CONTROLLING SHAREHOLDER AND FIRM VALUE: AN EMPIRICAL STUDY ON MALAYSIAN PUBLIC LISTED COMPANIES

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ABSTRAK

Kajian sebelum ini mengenai hubungan antara pemilikan korporat dan nilai firma memberi tumpuan yang lebih ke atas pemilikan lembaga pengarah atau pemilikan secara langsung. Pemeriksaan ke atas hubungan ini berdasarkan pemilikan muktamad pemegang saham terbesar adalah masih terhad, terutamanya di negara membangun seperti Malaysia. Kajian ini bertujuan untuk menyumbang kepada literatur yang sedia ada dengan memeriksa hubungan dari perspektif pemilikan muktamad. Penggunaan pemilikan muktamad yang meliputi pegangan saham secara langsung dan tidak langsung adalah lebih sesuai kerana majoriti firma-firma awam disenaraikan di Malaysia adalah di bawah kawalan pemegang saham dominan dan sebilangan daripada firma-firma ini dimiliki oleh pemilik muktamad melalui pegangan saham tidak langsung oleh rantai atau rantaian beberapa firma-firma. Dari sudut pandangan pemilikan muktamad, kajian ini menganalisis kesan pemegang saham kawalan kepada nilai firma bagi beberapa bidang struktur pemilikan korporat. Dengan menggunakan kaedah regresi data panel, 295 firma-firma yang tersenarai di Papan Utama Bursa Malaysia yang meliputi tempoh dari tahun 2001 hingga 2009 telah diperiksa. Keputusan menyokong bahawa kehadiran pemegang saham kawalan menyumbang kepada nilai firma yang lebih baik. Ini menunjukkan bahawa kewujudan mereka adalah kompeten dalam mengurangkan masalah agensi dalam firma pemilikan tersebar. Ia menyarankan bahawa pembangunan undang-undang dan peraturan-peraturan juga harus melindungi insentif pihak yang mengawal kerana kehadiran mereka adalah penting kepada pertumbuhan firma. Keputusan-keputusan untuk mekanisme kawalan mendedahkan bahawa pemegang saham kawalan adalah lebih cenderung untuk merampas aset korporat melalui pelbagai rantaian kawalan berbanding dengan struktur piramid. Penemuan seterusnya mencerminkan bahawa penglibatan dalam pengurusan oleh pemegang saham kawalan memudaratkan nilai firma. Ujian selanjutnya menunjukkan bahawa pemilikan pengurusan mereka adalah tidak linear berhubungan dengan nilai firma. Ini membayangkan bahawa set garis panduan dan peraturan-peraturan yang berbeza boleh diperkenalkan pada tahap pemilikan pengurusan yang berbeza dalam usaha untuk meminimumkan kesan negatif pemilikan pengurusan pemegang saham kawalan. Dari segi identiti pemilikan, keputusan menunjukkan bahawa pemegang saham kawalan kerajaan dan asing mempunyai kesan positif kepada nilai firma. Selain itu, firma kawalan asing berprestasi mengatasi firma-firma jenis yang lain. Akhir sekali, keputusan menunjukkan bahawa kesan buruk daripada penglibatan dalam pengurusan dan mekanisme kawalan adalah lebih ketara bagi firma-firma asing. Ia menampakkan bahawa kelebihan firma kawalan asing seperti kepakaran pengurusan tidak lagi berkesan dalam mengurangkan masalah agensi. Sebaliknya, ia bertukar menjadi faktor-faktor yang menggalakkan pemegang saham kawalan untuk mengekstrak manfaat persendirian.

CONTROLLING SHAREHOLDER AND FIRM VALUE:

