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Postprivatization corporate governance: The role of ownership structure and investor protection ☆

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Abstract

We investigate the role of ownership structure and investor protection in postprivatization corporate governance. Using a sample of 209 privatized firms from 39 countries over the period 1980 to 2001, we find that the government relinquishes control over time to the benefit of local institutions, individuals, and foreign investors, and that private ownership tends to

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concentrate over time. Firm size, growth, and industry affiliation, privatization method, as well as the level of institutional development and investor protection, explain the cross-firm differences in ownership concentration. The positive effect of ownership concentration on firm performance matters more in countries with weak investor protection.

JEL classifications: G32; G38

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1. Introduction

Corporate governance is defined as a response to the agency problems that arise from the separation of ownership and control in a corporation. In this paper, we examine corporate governance within the context of privatization. Privatization provides an interesting setting in which to understand corporate governance, because it is a discrete event that often leads to a drastic change in the ownership structure. Thus, privatization is a natural experiment allowing us to examine how corporate governance mechanisms evolve, interact, and affect firm performance (Denis and McConnell, 2003).

In this study, we investigate the relation between ownership structure, investor protection, and firm performance. We seek to answer the following questions: (1) What is the ownership structure that results from privatization and how does it evolve thereafter? (2) Does the level of investor protection influence the postprivatization ownership structure? (3) Does the postprivatization ownership structure depend on other factors? (4) How do ownership structure and investor protection relate to firm performance, and what explains this relation?

This paper addresses these important questions using a multinational sample of 209 newly privatized firms headquartered in 25 emerging markets and 14 industrialized countries. To our knowledge, our work is the first multinational study that tracks the postprivatization ownership structure and its determinants.[1] For several reasons, a multinational sample offers a valuable opportunity to study the role of ownership and investor protection in postprivatization corporate governance. First, national legal systems vary markedly across countries. For example, many countries suffer from a poor legal environment and a weak enforcement of laws (see, e.g., La Porta et al., 1998; Nellis, 2003). The deficiencies of this external governance mechanism offer an interesting opportunity to investigate whether the ownership structure, an internal governance mechanism, plays an important role and interacts with the legal system to address the manager/shareholder postprivatization agency problem. Third, governments in most emerging markets and industrialized countries undertook large-scale privatization programs in

[1] See Megginson and Netter (2001), Djankov and Murrell (2002), and Birdsall and Nellis (2002) for comprehensive surveys of empirical studies on privatization.