

GOVERNANCE MECHANISMS AND FIRM PERFORMANCE IN FAMILY-OWNED COMPANIES IN MALAYSIA

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ABSTRACT

The study examines the relationship between management and governance mechanisms upon the performance of family-owned companies. The results indicated that the performances of family-owned companies 'were influenced by the implementation of corporate governance in their management processes. Hence, the result reveals a significant association between family-owned companies' performance in relation to management and governance mechanisms. However, the findings found that Malaysian family-owned companies may be reluctant to protect the minority shareholders' rights as the findings show that the independent directors portrayed significant negative association with the firm's performance. The presence of the independent directors in the company could not improve the monitoring of the management activities and on shareholders' influence. In addition, the ROE result shows that the larger managerial ownerships, the higher the firms' performance but in turn it will heighten the minority shareholders' expropriation. The higher level of managerial ownership could lead to management entrenchment and ineffective monitoring due to conflict of interest.

Keywords: *Corporate Governance, family firms, firm performance*

INTRODUCTION

Various researchers define family firms differently. Due to this inconsistency, it appears that there is no consensus regarding the exact definition of a family firm. Miller et. al. (2007) reiterates that many definition of family firms with various classification of firms. They found that a family firm has been characterized as an organization which is usually controlled and managed by multiple family members (Shanker & Astrachan, 1996) and over a time frame of several generations (Andersons & Reeb, 2003). Some family-owned companies are characterized according to the proportion of equity ownership. According to Saito (2008), the founder or his descendent and the founding family will hold the largest shareholding in the company and this could be recognized as a family firm in Japan. Family firm can also be defined by the percentage of voting rights held by family members i.e. where family members hold at least 10% of voting rights (Maury, 2006). If more than 20% of voting rights held by family members (La Porta et. al., 1999), it will be considered as the largest controlling shareholder in the companies.

Naturally, family-owned companies usually start from a small business and gradually develop the company's assets to become a large business that allows them to be listed on the stock exchange. According to Claessens et. al. (2000), about 70% of Malaysian companies are family-owned. Two-thirds of the existing companies in Malaysia are made up of family-owned companies (Jasani, 2002). Shanker and Astrachan (1996) defined family firms as an organization controlled and usually managed by multiple family members and multiple generations (Andersons & Reeb, 2003). Family-owned companies comprise of controlling owner, sibling partnerships and cousin consortium (Gersick et. al., 1997). The controlling owner, known as the founder of the company, controls most of the firm's ownership and management. Sibling partnerships are formed when the founder distributes his shareholdings to his children. The cousin consortium will be formed after the ownership is distributed to the next generation of sibling partnerships (Lubatkin et. al., 2005). However, this research focuses on the general family-owned companies with the definition based on previous studies without classifying the stages of family firms.

This study differs from previous studies as all the information on family relationships are extracted from the corporate information section to determine the board of directors' name that may establish family ties for

example, the Chinese name by looking at the surname; while the Malay and Indian name by looking at the last name, e.g. Ahmad bin Ali, Aminah binti Ali or Pavaly a/l Muthusamy, Moona a/p Muthusamy. However, a detail analysis of the sample is made by looking at the directors profile section where the content provides the information about the directors' relationships. If there are two or more family members who are officers or directors, the company is considered to be family-owned which is consistent with Villalonga and Amit (2006) and Gomez-Mejia et. al. (2003). In addition, this study applied the fraction of equity stake held by all family members as being at least 5% and more (Claessens et. al., 2000; Gomez-Mejia et. al., 2003). This fraction of equity ownership is calculated by referring to the direct and indirect shareholdings (Haniffa and Hudaib, 2006) of the family members extracted from the shareholding analysis section in the company annual reports (Anderson & Reeb, 2003; La Porta et. al, 1998).

Objectives of the Study

The main objective of this study is to examine whether governance mechanisms in family-owned companies have any relationship with the firm's performance. The sub-objectives and research questions are developed according to the relationship between the firm's performance and management and governance mechanisms such as board size, board composition, role duality and managerial ownership. The sub-objectives are to examine whether board size, role duality, board composition and managerial ownership influences the firm's performance. The research questions are: Does any significant association exist between board size, role duality, board composition and managerial ownership to firm performance?

RESEARCH METHODOLOGY AND DESIGN

Sample Selection

The sample of public-listed family-owned company's consists of 1124 observation was obtained from the Main Market of Bursa Malaysia's website. The sample covers six industries on the main market, namely consumer product, industrial product, construction, plantation, properties and technology. The period from 2006 until 2009 was chosen because it was the latest 4 year source of information available at the time of the study.

