www.accfile.com

CORPORATE GOVERNANCE AND AGENCY COSTS: EVIDENCE FROM PUBLIC LISTED FAMILY FIRMS IN MALAYSIA

Haslindar Ibrahim and Fazilah M. Abdul Samad

ABSTRACT

This chapter examines the relationship between corporate governance and agency costs of family and non-family ownership of public listed companies in Malaysia. It presents a longitudinal study of the 290 publicly listed companies in the Main Board of the Bursa Malaysia over the period 1999–2005.The study applies the governance mechanisms such as board size, independent director and duality as a tool in monitoring agency costs based on asset utilization ratio and expense ratio as proxy for agency costs. There is strong evidence that larger board size has a significant effect as a device in mitigating agency costs. The study supports that independent directors and duality are viewed differently by family and non-family ownership. The evidence shows that an independent director in family ownership does not influence agency costs. But non-family ownership needs more independent directors to counsel and monitor the company and thus reducing the agency conflict with shareholders. The study also finds that family ownership experiences less agency conflicts

International Corporate Governance
Advances in Financial Economics, Volume 14, 109–130
Copyright © 2011 by Emerald Group Publishing Ltd
All rights of reproduction in any form reserved
ISSN: 1569-3732/doi:10.1108/S1569-3732(2011)0000014008

www.Accfile.com | @accfile

www.accfile.com

when duality role exists. Contrary, non family ownership experiences high agency costs when duality exists on board.

Keywords: Family firms; corporate governance; agency costs.

1. INTRODUCTION

The family controlled firm or family ownership is the most common form of business organization in the world. A torrent of literature explains that family ownership is central in most countries. Family-owned or controlled businesses account for over 80 percent of all firms in the United States. Indeed, families are present in one-third of the S&P 500 and hold nearly 18 percent of firms' equity stake (Anderson & Reeb, 2003). Other studies like Sraer and Thesmar (2006), Favero, Giglio, Honorati, and Panunzi (2006), Gursoy and Aydogan (2002), Mishra, Randoy and Jenssen (2001), Yeh, Lee and Woidtke (2001), and Gorriz and Fumas (1996) conduct research on the performance of family-controlled firms based on a sample of listed firms in their countries. The results show that family firms have superior performance compared to non-family firms.

Both family and non-family firms are classified according to their ownership structure. The ownership structure can be grouped into widely held firms and firms with controlling owners or concentrated ownership. A widely held corporation does not have any owners with substantial control rights. Basically, firms with controlling owners are divided into four groups which are widely held corporations, widely held financial institutions, families and state categories (Claessens, Djankov, & Lang, 2000; La Porta, Lopez-De-Silanes, & Shleifer, 1999). La Porta et al. (1999) study the 20 largest publicly traded companies in the richest 27 countries worldwide. They find that most companies are private and that ownership of listed firms is highly concentrated, thereby highlighting family ownership as significant corporations. According to the study of Claessens et al. (2000) on the separation of ownership and control in nine East Asian corporations (Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand), Malaysia has the third highest concentration of control after Thailand and Indonesia. Family control in Malaysia increased from 57.7 to 67.2 percent as the cut off level of voting rights increased from 10 to 20 percent.

www.Accfile.com | @accfile

www.accfile.com

In Malaysia, family ownership constitutes over 43 percent of the main board companies of the Bursa Malaysia (formerly known as the Kuala Lumpur Stock Exchange (KLSE)) from 1999 through 2005 yet studies examining the performance of family ownership are very limited specifically in the area of corporate governance and agency costs. Thus the study intends to investigate the impact of corporate governance mechanisms such as board size, independent director and duality on performance, as a tool in mitigating an agency costs between family and non-family firms in Malaysia.

Based on market capitalization, on average, family-controlled firms in Malaysia are smaller with average market capitalization of RM0.80 billion as compared to non-family-owned firms at RM1.33 billion. Meanwhile 60 percent of 125 family-owned firms in the sample hold more than 40 percent of the equity ownership. The results show that on average, family firms experience lower agency costs as compared to non-family firms based on the asset utilization ratio and expense ratio as an agency cost proxies. This is consistent with the previous studies by Ang, Cole and Lin (2000), McKnight and Mira (2003), and Jensen and Meckling (1976).

2. LITERATURE REVIEW

2.1. Family Ownership in Malaysia

Various studies have been done on the effect of ownership structure and firm performance in Malaysia. Abdul Rahman (2006) indicates that many listed firms in Malaysia are owned or controlled by family and that these companies appear to be inherited by their own descendants. Since independence, most Malaysian companies are controlled by foreigners from European countries, particularly the U.K.

On the contrary, Mohd Sehat and Abdul Rahman (2005) examine the ownership concentration from the perspective of direct shareholdings. The study is based on the 5 percent cut-off level for the top 100 Malaysian listed firms as determined by their market capitalization as at December 2003. The results show that average shares held by blockholders in each company were 55.84 percent. As such, half of the top companies have 57.11 percent shares held by blockholders. The findings also show the lowest ownership concentration is 5.90 percent while the maximum ownership concentration stated is 89 percent. Therefore, the ownership and control of corporations are highly concentrated in Malaysia.

www.Accfile.com | @accfile

www.accfile.com

The results of the World Bank (1999) study of a sample of firms comprising of more than 50 percent of the Bursa Malaysia market capitalization, corroborates that the five largest shareholders in these firms owned 60.4 percent of the outstanding shares and more than half of the voting shares. To illustrate, 67.2 percent shares are owned by family firms, 37.4 percent are in the hands of only one dominant shareholder and 13.4 percent are state controlled. Thus, family controlled seems to dominate and control the Malaysian capital market.

Gomez (2004) states that the debates regarding family enterprises have been considered in an Asian context, which relate to ethnic Chinese family-run firms. However, in certain circumstances, the ethnic Chinese family-run firms are ineffective and can curb economic growth. Currently, the economic success of most of the Southeast Asian countries is caused by Chinese immigrants. Apparently, the Chinese family run firms have contributed to the development of the robust Asian economic growth. As a result, the impediments and the economic growth arguments are overstated.

