

CHAPTER ONE – THE PROBLEM

1.1. Introduction

"Everyone has a weak spot. Company, like humans too have weak spot. It is most exposed when the time comes for a change of leadership. Our Company becomes even more vulnerable particularly now, if I could not handover to a suitable successor under such unprecedented demanding market forces. I strongly believe that our company needs to have a good management control system to provide the path of entry-exit that emphasis on retaining high performers while motivating them to create value for the company as we are about to deal with issue of liberalization in our industry. Hence, my consideration for my successor is not so much what this person stands for, but what contribution he can make to consolidate what has already been achieved and building upon it for the future. A good leader must have vision. He must be able to anticipate and address the significance changes of property consultancy services in and for our company. It is essential that he can inspire his people with enthusiasm to achieve the vision as a whole."

These are statements made by a prominent CEO of a Real Estate Service firm five years ago when he is about to decide on his retirement.

1.2. Background of The Problem

From the above statements, the CEO is at the crossroad in deciding the future of the company founded by him. The fact is that anyone who stays too long in a certain position will fall victim to the influence of power, personal vanity and past applause. No one is immune to this danger. The CEO is well aware of this danger, hence deliberately he retired from valuation practices but moving on to brokerage services as it is the best antidote for him to face new challenges. But he is still searching for **a good management control**

system, which addresses the issue of retaining high performers while motivating them to create value for the company in facing the wave of liberalization and globalization.

It is not an easy task because any management control system **needs to consolidate what has already been achieved and to build upon the past for the future**. He anticipated it would be a tough sell and an education process for its existing partners to transform the firm's existing structure and culture.

The fact is real estate service firms in Malaysia are partnerships or family-owned businesses even though some may be incorporated as private limited companies. Table 1 provides a breakdown of the type of business ownership in real estate services firms in Malaysia.

Table 1 - Real Estate Services Firms in Malaysia

| Type of Services | Valuation | Property Management | Agency | Total |
|-------------------|-----------|---------------------|--------|-------|
| Company Structure | | | | |
| Private Limited | 147 | 11 | 109 | 267 |
| Partnership | 34 | 2 | 17 | 53 |
| Sole Proprietor | 110 | 2 | 657 | 769 |
| Total | 291 | 15 | 783 | 1089 |

Sources: Board of Valuers, Appraisers & Estate Agents website
www.lppeh.gov.my/lppeh dated January 18, 2003

Since ownership and control are closely held together, it is understandable that real estate firms do not wish to disclose much. As a consequence, good control systems have never been in need. But as equity liberalization develops, attracting external and foreign capital becomes more important. This trend will change the existing structure and culture regarding disclosure and control.

It is generally accepted that a good management control system must promote good corporate governance, as there is a direct relationship

between corporate governance and the market value of companies. In the preliminary discussions with few real estate principals and partners in the industry, it is learnt that challenges facing real estate service firms due to globalization, information revolution and advancements in telecommunication are being felt. Immediate concern of these firms is the effect of equity liberalization of its industry. There is a need to understand how real estate service firms develop and implement management control systems in meeting the issue of separation of control and ownership.

1.3. Statement of the Problem

It is inevitable that real estate service firms are forced to evolve from partnerships or family-owned businesses when the industry liberalizes its equity participation to better integrate into the world economy and offer a more predictable environment for trade and foreign investment in accordance with WTO rules. As professional practice, real estate service firms are regulated and governed by The Board of Valuers, Appraisers and Real Estate Agents (hereafter referred as "**The Board**") in Malaysia. Currently, only registered persons with The Board are permitted to provide real estate consultancy services. This rule limits the size and structure of these service firms. From the record of The Board, most of these firms are established in the late 1970's or earlier 1980's, therefore it is likely most of these firms' main partners are at, or soon will have to hand over control to the next in line.

In the wave of K-Economy, what worked well in the "Old Economy" is no longer effective (Mark Gimein, 2000). A survey conducted by UNCTA on professional service firms in 1993 has concluded that it is importance for these service firms to develop a set of intangible assets that enable achievement of higher performance (UNCTA, 1993). A few studies have identified these attributes or critical success factors for Real Estate Services. They include

Finance, Technology, People, Strategies and Processes that must be focus to develop its competitive advantage (Gary Lenz, 1999 and Stan Ross, 1999).

