership by managers must balance

– Convergence or alignment of interests

– Entrenchment considerations — managerial ownership and control of voting rights may allow pursuit of self-interest

• Ownership and performance

– Stulz (1988)

• Model in which at low levels of management ownership, increased equity holdings improve convergence — enhance firm value

• At higher levels of insider ownership, managerial entrenchment prevents takeovers — decrease firm value

– Morck, Schleifer, and Vishny (MSV) (1988)

• Study based on 1980 data

• Performance (measured by q-ratio) related to management or insider ownership percentages

– Ownership concentration increased from 0 to 5%

• Performance improved

• Alignment-of-interest effect

• Direction of causality may be reversed — high performance firms more likely to give managers stock bonuses

• High performance firms may have substantial intangible assets that require greater ownership concentrations to induce proper use of these assets.

– Ownership concentration in range 5% to 25%

• Performance deteriorated

• Management entrenchment dampens performance

– Ownership concentration above 25%

• Performance improved but slowly

• Incremental entrenchment effects attenuated

– McConnell and Servaes (MS) (1990)

• Replicate MSV study using 1976 and 1986 data

– For 1976, relationship between ownership concentration and performance relatively flat with moderate convergence of interest effect up to 50%, after which curve flattens and then declines moderately

– For 1986, relationship curve rises relatively sharply to 40%, after which it is relatively flat to 50% followed by sharp decline

• Leverage, institutional ownership, R&D expenditures, and advertising Cho (1998)

• Replicates MSV patterns using ordinary least square regressions and 1991 data

• Tests for endogenous ownership structure

• Finds that corporate value affects ownership structure, but not reverse

• Bristow (1998)

• Sample of consistently derived insider holdings on 4, 000 firms during 1986-95

• Relationship between management ownership and performance varies for each of the ten years

• expenditures do not change initial findings

• Economic variables influence ownership-performance relationship

– Relative growth rates of industries

– Differences in demand-supply relationships among industries

– Relative value change patterns among industries and firms within them

– Stock price movements

• Interpretations of diverse data patterns

– May reflect economic identification problem discussed by Cho

– True relationship may be Demsetz-Lehn theory of no relationship between ownership level and performance

– Holderness, Kroszner, and Sheehan (1999)

• Percentage of managerial equity ownership

– Mean increased from 12. 9% in 1935 to 21. 1% in 1995

– Median increased from 6. 5% in 1935 to 14. 4% in 1995

• Doubling of managerial ownership may imply improvement in corporate governance in U. S.

– Managerial ownership and bond returns — Bagnani, Milonas, Saunders, and Travlos (1994)

– No relation between bond returns and managerial ownership below 5%

– Positive relation for managerial ownership between 5% and 25%

• Increased incentives for managers to act in shareholders' interest, taking risks that are potentially harmful to bondholders

• Rational bondholders required higher returns

– Weak negative relation for ownership above 25%

• Managers become more risk averse

• Managers have high stake in firm — greater incentives to protect their private benefits and objectives

• Managers' interest more aligned with bondholders — lower bond premia

– Financial policy and ownership concentration

– Share repurchases financed by debt

• Insider group does not tender its shares in repurchases — percentage equity shares increased

• Increased convergence of interest effect

– Incentive effects of high management ownership percentages performed positive role in LBOs and MBOs