On the contrary, he says that incorporation of Chinese enterprises does not give much effect with Chinese culture. The emergence of family firms is due to the difficulties migrants faced in securing startup capital and recruiting labor. For instance, partnerships were created to solve the problems faced when starting off the business. He also explains that for Malaysian cases, Chinese businessman have a history of intra-ethnic business partnership. The businesses traditions exist among migrants in the colonial period with some firms diminishing halfway and some emerging as successful family firms.

In Malaysia, the list of the 40 richest Malaysians 2009 is obviously dominated by family as issued by the Malaysian Business in February 2009 edition. From the list, 28 of the 40 richest people are family based and account for 70 percent of the top 40. According to the top 40 list of Malaysia's richest people, Tan Sri Robert Kuok appears to dominate the chart and he was well ahead of his rivals. His outstanding wealth accounted for RM26.6 billion or 27.6 percent of the wealth of the 40 richest declining from RM58.1 billion in 2008, however no other tycoon is yet able to unseat him as the country's wealthiest individual (Singh, 2009).

2.2. Agency Costs in Family Firms

Daily and Dollinger (1992) state that family firms should by virtue of their intra-familial altruistic element be excluded from agency problems. Kang (2000) proposes that the practical effects of family altruism and reliability show that family firms are the least costly and most significant type of firm. However, family firms could reduce agency related problems.

www.Accfile.com | @accfile

www.accfile.com

Based on the clan-oriented firm, Parsons (1986), states that there are less agency-related problems if there is family involvement. Perhaps, the clan control possesses goal consistency between people that decreases the requirement to control results that see the loss of motivation factors (Eisenhardt, 1989). Indeed, Becker (1974) explains that family members are encouraged to increase family income and consumption even though their welfare depends on their own consumption alone. Furthermore, the family has the right for certain privileges against agency problems.

According to Fama and Jensen (1983), family relationships between managers and owners can mitigate agency costs due to the multi-dimensional and long-term nature of the family relationship that improves the monitoring of the decision managers. This argument is supported by DeAngelo and DeAngelo (1985) who also claim that the involvement of the family serves to discipline and monitor managers. In addition, Kang (1998) agrees that family members are active monitors of their managers. He finds that the flow of information between family members and managers acts as a control mechanism, which means that all decisions made by managers must be justified and understood by family members in face-to-face conversations.

On the contrary, Chua and Schnabel (1986) provide theoretical findings that lead to competitive advantage for family firms. Indeed, they explain why the investments yield both pecuniary and non-pecuniary returns; the equilibrium pecuniary return will be lower for these investments. This is due to the holders of these investments obtaining extra compensation via non-pecuniary returns. In other words, families orienting non-pecuniary returns from their involvement in family firms may have a lower pecuniary cost of equity capital. As a result, it will partially explain the predominance of family firms in the competitive economy.

In general, agency problems soaring from the separation of ownership and management may differ in family firms due to the non-economic objectives. Consequently, agency costs can still come from majority–minority and lender–owner conflicts of interest. Theoretically, the agency costs may be negatively related to ownership equity, which means the agency costs could be lower at firms where a single family controls more than 50 percent of the firm's equity (Ang et al., 2000).

2.3. Agency Costs and Corporate Governance

The word 'governance' is very synonymous with organizations and corporate economy. This term has been used for a long time and is very significant to business organizations, especially in light of recent misconduct in the business

www.Accfile.com | @accfile

www.accfile.com

world. MacMillan and Downing (1999) state that corporate governance has become compulsory for a firm to perform competitively as well as in promoting a firm's entrance to the international capital market. Therefore, there is a need to apply good governance that is induced by the market.

There are limited studies examining the relationship between corporate governance mechanisms and agency costs. However, there is empirical evidence that the internal governance mechanisms play an important role as a monitoring device in restricting agency-related costs. According to Pearce and Zahra (1991), large boards are more powerful and effective than small boards. They document that large board size could lead to better alignment between firms and the environment, provide better advice and counsel in the management process of decision making and improve company image. Singh and Davidson III (2003) support that argument with evidence that the board size has a positive and significant influence on the asset utilization ratio. It suggests that a higher asset utilization ratio indicates lower agency costs.

However, Beiner, Drobetz, Schmid, and Zimmermann (2004) and Eisenberg, Sundgren, and Wells (1998) claim that the larger the board, the less effective the communication skills, coordination, and decision making compared to a small board. This statement is endorsed by Florackis and Ozkan (2004) who study a large sample of publicly listed U.K. firms between 1999 until 2003. Their findings show that board size has a negative coefficient in relation to asset turnover as the agency cost proxy, indicating that a larger board size is less efficient and leads to higher agency costs.

Agency costs occur from the misalignment of interests between the firm's managers and the firm's shareholders. This conflict of interest between manager and shareholders is caused by the physical presence of excess cash or cash equivalents (Jensen & Meckling, 1976).

Singh and Davidson III (2003) reveal that a board with small size has a positive and significant influence on asset utilization efficiency showing that higher asset utilization efficiency indicates lower agency costs. The results are consistent with Florackis and Ozkan's (2004) findings, which show that board size has a negative coefficient in relation to asset turnover, indicating that larger board sizes are less efficient (Beiner et al., 2004; Eisenberg et al., 1998).

The presence of outside directors on the board is perceived as a governance mechanism that could help in monitoring the agency problem. Consequently, Jensen (1993) and Berle and Means (1932) open the debate as to whether non-executive directors promote shareholders interest. Some researchers explain that non-executive directors are more likely to align themselves with top

www.Accfile.com | @accfile

www.accfile.com

management rather than the shareholders. This is not due to top managers having a strong influence over who is on the board (Hermalin and Weisbach, 1998; Bryd and Hickman, 1992; Mace, 1986), but because non-management directors typically hold an unimportant portion of the firm's stock (Rhoades, Rechener, & Sundramurthy, 2000; Brickly et al., 1994; Patton & Baker, 1987; Kosnik, 1987).