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ABSTRACT

Previous studies on corporate ownership and firm value relationship focused much on board ownership or direct ownership. The examination on the relationship based on ultimate ownership of the largest shareholder is still limited, especially in a developing country like Malaysia. This study seeks to contribute to the existing literature by examining the relationship from the perspective of ultimate ownership. The use of ultimate ownership which covers direct and indirect shareholdings should be more appropriate as majority of the publicly listed firms in Malaysia are under the control of dominant shareholders and a number of the firms are owned by the ultimate owner through indirect shareholdings by a chain or several chains of firms. From the standpoint of ultimate ownership, this study analyzed the effects of controlling shareholder on firm value for several areas of corporate ownership structure. Using the method of panel data regression, 295 firms listed on the Main Board of Bursa Malaysia covering the period from 2001 to 2009 were examined. The findings support that presence of controlling shareholder contributes to better firm value. This indicates that their existence is competent in mitigating the agency problem in dispersed ownership firm. It suggests that the development of the rules and regulations should also protect the incentives of the controlling party as their presence is important to the growth of the firm. The results for control mechanisms reveal that controlling shareholder is more likely to expropriate corporate assets through multiple control chains than pyramidal structure. The next findings reflect that involvement in management by the controlling shareholder is detrimental to firm value. Further test shows that their managerial ownership is non-linearly related to firm value. This implies that different set of guidelines or rules could be introduced at different levels of managerial ownership in order to minimize the negative impact of managerial ownership of the controlling shareholder. In terms of ownership identity, the results indicate that the government and foreign controlling shareholder have positive impact on firm value. Besides that, foreign controlled firms outperform other types of firms. Finally, the results show that the adverse effect of involvement in management and control mechanisms are more pronounce for foreign firms. It seems that the advantages of foreign controlled firms such as managerial expertise are no longer effective in mitigating the agency problems. In contrast, it in turn becomes the factors that encourage the controlling shareholder to extract private benefits.

CHAPTER 1 – INTRODUCTION

1.0 Background of the Study

Financial scandals, corporate collapses or economic crisis have often served as a drive for countries around the world to strengthen their corporate governance system (Mallin, 2009). This can be seen in a number of high profile corporate collapses and financial scandals such as the collapse of Barings Bank (one of the oldest established bank in the United Kingdom (UK)), the downfall of Enron (the largest bankruptcy in the United States (US) history) and the financial scandals of Royal Ahold (the third largest food retailer in the world). Basically, the failures of these firms were due to the weaknesses in their corporate governance such as poor internal control system and the lack of accountability of directors (Mallin, 2009). For Asia-Pacific region, the collapse of many of the markets in Asia-Pacific countries during the Asian Financial Crisis in 1997 could be seen as the key incident that leads to the awareness of the people to the importance of corporate governance in the region. The market or particularly corporate collapses have had negative impact not only to the shareholders and stakeholders but also to the economy as a whole. Even though many prevention steps have been taken to avoid such corporate collapses and financial scandals, there is no guarantee that it will not happen again. Corporate governance will certainly continue to play a very important role to stop or at least minimize the possibilities of such collapses and scandals to occur.

The development of corporate governance is a worldwide occurrence. It is a wide area which covers legal, ownership, cultural and other structural differences

(Mallin, 2009). Consequently, there is no one standard corporate governance practice that fits all countries or all firms. Under different conditions, different form of corporate governance practice and structure is needed (Loh & Mat Zin, 2007). For instance, the differences in legal structure are having essential influence on corporate ownership structure. Countries which provide good legal protection to corporate shareholders' rights (including minority shareholders' rights) tend to have dispersed ownership structure, while countries which have weak legal protection to shareholders' rights tend to have concentrated ownership structure (Mallin, 2009). Therefore, the corporate governance practice and structure should be design in the way that fit to the national needs of a firm and the country's regulatory framework (Loh & Mat Zin, 2007).

According to Singam (2003), the most important factors that contribute to a sound corporate governance system are corporate ownership structure, composition and operation of the firms. As one of the key determinants of corporate governance, corporate ownership structure and composition has become a popular research area by researchers around the world. Although in terms of practicality, policy makers are the ones who responsible to create and improve the policies, the findings from various studies by researchers in this area are essential to provide inputs in helping to create a good corporate governance system. Viewing the significant influence of corporate ownership structure on corporate governance, it is crucial for us to have a clear understanding about the ownership structure of a firm. Hence, detail studies on various aspects of corporate ownership structure were performed in this study.