The year 2010 was not chosen as the sample year since the submission of the annual report for all public listed companies on Bursa Malaysia were incomplete. Table 1 summarizes the process of selecting the final sample of the companies in the study.

Table 1: Sample Selection

No.	Industry	No. of Family Firm	No. of Observation (4 years)
1	Construction	23	92
2	Consumer Products	61	244
3	Industrial Products	129	516
4	Plantation	17	68
5	Properties	44	176
6	Technology	7	28
Total		281	1124
Less : Companies with incomplete data (29 x 4 years)			116
Less companies with outliers			25
Final sample of observation available for analysis			983

DATA COLLECTION

Data related to the management and governance and the financial indicator was extracted from the companies’ annual reports. The data collection consisted of three types of variables which were dependent, independent and control variables. The dependent variables were family-owned companies’ performance and the independent variables were board size, board composition, role duality and managerial ownership, while control variable is firm size.

The second step was to analyse the shareholding of each family member on the board who holds direct shares in the company. The companies which have at least 5% or more of the shares held by all family members meet the family-owned criteria. The third step is calculating the ROA and ROE on each sample as indicators of the firm’s performance. The information extracted from the income statements and balance sheets were manually calculated using the formula found in Microsoft Office Excel 2007. The analysis of the data was for the financial year ending 2006 until

2009. The data relating to independent and control variables such as board size, board composition, duality role, managerial ownership and firm size was extracted from the relevant sections, in particular from the corporate governance section, analysis of shareholdings section and also the income statement and balance sheet were from the companies' annual report.

DATA ANALYSIS

Firm Performance

After identifying family-owned companies, each company was then carefully examined to determine the firm performance. Most of the previous studies used the financial based performance measurement especially return on asset (ROA), return on equity (ROE) and Tobin-Q to investigate the firm performance (Haniffa & Hudaib, 2006, Anderson & Reeb, 2003, Martinez et. al., 2007 and Villalonga & Amit, 2006). According to Martinez et. al. (2007), financial performance should be divided into two types which are accounting performance for ROA and ROE ratios, while the market performance for a proxy of Tobins-Q. This study focuses on the accounting performance to determine if there is any significant relationship exists between family-owned companies and performance. The ROA and ROE measured from the firm values from the annual report. This study uses ROA because the value of ROA indicates the effectiveness of the company's asset usage in satisfying the shareholders' interest. The formula of ROA is earnings after tax divided by total assets of the company (Haniffa & Hudaib, 2006 and Martinez et. al., 2007). The value of ROE indicates the shareholders' expectation on their investment return. The formula is the ratio of net income for the year divided by the shareholder's equity of the company (Ibrahim et. al., 2008).

Independent and Control Variables

The independent variables consist of the management and governance mechanisms such as board independence, board size, role duality, managerial ownership and size of the company. Table 2 summarises all the variables used in the hypotheses tests.

Table 2: Operationalisation of the Variables

Variables	Acronym	Operationalisation
Dependent variables:		
Return on Asset	ROA	Ratio of the net income for the year divided by total equity of the company.
Return on Equity	ROE	Ratio of earnings after tax divided by total assets of the company.
Independent variables:		
Board Size	BSIZE	Total number of directors on the board of the company.
Categories of Board Size	BODSIZE	Indicator variable with the value of "1" if the directors is less than 9 members on the board and "0" if otherwise.
Board Composition	BODCOM	The ratio of independent NED to total number of directors on the board of company.
Categories of Board Composition	BCOM	Indicator variable with the value of "1" if the presentage of independent directors is lower than 38% on the board and "0" if otherwise.
Role Duality	DUAL	Indicator variable with the value of "1" if the chairman is also the CEO of the company and "0" is otherwise.
Managerial Ownership	MOWN	The ratio of shares owned by executive directors of the company as a group to total shares outstanding.
Categories of Managerial Ownership	MOWNSHIP	Indicator variable with the value of "1" if managerial ownership is less than 25% of shares held by executive directors and "0" if otherwise.
Control Variable Firm Size	SIZE	Natural log of sales of the company.

LITERATURE REVIEW

Generally, family businesses were started by the founder and subsequently continued by their children. Therefore, family members and family ownership can have a substantial influence on the management of the companies. Crisis between the majority and minority shareholders may also occur in family-owned companies and consequently increase the agency cost. Most of the family members hold substantial shares in the company and the remaining shares are held by others. As such, the majority shareholders (family members) have the opportunity to expropriate the minority shareholders’ right (Anderson & Reeb, 2003; Morck & Yeung, 2003).