However, Kaplan and Reishus (1990) and Fama and Jensen (1983) argue that reputation concerns, fear of lawsuits and market for their services, motivates non-executive directors to represent shareholders. Various studies state that boards dominated by non-executive directors are more likely to act in the best interests of shareholders (Borokkhovich, Parrino, & Trapani, 1996; Westphal & Zaiac, 1995; Brickley, Coles, & Terry, 1994; Bryd & Hickman, 1992; Weisbach, 1988; Hermalin & Weisbach, 1988). McKnight and Mira (2003) find that as the number of non-executives on the board increases, agency costs tend to decrease and this evidence supports that argument. In contrast, Ang et al. (2000), Agrawal and Knoeber (1996), and Hermalin and Weisbach (1991) find evidence that agency costs are significantly higher when the firm is managed by outsiders rather than an insider of the company.

According to Fama and Jensen (1983), the agency theory proposes that duality could not be practiced or that separating the leadership structure to reduce agency cost. Indeed, it is believed that it could enhance firm performance and mitigate agency conflict when the duality role is not practiced on the board. However, Florackis and Ozkan (2004) and McKnight and Mira (2003) find evidence that duality has no influence on agency costs. Therefore, this study seeks to establish whether there are any significant differences between family and non-family ownership in governing the company. Therefore, the testable null hypotheses have been developed as follows:

$H_0$1. There is no difference in relationship between number of board size and agency costs of family and non-family firms.

$H_0$2. There is no difference in relationship between the proportion of independent directors and agency costs of family and non-family firms.

$H_0$3. There is no difference in relationship between the existence of duality and agency costs of family and non-family firms.

www.Accfile.com | @accfile

www.accfile.com

3. DATA AND METHODOLOGY

3.1. Description of Data

This study uses secondary data regarding ownership structure and financial indicators for the period of 1999–2005. The data was taken from the annual reports of company and financial databases such as Worldscope, Datastream, and Perfect Analysis. Information on corporate governance mechanisms such as board size (BSize), independent directors (Outdir), and duality (Duality) were gathered from the Companies Annual Reports. This information was obtained manually by calculating the number of directors on the board, the number of independent directors on the board, and determining the duality role of CEO and chairman of the company for the years 1999–2005.

All companies listed on the Main Board of the Bursa Malaysia (formerly known as the Kuala Lumpur Stock Exchange (KLSE)) were selected as a sample for the study as at December 31, 1999. The study did not select the companies listed on the Second Board of the Bursa Malaysia due to the difference in the paid-up capital and listing requirements. Thus, there are a total number of 474 companies listed on the Main Board of Bursa Malaysia at the end of 1999. As a longitudinal study, it is important to ensure that all companies were active for the entire period of the study. Therefore, this study implements non-probability sampling by using the judgment method to select sample members to fit to some criterion (Cooper & Schindler, 2001).

To be selected as a sample the company must be active or survive for the entire period of the study, i.e. from 1999 to 2005. Companies that were newly listed after 31 December 1999 or delisted from the Main Board were excluded from the sample. In addition, the study excluded companies which failed to comply with any obligations under Practice Notes such as Practice Note No 4 (PN4) and Practice Note No 17 (PN17), and also companies with incomplete data.[1] There were 93 companies which failed to comply with any obligation under PN4 and PN17, and 46 companies with incomplete data. However, the study includes companies that changed their company' name (24 companies) during the study period. As well, the company must have completed a full accounting period or 12 months business operation for each year and should be consistent with the same year-end throughout the 7-year period.

Additionally, the study also excludes all 45 financial firms from the sample since the accounting standards for income and profit for these firms are significantly different from other industries (Campbell & Keys, 2002; Lemmon & Lins, 2001; Claessens, Djankov, & Lang, 1999). In Malaysia,

www.Accfile.com | @accfile

www.accfile.com

financial firms are licensed institutions covered under the Banking and Financial Institution Act, 1989 (BAFIA). The BAFIA provides new laws for licensing and regulation of groups and institutions such as commercial banks, finance companies, merchant banks, discount houses and money brokers. Therefore, the rules and regulations of financial companies are significantly different from other sectors and it is important to exclude them from the data in order to avoid miscalculation of measurements used in the analysis (Table 1).

The identification of family ownership is the primary concern in this study and is based on two criteria. The first criterion is the presence of a family member on the board, which has been used by Yammeesri and Lodh (2004), Anderson and Reeb (2003), and Yeh et al. (2001) to identify family firms. Then, the second criterion is that family members must hold at least 20 percent of outstanding equity stake as the cut off level benchmark as used by Sraer and Thesmar (2006), Favero et al. (2006), La Porta et al. (1999), and Berle and Means (1932). In order to be selected as family ownership, the selected firm must fulfill either one or both of these criteria. The study uses family ownership as a dummy variable which takes a value of 1 if the company is identified as family and 0 otherwise.

The study categorizes the sample as non-family ownership when the firm does not meet the criteria used in determining family ownership. Other types of ownership which have been included as non-family ownership are state-owned

Table 1. Description of Data Set Selected from the Main Board Companies.

Data Description	Number of Companies
Total of Main Board companies listed on Bursa Malaysia as at 31 December 1999	474
Minus:	
Finance related companies such as commercial banks, finance companies, merchant banks, discount houses and money brokers	45
Minus:	
Companies that fail to comply with any obligations under Practice Note (PN4 and PN17)	93
Minus:	
Companies with incomplete data	46
Number of Companies available for observation	**290**

www.Accfile.com | @accfile

www.accfile.com

firms (also known as government-linked company (GLCs)), foreign-owned firms, and other widely held firms. However, financial companies are excluded from the sample due to the difference in the regulatory requirements.

This study will apply two types of agency cost proxies to analyze the relationship between agency costs and corporate governance between full sample, family and non-family ownership. These are the asset utilization ratio (AC1) and expense ratio (AC2). The asset utilization ratio or asset turnover ratio is one of the efficiency ratios, which is annual sales divided by total assets. The asset utilization ratio measures how effectively the management of the company uses or organizes its assets. The company who experiences low asset utilization ratio indicates high agency costs meaning an inverse relationship to each other. This proxy for agency costs has been adopted by Florackis and Ozkan (2004), Singh and Davidson III (2003), and Ang et al. (2000). The expense ratio is also an efficiency ratio, as measured by operating expense divided by annual sales. This study adopts the agency costs proxy as used previously by Ang and Ding (2005) and Ang et al. (2000). This efficiency ratio measures how effectively the management of the company controls operating costs such as expenses on the luxury automobiles or company furniture, and also other direct agency costs. In contrast to the asset utilization ratio, agency costs are positively related to expense ratio. It indicates that a high expense ratio experiences high agency costs.

