



UNIVERSITI PUTRA MALAYSIA

***PERFORMANCE OF WIDELY HELD AND CROSS HOLDING FIRMS IN
MALAYSIA***

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PERFORMANCE OF WIDELY HELD AND CROSS HOLDING FIRMS IN MALAYSIA

By

BALAMURUGAN NALLAMUTHU

**Thesis Submitted to the Graduate School of Management, Universiti Putra
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June 2013

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfillment of the requirement for the degree of Master of Science

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June 2013

Chairman : Prof. Dr. Anuaar Md Nassir, PhD
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This study investigates the relationship between widely held firms (WH) and cross holding firms (CH) and their performance in an area which to the researcher's knowledge has not been studied before in Malaysia. WH firms are classified as public listed firms where individual shareholdings do not exceed 20% whereas CH firms are public listed entities with more than 20% ownership by another public listed firm. This study adopted the expected performance model created by Barber and Lyon in 1996 to determine the performance of the two types of firms. Thus, this research developed the expected performance models of the firms and compared them with actual and not past performance as extensively used in prior studies. To derive accurate industry comparisons, sample firms are re-categorized according to the Malaysia Standard Industrial Classification 2008 (MSIC, 2008). Prior studies used the Bursa Malaysia industry classification to compare the performance of firms against the industry. This study is based on panel data for 16 WH firms, 21 CH firms and 163 industry benchmark firms in Malaysia for the period 2004 to 2011. The main

objectives of the study are to compare the abnormal performance of WH and CH firms and to determine the relationship between abnormal performance and the two types of firms. Abnormal return on assets (ABROA) and abnormal return on sales (ABROS) were used to measure their performance. Based on ABROA and ABROS, the findings of the study show that the performance of CH firms to be superior to WH firms. This was confirmed by an independent means test. For the relationship between CH ownership and abnormal performance, statistical tests show that CH firms positively related to both ABROA and ABROS, although the latter is not significantly related to their performance. In contrast, widely held firms are negatively related to abnormal performance. Here too ABROS is not statistically significant in explaining the relationship. This study also noted that leverage as a control variable negatively related to abnormal performance regardless of the ownership type. This is consistent with previous studies conducted on firms in Malaysia and other parts of the world. Performance is positively related to the age of firms in both categories with older firms managing their assets more efficiently to create better results. On an overall basis, in Malaysia the performance of CH firms is better than that of WH firms and the CH firm shows positive relationship with performance and WH is negatively related with performance.

ABSTRAK

Abstrak kertas project yang dikemukakan kepada Senate Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Master Sains

KESAN STRUKTUR PEMILIKAN FIRMATERSEBAR DAN SILANG KE ATAS PRESTASI FIRMA DI MALAYSIA

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Kajian ini menyiasat tentang perhubungan struktur pemilikan firma dan prestasi firma tersebut. Kajian ini menggunakan model penilaian prestasi dijangka yang diilhamkan oleh Barber and Lyon pada tahun 1996. Sebanyak 16 syarikat dgn pemilikan saham tersebar dan 21 syarikat yang mempunyai pemilikan silang dari syarikat pemilikan awam yang lain. Pengkaji juga menggunakan sebanyak 163 syarikat untuk mendapatkan prestasi abnormal firma. Kajian ini juga menggunakan data dari tahun 2004 hingga 2011. Objektif kajian ini adalah untuk membandingkan prestasi antara firma pemilikan tersebar dan firma yang mempunyai pemilikan silang. Objektif lain adalah untuk menentukan perhubungan antara sturuktur pemilikan tersebut dengan prestasi abnormal.

Hasil kajian ini dapati bahawa syarikat pemilikan tersebar didapati mempunyai hubungan negatif dengan prestasi yang diukur dengan pulangan abnormal atas aset and pulangan abnormal atas jualan. Syarikat yang mempunyai pemilikan saham bersilang didapati mempunyai hubungan positif dengan prestasi abnormal . Namun demikian untuk kedua- dua struktur pemilikan tersebut didapati bahawa pulangan abnormal keatas jualan mempunyai hubungan tidak signifikasi dalam menjelaskan perhubungan tersebut.

