

## OWNERSHIP STRUCTURE AND FIRM PERFORMANCE: EVIDENCE FROM MALAYSIAN TRADING AND SERVICES SECTOR.

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### ABSTRACT

*The objective of this study is to examine the impact of ownership structure i.e. concentrated, managerial, government and foreign on firm performance of the Malaysian listed Trading and Services firms. This study was conducted for a period of six years (2005 to 2010). The study revealed that when firm are concentrated or managerial ownership, it can enhance the firm performance, while inversely occurs in government ownership firms. The Trading and Services firms are not affected by ownership structure under pre crisis period. The significant effect only can be seen in concentrated firm under during crisis and post crisis periods and for foreign ownership firms in post crisis period.*

**Keywords:** *Ownership structure, firm performance, crisis period.*

## 1.0 Introduction

Ownership structure is relatively varied across countries (Chen & Yu, 2012). Corporate ownership in Malaysia is typically characterized as concentrated shareholding compared with the ownership structure in Western countries (Claessens et al., 2002). In Malaysian companies, families hold around 44.7% of their shares (Carney & Child, 2013). Examples of Malaysian companies with family ownership are Tan Chong Motor Holdings Bhd., YTL Group, IOI Group, and some others. With a high level of concentration, there will be a strong monitoring power over company managerial decisions. This is because the block holders wish to safeguard their investments. In Indonesia, Korea, Malaysia, Singapore, Philippines, and Taiwan (China), 15% to 80% of companies have managers who are family members as the controlling owners (Claessens et al., 2000). When large shareholders act as managers, the possibility of conflict between shareholders and managers would be reduced. This will help the managers make decisions that can benefit and increase their firms' value. Ownership concentration and firm performance has a significant relationship. The equity owned by corporation, government, nominee and individual eventually influenced overall firm performance (Mat Nor, Shariff and Ibrahim, 2010). According to Sulong and Mat Nor (2008), large shareholders' ownership provides the incentive for the controlling shareholders to use their influence to maximize value, to exert control, and to protect their interests in the company.

Beside concentration of ownership and managerial ownership, government-controlled institutions also hold significant shares in the Malaysian listed companies. However, instead of placing more emphasis on their social objective, government-controlled companies in Malaysia appeared to be more closely politically connected (Mohd Ghazali & Weetman, 2006). They do not need to attract potential investor and worry about funding since they can easily obtain it from local banks at lower cost. In addition, Mohd Ghazali and Weetman (2006) found that government ownership companies may be less open in disclosing information pertaining to their performance to the public to protect the real or beneficial owners.

Since ownership in Malaysia varies with concentration, managerial, government, and foreign ownership, result is expected to show different effect on firm performance. Yet, there are not many empirical studies on ownership structure and firm performance in Malaysia Trading and Services Sectors. Thus, based on the context of Malaysia, this research contributes to the growing literature on ownership structure and firm performance.

### 1.1 *Trading and Services Sector in Malaysia*

In Malaysia, services sector is perceives as the engine of growth of the Malaysia's economy. As in 2012, it has recorded a significant performance where 54.6% of the country's GDP is represented by services trade which is valued of RM408.9 billion. The services sectors that generated the revenues for the economy are distributive trade (26.1%), government services (14.7%), finance (13.1%), real estate and business services (10.1%), information and communication (7.0%), transportation and storage (6.7%), utilities (4.6%), accommodations and restaurants (4.5%), insurance (4.1%) and other services (9.1%) (Department of Statistics Malaysia, 2013). Besides, Foreign Direct Investment (FDI) inflows in the services sector have also risen, particularly in financial services, shared services and outsourcing, as well as communications.