Andersons and Reeb (2003) and Villalonga and Amit (2006) defined family firm as where a member of the founding family either through blood or family, hold at least 5% of the firms’ equity. Villalonga et. al. (2006)

explained family firm definition to include content of family generation stages. The family-owned companies have been classified into several stages which are founder generation, 2nd generation and later generation of family firm. The founder family-owned companies can be identified by looking directly at proxy statements in the Annual Reports e.g. statement by the founder and his/her family equity holding (Andersons & Reeb, 2003). Lansberg (1999) noted that the formations of family-owned companies are related to the generation stages, known as three-level typology of family ownership stages. These stages consist of controlling owner, sibling partnerships and cousin consortium (Gersick et. al., 1997). The controlling owner run the companies in the first generation, followed by sibling partnerships in the second and a cousin consortium in the third.

Family-owned companies are fundamentally different from other companies. One of the traits presents in family-owned companies is that the companies' environment fully encourages the love of businesses and this strengthens their commitment to the businesses (Chami, 1997). Specifically, participation of family members in business activities as part of the management team, as board members as well as the shareholders gives them opportunities to consult and monitor the board of directors. In addition, the improvement in the monitoring system might also increase the firms' performance (Poza, 2007). Furthermore, the long-term nature of family relationship is advantageous in monitoring and disciplining managers (Fama & Jensen, 1983).

Previous researchers have examined the characteristics of family ownership on the firm's performance of family-owned companies. Studies from developed countries such as United States and Western Europe showed that family-owned companies perform better than non-family firms (Anderson & Reeb, 2003; Maury, 2006; Martinez et. al., 2007). The results in developing countries such as Southeast Asian countries indicated that family firms underperform as compared to non-family firms (Claessens and Fan, 2002). However, these studies did not deeply reveal the increase or decrease of family firms' performance in relation to corporate governance.

There are some family-owned companies which have poor performance than non-family firm. According to agency theorists, family control in family-owned companies could increase the agency cost in the companies. A company which is controlled by family members will have an opportunity to expropriate other shareholders by raising their concentrated block holding of shares. This can be carried out either by means of excessive

compensation, related-party transactions, special dividends, and risk avoidance (Anderson & Reeb 2003; Morck & Yeung 2003; Anderson et al. 2002). Therefore, the decrease of family-owned companies' performance stems from the corporate governance issues. This paper attempts to examine the relationship of corporate governance mechanisms and family-owned companies listed on Bursa Malaysia for the year 2006 until 2009.

Another problem that can arise in family-owned companies is that of information asymmetries. Haniffa and Cooke (2002) found that Malaysian companies disclose less when family members sit on the board. Easy accessibility of the company's internal information to family members who sit on the board may result in information withholding. Therefore, the demand for disclosure of information to the public in the annual report of the companies is higher as compared to when non-family members sit on the board. These problems could influence the performance of family-owned companies.

Hence, some researchers have conducted several studies on the association between corporate governance mechanisms and family firm performance (Klein, 1998; Daily & Dalton, 1998; Chau & Leung, 2006; Ferris & Yan, 2007; Leford & Urzua 2008; Chen & Nowland, 2008). There were also studies conducted in Malaysia to examine the relationship between family-owned companies performance and corporate governance mechanisms (Tee and Chan, 2008; Ibrahim et. al., 2008; Amran and Ahmad, 2009). This study attempts to examine whether the corporate governance mechanisms practiced by family-owned companies have any relationship with firm performance.

Family-owned companies in the perspective of management: Agency and Stewardship

According to Jensen and Meckling (1976), agency management takes place when there is a contract between the principal (shareholder) and the agent (CEO and top managements) to perform some services on their behalf. This theory has two types of agency problem related to the family firm (Villalonga et. al., 2006; Ali et. al., 2007) which are separation of ownership and management (Type I agency problem) and conflict between controlling and non-controlling (minority) shareholders (Type II agency problem). Previous researchers found that family firms mainly have problems in the type II agency problem rather than type I agency problem. Andersons and

Reeb (2003) and Ali et.al. (2007) state, when the family managers have more control over the firm, it provides opportunity for entrenchment. As a result, the minority shareholder could be expropriated by majority shareholder (Fan & Wong, 2002).

Other studies have shown that when family members have the principal control in the firm, it does not affect the presence of the independent directors as a monitoring mechanism in reducing the agency cost (Jaggi et. al., 2009). However, managerial ownership held by family members in the board of directors could reduce the agency problem. According to Andersons and Reeb (2003) and Maury (2006) evidence show that when the family ownership increases to the optimal point, it reduces the agency problem and enhances performance. However, entrenchment would take place when the managerial ownership increases further. As a result, performance would be at stake. Anderson and Reeb (2003) found that the percentage of managerial ownership could increase performance around 30%. If however the percentage is increased further, it would create agency problem.

