

SECTION 3  
CORPORATE  
GOVERNANCE: MALAYSIA



CORPORATE GOVERNANCE IN FAMILY RUN BUSINESS – A  
MALAYSIAN CASE STUDY

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**Abstract**

This paper addresses the debate on family run business and corporate governance before and after the Asian Financial Crisis in 1997. As there are only few studies on the corporate governance of family businesses in Malaysia, this paper aims to provide a broad view of the corporate governance practises of family run companies in Malaysia. The majority of family-run companies in Malaysia are operated by ethnic Chinese families in Malaysia. To understand the practices of corporate governance in these companies, this study selected 3 of the top 10 family run companies by market capitalization in Malaysia. This paper discusses the issues and problems related to family run businesses in the light of the separation of ownership and control, lack of board independence and protection of minority shareholders, lack of independence of external auditors, lack of transparency and disclosure as well as managerial entrenchment.

**Keywords:** corporate governance, family run business, Malaysia

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**1. Introduction to Family-Based Business in Asia**

In many countries of East Asia, ownership is concentrated within founding families (La Porta et al., 1999; Claessens et al., 2002). According to Claessens et al. (1999), analysis of ownership control conducted by world bank found that ten largest families in Indonesia, the Philippines, and Thailand control half the corporate sector (in terms of market capitalization), while the ten largest in Hong Kong and Korea control about a third. More extreme, in Indonesia and the Philippines ultimate control of about 17 percent of market capitalization can be traced to a single family and also in Malaysia, 28.3 percent of market capitalization was controlled by 15 families.

According to Suehiro (1993) the family business can be thought of “ ... as a form of enterprise in which both ownership and management are controlled by a family kinship group, either nuclear or extended, and the fruits of which remain inside that group, being distributed in some way among its members.” (p. 378).

Suehiro (1993) draws his inspiration from Chandler (1977) who defines family business in the following way:

“In some firms the entrepreneur and his close associates (and their families) who built the enterprise continued to hold the majority of stock. They maintained a close personal relationship with their managers, and they retained a major say in top management decisions, particularly those concerning

*financial policies, allocation of resources, and the selection of senior managers. Such a modern business enterprise may be termed an entrepreneurial or family one, and an economy or sectors of an economy dominated by such firms may be considered a system of entrepreneurial or family capitalism”.*

Interestingly, many Asian family firms are owned and operated by Chinese (Tan & Fock, 2001). In Malaysia, the Chinese (typically family oriented) controls more than half of the public listed companies in Bursa Malaysia (Low, 2003). Their strong presence has made sense for this article to analyse the characteristics of Chinese family business in order to understand how the family run businesses in Malaysia work. The aggressive nature of entrepreneurship and strong cohesiveness of families are key factors in Chinese family businesses (Yen, 1994). Zapalska & Edwards (2001) also found that there are significant links between Chinese culture and entrepreneurial activities in China. There are, however, significant differences between the Chinese and Western culture as regards business activity (Pistrui et al, 2001; Gatfield & Youseff, 2001; Begley & Tan, 2001).

Many aspects of Chinese culture, influenced by Confucianism, combine to promote collectivism and traditional respect for age, hierarchy, and authority in the Asian business environment (Zapalska & Edwards, 2001). Confucian culture emphasizes the values of paternalism and collectivism, both of which contribute to Asian business relations. More importantly, Chinese culture advocates conformity rather than individuality (Begley & Tan, 2001) and this is important in shaping managerial style (Hugh, 1986). The centralization of decision-making is acceptable in such a cultural context. Moreover, Chinese have a strong commitment to family, and thus business is perceived as an extension of the family system (Zapalska & Edwards, 2001).

Taiwanese family CEOs' sense of professionalism and family loyalty are derived from the enterprise system and the family system which coalesce in family firms (Yen, 1996). Informal family influence is more powerful than formal authority in family firms because CEOs and top management are also family members (Yen, 1996). The family system is designed to increase family welfare and status and preserve them for future family members. The family mentality of local entrepreneurs is a key motivator in the growth stage of an organization; but it may also obstruct the development of family firms (Yen, 1994). Recently, Chinese corporate culture has been experiencing dramatic changes. Lee and Chan (1998) found that the second generation of Singaporean entrepreneurs is quite different from their parents because they have absorbed many values of Western culture. Moreover, the division of family properties is, as a rule, rigid in Chinese culture, though it is also a factor in business diversification (Yen, 1994).

## 2. Research Objective and Methodology

This paper makes references to the corporate structures of Genting, IOI, YTL and Public Bank Berhad, to understand the practice of corporate governance in the context of Malaysian family run businesses. These 3 companies are the top 10 family run companies based on Starbiz's Malaysia Top 100 Companies by market Capitalization on 7<sup>th</sup> August 2008. As there is only limited literature in Malaysia on family-based corporate governance, we review a broad cross section of the literature from Asia and Europe to analyse the issues and problems of family-run companies to gain better insight. This paper also elaborates on some of the good practises of corporate governance in Malaysian family-run companies. Having presented both the weaknesses and strengths of family run businesses, we look into some of the reforms that can be explored to improve the overall corporate governance of family-run companies by maintaining some of the key features while implementing the western based corporate governance system. In this study, data and literature were mainly secondary.

