



# Exploring the Impact of Foreign Ownership and Ownership Concentration on Firm Performance: Evidence from Indian Manufacturing Firms

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## Abstract

*The dynamics of global business have changed significantly. The phenomena of foreign ownership and ownership concentration have taken centre stage in today's corporate environment. The subject of how foreign ownership and ownership concentration affect firm performance has appeared as a crucial problem as corporations look for opportunities outside of their national borders. The study intends to explore the association among foreign ownership, ownership concentration with firm performance. For measuring firm performance market based measure i.e. Tobin's Q and accounting based i.e. ROA & ROE is used. Foreign ownership is characterized by the % age of shares held by foreign promoters. Herfindahl Index (HHI) is used for ownership concentration. The companies are selected from NSE 100 index and data is gathered from the Annual Statements and PROWESS IQ database for the total of 7 years. Dynamic Panel Data is employed in the study and analysed using GMM estimates. After controlling endogeneity issue, result shows significant positive impact of Foreign ownership on Tobin's Q and ROE on firm performance where as significant negative impact on ROA. However, Ownership Concentration show significant positive impact on Tobin's Q and ROE where as significant negative impact on ROA.*

**Keywords:** Foreign ownership, Ownership Concentration, Tobin's Q, Return on Assets, Herfindahl Index, Return on Equity.

## 1. Introduction

The dynamics of international business have changed significantly. The phenomena of foreign ownership, which is characterised by international investments and acquisitions, has taken centre stage in today's corporate environment. The subject of how foreign ownership affects firm performance has emerged as a crucial problem as corporations look for opportunities outside of their national borders. This study intends to investigate the association between foreign ownership and firm performance. The phrase "foreign ownership" refers to any type of foreign private investment in a foreign nation that grants control and ownership over a collection of resources. India has experienced a tremendous shift since embracing economic liberalisation and globalisation in the early 1990s, making it, the major economy with the fastest growth across the world. The end of decades-long protectionist policies and the shift to a more open, market-based economy served as a catalyst for this development. India became a hub for foreign investors seeking for possibilities in a broad and dynamic market as a consequence of the country attracting substantial amounts of foreign direct investment (FDI). Foreign knowledge and capital have significantly changed India's corporate landscape, raising important considerations about foreign ownership and its effects on firm performance. In this age of globalisation, it is crucial for academics and policymakers to comprehend how the existence of foreign-owned organisations affects the business environment, economic development, and overall trajectory of Indian businesses.

One of the other crucial factors affecting firm performance is ownership concentration. The association between ownership concentration and firm performance is of major significant interest and debate in the field of corporate governance and finance. Ownership concentration refers to the disbursement of ownership stakes among shareholders in a company, and it plays an important role in shaping the dynamics of decision-making, corporate governance, and ultimately, the performance of the firm.

Based on this context, ownership concentration can be broadly divided into two main types: concentrated ownership and dispersed ownership. Concentrated ownership occurs when a small group of shareholders, often institutional investors or a dominant individual, holds a significant percentage of the company's shares. Dispersed ownership, on the other side, occurs when ownership is spread across a large number of shareholders with relatively smaller individual stakes. The separation of ownership and control is a common corporate governance problem first highlighted by Berle and Means (1932).

The affect of ownership concentration on firm performance is complex and multifaceted, with both positive and negative outcomes reported in various studies. Advocates of concentrated ownership argue that it can lead to more effective decision-making and strategic focus, as a smaller group of influential shareholders may have a stronger ability to align their interests and exert control over management. This concentrated control is believed to reduce agency costs and promote long-term value creation. Large shareholding positively affects the firm performance by Yasser and Mamun (2017).

The study aims to explore the impact of foreign ownership and ownership concentration on firm performance by taking the sample from NSE 100 database as on 31/03/2023 for the period of seven years from 2017-2023. The data is analysed using GMM estimates. After controlling the endogeneity issue, the result shows the significant positive impact of Foreign ownership on Tobin's Q and ROE on firm performance whereas significant negative impact on ROA. On the other hand Ownership Concentration shows significant positive impact on Tobin's Q and ROE whereas significant negative impact on ROA.

