OWNERSHIP CONCENTRATION AND FIRM'S PERFORMANCE EVIDENCE FROM THE MALAYSIAN EXCHANGE

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Puan Anita Hasli
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TAJUK PROJEK: CORPORATE GOVERNANCE AND PERFORMANCE
Dengan hormatnya perkara di atas adalah dirujuk.

Dimaklumkan bahawa Jawatankuasa Penyelidikan dan Perundingan UiTM Cawangan Sarawak di dalam mesyuaratnya yang ke-24 pada 11 April 2003 telah membuat keputusan seperti berikut:

1. Meluluskan cadangan penyelidikan yang dikemukakan oleh puan serta Encik Hamri Tuah dari Universiti Malaysia Sarawak.

2. Tempoh penyelidikan adalah selama 1 tahun, iaitu mulai 12 April 2003 hingga 11 April 2004.

3. Kos yang diluluskan adalah sebanyak RM 10,000.00.

4. Penggunaan geran yang diluluskan hanya akan diproses setelah perjanjian ditandatangani.

5. Semua pembelian peralatan yang kosnya melebihi RM 500.00 setiap satu perlu dibuat melalui Bahagian Bendahari, UiTM Cawangan Sarawak. Pihak Puan juga dikehendaki mematuhi peraturan-peraturan yang berkaitan dengan penerimaan peralatan tersebut. Panduan penerimaan peralatan baru dan pengurusannya, dilampirkan.

6. Sebarang peralatan /kelengkapan (termasuk buku dan jurnal) yang dibeli melalui geran ini adalah hak milik kampus cawangan dan hendaklah diserahkan ke Unit Penyelidikan dan Perundingan setelah projek tamat atau ditamatkan untuk kegunaan bersama.

7. Pihak Puan dikehendaki mengemukakan **Laporan Kemajuan Penyelidikan** sekurang-kurangnya satu kali di dalam tempoh penyelidikan.

Sekian, terima kasih.

'SELAMAT MENJALANKAN PENYELIDIKAN'

Yang benar

PROF. MADYA DR. ABDUL RAHMAN DEEN
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5 Jan, 2004

Puan Anita Hasli,
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Tuan,

Per: Ownership And Performance

Dengan hormatnya surat Puan bertarikh 26 Disember, 2003 adalah dirujuk.

Dengan sukacitanya dimaklumkan bahawa permohonan Puan untuk memasukkan Encik Mohd. Mokhtar sebagai ahli penyelidik didalam kumpulan Puan adalah diluluskan.

Diharapkan dengan penglibatan Encik Mohd. Mokhtar akan melancarkan lagi proses penyelidikan yang dijalankan.

Kerjasama serta sokongan yang diberikan dalam bidang penyelidikan amatlah dihargai.

Sekian Terima Kasih

'SELAMAT MENJALANKAN PENYELIDIKAN'

Yang benar,

Prof. Madya Dr. Abdul Rahman Deen,
Pengarah Kampus

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Date : **12th October 2004**
Project File No : **600-UiTMKS (UPP.5/2/36/SKK)**

Head
Institute of Research, Development and Commercialization (IRDC)
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Selangor

Dear Professor

FINAL RESEARCH REPORT "CORPORATE GOVERNANCE AND FIRM'S PERFOMANCE"

With reference to the above, enclosed are the three copies of the Final Research Report entitled "Corporate Governance and Firm's Performance"(i.e. Ownership Concentration and Firms' Performance –Empirical Evidence from the Malaysian Exchange) by two researchers from UiTMCSKS and one researcher from UNIMAS.

Thank you.

Yours faithfully

ANITA HASLI
Leader
Research Project

PROJECT TEAM MEMBERS

ANITA HASLI
Project Leader

....

MOHD MOKHTAR MOHD GHANI

....
Signature

HAMRI TUAH

....
Signature

Acknowledgement

Appreciation and thanks goes to all parties that were directly or indirectly involved in the completion of this project.

