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OWNERSHIP STRUCTURE AND ISLAMIC BANK PERFORMANCE

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Abstract: *Ownership structure is considered an important factor that affects a firm's health. Ownership identities are able to influence the governance issues- asymmetric information, agency conflicts and risk. This study conducted to investigate the relationship between ownership structures on bank performance in Malaysia consists local Islamic banks and foreign Islamic Banks. Secondary data extracted from annual reports of 3 local Islamic Banks and 3 foreign Islamic Banks from 2015 to 2016 period are collected. Techniques of data analysis used in this study are normality, heteroscedasticity, auto-correlation, correlation and panel data test. Panel data test describe the analysis on fixed effect model (FEM), random effect model (REM) and Hausman test. The result showed that foreign ownership and bank performance has a positive relationship to each other. It means it has largest impact to bank performance compared to local ownership structure.*

Keywords: *Ownership Structure, Bank Performance, FEM, REM, Hausman Test*

Introduction

Ownership structure is usually seen to be determined by country level corporate governance characteristics such as the development of the stock market and the nature of state intervention and regulation (Gang Bai *et al.*, 2013). Besides, its affects the scale of a firm's agency costs (Anis & Nora, 2015). Ownership structure of an economic unit is explained through two main dimensions. First, the degree of ownership concentration: units may be different because their ownership is more or less isolated. Second, the kind of owners: given the same degree of concentration (Sarra *et al.*, 2014). Ownership identities are able to influence the governance-issues asymmetric information, agency conflicts and risks. Therefore, it's expecting the difference ownership structure to show different degrees of performance.

Ownership structure is considered as an important factor that affects a firm's health (Zeitun & Tian, 2014). Ownership structure is like the hard core of corporate governance, a firm's *"owners,"* is those persons who share two formal rights: the right to control the firm and the right to appropriate the firm's profits, could be separated and held by different classes of persons (Hansmann, 2000). According to Nora Azureen (2015), bank ownership structure is divided into five types of ownership which is insider, family, government, institution and foreign ownership.

Performance evaluation is an important pre-requisite for sustained growth and development of any situation. It is customary in banks to evaluate the pre-determined goals and objectives, with the changing goals and objectives, the criteria of evaluation of banks have undergone changes overtime (Hasan, 2009). Performance analysis of banks can be done in many different ways, depending on the type of analysis and the specific needs of the user. One of them is through the ratio analysis method. Ratio analysis consists of the quantitative and qualitative aspects of measuring the relative financial position of banks among them and among industries (Bokpin, 2013).

Objectives

The general objective of this study is to examine the relationship between ownership structure and performance of Malaysian Islamic banks. There are two main ownerships will be discussed in this study which are local and foreign ownership. These variables will be tested whether they can give impact to the bank performance. The specific objectives of the study are:
1. To examine the impact of local ownership on bank toward its performance
2. To investigate the impact of foreign ownership on bank performance.

Literature Review

Ownership and Bank Performance

Performance evaluation is an important pre-requisite for sustained growth and development of any situation on banking development (Hassan, 2007). It is customary in banks to evaluate the pre-determined goals and objectives, with the changing goals and objectives, the criteria of evaluation of banks have undergone changes overtime.

Alejandro *et al*, (2004) found a positive relationship between ownership and bank performance in developing countries and no relationship in developed or industrialized from developed countries and the rest are from developing countries. Demirguc-Kunt and Huizinga (2000) also agree that in developing countries foreign banks lead the banking sector by obtaining higher spread and profits compared to developed countries. Few other researches concentrating on a particular country correspond with the ownership and performance findings. More specifically, Gilbert and Wilson (1998) and Hao *et al.* (2001) reported a positive association between foreign ownership and bank efficiency and a negative association between bank efficiency and state ownership in Korea. Besides, Sathye (2001) and Avkiran (1997) notice superior performance of domestic commercial banks compared to their foreign counterparts in Australia.

De Young and Nolle (1996) find that income efficiency of foreign commercial banks in the US is lower than domestic US banks and Clarke *et al.* (2000) investigate the effect of foreign bank entry in Argentina and indicate that foreign banks are more capable of generating income compared to domestic banks. Zhuang (1999) identified two essential aspects of corporate ownership structure as concentration and composition. According to him, the degree of ownership concentration in a firm determines how power is spread between its shareholders and managers. When ownership is dispersed, shareholding control tends to be weak because of poor shareholder monitoring.

On the other hand, concentrated ownership can create conditions for a new problem, because the interests of controlling and minority shareholders are not united. Therefore, it will be an economic image for minority shareholders to look for interests' protection through broad of directors. Anis and Nora (2015), argue that improve the share involvement for insider controllers may decrease agency cost and increase firm performance. However, Vasik and Cheorghe (2013) and Houda Arouri *et al*., (2014) found concentrated ownership is not associated with better operating performance or higher valuation.

