GO Green Research and Education

Journal of Business and Management Research
ISSN:2958-5074 pISSN:2958-5066
Volume No:2 Issue No:2(2023)

Foreign Ownership and Firm Growth: Evidence from Non-Financial Sector of Pakistan

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Abstract

This study has been carried out to examine the role of foreign ownership in firms' growth of non-financial sector of Pakistan. The study conducted on panel data which consists of 100 non-financial companies listed on Pakistan stock exchange (PSX) for the period of 10 years from 2011 to 2020. Fixed effect model has been used for analysis. Asset growth and sales growth have been used to measure firm growth while foreign ownership is estimated by using fraction of shares held by foreign shareholders. This research study is first of its kind on Pakistani data to investigate the impact of foreign ownership on firm's growth of listed non-financial companies. The study results show that foreign ownership significantly and positively impacts asset growth in Pakistan which indicates that higher foreign ownership leads to more asset growth. The results also revealed that foreign ownership positively effects sales growth, however this relationship is not statistically significant. Findings of the study will be important for decision makers, investors, and managers to understand the direction of the influence of foreign ownership on firm growth. The findings will help firms and policy makers to frame growth friendly policies.

Keywords: *Firm Growth, Foreign Ownership, Panel Data, Fixed Effects Model, Non-Financial Companies, PSX*

Introduction

Foreign ownership is an important governance tool which plays significant role to improve firm's performance and growth. Foreign ownership is the ownership or control of a firm by persons or entities that are not residents of the country where the company is situated. Foreign ownership can have important implications for both shareholders and

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ISSN:2958-5074 pISSN:2958-5066
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managers. Generally, foreign ownership brings new technology, investment and managerial expertise to firms which can help firms to boost its performance, productivity, value and shareholders wealth (Lindemanis et al., 2022). Further, foreign ownership can lead to transference of innovative skills, knowledge and experience to local employees, which can contribute to human capital development in the host country.

Likewise, foreign investors often have higher expectations for transparency, accountability, and shareholder rights, which can influence the behavior of management and can promote corporate transparency (Han et al., 2022). Therefore, local firms may adopt better ownership structure to attract foreign investment and improve firm growth. Firm growth is considered as a key indicator of firm success and competitiveness in the business environment and financial market. Growth depicts that the firm is able to expand its operations, increase its market share, and generate more revenues. Empirical evidence also exhibits firm growth is associated with different types of equity ownership. Ownership in the form of foreign investors can also impact firm performance and growth. Foreign ownership can lead to increased firm growth.

Foreign investors often bring proficiency that can help local firms to expand their operations and business. They may also have access to innovative markets and distribution networks, which can aid in the firm's growth (Sobhan, 2022). It is important to carefully manage ownership control and balance the benefits and risks of foreign ownership to promote the growth of local firms. Though foreign investors may not always have a greater number of shares but foreign ownership is considered as significant factor of the ownership structure of firms in the financial markets of developing countries (Douma et al., 2006). Foreign investors provide managers with an incentive to peruse higher growth and long term value for the sake of owners by monitoring the actions of managers (Choi & Park, 2019).

There exists empirical evidence regarding association of foreign investors and firm's growth. Likewise, Bena et al. (2017) stated that the financial value of firms increases

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ISSN:2958-5074 pISSN:2958-5066
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with larger foreign ownership. Greenaway et al. (2014) documented that firm's profitability initially increases with foreign ownership but productivity and profitability starts declining once foreign ownership reaches beyond 64 percent, this indicates that certain level of local ownership is necessary to grow and ensure ideal performance. Theoretically, it is observed that foreign ownership is related with firm growth.

The association is based on the idea of agency theory as foreign investors like other influential group can play moderating role and reduces the conflict of interest between management and shareholders. Further foreign investors play the role of liaising with local investors, organizations and foreign organizations. Douma et al. (2006) stated that foreign ownership enhances firm performance as foreign investors can play a significant monitoring role thus decreasing agency costs. The role of foreign ownership has attracted significant research interests over the last two decades (Choi & Park, 2019). Due to the crucial role of foreign ownership, many research studies have undertaken to examine the role of foreign ownership in firm performance.

