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Ownership Structure and Firm Performance in Malaysia

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Abstract

The aim of the study is to investigate the effect of different type of ownership structure on firm performance proxied by market measure (market to book value, MTBV) based on companies listed on Bursa Malaysia in the year 2006 to 2010. Firm performance in this study is proxied by market measure (market to book value, MTBV). Results of the study indicate that director ownership and foreign ownership have non-linear relationship with MTBV using quadratic function. While family ownership and ownership by government-linked investment companies have linear relationship. Director ownership has negative relationship which indicate the entrenchment effect at the lower stake. However, director ownership has positive relationship meaning the alignment effect occurs at the higher stake. However, foreign ownership has alignment effect at the lower stake and entrenchment effect at the higher stake. Government-linked investment companies has negative relationship. The findings of the study add to the ownership structure literature in the concentrated ownership market.

Keywords: Director ownership, family ownership, government ownership, foreign ownership, firm performance, Malaysia

1. INTRODUCTION

The ownership structure in Malaysia is majority held by directors and family members. The concentrated ownership might influence decision making process on the board level. The decisions might be biased towards controlling shareholders. Shareholdings by directors and family members would act as incentives to maximize firm performance. However, the non-liner relationship may occur when the entrenchment or the convergence-of-interest exist at certain percentage of shareholdings. For the government–linked investment companies (GLICs), being experienced institutional investors, they would take actions to monitor the performance of the invested firms and be more selective in their investments. Similarly, foreign investors would choose to invest in countries practiced strong investor protection and in firms with potential returns. They would not risk their investment if the return is not promising as shown by the huge outflow of foreign direct investment in the 1997 financial crisis.

Different institutional factors in concentrated ownership, as compared to diffuse ownership, would require policy makers to have different strategies to cater with the consequences. Having information on the influence of ownership structure would provide insights to the policy makers to develop effective corporate governance mechanisms. The aim of the study is to examine the effect of ownership structure on firm performance in Malaysia. The study considers different types of ownership structure pertinent to Malaysian listed companies: director ownership, family ownerships, government linked companies' ownership, and foreign ownership.

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2. LITERATURE REVIEW

2.1 Director ownership

Shares owned by directors may work as direct incentives for directors to have common interests with the shareholders, as the firm performance will also affect their wealth in the company (Jensen & Meckling, 1976). The presence of director ownership tends to reduce agency costs and increase performance (Han & Suk, 1998; Ang, Cole & Lin, 2000; Filatotchev et al., 2005; Krivogorsky, 2006). However, Chang (2003) and Lin et al. (2008) show that performance is negatively related. Morck et al. (1988) found that performance measured by Tobin's Q using the piece-wise method shows non-monotonous trend: positive relationship occurs at 0% to 5% and beyond 25%; negative relationship occurs at 5% to 25%. Several studies in the developed countries by McConnell and Servaes (1990), Short and Keasy (1999), and Wong and Yek (1991) have shown that the relationship is non-linear. These studies found that managers get entrenched (or aligned) at certain level of ownership which lead to decreased (increased) firm performance. Studies in Malaysia by Fauzias et al. (1999), Ruhani and Sanda (2001) and Kamardin (2014) also found the non-linearity relationship. Ruhani and Sanda (2001) found curvilinear relationship with concave shaped: positive relationship for ownership less than 36.7%; negative relationship for ownership exceed 36.7%. However, Kamardin (2014) found a curvilinear relationship (U-shaped) with Tobin's Q and a linear relationship with ROA which supports the convergence-of-interest hypothesis. Thus, the hypothesis is:

H_1: Director ownership is significantly associated with firm performance.

