DOES CORPORATE GOVERNANCE MATTER? EVIDENCE FROM RELATED PARTY TRANSACTIONS IN MALAYSIA

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ABSTRACT

This chapter investigates the relationship between related party transactions (RPTs), corporate governance, and firm performance. Specifically, this chapters examines the moderating effect of corporate governance on the RPTs–performance relationship. On the basis of 448 firm-year sample for 2005–2007, we find evidence that related transactions are detrimental to shareholders and thus reducing firm performance. However, the negative effect is mitigated with the presence of good governance, namely level of board independence and executive remuneration. Furthermore, we find auditor size as an external governance mechanism could also reduce the negative impact of RPTs.

Keywords: Corporate governance; related party transactions; MCCG.

JEL Codes: G32; G34; G38.

1. INTRODUCTION

Malaysia's capital market is synonymous with political connections or relationship-based economy. Due to the historical nature on how it (capital market) has been set up and the multicultural state of the community, it seems logical of such economic transactions be based on connections. Although not unique to Malaysia, family or state-run business groups and the informal nature of business relationships facilitate related party transactions (RPTs). RPTs are generally defined as transactions between a firm and related entities (e.g., subsidiaries, affiliates, principal owners, officers, and directors; Gordon, Henry, Louwers, & Reed, 2007).[1]

Many of such cases, these related transactions, are being dubbed as inevitable, useful, and recurring in ongoing operations (Organisation for Economic Co-operation and Development [OECD], 2009). These transactions, argued by the Task Force on Related Party Transactions established by OECD-Asian in 2008, have become increasingly challenging to the integrity on Asian capital market. The OECD, termed these transactions as abusive, argues that the costs of the transactions are high, whether in the form of one-off material expropriations of wealth, or the slow but surely expropriation of wealth through recurrent or continuous operational transactions. These transactions are often accompanied by a loss of business opportunity for the listed entity, overpayment of asset, or simply making use of financial services in a way that places the listed entity at risk (OECD, 2009). These RPTs are often pictured as nondisclosure to directors, especially when they are related parties (Young, 2005).

Among RPTs that were highlighted as abusive and detrimental to shareholders by the media are the Satyam case in India,[2] CNOOC Ltd in Hong Kong,[3] and Genting Malaysia Berhad in Malaysia.[4] Among the issues raised in the Genting Malaysia (Resorts World) RPT with its parent Genting Berhad were the appointment of a single "independent" property valuer for both of the transactions and the status of the independent directors when they sat on both boards (Genting Malaysia and Genting Berhad). Although the independent adviser for this transaction concluded that this transaction is rather immaterial and would not affect the future cash flow of the firms, alternatively it could be seen as cash extraction by the parent company, Genting Berhad. Another good example is Tai Kwong Yokohama Berhad shares plunges 38 percent when they announced of a recurrent party transaction on March 5, 2009 (*The Edge Daily*, 2009).[5]

Extant literature provides two contrasting views on the effect of RPT on firm performance. The first view is the conflict of interest view (Gordon,

Henry, & Palia, 2004a, 2004b), whereas the second is efficient transaction view. Gordon et al. (2004a, 2004b) argue that RPTs could either be detrimental to shareholders or it could represent a strategic economic decision by the company and therefore increases shareholders value. The first view point argued by Gordon et al. (2004a, 2004b) is the conflict of interest argument suggesting that such transactions are detrimental and value decreasing for shareholders. Gordon et al. (2004a, 2004b) based their argument on the notion of agency costs considered by Berle and Means (1932) and Jensen and Meckling (1976), which portrays the agency conflict between a manager and outside shareholders as the manager's tendency to expropriate the firm's resources for personal consumption. Gordon et al. (2004a, 2004b) state that the issues of RPTs are more of a concern when the monitoring mechanisms (i.e., board of directors) are involved in such transactions. Gordon and Henry (2005) argue that involvement in RPTs will increase the incentives for the directors to manage their earnings to justify their perquisites or mask their expropriation They argue that this scenario not only represents appropriation of firm's resources, but they also can conflict with and diminish the board of directors monitoring function. Furthermore, Ryngaert and Thomas (2007) explain that RPT could be detrimental to shareholders when the expected benefit from an RPT is less than could have obtained from a similar transaction with unrelated party.

Alternatively is the view referred as efficient transaction that these RPTs rationally fulfill economic demands of a company, such as securing in-depth skills and expertise or providing alternative forms of compensation. Gordon et al. (2004a, 2004b) and Ryngaert and Thomas (2007) argue that such transaction could be more effective and cost-efficient rather than engaging a similar transaction with an unrelated party. Ryngaert and Thomas (2007) outlined several potential benefits from RPTs. The first benefit is coordination of activities and feedback between contracting parties as it would be worthwhile to have related parties on board of directors as means to obtain quick feedback on operations. They state that these benefits arises from the need of fast information from vendors, the available information obtained from related parties are more reliable than from unrelated parties, and the due process of renegotiating contracts could be achieved with less hassle with related parties. Secondly is to promote contract efficiency facilitated from related parties' familiarities with each other. The third potential benefit is mitigation of holdup problems in the contracting process and the facilitation of investment in firm-specific relationships. They argue related parties have financial incentives to avoid holdup if they have substantial investment in related firms. Ryngaert and Thomas (2007) also

contend on the viewpoint of purely strategic business decision (e.g., advertising strategy) that RPTs could be beneficial.

Gordon et al. (2004a, 2004b) point out that these transactions do not harm the interests of shareholders as the amount of transactions is minimal and immaterial to firms. Therefore, the agency conflict that could exist is of little concern. Alternatively, it could be viewed that these transactions, no matter how small the amount is, present a risk exposure and bad publicity to the firm and could hurt a firm's share price, as demonstrated by Tai Kwong Yokohama Berhad in Malaysia. This corporate culture of RPTs could demonstrate the firms' inability to secure external or unrelated contract for economic transactions. These contrasting views offer very different implications of the potential costs and benefits of transactions with related parties.

Gordon et al. (2004a, 2004b) find industry-adjusted returns are negatively associated with RPTs. Ge, Drury, Fortin, Liu, and Tsang (2010) examine two types of RPTs (sales of goods and sales of assets) and find lower valuation coefficient for firms with these transactions than those without RPTs in China. Similarly, Kohlbeck and Mayhew (2010) find S&P 500 in 2001 firms with RPTs have significantly lower valuation and marginally lower subsequent return than firms with no connected transactions. Adopting an event study approach, Cheung, Rau, and Stouraitis (2006) find significant negative excess returns around the initial announcement of connected transactions. But Chien and Hsu (2010) find a negative relationship between RPTs and firm value for Taiwanese firms.

Corporate governance has been instrumental in the recovery from Asian Financial Crisis in 1997–1998, which included Malaysia. Among the major initiatives are the implementations of Malaysian Code on Corporate Governance (MCCG) as part of Bursa Malaysia's listing rule in 2001 and the incorporation of Minority Shareholders Watchdog Group (MSWG). Studies examining the impact on corporate governance in Malaysia have shown consistent results. Abdul Wahab, How, and Verhoeven (2007) find firm performance is significantly higher after the incorporation of MCCG in 2001. Furthermore, Abdul Wahab et al. (2007), utilizing a governance index, find that good corporate governance will result in higher firm performance. Haniffa and Hudaib (2006) find various corporate governance mechanisms effect firm performance. In short, corporate governance does matter, especially in mitigating the agency problem, and thus improving firm performance.

Therefore, the premise of this chapter is a simple one. We want to investigate the relationship between RPTs and firm performance and we want to examine whether presence of good corporate governance affects the expected negative relationship between RPTs and firm performance. Consistent with the

initiatives mentioned earlier, we included two sets of governance variables; namely, internal governance and external governance. The internal governance variables are duality, board independence, board size, and executive compensation. To control for external governance, we control for total shareholdings by institutional investors and auditor size in Malaysia. As our dependent variable is performance, we posit a positive relationship between governance mechanisms (internal and external) and firm performance. In addition, we include auditor size proxy by Big 4 or non-Big 4 auditing firms as another external governance mechanism. Fan and Wong (2005) find that auditor do play a governance role.