Several control variables used to control for companies characteristics such as firm size, firm risk, and firm age. Firm size is the natural log of total asset (lnasset) of the company. We also control for companies debt ratio as a firm leverage (Lev) by calculating total debt over total asset of the company. Firm age (Age) is measured as the number of years since the company is incorporated.

In this analysis, the data will be testified to establish which estimation of panel data regression is appropriate by using the Pooled Ordinary Least Squared (OLS), the Fixed and the Random effects approach. Both the Fixed and Random effects approach use the Redundant Fixed Effects-Likelihood Ratio and Correlated Random Effects-Hausman Tests to testify the significance of the Fixed and Random Effects model. Finally, the Fixed effect approach has been selected as the most appropriate model for this study. Thus we develop the following model in the study to analyze the relationship between corporate governance and agency cost for both family and non-family ownership.

www.Accfile.com | @accfile

www.accfile.com

Model. Corporate Governance and Agency Costs

$$\text{Agency Costs} = \alpha_0\beta_1\text{Lev} + \beta_2\text{Age} + \beta_3\text{Lnasset} + \beta_4\text{Bsize} + \beta_5\text{OutDir} + \beta_6\text{Duality} + \varepsilon$$

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics

Part A of Table 2 presents the firms characteristics statistics for full and individual samples of family and non-family ownership in Malaysia and Table 3 presents the differences in means test for both family and non-family. The descriptive statistics show an average value of leverage (the proportion of total debt to total asset) for the full sample of 26.0 percent

Table 2. Descriptive Statistics for Full Sample, Family, and Non Family for Year 1999 to 2005.

Variables	Full Sample (N = 290)		Family (N = 125)	Non Family (N = 165)
	Mean	Std Dev	Mean	Mean
A: Firms Characteristics				
Firm Leverage	0.26	0.255	0.256	0.262
Firm Age (years)	29.617	17.798	29.2	29.8
Firm Size (total asset) ('000)	1,936,356.6	4,517,151.2	1,700,708.6	2,114,877.7
Market Capitalization ('000)	1,100,952.6	3,189,398.3	803,379.00	1,326,387.1
B: Agency Costs Characteristics				
Asset Utilization Ratio (AC1)	0.703	2.482	0.559	0.813
Expense Ratio (AC2)	0.317	0.598	0.31	0.322
C: Governance (Board Structure) Characteristics				
Board Size (Number of person)	8	1.875	8	8
Independent Director (fractional)	0.385	0.088	0.361	0.403
Percentage of Duality in sample:	Non-Duality (0)	Duality (1)		
Full Sample	93.5%	6.5%		
Family	87.5%	12.5%		
Non-Family	98.2%	1.8%		

www.Accfile.com | @accfile

www.accfile.com

Table 3. Differences of Means Tests.

Variables	Family (N = 125)	Non Family (N = 165)	
	Mean	Mean	t-statistics
A: Firms Characteristics			
Firm Leverage	0.256	0.262	−0.199
Firm Age (years)	29.2	29.8	−0.28
Firm Size (total asset) ('000)	1,700,708.6	2,114,877.7	−0.773
Market Capitalization ('000)	803,379.00	1,326,387.1	−1.524
B: Agency Costs Characteristics			
Asset Utilization Ratio (AC1)	0.559	0.813	−0.862
Expense Ratio (AC2)	0.31	0.322	−0.167
C: Governance (Board Structure) Characteristics			
Board Size (Number of person)	8	8	0.373
Independent Director (fractional)	0.361	0.403	−4.341*

* significant at 0.01 level

while the leverage ratio for family and non-family are 25.6 percent and 26.2 percent, respectively. The results show that the family ownership uses less debt, however, family firms do not appear to use debt differently than non-family, which is consistent with the findings of Sraer and Thesmar (2006), Barontini and Caprio (2005), Anderson and Reeb (2003), Mishra et al. (2001), Mishra and McConaughy (1999), and Gorriz and Fumas (1996).

The average of firm age in all samples of the study is nearly 30 years old, ranging from 3- to 95 years old and is not statistically significant different between family and non-family ownership in this sample. Even though there is no significant difference in age between family and non-family, family firms are younger than non-family firms (29 versus 30 years old) consistent with Amit and Villalonga (2006), Sraer and Thesmar (2006), and Anderson and Reeb (2003). For the period of the study, the descriptive statistics show that an average value of total assets for all firms amounts to RM1,936.36 million. The data includes very small companies as well as large companies with a mean value of total assets of RM56,964.96 million and RM21.29 million, respectively. In relation to ownership structure, on average, family ownerships are smaller than non-family ownership but still of large size with average total assets of RM1,700.71 million relative to RM2,114.88 million, and statistically insignificantly different in mean. This result is similar with other empirical studies on family and non-family firms such as Sraer and Thesmar (2006), Favero et al. (2006), Amit and Villalonga (2006), Barontini and Caprio (2005), Anderson and Reeb (2003), and Mishra et al. (2001).

www.Accfile.com | @accfile

www.accfile.com

In addition, the mean value of market capitalization for all firms amounts to RM1,100.95 million with the highest (lowest) level being RM33,611.57 million (RM27.56 million). In comparing the average value of market capitalization between family and non-family ownership, the results show that non-family has RM1,326.39 million more market value than family, which amounts to RM803.38 million. However, this result shows that there is no evidence of statistically significant differences in means for risk or leverage, age, total assets, and market capitalization between family and non-family.

Part B of Table 2 presents the descriptive statistics of agency cost proxies as measured by the asset utilization ratio (AC1) and the expense ratio (AC2). For the full sample, the average ratio of operating expenses to assets and asset turnover is 31.7 and 70.3 percent respectively. In addition, on average, the mean value of asset utilization ratio for non-family ownership is higher with a value of 81.3 percent compared to family ownership of 55.9 percent. This finding suggests that non-family ownership experiences low agency costs as the higher the asset utilization ratio indicates low agency cost of the firms. Yet, there is no evidence of a significant difference in means between the groups. The finding is consistent with McConaughy, Matthews, and Fialko (2001) who use a similar agency cost proxy in their research on family and non-family ownership.

