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CHIEF EXECUTIVE OFFICER SHAREHOLDING AND COMPANY PERFORMANCE OF MALAYSIAN PUBLICLY LISTED COMPANIES

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ABSTRACT

This study aims to investigate the relationship between chief executive officer (CEO) shareholding and company performance. Specifically, the study investigates the influence of the level of direct and indirect CEO shareholdings on the market growth, profitability and liquidity of companies. A sample comprising 59 companies was obtained from Bursa Malaysia within a five-year period from 2009 to 2013. Results reveal that most CEOs of Malaysian listed companies own company shares either directly or indirectly. The CEOs of listed companies in Malaysia tend to retain controlling stakes by possessing a significant amount of shares in their companies. As a result, these companies demonstrate improved financial performance.

Keywords: *CEO shareholding, company performance, Malaysian public listed companies*

INTRODUCTION

Given the advanced technology and stiff competition in the business world at present, many private companies are tempted to expand their business scale by increasing the capital share of the company. A means to increase capital is to go public via initial public offerings (IPOs), which lead to sharing company ownership with investors. In this case, overall control and decision making rights in the company are divided among the principal and investors. As a result, the CEO of the company, as the agent of the principal, always faces the dilemma of either controlling the company by holding more shares or raising funds by issuing more shares to investors.

A CEO with low shareholding possesses less controlling power in company operations and management, whereas shareholders with high shareholding have more voting rights. Hence, shareholders can practice their voting rights to appoint the CEO. Many countries, such as Malaysia, Hong Kong, Singapore and the United Kingdom, are inflexible in allowing a CEO with less shareholding to retain controlling rights in a company. Consequently, company expansion may slow down because of the obstacles a CEO faces in the accumulation of cash reserve for future expenditure or expansion.

An increasing number of foreign companies have begun to register their IPOs in the United States. The main reason for this move is the flexibility offered by the United States SEC in terms of the substantial freedom of companies to decide their structure at the time of the offering. This flexibility includes the option that a CEO with less shareholding will retain the controlling right of the company. For instance, many young companies, such as Google, Alibaba and Facebook, registered their IPOs in the United States. Although the founders of these companies have small percentages of shares and still retain their controlling rights, these companies have raised high capitals in their IPOs. A case for this point is the founder of Facebook, Mark Zuckerberg, who retained only 22% of company ownership shares after IPO (Fortune, 2012). However, the total amount of capital raised reached \$16 billion (Bloomberg, 2012). Another example, Alibaba from China, raised \$21.8 billion from its IPO in the US (Business Insider Malaysia, 2014). However, its founder, Ma Yun, still retained the controlling right even with only 7.8% of shareholding (The Straits Times, 2014).

Overall, these companies expanded quickly and performed very well despite the CEO having a low shareholding. However, studies on the effect of the proportion of CEO shareholding on company performance are scarce. Particularly, the gap is evident in situations where CEOs have a low shareholding proportion and do not have a dominant controlling right. Therefore, this research aims to investigate the relationship between CEO shareholding and company performance in Malaysia.

LITERATURE REVIEW

Agency Theory

Agency theory emphasises the control issues resulting from conflicts of interest between top management and shareholders. Agency theory is built on the premise that the shareholder acts as a principal and delegates duties to the CEO, who is expected to act as an agent in the best interest of the principal. Three assumptions exist in agency theory. Firstly, the agent is risk-averse. Secondly, the agent is self-centred. Lastly, the interests of the agent are distinct from those of the principal. According to the third assumption, the agent may have different objectives from the principal, so the agent pursues a self-serving agenda. This scenario increases the possibility of opportunistic actions by the agent. For instance, a CEO may decide to enter the company into an aggressive diversification program of mergers and acquisitions with modest or even negative returns to shareholders. Therefore, the agency problem occurs whenever the agent looks after objectives that are opposed to the goals of the principal.

The CEO is one of the important components in the corporate governance of a company. However, to investigate a CEO with minimal shareholding will lead to improved corporate governance and company performance. According to agency theory arguments, CEOs have sufficient discretion to pursue objectives that are inconsistent with maximising shareholder wealth (Catherine & Jonathan, 1997).