## 3. Family-Based Corporate Governance

Even before the crisis in Asia, extensive debate was taking place in Europe, the United States and Japan about the relative merits of different types of corporate governance systems. Broadly speaking, two general types of corporate governance structures have been discussed.

The first type can be called a shareholder or equity market-based governance system of the Anglo-American type (EMS). This is usually contrasted with the continental European or Japanese-type stakeholder or relationship model. In this model (for example, the Japanese main bank system) banks rather than equity markets play a key role in monitoring the performance of corporations. Therefore, this type of governance structure could be called a bank-led governance system (BLS). Note that BLS can either be a Japanese-style main bank system as mentioned above, or a German-type of universal banking system. However, the BLS and EMS are not the only two possible types of corporate governance systems.

In both Northeast and Southeast Asia there is a preponderance of family-based firms that are not necessarily controlled by banks or by equity markets. Nevertheless they do operate as economic entities within the context of a relationship-based system. Thus corporate governance of family businesses or family-based corporate governance system (FBS) can constitute a third type of corporate governance.

**Table 1.** Comparison of EMS, BLS and FBS system of Corporate Governance

	Type of Corporate Governance System		
	Equity Market-Based System (EMS)	Bank-Led System (BLS)	Family-Based System (FBS)
Share of control-oriented Finance	Low	High	High initially, but may vary as family groups get bank and equity financing from outside
Equity markets	Large, highly liquid	Not necessarily small but less liquid than EMS	Small, less liquid
Share of all firms listed on Exchanges	Large	Not necessarily small	Usually small
Ownership of debt and equity	Dispersed	Concentrated	Concentrated
Investor orientation	Portfolio-oriented	Control-oriented	Control-oriented for family groups
Shareholder rights	Strong	Weak	Weak for outsiders
Creditor rights	Strong	Strong for close creditors but applied according to a “contingent governance structure” (Aoki)	Strong for close creditors; Weak for arm’s length creditors
Dominant agency conflict	Shareholders vs. management	Banks vs. management; Workers may be important stakeholders as in Aoki’s model of the Japanese firm	Controlling vs. minority investors
Role of board of directors	Important	Limited, but less so than in the case of FBS	Limited
Role of hostile takeovers	Potentially important	Quite limited	Almost absent
Role of insolvency and bankruptcy*	Potentially important	Potentially important; but possible systemic crisis may postpone bankruptcies	Potentially important
Monitoring of non-financial enterprises (NFE)	Not mentioned	Not mentioned	Information asymmetry and agency costs rise with the growth of firms, making monitoring more costly.
Self-monitoring	Not mentioned	Not mentioned	Initially, self-monitoring is effective because of non-separation of owner and management. Later stages present monitoring problems as agency costs rise due to separation of owner-managers and outside financiers.

\* Note: Berglöf uses the term insolvency but the problem of exit of insolvent firms is directly related to bankruptcy laws and procedures.

\*\* Source: Berglöf (1997), “Reforming Corporate Governance”, *Economic Policy* 24, and Khan (1999), “Corporate Governance of Family Businesses in Asia – What’s Right and What’s Wrong?”, *ADB Working Paper No.3*, and modified.

Given this threefold division, we can now ask: what are the relevant dimensions in which these systems can be compared and contrasted? Berglöf (1997) developed a set of criteria to answer this

question for EMS and BLS types of corporate governance. Table 3.1 compares and contrasts the EMS, BLS and FBS types of corporate governance, using Berglöf's and Khan's original criteria with modification of layout arrangement.

In discussing family business in East Asia, the emphasis will be on ultimate control and de facto control rights more than on formal ownership. In their studies of corporate control in Hong Kong, China, Indonesia, Korea, Malaysia and Thailand, Claessens, Djankov, Fan and Lang (1998, 1999b) and Claessens, Djankov and Lang (1998, 1999) have pointed out two important features of industrial organization in East Asia. These are:

a) Families have control over the majority of corporations.

b) Such control is also magnified "... through the use of pyramid structures, crossholdings and deviations from one-share-one-vote rules" (Claessens, Djankov, Fan and Lang, 1999b, p. 3).

In addition to Berglöf's original criteria for comparing the BLS and EMS, Khan (1999) introduced two additional features related specifically to corporate governance of family businesses. The first is monitoring of non-financial enterprises by the system, i.e., how the managers of corporations are monitored by outside financiers such as banks on the one hand, and equity markets or shareholders, on the other. This type of governance is intimately associated with how corporations are financed, i.e., corporate finance. Such monitoring by the firms' financiers is clearly an important function of the financial system. The monitoring of non-financial enterprises by the financiers has special relevance because a priori it is not clear if the financial distress of family-based firms is always signalled accurately to the outside financiers. Secondly and more generally, the issue of self-monitoring needs to be addressed. Self-monitoring is important because without some degree of self-monitoring FBS cannot function adequately.

