

**CORPORATE GOVERNANCE AND PROPERTY  
FIRMS' PERFORMANCE POST FINANCIAL CRISIS  
2008**

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## DECLARATION

I hereby declare that:

- (1) This Research Project is the end result of my own work and that due acknowledgement has been given in the references to all sources of information be they printed, electronic, or personal.
- (2) No portion of this research project has been submitted in support of any application for any other degree or qualification of this or any other university, or other institutes of learning.
- (3) The word count of this research report is 18843.

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## **ABSTRACT**

The research on corporate governance at corporations and listed companies is extensive, however, it does not assign sufficient weight to each individual industry particularly the property industry. Important questions that are still unexplored to date include: What are the corporate governance attributes among property firms? How do these corporate governance attributes affect their performance and risk-taking behavior? To answer these questions. This research examines the relationship between corporate governance (family ownership, government ownership, board size, director independency and risk- taking behavior) and property firms' performance in Malaysia.

This research is important because it presents the first empirical evidence examining whether family ownership, government ownership, board size, director independency and risk- taking behavior is associated with the performance of property firms. Investors or house buyers may consider to include corporate governance evaluation as to assess the strength of property firms when assessing property firms' performance and their investment decision.

The Top 30 property firms listed on Bursa Malaysia is chosen as the samples for this study. It covers the period from 2008 to 2017. A total of 275 panel data are collected for analysis. The analysis involve descriptive statistic, market trend, correlation between variables and multiple regression analysis. Five hypothesis are constructed base on area of interest and problem statement. Out of the five hypothesis, three rejected null hypothesis and two supported the null hypothesis.

The results show that the first independent variable- Family Ownership is positively related to the performance of property firms. Additional analysis reveals that family members of property firms are accumulating shares. For the last ten years, the total shareholdings of family members in property firms increased from 36% to 45%. This trend is consistent irrespective to the magnitude of earning growth.

The second independent variable- Government Ownership also proven to be positively related to the performance of property firms. This result is contrary to the public conjecture that government involvement will normally reduce the profit as the political objectives and social objectives are always a prevailing factor. The government ownership is positively contributes to higher profit though in a minimal amount. This suggests that government ownership is an effective organization structure.

The third and the fourth independent variable are Board Size and Directors' Independency. The null hypothesis are supported. The board size and the independency of the board do not related to the performance of property firms. The market trend to increase the independent directors primarily attribute to external pressures such as Minority Shareholders Watch Group and Bursa Malaysia. Property firms shall not follow this move unless it is proven beneficial to the company.

The last independent variable, the Risk-taking behavior adversely affect the performance of property firms. This result suggests property firms shall not incur high borrowing. Without proper risk management, it may causes the company falls into insolvency or winding up.

# **CHAPTER 1**

## **INTRODUCTION**

### **1.1 The Global Financial Crisis of 2008 and Corporate Governance**

The global financial meltdown in 2008 had sparked some important debates on financial regulation and corporate governance. Many have argued that the failure of these two factors is the main causes of the financial crisis.

The story of financial crisis 2008 started from a low interest rates environment in America. Low interest rates during the period of 2003 to 2007 and seemingly ever rising housing prices had encouraged massive investment in housing. During that time, a rapid growth was recorded on various property derivatives and mortgage-backed products. As the decade progressed, simple asset-backed securities (ABSs) evolved into the housing market, banks and financial institutions became willing to lend more money to mortgage borrowers with low credit score- subprime borrowers. In 2007, however, mortgage defaults increased significantly. Interest rate were rising, this made those adjustable rate mortgages of many subprime borrowers which had been taken out at low rates during the 2003-2004 period began to adjust upward in term of instalment payment. At the same time, housing price appreciation decelerated and even began to reverse. As a result, many borrowers found themselves unable to settle their new, higher monthly payments and became saddled with homes that in many cases were now worthless than what the borrower owed on the mortgage. All the complicated property derivatives and mortgage-backed securities were adversely affected due to the drastic deterioration in mortgage performance.

The subprime mortgage finally burst in March 2008. The trauma in the housing and credit markets lead to the nationalization of Fannie Mae and Freddie Mac (home loan providers) in September 2008. Shortly thereafter, the outgoing Bush administration allowed Lehman Brothers to fail. In the face of the economic meltdown, no bank willing or able to lend, credit dried up, and economic activity sputtered. The stock market again suffered massive losses. The economy deteriorated promptly and eventually fell into the deepest recession in decades (Bainbridge, 2012).

Many legislators and key economists posited that corporate governance failures was the key factor of the financial crisis of 2008, therefore significant change had been taken in the corporate governance legal regime for the last decade. To summarise, it was the burst in property bubble and unregulated financial institutions (in term of corporate governance) that caused the crisis. It is due to this reason, it attracted my interest to look into the corporate governance and property market in Malaysia.

## **1.2 BACKGROUND OF THE STUDY**

### **1.2.1 Corporate Governance in Malaysia**

While corporate governance in Malaysia is well formulated by the regulators via various legal framework such as Company Act, Malaysian Code of Corporate Governance (MCCG), Bursa Listing Requirements, there are still obvious shortcomings in corporate governance that need to be enhanced. If all these practices and requirements are adopted, then why the incidents of fraud, defalcation, mismanagement as well as scandals still happen? The board of directors, advisors and CEO of all these companies would need to understand the nature of the business, risks, finance and most importantly, the governance structure to ensure the companies are run professionally.

1MDB as the master developer for the RM 40 billion Tun Razak Exchange (TRX) development, had attracted many banks and developers to invest in TRX. Among the developers (property firms) involved include IJM Corporation Bhd, WCT Berhad,

Mulia Group from Indonesia and Lendlease from Australia. These companies had invested heavily and paid to 1MDB. However, 1MDB was unable to service its debt. To date the government had spent RM 7 billion to bail out 1MDB, however the full extent of 1MDB's debt and liability is yet to be ascertained (Star, 23 May 2018). Ever since the revelation of 1MDB scandal, questions arise in regard to these property firms are:

1. The composition of the board of directors (of 1MDB) consist of competence person?
2. What is the ratio of independent directors in the board (of 1MDB)? Are they really independent?
3. What will happen to these property firms if 1MDB is winded up?
4. Did they (the property firms) understand all the risks before making the decision to invest in 1MDB?
5. Are these firms taking excessive risk (in term of liabilities against equity)?
6. Is that better or safer to invest in the property firm owned by government (e.g. 1MDB)?

### **1.2.2 Definition of Corporate Governance**

The main purpose of efficient corporate governance is the protection of shareholders' right.

(Grais & Pellegrini, 2006)

Corporate governance defines as the method a corporation is directed and controlled to maximize shareholders value.

(Cadbury, 1992)



Corporate governance refers to the process and structure that a company apply to administer and manage the business and affairs towards above market returns and improvement in firms' accountability. The main goal is creating long-term shareholder value while having concern of the interest of other stakeholders.

(The Malaysian Code of Corporate Governance, 2017)

Corporate governance (Bainbridge, 2012), comprises of the legal rules, institutional structures, and best practices that determine which body within the corporation is empowered to make particular decisions. The decisions include what are the criteria to become the member of the board, what is the processes of nomination, how many board members, etc. Some are traditional norm evolved over time, some are best practices acceptable by general public. Normally these social rules and norms are enforced by security commissioners and authorities, however sometimes it is sanctions through market forces. Some other sources could be rules derive from the written law, acts, statues and judicial opinions, enforced by regulators.

In sum, corporate governance specify such matters as the procedures and protocol for making decisions on company affairs, how duties and power are share and disseminated among different stakeholders, and how to monitor the performance of various stakeholders toward maximization of shareholders' value.

### **1.2.3 Why Property Firms?**

Corporate governance practices differ across industries and companies, where a one size fit all approach is not practical. Many researchers (e.g. Haniffa & Cooke, 2002; Haniffa & Hudaib, 2006) had studied the influences of corporate governance to Malaysian listed companies in general, but no research has been carried out to examine the impact of corporate governance practices to property firms' performance.

The characteristics of property business is unique and highly risky if compared to other industries. It required huge capital investment and requires longer time for profit realisation. The processes start from purchasing land, conversion of land use, getting planning permission, building plan approval and subsequently launch to the market, construction, sub-division and finally the issuance of Certificate of Completion and Compliance. The developments are subject to many risks and threats during these processes. A simple high-rise building development would take at least 5 years to complete if nothing goes wrong; a township would take 20 to 30 years to completion.

It is due to this reason most developers command for a high premium in selling price; it is due to this reason many could not afford to own a house. It may not be true saying that all Malaysian spending their whole life serving housing loan, but it is an undeniable truth that majority of them are. Knowing that property is an important sector in Malaysia, yet, the research about the performance of property firms in relation to various corporate governance attributes is rare.

### **1.3 PROBLEM STATEMENT**

2018 has been a fascinating year for Malaysian as it is the first time Malaysian embrace a new government after 60 years of ruling by the same party since independence. It is due to this change various scandals had been disclosed. Companies like FGV Holding Bhd, Lembaga Tabung Haji, Mara and 1Malaysia Development Berhad (1MDB) had been charged related to money laundry and corruption.

These companies are incorporated under the Companies Act 2016. The way they are governed brings to question whether the spirit of good corporate governance, which covers the dimensions of board composition, directors' independency, risk management, among others, is practiced or otherwise.

While corporate governance in Malaysia is well formulated by the regulators via various legal framework such as Company Act, Malaysian Code of Corporate Governance (MCCG), Bursa Listing Requirements, there are still obvious shortcomings in corporate governance that need to be enhanced. If all these practices and requirements are adopted, then why the incident of fraud, defalcation, mismanagement as well as scandals still happen? The "gap" to be filled is that whether these CG scandals are due to lack of board independence, risk-taking behaviour, concentration of government ownership etc., or it's just merely due to kleptocracy government led by certain political leaders?

The board of directors, advisors and CEO of all these companies would need to understand the nature of the business, risks, finance and most importantly, the governance structure to ensure the companies are run professionally.

1MDB as the master developer for the RM 40 billion Tun Razak Exchange (TRX) development, had attracted many banks and developers to invest in TRX. Many property firms have invested heavily and paid to 1MDB. Ever since the revelation of 1MDB scandal, questions arise in regard to these property firms. Why are these companies willing to invest in an insolvent corporation? So far no research has been

carried out to analyse property firms in Malaysia in regard to corporate governance practices. This is the “gap” to be filled in this research.

As Malaysian, we wonder why the scandal still happened despite having all well-established legal frameworks. However, the problems could be manifested through various dimensions. These include code of corporate governance, board independence, size, committees’ skill, experience and board diversity (Dewji & Miller, 2013; Narwal & Jindal, 2015). Whereas these components have been viewed as important in determining firm’s level of adoption of corporate governance, mixed empirical support has been recorded. The results are mixed depending on the sample period and geographical locations. Besides, divergent findings have been recorded on how each of these dimensions contributes to firm performance (Adams & Mehran, 2011). It is against this backdrop that this study sought to address the missing links on how these variables interact. However, this study has chosen 5 independent variables against the property firms’ performance for analysis.

## **1.4 RESEARCH OBJECTIVES**

It is believed that the above mentioned scandals could be avoided if the spirit of good corporate governance is upheld. However, corporate governance could be manifested through various dimensions. This research seek to establish the influence of corporate governance on property firms’ performance. It is the property firms only to be examined. The characteristics of property business is unique and highly risky if compared to other industries. It required huge capital investment and requires longer time for profit realisation. The processes start from purchasing land, conversion of land use, getting planning permission, building plan approval and subsequently launch to the market, construction, sub-division and finally the issuance of Certificate of Completion and Compliance. The developments are subject to many risks and threats during these processes. A simple high-rise building development would take at least 5 years to complete if nothing goes wrong; a township would take 20 to 30 years to completion.

The corporate governance dimensions that were considered in the study include the relation between board size, directors' independency, family ownership, government ownership, and risk-taking behavior in relation to Performance (Dependent Variable). These dimensions will be interrogated to establish the independent influence to the performance of property firms in Malaysia.

1. The finding of this study will redound to the benefit of investors that corporate governance plays a vital role in performance of companies. Thus, enable the investors to locate the better firms through their (the firm) corporate governance practices. Indeed, making a better decision in both choosing property firms to invest or invest directly on the properties that developed by the respective property firm.
2. Property firms that apply corporate governance practices will be able to reap better profit. They may identify which specific or particular corporate governance factors that best suit their firms for implementation. It could be a long run strategy to build buyers confidence through sound corporate governance and subsequently achieve good branding for the company.
3. To contribute to the body of literature, fills the knowledge gap about board size, directors' independency and risk-taking behaviour effect on property firms' performance in Malaysia.
4. To contribute to the body of literature, fills the knowledge gap about family ownership & government ownership effect on property firms' performance.

## **1.5 RESEARCH QUESTION**

The following research questions are targeting on property firms listed in Bursa Malaysia.

- I. Are founding family ownership concentration positively related to performance? Founding family ownership defined as the total percentage of

shareholdings owned by the major shareholder and persons connected to him, in accordance to Section 197 of Companies Act 2016.

- II. Is government ownership concentration positively related to performance? Government ownership defined as the total percentage of shareholdings directly owned by Government Link Investment Companies (GLICs).
- III. Is board size positively related to performance? Board size refers to total number of director, both independent and non- independent, in the board.
- IV. Are directors' independency positively related to performance? Directors' independency refers to the proportion of independent directors in the board.
- V. Is financial risk-taking negatively related to performance? The risk indicator is measure in total liabilities over total equity.

