THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE PERFORMANCE OF PALESTINIAN FIRMS: AN EMPIRICAL STUDY

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ABSTRACT

This paper investigates the relationship between performance and corporate governance in Palestine. Firm performance is measured by Tobin's Q, whereas corporate governance is determined based on the level of ownership concentration. Prior research in developed economies provides evidence that ownership concentration has a significant impact on firm performance, while evidence in emerging economies is inconclusive. However, in Palestine there is no prior empirical research on this relationship. This paper reports the results of an empirical study of a sample of firms listed at Palestine Securities Exchange during the period (2003-2006). The sample of the study consists of (16) firms, which represent around 50% of all listed firms.

The paper reports a series of regressions that account for different specifications of firm valuation and ownership concentration. The results indicate that ownership concentration has a good explanatory power of market value change as measured by Tobin's q for years 2003 and 2006 but not for years 2004 and 2005. This paper provides some evidence, although not decisive, that ownership concentration is negatively related to firm value. This evidence invites further research in this area before deciding on the need for ownership de- concentration in Palestinian firms.

JEL: G30, G34, L25

KEY WORDS: Corporate Governance, Ownership Concentration, Financial Performance, Tobin's Q, Market Value and Book Value

INTRODUCTION

T he relationship between Corporate Governance (CG) and performance has received considerable attention in the financial economics literature in recent years. One of the key pillars of CG is the level of Ownership Concentration (OC). Conceptually, it has been argued that the more the firm's ownership is concentrated; the poorer its performance will be [(Jensen and Meckling, 1976):(Demsetz, & Villalonga, 2001). Studies have documented conclusive evidence on this relationship in developed economies [(Holderness et al, 1999, Demsetz and Villalonga (2001,) Agrawal, and Sahiba (2004)]. However, literature in emerging economies supports the notion that family control creates strong incentives that have potentially competing influences on the manner in, and extent to, which internal corporate governance mechanisms are utilized. A notable feature of this literature is its failure to reach a consensus regarding the nature of this relationship. Studies of this issue have reported conflicting results due to a number of reasons including measurement of variables, sample period, estimating technique and degree of success to account for the endogeneity of a firm's ownership structure {see for example, (Claessens et al., 2000), and Xu and Wang, (1999)}.

Expectedly, no prior studies have addressed this issue in Palestine, due to the very young experience with capital markets and portfolio investment. This paper examines the relationship between OC and performance of the firms listed at Palestine Securities Exchange (PSE), which are mostly characterized as family-owned and managed businesses. Unlike most emerging markets; the PSE established in 1997; is

still relatively small and dull with no more than (34) listed firms, and suffers from some informational inefficiency, high volatility and poor governance (Abdelkarim, 2007). This study seeks to add empirical evidence to the very limited conceptual insights regarding this relationship in the Palestinian context, and explores to what extent this evidence is consistent with that found in other countries.

The primary objective of the study is to examine the relationship between the degree of ownership concentration and performance of selected sample of firms listed at the PSE. In specific, this paper addresses the following research question: To what extent the degree of OC explains the change in market value of firms listed at the PSE?

The results of the study support the hypothesis that less OC improves corporate performance. These results call for a need to change the level of OC in firms listed at the PSE, which should come in the context of improving the quality of corporate governance and culture as whole. This change would only be possible when the Palestinian Government replaces the two extremely old and diverse Corporate Laws, which are still in effect in the Palestinian Territories. One law was enacted in the West Bank in 1964 and the other was enacted in the Gaza Strip in 1929, accompanied with a unified modern Corporate Law that responds to good governance principles and practices. Results should also encourage the Palestine Capital Market Authority to accelerate the process of drafting a Corporate Governance Code.

The remainder of this paper is organized as follows: Section 2 reviews the previous studies that examine the relationship between ownership structure and corporate performance, including research that has been conducted in other countries of this world. Section 3 presents the methodology and data, utilized in this study including the model specifications in order to test the hypotheses. Section 4 describes and discusses the results of testing the hypotheses. Section 5 summarizes the results and draws some conclusions.

LITERATURE REVIEW

Prior research indicates that corporate governance has a significant impact on firm performance. Theory suggests that improving performance and creating value can be achieved by paying greater attention to ownership structure and concentration (Jensen and Meckling, 1976). In this context, the effect of ownership distribution on firm performance and valuation has been the focus of extensive analysis in developed economies. In particular, Shleifer and Vishny (1986, 1997) have identified many potential benefits of de-concentrated ownership, including superior performance and higher firm value. Berle and Means (1982) argue that given the interests of management and shareholders are not generally aligned, corporate resources are not used efficiently in maximizing corporate profit. Therefore, they suggest that the relationship between ownership concentration and performance should be a positive one. However, Demsetz (1985) argues it is unreasonable to suppose that diffused ownership destroys profit maximization as a guide to resource allocation.

