Effect of Ownership Structure on Financial Performance of Banks

By

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This is to certify that **Mr. Kashif Munir**, having Registration # **MM 133030** has incorporated all observations, suggestions and comments made by the internal examiners and research project supervisor. The title of his Project is**: Effect of Ownership Structure on Performance of Banks.**

Mr. Shujahat Haider Hashmi
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Dedication

This research project is dedicated to my beloved family.

Acknowledgment

First of all I would like to thank all mighty Allah for giving me strength and courage to complete this research project. I would also like to express my gratitude to all those who supported me in completion of this assignment.

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Abstract

This study examine the effect of ownership structure on financial performance of the commercial banks in Pakistani financial sector by using the data sample of 29 banks in ten years from 2007 to 2016. Several structures of ownership concentration are studied along with performance measure variables to investigate the relationship. Panel regression techniques with fixed effect models is applied on the basis of Hausman specification test and likelihood test for different outcomes. Unbalanced panel regression is used on 282 observations. Overall analysis shows that the effect of ownership structure on financial performance of Pakistani banks is insignificant.

Keywords: Ownership concentration, financial performance, panel regression, commercial banks

CHAPTER 1

INTRODUCTION

The finance literature is replete with the studies that examine the effect of ownership structure on non-financial firm performance and other corporate outcomes. Substantially less attention has been dedicated, however, to the impact of ownership on bank performance. The influence of ownership structure on financial performance is important in banking. Indeed, shareholders have an incentive to monitor managerial decisions and return on their invested funds. But different types of shareholders have different reaction face a managerial decisions that influence the financial performance of banks. As a result, this study will focus on the impact of family ownership, institutional ownership, public ownership, foreign ownership on the financial performance of banks.

Ownership structure does not only tell us about owners of the business, but it also determines who is liable for it, who has control over it, how the business is going to be taxed and how the division of profits will take place. Therefore, the choice of ownership whether private, public, foreign, government or local etc. is very crucial in the context of banks and non-banking firms as well (Boubakri *et al.*, 2005). Ownership structure plays an integral part in the development of a strong and healthy banking system in emerging economies (Lang and So, 2002).Ownership structure is receiving much importance due to its relationship with corporate governance and agency theory.

According to the modern theory of corporate governance contract nature and principal agent problem laid a foundation for agency theory in economics by in Berle and Means (1932), they also pointed out that ownership structure of scattered managers and small shareholders have potential conflict of interest, and make company performance can’t achieve optimal goal. Jensen and Meckling (1976) suggests that managers acting as agent on behalf of their principals have tendencies to purse strategies that meet their own personal goals rather than those of principals

Concentrated ownership is an important element in corporate governance because it results in better monitoring of management. Ownership concentration has an impact on performance and performance is basically the indicator used to measure firm's success. As stated by Frich and Kohlar (1999) performance is conduct of activities for an organization over a period of time in part or in full with relation to its past or projected cost efficiency, responsibility or accountability of management. European Central Bank (2010), looks at financial performance of banks from the perspective of analyzing the main drivers of profitability; efficiency, earnings, leverage, and risk- taking. The report goes on to note that the performance however needs to incorporate the views of different stakeholders which include debt, equity holders, depositors and managers.

According to Jensen and Meckling (1976); Mehran and Cole (1998); Lang and Djankov (2000); Mitton (2002); Iannota, Sironi and Nocera (2007); Ongore (2011) argues that there is a positive strong relationship between concentration of ownership and profitability. However, contrary to above conclusions Lehn and Demsetz (1985); McConnell and Servaes (1990); Karathanasiss and Drakoes (2004); Berger et al., (2005) come up with a conclusion that, ownership concentration impacts negative on performance of the firm. They also pointed out that, firms are more prone to crises and financial distress if the concentration of ownership is high. Whereas, Shleifer and Vishney (1997); Thomson and Pederson (2000); Aydogen and Gursoy (2002) suggests that relationship between performance and ownership concentration rely on the controlling/ large shareholders. According to Ongore (2011) different type of shareholders always have different objectives and goals.

Clark et al., (2005) find that bank performance will be improved after privatization. Altnubas et al., (2001) concluded that German private commercial banks are more efficient and beneficial than investment and public banks**.** But the change of performance of private banks is better than public banks and are more efficient than public banks. Also, Iannotta *et al.*, (2007) compared the performance of 181 banks in 15 countries over the period (1994-2004). After the control of bank characteristics, countries, effect of time, they showed that public banks have less performance than private banks. Cole and Mehran (1998) assessed that strong positive correlation exists between ownership structure and profitability. Similarly, in emerging economies, Micco *et al.*, (2004) found a strong positive connection between ownership structure and performance. Study also showed that private sector banks and foreign banks had better profitability as compared to the public sector counterparts.

Cornett et al., (2009) observed that the influence of public ownership on the performance of banks around the period (1989-2004)**.** They found that the public banks are less profitable, have less capital and credit risk than private banks before 2001**.** It appeared that more prominent difference was observed in banking system of countries where there was political corruptions and higher involvement.