The remainder of paper is structured as follows: Literature review followed by Research Methodology, Data Analysis, and Results & Discussions.

## **2. Literature Review and Development of Hypothesis**

### **1. Foreign ownership and Firm Performance**

Jusoh (2016) found a significant positive correlation between foreign ownership and firm performance in Malaysia, suggesting that foreign investors can improve performance by reducing agency conflicts. Similarly, Douma (2006) highlighted the positive impact of foreign corporate shareholders, particularly in emerging markets. Aydin et al. (2007) investigates the impact of foreign ownership on firm performance on Turkish owned enterprises listed in Istanbul Stock Exchange. The findings shows that firm having foreign ownership perform well as compared to domestically owned firms. Nakano and Nguyen (2013) using panel data analyzed the affect of foreign ownership on firm performance on Japanese Electronics companies listed in Tokiyo Stock Exchange. ROA and Tobin's Q used as proxy of firm performance. The result shows that increase in foreign ownership significantly increases the market value but it takes time to reflect improvement in firm value. But with span of time, it shows significant positive growth in firm performance. Phung and Le (2013) study reveal that foreign ownership has a detrimental effect on a firm's performance in an emerging market because it is unable to participate in corporate governance procedures and foreign investors face knowledge asymmetry and foreign ownership is not concentrated. The study also suggest that impact of foreign ownership on firm performance is very complex and may vary depending upon context. Nofal (2019) using panel data of 66 non-financial Indonesian Firm for five years found that foreign ownership is significantly related to firm performance. Gurbuz et al. (2010) using panel of 205 non-financial listed companies covering the three-year period 2005-2007 found that foreign ownership increases a firm's performance up to a certain level beyond which an increase in it negatively affects investment and productivity, and thus does not add to the profitability of firms as measured by ROA in Turkey.

H1 : Foreign ownership is significantly related to firm performance.

### **2. Ownership Concentration & Firm Performance**

Various research is done to explore the relationship between ownership concentration and firm performance shows mixed results. Jadoon and Bajuri (2015) found a positive impact of ownership concentration on firm performance in Pakistan, while Al-Saidi (2013) reported that only government and family ownership concentrations influenced firm performance in Kuwait. Soliman (2013) identified a hump-shaped relationship between ownership concentration and

firm financial performance in Saudi Arabia, with performance peaking at intermediate levels of concentration. Wang et al. (2019) further supported the positive effect of ownership concentration on firm performance in China, with corporate ownership leading to higher performance than financial ownership. Yasser and Mamun (2017) analysed the impact of ownership concentration on firm performance using regression analysis. The result states that there is positive impact of ownership concentration on firm performance.

H2: Ownership concentration significantly affects firm performance.

### 3. Data And Methodology

#### 3.1 Data

The focus of our study is on the Indian Manufacturing industry. The sample consists of companies that are part of NSE100 as on 31<sup>st</sup> March 2023. It makes 100 companies to be identified for the study, and from these 100 companies, at first, 23 financial and banking companies were excluded as they followed different norms and regulations to conduct their business, Then next 9 government companies were dropped because their capital consists of funds mostly raised from Central/State Government and have less freedom to design their own ownership pattern. Furthermore, other 36 companies that do not belong to the manufacturing industry are excluded. It makes 39 manufacturing industries as the final sample for our study.

This is a quantitative study and data for the required sample has been gathered from the PROWESS database of CMIE (Centre for Monitoring Indian Economy) and the annual reports of the companies for the span of 7 years i.e. 2017-2023. For reporting the variable, the financial period ending 31<sup>st</sup> March is used in the study.

