Corporate Control
and Financial Performance
of New Zealand Companies

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1. Introduction

It is often argued that in the modern corporation the ownership of shares is so widely spread that management can pursue their own interests unchecked by shareholders. Symptoms of management's alleged pursuit of self-interest are believed to include conglomerate building and excessive salaries and perks (Dumaine, 1994; Amihud and Lev, 1981). This notion that managers may not act in the best interests of shareholders was first proposed by Adam Smith in the *Wealth of Nations*:

> The directors of [joint stock] companies, however, being the managers of other people's money than their own, it cannot be expected, that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company (Smith, 1776).\(^1\)

In contrast to the, perhaps, rather cynical view of managerial behaviour set out above, a more charitable view of managerial behaviour is given by *stewardship theory*, which proposes that “... the executive manager, far from being an opportunistic shirker, essentially wants to do a good job, to be a good steward of the corporate assets” (Donaldson and Davis, 1991, p.51).

This study has two objectives. The first objective - which I pursue in section 2 - is to address the issue of management versus owner control of New Zealand public listed companies. Specifically, I focus on the extent to which shareholders in New Zealand's public companies may have the ability to influence the actions of management. The second objective of this study - which I pursue in section 3 - is to investigate the extent to which the ownership of New Zealand companies influences financial performance.

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\(^1\) Cited in Hunt (1986), p.85.
2. Corporate Control in New Zealand

Previous studies of corporate control in New Zealand have, with the exception of Firth (1992), classified companies according to the degree of control of those owning (voting) shares. Following Fogelberg (1980), companies were given one of four control classifications: majority, minority, joint, or management. Each of these four types of control is seen to represent different stages in the detachment of ownership from management control (refer Table 1). At one extreme, majority control represents a situation where there is a major shareholder (or group of shareholders) that holds an unassailable position in terms of the control of a company. At the other extreme, management control represents a situation where shareholdings in a company are so widely dispersed as to ensure that no individual shareholder can exercise control in the direction of the company.

Table 2 shows the results of previous studies of corporate control in New Zealand, along with new data which were collected for this study. These new data were for the years 1990 and 1993. In addition, Fox and Hamilton's (1994) data for the year 1985 was updated with the inclusion of an additional 47 companies, to give a total sample of 143 companies for that year.

Two previous studies (Fogelberg, 1980; Fox and Hamilton, 1994) have interpreted changes in ownership leading up to 1985. The first study, by Fogelberg (1980), examined the 43 largest surviving New Zealand Stock Exchange (NZSE) companies listed between 1962 and 1974. Of these companies, Fogelberg comments that:

... by the early 1960s there had been a substantial movement towards management control. During the next 12 years this movement continued, 13 firms moved either directly or more closely towards management control (Fogelberg, 1980, p.55).

---

2 Thus previous studies use ownership to infer corporate control. In using the term ownership I am referring to the ownership of (voting) shares in a company. The term corporate control refers to who has power and influence what a company does, i.e., over its corporate strategy.

3 Fox and Hamilton's initial sample was based on those companies listed on the NZSE in 1985 that were also listed in 1975. The additional 47 companies represent those companies that were listed in 1985 and either 1980 or 1990.
### Table 1
#### Classification of Control Types

<table>
<thead>
<tr>
<th>Classification</th>
<th>Deemed to exist when:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Majority</td>
<td>Majority of capital (over 50%) held by one holder or a tightly-knit group</td>
</tr>
<tr>
<td>Minority</td>
<td>An individual or small cohesive group of shareholders hold sufficient votes to be able to dominate the company through their interest</td>
</tr>
<tr>
<td></td>
<td>Exists where there is an important minority interest or family group accounting for between 15 to 50% of the votes, where this minority interest is represented on the board</td>
</tr>
<tr>
<td>Joint</td>
<td>Minority interest strengthened by a close association with management, or management control enhanced by a sizeable minority interest</td>
</tr>
<tr>
<td></td>
<td>One of two situations may apply. Either:</td>
</tr>
<tr>
<td></td>
<td>• owning a minority interest of 10-15% coupled with board representation, or</td>
</tr>
<tr>
<td></td>
<td>• owning or controlling a minority interest of more than 5% with board representation and active management involvement</td>
</tr>
<tr>
<td>Management</td>
<td>Ownership is so widely distributed that no one individual or group has a minority interest which is large enough to allow them to exert dominance over the company's affairs</td>
</tr>
</tbody>
</table>