2.2 Family ownership

Family members having shares exceeding certain threshold would gain control over a firm members (Anderson & Reeb, 2003; Villalonga & Amit, 2006). A family can also gain control indirectly through pyramidal structure (La Porta et al., 1999). The positive aspect of family controlled firms is that they would monitor the firm performance and reduce agency costs (Jensen & Meckling, 1976; Fama & Jensen, 1983; Demsetz & Lehn, 1985; James, 1999; Joh, 2003). Family owners, for example have superior knowledge about the firm's activities since its inception (Kets de Vries 1993). In addition, trust between the family members create conducive working environment (Chami, 1999). On the negative aspect, family members with higher shareholdings could expropriate firms' assets for themselves through various ways such as excessive compensation, related party transactions, special dividends, and non-pecuniary benefits (Shleifer & Vishny, 1997; DeAngelo & DeAngelo, 2000). Mixed findings are reported: some studies report positive association with firm value (Mishra et al., 2001; Wiwattanakantang, 2001; Anderson & Reeb, 2003; Filatotchev et al., 2005; Villalonga & Amit, 2006; Maury, 2006; Andres, 2008; Saito, 2008); other studies do not find positive association with firm performance (Thomsen & Pedersen, 2000; Chen et al., 2005; Achmad et al., 2007; King & Santor, 2008; Randoy et al., 2009; Ibrahim & Abdul Samad, 2011). Thus, the hypothesis is:

H_2: Family ownership is significantly associated with firm performance.

2.3 Government-linked institutional investors (GLIIs)

The objective of government-linked investment companies (GLICs) is to hold the investment for a longer period. Thus, GLICs are expected to monitor the firm performance effectively. As institutional investors, GLICs are very selective in their investments and only invest in good performing firms. Experienced institutional investors are able to manage distress risks better than their inexperienced counterparts (Tykvová, & Borell, 2012). Some institutional owners, for example vulture investors, are experts in restructuring and turning around companies. Studies by Lau and Tong (2008) and Le and Buck (2011) on the relationship between GLICs and firm performance have reported positive relationship. The studies report that companies controlled by GLICs generally have good performance and do not suffer from financial distress. However, Thomsen and Pedersen (2000), Gunasekarage et al. (2007) and Wei et al. (2005) report GLICs have negative relation to firm performance. Thus, the hypothesis is:

***H_3*:** Shareholding by government-linked investment investors is significantly associated with firm performance.

2.4 Foreign ownership

The existence of foreign investors would mitigate the agency problem between controlling and minority shareholders because they are expected to reduce the opportunistic behavior of the controlling shareholders. Boyer and Zheng (2009) and Douma et al. (2006) report a positive relationship between the foreign ownership bring and firm performance. The higher is the percentage of foreign ownership the better would be the firm performance, thus lowering the likelihood of the firm to go bankruptcy. Che-Haat et al. (2008) indicates that foreign ownership has strong predictive power on firm performance in Malaysia. Generally, foreign investors would favor to invest

in country with strong investor protection law and in firms that have strong financial performance, large cash positions and high dividend payout (Baba, 2009; Lin & Shiu, 2003; Dahlquist & Robertsson, 2001, Chen et al, 2005). However, Omran et al. (2008) find no support that foreign ownership affects firm performance. Thus, the hypothesis is:

H₄: Foreign ownership is significantly associated with firm performance.

3. METHODOLOGY

The population of the study is companies listed on the Bursa Malaysia from 2006 to 2010. Based on stratified systematic sampling, 20 percent of the samples are selected from 943 companies listed on the Main Market of Bursa Malaysia in 2006. Due to different requirement and rulings used, the following companies are excluded: PN17 companies (distressed firms); REITS, closed-end funds; exchange traded funds; and financial institutions.. Companies with missing data on market to book value (MTBV) are also excluded. The final sample firms are 183 unique companies with 836 firm-year observations. Data on the ownership structure data are gathered from the annual reports available from Bursa Malaysia website while data on company financial characteristics are taken from the database. The model for the study is as follows:

$$Y_{it} = \alpha_0 + \alpha_1 DIROWN_{it} + \alpha_2 FMLYOWN_{it} + \alpha_3 GLIISOWN_{it} + \alpha_4 FORENOWN_{it} + \alpha_5(\text{Control Variables}) + \epsilon$$

Where:

Y	= Performance of company *i* in year *t* proxied by MTBV and ROA
DIROWN	= Percentage of directors' shareholding, direct and indirect
FMLYOWN	= Percentage of family shareholding
GLIISOWN	= Percentage of government–linked institutional investors' shareholding
FORENOWN	= Percentage of foreign shareholding
Control variables	= Log of total assets (Lnta), leverage, and GDP growth

Further analysis using quadratic function was conducted to examine the non-linearity of ownership structure.