Many studies found that foreign ownership has positive relationship with firm performance and value while others found no statistical relationship. However, few studies observed that foreign ownership negatively related with firm performance and value. Although several prior studies have focused on investigating the impact of foreign ownership on firm performance and firm value (Alquist et al., 2019; Din et al., 2021; Phung & Mishra, 2016 among others) but few researches have studied the link of foreign ownership and firm growth (such as Choi & Park, 2019; Nguyen et al., 2019; Pham et al., 2020). However, the association of foreign ownership and growth has not been investigated yet in Pakistan. To the best of authors knowledge, for the first time this study offers evidence from non-financial sector of Pakistan.

This paper contributes to the corporate literature by providing empirical evidence on foreign ownership and firm growth relationship from a developing country. The current study examines the role of foreign equity ownership of non-financial companies.

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The study has employed two measures of firm's growth i.e., assets growth and sales growth to provide robust evidence on the relationship. Employing multiple firm growth proxies helps to capture different aspects of a firm growth. This study uses fixed effects model, a more convenient and appropriate statistical method to estimate the effect of foreign ownership on firm's growth in a more recent period. The findings of the study will help to understand the direction of the relationship and the role of foreign ownership in the management activities of the firms.

Review of the literature and hypothesis development

Firm growth

Firm growth is the increase in the overall size of a company, generally it happens when firms expand their operations and sizes (Coad, 2018). Firm growth is the continuous process by which the revenue generating capability of the firms increased overtime (Hijazi & Shah, 2005). Firm that has a good record of rapid growth as compared to average growth of firms in the respective industry is also indicates firm growth. Typically, firms' growth is estimated through financial metrics such as market share, revenues, and assets but at the same time the notion of firm growth can also be seen from the prospective of non-financial indicators like employees and size (Pham et al., 2020).

Penrose (1995) defines firm growth in two perspectives, first firm growth refers to increase in specific volume and amount. Secondly, firm growth is a specific development process which is similar to the natural and biological development process resulting in improvement of quality or increase of size and volume. Generally, increase in the size of firms is considered as firm growth. However, there is a substantial difference between firm growth and firm size. Thus, it is imperative to clarify the difference between growth of a firm and its size (Whetten, 1987). Firm size is an overall increase, and it is an absolute number representing the volume of a company in particular time. Whereas, firm growth is about the change of the size of the firm over time (Weinzimmer et al., 1998).

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Foreign ownership

Foreign ownership is the ratio of ordinary shares/stocks held by foreigners to the firm's total outstanding common shares. It is documented that foreign ownership increases the reputation and exposure of firms. Foreign investors significantly influence management decisions of firms and affect firm value. Foreign ownership increase firm productivity as firm with foreign ownership are less likely to face financial constraints (Xu et al., 2022). Although there are only few studies to date have examine the direct impact of foreign ownership and limited literature available regarding association of foreign ownership and firm's growth, still scholars contend that foreign ownership may affect firm's growth. Alquist et al. (2019) show that foreign ownership plays significant role to ease constraints faced by a firm and documented that foreign ownership can significantly impact performance of the firm as foreign ownership reduces financial constraints by influencing management decisions. Choi and Park (2019) contended that foreign ownership and changes in foreign ownership significantly impact firm growth and value.

Foreign ownership and firm growth

Literature witnessed firm growth can be affected by foreign ownership as foreign shareholders steadily assess and evaluate performance of firms and firm value in financial markets. Higher ownership by foreigners lead to more efficient investment decisions as foreign investors help management in taking right investment decisions which increases firm performance and growth (Park et al., 2016). Foreigners also assist firms to raise additional capital to finance their potential investments through debt financing as foreign investors have international reputation and firm can take advantage of reliable relationship to access new foreign markets (Elsayed, 2010). In addition, foreign ownership also affects firm's firm performance by reducing financial constraints as foreign investors help firms to raise additional capital to finance their potential investments through debt financing as foreign investors have international reputation

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and firm can take advantage of reliable relationship to gain access to new foreign market (Alquist et al., 2019).