## **1.6 SIGNIFICANCE OF STUDY**

There were many research related to corporate governance have been conducted in Malaysia, however none of the study explains on the influence of corporate governance to property firms specifically. The finding of this study will redound to the benefit of investors that corporate governance plays a vital role in performance of companies. Thus, enable the investors to locate the better firms through their (the firm) corporate governance practices. Indeed, making a better decision in both choosing property firms to invest or invest directly on the properties that developed by the respective property firm.

The result of this research can help property firms to reap better benefit through applying suitable corporate governance practices. They may identify which specific or particular corporate governance factors that best suit their firms for implementation. It could be a long run strategy to build buyers confidence through sound corporate governance and subsequently achieve good branding for the company.

This research also contribute to the body of literature, fills the knowledge gap about board size, directors' independency and risk-taking behaviour effect on property firms' performance in Malaysia. And, it also fills the knowledge gap about family ownership & government ownership effect on property firms' performance.

The Minister of Finance took over Terengganu Investment Authority (TIA) and renamed it as 1 Malaysia Development Berhad (1MDB) in 2009 (Wright & Hope, 2018). This acquisition happened in 4 months after Najib Razak became the Prime Minister of Malaysia. The main objective of 1MDB was to drive economic development for the country. The strategic initiative is to promote foreign investment by forging global partnerships. Among the high profile developments proposed include Tun Razak Exchange and Bandar Malaysia. Since then, the company had been accused for various suspicious money transactions. The accusations includes defalcation, money laundering, fraud and even theft. Person involved include the then-Prime Minister Najib Razak, CEO Arul Kanda and special advisor Jho Low. 1MDB is an on-going scandal causing a crisis of confidence in Malaysia. Hence, the answer to whether there is a relation between government ownership and performance in property firms will reveals some important message to investors. The result of this research has justified that the 1MDB scandal is an isolated case, as the evidence shows that government ownership in property firm has a positive impact to the profit.

Property firms need to decide on sources of finance to build such a capital structure that maximises the firm's value. Different sources of finance subject to different risks. Some company's policy may allow high leverage in pursuing better profit, but some do not. From the result of this study, it is suggested that property firms should not raise debt to fund its operation. Increase in debt will result reduction in profit. Hence, property firms should select other methods such as retain profit, public or private placement, or issuance of convertible bond et cetera as sources of finance (Brealy, Myers & Allen, 2011).

If a firm does not borrow money, the chief executive officer (CEO) makes all investment and operating decisions. He has complete cash-flow rights and also control rights. These rights are split up when the company borrows money. If it takes out a bank loan, it enters into a contract with bank promising to pay interest and principal. When the firm falls into financial distress, stockholders may be reluctant to put in more money. High debt incurs high financial risk will reduce firms' appetites for business risk. These firms are more likely to drop out of the business during hard time. This is the reason why highly profitable growth companies, such as Microsoft or Google use mostly equity finance (Brealy, Myers & Allen, 2016).



## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.1 CORPORATE GOVERNANCE IN MALAYSIA**

Malaysia strives to achieve developed country status by 2020. Though many incidents had happened to make this vision seems difficult to be achieved by the given timeline, the government still eager to attract genuine investments to spur economic growth. After the financial crisis hit Malaysia in 1997, the Malaysian Institute of Corporate Governance were established one year later. The government realized that the public and various corporate sectors must be educated on the importance of corporate governance. In order to create awareness amongst the corporate sector, investors and public, the Malaysian Code on Corporate Governance (MCCG) was released on March 2000. The Malaysian Code focuses on four aspects of governance; namely:

Part 1- Board of directors, remuneration committees, shareholders, accountability and audit. Briefly, Part 1 listed down general principles of good governance. Depend on the nature of individual firms, it is expected that the corporate governance practices can be adjusted or diversified to suit the differences.

Part 2- identifies a set of recommendations and suggestions which could help companies in preparing their own approach to corporate governance. Part 2 lies down some non-compulsory rules. Firms own the liberty to comply or deviate from the recommendations. Firms shall state the extent of their changes if there is deviation.

Part 3- is targeted at investors and auditors with the intention of strengthening their roles in corporate governance. However, it is non-mandatory.

Part 4- provide elaboration notes to the above.

In the effort to keep up with the current changes and best practices, the Malaysian Code on Corporate Governance (MCCG) was revised subsequently in year 2007, 2012 and 2017.

The latest edition, MCCG 2017 applies new approach which aims to promote greater internalization of corporate governance culture. One of the key feature is it recognizes that firms are not a homogeneous group. Application of certain best practices may requires more flexibility and proportionality. The new approach identifies 3 processes as the main pillars of the best practices.

The first one is comprehend. Companies shall understand and internalize the spirit and intention behind the principles and practices including its desired outcomes. The second one is apply. Company shall implement the practices in substance to achieve the desired outcomes of building a strong corporate governance culture. The third one is report. It emphasizes on company disclosure of fair and meaningful information to stakeholders of the company.

## **2.2 THEORIES**

In order to study corporate governance, various theories had been developed by scholars. This research was guided by the postulations of a few major theories, namely, the Agency Theory, Steward Theory and Resource Dependence Theory.

### **2.2.1 Agency Theory and The Link between Directors' Independency and Performance**

The development of agency theory is originated from the concept of limited liabilities and separation of ownership in the financial market. Before there is a financial market, they were few wealth individuals owned and ran a company. During that time, there was no public ownership. There were only the privileged few that is rich enough to own a company. However, no matter how wealthy one is, there is a limit on the fund that he could raise. Thus, it limit the growth prospects of the company as they do not have sufficient fund to pursue expansion. In order to raise funds, the companies need money from the public, which constitutes a huge amount when it is pooled. Thus, stock market is created. Today, companies could be publicly listed in order to acquire external finance. In order to entice public to buy shares in the company, a concept known as the limited liability has been created.

The rationale for limited liability is to limit the loss to the amount invested while having the opportunities to enjoy lucrative returns through capital gain and dividend. Theoretically, by subscribing shares in a company, one becomes its shareholder or owner. However, many of these shareholders hold such a small proportion of ownership and thus will not be responsible in the daily operation of a company. They will, instead, appoint a board of directors, who is then responsible for managing the company. This separation of ownership and management indicates a delegation of the company's operation to the directors.

Agency theory first aroused when Ross (1973) explored it before Jensen and Meckling (1976) provided a detailed theoretical framework. In their definition, the shareholders are the principals of the company, and the managers and directors that the shareholders appoint are their agents, which the principals have delegated the daily operation of the firm. The theory posits that organizations exist to maximize shareholders' wealth (Eisenhardt, 1989; Shapiro, 2005). It was presumed that agents are self-interested and acts their own benefits and conflict to the interest of the shareholders (Adams, 2002). Thus, without governance control, agents (managers)

are more likely to deviate from the interest of shareholders causing agency conflicts. Agency theory contends that the main concern encourage to act in the principal's interests (Eisenhardt, 1989). This could be achieved when governance mechanism mitigating the conflicts are put in place. Thus, corporate governance is view as a key in bringing these two stakeholders interests into congruence, which leads to high performance. Despite the prominence of agency theory, it is criticized for the narrow view that managers are necessarily opportunists and act in conflict to the shareholders' interest.

Agency theory is simple and straight forward. In general, company are segregated into two main participants- the shareholders and managers. Their respective objective are consistent and clear. The theory assumes the nature of humans as selfish and generally not willing to sacrifice own interests to help others. It is due to these simplified factors, it gain popularity among the scholars.

Economists had struggled with the agency problem for centuries. The problem arises due to separation of ownership and execution was solved when Jensen and Meckling (1976) furnished a reasonable and convincing explanation. A company could growth and expand despite the self-interested notion of agents. In most of the recent governance research, the governance mechanisms are conceptualized in such a way to avoid managerial self-interest from happening.

Shareholders in protecting their investment require certain governance mechanisms that ensure the agents will try hard to attain results that are in line with shareholders' interests (Shleifer & Vishny, 1997). There are two ways shareholders could ensure the interests of managers in line with their own. It is either through internal governance mechanisms or external governance mechanisms. Most of the time both will be put in place to obtain the optimum result (Walsh & Seward, 1990). Internal mechanisms could be established through many ways. It could be in the form of effectively structured board, compensation contracts that promote shareholder participation and orientation. Though some criticize it, the concentrated ownership holdings can lead to active monitoring of executives. In other hand, external

mechanism means the law and market rules and regulation that is typically activated when internal mechanisms for controlling managerial opportunism have failed.

In an agency framework, Fama and Jensen (1983) find that one of the main task of the board is to resolve agency problems between shareholders and managers. The board need to set a proper compensation package; unproductive and inefficient managers have to be replaced. The outside directors play an important role as agency view of the board is that independent directors will not collude with inside directors (non-independent directors) to subvert shareholders' interests. An anticipated answer or recommendation evolved as agency theory progress. It was suggested that an effective board shall consist of outside directors in majority. The board's independence is crucial and in fact is the main factor in deciding whether a board can take action in the best benefit of shareholders effectively. The central question of this analysis is the impact of directors' independency to the performance of the companies.

### **2.2.2 Resource Dependence Theory and The Link between Family Ownership, Government Ownership, Board Size, Directors' Independency and Performance**

Resource dependence theory describes about how the external resources could impact on the behavior and performance of the companies. It is vital for companies to leverage on external resources strategically and tactically for better performance. The theory was formalized by Pfeffer and Salancik in 1978. Resource dependence theory provides a theoretical foundation for directors' resource role. It addresses that the board members themselves are the key contributors of strength to the company and able to change the environment. (Dalton, Daily, Johnson, & Ellstrand, 1999; Pfeffer & Salancik, 1978). In this regard, providing access to necessary resources is the main role of outside directors.

In order to fulfill the needs of a company, the board members have to be selected base on their skill, knowledge, experience and even background to achieve the best

composition for the board (Pfeffer & Salancik, 1978). Boyd (1990) posits that the number of directors in the board is not important, but the type of directors that matter. In some circumstances, board interlocks (the number of other directorships each director holds) is more important than board size. The “Resource-rich” directors are beneficial to the companies.

Pfeffer and Salancik (1978) suggest that directors could benefit the organization in 4 ways.

- (a) Provide counsel and advice to the management.
- (b) Provide information regarding environmental contingencies to the firm through various channels,
- (c) Provide priority access to resources,
- (d) Legitimacy

Recent research by Kor and Misangyi (2008) find support for these benefits. Their work suggests that good counsel and important advice could be offered by the board to the managers. Lester, Hillman, Zardkoohi, and Cannella (2008) find that the appointments of political related personnel as board members could be predicted by the resource require by the company, by differentiating among their human and social capital. Hillman, Shropshire and Cannella (2007) find that by having female directors in the board could benefit specific firms with specific forms of environmental dependencies. Makri, and Gomez-Mejia (2008) observe that family firms also benefited from specific types of directors over others. Thus, researches have progressed toward identifying particular types of directors who match specific environmental needs facing by the firms.

This theory may explains some of the context in this study. It includes the impact of board size, board independency, founding family ownership and government ownership to the performance of the property firms in study. More specifically, does government ownership or founding family ownership bring more resources that

required by the property firms? Does a larger board size or more independent board positively contribute to the resources required by the property firms? All these corporate governance dimensions will be examined in details.

### **2.2.3 Stewardship Theory and The Link between Family Ownership and Performance**

Stewardship theory suggests that the managers have the initiative to make the company successful as if the company belongs to themselves. In contrast to agency theory, it claims that managers are essentially trustworthy person who will always act for the benefits of the company (Donaldson & Davis, 1994). Proponents of stewardship theory argues that the existence of inside directors is the key for good performance and earning. The inside directors have a better understanding of the business and extensive knowledge of company's technology. They always possess important information to make a right decision compare to outside directors (Donaldson & Davis, 1991). Underlying this rationale is the assertion that there will be no major agency costs as managers are naturally reliable (Donaldson, 1990). Stewardship theorists also contends that the shareholders' rights and power will not be affected or erode due to the existence of senior executives (Donaldson & Davis, 1994). They also describe the executives and possess common interest with shareholders (Davis, Schoorman & Donaldson, 1997). It doesn't means that the executives and managers are selfless and always willing to sacrifice their own interest for the sake of company; rather, one must understand that there are a lot of cases in which managers conclude that there is no conflict between serving shareholders' interests and their own interests (Lane, Cannella, & Lubatkin, 1998). Relying on the basis that managers and executives are dependable person, there will be no significant agency cost. Board with substantial proportion of inside directors are more effective and efficient.

Baysinger and Hoskisson (1990) posit that the reputation of senior executives are tagged with the financial performance of the company they serve. If the company

runs well, they earn the glory and pride. And the good reputation always follows with the rewards. These managers apt to devote their best endeavor to maximize the company growth and profit. They exert due care on day to day operations and they concern the strategy for long term growth. They will be recognized by others for their companies' performance. The perception on their capability and successful are impacted directly on the companies' performance. Managers and directors are effectively managing their own careers in being effective stewards of the company (Fama, 1980).

