

Sensitivity Analysis of Managerial Ownership and Company Performance in Malaysia

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Abstract

This study investigates the sensitivity of managerial ownership on company performance of public listed companies in Malaysia. Three years panel data of 730 Malaysian public listed companies were examined. The results showed that the managerial ownership affected the firm performance at different levels of ownership. The low and moderate level of managerial ownership showed a positive and significant with ROA, ROE, Tobin's Q and share price. This is due to the low and moderate level of ownership, the managers having aligned their interests with those of the shareholders. However, the concentrated managerial ownership had negative and significant relationship with all performance indicators. Therefore, the involvement of management in monitoring and controlling activities fail to reduce agency conflict in the emerging economy. This study is perhaps the first that explain the different level of managerial ownership in relation to company performance utilizing extended agency theory in developing country.

Keywords Managerial ownership, performance, Malaysia

INTRODUCTION

The causal relationship utilised traditional agency theory which explain that the managerial ownership consider significant determinant on company performance. This theory emphasizes the conflict between unmonitored manager and widely dispersed ownership. Majority of the previous studies are based on developed market such as United States (US) and United Kingdom (UK) where the ownership is widely dispersed. However, recent literature questions the assumption of widely dispersed ownership and suggests a conflict between majority and minority shareholders. Unfortunately, very few studies to date investigated these issues in developing countries. Early

study by La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997) showed that the average of ownership in 49 countries by three largest shareholders is 46 percent. Further study by La Porta, Lopez-de-Silanes and Shleifer (1999) stated that the control is often concentrated within a family which is typically the founder of companies or their descendants. It is widely accepted that concentrated ownership has the potential to limit agency problem and reduce agency cost and therefore improves the company performance (Jensen and Meckling, 1976). This is due to efficient monitoring by higher concentrations shareholders through stronger incentives and more power by appointing directorship in order to monitor manager at lower cost.

Shareholders with large ownership in the company showed more willingness to play an active role in corporate decision making since they realize the outcome of the monitoring effort (Demsetz & Lehn, 1985; Demsetz & Villalonga; 2001, Faccio & Lan, 2003). Shleifer and Vishny (1997) mentioned that the shareholders with large ownership monitor the management by informal conversation or formal proxy in company. They added that when concentrated ownership exists, large shareholders have more incentives and resources to monitor management decisions and thus reduces the agency cost. There are other researchers that focused on the issue within the agency framework to explain the ownership concentration in relation to company performance (Fama & Jensen, 1983; Loderer & Martin, 1997; Claessens *et al.*, 2002; Fan & Wong, 2002; Tam & Tan, 2007; Hu & Izumida, 2008; Ming & Gee 2008; Perrini, Rossi, & Rovetta, 2008, Mohd Abdullah *et al.*, 2014). The management has more discretion to pursue their own objectives where there are no controlling shareholders. Hence, this study attempts to investigate the relationship between managerial ownership and company performance of public listed companies in Malaysia.

LITERATURE REVIEW

Researches that focus on relationship between managerial ownership and company performance showed an inconclusive result. Morck, Shleifer and Vishny (1988) found Tobin's Q to increase and decrease with managerial ownership. McConnell and Servaes (1990) found an inverted U-shaped relation between Tobin's Q and managerial ownership, with an inflection point between 40 percent to 50 percent ownership. Hermalin and Weisbach (1991) found a positive relationship between Tobin's Q and management ownership up to 1 percent, a negative relation for ownership between 1 percent to 5 percent, becoming positive again in the ownership range 5 percent to 20 percent, and turning negative for ownership exceeding 20 percent. Short, Zhang and Keasey (1999) in their studies found non-linear relationships between directors' shareholding and company performance. Therefore, empirical evidences on the relationship between managerial ownership and company performance suggests that the size of insider ownership does matter and the effect can be either both positive and negative. The positive relation at low level of managerial

ownership suggests the incentive alignment while the negative relation at high levels of managerial ownership provides the evidence that managers become entrenched and can indulge in non-value-maximizing activities without being disciplined by the shareholders (Himmelberg, Hubbard and Palia, 1999).