Tambahan pula hutang sebagai variable yang dikawal mempunyai hubungan negatif dengan kedua-dua struktur pemilikan yang dikaji. Hasil kajian ini selari dengan kajian lain di Malaysia dan diluar Malaysia. Memang diakui bahawa peningkatan hutang membawa risiko kewangan kepada firma. Selain daripada itu, umur mempunyai hubungn positif dengan kedua-dua struktur pemilikan tersebut membuktikan bahawa semakin berumur syarikat tersebut, semakin mahir menguruskan aset firma berkenaan untuk meningkatkan prestasi syarikat berkenaan. Kesimpulanya, prestasi abnormal firma pemilikan silang adalah lebih tinggi berbanding dengan firma pemilikan tersebar.

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I certify that a Thesis Examination Committee has met on 28 June 2013 to conduct the final examination of Balamurugan Nallamuthu on his thesis entitled **“Performance of Widely Held and Cross Holding Firms in Malaysia”** in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1988. The Committee recommends that the student be awarded the Doctor of Philosophy degree.

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DECLARATION

Declaration by Graduate Student

I hereby confirm that :

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LIST OF ABBREVIATIONS

CH	Non Widely Held Cross Holding
WH	Widely Held
ROA	Return on Assets
ROS	Return on Sales
ABROA	Abnormal Return on Asset
ABROS	Abnormal Return on Sales
NEP	New Economic Policy
GLC	Government Linked Companies
GLIC	Government Linked Investment Companies
UK	United Kingdom
US	United States of America
MISC	Malaysian Standard Industrial Code
OLS	Ordinary Least Square
EPS	Earning Per share

CHAPTER ONE

BACKGROUND OF RESEARCH

1.0 Introduction

The primary objective of a firm is to maximize shareholder wealth and various models of operations have been used towards achieving this. Prior to the industrial revolution, many businesses were owned and managed by the same individuals. Today, most listed corporations have large groups of individuals as owners of the entities, and since not all individual shareholders are able to participate in the daily operations of the firm, boards of directors are appointed by shareholders to hire managers who oversee the running of the firms.

This creates issues of separation of ownership and management of the modern organization. A research by Berle and Means (1932) on the separation of ownership and performance of firms noted that such a diffuse ownership structure concentrates considerable power in the hands of a manager whose personal interests may not coincide with that of the firm's shareholders. Owing to that, they believed that the performance of an entity is inversely related to the degree of diffusion in the shareholding structure. Also researchers found that it is often difficult to coordinate the actions of disparate groups of shareholders in order to enforce value maximization and proper monitoring of the manager.

However, a dispersed ownership structure can create an active capital market for the firm due to low barriers of entry for investors. The classic work of Berle and Means (1932) has become the basis for many studies in the field of separation of corporate ownership and company performance. This study also will evaluate separation of ownership and performance of public listed firms in Malaysia

Malaysia is an emerging economy, similar to that of other South East Asia countries like Indonesia, Thailand and the Philippines. Besides sharing similar characteristics of emerging economies such as concentrated ownership of companies and insider boards, Malaysia has another unique characteristic which is having a plural society that significantly contributes to the variations in ownership structure. Malaysia comprises numerous ethnic groups with Bumiputras (sons of the soil) predominating and Chinese and Indians forming 22.8% and 6.8% respectively of the population (9th Malaysia Plan, 2008)

Post-independence, the Malaysian economy was dominated by Chinese ethnic family businesses, and the other races especially the Bumiputras lagged behind in terms of equity ownership and income. Chinese family businesses contributed significantly to the development of the Malaysian and Asian economies. Their emergence was due mainly to the hardships faced by such

migrants in getting startup capital (Gomez, 2004). Most of the 40 wealthiest persons in Malaysia in 2008 were in some way or another related to family businesses (Ibrahim & Samad, 2010), and of the 40, 30 were Chinese businessman who controlled 78% of the total wealth of the wealthiest persons in Malaysia.