Moreover, Hake (2009) documented that foreign ownership tends to exert a positive effect on firm growth. Kao et al. (2019) stated that institutional ownership, family ownership and foreign ownership positively associated with firm value in Taiwan. Whereas Phung and Le (2013) found a negative relationship between foreign ownership and firm performance in emerging markets as it cannot serve as motoring tool due to high information asymmetry. Pham et al. (2020) studied the impact of capital structure and ownership structure on firm growth. They found that state ownership has a negative impact on firm growth while no statistical relationship found between foreign ownership and firm growth. Nguyen et al. (2019) empirically examined the relationship between ownership structure and firm growth in Vietnam. The study showed that state ownership negatively affects firm growth while foreign ownership positively associated with firm growth. They reported that the foreign ownership coefficient is positive but not statistically significant which indicates that the relationship is not significant.

Choi and Park (2019) have conducted a study to examine the relationship between foreign ownership and long-term growth and found that foreign ownership positively associated with firm value. Further findings revealed that changes in foreign ownership negatively associated with agency cost which indicates firm profitability in future. Shrivastav and Kalsie (2017) have conducted a research on foreign ownership and firm performance. Pooled ordinary least square method and random effect model have been used to study the influence of foreign ownership. The study found that foreign ownership significantly and positively effects firm performance under pooled OLS model while under random model the effect of foreign ownership is positive but insignificant. Rustam et al. (2019) studied the effect of foreign ownership in Pakistan and reported that foreign ownership positively related with firm size and growth. Moreover, foreign direct investment also enhances overall economic growth in developing countries (Tashfeen et

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al., 2022). Mishra (2014) also reported that both free float and traditional measures of foreign ownership has positive effect on firm value. Following the theoretical evidence from prior literature, this study predicts a significant relationship between the foreign ownership and firm's growth. After comprehensive literature review, the study developed following hypotheses:

H1: There exist a positive relationship between foreign ownership and assets growth of non-financial companies in Pakistan.

H2: There exist a positive relationship between foreign ownership and sales growth of firms in Pakistan.

Methodology

Data and Sample Size

This research study is quantitative in nature as secondary and panel data have been used to conduct study analysis. The sample of 100 firms have been selected on the basis of market capitalization. The data of 100 firms have been collected for the period of 10 years from 2011 to 2020. Such data have been collected from non-financial companies listed on Pakistan Stock Exchange (PSX). Annual reports of the sample firms have been used to collect data related to foreign ownership, assets and sales while financial data have been collected form PSX and State Bank of Pakistan (SBP).

Measurement of variables

In line wine with previous studies, following measures have been used to calculate each variable of the research study.

Firm growth

Firm growth has been estimated by two measures such as assets growth and sales growth. Various studies used formula to calculate asset growth and sales growth. Consistent with prior literature, following formal has been used to estimate asset growth:

$$\text{Assets growth of a firm } = \frac{\text{Total assets in current year} - \text{ previous year total assets}}{\text{Total assets in preceding year}}$$

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Moreover, as mentioned earlier sales growth has been also used to measure firm growth and sales growth can be estimated as:

$$\text{Sales growth of a firm} = \frac{\text{Net sales in current year} - \text{previous year net sales}}{\text{Total net sales in preceding year}}$$

Foreign Ownership

Foreign ownership is the proportion of ordinary shares/stocks held by the foreigners other than native citizens/ investors. Previous studies estimated foreign ownership by using a formula, this study also used same formula to calculate ownership by foreign investors. Foreign ownership can be calculated as:

$$\text{Foreign Ownership} = \frac{\text{Number of shares held by foreign shareholders at time t}}{\text{Total number of common shares of a firm at time t}}$$

Control Variables

Various studies in the literature examined the association between ownership structure and firm growth by using relevant control variables. Corporate literature suggests some financial variables beyond foreign ownership that can influence firm growth and firm performance. In consonance with corporate governance literature this study included firm size, firm leverage and dividend payout ratio as control variable in the research model. Moreover, natural log of total asset has been used to estimate firm size while debt to asset has been used to measure firm leverage. Whereas, dividend payout is estimated by the percentage of net earnings paid as dividend to the shareholders of firms.

