

## Equity Ownership and Firm Performance in Malaysia

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### Abstract

This study investigates the relationship between ownership structure and company performance of public listed companies in Malaysia. The ownership is divided into two categories; managerial ownership and institutional ownership. Panel data of Malaysian public listed companies were examined. The results showed that managerial ownership had negative and significant relationship with ROA and Tobin's Q. In contrast, institutional ownership showed positive and significant relationship with ROA and Tobin's Q. As a conclusion, the involvement of institutional investors in monitoring and controlling activities has the potential to reduce agency cost and as a result, the company performance increased. The finding provides useful insight in formulating new policy in relation to equity ownership, particularly in Malaysia.

**Keywords:** Managerial Ownership, Institutional Ownership, Performance, Malaysia

### Introduction

The effect of ownership structure on company performances is an important subject and debatable in corporate finance and accounting literatures. Empirical studies have not reached a conclusive finding regarding the effect of ownership structure on company performance. The causal relationship utilised traditional agency theory which explain the ownership that consider significant determinant on company performance. It is widely accepted that concentrated ownership has the potential to limit agency problem and reduce agency cost and therefore improves the company performance (Jensen and Meckling, 1976). This is due to efficient monitoring by higher concentrations shareholders through stronger incentives and more power by appointing directorship in order to monitor manager at lower cost. Shareholders with large ownership in the company showed more willingness to play an active role in corporate decision making since they realize the outcome of the monitoring effort. Shleifer and Vishny (1997) mentioned that the shareholders with large ownership monitor the management by informal conversation or formal proxy in company. They added that when concentrated ownership exists, large shareholders have more incentives and resources to monitor management decisions and thus reduces the agency cost. Hence, this study attempts to investigate the relationship between ownership structure and company

performance of public listed companies in Malaysia. The ownership is divided into two categories; managerial ownership and institutional ownership.

### **Literature Review**

The literature suggests that in concentrated ownership, the role of large shareholders and the absence of corporate control mechanism are dominant in developing economies. The research on ownership structure is interesting in Malaysia and other emerging countries since they are characterized by high ownership concentration which the shareholders are holding control in companies (Faccio and Lang 2002). High concentration ownership and less investor protection create the conflict between the majority and the minority shareholders (Sheilfer and Vishny 1997; La Porta et al. 1999). In concentration ownership companies, the Owner and the manager is usually the same person. This will significantly reduce the conflict of interest between the owner and the manager (La Porta et al. 1999). In addition, the role of business group and involvement of owner in supervising is considered as an important characteristic of corporate practices in the underdeveloped institutional framework in Malaysia.

In concentrated ownership companies, large shareholders could play an important role in monitoring the manager. The existence of large shareholders will help to monitor the managerial decisions. As a result, the agency conflict will be reduced and the company performance will be improved (Lehman and Weigand 2000; Sheilfer and Vishny 1986). The involvement of shareholder as a member of the board of director will increase the degree of monitoring toward the manager. The underlying assumption is to realign the ownership and corporate control in order to enhance the company performance. Lehman and Weigand (2000) stated that the incentive to monitor increase in ownership concentration as well as improving the control in companies.

The convergence-of-interest and the efficient monitoring hypothesis propose that the existence of large shareholders and concentrated ownership influence the level of agency cost and companies performance. The important issue in agency theory is to solve the agency problem and reduce the asymmetric information between the shareholders and the manager. The nature of company ownership structure will affect the agency problem between the shareholders and the manager. Problem arises when the company ownership dispersed is different compared to a company with concentrated ownership. Dispersed ownership is typical for US, UK and Japan companies. Most of the conflicts in the companies in these countries are between managers and shareholders (Jensen and Meckling, 1976). However, in concentrated ownership especially among companies in Western Europe and the most of Asian countries, conflict arises between controlling shareholders and minority shareholders (Fan and Wong, 2002).

Ownership structure determines the nature of agency conflict as well as distribution power and control in company (Jensen and Warner 1988). Sheilfer and Vishny (1997) stated that majority shareholder as a control mechanism to solve agency conflict. This opinion supported by Kabir, Catrijn and Jeunink (1997) where they found that more concentrated ownership provide an effective monitoring toward the manager. Controlling shareholders with large ownership concentration have incentive and power to acquire necessary information in order to supervise the manager. Higher ownership concentration is expected to reduce agency cost and to improve the company's performance as well.