CEO Shareholdings

Catherine and Jonathan (1997) claimed that the CEO is generally represented as the most powerful member of the organisation. However,

does a CEO with minimal shareholding retain the controlling right of the company? Controlling right refers to the power of the CEO who has typically legitimate authority in a company. The CEO is required to maintain the ownership position in a company to secure the controlling right and to be recognised as the manager and shareholder (Catherine & Jonathan, 1997; Bach & Smith, 2007). Zald (1969) argued that a CEO with significant shareholding has the ability to affect the company's direction and is likely to be more powerful than a CEO with minimal shareholding, as cited by Catherine and Jonathan (1997). In addition, a CEO with significant shareholding may be positioned to prevent involuntary dismissal (Fredrickson, Hambrick & Baumrin, 1988; Pfeffer, 1981; Catherine & Jonathan, 1997). Hence, a CEO with significant shareholding would cause either the agency problem with the shareholders or company performance improvement.

Fama and Jensen (1983) emphasised that shareholding is tied to the economics of the CEO with the company stakeholders, as cited by Veprauskaite and Adams (2013). Accordingly, the CEO is provided with incentive in terms of CEO shareholding to maximise company performance. Company performance will be enhanced if a CEO possesses high shareholding (Bach & Smith, 2007). Fischer and Pollock (2004) found that the effect of high CEO shareholding on company performance post-IPO is interactive and positive. Bach and Smith (2007) claimed that a CEO with high shareholding can lead to improved company performance if the CEO is able to act without board interference. However, Veprauskaite and Adams (2013) found that the shareholding of the CEO implies that decision-making power has a negative effect on company performance. The results of the study by Veprauskaite and Adams (2013) support the agency theory-based notion, wherein a CEO with significant shareholding possesses increased decision-making power on the board; as a result, financial performance is reduced.

Ozkan (2011) investigated the corporate governance of companies in the United Kingdom by examining the link between CEO 'pay performance' in terms of CEO shareholding and company performance. They found that the link between CEO pay performance in terms of CEO shareholding and company performance has not been completely effective as indicated in the Greenbury Report (1995).

Overall, several researchers found that a CEO will have a significant controlling right in a company if he or she has high shareholding; this situation will directly improve company performance (Zald, 1969, as cited in Catherine & Jonathan, 1997; Fredrickson, Hambrick & Baumrin, 1988; Pfeffer, 1981; Catherine & Jonathan, 1997; Fama & Jensen, 1983; Veprauskaite & Adams, 2013; Bach & Smith, 2007; Ozkan, 2011). Meanwhile, only a few studies discussed the negative relationship between a CEO with minimal shareholding and company performance. Veprauskaite and Adams (2013) found that a high CEO shareholding does not imply high company performance. When a CEO has a high shareholding, he/she may exercise the controlling right in a company in favour of his/her own interest at the expense of the shareholders.

Therefore, relevant hypotheses were developed as follows:

- H₁: A negative relationship exists between direct CEO shareholding and company performance.
- H₂: A negative relationship exists between indirect CEO shareholding and company performance.

METHODOLOGY

The sample in this study comprised 59 Malaysian publicly listed companies randomly selected from the list of Bursa Malaysia. The data covered the period of 2009 to 2013. Data on CEO shareholding and company financial performance were obtained from annual reports. The conceptual framework of the study based on the literature review and hypotheses is shown below:

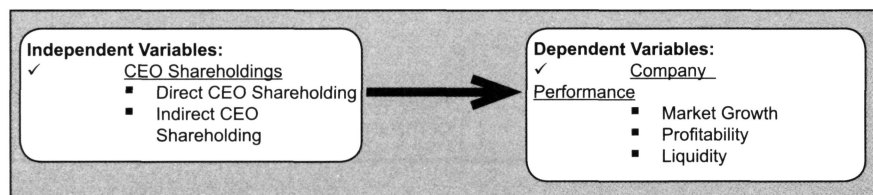


Figure 1: Conceptual Framework

The measurement of research variables is indicated in Table 1.