The Government introduced the New Economic Policy in 1970 with the twin-pronged objectives of eradicating poverty and reducing income inequality among the races. Explicit and deliberate efforts were introduced by the government to significantly increase the number of Bumiputras having greater access to commercial and industrial opportunities (NEP, 1970). The NEP targeted improving the ownership-inequality ratio from 2.4:33:63 for Bumiputras, other Malaysians and foreigners respectively to 30:40:60 by 1990. Besides that, the government also introduced the privatization policy in the 1990's to reduce the government's operating and development burden and to increase Bumiputra equity ownership. This creates many public listed firm which control by government directly or indirectly. CIMB Bank Berhad, report in 2004 on government ownership stated that government ownership created less value than private ownership. This empirical evidence enlightened the Malaysian government on the status of government owned companies in the Bursa Malaysia. As such, the government introduced a new entity - Government Linked Companies (GLC) in 2004 (Badawi, 2004). GLCs refer to private

companies owned by the state and were introduced in the GLC Transformation Plan of 2005 – 2015. This plan aims to enhance the performance of GLC companies and produce world-class business entities that could compete on the global markets.

Therefore, it is not surprising that the majority of public listed firms in Malaysia are Chinese family owned and government linked companies. A World Bank study in 1999 stated that 67.2% of the companies in Malaysia are family firms while 13.4% are state owned. As at 2011, 39% of the market capitalization of Bursa Malaysia is owned by institutional investors. The five largest Government Linked Investment Companies that is the Employees Provident Fund (EPF), Lembaga Tabung Angkatan Tentera (LTAT), Permodalan Nasional Berhad (PNB), Lembaga Tabung Haji and National Social Security Organization of Malaysia (PERKESO) make up 70% of the institutional ownership in Malaysia.

This economic scenario in Malaysia has led to many studies on family owned companies and GLCs to gauge the relationship between ownership and performance. Family owned companies and GLCs are highly concentrated in their ownership structures and the results of empirical studies on their performance are mixed. However, there is a lack of studies on dispersed and cross-holding ownerships in Malaysia. Thus this study intends to evaluate the

performance of widely held and cross holding firms against their expected performance. The findings of this study could be used as a guide by Malaysian regulators to improve the level of shareholders protection and enhance retailer participation in Bursa Malaysia.

1.1 Widely Held Firm

Cuervo Cazorra (2006) stated that in widely held firms, ownership is dispersed among many shareholders with no single major shareholder having a controlling stake. Managers are appointed by the board, which is normally control by the shareholders and they are professionals who make decisions on behalf of the dispersed shareholders. In this study, widely held firms are defined as those having no stakeholders owning more than 20% voting rights (La Porta et al., 1999)

1.2 Cross Holding Firms

East Asian economies such as Malaysia evidence the existence of many pyramidal structures and cross holding firm. (Claessens, 1999). Pyramidal structure defined as organization owning majority of the stock of corporation that hold majority of stock in another corporate. This repeat few times, thus create several level in pyramidal structure. Figure 1 show the pyramidal structure. In contrary cross holding firm is defined as ownership of shares in public listed company by another public listed company. (Shakir, 2010). However according to Morck et al, 2005, cross holding firms are own blocks of each other shares.

This called as crisscross holding. Figure 2 shows cross holding structure while figure 3 shows crisscross holding.