Stewardship theory is very much relevant to my study specifically to founding family ownership in property firms, e.g. IOI Properties Bhd, Paramount Corporation Bhd, YTL Corporation Bhd. The families is the major shareholders and the businesses were passed on to few generations. Family members are dominating senior management positions. Irrespective the key executives are insider or outsider, the businesses are always executed in such a way that in line with the family value. The connection between the stewardship theory and family ownership will be discussed in the subsequent section.

## **2.3 FAMILY OWNERSHIP CONCENTRATION**

In general, public companies in United State of America (USA) prefer the separation of ownership and control. This allows the managers to make vital decision with minimum interference from dispersed shareholders (Demsetz & Lehn, 1985). In contrast, Shleifer and Vishny (1986) in their research over the Fortune 500 firms, they find that there is approximately 33% of board seats and equity are held by founding family. They are long-term investors but holding poorly diversified portfolios. They had been seen as a unique class of principal as they continue to hold (some has passed on for few generations) substantial equity stakes and often control key management positions.



### **2.3.1 The Potential Costs of Family Ownership**

Family ownership control in companies is generally perceived as an inefficient ownership structure. If compare to dispersed ownership, it is less profitable. Overall, prior literature and general views (e.g. (Schack, 2001)) suggest that company with continuous family ownership leads to poor firm performance. Shleifer and Vishny (1997) note that combining control and ownership lead to shareholders concentration. As a consequence, company interests is exchanged for private gain. Having substantial proxy in cash flow rights due to ownership, founding families have the power and opportunity to take actions that benefit themselves at the expense of the companies. For instance, Fama and Jensen (1985) demonstrate with examples showing how large family shareholders oppress minority shareholders with different investment decisions and rules.

Demsetz (1983) posits that such owners may conduct phoenix activities or select non-pecuniary consumption by drawings valuable resources away from money-making projects. Fama and Jensen (1983) posit that the lucrative remuneration are associates with substantial control rights and voting proxy. Evidence shows that controlling shareholders seek to enrich themselves from the company. Maximum profits may be forgo when the owners prioritize their own benefits over those of minority owners. This phenomena is particularly obvious in companies owned by founding families as their shareholding are large and undiversified. Families often limit the key and top management positions to family members to prevent the cash flow rights and control rights fall into others' hand. This action leads to a competitive disadvantages as the companies have confined themselves to smaller pool of talents and capable personnel.

Barclay and Holderness (1989) see the disadvantage of rigid and unchanged management from other perspective. They posit that managerial entrenchment reduce the visibility of the company to the potential investors. Big investors unlikely to put their money in a company if they cannot control or influence in making decision. The value of the company drops when there are less bidders in the market. The same opinion was found in Gomez, Nunez and Gutierrez (2001) report about the corporate

structure in Spain. They reckon that family ownership can pose a big problem if they are no longer qualified or competent, but remain active in the management. The older family firms perform worse than non-family firms as a result of managerial entrenchment (Shleifer & Vishny, 1997).

Internal trading, self-dealing transactions, special dividends, or lavish compensation are among the few strategies engaged by families in expropriating wealth from the company. For example, family firms may diversify into new business in order to create more positions for their members. The managers in family controlled firms are having different interest from non-controlling shareholders. The non-controlling shareholders have less power and not involve in management because of lower ownership. Various board's plans have been used to oppress the minority shareholders while benefits the family (Schack, 2001). The tendency of wealth expropriation increased when the board and management positions is dominated by family (DeAngelo & DeAngelo, 2000). Conspiracy such as related-party transactions among the family members is difficult to be discovered, the innocent minority shareholders will be left to bear the consequential loss in most cases. In long run, under biased operation and management strategies, the firm's capital expansion plans will be affected, leading to reduction in operating profit and stock price performance.

In a behavioral study, Burkart, Gromb and Panunzi (1997) posit that employee morale and productivity will be affected adversely if families acting to pursue family-centered objectives instead of the company. In addition, families have the tendency to redistribute benefits from employees to themselves (Shleifer & Summers, 1988). In general, DeAngelo and DeAngelo (2000) find that prior literature and anecdotal views indicate that founding families and large shareholders always ensure that management serves family interests prior to company interests. Expropriation problem could be severe when families are wealthy and they plainly concentrate in sustaining control rather than wealth. Though various law and regulations are in place to prevent exploitation of public wealth (public traded companies), it is difficult to prevent unfair and biased evaluation in selecting members for the top management.

### **2.3.2 The Potential Benefits of Family Ownership**

Despite prior literature suggests that family ownership and control can lead to poor firm performance, Demsetz and Lehn (1985) find that family influence can also provide competitive advantages. In general, companies with many small and distributed shareholders suffer the free rider problem. In family business, concentrated shareholders have stronger economic motivations to reduce agency problem and free rider problem. The increase in family ownership means reduction in dispersed shareholders and non-perform shareholders. When companies' welfare and profit have a direct impact on family wealth and reputation, family members likely to monitor the managers closely or even dominate the management with their own members. Every successes, challenges, rises and falls in the course of business serve as a valuable lessons for the family (Burkart et al, 1997). These experience or knowledge will be passed on generation after generation as a legacy. Through these extensive knowledge of the company's technology and operations, it enable the family to provide superior oversight of the company operations. Compare to other shareholders (who buy and sell shares for profit), family shareholders provide a competitive advantage to the company.

Some family-owned businesses could serve as the living example of successful examples. The Novartis (one of the world largest drug-maker) owned by Sandoz's family since 1886 had recorded a market capitalization of USD 279 Billion to date. The Sandoz Family Foundation is the company single largest shareholder. And, the Malaysian company such as YTL Corporation Berhad has held a substantial equity stake (more than 40 percent) for over 60 years in the firm bearing the founder's name (Yeoh Tiong Lay). Founding families with a long term presence in their firms had shown resilient in down time and success in long run. Compare to outside shareholders with shorter managerial period, the prolonged participation and involvement of families suggesting a willingness for long term investment. Stein (1988) finds that those companies which make good investments are those having

shareholders willing to invest in long-term projects. These companies suffer less managerial problem. James (1999) posits that as the families always have a will to pass the business onto succeeding generations, they tend to be more prudent in making investment decision. This, in contrast to outside directors who prone to boost current earnings rather than good investments. This finding is derived from a two-period model on how family ownership provides motivation to invest according to the market rule (positive Net Present Value projects). In line with James (1999) argument, Chami (1999) and Casson (1999) posit that founding families view their companies as an asset and as a pride to pass onto their heirs rather than money to spend during their life time. The major concern of families are business sustainability and growth, thus, suggesting potentially long term value maximisation.

The main concern of the founding families are the reputation they hold from sustaining the family business and their continuous presence in the company and its effect on others. In line with the owner dependency theory, the long term nature of founding family ownership provide some advantages to the companies. Family's reputation helps businesses as most people like to deal with companies with good track records. These people include external parties such as business partners, suppliers or bankers. Families maintaining a long-term presence will enjoy a lower cost of debt financing compared to non-family firms Anderson, Mansi and Reeb (2003). The belief that trust takes time is true in both the business and society context. Some business decisions are made based on trust. As trust goes up, the cost go down. Substantial money could be saved dealing with trustworthy person as it reduce time, legal and accounting costs. One example could be drawn is the auto industry. It is well known that US car makers have a combative relationships with its suppliers and employees. By contrast, the Japanese auto industry has seen its suppliers as an integral part of a bigger system which leads to lower costs per car. This subsequently contribute more to the competitiveness of Japanese firms than US firms. In summary, either through direct involvement or indirect influence, concentrated family ownership enjoy enormous advantages to maximize company's profit. In view of the various competitive advantages enjoyed by the founding family, I expect to observe better firm performance in family firms versus non-family firms.

H1: There is a positive association between family ownership concentration and firms' performance.

## **2.4 GOVERNMENT OWNERSHIP CONCENTRATION**

Many people believe that businesses owned by government are either less efficient or less profitable than private firms. Boycko, Shleifer and Vishny (1996) posit that politicians are the main cause of consuming excess resources for their own gain. Government-owned firms prone to employ politically related people rather than those best qualified to perform desired tasks (Krueger, 1990). Such action could be originated from internal pressure or due to external forces. This is particularly true and obvious in Malaysia context as it could be seen that most Government-Linked Companies (GLC) are chaired by political-linked personnel. It is not uncommon that the incumbent personnel do not have the relevant knowledges that fit for the businesses in question.

More generally, profit maximization may not be the ultimate mission of government-owned firms. They have political objectives and social responsibility, such as wealth redistribution. (Shleifer & Vishny, 1997) and (Shepherd, 1989) sharing the same opinion that political goals such as employment and socioeconomic development are given the main priority in government-owned firms. Whereas profit is secondary in their mission. Unlike private companies, residual cash flow of these firm cannot be transferred easily. Therefore, it reduce their motivation to monitor managers, and leads poorer performance. As such, it is notorious that the Government Linked Companies (GLC) are seen to be less effective and therefore, less profitable than private companies.

Government ownership internalizes the operation and relationship between company and government. Regardless whether it makes overall sense or not, but it functions as an institutional substitute to regulation. In fact, the rationale behind the nonprofit-maximizing behavior is to correct market failures by acting differently than private companies (Arrow, 1969). For examples, the establishment of Tenaga Nasional

Berhad (TNB) and Telekom Malaysia (TM) is to equip the country with necessary infrastructures and facility. No single private company or bank can afford investment of this scale without government backing. With the existence of these companies under government ownership, the nation are able to enjoy the facilities with reasonable cost. Therefore, it is expected that government-owned companies perform poorer in monetary term (Shepherd, 1989). However, in term of credit, liquidity, or costs of capital, the government-owned companies are enjoying the advantage as there are wealthy.

The view that private firms are basically more efficient than government firms, remains controversial among scholars and economists. Vickers and Yarrow (1991) posit that agency problems occur in both the government firms and private firms. Managers own little of the share in most of the large private companies. Although the objectives of government and those of private shareholders may be different, the cost of monitoring managers is inevitable. The discussion on whether government firms or private firms are more efficient is primarily an empirical issue. To date the body of empirical evidence is mixed.

#### **2.4.1 MINISTRY OF FINANCE AND OTHER GOVERNMENT INVESTMENT ARMS**

Stem from the Minister of Finance (Incorporation) Act 1957, the Minister of Finance (MOF) was established as a corporate body. The authority of the MOF include enter into contracts, possessions, purchases, acquisitions, holdings and maintains tangible and intangible assets. It means that MOF is allowed to invest through various mechanism and strategies. In line with the findings of many scholar as mentioned above, profit is not the main objective of MOF investment, but to achieve better social responsibilities and help to spur the economic in the country. The purpose of investments of MOF companies are listed below:

1. To close the market gap- As some investments have high entrance barriers and require huge initial investment costs, the private sector has less incentive and priority to invest (eg: Tenaga Nasional Berhad).
2. To provide social services to the public such as public transportation and utilities services (eg: Prasarana Berhad). Government shall invest in facilities not traditionally provided by private sector. Such projects often require synergy arrangement with private sectors. For example, new forms of cooperative arrangements such as Public Private Partnership (PPP) is deployed in Mass Rapid Transit (MRT) Project.
3. To invest in strategic sectors such as technological research and development in order to stimulate economic growth. For example, Petroliam Nasional Berhad core business is gas processing and utilities and regastification which is an important technology to process the natural resource (carbon-based fuel) into valuable commodity.
4. To attract local and foreign investors to invest in specific areas such as biotechnology, information technology and communication (eg: Telekom Malaysia Berhad).

In Malaysia, there are 7 entities referred to as Government Link Investment Companies (GLICs) [including MOF (Inc.)] and they are:

1. Minister of Finance (Incorporated) [MOF (Inc.)]
2. Khazanah Nasional Berhad (Khazanah)
3. Employees Provident Fund (EPF)
4. Lembaga Tabung Haji (LTH)
5. Armed Forces Fund Board
6. Retirement Fund (Incorporated)

## 7. Permodalan Nasional Berhad (PNB)

Further, Government Link Companies (GLC) are companies that have been assigned with a commercial objective and are under the control of a GLIC. A GLIC has control over a GLC when it is the majority shareholder or single largest shareholder and when it has the authority to exercise and influence major decisions. There have been many critics that GLC practice cronyism when comes to appointment of board members and senior positions and so on.

For the purpose of this research the government ownership defined as the accumulative percentage of all the shares owned by the GLIC.

(Website of Ministry of Finance Malaysia)

H2: There is a negative association between government ownership concentration and firms' performance.



## **2.5 BOARD SIZE**

What is the optimum board size? Before we answer this question we must as well ask “why are there board of directors?” The national scandals such as 1MDB and Tabung Haji, and international scandals such as Enron and Volkswagen emission scandal, has proven that the existence of board of directors do not eliminate fraud and defalcation. In most cases, boards exist are merely a product of regulation. Among others, Company Act and Stock Exchange regulators impose various requirements on the formation of board of directors. It is worth to address that neither the Malaysian Code of Corporate Governance nor the Kuala Lumpur Stock Exchange (KLSE) Listing Requirement impose any rule on the minimum and maximum number of directors to form a board. Nevertheless, the Company Act 2017 stated that there must be at least one director in the company and a minimum of 2 directors in public company. Various coordination and communication problems may occur when the board size is too big. However, when the board size is too small it may not possess sufficient skills and capacity in respective industries. A board is considered achieving the right size as long as they are able to accomplish their duties efficiently and effectively. In Malaysia, the KLSE listing requirement in 2017, Chapter 15 allows multiple directorship however restrict on the upper limit. A director could hold up to a limit of 5 directorships in public listed companies. It aims to make sure that directors are able to perform their duties effectively and to ensure that the company is properly managed at all time.