Previous studies found that concentrated ownership structure is the most common form of ownership structure around the world (La Porta, Lopez-de-Silanes, & Shleifer, 1999; Claessens, Djankov, & Lang, 2000; Faccio & Lang, 2002). The statement made by Berle and Means (1932) pertaining to the universe of diffused ownership structure is more applicable to the UK and the US and not to many other countries. The universe of the concentrated ownership serves as a drive for a careful analysis on the impact of concentrated ownership structure on firm value. The relationship between ownership and firm value is often traced back to the work of Berle and Means (1932). According to them, the increase in firm size as a result of expansion in the business will lead to the separation of ownership and control in the firm. They argued that the separation of ownership and control in a firm will have certain degree of influence on firm value and the maximization of profits is no longer guaranteed. As the original owners' shareholding falls, so does their incentive to exert effort to generate shareholders' wealth. An important factor that may bring to the negative impact of firm value is connected to agency problems. The work of Jensen and Meckling (1976) and Fama and Jensen (1983) are essential to explain this relationship. It can be a problem as the agent (the managers or directors) may not always act in the best interests of the principal (the shareholders). The agent might misuse their power for personal financial or other advantages. In general, the agency theory by Jensen and Meckling (1976) is set from the background of the separation of ownership and control as illustrated by Berle and Means (1932).

In firms where the ownership structure is concentrated, the above problem is usually mitigated by the existence of large shareholder or controlling shareholder who is having more interest to monitor management. However, problems arise when these shareholders expropriate the interest of the minority shareholders as they are having more power to control the firm. Empirical studies provided mixed results and arguments concerning the effect of ownership concentration and firm value. One group of studies may provide support that concentrated ownership structure has positive impact on firm value (Shleifer & Vishny, 1986; Wiwattanakantang, 2001; Andres, 2008), while another group of researchers may offer support that the impact is negative, especially when the controlling shareholders controlled the firms through indirect shareholdings such as pyramidal structure (Lease, McConnell, & Mikkelson, 1984; Faccio, Lang, & Young, 2001; Claessens, Djankov, Fan, & Lang, 2002; Lemmon & Lins, 2003; Cronqvist & Nilsson, 2003). Thus, previous studies are still unable to provide clear-cut evidence on the said relationship. Generally, the potential for agency problems to occur is there, regardless of the types of ownership structure. The matter of concern here will be the impact of different ownership structure on firm value and the existence of an optimal ownership structure that minimizes agency costs.

This study addresses the above matters by analyzing the impact of ownership structure on performance of listed firms in Malaysia. In particular, it focused on the effects of the existence of the controlling shareholder on firm value as the ownership structure in this country is highly concentrated (Claessens et al., 2000; Mat Nor & Sulong, 2007; Mallin, 2009). Various important aspects of ownership structure or characteristics that could have impact on firm value such as control mechanisms, managerial ownership and identity of controlling shareholder have also been covered in this study.

1.1 Problem Statement

A sound corporate governance system is crucial to the well being of a firm especially to its shareholders and stakeholders. It is not just important for the individual firm, but also serves as an important element in maintaining a sound financial system and a strong economy. As one of the most important mechanisms of corporate governance, ownership structure may influences and detects the corporate direction and performance (Loh & Mat Zin, 2007). Performance measure on the other hand is one of the important issues pertaining to the survival of a company. However, the relationship between ownership structure and firm value is still debatable as there is no consensus among the findings from previous studies. Thus, clearer understanding of various aspects of ownership structure is important to access their impact on firm value.

In Malaysia, majority of the publicly listed companies are under the control of dominant shareholders. The work of Claessens et al. (2000) shows that most of the publicly listed companies in this country were dominated by family owned firms. This is followed by government and foreign owned firms. In a concentrated ownership environment, large shareholders or controlling shareholders are expected to play an important role in monitoring management. However, these shareholders and their management team may not be responsive to minority shareholders' rights. Hence, the potential agency problem in this country is largely between the large shareholders and the minority shareholders. There is not so much issue here regarding agency problem between the management and the owner. The agency problem might become worst when there is a control mechanism in place. The use of control mechanisms such as cross-shareholdings and pyramidal structure in a firm might make the situation more complicated. This is due to the owner might use these structures to control firm's resources from behind without needing to maintain a high direct ownership in that firm (Amin Nordin, Mat Nor, & McGowan Jr, 2010).

Another important factor that might have an impact on firm value is its ownership composition. It is crucial to identify who controls the firm as different types of controlling persons may have different impact on the firm's governance structure and firm value (Loh & Mat Zin, 2007). For example, in family controlled firms, the controlling owner would be more interested to involve in managerial and control activities. Conversely, the institutional shareholder who owned a large proportion of equity might not be interested to involve in the management of the firm and might be only be concerned about the profits of the firm. Similarly, in foreign and government owned firm, foreign investors and the government might have different interests. The differences in interests give raise to the question of whether the equity owners are playing their monitoring role (Loh & Mat Zin, 2007).

