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Investor Relations, Ownership Concentration, and Company Profitability

Evidence from Chinese Listed Firms

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***Abstract*—The study tested the relationship between investor relations (IR), ownership concentration, and company profitability in China stock market, applying the data from 2014 to 2016. Through the empirical test, the investor relations positively correlated with the profitability of enterprises. Further empirical tests show that equity concentration as a moderating variable, when it is too high, it will weaken the contribution of IR to corporate profitability. Therefore, the conclusion of this paper can play a revelation to the listed companies in China. Listed companies should recognize the importance of investor relations. Investor relations should be implemented as an important business strategic decision. Managers should find a suitable equity concentration and achieve the company's sustainable development.**

***Keywords*—investor relations; ownership concentration; company profitability**

I. Introduction

Investor relations are a result of mature capital markets. It is now an integral function of listed companies all over the world. To deal with the relationship between the company and investors, General Electric was the first firm that established investor relations (IR) department (J.Brennan & Tamarowski, 2000). IR was first put forward by the chairman of General Electric — Ralph Cordiner in 1953 (J.Brennan & Tamarowski, 2000). After that, in 1969, National Investor Relations Institute (NIRI) was set up, now it has about 4200 members. Investor relations contribute to the development of enterprises; it also plays a significant role in capital market function. The level of investor relations is closely related to the capital source, capital cost, corporate value, and company profitability in the firm.

The evaluation of the profitability of listed companies has attracted much attention from the academic community in recent years. In assessing the profitability of listed companies, the evaluator should consider the financial indicators and non-financial indicators, the level of investor relations is an essential position (Hoffmann & Fieseler, 2012). Scholars argue that investor relations help to stabilise the stock price of listed companies and make them more reasonable to reflect the real value of the company. Therefore, most scholars (Gul et al., 2010; J.Brennan & Tamarowski, 2000; Esterhuyse & Wingard, 2016) have studied the relationship between listed companies and investors to explore the role of investor relations in improving corporate performance. At the enterprise-level, a good investor relation can maintain stock price stability, effectively reduce the risk of investors, enhance investor confidence, broaden corporate financing channels, stabilise existing investors and attract potential investors. It maintains a good relationship between companies and investors and enhances the company's image so that enterprises can better base on the highly competitive capital market and achieve its maximum value (Deng, 2008). From the function of the capital market, a good investor relationship management can help to build the formation of price signal and an optimal allocation of market resources, like capital and human resource (Deng, 2008). This can reduce the shady, fraud, manipulation and speculation in the capital markets. So, in the following years, many types of the research study on IR theory. Most of them focus on information disclosure and the influence of stock price. There are fewer papers about the relationship of IR, ownership concentration and company profitability.

Based on previous studies, this dissertation will focus on how the IR influence company profitability from empirical evidence in China. In the same time, there are many studies, and researches show that ownership concentration has the influence on IR and company profitability. The subject of ownership concentration has been an interests issue in the developed economic society because it has a double side effect on investor relations and company profitability (Demsetz & Villalonga, 2001). Ownership concentration can bring benefits, but it may also bring agency problems. Therefore, I choose equity concentration as an intermediary variable in the research model.

Based on the study, I hope to contribute as follows: Firstly, through the study of the relationship between investor relations, ownership concentration and company profitability, this paper can rich investor relations theory literature. Secondly, this paper makes innovations in the construction of investor relationship indicators.

II. LITERATURE REVIEW

A. Investor Relations and Company Profitability

In each process of companies from the bud to the maturity, managers will develop the expected results of an anticipation of corporate strategic business activities to provide the right direction for the future development of the enterprise. Each stage of the enterprise to develop strategic business activities is expected to achieve the primary results of the expectations. The purpose is to enable enterprises to see their strengths and weaknesses, to see the good conditions in the outside world or the difficulties in the environment (Dul & Neumann, 2009). So, the company can adapt the uncertainty environment. If the development of corporate strategic business objectives can be completed or even over-fulfilled, companies can get great benefits. This will not only get more money but also maximize the profitability of the enterprise itself. Investor relations is an indispensable part of a business or organization's strategy of global, long-term direction, goals, tasks and policies, and resource allocation in a given period. It is through the active communication with investors crosses all sectors and segments of society, so that enterprises and the community to optimize the relationship between investors to achieve the maximum profitability (Esterhuyse & Wingard, 2016).