Further examination of the comparisons reveal that family ownership experiences low agency costs with the average expense ratio of family at 31.2 percent, which is slightly lower than non-family ownership at 32.0 percent. In this case, low expense ratio indicates low agency costs. But, again the difference is not statistically significant. The result supports the argument of DeAngelo and DeAngelo (1985) and Fama and Jensen (1983), who propose that family involvement can mitigate agency costs and improve monitoring of the firm's managers.

For corporate governance structure as depicted in Part C of Table 2, the average board size for full sample, family and non-family ownership is nearly eight persons on the board. This number is within the size that was recommended by Lipton and Lorsch (1992) and consistent with the previous study on performance of corporate governance in Malaysia conducted by Haniffa and Hudaib (2006). On the contrary, the results in Table 3 show that the *t*-statistics of differences were not significant in relation to board size between family and non-family ownership, which is inconsistent with Mishra et al. (2001). In addition, the minimum number of board members observed in the findings for all firms, is on average, about 4 persons and the maximum number about 16 persons.

www.Accfile.com | @accfile

www.accfile.com

The independent director shows a statistically significant difference in mean between family and non-family at the 1 percent level. In general, independent directors were more common in non-family than family ownership. The results show that the proportion of independent directors on the board is 40.3 and 36.1 percent for non-family and family, respectively. It shows that the board members of family firms have fewer or a lower proportion of outside representatives and is consistent with the findings of Amit and Villalonga (2006), Anderson and Reeb (2003), and Mishra et al. (2001). Furthermore, the percentage of independent directors in all samples was 38.5 percent, which means around one-third (1/3) of all board of director members, as regulated by the laws.

The frequency of the duality shows that only 6.5 percent out of all samples have not separated the role of chairman and CEO on the board. There are a few firms where both positions on the board are held by one individual, as observed by low frequencies of average percentage – 12.5 percent and 1.8 percent in family and non-family ownership, respectively. There is a lack of empirical evidence concerning the comparison of the duality role between family and non-family ownership. It is interesting to note that the duality concept should be explored to find it significant in increasing the efficiency of monitoring due to less monitoring contracting is required and decreasing information asymmetry as stated by Haniffa and Cooke (2002) and Pi and Timme (1993).

Table 4 presents the correlation matrix for the dependent and independent variables of the study. Family ownership is insignificantly negatively correlated to the following variables: asset utilization ratio (AC1), expenses ratio (AC2), firm leverage, firm size, firm age, and board size. With respect to the relationship between family ownership and board size, this result is inconsistent with Mishra et al. (2001) and Yermack's (1996) study on Norwegian and U.S. family firms, respectively. However, board size is quite highly significantly positively correlated to firm size (37.8 percent) and significantly negatively correlated to the firm age (−15 percent). It means that as the size of the firm becomes larger, the number of directors on the board also increases.

4.2. Corporate Governance and Agency Costs

The proposition is to investigate the effect of corporate governance mechanisms such as board size, independent director and duality as a device in mitigating agency costs for firms in Malaysia. The results as tabulated in Tables 5 and 6 show that the corporate governance matters in Malaysian firms depend on the aspect of corporate governance, ownership

www.Accfile.com | @accfile

www.accfile.com

Table 4. Pearson's Correlation Matrix.

Variables	AC1	AC2	LEV	LN-ASSET	AGE	BSIZE	OUTDIR	DUALITY	FAMILY
AC1	1								
AC2	−0.06	1							
LEV	0.003	0.086	1						
LNASSET	0.016	−0.081	−0.021	1					
AGE	−0.1	0.091	0.058	−0.019	1				
BSIZE	0.042	−0.091	−0.145*	0.378**	−0.150*	1			
OUTDIR	−0.045	0.086	0.1	−0.019	0.215**	−0.400**	1		
DUALITY	−0.015	0.019	0.038	0.108	−0.005	0.003	−0.003	1	
FAMILY	−0.05	−0.007	−0.01	−0.009	−0.009	0.016	−0.235**	0.261**	1

** significant at 0.01 level (2-tailed). * significant at the 0.05 level (2-tailed).

Table 5. The Fixed Effect Models by Using Asset Utilization Ratio (AC1).

Variables	Full Sample (N = 290)	Family (N = 125)	Non Family (N = 165)
Intercept	0.030	1.517	−0.525
	(0.232)	(15.151)***	(−2.785)***
Firm Leverage	−0.152	−0.081	−0.107
	(−6.301)***	(−3.838)***	(−3.224)***
Firm Age (years)	0.030	0.014	0.032 *
	(21.723)***	(12.021)***	(13.718)**
Firm Size (lnasset)	−0.038	−0.102	0.0004
	(−4.087)***	(−11.950)***	(0.030)
BSize	0.022	0.005	0.025
	(7.413)***	(2.249)**	(5.566)***
OutDir	0.398	−0.030	0.508
	(8.916)***	(−0.968)	(7.225)***
Duality	0.066	0.021	−0.060
	(2.899)***	(1.656)*	(−0.971)
Observation	2030	875	1155
R^2	0.748	0.686	0.74
Adj. R^2	0.735	0.673	0.73
F-stat (p-value)	6.958	162.577	90.619
	(0.000)	(0.000)	(0.000)

*** Significant at the 1% level. ** Significant at the 5% level.
* Significant at the 10% level. *t-statistics* are in parentheses

type, and also the measurements used as agency cost proxies. In this analysis, the study finds that all firms and both family and non-family reveal similar results, which are significantly positively related with regard to the relationship between board size and asset utilization ratio. This result

www.Accfile.com | @accfile

www.accfile.com

Table 6. The Fixed Effect Models by Using Expense Ratio (AC2).

