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Ownership structure and performance of professional service firms in a declining industry: Evidence from Vietnamese securities firms

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Abstract: This study posits that the declining industry is a good institutional environment to examine the relationship between ownership structure and firm performance of Vietnamese securities firms. This downturn decreases the return on investment of the industry and creates incentives for managers to expropriate shareholders more severely. In addition, different groups of shareholders recognizing the status of the industry may have their own reactions which are likely to affect firm performance. Using pooled OLS regression with a sample of 240 observations from 56 Vietnamese securities firms over the period from 2009 to 2016, we find supporting evidence of convergence-of-interest with a significantly negative relationship between insider ownership and profitability. In addition, foreign ownership is also positively related to firm performance. Firm size affects positively firm performance while number of employees has a negative impact on profitability.

JEL Classifications: M1, G34

Keywords: Vietnam, service, service firms, securities firms, ownership structure

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1. Introduction

Securities firms are facilitators in the financial market. They are typical professional service firms (Demirbag, McGuinness, Akin, Bayyurt, & Basti, 2016). Prior studies investigate securities firms from various perspectives including commission, technology, earnings forecasts, scale and ownership structure. This study posits that the declining industry in Vietnam is a promising laboratory to examine the effect of ownership structure on the performance of securities firms. When profitable business opportunities are less available, managers are more likely to use firm resources for their own interest and other groups of shareholders may have different reactions in this institutional environment. In addition, most of Vietnamese securities firms are non-listed, hence the information outside financial reports is not popular. Therefore, there is no research on ownership structure of securities firms in Vietnam. The research sample includes 240 observations collected from 56 firms over the period from 2009 to 2016. With pooled OLS regression controlled by year dummies, we find that insider ownership, foreign ownership and firm size are positively related to firm performance. Number of employees negatively affects firm profitability.

The remaining of this paper includes the following sections: Section 2 presents literature review and hypothesis development, Section 3 is institutional environment, Section 4

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describes research model, Section 5 depicts research data, Section 6 illustrates research findings and Section 7 presents conclusions.

2. Literature review and hypothesis development

Securities firms facilitate the buying and selling of financial instruments between buyers and sellers. They have a wide range of business activities such as securities brokerage, investment banking, financial advisory and securities trading. They are classified in the professional service industry where valuable expertise prevails over commonplace knowledge (Starbuck, 1992) and services are provided by professionals (Løwendahl, 2005). Securities firms have many characteristics of the professional service firm as follows: an expertise workforce processing a considerable amount of complex information with both qualitative and quantitative knowledge (Benner, 2010; Von Nordenflycht, 2010); specialized expertise obtained from training and experience (Greenwood & Lachman, 1996); high costs for employee recruitment and retention and; low capital intensity (Teece, 2003).

The extant literature shows that there are many prior studies on securities firms from different perspectives such as commission deregulation, new technologies, earnings forecasts. Economies of scale and ownership structure. Liu (2008) investigates the effects of commission deregulation on performance of Japanese securities firms over the period between 1994 and 1999. They find that the performance of their stocks tends to decrease when deregulation proceeds. Williams (2009) show the positive impact of new technologies on the transparency in trading activities of securities firms. In addition, Song, Mantecon, and Altintig (2012) examine the informational content of analysts' reports issued by securities firms on their affiliated companies from 2000 to 2008. Their research findings show that earnings forecasts for affiliated companies are higher than for other companies. Bartholdy and Feng (2013) earnings forecasts issued by securities firms playing the role of investment bankers and having headquarters near to the stock's headquarters are not better or worse. Besides, highly ranked securities firms also fail to forecast earnings more accurately. Moreover, Goldberg, Hanweck, Keenan, and Young (1991); Lee, Kim, and Kang (2014) develop studies on the efficiency of securities firms in terms of the economies of scale and scope. The former finds that smaller specialized firms experience economies of scale for while larger diversified firms experience diseconomies of scale. However, the latter shows that economies of scale in large firms are larger. Furthermore, S. K. Chen, Chen, Lin, and Zhong (2005) investigate the relationship between ownership and performance of Chinese securities firms. With a research sample of 145 firm-year observations, they find that direct government ownership is negatively related to firm performance. Analyzing the efficiency of 266 Taiwanese integrated securities firms between 2001 and 2005, J.-L. Hu and Fang (2010) report that foreign-affiliated ownership has a positive relationship with efficiency scores. Recently, Demirbag et al. (2016) investigate the efficiency of Turkish securities firms with a sample of 600 observations over the period from 2005 to 2011. They find that both bank affiliation and foreign ownership affect firm efficiency positively.