Investor relationship is a part that cannot be ignored in the company governance structure. Corporate governance through a series of laws and regulations on the relationship between enterprises and stakeholders to conduct a scientific division of the enterprise to develop a more rational, legitimate, and comprehensive program. Ultimately, it protects the interests of the company's internal and external stakeholders (Abe de Jong et al., 2007). Investor relations is to adjust the relationship between business and shareholders and achieve its optimisation. From the case study in Royal Ahold, Abe de Jong et al. (2007) find that a perfect corporate governance structure provides a strong guarantee for the improvement of corporate profitability. First of all, a sound corporate governance structure can significantly improve the profitability of enterprises; similarly, a higher profitability company have more opportunities to optimise the governance structure. Second, when a company has a sound governance structure, it will have an ability to achieve each stakeholder's power and interests, which improve people's trust in the enterprise. Shareholders will also put forward the scientific and practical advice to management. Managers will also develop a better business strategy and management programs to enable the management and governance structure of enterprises to be optimised so that this company will have more advantages than other companies. Finally, the majority of investors can put forward better comments and suggestions to business management and plan of activities, which can make the corporate governance structure get real optimisation and maximise the governance efficiency. Investor relationship management and corporate governance can improve the profitability of enterprises; they have a unique position.

About the relationship of IR and company profitability, Kirk and Vincent researched in 2014, showing IR firms have a higher market evaluation and disclose more information and has high stock liquidity. They model a hypothesis that there is a direct path from stock turnover to book-to-market value since increasing the stock liquidity. IR builds a credible information platform that increases the visibility of the company and improves the liquidity of the stock, thereby reducing the cost of stock transactions, increasing the volume of transactions. This increases the stock price and decreases equity capital costs, so that help company to keep the stock at a high-level price. So, with the increase of the level of investor relations, investors will have a roughly correct inference on the development trend of the company. The major investors are more inclined to spend more money to invest in their optimistic about the company's stock so that the corporate profitability straight up. The cost of a company in acquiring and using capital will reduce.

Higgins (1992) also suggests that IR can improve the level and quality of information disclosure and reduce the information asymmetry between listed companies and investors. It enhances mutual trust between listed companies and investors, improves investor satisfaction and loyalty and reduces equity capital costs. Also, it reduces the undervalued risk of listed companies, and thus maximises the value of listed companies. On the other hand, from Kelly et al. (2010), investor relations have importance on company strategies and will lead to managers significantly increased input their time and energy. In addition to financial aspects, its communication functions should be committed to meet a higher level of information needs such as corporate strategy information and communication activities.

Therefore, based on the mentioned research above, I propose Hypothesis 1: the investor relationship can affect the profitability of the company, and the high level of investor relations can improve the company profitability.

B. Ownership Concentration and Company Profitability

There are two popular views on the relationship between ownership concentration and the company's profitability. One is a related theory that two variables have the relationship; the other is irrelevant that two variables are not related.

Berle (1931) argue that there is a potential conflict between the interests of a company manager who without the company share and decentralised minority shareholders. In the case of a decentralised share of the company, it does not optimize the company's performance. The more diversified ownership in the company, the worse the company's operating performance and profitability. On the contrary, the company's business performance will be improved if they have a relative concentration of the ownership. Shleifer and Vishy's models show that certain ownership concentration is necessary (1986). The point that company's profitability has a more positive result if the company exist large shareholders under the same conditions. Because the major shareholder has the economic incentive ability to restrict the management from sacrificing the interests of shareholders and seeking their interests, it can monitor the manager's behaviour more effectively, help to enhance the effectiveness of taking over the market and reduce the agent cost. Also, the ratio of stock price to corporate earnings increases as the increase of ownership concentration.

Pedersen and Thomsen conducted a survey in Europe in 2000. They survey 435 large companies in 12 European countries and found that there is a significant positive correlation between the concentration of equity and the return on net assets (ROE) of the company. They have conducted an in-depth study of this conclusion and found that the relationship between ownership concentration and performance of 435 large European companies is nonlinear. So, ownership concentration will have a negative influence on firm performance when it exceeds a certain point. In the follow-up empirical test in my dissertation with reference to previous studies, I use return on asset (ROA) to measure the company's profitability.