Several studies have shown that public banks are less profitable, have more costs, less assets quality compared to private banks (Berger et al., 2004)**.** State owned banks have low financial and poor economic performance. In addition, the strong presence of public banks in the banking sector has been associated with lower financial development (Laporta et al., 2002; Barth et al., 2004)**.** The financial markets of Pakistan have demonstrated a change by moving out from the regulated environment into market oriented environment. This study provides insight into the effect of ownership structure on financial performance in Pakistani banking sector. This sector is an emerging sector which is not that mature in terms of governing laws, corporate governance and protecting interest of minority shareholders.

1.1 Overview of Banking Sector in Pakistan

The banking sector in Pakistan underwent a radical change over a period of 69 years since the partition of Indo-Pakistan sub-continent in 1947.At the time of division there was cash balance of four billion rupees in the Reserve Bank of India, and Pakistan was to receive Seven Hundred and Fifty Million Rupees out of it, which was initially and deliberately delayed by the Indian Government because they hoped that Pakistan would become bankrupt, Fifty Million rupees are still not paid till date. Apart from financial instability, absence of skilled human resource, weak products and services quality, technical and administrative difficulties, lack of and professionals, and political and socioeconomic conditions were among the few problems faced by Pakistan banking sector initially.

Reserve Bank of India was asked to finish the agreement to perform its duties as central bank for both the countries on 30th June 1948, as wrong policies were followed by the bank which was against the interest of Pakistan. Therefore, in the greatest interest of the country, the Government of Pakistan made a decision to establish a Central Bank for the country namely State Bank of Pakistan at Karachi on 1st July, 1948. The objective of the bank was to control the financial sector.

State Bank of Pakistan's policies were designed to revamp the banking sector. Special attention was paid to weed out unsound banks and encourage establishment of new banks and financial institutions in the country to accelerate growth of banking system. Initially, during 1950s and 1960s, this lead in corrupt practices and unhealthy competition due to limited powers of SBP.

During 1970s, the financial landscape of Pakistan changed significantly. In 1972, banking reforms were introduced and substantial power was given to State Bank of Pakistan to supervise and monitor the banking system of country. In 1974, with the promulgation of Nationalization Act, all existing private banks of country were nationalized by the Government. This nationalization policy drastically changed the financial system of

Pakistan and also discouraged the foreign financial institutions and private investors. It was observed before nationalization that having four largest banks in the country (including three private banks and one public sector bank) would not be fruitful for the balanced economic growth through banking system. These banks were owned by some large influential families which lead to exploitation of the resources of the banks.

The banking sector in Pakistan by the end of 1980s, had become barely conductive conducive to adequately meet the growing financial needs of the country. During the time of nationalization, banks were not properly operating on commercial ideologies. In addition political and bureaucratic interventions lead to increased financial intermediation costs. The government made intensive use of resources to close fiscal deficits. However, market responsiveness and financial strengths of the sector was severely affected. Excessive influence of trade unions in affairs of the banks and uncompetitive environment effected efficiency. Regulated interest rates control by government, weak credit allocation also impaired the performance of banking system due to which the quality of services deteriorated.

To address the issue of deteriorating performance of nationalized banks, a comprehensive privatization and reforms program was introduced in early 1990. The agenda of the program included liberalization of financial system, revision in regulations, removing barriers of entry for foreign financial institutions, introducing competition to strength financial institutions, improving competitive macroeconomic stability, removing subsidized credit schemes, strengthening of capital base of banks and liberalization of interest rate controls etc.

To make banking more productive, efficient and enabling environment for operational flexibility, and further deepening and widening financial market, the reforms of the banking sector were introduced in early 1997 and State Bank of Pakistan was granted full independence in early 1997. A strategy was formulated by SBP to revamp the banking supervisory functions. Therefore, merger and acquisition policy was developed through which banks were merged whereas some banks are still undergoing consolidation process since 2000.

The Pakistani financial sector has undergone considerable change in the post privatization period. Previously, large commercial banks were entirely owned by the government in terms of assets, investments and advances etc. Domination of government banks has significantly been reduced, as per 2016 SBP report, Pakistani banking sector comprised of 20 local private banks, four foreign banks and five commercial banks in public sector and scheduled specialized banks. The financial sector has been completely privatized now (except for National Bank of Pakistan). 16 private investment banks and 14 new domestic private commercial banks have been established in private sector. Even 23.5 percent of Pakistan's National Bank shares were floated through Stock Market.

Table 1

Position of number of Banks and Branches in Pakistan

Type of Bank	**Banks**	**Branches**
1 - Pakistani Banks	30	12,938
1a- Public Sector*	9	2,975
1b- Domestic Private	20	10,008
2 – Foreign Bank	4	10
Total	**34**	**12,993**

Source: State Bank of Pakistan, Scheduled Banks in Pakistan December 2016.

**Public sector banks also includes 4 specialized banks which are excluded from the study*

With this number and type of banks ownership structure in the country there is no doubt that there exists fierce competition in the banking sector. Over the past two decades, a new wave of bank privatization has been significantly altered banks ownership structure in Pakistan. While government reduced its ownership in banks, domestic private sector including local companies and individuals and foreign banks were allowed to enter into the banking system through opening branches, representative offices, or by acquiring shares of local banks stepped in the banking sector.

