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NON-FAMILY FIRMS: A MALAYSIAN CASE**

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ABSTRACT

By using the agency theory, this study shed a light on examining the determinants of agency costs in family and non-family firms. In addition, this study examining whether family firms have lower agency costs and whether the determinants of agency costs will be dissimilar with non-family firms. The sample for this study comprised of 530 firms of family and non-family firms. The observation period was for five years from 2001 to 2005. The Ordinal Least Square was employed to determine the objectives of study. The measurement used for the agency costs was asset turnover. It was found that the determinants of agency costs were leverage, size and cash holding. In fact, the determinants were similar in both firms except for the leverage. Leverage was only significantly related to asset turnover in family firms. Nonetheless, by looking at the effects of the industry, it can be said that there were some differences among the family and non-family firms pertaining to the impact of agency costs. Apart from that, it was found that family firms did not have lower agency costs as compared to non-family firms. Hence, this study provides evidence that the determinants of agency costs in family and non-family firms are alike. Furthermore, the family's involvement in running the business cannot help in alleviating agency costs particularly in Malaysian context. Though previous evidences stressed that family firms had suffer lower agency costs, this study proved that Malaysian family firms did not suffered lower agency costs as compared to non-family firms. Nevertheless, this study has been able to prove that leverage, size and cash holdings were the strong determinants of the agency costs had a greater influence on the agency costs.

Keywords: *agency costs, family firms, non-family firms, leverage, size, cash holdings.*

INTRODUCTION

Family firms play a prominent role in the economic growth of a country. Claessens *et al.* (2000), found an extensive family control in more than half of the East Asian corporations. In addition, Anderson and Reeb (2003) found that the family ownership is both prevalent and substantial in which the families are present in one-third of the S&P 500 of the public firms in the United States firms.

Furthermore, extensive family control is also found in the Republic of Korea's large business conglomerates so called, *chaebol*, which grow around family-controlled firms (Sok Siphana, 2000)¹. To add further, Song *et al.* (2006) showed that the Malaysian corporate ownership structure is highly concentrated in the family firms, followed by ownership in state agencies and others.

The study of the agency costs in family firms and non-family firms have been analyzed by various scholars such as Fleming *et al.* (2005), Ang *et al.* (2000), Chrisman *et al.* (2004) and Anderson *et al.* (2003). Those studies suggested that an agency cost is lower in family firms. Apart from that, studies by Ang *et al.* (2000), Fleming *et al.* (2005), Li and Cui (2003) and Kim and Lee (2003) conclude that leverage, size and cash holdings are the determinants of agency costs. Those determinants are indeed essential for firms to solve or mitigate the agency costs. Firms need to identify the determinants in order to find the solution in solving agency conflicts. Therefore, it motivates this study to analyze the Malaysian corporations' environment to determine whether the determinants of agency costs will be different in family firms as compared to non-family firms and whether family firms have lower agency costs as compared to non-family firms.

Agency costs may cause turbulence in both family and non-family firms (Enron and Adelphia) if they are not detected earlier. It is essential for the firms to spot or discover the determinants of agency costs before they can solve the matter. Previous studies such as McKnight and Weir (2008), Li and Cui (2003) and Kim and Lee (2003) found that leverage, size and cash holdings have turned to be the determinants of agency costs. Once the determinants have been detected, the firms can take the appropriate action to solve the agency problems. Therefore, this study will further analyze the determinants or factors of agency costs in both family and non-family firms. In addition, the study would be able to see whether the determinants of agency costs in family firms are similar with those in non-family firms. Finally, this study aims to know whether family firms have lower agency costs as compared to non-family firms. This study will contribute to the literature in relation to the determinants of agency costs in family and non-family firms. In addition, this study attempts to show that by having the family involved in managing a business, it will alleviate or reduce agency costs. Hence, it can be said that family firms suffer less severe agency costs as compared to non-family firms. Other than that, this study contributes to the determinants of agency costs that are explained by the agency theory. It is strongly believed that the three determinants identified, namely leverage, size and cash holdings are the strong determinants to identify agency costs. Hence, this study is useful as it can guide the management team in curbing the agency costs through the determinants identified. Finally, this study attempts to show that the determinants of agency costs should be dissimilar among the family and non-family firms. Previous studies such as that of James (1999), Chrisman *et al.* (2007)

¹ Paper presented by Secretary of State for Commerce Royal Government of Cambodia published at Ministry of Commerce

and Schulze *et al.* (2001) have discussed a uniqueness of family firms. Therefore, it is believed that the unique characteristic that is possessed by family firms deviate the determinants of agency costs with the non-family firms.