A common approach to empirical studies in this field is to focus on the impact of ownership on firm value. This line has often been taken in developed economies (see, for example, Demsetz and Lehn, 1985; D'Souza and Megginson, 1999). The approach has also been used in transitional economies (see Claessens *et al.*, 1997, in the Czech Republic) and in the study of enterprises in China (see, for example, Xu and Wang, 1999; Chen and Gong, 2000; Gul and Zhao, 2000).

The literature documents a linear relationship between degree of ownership concentration and ex-post firm performance measures (Demsetz and Lehn, 1985). Many studies conducted in the developed countries, like the US and Europe, documents a linear relationship between ownership concentration and firm performance (see for example Xu and Wang, 1999; Chen and Gong, 2000; Gul and Zhao, 2000). Claessens *et al.* (1997) finds a similar linear relationship in their study of reforms in the Czech Republic.

On the other hand, the literature identifies a non-linear relationship when examining the correlation between firm value and insider ownership in emerging economies (Morck *et al*., 1988; Wruck, 1989; Hermalin and Weisbach, 1991).

Gharaybeh, Batayneh, and Salameh, (1997)) was the first and only study which examine the relationship between a firm's ownership structure and its performance in the case of Amman Financial Market (AFM). They found the presence of a stronger correlation between stock returns of family controlled firms across all sectors compared to stocks that belong to uncontrolled firms. In addition, they found that unsystematic risk for different firms controlled by one family was very high. Despite the conceptual and empirical support for the endogenously of ownership structure, many studies have failed to consider this when estimating the effect of ownership structure on performance [(Morck, Shleifer & Vishny 1988; McConnell & Servaes 1990); And Demsetz and Villalonga (2001)].

The measure of firm performance and value creation that this paper focuses on is Tobin's Q. In theory, the Q ratio identifies the juxtaposition of the marginal efficiency of capital and the financial cost of capital (Tobin, 1978). Typically, in the finance and accounting literature, Q is taken as a proxy for marginal Q. In essence, the ratio gauges the marginal efficiency of capital compared to the financial cost of capital. The approach captures whether the value of a firm as an operational business is greater than the cost of the assets required to generate its cash flow, at that point in time. It is measured as a ratio of the market value of a company's debt and equity to the current replacement cost of its assets. Thus, Tobin's Q is positively related to investors' perceptions of managerial quality. A Q-ratio greater than one suggests that the firm is creating value greater than the cost of the assets utilized to produce its cash flow. This suggests investors are willing to pay a premium over the value of the firm's assets in anticipation of good future prospects under the present management. Conversely, a Q below one implies that investors are discounting the value of the firm's assets (Lang *et al*., 1991; Lang and Stulz, 1994). Hence, Tobin's Q has been widely embraced as a measure of firm performance in the finance and accounting literature (see, for example; Morck *et al*.; Hermalin and Weisbach, 1991; Zingales, 1994; McConnell and Servaes, 1995; Claessens *et al*., 1997; Claessens *et al*., 2000).

The Palestinian Context-Macroeconomic Overview

Thirty years of occupation in the West Bank and Gaza (WBG) has left a heavily distorted economy in a state that is almost completely dependent on the Israeli economy. While other countries in the region have grown and industrialized, the Palestinian economy retains the hallmarks of a less developed economy. The size of the average industrial enterprise is about four workers, no larger than it was in 1927 (Roy, 1999). While, the share of agriculture in GDP has declined, services and the public sector have been expanding rapidly, driven by donor funding and remittances from the export of labor. The share of industry remains low at around 12-13 percent. In contrast, in Jordan, for example, the industrial sector accounts for nearly 30 percent of GDP. It was hoped that with limited autonomy arising from the Oslo Accords of September 1993, the Palestinian private sector would take off. Free of the constraints imposed by military occupation, Palestinian entrepreneurs would rapidly invest and the thriving economy would attract foreign investment. Unfortunately, this did not materialize and the economy has suffered even more since Oslo.

Following the signing of the Paris Protocol in 1994, growth in the West Bank and Gaza in the latter half of the 1990s was moderate. Real per capita GDP grew approximately 3% on average from 1994-1999 with much of the growth concentrated in construction and commerce sectors. Unemployment rates declined significantly from nearly 28% in 1996 to approximately 11% in 1999. At the same time, high levels of remittances from Israeli employment, restricted trade relations, and high levels of donor aid inflow contributed to a declining competitiveness in the tradable food and services. This decline resulted

from higher costs of production, particularly domestic labor. High production costs also contributed in part to limited growth in private investment, representing approximately 15% of GDP in 1999 (World Bank, 2003).