* Derived from Fogelberg (1980, pp.61-64)
Table 2
Control Types of New Zealand Listed Companies, 1962 to 1993*

<table>
<thead>
<tr>
<th>Control classification</th>
<th>1962(^a)</th>
<th>1974(^a)</th>
<th>1981(^b)</th>
<th>1985</th>
<th>1990</th>
<th>1993</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
</tr>
<tr>
<td>Majority</td>
<td>7</td>
<td>16.3</td>
<td>3</td>
<td>7.0</td>
<td>45</td>
<td>22.1</td>
</tr>
<tr>
<td>Minority</td>
<td>14</td>
<td>32.6</td>
<td>13</td>
<td>30.2</td>
<td>78</td>
<td>38.2</td>
</tr>
<tr>
<td>Joint</td>
<td>5</td>
<td>11.6</td>
<td>6</td>
<td>14.0</td>
<td>19</td>
<td>9.3</td>
</tr>
<tr>
<td>Management</td>
<td>17</td>
<td>39.5</td>
<td>21</td>
<td>48.8</td>
<td>62</td>
<td>30.4</td>
</tr>
<tr>
<td>Totals</td>
<td>43</td>
<td>43</td>
<td>204</td>
<td>143</td>
<td>134</td>
<td>116</td>
</tr>
</tbody>
</table>

Sources: \(^a\)Fogelberg (1980); \(^b\)Chandler and Henshall (1982)

* The 1985, 1990 and 1993 samples comprise 66, 94 and 89 per cent respectively of all listed companies in each of these years.

If we conduct a Chi-square test on all the available data (as given in Table 2) we do find some significant differences in control classifications by year (refer Table 3). Interestingly, and in contrast to what we expect from Fogelberg's comments, no statistically significant change in the proportion of companies having various control classifications took place between 1962 and 1974.

Table 3
Chi-square Statistics for Differences in Distribution of Control Categories Between Adjacent Years

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Majority</td>
<td>2.29</td>
<td>66.51</td>
<td>15.99</td>
<td>9.92</td>
<td>0.43</td>
</tr>
<tr>
<td>Minority</td>
<td>0.07</td>
<td>4.32</td>
<td>3.75</td>
<td>2.48</td>
<td>0.20</td>
</tr>
<tr>
<td>Joint</td>
<td>0.20</td>
<td>3.15</td>
<td>0.83</td>
<td>3.08</td>
<td>3.61</td>
</tr>
<tr>
<td>Management</td>
<td>0.94</td>
<td>14.21</td>
<td>25.76</td>
<td>2.04</td>
<td>0.41</td>
</tr>
<tr>
<td>Chi-square statistic (3 dof)</td>
<td><strong>3.50</strong></td>
<td><strong>88.19</strong>*</td>
<td><strong>46.33</strong>*</td>
<td><strong>17.51</strong>*</td>
<td><strong>4.65</strong></td>
</tr>
</tbody>
</table>

* significant at .001 level
In contrast to what we expect from Fogelberg's comments, the first major changes in corporate control occurred between 1974 and 1981. Between these two years we found a significant difference in the proportion of majority and management controlled companies, with there being a higher proportion of majority controlled companies in 1981 and a lower proportion of management controlled companies in the same year.

The 1981-85 period saw further major changes in the distribution of companies among different control categories. Compared to 1981, in 1985 there was a greater proportion of listed companies in the majority and minority categories. Furthermore there were significantly fewer companies in the management controlled category in 1985 as compared to 1981.

The changes highlighted above are consistent with Fox and Hamilton's (1994) comment that:

... by 1981 there had been a big rise in the proportion of majority controlled companies and a roughly equivalent fall in the proportion of management controlled companies (as well as consistent if less marked shifts in the minority and joint categories). These changes continued on through to 1985 (Fox and Hamilton, 1994, p.74).

The 1985-90 period also saw a difference in the proportion of companies having majority control, with a greater proportion observable for 1990. There was no significant change in the distribution of firms by control classifications between 1990 and 1993.