Both BLS and EMS are closely associated with the dominant modes of corporate finance by banks and equity markets, respectively. In the case of FBS in East Asia, the financing can come from three different sources. First, under FBS in the initial phases of growth of family businesses, firms could be financed internally. Second, as the enterprise grows over time, the role of banks becomes more prominent. Third, at some point in time equity markets may become an even more significant source of corporate finance. However, the key difference between FBS as a governance system and BLS and EMS lies in the fact that neither the banks nor the equity markets ultimately control or oversee the family business groups. That control resides with the family (or families) in the final analysis. This is because of various mechanisms of control such as control

through subsidiaries that are at the disposal of the family groups, as will be discussed in the next sections.

#### **4. Issues and Problems of Corporate Governance in Family-Based System**

In general, discussions on corporate governance relate issues to 5 major areas: rights and responsibilities of shareholders, role of shareholders, equitable treatment of shareholders, disclosure and transparency and duties and responsibilities of the board. Other issues include internal controls and independence of the company's auditors, oversight and management risk, oversight of the preparation of the company's financial statement, review of the compensation arrangements for CEO and other senior executives, the resources made available to directors in carrying out their duties, the way in which individuals are nominated for positions on the board and dividend policy Jaffer & Sohail (2007)

There are some specific problems in corporate governance in relation to family-based business. These are:

##### **4.1. Lack of Separation of Ownership and Control**

In Malaysia, the Listing Requirements are modeled after the Anglo Saxon model more particularly the UK Codes comprising of the Cadbury, Greenbury and Hampel Report (Kang, 2001). Besides, the Malaysia Code of Corporate Governance (MCCG) is also modeled from these reports. In relation to the MCCG, the code requires the separation of ownership and control.

The code suggests that the separation of ownership and control in order to stay objective when making strategic policy decision (Robert, 2002). The separation of two roles is to ensure effective check and balance over the management performance (Haniffa and Cooke, 2002). If the owner also becomes the manager and chairman, he will be unlikely to monitor the activities of the management in an independent and objective matter (Lai, 2007). This is due to the fact that the Chairman of the board is also responsible for the selection of new board members, monitoring the performance of the executive directors and settling any conflicts which arise within the board (Laing and Weir, 1999). Therefore, the separation is to prevent the owner to make any decision for his own benefit or own-self-interest at the expense of shareholders and to avoid concentration of power.

However, this separation of ownership and control can hardly be seen in Malaysia's family-owned companies. We can see many FBS companies are owned and managed by the founder or their generations such as Genting Berhad, YTL

Corporation Berhad and IOI Corporation Berhad. Referring to the Table 2, we can see that the owners of the family-owned companies always assume the role of Chairman and CEO. For example, Tan Sri Lim Kok Thay from Genting Berhad is the owner, Chairman in the board and also the CEO for the corporation. For

IOI, Tan Sri Dato' Lee is the owner and he is the Chairman and CEO of the company. For TYL Corporation, Tan Sri Dato' (Dr) Yeoh Tiong Lay is the owner and Chairman of the company, his eldest son Tan Sri Dato' (Dr) Francis Yeoh is the Managing Director for the company.

**Table 2.** Duality Roles of Owners in Malaysian FBS

	IOI Corporation Berhad	Genting Berhad	YTL Corporation Berhad
Chairman/ Owner			Tan Sri Dato' Seri (Dr) Yeoh Tiong Lay
CEO/ MD	Tan Sri Dato' Lee Shin Cheng	Tan Sri Lim Kok Thay	Tan Sri Dato' (Dr) Francis Yeoh Sock Ping

The duality of roles of the owners in the above family-owned companies is not recommended in MCCG. The MCCG requires a balance of power and authority between the Chairman and CEO, so that no one individual has unfettered powers of decision.

In summary, the lack of the separation of ownership and control is one of the major problems of corporate governance in Malaysian family run companies. The family run businesses do not have separation and may well exert substantial influencing power on the board of directors which in turn may influence dividend policy and investment (Claessens et al. 2000) and also the remuneration policy. The audit committees and remuneration committees may not be able to mute the concentration of power in such few hands.

#### **4.2 Lack of Independence on the Board**

Board independence is associated with the entry of outsiders into the board (Zulkafli, Samad and Ismail, 2006). The board should consist of two types of director, namely executive and non-executive (Weir and Laing 2001). The executive directors are responsible for day-to-day management of the company. They have direct responsibility for aspects the business such as finance and marketing. They also help to formulate and implement corporate strategy. They should have brought in specialised expertise and a wealth of knowledge to the business. Whereas, the non-executive directors are in the monitoring roles as mentioned in the Cadbury Report. Dare (1993) argues that non-executive directors are effective in monitoring when they question company strategy and ask awkward questions. They should able to provide independent judgement when dealing with executive directors in areas such as pay rewards, executive director appointments and dismissals.