Table 2

Financial Position of All Banks

Figures in PKR Million

Particulars	**31 Dec,2007**	**31 Dec, 2016**
Total Assets	4,376,591	17,590,361
Total Liabilities	3,968,896	17,590,251
Profit Before Taxation	121,823	334,589
Head Office/ Share Capital Account	166,074	1,453,765
Deposits and other accounts	3,270,791	11,263,819
Advances – Net	2,440,903	5,906,932
Investments – Net	833,266	7,268,845

1.2 Problem Statement

Earlier works on ownership structure and firms financial performance have solicited different views in research leaving the study inconclusive. Even most of the studies on ownership structure and financial performance has been done on developed countries and Middle East and North African (MENA) countries. Privatization of banks has significantly altered bank ownership structure in Pakistan and banking sector considered as back bone of our economy. In Pakistani context very few literature on latest data is available regarding ownership concentration and its effect on financial performance of commercial banks. Thus, this study focuses on the effect of ownership structure on financial performance of commercial banks in Pakistan.

1.3 Research Questions

Current study provides the answer to following questions:

1 Does the ownership structure effects on the commercial banks' financial performance in Pakistan?
2 Is there any significance relationship between institutional ownership structure and financial performance?
3 Do the family ownership structure effects banks financial performance?
4 What is the importance of government ownership in Pakistani banking sector?
5 Does foreign ownership structure play any significant role in banking sector of Pakistan?

1.4 Research Objectives

- One of the objective of the study is to provide evidence from Pakistani banking sector (listed commercial banks) that how financial performance changes as ownership concentration degree changes

- To analyze whether commercial banks in Pakistan with different type of ownership structure presents significant difference in their financial performance.

- To explain the result of ownership concentration whether institutional, foreign, family, or government ownership on banks financial performance.

1.5 Significance of Study

After privatization Pakistani banking sector has become an emerging industry where diverse set of ownership structure is available. This study is beneficial to understand how ownership structure effects financial performance of commercial banks in Pakistan and will be beneficial for finance professionals, financial advisors, investment companies, foreign investors, family owners, and government officials to understand on the role of ownership structure and its effect on financial performance. Study will also contribute to these policies, which ensure that their ownership structure creates value for their institutions.

1.6 Organization of Study

Rest of the study is organized in following manners:

Chapter two discusses the relevant past studies with particular reference to ownership structure and financial performance. Chapter three describes the data and methodology used in this study. Chapter four reports the results and discussions and chapter five concluded the study.

CHAPTER 2

REVIEW OF LITRATURE

2.1 Literature Review

The relationship between structure of ownership and performance of an organization has been studied by many researchers generally who were interested in corporate finance ever since the original paper of Berle and Means (1932) who looked at ownership basically from management-owner structure. They also discussed the role played by management as well as minority versus majority shareholders in organization's performance. Ownership structure has been categorized into ownership identity and ownership concentration (Lee, 2008). He defines concentration of ownership as a distribution of shares held by majority shareholders. The concentration of ownership is very important in the perspective of a bank and is a crucial element for the growth and development of strong and healthy banking system in emerging countries. Ownership identity is mainly categorized into foreign, domestic, public, private investors and institutional investors.

In the case of banking, concentrated ownership may hurt bank performance as well as increase the operating costs. Whereas, Ungureanu (2008) argue that ownership structure improves banks monitoring and control of almost all its activities through a better flow of information. Berger et al., (2005) found a negative impact of concentrated ownership on performance. Companies with high concentration of ownership are found to be more prone to financial distress and crises as compared to others (Nora and Rejab, 2015). Perrini et al., (2008) study suggests that businesses that are owned by family often face governance issues because their main goal is sustaining key chief executive position in family and investing in projects that have low risk for the ultimate survival of their company. Thillainathan (1999) says that the presence of large number of shareholders in a bank with high decision making authority and control creates moral behavioral hazards in banks and can jeopardize banks long term performance.

Berle and Means (1932) argues that the concentration of ownership if more noticeable in the developing economies. Khamis, Hamdan, and Elali (2015) argues that emerging market environments often have a lot more concentration of ownership which causes majority and minority shareholders to enter into potential conflicts which ultimately can affect the performance of the firm. They also argue that according to the agency theory concentration of ownership ends up in improved monitoring of the management which further suggests that ownership is a crucial part of corporate governance as it also advances the company's performance.

Some studies such as Demesetz and Lehn (1985); Demesetz and Vilalonga (2001); Kumar (2003); Rowe and Davidson (2002), found that there existed no significant relationship between the concentration of ownership and the value of the company. Morck et al., (2000) indicate that firms that are owned by family often show too much risk aversion and let go strategies that could result in profit because they are concerned of their family legacy and their high amount of concentration in businesses wealth. Kiruri (2013) studied ownership structure and how it effects the profitability of the bank and according to his result, concentration of ownership is negatively correlated with the profitability of the bank.

Claessens; Djankov; and Lang (2000) found that the type of ownership structure help determine the performance of the firm. Lee (2008) finds that the performance of a firm can significantly improve if its ownership structure increases. Ongore et al., (2011), findings indicate a significant negative association between state ownership of firms and financial performance. According to Kaserer and Moldenhauer (2008), if insider ownership exists in a firm its performance would increase. A study done on Standard and Poor's 500 firms by Anderson and Reeb (2003) shows that firms that are family- owned perform better than firms that are non-family owned. According to Pinteris (2002) if the controlling family's ownership is lesser so will its profitability be. Family owned organizations have much more effective structure as compared to firms which are not owned by family. Cubin and Leech (1983) findings show that a positive correlation exists between concentration of ownership and profitability.