Variables	Full Sample (N = 290)	Family (N = 125)	Non Family (N = 165)
Intercept	1.667	1.138	1.581
	(13.918)***	(4.836)***	(11.090)***
Firm Leverage	0.019	0.130	−0.009
	(1.102)	(3.216)***	(−0.430)
Firm Age (years)	0.016	0.015	0.019
	(18.462)***	(10.917)***	(15.139)***
Firm Size (lnasset)	−0.135	−0.100	−0.138
	(−14.542)***	(−5.373)***	(−12.157)***
BSize	0.001	0.005	0.002
	(0.848)	(1.543)	(1.099)
OutDir	−0.028	0.042	0.021
	(−1.223)	(0.887)	(0.633)
Duality	−0.109	−0.068	0.058
	(−3.473)***	(−1.384)	(1.815)*
Observation	2030	875	1155
R^2	0.75	0.663	0.708
Adj. R^2	0.707	0.605	0.657
F-stat (p-value)	17.605	11.278	14.001
	(0.000)	(0.000)	(0.000)

*** Significant at the 1% level. ** Significant at the 5% level.
* Significant at the 10% level. *t-statistics* are in parentheses

supports the findings of Singh and Davidson III (2003) who finds evidence that board size is significantly positively related to the asset utilization ratio, which leads to lower agency costs.

Furthermore, as suggested by Pearce and Zahra (1991), larger boards are more powerful and effective than small boards, which could lead to better alignment between firms and the environment, and provide better advice and counsel in management processes and decision making thereby improving the company image. As a result, there is strong evidence that board size has a significant effect as a device in reducing agency costs by increasing the number of members on the board. Moreover, the board of directors must be composed of valuable and knowledgeable persons who can give advice, counsel, and as a channel for communicating information between external organizations and the firm (Pfeffer & Salancik, 1978).

The study also finds that having independent directors on the board has a positive and significant influence on the asset utilization ratio, however, no evidence is found regarding expense ratio for all firms in Malaysia. Therefore,

www.Accfile.com | @accfile

www.accfile.com

the study agrees that as the number of outside directors on the board increase, the asset utilization ratio also increases, hence mitigating agency costs. In fact, various studies state that boards dominated by non-executive directors are more likely to act in the shareholders' best interests and thereby may minimize the conflicts between shareholders and managers (McKnight & Mira, 2003; Westphal & Zaiac, 1995; Brickley et al., 1994; Bryd & Hickman, 1992; Hermalin & Weisbach, 1988). Furthermore, Kaplan and Reishus (1990) and Fama and Jensen (1983) claim that for reputation concerns, fear of lawsuits and the market for their services motivates non-executive directors to represent shareholders.

The proportion of independent directors is significantly positively related to the asset utilization ratio, but not significant to the expense ratio for non-family firms. But for family firms, the results are in the opposite direction to non-family, which is negatively (positively) related to asset utilization ratio (expense ratio), but not statistically significant. The result indicates that the effect of corporate governance differs with the ownership type. It shows that firms with non-family ownership prefer more independent directors on the board as this may bring in expertise, experience, contacts, and contracts, but is often more specifically for political reasons, legitimacy and reputation (Haniffa & Hudaib, 2006; and Pfeffer & Salancik, 1978). Conversely, family ownership does not rely on outside directors, which maybe due to outside directors lacking knowledge about the family firm's specific interests and consequently be detrimental to the firm's strategic mission. Furthermore, family ownership usually has greater access to more comprehensive internal information and is also more concerned with family interests (Haat & Mahenthiran, 2003; Haniffa & Cooke, 2002).

In relation to the role of duality, there is a statistically significant positive relationship with the asset utilization ratio and a significant negative relationship to the expense ratio for all firms. Firms with family ownership also reveal similar results with asset utilization ratio, but the relationship is not significant with the expense ratio. The results indicate that firms with duality practice could increase the asset utilization ratio. In fact, firms with a high asset utilization or turnover ratio illustrate that firms have generated a large amount of sales, and, definitely cash flow for a given level of their assets. This scenario describes firms that have been identified with efficient asset management practices that create shareholder value, thus, having less agency conflict relative to those firms with a lower asset turnover. Generally, there is strong evidence that firms with a duality role experience less agency conflicts (Singh and Davidson III, 2003).

Conversely, non-family ownership with duality role is significantly positively related to expense ratio, but not significant to asset utilization ratio. The results

www.Accfile.com | @accfile

www.accfile.com

show that the existence of a duality role on the board increases the expense ratio, indicating that these firms experience high agency costs. This finding is further supported by Fama and Jensen (1983) who argue that if the role of duality is separated on the board, it could mitigate agency conflict. Furthermore, Bliss and Balachandran (2003) suggest that the Malaysian regulatory authorities mandate the separation of board CEO and chairman to avoid that person becoming vested with too much power and making decisions that do not maximize the shareholders' wealth. Duality is found to be uncommon in Malaysia with a small frequency value of less than 10 percent. The MICG also recommends that firms separate the positions of the CEO and chairman to avoid excessive power being held by one person (Haniffa & Hudaib, 2006).

5. CONCLUSIONS

This study investigates the effect of corporate governance mechanisms on firm performance and also agency costs between family and non-family ownership of 290 Malaysian public-listed companies over the period of 1999–2005. The research findings of the study provide significant evidence that with a higher number of independent directors on the board, the higher the agency costs faced by family ownership, however, the results are not statistically significant. It means that family ownership does not rely on outside directors and they usually have greater access to more comprehensive internal and external information and are also more concerned with family interests (Haat & Mahenthiran, 2003; Haniffa & Cooke, 2002). Conversely, non-family ownership needs more independent directors to counsel and monitor the company and hence reduce the agency conflict with shareholders. This strong evidence implies that a higher presence of independent directors in a non-family owned firm could improve the firm's value by bringing in their expertise and contacts to the firm (Grace, Ireland, & Dunstan, 1995; Kesner & Johnson, 1990; Tricker, 1984). In addition, this result agrees that independent directors of non-family owned firms influence the quality of decision and director's thoughtfulness in providing strategic direction for the companies (Pearce & Zahra, 1992).

The results of the study can create awareness for both scholars and practitioners. As an original piece, this study reveals the significance of Malaysian family business performance in the competitive marketplace. Indeed, the non-family performance is also evaluated. To academicians, even though there is a plethora of research in the U.S. and Europe, the scarce study on Malaysian family firms means that this study has enriched the family performance literature from the perspective of agency costs and

www.Accfile.com | @accfile

www.accfile.com

corporate governance. To practitioners, this study encourages and supports family firms, and considers some family attributes as a value to excel in the business market.