Figure 1.1: Pyramidal Structure Firm

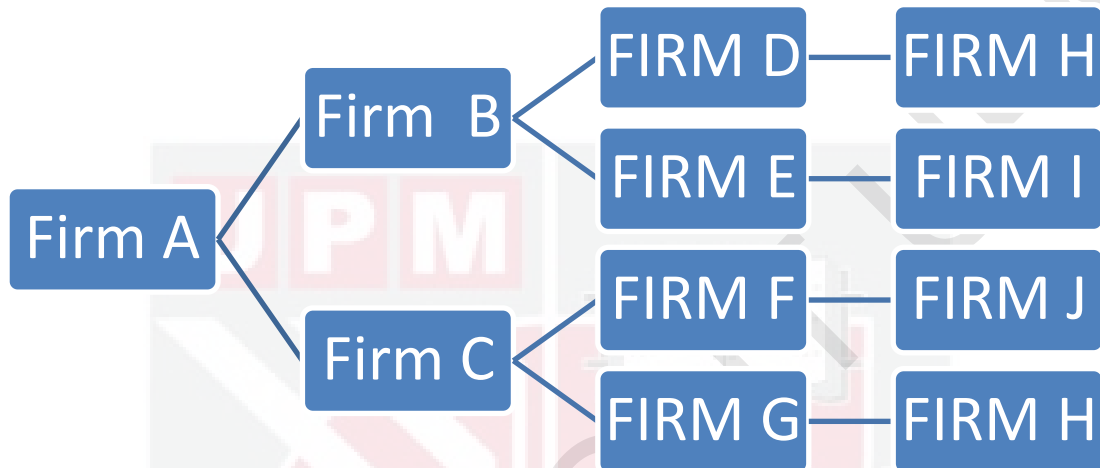


Figure 1.2: Cross Holding Firm

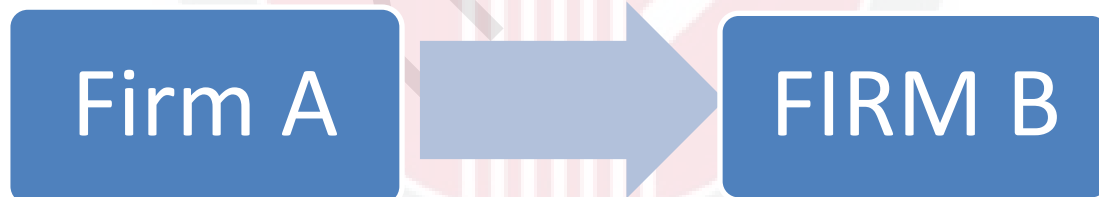
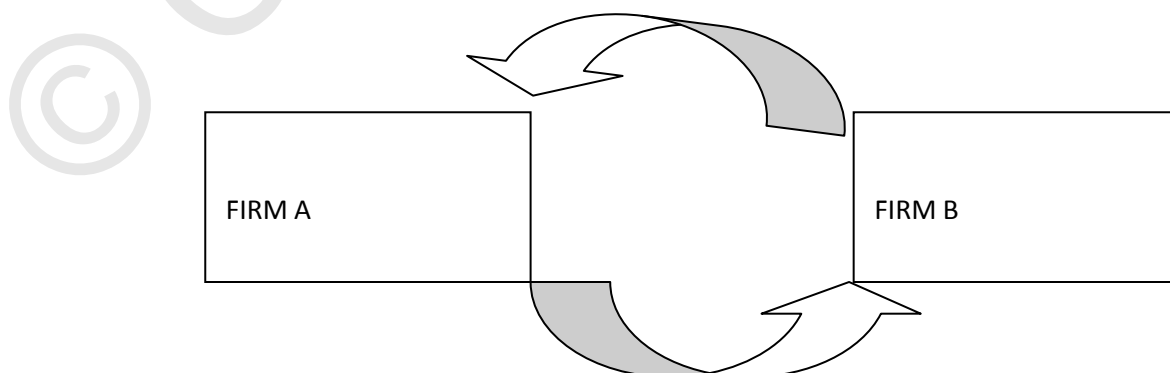


Figure 1.3: Crisscross Holding Firm



For the purpose of this study, cross holding firm defined as public listed firm having another public listed firm as major shareholder. As shown in figure two , this firm A will have more than 20 % shareholding in firm B. Firm B will be classify as non widely held cross holding firm which will be compare to widely held firm in this study. This will significantly contribute to the current body of literature on ownership and performance. Previous study on highly concentrated firm focus on family owned, Government linked company and pyramidal structure and non on cross holding

1.3 Research Gap Identification

Markets in emerging countries are substantially different from those in developed countries such as those in the U.S. and U.K. especially in terms of institutional setting, and regulatory and legal environments (Prowse, 1992). As studies determining the performance of widely held and cross holding firms are mostly based on the institutional settings in developed countries, it is not appropriate to apply those results to such Malaysian companies. The unique characteristics of Malaysia require a new study to be conducted to evaluate their performance. Prior research on the relationship between ownership and performance in Malaysia has focused on family owned companies, GLCs, pyramidal structures and institutional ownership.

This study will also introduce the Expected Performance Model to evaluate the performance of widely held and cross holding companies and reclassify them according to the Malaysia Standard Industrial Code, 2008 to derive a more accurate industry average. The Expected Performance Model and industry classification is discussed in detail in chapter 3. The gaps in research as based on earlier literature are illustrated in Table 1.