Insider Ownership

Jiang and Kenneth (2013) showed that entrenchment effects exist as insider ownership increases, insider become increasingly cost averse and pursue hedging. This is because insiders may not hold well-diversified portfolios and therefore have incentives to reduce cost of the firms return. Banks whose managers hold a relatively large proportion of the banks stocks have incentives take higher problem than banks whose managers hold a relatively small proportion of the banks stocks (Saunders *et. al*, 1990).

Belkhir (2009) found statistically significant relationships between performance and insider ownership and block holder ownership. The less insider and block holder ownership leading to better performance. Poor firm performance may lead insiders and block holders to reduce their equity ownership in the bank. He examines the interrelations among ownership structure and board characteristics in a sample of 260 banks and Savings-and-Loan Holding Companies (SLHCs) available in the Research Insight database of Standard & Poor's in 2002.

Family Ownership

The ownership by an important individual (or the members of the founding family) is often associated with the right to control the resources of the firm. According to Qi Liang and Pixun Xu (2013), the combining ownership and management is advantageous because the presence of large shareholders who are also the managers mitigates the problem of wealth expropriation by management. Also, such investors have a strong incentive to monitor managers since their wealth is closely associated with the economic performance of the firm (Anderson & Reeb, 2003).

These investors are motivated to maintain a long-term perspective in their firms because they often make firm-specific investment in human capital and view the firm as an asset that needs to be protected to pass on to their descendants (Casson, 1999; Thomsen & Pedersen, 2000). If the largest investor is a member of the founding family, their entrepreneurial ability may be a value-increasing asset, in particular for a young and fast-growing firm (Short, 1994). Pornsit *et al.* (2013) hypothesized that founding family members become entrenched at much lower levels of ownership than other managers who acquire an equity stake in the firm.

Government Ownership

Government ownership is associated with political influence and bureaucratic sectored interest, which is represent at times governance failure, incompetence and corruption and high probability of crisis (Shleifer & Vishny, 1997). Barry *et al.,* (2008) found that government ownership has a significant and positive impact on bank revenue. The government tend to involved in financing projects that would not privately financed and acquires control of banks in order to provide employment, subsidies and other benefits to supporters.

La Porta *et al.,* (2002) found that government ownership of banks is associated with lower subsequent growth of per capita income, and in particular with lower productivity growth rather than slower factor accumulation. This evidence supports *"political"* theories of the effects of government ownership of firms. The data show that such ownership is large and pervasive, and higher in countries with low levels of per capita income, backward financial systems, interventionist and inefficient governments, and poor protection of property rights.

Institutional Ownership

Brickley *et al.,* (1997) stated that there is positive relationship between institutional ownership and firm performance. Institutional investors may be motivated to sacrifice their responsibility to monitor management in order to carry out business operations with the firm and to work co-operatively with the management; thus inefficient monitoring and related party dealings can have a negative effect on a firm’s performance.

Foreign Ownership

The foreign ownership has a favorable impact on the governance and performance of the firm (Micro *et. al.*, 2004); such evidence is more distinct in newly liberalized economies. It is argued that, compared to their domestic investor counterparts, foreign investors are in a better position to exploit imperfections in capital, labor and technological markets, and thereby to influence firm performance positively. Also, companies with foreign corporate ownership are empowered with superior financial, technological and organizational (Khanna & Palepu, 1999).

Choi and Hasan (2005) found a statistically strong positive relationship between foreign ownership and bank performance. Using data of Korean commercial banks over the 1998 to 2002, they found that there is a positive and significant association between the foreign ownership variables with bank performance. They observed that the extent of foreign ownership level had a positive and statistically significant impact on bank performance.

Uddin and Suzuki (2011) found that foreign ownership has a statistically significant positive impact on bank performance. Private ownership also have a statistically significant positive impact on income efficiency and return on assets, whereas negative effect on cost efficiency. A bank with private ownership, longer period of operations, excessive diversification activities, and higher amount of unutilized funds tends to become less cost efficient and non-performing loan increases with the rise of diversification activities and periods of operation and decreases with foreign or private ownership.

Bank Performance

The dependent variable of the study is bank performance which is measured by using return on equity (ROE). ROE have been most common used by previous researchers in measuring bank performance as it indicates the real financial conditions of banks (Lin & Zhang, 2007). Return on Equity measures how beneficially a company employs its equity, that is, the money raised from shareholders. A higher ROE means that the company is efficient in using its equity.

Methodology

The framework focuses on the relationship between ownership structure and bank performance. Banks performance measure by return on equity (ROE) is the dependent variables, while ownership structure includes variables such as local ownership and foreign ownership are the independent variables.