Prof. Dr. Azni Zain Ahmad
Assistant Deputy Chancellor (Research)

Prof. Madya Dr. Jamil Hamali
Dean, Faculty of Business Management.

Thanks to all parties that had given their cooperation and support in the completion of this research.

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ABSTRACT

This study investigates the effect of ownership structure and concentration on firm's performance. Ownership structure and concentration were determined by observing ownership with regard to identity and ownership with significant variables and the relative importance of each predictor on the performance indicators i.e. firms profitability. Firm's profitability is measured by return on assets, return on capital employed and operating margin. The study involved pooled data over a period of 4 years (1998-2001) with a total of 402 observations extracted from the Malaysian Stock Exchange Berhad. The results showed that 80% of the owners were individual owners, other companies and nominees. There is minimal government, social responsible funds and family involvement in these companies. Apparently, diffused ownership is the norm. The top 5 and 10 shareholders hold an approximate 50% and 60% respectively of the shares in these firms. The finding revealed that none of the variables were consistently significant over the 4 years. Implicitly, this implies that ownership structure and concentration of ownership were not able to exert total control over the governance of the firm through monitoring the actions of the managers. Arguably this study makes a contribution to the extant literature on governance and an interesting perspective on a developing country.

CHAPTER 1

INTRODUCTION

I.0 Introduction

This chapter highlights the background, objectives, significance and scope of the research.

1.1 Background of the Study

According to the encyclopedia of corporate governance (ENCYCOGOV.COM), the ownership history of large enterprise began with entrepreneurial capitalism, which started about 1650 in Western Europe. This was the era when corporations were controlled and owned by the managers. It evolved into managerial capitalism, which started about 1860 in Western Europe and USA. This was the era of listed corporations controlled by managers but mainly owned by various non-managers. Finally, in the information age, it culminated into institutional capitalism, which started about 1980 in Western Europe, USA and Japan. This was the era of corporations controlled by managers but mainly owned by financial institutions.

Low (2002) reviewed literature dating from Berle's and Means (1933) work on separation of ownership and control until La Porta et. al.'s recent works on the issue and found that contemporary evidence suggests that a concentrated ownership exists, particularly in East Asia. They further revealed that empirical research on corporate governance, with the exception of Japan, in the rest of East Asia is minimal. In Malaysia, corporate governance was given the extra attention only after the Asian Financial Crisis.

1.2 Statement of the Problem

Observers had pinned downed one of the major contributors of the vulnerability of certain companies and the economy in general was poor governance. Against this observation, the high-level Finance Committee on Corporate Governance (Finance Committee) was established by the Minister of Finance in 1998, which culminated in the publication of the Malaysian Code on Corporate Governance in 2000.

Thus, in recent years the attention given to good governance has been given much attention by many researches. By and large the evidence from empirical works done by researches of the impact of governance on the effectiveness of firms in Malaysia are still minimal. Information on the effect of ownership characteristics are important for traditional users such as creditors, financial analysts, consultants, customers and potential shareholders. It is implied that with the right owners, firms' value can be enhanced. The investing public would be able to make efficient and effective investment decision. It can assist efficient and effective decision making among the board and management. Policy makers and regulatory bodies to draw policies and regulations to enhance good governance of public listed companies could also use it as a guide. The financial, customer, shareholder, process and development objectives are assumed to be easily achieved with the proper governance of public listed companies, beside complying to mandatory requirements such as the MASB and the Companies Act 1965.

The immense attention to good governance has prompted academicians and practitioners alike to study the relationship between governance and performances of corporations in Malaysia. Currently, only a few empirical studies on this subject relating to the Malaysian corporations have been published and the findings so far are inconclusive. Thus, this corporate performance study should contribute to the growing number of attempts at studying corporate control actions (or lack of them).

Malaysia has adopted to a certain extent both the Anglo-Saxon's and Anglo-American concepts of finance. Therefore, this study follow the many research that has embraced the agency theoretic framework or sometimes referred to as separation of ownership and control which was derived from the Jensen et. al's 1976 work on "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (Low, 2002). The ownership structure may often be an important agency control in the success and efficiency of firms and eventual creation of firm's value. We develop a hypothesis concerning the impact of ownership structure on the profitability of public listed companies on the MSEB. Specifically, the investigation attempts to find the link between ownership structures on the earning power of the firms, which is measured by the return on assets.