From another standpoint, the agency cost differs across generations. Blanco-Mazagatos et. al. (2007) analysed the influence of financial resources on the agency cost in family-owned companies and discovered that agency cost in the first generation was lower. This is because the founder who is active in management with limited financial resources could control the agency problems. The second and later generations tend to incur higher agency cost because of the dispersion of ownership and the diversity of roles that family member perform in the firm. Additionally, information asymmetries and conflict of interest between shareholder and manager would increase. In this case, the weakness is the lack of governance mechanism to reduce managerial opportunism.

On the other hand, the stewardship management principles are practised when the interplay between trust and family occurs in family-owned companies. The presence and involvement of one or more controlling family in the management are the main characteristics that distinguish the family firms from the other types of corporations. Because of these factors, the family constitution¹ and traits influence the management environment. The harmonization of emotion and behaviour of family members are essential to avoid disrupting the management of the business by the build-up of trust element among them. Besides, the deep interpersonal trust developed

¹ The family vision, mission, values, and policies regulating family members' relationship with the business.

among them that applies within internal and external network creates competitive advantages for the success of the family-owned companies (Karra, Tracey & Phillips, 2006).

Most of the family-owned companies perceived a significantly higher value of stewardship perceptions in family firm leadership rather than non-family firm (Davis, Allen & Hayes, 2010). The quality of relationship of leader-follower, trust and commitment are essential in stewardship behaviour in family-owned companies (Pearson & Marler, 2010). The benefit behind the stewardship motive and behaviour is to be a good steward as a family leader towards his or her family. Consequently, 'the good steward is more likely to be concerned with the employees' welfare, with regard to continuity of employment; assignments to challenging, desirable jobs; opportunities to have new experiences; and other behaviours which many employees would view as supportive and positive' (Pearson & Marler, 2010, p.1120). As a result, the family-owned companies create a higher quality of relationship between a leader and his employees which is both family and non-family employees. The trust, respect, obligation and commitments are developed among employees of family firms that create an effective leadership.

Davis et. al. (2010), found that the stewardship behaviour is positively associated with trust and commitment among family employees. When the firm adopted the stewardship, trust among non-family employees will be developed. It proved that stewardship behaviour can assist the family firms in creating a healthy environment among their employees. The reason behind the good steward practice in leadership is the influence of the director who practises the role duality in the family-owned companies. The stewardship perspective believes that the directors who hold two positions on the board which is the executive director and the chairman position would enhance the boards' effectiveness in making the best decision for the shareholders and the firms (Haniffa & Cooke, 2002). Furthermore, the corporate leadership is clearer and more consistent when the power and authority are concentrated toward one director (Donaldson & Davis, 1991).

Descriptive Analysis

Table 3 presents the descriptive statistic for the number of industry based company. The study revealed that 44.3% of the companies in the Industrial Product category are family-owned companies with a mean of 0.0398 (ROA) and 0.1313 (ROE). The mean value of ROA and ROE

indicate that the companies in this industry perform better and effectively use the company's asset to satisfy shareholders' interest and is aligned with the shareholders' expectation of good investment. On average, the companies under all industries except properties performed better. Table 4.2 provides descriptive statistics for the overall family-owned companies and corporate governance mechanisms consisting of ROA, ROE, board size (BSIZE), role duality (DUAL), the presence of independent directors on the board (BODCOM), shares owned by executive directors (MOWN) and firm size (SIZE).

Table 3: Descriptive Statistic for Number of Companies based on Industry

Industry	No. of Companies	Percentage (%)	Means	
			ROA	ROE
Construction	88	8.9	0.0370	0.1163
Consumer Product	213	21.7	0.0364	0.1189
Industrial Product	435	44.3	0.0398	0.1313
Plantation	61	6.2	0.0382	0.1257
Properties	161	16.4	0.0332	0.1049
Technology	25	2.5	0.0361	0.1189
Total	983	100%		

MULTIPLE REGRESSION ANALYSIS

In terms of the validation of the model, there are several steps and assumptions that have to be made, which are, the error term is normally distributed, there are constant variance, the error terms are independent of each other and a linear relationship exists between each X and Y in the population. The study used linear multiple regression analysis to test the relationship between family-owned companies' performance and corporate governance mechanisms (board size, independent NEDs on the board, role duality and managerial ownership) and control variable (firms' size). The proxy for dummy variables are BODSIZE with the value of "1" if the directors are less than 9 members on the board and "0" otherwise, BCOM is indicator variable with the value of "1" the percentage of independent directors is less than 38% on the board and "0" otherwise. This figure is used to reflect good governance practices of at least one third of directors should be independent directors.

