Pertanika J. Soc. Sci. & Hum. 21 (S): 99 - 110 (2013)

SOCIAL SCIENCES & HUMANITIES

Journal homepage: http://www.pertanika.upm.edu.my/

An Empirical Examination of Family-Managed Firms and Non-Family-Managed Firms: Evidence from Malaysia

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ABSTRACT

The purpose of this study is to explore the firm characteristics of family-managed firms in Malaysian public-listed firms. Selected firms were matched for size and industry before comparisons were made between the family-managed firms and non-family-managed firms. The data were collected using secondary sources. Various firm characteristics were investigated. The findings indicate that firms managed by families have a significantly larger board size, higher number of non-independent directors and executive directors and their directors have significantly longer experience working in the firm. However, the results suggest that the directors of these family-managed firms significantly lack professional qualification and tend to have fewer meetings compared to those directors in non-family-managed firms. The findings also indicate that the compensations paid to the executive directors of family-managed firms are significantly higher than those paid to executive directors of non-family managed firms. The results also suggest that these firms have not utilised their assets efficiently to generate sales compared to their non-family-business counterparts.

Keywords: Family managed firms, firm characteristics, Malaysia

INTRODUCTION

Family firms are unique (Saito, 2008). It is also claimed that there are differences in the way family firms are run compared to the way non-family firms are run. McConaughy *et al*. (1998) claim that family businesses are more efficient in managing their businesses. This ownership structure is claimed to be common among public-listed firms in developed and developing countries, and contribute to wealth creation and job generation in the development of the economy (Jorissen *et al*., 2007). Faccio

ARTICLE INFO

Article history:
Received: 20 December 2012
Accepted: 31 July 2013

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ISSN: 0128-7702

and Lang (2002) find that 44 % of firms in Western Europe are controlled by families. Anderson *et al*. (2003) reveal that founding families are present in one third of 500 firms in the US, and more than 50 % of businesses in East Asia are family-owned (Tsai *et al*., 2006). Saito claims that it is important to generate stylized facts on family firms from different countries because of the various characteristics of the countries, such as their legal system and corporate governance system, which may affect the family firms. Family businesses are claimed to be different from non-family businesses because they are owned or controlled by family members, and, thus, have a great potential for the family to be involved in or influence business matters (Jorissen *et al*., 2007). Despite the significance of these businesses, prior studies claim that very little research has been done in less developed countries where their corporate governance mechanisms are still evolving (Carcello *et al*., 2002; Yatim *et al*., 2006).

This paper attempts to explore the corporate governance structure of family-managed firms among public-listed firms in Malaysia. Besides being a developing country with an emerging market in Asia, Malaysia was chosen for this study because of its unique concentrated business environment. It is claimed that owner-managed firms are common among Malaysian firms (Mat Nor & Sulong, 2007), especially in the form of family businesses (Haniffa & Hudaib, 2006; Hanazaki & Liu, 2006). This claim is further supported by Ow-Yong and Guan (2000), who posit that listed firms in Malaysia evolved from traditional family-owned firms, and some of these firms continue to be managed as such. Unlike firms with dispersed shareholdings, these firms are believed to have reduced agency problems and agency costs due to a better match of control and cash flow rights of the shareholders (Abdul Rahman and Mohamed Ali, 2006). In order to examine the differences in the characteristics and corporate governance structure between public listed firms which are managed by families and those managed by nonfamilies, a comparison is made between the groups. Among others, board size, board activity, the education level of the directors and remuneration of the directors are investigated.

The rest of this paper is structured as follows. Literature Review gives a review of the relevant literature and Methodology describes the sample and methodology used for the study. Result and Discussion presents and discusses the empirical results and, finally, Conclusion provides the conclusions of the study.