Estimation technique used for regression analysis

Fixed effects model has been used to examine the link of foreign ownership and firm growth as FEM is a reliable practice to run on panel data (Ali & Hashmi, 2018). Further fixed effect model is selected as the more appropriate model for the examination by using both Likelihood and Hausman test to panel data which indicates a significant value of Chi square for fixed effects model. The results of both Likelihood and Hausman stats exhibit fixed effect model is the best fit model as compared to common effect and random effect model.

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Econometric model

The main purpose of the study is to test the relationship between foreign ownership and firm growth. As discussed, two measures i.e., assets growth and sales growth have been used to measure firm growth. Hence, following two equations reflect the econometric model of the study:

$$AG_{i,t} = \beta 0 + \beta 1FO_{i,t} + \beta 2FS_{i,t} + \beta 3FL_{i,t} + \beta 4DPR_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$SG_{i,t} = \beta 0 + \beta 1FO_{i,t} + \beta 2FS_{i,t} + \beta 3FL_{i,t} + \beta 4DPR_{i,t} + \varepsilon_{i,t} \quad (2)$$

Where:

i = stock/firm
t = year/time
β = beta
$\beta 0$ = intercept
$AG_{i,t}$ = asset growth
$SG_{i,t}$ = sales growth
$FO_{i,t}$ = vector of variable foreign ownership
$FS_{i,t}$ = vector of control variable size of firm
$FL_{i,t}$ = vector of control variable firm leverage
$DPR_{i,t}$ = control variable dividend payout ratio
$\varepsilon_{i,t}$ = ε represents error term

Results and Discussion

This section describes the results of different tests such as descriptive statistics, correlation analysis and regression analysis. Further provides the results of hypothesis testing and explains the findings in light of the relevant prior literature.

Descriptive Statistics

Descriptive statistics shows the general behavior of data and descriptive details such as value of standard deviation, mean, median, minimum value and maximum value of the study variables.

Table 1. Descriptive Statistics of the Variables

	AG	SG	FO	FS	FL	DPR
Mean	0.1259	0.1065	0.0648	16.936	0.1851	0.3541

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Median	0.0979	0.0911	0.0017	16.910	0.1412	0.2977
Maximum	0.7390	0.7526	0.6356	20.574	0.7517	1.1833
Minimum	-0.2580	-0.4670	0.0000	13.468	0.0000	-0.6800
Std. Dev.	0.1398	0.1583	0.1377	1.2960	0.1825	0.2892
Skewness	1.2527	0.3322	2.6662	0.2082	0.9361	0.6330
Kurtosis	5.9821	6.2633	9.4286	3.1814	3.0761	2.7178
Observations	1000	1000	1000	1000	1000	1000

Note. AG represents asset growth, SG = sales growth, FO = foreign ownership, FS = firm size, FL = firm leverage, DPR = dividend payout ratio whereas Std. Dev. is the standard deviation.

Table displays the statistical behavior of the variables data. Value of mean is range from 0.0648 (foreign ownership) to 16.936 (firm size). The mean indicates average value of the respected variable. Standard deviation is the degree of dispersion or deviation from mean value. The standard deviation value is range from 0.1377 (foreign ownership) to 1.2960 firm size). The table also presents the minimum value, maximum value, skewness and Kurtosis. The skewness values indicate data is positively skewed.

Correlation Analysis

Table 2 depicts the correlations between study variables. Correlation analysis is used to examine check the correlation among study variables. Further it gives the idea about positive and negative correlation among study variables.

Table 2. Correlation Matrix

	Asset growth	Sales growth	Foreign ownership	Firm Size	Firm leverage	Dividend payout ratio
Asset growth	1					
Sales growth	0.3269	1				
Foreign ownership	-0.0029	0.0035	1			
Firm Size	-0.1345	-0.1827	-0.1092	1		

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Firm Leverage	-0.0234	0.1095	-0.1051	0.0080	1	
Dividend payout ratio	-0.0704	-0.0592	0.1433	0.0838	-0.1268	1

Note. Correlation of study variables such as Asset growth, Sales growth, Foreign ownership, Firm size, Firm leverage, Dividend payout ratio. + values show positive correlation while – signs indicate negative correlation study between variables.