On the other hand, concentrated ownership means interests conflict between controlling shareholders and minority shareholders, and it is difficult to protect minority shareholders (La Porta et al., 1999). La Porta et al. think (2002) in emerging markets, weaker external regulatory mechanisms and less developed institutions may exacerbate the risk of major shareholders against the interests of minority shareholders. Wang and Shailer conducted an empirical research in different countries in 2015: Chile, Brazil, Turkey, China, Poland, Colombia, Hungary, Korea, Thailand, and Jordan. They divide the ownership concentration into three levels, low, medium, and high. Compared with countries with the lower concentration, the high degree and medium degree of ownership concentration are relatively lower in the firm's performance. And there is no evidence of nonlinear effects.

Based on China's economic research background, Yan (2006) find that non-state-owned final holding company performance is higher than the state-owned final holding company. The existing listed companies in China are mostly from the whole original state-owned enterprises or part of the restructured state-owned enterprises. Ownership structure in these companies shows the high proportion of state-owned holding, the stock is too concentrated and cannot flow. State-owned shares in the control position will bring a long agent chain is incomplete information, insider control and other issues. For example, If the principal holder of the shares is not clear, the right of the "resources" is not very clear, the operator may use this property to maximize their interests, which may easily form a strong insider control. In addition, she also suggested that a high degree of decentralization of equity may not be the best choice to improve and optimize the ownership structure, the more feasible way is to form a number of listed companies in the relative holding of the ownership structure, to maintain a moderate equity concentration, and through the active participation of corporate shareholders to improve the corporate governance structure. According to Yan's market research in the China, I add "state holding" control variable in the later variable design to make a more accurate result.

According to previous studies, the company that maintains an appropriate ownership concentration structure can conduct to a better company's profitability. But the ownership structure cannot be too concentrated or too scattered

C. *Investor Relations, Ownership Concentration and Company Profitability*

Through the literature review about investor relations, ownership concentration and company profitability, I find they have relationships between each other. Under the view of "law and finance" theory, the ownership concentration is the substitute for the lack of legal protection of investors mechanism (Rubin, 2007). Equity is the right of the shareholder to obtain economic benefits from the company and obtains the company's management rights based on the amount of capital invested by them (A.Gul et al., 2010). According to Berle (1931), the concentration of ownership will lead an agency problem. This agency conflict mainly concentrated in the large shareholders and small shareholders outside the company. So,the high ownership concentration will make the effect of IR worse. Rare people did the study about the relationships between them. I research IR, ownership concentration and company profitability. In the process of verifying the hypothesis that IR has a positive impact on the company's profitability, finding what the impact of the role of ownership concentration.

Hypothesis two: ownership concentration plays a moderating role in the process of investor relationship management affecting the profitability of the company. In a certain range, the profitability of the company with low equity concentration is higher than that of the company with high equity concentration.

III. RESEARCH DESIGN

A. *Variable Definitions*

1) *Investor relations*

Company website as a communication medium has specific advantages to companies and investors. For companies, it is cost-effective and flexible to publish information on a website; while, for investors, it is easy, fast, and cheap to get the reliable and up-to-date source of information. With the development of internet technology, more and more companies tend to use the corporate website as a communication channel for investor relations (Nel & Brummer, 2016). At present, almost all the listed companies in China have their corporate websites with dedicated investor relations sections. So, this paper uses the scoring system which based on internet information to measure the level of a company's investor relations.

According to UK Investor Relations Society (IRC), best practice guidelines (2013), the measurement of investor relations are divided into 11 categories: accessibility, navigation, timeliness, company information, financial information, relevant news, investment case, shareholder information, bondholder information, corporate governance, and corporate responsibility. Every category has different attributes. For example, the accessibility means that the website of this company should be fully accessible to all investors. Attributes in accessibility are like website entry and different formats of investor relation.

From the guidelines, the scoring system to measure the level of investor relations in this paper divided into four aspects. The first one is investor relations management basic information that relate to accessibility and navigation. The second one is strategic information that relates to investing case and financial information. The third one is interactive communication information that relates to shareholder and bondholder information. The last one is other information that including company information, voluntary information disclosure and social information. If the relevant information was disclosed on the website of a company, then this attribute assigned 1 point, otherwise 0.