Prior to the outbreak of the Intifada in September 2000, trade between the WBG and Israel had effectively become internal, reflecting a customs union regime, and the majority of Palestinian workers were employed by Israeli firms. Roughly, 85% of Palestinian foreign trade was with and through Israel, and Israeli firms account for roughly one fourth of Palestinian employment. The last six years of escalated conflict in the WBG have left the Palestinian economy mired in crisis. Israeli military and security measures, increased during the six years of the Intifada, have imposed major costs on the WBG economy, heavily undercutting its current and future developmental prospects. The closures regime—i.e. the multi-faceted system of restrictions on the movement of goods and people both within the WBG and through Israel to the rest of the world—along with construction of the separation barrier have fragmented the WBG economic space, and further reduced the WBG's productive potential. Such adversities have contributed to significant declines in trade, employment and investment resulting into a decline in per capita income of 48% and in high rates of unemployment and poverty.

The economic crisis has become worse subsequent to the 2006 public elections. Decisions by the Government of Israel to suspend the transfer of clearance revenues collected on behalf of the Palestinian Authority (PA) and by foreign donors to cease budget support for PA following the public elections held in January 2006 have provoked an unprecedented fiscal crisis for the PA government. Consequently, threatening to undermine public institutions and authority. International political difficulties and increasing domestic friction drove the already fragile economic recovery of 2004-2005 into a tailspin. Although hard data are scarce, real GDP is estimated to have fallen within a range of 5 to 10 percent in 2006, less than it initially had been feared, but still leaving average real per capita GDP at almost 40 percent below its 1999 level, and unemployment and poverty at totally unprecedented rates (40% and 65% respectively) (PCBS, 2007). Stronger-than-expected official and private inflows have helped prevent a much sharper decline in incomes and consumption in 2006, thus cushioning the overall contraction.

More troubling than the negative growth rates over the past few years is the changing composition of the economy, as GDP is being increasingly driven by government and private consumption from remittances and donor aid, while investment has fallen to exceedingly low levels, leaving little productive base for a self-sustaining economy. Furthermore, WBG faces an expanding labor force and a shrinking private sector. Thus, the public sector has become the only alternative for jobs. With few options at its disposal, and despite an unsustainable wage bill, the PA has resorted to absorbing workers as a way to alleviate poverty. As a result, public sector employment has grown by 60% since 1999 and by 2006 stood at about 157,800 (World Bank, September 2007). Thus, while the public sector has expanded, the economy's productive capability has begun to hollow out making it increasingly donor dependent.

In addition, unpredictability of border crossings and checkpoints has prevented Palestinian businesses from importing inputs and exporting products in a timely and planned manner. As a result, the pace of capital flight has reached an all-time high in the last two years with almost no foreign direct investment and most local capital being kept abroad or invested in real estate or short term trading activities. The IMF estimated that already-low private investment declined by over 15% between 2006 and 2007.

The Palestinian Context-Business Environment

Modest improvements in the macro-economy in the 1990s were roughly consistent with a generally more favorable business environment for firms. In particular, there were important achievements in improving

access to infrastructure and finance during the 1990s. Relative to other countries in the Arab region, such as Egypt, which continue to maintain high levels of direct intervention by the public sector in economic activity, the West Bank and Gaza have traditionally maintained a business environment more conductive to private enterprise. This is reflected in part by a 2000 World Bank Business Environment (WBES) firm survey conducted just prior to the outbreak of the second Intifada in September 2000. Among the top five constraints identified by firms in the WBES were (1) high levels of policy instability and uncertainty; (2) corruption; (3) inflation; (4) the exchange rate; and (5) taxes and regulations. This represented a tentative shift from concerns recorded in the previous 1996 survey, which identified infrastructure and access to finance as being among the more significant obstacles and likely reflects much of the progress in infrastructure investment and improvement in the general economy following a relative period of prosperity in the mid 1990s. In particular, there was a reduction of corporate income tax rates from 38 to 20% and the enactment of the investment promotion law[1]. These results are roughly consistent with the perceptions of foreign investors. A recent FIAS survey of investors identified two main areas for concern: a weak economic legal and regulatory environment and the unclear role of the PA in economic activity and a perception of corruption. Also, the economy's structural dependence on the Israeli economy, costly security and transit procedures, and relatively high market wages, have contributed in part to high cost structure firms. In addition, private firms have insufficient capacity to ensure high uniform products quality, and conformity with best practices. However, perceived obstacles in doing business in the WBG have changed since September 2000.

The Investment Climate Assessment (ICA) of the World Bank in 2006 reveals that shrinking market access and the lack of free movement are the main constraints to growth for Palestinian enterprises. Relative to other countries in the region, the Palestinian investment climate is good, petty corruption is low, the bureaucracy is relatively efficient and financial markets are well developed. Despite this, Palestinian enterprises have not invested enough to maintain their international competitiveness. Managers know they need to invest and have access to the necessary resources. However, they are unwilling to do so unless they are assured secure and predictable access to both domestic and international markets.