In the Malaysian context, the MCCG requires all listed companies to have at least one third of the board comprised of independent directors and the size

of the board should reflect its effectiveness. The independence of board of directors is one of the main issue in Malaysian FBS. Normally, in the FBS, the degree of concentration of ownership is high (La Porta et al. 1999; Faccio and Lang 2002; Claessens, Djankov and Lang 2000; Lemmons and Lins 2003). As a result, the high degree of the concentration of ownership will make the independence of the board questionable and reduced its effectiveness.

Referring to Table 3 we can see the independence of the board is questionable. For example, in IOI Corporation, there are 3 family members in an 8 member's board. Although the appointment of the directors is decided by nomination committee which comprises of independent directors, but the strong influences of 3 family members can affect the nomination committee's decisions. This is very obvious in YTL Corporation; there are 7 family members in the 13 members' board. Even though the appointment of the directors is undertaken by the board, but it was through the recommendation of the managing director (MD) who is the son of the founder. As a result, this may influence the board's decision and effectiveness. Besides, the MD is also sitting in the audit committee. It shows that the owners' influence is very strong in YTL Corporation. For Genting Berhad, it has 8 directors on the board; one is chairman and chief executive (Tan Sri Lim), one deputy chairman, one executive director, two non-independent non-executive directors and three independent non-executive directors. This composition fulfills the requirements of the MCCG where it is recommended that at least three be non-executive directors. However, the independence of the board is not guaranteed because the founding family holds at least 39% of the 3 companies mentioned. Such a big shareholding allows the family to have substantial influence over management and the board. Therefore, we can see that lack of independence of the board in these 3 family-owned companies.

**Table 3.** IOI Corporation Bhd, Genting Bhd and YTL Corporation Bhd: Family Members in the Board, Members in Audit and Remuneration Committee

	IOI Corporation Berhad	Genting Berhad	YTL Corporation Berhad
% - Family control	40.79	39.6	52.64
Board	<p>3 family members in the 8 member's board.</p> <p><u>Executive Chairman</u> Tan Sri Dato' Lee Shin Cheng (He is an Executive Chairman and CEO)</p> <p><u>Executive Director</u> Dato' Lee Yeow Chor (Also Group Executive Director)</p> <p><u>Non-Independent Non-Executive Director</u> Puan Sri Datin Hoong May Kuan (Wife of Tan Sri Dato's Lee Shin Cheng)</p>	<p>1 family member in the 8 member's board</p> <p><u>Chairman</u> Tan Sri Lim Kok Thay (Also a CEO of the Group)</p>	<p>7 family members in the 13 member's board.</p> <p><u>Executive Chairman</u> Tan Sri Dato' Seri (Dr) Yeoh Tiong Lay</p> <p><u>Managing Director</u> Tan Sri Dato' (Dr) Francis Yeoh Sock Ping</p> <p><u>Deputy Managing Director</u> Dato' Yeoh Seok Kian</p> <p><u>Directors</u> Dato' Yeoh Soo Min Dato' Yeoh Seok Hong Dato' Michael Yeoh Sock Siong Dato' Yeoh Soo Keng Dato' Mark Yeoh Seok Kah</p>
Audit Committee (AC)	<p>1. YM Raja Said Abidin b Raja Shahrome – 63 years. Appointed on 1 December 1999. (Chairman / Independent Non-Executive Director)</p> <p>2. Datuk Prof Zainuddin b Muhammad - 63 years. Appointed on 24 July 2001. (Member / Independent Non-Executive Director)</p> <p>3. Quah Poh Keat – 56 years. Appointed on 15 August 2008. (Member / Independent Non-Executive Director)</p>	<p>1. Tan Sri Dr. Lin See Yan – 69 years. Appointed on 28 November 2001. Chairman/Independent Non-Executive Director</p> <p>2. Dato' Paduka Nik Hashim bin Nik Yusoff – 71 years. Appointed on 8 June 1979 Member/Independent Non-Executive Director</p> <p>3. Mr Chin Kwai Yoong – 60 years. Appointed on 23 August 2007. Member/Independent Non-Executive Director</p> <p>4. Mr Quah Chek Tin – 57 years. Appointed on 12 April 1999. Member/ Non-Independent Non-Executive Director</p>	<p>1. Dato' (Dr) Yahya Bin Ismail – 80 years. Appointed on 6 April 1984. (Chairman/Independent Non-Executive Director)</p> <p>2. Tan Sri Dato' (Dr) Francis Yeoh Sock Ping – 54 years. Appointed on 6 April 1984. (Member/Managing Director)</p> <p>3. Mej Jen (B) Dato' Haron Bin Mohd Taib – 73 years. Appointed on 3 July 1990. (Member/Independent Non-Executive Director)</p> <p>4. Dato' Cheong Keap Tai – 60 years. Appointed 30 September 2004. (Member/Independent Non-Executive Director)</p>
Remuneration Committee (RC)	<p>1. Tan Sri Dato' Lee Shin Cheng (Chairman)</p> <p>2. YM Raja Said Abidin b Raja Shahrome</p> <p>3. Datuk Prof Zainuddin b Muhammad</p>	<p>1. Dato' Paduka Nik Hashim bin Nik Yusoff Chairman/Independent Non-Executive Director</p> <p>2. Tan Sri Dr. Lin See Yan</p> <p>3. Tan Sri Lim Kok Thay</p>	Not available
Nomination Committee (NC)	The Nomination Committee of the Company comprises the independent directors. The Nomination Committee is responsible for making recommendations for any appointments to the Board.	<p>1. Tan Sri Dr. Lin See Yan Chairman/Independent Non-Executive Director</p> <p>2. Dato' Paduka Nik Hashim bin Nik Yusoff</p>	The appointment of Directors is undertaken by the Board as a whole. The Managing Director recommends candidates suitable for appointment to the Board, and the final decision lies with the entire Board.