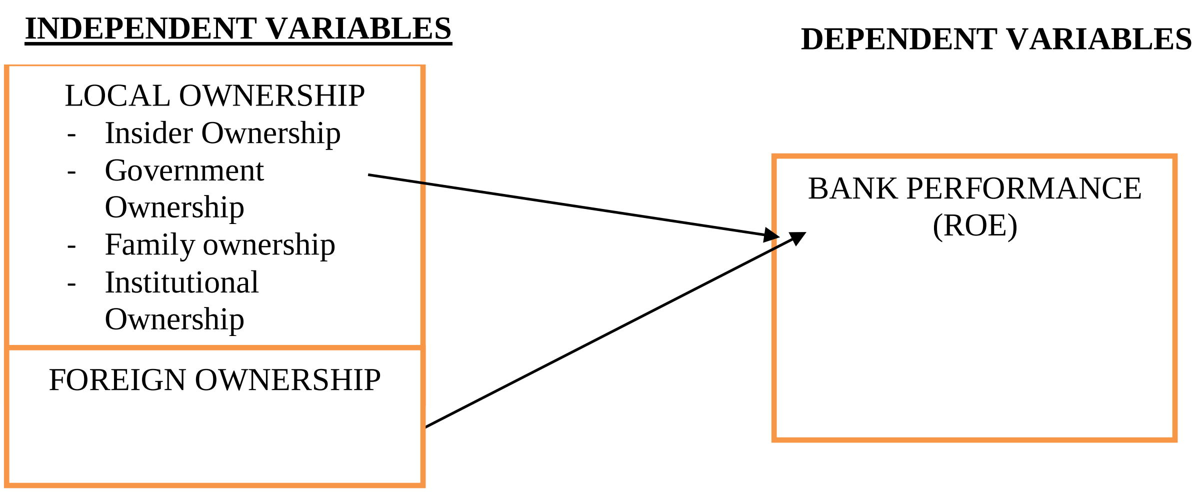

Figure 3.1: Research Framework

Population and Data Collection

The commercial Islamic banks in Malaysia as at 2017 consist of 10 domestic banks and 6 foreign banks. In order to examine the relationship of variables in the research framework, secondary data comprising of financial ratios extracted from annual reports of 3 local Islamic Banks and 3 foreign Islamic Banks from 2015 to 2016 period are collected.

Table 1: summary of variables and measurements

CATEGORIES	VARIABLES	MEASUREMENTS	SOURCES
LOCOWN	INSIDER	Total number of shares held by board of directors in period t / total number of shares in period t	Belkhir (2005)
	FAMOWN	Total number of shares held by family in period t / total number of shares in period t	Gursoy & Aydogan (2002) Laeven & Levine (2009) Barry, Lepetit & Tarazi (2010)
	GOVOWN	Total number of shares held by government in period t / total number of shares in period t	
	INSOWN	Total number of shares held by institution in period t / total number of shares in period t	
FOROWN		Total number of shares held by foreigner in period t / total number of shares in period t	Detragiache & Gupta (2006)
PERFORMANCE		ROE = net income /book value of equity	Lin & Zhang (2007)

Techniques of Data Analysis

In this section, techniques of data analysis used to answer the research question are normality, heteroscedasticity, auto-correlation, correlation and panel data test. Panel data test describe the analysis on fixed effect model (FEM), random effect model (REM) and Hausman test.

Results and Discussion

Panel Data Analysis

The regression analysis for this study is conducted by using GLS (General Least Square) estimation. GLS method is found to be more appropriate as it helps to reduce the normality issue in the model. GLS is a transformed model of OLS and it is more appropriate than OLS in the case of non-normal data (Gujaraty, 2003). White's General Hetersocedasticity and AR (1) are conducted as to solve heteroscedasticity and auto-correlation problems, while fixed effects model is used for the most appropriate model and it is found from the Hausman test.

Variable	Beta Coefficient	t-statistics	p-value
LOCOWN	0.319414	7.888035	0.8385
FOROWN	0.444926	2.517927	0.0125
AR (1)	0.353769	6.787864	0.0000
R-squared	0.925111		
Adjusted R-squared	0.914929		
F-statistic	563.2996		
Sig F-statistic	0.0000		
Durbin-Watson stat	1.999625		
N	12		

Table 2: Ownership Structure and Bank Performance

According to table above, the result indicates a relationship between all of independent variables and ROE. The weighted adjusted R-squared consist of LOCOWN and FOROWN is 91.5% variation in ROE. It is also found that LOCOWN and FOROWN are significant in explaining variations in ROE.