The table indicates that asset growth positively correlated with sales growth (r=0.3269) while negatively correlated with other variables. Sales growth positively related with asset growth, foreign ownership and firm leverage while negatively correlated with firm size and dividend payout ratio (r=-0.1827 & 0.0592 respectively). Moreover, foreign ownership negatively correlated with asset growth, firm size and firm leverage whereas foreign ownership positively related with sales growth and dividend payout ratio.

Regression Analysis

Generally, three models have been applied on panel data such as Common Effect Model (CEM), Fixed Effect Model (FEM) and Random Effect Model (REM). Further Likelihood test and Hausman test have been run to select more appropriate model. The results of both tests have been provided in the following tables.

Table 3. Results of Likelihood Test

	Model-1 (Asset Growth)			**Model-2 (Sales Growth)**		
Test	stats	d.f	probability	stats	d.f	probability
Cross sections f	4.3944	(99,896)	0.00	3.1525	(99,896)	0.00
Cross-sections chi-square	395.7816	99	0.00	298.863	99	0.00

Likelihood test is the best way to choose more efficient model between CEM and FEM (Ali & Hashmi, 2018). The results of both models depict that Chi square values are significant (p-value = 0.000 & 0.0000 respectively) which concludes FEM is the more efficient model.

Table 4. Results of Hausman Test

	Model-1 (Asset Growth)			**Model-2 (Sales Growth)**		
Tests	Chi-Sq. stats	Chi-Sq. d.f	Prob.	Chi-Sq. stats	Chi-Sq. d.f	Prob.
Cross-sections random	20.3912	4	0.004	70.4423	4	0.0000

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Hausman test is used to choose the more appropriate model between FEM and REM (Ali et al., 2021) The results of both models indicate that values of chi square are significant (p-value = 0.004 & 0.0000 respectively) which suggests FEM is the more efficient model as compared to random effects model.

Fixed Effects Model

By using likelihood and Hausman test on panel data, fixed effect model has been selected and applied on panel data to investigate the effect of foreign ownership and control variables on two measures of firm growth. Two models have been developed to separately examine the effect of explanatory variables on asset growths and sales growth. In the first model, explanatory variables have been regressed with asset growth while in second model independent and control variables have been regressed with sales growth. commonly, fixed effects model helps to control individual-specific characteristics in order to better understand the relationships between different independent and dependent variables over time.

Table 5. Results of Fixed Effects Model

	Model-1 (Asset Growth)			**Model-2 (Sales Growth)**		
	Coefficients	Std. Err	t-stats	Coefficients	Std. Err	t-stats
C	1.0332	0.1671	6.1817	2.0855	0.1962	10.625
FO	0.1490*	0.0683	2.1799	0.0799	0.0438	1.8213
FS	-0.0537***	0.0098	-5.4562	-0.1184***	0.0115	-10.242
FL	-0.0259	0.0373	-0.6933	-0.0014	0.0802	-0.0178
DPR	-0.0060	0.0199	-0.3009	0.0350	0.0234	1.4968
(Prob) F-Stats	0.0000			0.0000		
R-Square	0.3421			0.2929		
Adj. R-Square	0.2664			0.2116		
Durbin-Watson stats	1.7112			1.6660		
Observations	1000			1000		

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Notes: Table shows results of Fixed Effects Model (FEM). Two proxies of firm growth have been used i.e., asset growth and sales growth. In Model-1 dependent variable is asset growth while in model-2 dependent variable is sales growth. C shows intercept, FO = foreign ownership, FS = firm size, FL = firm leverage, DPR = dividend payout ratio. Significance level; * shows p-value is less than 0.05 while *** shows p-value is less than 0.001.

