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The Relationship between Foreign Ownership and Financial Performance: A Vietnam Cases Study

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Authors' contributions

This work was carried out in collaboration between both authors. Both authors read and approved the final manuscript.

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ABSTRACT

To implement the policy of attracting capital from foreign investors into the stock market, the Vietnamese government (2015) issued Decree 60 to allow joint-stock companies to attract indirect capital flows from foreign investors. Foreign ownership is said by some studies to increase the efficiency of the company's operations, however, there are also some studies that suggest that a too high foreign ownership rate will reduce the operating efficiency of enterprises. To determine the relationship between these two issues, we conducted a study with 100 companies listed on the Vietnamese stock market from 2015 to 2022. With the use of dynamic panel data model (GMM) , the analysis results show that foreign ownership has a nonlinear relationship with financial performance of the business. With a certain percentage of foreign ownership (0 to nearly 40%) will increase the financial efficiency of the enterprise, however this ratio exceeding the upper limit will have the opposite effect. From these results, we have made some recommendations in corporate governance related to ownership structure.

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1. INTRODUCTION

In the current integrated economy, the stock market has become an effective capital mobilization channel, attracting a lot of attention from domestic and foreign investors. The trend of allowing foreign investors to invest more and more deeply in the stock market and in domestic enterprises has directly or indirectly affected the financial performance of the enterprises themselves and is always a matter of concern for business managers [1]. The relationship between equity ownership structure and firm performance has been discussed by many researchers [2]; Liu, Bredin & Cao [3]. In which Liu, Bredin & Cao [3] show that foreign ownership has a positive impact on firm performance. Huang & Shiu, [4] argue that having foreign ownership increases liquidity and increases stock value. Douma, George & Kabir [5] reported that companies with foreign ownership will have better performance than other companies. Besides, Huang & Shiu, [4] also said that a too high foreign ownership ratio can also lead to reduced corporate efficiency due to increased agency costs. In order to attract indirect capital from foreign investors, the Government of Vietnam [6] issued Decree 60, allowing foreign investors to trade with shares of domestic companies. This decision of the Government is also expected to have a positive impact on the long-term prospects of the process of restructuring the economy and the stock market of Vietnam.

It can be seen that the relationship of foreign ownership to corporate performance is still a matter of disagreement. Besides, in order to have a basis for making recommendations to corporate administrators related to foreign ownership, we carry out this study with the aim of identify and measure the relationship of foreign ownership to the performance of enterprises. To conduct this study, we answered the following questions:

i) What is the relationship between foreign ownership and firm performance?
ii) What recommendations are given to enterprises in the matter of foreign ownership?

2. LITERARY REVIEW

2.1 Foreign Ownership

In enterprises, ownership structure can be defined in two aspects: centralized ownership and mixed ownership [7]. Meanwhile, research by Demsetz & Lehn [8] suggests that there are three ways to measure ownership concentration: The percentage of common stock owned by the five largest shareholders; Ratio of equity owned by the 20 largest shareholders, and approximately the Herfindahl index. Gursoy & Aydogan [7], mixed ownership would include family ownership, government ownership, foreign ownership, cross-ownership, and conglomerate ownership. Foreign ownership refers to ownership that controls part or all of a business by individuals who are not nationals of that country or by companies whose headquarters are not located in that country [6].

2.2 Financial Performance of the Business

Research on corporate performance comes from organizational theory and strategic management [9]. Standing from many different angles, there are different concepts, but it is difficult to find a consensus in the concept of corporate performance because its meaning is very broad. In simple terms, financial performance of the business is profit maximization, enterprise value maximization, and shareholder benefit maximization. A company's performance can be measured by a number of metrics based on its accounting or finance. The most common are ROA (return on assets), ROE (return on equity), and ROS (return on sales). In which ROA, ROE are used by many studies to measure corporate performance such as: Zeitun and Tian [10]; Akinyomi [11]; Ebimobowei, [12].

2.3 The Relationship between Foreign Ownership and Firm Performance

Jensen and Meckling (1976) were the first to study the relationship between foreign ownership and firm performance. The above authors argue that foreign ownership in the ownership structure has a positive impact on firm performance. In agreement with Jensen and Meckling, Claessens & Djankov (1999) argues that foreign investors are experienced in the financial market as well as in corporate governance. Therefore, the presence of these investors in the company's ownership structure is essential. According to Ongore [1], foreign ownership is widely recognized as having an important role in the performance of companies, especially in developing economies. Huang & Zhu [2] show that foreign institutional ownership plays an important role in corporate governance, especially in minimizing agency costs. Batten and Vo [13] have proven that foreign investors prefer to invest in large companies with stable profits and low leverage. Liu, Bredin & Cao [3] indicate that foreign ownership has a positive impact on firm performance.