PREVIOUS STUDIES

In common terms, a family firm can be defined as a firm controlled by the family members either through blood ties or through marriage. In addition, family firms normally appoint their family members to run and organize their firms. There is no exact definition of family firms to date. In fact, previous studies have come up with a number of definitions.

There are a few literatures which define family firms in a general and wider scope such as that of Ali *et al.* (2006), Chua *et al.* (1999), James (1999), Chrisman *et al.* (2004) and Ellul *et al.* (2007). Ali *et al.* (2006) and Ellul *et al.* (2007) emphasized on *founders or descendants*. On the other hand, Chua *et al.* (1999) highlight on *members of the same family*. In spite of that, Chrisman *et al.* (2004) identified a family firm by looking at the family involvement in the components of ownership, management and succession. Thus, the definitions from the literature given in general stressed on the founders as well as the descendants that inherited the business from one generation to another generation.

Agency Theory/Costs

The idea of the agency theory has been pioneered by Jensen and Meckling (1976). This theory is derived due to the principal-agent relationship. The agency costs arise when the Directors do not perform / act with the best interests of the shareholders. In supporting that notion, Ugurlu (2000) asserted that due to the separation of ownership and control, the conflicts of interests between the Directors and shareholders resulted in agency costs to occur. In addition, Cahan and Hossain (1996) asserted that due to the misalignment of the principal's and agent's goals, the principal may incur expenditure to impede an agent's activity. Consequently, the monitoring and bonding costs (i.e; contract or debt covenant) as well as residual loss encompass agency costs (Cahan and Hossain, 1996).

The agency costs commonly arise among the Directors and the shareholders, outside minority shareholders and shareholders and bondholders. What if the Director is the owner itself? This refers to the family firms with the family members running the company. As suggested by Anderson *et al.* (2003), since family firms have concentrated shareholdings, the agency costs would decrease as they have many incentives to combat it. In addition, if the ownership has become more concentrated, it will lead to similar interests and goals. Other than that, Baldrige and Schulze, (1999) argued that direct owner management should reduce agency problems and related costs. Logically, agency cost should be reduced if the firms are managed by the family firms. As supported by Chrisman *et al.* (2004),

family involvement decreases the overall agency problems. In spite of that, Chrisman *et al.* (2007) asserted that there would be no agency problems among owners and managers of family firms because the owner and the manager would be the same person or rather the single entity.

Unique Characteristics of Family Firms

Family-owned businesses or rather family firms normally have several unique characteristics and concepts which they apply. For instance; family ties and traditions, stewardship and altruism. The uniqueness of the family ties and loyalty has been observed by James (1999). This refers to the family firms' Directors or the owners who have their long-term horizon that concerns the firm sustainability and growth. They are not willing to take any risks of their business being collapsed due to their own mistakes such as greediness and mishandling of the firms' funds.

The second characteristic is stewardship. Chrisman *et al.* (2007) asserted that by applying the stewardship concept in running the family business leads to a good consequence. For instance, the family Director will be more accountable for his doings while he needs to maintain the good reputation of the family business. Apart from that, Corbetta and Salvato (2004) study asserted that the owners and Directors of family firms devoted themselves to the business to ensure success in their businesses.

Finally, the characteristic is altruism. Several studies such as Schulze *et al.* (2001), Corbetta and Salvato (2004) and Dyer (2006) have highlighted the concept of altruism. Corbetta and Salvato (2004) argued that altruism is selfless concern and commitment to others without any expected return. In addition, Dyer (2006) argued that the consequence to altruism often leads family owners to feel reluctant to monitor and discipline their Chief Executive Officer and this makes the family Chief Executive Officer become entrenched. Hence, the leadership still remains with the same person.

Agency Costs in Family Firms and Non-Family Firms

In most agency relationships, both the principal and agent have to bear the monitoring and bonding costs that comprise of financial, non-financial and other matters as well. There will be some dispute between the principal and agent pertaining to the agent's decisions. This is because the principal would expect that those decisions will maximize the welfare of the principal (Jensen and Meckling, 1976). Due to that, the term agency costs derive from the costs to align the divergence of interests, together with the monitoring and bonding costs in order to limit this divergence of interests (Bartholomeusz and Tanewski, 2006). Other than that, agency problems arise because the Directors have the chance to benefit themselves with the firms' properties which somehow will reduce the wealth as deserved by the firms' shareholders (Fosberg, 2004).