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## **Ownership Structures, Governance and Corporate Performance: *Theories and Issues***

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# **Ownership Structures, Governance and Corporate Performance:**

## **Theories and Issues**

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### **Introduction**

The objective of this paper is to review the state of knowledge of the relationship between different corporate ownership structures and corporate performance. There exists a substantial literature which seeks to understand whether there is a relationship between governance structures and good governance observance (Denis and McConnell 2003). Denis and McConnell note that most early governance research appears in the Anglo-US dominated literature and focuses on issues of governance where ownership of individual corporations is widely dispersed, there exists a well developed and regulated market for corporate securities, and dominant-owner control of corporations is the exception. This pattern of ownership and control, however, is not to be found in much of Asia and, to a degree, in Europe (excluding UK and Ireland, Faccio and Lang 2002). There is evidence that capital market conditions, historical development patterns or the level of development and enforcement of shareholder rights and corporate governance regulation result in patterns of ownership or control involving dominant stakeholders (dominant owner, financier) ( Claessens and Fan 2002; Claessens, Djankov and Lang 2000; Li et al. 2006; Faccio and Lang 2002).

In this paper we seek to establish how these alternative forms of ownership and control are related to the dominant theoretical literature on governance. This leads us to consider how various ownership structures are handled in agency theory and to outline the theoretical control and performance issues which result. We then turn to the empirical literature; we discuss the outcomes predicted by theory and then the measurement issues inherent in determining whether these outcomes are realised in practice. Within this discussion we consider ‘performance measurement’ issues in corporate performance. Finally we consider the existing empirical record on the relationship of different ownership structures and control structures to corporate performance. In conclusion we note that the literature is inconclusive in its assessment of the relationship between ownership and performance It is also

apparent that the empirical record to date has little to say about ownership structure and corporate performance in economies where capital markets, shareholder protections and legal enforcement are weak or underdeveloped.

### **Agency Theory**

Berle and Means (1932), observing the USA early in the 20<sup>th</sup> century, noted that the dispersion of equity ownership had led to a transfer of corporate control from individual owners to professional managers in the joint-stock company. Berle and Means emphasised that when control is distinct from ownership, those in control may deploy assets in ways that benefit those in control rather than owners. As a result of their analysis, much of the literature on corporate governance assumes widely dispersed ownership and focuses on managing conflicts of interest between managers and shareholders.

Agency theory, (Jensen and Meckling 1976) derives from the separation between ownership and control in the modern stock issuing corporation. Such a separation, when coupled with the inability to completely specify contracts, will give the agents (managers) opportunities to pursue activities which will benefit themselves at the expense of their principals (owners). The basic premise is that ‘if both parties to the relationship are utility maximisers there is good reason to believe that the agent will not always act in the best interests of the principal’ (p. 308). Jensen and Meckling propose that the agent/principal divergence of interests causes agents to fail to maximise the welfare of the principal. This failure is the most important cost resulting from the principal and agent conflict and is known as the ‘agency problem’.

Prasad (1990) argues that agency theory is a subset of organisation theories. Jensen (1988) considers that agency theory is derived from the nexus of contracts view of the organisation. From this view, agency theory perceives the firm as a nexus of contracts between different parties, known as the firm’s stakeholders. This theory assumes the contracts to be incomplete in nature, not fully specifying and not able to specify completely, the parties’ obligations for every conceivable contingency

(Berglof 1990)<sup>1</sup>. This incomplete specification is the grounds for conflicts of interest among the parties involved. To overcome the potential conflicts, there has evolved a system of internally and externally mediated rights, structures, processes and guidelines, or 'corporate governance', relating to how the firm should be governed and directed in order to achieve the firm's goals. Lannoo (1995) defines corporate governance as '...the whole system of rights, processes and controls established internally and externally over the management of a business entity'. Monks and Minow (1995) argue that corporate governance addresses the challenge of 'how to grant managers enormous discretionary power over the conduct of the business while holding them accountable for that power.'

The 'agency problem' engenders the need to monitor the actions of management and to have in place control mechanisms to align the interests of principals and agents. However, monitoring mechanisms are not without costs. Monitoring or agency costs will be borne by the principals as the capital owners in this relationship. The owners have the incentive to ensure that managers do not diverge from the goal to maximise shareholder value. However, as rational entrepreneurs, owners have to consider the cost and benefits of monitoring mechanisms that they choose to oversee management. Agency theory seeks to define the nature of contracts that will minimise agency costs; that is the costs of monitoring, motivating and ensuring the commitment of the agent (Davis and Thompson 1994).

Jensen and Meckling (1976) argue, in their convergence-of-interest hypothesis, that corporate performance will increase with the level of management or insider ownership in a company. On the other hand, Demsetz (1983), within a similar theoretical framework, has argued that the increased level of insider ownership will reduce corporate performance. This argument is known as the entrenchment hypothesis. Studies by Morck, Shleifer and Vishny (1988) and McConnel and Servaes (1990; 1995) support the view that increased managerial ownership adversely impacts a firm's value over certain ownership ranges. Proponents of this

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<sup>1</sup> Consequently, these contracts include not only the explicit legal contract, in which the terms are clearly specified (e.g. employment contracts), but also long term relationships built on implicit contracts of shared understandings (Boatright 2002)

hypothesis suggest that providing managers with share ownership to align their interests with the owners may not effectively solve the agency problems.

### **The Agency Problem and Ownership Structure**

The pattern of ownership concentration and composition will determine which party has the dominant power in the organisation (Jensen and Warner 1988). Observation of a company's ownership structure provides one basis for identifying the distribution of power among interested parties in an organisation.

Recent literature brings into question the assumption of widely dispersed ownership and suggests that perhaps the more fundamental conflict of interest is between majority and minority shareholders. After the mid-20<sup>th</sup> century the ownership concentration in more developed economies with strong capital markets has shifted into the hands of financial institutions, such as pension or mutual funds (Hawley and Williams 1997; Li et al 2006). Li et al. (2006, 2982), with a sample of 45 countries, find that the mean level of institutional blockholding is 9.7% of issued shares and the proportion of firms with at least one institutional holder is 47.6%. They find that large shareholding by institutions is more prevalent among 'widely-held' rather than closely (or family-held) firms. Studies by Dyck and Zingales (2004) and Nenova (2003) have gone on to study the private 'benefits' to block-holding shareowners.