Table 1.1: Research Gap Identification

Research issues	Previous studies	Research gap addressed by this study	Contribution
Ownership	<ul style="list-style-type: none"> • Family • GLC • Managerial • Concentrated • Institutional • Pyramidal 	<ul style="list-style-type: none"> • Widely held • Cross holding 	<ul style="list-style-type: none"> • Complete the literature on relationship between ownership and performance in Malaysia
Performance Benchmark	<ul style="list-style-type: none"> • Past performance 	<ul style="list-style-type: none"> • Expected performance model 	<ul style="list-style-type: none"> • More accurate benchmark with internal and external influence on performance
Industry	<ul style="list-style-type: none"> • Bursa Malaysia classification 	<ul style="list-style-type: none"> • Malaysia Industrial Standard Code, 2008 	<ul style="list-style-type: none"> • Classification according main business activity of firm • Provide more accurate industry influence on performance

1.4 Structure of Ownership

Structure of ownership refers to the owners of the company such as the state, an institution, and domestic or foreign individuals. Ownership concentration refers to the share or percentage of ownership by shareholders of the company. Ownership concentration, in turn, could be based on whether the firm's shareholding is widely or closely held (Jiang.P, 2004). In his study on ownership and control of the company, La Porta et al. (1999) concluded that firms can be categorized as follows:

- Family or individual;
- State;
- Widely held financial institution;
- Widely held corporation; and
- Miscellaneous, such as trusts, cooperatives

Compared to the ownership structures in well developed economies such as the U.S. and UK with their strong legal protection afforded to minority shareholders, ownership structures in emerging economies are often of the pyramidal and cross holdings types. Even in the U.S., one third of companies are classified as family owned whose ownership is by nature highly concentrated (Villalonga & Amit, 2006). According to Barotini and Caprio (2005), 77% of companies in Italy, 63% in France, and 48% in Germany are family owned. Furthermore, the researchers highlighted that half of the European companies have 37% share ownership concentrated in the hands of a single individual. This shows that worldwide, highly concentrated firms play a significant role in the economy. This finding however contradicts the advocacy of

the separation of ownership with management which champions that widely held firms reduce separation costs. Similarly, in South East Asia, Malaysia is ranked third in terms of concentration of control of firms after Thailand and Indonesia (Claessens et al, 2000). This explains why much research in Malaysia is focused on highly concentrated firms such as government linked companies, family owned enterprises, and institution owned companies. This study will focus on widely-held and cross-holding firms that have not received wider coverage in earlier studies.

1.5 Problem Statement

The impact of ownership structure on company performance is a much studied topic in the literature of corporate finance, and the effect of ownership concentration on firm performance is theoretically complex and empirically ambiguous. In theory, highly concentrated firms should produce superior results due to closer monitoring by large numbers of shareholders. However, various researches have noted that tunneling is also visible in highly concentrated firms (Earle et al., 2005) On the other hand; widely-held corporations are considered ideal organizations that take care of the interests of all shareholders, although research also shows that the lack of monitoring by dispersed shareholders creates avenues for manager to misappropriate assets of the firm. Malaysian firms are highly concentrated with many owners also acting as directors (La Porta et al., 1999). Claessens et al. (1998) noted that a control structure dominated by founder families and their successors are predominant in Malaysia. This highly concentrated ownership structure allows the creation of cross holdings and

pyramid structure companies. Theoretically such cross holdings will allow larger shareholders to exploit minority shareholders, although Claessens et al. (1999) found no substantial proof of that in the Malaysian context. The Malaysia economy is also strongly represented by family owned companies and government linked companies. A study conducted by the World Bank in 1999, showed that 67.2% and 13.4% respectively of firms listed on the Bursa Malaysia were family and government owned entities. It was further confirmed by research conducted by Claessens, 2000 who used the 20% voting right cut-off in determining the ultimate owner of the firm. Though the number of widely held companies on Bursa Malaysia is significantly small, they should be included in empirical research to provide a more complete picture of the relationship between ownership and performance in the Malaysian setting.