LITERATURE REVIEW

Family businesses are regarded as the most common ownership structure around the world (La Porta *et al*., 1999). It is claimed that the structure of family firms is different compared to non-family firms. This structure would normally affect their governance structure, such as the selection of their board members, the CEO and their decision processes (Bartholomeusz & Tanewski, 2006). Family businesses would normally choose their family members to sit on their boards and to be their chairman. Horii (1991) observes that family businesses tend to place their family members in the top management position of the organisations. In addition, knowledge and expertise are more likely to be passed on within families as opposed to shared with outsiders (Andres, 2008). Even though professionals are more qualified, family enterprises will only hire professionals after their businesses reach a critical size because they believe the professional interest may not be aligned with the interest of the family (Bhattacharya and Ravikumar, 2001). Family businesses are also claimed to have committed, undiversified stake in the firm and induce strong incentive to monitor as the firm survival and its value maximisation are important to them (Fleming *et al*., 2005).

Tsai *et al.* (2006) claimed that informal family influence is more powerful than formal authority in Taiwanese family firms because CEOs and top management are also family members. Tsai *et al*. find that CEO turnover is significantly lower in family firms and its relation to firm's performance is negative. They further claim that there are two opposite effects of family firms: the family firms have sufficiently high ownership concentration to help solve the firms' problem, and to discipline the CEO, but on the other hand, they may also create conditions for new agency problems, when the interests of the controlling shareholders and the managers are still not perfectly aligned. This is agreed by Andres (2008), who claims that family businesses with concentrated shareholdings have strong economic incentives to monitor managers and decrease agency costs; this is also due to the fact that the agency conflict does not arise as family members are also part of the executive board. However, this combination of management and control might also lead to sub-optimal investment decisions when the interests of the family are not in line with those of other shareholders (Fama & Jensen, 1983). For example, it is claimed that the family's role in selecting managers and members of the board may increase entrenchment and lower the firm value since the external parties can hardly capture control over the firm. It is also claimed that family control provides family members with a unique opportunity to use their concentrated block-holding to expropriate the wealth of outside shareholders through excessive compensation, related-party transactions, special dividends and risk avoidance (Bartholomeusz & Tanewski, 2006).

It is claimed that these corporate governance attributes (such as its board size, and board leadership or role duality) are related to the corporate performance of the firm, (Haniffa & Hudaib, 2006). Haniffa and Hudaib posit that the size of the board does matter as it affects the extent of monitoring, controlling and decision-making in a firm. Small boards are said to help in alleviating the effort problem and in becoming more effective. But, when they grow too big, boards become more symbolic rather than part of the management process. Jeremias (2007) claims that firms might minimise agency costs if the board of directors effectively supervises managers. Accordingly, there are arguments that the boards' manager-monitoring activities will be more effective when they are dominated by independent, outside directors. Furthermore, the value of outside directors is related to their ability to judge firm performance objectively; inside directors may lack this quality, which will limit their effectiveness as corporate monitors. Boards of directors which are more independent from management tend to perform management-monitoring activities more effectively, which will in turn minimise the likelihood of managers engaging in opportunistic behaviour, and discipline them to run the firm more efficiently. But in family businesses, the family members are normally appointed as the directors and sit on the board, thus, they are not independent. Lansberg (1999) argues that, in the case of family businesses, even when they are well stocked with independent outsiders, they tend to focus too narrowly on business issues. Too often, independent directors are not chosen for any particular knowledge or sensitivity to the family side of the business. On the contrary, they are selected for precisely the opposite reasons; for example, because they are from the larger corporate world, they presumably have much experience into which the family firm can tap.

A study by Amran and Che Ahmad (2009) finds evidence that independent directors' background and competencies are essential factors that contribute positively to family firms. The study claims that family firms are facing challenges in searching for qualified directors to sit on their boards and encounter the problem of incompetence agents. Amran and Che Ahmad conclude that educational background and skills may influence the performance of family firms. They further claim that a family's special technical knowledge concerning a firm's operations may put it in a better position to monitor the firm more effectively. They also claim that families have the incentive of counteracting free-rider problems that prevent atomised shareholders from bearing the costs of monitoring, ultimately reducing agency costs. This is supported by another study, which claims that directors appointed among family members have excellent knowledge of the firm due to their long-standing relationship with the senior management of the firm. In addition, some family firms institute succession plans, which include training for successors (Smith & Amoako-Adu, 1999).