The following multivariate model is estimated as follows:

$$\text{Model 1: } Q\text{-}ROA_t = \alpha_o + \beta_1 \text{ BSIZE} + \beta_2 \text{ BODCOM} + \beta_3 \text{ DUAL} + \beta_4 \text{ MOWN} + \beta_5 \text{ SIZE} + \text{dummy variables} + \varepsilon$$

$$\text{Model 2 : } Q\text{-}ROE_t = \alpha_o + \beta_1 \text{ BSIZE} + \beta_2 \text{ BODCOM} + \beta_3 \text{ DUAL} + \beta_4 \text{ MOWN} + \beta_5 \text{ SIZE} + \text{dummy variables} + \varepsilon$$

- Q-ROA_t = Return On Asset
- Q-ROE_t = Return On Equity
- BFSIZE = No. of board directors
- BODCOM = Board composition; the proportion of independent directors on the board
- DUAL = Role Duality; chairman of the board of director is also as a CEO
- MOWN = Managerial ownership; shareholdings held by directors
- SIZE = Size based on natural logarithm of sales
- Dummy variables = The categorical of board size and board composition.
- ε = Error term

HYPOTHESES DEVELOPMENT

Board Size

The number of directors influences the effectiveness and efficiency of the company’s performance. It affects the administration and management structures (Lipton & Lorsch, 1992; Jensen & Meckling, 1976), arrangement schedule, coordination of work, time taken in decision making at a meeting (Lansberg, 1999), level of monitoring activities (Ferris & Yan, 2007) and also the level of understanding with diverse stakeholders and the management (Pearce & Zahra, 1992). From the perspective of agency theory, large size company requires greater number of directors to monitor and control the firm’s management.

Previous researches have examined the association of board size and corporate performance. Most of the results indicate that a small board size have an effective monitoring, communicating and control of the company (Yermack, 1996; Lipton & Lorsch, 1992; Jensen & Meckling, 1976, Singh & Davidson, 2003; Haniffa & Hudaib, 2006). The studies on family firms also showed a significant negative relationship between board size and firm performance (Lansberg, 1999, Ibrahim et. al., 2008; Amran & Ahmad, 2009).

Ferris and Yan (2007) alternatively posed that a large board size has a greater number of people reviewing the management actions. A large board makes effective monitoring activities in their management. Ehikioya (2009) suggests that a large board size has the ability to push the managers to pursue lower costs of debt and increase firms performance. This leads to the first null hypothesis:

H1: There is no association between the board size and family firm performance.

Role Duality

Role duality measures the separation of leadership on the board of directors. MCCG recommended a balance of power and authority so that no one individual has unfettered power of decision. If the company has a combined role of chairperson and CEO, a strong independent candidate is important to sit on the board. Consistent with Haniffa and Hudaib (2006), the role duality is measured as value of “1” if the chairman is also the CEO of the company and “0” if otherwise.

The chairman holds role duality when he is also the CEO of the company. Lau and Leung (2006) found that the separation of leadership on the board enhance the monitoring quality. Consistent with prior researches, the current study focuses on role duality. Prior studies suggest that separate leadership is effective in monitoring the management (Donaldson & Davis, 1991, Haniffa & Hudaib, 2006; Amran & Ahmad, 2009).

On a contrary, Bartholomeusz and Tanewski (2006) indicated that family-owned companies are more likely to allow the role of CEO and chairman to be held by the same person than non-family owned companies. The family CEO as a steward has the ability to facilitate rapid decision making (Breton-Miller & Miller, 2009). According to the stewardship theory, the director who occupies the two top positions can easily achieve the company’s objectives. The foregoing discussion thus leads to the following null hypothesis:

H2: There is no association between role duality and family firm performance.

Board Composition

Board composition measures the percentage of independent directors on the board. The independent board members are classified according to the definition of Bursa Malaysia Listing Requirements. To distinguish between non-executive directors and independent director, the Listing Requirement stated that independent directors are directors who are not officer of the companies, neither related to the officers nor representing the family holding of its shares. These independent directors, in the view of the company's board represent the interest of the shareholders and are free of any relationship that would interfere with the exercise of their independent judgement.

In this study, the board composition is measured as the ratio of independent NEDs to the total number of directors on board of each company (Haniffa & Hudaib, 2006; Shamsar & Annuar, 1993). Previous study found that the firm performance is highest in Asian family-owned companies when board independence is 38 % and if it is more than 38% it will reduce the firm performance (Chen & Nowland, 2008). Therefore, the categories of board composition is measured as value of "1" if managerial ownership is lower than 25% of shares held by executive directors and "0" otherwise.