The presence of good governance warrants through assuring the RPTs are not detrimental to shareholders. Therefore, we predict a weaker negative relationship between RPTs and firm performance for firms with good corporate governance. Studies consistently show that RPTs occur in companies with weak governance and monitoring mechanisms (Gordon et al., 2004b; Kohlbeck & Mayhew, 2010), providing the possibility of opportunistic behavior. Gordon et al. (2007) argue that RPTs must be assessed in the firm's overall corporate governance structure, especially when dealing with gray directors, which are directors who are neither insiders nor totally independent of the firm. Studies examine RPTs in the context of agency conflict between minority and majority shareholders. Evidence pertaining to the role of corporate governance on related transactions has been rather consistent. Gordon et al. (2004a, 2004b) find firms with weaker corporate governance mechanisms are associated with more and higher dollar amounts of related transactions. On the basis of Australian sample, Gallery, Gallery, and Supranowicz (2008) find firms with higher proportion of independent directors and formation of an audit committee are associated with lower amount of related transactions. Chien and Hsu (2010) find a positive moderating effect of corporate governance on the related transactions-firm performance relationship and deduce that presence of corporate governance could "transfer" RPTs "conflict-of-interest" to "efficient transactions."[6]

There are several contributions to this chapter. First, this chapter takes into consideration unique institutional settings in Malaysia in examining the nature of RPTs. We included the percentage of Bumiputras directors and political involvements of directors as these are representatives of the Malaysian capital market. In addition, we provide further evidence regarding the role of corporate governance, both internal and external mechanisms in the Asian market, highlighted as a gap by Claessens and Fan (2002). This is further supported by Young (2005) who argues that the

extent and size of RPTs are indication of firm's corporate culture and corporate governance mechanism. In addition, our analysis is consistent with the statement made by Gordon et al. (2007) that RPTs must be examined with firms' governance structure.

Furthermore, we extend the work of Munir and Salleh (2010) that examines related transactions and earnings quality. Evidence examining RPTs in Malaysia is relatively scarce. In fact, evidence regarding RPTs are confined to the United States (Gordon et al. 2004a, 2004b), Hong Kong (Cheung et al., 2006), China (Berkman, Cole, & Fu, 2009), and Australia (Gallery et al., 2008).

The working paper by Munir and Salleh (2010) that examined the relationship between RPTs and earnings quality in Malaysia provide the latest evidence on RPT in Malaysia. We provide an extension on evidence as we examine a larger sample (2005–2007 as compared to 2004 by Munir & Salleh, 2010), including various governance mechanisms and take into account Malaysia's institutional settings, namely, political connections and culture in RPTs. In fact, we differ with Munir and Salleh (2010) on several terms. First, unlike Munir and Salleh (2010) that utilize annual reports, our main source of data is the circulars to shareholders that are consistent with extant literature. Secondly, we used three years of data (2005–2007) instead of one year (2004) by Munir and Salleh (2010).

The sample firms consist of 448 firms that recorded RPTs listed on Bursa Malaysia for the period 2005–2007. We employ panel data set to control for both heteroskedasticity and serial correlations. In this study, we based our RPTs on two main types of RPTs, which are RPTs that needed independent advice and recurrent RPT (RRPT). Both of these types of RPTs are available as circulars to shareholders and made available to the public through the Bursa Malaysia web site.

On the basis of a 448 firm-year observations during 2005–2007, we find evidence to support the argument of conflict of interest for RPTs. Employing the number of RPTs and the total amount involved in those transactions as proxies, we document negative and significant relationship between RPTs and firm performance, although the economic significance stands at only, on average, 1 percent of return on assets. We also ascertain that presence of good corporate governance could mitigate the negative impact of RPTs. In particular, we find the level of board independence, executive directors' remuneration, and auditor size as governance mechanisms play a monitoring role and thus reduce the negative impact on firm performance.

The chapter is organized as follows. Section 2 discusses the institutional background and highlights the rules and regulation regarding RPTs in Malaysia. Section 3 explains research methodology and describes the data, and Section 4 discusses the results. Section 5 concludes the chapter.

2. INSTITUTIONAL BACKGROUND

2.1. Malaysia Capital Market

Malaysian capital market is shaped from the close identification between the racial and the economic function in Malaysia (Gomez & Jomo, 1999). Malaysian society consist of multiracial that shaped the country, and business are run externally through political (Mohamad, Hassan, & Chen, 2006) and internally through cultural values (Haniffa & Cooke, 2002).

The imbalance of the economic wealth among the ethnicity had caused the 1969 riot between the Malays and the Chinese. The riots had forced the government to initiate the New Economic Policy (NEP) in 1970 to reduce the imbalance wealthy among the races and overcome the interethnic crisis. The NEP formulated to restructure the controversial socioeconomic problem during the year 1971 under the second Malaysian Prime Minister Tun Abdul Razak. The main focus of NEP is to achieve national unity by reducing the gap of poverty among the races, create a unity among the races by restructuring the society to achieve interethnic economic parity between the Malay Bumiputeras and the Chinese non-Bumiputeras (Gomez & Jomo, 1999). However, the NEP has impacted positive institutionalized discrimination in favor of Bumiputeras by offering them concession such as grants, education, trade, and employment (Haniffa & Cooke, 2002).

The government play an important role to achieve the NEP objective (Gomez & Jomo, 1999). Among the important role taken by the government is increasing the corporate ownership of Bumiputras in three government bodies. The first body comprises public sector such as water supply, telecommunication, civil aviation, and refuse collection. Whereas second body consists of statutory bodies established by law at federal and state level, the third body comprises of government-owned private or public firms established under the 1965 Companies Act.

The main objectives of these three government bodies are to promote Bumiputras involvement in education, employment, and mainly to corporate stock ownership. The restructuring of foreign equity participation has raised the equity from zero to 30 percent, and Chinese and Indian equity maintained at 40 percent (Norhashim & Abdul Aziz, 2005).

2.2. Related Party Transactions in Malaysia

RPTs are defined as transactions entered into by the listed issuer or its subsidiaries that involve the interest, direct, or indirect of a related party

(Bursa Malaysia Listing Requirements, Part E, Section 10.02, para k), whereas RRPT means a RPT that is recurrent, of revenue of trading nature, and that is necessary for day-to-day operations of a listed issuer of its subsidiaries (Bursa Malaysia Listing Requirements, Part E, Section 10.02, para j).[7]

FRS 124 defines RPTs as transaction with related parties, regardless whether a price is charged for those transactions. In addition, FRS 124 describes related parties as those which have interest that could significantly influence the firm. Bursa Malaysia Listing Requirements, Section 10.02 further elaborates on the definitions of related party. In a nutshell, the listing requirements list directors and major shareholders and persons related to them as related parties. This is further supported by Section 6A of the Companies Act 1965, which states that a person shall be deemed to be connected with a director if he is a member of that director's family or a body corporate that is associated with that director or a trustee or a trust under which that director or a member of his family is a beneficiary or a partner of that director or a partner of a person connected with that director.

Section 10.08 of Part E in Chapter 10 of Bursa Malaysia Listing Requirements states that the company needs to make an announcement of the RPT if it exceeds 0.25 percent of any of the percentage ratios.[8] Furthermore, if any of the percentage ratios exceeds 5 percent, the transaction needs to obtain a shareholder approval in general meeting and appoint an independent adviser (Chapter 10, Section 10.08, para 2), whereas if the percentage ratios exceeds 25 percent, principal adviser must be appointed and the adviser must ensure transactions are fair to shareholders, comply to law, ensure full disclosure, and confirm to exchange after transaction has been completed (Chapter 10, Section 10.08, para 4). A RRPT only triggers an announcement when the consideration is RM 1 million or more or one of the percentage ratios is 1 percent or more (Chapter 10, Section 10.09, para 1).

In relation to the circulars to shareholders, information such as the announcement dates, nature of transactions, types of transactions, related parties and their relationships, amount transacted, and owing (from previous RPTs) are disclosed. Letters of recommendation from independent directors, board of directors, and independent advisers are attached on to the circulars as well.

2.3. Corporate Governance Environment in Malaysia

Much of the highlight on corporate governance was from the Asian Financial Crisis aftermath in 1998–1999. However, corporate governance is not new in

Malaysia capital market. Apart from the existing Companies Act 1962, there are numerous initiatives dated from as early as 1987. Among the major initiatives was the revised Bursa Malaysia Listing Requirements in July 1998, which require a company to appoint an independent adviser to advise minority shareholders as to fairness and reasonableness of a RPT. Furthermore, the MCCG was introduced in 2000, later became part of the revamp Bursa Malaysia Listing Requirements in January 2001. The MCCG had a revision in 2007 when the audit committee was formed entirely by nonexecutive directors when majority were independent.

