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CEO's Family Control and Firm Performance: Malaysian Evidence

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Abstract: Using a sample of 634 listed companies on the main board of Bursa Malaysia in 2013, this study investigates whether CEO family control in a substantial, influence the performance of the company. Consistent with alignment hypothesis, it is postulated that CEO family ownership has a significant positive impact on the performance of the firm. The results do not support our hypothesis, leading to the conclusion that alignment hypothesis which applies in the developed market with widely dispersed ownership firms may not apply to a highly concentrated ownership type of companies in Malaysia. Other variables of growth in capital expenditure and leverage have a significant association with a performance as expected.

Key words: Agency costs, alignment hypothesis, family ownership, firm performance, Malaysia

INTRODUCTION

Ownership structure plays an important role in reducing conflict of interests between controlling shareholders and minority shareholders and it can also be considered as one of the factors to determine the company's performance. Besides that, ownership structure will help in aligning managerial interests with those of shareholders and thus, agency conflict might be reduced (Chen and Steiner, 1999). Even though ownership structure can affect a firm's value and performance, it is still questionable whether external shareholders can give impact to the future performance of a firm (Shleifer and Vishny, 1997). There are several types of ownership structures commonly related to the Malaysian environment, such as family ownership, managerial ownership, foreign ownership and institutional ownership. The concern of this study is based on the family ownership on the firm's performance. However, there is still no consensus on the accepted definition on family firm. Although, some studies in the finance literature identify any public company where a family or a founder owns more than 5 percent as a family firm (Anderson and Reeb, 2003; Short, 1994) other studies define firms only as family firms if the first

succession into the second generation has taken place. However, in most studies, a family firm has been characterized as a firm that is controlled and usually managed by multiple family members, sometimes from multiple generations. For the purpose of the study, attention is given towards, family ownership which represents those who owned shares and also involved in managing the companies (Ismail and Sinnadurai, 2012). Controlling families often hold large equity stakes and frequently have executive representation in the company. Prior evidence shows that in the US and other developed market, family firms tend to have higher valuations and profitability than nonfamily firms (Anderson and Reeb, 2003; Gramlich and Sorensen, 2004). In addition, family control is always associated with higher profitability while passive family control does not affect company's profitability (Maury, 2006). However, in a market with lower shareholder protection, family control may harm minority shareholders due to the risk of expropriation when family control is tight (Anderson and Reeb, 2003). A recent study on the relations between different types of ownership identity and different performance measures for listed corporations in emerging markets provide evidence that non-government ownership (including individual and family, managerial or institutional) companies performed better than government companies.

The value of the firm would be decreased due to managers' non-value maximising behaviour that is contradicted with the interest of outside shareholders (Jensen and Meckling, 1976). However, block-holder ownership can increase efficiency as holders of large blocks have more incentive to monitor managers efficientlyand thus improve performance (Shleifer and Vishny, 1997).

In line with the alignment theory, family relationship among managers and owners create advantages in reducing agency costs (Fama and Jensen, 1983). Firms controlled by a founding family have more incentives and operate more efficiently to improve firm performance

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compared to other firms (McConaughy *et al*., 2001). Family involvement in ownership and management has a positive relationship with the financial performance of the company (Charbel *et al*., 2013). The family director usually will have 2 choices-to strive hard to ensure that family companies are making a high profit and later they are the ones that will receive returns in terms of bonus or shares or just fell comfortable with the current situations within which they are operating and only endeavor to sustain their business (Amran and Ahmad, 2009).

With conflicting evidence on the effect of the CEO's family control on performance, this study aims to contribute to the extant literature by documenting evidence on whether CEO's family control in a different ownership structure, legal and cultural setting can increase performance consistent with alignment hypothesis. The results may have policy implication and business relevance for both Malaysian and non-Malaysian stakeholder. The empirical evidence on efficiency gains from family control towards higher firm performance would lead to higher foreign investment in the country.

Hypotheses development: Since in the early 1990s, the issues of agency costs have been well debated by many scholars focusing on possible indicators of agency costs, types of agency costs and not to forget the impact of agency problems to the performance of the company (Hall, 1998). If the issues persist, firm performance could be affected negatively. Accordingly, to alignment hypothesis, one way to reduce agency costs is by aligning the interest of owners and managers. Similarly, using alignment hypothesis previous studies had managed to prove that family relationship among managers and owners can create advantages in reducing agency costs (Fama and Jensen, 1983). Consistently, firms controlled by a founding family have more incentives and operate more efficiently to improve firm performance compared to other firms (McConaughy *et al*., 2001). Later study also documented evidence that family control is associated with higher profitability suggesting that family management may significantly increase the efficiency of the firms (Maury, 2006). We, therefore, hypothesize that:

- H_1: there is a significant association between family ownership and performance of the firm