Given all this, a well-established legal infrastructure and strict enforcement would play an important role in protecting the interest of shareholders as well as the stakeholders, even though it might be difficult to ensure or prove that the dominant shareholder or the directors' interest are parallel with minority shareholders or other stakeholders. Thus, an insight study of various aspects of ownership structure and corporate control in the country is important to provide inputs in helping to achieve the objective.

Different aspects of ownership structure and the potential agency problems in this country give rise to the motivation to conduct this study. A more important factor that drives to the analysis in this study is that there are still limited studies in the area of corporate ownership which focus on ultimate ownership of the largest shareholder, especially in developing countries such as Malaysia (Song, 2007). In Malaysia, studies of corporate ownership mainly focused on board ownership or direct ownership (Mat Nor, Redzuan, & Mohd Said, 1999; Ali & Sanda, 2001; Ahmad, Ishak & Manaf, 2003, Mat Nor and Sulong, 2007; Sulong and Mat Nor, 2008). In a concentrated ownership environment, it is crucial to study the effects from the standpoint of ultimate ownership as a majority of the publicly listed firms in this country are under the control of dominant shareholders or the ultimate owners (Claessens et al., 2000; Song, 2007). The ultimate owner is expected to be the person that has vital influence on the decision-making processes and the operations of the business and one who can directly affect firm value. This study seeks to contribute to the literature by investigating the impact of controlling shareholder in various firms' ownership structures on firm value from the perspective of ultimate ownership.

As stated above, previous studies often used direct ownership in the analysis. According to Wiwattanakantang (2001), this is due to the ownership data used in most of the studies came from the databases that provide only the direct shareholdings of the major shareholders. It is also observed that although some of the studies are using ownership information from the annual reports which provide more ownership information, the analysis is still focusing on direct ownership. This might be due to the difficulties and time constraints in tracing the indirect ownership data. The use of direct shareholdings might not reflect the actual situation in Malaysia as a number of the firms are controlled through indirect shareholdings by a chain of firms that are privately held (Song, 2007). Following La Porta et al. (1999), Wiwattanakantang (2001) and Song (2007), the ultimate owner of the largest shareholder is traced to provide a clearer picture that closely reflects the impact of controlling shareholder or ultimate owner on the value of Malaysian-listed firms. The ultimate ownership is based on control rights of the ultimate owner that consist of direct and indirect shareholdings (Lin, Ma, Malatesta, & Xuan, 2012).

An important issue regarding ultimate ownership is the use of control mechanisms such as pyramidal structure, cross-shareholdings and multiple control chains which separate the cash flow and control rights. Empirical evidence consistently show that the used of control mechanisms have negative impact on firm value (Faccio et al., 2001; Claessens et al., 2002; Lemmon & Lins, 2003; Cronqvist & Nilsson, 2003). However, studies on control mechanisms in Malaysia are very limited. The only local paper that empirically investigated the effects of pyramidal structure is by Amin Nordin et al. (2010). However, their study is mainly focus on the effects of pyramidal structure on firm capital structure. For multiple control chains, none of the studies either local or non-local have empirically examining the effects based on this mechanism besides the discussion made by Faccio and Lang (2002). Thus, this study will fills up the gap by examining the impact of pyramidal structure and multiple control chains on firm value.

The effects of involvement in management by the controlling shareholders and their managerial ownership on firm value are examined as the understanding of the relationship based on ultimate ownership in this country is still limited. Hence, the managerial ownership in this study is different from other studies as it is defined as the ownership of the controlling shareholder who involved in the management of the firm rather than directors' ownership.

The impacts of identity of controlling shareholders are also being assessed in this study. As different identities of the owner could have different impacts on firm value, it is believed that the involvement in management and the use of control mechanisms by different identity of controlling shareholder might have different effects on firm value. Thus, the examination on the interaction effects between these ownership characteristics are covered in this study. As far as concern, no previous study has looked into the interaction effects between identity of controlling shareholder and control mechanisms. The outcomes of the interaction effects are important as they could provide some implications to us on how the combination between these firms' characteristics affects firm value. It may provide valuable information to the regulators or policy makers in their process of developing a sound corporate governance system.