#### 3.2 Variables

##### 3.2.1 Dependent Variables

We use Market-based measure (TBQ) and accounting-based (ROA, ROE) measures to analyse the firm performance

- Tobin's Q (TBQ) is an economic ratio used to compare an index's market value to its book value of total assets.
- Return on Assets (ROA) is an index of profitability used to measure how well a company is generating profits from its total assets.
- Return on Equity (ROE) is a financial ratio that shows how well a company is managing the capital invested by shareholders.

##### 3.2.2 Explanatory Variables

- Foreign Ownership (FOR) is the %age of shares held by foreign promoters in total shareholding.
- Ownership Concentration (LHHI) is the distribution of ownership stake among shareholders in a company.

##### 3.2.3 Control Variables

The other potential determinants of firm performance that are not caught by foreign ownership and ownership concentration are incorporated as control variables in the study. Based on the above literature, different studies use various control variables in regression models (Age, Size, Growth, Debt, Advertisement Intensity, Market Risk, and Asset Tangibility) to control for potential impact on firm performance. In our study, we use 4 control variables i.e. Dividend payout ratio(DPR), Market Risk(RS), Growth (GRW), and Firm Size (SIZE).

- DPR is measured by dividend per share divided by earnings per share. Foreign investors choose firms paying less dividends because of tax advantage over capital gains in foreign countries.
- Market Risk (RS) is the systematic risk of stock & it is represented by Beta. The higher the beta, the more unsteady the value of the firm hence, leading to a lower value of the firm.
- Growth (GRW) is the proxy for profitability and future opportunities available to the company and it is measured by the market value of equity to book value of equity. We foresee a positive effect of growth on firm performance.

- Firm SIZE (SIZE) is measured by taking a natural log of Total Assets. Bigger firms can enjoy an advantage from economies of scale against smaller firms. In this way, it has a positive impact on the firm performance but increasing the firm's assets unnecessarily means more than enough investments in assets that can be the reason for loss of control by managers over strategic and functional issues and hence, can affect firm performance negatively.

**Table No. 1: List of Key Variables**

Sl. No.	Construct	Acronym	Definition/Measurement
1.	Ownership Concentration	LHHI	Natural log of Herfindahl Index (HHI)
2.	Foreign ownership	FOR	% age of shares held by foreign promoters
3.	Firm Performance a) Market Based (Tobin's Q) b) Accounting based (ROA and ROE)	TBQ ROA ROE	Tobin's Q – Market capitalization + Book value of Debt to Total Assets ROA (Return on Assets) – Profit before depreciation, interest, tax to Total Assets ROE (Return on Equity) – Profit before depreciation, interest, tax to Shareholders Equity
4.	Dividend Payout Ratio	DPR	DPS / EPS
5.	Risk	RS	Systematic risk of stock and it is measured by Beta
6.	Growth	GRW	Market value of Equity / Book value of Equity
7.	Size	SIZE	Natural log of Total Assets

### 3.3 Methodology

The study uses Panel data as it includes observations on the same cross-sectional units over several time periods. It has the advantage of taking into consideration the individual or group effects along with time effects. Here, we can also control unobserved heterogeneity which is present in panel data (Woolridge,2010). The selection of the optimal estimating approach is contingent upon the firm's performance in various scenarios. Pooled regressions may produce consistent findings when unobserved company variables are uncorrelated with foreign ownership and firm performance. Thus, after considering this assumption into account, earlier research employed pooled regressions. Besides, a number of firm-level factors, including innovation, technology, top management decisions, and others, shows a big impact on the performance of the company. So that to provide consistent results, some research began including these firm-level variables using the Fixed Effects estimation approach. (Nakano & Nguyun,2013). Foreign investors are likely to react differently to some business decisions, such as taking on large projects that could have an effect on the company's performance, new advances in the industry, or quickly acquiring an ownership share in a company. All these may influence the firm performance as well as an ownership stake in a company at a fast pace. Thus, Fixed Effects regression may not yield consistent results as foreign ownership and ownership concentration may start positively influencing firm performance. Thus, developing a dynamic relationship between foreign ownership, ownership concentration, and firm performance (Nakano & Nguyun,2013).