In view of the past and continuous outstanding performance of the services environment, the government has included the services sector as one of the main driving force under the 10<sup>th</sup> Malaysian Plan to sustain its long term economic growth. It is expected to remain the primary source of growth, motivated mainly by the expansion in finance and business services, wholesale and retail trade, accommodation and restaurants as well as the transport and communications subsectors. In line with the aspiration to become a developed nation by 2020, the services sector is expected to grow at 7.2% annually until 2015, raising its contribution to GDP to 65% by the end of the Plan period (Tenth Malaysia Plan, 2011). This growth will depend largely on improving the sector's productivity and attracting of RM44.6 billion in new investment for the services sector to reach the targeted GDP contribution. During the Plan period, the services sector will be liberalized under the ASEAN Framework Agreement on Services (AFAS), World Trade Organization (WTO) and free trade arrangements (FTAs). In keeping with the AFAS, further liberalization will be undertaken for all 128 subsectors, allowing at least 70% ASEAN equity ownership by 2015. In this regard, the Government will expand on its commitments made to the WTO in 1995 to liberalize 65 services subsectors. Malaysia will make further improvements to its offers including areas such as healthcare, professional services, environment, transport, education and telecommunications, as well as tourism and information and communications technology (ICT) services. Malaysia will also continue to negotiate free trade arrangements in the services sector with its major trading partners (Tenth Malaysia Plan, 2011).

## **2.0 Literature Review**

### *2.1 Concentrated Ownership*

Hill and Snell (1988) found that, there is positive relationship between ownership structure and firm performance, as measured by profitability. This resulted from firm strategic choice. Concentrated firms encourage innovation as strategy linked to increasing the value of the firms. Meanwhile, they discourage diversification strategy due to this strategy would tied manager and interest objective together. However, Arosa et al. (2010) showed that concentrated in non-listed Spanish firms either family or non-family not related to firm performance. But, the author do finds the relationship towards performance in family firms is based on which generation manages the firms. The positive relationship can be seen in first generation at low level of control right due to monitoring hypothesis and negatively related at high level of ownership as result of expropriation hypothesis. When the subsequent generation has joined, the ownership disperses.

Family ownership creates value for all the firm's shareholders only when the founder is still active in the firm either as the CEO or as a Chairperson with a hired CEO (Villalonga & Amit, 2006). When family firms are run by descendent-CEO, minority shareholders, those firms would be worse off than they would be in nonfamily firms in which they would be exposed to the classic agency conflict with managers. There is negative impact on company performance when the control is passed to the next generation of the family (Cucculelli & Micucci, 2008; Arosa et al., 2010).

According to Alimehmeti and Paletta (2012), an Italian listed firm shows the positive relationship between ownership concentration and firm value for the year 2006 to 2009 except 2008. In year 2008, the result indicate a non-linear relationship exist prove to that the financial crisis has enhanced the expropriation effects divergent the monitoring effects. Other researchers such as Barclay and Holderness (1989), McConnell and Servaes (1990), and Omran (2009) also found positive relationship between ownership concentration and firm performance.

H<sub>1</sub> There is a positive relationship between ownership concentration and firm performance.

## 2.2 *Managerial ownership*

The good news with CEO or top management stock ownership is the potential to reduce agency conflict (Jensen & Meckling, 1976) since it could reduce excessive consumption by the CEO or top management and increase the firm's value. However, the bad thing with CEO stock ownership is that with higher holding stock, it lags them from internal and external company discipline; thus reducing firm value (Jensen & Ruback, 1983). Since 1980, larger companies have used stock and stock options as a way to compensate top management. Thus, with larger stock ownership, the CEOs are more likely to be entrenched to their position (Hall & Liebman, 1998).

Managers with low level of ownership are unable to do this since a variety of market discipline measures can be enforced upon them, so that they would work towards increasing shareholder wealth (Griffith, 1999). Based on simultaneous equations, Loderer and Martin (1997) revealed that firm performance will not higher with increases in managerial ownership. But, better performance firm can enlarge the managerial shareholding. However, Belghitar, Clark and Kassimatis (2011) indicate that the effect of managerial ownership on firm performance varies with the degree of ownership. At low and high level of ownership, firm performance hinder, whereas performance is enhance at intermediate level. It's due to managers' personal costs during low ownership and managerial entrenchment at high level of ownership.

H<sub>2</sub> There is a negative relationship between managerial ownership and firm performance.