Source: IOI Corporation Berhad's Audited Report 2008; YTL Corporation Berhad's Audited Report 2007; Genting Berhad' Audited Report 2007.

In addition, the independence of non-executive directors is difficult to justify when he or she is appointed to the board many times and for more than 3 years. According to O'Sullivan and Wong (1999), non-executive directors with many years of experience on the same board may become less effective monitors as they build up close relationships with executive director/ owner/dominant shareholders in FBS. For example, one of the independent non-executive director has sat on the Genting board since June 1979. This is similar to YTL Corporation and IOI Corporation as we look at the members of audit committee in YTL and IOI in Table 4.2 above. This close relationship has caused problems for the independence board of directors in FBS.

#### **4.3 Lack of Protection for Minority Shareholders in Family-Based System**

PricewaterhouseCoopers Corporate Governance Survey of 2002 showed that many public listed companies have substantial shareholders who act as directors and are involved in the management as well (Satkunasingam and Shanmugan, 2006). As a result, minority shareholders under such conditions have very little say in the management, ethics and practices of these types of corporations (Reed, 2002; Thillainathan, 1999). Under such circumstances, will the minority shareholders in family-based companies take action against the errant corporations on their own?

According to Satkunasingam and Shanmugan (2006), minority shareholders in Malaysia are at a greater disadvantage than minority shareholders in developed countries like Australia because they do not only have to contend with conflicting interests with dominant shareholders at times, but they also have to contend with government interference that at times prevents even dominant shareholders from exercising their rights as shareholders; a move which may indirectly harm minority shareholders who seldom have the clout to make themselves heard. It is therefore left to the minority shareholders to represent their own interests. They are unlikely to do this in light of the local culture and politics. Even with the Minority Shareholder Watchdog Group (MSWG), the minority shareholders' interest still can not be guaranteed in the FBS because the dominant shareholders or concentration of shareholding can rule over any minority shareholders' decision in the Annual General Meeting (AGM).

In FBS, although shareholders including minority shareholders can enjoy one-share-one-vote rule, with proxy voting legally allowed and practiced. However, the minority shareholders could not influence the vote, and there is no real discussion of board decisions during such meetings. As a result, many major transactions of the FBS companies such

as amendment of the articles, bonded indebtedness, sale of major corporate assets, investments in other companies and mergers managed approved by two-thirds majority vote of shareholders. In short, all these created problem of exploitation of minority shareholders' interests in FBS.

#### **4.4 Lack of Independence of External Auditor**

In FBS, the appointment and removal of a director is done according to simple majority vote by shareholders. Therefore, major shareholders such as family-owned companies would have a disproportionate influence over the proceedings (RHB, 2008). The same method applied to appointing external auditor; therefore, auditor independence could be weakened due to the influence of dominant shareholders. Some auditors may even collude with the management in order to continue providing services to the company.

#### **4.5 Lack of Transparency and Disclosure: Continuous Disclosure and Related-Party Transactions**

In FBS, small investors are often at a great informational disadvantage compared with controlling family shareholders. Normally, the information flow very fast to the family members because of the duality roles of owners in FBS. It is arguably of greater importance for family companies to effectively implement a policy of continuous public disclosure of relevant operational, financial, and corporate events to enhance transparency for all shareholders.

Although the FBS companies fulfil the requirements of Bursa by publicising the Audited Report annually and continuously providing important information to Securities of Commission (SC) and Bursa Malaysia, yet we cannot guarantee there is no insider trading in FBS companies. This is because the owners have access to non-public information about the company.

#### **4.6 Managerial Entrenchment**

Due to the strong influence of founding family in the board, there is high chance that the nomination committee may not appointing directors out of pure merit consideration, particularly the position of CEO. Likewise, this invisible hand may also influence the selection process of the professionals to run the various functions of the company's operation. This will deprive the family run companies of efficient labour market which is enjoyed by non family-run public listed company (Schulze, et al. 2001). Further supporting this claim, studies done in Europe suggested that family-run companies are more

exposed to managerial entrenchment (e.g. Gomez-Mejia, Nunez-Nickel and Gutierrez, 2001; Thomsen and Pedersen, 2000). The problem of managerial entrenchment is due to perception that family-run companies have natural inclination to favour applicants related to the founding family, this perception could subsequently reduce the quality of applicants for key managerial positions in the company.