La Porta et al. (1998) studied a sample of large non-financial firms from 49 countries and found that average ownership by three largest shareholders was 46 percent. A study by La Porta, Lopez-de-Silanes and Shleifer (1999) revealed that within a range of countries control is often concentrated within a family who are often the founder of the firm or their descendants. Studies by Zingales (1994), Kunz and Angel (1996), Rydqvist (1996), Taylor and Whittred (1998), Nicodano (1998), Smith and Amoako-Adu (1999), and Faccio and Lang (2002) document concentrated family ownership by families in Europe, Canada, and Australia. Claessens, Djankov and Lang (2000) examined nine East Asian countries and also found a predominance of family control and family management. According to La Porta et al. (2000) the important implication of this evidence for the study of corporate governance is the relative irrelevance of the Berle and Means framework in most countries in the world and the centrality of family control.

Pyramidal- and cross-ownership are two types of ownership and control patterns that permit controlling shareholders to control corporations (Wiwattanakantang 2001). Pyramidal ownership allows the controlling corporations to exercise power in a group via layers of companies through a chain of ownership relations. Spreading their investment over a large number of firms and concentrating those of the entrepreneur at the top of the pyramid allows the entrepreneur to control a larger set of assets of various companies (Bianco and Casavola 1999). La Porta, Lopez-de-Silanes and Shleifer (1999) reveal that the pyramid structure is very common in a sample of the twenty largest firms in each of twenty-seven wealthy countries studied. They found that 26 percent of the firms that have controlling shareholders are controlled through a pyramid structure. A study by Claessens, Djankov and Lang (2000) found that corporate control is enhanced through pyramid structures and cross-holdings among firms in nine East Asian countries. In the case of Indonesia, 'pyramidal ownership structure with ultimate owners is more prominent where family holding is high and in a number of cases one family owned several publicly listed companies' (Claessens, Djankov and Lang 2000, 92). The main agency problem within this type of ownership arises from conflict between relatively "strong" block shareholders and "weak" minority owners.

Cross-shareholding ownership occurs when a company further down the chain of control has some shares in another company in the same business line. This mechanism not only will assume effective control for block shareholders, but also protects the power of the controlling shareholders. Claessens, Djankov and Lang (2000) argue that this type of ownership is also part of the pyramidal structure. This can be used to insulate the controlling shareholders from being monitored by any corporate governance mechanisms (Wiwattanakantang 2001).

Shleifer and Vishny (1997) believe that the dominant agency problem around the world is the conflict between outside investors and controlling shareholders who have almost full control over managers. Shleifer and Vishny (1997) argue that this problem may also arise between shareholders and creditors, and between shareholders and other stakeholders. Therefore, the type of ownership structure may

be the most important factor in shaping the corporate governance system of any country (Aoki 1995).

Within the corporate governance context, the key aspects of corporate ownership are its concentration and composition (ADB 2000). The degree of concentration determines the distribution of power within a company, whether it is dispersed or concentrated. The structure and concentration of shareholding are two elements that may limit the role of the corporate control (Lannoo 1999). When ownership is dispersed, shareholder control tends to be weak because of poor shareholder monitoring due to the 'free-rider' problem (La Porta, Lopez-de-Silanes and Shleifer 1999).

By contrast, when a concentrated ownership exists, large shareholders have the incentives and resources to monitor management decisions and reduce agency costs (Shleifer and Vishny 1986). This is particularly relevant to the family-based ownership that exercises corporate control through pyramidal ownership and high involvement of family members appointed to the board or management team.

Shleifer and Vishny (1997) view concentrated ownership from the position of the effectiveness of law and regulations in protecting property rights. They suggest that the benefits from family based concentrated ownership are relatively larger in countries that are generally less developed, where property rights are not well defined and/or protected by the judicial system. Li et al. (2006) argue that their results suggest that large institutional block-holdings are significantly less prevalent in countries with weak macro governance characteristics (shareholder rights, legal enforcement, financial disclosure) and where they do invest in such countries they will seek a large, perhaps controlling interest.

The forgoing discussion of the implications of concentrated rather than dispersed share-ownership makes it clear that different agency problems arise when there is little separation of ownership and control, with equity ownership concentrated in the hands of inside owners (Lins and Servaes 1999). As a consequence, the agency problem has shifted from the traditional manager-shareholders relationship to the conflict between 'majority and minority shareholders'.

## **Corporate Governance and Control Mechanisms**

Central to the study of the effects of ownership structure and firm performance is the concept and definition of 'control' (Short 1994). Fama and Jensen (1983) consider a firm's decision process, namely initiation, ratification, implementation, and monitoring, in defining the concept of control. They argue that 'an effective system for decision control implies, almost by definition, that the control (ratification and monitoring) of decisions is to some extent separate from the management (initiation and implementation) of decisions' (p. 304). Within this context, control refers to the ability of a particular individual or group to dominate the decision making process within a firm.

Most early empirical studies differentiate between owner-controlled firms and management-controlled firms. Firms are generally classified as being owner-controlled if a dominant shareholding interest owns a specified fraction of the firm. On the other hand, if the shareholding interests are so diverse that no single interest or coalition of interests can effectively control the firm (Short 1994), it should be classified as the management-controlled firm. Furthermore, she claims that most researchers utilise the percentage of ownership as the criterion to differentiate the ownership type of a firm. Short (1994, 216) argues that there is 'little consensus with regard to the central issue: at what level of ownership and within which type of ownership structure is there effective control of the firm'. This argument is based on the use of different definitions of control as implied by different cut-off points of ownership in each study.

McEachern (1975) argues that owner-controlled firms can be classified further into two groups: outside owners who were not actively involved in management (externally controlled firm) and owners who were also managers (owner managed firms). This classification is based on the argument that controlling shareholders who were also managers had different incentives from those shareholders external to the firm. In his study of 48 large US firms, McEachern (1975) demonstrated a significant difference in firm performance between these types of ownership.

Cubbin and Leech (1983) raised two important dimensions in regard to the separation of ownership and control: the location of control (internal or external) and



the degree of control (measured by the voting power exercised by the controlling group of shareholders). They believe that the degree of control is dependent on the location of control, as owner-managed firms exhibit a higher degree of control for any given level of shareholding than external-controlled firms.