## 2.3 *Government ownership*

State ownership and firms' performance have a convex relationship (Wei and Varela, 2003; Wei et al., 2005; Ng et al., 2009). Ng et al. (2009) stated that strong privatization and state control give benefits to Chinese firm during 1996 to 2003. It because both concentrated firm and the balance of power jointly contributed to firm performance. However, firm with mixed control experience poor performance due to ambiguity of ownership control, property rights, agency issues, profits and welfare objectives. Moreover, the result also shows inverse relationship between SOEs firm size and performance. The larger the size of SOEs firm, the poorer the firm would perform. It happen since it involved more government bureaucracy, high agency costs, and difficult to manage if any changes in economic and political environment.

Other than that, Leuz and Oberholzer-Gee (2006) reported Indonesian companies enjoy low cost of capital provided by state-owned local bank since they are politically connected to the former President Suharto. In Malaysia, Najid and Abdul Rahman, (2011) reported that with government involvement, the GLC (government linked companies) shows a positive relationship to firm performance. Investors do believe that companies backed by the government can face any difficulties and put effort to enhance the company as basis of equality and stability of the economy. It supports the previous finding by Eng and Mak, (2003). Firm with government involvement have benefit it term obtaining information and easier to get financing from different channels than non-state firms.

H<sub>3</sub> There is a positive relationship between government ownership and firm performance.

#### 2.4 Foreign ownership

By using return on assets (ROA) and Tobin's Q to measure firm performance, Douma et al. (2006) reported that foreign firms in India perform better than domestic firms. Foreign ownership firms are positively and significant to influence firm performance. The result contradicted with previous study by Barbosa and Louri (2005). The authors find that after controlling for firm industry specific effect, the performance of Portugal firms is not affected by foreign ownership. The result based on 523 firms in Portugal in year 1992. However, positive relationship between foreign ownership and firm performance reported in Greece as measured by upper quantiles of gross return on assets based 2561 firms in year 1997. Firms in Russia with foreign ownership have higher productivity than domestic firms (Yudaeva et al., 2003). Similarly, Srithanpong (2012) indicated that foreign ownership positively effect on performance of Thai construction industry. Foreign firms are more productive, high construction capability and pay higher average wages than domestic firms. Additionally, it also may provide financial support, transfer of technology, and experience (Huang & Shiu 2009; Gurbuz & Aybars 2010; Romalis 2011).

H<sub>4</sub> There is a positive relationship between foreign ownership and firm performance.

### 3.0 Methodology

This study used the annual report of Bursa Malaysia Public Listed firms for the period of 2005 to 2010 to obtained data for ownership. This period of study was chosen to see the effect of ownership structure during subprime crisis which occurred in 2007 and 2008. Therefore, this study will be more significant since it would capture three stages of economic condition: before crisis (2005-2006), during crisis (2007-2008), and after crisis (2009-2010). Erkens et al. (2012) examined the influence of corporate governance on firms' performance during the 2007-2008 financial crisis. They suggested that firms with high institutional ownership faced high risk prior to crisis resulting in more losses incurred during crisis.

Other than that, data for return on assets and control variables collected from Datastream. This study mainly focuses on listed Trading and Services Firms. Firm which do not have complete data during the period of study will be excluded from the sample. Hence, a balance panel data of 73 firms examined from the total of 177 firms.

The empirical model used in this study can be described as follows:

$$ROA_i = \beta_0 + \beta_1 CO + \beta_2 MO + \beta_3 GO + \beta_4 FO + \beta_5 MTBV + \beta_6 LEV + \beta_7 FZ + \varepsilon_{it}$$

Where;  $\beta_0$  = constant term;  $ROA$  = Return on Assets for firm  $i$ ;  $CO$  = Concentrated Ownership;  $MO$  = Managerial Ownership;  $GO$  = Government Ownership;  $FO$  = Foreign Ownership;  $MTBV$  = Market-to-Book Equity Ratio;  $LEV$  = Leverage; and  $FZ$  = Firm Size.

Return on Assets (ROA) is used as a proxy for firm performance. It regresses against the ownership structure (concentrated, managerial, government and foreign) and other control variables (investment opportunities, leverage and firm size). ROA has been used by many studies to measure for firm performance including Demsetz and Villalonga (2001), Douma et al. (2006) and Phung and Hoang (2013).