The literature discusses a few important issues of the board size effect. First, the communication, coordination and decision making become more bureaucratic and lengthy with the increase in board size. Jensen (1993) and Yermack (1996) posit that board size increases entail communication and coordination problem. The resultant inefficient control of management will cause agency problem because the management and control are segregated. Given it a thought, if the board size effect is the main cause for impaired communication and coordination, firms should be able to make the necessary adjustment or changes in order to preserve value. However this does not happen in reality. Jensen explains that the integrity of the board members are

compromised in bigger boards. The discussion on performance and control of senior management tend to be less honest in larger group. Yermack (1996, p. 210) suggests that “CEO performance incentives provided by the board through compensation and the threat of dismissal operate less strongly as board size increases”. To summarise all, the board’s ability to resist CEO control interact negatively with board size.

Other literature (Yermack, 1996) on Fortune 500 industrial firms has confirmed of a negative correlation between firm value and the size of a firm’s board of directors. However, Gilson & Roe (1993) argue that this finding should not be treated as an axiom to corporate governance. Other nature of the firms, such as board’s role is varies firm by firm and country by country. Yet, many companies are operating in different legal or cultural environment. Yermack’s results shall not apply to small companies as firms as Fortune 500 consist of largest firms in United States. In facts, for board size below six person, Yermack finds no consistent evidence to correlate between board size and firm. He further recognized that his samples are dominated by firms with large boards, is inappropriate for testing hypotheses about smaller board.

Further to Yermack’s study, Eisenberg, Sundgren and Wells (1998) carried out a research on smaller firms- total assets not more than two million Finnish Marks. They reported that companies with small boards achieve greater profit on investment if compare to companies in their own peers. To small firms with small boards in Finland, the result shows that board size is negatively relate to profit.

While Eisenberg et al (1998) and Yermack (1996) find an inverse correlation between board size and profit. Bhagat and Black (2002) find that there are some hints implying a negative relation between the two, however no concrete proof on the relationship between board size and performance could be justified from their study. This means that their result does not completely in line with Yermack’s findings. The explanation given is that the difference in results could be due to the approach taken. They reckon that the number of directors is always taken to be endogenously related to other control variables that may have a relationship with performance. The approach taken might be different if compare to Yermack.

The above studies are based on large companies in US and small companies in Finland. Perhaps Guest (2009) study could provide a better picture on the influence of board size. Guest (2009) analyses the relation between number of directors and profitability for a large sample of 2746 UK firms over a long time period (1981–2002). It is approximate more than 25,000 firm-year observations. The purpose of using long and large panel data is to make sure that the results could avoid any kind of bias in particular time period under examination and it allowed various econometric methods to control for endogeneity. He finds significant evidence that the number of directors in the board is negatively correlates with the 3 other different firms' performance measures (profitability, Tobin's Q and share returns). The fundamental evidence is proven to be robust to various kind of regression models. The result also proven solid against various econometric models. The models control different types of endogeneity. He also check the relationship between various firm characteristics and board size. However, he confirms that no evidence was found to relate these characteristics to firm performance. By the way, he finds that the large firms with larger board size shown strongest negative relation between board size and performance. Overall, this result supports Yermack's opinion that problems of poor coordination and communication, together with lengthy decision-making reduce the effectiveness of large boards.

Another research that support the negative relation between board size and profitability was conducted by Bonn, Yokishawa and Phan in 2004. The research concentrated in Japanese and Australian firms to examine the influence of board structure on firms' profit. A negative correlation was found for Japanese firms when they measured the performance by return on assets. Whereas for the Australian firms, it shown no relationship between the two variables.

A contrary result were recorded by Mak and Li (2001). In the examination of 147 Singaporean firms based on data in 1995, they find that the performance is positively correlate to board size. The Ordinary Least Square (OLS) shows that both the company's size and board size have a positive impact on company's profitability. However, they did not obtain the same result in the two stage lease squares (2SLS)

regressions. Adam and Mehran (2005) carried out a study in the USA banking industry. They measure the performance by Tobin's Q and find that board size and profit are positively related. Nevertheless, there was a similar research conducted in USA by Yermack (1996) and Eisenberg et al (1998) obtained contradictory results. Adam and Mehran (2005) further explain that the correlation between board size and performance is industry specific, suggesting that different board size work well for different industry. The suitability of certain board size depending on type of industry and their organizational structures.

The increase of directors sit on the board does not increase its effectiveness. However, a minimum number of directors are required to ensure the board has adequate skill, knowledge and experience to supervise the management and business affairs. The directors shall at all time exert their powers for the best interest of the company. Boards with a large number of directors pose some weakness and it is expensive for the company to maintain. Important duties such as planning, coordinating, decision making and even the routine work such as attending compulsory Continuing Professional Development Courses (CPD) can be cumbersome with many board members.

In most cases, empirical findings on board size suggesting that there is a negative relationship with firms' performance. The cohesion among the board members reduce as the board size increases. Although Adam and Mehran (2005) having a contrary result, it was suggested that such performance influence may be "industry specific". Therefore, this research seek to close this gap on the impact of board size "specifically" to the performance of property firms in Malaysia. The theoretical perspective suggests that bigger boards produce various problems such as communication breakdown, lengthy decision making process, and free rider issue among non-active directors, the third hypothesis is as follows:

**H3: There is a negative association between board size and firms' performance.**

## **2.6 DIRECTORS' INDEPENDENCY**

“Board composition should support objective and independent deliberation, review and decision-making. A board comprising a majority of Independent Directors allows for more effective oversight of management. In considering independence, it is necessary to focus not only on whether a director’s background and current activities qualify him or her as independent but also whether the director can act independently of management.”

(Malaysia Code of Corporate Governance, 2017; Pg. 22)

The general market advocates companies to improve on directors’ independency for 2 main reason. The first is to overcome the agency problem. The second is to protect the minority shareholders. In facts, Bursa Malaysia Listing Requirement (BMLR) also impose a minimum of 2 person or minimum 1/3 of the board member shall be independent directors. In addition, the nominating committee shall comprises exclusively of non-executive directors, a majority of them must be independent. The same rule applies to audit committee and on top of it the chairman of the committee must be an independent director.

Same like to MCCG and BMLR, most of the security commissioners and investment watchdogs around the world having the similar regulations or requirements on listed companies. This pattern stem from the agency theory that the board’s ultimate task is to monitor management. Only the independent directors can effectively provide oversight of management and particularly the oversight of the CEO. Jensen and Meckling (1976) posit that board directors in a modern enterprises are responsible for monitoring management. Some regulatory changes had focus on independence. Outside directors are always in a better position to monitor managerial activities as their remuneration and career do not rely on acquaintance with managers. Whereas the inside directors may be pressurize into co-operate with the CEO .As such, independent board is expected to provide better consultancy and more independent views base on professional judgement and leads to better company performance and valuation.

Kaplan and Reishus (1990) posit that outside directors are perceived to be better person to monitor the managerial operations. This is consistent with Fama and Jensen (1983) finding that the outside directors will be better in monitoring of managerial decisions. The involvement of outside directors means fewer cronies. The board will be upgraded with the increase in real professional and experienced people. Mace (1986) points out that it is not the ability to monitor people should worship about, outside directors are valued for their ability to counsel, to advise, and to signal the company to do well. Although the reason given by Mace is different from Kaplan and Reishu (1990) and Fama and Jensen (1983), the results are consistent with each other. Perhaps Mace views could be better explained with Resource Dependence Theory.

Kaplan and Reishu (1990) finds that the proportion of outside directors (non-executive directors) is likely to react positively with companies' performance, as outside directors bear a reputation cost if projects fail. In general, outside directors hold a small stake or none in a company. In the sample of 780 public U.S. companies, the median outside director stock ownership is only 1%. The earning that they can derive from share is very limited, but the reputation cost is enormous if the company suffers financial problems. This asymmetry suggests that outside directors have a phobia on high risk projects with a high probability of bankruptcy, even when the projects is feasible and reflects good return. Vice versa, inside directors suffer lesser reputation cost since it is shared with more directors; the cost of poor decision making is spread among a larger group, thereby cushioning the effect on any individual decision maker. Bhagat and Black (2002) posit that risk avoidance is one of the major characteristic of outside directors.

However, some studies demonstrated otherwise, empirically. Hermalin and Weisbach (2003) in their research of U.S. firms show no relation between the proportions of outside directors and the performance. Monks and Minow (1995) describe independence as equivalent to indifference. The independent outside directors may come from various background with different expertise, however they are lack of in-depth understanding of company business, and also lack of understanding of respective corporate strategies (Klein, 1998).

Bhagat and Black (2002) conducted a long horizon and large-sample study of whether the degree of directors' independency (calculated by the fraction of independent directors deduct the fraction of inside directors on a company's board) correlates with various measures of the long term performance of large American firms. Inverse correlation was observed between board independency and long term firm performance. The study finds that the increase in board independence does not leads to improvement in firm performance. By contrast, they contend that greater board independence could harm company performance. Combined with similar results from Hermalin and Weisbach (2003) and Monk and Minow (1995), it does not support the traditional theory favouring the monitoring board, with a high degree of board independence.

Rosenstein and Wyatt (1990) on their examination of wealth effects on the appointment of outside director finds significantly positive share price reactions. However, it need to be highlighted that the finding purely justified the share-price reaction but not the profitability. Their finding did not by any mean point to the appointment of outside director are superior to inside director. The empirical results only shown that outside directors are chosen in the interest of shareholders.

International evidence on the relation of independent directors and performance is inconclusive (Denis & McConnell, 2003). Fama and Jensen (1985) contend that it is very difficult to find empirical proof of board independence and performance because the management oversight strength demonstrated by outside directors are always offset by the operational expertise of inside directors. Existing evidence regarding the insignificance of board independence may be explained in this manner.

According to IMF, failure in corporate governance is one of the major contributor to the Asian financial crisis in 1997 and 2008. Malaysian authorities and security commissioners had brought in the concept of a monitoring board and implemented it strictly. It was expected that these governance exercise (directors' independency) could serve as a tool and reform measures to improve investors' confidence although the empirical results in the US and elsewhere are inconclusive.

The American-style monitoring board structure was adopted by Malaysian authorities and security commissioners since 1998. Since then, a couple of amendment and a series of regulatory adjustment had been done to suit local environments. The Bursa Malaysia Listing Requirements (BMLR) required all firms listed on the Kuala Lumpur Stock Exchange (KLSE) to have at least two person or one third of the board composed of outside directors. The main objective is to induce companies to improve transparency. Higher transparency means that there are more experienced people and real professionals provide insights form different perspective to the boards. When the transparency improved in a company, it means that a check and balance mechanism is in place. Though it may not directly leads to better profit, it minimize the risk of pilferage and defalcation. It also ensure the rights of minority shareholders are protected. Thus my fourth hypothesis is as follows:

H4: Firm performance increases with directors' independency.



## **2.7 RISK-TAKING BEHAVIOR**

Taking risks is part and parcel of businesses. The Malaysian Code of Corporate Governance suggests that an appropriate risk management and policy on internal control shall be the responsible of the board. The board must ensures the system function effectively and forms as a part of corporate culture. It further explains that: “Proper risk management and internal control are important aspects of a company’s governance, management and operations. Risk management focuses on identifying threats and opportunities while internal control helps counter threats and takes advantage of opportunities. Proper risk management and internal control assist companies in making informed decisions about the level of risk that they want to take and implement the necessary controls to effectively pursue their objectives.”

(Malaysian Code of Corporate Governance, 2017; Page 39)

In business point of views, risks always come parallel with gain. Playing it right, the higher the risk you take, the greater the return you may gain. The management literature has reckoned the essential role of risk-taking on company performance (Porter, 1980). Enterprise risk plays an important role in sustaining competitive advantages that could lead to greater economic growth (Acemoglu & Zilibotti, 1997). Kim and Mauborgne (2005) suggest using “Blue Ocean Strategy” to explore uncontested market and making competition irrelevant. It is part of the corporate risk-taking behavior in order to acquire bigger and new market through value innovation. Other strategies may include product differentiation, technology innovation improving economies of scale, mergers and takeovers and etc. Every strategy pursued by the firms carry risk. Furthermore, some finance literature (Goyal & Santa-Clara, 2003; Fu, 2009) findings support the view that firm-specific risk, has a positive influence on company’s share price. The companies that fall into this category are those focus in long term growth strategies. These companies perform better with more efficient resource allocation and effective information generation.

US Federal Reserve Chairman Ben Bernanke (2008, as cited in (Bullard,Christopher, Neely & David, 2009, page 405)) in his comment about the subprime crisis has

pointed out that the main cause of the problem is due to many financial firms did not appreciate the risks they were taking and these firms engaged in various complex mortgage-related products. He also pointed out that the ultimate cause of the crisis is due to directors pursuing better value for shareholders. Before the crisis, the directors were pressurized under market force to adopt higher-risk strategies to pursue higher return. Those financial firms involved in risky trading when they had not built the capability to analyze the portfolio risk of these activities.