2.3.1. External Corporate Governance in Malaysia

An important area of corporate governance is the fair treatment and protection rights to all shareholders, with particular focus on rights of minority shareholders. Given Malaysian companies are generally characterized by dominant controlling shareholders, the protection of minority shareholders right becomes even more critical. Hence, to monitor and protect the rights of minority shareholders and to promote shareholder activism, the High Level Finance Committee in February 1999 in their Report on Corporate Governance to the Ministry of Finance proposed the setup of a MSWG. In 2001, MSWG was established and funded by five local institutional investors, namely, Employees Provident Fund (EPF), The National Equities Corporation (PNB), The Armed Forces Fund Board (LTAT), Pilgrims Fund Board (Lembaga Urusan Tabung Haji), and Social Security Organisation (SOCSO). Some of the main roles of the MSWG are to act as a platform in initiating collective shareholder activism on unethical or questionable practices by management of the public listed companies; monitor for breaches and noncompliance in corporate governance practices by public listed companies; to disclose current corporate governance practices to stakeholders, and develop and provide training, education, and awareness programs to promote shareholders activism and the benefits of good corporate governance practices.

2.3.2. Auditing in Malaysia

As in other countries, auditors in Malaysia are bound by common auditing practices and requirements.[9] The Companies Act 1965 stresses the need for the auditor to be independent and to be given broad powers to inspect records and to obtain information for audit as well as to have the right to attend and address the general meeting of the firms (Ali, Haniffa, & Hudaib, 2006). In their analysis, Ali et al. (2006) argue that auditing practice in Malaysia is merely to fulfill legal requirements and provide an *image* of a

modern economy to attract investments from overseas rather than to address the unique needs of a multicultural society. Our study provides an alternative or extended view on the role of auditors, especially after the corporate governance reforms of 2001.

3. DATA AND RESEARCH METHODS

The sample for this study consists of companies listed on Bursa Malaysia from 2005 to 2007. We included companies that are listed on Main, Second, and MESDAQ Market boards. The data for the primary variables (RPT and governance variables) are hand collected from the annual reports and circulars to shareholders. The remaining data were collected from Compustat Global and Mergent Online databases.

3.1. Data Collection

The main source of data for this study is the circulars distributed to shareholders and publicly available pertaining to RPTs. There are two types of RPTs. The first is RPT with independent advice, whereas the second type is RRPTs. In general, we identify the amount and case for each transaction.[10] Our main source of data for RPT and RRPT is the circular announcement downloaded from Bursa Malaysia's web site. As mentioned in Section 10.02 of Bursa Malaysia Listing, we defined RPT as those transactions that trigger independent advice to shareholders, whereas RRPT means a RPT that is recurrent of revenue of trading nature and that is necessary for day-to-day operations of a listed issuer of its subsidiaries.

3.2. RPT, Corporate Governance, and Firm Performance

To examine the relationship between RPT and firm performance and whether corporate governance could mitigate the projected negative relationship between RPT and performance, we employ the following panel least squares model:

$$
\begin{aligned}
\text{ROA} = {} & b_0\text{Constant} + b_1\text{RPT}_{it} + b_2\text{DUALITY}_{it} + b_3\text{BODIND}_{it} \\
& + b_4\text{BODSIZE}_{it} + b_5\text{EXECREM}_{it} + b_6\text{INSTOWN}_{it} \\
& + b_7\text{BIGN}_{it} + b_8\text{ASSETS}_{it} + b_9\text{DEBT}_{it} + b_{10}\text{MANOWN}_{it} \\
& + b_{11}\text{BUMI}_{it} + b_{12}\text{BODLOCK}_{it} + b_{13}\text{FAMILY}_{it} + b_{14}\text{POLITIC}_{it} + e_{it}
\end{aligned}
$$

The main dependent variable is ROA, which is net income scaled by total assets. We operationalized two variables to capture the significance of RPTs. First, we employ the total number of RPTs (RPTTRAN) scaled by the number of directors. Second, we utilize the total amount of RPTs scaled by total assets (RPTASSETS). We examine the total amount to gauge the importance to the related party, expecting that higher value intensifies any conflicts of interest (Gordon et al., 2004a, 2004b). Data for both variables were hand collected from circulars. Our choice of variable is much similar to Gordon et al. (2004a, 2004b), Ryngaert and Thomas (2007), and Gallery et al. (2008).

We use the following internal governance structures, DUALITY, which takes the value of 1 if the company separates the role of CEO and chairperson, the proportion of independent directors on board (BODIND) and board size (BODSIZE). Furthermore, we include total executive directors' remuneration (EXECREM) to control for managerial incentives.

The first corporate governance variable we take into consideration is the separation of the CEO and chairperson (DUALITY). A concentration of power occurs when the CEO and chairperson is the same director, which reduces the ability of the board to monitor and control the management (Jensen, 1993; Westphal & Zajac, 1994).[11] The chairperson of the board is accountable for organizing board meetings and structuring compensation. As such, given both positions to the same person represents conflict of interest. Consequently, separating the position of the CEO and chairperson of the board and allocating these roles to different persons increases the ability of the board to monitor and control the CEO independently (Jensen, 1993). As the separation of duties between CEO and the chairperson demonstrates good governance, we predict a weaker negative relationship between RPT and ROA for firms that separate them (DUALITY).

The second internal corporate governance we examine here is the level of board independence (BODIND). Independent directors are often viewed as being relatively less loyal to and more independent of the CEO and therefore are thought to be relatively more capable of impartially monitoring their decision-making process firm (Fama & Jensen, 1983; Hermalin & Weisbach, 1988). Furthermore, independent directors could play a leading role when conflict of interest occurs between management and shareholders, such as takeover and compensation packages that lead to formation of numerous committees (Conyon & Peck, 1998). Furthermore, independent directors by virtue of their distance from management operations contribute the weight of legitimacy to board decisions. However, independent directors could be ineffective as they are only a minority, and because their interests are not aligned with the remaining directors and management, they might not be able

to perform duty as well as expected. Furthermore, there is a possibility that independent directors have been handpicked by the CEO or chairperson when they are closely aligned with management (Westphal & Zajac, 1994; Conyon, Gregg, & Machin, 1995). Furthermore, effective monitoring by independent directors can also be inhibited when the independent directors have been on the board for a long time, and thus their professional judgment may become subsumed by personal relationship (Thompson and Davis, 1997). On the basis of this argument, we predict a weaker negative relationship between RPT and ROA for firms with high level of board independence (BODIND).

In relation to board size (BODSIZE), we offer the following arguments. On one hand, smaller boards help to alleviate to become more effective in relation to solving problem (Jensen, 1993). Board should be small enough to function effectively and at the same time large enough to achieve a diversity of desirable experiences and backgrounds required. Furthermore, larger boards are less cohesive than smaller boards and are more likely to produce an alternative political coalition within the board to challenge and dominate one of the CEO (Denis & Denis, 1994). Consequently, larger boards result in decreased ability of the board to control the CEO (Jensen, 1993; Yermack, 1996) and slower decision-making (Kole & Lehn, 1997). Furthermore, Haniffa and Hudaib (2006) argue that a small board may be seen to be more effective to improve performance and to limit directors' incentives to shirk, as the role performance of each member is easier to monitor and decisions can be made more quickly. On the other hand, bigger boards provide the resources and the possibility of increase in economies of scale (Haniffa & Hudaib, 2006). Therefore, we predict a stronger negative relationship between RPT and ROA for firms that have bigger board size (BODSIZE).

The fourth internal governance mechanism is executive remuneration (EXECREM). Bebchuk and Fried (2003) argue that executive compensation could be a tool to realign managers' and shareholders' interest, although at the same time, it could present as another agency problem as the managers utilized compensation packages for their own benefits. For EXECREM, we predict that the level of remuneration will actually weaken the expected negative impact of RPT on ROA.

For external governance mechanism, we include the percentage of institutional investors ownership (INSTOWN) and auditor size (BIGN) which takes the value of 1 if the firm is audited by Big 4 auditor, zero otherwise. We argue that institutional investors could play a monitoring role due to their fiduciary duties to contributors (Hawley & William, 1997), expertise, and size (Shleifer & Vishny, 1997; Jennings, 2005). Furthermore, institutional investors have the information-gathering capability (Shleifer

& Vishny, 1997), volume of shareholdings (Van Nuys, 1993), and the ability to derive expected net benefits from monitoring that make it worthwhile to engage in shareholders activism (Woidtke, 2002). In the case of Malaysia, the incorporation of MSWG in 2000 enhances their role in relation to corporate governance. In relation to RPT, we predict a weaker negative relationship between RPT and ROA with the presence of high institutional ownership. In Malaysia, evidence suggests that institutional investors do play a monitoring role. Abdul Wahab et al. (2007) find a positive relationship between institutional ownership and firm performance, whereas Abdul Wahab, How, and Verhoeven (2008) document evidence that their presence could influence good governance in Malaysia.