To examine the effect of concentrated ownership, this study employed Herfindahl index. It based on total shares owned by the largest five shareholders (Cespedes et al., 2010 and Fazlzadeh et al., 2011). Government ownership is defined as when company shares are held by federal/states institutions, agencies, and government-linked companies (GLCs) through the 30 top shareholders in the list (Mat Nor and Sulong, 2007). Similarly, for foreign ownership measured by the sum of all shares in the hand of foreign shareholders who are in the list of 30 largest held though either nominee companies or other corporate foreign share holdings. Managerial ownership is measured as the percentage of shares held by executive directors to total number of shares issued. This method is similar to Abdullah (2006).

As for control variables, market-to-book value of equity ratio is a measure of investment opportunities (Adjaoud and Ben-Amar, 2010). Leverage is measured based on debt to equity ratio as suggested by previous researches such as Lev and Kunitzky (1974) and Gaver, and Gaver, (1993). Firm size is one of the control variables measured by using log of total assets (Chae et al., 2009).

## 4.0 Findings

### 4.1 Descriptive Statistics

Table 4.1 presents the descriptive statistics for variables used in the study for the period of 2005 to 2010. The average (median) of ROA (proxy for firm performance) in Malaysia listed Trading and Services firms was 5.00% (4.51%) and the maximum was 37.38%. Ownership concentration based on Herfindahl index, *HI5*, showed that concentration ranges from 3.81% to 97.92%. The mean percentage of the five largest shareholders was 51.74% implying that more than 50% of the share ownership was held by top five Malaysian companies' shareholders. The average (median) of managerial ownership in Malaysia listed companies was 4.81% (0.11%) and the maximum was 62%. Besides, the average government ownership was 6.89% and the highest being 79.18%. On other hand, the result showed that the average (median) 15.58% (7.03%) of Malaysia Trading and Services firms' shares were held by foreigners with the maximum of 77.45%. In terms of firm size, average (median) was 8.97 (8.81) and ranged from 6.18 to 12.46.

Table 4.1: Descriptive Statistics

Variables	Mean	Median	Maximum	Minimum	Standard Deviation
ROA (%)	5.00	4.51	37.38	-14.13	6.49
CO (%)	51.74	48.15	97.92	3.81	18.57
MO (%)	4.81	0.11	62.00	0.00	10.83
GO (%)	6.89	0.64	79.18	0.00	12.58
FO (%)	15.58	7.03	77.45	0.00	19.17
MTBV	1.08	0.95	13.36	-49.09	4.14
LEV (%)	57.14	40.39	336.11	0.00	62.49
FZ (%)	8.97	8.81	12.46	6.18	0.75

*Notes.* ROA = return on assets ; Ownership structure: *HI5* = Concentrated based on Herfindahl Index; *MO* = Managerial Ownership; *GO* = Government Ownership; and *FO* = Foreign Ownership; control variables consists of *MTBV* = Market to book value; *LEV* = Leverage; *FZ* = Firm Size.

## 4.2 Empirical Result.

Table 4.2: The relationship between ownership structure and firm performance (ROA).

Variables	Coeff	S.E
Constant	69.29***	(15.02)
CO	0.10**	(0.05)
MO	0.91***	(0.15)
GO	-0.14*	(0.07)
FO	0.09	(0.08)
MTBV	-0.25*	(0.14)
LEV	-0.01	(0.01)
SZ	-8.23***	(1.63)
R-squared	0.47	
Adjusted R-squared	0.36	
F-statistic	4.05***	
Durbin-Watson	2.32	

\*\*\*, \*\*, \* indicate significance at the 1%, 5 % and 10% levels

Table 4.2 present the regression result based n panel fixed effect model. There are five variables significantly influence Trading and Services firm performance. This study found that there is a positive relationship between ownership concentration and firm performance at 5% significant level. Thus, the hypothesis (H<sub>1</sub>) was accepted. The result is consistent with earlier study by Barclay and Holderness (1989), McConnell and Servaes (1990), Omran (2009) Alimehmeti and Paletta (2012). The controlling shareholders often act as the manager too. Since they know the nature of the company business very well, most of the time their main focus is on investment and on increasing the firms' performance instead of increasing dividends to shareholders (Ali et al., 2007).