There are many extensive studies on GLC and highly concentrated family-owned companies in the Malaysian context but none on widely-held and cross-holding companies. The study by Issham et al. (2008) evaluating the performance of GLCs and non GLCs using the Economic Value Added methodology concluded that the latter create better value. Ab Razak et al. (2008) and Najid & Abdul Rahman (2011) used market and financial measures such as the Tobin Q and ROA to establish that non GLCs performed better than GLCs. Amran and Ahmad (2010) conducted studies on the performance of family- and non family-owned companies. Mat Nor et al. (2010) concluded that a firm's performance significantly related to ownership structure.

Prior literature shows that many studies conducted in Malaysia focus on family owned firms, government linked companies, and pyramid structure firms. However, as mentioned earlier, there is no literature on widely-held and cross-holding firms. The former are defined as having no single shareholder owning more than 20% equity (La Porta, 1999), whereas cross-holding firms are public listed firms that are controlled by another public listed firm (Gursoy & Aydogan, 2002). For the purpose of this study, cross holdings firms with shareholdings exceeding 20% by another public listed company are included. Issues such as the behavior of widely-held and cross-holding firms in terms of ownership structure and performance against industry standards have not been extensively analyzed empirically in Malaysia. As such, this study attempts to gauge the relationship between ownership of widely-held and cross-holding firms and their performance with a view to contributing to the current literature on ownership structure of firms in Malaysia.

1.6 Objective of Study

This study examines the relationship between widely-held and cross-holding firms and their performance. Specifically, the objectives are:

- I. To compare the abnormal performance of widely-held companies and cross-holding companies; and
- II. To determine the relationship between widely held-companies and abnormal performance

- III. To determine the relationship between cross holding companies and abnormal performance

1.7 Significance of the Study

In general, an investor in a firm, in return for risking his capital, would be concerned about the performance of the company. This study which uses industry as an independent variable to determine performance of companies will provide investors a clearer picture of the performance of widely-held firms and cross-holding companies against the industry average. The results of this study will assist current and future investors in evaluating the expected and actual performance of such firms towards formulating their investment strategies.

Policy makers and regulatory bodies such as the Treasury, Ministry of Finance Incorporated, Khazanah Holdings, Economic Planning Unit, GLIC and others would be interested in the performance of the above companies. This study will assist them in introducing measures and policies to strengthen regulatory mechanisms and monitoring in the interest of protecting minority shareholders. Past studies show that countries that have efficient corporate laws which protect minority shareholders will have a more diffused ownership. Therefore, regulators will benefit from this study and

be able to establish improved regulatory mechanisms that provide better protection to minority shareholders.

This study is expected to contribute to the existing body of knowledge on the relationship between ownership and performance, specifically that of widely-held companies and cross-holdings companies. It is intended to evaluate the performance of those companies by adopting the expected performance model developed by Barber and Lyon in 1996. This model clearly defines changes in a firm's performance relative to an industry benchmark and, as such, researchers would benefit from the new methodology used in evaluating performance. Furthermore, industry classification will be based on the Malaysia Standard Industrial Classification 2008. (MISC, 2008) which is a new method employed in research in Malaysia. To the best of this researcher's knowledge, this is the first study using the classification of companies according to the MISC 2008. Studies to-date utilized the Bursa Malaysia classification of companies which does not clearly reflect the main activity of the listed firms. For example Bumi Armada is classified in Trading and Services but its actual activities are oil and gas related. Therefore, a reclassification of companies according to the MISC code will establish an appropriate valuation of the industry average against which the performance of individual firms could be benchmarked. Besides the widely-held companies and industry classification, determining performance by comparing expected performance with actual performance and matched against industry standards will be the major difference in this study compared to previous studies. This

will thus add significantly to the current body of literature on ownership structure and performance of companies.

1.6 Organization of the study

This thesis is organized into five chapters. Chapter 1 provides an overview of ownership and management of companies and the ownership scenario in Malaysia, as well as the objectives and significance of the study.

Chapter 2 reviews the literature on the research topic and includes theories related to ownership and performance. The literature review also covers past studies on the above subject matter.

The research methodology is covered in Chapter 3. This chapter discusses the methodology used, data, and research design. Models of expected performance are also outlined as well as the statistical tests and techniques of data analysis.

Chapter 4 consists of the findings of the study. It documents the overall results of the study with the outcomes of statistical tests conducted through a non-parametric test

Chapter 5 concludes the thesis and discusses the contribution of the study, its limitations, and provides suggestions for future research.



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