In summary, we conclude that, over the period from 1962 to 1993, there has been a major shift to majority control among New Zealand public companies: by 1993 50 per cent of our public companies were majority controlled. This increase in majority controlled companies has taken place along with a decline in the proportion of our companies that are management controlled. Fogelberg's (1980) study found that 39.5 per cent of the 43 largest companies in the year 1962 were management controlled. In contrast, by 1993 only 2.6 per cent of all public listed companies were management controlled. A significant increase in the proportion of minority controlled companies is also evident over the 1962 to 1993 period, as is a significant decrease in the proportion of listed companies having joint control.
From the preceding analysis, we can conclude that there is little evidence of a “managerial revolution” in terms of the control of New Zealand public listed companies. In fact, the reverse is the case, with companies coming more and more under the control of major shareholders. It therefore appears that there is likely to be little scope for managers to depart from actions which are in the best interests of shareholders. In the event that managers do pursue actions which are not in the interests of major shareholders then, given the high degree of control exhibited by these shareholders, it is likely that moves would be taken to align management's actions with those desired by shareholders.

3. Ownership and Performance of New Zealand Listed Companies

3.1 Introduction

Berle and Means (1932) gave popular credence to the notion that the twentieth century has seen a separation of corporate ownership from corporate control, i.e. that there has been a “managerial revolution.” It has been argued that such a separation of ownership from control can lead managers to engage in actions which are not in the best interests of shareholders. In management-controlled firms, shareholders - by virtue of diffuse ownership - are seen to be powerless to constrain managers pursuit of self-interest. Ultimately it is proposed that this pursuit of self-interest by managers will be reflected in poor corporate performance. Hence the rationale for ownership-performance studies, which seek to test the proposition that various types of corporate control will ultimately be associated with corporate performance.

Numerous studies have sought to determine whether the ownership structure of companies influences corporate financial performance (for reviews, refer Nyman and Silberston, 1978; Firth, 1992; Bothwell, 1980; Murali and Welch, 1989). Typically these studies define different types of control depending on the percentage of shares held by the major, i.e., largest, shareholder.

Reviews of the ownership-performance literature all conclude that no consistent findings have been found (e.g., Murali and Welch, 1989; Reeder, 1975; Short, 1994). For example, in reviewing 26 ownership-performance studies Short (1994) commented that:
The empirical research on the effects of ownership structure on firm performance spans several decades, but has failed to reach any conclusions as to whether the type of ownership structure does significantly affect performance (Short, 1994, p.206).

One major criticism that can be levelled at previous ownership-performance studies is that invariably researchers have derived several control categories, based on rather arbitrary levels of ownership.

### 3.2 Previous New Zealand Research

Only one previous study has examined the relationship between ownership and performance of New Zealand public listed companies, namely Firth (1992). The sample for that study comprised 149 public companies for the year 1986. Firth's financial data was also for the year 1986, except for the variable *growth* which was defined as growth in shareholder's equity over the previous five years. For the purposes of analysis, Firth classified his companies as either owner-managed or owner-controlled:

Owner-controlled firms were those where there was a single shareholder (or closely associated group) who owned 20% or more of the firm's stock and who was judged to exercise some form of control (Firth, 1992, p.6).

Firms were classified as owner-managed if they were not owner-controlled. Firth found no association between control-type and either return on shareholders equity or growth. From this he proposed that:

Managerial theories of the firm suggest that manager-controlled companies will be less profitable and perhaps show a faster rate of growth. The current study suggests manager-controlled firms' profitability is no different from other categories of companies (Firth, 1992, pp.16-17).

There are several concerns that we should have in interpreting Firth's findings. First, the results may, in part, be due to the arbitrary nature of his control-classification system. Whether or not a shareholder holds more than 20 per cent of issued capital is hardly a sound
basis to separate companies into owner versus management controlled classifications. Second, as Firth's data almost exclusively focuses on a single year, namely 1986, there may not be time for any association to appear; the treatment effect will have been applied for varying durations prior to 1986; some long, some short. If Firth averaged his variables over a longer time period, performance aberrations in individual years would be less apparent, leading to a clearer picture of the ownership-performance relationship being given.

Given the shortcomings of much of the previous ownership-performance literature, we decided that it would be instructive to conduct an analysis which sought to overcome these same shortcomings. It is to this study which we now turn our attention:

3.3 Sample and Method

The sample comprised all companies listed on the New Zealand Stock Exchange (NZSE) between 1987 and 1993. Financial institutions and mining companies were excluded from analysis because of their unusual balance sheet characteristics. Companies which merged over the period of interest were also excluded, on the basis that there was not a single company to which we could attribute performance and ownership. These exclusions left us with a total of 56 companies for the purposes of analysis.