Contrary to expectation, the result in Table 4.2 also showed that managerial ownership positively and significant at 1% influence the firm performance. This indicates that increase manager holding share in Trading and Services firms able to influence firms enhance the performance. The hypothesis (H<sub>2</sub>) that there is negative relationship between managerial ownership and firm performance was rejected. As for government ownership, it shows a negative relationship toward firm performance at 10% significant level, hence H<sub>3</sub> was rejected. When firm has mixed control between corporate and government, it would lead to poor firm performance due to ambiguity of ownership control, property rights, agency issues, profits and welfare objectives (Ng et al., 2009). The positive and insignificant result shows for foreign ownership, therefore H<sub>4</sub> was rejected. The performance of Trading and Services firms in Malaysia is not affected by foreign shareholding consistent with previous research by Barbosa and Louri (2005). Looking on control variable, firm investment opportunities and size of the firm negatively influence firm performance at 10% and 1% significant level, respectively. There is a tendency that the firm overinvestment in negative NPV projects and the agency problem is higher in large firm.

Table 4.3: The affect of ownership structure and firm performance (ROA) under three stage crisis periods.

Variables	Pre crisis	During Crisis	Post Crisis
Constant	13.6 (8.87)	9.95 (7.74)	39.88*** (14.83)
CO	0.00 (0.04)	0.07** (0.03)	0.18*** (0.06)
MO	-0.10 (0.06)	-0.04 (0.05)	0.03 (0.13)
GO	0.00 (0.04)	0.03 (0.05)	0.17 (0.12)
FO	0.02 (0.04)	0.03 (0.03)	0.13** (0.06)
MTBV	1.18*** (0.34)	-0.38*** (0.12)	-0.53** (0.22)
LEV	-0.02** (0.01)	-0.03*** (0.01)	0.00 (0.02)
SZ	-1.05 (0.97)	-0.66 (0.85)	-5.27*** (1.65)
R-squared	0.16	0.2	0.13
Adjusted R-squared	0.11	0.16	0.08
F-statistic	3.23***	5.04***	0.13***
Durbin-Watson	2.04	2.09	2.38

\*\*\*, \*\*, \* indicate significance at the 1%, 5 % and 10% levels

Table 4.3 present the result during the three stage crisis periods based on panel random effect model. The results showed that ownership structure (concentrated, managerial, government and foreign) does not influence firm performance before the crisis in year 2005 to 2006. However, during the crisis period 2007 to 2008, only concentrated ownership reported positive and significant at 5% in influencing Trading and Services firms' performance. Continuously, after the crisis (2009-2010), it strongly affected the firm performance at 1% significant level. It showed that the firm with high ownership concentration would focus more to secure and maintain the company performance facing the crisis and unstable economic condition rather than focussing on the shareholder's interest.

Foreign ownership also positively influences the firm performance for the post crisis period. Firm with high foreign ownership could help solving issue due to crisis especially in term of financial support, transfer of technology, and experience (Huang & Shiu 2009; Gurbuz & Aybars 2010; Romalis 2011). As for control variables, firm investments opportunities help improve the firm performance under the pre crisis period. The result contradicted under the crisis and post crisis period. The higher the firm facing leverage, the poorer the performance showed under the pre crisis and during crisis periods. Likewise, the size of the firm influences the performance for the post crisis period at 1% significant level.

## **5.0 Conclusion**

Based on 73 listed Trading and Services firms in Malaysia, this study examined the relationship between ownership structure (concentrated, managerial, government and foreign) and firm performance. The period of study was conducted from year 2005 to 2010. During the period of study, the subprime crisis happened around 2007 and 2008. Hence, this research further capture the impact of ownership structure on firm performance under three different stage namely pre crisis, during crisis and post crisis. The empirical result showed that concentrated firm positively influences firm performance. However, the influence is not significant for pre crisis period. The higher the managerial ownership, firm reported high performance. Whereas, poor firm performance can be see with increases of government ownership. Foreign ownership firm only gain benefit after the crisis period. The higher the firm foreign ownership, the better it performs during the post crisis period.

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