1.3 Objectives of the Study

This study attempts to achieve the following objectives:

I. To determine the ownership concentration for companies listed on the KLSE.

ii. To investigate the impact of ownership concentration on the performance of public listed companies on the Malaysian Exchange.

1.4 Significance of the Study

The findings will provide fundamental knowledge to the investing public as to whether ownership structure affects the performance of the firm and inevitably the wealth of shareholders. This would enable them to make better investment decision. Also, the findings will assist decision-making with regard to their control over their corporations. Finally, the policy makers and regulatory bodies e.g. Bank Negara Malaysia, KLSE, Security Commission, Companies Commission Malaysia etc. would benefit from the empirical works and they could use it as a guide to draw policies and regulations so that Public Listed Companies are better governed.

1.5 Scope of the Study

This study focuses on public listed companies on the Malaysian Exchange. These companies comprised of Technology, Consumer Products, Industrial Products, Construction, Trading and Services, Infrastructure Project Companies, Hotel, Properties, Plantation, and the Mining sectors.

1.6 Organization of the Report

The paper is structured as follows. First, we provide an overview of the literature on governance and its effect on the performances of firms. Next, we describe the method employed in this study. Third, we present the results of the descriptive analysis and regression analysis. The descriptive analysis describes the concentration of the owners with regard to identity and without regard to identity. The regression analysis assesses the influence of the ownership concentration on firms' performance. Finally, in the concluding section, we discuss the findings and raise issues for future research.

1.7 Definition of Terms

- **Ownership Concentration:**

I) Ownership concentration among shareholders without regard to identity

II) Ownership concentration among shareholders with regard to identity

- **Performance**

Performance is measured by return on assets, return on capital employed and operating margin.

Return on assets is simply profits divided by total assets. ROA = EAT/Total Assets, where profit is earnings based earnings after tax.

Return on Capital Employed (%). Return on capital is determined by: Earnings after tax/Capital Employed. It measures overall effectiveness in generating profits with available capital.

Operating Margin i.e. operating profit / earnings before interest and taxes as a percentage of sales

CHAPTER 2

LITERATURE REVIEW

2.0 LITERATURE REVIEW

Empirical research on the relationships between separation of ownership and control and its effect on not only firms' effectiveness has grown since the pioneering works of Berlet and Means in 1933.

Seiko (1994) contended that promotion of family members to senior management or board position diluted the pool of non-family talent and lead to corporate failure when family members were not capable of maintaining and enhancing the business left by the founder. Constand et. al (1998) indicates that there is no evidence of a relationship between profitability and ownership concentration. Similar findings also found in Claessens et al.'s (1999) survey that in nine East Asian Countries, there was a negative correlation between founding family firms and performance and the performance of the founders were better than their descendants. There is lack of significant relationships between governance structure (leadership structure, board composition, board ownership, CEO compensation, CEO tenure and CEO ownership) and firm performance (Coles et. al, 2001). Mishra et al. (2001) however, found that founding family control through directorship had little impact on firm value. It was found that the coupling of ownership and control is positively associated with short-term profitability(Carney and Gedajlovic, 2002). Faizah(2002) found that ownership structure does enhance performance of the plantation firms listed on the KLSE in a positive manner. A study of Malaysian companies on the Kuala Lumpur Stock Exchange (1989-2000) revealed that there is a statistically significant positive relationship between board remuneration and sales turnover, and a statistically significant negative relationship between board remuneration and ownership concentration (Dogan and Smyth, 2002).

Evidence from the Zaibatsu dissolution program in Japan from the late 1940's, it was found that there was no significance between ownership and profitability (Miwa and Ramseyer, 2003). However, in a study on group-affiliated firms in Korea, it was found that performance determines ownership structure and not vice versa. There was also evidence that controlling shareholders use insider information to take direct and indirect equity stakes in profitable or promising firms and transfer profits to affiliates through intragroup trade (Chang, 2003).