Lastly, the entire analyses in this study are conducted using panel data, rather than cross-sectional data which are commonly used in the previous studies. That means the use of panel data analysis in examining the effects of ownership structure on firm value based on ultimate ownership is rare especially in Malaysian context. The panel data analysis enables us to study the behaviors of the sample firms over time. The combination of cross-section and time series data in panel regression models can improve the accuracy or quality of the results that would be impossible if using cross-section or time series analysis (Gujarati & Porter, 2009). Thus, it helps to enhance the quality of the findings in this study.

1.2 Research Questions

The following questions are raised in order to address the research problems in this study.

1) Does presence of controlling shareholder has an impact on firm value?
2) Do control mechanisms have an impact on firm value?
3) Does involvement in management by controlling shareholder have an impact on firm value?
4) What is the relationship between the managerial ownership of the controlling shareholder and firm value?
5) Does identity of controlling shareholder have an impact on firm value?
6) Which type of firm is having best performance?
7) Do the interaction effects between involvement in management and identity of controlling shareholder have an impact on firm value?
8) Do the interaction effects between control mechanisms and identity of controlling shareholder have an impact on firm value?

1.3 Research Objectives

The above research questions dictate the needs of the study to achieve the following objectives. Specifically, the first and the second objectives are related to the first two research questions. The third objective is connected to the third and fourth research questions where the impact of involvement in management by controlling shareholder is addressed by two methods. Firstly, performance comparison is made between firms where the controlling shareholder is involved and not involved in management. Secondly, the impact of involvement in management is studied using the absolute measure of managerial ownership of the controlling shareholder. The fourth objective is associated to the fifth and sixth research questions. Lastly, the fifth objective is interconnected to the last two research questions.

1) To determine the effects of presence of controlling shareholder on firm value.
2) To determine the effects of control mechanisms on firm value.
3) To determine the effects of involvement in management by controlling shareholder on firm value.
4) To determine the effects of identity of controlling shareholder on firm value.
5) To determine the interaction effects among involvement in management by controlling shareholder and control mechanisms with identity of controlling shareholder on firm value.

1.4 Significance of the Study

This study is important in providing a better understanding on the ownership structure and control in a developing country like Malaysia. The area of study which covers important aspects of ownership structure such as control mechanisms, managerial ownership and identity of controlling shareholder will provide important information and knowledge to investors, researchers as well as policy makers or the government to have a clearer picture on the ownership structure, corporate control and their effects on firm value in this country. The ownership in this study is defined based on control rights of the largest shareholder as there are a number of firms in Malaysia are controlled indirectly by the owners through control mechanisms. Thus, the findings are expected to be closely reflects the actual ownership and corporate control in the country.

The findings of the study provide important implications or information about the condition of ownership structure that has higher potential for conflict of interest between controlling shareholders and minority shareholders. The insight studies on the effects of different aspects of ownership are important to generate such information. This may serve as an input to the government, regulatory authorities or policy makers in the process of strengthening the areas of regulation, particularly with regards to ownership distribution that have potential for agency problem to occur. Hence, it may help the authorities or policy makers in their effort to produce a more comprehensive and effective legal infrastructure which in turn will enhance the corporate governance system. The improvement in legal infrastructure and corporate governance system will help to increase investor confidence and strengthen the equity market in the country.

Investors may be benefited from the results of this study. The findings may provide some signal to the potential or existing investors about the potential risk of their interest being expropriated by the controlling shareholder for their investment in a particular firm based on the type or combination of different aspects of ownership structure of the firm as covered in the study.

This study also contribute to the existing literatures as the analysis of ownership structure from the perspective of ultimate ownership and the method of analysis which used panel data is still limited in this country. The theoretical contribution includes enhancing the knowledge of the agency theory where the corporate ownership is concentrated. It particularly provides further evidence in explaining the agency problems between controlling shareholders and minority shareholders in the country. Besides that, it also provides new evidence and knowledge towards the agency problems based on different aspects of ownership structure which includes control mechanisms, managerial ownership of the controlling shareholder and identity of controlling shareholder.

1.5 Definition of Key Terms

There are several important key terms that are used regularly throughout this study. Therefore, it is important to have a common understanding on the concepts or meanings of these key terms. These commonly used terms include alignment effects, cash flow rights, control rights, controlling shareholder, entrenchment effects, family controlled firm, foreign controlled firm, government controlled firm, managerial ownership, multiple control chains, pyramidal structure and ultimate owner.