**Managerial Ownership and Companies Performance**

According to Jensen and Meckling (1976), the managerial ownership has a potential to align the interest between the manager and the shareholders. Recent studies had examined the relationship between managerial ownership and corporate performance. Jensen (1983) stated that the most powerful link between shareholders wealth and executive wealth is direct ownership of shares by manager. This statement supported by Porter (1992) who believed that outside owner should be encouraged to hold larger shares and to take a more active and constructive role in companies. Academic and researchers that underwent the study of the clash between the motivations of investors and managers found that the simplest way to resolve this conflict is to have a significant ownership commitment from corporate managers. Assuming that manager's objectives parallel with shareholders' objectives, conflict between the shareholder and the manager can be resolved when manager holds ownership in companies. Fama and Jensen (1983) and Morck et al. (1988) asserted that when a manager owns low level of company equity, they tend to have higher incentives to keep their strategies in line with the preferences of other owners since their bonding to firm's outcome is high. However, when managerial ownership reaches at a certain point, they would allocate the firm resources for their own interest (McConnell and Servaes, 1995).

Large empirical literature investigates the relationship between managerial ownership and firm's performance and provides mixed result. Jensen and Meckling (1976) argue that agency cost and managerial ownership are negatively related and have positive relationship between managerial ownership and firm's performance. The convergence of interest hypothesis suggests a positive relationship between managerial ownership and firm's performance due to lower agency cost. While a negative relationship between managerial ownership and firm's performance is suggested by entrenchment hypothesis which explain that managerial ownership above a certain threshold will have destroying effect due to conflict between large block holders. A manager owning the large fraction of the shares in the firm bears the consequences of managerial action that either create or destroy the firm performance. Therefore, managerial shareholders are likely to work hard and create better investment decision and high managerial ownership firms should perform better. This study utilized the agency theory framework and the following hypothesis is proposed:

H1: The higher concentrated managerial ownership exhibit the higher company's ROA.

H2: The higher concentrated managerial ownership exhibit the higher company's Tobin's Q.

**Institutional Ownership and corporate Performance**

The role of institutional ownership in economy is a debatable subject. As one of the owners of companies, institutional shareholders have the certain rights, including the right to elect the board of directors. The board has the responsibility to monitor corporate managers and their performance. If institutional shareholders dissatisfied with the company performance they will choose either to sell their shares, hold their shares and voice their dissatisfaction or hold their shares and do nothing. Hirschman (1971) characterized these alternatives as exit, voice and loyalty. Institutional investors normally hold large equity ownership. Therefore, institutional investors have the potential to influence management's activities directly through their ownership and indirectly by trading their shares (Gillan and Stark, 2003a). Many authors argued that the involvement of large shareholders in monitoring or controlling activities has the potential to limit agency problems (Shleifer and Vishny, 1986; Admati, Pfleiderer and Zechner, 1994; Huddart, 1993; Maug, 1998; and Noe, 2002). Study by Han and

Suk (1998) found that stock return has a positive relationship with institutional ownership. These authors have further argued that only large shareholders have incentive to monitor company activities. This initiative will lead to improvement in the company performance.

According to Thomsen and Pedersen (2000) Institutional ownership is likely to imply advantages in terms of finance, low risk aversion and a relatively long time horizon. Therefore, institutional investors are characterized by portfolio investments and normally they have strong relationship with the company that they invested in. Thomsen and Pedersen (2000) added that institutional ownership that relatively specialized as owner, their performance is often measured in terms of financial success, and their objectives can be described as shareholder value liquidity. It is believed that institutional investors have positive effect with firm performance. Consistent with above argument, the hypothesized is proposed:

H3: The higher the concentrated institutional ownership in a company the higher could be the ROA.

H4: The higher the concentrated institutional ownership in a company the higher could be the Tobin's Q.