Besides, some studies suggest that the relationship between foreign ownership and firm performance is nonlinear Huang & Shiu [4], Douma et al. [5]. The above authors believe that when the foreign ownership ratio increases to a large enough threshold, they will participate in the management of the company by participating in the board of directors and the executive board. This generates agency costs, which reduces the operating efficiency of the business. Greenaway, Guariglia & Yu [14] study of the relationship between foreign ownership and performance of Chinese companies also shows an inverted U-shaped graph. In addition, Gurbuz and Aybars [15] when studying for firms in Turkiye and Gupta, Agarwal & Jagwani [16] in India also found a non-linear relationship between foreign ownership and performance of firms. Based on the research results analyzed above, we hypothesized for the study as follows:

Hypothesis 1: Foreign ownership positively affects the performance of Vietnamese enterprises.

3. DATA AND METHODS

Based on the analysis results in part 2, we build a model to measure the relationship between foreign ownership and financial performance of the business as follows:

$$ROA_{it} = \beta_0 + \beta_1 FII_{it} + \beta_2 SIZE_{it} + \mu_{it}$$

In there:

ROA_{it} is the financial performance of the business, as measured by profit after tax/total assets;

FII_{it} is foreign ownership, measured as % of share ownership by foreign investors

$SIZE_{it}$ is the firm size, as measured by the logarithm of total assets (control variable).

Research data is collected from financial statements, annual reports, corporate governance reports from the official websites of companies listed on the Vietnam stock market over a period of 8 years from 2015 to 2021 for 100 companies. These companies are randomly selected according to the following conditions: first, non-financial companies, companies must be listed continuously from 2015 to present. We exclude financial companies because this is a conditional business, so foreign ownership of shares is subject to separate regulations [17], and to be able to analyze by model Generalized Method of Moments dynamic panel data, the necessary condition is that the data must be in the form of a balanced table, so non-continuous listed companies will be excluded. As a result, we obtain a balanced panel dataset with 800 observations.

Collected data is put into descriptive analysis and relationship analysis, measuring the relationship between foreign ownership and financial performance of the business using the Generalized Method of Moments dynamic panel data model (GMM). GMM has the advantage of overcoming endogeneity and autocorrelation problems and providing robustness to the estimate [18]. Besides, considering the lag of data as well as the use of instrumental variables will help GMM model overcome defects such as heteroscedasticity and autocorrelation, multicollinearity [19,16].

4. RESEARCH RESULTS

4.1 Descriptive Statistics

Fig. 1 detailed description of the distribution of ROA and FII data included in the study sample. From this result we find that: the average ROA of the enterprises in the survey sample is 0.07 (corresponding to 7%), and it is concentrated mainly in the range of 0.05 to 0.1 (5% to 10%), however there are the dispersion of ROA of enterprises included in the survey sample, some enterprises have ROA> 50% (Petroleum General Services Joint Stock Company in 2019 = 0.99) but there are also enterprises with ROA<0 (Hoang Giang International Joint Stock Company in 2016= -0.12); The average ownership rate of foreign shareholders is 17.3%, of which there are many enterprises with this ratio >50% (Taicera Ceramics Industry Joint Stock Company in 2018 =0.88).