In relation to auditor as external monitoring mechanism, Fan and Wong (2005) argue that firms with higher agency conflict will appoint a Big 5 auditor to enhance their credibility with investors and play a certification role. Therefore, we would predict a weaker negative relationship between RPT and ROA if the firm employs a Big 4 auditor.[12]

3.3. Control Variables

We include two country variables. The first variable is POLITIC, which is the number of directors with political involvement scaled by the total number of directors.[13] The premise of inclusion of the variable is because political intervention is prevalent in Malaysia's capital market. Evidence suggests that politically connected firms are plagued with inefficiency (Johnson & Mitton, 2003) and bound to be bailed out in event of failure (Faccio, Masulis, & McConnell, 2006). The second variable is ethnicity, which is the proportion of Bumiputras directors (BUMI) on the board.[14] We predict a negative relationship for both variables against ROA. The seminal work of Gul (2006) provides evidence that political connections and ethnicity do matter in the Malaysia's capital market. He finds evidence of politically connected firms borne higher risk than nonconnected firms, resulting in higher audit fees. Salleh, Stewart, and Manson (2006) complements Gul's (2006) work as they find positive relationship between ethnicity and audit fees. Furthermore, Abdul Wahab and Abdul Rahman (2009) find evidence to suggest that the monitoring function of institutional investors are mitigated by presence of political interference.

We control for firm size by including the natural log of total assets (LNASSETS). In addition, we control for leverage (DEBT), which is the ratio of total debt to total assets. Furthermore, we include the level of managerial

shareholdings (MANOWN). To control for interlocking boards, we devise a variable, BODLOCK, which is the total of interlocking companies scaled by the number of directors on the board. We also formulated an indicator variable if the board members are closely related (FAMILY). Industries and period dummies are also included, but not reported (Table 1).

Table 1.   Operational Definitions of Variables.

Abbreviation	Definition	Source(s)[a]
Panel A: Dependent variable		
ROA	Return on assets is net income over total assets	Compustat Global
Panel B: Related party transaction		
RPTTRAN	Number of RPTs scaled by number of directors	Circulars to shareholders
RPTASSETS	Total value of RPTs scaled by total assets	Circulars to shareholders
Panel C: Internal governance		
DUALITY	Takes the value of 1 if the firm separates the CEO and chairperson	Annual reports
BODIND	Proportion of independent directors on the board	Annual reports
BODSIZE	Total number of directors on board	Annual reports
EXECREM	The natural log transformation of executive compensation	Annual reports
Panel D: External governance		
INSTOWN	Total percentage of institutional investors	Annual reports
BIG_N	Takes the value of 1 if the auditor is a Big 4 auditor	Annual reports, Compustat Global
Panel E: Firm characteristics		
LNASSETS	The natural log transformation of total assets	Annual reports, Compustat Global
DEBT	Total debt over total assets	Annual reports, Compustat Global
MANOWN	Total percentage of direct managerial shareholdings	Annual reports
BUMI	Proportion of executive Bumiputras directors on board	Annual reports
BODLOCK	The total number of interlocking directors scaled by number of directors	Annual reports
FAMILY	Takes the value of 1 if the firms' directors are family related	Annual reports
POLITIC	The total number of directors that have political connections scaled by the number of directors	Annual reports

[a]The circulars to shareholders are available from Bursa Malaysia's web site. The annual reports are downloaded from the Bursa Malaysia's website and Mergent online database.

3.4. Sample Description

Table 2 describes the cross-tabulation analysis regarding the number of RPTs (RPTTRAN) and the value/amount for those transactions (RPTAMT) for each year during sample period. Our analysis shows that two industries, manufacturing (MANU) and consumer (CONSUMER), record the most number of transactions across the sample period of 2005–2007 with MANU and CONSUMER having nearly 67 percent of total number of transactions. In relation to the total amount of related transactions (RPTAMT), MANU and CONSUMER register a total amount of RM 4.863 billion. In contrast, construction (CONSTRUCT) and health (HEALTH) industries record the lowest number of related transactions at 103 (2.553 percent) and 16 (0.399 percent) respectively. Interestingly, CONSTRUCT and HOTEL did not register any related transactions for 2006 and 2007, respectively. Although our analysis shows that the year 2005 records the highest number of transactions at 1,567 (38.749 percent of total transactions), the year 2006 records the highest total of related transactions at 3.030 billion, which is 46.472 percent of total amount of related transactions during the sample period.

Table 3 presents the descriptive analysis for sample period. The dependent variable, return on assets (ROA) has a mean (median) of 5.192 (5.018) with a range of between −32.731 and 30.697. Panel B of Table 2 presents the descriptive on RPTs. On average, sample firms record 9.027 RPTs (RPTTRAN), which averages to RM 145.6 million (RPTAMT). Although seems significant, this average only amounts to 0.139 or 13.9 percent of total assets (RPTASSETS).

Panel C of Table 3 tabulates the internal governance variables. More than half of the sample firms (57.8 percent) separates the CEO and chairperson post (DUALITY), and nearly one-third (33.7 percent) of directors on board are independent (BODIND). The size of the board (BODSIZE) averages (median) of 5.975 (6.000) ranging between 3 and 11 board members. The executive remuneration (REMEXEC) averages RM 1.687 million.

The first external governance variable, institutional ownership (INSTOWN) averages 14.846 percent with a maximum of 82.799 percent, whereas nearly 60 percent (55.8 percent) of sample firms are audited by a Big 4 auditor. As depicted by panel E of Table 3, the sample firms average RM 1.119 billion with a maximum of RM 29.75 billion. The ratio of debt to total assets (DEBT) stands at 0.441, whereas the average direct managerial shareholdings (MANOWN) is 3.512 percent with a maximum of 76.874 percent. And 35.9 percent of directors are Bumiputras (BUMI), whereas on

Table 2. Descriptive Analysis of Number and Amount of Related Party Transactions for Sample Firms (2005–2007, $n = 448$).

		2005	%	2006	%	2007	%	Total	%
AGRI	RPTAMT ('000)	222000	1.042	368000	1.215	1290000	9.485	1880000	2.883
	RPTTRAN	26	1.659	42	3.075	28	2.520	96	2.374
CONSTRUCT	RPTAMT('000)	153000	0.718	0.000	0.000	20880	0.154	173900	0.267
	RPTTRAN	30	1.914	0	0.000	14	1.260	44	1.088
MINING	RPTAMT('000)	1990000	9.343	3936000	12.990	1390000	10.221	7316000	11.221
	RPTTRAN	116	7.403	99	7.247	95	8.551	310	7.666
MANU	RPTAMT('000)	11950000	56.082	17400000	57.426	4.320000	31.765	33670000	51.634
	RPTTRAN	431	27.505	438	32.064	382	34.383	1251	30.935
CONSUMER	RPTAMT('000)	3600000	16.901	5970000	19.703	5390000	39.632	1.4960000	22.945
	RPTTRAN	537	34.269	459	33.602	426	38.344	1422	35.163
TRANSPOT	RPTAMT('000)	844000	3.962	1080000	3.564	4010000	2.949	2325000	3.566
	RPTTRAN	106	6.765	101	7.394	54	4.860	261	6.454
WHOLESALE	RPTAMT('000)	807000	3.789	727000	2.399	340000	2.500	1874000	2.874
	RPTTRAN	177	11.295	134	9.810	86	7.741	397	9.817
HOTEL	RPTAMT('000)	120000	0.563	591000	1.950	0.000	0.000	711000	1.090
	RPTTRAN	96	6.126	63	4.612	0	0.000	159	3.932
HEALTH	RPTAMT('000)	17550	0.082	6720	0.022	214000	1.574	238300	0.365
	RPTTRAN	5	0.319	5	0.366	5	0.450	15	0.371
OTHER	RPTAMT('000)	1601000	7.517	221300	0.730	234100	1.721	2056000	3.154
	RPTTRAN	43	2.744	25	1.830	21	1.890	89	2.201
total	RPTAMT	21300000	32.669	30300000	46.472	13000060	20.859	65200000	100.000
	RPTTRAN	1567	38.749	1366	33.778	1111	27.473	4044	100.000

Notes: RPTAMT is total value/amount of related party transactions, whereas RPTTRAN is the total number of related party transactions. AGRI is agriculture; CONSTRUCT is construction, whereas MINING is mining industries. MANU, CONSUMER, TRANSPORT, WHOLESALE, HOTEL, HEALTH, and OTHER are manufacturing, consumer, transportation, wholesale, hotel and tourism, health and hospitality, and other minor industries, respectively.

