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Financial centers and ownership concentration: When is ownership concentration value relevant? Evidence from an emerging market

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ABSTRACT

Does the location of a firm's headquarter effect ownership concentration? Do stock market participants value ownership concentration differently for firms located at different geographic locations? Using data from India, this paper shows that firms headquartered in Mumbai, the main financial center of a country, have lower ownership concentration than firms headquartered elsewhere. We argue that clustering of firms in the financial center reduce information asymmetries and lower the incentives for concentrated ownership. Our results also show that as the extent of analyst following increase, the difference between ownership concentration of firms headquartered in Mumbai and firms headquartered elsewhere goes up. We argue that higher analyst coverage reduces information asymmetries quicker for firms headquartered in the financial center and results in larger difference between the two groups. In addition, we also show that ownership concentration is value relevant only for firms headquartered in the non-financial centers. We show no relationship between ownership concentration and firm performance and valuation in the financial centers. This paper provides evidence that location of a firm's headquarter in the financial center can significantly alter its information environment. Reduced information asymmetries lower the incentives for concentrated ownership in the financial centers.

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1. Introduction

Why do certain firms have higher ownership concentration than the others? Does the extent of ownership concentration always signal the amount of information asymmetries in firms? Given the separation between ownership and control, when is ownership concentration related to agency problems and when is it not related to agency conflicts? The answers to above questions have formed the basis for plentiful of previous literature (Mitton, 2002; Claessens and Fan, 2002).[1] Most of this literature revolves around understanding how firm-specific and country-specific characteristics affect incentives to have concentrated ownership and how do these incentives lead to positive/negative firm performance. Dharwadkar et al. (2000),

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[1] Given the separation between ownership and control, ownership concentration can be considered as a tool to reduce agency conflicts between managers and owners. Ownership concentration would, therefore, be considered as value enhancing mechanism. However, ownership concentration results in agency conflict between controlling shareholder and minority shareholders. Therefore, it may be considered as value destroying mechanism. Without documenting the performance, it is hard to find whether ownership concentration is good or bad.

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