Faccio and Lang (2002), in their study of ultimate ownership of corporations in Western Europe, consider two measures of ownership, cash-flow rights, representative of the ultimate ownership stake and control rights, the percentage of voting rights ultimately accruing to controlling shareholders. While their study does not set out to consider effective exercise of control they do note that approximately two-thirds of family controlled Western European firms have top managers from controlling families.

Moerland (1995) proposes ownership structures are a central distinguishing feature of financial systems. Distinctions between different financial systems may help explain differences in ownership and control structures. Berglof (1990) differentiated financial systems as market or bank-oriented, based on the pattern of capital mobilization used by companies to finance their operations. In Anglo-Saxon countries, for example, ownership concentration is low (Charkham 1995; Faccio and Lang 2002) and companies have access to stock markets for equity capital raisings. By contrast, concentrated ownership is a salient feature in some countries in Continental Europe (Moerland 1995; Faccio and Lang 2002) and in East Asia (ADB 2000). In these countries, corporate financing through bank loans and other non-equity sources remain more dominant.

On the other hand, research suggests that financial structures alone are not explanatory and indeed the pattern of financing may be an outcome of conditions leading to different ownership and control regimes rather than the cause, meaning that ownership structure should be treated as endogenous rather than exogenous. A number of recent studies have modelled this approach (Al Farooque et al. 2007; Nenova 2003). Nenova (2003), for example, in her cross-country analysis of the value of corporate voting rights and control concludes that the legal environment, degree of law enforcement, investor protection provisions, takeover regulations and power concentrating corporate charter provisions overall explain 68 percent of the

value of control-block votes. This finding suggests rational response to differences in these conditions resulting in either compensating or exploitative incentives to block control. Dyck and Zingales (2004) also conclude that higher private benefits of control are associated with less developed capital markets. La Porta et al. (2000) and Li et al. (2006) support the position that the degree of investor protection and the legal environment are critical to governance processes. Shleifer and Wolfenson (2002) relate this to the degree of development of equity markets.

### **Internal Mechanisms of Corporate Control**

Corporate control exercised may be either internal or external to the corporation. As external control, 'the market for corporate control' refers to the control function provided by market competition as an instrument in disciplining management behaviour. Agency theory's approach to external control assumes the efficient operation of capital markets; for corporations listed on the stock exchange then, the value of residual claims held by shareholders is reflected in the company's share price on the stock market. The efficient capital market serves as a mechanism to discipline a company's governance performance as it is reflected in a share price. Within this mechanism are included the capital market, the product market, and the managerial labour market (Fama 1980; Fama and Jensen 1983). The 'market for corporate control' is considered to be active in market economies characterized by a relatively well-developed capital market and low ownership concentration (Aoki 1995) and where a relatively dispersed share-ownership exists.

As we have noted above, there is evidence that to a considerable degree in Europe and in Asia the conditions for an active 'market for corporate control', namely a well-developed capital market and low ownership concentration, do not exist. Further, we have noted the growing phenomenon of institutional block-shareholding across many jurisdictions.

The study by ADB (2000) in East Asian countries found that the market for corporate control has been largely inactive in this region. Sarkar, Sarkar and Bhaumik (1998) argue that the link between the market for corporate control and firm performance in developing countries can be weak for several reasons including

limitations on the amount of company information and high transaction costs associated with a takeover.

In the absence of a well functioning external market for control internal control mechanisms ‘provide an early warning system to put the organisation back on track before difficulties reach a crisis stage’ (Jensen 2000, p.49). The board of directors at the apex of the internal corporate governance control system has the final responsibility for the functioning of the firm. The board of directors can act to restrict potential conflicts of interests between managers and shareholders. Van den Berghe and De Ridder (1999) argue this can possibly be best achieved if directors are independent of management and have appropriate knowledge of the firm.

In a two-tier board system, as commonly found in continental European countries, a company’s board structure consists of an executive board and a supervisory board. Within this system, executive boards coincide with the top-level management team, while the supervisory board is completely composed of outside experts with a broader control function than in Anglo Saxon countries (Moerland 1995). In principle this type of board system leads to a formal separation of supervisory and executive responsibilities.

Agency theorists propose managerial incentive schemes may be used by boards (Rindova 1999) as an internal to the firm instrument for resolving agency problem through the ‘incentive alignment solutions’. The basic argument is that ‘management should be more willing to act to maximise shareholder value if doing so provides management with greater reward as well’ (Denis 2001, 201).

Dharwadkar, George and Brandes (2000) argue there are significant differences in agency problems between different governance contexts. They suggest that the agency problem in countries with relatively strong governance structures should be resolved differently from those of countries with relatively weak governance structures such as those prevalent in emerging economies. Therefore, Dharwadkar, George and Brandes (2000) distinguished between “traditional” agency problems, which are common in developed economies, as opposed to “unique” agency problems, which they posit exist in emerging economies.

The “unique” agency problem in emerging and developing countries is characterised by the expropriation of minority shareholders (La Porta et al. 2000). Morck, Shleifer and Vishny (1988) propose that the expropriation problem occurs within a weak governance context when large or majority owners assume control of the firm and deprive minority owners of their rights. A study by Husnan (2001) suggests that most East Asian corporations have the majority of their shares held by the founding owner. Moreover, this study also found that these countries have relatively small and not-well developed capital markets. There is also evidence that one means whereby the controlling owner retains majority control is through selling small amounts of a company’s equity (Claessens, Djankov and Lang 2000). As such, the market for corporate control will work differently in such countries.

There are arguments that ownership concentration can be both a complement to and a substitute for shareholder protection in countries with poor legal protections. Shleifer and Vishny (1997) suggest that ownership concentration can be a substitute for legal protection because large owners perform the monitoring function. Burkart and Panunzi (2001) claim that outside block ownership is an optimal substitute for legal shareholder protection when the law is of intermediate quality, while it acts as a complement when the law is poor. On the other hand, Li et al. (2006) demonstrate that poor shareholder protection may deter institutional investors from taking a large stake unless it is a controlling stake.

There are several arguments advanced in support of the appointment of owners’ related family members to the management or board of a company. McConaughy et al. (1998), for example indicate that family relationships improved monitoring and provided incentives that are associated with better firm performance. Family members are assumed to have a special interest in the firm’s success, given that the firm represents the legacy of its founder and the social status of the family is likely to be tied to a firm’s performance. The “reputation effect” of this relationship could prevent social sanctions against the family, so it might have a positive impact on firm performance (Kets de Vries 1993). In addition, given the long-standing relationship between the family and a company, it could provide the appointed family members with excellent knowledge of the firm (Smith and Amoako-Adu

1999; McConaughy, Matthews and Fialko 2001). From this view, owners' involvement in the board and/or management team might complement other disciplinary mechanisms and enhance performance.