Given the rather arbitrary nature of many control-classification schemes we decided to operationalise ownership in a more compelling way. This was done by measuring ownership as the proportion of issued voting capital held by the major, i.e., largest, shareholder. A further consideration in selecting this method was the low incidence of companies in the majority and joint control classification categories of Fogelberg's (1980) classification scheme, thereby making any analysis which adopted that particular classification scheme of limited value.

Ownership was indeterminable for one company, the Helicopter Line, which was consequently excluded from analysis, leaving us with a final sample size of 55 companies. Data for ownership was collected for one year only (1990), the mid-year of our performance and ownership variable observations.
Performance measures used were return on assets (ROA) and return on equity (ROE). Performance data were collected for each year from 1987 to 1993. For the same period we collected data for two control variables. The first control variable, firm size was measured as the natural logarithm of total tangible assets. The second control variable, leverage was measured as: (current + term liabilities + minority interests)/total tangible assets, multiplied by 100.

Three year averages were calculated for each of the performance variables. The first, which relates to performance prior to 1990 averaged ROA and ROE for the years 1987 to 1989. The second, which relates to financial performance after 1990, averages performance variables for the years 1991 to 1993. The first performance averages were chosen to allow investigation of the possibility that performance influences ownership; whereas the second performance averages were chosen to investigate the proposition that ownership impacts on corporate performance.

### 3.4 Cross-sectional Analysis

We first conducted a cross-sectional analysis with all our data for the year 1990 (refer Table 4 for the correlation matrix). No correlation was found between ownership and either ROA or ROE, nor was there any correlation between ownership and company size or leverage.

<table>
<thead>
<tr>
<th>Own</th>
<th>ROE</th>
<th>ROA</th>
<th>Size</th>
<th>Leverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>-.2103</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>-.0340</td>
<td>.5023</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>-.1030</td>
<td>.1976</td>
<td>.0811</td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>.0771</td>
<td>.0196</td>
<td>-.2255</td>
<td>.0771</td>
</tr>
</tbody>
</table>

Table 4
Correlation Matrix of Ownership and Performance for 1990

*Note: \(^a\)p<.1; \(^b\)p<.05; \(^c\)p<.001*
Given that financial data for individual years may not provide an adequate basis for testing our hypotheses we derived two more correlation matrices, one relating to future financial performance, the other to prior financial performance. We will now discuss the results of these analyses.

### 3.5 Ownership and Future Financial Performance

Our correlation matrix for 1990 ownership and performance variables for the three years following 1990 is shown in Table 5. I found no correlation between the 1990 ownership variable and subsequent financial performance, either measured as ROA or ROE. In addition 1990 ownership was not associated with future levels of leverage or firm size.

<table>
<thead>
<tr>
<th>Own</th>
<th>ROE (future)</th>
<th>ROA (future)</th>
<th>Size (future)</th>
<th>Leverage (future)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>-.1052</td>
<td>-.1824</td>
<td>-.1394</td>
<td>.0973</td>
</tr>
<tr>
<td>ROA</td>
<td>.7617c</td>
<td>.0572</td>
<td>.0617</td>
<td>-.1336</td>
</tr>
<tr>
<td>Size</td>
<td>.0617</td>
<td>.3202b</td>
<td>.0584</td>
<td>-.0584</td>
</tr>
</tbody>
</table>

Note: a$p<.1$; b$p<.05$; c$p<.001$

### 3.6 Prior Financial Performance and Ownership

I next looked at 1990 ownership and past financial performance (refer Table 6). From this table we see that one performance variable, past ROA, is negatively and significantly associated with the 1990 ownership variable. The other performance variable, ROE was not significant. It therefore appears that past ROA may influence ownership. The nature of this possible relationship is most interesting, with lower levels of past ROA being associated with higher levels of current shareholdings.
I elected to conduct a further analysis to explore what appears to be a relationship between previous ROA and corporate ownership. For this analysis we used the ROA average of companies for 1987 to 1989 and examined the net change in ownership and the percentage change in ownership by the major shareholder of each company. Given the lack of availability of some ownership data for the year 1993 for some companies, our sample for this analysis was reduced to 50 companies.