Jeremias (2007) claims that CEO duality might impede the effectiveness of a firm's control mechanisms. He argues that the CEO and the chairman of the board should not be the same person in order to ensure that the board is more independent from management. If the CEO is also the chairman of the board of directors, he might have a significant influence on the board, which could diminish the board's ability to oversee managerial decisions and activities and, thereby, negatively affect performance. The board, with the high influence of the management, will not be able to discipline the management appropriately as the management who controls the board will over-rule such initiatives and a non-executive chairman promotes a higher level of corporate openness. Jeremias (2007) claims that the existence of CEO duality could diminish the board's ability to supervise management decisions and activities and, thus, give negative feedback on the firm's performance. However, in family businesses, the firm would normally appoint the family member to be the CEO and chairman of the board.

Prior studies claim that structures of ownership will affect the firm's performance (Saito, 2008; Tsai *et al*., 2006). Among others, family ownership is claimed to affect this relationship. Tsai *et al.* (2006) claim that family firms have a positive impact on firm values because they typically have longer planning horizons that result in valuable investment strategies. They conclude that family firms have effective organisational structures because they perform better compared to non-family firms. The evidence from McConaughy *et al.* (1998) proves that family relationship improves monitoring and provides incentives that are associated with better firm performance. This is supported by Anderson *et al.* (2003), who find evidence that family ownership is associated with lower agency cost of debt. After controlling for industry and firm specific characteristics, their study indicates that the costs of debts financing for family firms are lower than those in non-family firms. This is supported by McConaughy *et al.* (1998), who claim that the unique relationship between the family descendant in management and the firms holds the potential for improved monitoring and top managerial incentives. They find firm efficiency and value related to the person who owns and manages the firm. Family-managed firms are managed by both tenure and their descendants, and for this reason, their firms are run more efficiently than they would be run by managers outside the family.

Thus, this study examines these corporate governance attributes of family businesses in Malaysian firms. Specifically, this study investigates the differences between the corporate governance attributes (such as board size, board activity, board independence and the existence of CEO duality) of family-managed firms and non-family-managed firms.

METHODOLOGY

The study uses secondary data from annual reports of public-listed firms. These annual reports are available and downloadable from the website of the exchange[1]. Firstly, 50 firms which were defined as family-managed firms were selected; then, after matching the industry category and size, another 50 firms were selected and categorised as non-family-managed firms. This study defines a firm as a family-managed firm if 2 or more directors on the board of directors are related, and at least one of the family members holds an executive director's position in the firm and their shareholdings

[1]http://www.announcements.bursamalaysia.com

are equal to or more than 20% (as used by Bartholomeusz & Tanewski, 2006).

Independent t-tests were carried out to investigate the differences in the governance structure and characteristics between the two groups, namely family-managed firms and non-family-managed firms.

RESULTS AND DISCUSSION

Descriptive statistics

The descriptive statistics for sample firms used in this study are presented in Table 1. The table shows the statistics of family-managed firms and non-family-managed firms.

The sample firms include firms from the industrial sector (40 firms), consumer sector (28 firms), trading/services sector(12 firms), properties sector (12 firms) and technology and plantation sector (4 firms each). The firms were categorised as family-managed firms and non-family-managed firms after matching for size and industry category.

Independent Sample T-test Analysis

Table 2 displays the independent t-test results relating to the characteristics and governance structure of sample firms from both categories, family-managed firms and non-family-managed firms.