### **Performance Measurement**

The purpose of corporate governance is to monitor and improve firm performance (Borsch-Supan and Koke 2002). While there is acceptance of firm performance as a multidimensional construct (Peng and Luo 2000) there is disagreement as to what criteria and indicators of performance should be employed (Dalton et al. 1980; Ford and Schellenberg 1982). Hannan and Freeman (1977) argue that the disagreement in regard to organisational performance is so intense that some have questioned the usefulness of studying performance at all.

Performance measurement systems have historically developed as a means of monitoring and maintaining organisational control in order to ensure the achievement of organisational goals and objectives (Brignall and Ballantine 1996; Ghalayani and Noble 1996). An appropriate performance measurement system should enable organisations to monitor the implementation of plans, determine how successful these plans are, and how to improve them.

Venkatraman and Ramanujam (1986, 803) differentiate three domains in the performance measurement concept as (a) domain of financial performance, (b) domain of financial and non-financial (operational) performance, as a broader conceptualisation of business performance, and (c) domain of organisational effectiveness.

Venkatraman and Ramanujam (1986) argue that most of the studies utilising performance measurement have restricted their focus to the first two domains. They believe that this tendency is due to the availability of data and the implications of that for operationalisation. Kald and Nilsson (2000) argue that difficulties in using performance measures other than the financial lie in translating programs and activities to be measurable.

Early models of performance measurement focused solely on financial-accounting measures, an extension of the company's financial reporting systems (Atkinson, Waterhouse and Wells 1997). Such measures, for example 'Return On Investment' (ROI), are widely regarded as the most useful measures and the ultimate bottom line of business performance. However, this has been claimed as traditional and of little help in measuring performance in the new competitive environment (Chow, Haddad and Williamson 1997).

Several performance measurement models have been developed that could be considered as improvements on the traditional financial models. These models are finance related and take the position that business processes' ultimate success can be viewed through focussing on financial performance measures. Among these models are the Balanced Scorecard (Kaplan and Norton 1996), the Economic Value Added (Stern, Shiely and Ross 2001) and the Strategic Performance Measurement (Waterhouse and Svendsen 1998) models. All of them retain financial performance measures and use additional indicators that are non-financial, or they utilise operational performance measures as complementary.

Sloan (2001) argues that accounting data serves as an important source of information for governance mechanisms that help alleviate the agency problems faced by a company. Sloan (2001) believes that accounting information is required for most governance mechanisms to operate efficiently. Although accounting information is useful and important in corporate governance studies, not all of the agency costs are reflected in the accounting measures (Wiwattanakantang 2001). This limitation has led researchers to utilise information based on the market indicators of performance, such as stock prices in measures such as Tobin's Q. For example, Bacidore et al. (1997, 14) argue that the financial performance measurement through the firm's stock price is appropriate in measuring shareholder wealth creation by determining 'how much shareholders increase their wealth from one period to the next based on the dividends they receive and the appreciation in the firm's stock price'.

The issue of the use of the accounting profit rate and/or Tobin's Q as a measure of firm's performance is important for the study of the ownership/performance

relationship. These two measures differ from each other in two aspects (Demsetz and Villalonga 2001, 213). Firstly, the time perspective: accounting profit is backward-looking, while Tobin's Q is a forward-looking measure of performance. Accounting profit rates are affected by accounting practices and emphasise what management has accomplished. Tobin's Q, on the other hand, reflects the value investors assign to a firm's intangible assets based on predicted future revenue stream.

A second distinction is in regard to who is measuring performance. The accounting profit rate measurement is done by the accountant, constrained by standards set by his/her profession. Tobin's Q measures are used in common by the community of investors constrained by their perceptions (i.e. optimism, pessimism). Demsetz and Villalonga (2001) believe that this later measure is preferred by economists. However, they further argue that Tobin's Q measurement is affected by the psychology of investors, as it will also include the prospects and the outcomes of present business strategies.

The two measures are interrelated. According to Demsetz and Villalonga (2001, 213) the investor community who developed Tobin's Q measurement do not 'ignore the past in their attempts to determine reasonable expectations for the future profitability of firms'. The reason is that 'high accounting profits are usually accompanied by high stock prices' (p.214). The use of the market value of the firm as a numerator of Tobin's Q to some significant degree reflects accounting profit rates.

Gugler and Yurtogula (2003, 380) argue that average measures of performance such as Tobin's Q 'confound intramarginal and marginal returns', and in particular are not suitable for exploring the agency aspects of managerial behaviour. They further argue that the use of average performance measures requires a fully specified structural model, one not available in this research. They suggest 'marginal Tobin's Q, or  $q_m$ , the ratio of the firm's returns on its investment to its costs of capital. Bjuggren, Eklund and Wiberg (2005) have used marginal Tobin's Q in a recent study involving vote-differentiated shares in Sweden.

In order to use market indicators to measure performance, it must be assumed that stock prices reflect the true value of the firm (Lindenberg and Ross 1981). It is possible that market indicators that represent the true value of a firm can only be found in fully developed capital markets. Khanna and Palepu (1999) argue that this assumption may not be met in the case of emerging economies.

Research has found both accounting and market-based performance measures to be related to the corporate governance decisions, as in the case of CEO compensation (Engel, Gordon and Hayes 2002). The use of accounting measures may not be accurate in this case because this measure is subject to manipulation by management (Wiwattanakantang 2001). On the other hand, a market-based measure may not be 'an efficient contracting parameter because it is driven by many factors beyond the control of the firm's executives' (Bacidore et al. 1997, 11).

Another relevant issue in regard to performance measures is the appropriateness of one measure in different institutional contexts. Claessens and Djankov (1999, 502) argue that in a country with weak minority shareholder protections, the use of stock market performance may lead to a 'downward bias in the relationship between ownership and firm's valuation'. Similar problems also exist for accounting data, since data quality relies heavily on the quality of accounting standards (Claessens and Djankov 1999b). Based on the firms' objective of maximising shareholder wealth, the performance measurement chosen should be able to measure shareholder wealth creation (Bacidore et al. 1997). Different environmental and contextual settings must be considered in the choice of performance measurement, particularly in cross-country studies.