This study finds that the declining securities industry in Vietnam is a good opportunity to analyse the impact of ownership on firm performance. A declining industry decreases the return on investment in the market, hence managers are more likely to transfer firm resources from profitable projects to negative NPV projects. Consequently, the agency problem becomes more severe. Several studies indicate that the expropriation of shareholders is significantly greater under the effect of financial crisis (Lemmon & Lins, 2003; Mitton, 2002; Tran, Alphonse, & Nguyen, 2017). In addition, when recognizing the status of the industry, different groups of shareholders are likely to have their own reaction which can affect performance of securities firms. Ownership structure consists of two dimensions namely ownership concentration and the nature of shareholders. Firms with different entities holding its stocks are different from each other despite the same

degree of ownership concentration (Iannotta, Nocera, & Sironi, 2007). This study uses both dimensions: ownership concentration is measured by major shareholder ownership and various entities holding stocks include insider, major shareholders, foreign shareholders, state agencies and banks.

Shleifer and Vishny (1986) and Porta, Lopez-de-Silanes, Shleifer, and Vishny (2002) argue that ownership concentration improve the control of managers, hence firm performance is better. This argument is supported by Gaur, Bathula, and Singh (2015); Mínguez-Vera and Martín-Ugedo (2007). Nevertheless, Villalonga and Amit (2006) posit that large institutional investors are not likely to have incentives to control managers (Villalonga and Amit, 2006). Omran, Bolbol, and Fatheldin (2008) fail to find a significant relationship between ownership concentration and firm performance. We hypothesize that large shareholder ownership affects firm performance.

H1: Large shareholder ownership is related to firm performance.

There are two opposite arguments on the relationship between insider ownership and firm performance. The convergence-of-interest hypothesis developed by Jensen and Meckling (1976) argues that insiders holding more stocks are more likely to pursue the same objective with shareholders. Therefore, high insider ownership leads to better firm performance. However, according to the entrenchment hypothesis, high insider ownership tends to reduce the effectiveness of management control and shareholders experience more severe expropriation (Morck, Shleifer, & Vishny, 1988). In the service sector, empirical evidence of the two hypotheses is mixed (M.-H. Chen, Hou, & Lee, 2012; Gu & Kim, 2001; Im & Chung, 2017; Park & Jang, 2010). In this study, we hypothesize that insider ownership has a relationship with firm performance.

H2: Insider ownership is related to firm performance.

Moreover, the impact of foreign ownership on firm performance is also debatable. The liabilities of foreignness are obstacles of foreign firms and firms with foreign ownership tend to be less efficient than domestic ones (Demirbag et al., 2016). Conversely, foreign investors are more likely to improve firm performance with better control and management since they can collect knowledge and information that are not available in the domestic market while domestic firms suffer liabilities of localness. We hypothesize that foreign ownership affects firm performance.

H3: Foreign ownership is related to firm performance.

State ownership is an interesting issue in transition economies like Vietnam and China. F. Hu and Leung (2012) argue that corporate governance in state-owned firms is less effective than in private ones. The government pursues many other goals including social, political ones beside economic goals. In addition, there is lack of a particular owner having strong incentives to monitor managers effectively. State-owned firms experience the "double principal-agent problem" since they are operated by managers appointed by politicians and politicians are agents of citizens who are real owners of state-owned firms (Gugler, 2003). We hypothesize that state ownership negatively affects firm performance.