The first row of the table indicates that family-managed firms have a significantly larger board size compared to the non-family-managed firms. The average mean size is 8.4 compared to 6.86. This larger board may be attributed to a higher number of non-independent and executive directors in their firms as shown in the following rows. The results appear to suggest that family-managed firms have a significantly higher number of non-independent directors (mean = 5.18) and executive directors (mean = 4.24), compared to non-family-managed firms. A plausible explanation for these significant results may be that family-managed firms prefer to appoint family members who have shares and interests in the firms rather than outsiders to the board of directors as well as to manage the firm. This is consistent with earlier observations by Horii (1991), who posits that family businesses tend to place family members in the top management position of the organisations. It is further claimed that even though professionals are more qualified, family enterprises will only hire professionals after their businesses reach a critical size because they believe the professional interest may not be aligned with the interest of the family (Bhattacharya & Ravikumar, 2001). Thus, in the case of family businesses, the appointment of the independent directors may be done only because of the requirement by law. From the results in Table 2, it is observed that the number of independent directors in both categories of companies are about the same and not statistically different; this may be due to the fact that both categories are listed companies which are supposed to adhere to the law, which requires them to have a certain percentage of independent directors to monitor the management.

The results also show that the chairman of the board is significantly related to the

TABLE 1
Descriptive Statistics of the 100 Sample Firms and the Variables in the Study

	Family-Managed Firms				Non-Family-Managed Firms			
	No of firms	Minimum	Maximum	Percentage (%)	No of firms	Minimum	Maximum	Percentage (%)
Net profit/loss after tax:								
Loss to RM0	6	-24,372,168	-6,291,000	12	15	-35,541,097	-2,041,346	30
RM0 to RM20,000,000	26	1,599,342	18,294,000	52	22	638,297	18,914,905	44
RM20,000,001 and above	18	20,364,595	154,278,000	36	13	20,940,045	174,912,000	26
Total compensations:								
RM100,000 – RM2,000,000	23	179,000	1,970,000	46	42	141,000	1,970,037	84
RM2,000,001 – RM5,000,000	21	2,077,000	4,484,907	42	7	2,045,000	4,157,069	14
RM5,000,001 – RM16,000,000	6	5,001,348	15,110,000	12	1	10,580,000	10,580,000	2
Earnings per share:								
Loss to RM0	6	-16.50	-0.31	12	15	-31.00	-0.71	30
RM0 to RM20	28	0.70	19.2	56	27	0.54	19.74	54
RM20.01 to maximum	16	20.50	47.19	32	8	22.60	74.83	16
Total assets (RM):								
Below 100,000,000	2	80,614,739	96,031,930	4	8	47,179,904	89,494,066	16
100,000,001 – 500,000,000	36	113,428,072	496,978,153	72	33	109,816,266	451,531,000	66
500,000,001 – 1,000,000,000	8	621,371,926	920,744,366	16	7	607,889,000	879,594,508	14
1,000,000,000 and above	4	1,015,183,000	2,133,046,000	8	2	1,239,275,000	1,309,911,618	4
Total Sales (RM):								
Below 100,000,000	8	24,721,000	91,585,651	16	20	8,820,000	92,332,045	40
100,000,001 – 500,000,000	29	108,221,063	483,254,974	58	22	108,974,000	496,545,000	44
500,000,001 – 1,000,000,000	9	536,224,935	976,100,278	18	6	518,172,413	740,139,018	12
1,000,000,000 and above	4	1,035,647,000	1,662,034,000	8	2	1,372,850,318	2,047,302,008	4

TABLE 1 (continue)