4. EMPIRICAL RESULTS

Table 1 summarizes descriptive statistics of the study variables. Director ownership (DIROWN) and family ownership (FMLYOWN) are high in Malaysia with the average of 36.35 percent and 26.05 percent respectively. Family ownership is measured as an individual or a family holding at least 10 percent of the shares outstanding and that individual or the representative of that family serves on the board of directors. The average holding for government–linked institutional investors (GLIISOWN) is low at 4.34 percent. The average holding of foreign ownership (FORENOWN) is also low at 5.56 percent. The average total assets is RM804,086,000. The average and maximum leverage is about 22.3 percent and 190 percent respectively. The average performance for MTBV is 1.151 which is considered normal. However, the minimum (-15.34) and maximum (33.22) values can be considered as extreme cases. The extreme values are also shown for ROA with the minimum (-229.06) and maximum (56.96) values indicate the existence of outliers.

Table 1. Descriptive statistics of variables

Variables	Mean	Median	Std. Deviation	Minimum	Maximum
DIROWN	36.348	37.580	21.740	0.000	79.280
FMLYOWN	26.051	27.170	23.547	0.000	79.280
GLIISOWN	4.336	0.000	10.196	0.000	81.000
FORENOWN	5.562	1.155	10.578	0.000	69.950
TOTAL ASSETS ('000)	804,086	205,300	2,715,935	13	36,637,299
LEVERAGE	0.223	0.188	0.407	0.000	1.898
GDP	0.045	0.056	0.031	-0.015	0.074
MTBV	1.151	0.740	2.478	-15.340	33.220

Pearson correlation is conducted between explanatory variables. Results indicate that the highest correlation (positive) is between family ownership and director ownership at 0.64. The high correlation raises concern on the possibility of multicollinearity problems. Thus, we conduct further analysis using variance inflation factors (VIF). The result shows the values of VIF are less than 10 which indicate that there is no serious problem in multicollinearity. In addition, foreign investors and GLICs have tendency to invest in companies with low director ownership and family ownership. Table 2 reports the results of regression analyses where performance is measured using ROA and MTBV. Heteroscedasticity is checked using the Breusch-Pagan test. The test is significant at 1% level. So, we use robust regression analysis.

Table 2. Results of regression analyses

Variables	MTBV	
	Coefficient	**t-statistics**
DIROWN	-0.0576	-2.68***
DIROWN2	0.0008	3.14***
FMLYOWN	-0.0085	-2.49**
GLIISOWN	-0.0192	-1.67*
FORENOWN	0.0993	3.77***
FORENOWN2	-0.0019	-3.67***
LNTA	0.0960	1.11
LEVERAGE	-0.3552	-2.80***
GDP	3.1883	1.08
CONSTANT	0.6341	0.82
R-squared	0.0711	
F-statistic	4.83***	
N	826	

Note: ***.**.* show significant level at 1%, 5% and 10% respectively.

Results of regression analysis are reported in Table 2. The results show the non-linearity of director ownership (DIROWN) and foreign ownership (FORENOWN). Director ownership has a curvilinear relationship with U-shaped which indicates the existence of entrenchment effect at the lower stake but alignment effect at the higher stake. Firm performance increases when the directors have more shareholdings. The opposite relationship with concave shaped is found for the foreign ownership, where the alignment effect occurs at the lower stake and entrenchment effect at the higher stake. Family ownership and ownership by government-linked investment companies (GLIIS) also leads to lower MTBV.

5. CONCLUSION

This study adds to the literature with regards to the methodology and influence of ownership structure on the firm performance in a concentrated ownership market, Malaysia. The findings indicate the non-linearity function of ownership structure (director ownership and foreign ownership) is applicable for market measure. The results highlight that higher ownership by directors lead to the convergence-of-interests hypothesis. Shareholdings by directors act as effective mechanisms to maximise shareholders' wealth. The entrenchment effect occurs at the lower ownership. However, the higher ownership of foreign investors would lower the firm performance. Government-linked investment companies have no effect on performance. This may be due to the low ownership of government linked investment companies in the companies which they have no influence on the decision making. The limitation of this study is that we consider only 20 percent of the population. Thus, there is a possibility that the sample is biased even though random sampling is used.

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