1.5.1 Alignment Effects

Alignment effects refer to the effects that arise when there is an alignment of interest between shareholders and managers or controlling shareholders and other minority shareholders (Florackis, Kostakis, & Ozkan, 2009). The alignment of interest between these parties is perceived to have positive influence on firm value (Morck, Shleifer, & Vishny, 1988; McConnell & Servaes, 1990; Short & Keasey, 1999; Cui & Mak, 2002; Davies, Hillier, & McColgan, 2005; Florackis et al., 2009). This is because they are expected to work together with the same objectives to ensure that their firms are performing well in the long run and bring benefits to all of them.

1.5.2 Cash Flow Rights

Cash flow rights refer to the rights that arise through the purchase of shares (Claessens et al., 2000). It is also refers to as actual shareholdings of a particular shareholder. The owner of the shares is entitling to claims on cash payouts or dividend. The total cash flow rights are equal to the sum of the direct and indirect cash flow rights (Claessens et al., 2000; Faccio & Lang, 2002; Amin Nordin et al., 2010; Bae, Baek, & Liu, 2012; Francoeur, Amar, & Rakoto, 2012). Direct cash flow rights are the direct shareholdings which held under the name of a shareholder, while indirect cash flow rights are the shareholdings of a shareholder through indirect ownership or intermediary entities. The indirect shareholdings arise when one party (first party) owns shares of another entity (second entity) which owns shares of a third entity. The first party in this case is said to have indirect shareholding in the third entity through its shareholding in the second entity. The indirect cash flow rights are obtained by multiplying the cash flow rights along the chain of ownership (Boubaker & Sami, 2011; Bae et al., 2012; Lin et al., 2012).

1.5.3 Control Rights

Control rights are referring to the voting rights of a shareholder. The owners of control rights are having the rights to vote for board of directors and influence or dictate decisions that require approval from shareholders. The aggregate control rights of a shareholder is the summation of his direct and indirect control rights (Claessens et al., 2000; Wiwattanakantang, 2001; Faccio & Lang, 2002; Song, 2007; Amin Nordin et al., 2010; Bae et al., 2012; Francoeur et al., 2012; Lin et al., 2012). Similar to the definition of direct cash flow rights as in section 1.5.2, the direct control rights are referring to the direct shareholdings of a shareholder. Indirect control rights are referring to the percentage of shareholdings at the weakest link within a chain of ownership (Bae et al., 2012; Francoeur et al., 2012). In the case where a firm is not controlled by the owner through indirect shareholdings, the control rights of the owner are equal to the cash flow rights.

1.5.4 Controlling Shareholder

Controlling shareholder in this study is defined as a person who owns at least 33% of company's voting shares or control rights. The definition of the controlling shareholder is based on the definition by Bursa Malaysia's Main Market Listing Requirement (Bursa Malaysia, 2009a). This should be more appropriately reflects the corporate ownership and control in Malaysia as it is defined based on the economic or legal frameworks of the country (Wiwattanakantang, 2001). At this level of ownership, a shareholder could have significant influence on corporate decisions.

1.5.5 Entrenchment Effects

Entrenchment effects are referring to the effects that arise when the interest between shareholders and managers or controlling shareholders and other minority shareholders are not aligned (Florackis et al., 2009). The conflict of interest between these parties is perceived to have negative influence on firm value (Morck et al., 1988; McConnell & Servaes, 1990; Short & Keasey, 1999; Cui & Mak, 2002; Davies et al., 2005; Florackis et al., 2009). This is due to the managers or controlling shareholders might exert insufficient effort in monitoring management and extract private benefits from the firms in the expense of the interest of shareholders or minority shareholders.

1.5.6 Family Controlled Firm

A firm is defined as family controlled firm when it is owned by a controlling shareholder (as defined in section 1.5.4) whose identity is either an individual or a group of family members (La Porta et al., 1999; Wiwattanakantang, 2001; Claessens et al., 2002). In this study, family members are defined based on the definition by Bursa Malaysia's Main Market Listing Requirement. Following this, spouse, parent, child, sibling and relatives of in-laws in relation to a person are defined as family members (Bursa Malaysia, 2009a). The family members are grouped together as a single shareholder as they might vote as a coalition.

1.5.7 Foreign Controlled Firm

A firm is defined as foreign controlled firm when it is owned by a controlling shareholder (as defined in section 1.5.4) whose identity is a foreign investor. This includes foreign family and foreign corporations (Wiwattanakantang, 2001).