	Family-Managed Firms				Non-Family-Managed Firms			
	No of firms	Minimum	Maximum	Percentage (%)	No of firms	Minimum	Maximum	Percentage (%)
Firm with CEO duality	8	N/A	N/A	16	5	N/A	N/A	90
Firm without CEO duality	42	N/A	N/A	84	45	N/A	N/A	10
CEO's background education:								
Doctor of philosophy	1	N/A	N/A	2	2	N/A	N/A	4
Master	5	N/A	N/A	10	12	N/A	N/A	24
Bachelor	14	N/A	N/A	28	15	N/A	N/A	30
Diploma	2	N/A	N/A	4	4	N/A	N/A	8
Others	7	N/A	N/A	14	3	N/A	N/A	6
Not stated	21	N/A	N/A	42	14	N/A	N/A	28
Board positions:								
Main board	41	N/A	N/A	82	42	N/A	N/A	84
Second board	9	N/A	N/A	18	8	N/A	N/A	16

CEO in family-managed firms compared to those in non-family-managed firms. Further investigation of this data reveals that 18 out of 50 of the chairman of the family-managed firms are related to the CEO, and another 8 chairmen also act as CEOs for the firms. However, none of the chairmen is related to the CEO in non-family-managed firms. CEOs in family-managed firms appear to have significantly more years of experience (mean = 15.26 years) compared to their counterparts in non-family-managed firms (mean = 7.12 years). This may be due to the fact that in family businesses the descendant has been trained and developed to manage the firm and has been exposed to the working environment and culture of the firms from the start of the business, as it is claimed that some family firms develop succession plans and training for their successors (Smith & Amoako-Adu, 1999). However, there is a significantly lower number of CEOs in family-managed firms who have professional qualification and higher education compared to those CEOs in non-family-managed firms. This may be due to the fact that in family managed firms, CEOs are appointed based on their family values and relationship, as well as their past experience in handling the family businesses rather than on educational or professional qualification. In these firms, older members of the family will continue to head the firm until they can pass the management to a suitable descendant. Their aim is to determine survival and safeguard the future of the firm as well as that of the following generations (Bhattacharya &

Ravikumar, 2001). On the other hand, CEOs of non-family-managed firms are usually appointed based on merit, knowledge and qualification.

As indicated in the last three rows of Table 2, the total directors' compensation in family-managed firms also appears to be significantly higher than that of non-family-managed firms. The detailed statistics show that this high compensation payment is due to the high payment to executive directors in compensation, which also shows a significant result. The descriptive statistics show that the average mean for total directors' compensation and executive directors' compensation is about 2.97 million and 2.64 million respectively in family-managed firms, which is almost double the amount paid to their counterparts in non-family-managed firms of 1.47 million and 1.24 million respectively. However, the payment to the non-executive directors is approximately the same for both categories of firm, with the average mean of 2.5 million for family-managed firms and 2.3 million for non-family-managed firms, and the results indicate an insignificant difference. This result appears to suggest the possibility that family-managed firms adopt a different compensation plan compared to non-family-managed firms, as the payments would flow to the board members who are family members. Further investigation in this domain is needed before any conclusion can be made.

Family-managed firms appear to have significantly fewer board meetings compared to non-family-managed firms. A detailed investigation of the data reveals that the majority of the family-managed firms have either 4 or 5 meetings in a year, whereas the majority of the non-family-managed firms have either 5 or 6 meetings every year. The law requires listed firms to have at least 4 meetings every year, or one meeting each quarter. The 4 or 5 meetings conducted by family-managed firms may be conducted to make sure that this requirement is fulfilled. Another plausible explanation is that as family members, they may have informal meetings during which some of the firms' problems or issues may be solved or discussed, therefore, they may need fewer meetings than would non-family-managed firms, the board members of which rarely have the opportunity to meet without reason.

In terms of performance, at 10 % level of significance, the total sales of family-managed firms are statistically different compared to the total sales of non-family-managed firms. Earnings before interest and tax and earnings per share of family-managed firms are also statistically higher than those of non-family-managed firms. However, the results also indicate that family-managed firms have a significantly lower asset utilisation ratio compared to that of non-family-managed firms.