The OECD (2010) Corporate Governance Committee already completed several papers on risk management and Corporate Governance. Their key findings are listed below:

- In most of the cases, risk management has not receive well attention, or is insufficiently covered, by existing corporate governance standards or codes. The awareness on risk management shall be improved and the implementation shall be strengthen by security commissioners and corporate governance regulators.
- It encourage the disclosure of risk factors in an understandable fashion. The disclosure should identify various risk factors and rank them in order. The order is based on the importance according to qualitative selection. The board should make sure that the firm communicates the risk factors to the market in a transparent manner. The process of risk management and the results of risk assessments should be appropriately disclosed.
- The risk management and control functions shall be treated as an independent of profit centers and the “chief risk officer” or equivalent shall be taken as an individual function as if audit committee or equivalent. It should report directly to the board of directors along the lines already advocated in the OECD Principles.
- Review and guidance should be driven by the board to ensure corporate strategies are align with risk-appetite and the internal risk management structure.
- .Each business unit shall not be treated separately rather it should be considered as a bigger conglomerate in order to ensure risk management to be implemented

effectively. The board is encourage practice to involve the board in both establishing and overseeing the risk management structure.

- The regulators and other standard setters shall aware that the risks shall be managed and communicated to the correct stakeholders and ensure that it is fully understood. Besides, one must understand that risk is part and parcel of business that not to be eliminated.

- The failure of risk management is the main cause of the crisis. The firms have not adjusted the risk management policy to suit the corporate strategies. The firms did not manage the risks properly. Risk management has not been taken as an important part of implementing the firm's strategies. In most of the cases, the boards are unaware of the risk facing by the firm.

Property firms are dealing with various challenges and uncertainty. The key role of the board is to have effective oversight of the risk involved. The entire board must protect the profitable activities in the facing of inevitable routine risks and always be prepared for the worst. Some companies will establish risk committees to fulfill this roles; some companies will assign it to audit committees to have internal control to monitor the risks. The risk management task could either be carried out by the risk committee independently, or it could be combined with audit task and handle by the audit committee.

An investigation was conducted over a sample of 98 international banks and their performance during the financial crisis, Beltratti and Stulz (2012) find no evidence to connect the bank performance and incentives/ compensation provided to the CEOs. (the incentive is compute by the fraction of equity-based compensation is higher). By contrary, the findings show that banks providing higher incentives to CEOs performing worse in the crisis. Perhaps Lang and Jagtiani (2010) understanding could be drawn to explain the above findings. According to Lang and Jagtiani (2010), two type of approaches always been used to address agency problem. The first, (Jensen & Meckling, 1976) is to better align the principal objective with the agent's incentives through compensation. The second approach (Adams, 2002) is through effective

internal controls, monitoring, and oversight. The compensation approach, instead of mitigate the principal agent problem, often leads reckless high risk strategies expecting higher return in shorter time. CEOs tend to opt for the riskier plans that producing high short-run returns. It seems that the second approach turn out to be more crucial to ensure the companies do not embrace excessive risk that beyond their control. Though, they added, that many large financial firms failed on both counts.

Having considering the risk behavior of companies, Lang and Jagtiani (2010) suggest 3 principles on compensation. The first principle is that compensation should be in line with effective controls and risk management should not encourage excessive risk-taking beyond the companies' capability; companies should not incur any risk that cannot be fully identified or managed. Second, compensation should not induce excessive risk-taking beyond the companies' capability; companies should not incur any risk that cannot be fully identified or managed. Third, the board of directors shall ensure active and effective oversight are put in place, corporate governance is strengthen to support compensation plan. The board capability in putting proper risk controls in place is the key factor deciding whether compensation can successfully improve the profitability.

In short, failures in risk handling and risk governance may cause catastrophe damages. The financial crisis had caused collapse of firms. The damages affect wider community through loss of jobs, goods and services. These losses are felt particularly severely in third world countries and emerging markets where the jobs are scarce and the economies are vulnerable. Risk could cause damages, but remember risk is a double-edged sword. Risk, if well managed could bring exceptional benefits to the firms. Spira and Page (2003) suggest that through proper governance, risks can be objectively identified, quantified and thus strategically monitored. Board of directors shall review the risk management framework and processes and make sure that it is relevant for use. They must also monitor the effectiveness of risk treatment and risk mitigation plan for action.

As most economists considered risk is necessary for the companies' long term growth, my fifth hypothesis is as follows:

H5: There is a positive association between Risk-taking Behaviour, RISK and firms' performance.

## **CHAPTER 3**

### **METHODOLOGY**

#### **3.1 INTRODUCTION**

This chapter describes the methodology involved in selecting the samples, collecting data and analyzing the data. The method used to examine the objectives of this study is explained in 5 sections, namely: research design, sampling design, source of data, measurement of variable and research model.

#### **3.2 RESEARCH DESIGN**

This paper focuses on the correlation between corporate governance dimensions and the performance of listed property firms in Malaysia. In order to achieve this objective, quantitative method (correlational design) will be applied to examine 5 corporate governance dimensions and performance of the property firms with the intention to enhance precision in the description of parameters and discernment of the relationship among them.

According to Goertzen (2017, P.12) “quantitative research methods are concerned with collecting and analyzing data that is structured and can be represented numerically. One of the central goals is to build accurate and reliable measurements that allow for statistical analysis...Because quantitative research focuses on data that can be measured, it is very effective at answering the “what” or “how” of a given situation. Questions are direct, quantifiable, and often contain phrases such as what percentage? what proportion? to what extent? how many? how much?”.

The main purpose of choosing quantitative approach is because this study wish to employ mathematical models to various values and financial data to find significant support to multiple hypothesis. I seek to obtain fundamental connection between various variables with empirical observation and mathematical expression of quantitative relationships

### **3.3 SAMPLING DESIGN**

A panel data comprises of 30 firms cover the period from 2008 to 2017 will be used for my study. The non-probability sampling method is adopted. The top 30 companies based on market capital fall under the property category will be selected on the Main Market of the Bursa Malaysia. The Bursa Malaysia interprets property firms as companies invest in real estate through development, investment, ownership including real estate providers such as real estate brokers, agencies, leasing companies, management companies and advisory services. As at 31 December 2017, there are a total of 98 property firms listed in Bursa. As my study focus on the performance of these firm after financial crisis 2008, the data to be collected commence from 2008. And it ended in 2017 as this is the latest possible data I could obtain from open sources. As the study covers a period of 10 years, the key resource of information is the annual reports from respective firms. Their availability is a critical factor as to decide whether particular firm could be included. During this period, many firm are newly listed and de-listed. This research employs a panel data, only the top 30 property firms based on market capitalization as at 31 December 2017 are included in the sample. Remaining 68 firms were be filtered out. This means that firms listed after 2017 are excluded. Out of these 30 firms, some are listed less than 10 years. Altogether, the data sample consists of around 275 firm-year observations.

### **3.3.1 Sampling Size**

According to Sekaran and Bougie (2010), various factors need to be considered in deciding sample size for research. The first consideration is the research objective and time that poses a limitation on the population's size that could possibly be attained. The extent of precision desired and cost incurred are other considerations that have been taken into account. And the reasonable risk in making prediction of level of precision served as the last factor in consideration.

In deciding the sampling size, the study follows Saunders, Lewis and Thornhill (2009) recommendations. Non-probability method is chosen due to two main reasons. First, not the entire population is used as it is impractical due to time constraints. Besides, the firms with higher market capitalization are chosen as these firms shall score higher in corporate governance compliance as compared to small firms. As the research focuses on the corporate governance variables to companies' performance, the data extracted from the larger companies shall be more relevant if compared with small companies. Yet, the lower limit of the sampling units is decided based on Pallant (2011) recommendation in deciding the suitable sample size for multiple linear regression analysis. Combining these few important factors, the optimal sample size is around 250. Therefore the top 30 out of 101 property firms in terms of market capitalization as at 31 December 2017 are selected.

### **3.3.2 Sampling Period**

The sampling period starts from 2008 and ends at 2017. The main reason for limiting my study after the crisis is because the improvement and enhancement of corporate governance standards has always followed the manifestation of major failures. Public pressure drives the regulators to strengthen highlighted areas to prevent the same problem from occurring in the future. The burst of the property bubble in 2008 had pointed to failures of risk management systems and competency of the board (which is related to the independency of the board). Various measures have been taken since then to address



these issues. The revised MCGG 2012 had focus on the board structure and composition, where the company directors are required not only to make strategic decision to propel the business but also establishing effective risk management.

The second reason being that during the crisis people react irrationally. The Bank Negara annual report 2008 had shown that Malaysian Gross Domestic Production (GDP) had dropped by 28.1% in 2008. The consumer confidence dropped to the lowest level; the market sentiment was so low that even the companies with good fundamental and governance were hit hard. As the crisis happened, market development were greatly affected by financial panic. The inclusion of financial data during the crisis may tempers the result of the research finding as people react irrationally during this period. Thus, 2008 is chosen as the starting point when the market re-gain its confidence and gradually growth until these days.

The list of selected sample companies is attached in **Appendix A**

### **3.4 SOURCE OF DATA**

The annual reports of the respective companies is the definite source to obtain the basic information for this study. Both the hard and softcopies of Annual Reports can be accessed at the Bursa Malaysia library. Information pertaining to financial statements, shareholding and directorship are available online at the Bursa Malaysia website. Information obtained from the above mentioned resources include the company ownerships, number and profiles of directors and financial statements (profit and loss, assets, liabilities and equities). Certain information such as family and government ownerships are not directly available from any print-out or websites. Various data had been reviewed and assessed rigorously in order to derive these information. Bloomberg Finance has also been used for obtaining and interpreting raw financial data into useful information such as Return on Asset, Return on Equity and Risk Indicator. At last, these data have been used to generate some useful information to support my findings.

Sekaran and Bougie (2010) stated that secondary data is the information obtained from sources which already exist. The secondary data required for this study basically derived from financial reports and other information in contained in the annual reports of respective property firms. The direct raw data consist of number of directors, number of independent directors, family ownership, government ownership and other financial figure. Subsequently these data was processed (with Microsoft Excel) into a meaningful unit such as percentage and proportionate. It was then processed with Statistical Package for Social Science (SPSS) for result.

### **3.5 MEASUREMENT OF VARIABLES**

This particular section illustrates the main features and terms of measurement for each variable. The focal points of this research are family ownership concentration, government ownership concentration, board size, directors' independency, and risk-taking behaviour in the regression. The main purpose is to obtain a broader perspective and deeper understanding on the connection between governance variables and profit. Various control variables such as family ownership, government ownership, board size, directors' independency and risk indicator are labelled as independent variables, performance of the property firms which are proxy by return of asset and return on equity are termed as dependent variable. Return on Asset and Return on Equity has been chosen to measure firms' performance as it is the most acceptable formulae in empirical study of finance and investment. It enables measurement for both of the value of a firm's tangible assets and intangible assets. This measurement is one of the best indicator of the firm's performance recognized by economists. The measurement of variables used are described as in Table 1.

**Table 1: Summary for Variable Measurement**

<b>Variable (Dependent)</b>	<b>Code</b>	<b>Measurement</b>	<b>Adopted From</b>
Return on Assets	ROA	Net income/ total assets	Bhagat and Black (2002) Mossman et al (1998)
Return on Equity	ROE	Net income/ total equity	Chazi, Khallaf & Zantout (2018)
<b>Variable (Independent)</b>			
Family Ownership Concentration	FAMOWN	% of equity ownership by owner of a family (including family members as defined in Cl.197 Companies Act 2016)	Anderson, Mansi & Reeb (2003)
Government Ownership Concentration	GOVOWN	% of equity ownership by Government Link Investment Companies (GLICs)	Najid & Rahman (2011)
Board Size	BODSIZE	Number of directors on the board of directors	Guest (2009)
Director Independency	INDDIR	% of independent directors on the board of directors	Kaplan & Reishus (1990)
Risk Indicator	RISK	Net debt/ total shareholder's equity	Chazi, Khallaf & Zantout (2018); Hashim & Davi (2008)

### 3.5.1 Performance Measure

Profitability has been used as the measurement of firm performance in this study. For the analysis of financial data, accounting profitability is preferred by most of the economists as compared to stock market-based measures for multiple reasons. The first reason are pointed by Lo and Mackinlay (1988) that some market inefficiencies was seen even in the developed countries. Conrad and Kaul (1998) also share the same opinion. Market inefficiency scenario is even more obvious in developing

countries (Butler & Malaikah, 1992). Thus, Malaysian stock prices are unlikely to represent the real and complete information. Second, Mossman et al (1998) posit that the financial survivability of a firm is better reflected through its accounting profitability than its stock market value. Accounting measures are used to detect financial distress or bankruptcy. Third, no stock market value is available for private firms whereas both the public firms and private firms provide accounting measures for evaluation purpose.

### Measures of Property Firms Performance and Corporate Governance

This use the following proxies to measure the performance

#### Profitability Measures

1. ROA= Return on assets= net income/ total assets
2. ROE= Return on equity= net income/ total stockholders' equity

### **3.5.2 Family Ownership Measure**

In accordance to Clause 197 of Companies Act 2016, member of director's family means director's spouse, parent, child, including adopted child and stepchild, brother, sister and the spouses of director's child, brother and sister. This study strictly follow this definition as shareholdings structures of listed companies also capture the equity held by the directors' family in the same manner. There is very limited guideline on the computation of family equities. The computation of family ownership used in this study is strictly limiting to the proxy held by the directors and member of his/ her family. The study compute the family ownership by accumulating total equity held by the directors and his/her family in term of percentage. This determination is straightforward for younger firms since the shareholding statement denotes the founder, his/her immediate family members, and their holdings. However, difficulty arises in older firms as the ownership have passed through few generation after the founder. Some family expands to include distant relatives such as second or third

cousins whose last names may no longer be the same. It is difficult to resolve descendant issues by examining corporate histories for each firm in our sample, thus, it was ignored.