## 5. The Benefits of the Family-based System

Despite the problems and issues raised above, family based corporate governance system certainly are still relevant to the corporate world not just the East Asia, where families still control sizeable businesses across the world, but also in the United States where families control as much as 30 percent of the largest public firms and participate in management of as much as one third of these (Kang, 2000). The key strengths of FBS include reduced agency cost and altruistic behaviours, efficient leadership structure and business continuity.

### 5.1 Reduce Agency Cost and Altruism

There is no current literature exploring the benefit and strength of family-run companies in terms of agency cost and altruism in the context of Malaysia. Fortunately, we can draw on some of the research carried out in Europe to understand the strength in this regard. Dalton and Daily (1992) argued that family-run companies are one of the most efficient forms of organizations because of the little separation between control and management decisions. This alignment between control and management reduce the agency cost which is typically associated with the widely held public companies (Berle and Means, 1932). In widely held public companies, the alignment of control and management requires the incentive schemes such as performance based salary or stock options, external monitoring from auditors and capital financiers, as well as close monitoring and regulations from statutory boards to ensure both director board and management act in the interest of the company in both short and long time horizon.

In contrary, family-run companies may benefit from employment relationships based on altruism and trust. Altruism refers to decisions that are made for selfless reasons to benefit others, rather than decisions made for selfish reasons typically assumed by classical economics literature (Lunati, 1997). In fact, researchers in several fields have long recognized the value of altruism in employment contracts. For instance, Chami and Fullenkamp (2002) recognized that developing trust via mutual, reciprocal altruism can reduce the necessity of increase monitoring and

incentive-based pay. Moreover, this altruistic behaviour reduces excessive private consumption of perks and effort aversion of managers at the expense of the company owner. De Paola and Scoppa (2001) also suggested that altruism within the family could lead to superior employment contracts by the companies. In addition, because of owner-management alignment in family-run companies, both parties are naturally patient investors with a long time horizon (Kang, 2000). A founder who plans to pass his business to an heir will be more likely to use firm resources efficiently than a founder who does not plan on transferring the business to a family member. Another demonstration of altruistic behaviour is the synonyms of company with the family, thus giving the company leader as the patriarch, the motivation to run the business with the interest of company in mind (Lai, 2007). Moreover, Family ties, loyalty, insurance, and stability provide the necessary incentives for family managements to make decisions according to market rules (James, 1999).

### 5.2 Structure of Leadership for Family Based System Corporation

Leadership structure has important impacts on the nature of decision making process for a company. Politically correct “good corporate governance” in this regard, means transparency on decision making process by encouraging various groups to form the committees and votes on the decision openly, however this process may take long time to reach consensus, and also subjected to the possibility of confidential information leakage to competitors, this is in contrary to family based system, which emphasis on trust and believe important decision should be made privately for the interest of the company. The founder often unilaterally makes business decisions, and seeks board endorsements subsequently (Yueng & Soh, 2000). This unitary leadership structure becomes important in maintaining the decision making process to sustain competitive advantage in the market, because it offers a clear mandate to a single leader to react faster to external events (Fan, Lau and Wu, 2002).

Normally founding family members assume positions of chairman and CEO to preserve the powers to decide within the corporate structure. This arrangement is always attacked by EMS’ s school of thought followers, however one must not forget that companies like Enron, World-com, Vivendi and Deutsche Telecom practised the separate management and board and yet the scandals could not be avoided (Sonnenfeld, 2004).

As shown in Table 4.2, typically the Malaysian family run companies have founding family members for the position of Chairman and CEO, this is same as FBS in other countries such as Hong Kong. For

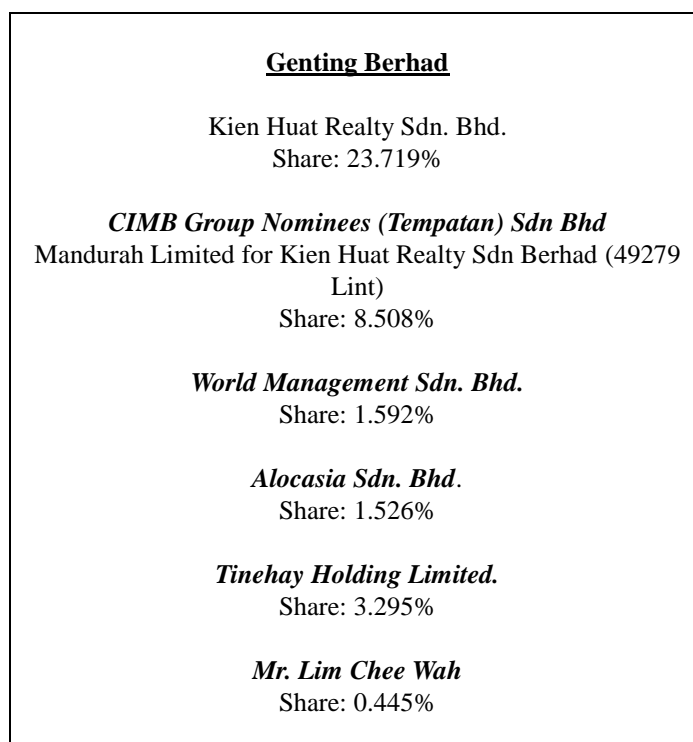


example property tycoon Mr. Li Ka Shing (Asia's richest man) holds the chairman position at the Cheung Kong Holdings while his elder son, Mr. Vitor Li is the Managing Director.