H4: State ownership is negatively related to firm performance.

Morck, Nakamura, and Shivdasani (2000) posit that banks play an important role in corporate governance of non-financial firms. Bank ownership can improve firm value when the benefits of banks and other shareholders are closely aligned. Lin, Zhang, and Zhu (2009) argue that direct bank ownership is beneficial to borrowing firms in developed markets. Securities firms are facilitators of stock trading and consultancy service providers in the financial market. Bank ownership are hypothesized to improve their performance since banks have advantages in information and expertise in the financial sector.

H5: Bank ownership is positively related to firm performance.

Furthermore, we also utilize other firm-specific variables as control variables including CEO duality, firm size, number of employees and leverage. A single CEO-chairman

makes the monitoring mechanism of the board of directors towards the CEO less effectively (Goyal & Park, 2002). Therefore, firm profitability tends to be lower if the CEO simultaneously takes the position of chairman. In addition, larger firms have more opportunities to obtain resources with lower costs, hence firm size is positively related to firm performance (Demirbag et al., 2016; Liao, Yang, & Liu, 2010; Radić, Fiordelisi, & Girardone, 2012). Number of employees are hypothesized to affect firm performance negatively in the declining period since firms with more employees incur higher costs given business opportunities are scarce. Moreover, we also use leverage as a control variables. Its impact on firm performance are mixed in many prior studies (S. K. Chen et al., 2005).

3. Institutional environment

Vietnamese stock market was established in 2000 with the first stock exchange in Ho Chi Minh City (HSX). During the first five years, the trading activities were inconsiderable since there were about 30 listed firms. From 2005, along with the economic growth, the number of listed firms started to increase rapidly and another stock exchange was established in Ha Noi (HNX). Over two years from 2006 to 2007, Vietnamese stock market attracted a large number of domestic and foreign investors and over 100 securities firms were founded. Most of them were non-listed firms. According to the legal documents on securities, the maximum proportion of shares that foreign investors were allowed to hold is 49%. However, after a short booming period, the market started to decline from 2008 and the crisis affected securities firms significantly. Although Vietnamese stock market experienced a slight recovery in the following years, most of securities firms were still facing many difficulties to maintain their business activities. By the end of 2016, about 30% of Vietnamese securities firms were dissolved, merged or go bankrupt.

FIGURE 1. AVERAGE RETURN ON ASSETS OF VIETNAMESE SECURITIES FIRMS FROM 2009 TO 2016

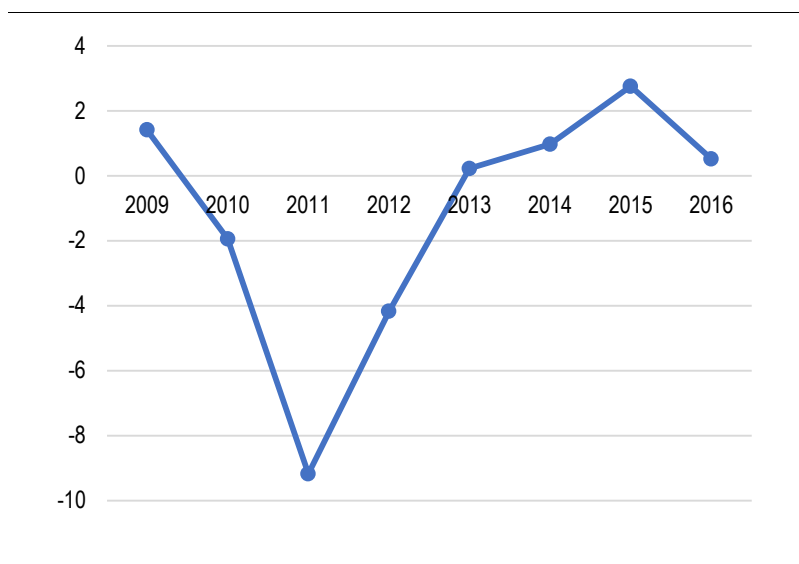


Figure 1 shows average return on assets of Vietnamese securities firms from 2009 to 2016. On average, they only obtained the profitability of 1.8% in 2009 and then experienced 3 years of negative profit from 2010 to 2012. In 2013, the industry reached the break-even. The average return on assets increased slightly to reach a peak of 2.8% in 2015 but it started to decline in 2016.