MATERIALS AND METHODS

Data: The study consist of 634 companies listed on Bursa Malaysia in the year of 2013 (exclude PN17, PN4, finance, insurance, IPO, newly listed companies in the past two years and companies with missing data). There are several reasons for imposing the requirement that sample estimation companies were continuously listed. Firstly, the criterion removes companies that entered liquidation during the investigation period.These companies performed extremely poorly. Secondly, the requirement that companies were continuously listed ameliorates the impact of Initial Public Offering (IPO) effects on the sample.Empirical evidence, consistent across a wide range of countries, indicates that IPOs tend to underperform in the long run (Balatbat *et al*., 2004). Hence, in the first five years after listing, IPO firms are likely to perform poorly. Finally, international evidence supports the hypothesis that in the first year after listing, IPO firms manage earnings to meet the prospectus forecasts (Cormier *et al*., 2006; Gramlich and Sorensen, 2004).

Variables

Firm performance: This study employs accounting profit rate to measure firm performance on the basis that the method is backward looking that represent profitability and productivity (Demsetz and Lehn, 1985; Demsetz and Villalonga, 2001) and constrained by the standards set by the professions (Demsetz and Villalonga, 2001). Similarly, to avoid the effect of market variations on the data selected we decided to use an accounting-based measure on Return on Asset (ROA) (Chen and Yu, 2012). Besides, ROA is widely accepted in management research and is not affected by financing decisions for example return on equity (Gomez-Mejia and Palich,1997). Therefore, in answering the hypothesis 1 and for robustness of the results, we used accounting rate of return as an alternative measure of firm performance, in place of Tobin's Q.

Family ownership: The study had used Ismail and Sinnadurai (2012) definition to measure family ownership.It is measured as the sum of percentage shareholdings for each shareholder in the CEO's family. Data were obtained from the annual reports, sourced from Bursa Malaysia website. The following steps were taken to measure family ownership. Firstly, the shareholdings of the CEO were obtained from the note to the Financial Statements entitled, "Directors' Shareholdings". The CEO's percentage shareholding was recorded as the sum of his/her holdings. Secondly, the section of the Annual Report entitled, "Directors' Profiles" was perused for details of familial relationships between each director and the CEO.This section also discloses familial relationships between the CEO and significant shareholders who are not directors. A director or another shareholder is defined

as having a familial relationship with the CEO if he/her is either the first cousin or more closely related to the CEO by blood or marriage. Thirdly, for each director related to the CEO, the percentage of shareholdings was obtained using the same process as for the CEO. For non-director shareholders in the same family as the CEO, percentage shareholdings were obtained from the note to the Financial Statement entitled, "Analysis of Shareholdings".

Control variables: Variables such as debt ratio are included as control variables calculated as the book value of total debt to the book value of total assets. These are used as control variables to gauge the extent to which none equity capital is used to finance the assets of a firm8. Besides, capex growth is included to scale the level of investment made on the particular that can affect the performance of the firm. Capex growth is measured by the percentage of total capital expenditure increased during the year in relation to previous year.

Model of the study: The model testing the research hypothesis is as follows:

$$ROAi = \beta_0 + \beta 1 FAMOWN\ i + \beta_2 CAPEXGROWTHi + \beta_3 DEBTRATIOi \ldots + \varepsilon_i$$

Where:

ROA	=	The performance of company
i	=	Measured by return on assets
FAMOWN	=	The percentage of shares own by families of the Chief Executive Officer
CAPEXGROWTH	=	The percentage of capital expenditure growth
DEBTRATIO	=	The book value of the total debt to the book value of the total asset
β_0, β_3	=	regression parameters
ε_i	=	The stochastic disturbance term

RESULTS AND DISCUSSION

Descriptive statistics: Table 1 presents descriptive statistics for dependent, independent and control variables for the sample companies.The statistics show that on average, 33.4% of equities are in the hands of the CEO's family with a minimum of 0% and a maximum of 95.1%. The result is slightly higher than the previous study conducted in Malaysian setting by Amran and Ahmad (2009). The variations in the results could due to different year and definition of ownership used in the study. Our results also indicate that even on these challenging economies firm performance measured by ROA had reached an average of 3.09% which is an encouraging positive returned. The worst performed company reported a loss on assets of 770.5%. CAPEXGROWTH measures the percentage increase in capital expenditure in relation to the previous year. On average, capital investment grows at a rate of 8.5% from previous year. The result also shows that the highest increased in capital expenditure is an increase of 565.8 % from a year earlier and some companies spent less than the previous year showed as negative CAPEXGROWTH. The highest reduction is 98.9% in comparison to the last year.