1.5.8 Government Controlled Firm

A firm is defined as government controlled firm when it is owned by a controlling shareholder (as defined in section 1.5.4) whose identity is the federal or state government (Wiwattanakantang, 2001).

1.5.9 Managerial Ownership

Managerial ownership in this study is refers to the ownership percentage of the controlling shareholder (as defined in section 1.5.4) who involved in the management of the firm. This is different from the common definition of managerial ownership as shown in the previous studies where it is defined as board ownership or the shareholdings of the managers. For family firm, involvement in management is identified when at least one of the family members are holding firm's top management position (Claessens et al., 2000; Wiwattanakantang, 2001). Firm's top management means holding a position as the managing director, CEO, or executive director of a firm. For foreign firm, involvement in management is identified when there is at least one member of the foreign controlling family or employee of the foreign controlling corporation holds any position in the top management of the firm

(Claessens et al., 2000). For government firm, the involvement in management is determined when: (1) the managing director, CEO or any executive director of the firm is at the same time holding top management position of the controlling shareholder's entity, or (2) the managing director, CEO or any executive director of the firm is a nominee director of the controlling shareholder. These criteria are set to allow for the examination on the impact of government's involvement in management. This is relevant to the environment in Malaysia as a large proportion of listed firms in the country are government controlled firms.

1.5.10 Multiple Control Chains

Multiple control chains is refers to a kind of ownership structure where an ultimate owner owns a firm through a number of channels or a multitude of control chains (Faccio & Lang, 2002). In this study, a firm is defined as control through multiple control chains when the ultimate owner as stated in section 1.5.12 owned the firm through more than one chain and each of the chain is having at least 5% of control rights (Faccio & Lang, 2002). Thus, the total control rights of the ultimate owner for this kind of firm are obtained by horizontally adding up the control rights of the ultimate owner from every chain.

1.5.11 Pyramidal Structure

Pyramidal structure is refers to a group of firms whose ownership structure shows a top-down chain of control with the ultimate owner positioned at the top of the structure (Amin Nordin et al., 2010). Following La Porta et al. (1999), Wiwattanakantang (2001), and Amin Nordin et al. (2010), a firm is defined as control through pyramidal structure when the structure of the firm fulfilled all the following three criteria: (1) the ultimate owner as defined in section 1.5.12 owned the firm indirectly through a firm or a chain of firms, (2) at least one firm in the chain is publicly listed, and (3) the inter-company links along the chain is over a threshold of 33%.

1.5.12 Ultimate Owner

Ultimate owner is refers to the largest shareholder of a firm based on his control rights as stated in section 1.5.3 (Wiwattanakantang, 2001; Song, 2007; King & Santor, 2008; Silva & Majluf, 2008). In a free-standing firm where the firm is free from control mechanism, particularly pyramidal structure (as defined in section 1.5.11) and multiple control chains (as defined in section 1.5.10), the ultimate owner is the person who has the largest direct shareholdings of the firm. In the case where the ultimate owner owned 33% or more of control rights, the ultimate owner will also be defined as the controlling shareholder (as defined in section 1.5.4) of the firm.

1.6 Organization of the Chapters

This thesis is structured in five chapters. Chapter 1 describes background of the study, problem statement, research questions, research objectives, significance of the study, definitions of key terms and organization of the chapters in this thesis. Chapter 2 reviews the literatures related to this study and develops the respective hypotheses. Chapter 3 presents the research design, measurement of variables, statistical methodology and model specification. Chapter 4 reports results and provide the discussion on the findings of the study. Chapter 5 presents the conclusion and implication of the results. Limitation of the study and suggestions for future research are also discussed at the end of this chapter.

CHAPTER 2 – LITERATURE REVIEW

2.0 Introduction

This chapter reviews the related literature that leads to the formulation of the hypotheses. The areas of literature review include theoretical aspects of the research and empirical evidences from previous studies. Section 2.1 is related to the theory of agency and corporate ownership structure. Section 2.2 is related to corporate ownership and control in Malaysia. Sections 2.3 to 2.6 will focus on various aspects of ownership structure and their effects to firm valuation. In particular, it includes the controlling shareholder and firm value, control mechanisms and agency costs, involvement in management by controlling shareholder and identity of controlling shareholder. The hypotheses of this study were presented at the end of each section beginning from section 2.3 to section 2.6.