### Model of Ownership Structure and performance

The econometric model developed comprises two equations. The first model utilizes ROA as performance indicator and second model utilize Tobin's Q as performance indicators. These equations are tested in the current paper and are formally presented below:

Performance =

$$\alpha_0 + \beta_1 LMAN_{it} + \beta_2 LINST_{it} + \beta_3 LSIZE_{it} + \beta_4 GROW_{it} + \beta_5 LEV_{it} + \beta_6 LPRO_{it} + \beta_7 AGE_{it} + \varepsilon_{it}$$

Performance ROA (Return on Asset) & Q (Tobin's Q)

$\alpha_0$  Intercept/constant term.

LMAN Log of managerial ownership

LINST Log of institutional ownership

LSIZE Log size (log of total assets)

GROW Growth

LEV Leverage

LPRO Log of profitability

AGE Company age

$\varepsilon$  Error term

$i$   $i$ th firm

$t$   $t$ th period

### Data

Data of this study was collected from secondary sources. Accounting information was collected from Osiris database. Ownership data was collected from the list of thirty largest shareholders in annual report which is downloaded from Bursa Malaysia website. After considering the incomplete information, there were 730 usable samples covering three periods from the 2007 to 2009. However, the companies classified under the finance sector were excluded in this study because of their unique features and business activities, as well as differences in compliance and regulatory requirement. Normality check of the data was also carried out and some of the measures were transformed into logarithm to control for skewed nature of data. As multivariate regression is used to analyze the data in this study, assumptions of multicollinearity, homoscedasticity and linearity are also tested.

**Result of data Stationary Normality Test**

The result of data stationary normality test using data mean, medium, standard deviation, skewness and kurtosis are shown in table 1. Population or sample assumed normally distributed when mean of variables similar to value of medium, skewness value is zero and kurtosis value equal to 3. Skewness and kurtosis are two components in determining normality (Pallant, 2005). The diagnostic test showed that no variables have the value of mean equal to value of median. In addition the skewness value of variables are mix both positively and negatively indicating that their distributions are skewness to the right side as well as to left side of the curve. Sample assumed normally distributed if skewness value is zero. The kurtosis value of variables range from 1.026 (AQ) to 578.334 (ROA) and no variable showed the value of 3. Therefore, it indicates that the result violates the assumption of normally distribution.

Utilizing SK test to evaluate the normality for all variables also showed it significant at 1 percent ( $P < 0.01$ ) and these means all the variables are failed to fulfill the normality test. Since the data distribution is not normally distributed, the estimation method of ordinary least square (OLS) to analyse the sample data would produces bias and inefficient estimators. Therefore, the generalized least square (GLS) method of estimation is more appropriate and it is expected to yield a much better result (Gujarati 2003). The issue which involves the variables of non-normal distribution is quite common in research that involves a large sized sample (Pallant, 2005). As a result, the assumption of normality is not seriously offended since this study covers a large sample size.

Table 1: Results of normality test

	ROA	TQ	LMA	LINST	LSIZE	GRW	LEV	LPRO	AGE
			N						
Mean	0.064	0.617	1.178	0.979	5.531	1.422	0.188	4.239	15.396
Median	0.060	0.330	1.540	1.190	5.480	0.710	0.060	4.192	13.000
Maximum	11.08	38.000	1.990	2.190	7.850	14.900	16.174	6.962	50.000
Minimum	-21.94	-1.350	-	-	0.780	0.010	-0.062	1.041	0.000
			2.000	2.700					
Std. Dev	0.698	1.638	0.854	0.779	0.661	1.940	0.877	0.782	11.242
Skewness	-	12.668	-	-	-	3.014	13.292	-0.022	1.312
	15.280		1.796	1.372	0.324				
Kurtosis	578.33	233.68	5.584	6.051	7.998	13.876	203.88	3.868	3.984
	4	6					0		
SKtest	4378.9	3932.5	711.1	571.8	284.3	1413.4	3992.0	28.27	428.90
	7	5	8	1	9	9	5		
Probability	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*

**Notes:**

1. The \* denotes p-value significance at 1 percent level ( $P < 0.01$ ).
2. ROA = Return on assets, TQ = Tobin's Q Ratio, LMAN = Log Managerial ownership, LINST = Log institutional ownership, AQ = audit quality, LSIZE = Log total assets,

GRW = market value of share divided by book value of share, LEV = total debt divided by total assets, LPRO = log profit or loss, AGE = year of listing.

