

Executive Stock Option and Blockholder Ownership as Governance Mechanisms on Firm Performance

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Abstract

Separation of ownership and control led to agency conflicts between the majority and minority shareholders in South East Asian Corporations. Using panel data pooled GLS estimations, this study investigates the effects of Executive Stock Option (ESO) granting and blockholder ownership on firm performance of Malaysian non-financial listed companies. A positive significant increased relationship between ESO granting and firm performance is found which conform incentive alignment hypothesis, coupled with the modest effect of blockholder ownership while considering both market and accounting based performance measurements. These explanatory variables are in tandem with the enhancement of future revenues by alleviating the conflicts between shareholders and managers of Malaysian firms. The low positive relationship is indicating the blockholder ownership as a monitoring device that has modest power. Additionally, industry effects on firm performance also been observed.

Keywords: Blockholder Ownership, Executive Stock Option (ESO) Granting, Executive Stock Option Scheme (ESOs), Firm Performance, Malaysia, Panel Data Analysis.

1.0 Introduction

In modern corporations, businesses are managed potentially by two parties - shareholders and managers (Hadani et al., 2011). Shareholders usually do not manage their businesses by themselves; instead they hire the managers to do so. Consequently, this creates asymmetric information problems, first addressed by Jensen and Meckling (1976). This separation issue exists in the organizations partly because of the advantages of specialization of management and risk bearing; and also due to agency problem arising from the separation. These conflicts of interests, coupled with costly perfect contracts writing or keeping an eye on the controllers, eventually reduce the value of the firm; other aspects kept equal (Denis and McConnell, 2003). These ideas outline the basis for corporate governance mechanisms that result from the separation of ownership and control. The main objective of this study, therefore, is to verify the likelihood of Executive Stock Option Scheme (ESOs) in reducing the agency conflicts among stakeholders. Given the scenario of Malaysia where the owners are present in the management (Claessens et al., 2002), ESOs raises a question as to whether it is intended to adopt for their own benefits. The second key objective is to explore the impact of blockholder ownership on certain major corporate decisions that affect firm value. In this study, Executive Stock Option (ESO) granting is considered to validate the purpose of ESOs adoption where blockholder ownership is also in the management of the company. We found that Malaysian executives are tying their wealth by ESOs adoption where executives may expropriate minority shareholders' wealth due to poor corporate governance structure.

Two-thirds of the Malaysian firms are each controlled by a single shareholder with high ownership concentration; and the limited conflict between large shareholders and managers (Claessens et al., 2000) has a different set of agency problem all together. These corporate scenarios of Malaysian firms differ from the developed markets' dispersed ownership structure, where introduction of ESOs is a burning question of aligning the interests between executives and the shareholders.