### **5.3 Business Continuity (Absence of Hostile Takeover)**

Family run companies compared to widely held public companies, have lower risk of hostile takeover by other companies, this is mainly due to the nature of ownership structure that enable the founding family to have more control power than their actual share ownership represent (Khan, 1999). This in turn, leads to business continuity that provides more focused strategic direction and facilitate restructuring and long-term commitment (Shleifer and Vishny, 1986). Moreover, with the guidance of founding family, the company can expect to benefit from a continuity of

entrepreneurial vision which may be throttled should the potential of hostile takeover is pre-occupying the mind of the management. Typically family run companies employ two methods for takeover defences: (1) multiple share classes with unequal voting power resulting in incumbent management holding shares with higher voting power, or (2) a pyramid ownership structure (popular in Malaysia). In Genting Berhad, the founding Lim family uses various vehicles to own up to about 39 percent of the total ownership to ensure hostile takeover is of distant possibility. This approach is very similar to the Hong Kong conglomerate, Cheong Kong Holding (HK) which both Li Ka Shing and his son control about 77% of the total share through various vehicles. The ownership of Genting Holding Berhad that takes the following forms (Figure 1) will make the takeover almost impossible:



**Figure 1.** Ownership Structure of Genting Berhad

## **6. Reforming Family-Based System of Corporate Governance**

In previous sections, we have discussed the strengths and weaknesses of FBS, thus the question to ask is: should FBS be retained or reformed? What kind of changes (firms' internal structure, external institutional, capital financing and etc.)? Khan (1999b) has argued that FBS is essential during the earlier capital accumulation stage due to its low agency cost and effective internal control; this

practically had been proven after the 1997 Asia Financial Crisis, where most companies who survived through and grew faster are followers of FBS. This however does not mean that FBS is flawless, as we have identified in earlier sections that it has many corporate governance issues. BLS and EMS have many good features that can be served as part of long-term model for FBS to move forward. Randoy and Jenssen (2003) proposed unique combination of features of both FBS and BLS/EMS to obtain the agency advantages due to altruism as well as capital

and managerial advantages inherent from BLS/ EMS. This hybrid of system will require reformation in both the internal structure initiated by family run companies and institutional change by the statutory boards.

### 6.1 Internal Structural Reforms (Separation of Chairman and CEO)

Some of the problems due to lack of separation of ownership and management can be mitigated by having a corporate structure as proposed by Randoy and Jenssen, in which the founding family holds the position of non executive chairman and elect external professional as the CEO. Having founding family members to assume the position of non executives has several advantages.

First, the reduction of agency cost. By aligning the interest of shareholders, either in the form of both economic and altruistic incentives, will lower the agency cost of hiring an external professional as the CEO (Steier, 2003). Second, by hierarchically occupying at a higher level than CEO would provide effective and close monitoring of CEO's behaviour and check agency loss due to CEO as the agent. The owner also has the legitimate power to initiate move to replace CEO should the performance is under par. Third, founding family would be more inclined to preserve and continue the family's overall vision and plan the long-term goals of the company, one of the

key advantages of a family firm (Ward and Aronoff, 1994; Litz and Kleysen, 2001; Athanassiou, Crittenden, Kelly and Marquez, 2002)

Another benefit of this arrangement is that it addresses the managerial entrenchment problem faced by family-run companies. It will enable the company to scout for talent most suitable for the success of the company's operation. Having an external professional as CEO will also change the perception of new recruit as well as providing motivation to the existing staff that the company is practicing merit based employment.

One of Malaysian family-run companies that has moved towards this corporate structure, is notably (Table 6.1), Public Bank Berhad where the founder of the company, Tan Sri Dato' Sri Dr. Teh Hong Piow assumes the position of non executive Chairman with the CEO position being held by Dato' Sri Tay Ah Lek, a professional banker with 30 years experience in banking sector. This change in leadership structure has set a good example for the rest of the companies in Malaysia to emulate. Understandably, Public Bank was awarded a number of accolades under the category of good corporate governance, for example:

- 1) Ranked 2nd in Best Corporate Governance (for Malaysia) by Euromoney in 2007
- 2) Best Corporate Governance in Asia by FinanceAsia in 2008
- 3) Corporate Governance Asia Recognition Award by Corporate Governance Asia in 2008