According to MCCG 2000, the Code recommended that one third of the independent NED to sit on the board of directors. Therefore, this study follows the recommendation to determine the independent NED. Previous studies on business firm indicate that the association of independent NED and firms' performance is a positive relationship. These evidences have been supported by Hillman and Dalziel (2003) on family firms where a significantly higher proportion of independent directors lead to the independence of board of directors. In addition, the higher proportion of independent directors can effectively monitor the activities and the decision of the management (Chau & Leung, 2006).

However, from the family firms' perspectives, the presence of the majority of independent directors in family firms tend to have poor performance due to less knowledge of the firms (Klein et. al., 2005). Bartholomeusz and Tanewski (2006) also found that family firms are likely to have a lower proportion of independent directors on their boards than non-family firms. Mishra (2001), Klein et. al. (2005) and Amran and Ahmad (2009) indicate that independent board is negatively related to performance. The hypothesis to be tested, stated in its null form is:

H3: There is no association between board composition and family firm performance.

Managerial Ownership

Managerial ownership measures the proportion of shares owned by company's executive directors. Prior research indicates that the managerial ownership is positively associated with firm performance (Jensen & Meckling, 1976). The share incentives could motivate the managers to enhance performance. The managerial ownership is measured by the proportion of shares owned by executive directors of the company as a group to total shares outstanding (Haniffa & Hudaib, 2006). This study focuses on the direct shares in the company owned by the executive directors on the board. However, previous studies found a significant positive (<25%) and negative (>25%) relationship of managerial ownership with firm performance (Jelinek & Stuerke, 2009; Chau & Leung, 2006; Anderson & Reeb, 2003). Therefore, the categories of managerial ownership is measured as value of "1" if managerial ownership is lower than 25% of shares held by executive directors and "0" otherwise.

The managerial ownership of the company is held by the executive directors who have the shareholding in the company. The agency theory suggests that the increase of shares owned by the executive directors will reduce the agency cost (Jensen & Meckling, 1976). It is suggested that, the managerial ownership can motivate the directors to enhance their performance and align the interest of the managers and shareholders. Previous studies in business portrayed mixed result where there is insignificant and nonlinear relationship between managerial ownership and firm performance (Tee & Chan, 2008; Jelinek & Stuerke, 2009). These results suggest that a certain level of managerial ownership would reduce performance. At this level, the managerial ownership can lead to management entrenchment and ineffective monitoring due to a conflict of interest. The foregoing discussion thus leads to the following null hypothesis:

H4: There is no association between managerial ownership and family firm performance.

FINDINGS

Board Size

This study indicates that the average board size of Malaysian family-owned companies is eight (8) directors. This is according to the mean score of 7.5 with the minimum and maximum number of directors of 4 and 15 for all years respectively. This mean result is consistent with Haniffa and Hudaib (2006) and Ibrahim et. al. (2008). This study carried out a narrow analysis which categorizes the board size into small and large. The small board consists of 1 to 9 directors, while the large boards are more than 9 members. Table 4.2 indicates that most family-owned companies in Malaysia have a small board rather than a large one, about 870 out of 983 observed companies. Previous studies found that a small size is positively related to better performance of the companies (Jensen & Meckling, 1976, Singh & Davidson, 2003; Haniffa & Hudaib, 2006).

Board Composition

Descriptive statistics on board composition shows that the average proportion of independent directors on the board of director is 40.7% with the mean score 0.407. Therefore, the result indicates that family firms have fulfilled the MCCG 2000 requirement recommending that at least one third of the board should be independent directors. In the years 2006 and 2007, the minimum and maximum proportion of independent directors is 0.17 and 0.80 respectively. The year 2008 showed that the minimum and maximum proportion of independent directors is 0.22 and 0.80. However, in the year 2009, the proportion of independent directors decreased with similar result occurring in previous years. This study has categorized the board composition into two groups, less than 38% and more than 38% presence of independent directors on the board of directors. The specific percentage was chosen according to the findings of previous study (Chen and Nowland, 2008). Table 4 shows that the majority of the companies have independent directors on the board of directors, less than 38% in the year 2006 and 2007, i.e about 149 and 140 companies. It shows that there is an increase number of family-owned companies having independent directors of more than 38 % on the board (133 for year 2008 and 103 for year 2009). The results indicate that family-owned companies were slow to adopt the MCCG requirement in their management.

Role Duality

The results indicate that 51.4% (505 companies) of the family firms are practising role duality (see Table 4). Specifically, from the year 2006 until 2008, the percentage of role duality decreases annually. For the year 2009, the result showed an increase on the percentage of separation of role duality among family-owned companies (55.4% or 108 companies). Therefore, the results indicated that family firms in Malaysia start to practice the separation of role duality in their companies in compliance with the best practice of MCCG code.