2.1 The Theory of Agency and Corporate Ownership Structure

The theory that is very essential when dealing with the area of corporate ownership structure is the theory of agency. A large number of previous works that has been constructed in this area is based on the theoretical framework of principal-agent as proposed by Jensen and Meckling (1976). Basically, this theory suggests that the problem of agency arises whenever the owner (the principal) of a firm hires another party (the agent) to run the firm. The major challenge here is how to ensure that the agent act in the best interest of the principal. Although much of the agency theory focused on the principal-agent problems, it is important to aware that there is another type of agency relationship that has significant connection with corporate ownership structure. This agency relationship is between the major shareholder and the minority shareholders. It is commonly referred to as the agency problem in the environment of concentrated corporate ownership structure where the agency conflict arises when the interest of the major shareholders are misalign with the interest of other minority shareholders. It is also called the principal-principal conflicts in several recent studies (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008; Chen & Young, 2010; Jiang & Peng, 2010).

In order to provide a clearer understanding on the concept of corporate ownership and control and its relationship with the agency theory, this section is further divided into two parts, namely section 2.1.1 and 2.1.2 which review the literatures related to dispersed and concentrated ownership structure and corporate control and their relationship with the two types of agency conflicts as stated above.

2.1.1 Dispersed Ownership Structure

Ownership structure is viewed as a very important corporate governance mechanism to explain the corporate control of a firm. Generally, the structure of corporate ownership can be classified into two categories, which are dispersed and concentrated ownership structures. The dispersed ownership structure is a characteristic of firms in the UK and the US. The corporations in these countries seldom have dominant shareholders and the shareholders usually owned a very small percentage of firm’s shares. The condition that leads to the formation of the dispersed ownership structure is greatly related to the separation of corporate ownership and control (Berle & Means, 1932). The developments of the dispersed ownership structure and its relationship with the separation of ownership and control as well as the related agency conflict are discussed in the following two parts.

2.1.1(a) The Separation of Ownership and Control

According to Berle and Means (1932), as countries industrialized and markets developed, there will be a growing dispersion of ownership. As a firm growth and expand its business, the demand for capital will increase in order to support the growth. Unfortunately, the ability of the owner to support the increasing demand for capital is limited. Therefore they have to accumulate the monetary support from outside investors. This leads to the growing dispersion of ownership.

This argument is supported by Demsetz and Lehn (1985), where they contended that there is an inverse relationship between firm size and ownership concentration. As firm size becomes larger, its ownership will be more diffuse. They explained that there are two reasons for the existence of the dispersed ownership. Firstly, the proportion of ownership in a larger firm after expansion will be more costly. This is because the total value of a firm after expansion to larger size through injection of additional capital has become larger. Thus, a shareholder needs to top-up his investment in the firm after the expansion if he wishes to maintain the same proportion of ownership for before and after the expansion. Therefore, it has a negative impact on concentration of ownership. Secondly, for a given degree of control, it generally requires a smaller share ownership when the firm size is larger. Leland and Pyle (1977) contended that it is costly for the owners to maintain a high percentage of shares in their firms as their personal portfolio will then be less diversified. They further argued that the owner will maintain a high proportion of equity only if the future cash flow of the firm is expected to be higher than its current value.

The dispersed ownership structure has leads to the separation of ownership and control of a firm, where the shareholders own the firm and managers control the firm. The situation comes about as there are too many investors who own the firms and they could not jointly run the company or involve in the daily decision making process needed in the operations (Kim & Nofsinger, 2007). Shareholders are not interested to be involved in the management activities as it is too costly for them as compared to their small proportion of investment in the firm. Hence, managers will be hired to perform the task for them.

2.1.1(b) The Separation of Ownership and Control and the Agency Conflict

The separation of ownership and control between the principal (owner) and the agent (manager) can be a problem. This agency relationship could raise drawbacks to the owner which are mainly associated with the opportunistic behavior or the self-interest of the manager. In particular, the owner is facing a risk of interest expropriation by their manager as the manager may not act in the best interest of the owner. The manager may abuse the power given by the owner in gaining financial or other benefits from the firm. Besides that, the manager who involve in the management of the firm is mastering more information about the firm as compared to the owner. Practically, this information asymmetry problem put the owner at a