### **3.5.3 Government Ownership Measure**

In Malaysia, there are 7 entities referred to as Government Link Investment Companies (GLICs) [including MOF (Inc.)] and they are:

1. Minister of Finance (Incorporated) [MOF (Inc.)]
2. Khazanah Nasional Berhad (Khazanah)
3. Employees Provident Fund (EPF)
4. Lembaga Tabung Haji (LTH)
5. Armed Forces Fund Board
6. Retirement Fund (Incorporated)
7. Permodalan Nasional Berhad (PNB)

Further, Government Link Companies (GLC) are companies that have been assigned with a commercial objective and are under the control of a GLIC. A GLIC has control over a GLC when it is the majority shareholder or single largest shareholder and when it has the authority to exercise and influence major decisions.

For the purpose of this research the government ownership refers to the accumulative percentage of all the shares directly owned by the GLIC.

(Website of Ministry of Finance Malaysia)

### 3.6 RESEARCH MODEL

This research use multivariate regression analysis to examine the relation between the performance and risk-taking of the sample property firms and their corporate governance attributes using the panel data over the period 2008-2017. Specifically, we use the following multivariate regression model:

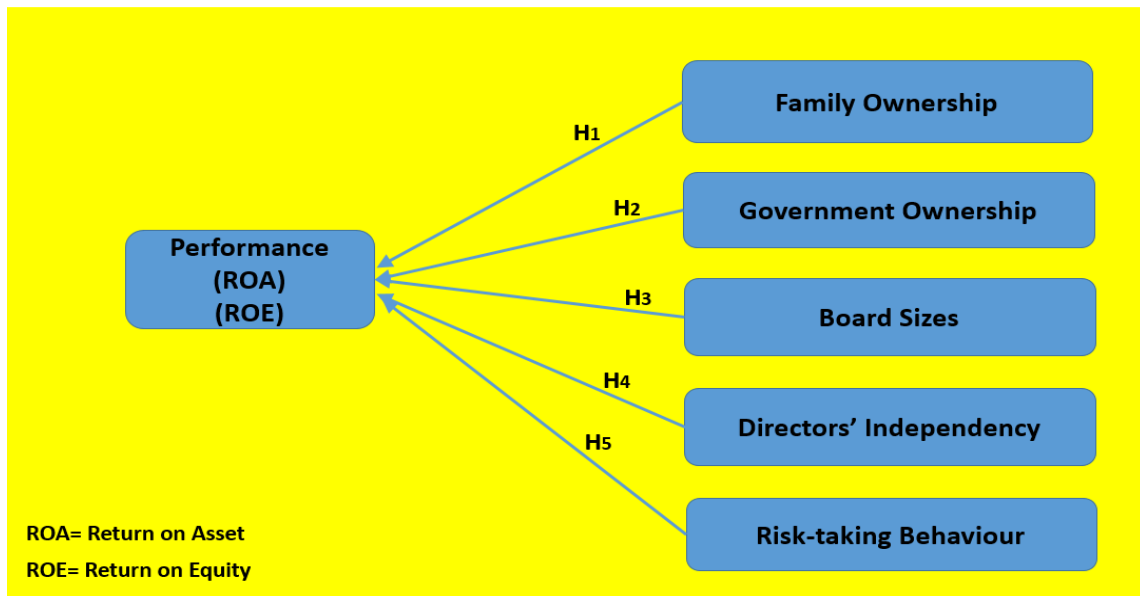
$$ROA = \alpha + \beta_1 \text{ FAMOWN} + \beta_2 \text{ GOVOWN} + \beta_3 \text{ BODSIZE} + \beta_4 \text{ NED} + \beta_5 \text{ RISK} + \varepsilon$$

$$ROE = \alpha + \beta_1 \text{ FAMOWN} + \beta_2 \text{ GOVOWN} + \beta_3 \text{ BODSIZE} + \beta_4 \text{ NED} + \beta_5 \text{ RISK} + \varepsilon$$

The diagram below shows the conceptual framework of this research.

Figure 1: Conceptual Framework

### CONCEPTUAL FRAMEWORK



### Hypothesis 1

H<sub>0</sub>: There is no relationship between family ownership concentration and firms' profitability.

H<sub>1</sub>: There is a relationship between family ownership concentration and firms' profitability.

Chami (1999) and Casson (1999) posit that founding families view their companies as an asset and as a pride to pass onto their heirs. Hence, family ownership concentration and firms' profit has a significant positive relationship.

### Hypothesis 2

H<sub>0</sub>: There is no relationship between government ownership concentration and firms' profitability.

H<sub>2</sub>: There is a relationship between government ownership concentration and firms' profitability.

Shleifer and Vishny (1996) and Shepherd (1989) sharing the same opinion that political goals such as employment and socioeconomic development are given the main priority in government-owned firms. Hence, government ownership concentration and firms' profit has a significant negative relationship.

### Hypothesis 3

H<sub>0</sub>: There is no relationship between board size and firms' profitability.

H<sub>3</sub>: There is a relationship between board size and firms' profitability.

Jensen (1993) and Yermack (1996) posit that board size increases entail communication and coordination problem. Hence, board size and firms' profit has a significant negative relationship.

#### Hypothesis 4

H<sub>0</sub>: There is no relationship between directors' independency and firms' profitability.

H<sub>4</sub>: There is a relationship between directors' independency and firms' profitability.

Jensen and Meckling (1976) and Fama and Jensen (1983) posit that the outside directors will be better in monitoring of managerial decisions. Hence, directors' independency and firms' profit has a significant positive relationship.

#### Hypothesis 5

H<sub>0</sub>: There is no relationship between risk-taking behaviour and firms' profitability.

H<sub>5</sub>: There is a relationship between risk-taking behaviour and firms' profitability.

Porter (1980) posits that enterprise risk plays an important role in sustaining competitive advantages that could lead to greater economic growth. Hence, risk-taking behaviour and firms' profit has a significant positive relationship.

Bromiley (1991) posits that poor financial performance of firms will increase financial risk-taking. Then risk-taking appeared to result in further poor performance. In sum, risk taken have poor returns.

The above mentioned 5 hypothesis will be tested in order to justify their correlation to property firms' profitability.



## **CHAPTER 4**

### **RESEARCH RESULTS**

#### **4.1 INTRODUCTION**

This chapter will provide a result and answer the research questions and objectives through the analysis of the data collected. In order to dissect the data into meaningful information, this study basically segregated into three sections. It started with descriptive statistic about the variables used namely Return on Equity (ROE), Return on Asset (ROA), Family Ownership (FAMOWN), Government Ownership (GOVOWN), Board Size (BODSIZE), Directors' Independency (INDDIR) and Risk (RISK). Subsequently, the correlations between these variables are examined in order to establish their connections. And ended the last section with multiple regression analysis.

## 4.2 DESCRIPTIVE STATISTIC

The total of 275 samples has been taken in this analysis.

**TABLE 2: DESCRIPTIVE STATISTIC**

	N	Minimum	Maximum	Mean
ROE	275	-51.26	59.73	8.0134
ROA	275	-20.95	35.98	4.9181
FAMOWN	275	.00	80.78	41.3747
GOVOWN	275	.00	91.28	11.3133
BODSIZE	275	4	13	7.67
INDDIR	275	25.00	87.50	47.9758
RISK	275	-122.19	179.94	19.6914

Table 2 shows the descriptive statistic of all the variables in the study. The statistic consist of minimum, maximum, mean and standard deviation. The mean of Return on Equity (ROE) is 8.01% with a standard deviation of 9.31%. A 9.31% standard deviation is considered high and it may indicates either the property market is volatile or the returns could be insistence. This is also reflected in the minimum value of -50.26% and the maximum value +59.73% in ROE. The mean of Family Ownership (FAMOWN) is 41.37%. It means that in average, the family members are controlling 41% of the ownership in property firms. The maximum family ownership of 80.78% happened in Berjaya Asset Berhad by Vincent Tan Chee Yioun's family in 2012. Tan's family is having the controlling stake in Berjaya Asset Berhad throughout the entire period of this study. However, it is worth addressing that some firms are having 0 family ownership as these firms are owned by government and the rest of the shareholders are consist of various funds and banks. The mean of Government Ownership (GOVOWN) is 11.31%. The government ownership in property firms is low if compare to family ownership. Most of the properties firms in this study are having very low ownership or zero ownership by government. However, the property firm that having the highest government ownership is 91.28% which happened to

UEM Sunrise Berhad in year 2013. The record also indicated that the government is holding more than 80% stake in this company for the last 10 years.

Table 2 shown that the mean of Board Size (BODSIZE) for property firms is 7.67 and the standard deviation is 2.05. The mode of board size is 7 (not in table). The board size of 7 person occurred 54 times out of the 275 samples in this study. All companies comply with Bursa Malaysia Requirement having minimum 2 directors. The mean of Independent Directors (INDDIR) is 47.98% with a standard deviation of 12.80%. All companies comply with the requirement having a minimum of 1/3 of the board of directors are independent directors. However this may not comply with the recommendation of Malaysian Code of Corporate Governance 2017 at least half of the board comprises of independent directors. The mean of Net Debt over Equity (RISK) is 19.69% and the standard deviation is 44.33%.

**TABLE 3: VARIABLES IN TIME-SERIES**

<b>Variable</b>	<b>ROE</b>	<b>ROA</b>	<b>FAMOWN</b>	<b>GOVOWN</b>	<b>BODSIZE</b>	<b>INDDIR</b>	<b>RISK</b>
<u>Mean</u>							
2008	6.04	3.55	35.92	10.96	7.67	47.47	11.01
2009	6.45	3.69	38.10	10.85	7.56	46.69	11.72
2010	8.57	4.96	38.37	9.47	7.48	47.36	10.45
2011	5.56	3.98	40.14	11.84	7.67	46.90	18.21
2012	7.97	5.58	41.28	12.38	7.63	48.85	26.96
2013	11.60	7.25	42.16	11.65	7.61	47.51	15.94
2014	9.47	5.77	42.30	11.20	7.52	49.12	16.54
2015	9.84	6.29	44.34	12.46	7.80	49.03	22.72
2016	7.13	4.02	44.81	10.72	7.87	48.72	28.81
2017	6.98	3.79	44.14	11.31	7.83	47.67	30.17
<u>Std. Dev.</u>							
2008	7.16	4.11	19.36	20.02	2.24	12.34	33.36
2009	9.50	4.77	19.86	19.92	2.26	10.64	42.61
2010	11.00	6.27	20.44	17.54	2.24	12.06	37.68
2011	12.82	6.68	21.87	25.52	2.34	12.76	45.18
2012	9.09	7.61	21.97	26.36	2.27	13.21	50.86
2013	13.74	7.25	42.16	11.65	7.61	47.51	15.94
2014	7.17	4.81	22.81	23.96	2.13	12.79	52.53
2015	8.35	5.91	20.68	24.02	1.69	14.00	43.97
2016	6.18	3.96	20.62	19.65	1.80	14.11	40.98
2017	4.85	2.97	20.12	20.24	1.82	13.61	39.64
<u>Maximum</u>							
2008	19.28	12.71	72.18	81.56	12.00	75.00	60.61
2009	42.23	19.56	72.18	82.63	13.00	75.00	92.85
2010	49.50	25.87	71.64	73.05	13.00	80.00	89.59
2011	30.95	22.43	74.01	90.96	13.00	83.33	150.14
2012	38.65	35.98	80.78	90.74	13.00	83.33	179.94
2013	59.73	34.35	79.31	91.28	12.00	85.71	167.12
2014	30.55	19.04	79.31	88.73	13.00	85.71	146.61
2015	28.59	21.84	75.38	91.02	11.00	87.50	123.83
2016	19.44	14.45	73.44	89.43	12.00	85.71	114.70
2017	19.90	12.97	73.44	85.46	12.00	83.33	95.16

<u>Minimum</u>								
2008	(8.45)	(2.27)	0.29	0.00	4.00	28.57	(73.05)	
2009	(8.19)	(3.84)	0.00	0.00	4.00	33.33	(85.81)	
2010	(4.54)	(2.02)	0.28	0.00	4.00	33.33	(58.75)	
2011	(51.26)	(20.95)	0.33	0.00	4.00	33.33	(54.37)	
2012	(6.71)	(3.31)	0.27	0.00	4.00	30.00	(28.58)	
2013	(7.06)	(1.74)	0.00	0.00	4.00	25.00	(99.63)	
2014	(7.72)	(3.57)	0.00	0.00	4.00	25.00	(122.19)	
2015	(13.25)	(5.78)	0.00	0.00	5.00	28.57	(45.46)	
2016	(2.77)	(1.60)	0.00	0.00	5.00	28.57	(61.66)	
2017	(0.52)	(0.33)	0.00	0.00	5.00	28.57	(44.39)	

Table 3 shows the time-series variables for the Top 30 property firms during 2008 to 2017 with a total 275 observations. It shows that the return (in term of ROE & ROA) gradually increase after the crisis 2008 and reached its peak on year 2013 and gradually decrease until 2017. The mean ROE of 8.01% corresponds to Zabri et al (2016) findings that the average ROE for Malaysian listed companies stood at 8%.