We found no correlation between average ROA for 1987-90 and either the net change in ownership between 1990 and 1990, or the percentage change in ownership over this period (r=0.09 and 0.08 respectively). Further analysis was conducted with the companies in our sample being divided into three categories (high, medium and low) based on ROA over 1987-89. We note that there is no difference in the incidence of change in the identity of major shareholder by ROA category (refer Table 7; Chi-square statistic=4.26; not significant).

### Table 6
Correlation Matrix for 1990 Ownership and Past Performance

<table>
<thead>
<tr>
<th></th>
<th>Own</th>
<th>ROE (past)</th>
<th>ROA (past)</th>
<th>Size (past)</th>
<th>Leverage (past)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROE (past)</td>
<td>-.2069</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROA (past)</td>
<td>-.2327&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.8373&lt;sup&gt;c&lt;/sup&gt;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size (past)</td>
<td>-.1388</td>
<td>.2173</td>
<td>.0620</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leverage (past)</td>
<td>.0459</td>
<td>-.2004</td>
<td>-.1479</td>
<td>.2429</td>
<td></td>
</tr>
</tbody>
</table>

Note: <sup>a</sup>p<.1; <sup>b</sup>p<.05; <sup>c</sup>p<.001
Table 7  
Chi-square Analysis

<table>
<thead>
<tr>
<th>ROA category</th>
<th>No. of companies</th>
<th>Observed no. of cases of change in the identity of the major shareholder during 1990-93</th>
<th>Expected no. of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>16</td>
<td>2</td>
<td>4.48</td>
</tr>
<tr>
<td>Medium</td>
<td>17</td>
<td>4</td>
<td>4.76</td>
</tr>
<tr>
<td>Low</td>
<td>16</td>
<td>8</td>
<td>4.48</td>
</tr>
</tbody>
</table>

Table 8  
t-tests for Net Change in Ownership, Comparing ROA Categories

<table>
<thead>
<tr>
<th>ROA category</th>
<th>Medium</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>-0.044</td>
<td>0.050</td>
</tr>
<tr>
<td>Medium</td>
<td></td>
<td>0.089</td>
</tr>
</tbody>
</table>

Table 9  
t-tests for Percentage Change in Ownership, Comparing ROA Categories

<table>
<thead>
<tr>
<th>ROA category</th>
<th>Medium</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>1.313⁺</td>
<td>0.152</td>
</tr>
<tr>
<td>Medium</td>
<td></td>
<td>0.891</td>
</tr>
</tbody>
</table>

ᵃ Significant at 10% level

Furthermore, t-tests reveal no difference in net ownership change between 1990 and 1993 between various ROA categories (refer Table 8). Next, I examined differences between ROA categories and the percentage change in ownership over 1990 to 1993. This analysis revealed only one significant difference between performance categories. Companies in the low ROA
category had significantly higher percentage changes in their ownership during 1990-93 than did companies in the medium ROA category, but not compared to companies in the high ROA category (refer Table 9). This lends some support to the notion that poor ROA leads to increased concentration of ownership by the major shareholder; perhaps during times of poor performance major shareholders place a higher future value on shares than do other shareholders, and therefore increase their ownership stake.

4. Conclusion

This study has shown that major changes have taken place in the control of New Zealand public companies since 1962. In particular New Zealand companies have become more majority controlled and less management controlled. As I mentioned previously, this indicates that - in terms of the literature reviewed - managers have little scope to pursue actions which are not in the best interests of shareholders. The large proportions of issued voting shares held by major shareholders in New Zealand listed companies suggests that if managers do pursue such self-interested behaviour then major shareholders will certainly have the power to discipline or replace them.

I also show that ownership of public companies does not appear to influence financial performance. One reason for this finding may lie in the nature of ownership in New Zealand listed companies. The high incidence of major shareholders having a large proportion of all shares means that there are likely to be very few companies where managers actually have the potential to engage in unmonitored and self-interested behaviour; hence making it difficult to find any ownership-performance relationship that may exist. This shortcoming is exacerbated by the small sample size that was available for analysis.

Finally, it appears that companies which perform poorly in terms of ROA are likely to have a larger relative changes in their ownership than do companies which perform only moderately well in terms of ROA.
References