Managerial ownership is common in Malaysian public listed companies. The study by Claessens *et al.* (2002) documented that at 20 per cent cut-off, about 85 per cent of the public listed companies in Malaysia have owner managers. Large empirical literature investigates the relationship between managerial ownership and firm's performance and provides mixed result. Jensen and Meckling (1976) argue that agency cost and managerial ownership are negatively related and have positive relationship between managerial ownership and firm's performance. The convergence of interest hypothesis suggests a positive relationship between managerial ownership and firm's performance due to lower agency cost. While a negative relationship between managerial ownership and firm's performance is suggested by entrenchment hypothesis which explain that managerial ownership above a certain threshold will have destroying effect due to conflict between large block holders. A manager owning the large fraction of the shares in the firm bears the consequences of managerial action that either create or destroy the firm performance. Therefore, managerial shareholders are likely to work hard and create better investment decision and high managerial ownership firms should perform better. Therefore, the study related to managerial ownership in Malaysia needs to segregate the ownership level since the different levels of ownership affect the firm in different directions.

DATA

Data of this study was collected from secondary sources. Accounting information was collected from Osiris database. Ownership data was collected from the list of thirty largest shareholders in annual report which is downloaded from Bursa Malaysia website. After considering the incomplete information, there were 730 usable samples covering three periods from the 2007 to 2009. Normality check of the data was also carried out and some of the measures were transformed into logarithm to control for skewed nature of data. As multivariate regression is used to analyze the data in this study, assumptions of multicollinearity, homoscedasticity and linearity are also tested.

Result of Data Stationary Normality Test

The result of data stationary normality test using data mean, medium, standard deviation, skewness and kurtosis are shown in table 1. According to Tabachnick and Fidell (2001), to use of the analysis of variance for the population or samples of observation is assumed to be normally distributed and it is important where to conduct parametric statistical techniques. Population or sample assumed normally distributed when mean of variables

similar to value of medium, skewness value is zero and kurtosis value equal to 3. Skewness and kurtosis are two components in determining normality (Pallant, 2005). The diagnostic test showed that no variables have the value of mean equal to value of median. In addition the skewness value of variables are mix both positively and negatively indicating that their distributions are skewness to the right side as well as to left side of the curve. Sample assumed normally distributed if skewness value is zero. The kurtosis value of variables range from 4.868 (LPRO) to 578.334 (ROA) and no variable showed the value of 3. Therefore, it indicates that the result violates the assumption of normally distribution.

Utilizing SK test to evaluate the normality for all variables also showed it significant at 1 percent ($P < 0.01$) and these means all the variables are failed to fulfill the normality test. Since the data distribution is not normally distributed, the estimation method of ordinary least square (OLS) to analyse the sample data would produces bias and inefficient estimators. Therefore, the generalized least square (GLS) method of estimation is more appropriate and it is expected to yield a much better result (Gujarati 2003). The issue which involves the variables of non-normal distribution is quite common in research that involves a large sized sample (Pallant, 2005). In fact, this argument is agreed by Norusis (2000) and Kleinbaum, Kupper, Muller, and Nizam (1998), who explain that variance analysis is not heavily dependent on the assumption of normality since the data is large. As a result, the assumption of normality is not seriously offended since this study covers a large sample size.