Unfortunately, the growing settlements and movement restrictions imposed by Israeli authorities since 2001 overshadow all other positive elements of the investment climate. The restrictions close-off markets raise transaction costs and prevent producers from guaranteeing delivery dates. The closures also serve to keep firms small and prevent them from attaining minimum efficient scale. The percentage of WBG enterprises selling within the territories has fallen by half since 2000. More importantly, markets in the West Bank appear to be shrinking because of movement restrictions imposed to protect Israeli settlements. In 2000, nearly 60 percent of firms made a significant share of their sales outside of their home city; by 2006, this had fallen to around 40 percent. The most difficult issue to overcome is the uncertainty caused by the movement restrictions. For example, the survey reveals that on average it takes around 22 days to clear imports for companies in the West Bank. However, the longest time averages nearly 43 days. On-time delivery is a requirement in the modern export market, but Palestinian producers can never be sure, when their cargo will move. Consequently, to a large degree, they are frozen out of the high value export market.

The Palestinian Context-The Private Sector

The Palestinian Private sector is unique in more than one important aspect. It is mostly dominated by small and medium family enterprises, with poor performance and governance. The number of relatively huge corporations is still low. Traditionally, the private sector has played an important role in the development of the Palestinian economy, particularly with the respect to employment. Prior to the onset of the Intifada in September 2000, there were approximately 80,355 private establishments in the WBG, with the majority located in Ramallah, Hebron and Gaza. Average firm size has been less than four persons, with gross average capitalization levels of US $10,000[2]. In addition, there were an estimated

80,000 micro enterprises, represented mainly by family business activities largely involved in trading, small-scale manufacturing, services and agriculture. The majority of firms have traditionally been concentrated in services (retail, hotels, restaurants, business services) and industry (food and beverage, metal fabrication, textiles\ garments and furniture) and private employment is nearly 70% of the domestic labor force in the West Bank and more than 65% in Gaza. The entry and growth of new firms in the West Bank and Gaza has been relatively dynamic with nearly 17% of firms sampled for the WBES in 2000, established over the period 1997-1999. Most new firms were small, medium sized, and nearly half were engaged in export activities, relative to the total sample of firms. Registration of new companies rose over 50% to 831 in 1999, with nearly 80% of new private limited companies registered in the West Bank (UNSCO, 2000). There was also a surge in the registration of foreign companies with 11 companies registered in 1999 relative to 4 in 1998.

Investment has fallen to precariously low levels, over the 2001-2006 endangering the prospects for long-term growth. Public investment to maintain or add infrastructure has nearly ceased, and in the last two years, almost all government funds have been used to pay salaries and cover operating costs. Total private investment, which was approximately, $1.3 billion in 1999, was unlikely to exceed $100 million in 2002. It is estimated that of the $305 million damage to physical assets, roughly 52% are private sector assets (World Bank, 2003). In total real private GDP has declined by almost 29% by 2003 from its 1999 level and already-low private investment is estimated by the IMF to have fallen by over 15% between 2005 and 2006. In addition, the market value of companies listed on the Palestine Securities Exchange had dropped by more than 40% by the end of 2004, but it started to rise in 2005 to reach unprecedented level of $3,500 million by the end of that same year (increase by 200% from the level of 2000). However, the beginning of 2006 Palestine Stock Exchange, like other Arab markets, has been going through a severe price correction process, led so far to a loss of around 60% of its capitalization value.

A recent World Bank Investment Climate Assessment (2006) found that less than a quarter of private sector firms made any investments in 2005/2006 and that manufacturing equipments were on average over 10 years old. Managers had access to finance, but were operating at less than 60% capacity, and saw few opportunities for investment under the current closure regime. Gross capital formation in the private sector fell by over 60% between 1999 and 2005 (See Table 1). The lack of investment in public infrastructure and private firms is eliminating any residue of the Palestinian productive base, making the economy more aid-dependent. When conditions improve, large investments will be needed just to rehabilitate assets let alone create new wealth.

Moreover, the unpredictability of the border openings has prevented firms from importing inputs and exporting products in a planned and profitable way. In response, enterprises have closed and large amounts of financial and human capital have fled. The pace of capital flight reached an all-time high in the last two years. Investors have always been wary of investing in WB&G, with almost no foreign direct investment in the past few years and most local capital is kept abroad or invested in real estate or short term trading activities. Now local entrepreneurs are closing existing operations and moving them to neighboring countries. This capital and the entrepreneurial and technical talent that go with it are irreplaceable and unlikely to return unless conditions dramatically improve.