Table 1: Measurement of Research Variables

Variables	Abbreviations	Operationalisation	Empirical Studies
Independent Variables <u>A. CEO Shareholdings</u>			
1. Direct CEO Shareholding	Direct	Direct = Total Direct / Total Shares' Outstanding X 100%	Catherine and Jonathan (1997)
2. Indirect CEO Shareholding	Indirect	Indirect = Total Indirect / Total Shares' Outstanding X 100%	
Dependent Variables <u>B. Company Performance</u>			
1. Earnings per Share	EPS	EPS = Profit After Tax / Total Share Outstanding X 100%	Bhagat and Bolton (2008)
2. Return on Assets	ROA	ROA = Profit After Tax / Total Assets X 100%	
3. Return on Equities	ROE	ROE = Profit After Tax / Total Shareholders' Equity X 100%	Watson and Head (2004)
4. Current Ratio	CR	Current Ratio (CR) = Current Assets / Current Liabilities	
Control Variable <u>C. Company Size</u>			
1. Total Assets	TA	Natural log of company total assets	Veprauskaite and Adams (2013)

DATA ANALYSIS AND RESULTS

Descriptive Analysis

Table 2 presents the descriptive statistics of independent, dependent and control variables. The mean, mode and median of direct CEO shareholding are 8.00, 0, and 2.91, respectively. The mean indicates that the average percentage of shares held by the CEO is 8. The standard deviation of direct CEO shareholding is 10.28, which means that the data are reasonably close to the mean. For indirect CEO shareholding, the mean is 13.58, the mode is 0.00, the median is 1.83 and the standard deviation is 17.90. The mean of 13.58 shows a tendency towards 13, and the standard deviation is close to the mean.

EPS has a mean of 9.28, which indicates its average, a mode of -0.50 and a median of 7.19. The standard deviation of EPS, 11.34, represents its amount of variation of dispersion. The mean, mode and median of ROA are 3.22, 3.33 and 4.12, respectively. The mean of ROE is 4.46, which indicates that the average ROE of the sample companies is 4.5. ROE has the high standard deviation of 12.81, which reveals the large spreading out of variation of dispersion. Moreover, the measurement of CR is the logarithm of the current ratio. The mean, mode and median of the current ratio (CR) are above 0.80 with a small standard deviation of 0.65, which indicates that the variation of dispersion of CR data is small. Company size as the control variable is measured by the logarithm of total assets (TA). Table 2 shows that the average of TA is 19.37. The mode and median of TA are 18.40 and 19.34, respectively, which are close to the mean. The standard deviation of 1.30 indicates a low variation of dispersion within the spreading out of the data.

Table 2: Descriptive Statistics of Independent, Dependent and Control Variables

Variables	Mean	Mode	Median	Standard Deviation
Independent Variables				
Direct	8	0	2.91	10.28
Indirect	13.58	0	1.83	17.90
Dependent Variables				
EPS	9.28	-0.50	7.19	11.34
ROA	3.22	3.33	4.12	7.18
ROE	4.46	1.12	6.61	12.81
CR	0.83	0.88	0.81	0.65
Control Variable				
TA	19.37	18.40	19.34	1.30
*N=295 observations				

Sample Company Profiling

Table 3 presents the profile of the sample companies. Eight industries were identified from the 59 sample companies within a five-year period. Industrial crops and products have the highest frequency of 25 among the sample companies. Trade and services and consumer industries have the second and third highest frequency with 14 (23.73%) and 7 (11.86%), respectively. Finance and plantation possess the smallest and the same percentage of 1.69% (N=1) among the eight industries.

CEO shareholdings are the independent variables in this research. On average, 37 CEOs of the sample companies had both direct and indirect CEO shareholdings from 2009 to 2013. Eighteen CEOs possessed only direct CEO shareholding, which has the highest percentage (30.50%) within five years. In 2012, 6 out of 59 CEOs of the sample companies had solely indirect CEO shareholding. During the same year, only one CEO did not have both direct and indirect shareholdings.

Regarding company size, Table 3 reveals that throughout the five years, most of the sample companies had total assets within the range of RM100 million to RM500 million, with an average percentage of 48.14% (N=28).