Table 4: Descriptive Statistics For Nominal Independent

	All		2006		2007		2008		2009	
	Firms	%	Firms	%	Firms	%	Firms	%	Firms	%
Duality	505	51.4	142	53.4	138	52.5	138	46.7	87	44.6
Separation	478	48.6	124	46.6	125	47.5	121	53.3	108	55.4
Small Board	870	88.5	236	88.7	236	89.7	226	87.3	172	88.2
Large Board	113	11.15	30	11.3	27	10.3	33	12.7	23	11.8
< 38% of independent dir.	507	51.6	149	56	140	53.2	126	48.6	92	47.2
> 38% of independent dir.	476	48.4	117	44	123	46.8	133	51.4	103	52.8
< 25% of executive dir.	954	97	260	100	263	100	259	100	166	85.1
> 25% of executive dir.	29	3	0	0	0	0	0	0	29	14.9

Table 5 presents the descriptive analysis of ROA and ROE based on the categories of dummy variables which consists of board size, board composition and managerial ownership. Independent sample T-test was used to test whether the mean score for ROA and ROE between two groups of the categories of dummy variables are significantly different. The parametric test indicates that only board size and board composition has significant difference of ROA and ROE. The results showed that the mean score for ROA and ROE of BODSIZE for large board is significantly higher than the mean score for small board. This indicates that the large board has a better performance compared to small board. Besides, the mean score for ROA and ROE of BCOM for less than 38% of independent directors on the board is significantly higher than the mean score for more than 38% of independent directors on the board. This indicates that companies with less

than 38% of independent directors have better performance and when the board have more than 38% of independent directors, the firm performance begin to decline. Both results are significant at 1% level.

Table 5: Independence Sample T-Test for ROA and ROE by Categories of Dummy Variables

Variables	Categories of Dummy Variables	N	Mean		t	
			ROA	ROE	ROA	ROE
BODSIZE	1 – 9 director members	870	.037	.118	-3.990***	-5.600***
	> 9 director members	113	.043	.154		
BCOM	< 38% of independent directors	507	.040	.130	4.317***	3.719***
	>38% of independent directors	476	.035	.114		
MOWNSHIP	< 25% of executive director's shares	954	.037	.122	-.607	.589
	< 25% of executive director's shares	29	.039	.115		

***Significant at the 1 per cent level (2-tailed)

Henceforth, the test result of hypotheses in the study is summarized in Table 6.

Table 6: Regression Analysis Result

	Hypothesis	Null Hypotheses	Variables	Result	Alternative Hypotheses	
					ROA	ROE
1	BFSIZE	There is no association between the board size and family firm performance.	BFSIZE	Reject H ₁	Non-significant	Significant (-)
2	DUAL	There is no association between the role duality and family firm performance.	DUAL	Reject H ₂	Significant (+)	Non-significant
3	BODCOM	There is no association between the board composition and family firm performance.	BODCOM	Reject H ₃	Non-significant	Significant (-)
4	MOWN	There is no association between the managerial ownership and family firm performance.	MOWN	Reject H ₄	Significant (-)	Significant (+)

The study rejects the null hypotheses that there is no association between the family-owned companies' performance and corporate governance mechanisms. This study accepts the alternative hypotheses which provide significant association between family-owned companies' performance and board size, role duality, board composition and managerial ownership. The results showed that board size has a significant negative relationship with firm performance on ROE. The results are similar to Ibrahim et. al. (2008) who found significant negative association between board size and family firms' performance in Companies listed on Bursa Malaysia (Haniffa & Hudaib, 2006). The possible explanation is that a small board is easier to administer and manage (Singh & Davidson III, 2003), thus allowing effective monitoring of the management (Lipton & Lorsch, 1992; Jensen & Meckling, 1976). The study suggests that small board size enables a dynamic board to produce an organized and systematic management that can reduce the agency cost. Therefore, the firms will have excellent performance.

The variable duality role (DUAL) is found to have a significantly ($p = 0.00$) positive relationship with firm performance on ROA. Previous study supported the result. According to Dahya, Lonie & Power (1996), the combination of the role of CEO and chairman is the best way to manage a company. The findings of this study contradict with the findings of Ibrahim et. al. (2008) and Amran and Ahmad (2009). They found a significant negative association for Malaysian family-owned companies. This implies that the argument based on the stewardship theory where a director who holds the two top positions can easily achieve the company's objectives. It is because the directors have superior knowledge and strong capability to manage the company and they act in the best interests of the firm. In addition, Bartholomeusz & Tanewski (2006) indicate family firms are considerably more likely than non-family firms to allow the role of CEO and the chairman to be held by the same person. Breton-Miller and Miller (2009) found that having a family CEO as a steward can influence the business. He has the ability to facilitate rapid decision making which is useful in a dynamic setting maintaining the integrity which could strengthen the firms' performance.