Table 5 shows the results of the regression analysis. Value of F-stats is highly significant in both models which revealed that both models are valid. Results of model-1 depicts that foreign ownership positively affect assets growth as the coefficient value is positive and statistically significant (0.1490* p-value<0.05). The coefficient value of 0.1490 indicates that one-unit increase in foreign ownership leads to 0.149 units increase in asset growth. The results of model-1 also show that firm size negatively and significantly effect asset growth (-0.0537*** p-value<0.001). The relationship between control variable financial leverage and assets growth is negative and insignificant (-0.0259, p-value>0.05). Similarly, the relationship between dividend payout ratio and asset growth is also insignificant (-0.060, p-value>0.05).

Moreover, results of model-2 show that foreign ownership does not significantly affect sales growth as the coefficient value is positive but not statistically significant (0.0799, p-value>0.05). The result also depicts that firm size negatively and significantly affect sales growth (-0.1184*** p-value<0.001). The relationship between control variable financial leverage and sales growth is insignificant (-0.0014, p-value>0.05). Likewise, the association of dividend payout ratio and sales growth is also insignificant (0.0359, p-value>0.05). These results indicate that except firm size other control variables such as financial leverage and dividend payout do not significantly affect sales growth.

As discussed, firm growth has been measured by asset growth and sales growth. Firm growth is dependent variable therefore two hypotheses have been estimated and tested. First hypothesis of the study stated that there exists a positive relationship between foreign ownership and asset growth. The regression analysis confirmed that foreign ownership positively and significantly affects asset growth. hence, first hypothesis has been accepted. This finding is consistent with the study of Hake (2009)

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also found a positive and significant relationship between firm growth and foreign ownership. Whereas second hypothesis of the study posit that foreign ownership has a positive and significant effect on sales growth. Moreover, Mishra (2014) also reported that foreign ownership can positively and significantly effect firm value. However, the result of the fixed effect model revealed that foreign ownership does not significantly affect sales growth. Therefore, second hypothesis has been rejected. Some studies like Nguyen et al. (2019) also found similar results while studying foreign ownership and firm growth relationship.

Increase in foreign ownership does not necessarily increase sales growth as the role of foreign ownership is limited. Foreign ownership does not directly influence sales or customer decision making. Sales growth is largely determined by factors such as the product, customer base, and business environment of the country. Moreover, in Pakistan foreign ownership has limited influence on sales growth of firms as the economy is largely based on domestic consumption and Pakistan is not merely dependent on foreign ownership and investment. Foreign ownership is certainly in the form of long-term investments and consequently does not directly contribute to immediate sales growth. Therefore, foreign ownership alone will not unswervingly affect sales growth in Pakistan.

Conclusion

Firm's growth is essential for the economic development of the country. Firms have a very important role to play in developing economies as firm creates employment opportunities, generates revenues and increases nation's wealth. Foreign investors can influence growth of firms and further helps firms to increase earnings, productivity, assets and value of the company. This study has been carried to examine the relationship between foreign ownership and firm growth. The current study is based on panel data and data has been collected from 100 non-financial companies listed on Pakistan stock exchange (PSX) for the period of 10 years from 2011 to 2020. Fixed effects model has been used to test the effect of foreign ownership on firm growth of selected sample non-financial companies.

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Firm growth has been measured by using both sales growth and asset growth. This research study is first of its kind to investigate the relationship between foreign ownership and firm's growth of listed non-financial companies in Pakistan. Based on the empirical evidence, it is stated that foreign ownership positively influences firm growth. The findings of the study are important for decision makers and managers of non-financial companies.

Limitation and directions for future research

This study has taken data from only non-financial companies and future research is suggested to include data of financial companies and conduct a comparative study. This study used only two proxies to measure firm growth, future studies can include others measure to validate the findings of the study. This study investigated foreign ownership only, other studies can include different ownership variables to expand the knowledge on ownership structure and firm growth relationship. This research study uses data of only one developing country, future research is suggested to conduct cross-country research as conducting cross-country research by incorporating data from multiple developing countries can provide valuable insights and enhance the generalizability of the findings. The study collected only 10-year panel data, longer time period data may be used in the future to provide more robust results and increase the validity of the findings.

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ISSN:2958-5074 pISSN:2958-5066
Volume No:2 Issue No:2(2023)

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