Observation on the time-series average of Family Ownership shows that the family ownership increase gradually from 36% to 45% for the last ten years. It means that the property sector has a high concentration of family ownership. Perhaps this could be explained as the land is considered as an important asset in Asian culture. In contrast, the government maintained the ownership at around 11% over the last ten years. This is an unexpected result as the general presumption is that the government involvement in property sector was increasing after the take-over of SP Setia Berhad in 2013. Perhaps this perception occurred as the government changed its role from a silent investor to an active investor to acquire higher return.

Table 3 also provides a clearer picture about the board directors in yearly basis. The average number of directors (BODSIZE) in property firms are quite consistence over the last 10 years. The average number of independent directors (INDSIZE) are gradually increased commenced from 2009 until 2016. This increment is consistent but very small. However, the number dropped in 2017. In line with the mean value of

total board directors and independent directors as described earlier, the ratio of independent directors over the total directors also does not change much over the last 10 years.

Table 3 also provides a clearer picture about the risk taken by property firms in yearly basis. As previously discussed, the risk factor is measured on the ratio of net debt over the company's equity. For the last ten years, it could be observed that the debt raised by the companies are increasing from 11% to around 30% over its equity.

### **4.3 CORRELATION BETWEEN VARIOUS CORPORATE GOVERNANCE DIMENSION AND COMPANY PERFORMANCE**

This section elaborate on the results derived with multiple regression model of SPSS. The outputs are presented in various tables to explore the relationships among variables.

Table 4 presents the results of the correlation analysis with SPSS. From the table, the RISK and performance (ROE & ROA) has a negative correlation. The RISK is statistically significant related to ROE and ROA. The correlation between RISK and ROE is  $r = -.249$ , while the correlation between RISK and ROA is higher,  $r = -.358$ . The rest of the independent variables such as FAMOWN, GOWOWN, BODSIZE and INDDIR are statistically insignificant to ROE and ROA.

**TABLE 4: CORRELATION ANALYSIS****Correlations**

		ROE	ROA
FAMOWN	Pearson Correlation	.071	.118
	Sig. (2-tailed)	.241	.051
	N	275	275
GOVOWN	Pearson Correlation	.024	-.046
	Sig. (2-tailed)	.698	.449
	N	275	275
BODSIZE	Pearson Correlation	.029	-.069
	Sig. (2-tailed)	.632	.252
	N	275	275
INDDIR	Pearson Correlation	-.073	-.029
	Sig. (2-tailed)	.226	.631
	N	275	275
RISK	Pearson Correlation	-.249**	-.358**
	Sig. (2-tailed)	.000	.000
	N	275	275

\*\* . Correlation is significant at the 0.01 level (2-tailed).

## 4.4 MULTIPLE REGRESSION ANALYSIS

**TABLE 5: COLLINEARITY STATISTICS**

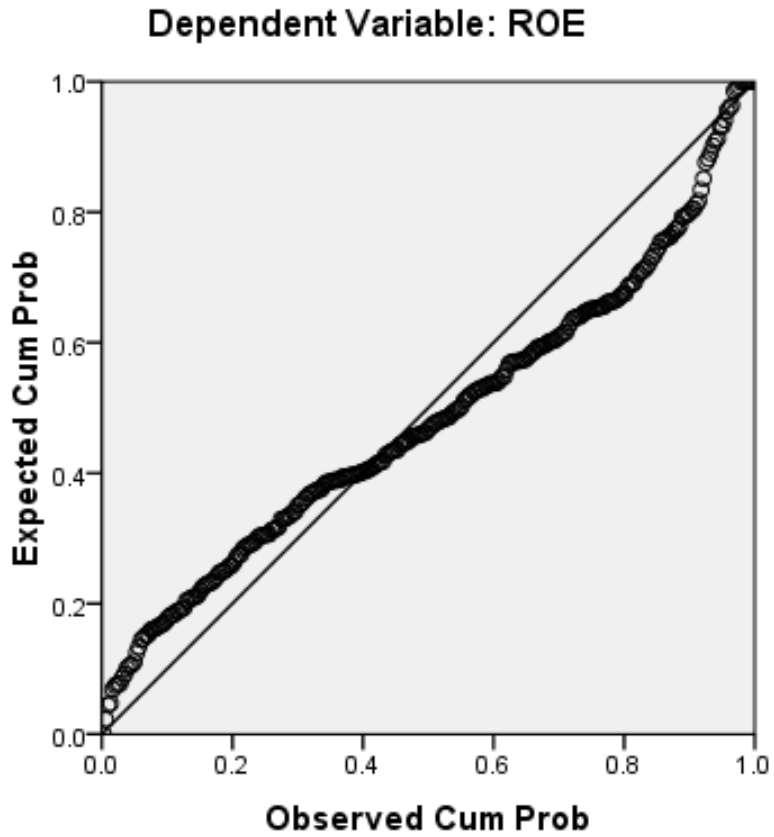
Model		Collinearity Statistics			
		ROE		ROA	
		Tolerance	VIF	Tolerance	VIF
1	(Constant)				
	FAMOWN	.560	1.786	.560	1.786
	GOVOWN	.536	1.867	.536	1.867
	BODSIZE	.795	1.257	.795	1.257
	INDDIR	.831	1.203	.831	1.203
	RISK	.920	1.087	.920	1.087

Collinearity diagnostics had been conducted on the variables as part of the multiple regression procedure. This process is conducted to ensure the problems with multicollinearity that may not be observed in correlation matrix could be captured. In Table 5 labelled Collinearity Statistics, two values are given: Tolerance and VIF. If the value of Tolerance is below 0.10 it suggests the possibility of multicollinearity. If the value of VIF is greater than 10, it is indicating multicollinearity as well. However, the independent variable in this model present value higher than 0.10 and with VIF below 10. Therefore, the model does not violet the multicollinearity assumption.

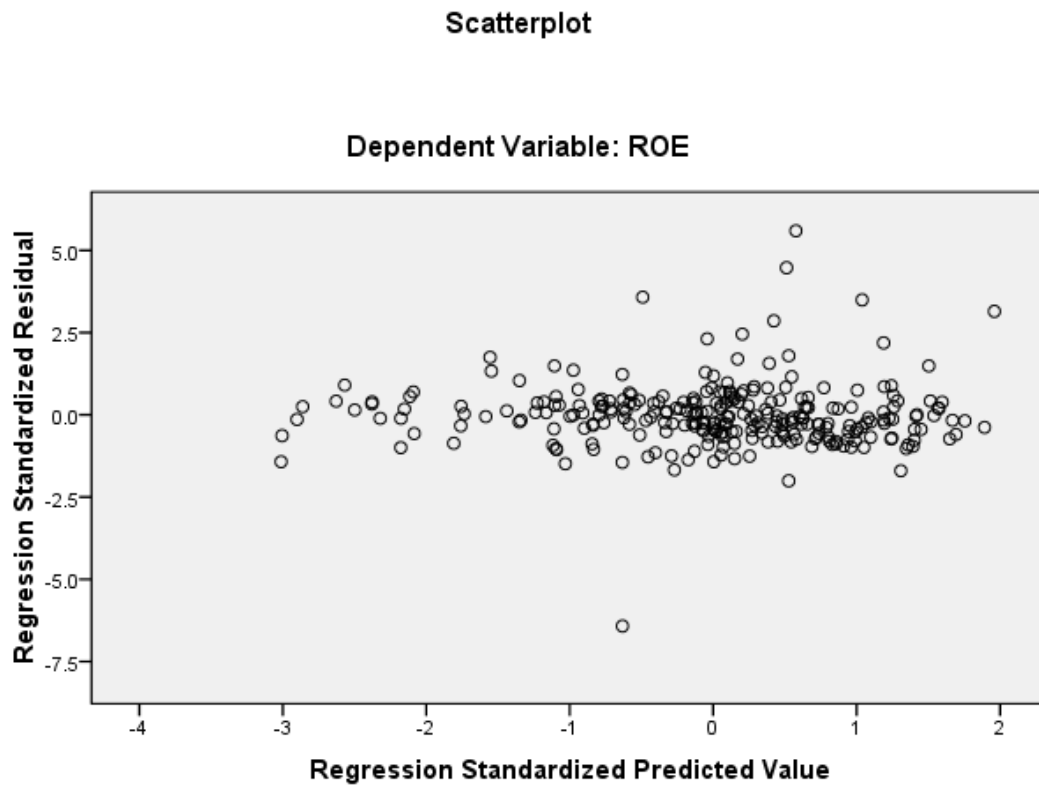


**FIGURE 2: NORMAL P-P PLOT OF REGRESSION STANDARDIZED RESIDUAL**

**Normal P-P Plot of Regression Standardized Residual**



**FIGURE 3: SCATTERPLOT**



As part of the analysis for multiple regression model, the homoscedasticity, independence of residuals, outliers, normality and linearity assumptions must be checked. In Figure 2, the Normal Probability Plot (P-P) of the Regression Standardised Residual show many points. It is suggesting there is no major deviation from normality as these points are forming a reasonably straight diagonal line in upward pattern.

In Figure 3: Scatterplot, it could be observed that the points quite rectangularly distributed, with most of the points concentrated in the right center. As the points show no clear and systematic pattern, it could be indicating that curvilinear do not happen.

#### 4.4.1 Regression Results

**TABLE 6: REGRESSION RESULTS**

		<b>Model 1 (ROE)</b>	<b>Model 2 (ROA)</b>
Constant	Coefficient	3.630	3.112
	p-value	0.400	0.222
FAMOWN	Coefficient	0.082**	0.057***
	p-value	0.019	0.006
GOVOWN	Coefficient	0.076**	0.043**
	p-value	0.022	0.029
BODSIZE	Coefficient	0.243	-0.340
	p-value	0.411	0.848
INDIR	Coefficient	-0.012	0.004
	p-value	0.802	0.888
RISK	Coefficient	-0.061***	-0.049***
	p-value	0.000	0.000
Adjusted R-squared		0.075	0.139
F statistic		5.446	9.816
F sig.		0.000	0.000
***. P-value is significant at the 0.01 level. ** . P-value is significant at the 0.05 level. * . P-value is significant at the 0.10 level.			

After the preliminary checks were conducted to make sure no violation of the assumptions of multicollinearity, homoscedasticity, normality and linearity, SPSS is applied to run the multiple regression model to examine the empirical relations between the variables in test. As mentioned in the earlier chapter, the model is run with panel data of property firms from years 2008 to years 2017. Table 6 reports the results of the regression using ROE and ROA as dependent variables. The result shows that both the ROE and ROA model fit the data of the entire sample. From the result, it also shows that the models are statistically significant (Sig. = .000; this really means  $p < .00005$ ). In addition, both models are consistent in the independent variables that are statistically significant.

From the value of adjusted R Square = .075 (ROE model), it means that the model (which includes FAMOWN, GOVOWN, BODSIZE, INDDIR and RISK) explains 7.5 percent of the variance in ROE. Meanwhile it is 13.9% for ROA.

Based on the unstandardized coefficient shown in Table 6, the five independent variables to predict the ROE could be written as the multiple linear equation as below.

$$\text{ROE or ROA} = \alpha + \beta_1 \text{ FAMOWN} + \beta_2 \text{ GOVOWN} + \beta_3 \text{ BODSIZE} + \beta_4 \text{ INDDIR} + \beta_5 \text{ RISK} + \varepsilon$$

$$\text{ROE} = 3.63 + 0.082 \text{ FAMOWN} + 0.076 \text{ GOVOWN} + 0.243 \text{ BODSIZE} - 0.012 \text{ INDDIR} - 0.061 \text{ RISK}$$

$$\text{ROA} = 3.112 + 0.057 \text{ FAMOWN} + 0.043 \text{ GOVOWN} - 0.34 \text{ BODSIZE} + 0.004 \text{ INDDIR} - 0.049 \text{ RISK}$$

In order to analyse how good each of the variables contributes to the model, the Table 6: Coefficients is referred.

#### **4.4.2 Evaluating Family Ownership Effect**

The family ownership (FAMOWN) has a significant positive relationship with performance. The increase in 1% on the family ownership would increase the ROE by 0.082%. The increase in 1% on the family ownership would increase the ROA by 0.057%.

#### **4.4.3 Evaluating Government Ownership Effect**

The government ownership (GOVOWN) has a significant positive relationship with performance. The increase in 1% on the government ownership would increase the ROE by 0.076%. The increase in 1% on the government ownership would increase the ROA by 0.043%.

#### **4.4.4 Evaluating Board Size Effect**

The board size (BODSIZE) is statistically insignificant to the performance. It means that the number of directors in the board has no relation to the profit of the company.

#### **4.4.5 Evaluating Directors' Independency Effect**

The directors' independency (INDDIR) is statistically insignificant to the performance. It means that the ratio of independent directors in the board has no relation to the profit of the company.

#### **4.4.6 Evaluating Risk-taking Behaviour Effect**

The risk-taking behaviour (RISK) has a significant negative relationship with performance. The increase in 1% on the net debt over shareholder's equity would reduce the ROE by 0.061%. The increase in 1% on the net debt over shareholder's equity would reduce the ROA by 0.049%.