It is an important concern how the ownership structure of a bank effects its performance. Ownership structure of different types have significant implications for performance and corporate governance as argued by (Shleifer and Vishny, 1997). The equity ownership structure is the foundation in the corporate governance problem, basically the structure of equity helps in deciding the company's decision-making and incentive mechanism, which affects the company behavior as well as business performance. Some ownership structure focuses more on personal interest of the largest shareholders. Whereas, some structure is more concern for the long term survival of the banks. Hence, the objectives, interest and priorities of ownership structure determines bank performance**.**

Lee and Jun (2011) attribute that ownership structure determines the decision making, incentives, behavior of firm and eventually the performance**.** Lee (2008) recognize ownership structure to be an internal mechanism of corporate governance**.** Coarse (1937) provided insight into the effects of dispersed ownership on performance**.** Buchanan and Tullock (1962) pioneers of the Public Choice theory negatively portrayed government as poor owners who are bureaucrats with self-interests that were politically motivated**.** Shleifer et al. (1968) state that a higher ownership concentration allows firm to make better decision. Some studies believe that positive relationship with family ownership and firm's performance exist because of absence of free riding by management (Reeb and Anderson, 2003). Demsetz and Villionga (2001) found evidence of no relationship between ownership structure and performance and elaborate that high return is due to interplay of market forces. Berger (2003) found positive relationship ownership and performance.

Gupta (2005) discovered that companies owned by government have negative effects on the financial and operational indicators such as profitability, productivity, and investment in India. Iannota et al., (2007) finds that the banks owned by government are not that profitable or less profitable as compared to the banks owned by private owners despite their lower operating cost. Berger et al., (2005) finds that in long run, banks owned by government have lower or poor performance than their other counter parts. However, in contrast to these findings, Aydogan and Gursoy, (2002) concluded that government owned bear high risk, therefore, they have better financial performance. Najid and Rehman (2015) also found that ownership of state has a strong positive correlation with financial performance. The research of Sun and Tong (2003) showed that state ownership had negative impacts on firm's performance in China whereas foreign ownership does not indicate uniformly strong or positive impacts on firm's performance.

Large shareholders interest, priorities and objectives have different effects to bank performance**.** Thomsen and Pedersen (2000) observed that the presence of large shareholders has significant impact on bank performance. Antoniadis et al., (2010) finds high level of ownership concentration and diffused ownership in banks leads to an increase in bank profitability. Nora and Rejab (2013) argue that existence of large shareholders are also connected with the high performance of banks.

2.2 Ownership Structure and Agency Theory

The theory emanates from the fact that ownership and control of most modern firms is different**.** Jensen and Meckling (1976) defined the agency relationship as where the principal engages the agent to act on his behalf**.** They noted that if the agent and principal are all utility maximizes, the agent would act on his own self-interest**.** The ownership structure receives much attention because of its correlation with corporate governance and agency theory. Many researchers in order to justify mixed results found different dimensions of structures of ownership within an organization. One of the most focused dimension is managerial ownership and ownership concentration. Ownership concentration is the fraction of equity held by the owners. Demsetz and Villalonga (1985) defined ownership concentration as the number of shares owned by large shareholders.

The ownership concentration is considered to reduce the agency problem between shareholders and managers and helps to separate ownership and control. According to the agency theory, concentration of ownership helps in monitoring the management in a better way because they have a large interest in the company and therefore interested in how company is operating, because they receive a large amount of profit. Therefore, ownership structure plays an important part in corporate governance. Xu and Wang (1997); Pivovarsky (2003) were able to determine a substantial relationship between the two. Servaes and McConnell (1990) found a positive but less significant relationship between agency theory and concentration of ownership**.** Other studies such as Demesetz and Lehn (1985); Davidson and Rowe (2002); Kumar (2003), discovered that there is insignificant relationship between value of companies and concentrated ownership.

According to the traditional agency theory, the concentration of ownership increased the capability of shareholders to monitor the management of that company. This prevents the management from taking decisions which are only in their own interest which could create negative affect on the company performance.

2.3 Institutional Ownership and Firms Performance

The willingness of Institutional investors to pressurize the management to take action which is in the interest of shareholders is increasing. With the increase in the share of ownership of institutional investors, the regulators are also focusing on the role of these shareholders in monitoring, disciplining and influencing the management of corporates. The series of scandals in the corporate world since last two decades speaks of corporate governance failure. Suggestions for reform coming from Sarbanes-Oxley Act or changes in rules proposed by the NASDAQ and New York Stock Exchange (NYSE), mainly concentrate on how well the management decisions are being monitored.

Institutional investors' role as monitors of corporates has been the focus of attention of considerable bodies of research**.** As per the argument presented by Grossman and Hart in 1980 institutional investors can better achieve the benefits as they have an incentive to monitor due to their large shareholding size. Shleifer and Vishny (1986) came up with similar findings related to large shareholders, saying that these shareholders are more incentivized to monitor managers as compared to the shareholders who have no wealth or very little wealth invested in the corporation. Research till date has focused on institutional investors' role in monitoring of firms mainly focusing on institutional investor's activism. Not much evidence is available on the impact of institutional ownership and monitoring on the profitability and financial performance of corporates. However, mixed results of such studies have been seen.