4. Research model

From the hypotheses developed in Section 2 and prior studies, we establish the research model in which firm performance is a function of ownership structure and control variables as follows:

$$ROA_t = \alpha + \beta_1 LAR + \beta_2 INS + \beta_3 FOR + \beta_4 STA + \beta_5 BAN + \beta_6 DUA + \beta_7 SIZ + \beta_8 EMP + \beta_9 LEV + \varepsilon \quad (1)$$

Where:

Firm performance (ROA) is the ratio of earnings before interest and taxes to total assets. Utilizing EBIT to measure return on assets is likely to decrease the earnings manipulation effect conducted by managers (Dah, Frye, & Hurst, 2014; Firth, Fung, & Rui, 2006). Major shareholder ownership (LAR) is total ownership of shareholders holding from 5% of firm shares. Insider ownership (INS) is total ownership of the board of directors, the board of management and the supervisory board. Foreign ownership (FOR) is total ownership of foreign institutional and individual shareholders. State ownership (STA) is the percentage of shares held by state agencies. Bank ownership (BAN) is the proportion of shares held by banks. CEO duality (DUA) is a dummy variable which is assigned 1 if the CEO is simultaneously in charge of the chairman position and 0 otherwise. Firm size (SIZ) is the natural logarithm of total assets. Number of employees (EMP) is the natural logarithm of total number of employees. Leverage (LEV) is total liabilities divided by total assets.

As discussed in Section 2, the expected signs exploratory variables are as follows: LAR (+/-), INS (+/-), FOR (+), STA (-), BAN (+), DUA (-), SIZ (+), EMP (-), LEV (+/-). Both dependent and independent variables are winsorized at 3% to avoid the effect of outliers. The key findings remain steady with the winsorization of 5%. This implies that research data winsorized at 3% is not affected by outliers.

Equation (1) is estimated by pooled ordinary least squared model with year dummies added to control the year effect. Moreover, we also use the regression model clustered by firm to control within-firm correlated residuals for Equation (1) as a robustness check.

5. Research data

The research data is hand-collected mostly from annual reports of securities firms over the period from 2009 to 2016. Before 2009, the structure of annual reports is simple, hence we are not able to collect the necessary information on ownership structure for this research. Accounting information is obtained from the database of Tan Viet Securities Company (www.tvsi.com.vn). Firm-year observations with missing or incomplete information are eliminated from the research data. The final research sample includes 240 firm-year observations from 56 securities firms.

TABLE 1. DISTRIBUTION OF OBSERVATIONS BY YEAR

Year	No. Obs	Percent	Year	No. Obs	Percent
2009	15	6.25	2013	35	14.58
2010	20	8.33	2014	36	15
2011	28	11.67	2015	36	15
2012	35	14.58	2016	35	14.58

Table 1 presents number of observations by year. Although most of Vietnamese securities firms were established before 2009, this year contributes the smallest number of observations to the research sample. This is explained that many firms failed improve the structure of their annual reports. Between 2012 and 2016, the number of observations is from 35 to 36. Overall, the number of securities in the from 2009 to 2016 reflects the declining period as discussed in Section 3.

6. Research results

Table 2 illustrates descriptive statistics of both dependent and independent variables. The average return on assets is -1.09. This value is consistent with the institutional environment of Vietnamese market in which the availability of business opportunities for securities firms is limited. Besides, major shareholders account for a large proportion of equity. The minimum and maximum value of major shareholder ownership are 18.93% and 100%. The average value is considerably high with 68.16%.