**TABLE 7: RESULTS ON NULL HYPOTHESIS**

<b>Hypothesis</b>	<b>Code</b>	<b>NULL HYPOTHESIS</b>	
		<b>Supported (<math>p &gt; 0.05</math>)</b>	<b>Rejected (<math>p &lt; 0.05</math>)</b>
H1: No Relationship between Family Ownership Concentration and Profitability	FAMOWN		✓
H2: No Relationship between Government Ownership Concentration and Profitability	GOVOWN		✓
H3: No Relationship between Board Size and Profitability	BODSIZE	✓	
H4: No Relationship between Directors' Independency and Profitability	INDDIR	✓	
H5: No Relationship between Risk-taking Behaviour and Profitability	RISK		✓

## CHAPTER 5

### DISCUSSION AND CONCLUSION

#### 5.1 INTRODUCTION

The main objective of this research is to assess the performance of property firms in Malaysia in relation to 5 corporate governance dimensions after the financial crisis. The corporate governance dimensions in question include family ownership concentration, government ownership concentration, board size, board independence and risk-taking behavior. The results are shown in Table 8.

#### 5.2 DISCUSSION OF MAJOR FINDINGS

TABLE 8: SUMMARY OF THE RESULTS

Hypothesis	Relation Positive or Negative	ROE & ROA	
		Statistically Significant	Statistically not Significant
H1: Family Ownership Concentration is positively related to performance	Positive	✓	
H2: Government Ownership Concentration is negatively related to performance	Positive	✓	
H3: Board Size is negatively related to performance	Insignificant		✓
H4: Directors' Independency is positively related to performance	Insignificant		✓
H5: Risk-taking behaviour is positively related to performance	Negative	✓	

Table 8 give us the following results,

- H1: Family ownership concentration is statistically significant to performance and the relationship is positive.
- H2: Government ownership concentration is statistically significant to performance and the relationship is positive.
- H3: Board Size is statistically insignificant to performance.
- H4: Directors' Independency is statistically insignificant to performance.
- H5: Risk-taking behavior is statistically significant to performance and the relationship is negative.

The results show that the property firms in Malaysia are making profit for the last 10 years. This results show all possible sense as Malaysia is a developing country with steady population growth. The population growth is the main thrust for demand in properties, be it in industrial, commercial or residential. (Liew & Rowland, 2016). At the beginning few years after the financial crisis in 2008, the property firms only able to make a minimal profit at the average of 6% return on equity. However the ratio experienced a marginal growth every years until it reached the peak at 11.60% in year 2013. After year 2013 the average profits keep dropping every year. Perhaps the trend from 2008 to 2013 could be explained by the restoration of economic confidence after the crisis. Notably it reached the highest level in 2013. Liew and Rowland (2016) relate this huge profit to the positive effect in stock market influenced by the general election. After the general election everything goes back to its normal norm and the market slowly revert to its moderate growth.

### **5.2.1 H1: Positive Association between Family Ownership (FAMOWN) and Firms' performance (ROE & ROA).**

The result shows that property firms with higher family ownership are significantly perform better. Based on the profitability measure of firm performance, both the ROE



and ROA indicate that family firms perform better than non-family firms. This finding is consistent with the notion that family firms encounter lesser agency problem. Family involvement reduces the chances of opportunists manipulating companies' earning, therefore improves the earnings quality. In sum, this study further reinforce Demsetz and Lehn (1985) and Burkart et al (1997) views that continued family ownership may not directly lead to a less effective organisational structure. For family firms, the important attribute to minimize the family manipulation rely on the ability of outsider to monitor family activity. In a transparent and well- regulated markets, family ownership in property firms reduce agency problem without reduction of quality in decision-making.

In addition, the increasing family ownerships imply that family members have faith in the companies. When companies' welfare and profit have a direct impact on family wealth and reputation, family members likely to monitor the managers closely or even dominate the management with their own members, to maximize the companies' value.

### **5.2.2 H2: Positive Association between Government Ownership (GOVOWN) and Firms' performance (ROE & ROA).**

Contrary to public notion, the evidence shows that government ownership has a positive relation on firms' performance. Perhaps other than fulfilling its social responsibilities, government's firms owe a duty to the nation and the public to increase wealth. For example, KWSP's vision is to help its members to secure a better future. The government ownership in property firms are maintaining in the region of 10% to 12% for the last ten years. It could be observed that government involvement in property market are mostly as a monitoring role. Most of the time the government's representatives are occupying the non-executive director positions.

### **5.2.3 H3: Findings about Board Size (BODSIZE) and Performance (ROE & ROA)**

The results shows that the board size not contributed to the profit of property firms. The evidence refuted my earlier projection that board size and performance has a negative relationship. Nevertheless, this results reinforced Ponnu (2008) and Bhagat and Black (2002) findings that no concrete proof can justify the board size affects performance. Klein (1998) findings is also drawn here as he finds that that is no systematic association between board size and performance.

### **5.2.4 H4: Findings about Director Independency (INDDIR) and Performance (ROE & ROA)**

The results shows that the directors' independency not contributed to the profit of property firms. This results reinforced Hermalin and Weisbach (2003) findings that in their research of U.S. firms show no relation between the proportions of outside directors and the performance.

### **5.2.5 H5: Negative Association between Risk-taking Behavior (RISK) and Firms' performance (ROE & ROA).**

Risk taking is one of the important dimension in strategic management. Risk-taking is a proactive action of business in pursuing innovative advantages. However, the results of this study conclude that financial risk-taking is negatively associates with performance. As the study based on the debt ratio as the measure of risk-taking behaviour, it means that high leverage is detrimental to property firms. Conclusion could be drawn from here is that unlike technology firms, property firm rarely grant any advantage form innovative design concepts or new features added to the properties; the prime factor is always the location. The implication is property firm

shall retain profit and reduce borrowings in order to generate higher profit in future development.

### **5.2.6 Empirical Results from This Study Compare to The Recent Researchs**

The hypothesis 1 and hypothesis 2 support the recent finding of Margaritis and Psillaki (2010). They posit that ownership concentration has a positive and significant effect on firms' performance. Shyu (2011) finds that increase in family ownership enhances firm performance, thereby driving family ownership even higher. Based on her research in Taiwan, the concentration of family ownership indicates that the wealth of a family is closely related to firm performance, in which the family has stronger incentive to maximize firm performance.

The result of hypothesis 5 shows financial risk-taking is significantly relate to profit in a negative way. This is in line with Innocent, Ikechukwu and Nnagbogu (2014) research who find that debt ratio and debt-equity ratio (DER) have negative relationship with Return on Assets (ROA). In addition, Raza (2013) study shows negative relation between performance and leverage. His research shows that long term debt is more expensive due to certain direct and indirect costs. Therefore employing high level of debt results low profitability.

## **5.3 LIMITATION OF THE STUDY**

First, the performance of the firms are measured base on accounting profitability. Some may argue that the accounting profitability is not the appropriate tool in measuring performance as it is subjected to creative accounting or manipulation of profit that in the end jeopardize the firms' value. This group of people believe in market- based valuation.

The independent variables chosen in this study basically derived from various corporate governance dimensions. The value of adjusted R square in the results is low. This imply that corporate governance dimensions may not be the convincing

answer to firms' performance. Rather, other factors such as business strategy, marketing strategy or corporate structure could be the prime contributing factors in firms' performance.

The targeted samples are property firms. In general these companies are categorized under the property index, the nature of their businesses may not be purely property related. For example, Berjaya Assets Berhad involve in property market but at the same time running gaming (lotteries) and food and beverage (Starbucks franchisee) businesses as well. Many successful companies had evolved into conglomerate structure. These companies may have many core businesses other than property itself. Besides, the panel samples of Top 30 property firms may not represent the property firm as a whole as some of the big property firms are not listed in Bursa or de-listed due to various reasons. IJM Property is one of the example.

## **5.4 IMPLICATIONS**

Some useful implications could be drawn from this research. Investors can refer to the results of this research when they are considering to diversify their portfolio with property firms. Conservative investors who preferred passive investment can use the results in selecting a property from a better company.

The evidence suggests, investors should select property firms with high family ownership and high government ownership. If there is any sign of family members or government increase shareholdings in the property firm, it shall indicates that the shareholders have faith and confidence in the future of the company. In family business, concentrated shareholders have stronger economic motivations to reduce agency problems and free rider problem. The increase in family ownership means reduction in dispersed shareholders and non-perform shareholders. When companies' welfare and profit have a direct impact on family wealth and reputation, family members likely to monitor the managers closely or even dominate the management with their own members. In the other hand, the government ownership in property

firms can eliminate various transaction issues and approval problems when dealing with all different local authorities and government agencies. Firms with high government ownership enjoy lower subsidized land cost and subsidized development cost. Besides, they are benefitted for having the priority to participate in government initiated projects. Investors could buy their share and expect to enjoy capital growth and dividend.

The main objective behind deciding on sources of finance is to build such a capital structure that maximises the firm's value (Titman, Keown & Martin, 2018). Generally, businesses use a combination of different finance sources. The results of the study shows rising debt reduces profit. The debt requires a very discipline repayment of principal and interest. Default in repayment could risk a company into winding up. This is a challenge for property firms that need regular and timely cash flow. In general, big company opts to rights issues or private placement to raise fund. Whereas investors shall avoid property firms with high gearing.

The Bukit Bintang City Centre (BBCC) development is drawn here to illustrate how property firms reduce debt. The redevelopment of old Pudu Prison site (now called BBCC) is located in the 19 acre prime land in the center of Kuala Lumpur. The Urban Development Authority (UDA) being a government owned company did not have the financial strength to undertake this development on its own. After due consideration, UDA decided to partner Eco World Development Group Berhad (EcoWorld) and Employee Provident Fund (EPF) via a special purpose vehicle (SPV). Joining their strengths, the consortium enjoys the following benefits.

- a) With the involvement of EPF, the consortium having sufficient fund injected from EPF without raising debt. This reduce the cost of borrowing.
- b) UDA in its role protecting the interest of Bumiputra in real estate in the City could fulfill its social responsibility by ensuring Bumiputra participation in the project.

- c) EcoWorld as a family business could utilize their skills and experience to the fullest with minimum worry on the finance and authorities' approval.

With combined forces, the consortium maximize the family ownership and government ownership as 3 companies hold 100% of the shares without any dispersed shareholders. At the same time the consortium avoid debt by having support from EPF.

Market regulators advocate the benefits of having board diversity (direct related to board size) and independent directors to reduce agency cost. The empirical results of this research suggests otherwise (statistically insignificance). The approach of having more independent directors may not benefits the firms as perceived. Firms may want to review their nominating policy and board committee composition with respect to selecting board member in future.

## **5.5 RECOMMENDATIONS FOR FUTURE STUDY**

The main reason this research focusing in the property firms mainly due to the unique nature of the business. As mentioned earlier, it is very difficult to obtain a pure result purely from property firms as companies nowadays involve in various businesses. Big companies nowadays appear as conglomerate rather than doing one single business. Globalization and technology advancement gradually erase the line between different businesses. Perhaps the future study shall embrace the property firms in a more general context and expand the coverage to cross-countries. Perhaps this will draw a more meaningful and precise result for practical application.

## **5.6 CONCLUSION**

One of the major cause of financial crisis attribute to poor corporate governance. While previous research have shown that firm performance deteriorated due to poor corporate governance during the crisis (e.g. Lemmon and Lins, 2002; Mitton, 2002), they did not show the subsequent influences after the crisis. This research addresses this issues by demonstrating how the property firms' performance were affected by five corporate governance characteristics. The result shows evidence that property firms with higher family ownership outperformed firms with dispersed ownership. The result also shows evidence that property firms with higher government ownership perform better than the lesser. Combining this two evidences may suggests one another theory- that ownership concentration associate positively to property firms' performance. The results also shows excessive risk-taking by borrowing reduce company profit, thus, investors shall avoid property firms with high gearing.

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## APPENDIX A

### Top 30 Property Firms From (Market Capitalisation as at 31 Dec 2017)

	<b>Company</b>	<b>Market Capital RM (Million)</b>
1	IOI Properties Group Berhad	12,113
2	S P Setia Berhad	9,936
3	Malaysian Resources Cooperation Berhad	4,913
4	UEM Sunrise Bhd	4,718
5	Eco World Development Group Berhad	4,563
6	UOA Development Berhad	4,142
7	Mah Sing Group Berhad	3,520
8	Eastern & Oriental Berhad	2,436
9	OSK Holdings Berhad	2,222
10	IGB Berhad	1,900
11	TA Global Berhad	1,889
12	Selangor Properties Berhad	1,649
13	LBS Bina Group Berhad	1,614
14	Berjaya Assets Berhad	1,485
15	Matrix Concepts Holdings Berhad	1,458
16	Tropicana Corporation Berhad	1,339
17	KSL Holdings Berhad	1,097
18	MCT Berhad	961
19	Paramount Corporation Berhad	912
20	GuocoLand (Malaysia) Berhad	848
21	YNH Property Berhad	735
22	MKH Berhad	734
23	Plenitude Berhad	660
24	HCK Capital Group Berhad	548
25	Sunsuria Berhad	547
26	Rapid Synergy Berhad	506
27	Daiman Development Berhad	489
28	Karambunai Corporation Berhad	462
29	Land & General Berhad	365
30	SHL Consolidated Berhad	203