It is showed that local and foreign ownership are increased, the performance also increased. It is indicated that the share that banks acquire from local or foreign owners valuable and it is chance to increased their profit. It is show that, the local ownership with high managers or family relation hold bank shares, they had right to control the decision making of banks. The decision may unbalance because maybe they make the decision only for individual or family manner and its can influences the bank performance in future. The table also shows that FOROWN has the highest beta coefficient value with 44.49%, indicating the strongest contribution in explaining the dependent variable. It is also show the Durbin Watson statistics with 1.996.

Impact of Local Ownership toward Bank Performance

A table shows that the local ownership is insignificant relationship with bank performance (0.8385). However, local ownership and bank performance has positive relationship to each other. It is can conclude that the higher local owned (include of government, family, insider and institutional ownership) shares the better performance that banks can achieved. The local's role as a bank owner and regulator will increase agency problem in a bank. Their decision might not only base on a commercial basis but also on development and political agenda. Local owned acquired control of banks in order to finance projects that may not get privately financed. Thus, this study hypothesized the relationship between local ownership and bank performance is positive as accepted.

The result have the same opinion with Barry *et al.,* (2008) found that government ownership has a significant and positive impact on bank revenue. Before the banking sector reforms, public banks were heavily protected by government whereas the private banks had to face many restrictions in their operations. This may have led the public banks to be more profit efficient than the private banks. The government acquires control of banks in order to provide employment, subsidies and other benefits to supported, who return the favor in the form of votes, political contribution and bribes. Active monitoring of institutional shareholding improved firm value only up to a certain level of shareholding (efficient monitoring). At high levels of shareholding, institutional shareholders may encourage sub-optimal decisions harmful to the firms but beneficial to themselves (entrenchment).

Impact of Foreign Ownership toward Bank Performance

The result of this study showed that the relationship between foreign ownership and bank performance is significant with 0.0125. Besides, foreign ownership and bank performance has a positive relationship to each other. It concludes that with the more foreign owner shares in the bank, the better performance that can they achieved in the future. As we know, foreign banks operating in developing countries have a tendency to be characterized by superior management practices, good management of risks, advance technology, high operational efficiency and large profitability. Foreign banks are also associated with high bank capital and better regulation and supervision from their parent company. This characteristics and the ability to raise capital or liquid funds from the international markets and supports from their parent bank and reduced their risks. Thus, this study hypothesized the relationship between foreign ownership and bank performance is positive as accepted.

This result accepted from opinion Choi and Hasan (2005) found a statistically strong positive relationship between foreign ownership and bank performance. Evidence indicates that there is a positive and significant association between the foreign ownership variables with bank performance. They observed that the extent of foreign ownership level had a positive and statistically significant impact on bank performance. The result also has a same opinion with Barry *et, al.* (2008) found that foreign ownership has a significant and positive impact on bank revenue. The banks that owned by foreign investors appear to be higher efficient score on performance during post-crisis period.

Their findings imply that the entry and growing involvement of foreign investors is still beneficial for the efficiency of the banking industry. The results strongly support banks with a low degree of foreign ownership are more profitable and able to raise more net interest revenues than banks with a high degree of foreign ownership. The foreign-owned banks located in developing countries tend to be characterized by higher profitability, lower overhead costs, and lower non-performing loans compared to stated-owned banks. Thus, foreign banks represent the best practice banks in the industry, whose actions are closely followed by domestic banks.

To find out the best of set of the relationship between ownership structure and bank performance with five-predictor random effects model (REM) was proposed. The five predictor variables are local ownership (X_1), foreign ownership (X_2). The equation of the proposed random effects model (REM) is as follow:

$$Y_{it} = \beta_0+\beta_1 X_{1it} + \beta_2 X_{2it} + w_{it}$$
$$Y_{it}\ (ROE) = 35.38 + 31.94\ (X_{1it}) + 44.49\ (X_{2it}) + w_{it}$$

Conclusion

The result shows that the foreign ownership has largest impact to bank performance compared to local ownership structure. The impact of different types of ownership to bank performance shows that the differences have their own effect on performance of each banking system. The existence of large shareholders, beneficial owners and managers to reduce agency problems, when the controlling shareholder equity ratio is relatively large, its own interests are closely linked with the interests of the company, the controlling shareholder in the company's decision-making in the big event will give serious consideration to the company interests, and avoid opportunistic mentality.

They will unconditionally pursue development of the company and controlling shareholders will reduce the behavior that is bad for the interests of company. It is beneficial to enhance the performance of banks. On the other hand, too concentrated ownership structure is not an effective mechanism, because the large shareholders are free to shift corporate resources to pursue their own interests and development.

Conflicts of interests between managers and shareholders are argued to be more important in firms with discrete ownership structures, as coordination problem hinders effectively monitoring of managerial actions by small shareholders, who have to rely on external monitoring through the market for corporate control (Jensen, 1988).

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