Blockholder Ownership as Governance Mechanism on Firm Performance: Evidence From Malaysia

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Abstract

We examined the relationship between blockholder ownership and firm performance in the context of high concentrated ownership in Malaysia coupled with weak regulatory framework. Blockholder ownership is used as monitoring device to verify the significant role in managerial decisions accordance with maximizing shareholders' wealth. Consequently, blockholders may have personal incentive to the expropriation of minority shareholders' wealth by exercising their corporate control. We found a positive significant relationship with small effect of beta coefficients by both market and accounting based measurements. The positive relationship of blockholders as institutions is the conformity of monitoring hypothesis. The results indicate a very week monitoring impact of blockholders on executives' decisions that improve the firm performance by reducing the agency costs. Additionally, the significant low positive effect of profit volatility is representing the efficacy of blockholders until a certain level.

Keywords: agency cost, blockholder ownership, corporate control, corporate governance, firm value, Malaysia, ownership concentration, panel data analysis

1. Introduction

The current research direction on incentive makes it necessary to examine the effectiveness of corporate governance reform in a country which depends on the distinct countrywide business systems (Pedersen & Thomsen, 1999). Jensen & Meckling (1976) relate agency theory to modern corporation and form relative amount of ownership claims held by insiders and outsiders. Insiders are the management, and outsiders refer to the investors with no direct role in the management of a corporation. They formalize the survival of organizations by "separation of ownership and control." Shareholders experience a loss of control over their resources to oversee managerial activities in modern corporations. Management exercises more freedom rather if at least ownership is concentrated or firm is managed by its owners. Recently, this image of one run by professional managers without accountability to shareholders clearly stuck. There are some evidences of concentrated ownership existence around the world. Shleifer & Vishny (1986) demonstrated that there is a modest ownership concentration even in largest American firms. Since management and ownership usually do not coincide, Berle & Means (1932) perceived a conflict of interests between parties. Studies by Hartzell & Starks (2003) found that blockholders could be an efficient control mechanism to align the interests between stakeholders. When share is more concentrated, atomistic shareholders get priority to co-ordinate and demand information from management. On the other hand, when share is diffusely held among investors, the information asymmetries are greater between managers and the shareholders. Therefore, it is more difficult for shareholders to gauge the managerial action whether they are acting for their best interests. This inability may lead the managers to pursue their own interests rather than maximizing shareholders' wealth. Therefore, outside blockholders can play an important role of minimizing the deviation of interests between managers and shareholders as they can monitor the managers closely.

Malaysian corporate sector is characterized by concentrated ownership (Haniffa & Hudaib, 2006), pyramid structure, cross-holding; and sometimes with dual class shares (Note 1) that well-defined in family controlled firms (Claessens et al., 2000). Managers usually come from the same family of large controlling shareholders where managers (agents) and shareholders (principals) conflicts of interests are limited. According to Zhuang (2001), Asian countries are characterized by concentrated ownership and weak regulatory structure leading to a weak corporate governance