The Financial System

The Palestinian private businesses do not have many adequate financing options, neither in amount nor in variety. The financial system cannot be characterized as sound, functioning or efficient. To the contrary, the financial intermediation through the banking industry is too low as reflected in the credit to deposits ratio. This ratio is on average below 30%, while it goes beyond 70% in neighboring countries as well as in OECD countries. Furthermore, more than two thirds of banking credits extended to private businesses

have been either in the form of short-term loans or overdrafts, while long–term financing is almost none existent. That explains why the capital structure of almost all Palestinian corporations is geared heavily towards equity financing, with extremely low indebtedness (Abdelkarim, 2007).

The establishment of Palestine Securities Exchange (PSE) in 1997 has provided public shareholdings with new opportunities for long – term financing, at a time when banks exercised and conservative credit policies [Abdelkarim (1995), and Sabri (2003)]. In February 2005 the Palestinian Capital Market Authority (PCMA), was established in accordance with to the Securities Law number 12 for year 2004. The PCMA is the sole legal entity that is responsible for monitoring the trading activities at the PSE as well as for organizing the conduct of the listed companies and the brokerage member firms.

The PSE performance has developed over years. However, it is still performing under its potential and still invites considerable reforms. Governance, disclosure and efficiency are issues still of concern to policy makers and investors. Another issue of importance and relevance to the performance of the PSE is the high degree of ownership concentration in the Palestinian corporations traded. It is widely perceived that this phenomenon has been negatively affecting the fair pricing of stocks; consequently, impairing confidence in the PSE as a whole. This explains why the PSE continues to lack sufficient depth and liquidity. Opening up corporate ownership is expected to attract foreign portfolio investments and in turn improves quality of governance. Table 1 below provides key indicators on the performance of the PSE over the most recent five years.

Table 1: Some Indicators on the PSE Performance for a Number of Recent Years

Years / Indicators	2003	2004	2005	2006	2007
Market Capitalization (Millions $)	650.47	1096.52	4456.18	1891.51	2437.156
Listed Companies	24	26	28	31	35
Shares Traded (Millions $)	40.35	103.64	369.567	125.55	274.33
Trading Value (Millions $)	58.33	200.56	2096.16	1047.1	816.98
Turnover	0.76	1.66	6.44	1.44	3.095
Market Value to GDP (Millions $)	0.150	0.248	0.93	0.387	0.493
Value Traded to GDP (Millions $)	0.0134	0.045	0.441	0.214	0.165
GDP (Millions $)	4325.4	4415.3	4750	4892.1	4941.021

Sources: Arab Monetary Fund (AMF) bulletin, several issues, and PSE Public Relation Department Publications.

METHODOLOGY AND DATA

Hypothesis: Based on the theory and empirical evidence on the relationship between ownership concentration and firms' performance, the null hypothesis of this study is formed as follows:

> *H01: There is a statistically insignificant relationship between degrees of ownership concentration and firm performance as measured by Tobin's Q.*

Research Model: This paper examines data relating to 16 selected firms listed at the (PSE) for the years (2003-2006). The selection of these years was motivated by the availability of trading data over the test period. This paper follows the tradition of empirical work in corporate governance by examining the performance of the firm in the form of regression analysis. Performance (in this case, measured by Tobin's *Q*) is the dependent variable in the model, and corporate governance measured in terms of OC is the independent variable together with other control variables that have theoretical validity

The hypothesis of the study is tested by the following regression model:

$Q = \alpha + \beta 1 SALES + \beta 2 DEBT + \beta 3 GR + \beta 4 OC + \beta\ Dv(x1) + \beta\ Dv(x2) + \beta\ Dv(X3) + \beta\ Dv(X4) + \beta\ $ Cash Flow $+ \beta\ $ Debit $1 + e$

Definition of Variables of the Model

Dependent Variable-Performance: Performance is measured as Tobin's Q by dividing the sum of the market value by book value, as follows:

$$Q = \frac{Market\ Value\ of\ the\ Firm}{The\ Book\ Value\ of\ the\ Total\ Asset} \tag{1}$$

Where, the market value= Number of outstanding shares at the end of the year multiplied by its price on that date.

Independent Variable Ownership Concentration: Ownership concentration measured by the sum of the voting rights held by the five largest shareholders.

Control Variable: We use a group of control variables in this study to avoid the bias of the main independent variable. The following are explanations of those variables:

Sales: Measures the size effect of firms and will be taken as the natural logarithm of annual sales revenue in billion US dollar.

Debt: The financial leverage is taken as the debt/asset ratio, which equals the book value of debt divided by the value of total assets.

Debt 1: alternative measure of leverage, Calculated by total debt / equity.

Net Income Growth: Growth of net income. Growth is computed as the difference between income for period t and t - 1 over t - 1.

Cash Flow: is an alternative measure used instead of the net income growth. This measure is identified as the net cash flow shown in the cash flow statement.

Dummy variables for each test year are as follows:

> Dv(X1) = 1 if the year 2003, 0 otherwise.