TABLE 2. DESCRIPTIVE STATISTICS

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA (%)	240	-1.09	11.23	-36.83	13.99
LAR (%)	240	68.16	26.87	18.93	100.00
INS (%)	240	23.75	28.88	0.00	100.00
FOR (%)	240	13.63	19.73	0.00	49.00
STA (%)	240	8.31	20.08	0.00	75.60
BAN (%)	240	8.43	20.28	0.00	75.60
DUA	240	0.28	0.45	0.00	1.00
SIZ	240	12.58	1.32	10.05	14.94
EMP	240	3.99	0.90	2.48	5.94
LEV (%)	240	26.68	23.24	0.68	79.65

Note: ROA is operation income divided by total assets. LAR is total ownership of shareholders holding from 5% of firm shares. INS is total ownership of the board of directors, the board of management and the supervisory board. FOR is total ownership of foreign institutional and individual shareholders. STA is the percentage of shares held by state agencies. BAN is the proportion of shares held by banks. DUA is a dummy which takes 1 if the CEO is also the chairman, 0 otherwise. SIZ is the natural logarithm of total assets. EMP is the natural logarithm of total number of employees. LEV is total liabilities divided by total assets.

In addition, the descriptive statistics indicate that there are firms whose shares are completely held by insiders. The maximum value of foreign ownership is 49%. This percentage reflects the limit of equity held by foreign investors in accordance with Vietnam regulations on foreign investment. There are some foreign securities established subsidiaries in Vietnam but their ownership can not exceed this limit. The mean value of

state and foreign ownership are 8.31 and 8.43 respectively. There are about 28% observations with CEO duality.

TABLE 3. CORRELATION MATRIX

	ROA	LAR	INS	FOR	STA
LAR	-0.1106* (0.08)	1			
INS	-0.0629 (0.33)	0.3900*** (0.00)	1		
FOR	0.0855 (0.18)	0.1032 (0.11)	-0.3117*** (0.00)	1	
STA	0.1847*** (0.00)	0.0284 (0.66)	-0.3231*** (0.00)	-0.0284 (0.66)	1
BAN	0.1476** (0.02)	0.1164* (0.07)	-0.2363*** (0.00)	-0.1024 (0.11)	0.8207*** (0.00)
DUA	0.0548 (0.39)	-0.1022 (0.11)	0.0572 (0.37)	-0.0397 (0.54)	-0.0993 (0.12)
SIZ	0.3941*** (0.00)	-0.3810*** (0.00)	-0.4645*** (0.00)	0.0737 (0.25)	0.4701*** (0.00)
EMP	0.2547*** (0.00)	-0.3442*** (0.00)	-0.5082 (0.00)	0.1845*** (0.00)	0.5289*** (0.00)
LEV	0.1125* (0.08)	0.1013 (0.11)	-0.0350 (0.58)	-0.1465*** (0.02)	0.1161* (0.07)
	BAN	DUA	SIZ	EMP	
BAN	1				
DUA	-0.1589*** (0.01)	1			
SIZ	0.4059*** (0.00)	-0.0143 (0.82)	1		
EMP	0.4158*** (0.00)	0.0315 (0.63)	0.8334*** (0.00)	1	
LEV	0.1246** (0.05)	0.0002 (1.00)	0.3430*** (0.00)	0.3217*** (0.00)	

Note: ROA is operation income divided by total assets. LAR is total ownership of shareholders holding from 5% of firm shares. INS is total ownership of the board of directors, the board of management and the supervisory board. FOR is total ownership of foreign institutional and individual shareholders. STA is the percentage of shares held by state agencies. BAN is the proportion of shares held by banks. DUA is a dummy which takes 1 if the CEO is also the chairmanman, 0 otherwise. SIZ is the natural logarithm of total assets. EMP is the natural logarithm of total number of employees. LEV is total liabilities divided by total assets. t-statistics are in parentheses. *** is significant at the 1% level. ** is significant at the 5% level. * is significant at the 10% level.