Table 1 Results of normality test

	ROA	ROE	TQ	SP	LMAN	LSIZE	GRW	LEV	LPRO	AGE
Mean	0.064	0.118	0.617	1.559	1.178	5.531	1.422	0.188	4.239	15.396
Median	0.060	0.070	0.330	0.070	1.540	5.480	0.710	0.060	4.192	13.000
Maximum	11.08	5.880	38.000	44.500	1.990	7.850	14.900	16.174	6.962	50.000
Minimum	-21.94	-2.840	-1.350	0.010	-2.000	0.780	0.010	-0.062	1.041	0.000
Std. Dev	0.698	0.360	1.638	2.870	0.854	0.661	1.940	0.877	0.782	11.242
Skewness	-15.280	3.757	12.668	7.110	-1.796	-0.324	3.014	13.292	-0.022	1.312
Kurtosis	578.334	57.407	233.686	80.235	5.584	7.998	13.876	203.880	4.868	4.984
SKtest	4378.97	1992.53	3932.55	2852.87	711.18	284.39	1413.49	3992.05	28.27	428.90
Probability	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*

Notes:

1. The * denotes p-value significance at 1 percent level ($P < 0.01$).
2. ROA = Return on assets, ROE=Return on equity, TQ = Tobin's Q Ratio, SP= Share price, LMAN = Log Managerial ownership, LSIZE = Log total assets, GRW = market value of share divided by book value of share, LEV = total debt divided by total assets, LPRO = log profit or loss, AGE= year of listing.

Results of Multicollinearity Test

This study must ensure that the data must be independent of one another. It means that observations or independent variables must not be influenced by other independent variables (Pallant, 2005). According to Steven (1996), it is very serious if this assumption is violated. He added that each study must ensure that all observations are independent. This study is based on Pair-wise Pearson correlation matrix for the variables and the results are provided in tables 2. It indicates that multicollinearity is not a problem, as the correlations between all variables are relatively low. According to Gujarity (2003), multicollinearity could be a problem when the correlation exceeded 0.80. The low intercorrelation among the explanatory variables used in the regression indicates no reason to suspect serious multicollinearity.

Table 2 Result of multicollinearity test using Pearson Correlation matrix

	ROA	ROE	TQ	SP	LMAN	LSIZE	GRW	LEV	LPRO	AGE
ROA	1.000									
ROE	0.183*	1.000								
TQ	0.049*	0.069*	1.000							
SP	0.063*	0.530*	0.232*	1.000						
LMAN	-0.036**	-0.198*	-0.175*	-0.358*	1.000					
LSIZE	-0.30*	0.312*	-0.021	0.365*	-0.274*	1.000				
GRW	0.062*	0.450*	0.187*	0.774*	-0.366*	0.460*	1.000			
LEV	0.126*	-0.018	0.255*	0.003	-0.023	-0.107*	0.003	1.000		
LPRO	0.093*	0.551*	0.242*	0.463*	-0.297*	0.657*	0.547*	0.025	1.000	
AGE	0.018	0.181*	0.015	0.263*	-0.277*	0.322*	0.273*	0.020	0.255*	1.000

Notes:

1. The * and ** indicate correlation are significant at the 0.01 (2-tailed) and 0.005 (2-tailed) levels, respectively.
2. ROA = Return on assets, ROE=Return on Equity, TQ = Tobin's Q Ratio, SP=Share Price, LMAN = Log Managerial ownership, LSIZE = Log total assets, GRW = market value of share divided by book value of share, LEV = total debt divided by total assets, LPRO = log profitability, AGE = year of listing.

Sensitivity Analysis of Managerial Ownership and Performance

Previous empirical literature investigated the relationship between managerial ownership and firm performance with inconclusive findings. Different studies used different levels of managerial ownership and documented different impact for the level of manager ownership on company performance. Morck *et al.* (1988) found non-linear relationship between managerial ownership and firm performance. Further analysis in this study was to investigate the impact of different levels of ownership concentration on firm performance. Therefore, the level of managerial ownership was divided into three categories: less than 5 per cent as low level of managerial ownership, 5 to 25 per cent as moderate

level of managerial ownership and more than 25 per cent as concentrated level of managerial ownership. This classification was based on the studies by Morck *et al.* (1988), McConnell and Servaes (1990), and Hermalin and Weisbach (1991).