TABLE I. INDICATORS OF INVESTOR RELATIONS

Level 1 Indicators	Level 2 Indicators	Level 1 Indicators	Evaluation Criteria
Level of IR	Basic Information of Investor Relations	Whether can enter the company's website	According to the information disclosed by the enterprise 0 ~ 1 assignment
		Whether there is an investor interactive network platform	
		Investor relations management department	
		Investor Relations Management System	
	Strategic Information	Shareholders' General Meeting Resolutions Announcement	
		Periodic analysis of product or service strategic planning and performance analysis	
	Financial information	Regular Announcement (Annual Report, etc.)	
		Financial (index) performance information	
		Real-time information on stock prices	
		Share capital information (share capital structure)	
		Temporary announcement (the latest announcement)	
		Shareholders' return	
		Raised funds (issue financing)	
	Information of interactive communication	Whether there are investors online Q & A platform (Q & A detailed record)	
		Whether there are investors' consult messages and text records	
		Whether there are investors visit appointments	
		Whether there is investor education	
		Whether there is an investor consultation contact (telephone, e-mail, mailing address)	
		Investor Services	
	Other information, including company information, voluntary disclosure of information and social information	Internal Control Evaluation Report	
		Sustainability Report	
		Disclosure of Social Responsibility Report	
		Governance (organization) structure	
		Director information	
		Staff honor list	

The scoring system has 25 attributes. To calculate the total score of IR in one company, this paper refers to previous researchers (Aitken, Hooper &Pickering 1997, Zhao 2011) on the construction of investor relations index model. Firstly, sums up all the scores and then averages them.

$$IRI = \frac{\sum_{1}^{25} score}{25}$$

IRI is investor relations index. Scores represent the actual score for each investor relationship indicator (i = 1, ... 25). 25 is the largest possible score for investor relations index. In this case, the IRI is a value between 0 and 1, with a maximum of 1 and a minimum of 0.

2) Ownership concentration

The ownership concentration is a quantitative indicator that shows the concentration of ownership or the decentralization of ownership as a result of the difference shareholding ratio of all shareholders. The institutional investors and institutional entities hold the proportion of corporate stocks continue to be on. The main body of a big company's shareholders is transformed from many individual shareholders to a small number of institutional shareholders. So, the top five major shareholders are institutional investors, the company's top-five shareholders of the shareholding ratio can fully represent a company's ownership concentration. Many papers adapt the top 5 shareholders holding ratio as an alternative variable to the ownership concentration (Gul et al., 2010; Gaur et al., 2015). This paper also uses the proportion of the top 5 shareholders to measure ownership concentration in a company.

3) Company profitability

This paper uses the Return on Total Assets (ROA) to measure company profitability.

ROA is a ratio that calculated by comparing the net profit with the average total assets in a period.

$$ROA = \frac{net\ income}{average\ total\ assets}$$

In other words, the return on assets measures the effectivity of a company to produce their profits by managing its assets in a period. (Herold, et al., 2007)

ROA is one of the most frequently used indicators that measure the company's profitability. A higher ROA indicates a better use of corporate assets and a good result of increasing income and saving money or other aspects (Wijayanto, 2010).

4) Control variables

Some control variables are also needed to be considered into the regression model. There are two types of control variable: one is related to company profitability, other is related to ownership concentration. The first type of control variables: company size, financial expense ratio, Asset - liability ratio. The second type of control variables: the nature of the property, management shareholding ratio.

TABLE II. NAME OF VARIABLES

Variable	Variable name	Variable symbol
Dependent variable	Company profitability	ROA
Independent variable	Investor relation	IR
Moderating Variable	ownership concentration	Stoh5
Control variables	Property Nature	STATE State assignment is 1 otherwise 0
	Total assets of company	SIZE
	Asset - liability ratio	RLTA
	Financing Expenses Rate	FER
	Management Shareholding Ratio	Mstoh

B. Research Model

According to the research hypothesis, this paper establishes the multiple regression models as follows.