Table 3 presents the correlation coefficients of variables. Number of employees and firm size are associated with a large coefficient of 0.83 at 1% of significance. Bank ownership and state ownership are also highly correlated at the significance level of 1%. However, the multicollinearity test shows no significant evidence of multicollinearity in the two pairs of variables.

TABLE 4. REGRESSION RESULTS

Variables	OLS regression		OLS regression clustered by firm	
	Coefficients	t-statistics	Coefficients	t-statistics
<i>Intercept</i>	-50.1553***	-4.96	-50.1553****	-4.28
<i>LAR</i>	-0.0370	-1.13	-0.0370	-0.92
<i>INS</i>	0.0778***	2.71	0.0778**	2.09
<i>FOR</i>	0.0994**	2.54	0.0994**	2.24
<i>STA</i>	0.0873	1.45	0.0873	1.57
<i>BAN</i>	-0.0272	-0.47	-0.0272	-0.46
<i>DUA</i>	1.0292	0.71	1.0292	0.71
<i>SIZ</i>	4.8297***	5.11	4.8297***	3.89
<i>EMP</i>	-3.0306**	-2.06	-3.0306*	-1.79
<i>LEV</i>	0.0246	0.72	0.0246	0.55
<i>No. OBS</i>		240		240
<i>F-STATISTICS</i>		6.02***		5.81***
<i>R-SQUARED</i>		0.252		0.311

Note: The dependent variable is ROA measured by operation income divided by total assets. LAR is total ownership of shareholders holding from 5% of firm shares. INS is total ownership of the board of directors, the board of management and the supervisory board. FOR is total ownership of foreign institutional and individual shareholders. STA is the percentage of shares held by state agencies. BAN is the proportion of shares held by banks. DUA is a dummy which takes 1 if the CEO is also the chairmanman, 0 otherwise. SIZ is the natural logarithm of total assets. EMP is the natural logarithm of total number of employees. LEV is total liabilities divided by total assets. t-statistics are in parentheses. *** is significant at the 1% level. ** is significant at the 5% level. * is significant at the 10% level.

Table 4 reports the results of OLS regression and OLS regression clustered by firm. All of the regression models are added year dummies but they are not presented for brevity. In line with convergence-of-interest hypothesis proposed by Jensen and Meckling (1976), insider ownership is positively related to firm performance at 1% and 5% of significance in both regression results. This implies that insiders tend to serve shareholder better if their interest are more aligned. Moreover, foreign ownership has a significantly positive relationship with profitability. Foreign investors are likely to have information and knowledge that are not available in the domestic market, hence they can contribute considerably to firm operation. Firm size is positively correlated with firm performance at the significant level of 1%. This can be explained that larger firms may have lower costs of raising funds and other resources or set higher prices for their services due to their reputation. Remarkably, number of employees has a negative impact on firm profitability. This is consistent with the institutional environment of Vietnamese market from 2009 to 2016. When the industry declines, investment opportunities are less available in the market. Firms with more employees incur higher costs and experience lower profitability.

7. Conclusion

This study argues that the declining industry is a good institutional environment to examine the relationship between ownership structure and firm performance of Vietnamese securities firms. This downturn decreases the return on investment of the industry and creates incentives for managers to expropriate shareholders more severely (Lemmon & Lins, 2003; Mitton, 2002; Tran et al., 2017). In addition, different groups of shareholders recognizing the status of the industry may have their own reactions which are likely to affect firm performance. Using pooled OLS regression with a sample of 240 observations, we find supporting evidence of convergence-of-interest with a significantly negative relationship between insider ownership and profitability. In addition, foreign

ownership is also positively related to firm performance. One of explanations is that foreign investors can create advantages for securities firms in terms of costs or revenues. Firm size affects positively firm performance while number of employees has a negative impact on profitability. These findings can be explained that larger firms are more profitable due to their reputation and firms with more employees pay higher costs given limited business opportunities.

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