On the contrary, there were researches that bore different results. Xu and Wang(1999) found that there is a positive and significant correlation between ownership concentration and profitability. It has been suggested that concentrated ownership can improve performance and that bank influence in such system is significantly less important (Edwards and Nibler, 2000). Gedajlovic and Shapiro(2002) also found that there is a positive relationship between ownership concentration and financial performance, which is consistent with the agency theory predictions. Gursoy and Aydogan(2002) concluded that there is a significant impact of ownership structure—ownership concentration and ownership mix—on both performance and risk-taking behavior of the firms in their sample. Higher concentration leads to better market performance but lower accounting performance. Family owned firms, in contrast to conglomerate affiliates, seem to have lower performance with lower risk. Government-owned firms have lower accounting but higher market performance with higher risk.

It can be perceived that further investigations in this domain are encouraged (Daily et. al. 2003) and additional research would add richness to this tradition of research.

CHAPTER 3

HYPOTHESIS AND RESEARCH METHODOLOGY

3.0 Hypothesis Formulation

The relationship between types of owners for both categories (i.e. with regard to identity and without regard to identity) and firms' performance is examined firstly as:

$$\mathbf{Y = \alpha + \beta_i OW_i + \beta_j OW_j + \varepsilon}$$

Where

Y, represent performance variables = ROA, ROCE, OM

OW_i represent type of owners with regard to identity, i = 1, …,9

OWj represent type of owners without regard to identity, j = 10, …,15

α, is the intercept of the model

β represents the estimate of the regression model

ε, *is the stochastic error term*

Other factors may also affect the performance of the firms. These factors were treated as control variables i.e. sales and leverage and could possibly affect ROA, ROCE and OM of the firms.

$$\mathbf{Y = \alpha + \beta_i OW_i + \beta_j OW_j + \beta_{16} Sales + \beta_{17} Leverage + \varepsilon}$$

Ordinary Least Square (OLS) regression procedure was used. The model was used to test the hypothesis for four- year samples for the year 1998, 1999, 2000, and 2001. The null hypotheses to be tested are:

H_0: *Ownership concentration is irrelevant to firm's performance, and*

H_0: The larger the shares held by top shareholders the higher the performance.

3.1 Sample Selection

This study used a pooled time series and cross sectional observations of 402 public listed Malaysian companies spanning their 1998-2001 fiscal years. Firms included in the sample represent a broad cross-section of small, medium and large publicly traded Malaysian firms drawn from 10 sectors (Technology, Consumer Products, Industrial Products, Construction, Trading and Services, Infrastructure Project Companies, Hotel, Properties, Plantation, Mining). The major sectors that were being considered were Consumer Products-78, Industrial Products-134, Construction-30, Trading and Services-52, Properties-57 and Plantation-28 while others account for 23. Finance sectors, unit trust, mutual funds, MESDAQ and PN4 companies on the MSEB were excluded. We followed the extant literature. Data was obtained from the proxy statements for the year 1998-2002. The ownership structure and characteristics were collected from annual reports, MSEB company files and others. Only reliable and correct data were included.

3.2 Variables

i. ***Ownership Structure and Concentration***

With publicly listed companies in Malaysia, one can quantify the ownership mix and concentration, which makes it possible to study this issue. These companies are typically owned by the state, federal, legal persons (institutions-other companies, banks, non-bank financial institutions i.e. securities firms, trust and investment companies, mutual funds, insurance companies, provident funds, pilgrimage funds), individuals, employees and foreign investors. We follow Xu and Wang (1999), Gedajlovic and Shapiro (2002) and Constand et. al (1998), which also includes our own classification, which are

I) Ownership concentration among shareholders without regard to identity will be confined to a) less than 5%; b) 5%-10%; c) 10%-20%; d) more than 20%; e) largest 5 shareholders; f) largest 10 shareholders