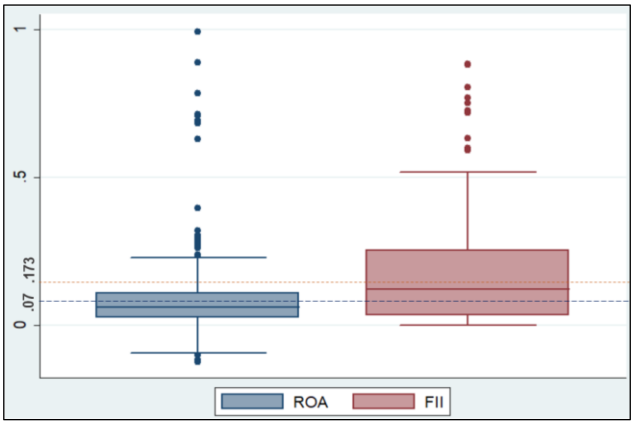

Fig. 1. Distribution of ROA and FII

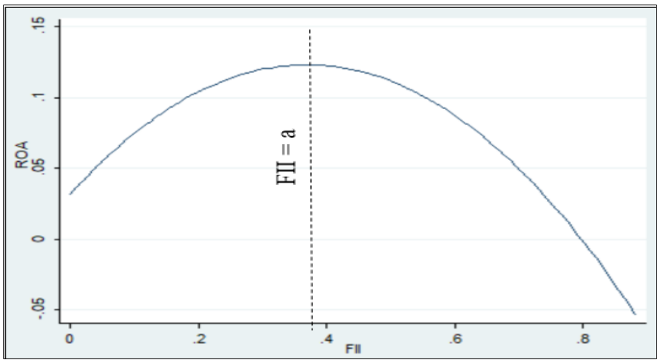

Fig. 2. Relationship between FII and ROA

Besides, for the variable SIZE, the average value is 9.19, ranging from the smallest value 8.11 (Do Thanh Industry Joint Stock Company in 2016, with an asset value of 130 billion VND) to the maximum value of 11,007 (Hoa Phat Group Joint Stock Company in 2022 with an asset value of more than 101 trillion VND). Hoa Phat is a very large corporation with strong financial potential and scale, often one of the largest capitalization companies in Vietnam.

4.2 The Relationship between Foreign Ownership and Firm Performance

The results describing the relationship between foreign ownership and financial performance of the business are shown in Fig. 2, showing that: In the condition that other factors remain unchanged, when the foreign ownership ratio is starts to appear and increases to a certain value, the company's operating efficiency increases, reaching its maximum when FII = a (approximately 40%). But when FII rises above the above threshold, the financial performance of the business will fluctuate negatively with FII.

Based on the graph showing the relationship between FII and ROA shown in Fig. 2, we find that the graph has a parabolic shape, with a maximum when FII = a, so its mathematical equation will have a quadratic form with beta coefficient of FII^2 <0. The above relationship can be written in the form of a general equation as follows:

$$ROA = \beta_1 FII^2 + \beta_2 FII + \beta_0$$

However, to confirm this relationship is nonlinear or not, we will use regression model to measure.

4.3 Measurement Model Results

The analysis results of the relationship of foreign ownership to the performance of enterprises in Table 1 show that:

The model's fit measurement values such as Wald chi 2(P), AR2, Sargan test and Hansen test all show that the measurement model that the research builds is appropriate.

Table 1. Results of measuring the relationship between foreign ownership and performance

Vaiable	Coef.	z	P>z	CI 95%	
FII	0.85	3.34	0.001	0.35	1.35
FII^2	-0.97	-2.94	0.003	-1.61	-0.32
SIZE	-0.05	-2.6	0.009	-0.08	-0.01
_cons	0.43	2.57	0.01	0.10	0.76
Wald chi2 (p)	129.86		<0.001		
Arellano-Bond test for AR2 (check for autocorrelation)			0.095		
Sargan test of overid			0.143		
Hansen test of overid			0.532		
Hansen tests of exogeneity of instrument subsets			0.779		

Besides, the research results show that the regression coefficient FII = 0.85 > 0 and P < 0.05, so FII has a significant positive impact on the financial performance of the business. Meanwhile, FII^2 = -0.97 < 0 and P < 0.05, so the relationship between foreign ownership and financial performance of the business has a nonlinear form (second order form) similar to that described in Fig. 1.

In the case of FII <a, an increase of foreign ownership ratio >1% will increase the operating efficiency of the enterprise by 0.85%. Conversely, when FII>a, the foreign ownership ratio increases to 1% of the unit, which will reduce the operating efficiency of the enterprise by 0.97%.

In addition, the research results confirm that the control variable (SIZE) has a statistically significant negative effect (P<0.05) with the financial performance of the business.

5. DISCUSSION

Our research results show that the relationship between FII and ROA is nonlinear, which has been proved by Huang & Shiu [4], Douma et al. [5]. Within a certain limit of foreign ownership ratio (0, a), then FII has a statistically significant impact on ROA, Our research results have been supported by some previous studies. proven as: Claessens & Djankov [20]; Ongore [1]; Huang & Zhu [2]; Batten and Vo [13]; Liu, Bredin & Cao [3]. Claessens & Djankov [20] argue that foreign investors are experienced in financial markets as well as in corporate governance and this is good for businesses. Oxelheim & Randoy (2003) explain that foreign management and control help improve cooperation, sharing branding experience. Diversity of nationalities also promotes global relationships with people to open markets and higher operational efficiency (Djankov & Hoekman, 2000). We believe that the presence of foreign investors helps to overcome the financial and capital management constraints of companies in Vietnam. Taking advantage of these advantages helps companies operate more efficiently. Besides, the presence of foreign owners in the company is also highly appreciated by the market for its transparency and long-term efficiency, which increases the share price, which in turn leads to increased financial efficiency.