Table 3. Descriptive Analysis of Firm Performance, Related Party Transactions, Corporate Governance, and Firm Characteristics for Sample Firms (2005–2007, $n = 448$).

	Mean	Median	Maximum	Minimum	Standard Deviation
Panel A: Dependent variable					
ROA	5.192	5.018	30.697	−32.731	8.485
Panel B: Related party transaction					
RPTTRAN	9.027	7.000	66.000	1.000	8.391
RPTTRAN2	1.598	1.000	12.000	0.125	1.571
RPTAMT('000)	145600	25100	4.212000	18.10	475000
RPTASSETS	0.139	0.063	0.896	0.000	0.192
Panel C: Internal governance					
DUALITY	0.578	1.000	1.000	0.000	0.494
BODIND	0.337	0.375	0.857	0.000	0.216
BODSIZE	5.975	6.000	11.000	3.000	1.368
REMEXEC('000)	1687	1187	37490	20.00	2292
EXECREM	13.947	13.987	17.440	9.903	0.936
Panel D: External governance					
INSTOWN	14.846	10.694	82.799	0.000	14.917
BIG_N	0.558	1.000	1.000	0.000	0.497
Panel E: Firm characteristics					
ASSETS ('000)	1119000	386300	29750000	24400	2605000
LNASSETS	19.892	19.772	24.116	17.010	1.249
DEBT	0.441	0.445	0.916	0.009	0.207
MANOWN	3.512	0.082	76.874	0.000	9.128
BUMI	0.359	0.333	1.000	0.000	0.256
BODLOCK	0.350	0.333	1.000	0.000	0.260
FAMILY	0.348	0.000	1.000	0.000	0.477
POLITIC	0.016	0.000	0.286	0.000	0.055

Notes: ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors are linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size.

average, only 35 percent of the board has interlocking boards. And 38.4 percent of the sample firms are family firms (FAMILY), whereas only a mere 1.6 percent of the board members have political connections (POLITIC).

4. RESULTS

4.1. Univariate Analysis

Table 4 tabulates the correlation matrix, both Pearson and Spearman-rank for test variables. The correlations (both Pearson and Spearman-rank) between ROA and RPTTRAN are negative, but insignificant. Similarly, negative correlations between ROA and RPTASSETS are recorded, with the Pearson correlation significant at 1 percent level. These findings give initial support to the conflict-of-interest argument raised by Gordon et al. (2004a, 2004b) that related transactions will be detrimental to shareholders and thus reduce the firm value. We find positive and significant correlations between the various corporate governance mechanisms and ROA, with the exception of BODIND, whereas DUALITY is significant for Spearman-rank correlation only. Initial evidence suggests that good governance results in higher firm performance. The correlation analysis shows negative but insignificant relationship between POLITIC and ROA. No other correlations worth nothing here.

   To further investigate, we group the sample firms into quartile based on the number of transactions in which Q1 presents the less number of recorded transactions and Q4 presents the group that record high number of related transactions. On the basis of this analysis presented in Table 5, we find firms that record less related transactions have significantly lower total amount or value in related transactions. In addition, firms with less number of transactions have significantly higher number of directors (BODSIZE). Furthermore, we find firms with higher number of related transactions (Q4) are significantly larger (ASSETS), have higher debt to assets ratio (DEBT), higher managerial ownership (MANOWN), and have more Bumiputras directors on board.

   We then group the firms into quartiles according to the total amount (in RM) of recorded RPTs presented in Table 6. Similar to Table 5, Q1 presents the firms that have lower amount of RP transactions, whereas Q4 forms the group of firms that have larger amount of recorded transactions. We find firms with larger amount of related transactions (Q4) are significantly smaller in size (LNASSETS) and have significantly higher direct managerial

Table 4. Correlation Analysis.

	ROA	RPTTRAN2	RPTASSETS	DUALITY	BODIND	BODSIZE	EXECREM	INSTOWN
ROA	1.000	−0.069	−0.047	0.103**	0.065	0.160***	0.241***	0.218***
RPTTRAN2	−0.075	1.000	0.348***	−0.035	0.007	−0.213***	−0.034	−0.018
RPTASSETS	−0.150***	0.215***	1.000	0.021	0.004	−0.042	−0.007	−0.049
DUALITY	0.070	0.026	−0.042	1.000	0.037	0.064	−0.045	0.048
BODIND	0.043	−0.067	0.031	0.050	1.000	0.039	−0.149***	0.038
BODSIZE	0.116**	−0.243***	−0.040	0.071	0.038	1.000	0.137***	−0.016
EXECREM	0.256***	−0.056	0.018	−0.054	−0.147***	0.187***	1.000	0.046
INSTOWN	0.172***	0.052	−0.018	0.099**	0.026	−0.054	0.066	1.000
BIGN	0.143***	0.006	−0.008	0.032	0.052	−0.026	0.007	0.080*
LNASSETS	0.289***	0.216***	−0.076	0.026	0.108**	−0.019	0.307***	0.269***
DEBT	−0.266***	0.113**	0.068	−0.018	0.088*	−0.141***	0.065	−0.012
MANOWN	0.062	0.024	0.012	−0.034	−0.003	−0.036	0.009	0.098**
BUMI	0.053	0.018	0.031	0.218***	0.225***	−0.054	−0.175***	0.159***
BODLOCK	0.050	−0.002	−0.024	0.063	0.057	−0.092*	0.108**	0.134***
FAMILY	0.021	−0.018	−0.100**	−0.078	−0.063	0.095**	0.024	−0.150***
POLITIC	−0.074	0.077	0.036	0.021	0.030	−0.087*	0.043	−0.004

	BIGN	ASSETS	DEBT	MANOWN	BUMI	BODLOCK	FAMILY	POLITIC
ROA	0.179***	0.333***	−0.295***	−0.090*	0.097**	0.057	−0.005	−0.047
RPTTRAN2	0.017	0.167***	0.095**	0.038	0.096**	−0.010	0.030	0.100**
RPTASSETS	−0.002	−0.107**	−0.006	−0.014	0.090*	−0.018	−0.125***	0.061
DUALITY	0.032	0.038	−0.021	−0.255***	0.201***	0.065	−0.078	0.010
BODIND	0.051	0.112**	0.068	−0.074	0.230***	0.024	−0.051	0.054
BODSIZE	−0.025	0.022	−0.120**	0.001	−0.103**	−0.099**	0.090*	−0.064
EXECREM	−0.015	0.329***	0.067	0.144***	−0.160***	0.082*	0.043	0.070
INSTOWN	0.128***	0.304***	0.008	0.010	0.186***	0.114**	−0.138***	0.048
BIGN	1.000	0.146***	−0.072	0.002	0.119***	0.081*	−0.057	−0.059

(continued)

Table 4. (*Continued*)

	BIGN	ASSETS	DEBT	MANOWN	BUMI	BODLOCK	FAMILY	POLITIC
LNASSETS	0.144***	*1.000*	0.244***	−0.040	0.212***	0.242***	−0.119**	*0.058*
DEBT	−0.077	0.246***	*1.000*	*0.050*	0.185***	*0.003*	−0.179***	*0.114**ʼ*
MANOWN	0.048	−0.085*	0.015	*1.000*	−0.176***	−0.010	0.099**	*0.022*
BUMI	0.139***	0.235***	0.176***	−0.045	*1.000*	0.074	−0.202***	*0.056*
BODLOCK	0.079*	0.270***	0.005	−0.078*	0.060	*1.000*	0.090*	*0.014*
FAMILY	−0.057	−0.089*	−0.168***	−0.030	−0.204***	0.086*	*1.000*	*0.101**ʼ*
POLITIC	−0.058	−0.006	0.117**	−0.002	0.014	−0.006	0.073	*1.000*

Notes: Spearman-rank correlations are italicized. ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and the CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is the total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors are linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size. ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and the CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is the natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors are linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size.

Table 5. Differences in Firm Performance, RPT Value, Corporate Governance, and Firm Characteristics between Low and High Number of RP transactions for Sample firms (2005–2007).