**Table 4.** Ownership and Board of Public Bank Berhad

	<i>Public Bank Berhad</i>
<i>% -Founding Family control</i>	22.9%
<i>Board</i>	Non-Executive Chairman Tan Sri Dato' Sri Dr. Teh Hong Piow Independent Non-Executive Chairman Tan Sri Dato' Thong Yaw Hong Independent Non-Executive Co- Chairman Dato' Sri Tay Ah Lek Chief Executive Officer And others
<i>Audit Committee (AC)</i>	The Remuneration Committee is made up entirely of Independent Non-Executive Directors
<i>Remuneration Committee (RC)</i>	The Remuneration Committee is made up entirely of Independent Non-Executive Directors
<i>Nomination Committee (NC)</i>	The Remuneration Committee is made up entirely of Independent Non-Executive Directors

*Source:* Public Bank Berhad's Audited Report 2007; Public Bank Berhad official website: [ww2.publicbank.com.my](http://ww2.publicbank.com.my)

### 6.2 Takeover Defence

One limitation to this separation of Chairman and CEO is the effective monitoring mechanism to evaluate the Chairman's performance of his or her monitoring duties; this could result in corruption on the part of the Chairman and the negligence or slack in his or her duties (Henry, 2002). While, incentive

alignment with both economic and altruistic means, may sound reasonable, its effectiveness will need a longer time to assess. Randoy and Jenssen (2003) found that family-run companies with a founding family member as Chairman and without takeover defence outperformed those companies that employed takeover defence. In previous section, it was asserted that takeover defence could lead to business

continuity, however the drawback is that, without the risk of losing control, the comfort zone may breed errant and unrepentant Chairman, therefore, it must be a trade off between business continuity for stable growth and effective check on the performance of the Chairman. In the case of family-run companies in Malaysia with high ownership concentration, it will not be an easy task to have the founding family giving up some of the controlling power, unless, the state formulates statutory requirement to increase the floating share in the capital market for family-run companies. The reform in this aspect will not happen in the near future, however, if the founding family recognizes the benefit of trade off between ownership control and efficient external capital financing, the FBS will be more robust and transparent, thus being able to provide an alternative system to EMS / BLS.

### 6.3 Institutional Reform for FBS

In principle, EMS is by far the more efficient system of corporate governance compared to FBS. Whilst we cannot ignore the current recession due to the fall of financial institutions in EMS-based corporations such as Merrill Lynch, Bear Stearns and Lehman Brothers in the US, as well as Northern Rock and Bradford & Bingley in the UK; in terms of corporate governance, the EMS system still shows reasonable accountability and transparency compared to that of the FBS. Taking Hong Kong as example, they had recovered a lot faster than other East Asia countries' FBS-based companies such as Thailand, Indonesia, and South Korea. The significant difference is that Hong Kong has comparably stronger banks and equity markets unlike Malaysia where the government opts to intervene in the market.

Khan (1999b) has suggested a few ways of reforming FBS in Malaysia, by taking into account Malaysia's social and political environment:

#### a. Financial firm's managerial expertise

Recruitment and training competent professionals so that financial institutions can understand and monitor the firms they finance efficiently and effectively.

#### b. Role of competition and contestability of the market structure

The elimination of inefficient firms and encouraging the entry of new firms through competition will improve corporate governance and firm performance.

Shareholder activism is another important aspect of corporate governance to protect the rights of minority shareholders. As a result, Minority Shareholder Watchdog Group (MSWG) was established in 2000 to provide assistance to minority shareholders and to act as a watchdog over companies. The group's five founding shareholders were PNB, the Employees Provident Fund, Lembaga Tabung Angkatan Tentera (LTAT), Lembaga Tabung Haji (LTH) and Pertubuhan Keselamatan Sosial

(PERKESO) which are government investment agencies. This is certainly the correct path for promoting greater transparency when these shareholders take ownership of the family-run companies, however this is merely first step towards shareholders activism, these founding shareholders must take more proactive approach by demanding participation in the board activities or minimum, constantly applying pressure to the board when there is sign of exploitation on the rights of minority shareholders

## 7. Conclusion

Family-run businesses, especially the public listed companies in Malaysia and East Asia have their own set of corporate governance compared to western based or Japan based systems. While, the western based system, particularly the Anglo Saxon model has gained traction in many Asian countries, which prompted the governments to impose some corporate governance practices into local companies, this enforcement has resulted the divergence of corporate governance practices and policies among the Asian companies. Nonetheless, many family-run companies in Hong Kong, Korea, Taiwan, Thailand, Malaysia and others still uphold few key elements of their corporate governance characteristics. We have examined many of the issues and problems of family-run companies in the perspective of prevailing EMS, it is no surprise that the separation of owner/management, lack of transparency and an independent board, exploitation of minority shareholders' rights are the major problems of the FBS. Family-run companies encompass different management values than those of the equity based company.

The biggest advantage of FBS would be the altruistic behaviours that naturally align the interest of the board and management, thus ensuring internal control is effective and less costly. Yet, we think that internal control is insufficient to ensure good corporate governance as a whole. From past studies, it is evident that institutional reforms such as the financier's monitoring as well as minority shareholders activism could provide extra monitoring of the family run companies. This multi pronged approach could be the best mean to ensure effective corporate governance for family run companies.

The altruistic behaviours in relation to corporate governance have not been verified in the Malaysian context empirically, thus it will be a valuable insight in this regard by future studies of these behaviours.

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