Table 3 Levels of managerial ownership and firm performance

Level of Managerial Ownership	ROA		ROE		Tobin's Q		Share Prices	
LMAN (< 5%)	0.420*	0.131	0.680**	0.331	0.311	0.121	0.211	0.023
LMAN (5-25%)	0.710*	0.242	0.621*	0.090	0.971**	0.721	0.313**	0.421
LMAN (> 25%)	-0.013*	0.031	-0.220**	1.030	-0.001*	0.830	-0.021*	0.131

Note: The * indicates significant at 1 per cent ($p < 0.01$), ** indicates significant at 5 per cent ($p < 0.05$) and *** indicates significant at 10 per cent ($p < 0.1$).

Table 3 provides the evidence that the managerial ownership affected the firm performance at different levels of ownership concentration. For the level below than 5 per cent, both the accounting-based performance indicators ROA and ROE showed positive and significant associations with managerial ownership. The Q ratio and share prices indicated a positive and statistically insignificant relation with this level of managerial ownership. This is consistent with the study by Holderness, Kroszner and Sheehan (1999) who found a significant, positive relationship between firm performance and managerial ownership within the range of less than 5 per cent. At this level of managerial ownership, the managers have aligned their interests with those of the shareholders and as a result, the firm performance increased.

Further, the analysis on moderate level of managerial ownership between 5 to 25 per cent also showed a positive and significant association with firm performance for all performance indicators. Theoretically, with this range of managerial ownership, the managers are able to collect information, oversee the management and assist to reduce the principle-agent problems between the managers and shareholders (Jensen & Meckling, 1976). Therefore, the moderate level of managerial ownership has a positive effect on the firm performance.

However, the concentrated managerial ownership above 25 per cent exhibited a negative association with all performance indicators. This supports the entrenchment theory and convergence of interest hypothesis because as the managerial ownership exceeds 25 per cent, the manager become self-centred and has a tendency to use the firm's wealth for personal benefits rather than increasing the firm performance. This explains that the firm performance improves with higher managerial ownership until a certain level which the

managers become entrenched and yet they get involved in risky investments at the expense of outside investors (Morck *et al.*, 1988). This result is consistent with most of the previous studies which found a positive relationship between managerial ownership and firm performance for the low level of managerial ownership and a negative relationship for the high level of managerial ownership (Morck, Strabgeland and Yeung, 1998; McConnel & Servaes, 1990; Hermalin & Weisbach, 1991; Cho, 1998; Florackis, Kostakis, & Ozkan, 2009).

CONCLUSIONS

Agency theory proposed that the concentrated ownership would contribute to a more effective monitoring process. Utilizing panel data of listed companies for the year 2007-2009 covering 730 listed companies on Bursa Malaysia showed that the managerial ownership failed as a controlling and monitoring mechanism to neutralize the agency conflict and optimize the company performance. The finding showed that the managerial ownership is beneficial only in non-concentrated firms. The lower and moderate level of managerial ownership influent company performance positively. The managers with this level of ownership have a motivation to collect information, oversee the management and assist to reduce the principle-agent problems between the managers and shareholders. However, high level of managerial ownership influent company performance negatively. The controlling owner in concentrated ownership company may use his or her position in the firm to extract private benefits at the expense of the other shareholders. This is due to greater managerial ownership can lead to greater agency problems due to an entrenchment effect. In particular, the managers with sufficient ownership have control rights, and therefore they have the ability to influence the firms to commit the self-serving transactions and thereby expropriate wealth from outside shareholders. Managerial entrenchment problem proposed that the managers who want to maximize private benefits would opportunistically withhold or manipulate information to outside investors, particularly when minority investor protection is weak. It is doubtful that even entrenched managers are totally immune from disciplinary forces such that they openly disclose details of self-serving investments or contract. Thus, the incumbent managers are likely to have incentives in hiding their efforts to expropriate wealth or secure their positions and only disclose information that is in their best interests. When the managers hold a relatively large equity stake, their concentrated control allows them to use corporate disclosures for personal interests, rather than for the best interests of outside shareholders. The principal agent problems cannot be solved through an increase of managerial ownership. This finding supports the view that the concentrated managerial ownership can lead to more severe agency problems.

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