### Results of Multicollinearity Test

This study must ensure that the data must be independent of one another. It means that observations or independent variables must not be influenced by other independent variables (Pallant, 2005). According to Steven (1996), it is very serious if this assumption is violated. He added that each study must ensure that all observations are independent. This study is based on Pair-wise Pearson correlation matrix for the variables and the results are provided in tables 2. It indicates that multicollinearity is not a problem, as the correlations between all variables are relatively low. According to Gujariti (2003), multicollinearity could be a problem when the correlation exceeded 0.80. The low intercorrelation among the explanatory variables used in the regression indicates no reason to suspect serious multicollinearity.

Table 2:  
Result of multicollinearity test using Pearson Correlation matrix

	ROA	TQ	LMAN	LINST	LSIZE	GRW	LEV	LPRO	AGE
ROA	1.000								
TQ	0.049*	1.000							
LMAN	-	-	1.000						
	0.036*	0.175*							
	*								
LINST	0.019	0.091*	-	1.000					
			0.467*						
LSIZE	-0.30*	-0.021	-	0.340*	1.000				
			0.274*						
GRW	0.062*	0.187*	-	0.308*	0.460*	1.000			
			0.366*						
LEV	0.126*	0.255*	-0.023	0.008	-	0.003	1.000		
					0.107*				
LPRO	0.093*	0.242*	-	0.353*	0.657*	0.547*	0.025	1.000	
			0.297*						
AGE	0.018	0.015	-	0.174*	0.322*	0.273*	0.020	0.255*	1.000
			0.277*						

#### Notes:

1. The \* and \*\* indicate correlation are significant at the 0.01 (2-tailed) and 0.005 (2-tailed) levels, respectively.
2. ROA = Return on assets, TQ = Tobin's Q Ratio, LMAN = Log Managerial ownership, LINST = Log institutional ownership, LSIZE = Log total assets, GRW = market value of share divided by book value of share, LEV = total debt divided by total assets, LPRO = log profitability, AGE = year of listing.

### **Results of Regression Analysis on ROA**

The analysis begin with the report of the regression using generalized least square (GLS) estimations technique on ROA in model 1 and Tobin's Q in Model 2. The F-statistic for model 1 and model 2 are statistically significant at 1 % level. The  $R^2$  for models 1 and model 2 indicated the value 0.18 and 0.29 respectively. The adjusted  $R^2$  for model 1 recorded the value 0.16 and 0.28 for model 2. The regression analyses using GLS estimation technique on ROA and Tobin's Q reported in table 3.

### **The Effect of Ownership and ROA**

The regression utilizing GLS estimation technique reported in table 5.6 showed that the managerial ownership coefficient is negative and statistically significant at 5 percents level. The coefficient of man ownership (LMAN) is -0.012 and this explained that if 1 percent increase in managerial ownership would lead to 0.012 percent decreased percent in ROA. This is consistent with studies by Morck et al. (1988), Demsetz and Lehn (1985), Shleifer and Vishny (1997) and Himmelberg et al (1999). Another studies by Loderer and Martin (1997) and Demsetz and Villalonga (2001) found no relationship between managerial ownership and ROA. The result is statistically failed to support hypothesis H01a. The result is consistent with entrenchment hypothesis which suggests a negative relationship between managerial ownership and firm's performance. The entrenchment theory emphasizes that the manager of the firm uses the resources for their personal benefit, and decrease the firm's performance. The finding contradicts with the agency theory which proposed that the increases of managerial ownership will increase the firm performance. In contrast, institutional ownership shows the positive and statistically significant at 10 percents level ( $P < 0.10$ ). The coefficient of institutional 0.018, therefore one percent increase in institutional ownership would lead to increase of 0.018 percent in RAO. This finding support H02a which proposed that the higher the concentrated institutional ownership in a company the higher could be the company performance. This is consistent with finding by Han and Suk (1998). Institutional ownership is likely to take advantage in term of finance, low risk aversion and relatively long time horizon.

