

CHAPTER 1

INTRODUCTION

1.1 OVERVIEW

The issue of distribution of share ownership and corporate performance was first drawn the attention by Berle and Means in 1932. Following Jensen and Meckling (1976), various studies showing how the allocation of shares can influence the value of the corporation have continued to evolve on finance literature, whether in both theoretical and empirical front.

According to Jensen and Meckling, the conflict of interest between shareholders (owners) and managers (agents) exists because of the natural tendency of managers to allocate firm's resource in their own interest. Thus, agency costs¹ were incurred to monitor the agency relationship and to ensure the agents act at the best interest of the shareholders, or the owners of the corporation. In their article, it also pointed out that as the owner-agent's fraction of the equity falls, the fractional claim on the outcomes falls. The agents will have the tendency to appropriate larger amounts of the resources in the form of perquisites.

However, Jensen and Meckling argued that this might not be the most important source of conflict. They explained that the most important conflict that might arise when agent's fractional claim fall, the agent's incentive to devote significant effort to profitable investment and financing policies falls. In other words, the assumption that firms will always pursue the goal of maximizing the firms' economic profits possible might not be true in the theory of firm in all circumstances (Nicholson, 1994).

In Malaysia, Puthucheary pioneered the study on ownership problem in corporate economy. Several other researchers, such as Sieh (1978) and Lim

¹ Agency costs are defined as the sum of the monitoring expenditure by the principal, the bonding expenditure by the agent and the residual loss.

(1981) continued the effort in examining the ownership and control problem in the corporate economy, especially in the distribution of stock ownership of large corporations in Malaysia.

In Lim's analysis, she examined that large corporations in Malaysia are ownership concentrated. The concentration of ownership deflates the power of small stockholders and inflates the power of big shareholders. She also described that there are three types of directors in Malaysian corporations, those are executive-professional directors, owner-directors and functional directors. Among the three types of directors, owner-directors represent a substantial amount in the Malaysian corporations. These directors are not simply managing the companies, but own them as well. As the conflicts of interest exist between these two parties, the problem of whether they will always act at the best interest of owners shall be questioned. These issues on the structure of corporate ownership and corporate governance have again been discussed in 1997 when the economy plunged into the declining stage. It was pointed out by Datuk Megat Najmuddin Khas² that the Malaysian Corporations are still dominated by the owners of the corporation and this has caused the corporation not professionally run.

1.2 OBJECTIVE OF STUDY

The main objective of this paper is to examine the effect of ownership structure on the performance of Malaysian public-listed companies, and in what ways it does.

There are three main concerns from the argument. First, whether there is effect of ownership concentration towards the corporate performance in Malaysia. Second, does the ownership concentration promote better performance of the corporation or does it hurt the performance of the corporation. Third, to examine whether there is relationship between insider ownership and corporate performance.

1.3 SIGNIFICANCE OF STUDY

As prior research are concentrated on the foreign corporations or large corporations listed under the Fortune 500 companies, there are limited local evidence that may prove the effect of ownership structure on the performance of domestic companies. The findings of this study will provide some insights for the related parties, whether alteration in ownership structure shall be done to encourage a better performance of the corporation and to ensure a fair and competitive business environment.

In addition, different measurement in ownership and corporate performance are to be used in our study, this might provide a different findings to our topic. The study will give additional contribution to the finance and economic literature on the issue of ownership structure in Malaysian corporate economy.

1.4 SCOPE OF STUDY

Various studies had been conducted in several countries, especially in United State of America and several East Asian countries or large corporations registered under the Fortune 500 companies. These studies provide different arguments and conclusions on this issue of ownership structure on the Malaysian public-listed companies. The study will focus on the main-board³ and second-board⁴ companies in various industries such as consumer products, industrial products, construction, trading or services, finance, property and plantation listed under the Kuala Lumpur Stock Exchanges, which represent the large and medium enterprises in Malaysia.

² *Presiden of the Federation of Public Listed Companies and the Malaysian Institute of Corporate Governance in 1997.*

³ *Companies that have paid-up capital of RM60million, at least 25% of the paid up capital in the hands of minimum number of public shareholders holding not less than 1000 shares each and issue of prospectus is necessary at IPO.*

⁴ *Companies that have paid-up capital of RM40million, 500 public shareholders not less than 1000 and summary of prospectus shall be issued and advertized.*

In October 1999, the total number of listed companies is 748, which comprises of 463 main-board companies and 285 second-board companies.

1.5 LIMITATIONS OF STUDY

Some of the potential problems faced in conducting the study are the data limitation and difficulty in defining ownership and qualitative variables. The sample chosen are from a list of selected public-listed companies. As the data published in Annual Companies Handbooks and other sources are the historical financial information of the companies, the study will only cover the financial period of 5 years, from 1993 to 1997. The selected sample companies will also be restricted to the corporations that have completed data for the variables of interest. Thus, only 100 listed companies are selected.

We also faced the difficulty in defining ownership concentration and identifying the insider ownership of the corporation. In this study, we define the ownership concentration as the percentage of the top five largest shareholders and insider ownership as the percentage of shares owned by directors and officers. As there are conglomerates in Malaysian corporations that owned substantial number of subsidiaries in various sectors, we find inability to identify the directors' holdings in their subsidiary companies. We solve the problem by only considering the directors' direct interest in the companies.

Besides, we also faced the problem in defining qualitative variable, such as innovation. In this study, we make the assumption that cost of innovation is included in the research and development (R & D) expenses. However, as we are unable to obtain the data for companies' research and development expenses, we use the growth in net income as proxy for R & D expenses.

As our samples are taken from the corporations listed under KLSE, the findings of the study will only apply on the large and medium enterprises in

Malaysia. The study is also limited to the listed companies due to the fact that the financial information of the small enterprises is not published and easily obtained by outsiders.

1.6 ORGANIZATION OF STUDY

Chapter 1 of this paper comprises the introduction of the study. It explains some background of the structure of corporate ownership and the implication on the corporate performance and nature of ownership structure problem in Malaysia. It also includes the objective of study, significance of this study, scope of study and the limitation of study.

Chapter 2 reviews the theoretical consideration and some empirical evidences from prior research. This includes a summary of empirical studies examining the ownership structure and corporate performance.

Chapter 3 discusses the research methodology, such as sample design, hypotheses, selections of variables, sources of data and data analysis techniques used to conduct the study.

The results of the study are presented in Chapter 4 with a summary of statistic, analysis of measures, testing of hypotheses and a summary of research result. Chapter 5 gives the conclusion and recommendation for further research for the study.