In short, Real Estate Service Firms generally are facing macro and micro challenges, which are interrelated. They are as follows: -

a) The Macro Challenges – The factors that are expected to have profound effects on industry structure:

- Global reach,
- All markets are local markets,
- No geographical bind of foreign competitors,
- Speed to market with flexibility and innovation,
- E-commerce, real-time delivery,
- In-depth local business needs, and
- Relationship networking.

Several studies suggested that companies which have the most appealing customer propositions, the best quality and service standard at lowest cost will lead the market (UNCTA, 1993; Gary Lenz, 1999 and Stan Ross, 1999).

b) The Micro Challenges are derived from the limitations of current legislative and practices to face the equity liberation of the Real Estate Industry, which is likely to take effect in year 2003. Among the issues faced by most of the real estate service firms are:

- Most of them may not be ready to compete and attract external capital as they do not yet have in place an effective disclosure system which meet the expectation of non-participative investors;
- Most of them will have to deal with issues of agency when their businesses will be managed by professional managers as required by market norm upon equity liberalization for check and balance. These professional managers may not be the

shareholders but are actually agents of the shareholders. Being agents of the shareholders, they are to maximize the shareholders' wealth. But will the managers make decisions and take actions that will always serve the best interest of the shareholders? It is inevitable that there will be instances whereby conflict of interest are bound to happen when the managers' interest supercede the shareholders' interest; and

- Some of the real estate services firms are about or going through succession process. It will complicate the underlying problems of these firms when they have to deal with equity liberalization in the industry.

As such, it is important that real estate service firms must find out what to retain or uproot to replace with new forms and content in meeting the macro challenges and equity liberalization. Creating the right balance between the two is not a once-off change but an ongoing process.

1.4. Objectives of The Study

This study focuses on a real estate service firm in Malaysia by employing Economic Value Added (EVA) as an alternative Management Control System to address the concern of separation of ownership and control. This study also explores the use of EVA as a basis for motivating and retaining high potential people in creating shareholders' value. Specifically, the objectives of the study are:

- i. To examine some general characteristics of EVA as discussed in the literature to match the desired characteristics of an alternative management control system, which minimizes agency cost while creating wealth for the investors,

- ii. To identify the desired characteristics of an alternative management control system that retains high performers while motivating them to create wealth for shareholders. The experience of EVA implementation in a Foreign Real Estate Service Corporation (hereafter referred to as **Foreign Corporation**) is analyzed to meet this objective, and
- iii. To recommend some consideration for management action when implementing EVA within the Local Real Estate Firm (hereafter referred to as **Local Firm**).

1.5. Rationale & Importance of The Study

Currently, service companies account for 70-85% of employment in the industrialized world and its rapidly growing sub-sector --- "Knowledge Organizations" (Karl-Erik Sveiby, 1998) has already bypassed the manufacturing sector in many countries. Malaysia is moving towards the same direction at a rate faster than those in developed countries. This process is being expedited by globalization, information revolution and rapid technology advancement, particularly in telecommunication.

The motivation to select real estate services, as it is one of the service sub-sectors first to experience the Knowledge Economy because most professional services firm are designed around a skeleton of information and competencies of people. Moreover, the long pending issues of equity liberalization would likely to take effect in 2003. It is a fact that most of the professional service firms' structure and culture may not be effective with the development of separation between ownership and control. On the other hand, many failures of corporations such Enron, Worldcom again shattered public confidence on its mechanism of management control. Hence, critical management question is whether one could have identified the potential

problems before the fact and designed a more productive organization for real estate services firms instead of falling into the same traps like other large managed corporations.

The choice of real estate service industry for this study is because of the researcher personal interest in the industry. It is the researcher believes that knowledge acquired must be applied to address real management issues. It will enhance learning experience when observing the interactive and dynamic of application. Moreover, there are very few EVA adopters in Malaysia and none in real estate service industry; therefore the **Foreign Corporation** was selected because of

- a) It has similar back ground and is affiliated with the **Local Firm**,
- b) EVA is one of its performance metrics, and
- c) It had experienced the separation of ownership and control many years ago.