### **The Effect of Ownership and Tobin's Q**

Model 1 on table 3 report the managerial ownership coefficient on Tobin's Q is negative and significant at 5 percents level ( $P < 0.05$ ). The coefficient of LMAN recorded the value -0.086 shows that 1 percent increase in managerial ownership will lead to decrease 0.086 percent in Tobin's Q, and therefore the result reject the hypothesis H01b. This is not surprising since the result may be attributed to the managerial entrenchment which results in a decrease of firm performance for increasing of managerial ownership (Ming and Gee, 2008). However, institutional ownership shows the positive and statistically significant at 5 percents level ( $P < 0.05$ ). One percent increase in institutional ownership would lead to increase of 0.063 percent in Tobin's Q. This finding supports the hypothesis H02b which proposed that the higher the concentrated institutional ownership in a company the higher could be the company performance. This is consistent with the finding by Shleifer and Vishny (1986) and Han and Suk (1988) where they found that the presence of institutional investor will have a positive effect on the market value of the firm because of the more effective monitoring.

Many other authors proposed that the involvement of institutional investors in monitoring and controlling activities has the potential to reduce agency cost (Shleifer and Vishny, 1986; Admati et al., 1993; Huddart, 1993; Maung, 1998; Noe, 2002).

Table 3: Regression for GLS estimation

Independent variables	Hypotheses	ROA		Tobin's Q	
Constant		1.015	0.160	1.724	0.424
LMAN	H1 & H2	-0.012**	0.014	-0.086**	0.039
LINST	H3 & H4	0.018***	0.023	0.063**	0.062
Control variables					
LSIZE		-0.288*	0.021	-0.429*	0.054
GROW		0.008	0.006	0.181*	0.016
LEV		0.089***	0.010	0.342*	0.025
LPRO		0.165***	0.017	0.151*	0.045
AGE		0.001**	0.001	0.001	0.002
R <sup>2</sup>		0.18		0.29	
Adjusted R <sup>2</sup>		0.17		0.28	
F-statistics		366.85*		623.83*	
Durbin-Watson stat		Na		1.512	
Baltagi-Wu LBI (Locally best in variance)		Na		2.390	

Notes:

1. The \* indicates significant at 1 percent ( $P < 0.01$ ), \*\* indicates at 5 percent ( $P < 0.05$ ) and \*\*\* indicates at 10 percents ( $p < 0.1$ ).
2. LMAN = Log Managerial ownership, LINST = Log institutional ownership, LSIZE = Log total assets, GRW = market value of share divided by book value of share, LEV = total debt divided by total assets, LPRO = log profitability, AGE = year of listing, LIQ = total current assets divided by total current liability.

### Conclusions

Agency theory proposed that the concentrated ownership would contribute to a more effective monitoring process. The managerial ownership failed as a controlling and monitoring mechanism to neutralize the agency conflict and optimize the company performance. There is a negative effect of managerial ownership on firm performance. The findings showed that managerial ownership exhibited negative associations with ROA and Tobin's Q. Therefore, providing managers with shares to align their interests with the owners may not solve the agency problems or reduce agency costs and thus fails to improve company performance. The managerial ownership is beneficial only in non-concentrated firms. The controlling owner may use his or her position in the firm to extract private benefits at the expense of the other shareholders by appointing the managers that represent their own interests. In particular, the managers with sufficient ownership have control rights, and therefore they have the ability to influence the firms to commit the self-serving transactions

and thereby expropriate wealth from outside shareholders. When the managers hold a relatively large equity stake, their concentrated control allows them to use corporate disclosures for personal interests, rather than for the best interests of outside shareholders. As a conclusion, managerial ownership does not influence corporate performance in Malaysia and the principal agent problems cannot be solved through an increase of managerial ownership. This finding supports the view that the managerial ownership can lead to more severe agency problems.

In contrast, the institutional demonstrate a positive and significant relationship with ROA and Tobin's. Therefore, in Malaysia, institutional investors are believed to play an active role in monitoring the management. These efforts contribute to the realignment of the manager and shareholders' interests and reduced agency conflicts as well as reduced the agency costs. As a result, the company performance improves. The results also suggest that institutional ownership can enhance firm performance in countries with a weak legal protection for shareholders such as Malaysia. The reason for the positive results could be that the institutional investors have much stronger incentives to monitor the companies that they invest in, especially when they have larger ownership and exit is costly. Many authors argued that the involvement of large shareholders in monitoring or controlling activities has the potential to reduce agency problems since they have the expertise and resources. In addition, the institutional investors normally hold large equities. Therefore, they have the potential to influence the management directly through their ownership or indirectly by trading their shares.

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