There are a number of papers available which have focused on direct impact of institutional investor's ownership on the profitability and financial performance of corporates in addition to institutional investor activism. According to McConnell and Servaes (1990), the percentage of ownership of institutional investors is positively correlated to a firms Tobin's q. As per Nesbitt (1994); Smith (1996); Del Guercio and Hawkins (1999), there is a positive correlation between institutional ownership and performance of firms as measured by using various techniques. However, Knoeber and Agarwal (1996); Karpoff et al., (1996); Duggal and Miller (1999); Faccio and Lasfer (2000) did not find any significant relation. Thus, the end result of the research is mixed. In many different studies presented, impact of institutional investor's ownership on different performance measures is still unclear.

2.4 Ownership Structure and Commercial Banks in Pakistan

Banking sector plays very important part in an economy as it mobilizes deposits, facilitates payment system, allocate credit for the various household consumption, and for many other governmental and productive uses. According to Jaffe and Levonian (2001); Wachtel (2001) banks play a very crucial role through fund allocation for the highest value use, reduce the costs and risks, and provide variety of economics and commercial activities.

With different number of banks diverse type of ownership structure in the country, there is no doubt that there exists fierce competition in the banking sector**.** Over the past two decades, a new wave of bank privatization has significantly altered bank ownership structure in Pakistan**.** While government reduced its ownership in banks, domestic private sector including local companies and individuals and foreign banks were allowed to enter into the banking system through opening branches, representative offices, or by acquiring shares of local banks stepped in the banking sector**.**

Family owned firms through their ownership structure dominate the Pakistani corporate sector. The operations of these businesses rely heavily on the founding families to fund their operations (Shahwaaz, 2001). These corporates are controlled by these firms either directly or indirectly through investments in shares and associated companies. All decision making of these firms is with the family owners. In addition, there are poor disclosure practices and weak corporate governance structures. The owners of these firms use their discretionary powers to get personal benefits. So the external investors are not able to control, monitor or check the discretionary behavior of the family controlled firms resulting from dominance of the family members over the board of Directors. Moreover the family owners also gain benefits by transferring the funds across different family companies.

2.5 Hypothesis Development

Based on the review of literature the following hypothesis can be formulated:

Hypothesis 1: Banks ownership concentration has a positive effect to financial performance of banks

Hypothesis 2: Institutional ownership structure have significant effect on the profitability of commercial banks

Hypothesis 3: There exist significant relationship between family ownership structure and banks profitability

Hypothesis 4: Government ownership structure have positive effect on the profitability of commercial banks

Hypothesis 5: Foreign ownership structure has significant effect on profitability of the commercial banks in Pakistan.

CHAPTER 3

METHODOLOGY AND DATA DESCRIPTION

3.1 Research Methodology

This section covers the conceptual framework and methodology used in this study. This study has cross sectional data, thus the method identified for the study is panel regression to capture the relationship among variables. This technique is consistent with methodology used by Nora and Rejab (2013); Bonin et al., (2004); Bikram (2003) in their studies. Most recent and accurately available data on variables for year 2006 to 2016 has been used for broader coverage. To choose between fixed effect model or random effect model redundant fixed effects likelihood tests and Hausman tests were used. Final data used is unbalance panel due to missing data for some banks for some years to shed light on how ownership structure effects financial performance in Pakistan's banking industry.

3.2 Data Description, Population, and Sample size

This study aims to cover entire population of listed commercial banks in Pakistan which are locally incorporated**.** The purpose of this study is an attempt to analyze the effect of ownership structure on bank performance**.** More specifically, to analyze if banks owned by public sector, private, family and institutional owned banks differ significantly in performance**.**

Most recent past data on all related variable limited to commercial bank in sample is taken**.** Development banks, investment banks, mutual funds, and micro-finance banks are excluded from the sample**.** Further, those banks drop from the sample who were eventually acquired by other bank(s) over the period of the study. Data from various annual reports from the period ending 31 December, 2007 to financial year ending 31 December, 2016**.** These were the periods where banks showed stability in performance and data is easily available and correct, hence it is a suitable period for data collection. Source of the data are from different issues of the consolidated annual publication publicly available of Banks is taken from the State Bank of Pakistan's data base and particular websites of the commercial banks**.**

This study uses ownership data of sample banks as incorporated in their annual reports under 'Pattern of Shareholdings' title. It only considers the data having shareholding of 5% and above. This percentage is in accordance with the definition of major shareholders by State Bank of Pakistan under Corporate and Commercial Banking Prudential Regulations. Shareholders are then further bifurcated into different types of ownership structure such as institutional ownership, family ownership, government ownership, and foreign ownership.

3.3 Model Specifications

The econometric model that we use in testing for the presence of ownership effects on bank performance is the following:

$$\text{Performance}_{it} = \beta_o + \beta_1 INSTO_{it} + \beta_2 FRGNO_{it} + \beta_3 FO_{it} + \beta_4 GOVNO_{it} + \sum CNTRL_{it} + e_{it} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{Eq. (i)}$$

INSTO= Institutional Ownership

FRGNO= Foreign Ownership

FO= Family Ownership

GOVO= Government Ownership

CNTRL = control variables

e = error term

β = coefficient or marginal effect

i is a bank at time *t*

3.4 Variables and Measurement

To measure the dependent variable (banks performance), ROA = return on asset; ROE = return on equity; and NIM= net interest margin is used**.** Whereas, for ownership concentration institutional ownership, foreign ownership, and government ownership are considered as independent variable, that is used in this study**.**

Performance = ROA, ROE, and NIM

ROA= this is capacity of earning profit by a bank on its total asset employed and is calculated as Earnings after tax divided by total assets

ROE = this is direct measure of return to the shareholders. It is calculated as Earnings after tax to total shareholders' equity.