Years	2009		2010		2011		2012		2013		Average	
CEO Shareholdings												
CEO with both direct and indirect	35	59.32	39	66.10	38	64.41	35	59.32	37	62.70	37	62.37
CEO with direct only	18	30.50	15	25.43	15	25.42	17	28.81	17	28.80	16	27.79
CEO with indirect only	3	5.09	3	5.08	1	1.70	6	10.17	4	6.80	4	5.77
CEO without both direct and indirect	3	5.09	2	3.39	5	8.47	1	1.70	1	1.70	2	4.07
Company Size, TA												
≤ RM100 million	14	23.73	14	23.73	16	27.12	15	25.42	12	20.34	14	24.07
> RM100 million- RM500 million	31	52.54	28	47.46	26	44.07	28	47.46	29	49.15	28	48.14
> RM500 million	14	23.73	17	28.81	17	28.81	16	27.12	18	30.51	17	27.80

*N = 59 (100%)

Normality Test

Normality of data assessment is a prerequisite for many statistical tests because normal data are a fundamental assumption in parametric testing. In accordance with Kim (2013), Table 4 shows that the values of skewness and kurtosis of all variables are less than 2 and 7, respectively. Therefore, all variables are considered normal.

Table 4: Normality Test

Variables	Direct	Indirect	EPS	ROA	ROE	CR	TA
Skewness	1.535	1.168	0.523	-1.089	-1.964	0.565	0.493
Std. Error	0.142	0.142	0.142	0.142	0.142	0.142	0.142
Kurtosis	1.460	0.195	0.054	1.880	5.912	0.523	0.677
Std. Error	0.283	0.283	0.283	0.283	0.283	0.283	0.283
*N=295							

Correlation Analysis

Table 5 shows the Pearson correlation analysis of the independent variables. The correlations among independent variables are less than 0.7. According to Larose (2006), the results obtained from Table 5 indicate that the correlation between the two independent variables, Direct and Indirect, is between -0.33 and 0.33. Therefore, these variables are not correlated to each other and have no multicollinearity problem.

Table 5 also shows the correlations of the independent variables (Direct and Indirect) with the dependent variables (EPS, ROA, ROE and CR) and the control variable (TA). Indirect and Direct are not correlated with the dependent (EPS, ROA, ROE, and CR) and control (TA) variables. However, the estimation of correlations among independent, dependent and control variables is not crucial for the proceeding analyses.

Table 5: Correlation Analysis

Variables	Indirect	Direct	EPS	ROA	ROE	CR	TA
Indirect	1						
Direct	-0.264 0	1					
EPS	0.167 0.004	-0.192 0.001	1				
ROA	0.097 0.095	-0.189 0.001	0.645 0	1			
ROE	0.111 0.056	-0.187 0.001	0.617 0	0.934 0	1		
CR	0.006 0.916	-0.146 0.012	0.133 0.022	0.186 0.001	0.166 0.004	1	
TA	0.143 0.014	-0.171 0.003	0.483 0	0.294 0	0.271 0	-0.224 0	1

Multicollinearity (Tolerance and VIF)

Table 6 shows the values of tolerance and VIF of the relationship between Direct and Indirect for each dependent variable. The results indicate that no multicollinearity relation exists between the two. This finding is evident because they are in accordance with the rule of thumb, whereby tolerance and VIF values are not between [0.1 and 0.2] and [5 and 10], respectively.

Multiple Linear Regression Analysis

Regression analysis is important to describe the relationship between CEO shareholdings and company performance by controlling the company size (TA) of the sample companies. According to Table 6, model 1 has the highest R² of 0.251, whereas model 4 has the lowest R² of 0.085. Although model 1 has the highest R², it accounts for only 25.10% of the variations in the dependent variable (EPS). The same condition applies to model 4, given that Table 6 reveals that reliance on this model will account for only

8.50% in CR. Furthermore, models 2 and 4 show an R² of about 10%, which means the dependent variables, ROA and ROE, are weakly explained by the two, respectively. Briefly, each R² of the models only describes the overall results of the relationship among variables but does not provide the specific results of a particular variable towards the dependent variable.