### **The Ownership-Performance Relationship**

There is a growing body of research in the economics and management literature that seeks to identify whether there is a link between the structure of stock ownership, managerial behaviour and corporate performance. Most of the early research has focused on corporations with diffused ownership within the framework of the conventional Anglo-Saxon model of corporate control.



One of the most commonly investigated empirical problems has been the relationship between types of ownership and organisational performance (Leblebici and Feigenbaum 1986). Craswell, Taylor and Saywell (1997) note that different points of view find support in the mixed results of existing empirical research, almost all of which is US-based (e.g. Demsetz and Lehn 1985; Morck, Shleifer and Vishny 1988; McConnel and Servaes 1990).

Research on optimal ownership structures relating to the levels of private benefits and controls (e.g. Grossman and Hart 1988) has extended beyond the Anglo-Saxon environment. This research, although also still mainly at the level of theoretical debate, is especially important for countries with relatively high concentrated ownership. Many of these countries have been identified as having relatively low protection of minority shareholders, allowing expropriation of minority shareholders by the controlling shareholders (Shleifer and Vishny 1997). These expropriations take various forms, such as related parties transactions, asset stripping and other forms of transferring of revenue and assets between firms (e.g. Morck, Shleifer and Vishny 1988; La Porta et al. 2000). In this environment agency conflicts have been identified as the expropriation of minority shareholders (Shleifer and Vishny 1997; La Porta et al 2000). However, the expropriation by controlling owners is constrained by their financial incentives (Filatotchev et al. 2001).

Krishnamurti, Sevic and Sevic (2005), in a post-crisis study of larger East Asian corporations report no strong evidence of expropriation in Indonesia, Philippines and Thailand, a finding at variance with Claessen et al. (1999, 2002) and Lemmon and Lins (2003). It is noted that Claessen's results include small as well as large corporations while Lemmon and Lins focus on the disruption of the Asian crisis. La Porta et al. (2000) show that countries with poor investor protection typically exhibit more ownership concentration than do countries with good investor protection and they argue that the choice of concentrated ownership, other things being equal, should lead to lower expropriation.

A number of studies provide empirical evidence of the relationship between corporate ownership pattern and firm's performance. A study by La Porta et al. (2000) of the largest quoted firms from 27 countries found that higher cash flow

ownership was associated with higher corporate valuation. This study also revealed that such an effect was greater in countries with weak or inferior investor protection. Using a data-set of 2,658 companies listed in East Asian countries, Claessens et al. (1999) documented that high cash flow rights in the hands of large-block holders were positively related to corporate valuation.

The most researched topics in this literature are the effect of the owner's stake on performance (Demsetz and Lehn 1985; Morck, Shleifer and Vishny 1988; Bjuggren et al. 2007; Filatotchev, Lien and Piesse 2005), the optimal bundling of cash flow and control rights (Grossman and Hart 1988; Harris and Raviv 1988), the costs and benefits of a single large controlling shareholder (Shleifer and Vishny 1986; Burkart, Gomb and Panunzi 1997), and of several large shareholders (Pagano and Roell 1998) and of group affiliation (Chang and Hong 2000). Until recently empirical research in this area has mostly been limited to studies based on data from developed economies.

A study conducted by Morck, Shleifer and Vishny (1988) presents conflicting results about the relationship between ownership structure and firm value. A study by Holderness and Sheehan (1988) using both ROE and Tobin's Q as performance measures, found no significant difference between majority held shareholding by a single individual or entity and diffusedly held shareholding. Murali and Welch (1989), comparing closely held firms and widely held firms, obtained similar results using purely accounting profit rates as a measure of performance.

Thomsen and Pedersen (2000) looking at 435 firms in 12 European Union countries, found a significant relationship between concentrated ownership, shareholding by institutional investors and accounting profit. Wiwattanakantang (2001) found that the presence of controlling shareholders is associated with higher firm performance. Further, this study reveals that family-controlled firms have significantly higher performance relative to firms with no controlling shareholder, as measured by return on assets and the simplified Tobin's Q.

It should be pointed out that temporal variations as well as nation-specific factors are expected to influence the ownership-performance relationship. Lemmon and Lins

(2003), for example, found that cumulative stock returns (measured as 'buy and hold' return ) during the Asian Crisis were 12 percent lower for those East Asian corporations with pyramidal structures which allowed managers and owners to separate their control and cash flow rights.

A meta-analysis with focus on the impact of institutional owners in the USA (Sundaramurthy, Rhoades and Rechner 2005) found no significant association between institutional ownership and financial performance. The finding of no significant relationship held when tested for moderating variables such as non-linear executive ownership variables. The broader meta-analysis of Sanchez-Ballesta and Garcia-Meca (2007), covering 33 studies from both European and Anglo-Saxon countries found no significant relationship overall between ownership concentration and firm performance. They found, however, moderating influences based on sub-group analysis relating to the particular governance system (continental system or Anglo-Saxon), the measurement of performance used and controls for endogeneity.

Research utilising the agency theory perspective assumes that ownership features influence corporate behaviour and performance. However, as has been argued by Jensen (1983), variations in capital markets, product and factor markets, internal control systems and political, legal and regulatory systems have influenced agency costs arising from differential ownership structures. Given various measurements of both ownership and performance variables and different institutional environments, it is expected that the outcome will also vary. Debreu (1959) notes 'performance, in whatever form constructed, is itself a noisy dependent variable'.

The literature on the ownership-performance relationship has the basic proposition that different patterns of ownership structure lead to different impacts on firm performance. Early empirical evidence referred almost exclusively to Anglo-Saxon firms (Lehmann and Weigand 2000). Later studies have focussed more widely, with a number of studies focussing on East Asia in particular (Tam and Tan 2007; Filatotchev, Lien and Piesse 2005; Cho and Kim 2007). Studies are summarised in Table 1. The results are somewhat mixed, due to the wide variation in measures of performance and ownership. The conflicting results may also be attributable to the underlying model used in the studies. Later studies (Cho and Kim 2007; Al

Farooque 2007; Filatotchev, Lien and Piesse 2005) have considered models involving both endogeneity of ownership structure and non-linear relationships.