Table 1: Descriptive Statistics of dependent, independent and control variables

Variables	Min. (%)	Max. (%)	Mean (%)
FAMOWN	0.00	95.050	33.400
ROA	-770.55	163.240	3.090
CAPEX GROWTH	-98.91	565.840	8.470
DEBTRATIO	0.00	99.700	17.830

Table 2: No. of firms by category of ownership

Varibles	Frequency	%
CEO's family dominated	435	68.60
Others	199	31.40
Total	634	100.00

Table 2 segregates the sample companies into CEO's family dominated firm and others. The companies are categorized as CEO's family dominated firms if at least 20% of the firm's equity are owned by the CEO's family (Ismail and Sinnadurai, 2012). The result shows that 435 (68.6%) of the sample companies listed on the main board of Bursa Malaysia can be categorized as a CEO family dominated companies. The finding is consistent with previous studies where Malaysian companies are not widely dispersed ownership companies with an average of 60% is family-owned firms (Amran and Ahmad, 2009).

Table 3 presents descriptive statistics of CEO's family dominated firms by industry sector. The results show 31% out of 435 CEO family dominated firms is from industrial product industry sector. Another 20% are from trading and services, followed by 18% from consumer products industry sector. The result is consistent with previous evidence where the 3 types of the industry continue to rank as the top three with the highest number of companies with high involvement of the CEO family in the business 1. Most of the family companies in Malaysia involved in a business that need a huge amount of capital, in the industry with a large market segment where the consumer highly demands it (Amran and Ahmad, 2009).

Results of hypothesis tests: Table 4 reports the results of the tests of the research Hypothesis. The model is significant at the 1 percent level ($F = 19.44$, $p = 0.000$) with an adjusted R^2 of 8.1%.The coefficient attaching to CEO family ownership is not significant. Thus, the results do not support H_1, postulating a more efficient management

Table 3: List of sample companies based on the sector

	Family ownership	
Variables	Frequency	%
Industrial product	135	31.03
Trading/Services	90	20.69
Consumer product	78	17.93
Properties	56	12.87
Plantation	26	5.98
Construction	26	5.98
Technology	19	4.37
Others	5	1.15
Total	435	100.00

Table 4: Linear regression results for 634 companies

Varable labels	Coefficients	β	t-statistics (significance)	Variable p-value
INTERCEPT	0.000		0.003	0.998
FAMOWN	-0.040	-0.04	-1.021	0.308
CAPEX GROWTH	0.228	0.228	5.959	0.000
DEBTRATIO	-0.180	-0.18	-4.673	0.000

R^2 (%) = 8.500; Adjusted R^2 (%) = 8.100; N = 634.000; F-Stats. =19.440 (0.000)

of companies controlled by CEO families. The result is inconsistent with studies in other developed market such as in Italy which had found that the presence of a family CEO would have positive impact on firm performance (Minichilli *et al*., 2010). The non-association between performance and CEO family ownership perhaps can be explained by the fact of the different ownerships structure of Malaysian companies. In the Malaysian context, high family ownership may result in the low performance of the firm. The non-association results indicate the possibility of entrenchment effect of highly concentrated market owned by the family firm. For CAPEX growth, the significant positive relationship with the performance of the firm meets expectation. Increased in capital expenditure for the year could stimulate growth for the company and subsequently affect the performance of the firm. About DEBTRATIO, the coefficient is negative and significant at the one percentage level. Our interpretation is that high leverage firm will incur the high cost and will have the high financial risk that can affect performance of the firm. The result is consistent with the previous study which highlighted that firm leverage is negatively related to firm performance (Chang and Wang, 2007).

CONCLUSION

Agency problem could exist in a situation where there is a conflict between the interest of the owners and the managers or directors who run the company. Types of agency costs include monitoring, structuring, opportunity and guarantee or issuance costs (Hall, 1998). Given scarce of resources, agency costs that persist to occur can affect the performance of the company. One way to mitigate the conflict is by aligning the interest of manager with the owner. One of the methods used is to allow managers to own some percentage of shares in the company. In Malaysia, 69.3% of the sample companies listed on the main board of Bursa Malaysia can be categorized as a CEO family dominated companies. Many previous studies that had been conducted had proven that ownership structure is important to improve corporate governance systems and can act as mechanism to combat agency costs.

However, it is found that though the model is significant there is no significant relationship between CEO family ownership and firm performance. Our result do not support alignment hypothesis, leading to a conclusion that alignment hypothesis that in the developed market with widely dispersed ownership may not apply to a highly concentrated ownership type of companies in Malaysia. The results may differ with other literature as some variables that can explain the variations are not taken into consideration in the model. Besides Malaysian economic conditions during the year of 2013 is not encouraging and therefore affects the performance of the companies. The results further indicate that there is a significant negative correlation between debt ratio and performance of the firm. Given the current economic conditions, engaging in debt to finance the operations may not be a wise decision as this might affect the performance of the firm negatively. Besides, the result indicates that growth of capital expenditure is positively correlated with performance of the firm. The higher investment on the capex expenditure may encourage growth and subsequently increase performance of the firm.

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