1.6. Methodology & Limitations of The Study

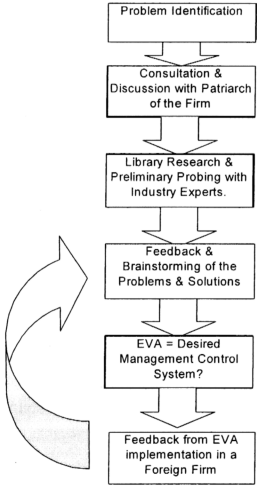
This study is a case study drawn on the experience of a **Foreign Corporation** to provide a learning path to the **Local Firm** in addressing the management concerns faced by them. Action research model was adopted as the framework of this study. Interactive and consultative approach has been employed to identify the management concerns faced by the **Local Firm** as illustrated in Figure 1 and the **Foreign Corporation** was selected to understand its experience in EVA implementation.

Library research provides the basis understanding of the challenges faced by real estate industry locally and globally. It is supplemented by having preliminary discussions with selected few real estate principals and players in the industry to understand their views on the macro and micro challenges felt by them. The magnitude of such challenges affects each firm

differently and some believe such challenges are good while others approach the challenges with cautions.

Various brainstorming sessions with the partners of the **Local Firm** were held to diagnose the problems and issues faced by them. In the course of brainstorming, an alternative management control system desired by them has been developed. The Partners participated in the brainstorming sessions are the founder (thereafter referred to as **Patriarch**), the second liner (thereafter referred to as **Senior Partners**) and third liner (thereafter referred to as **Younger Partners**) (See Chapter Three).

Figure 1 . Approach of Study



Sources: Adapted From Action Research Model
Thomas Cummings & Christopher G Worley, 1997 pp28

Probing and observation technique were adopted to collate information on the feedback of EVA implementation in the **Foreign Corporation**. The interviewees in the **Foreign Corporation** were divided into two groups i.e. marketing staff and supporting staff. Two to three persons were identified from each group as interviewees without their actual knowledge. Non-structure questions were probe to them during conversation to solicit for feedback on EVA implementation. Probing techniques and observation were adopted to gauge for true feeling from the staff because staff would not reveal true feeling and/ or facts when they knew they were interviewed. A voice recorder was used to assist in collating information during conversation, which was subsequently recorded in written descriptive format.

As an explorative study, content analysis and descriptive presentation were adopted. EVA was compared and mapped with the alternative management control system desired by the **Local Firm** (See Chapter Three). Where as the feedback from the two groups of staff in the **Foreign Corporation** was analyzed from the notes recorded by grouping the answers to common questions thereafter refine them according to similarity and/or differences on central issues (See Chapter Four).

The probing technique used in-between conversation with the staff is confusing even with the assistance of voice recorder as there are difficulties in coding and interpretation when translating voice to text note later on. Most of the time, conversations held in a group of three or four persons, which mean sampling is inconsistent. Some of the questions probed to them may not receive any response as it was done in the group conversation and it is also subject to interpretation bias. Hence, it affects the quality of analysis where subjective judgment has been employed. Even though, reasonable care has been taken to establish the reliability of information, but this study is neither conclusive nor representative.

1.7. Organization of The Report

This study consists of five chapters. Chapter One (1) discusses the problems, objectives, methodology and organization of this study.

Chapter Two (2) reviews literature on the framework of Economics of Organization Architecture, a brief understanding of agency theory and the elements of succession planning from the work of James Brickley, Clifford Smith & Jerold Zimmerman (1999) and Egon Zehnder International (2002) respectively. It also presents the background and characteristics of EVA by focusing on Performance Measurement and Incentive Compensation from financial and management literatures.

Chapter Three (3) analyses the result of brainstorming with the Partners of the **Local Firm** based on the framework of "Organization Architecture" to establish the desired characteristics of an alternative management control system; while, work of Egon Zehnder International provides a systematic approach in analyzing succession planning and act as a guide in developing the entry-exit path to be incorporated in the management control system. This is followed by examining the compatibility of EVA in accordance to the set of characteristics presented earlier in Chapter Three (3).

Chapter Four (4) discusses the feedback of EVA implementation in the two **Foreign Corporation** offices i.e. Hong Kong and Singapore. Various issues were analyzed to gain some understanding based on these findings.

Chapter Five (5) deals with the conclusion of the study and recommendation for management action in preventing any debacles when implementing EVA - Management Control System in the Local Firm.