Studies using ownership structure measures can be categorised into four groups; (1) emphasis on managerial versus owners' control of shareholding (e.g. Kamerschen 1968; Thonet and Poensgen 1979; Kapopoulos and Lazaretou 2007), (2) emphasis on majority versus diffusedly held ownership (e.g. Holderness and Sheehan 1988; Murali and Welch 1989 ), (3) measure of ownership owned by directors and/or officers (e.g. Lloyd, Jahera and Goldstein 1986; Kim, Lee and Francis 1988; Braun and Sharma 2007), and (4) combination of ownership measures (e.g. McConnel and Servaes 1990, 1995; Han, Lee and Suk 1999; Bjuggren, Eklund and Wiberg 2007).

The use of some categorisations of ownership measures has been criticised by Demsetz and Villalonga (2001) as putting together shareholdings owned by persons with different interests. In particular they note where managers and directors are not separately distinguished these two groups may have conflicting interests. They contend that the fractions of shares owned by outside shareholders (including directors) and by management should be measured separately for their impact on firm's performance.

Table 1: Effect of Ownership and Control on Firm Performance – A Summary of the Empirical Findings

Author(s)	Sample and Period	Ownership Variable(s)	Performance Variable(s)	Main Results
Kamerschen (1968)	47 large US firms (1959-1964)	a. Management control (MC) $\leq$ 10% single block of voting control b. Owner controlled (OC) $\geq$ 10% c. Dummy for change in control from 1929 to 1963	- Return on equity	No significant difference between MC and OC firms, but significant positive relationship between ROE and change in control
Steer and Cable (1978)	82 U.K. firms (1967-1971)	a. Owner control (OC) $\geq$ 15% of cohesive group or $\geq$ 3% ownership by managers b. Management control (MC) otherwise	- Return on equity - Return on assets - Return on sales	OC firms are significantly more profitable (weak) than MC firms for all measure of performance
Thonet and Poensgen (1979)	62 large German Industrial firms (1961-1970)	a. Management control (MC) $\leq$ 25% of cohesive stock ownership b. Owner control (OC) $\geq$ 25% of cohesive stock ownership and no other part with 25% of cohesive stock ownership	- Return on equity (ROE) - Stocks return assuming dividends are reinvested (SR) - Market value to book value (MBV) - Growth of Total Assets	OC firms are significantly less profitable than MC firms (for ROE and MBV), and no significance difference between OC and MC for SR. OC firms have greater growth in total assets
Bothwell (1980)	150 large US firms (1960-1967)	a. Management control (MC) $\leq$ 10% single block of common stock b. Weak owner control (WOC) $>$ 30% $>$ 10% c. Strong owner control (SOC) $\geq$ 30% d. All owner control (AOC) = WOC+SOC	- A risk adjusted return on sales (RARS) - Return on equity (ROE)	WOC and AOC firms with a large degree of monopoly significantly more profitable than MC firms for RARS, otherwise not

Table 1 (*Continued*)

<b>Author(s)</b>	<b>Sample and Period</b>	<b>Ownership Variable(s)</b>	<b>Performance Variable(s)</b>	<b>Main Results</b>
Demsetz and Lehn (1985)	511 large US firms (1976-1980)	Ownership concentration: a. A5 – percentage of equity owned by 5 largest shareholders b. A20- percentage of equity owned by 20 largest shareholders c. AH- approximation of Herfindal measure of ownership concentration	Accounting rate of return (average annual net income/book value of shareholders equity)	No significant relationship between ownership concentration and accounting rate of return
Lloyd, Jahera and Goldstein (1986)	779 US firms (1978-1981)	a. Percentage of shareholdings by officers and directors (manager controlled) b. Percentage of shareholding by largest shareholder (voted as a block) and owner controlled	Monthly common stock returns	No significant relationship between ownership and return
Kim, Lee and Francis (1988)	157 US firms (1975-1978)	Stockholdings of officers and directors (insider ownership); d. Lowest quartile e. Second quartile f. Third quartile g. Highest quartile	- Market value of outstanding equity shares - Price earnings ratio (equivalent EPS ratio)	The firms with high insider ownership outperform low insider ownership firms
Holderness and Sheehan (1988)	101 majority held and 101 diffusely held large US listed firms (1979-1984)	a. 95% > majority held > 50.1% ownership by single individual or entity (other corporation or fund) b. Diffusely held < 20% ownership by any shareholder	- Tobin's Q by firm's market value to replacement cost of plants and inventories - Return on equity	Finds no significant difference in performance between majority held and diffusely held firms

Table 1 (Continued)

Author(s)	Sample and Period	Ownership Variable(s)	Performance Variable(s)	Main Results
Morck, Shleifer and Vishny (1988)	371 large US firms (1980)	<ul style="list-style-type: none"> <li>a. Combined shareholding by all members of the board in the ranges (0-5%), (5-25%) and (25-100%)</li> <li>b. Combined shareholding by top two officers</li> <li>c. Dummy for presence of founder</li> </ul>	<ul style="list-style-type: none"> <li>- Tobin's Q by market value of stock, preferred stock and debt to replacement cost of plant and inventories</li> <li>- Profit rate by net cash flow to replacement cost of capital</li> </ul>	Profitability is significantly increased for board membership in the (0-5%) and significantly decreased in the (5-25%) and if founder is present in the board of old firms. Similar results for top two officers.
Murali and Welch (1989)	43 closely held and 83 widely held US firms (1977-1981)	<ul style="list-style-type: none"> <li>a. Closely held firms &gt; 50% by small group or individual</li> <li>b. Widely held firms, all other firms</li> </ul>	<ul style="list-style-type: none"> <li>- Adjusted stock market return</li> <li>- Return on assets</li> <li>- Return on equity</li> </ul>	No significant difference in performance between closely held and widely held firms
McConnel and Servaes (1990)	1,173 firms (1976) 1,093 firm (1986) US firms listed on NYSE or AMEX 1976 and 1986	<ul style="list-style-type: none"> <li>a. Insider stock ownership by managers and directors</li> <li>b. Institutional ownership</li> <li>c. Blockholders as combined ownership by non-insiders who have more than 5% ownership</li> <li>d. Largest single blockholders</li> <li>e. Dummy for presence of blockholders</li> <li>f. Insiders plus blockholders</li> <li>g. Insider ownership in range (0-5%), (5-25%) and (25-100%)</li> <li>h. Insider plus all blockholders in the ranges (0-5%), (5-25%) and (25-100%)</li> </ul>	<ul style="list-style-type: none"> <li>- Tobin's Q by market value of stock, preferred stock and debt to replacement value of assets</li> <li>- Return on assets by earnings before depreciation, interest and taxes divided by replacement value of assets</li> </ul>	Both measures of profitability significantly increasing with ownership by managers and directors (similar result for insider plus all blockholders). Performance increased significantly with institutional ownership. No measure of blockholder ownership seems to have any effect