Considering this dynamic relationship into consideration, the instrumental variable (IV) approach becomes vital. When explanatory variables have a correlation with the regression error term, they become endogenous regressors. IVs are the most commonly utilized solution for this problem. When there are endogenous regressors, using IV yields consistent parameter estimates as in the presence of endogeneity OLS estimates can produce biased results (Nashier and Gupta,2023). Thus, this study used the Generalized Methods of Moments (GMM) of Arellano and Bond (1991) and was further extended by Arellano and Bover(1995) and Blundell and Bond(1998) also known as dynamic panel data analysis as these models can take care of heteroscedasticity, endogeneity, and serial autocorrelation of unknown form by including lagged values of dependent variables as one of the regressors (Yavaş and Erdogan,2016)

The study consists of 6 different regression models with panel data of 39 manufacturing firms for 7 years (2017-2023) for 3 DV namely Tobin's Q (market-based) and ROA and ROE (accounting-based). All estimations are done by following the dynamic panel data approach consists of Generalized Methods of Moments of Arellano and Bond and Arellano-Bover / Blundell–Bond using Gretl Software. The following regression model would be considered for each dependent variable (TQ, ROA, and ROE).

$$\lambda_{it} = \delta \lambda_{i,t-1} + \lambda'_{it} \beta + u_{it}$$

where,

subscript t means time period and i means firm,

$\lambda_{it}$  is firm performance (TQ, ROA, and ROE),

$\delta\lambda_{i,t-1}$  is lagged value of dependent variable (TQ<sub>i,t-1</sub>, ROA<sub>i,t-1</sub>, and ROE<sub>i,t-1</sub>)

$\lambda'_{it}\beta$  is different explanatory variables such as Foreign Ownership (FOR) and Ownership Concentration (LHHI) and control variables such as Dividend Payout Ratio (DIV), Risk (BETA), Growth (GRW), and Firm Size (SIZE).

In order to avoid individual effects, first differencing is used. According to Arellano and Bond, the instruments required for estimate must be "internal," which means that lagged values of instrumented variables can be used. No external instruments employed in the analysis. However, they are permitted. As the instruments, we employ first and second-order lag values for each explanatory variable. In order to determine whether the instruments are valid and the model is appropriately stated, we use the Arellano-Bond serial correlation test for second-order serial correlation AR(2) on the residuals in the regression. The null hypothesis of "no autocorrelation" for AR(1) is usually rejected which is expected. The AR(2) is a crucial Arellano-Bond test as it can identify level autocorrelation. It is essential for the residuals of the first-difference equations to be free of second-order serial correlation. So, AR(2) should not be significant or the null hypothesis of no serial autocorrelation should not be rejected which applies to all six regression equations in our study. Sargon test is used to ensure the validity of instruments and the null hypothesis of this test ensures that instruments used in the study are valid. In our study, all 6 models revealed that instruments are valid having a p-value more than 0.05. So, we conclude that our model is well-specified.

## 4. Analysis

### 4.1 Summary Statistics

Table 2.1 provides the summary statistics for each variables considered in our study. The average of Tobin's Q(TBQ) is 9.73. The average ROA is 18.28 with a maximum return of 52.78 and a minimum of -8.35. The average Return on Equity(ROE) is 29.65 with a maximum return of 169.35 and a minimum of -29.42. The average foreign ownership(FOR) is 19.10 percent of total shareholdings with a maximum of 75 percent and a minimum of 0 percent. The average Ownership Concentration(LHHI) of the companies is 7.21 with a maximum of 8.64 and a minimum of 4.80. The average DPR of companies is 20.28 percent with a maximum payout of 291.80 percent and a minimum of -3500. The average systematic risk (RS) of stocks is around 0.80. The average growth(GRW) rate of companies is 10.39 with a maximum of 97.61 and a minimum of 0. The average size (SIZE) measure of the companies is 9.74.