> Dv(X2) = 1 if the year 2004, 0 otherwise.

> Dv(X3) = 1 if the year 2005, 0 otherwise.

> Dv(X4) = 1 if the year 2006, 0 otherwise**.**

RESULT

Descriptive Statistics

Prior to running the regressions, a descriptive statistics and a bivariate correlation analysis of the dependent and independent variables were conducted. Table (2) presents descriptive statistics for model variables.

Table 2: Descriptive Statistics of the Variables during the Test Period (2003-2006)

Variables	Mean	Std. Deviation	N
Q	1.5001481	1.64506285	64
OC	.5359640	.18729082	64
x1	.2500	.43644	64
x2	.2500000	.43643578	64
x3	.2500000	.43643578	64
x4	.2500000	.43643578	64
SALES	6.2848657	1.60558269	64
Debt	1.6288665	9.17180014	64
Gr	.6209953	2.22551262	64
Cash	1.3271734E+07	3.60949582E+07	64
Debt1	1.2053082	2.17696034	64

The results, reported in Table (3), indicate that the correlation between independent and dependent variables. As we can see, there is a significant negative correlation between ownership concentration and performance as measured by Tobin's Q with (0.314) degree for among the tested period. This negative correlation can be explained by the regression result later in this paper, so we can say that the negative correlation is due to the concentration of ownership, which leads to a negative effect on firms' market value. The matrix of correlation indicates also the results of correlation between the other variables, Q correlates negatively with debt to assets ratio by (-0. 232), but it is not significant; on the other hand, it correlates positively and significantly with sales (0.336), while correlation is about (-.127) between debt and income. We see also that the Q correlates negatively with debt to equity ratio by (-.153) degree, positively with net cash flow by (0.226).

Overall, we can argue that the matrix shown in Table (3) for variables, including the dummy variables and the new one, indicates a serious correlation between independent and dependent variables especially between sales and market value of the firm, and the correlation shown between market value and ownership concentration.

Regression Results

To achieve our objectives we run a single regression for the four years using dummy variables X1=1 if the year 2003, 0 otherwise. X2=1 if the year 2004, 0 otherwise. X3=1 if the year 2005, 0 otherwise. X4 =1 if the year 2006, 0 otherwise. To test the hypothesis of this study we used three models of regression:

First model: included Q as dependent variable, ownership concentration, net cash flow, debit to equity ratio, sales and four dummy variables represent the years of the study as independent variables.

Second model: included Q as dependent variable, ownership concentration, debt to assets ratio, sales, net income growth and the dummy variables as independent variables.

Third model: included Q as dependent variables, ownership concentration, debt to equity ratio, debit to assets ratio, net income growth, net cash flow, and the dummy variables as independent.

Table 3: Correlation Matrix for the Variables during the Test Period

Variables	OC	Q	Debt1	SALES	Cash	Gr	Debt	x1	x2	x3	x4
OC	1	-.314	-.069	-.152	-.167	-.025	-.232	.024	.075	-.123	.024
Sig. (2-tailed)		.011*	.588	.230	.187	.845	.065	.850	.557	.333	.850
Q		1	-.153	.336	.226	.019	-.133	-.341-**	.257*	.257*	-.173
Sig. (2-tailed)			.227	.007*	.073	.884	.293	.006*	.040**	.040**	.171
Debt 1			1	-.001	-.109	-.127	.236	.038	.000	-.132	.093
Sig. (2-tailed)				.995	.390	.318	.060	.766	.997	.300	.463
Sales				1	.229	.079	.020	-.205	.019	.173	.013
Sig. (2-tailed)					.069	.536	.876	.105	.880	.172	.921
Cash flow					1	-.082	-.054	-.139	.062	.064	.013
Sig. (2-tailed)						.518	.675	.275	.629	.617	.917
GR						1	-.034	-.166	-.001	.168	-.001
Sig. (2-tailed)							.788	.189	.996	.185	.996
Debt							1	.259	-.086	-.086	-.086
Sig. (2-tailed)								.039**	.498	.499	.498
X1								1	-.333	-.333-**	-.333-**
Sig. (2-tailed)									.007*	.007*	.007*
X2									1	-.333-**	-.333-**
Sig. (2-tailed)										.007*	.007*
X3										1	-.333-**
Sig. (2-tailed)											.007*
X4											1
Sig. (2-tailed)											

*This table includes the matrix correlation between the dependent variable, namely market value of the firm as measured by Tobin's Q, and the independent variables: ownership concentration (OC), Debt to assets ratio (Debt), sales, net cash flow, Debt to equity ratio (Debt 1), and dummy variables: X1 =1 If year 2003, 0 otherwise. X2 =1 if year 2004, 0 otherwise. X3 =1 if year 2005, 0 otherwise. X4 =1 if year 2006, 0 otherwise.** and * indicate correlation (2-tailed) significance at the 0.05 and 0.01 levels respectively.*

Results of the first model in Table (4), shown the adjusted R2 for the regression is (0.288). In this case, we could say there is a significant relationship between the dependent and independent variables, according to the F value and the level of significance that appears in the table (4) which was (0.00). Therefore, we can argue that the independent variables could explain the change in market value of firms listed at Palestine Stock Exchange, due to the level of explanatory power of the adjusted R2 and the level of significance.