NOTES

1. PN4 and PN17 are the criteria and obligations pursuant to paragraph 8.14 and 8.14c, respectively, of the listing requirements in the Bursa Malaysia. Both PN4 and PN17 occur when firms have financial difficulties. PN4 is further amended to PN17 with came into effect on January 3, 2005.

REFERENCES

Abdul Rahman, R. (2006). *Effective corporate governance* (1st ed.). Uitm, Shah Alam, Malaysia: University Publication Centre (UPENA).

Agrawal, A., & Knoeber, C. R. (1996). Firm performance and mechanisms to control agency problems between managers and shareholders. *Journal of Financial and Quantitative Analysis*, *31*, 377–397.

Amit, R., & Villalonga, B. (2006). How do family ownership, control, and management affect firm value? *Journal of Financial Economics*, *80*(2), 385–417.

Anderson, R. C., & Reeb, D. M. (2003). Founding-family ownership and firm performance: Evidence from the S&P 500. *Journal of Finance*, *58*(3), 1301–1328.

Ang, J., Cole, R., & Lin, J. (2000). Agency costs and ownership structure. *Journal of Finance*, *55*(1), 81–106.

Ang, J. S., & Ding, D. K. (2005). Government ownership and the performance of government-linked companies: The case of Singapore. *Journal of Multinational Financial Management*, *6*, 37–62.

Barontini, R., & Caprio, L. (2005). *The effect of family control on firm value and performance: Evidence from Continental Europe*. ECGI Finance Working Paper No 88/2005, http://ssrn.com/abstract=675983

Becker, G. S. (1974). A theory of social interaction. *Journal of Political Economy*, *82*, 1063–1093.

Beiner, S., Drobetz, W., Schmid, F., & Zimmermann, H. (2004). *An integrated framework of corporate governance and firm valuation: Evidence from Switzerland*. ECGI paper 34/2004.

Berle, A., & Means, G. (1932). *The Modern Corporation and Private Property*. New York, NY: MacMillan.

Bliss, M., & Balachandran, J. (2003). *CEO Duality, Audit Committee Independence and Voluntary Disclosure in Malaysia, in International Conference on 'Quality Financial Reporting and Corporate Governance-Building Public Trust, Integrity and Accountability'*. Kuala Lumpur, MALAYSIA, pp. 1–27.

Borokkhovich, K. A., Parrino, R., & Trapani, T. (1996). Outside directors and CEO selection. *Journal of Financial and Quantitative Analysis*, *31*(3), 337–355.

www.Accfile.com | @accfile

www.accfile.com

Brickley, J. A., Coles, J. L., & Terry, R. L. (1994). Outside directors and the adoption of poison pills. *Journal of Financial Economics*, *34*, 371–390.

Bryd, J. W., & Hickman, K. A. (1992). Do outside directors monitor managers? *Journal of Financial Economics*, *32*, 195–221.

Campbell, T. L., & Keys, P. Y. (2002). Corporate governance in South Korea: The Chaebol experience. *Journal of Corporate Finance*, *8*(4), 373–391.

Chua, J. H., & Schnabel, J. A. (1986). Nonpecuniary benefits and asset market equilibrium. *Financial Review*, *21*, 185–190.

Claessens, S., Djankov, S., & Lang, L.H.P. (1999). *Expropriation of minority shareholders: Evidence from East Asia*. World Bank Policy Research Paper No. 2088, http://www.worldbank.org/research/interest/prr_stuff/working_paper/2088.pdf

Claessens, S., Djankov, S., & Lang, L. H. P. (2000). The separation of ownership and control in East Asian corporation. *Journal of Financial Economics*, *58*, 81–112.

Cooper, D. R., & Schindler, P. S. (2001). *Business Research Method* (7th ed.). Singapore: Irwin/McGraw Hill Publication.

Daily, C. M., & Dollinger, M. J. (1992). An empirical examination of ownership structure in family and professionally-managed firms. *Family Business Review*, *5*, 117–136.

DeAngelo, H., & DeAngelo, L. (1985). Managerial ownership of voting rights: A study of public corporations with dual classes of common stock. *Journal of Financial Economics*, *14*, 33–69.

Eisenberg, T., Sundgren, S., & Wells, M. (1998). Larger board size and decreasing firm value in small firms. *Journal of Financial Economics*, *48*, 35–54.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of Management Review*, *14*, 57–74.

Fama, E. F., & Jensen, M. C. (1983). Separation of ownership and control. *Journal of Law and Economics*, *26*(June), 301–325.

Favero, C.A., Giglio, S.W., Honorati, M., & Panunzi, F. (2006). *The performance of Italian family firms*. ECGI Working Paper No. 127/2006, http://ssrc.com/abstract_id=918181.

Florackis, C., & Ozkan A. (2004). *Agency costs and corporate governance mechanisms: Evidence for UK firms*. Working Paper, University of York, UK.

Gomez, E. T. (2004). De-essentialising capitalism: Chinese networks and family firms in Malaysia. *NIASnytt*, *3*, 8–10.

Gorriz, C. G., & Fumas, V. S. (1996). Ownership structure and firm performance: Some empirical evidence from Spain. *Managerial and Decision Economics*, *17*, 575–586.

Grace, M., Ireland, A., & Dunstan, K. (1995). Board composition, non-executive directors' characteristics and corporate financial performance. *Asia-Pacific Journal of Accounting*, *17*, 121–158.

Gursoy, G., & Aydogan, K. (2002). Equity ownership, risk taking and performance: An empirical investigation in Turkish listed companies. *Emerging Markets Finance and Trade*, *38*(6), 6–25.

Haat, M.H.C., & Mahenthiran, S. (2003). Is corporate governance is an issue in PN4 companies? In *International Conference on 'Quality Financial Reporting and Corporate Governance-Building Public Trust, Integrity and Accountability'* (pp. 1–30). Kuala Lumpur, Malaysia.