(ii) Ownership concentration among shareholders with regard to identity: a) individual owners; b) Malaysian Finance Institution; c) Investment, Trust, Cooperation; d) Other companies; e) Government; f) Nominees; g) Foreign owners; h) Social responsible funds; I) Family

i. ***Size***

In this study, firm size is defined as the firm's sales for the financial year. Sales are chosen, as the data is also required for other variables of the study, thus it is more cost effective in the data collection process. Foster (1986) used total assets, sales and market capitalisation to measure firm size.

ii. ***Performance Indicators***

a) Return on Assets (%)

Return on assets (ROA) is an accounting measure of performance. This performance measures does not tell us how much management has increased shareholders' wealth as it only provides an indication of average profitability alone, without assessment of shareholder value creation. However, even other sophisticated measurements such as the EVA do not accurately assess shareholder value creation (Griffith et. al, 2002). Thus, the ROA, based on availability of database, is the best operational firm performance measure for public listed companies on the MSEB. Return on assets is defined as:

ROA = EAT/Total Assets

where profit is earnings based earnings after tax.

ROA measures overall effectiveness in generating profits with available assets. It resolves the shortcomings of the net profit margin and total asset turnover. It explains the earning power of the firm. Also, according to Prowse (1992), since stock market returns are expected to adjust for any divergences between shareholders and managers, accounting-based measures such as ROA are preferable in studies relating ownership structure to financial performance. Operating profit and earnings before tax is also considered to look at the effects of leverage, before and after, assuming optimal leverage. Thus, profits from operation pre-tax earnings and post tax earnings are obtained to look at three different returns and how ownership would affect these three levels of return.

b) **Return on Capital Employed (%)**

Return on capital is determined by:

Earnings after tax/Capital Employed. It measures overall effectiveness in generating profits with available capital.

c) **Operating Margin** i.e. operating profit / earnings before interest and taxes as a percentage of sales

iii. ***Firm growth***

(Gedajlovic et. al 2002) Firm growth, measured as year-over-year sales growth, will be used as a control for demand conditions and product-cycle effects.

iv. ***Financial Leverage***

(Gedajlovic et.al. 2002, Harris et. al. 1991) Financial leverage, measured as the ratio of debt to capital employed, was included because according to Harris and Raviv (1991), a firm's capital structure may influence its investment decisions and the discretion afforded its managers. Debt refers to total debt is measured as short-term debt + related loans + long term debt. Capital employed is measured as total assets less current liabilities.

CHAPTER 4

DATA ANALYSIS AND DISCUSSION OF RESULTS

4.0 Introduction

This section provides a summary of descriptive analysis for all the companies and the major 6 sectors that became the main focus of the study.

4.1 Descriptive Analysis for all Companies

This section is a summary analysis all the companies collected as samples. The complete descriptive analysis is available in the Appendix 1: Table 1a-1d.

4.1.1 Summary of Descriptive Analysis for Companies

Table 1: Summary for descriptive analysis for all Companies: 1998-2001 (n=402)

	Variables	Ownership (%)
A.	With regard to identity	
	1.Individual	34%-37%
	2.Malaysian finance institution	1%
	3.Investment, Trust, fund, Cooperation	3%-6%
	4.Other companies	19%-22%
	5.Government	0.3%-0. 5%
	6.Nominees	21%-25%
	7.Foreign	8%-16%
	8.Social responsible funds	2%-3%
	9.Family	3%-4%
B	Without regard to identity	
	1.less than 5%	99%
	2.5%-10%	0.05%
	3.10%-20%	0.03%
	4.More than 20%	0.03%
	5.Largest 5 shareholders	52%-54%
	6.Largest 10 shareholders	60%-64%

Table 1 shows that the individual owners, other companies and nominees form the majority of owners, which comprise of nearly 80% of the ownership of these firms. There is minimal government and social responsible funds involvement in these companies. Family ownership too appears diffused and minimal which is a stark characteristic of publicly listed companies in which concentration of ownership by families are weakened.