Thus, we must reject the null hypotheses and argue that there is a statically significant negative relationship between ownership concentration and performance of the Palestinian firms. A possible explanation for this; is that the typical listed firm in Palestine's stock market is highly concentrated. The market, therefore, negatively responds to this ownership concentration and lowers the value of the firms that has a high level of concentration, as the expectation is that the top five shareholders will control the vast majority of firms.

Based on the above discussion, we can draw the relationship between the market value and dependent variables as follows:

$$Q = 1.951 - 2.380 \, OC + 0.218 \, Sales - 1.251 \, X1 \tag{2}$$

Table 4: Regression Results of the First Model

Dependent	β	Sig
Q		
Intercept	1.951	0.842
OC	-2.380	0.017*
CF	0.00003	0.532
Sales	0.218	0.064**
Debit 1	- 0.097	0.241
X1	-1.251	0.017*
X2	0.292	0.560
X4	-0.916	0.072
Adjusted R2	0.288	
F	4.647	0.000

*This table includes the regression results of the first model, which includes market value of the firm measured by Tobin's Q as dependent variables, and a number of independent variables: ownership concentration (OC), sales, net cash flow (CF), Debt to equity ratio (Debt 1), dummy variables X1 =1 If year 2003, 0 otherwise. X2 =1 if year 2004, 0 otherwise. X3 =1 if year 2005, 0 otherwise. X4 =1 if year 2006, 0 otherwise. ** and * indicate (2-tailed) significance at the 0.10 and 0.05 levels respectively.*

In addition, Table (5) shows the regression result for the second model. As we see the adjusted R2 for the regression of the second is (0.288), the explanatory power of this model is very close to that one that appears in the first model. In this case, we could say that there is relationship between the dependent and independent variables according to the **F** value and the level of significance that appear in table (5), which is (sig, 0.00**).** However, it should be noted that the adjusted R2 is weak under the three models but it is significant; therefore, we can say that the independent variables could explain the market value of the firms listed at Palestine Stock Exchange, due to the explanatory power of the adjusted R2 and the level of significance.Thus, we must reject the Hypothesis of the irrelevance of ownership concentration. A possible explanation for this is that the typical listed firm in Palestine stock market is highly concentrated.

Table 5: Regression Results of the Second Model

Dependent	β	Sig
Q		
Intercept	2.248	0.031
OC	-2.670	0.009*
Sales	0.239	0.04*
Debit	- 0.026	0.212
GR	-0.050	0.540
X1	-1.48	0.005*
X3	-0.239	0.634
X4	-1.236	0.013*
Adjusted R2	0.288	
F	4.647	0.000

*The above table (6) includes the regression results of the second model. Dependent variable market value of the firm as measured by Tobin's Q, and the independent variables: ownership concentration (OC), sales, growth in net income (GR), Debt to assets ratio (Debt), dummy variables X1 =1 If year 2003, 0 otherwise. X2 =1 if year 2004, 0 otherwise. X3 =1 if year 2005, 0 otherwise. X4 =1 if year 2006, 0 otherwise. ** and * indicate (2-tailed) significance at the 0.10 and 0.05 levels respectively.*

Based on the above discussion, we can draw the relationship between the market value and dependent variables according to the second model as follows:

Q = 2.248 –2.670 OC + 0.239 Sales – 1.48 X1- 1.236 x4 $\qquad$ (3)

Table 6: Regression Results of the Third Model

Dependent	β	Sig
Q		
Intercept	2.080	0.048
OC	-2.622	0.011*
Sales	0.228	0.055**
Debt	- 0.02	0.343
GR	-0.054	0.511
Cash Flow	0.00000025	0.630
Debt 1	-0.087	0.314
X1	-1.204	0.028*
X2	0.272	0.591
X4	-0.946	0.066**
Adjusted R2	0.28	
F	3.728	0.001*

*The above table (6) includes the regression results of the third model. Dependent variable market value of the firm as measured by Tobin's (Q), and the independent variables: ownership concentration (OC), sales, Debt to assets ratio (Debt), growth in net income (GR), net cash flow (CF), Debt to equity ratio (Debt 1), dummy variables X1 =1 If year 2003, 0 otherwise. X2 =1 if year 2004, 0 otherwise. X3 =1 if year 2005, 0 otherwise. X4 =1 if year 2006, 0 otherwise. ** and * indicate (2-tailed) significance at the 0.10 and 0.05 levels respectively.*

In Table (6), the dependent variable [market value (Q)] was tested in the regressions using the third model in which we used the all variables. Results of the regressions for this model, have added little value. As shown in Table 6, we can argue that the relationship is clear between the dependent and independent variables, negatively with ownership concentration with **(-2.622),** which is significant at 0.05.