Unstandardized coefficients (β) were used to estimate how the independent variables affect the dependent variables by developing a regression equation. The values and equations in Table 6 were used to build the regression equations as follows:

$$\text{Model: } CP = \alpha + \beta_1 CS + \beta_2 CSIZE + \varepsilon$$

(i)	Y (EPS) = -67.211 -0.103 (DIRECT) + 0.049 (INDIRECT) + 3.957 (TA)
(ii)	Y (ROA) = -24.648 -0.096 (DIRECT) + 0.009 (INDIRECT) + 1.472 (TA)
(iii)	Y (ROE) = -40.680 -0.167 (DIRECT) + 0.030 (INDIRECT) + 2.379 (TA)
(iv)	Y (CR) = 3.434 -0.012 (DIRECT) + 0.000 (INDIRECT) -0.129 (TA)

To test the regression model, we hypothesised that no relationship exists between direct CEO shareholding and company performance by controlling company size, TA, and no relationship exists between indirect CEO shareholding and company performance by controlling company size, TA. Table 6 shows the results of regression model A with sub-models I, II, III and IV. The results show that Direct is statistically significant ($p < 0.05$) to ROA, ROE and CR but shows a statistically weak significance ($p < 0.1$) to EPS. Company size, TA, also shows significance ($p < 0.05$) to models I to IV. Moreover, Direct has a negative t-value of -1.767 , -2.361 , -2.301 and -3.271 for EPS, ROA, ROE and CR, respectively. Therefore, a significantly negative relationship exists between direct CEO shareholding and company performance (EPS, ROA, ROE and CR) by controlling company size, TA. Hence, an increase in Direct decreases EPS, ROA, ROE and CR. The unstandardized coefficients, β , reveal that an increase of 1% in Direct decreased 16.70% of EPS, 1.20% of ROA, 10.30% of ROE and 9.60% of CR.

However, Indirect is statistically insignificant ($p > 0.05$) to company performance (EPS, ROA, ROE and CR). Therefore, no relationship exists between indirect CEO shareholding and company performance by controlling company size, TA. The null hypothesis (H_0) is thus accepted.

Table 6: Multiple Linear Regression Analysis

Model: A. $CP = \alpha + \beta_1 CS + \beta_2 CSIZE + \varepsilon$		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		β	Std. Error	Beta	t-value	Sig.	Tolerance	VIF
EPS $R^2 = 0.251$ I. $EPS = \alpha + \beta_1 DIRECT + \beta_2 INDIRECT + \beta_3 TA + \varepsilon$	(Constant)	-67.211	8.773		-7.661	0		
	Direct	-0.103	0.059	-0.094	-1.767	0.078**	0.912	1.096
	Indirect	0.049	0.033	0.078	1.466	0.144	0.921	1.086
	TA	3.957	0.449	0.456	8.806	0	0.960	1.041
ROA $R^2 = 0.107$ II. $ROA = \alpha + \beta_1 DIRECT + \beta_2 INDIRECT + \beta_3 TA + \varepsilon$	(Constant)	-24.648	6.068		-4.062	0		
	Direct	-0.096	0.04	-0.137	-2.361	0.019*	0.912	1.096
	Indirect	0.009	0.023	0.023	0.401	0.689	0.921	1.086
	TA	1.472	0.311	0.268	4.735	0	0.960	1.041

ROE R ² =0.096 III. ROE = $\alpha + \beta_1$ DIRECT + β_2 INDIRECT + β_3 TA + ϵ	(Constant)	-40.68	10.893		-3.734	0		
	Direct	-0.167	0.073	-0.134	-2.301	0.022*	0.912	1.096
	Indirect	0.03	0.042	0.041	0.713	0.476	0.921	1.086
	TA	2.379	0.558	0.243	4.263	0	0.960	1.041
CR R ² =0.085 IV. CR = $\alpha + \beta_1$ DIRECT + β_2 INDIRECT + β_3 TA + ϵ	(Constant)	3.434	0.561		6.117	0		
	Direct	-0.012	0.004	-0.192	-3.271	0.001*	0.912	1.096
	Indirect	0	0.002	-0.008	-0.137	0.891	0.921	1.086
	TA	-0.129	0.029	-0.256	-4.476	0	0.960	1.041
*Significant at p <0.05, **Weakly significant at p <0.1								