For Hypothesis one: investor relation has a positive influence on company profitability (ROA).

$$ROA=\beta_{10}+\beta_{11}IR+\beta_{12}STATE+\beta_{13}SIZE+\beta_{14}RLTA+\beta_{15}FER+\beta_{16}Mstoh+\epsilon$$

For Hypothesis two: In the process that investor relationship management has a positive impact on the company's profitability, equity concentration will have a moderating effect.

$$ROA=\beta_{40}+\beta_{41}IR+\beta_{42}Stoh5+\beta_{43}IR*Stoh5+\beta_{44}STATE+\beta_{45}SIZE+\beta_{46}RLTA+\beta_{47}FER+\beta_{48}Mstoh+\epsilon$$

C. Sample and Data Source

Based on the timeliness and availability of data, this paper selected the listed companies from Shanghai Stock Exchange and Shenzhen Stock Exchange in China as the research samples. The observation time was from January 1, 2014, to December 31, 2016. All the data are from CSMAR database that is one of the most popular economic databases in China.

According to the research, some conditions and limitations should be considered in the process of choosing the suitable samples. The data were screened in the following order: firstly, to ensure the continuity of the sample, I delete the sample companies which has the label of S (unfinished split share reform), ST (ordinary risk warning), * ST (company Risk, generally for two consecutive years of losses). Second, due to the particularity of financial and insurance company's financial system, it is necessary to remove the financial and insurance companies to ensure data comparability.

In addition, when calculating and measuring the level of investor relationship, the company's annual report and the company's website are used as a platform for listed companies to carry out investor relationship management activities. Finally, this paper includes 3371 A-share research samples.

IV. EMPIRICAL RESULT

The relationship between company profitability, investor relation and the ownership concentration for the public firm will be analysed by using multivariate regression model in this section.

A. Descriptive Statistics

TABLE III. DESCRIPTIVE STATISTICS

Variable	Obs	Mean	Std.Dev.	Min	Max
ROA	3371	3.04	5.11	-45.05	38.08
IR	3371	0.19	0.11	0.00	0.72
Stoh5	3371	50.93	16.34	0.81	98.47
FER	3371	2.46	3.96	-15.99	24.78
SIZE	3371	27.20	108.56	0.09	2405.38
RLTA	3371	50.01	20.28	1.56	127.96
STATE	3371	0.62	0.49	0.00	1.00
Mstoh	3371	0.02	0.07	0.00	0.81

"Table III" lists descriptive statistics for all variables in the empirical analysis. The return on assets (ROA) varies greatly among different companies. The maximum value is 38.08% while the minimum is -45.05%, which indicates the uneven development of listed companies in China. Regarding investors relations, the mean is 0.19, and the standard deviation is 0.11. The average can reflect the true level of a credible investor relationship in China because the standard deviation is small. The level of investor relations is low. The function of China information disclosure mechanism in the capital market should be improved. Descriptive statistics also show that the score of investor relations in some companies' is 0. This indicates some of them did not build investors relations system. They do not even pay attention to this matter.

Relevant indicators of the company's ownership structure are property nature, top 5 shareholders holding ratio and management shareholding ratio. The mean of property nature is 0.62 that indicates most Chinese companies are state-owned. From top 5 shareholders holding ratio, the maximum is 98.47% while the minimum is 0.81%. There is a large difference between sample companies' equity concentration. The management shareholding ratio is very low, the maximum is only 0.81%, and the mean is 0.02%. These number is close to zero. The proportion of the company's management shareholding ratio is too low, which indicates the company may not consider taking enough equity incentives (A.Gul et al., 2010).

B. Correlation Matrix

"Table IV" shows the correlation coefficient analysis of each major variable. As can be seen from this table, the correlation coefficients of the main variables are less than 0.35, indicating that there are no serious multiple collinearities between the variables of the regression model.

TABLE IV. CORRELATION COEFFICIENT ANALYSIS

	ROA	**IR**	**Stoh5**	**FER**	**SIZE**	**RLTA**	**STATE**	**Mstoh**
ROA	1							
IR	0.05***	1						
Stoh5	0.146***	0.106***	1					
FER	-0.228***	0.012	-0.022	1				
SIZE	-0.004	0.161***	0.247***	0.013	1			
RLTA	-0.308***	0.045***	0.08***	0.371***	0.148***	1		
STATE	-0.099***	0.018	0.158***	0.023	0.092***	0.129***	1	
Mstoh	0.093***	-0.021	-0.005***	-0.059	-0.04**1	-0.063***	-0.324***	1