	Q1	($n = 112$)	Q4	($n = 112$)		
	Mean	Median	Mean	Median	*t*-Test	Mann–Whitney
ROA	4.840	5.015	4.721	4.037	0.916	0.270
RPTAMT ('000)	44840	7353	386000	66650	**0.000**	**0.000**
RPTASSETS	0.105	0.030	0.218	0.157	**0.000**	**0.000**
DUALITY	0.616	1.000	0.580	1.000	(0.586)	
BODIND	0.313	0.375	0.324	0.333	0.719	0.918
BODSIZE	6.232	6.000	5.402	5.000	**0.000**	**0.000**
REMEXEC ('000)	1750	1179	1584	1135	0.510	0.576
EXECREM	13.970	13.980	13.838	13.942	0.326	0.576
INSTOWN	16.173	13.284	16.808	11.410	0.770	0.996
BIG_N	0.554	1.000	0.589	1.000	(0.589)	
ASSETS ('000)	1121000	300900	1669000	538800	0.212	**0.000**
LNASSETS	19.712	19.522	20.306	20.105	**0.001**	**0.000**
DEBT	0.409	0.390	0.485	0.497	**0.007**	**0.013**
MANOWN	1.942	0.054	4.615	0.082	**0.026**	0.229
BUMI	0.322	0.333	0.380	0.400	**0.086**	**0.023**
BODLOCK	0.361	0.333	0.374	0.333	0.709	0.980
FAMILY	0.295	0.000	0.330	0.000	(0.564)	
POLITIC	0.009	0.000	0.026	0.000	(0.162)	

Notes: Firms are formed into quartiles based on RPTTRAN. Quartiles Q1 and Q4 denote low and high number of related party transactions respectively. ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and the CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is the natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors is linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size. Significant *p*-values are bold. The figures in parentheses denote chi-square statistics.

Table 6. Differences in Firm Performance, RP Transactions, Corporate Governance, and Firm Characteristics between Low and High Value/ Amount of RP Transactions for Sample Firms (2005–2007).

	Q1	($n = 112$)	Q4	($n = 112$)		
	Mean	Median	Mean	Median	t-Test	Mann–Whitney
ROA	4.631	4.500	3.011	3.275	0.185	0.134
RPTTRAN	6.080	4.000	12.330	11.000	**0.000**	**0.000**
RPTTRAN2	1.021	0.667	2.320	1.929	**0.000**	**0.000**
DUALITY	0.509	1.000	0.571	1.000	(0.348)	
BODIND	0.348	0.400	0.348	0.354	0.996	0.555
BODSIZE	5.857	6.000	5.813	6.000	0.802	0.436
REMEXEC ('000)	1914	1180	1512	1080	0.121	0.870
EXECREM	13.936	13.981	13.949	13.892	0.921	0.870
INSTOWN	16.357	14.865	14.632	9.481	0.426	0.163
BIG_N	0.571	1.000	0.500	0.500	(0.284	
ASSETS ('000)	1656000	496200	1065000	252300	0.166	0.013
LNASSETS	20.197	20.023	19.761	19.346	**0.016**	**0.013**
DEBT	0.473	0.474	0.480	0.489	0.784	0.711
MANOWN	2.550	0.169	4.766	0.152	**0.070**	**0.070**
BUMI	0.330	0.333	0.371	0.333	0.213	0.171
BODLOCK	0.380	0.400	0.338	0.333	0.229	0.111
FAMILY	0.438	0.000	0.250	0.000	**(0.003)**	
POLITIC	0.014	0.000	0.024	0.000	(0.237)	

Notes: Firms are formed into quartiles based on RPTAMT. Quartiles Q1 and Q4 denote low and high value/amount of related party transactions, respectively. ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and the CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is the natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors is linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size. Significant p-values are bold. The figures in parentheses denote chi-square statistics.

ownership (MANOWN). From this exercise, we observed the differences in size and managerial shareholdings between firms that record both low and high number and value of related transactions. The findings are similar with Table 5 with few exceptions.

4.2. Multivariate Analysis

4.2.1. Number of Related Party Transactions

Table 7 tabulates the regressions results when we used RPTTRAN as the main independent variable for RPTs. The main regression result in column 1 of Table 7 shows a negative and significant relationship between RPTTRAN and ROA (-0.646, $t = -2.112$, $p < 0.05$), which means the higher the number of reported RPTs, the less the firm performance, measured by ROA. However, the economic significance for this relationship is rather minimal at a mere -1.014 percent of ROA (-0.646×1.571). Nonetheless, this finding gives support to the conflict-of-interest argument raised by Gordon et al. (2004a, 2004b). In addition, our findings are similar with most studies (Gordon et al., 2004a, 2004b; Ryngaert & Thomas, 2007; Cheung et al., 2006; Kohlbeck & Mayhew, 2010). The main regression also shows positive and significant results for EXECREM, ASSETS, and MANOWN, whereas negative and significant result for DEBT. Columns 2–7 present the regressions results when we include individual interaction terms. We find the main independent variable (RPTTRAN) remain negative and significant, with the exception of columns 4 and 5 of Table 7. The results for the remaining variables remain similar to column 1, demonstrating the robustness of the model used. However, we find insignificant findings when we interact the various governance variables with RPTTRAN. Nevertheless, we find the direction of the coefficients of the interaction variables are positive (with the exception of BODSIZE and EXECREM presented in columns 4 and 5 of Table 7, respectively) suggesting that it could reduce the negative effect of RPTTRAN on firm performance.

4.2.2. Value of Related Party Transactions

Table 8 exhibits the panel least squares when we employ the total value/ amount of the related transactions scaled by total assets (RPTASSETS) as the main independent variable. The main regression, tabulated in column 1 of Table 7, shows that the coefficient (-4.608, $t = -2.508$, $p < 0.05$) of RPTASSETS is negative and significant. One standard deviation increase in

Table 7. Regression Results for Firm Performance, Number of Transactions, Corporate Governance, and Firm Characteristics for Sample Firms (2005–2007, $n = 448$).

Variable	1 ROA	2 ROA	3 ROA	4 ROA	5 ROA	6 ROA	7 ROA	8 ROA
INTERCEPT	−61.186	−60.544	−60.997	−63.152	−65.509	−61.172	−60.946	−62.582
	−6.409***	**−6.342*****	**−6.353*****	**−6.471*****	**−5.572*****	**−6.394*****	**−6.357*****	*f−5.131****
RPTTRAN	−0.646	−1.083	−0.700	0.642	1.855	−0.659	−0.728	0.483
	−2.112**	**−2.157****	**−1.634***	*0.496*	*0.461*	**−1.648***	**−1.741***	*0.110*
DUALITY	0.836	−0.156	0.842	0.860	0.803	0.835	0.833	−0.388
	0.933	*−0.124*	*0.938*	*0.959*	*0.895*	*0.931*	*0.929*	*−0.298*
BODIND	1.954	2.010	1.557	2.014	1.966	1.961	1.958	1.114
	0.917	*0.944*	*0.520*	*0.944*	*0.922*	*0.917*	*0.918*	*0.363*
BODSIZE	−0.029	−0.055	−0.025	0.294	−0.027	−0.030	−0.033	0.386
	−0.083	*−0.156*	*−0.070*	*0.611*	*−0.075*	*−0.083*	*−0.091*	*0.779*
EXECREM	1.772	1.820	1.771	1.789	2.110	1.772	1.775	1.858
	3.536***	**3.625*****	**3.530*****	**3.565*****	**2.888*****	**3.530*****	**3.537*****	**2.477****
INSTOWN	0.021	0.020	0.022	0.019	0.021	0.020	0.022	0.029
	0.712	*0.654*	*0.724*	*0.642*	*0.700*	*0.510*	*0.720*	*0.709*
BIGN	0.700	0.718	0.698	0.732	0.702	0.703	0.466	0.607
	0.802	*0.824*	*0.798*	*0.837*	*0.804*	*0.803*	*0.391*	*0.502*
LNASSETS	2.278	2.253	2.275	2.281	2.254	2.278	2.269	2.238
	5.132***	**5.082*****	**5.122*****	**5.137*****	**5.065*****	**5.126*****	**5.108*****	**5.021*****
DEBT	−13.273	−13.151	−13.262	−13.512	−13.123	−13.270	−13.264	−13.431
	−5.539***	**−5.494*****	**−5.528*****	**−5.609*****	**−5.448*****	**−5.528*****	**−5.528*****	**−5.519*****
MANOWN	0.071	0.070	0.072	0.074	0.073	0.071	0.071	0.075
	1.690*	**1.667***	**1.702***	**1.747***	**1.736***	**1.687***	**1.698***	**1.777***
BUMI	1.373	1.552	1.347	1.338	1.476	1.370	1.394	1.534
	0.688	*0.776*	*0.672*	*0.670*	*0.738*	*0.685*	*0.697*	*0.760*
BODLOCK	−1.574	−1.752	−1.577	−1.705	−1.453	−1.583	−1.556	−1.904
	−0.867	*−0.963*	*−0.868*	*−0.937*	*−0.795*	*−0.868*	*−0.856*	*−1.027*
FAMILY	0.314	0.380	0.291	0.291	0.274	0.313	0.317	0.321
	0.315	*0.382*	*0.290*	*0.291*	*0.274*	*0.314*	*0.317*	*0.319*