DISCUSSION AND CONCLUSION

Two main conclusions were derived from this study. First, a significantly negative relationship exists between direct CEO shareholding and company performance (EPS, ROA, ROE and CR) by controlling company size (TA). The percentage of negative relationship between these two variables is weak (not more than 17% of the negative relationship overall). This result shows that direct CEO shareholding does not improve the performance of Malaysian publicly listed companies because of the different practices in Malaysia as opposed to the flexibility in western countries, such as the United States. In Malaysia, most CEOs tend to keep the controlling right by possessing high shareholding in companies. Furthermore, among Malaysian publicly listed companies, several began as small-medium enterprises in which the founders (CEO) held the highest shareholding. Even after their companies are listed in the open market after IPO, these CEOs tend to hold high shareholding to maintain the controlling right of their companies. With the controlling right, they acquire the ability and power to decide and affect the direction of the company.

Another reason could be that many Malaysian publicly listed companies are family-owned. Hence, family members own enough of the equity such that they execute control over strategy and company direction and hold top management positions. For instance, in a family-owned company, the person who is the controlling shareholder could become the CEO of the company. The CEO would want to hold high shareholding to retain his or her controlling right in the company. Family members will also desire to provide healthy return and protect their wealth with the controlling right. Moreover, with high shareholding on hand, family members can avoid taking-over of the family-owned business by others. With these strategies, their business could last longer and continue to operate in the future.

Conversely, CEOs in western countries tend to give up their shareholding to the public but keep the controlling right and manage to make the company perform very well. As mentioned in the introduction, the CEOs of Alibaba, Google and Facebook have had their company IPOs listed in the American Stock Exchange, namely, NYSE for Alibaba and NASDAQ for Google and Facebook. Despite the CEOs of these companies owning less shares, these companies continue to perform very well after issuing shares. Therefore, Malaysia could learn, change and follow the practice of western countries. The Securities Commission of Malaysia (SCM) can consider modifying the structure to provide substantial freedom to the companies

to decide the structure of their companies at the time of offering, including allowing a CEO with minimal shareholding to retain the controlling right.

According to the literature review, this result is consistent with that of Zald (1969) as cited in Catherine and Jonathan (1997). According to Zald, a CEO with significant shareholding has the ability to affect company direction and is more likely to become more powerful than a CEO with minimal shareholding. The result also is consistent with the findings of the Greenbury Report (1995) as cited in Ozkan (2011), and Veprauskaite and Adams (2013). However, this result is inconsistent with those of several previous studies, such as Zald (1969) as cited in Catherine and Jonathan (1997), Fischer and Pollock (2004) as cited in Bach and Smith (2007). These studies reported that an interactive (positive) relationship exists between CEO shareholdings and company performance.

The second major conclusion of this study is that indirect CEO shareholding has an insignificant relationship with company performance (EPS, ROA, ROE and CR) by controlling the company size (TA). Indirect CEO shareholding refers to the shareholding of the CEO in other related companies held by a third party. Therefore, it has no direct impact on company performance. Meanwhile, indirect CEO shareholding may be non-voting right shares. One reason is that companies issue non-voting shares to their employees, such as the CEO, so that part of the remuneration can be paid in dividend. Another reason is that CEOs receive salaries as their remuneration instead of holding any share, which is included as indirect share in companies. The main roles of the CEO are to ensure that the overall operation and resources are executed and managed well, make major corporate decisions and act as the middleman for communication between the board of directors and company management to maximise company performance. Therefore, indirect CEO shareholding has no relationship with company performance (EPS, ROA, ROE and CR).

In summary, the lower the direct CEO shareholding is, the better the company performance is. Although the hypothesis is valid and consistent with the context in western countries, the percentage of negative relationship between these two variables is very weak. Therefore, the results do not completely imply the context in Malaysia. Except for this condition, an insignificant relationship exists between indirect CEO shareholding and company performance (EPS, ROA, ROE and CR) by controlling company size (TA).

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