NIM = ratio indicates the earning capacity through core banking operations. It is calculated as Total interest earned minus total interest expense divided by average total assets

3.5 Control Variables

Many control variables are also added in the model to minimize the affect size, advances, growth and non- performing loan**.** The control variables includes other variable than ownership structure that might affect the performance favorably of banks, which includes:

Firm size (FS) = Natural Logarithm of bank's total asset**.**

Gross Advances (GROSSADV) = total amount of loan issued by bank

Growth (GRWTH) = Percentage increase in sales from previous year**.**

Non-performing loans to gross advances (NPL to GADV) = It shows the percentage of NPLs as gross advances made by a bank and evaluates assets quality based on loan portfolio.

Control variable taken in this study had also been used by Sarkar et al., (1998), in their studies on ownership structure and bank performance in Indian context, as well as in the context of other countries (Davies and Brucato, 1987; Fidrmuc et al., 2006; Wu et al., 2007).

3.6 Measurement of Variables

3.6.1 Financial Performance

Performance being measured in terms of profitability, and efficiency in portfolio management. The most common use of performance variables are the return on assets (ROA) and return on equity (ROE) to measure the performance of banking operations Claessens et al., (2000); Demirguc-kunt and Huizinga (1999); Mahajan et al., (1996) and the measure of efficiency here are Net Interest Margin (NIM) (Davies and Brucato,1987). All the measures of profitability and efficiency used in this study is based on accounting information and as such, are accounting measures or the econometric approach (Kumbirai and Webb, 2010).

3.6.2 Ownership Structure

In identifying ownership structure, percentage of shares held by controlling shareholder, group name or individual name of the largest shareholders in the shareholders list of the commercial banks is examined as a proxy of ownership concentration (Lee, 2008). A bank is categorized as institutional ownership if the major shareholder in the bank is an institutional investor, such as banks, insurance companies, pension funds, and mutual funds (Avulamusi, 2012). While is categorized as foreign ownership if the bank is owned by foreigners or the bank is a subsidiary of foreign banks. A bank is categorized as government ownership if the largest shareholder is a government owned company.

To further explanation this, the data pertaining to shareholding structure has been obtained from Audited Financial Statements of all Pakistani Commercial Banks. Within the financial statements, the data has been gathered from the pattern of shareholding given under the code of corporate governance. The methodology used was gathering institutional data from shareholders category. Thereafter the percentage of institutional shareholders was determined by dividing shares owned by institutional investors by the total number of outstanding shares.

It is pertinent to mention that State Bank of Pakistan has created a separate category for the banks wherein the Government has major shareholding. Therefore data for such banks has been obtained from State Bank of Pakistan's reports related to these banks.

The foreign banks have their subsidiaries operating in Pakistan and their data was obtained from the consolidated financial statements of these banks under the heading of pattern of shareholding. In addition this data was cross verified from the reports available on SBP website.

The data for family ownership to ascertain the ultimate shareholding of each family was collected by clubbing the percentage of shareholding using Surnames under the heading of pattern of shareholders.

CHAPTER 4

RESULT AND DISCUSSION

The purpose of this section is provide detailed empirical evidence of the study. These evidences are based to provide comprehensive results which include descriptive statistics, selection of appropriate model by conducting various test, and model results.

4.1 Descriptive Statistics

To observe, summarize, and describe the data in meaningful way plus to assure the accuracy of data, descriptive statistic test is used before any other test to panel data. It shows general behavior of data including dependent and independent variables.

Table 3

Descriptive Statistics

Variables	Mean	Maximum	Std. Dev.
ROA	0.0172	11.71	1.912077
ROE	0.0760	234.71	27.81098
NIM	0.0308	7.17	1.50942
INSTO	0.2556	0.9899	0.275071
GOVO	0.1390	1	0.272998
FO	0.0838	0.843508	0.17202
FRGNO	0.0147	0.3471	0.051819

Table 3 shows the statistical behavior of the data for the period of 2007 to 2016.

Table 3 contains some descriptive analysis used in this study for different variables. The study indicates that the Mean of ROA for the period covering last ten years is 1.07 percent with standard deviation being 1.91. However, the average return on equity has been much higher amounting to 7.60 percent .This is mainly because of the fact that share of equity in bank financing is very small. The main source of funding in commercial banks are deposits which are used to finance investments and advances. The average Net Interest Margin was 3.08% over the period of study.

Foreign owned banks hold an average of 1.5 percent of shares in Pakistani Banks. This percentage of ownership is much lower as compared to any other type of ownership structure. Presently, only four foreign banks are operating in Pakistan. In domestic banks, institutional owners hold 25% shares which is highest in percentage whereas government owns 14%. In addition influential families own 8% shares in domestic banks.

4.2 Selection of Models

This study has cross sectional data and for this type of data panel estimator is used. Panel data represents information across both time and space. Now, to choose what class of panel estimator can be employed either fixed effect model or random effect model; redundant fixed effects likelihood tests were used. Selection criteria between both models was the value of *P*. If P-value of the likelihood test is significant, then random effect is rejected.