POLITIC	−4.934	−4.909	−5.050	−4.853	−5.241	−4.915	−4.807	−5.157
	−0.585	−0.583	−0.596	−0.574	−0.620	−0.581	−0.568	−0.608
RPTTRAN × DUALITY		0.639						0.822
		1.114						1.275
RPTTRAN × BODIND			0.226					0.535
			0.186					0.412
RPTTRAN × BODSIZE				−0.243				−0.330
				−1.021				−1.275
RPTTRAN × EXECREM					−0.180			−0.001
					−0.622			−0.004
RPTTRAN × INSTOWN						0.001		−0.006
						0.054		−0.387
RPTTRAN × BIGN							0.146	0.082
							0.292	0.157
Period and industry fixed (dummy variables)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	0.276	0.277	0.274	0.277	0.275	0.274	0.274	0.273
F-statistic	**7.811*******	7.591***	7.495***	7.577***	7.522***	7.493***	7.498***	6.418***

Notes: ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and the CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors are linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size. Significant *p*-values are bold.

*Significance level at 10 percent.
**Significance level at 5 percent.
***Significance level at 1 percent.

Table 8. Regression Results for Firm Performance, Value of Transactions, Corporate Governance, and Firm Characteristics for Sample Firms (2005–2007, $n = 448$).

Variable	1 ROA	2 ROA	3 ROA	4 ROA	5 ROA	6 ROA	7 ROA	8 ROA
INTERCEPT	−58.735	−59.330	−55.798	−61.212	−50.999	−58.927	−57.581	−49.277
	−6.183***	**−6.240*****	**−5.781*****	**−6.422*****	**−4.912*****	**−6.187*****	**−6.076*****	**−4.684*****
RPTASSETS	−4.608	−2.163	−13.012	11.789	−76.570	−3.758	−9.547	−77.939
	−2.058**	*−0.737*	**−2.261****	*1.215*	**−1.891***	*−1.237*	**−2.970****	**−1.859***
DUALITY	0.658	1.401	0.837	0.751	0.838	0.659	0.757	1.045
	0.737	*1.283*	*0.935*	*0.846*	*0.937*	*0.737*	*0.850*	*0.970*
BODIND	2.471	2.181	−0.123	2.447	2.258	2.416	2.323	−0.526
	1.166	*1.026*	*−0.046*	*1.163*	*1.068*	*1.136*	*1.099*	*−0.200*
BODSIZE	0.117	0.176	0.137	0.584	0.098	0.123	0.134	0.778
	0.338	*0.504*	*0.398*	*1.343*	*0.283*	*0.354*	*0.390*	**1.798***
EXECREM	1.983	1.901	1.895	2.021	1.435	1.968	1.911	1.265
	3.983***	**3.800*****	**3.804*****	**4.080*****	**2.498*****	**3.935*****	**3.840*****	**2.211***
INSTOWN	0.023	0.022	0.025	0.026	0.025	0.032	0.029	0.042
	0.763	*0.736*	*0.827*	*0.854*	*0.841*	*0.853*	*0.955*	*1.124*
BIGN	0.776	0.732	0.775	0.799	0.680	0.724	−0.416	−0.250
	0.891	*0.839*	*0.892*	*0.923*	*0.780*	*0.822*	*−0.392*	*−0.239*
LNASSETS	1.938	1.984	1.895	1.907	1.930	1.955	1.954	1.853
	4.519***	**4.618*****	**4.418*****	**4.476*****	**4.514*****	**4.536*****	**4.571*****	**4.334****
DEBT	−13.267	−13.129	−12.972	−13.869	−13.457	−13.358	−13.388	−14.237
	−5.548***	**−5.485*****	**−5.417*****	**−5.800*****	**−5.641*****	**−5.549*****	**−5.615*****	**−5.929****
MANOWN	0.066	0.065	0.066	0.064	0.064	0.068	0.063	0.059
	1.578	*1.547*	*1.588*	*1.523*	*1.537*	*1.606*	*1.497*	*1.420*
BUMI	1.820	1.716	1.504	1.953	1.555	1.950	1.862	1.527
	0.912	*0.861*	*0.753*	*0.986*	*0.782*	*0.962*	*0.936*	*0.765*
BODLOCK	−1.321	−1.242	−1.131	−1.563	−1.141	−1.379	−1.078	−1.134
	−0.732	*−0.688*	*−0.627*	*−0.870*	*−0.633*	*−0.760*	*−0.598*	*−0.633*
FAMILY	0.085	−0.080	−0.068	−0.012	−0.175	0.113	0.021	−0.493
	0.085	*−0.080*	*−0.068*	*−0.012*	*−0.174*	*0.113*	*0.021*	*−0.493*

	1	2	3	4	5	6	7	8
POLITIC	−5.818	−4.990	−4.526	−6.120	−3.902	−5.776	−4.836	−2.142
	−0.694	−0.594	−0.540	−0.736	−0.466	−0.688	−0.578	−0.259
RPTASSETS × DUALITY		−5.218						1.517
		−1.175						0.325
RPTASSETS × BODIND			23.797					24.286
			1.658*					**1.646***
RPTASSETS × BODSIZE				−2.785				−3.948
				−1.727*				**−2.330****
RPTASSETS × EXECREM					5.112			5.969
					1.783*			**1.976***
RPTASSETS × INSTOWN						−0.062		−0.041
						−0.444		−0.295
RPTASSETS × BIGN							8.404	6.501
							2.127**	**1.649***
Period and industry fixed (dummy variables)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	0.275	0.276	0.279	0.281	0.280	0.273	0.282	0.297
F-statistic	**7.769*****	7.557***	7.655***	7.715***	7.702***	7.465***	7.742***	7.098***

Notes: ROA is net income over total assets. RPTTRAN is the number of related party transactions, whereas RPTTRAN2 is RPTTRAN scaled by number of directors. RPTAMT is the total value of the related party transactions, whereas RPTASSETS is RPTAMT scaled by total assets. DUALITY takes the value of 1 if the firm separates the chairperson and the CEO. BODIND is the proportion of independent directors on the board. BODSIZE is the total number of directors on board. REMEXEC is total executive remuneration, whereas EXEMREM is the natural log transformation of REMEXEC. INSTOWN is the total institutional investors' shareholdings. BIGN is an indicator variable that takes the value of 1 if the firm is audited by a Big 4 auditor. ASSETS is total assets, whereas LNASSETS is the natural log transformation of ASSETS. DEBT is total liabilities scaled by total assets. MANOWN is direct managerial shareholdings. BUMI is the proportion of Bumiputras directors on board. BODLOCK is the number of interlocking directors scaled by board size. FAMILY takes the value of 1 if the board of directors are linked through family ties. POLITIC is the number of directors that have political involvement, scaled by board size. Significant *p*-values are bold.

*Significance level at 10 percent.

**Significance level at 5 percent.

***Significance level at 1 percent.

the value of RPTASSETS (SD = 0.192) will result in a decline of −0.88 (−4.608 × 0.192) percent in ROA.

In columns 2–7 of Table 7, we include the single interaction variable of RPTASSETS and the six corporate governance variables. We find, in column 3 of Table 8, the coefficient of RPTASSETS × BODIND is positive and significant (23.797, $t = 1.648$, $p < 0.10$). This finding reveals that the level of independence mitigates the negative impact of RPT, when amount is concerned, on firm performance. We find similar evidence for the interaction variable RPTASSETS × EXECREM (5.112, $t = 1.783$, $p < 0.10$) shown in column 5 of Table 8.[15] These results suggest that internal corporate governance mechanisms matter in monitoring the RPTs and whether it could be detrimental to shareholders. In addition, we find an external corporate governance mechanism, BIGN, also reduces the negative relationship between RPT and performance as the interaction term, RPTASSETS × BIGN is positive and significant (8.404, $t = 2.127$, $p < 0.05$). Our evidence gives support to Fan and Wong (2005) and Chien and Hsu (2010) that external auditors do play a governance role. Interestingly, we find a negative and significant coefficient for RPTASSETS × BODSIZE (−2.785, $t = −1.783$, $p < 0.10$). This finding suggests that the bigger the board, the more negative the impact of related transactions on firm performance. This is consistent with our arguments raised earlier that bigger boards will prevent effective monitoring and reduce the ability of decision-making. To reflect the robustness of the model employed, we ran a single regression by including all the interaction terms. The results tabulated in column 8 do not differ, statistically, from the single regressions presented earlier from columns 2 to 7.