**Table No. 2.1 : Descriptive Statistics**

Variable	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis
TBQ	9.733064	8.415196	1.072838	44.79777	1.547211	5.081888
ROA	18.27691	11.7938	-8.34656	52.78107	0.866811	3.337005
ROE	29.65295	27.20227	-29.4161	169.3474	2.41196	9.904889
FOR	19.10158	27.46766	0	75	0.971681	2.143719
LHHI	7.20849	0.893882	4.798781	8.644279	-0.48895	2.689215
DPR	20.27936	262.8558	-3500	291.8011	-11.7099	145.2348
RS	0.803824	0.388451	-0.10355	2.182568	0.419151	3.483261
GRW	10.39363	14.60213	0	97.61226	3.35678	16.04992
SIZE	9.743434	1.084768	7.056175	12.36218	0.099098	2.526557

### 4.2 Correlation Analysis

Table 2.2 represents the correlation table . The highest correlation coefficient is 0.60 significant at 5% between Foreign Promoters (FOR) and Ownership Concentration (LHHI) and lowest at -0.45 between firm size and growth rate significant at 5%. The correlation table also shows that all explanatory and control variables are weakly correlated with each other. Hence, no multicollinearity issue is observed in the regression models.

**Table No. 2.2 : Pearson Correlation table between explanatory and control variables.**

	TBQ	ROA	ROE	FOR	LHHI	DPR	RS	GRW	SIZE
TBQ	1								
ROA	0.7135*	1							
ROE	0.7010*	0.8442*	1						
FOR	0.3134*	0.2988*	0.4034*	1					
LHHI	0.0905	0.0574	0.1382*	0.6052*	1				
DPR	0.0775	0.1716*	0.1331*	0.0772	0.0629	1			
RS	-0.3319*	-0.4447*	-0.3245*	-0.2146*	-0.1812*	-0.0645	1		
GRW	0.7331*	0.6722*	0.8882*	0.4365*	0.1827*	0.0907	-0.2816*	1	
SIZE	-0.6334*	-0.5465*	-0.4240*	-0.3067*	-0.2762*	-0.0882	0.4980*	-0.4577*	1

\*Denotes significant at 5%

## 5. Results and Discussions

The effect of Foreign Ownership (FOR) and Ownership Concentration (LHHI) on Firm Performance is analyzed using 6 different GMM regressions presented in Table 3.1. In the 1<sup>st</sup>, 3<sup>rd</sup>, and 5<sup>th</sup> models, Foreign Ownership is regressed as an independent variable along with a lagged value of dependent variables (TBQ, ROA, and ROE) and 4 other control variables including DPR, RS, GRW, and SIZE. In the 2<sup>nd</sup>, 4<sup>th</sup>, and 6<sup>th</sup> models, Ownership Concentration is regressed as an independent variable along with a lagged value of dependent variables (TBQ, ROA, and ROE) and 4 other control variables including DPR, RS, GRW, and SIZE.

Foreign Ownership (FOR) is positively and significantly related to Tobin's Q and ROE at 5 percent and 1 percent significance level respectively but the relationship with ROA is negative and significant at 1 percent significance level. This implies that foreign ownership affects how well a company performs by bringing in more money and giving access to the global capital market, cutting-edge technologies, and managerial talent. In the end, this improves the company's performance while also acting as a monitor. Thus, influencing management choices. So, our H1 is partially accepted. The results are consistent with (Nakano and Nguyen,2013, Shrivastava and Kalsie, 2017). When we look at the negative coefficients of Foreign Ownership with ROA, it implies that when foreign ownership surpasses the threshold level, firm performance begins to suffer. This may occur because they are unaware of the dynamics of domestic market conditions of the country and it may lead to inappropriate decisions. These results are in line with (Yavaş and Erdogan,2016).