Likelihood Test on Return on Asset

Test Summary	**Statistics**	**d.f**	**P-value**
Cross section F	10.159447	-28,245	0

P-value of the likelihood test is significant

Likelihood Test on Return on Equity

Test Summary	Statistics	d.f	P-value
Cross section F	12.60223	-28,245	0

P-value of the likelihood test is significant

Likelihood Test on Net Interest Margin

Test Summary	Statistics	d.f	P-value
Cross section F	18.72631	-28,245	0

P-value of the likelihood test is significant

The null and alternative of the test are:

Ho = Random effect model is appropriate

H1 = Fixed effect model is appropriate

Now, Hausman specification test is conducted to rule out the two possibilities to choose from, either fixed effect of common effect model.

4.3 Hausman Specification Test

Hausman test is used in this study to differentiate the choice between fixed effect and random effect model of panel estimator. This test helped in making decision about best suitable option for this study. If preferred model is random effect then null hypothesis and if model is fixed effect then alternative hypothesis.

Ho = Random effect model is appropriate

H1 = Fixed effect model is appropriate

Hausman Test on Return on Asset

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross section F	14.358257	8	0.0729

Hausman Test on Return on Equity

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross section F	6.664317	8	0.5732

Hausman Test on Net Interest Margin

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross section F	18.829782	8	0.0158

4.4 Model Results

To check the validity of the study and data, regression model was used. These regressions are estimated by using panel data. Based on the results Hausman specification test and P-value, Random effect is used to examine performance variable i.e. Return on Asset and Return on Equity whereas, for Net Interest Margin, Fixed Effect Model is used in this study.

Table 4

Ownership Structure and Banks Performance (Dependent Variable: ROA)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-8.17433	2.299801	-3.55436	0.0004
FO	-1.03268	1.178797	-0.87605	0.3818
FRGNO	0.959441	4.733507	0.202691	0.8395
GOVO	-0.74079	0.900625	-0.82252	0.4115
GRWTH	-0.0003	0.00247	-0.12067	0.904
INSTO	-0.43954	0.79925	-0.54994	0.5828
Ln_GROSSADV	-0.02558	0.221594	-0.11545	0.9082
Ln_FS	0.536949	0.25262	2.12552	0.0344
NPL_TO_GADV	-0.04077	0.010173	-4.00803	0.0001
R-squared				0.107122
Adjusted R-squared				0.080957
F-statistic				4.094119
Prob (F-statistic)				0.000126
N				282

Note: The results presented in this tables are from unbalanced random effect model

It can be seen from the Table 4 that ownership variable FRGNO have a positive effect on profitability variable i.e. return on asset, but the effect is insignificant. It appears from the result that ownership structure does not have any significant effect whatsoever on the return on asset of Pakistani commercial banks. Banks owned by family owners can create agency conflict which reduces performance. Institutional owners has their own short term objectives which restrains bank from long term profitability, and high level of government ownership have a depressing impact on banks performance due to government intervention in credit allocation, social projects initiated by government and political pressures etc. This result is in support of the argument provided by Lehn and Demsetz (1985); McConnell and Servaes (1990) and in contrast to findings of Mehran and Cole (1998) and the hypothesis used in this study.

Among the control variable used in this study, only non-performing loan to gross advances and size of the bank has significant effect on return on asset. But, the effect of NPL to gross advances on ROA is negative, means if bank has a bad portfolio of advances then it will hurt its profitability and if banks has good portfolio quality of advances its profitability will be improved and having a positive effect on ROA. Gross advances and growth of bank has no effect on ROA which is contrary to the popular belief that if bank is aggressive in making advances available to households and businesses for consumption it will be profitable and have enormous growth.

Table 5

Ownership Structure and Banks Performance (Dependent Variable: ROE)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-100.4515	24.4729	-4.1046	0.0001
FO	-9.849775	11.32522	-0.86972	0.3852
FRGNO	-33.72647	54.37806	-0.620222	0.5356
GOVO	-8.155392	7.820808	-1.042781	0.0298
GRWTH	-0.000874	0.049552	-0.01764	0.9859
INSTO	-15.21126	7.553713	-2.013746	0.045
Ln_GROSSADV	-4.429062	4.288433	-1.032793	0.3026
Ln_FS	10.56272	4.522997	2.335336	0.0203
NPL_TO_GADV	-0.431909	0.172624	-2.502019	0.0129
R-squared				0.111936
Adjusted R-squared				0.255912
F-statistic				4.301275
Prob(F-statistic)				0.000068
N				282

Note: The results presented in this tables are from unbalanced random effect model

Table 5 depicts that the influence of ownership structure on Return on Equity is negative. Independent variable government ownership and institutional ownership has statistical significant effect on ROE but effect is negative. Which means when government ownership and institutional ownership increases by 1%, ROE will decrease by 0.0298 and 0.045% respectively. These results are not in accordance with the hypotheses used in this study and findings of Gupta (2005); Iannota et al., (2007); Berger et al., (2005).

For control variable total asset has significant positive effect on return on equity, meaning that when the size of bank increases return of equity also increases. Non-performing loan to gross advances has significant negative effect on ROE, means banks income level falls as the nonperforming loans goes up. Bad loan amount is not banks money it is the money deposited by depositors and invested by investors/shareholders to gain from it.