a. Standard errors in parentheses * p < 0.10, ** p < 0.05, *** p < 0.01

C. Regression Analysis

The empirical results support the Hypothesis one. From the regression analysis, the first column of model 1 in the table, investor relations is positively correlated with the profitability of the company at 1% significant level. ROA will increase 0.21% when the company's IRM score increase 0.1. This shows that the company in the capital market can earn more money with the higher level of company investor relations. Meanwhile, the level of investor relations can be reflected in the capital market. Therefore, listed companies can improve the company's profitability by improving the number and quality of information disclosure, and enhance the interaction between investors to attract investors. From another point of view, investor relations improve the company's profitability because company's managers can extract information from the feedback about corporate value creation strategies of securities brokers and investors (Higgins, 1992). Management can better understand how investors respond to some company specific actions. This has a direct impact on the company's strategic decisions and stock prices. This also reflects the two-way communication of information in investor relations, which is good for both investors and companies.

TABLE V. REGRESSION RESULTS OF MODEL ONE

	ROA
IR	2.6068*** (0.009)
FER	-0.1520*** (0.000)
SIZE	0.0020* (0.058)
RLTA	-0.0720*** (0.000)
STATE	-0.4724** (0.044)
Mstoh	5.2117*** (0.001)
_cons	6.6295*** (0.000)
N	3371
adj. R2	0.1211

a. Standard errors in parentheses * p < 0.10, ** p < 0.05, *** p < 0.01

The cross term IR * Stoh5 is added to Model 2 in "Table VI". The IR and Stoh5 have more positive impact on the company's profitability. IR for each additional 0.1, ROA will increase 0.72%. At the same time, when Stoh5 increase 1%, ROA will increase 0.071% naturally. However, the cross term IR * Stoh5 has a negative influence on company profitability. This indicates that IR will reduce the degree of promotion of ROA with the higher ownership concentration.

TABLE VI. REGRESSION RESULTS OF MODEL TWO

	ROA
IR	7.2023** (0.02)
Stoh5	0.0710*** (0.000)
IR*Stoh5	-0.0954* (0.081)
FER	-0.1441*** (0.000)
SIZE	0.0005 (0.630)
RLTA	-0.0727*** (0.0053)
STATE	-0.7349*** (0.000)
Mstoh	4.1287*** (0.002)
_cons	3.3117*** (0.006)
N	3371
R^2	0.3532

a. Standard errors in parentheses * p < 0.10, ** p < 0.05, *** p < 0.01

In the company's ownership concentration conditions, the major shareholders have the power and ability to influence the composition of management and supervise the management decision-making process, to effectively solve the decentralised share of the management agent problem (Omran, et al., 2008). But when the concentration of ownership is too high in the company, the agency problem will appear between the controlling shareholder, small and medium-sized investors (Fama & Jensen, 1983). The company's management will be useless; there is no ability to form a right balance between the management and major shareholders. Large shareholders use the control of the company to pursue their interests. According to Rubin (2007), large shareholders are more informed, if a minority holds the information rather than a lot of people, the possibility that any insider will trade on such information will be greater. They screened the information disclosed by the company and violated the Investor Relations Management Treaty. In short, from the company's profitability, if the ownership concentration is too high, it may make the major shareholder limit the protect function of the investor relation which belong to corporate governance to obtaining more invasive interests. It inhibits the role of investor relations in enhancing the company's profitability. The result is to make the profitability of listed companies lower.

V. CONCLUSION

This paper examines the relationship between investor relations, ownership concentration and corporate profitability of Chinese listed companies. The total sample eliminates the existence of business risk or delisting risk of the company, so we can identify the sample is a good business performance and stability of the company, the empirical results are true and reliable. After research, it concluded that the investor relations of Chinese companies positively correlated with the profitability of enterprises, which shows that raising the level of investor relations of listed companies will help to enhance the profitability. Investors make investment decisions through information disclosure and interactive communication of listed companies. Through the investor relations management activities, enterprises can let existing, and potential investors understand the business situation, development prospects, and thus obtain the recognition and trust of investors, which the company to improve its value. Based on results, listed companies and regulators need to understand the importance of investor relations. Specifically, the following aspects can be used to improve the level of investor relations of listed companies: the investor relationship management should be regarded as a strategic decision of the company. The company develops rules and regulations on investor relations and hires experts from investor relations management to train employees in the company, creating a top to down atmosphere of learning investor relations.

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