Thus, according to results that appear in the three models, if we take the result of F test, which is no less than (3.728) with a significant level of (0.001), we can say that the model can represent the relationship between the independent variables and dependent. Therefore, it is possible to reject Hypothesis 1 – the irrelevance of Ownership Concentration- and say there is a statistically significant relationship between the independent variables specially debts ratio and ownership concentration and the market value of firms listed at Palestine stock exchange.

Thus, we can represent the relationship as follows:

Q = 2.080 – 2.622 OC – 0.228 Sales – 1.204 X1 – 0.946 X4. $\qquad$ (4)

The impact of ownership structure is examined in the regressions using a legal person's shares. High levels of ownership concentration might be thought of as impinging upon the efficient operation of a firm and hence lead to poor performance as measured by Q. Ownership Concentration, on the other hand, it could also be regarded as a form of potential support for the firm in adverse situations, implying greater protection of shareholder value.

Furthermore, we run another regression by using the growth in net income as a dependent variable and firm value, as measured by Tobin's Q, as an independent variable; at the same time, we run it with the other independent variables. The results of this regression did not add any meaningful information to the study; thus, we omitted these results.

The level of ownership of shares by owners has a negative relationship with performance as measured by Tobin's Q. This is an interesting finding, as previous studies have tended to be inconclusive on a year-by

year basis, or with different specifications of performance. It appears that the market has greater regard for ownership concentration, rather than sales, income growth, net cash flow, debt to assets ratio, and debt to equity ratio. The evidence therefore does not support Hypothesis 1. The structure of share ownership has explanatory power.

Net income growth has been negative in our study but insignificant. In previous studies, researchers have consistently identified growth in income as having explanatory power in the regressions (see, for example, Gul and Zhao, 2000). However, our findings fail to identify any significance in the coefficients of income growth, or net cash flow.

The coefficient for the independent variable SALE, used as a measure of size, are positive and significant at the 5 per cent level for regression in the three models.

The coefficient for the independent variable DEBT (1), debt, indicates a negative statistical insignificance at the 5 per cent or 10 per cent level in the three models. Negative relationships are consistent with conventional theory, which supports the concern that investors will have concerning high levels of debt. While a number of clear results have been obtained from this study, it is also recognized that the explanatory power of the regression according to R2 may be relating to certain variables provide unclear guidance. Future research could incorporate alternative specifications of performance, other variables with potential explanatory power, and tests for nonlinear effects and utilize a larger sample size.

In summary the overall results reported in this paper rejects the null hypothesis that there is a statistically insignificant relationship between ownership concentration and performance of sample firms measured by Tobin's Q.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

This research incorporates recent data on Palestinian listed firms by studying the impact of ownership concentration and firm performance. The findings indicate that better explanatory power is available in model three; suggesting evidence of a process of maturity in the PSE and a need to be cautious in interpreting utilized data.

Our findings suggest that ownership concentration, without consideration of the structure of the shareholdings, explains firm performance. The (OC) was negatively related to the performance of firms listed at PSE. These results invite further research of the relationship between OC and firm market value. They may also imply that the issue of corporate governance in Palestinian firms deserves more serious attention. Further research in this area may include the relationship between OC and firm performance; however, by using different measures of OC such as structure of shareholdings or structure of Board (executive vs. nonexecutive). Besides, other measures of firm performance may be used instead of Tobin's Q such as Earnings Per Share and Risk Adjusted Rate of Return.

Recommendations

Due to the findings above, one can interpret these results and recommend the following:

The negative relation between the performance and ownership concentration is an interesting and expected result in the Palestinian situation; it supports the change in ownership structure and requires a lower percentage of stock holdings by a few people.

These findings support the need for ownership de-concentration for Palestinian firms listed at the Palestine Securities Exchange (PSE). It is known that high ownership concentration is one of the main impediments to good corporate governance. Thus, there is a need for Palestinian firms to reduce OC, which in turn would enhance Corporate Governance. However, this strategic change requires strong will, positive attitude and good management, so that adverse effects of that change will be minimized.

END NOTES

1 For a more complete discussion see David Sewell (2001) Government and the Business Environment in the West Bank and Gaza, MENA Working Paper Series No.23.
2 See the Palestinian Central Bureau of Statistics, Bernard O'Sullivan (2000) SME Sector Study. Prepared for the IFC, and UNSCO (2000) Special report on the Palestinian Economy.

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