This test depicts that value of R-square is not satisfactory but is acceptable for panel regression test. There may be few other crucial variables which are missing in the current study which also influence banks performance (i.e. return on equity).

Table 6

Ownership Structure and Banks Performance (Dependent Variable: NIM)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	9.289532	1.779413	5.22056	0
FO	1.297863	1.059984	1.224417	0.222
FRGNO	11.69623	12.54151	0.932601	0.3519
GOVO	-3.02892	1.153335	-2.62623	0.0092
GRWTH	-0.00244	0.00163	-1.49945	0.0135
INSTO	-0.05965	0.751296	-0.07939	0.9368
Ln_GROSSADV	0.779639	0.148486	5.250577	0
Ln_FS	-1.05422	0.17224	-6.12067	0
NPL_TO_GADV	-0.01048	0.006778	-1.54639	0.1233
R-squared				0.720723
Adjusted R-squared				0.679687
F-statistic				17.56294
Prob(F-statistic)				0
N				282

Note: The results presented in this tables are from unbalanced fixed effect model

Table 6 shows that dependent variable government ownership, control variable growth, and total assets has significant negative effect on net interest margin. According to this test, banks owned by government has negative effect on net interest margin. If government ownership increases, NIM will decrease and vice versa. This result also support previous studies conducted by Gupta (2005) and Iannota et at., (2007). Whereas, Gross advances has significant effect on net interest margin because portfolio of advances helps banks to earn interest income.

Whereas, family ownership, foreign ownership, institutional ownership and non-performing loans to advances has insignificant effect on banks performance (i.e. net interest margin). Family ownership and foreign ownership has a positive insignificant effect on net interest margin. These banks seem to have a higher Net Interest Margin, reason behind may be the low cost current account deposit, huge amount saving accounts etc. even they may have a large portfolio of advances to commercial, small and medium enterprises. This result supports the hypothesis and findings of previous research Morck et al., (2000); Micco et al., (2004). Coefficient of determination R-square of this model explains that about 72 percent variation in NIM is explained by ownership structure and other control variables. R-square depicts a higher explanatory value.

CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1 Conclusion

The choice of ownership whether, institutional, government, foreign, or family ownership etc. is very important in the context of financial institution's. This study has examined the effect of ownership structure on financial performance of Pakistani commercial banks. Sample of 29 commercial banks were taken for the most recent past years (i.e. 2007-2016). Regression techniques indicate mixed results which are consistent with the findings of most studies in the existing literature (Ungureanu 2008; Berger et al., 2005; Rowe and Davidson 2002; Lee, 2008).

Overall, the findings on Pakistan's commercial banks provides evidence that different type of ownership structure have different impact on the performance of banks. The result shows that institutional ownership has significant negative effect on return on equity, means when percentage of institutional investor's shareholding in a bank increases, banks performance will decrease. The reason behind may be is that, these are traditional investors like pension funds, insurance companies and investment funds who are mainly concerned to gain from short term investment. While on the other side institutional ownership has insignificant relationship with banks performance measures (i.e. return on asset and net interest margin).

Foreign ownership structure has insignificant effect on financial performance variables used in this study. In Pakistani banking sector presence of foreign banks and their operations is very limited, currently only four banks are operating in Pakistan with foreign ownership structure. Further, foreign banks scarify profitability to increase their market share. This result is in contrast to study conducted by Micco et al., (2004) on Latin America.

Surprisingly, family ownership structure do not have any significant effect on the performance of the bank in Pakistan. Result suggest that ownership structure does not describe changes in financial performance of family owned banks, one reason may be is because only 8 percent of bank in Pakistan are owned by family owners. Indeed, family shareholders i.e. controlling shareholders can expropriate minority shareholders creating agency conflict which reduces banks performance. This result is similar to the findings of (Shleifer and Vishny, 1986).

Banks owned by government have negative impact on financial performance variables used in this study. Government owned banks are lagging behind other banks and performed the worst. One of the main reason behind is increasing non-performing loans, lack of fresh capital injection, aging work force, and non-proactive assessments by specialists etc. Result in study is in accordance with the research conducted by Buchanan and Tullock (1962); Gupta (2005); Iannota et al., (2007); Sun and Tong (2003) where they argued that government owned bank has negative relationship with performance. Whereas, these results are in contrast to the research conducted by (Gursoy, 2002).

5.2 Limitations

One of the limitations of this study was that only ten years data was used (2007 – 2016). This data may be unstable as during this time period global financial crisis took place. Further, the scope of the study is limited to Pakistani Commercial Banks only and does not focus on emerging economies. Neither has it focused on the microfinance banks, investment banks, leasing companies, house finance, insurance companies, and development financial institutions within the country. As these banks play a very important role in financial inclusion, therefore, the scope of the study can be enhanced by adding these banks and time frame.

5.3 Recommendations

This study can help the commercial banks, finance professionals, financial advisors, investment companies, foreign investors, family business owners, and government officials to understand in improving their productivity and financial performance etc. keeping into consideration the ownership structures. This can also help in improving the regulatory framework for financial soundness of banks as well as their operational efficiency. Ultimately the corporate governance can be improved through this study by making or amending laws and legislations.

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