Table 1 (*Continued*)

Author(s)	Sample and Period	Ownership Variable(s)	Performance Variable(s)	Main Results
Hermalin and Weisbach (1991)	134 US firms listed in NYSE (1971, 1974, 1977, 1980, 1983)	Combined stock ownership by present CEO and all former CEOs still in the board in the ranges a. 0% -1% b. 1% -5% c. 5%-20% d. 20%-100%	Tobin's Q by ; market value of stock, preferred stock and debt to market value of capital stock, inventories and other assets Return on assets by EBIT to replacement value of assets	Performance increased significantly with the CEO ownership in the (a) range and decreased significantly in (b) range. Otherwise the different regressions present insignificant or contradicting evidence
Denis and Denis (1994)	72 US firms with $\geq 50\%$ insider ownership by managers and directors (1985)	a. Majority ownership $\geq 50\%$ insider ownership by managers and directors b. Institutional ownerships c. Dummy for outside blockholder ownership d. Dummy for family and founder involvement in management or BOD	- Return on equity - Return on assets - Operating income to assets - Tobin's Q - Market to book ratio	No difference in performance between majority-controlled firms and other firms. The likelihood of majority control increases significantly with family/founder involvement
McConnel and Servaes (1995)	US firms listed in NYSE or AMEX 990 (1976) 876 (1986) 780 (1988)	a. Insider stock ownership by managers and directors b. Institutional ownership c. Blockholders as combined ownership by non-insiders who have more than 5% ownership	Tobin's Q by market value of stock, preferred stock and debt to replacement value of assets	Similar result with previous study (1990), except Tobin's Q is significantly increasing with blockholder ownership.



Table 1 (*Continued*)

<b>Author(s)</b>	<b>Sample and Period</b>	<b>Ownership Variable(s)</b>	<b>Performance Variable(s)</b>	<b>Main Results</b>
Himmelberg, Hubbard and Palia (1999)	Small and large US firms; 398 (1982) 425 (1983) 427 (1984)	a. Percentage of common equity holdings by all top-level managers (the value is transformed using $\log(m/m-1)$ ) b. Average percentage of equity ownership per top-level managers (using log of this value)	- Tobin's Q by market value of stock + estimated market value of preferred stock + book value of total liabilities to book value of total assets - Return on Total Assets	Find some evidence of roof-shaped relation. After controlling for firm characteristics and firm fixed effects, there is no relation between managerial ownership and performance
Holderness, Kroszner and Sheehan (1999)	US listed firms 1,419 (1935) 4,202 (1995) Limited sample 120 large firms in 1935 and 1995	a. Percentage and dollar ownership by the firm's officers and director both directly and indirectly b. Percentage and dollar ownership by CEO (MO) c. Combined shareholding by officers and directors in the ranges (0-5%), (5-25%) and (25-100%)	Tobin's Q by market value of stock, book value of debt to book value of assets	Profitability is significantly increasing for MO in the (0-5%) range and significantly decreasing in the (5-25%) range for 1935 sample. For the 1995 sample Tobin's Q is significantly increasing for MO in the (0-5%) range
Han, Lee and Suk (1999)	2000 firms from G-7 countries (1991-1994)	a. Insider ownership (ratio of closely held shares to total number shares outstanding) b. Closely held shares (shares held by officers, directors, beneficial owners and principal stockholders)	- Return on Equity - Asset Turnover - Net Profit Margin	Find no evidence that firm performance is improved by concentration of insider ownership

Table 1 (*Continued*)

<b>Author(s)</b>	<b>Sample and Period</b>	<b>Ownership Variable(s)</b>	<b>Performance Variable(s)</b>	<b>Main Results</b>
Thomsen and Pedersen (2000)	435 firms in 12 EU countries (1990-1995)	a. Ownership share (votes) of the largest owner in percentage b. Dummy variable for the identity of largest owner for each: bank, non-financial company, family (single person or foundation), government, institutional investors	- Market to book value of equity (MBV) - Return on Assets (ROA)	There is a positive effect of ownership concentration on performance (MBV and ROA). The effect of ownership concentration is dependent on owner identity
Wiwattanakantang (2001)	270 Thailand Firms (1996)	a. Dummy variable for (a) controlling shareholders, (b) family ownership, (c) government ownership, (d) foreign investor (e) more than one controlling shareholder b. Dummy variable for (a) controlling shareholders and (b) their involvement in management within in the range [25-50], [50-75], and [75-100]	- Simplified Tobin's Q - Sales-asset Ratio - Return on Assets	Controlling shareholders is associated with higher performance. The controlling shareholders' involvement in the management has a negative effect on performance. Family controlled firms have significantly higher performance
Demsetz and Villalonga (2001)	223 US firms (1976-1980)	a. Percentage of shares owned by management b. Percentage of shares owned by (outside) five largest shareholders	Tobin's Q	No significant effect of ownership structure on firm performance

Table 1 (Continued)

Author(s)	Sample and Period	Ownership Variable(s)	Performance Variable(s)	Main Results
Filatotchev, and Piesse (2005)	Lien 228 Taiwan listed firms excl.fin. 1999	a. Family; equity holding of lgest. Indiv shareholder +close family. b. Instrumental variables for i) family ii) foreign funds iii) foreign banks iv) domestic funds v) domestic banks.	Return on capital employed (ROCE); Return on assets (ROA); earnings per share (EPS); sales revenue as % issued capital.	No signif. effect family ownership instrumental variable on any performance measure; signif. positive influence of institutional investors on 4 measures of performance; test for non-linearity no signif. coefficients.
Chen, Chen and Chung (2006)	New Zealand listed companies, 1994-2004.	a. Majority control (>50%) single or tight group. b. Minority control (15-50%). c. Management control – dispersed ownership.	ROE (rate of return on shareholder equity) Ratio of sales to assets.	Concentrated ownership has a positive impact on profitability and operational efficiency.
Cho and Kim (2007)	347 Korean listed cos. In 1999.	a. large shareholder ownership 0-5 5-25 25-100% b. blockholder ownership; c. managerial ownership.	Ratio of profit to total assets (ROA).	Large shareholders have a positive influence on corporate performance.
Al Farooque et al. (2007)	Bangladesh; Pooled sample 723 firm years, 1995-2002.	a. Board shareholding as % total shareholding. b. Institutional shareholding as % total shareholding.	Market -to-book value of equity.	Significant negative reln. between board shareholding and performance; supports non-linear relationship; Significant negative reln. Between institutional shareholding and performance; Model 2 suggest ownership and performance are endogenously determined.