Also in this relationship, when FII >a (approximately 40%), the increase in foreign ownership ratio will reduce the operating efficiency of the enterprise. This result is confirmed by some previous studies such as Huang & Shiu [4]; Park [21]; Douma et al. [5]; Greenaway, Guariglia & Yu [14]; Gurbuz and Aybars [15]; Gupta, Agarwal & Jagwani [16]. Greenaway, Guariglia & Yu [14] when research in China shows that this relationship has an inverted U shape and the financial performance of the company is maximized when foreign ownership is in the range of 40% to 65%, then decreases. Park [21] when studying companies listed at the Tokyo Stock Exchange also found that the operating efficiency of enterprises increases when foreign ownership increases to about 40%-45% and then starts to decrease when ownership increases. Huang & Shiu [4] said that, when the foreign ownership rate is high, agency costs will increase, thereby eroding the profits of enterprises, thereby reducing the operating efficiency of enterprises. We believe that when foreign ownership reaches a large enough percentage, they will directly participate in running the company through personnel at the board of directors, executive board and become internal shareholders of the company. At this time, according to agency theory, the increase in foreign ownership ratio will face increased agency costs. The increase in foreign ownership increases agency costs, which can be explained as follows: when the foreign ownership ratio increases, the pressure to control the company's operations increases. Because owners always set the highest profit goals. As a result, owners tend to gain control over all operations. This means that the population to key executive positions is limited and it is difficult to be flexible with executive decisions. In addition, the conflict also lies in the division of profits that the business generates. Owners and investors, enjoy most of the profits. The executive team, enjoys a certain salary, allowances, bonuses and they may not be satisfied with this. Those fierce conflicts of interest have created great losses in the business and are often referred to as agency costs. In fact, there is always asymmetric information between investors and managers. Due to this asymmetric information, managers have the opportunity to perform actions that affect the interests of investors.

And when a large ownership ratio changes the nature of the company becoming a foreign company, it will increase tax costs and management costs in the host country. For example, according to the Vietnamese government (2013), foreign companies will not enjoy tax incentives such as import-export tax, land use tax, and corporate income like Vietnamese companies, and at the same time some areas of exploration and mining areas... are subject to corporate income tax from 32-50%. Preferential policies and support policies applied to domestic enterprises are no longer valid, increasing costs, leading to reduced profits, thereby reducing business efficiency.

6. CONCLUSIONS AND RECOMMENDATIONS

In order to identify and measure the relationship between foreign ownership and corporate performance, we conducted a random survey of 100 non-financial companies listed on the Vietnamese stock market for 8 years. (the period from when the government allowed foreign investors to buy shares of domestic companies - 2015 to present.

The analysis results show that the relationship between foreign ownership and performance of Vietnamese enterprises is nonlinear (order 2). Specifically, when foreign ownership is within a certain limit (<a;approximately 40%), the fact that shareholders have foreign elements will increase the financial performance of the business of the enterprise; Conversely, when the foreign ownership ratio increases beyond a certain value (>a), it has a negative effect on the performance of the enterprise.

Based on the research results, as well as the descriptive results showing that the foreign ownership rate of Vietnamese enterprises is currently <18%, corporate managers can apply policies to increase the foreign ownership ratio to some extent. This will meet the capital needs of enterprises, while taking advantage of foreign shareholders will help Vietnamese enterprises increase financial performance of the business. For enterprises with a high foreign ownership ratio, it is necessary to calculate and consider carefully before deciding to increase the foreign ownership ratio. Because increasing foreign ownership risks changing the structure of major shareholders, changing the structure of the board of directors and controlling the operation of the enterprise. These changes will increase costs for businesses, thereby reducing financial performance of the business.

7. LIMITATION OF THE STUDY

With the main objective, we only consider the relationship between financial performance (ROA) and foreign ownership (FII). Therefore, there may be factors that affect financial performance other than those included in the research model that have not been considered. This will open the door for a more comprehensive study in the future, and also need to measure financial performance in terms of ROE, ROS or Tobin's Q.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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