The findings shown in Table 7 and 8 demonstrate that both the number of RPTs and the total amount of the transactions are important influences in relation to firm performance.

5. CONCLUSION

This study examines the relationship between RPTs, corporate governance, and firm performance. Specifically, we investigate the role of corporate governance, both internal and external mechanisms, in moderating the impact of RPTs on performance. On the basis of 448 observations during 2005–2007 period, we find a negative relationship between related transactions, proxied by the number of transactions and the total value/amount, scaled by number of directors and total assets, respectively, against performance. Our findings

are consistent with extant literature (Gordon et al., 2004a, 2004b; Ryngaert & Thomas, 2007; Kohlbeck & Mayhew, 2010) and support the conflict-of-interest argument. Our analysis also demonstrate that an increase in one standard deviation of the number of RPTs and the total amount of those transactions will result in a decrease of 1.014 and 0.88 percent in ROA, respectively. We find that corporate governance does matter, in relation to minimizing the impact of RPTs. We find the natural log transformation of executive remuneration, level of board independence, and the presence of a Big 4 auditor mitigate the negative impact of RPTs on performance. Our findings give support to the suggestion made by Gordon et al. (2007) as the need to assess RPTs with the firms' governance structure.

This study suffers from some caveats. First, this study presently ignores the various types of related transactions. As highlighted by Cheung et al. (2006) and Kohlbeck and Mayhew (2010), some type of transactions could actually benefit the shareholders. In addition, the study failed to document the parties that involved in the related transactions. We view the importance of studying the independence level of third parties involved in such transactions. These parties, namely, independent property valuer and independent adviser, provide good area of research as to determine the nature of transparency and governance surrounding RPTs. An important note is to acknowledge the possible endogeneity problem among the corporate governance variables.

NOTES

1. See Gordon et al. (2007) for various definitions of RPTs. Young (2005) Ryngaert and Thomas (2007) extend the definition by including appointments of family members on the board and managerial team as RPTs.

2. On December 16, 2008, the board of directors of Satyam (now Mahindra Satyam) approved the acquisitions of Maytas Properties and Maytas Infrastructure for $1.3 billion and $300 million, respectively. Both Maytas Properties and Maytas Infra were entities related to B. Ramalinga Raju, the founder and chairman and CEO of Satyam. Concerns over valuations of the two entities, the timing, method and payment, and alleged concerns around the deal from independent directors led to greater scrutiny of Satyam by investors and termination of the proposed acquisition delays. Following this, four independent directors resigned, and on January 7, 2009, Raju revealed a $1 billion accounting fraud and resigned as chairman and CEO of Satyam, admitting that for the past several years, he had been inflating cash reserves and overstating revenues (OECD, 2009).

3. At an extraordinary meeting of the company in March 2007, CNOOC Ltd sought authorization to deposit funds for three years with sister company CNOOC Finance Ltd, controlled by CNOOC Ltd' state-owned parent China National Offshore Oil

Corp. Shareholders were concerned that the deposits were unsecured and that intra-group lending could expose them to risk of losses from noncontrolled entities. At the meeting, over 52 percent independent shareholders voted against the resolution, forcing the company to claw back monies already deposited (OECD, 2009).

4. Genting Malaysia Genting Malaysia (Resorts) had entered into S&P agreements with parent Genting Berhad to acquire: (a) 25-storey Wisma Genting office building for RM259.6 m (including RM46.9 m debt owed to Genting Berhad) and (b) Segambut land comprising two adjoining land parcels with total area of 380,906 sq ft forRM24.6 m (including RM8.6 m debt owed to Genting Berhad).

5. The recurrent party transaction was between Tai Kwong Yokohama Berhad and HSG Investments Pte Ltd, a unit of Hup Soon Global Corporation Ltd.

6. Chien and Hsu (2010) concluded that "switch" from conflict-of-interest to efficient transactions because the coefficient for the interaction term between RPTs and corporate governance was positive.

7. Examples of recurrent RPTs are selling and purchasing of raw materials and finished goods, management fees, rental and leasing payments, advertising, and marketing fees.

8. Percentage ratios means the figures, expressed, resulting from each of the following calculations based on the assets or subject matter of the transactions:

(i)   Value of assets compared with the nest assets of listed issuer.
(ii)   Net profit compared with the net profit of listed issuer.
(iii) The aggregate value of the transaction compared to the net assets of listed issuer.
(iv)   The equity share capital issued by the listed issuer as consideration for an acquisition.
(v)   The aggregate value of the consideration given or received in relation to the transaction, compared with the market value of all ordinary shares of the listed issuer.
(vi)   The total assets that are the subject matter of the transaction compared with the total assets of the listed issuer.
(vii) The relative value of joint venture.
(viii) The aggregate original costs of investment of the subject matter of the transaction divided by the net assets of the listed issuer.

Abridged version from Chapter 10, Section 10.02 of Bursa Malaysia Listing Requirements.

9. See Favere-Marchesi (2001) for a thorough review of audit requirements in Malaysia.

10. We excluded firms that record RPTs but did not disclose the amount involved.

11. There is empirical evidence that the administrative functions of the chairperson–CEO are significantly different from the functions of the chairman who does not hold any other office in the same firm. The chairperson–CEO often concentrates on functions that relate to the firm as a legal and financial entity, affect future growth prospects, and various publics with which the firm comes into contact (Stieglitz & Janger, 1963). In contrast, the administrative functions of the chairperson, who does not hold another office, tend to be rather varied. The person

is responsible for managing the board, overseeing how it carries out it majors responsibilities.

12. The sample period is 2005–2007, which is after the demise of Arthur Andersen.

13. We did not cross-check with the list created by Johnson and Mitton (2003) because the list was created based on 1998 data.

14. The three main ethnic groups in Malaysia are Bumiputras, which literally means ''sons of the soil,'' Chinese, and Indians; the latter two groups resulted from British colonialism, which allowed Chinese migration (from mainland China) and Indian immigrants to work in the plantation sector.

15. Technically, the net negative impact is -13.72 percent $((-76.57 + 5.112) \times 0.192)$ instead of -14.70 (-76.57×0.192). See Table 3 for supporting descriptive analysis. However, this result should be treated carefully because the interacted variables are continuous in nature.

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APPENDIX A. EXAMPLES OF RPT AND RRPT
(2005–2007)

Berjaya Land Berhad

Dear Sir/Madam,

Proposed acquisition of Sungai Besi Land together with all existing buildings and structures erected thereon by SMSB from STC for a total consideration of RM 640.0 million; and

Proposed acquisition of Sungai Tinggi Land by SMSB from BCSB and the proposed appointment of BCSB as the turnkey contractor to carry out the construction of the NEW Turf Club for a total cash consideration of RM 605.0 million.

SMSB is effectively a wholly-owned subsidiary of B-Land, which in turn is 61.53% owned subsidiary of BGroup as at 30 September 2004.

BCSB is effectively a wholly-owned subsidiary of BGroup.

The purpose of this Circular is to provide you with the detailed information on the Proposals, to set out your board's recommendation thereon and to seek your approval for the ordinary resolutions relating to the Proposals as set out in the Notice of EGM enclosed to this Circular.

The Proposed Sungai Tinggi Land Transaction is a related party transaction in view of the interests of certain Directors and major shareholders of B-Land as set out in Section 10 of this Circular and in compliance with Chapter 10 of the Listing Requirements, B-Land has appointed Kenanga as the independent adviser and their independent advice letter is set out in Part B of this Circular.

Independent Advice from K & N Kenanga Bhd

After taking into account all the factors included in our evaluation, we are of the opinion that, based on the information made available to us, the proposed Sungai Tinggi Land Transaction is fair and reasonable to far as the shareholders of the company are concerned and is not to the detriment of the minority shareholders of B-Land. Accordingly, we recommend that you vote in favor of the resolution pertaining to the proposed Sungai Tinggi Land Transaction to be table at the forthcoming EGM of your company.