Table 1 (*Continued*)

Author(s)	Sample and Period	Ownership Variable(s)	Performance Variable(s)	Main Results
Kapopoulos and Lazaretou (2007)	Greece; 175 listed firms, 2000.	a. fraction of all shares held by owners with minimum of 5% shareholding; b. fraction of all shares held by firm's management owning a minimum of 5% shareholding	Tobins Q  Accounting profit rate.	More concentrated ownership structure positively related to higher firm profitability; Profitability a positive predictor of ownership structure indicating endogeneity of ownership structure.
Braun and Sharma (2007)	USA; 84 listed family firms.	Family controls at least 10% of voting rights.	Buy and hold market – adjusted returns.	Firm performance is negatively related to rising ownership when CEO/Chair role is not combined.
Bjuggren, Eklund and Wiberg (2007)	Sweden; 95 listed firms, 1997-2002.	a. % equity largest owner; b. % equity 5largest owner.  c. % votes controlled, lgest. Owner, d. % votes controlled, 5lgest. Owner  e.% equity controlled, foreign owner f.. % votes controlled. Foreign owner.	Marginal q; ( measure of marginal performance rather than average performance as Tobins Q)	Significant negative relationship between concentrated ownership and investment performance; Significant and negative relationship between vote-differential and firm investment performance

Source: Authors' compilation

The studies on the ownership-performance relationship that came after the Demsetz and Lehn (1985) critique focus on the fraction of shares owned by a firm's management. In regard to this issue Demsetz and Villalonga (2001, p.214) argue that 'exclusive reliance on this measure to track the severity of the agency problems suggests that all shareholders classified as management have a common interest. This is not likely to be true'. These writers provide the example of a board member who has a position because he/she has, or represents someone who has large holdings of the company's stock. They argue that this type of board is likely not to have interests identical to those of professional managers.

Prior to Demsetz and Lehn (1985), studies of this relationship used purely accounting profit (e.g. Kamerschen 1968; Steer and Cable 1978; Bothwell 1980). Some later researchers, although still utilising accounting profit, have already relied on Tobin's Q as a measure of firm performance. Included among these are Demsetz and Lehn (1985); Holderness and Sheehan (1988); Morck, Shleifer and Vishny (1988); McConnel and Servaes (1990); and Denis and Denis (1994). Other researchers, including Hermalin and Weisbach (1991); McConnel and Servaes (1995); Himmelberg, Hubbard and Palia (1999); Holderness, Krozner and Sheehan (1999) have relied mainly on Tobin's Q as a measure of firm performance in their studies. The issues relating to the use of the accounting profit rate and/or Tobin's Q as a measure of firm's performance has been discussed at length on page. Gugler and Yurtoglu (2003) have, as discussed earlier, proposed marginal Tobin's Q and, along with Bjuggren et al. (2007), used this as their dependent variable.

The majority of empirical studies in the ownership-performance relationship employ dummy variables to classify firms by control type (e.g. Pedersen and Thomsen 1997). Some of the studies (e.g. Demsetz and Lehn 1985) have utilised continuous variables for shareholder concentration measures. However, the use of both dummy and continuous variables in this relationship has implicitly assumed that 'if there is some difference in performance of firms due to different ownership structures, the relationship is uniform' (Short 1994).

The assumption of linearity in the relationship between ownership and performance has been claimed as producing misleading results (Short 1994). This assumption does

not recognise the possibility of relationships which may exist within various ranges or classifications of ownership levels. Morck, Shleifer and Vishny (1988) criticised a study by Demsetz and Lehn (1985) which failed to find a significant relationship between ownership concentration and performance, on the grounds that their result may be due to their use of a linear specification which failed to capture any existing non-linear relationship. Cubbie and Leech (1983, 365) argued that 'the misclassification resulting from the use of fixed rules [in classifying ownership category] which make no allowance for variation in dispersion between companies is likely to be a serious source of bias in cross-sectional empirical studies'. To overcome this problem, Short (1994) suggests the need for more complex and finer ownership classifications to be defined, using several different cut-off points.

The identity of large shareholders is perceived to be another important aspect in the study of the ownership-performance relationship (Short 1994). McConnel and Servaes (1990), Li et al. (2006) suggest that some block shareholders might be more passive investors whilst others may play a more active monitoring role. It was suggested, therefore, that differences in the identity of large shareholders should be further investigated to discover the level of ownership at which shareholders find it profitable to exercise close monitoring processes. According to Short (1994, 223) this process is reasonable 'rather than simply defining shareholders as being large if they own more than some arbitrary percentage of equity'.

## **Conclusion**

This discussion highlights a number of issues associated with empirical research on the effect of ownership and control structure on firm performance. The main area of contention within this relationship is that of 'defining variables that empirically capture the notion of control' (Short 1994, 227). Studies by Morck, Shleifer and Vishny (1988) and McConnel and Servaes (1990) could be seen as an important contribution in this area as both studies consider the possibility of non-linear relationship between ownership and performance. Moreover, both of these studies and those of Holderness and Sheehan (1988) have also pioneered the use of Tobin's Q as an alternative measure of performance within the ownership and performance relationship. Marginal Tobin's Q has been added to the array of performance measures used (Gugler and Yurtoglu 2003).

There has been very limited research into the relationship between measures of corporate performance and ownership structure in countries such as those of East Asia. The results generated by the studies using a range of ownership and a range of performance measures and summarised in Table 1 remain inconclusive on whether the type of ownership structure does significantly affect performance within the jurisdictions studied. The theory suggests that the results from economies with strong investor protection regimes and legal enforcement may not be directly applicable to economies where investor protection and legal enforcement are weak. The studies identified from East Asia are, however, similarly inconclusive at this point.

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