Ownership Concentration (LHHI) is positively and significantly related to Tobin's Q and ROE at 10 percent and 5 percent significance levels respectively but the relationship with ROA is negative and significant at a 10 percent level of significance. This implies that LHHI lowers agency expenses and improves the company's market success. The results are consistent with (Nashier and Gupta,2023) while the negative coefficient with ROA signifies it can influence firm performance up to some extent. So, our H2 is partially accepted. In the case of CV, the coefficients of DPR, and GRW are significantly positive at 1 per cent significance level in all the models, the coefficients of SIZE are significantly negative to TBQ but with ROA and ROE, it is positive and insignificant and RS is negatively related to firm performance in all the models. In all the models, the lagged value of dependent variables is highly significant at 1 per cent.

**Table No. 3 :Estimation Results**

Variables	TBQ		ROA		ROE	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
TBQ(-1)	0.808*** (22.3)	0.825*** (20.42)				
ROA(-1)			0.897*** (13.2)	0.899*** (8.768)		
ROE(-1)					0.827*** (12.4)	0.828*** (12.38)
FOR	0.005** (2.102)		-0.047*** (-3.226)		0.081*** (3.379)	
LHHI		0.124* (1.671)		-3.681* (-1.808)		3.381** (2.392)
DPR	0.000*** (2.652)	0.000** (2.434)	0.001*** (3.416)	0.001*** (4.364)	0.002*** (2.579)	0.003*** (3.978)
RS	-0.166 (-1.319)	-0.142 (-1.118)	-0.384 (-0.366)	-0.267 (-0.223)	-2.596 (0.759)	-1.738 (0.531)
GRW	0.092*** (4.373)	0.092*** (4.633)	0.329*** (4.039)	0.314*** (4.271)	1.327*** (5.144)	1.313*** (4.769)
SIZE	-8.672*** (-6.231)	-8.657*** (-6.656)	2.859 (0.747)	2.283 (0.415)	3.414 (0.408)	2.498 (0.369)
AR(1) errors	-2.836***	-2.824***	-2.768***	-2.709***	-2.24**	-2.237**
p value	0.004	0.004	0.005	0.006	0.025	0.025
AR(2) errors	-1.283	-1.345	-0.955	-1.081	0.644	0.664
p value	0.199	0.178	0.339	0.279	0.519	0.506
Sargan over-identification test	36.213	34.67	33.675	32.448	32.859	30.287
p value	0.137	0.179	0.434	0.494	0.201	0.301
Wald test: Chi-square	4701.91***	592.189***	703.853***	1063.37***	300.282***	303.283***

z statistics are in parentheses; \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## 6. Conclusion

This study examined the relationship between foreign ownership, and ownership concentration on firm performance of 39 Indian Manufacturing firms for the period of 7 years from 2017-2023. As foreign ownership in manufacturing firms is increasing through foreign direct investments, it is need of an hour to understand how it affects firm performance as there is not much consistency in previous literature. The empirical findings in the review of literature shows contradictory results, with some findings concluding that foreign ownership promotes business profitability and others concluding the opposite. Ownership concentration is one of the governance mechanisms as owners with concentrated ownership can influence management choices. Certain scholars contend that increased ownership concentration can enhance the companies performance by increasing the owners' willingness or capacity to oversee agents. Besides, some contend that when markets are efficient, managers will be disciplined by market observation. This underscores the significance of the topic even more. The unique aspect of this study lies in its methodology as results are based on Generalized Methods of Moments (GMM) estimates. The result shows that firm performance is influenced by both market-based and accounting-based measures.

## 7. Limitations and Future scope of Research

Since Indian manufacturing firms are considered in our study. In the future, other sectors, and different countries can be included in the study to get greater insights. Furthermore, relative study is also possible using different sectors. Along with this, more firm-level variables can be included for a more extensive study.

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