Haniffa, R., & Hudaib, M. (2006). Corporate governance structure and performance of Malaysian listed companies. *Journal of Business Finance and Accounting*, *33*(7–8), 1034–1062.

Haniffa, R. M., & Cooke, T. E. (2002). Culture, corporate governance and disclosure in Malaysian corporation. *Abacus*, *38*(13), 317–349.

www.Accfile.com | @accfile

www.accfile.com

Hermalin, B. E., & Weisbach, M. S. (1988). The determinants of board composition. *Rand Journal of Economics*, *19*(4), 589–606.

Hermalin, B. E., & Weisbach, M. S. (1991). The effects of board composition and direct incentives on firm performance. *Financial Management*, 101–112.

Hermalin, B. E., & Weisbach, M. S. (1998). Endogenously chosen boards of directors and their monitoring of the CEO. *American Economic Review*, *88*(1), 96–118.

Jensen, M. C. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance*, *43*(3), 831–880.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics*, *3*(4), 305–360.

Kang, D. (1998). *The impact of ownership type on performance in public corporations: A study of the US textile industry 1983–1992*. School Working Paper Harvard Business.

Kang, D. (2000). The impact of family ownership on performance in public organization: A study of the U.S. fortune 500, 1982–1994, 2000. *Academy of Management Meeting*. Toronto, Canada

Kaplan, S. N., & Reishus, D. (1990). Outside directorships and corporate performance. *Journal of Financial Economics*, *27*(2), 389–410.

Kesner, I. F., & Johnson, R. B. (1990). An investigation of relationship between board composition and shareholder suits. *Strategic Management Journal*, *11*, 327–363.

Kosnik, R. (1987). Greenmail a study of board performance in corporate governance. *Administrative Science Quarterly*, *32*, 163–185.

La Porta, R., Lopez-De-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *Journal of Finance*, *54*(2), 471–517.

Lemmon, M., & Lins, K. V. (2001). Ownership structure, corporate governance, and firm value: Evidence from the East Asian financial crisis. *Journal of Finance*, *58*(4), 1445–1468.

Lipton, M., & Lorsch, J. (1992). A modest proposal for improved corporate governance. *Business Lawyer*, *48*, 59–77.

Mace, M. (1986). *Directors: Myth and reality*. Harvard University: Boston, MA.

MacMillan, K., & Downing, S. (1999). Governance and performance: Goodwill hunting. *Journal of General Management*, *24*(3), 11–21.

McConaughy, D. L., Matthews, C. H., & Fialko, A. S. (2001). Founding family controlled firms: Performance, risk and value. *Journal of Small Business Management*, *39*(1), 31–49.

McKnight, P.J., & Mira, S. (2003). *Corporate governance mechanisms, agency costs and firm performance in UK firms*. http://ssrn.com/abstract=460300.

Mishra, C. S., & McConaughy, D. L. (1999). Founding family control and capital structure: The risk of loss of control and the aversion to debt. *Entrepreneurship: Theory and Practice*, *23*(4), 53–64.

Mishra, C. S., Randoy, T., & Jenssen, J. I. (2001). The effect of founding family influence on firm value and corporate governance. *Journal of International Financial Management and Accounting*, *12*(3), 235–259.

Mohd Sehat, R., & Abdul Rahman, R. (2005). *Ownership of the firm and corporate value*. Working Paper Faculty of Accountancy, Universiti Teknologi MARA, Shah Alam, Selangor.

Parsons, D. (1986). The employment relationship: Job attachment, work effort, and the nature of contracts. In: O. Ashenfelter & R. Layard (Eds), *The Handbook of Labor Economics* (pp. 789–848). Amsterdam: North Holland.

Patton, A., & Baker, J. C. (1987). Why won't directors rock the boat? *Harvard Business Review*, *65*, 10–12.

www.Accfile.com | @accfile

www.accfile.com

Pearce, J. A., & Zahra, S. A. (1991). The relative power of CEOs and boards of directors: Association with corporate governance. *Strategic Management Journal*, *12*, 135–188.

Pearce, J. A., & Zahra, S. A. (1992). Board composition from a strategic contingency perspective. *Journal of Management Studies*, *29*(4), 411–438.

Pfeffer, J., & Salancik, G. R. (1978). *The external control of organizations: A resource dependence perspective*. New York: Harper and Row.

Pi, L., & Timme, S. G. (1993). Corporate control and bank efficiency. *Journal of Banking Finance*, *17*, 515–530.

Rhoades, D., Rechener, P., & Sundramurthy, C. (2000). Board composition and financial performance: A meta analysis of the influence of outside directors. *Journal of Managerial Issues*, *12*(1), 76–91.

Singh, B. (2009). Malaysia's 40 richest. *Malaysian Business* (February), 16.

Singh, M., & Davidson, W. N., III. (2003). Agency costs, ownership structure and corporate governance mechanisms. *Journal of Banking and Finance*, *27*, 793–816.

Sraer, D., & Thesmar, D. (2006). *Performance and behavior of family firms: Evidence from the French stock market*. ECGI Working Paper No. 130/2006, http://ssrn.com/abstract_id=925415

Tricker, R. I. (1984). *Corporate governance practices, procedures and powers in British companies and their board of directors*. England: Gower Publishing Company Ltd.

Weisbach, M. S. (1988). Outside directors and CEO Turnover. *Journal of Financial Economics*, *20*(1), 431–460.

Westphal, J., & Zaiac, E. (1995). Who shall govern? CEO/board power, demographic similarty, and new director selection. *Administrative Science Quarterly*, *40*, 60–83.

World Bank. (1999). Report on the observance of standards and codes on Malaysia, http://www.worldbank.org/ifa/rosc_cg_malaysia.html.

Yammeesri, J., & Lodh, S. C. (2004). Is family ownership a pain or gain to firm performance? *Journal of American Academy of Business, Cambridge*, *4*(1/2), 263–270.

Yeh, Y. H., Lee, T. S., & Woidtke, T. (2001). Family control and corporate governance: Evidence from Taiwan. *International Review of Finance*, *2*(1/2), 21–48.

Yermack, D. (1996). Higher market values of companies with a small board of director. *Journal of Financial Economics*, *40*(2), 185–211.

www.Accfile.com | @accfile