The result for board composition (BODCOM) has a significant negative association with the firm's performance on ROE. This result is consistent with Ibrahim et. al. (2008). They found significant negative association between independent directors and firm performance and suggest that the presence of independent directors on the board does not

improve the Malaysian family-owned companies' performance. This result is also similar to Mishra (2001) and Klein et. al. (2005) who found negative relationship between independent directors and firm performance. One possible explanation is that family members actively monitor their manager and understand their company better (Kang, 1998). The study suggests that the monitoring mechanism of family-owned companies relating to family members' trust, integrity and stewardship with accountability to deliver their commitment creates competitive advantages for the success of the companies. In addition, the presence of the majority independent directors in family firm tend to have a poor performance due to inadequate knowledge of the firm and focus on short term goal by the managers (Klein et. al., 2005).

On the other hand, the results found that the managerial ownership have a relationship with family-owned companies on ROA and ROE. However, both results have contrary significant association between them. The firm performance based on ROA has negative relationship with managerial ownership. The result indicates the increasing level of insider shareholding cannot solve the agency problem in enhancing firm performance. This results are supported by Jelinek and Stuerke (2009) who found that a negative relationship between managerial equity ownership and firm performance at certain level of managerial ownership. One possible explanation is a higher level of managerial ownership can lead to management entrenchment and ineffective monitoring due to a conflict of interest (Cheu & Leung, 2006).

Other possible explanation is when the executive directors hold a higher level of shares in the company, they have sufficient control of the decisions which could expropriated the minority shareholders (Fan & Wong, 2002). Anderson and Reeb (2003) found a negative relationship between managerial ownership and firm performance at a certain level of managerial ownership for Standard and Poors 500 U.S. companies. However, Table 6 shows that family-owned companies' performances on ROE have significant positive association with managerial ownership. The result is similar to Jensen and Meckling (1976). The study found that the higher level of managerial ownership aligns the interest of managers and shareholders, thus lowering agency cost and increasing firm's value. The study suggests that the insider shareholding is a motivating mechanism for directors to provide excellent performance to the firms. Therefore, they could enhance the firm performance.

SUMMARY OF THE FINDINGS

The study reveals a strong relationship between firms with small boards and firm's performance. Hence this study suggests that small board could be good for corporate governance mechanisms to improve the companies' performance. Small board is easier to manage and is also effective in monitoring the management. In addition, most of the Malaysian family-owned companies studied (870 out of 983 companies) have small board directors. The firm value of family-owned companies has a higher profit when role duality exists. The results showed that the corporate governance of family-owned companies is different with non-family firms. The study suggests that role duality could be a superior corporate governance mechanism which tends to increase firms performance. The directors with dual leadership help to strengthen the role of the CEO as the chairman which effectively monitors the management. The dual leadership can be practiced in management if a candidate with sound knowledge and accountability is able to manage the business without causing power imbalance. According to the Code of Corporate Governance, firm can practice role duality on the board which has strong independent element and is able to balance the power and authority and publicly explained to the stakeholders.

CONCLUSION

According to the Code of Corporate Governance, an effective board composition with independent judgment in decision making should have at least one third of the board membership. Therefore, the presence of independent directors on the board as a monitoring mechanism is to enhance the firm's performance. However, the representation of independent directors on the board of directors in family firm does not improve the firm's performance. The study found that the relationship between the firm's performance and board composition for Malaysian family-owned companies is significant negative on ROE. The study suggests that the monitoring mechanism of family-owned companies relating to family members' trust, integrity and stewardship with accountability to deliver their commitment creates competitive advantages for the success of the companies.

The study shows significant evidence that managerial ownership serves as a motivation to the directors to perform better in management

which tends to improve the firm performance. In addition, there are different results on relationship between managerial ownership (MOWN) and firm value. The ROA value shows significant negative relationship with MOWN, suggesting that the increasing of insider shareholdings on the companies could weaken the firm value. The higher shares holding of the company held by executive directors reveal that entrenchment can occur and will reduce the firms' performance. Hence, ROE value shows significant positive relationship with MOWN suggesting that increase of insider shareholdings on the companies could enhance the firms' value. The insider shareholding is a motivating mechanism for directors to provide excellent performance to improve the firms.

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