CONCLUSION

The objective of the study is to explore the differences between family-managed firms and non-family-managed firms in Malaysia. The findings indicate that governance characteristics of family-managed firms and non-family-managed firms are significantly

TABLE 2
Independent Sample T-tests of the 100 Sample Firms

Variable	Categories	N	Mean	T value (sig)
Board size	Family-managed firms	50	8.40	4.158
	Non-family-managed firms	50	6.86	(0.000)
No of independent directors	Family-managed firms	50	3.22	-0.224
	Non-family-managed firms	50	3.26	(0.823)
No of non-independent directors	Family-managed firms	50	5.18	5.431
	Non-family-managed firms	50	3.60	(0.000)
No of executive directors	Family-managed firms	50	4.24	8.320
	Non-family-managed firms	50	2.26	(0.000)
No of non-executive directors	Family-managed firms	50	4.16	-1.260
	Non-family-managed firms	50	4.60	(0.211)
No of related directors	Family-managed firms	50	3.94	30.524
	Non-family-managed firms	50	.00	(0.000)
Independent directors (%)	Family-managed firms	50	.3879	-4.836
	Nonfamily-managed firms	50	.4855	(0.000)
Chairmen are related to CEO	Family-managed firms	50	.36	5.250
	Non-family-managed firms	50	.00	(0.000)
CEO Duality	Family-managed firms	50	.16	0.887
	Non-family-managed firms	50	.10	(0.378)
Years of CEO's experience	Family-managed firms	50	15.26	5.050
	Non-family-managed firms	50	7.12	(0.000)
CEO has professional qualification	Family-managed firms	50	.16	-3.233
	Non-family-managed firms	50	.82	(0.002)
CEO has higher education	Family-managed firms	50	.4400	-2.244
	Non-family-managed firms	50	.6600	(0.027)
Board activity (meetings)	Family-managed firms	50	4.94	-1.898
	Non-family-managed firms	50	5.50	(0.061)
Total sales	Family-managed firms	50	389, 179, 837.68	1.730
	Non-family-managed firms	50	263, 348, 846.40	(0.087)
Earnings before interest and tax	Family-managed firms	50	27, 649, 958.74	2.155
	Non-family-managed firms	50	13, 603, 991.80	(0.034)
Asset utilisation ratio	Family-managed firms	50	1.6764	-1.656
	Non-family-managed firms	50	2.5031	(0.091)
Earnings per share	Family-managed firms	50	12.9700	1.610
	Non-family-managed firms	50	7.9068	(0.091)
Executive Directors' compensation	Family-managed firms	50	2,642,152.84	3.317
	Non-family-managed firms	50	1,236,856.78	(0.000)
Non-Executive Directors' compensation	Family-managed-firms	50	250, 095.02	0.278
	Non-family-managed firms	50	230, 321.08	(0.781)
Total Directors' compensation	Family-managed firms	50	2, 975, 760.50	3.475
	Non-family-managed firms	50	1, 475, 562.52	(0.001)

different. Firms managed by families have a significantly larger board size, higher number of non-independent directors and executive directors and their directors have a significantly longer experience working in the firm compared to non-family-managed firms. However, the results suggest that the directors of family-managed firms significantly lack professional qualification and tend to have fewer meetings compared to directors of non-family-managed firms. The findings also indicate that the compensations paid to the executive directors of family-managed firms are significantly higher than those paid to executive directors of non-family-managed firms. Even though the family-managed firms appear to have significantly higher earnings per share and total sales compared to the non-family-managed firms, they have not utilised their assets efficiently compared to non- family-managed firms.

This study provides information to potential investors about the differences between family-managed firms and non-family-managed firms. In addition, it also provides a basis for more detailed study on family-managed firms in Malaysia, where this unique concentrated business environment is claimed to be common.

However, the conclusions drawn from this study should be interpreted in a limited way, which would potentially represent opportunities for further investigation in future research. This study is a cross-sectional study that uses data from one year only. Future research could extend the study to include data collected over more years for a longitudinal study.

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