PROFIT REDISTRIBUTION IN FAMILY-CONTROLLED, GROUP-AFFILIATED PUBLICLY-LISTED CORPORATIONS IN MALAYSIA

Ng Sin Huei, Philip Shrives**, Yeoh Ken Kyid****

Abstract

This paper attempts to examine the potential occurrence of profit redistribution in family-controlled business groups in Malaysia. It is argued that there exists a tendency for business groups with extensive family ownership and control to redistribute resources from group affiliates that outperformed to affiliates that underperformed. This phenomenon is prevalent particularly in large business groups where the link between business groups and politics is most clearly displayed. Such 'propping up' activities are believed to adversely affect the shareholders of the outperforming affiliates as the performance of these affiliates diminishes due to the profit redistribution. They also result in inefficient allocation of resources within the business group, though it is found that higher board independence may reduce such inefficiency.

Keywords: Profit Redistribution, Family-controlled Business Groups, Expropriation of Minority Shareholders, Tobin's Q, Board Independence

**Corresponding author. Faculty of Business, Communications & Law, INTI International University, 71800 Putra Nilai, Malaysia*
Tel: 606-7982000
Fax: 606-7982338
Email: sinhuei.ng@newinti.edu.my
*** Newcastle Business School, Northumbria University*
****Taylor's Business School, Taylor's University*

1 Introduction

In Malaysia, cases of acts of expropriation by controlling shareholders are not unheard of. For instance, one of the relatively recently, questionable transactions highlighted, involved one of the large family-controlled business groups in Malaysia, the Genting Group. The transaction involved the acquisition of the 25-storey office building for RM259 million, and lands for RM24.5 million, by one of the affiliated corporations, Genting Malaysia (Resorts) from its parent company, Genting Berhad in September 2009.[30] The Genting group operates under the pyramidal ownership structure in which Genting Malaysia's ownership is controlled by Genting Berhad whose ownership is controlled by the founding family. Several issues of concern have been raised by the investors in the particular related party transaction (RPT) (Business Times, 16 December 2009): (i) the Malaysia's Minority Shareholder Watchdog Group (MSWG) criticized that Genting did not portray the spirit of good corporate governance in the RPT as it did not seek the approval of its minority shareholders for the RPT, (ii) since both companies are publicly-listed (Genting Malaysia and Genting Berhad), they should appoint their own 'independent' property valuer/advisor instead of sharing the same independent advisor as they did, (iii) the fact that several directors were serving as independent directors in both companies at the same time raises the question of the independence of these directors, (iv) the fact that Genting Malaysia (Resorts) is a cash cow causes the investors to link the RPT as the act of cash extraction by Genting Berhad, the parent company (a divergence of cash flow to control right issue).

The Genting example is particularly relevant to the research problem of this study as it involves the activities of a business group that are believed to benefit the controlling family at the expense of the public minority shareholders, including the alleged profit redistribution from the cash cow company.

2 Problem Statement

Within the corporate sector, forming business groups is a common practice in family businesses in Malaysia. A family-controlled business group is formed when two or more publicly-listed corporations are simultaneously controlled by the same family. In other words, the family acts as the common

[30] The Genting group is one of the large family-controlled business groups in Malaysia.

controlling shareholders for the corporations.[31] Family-controlled business groups in Malaysia often operate across a diversified range of activities within a sector, as well as across many sectors as diverse as plantation, manufacturing, trading, services, construction and property development (Thillainathan, 1999). The formation of business groups by controlling families can bring additional agency problems which do not exist in Anglo-Saxon countries, particularly in US and UK corporations (Morck and Yeung, 2003). It is believed that a specific type of expropriation known as 'tunnelling' of resources out from the listed member corporations is more prevalent in family business groups than non-group affiliated family corporations (Bertrand *et al.*, 2002, 2008; Bhaumik and Gregoriou, 2010).

How a business group facilitates private benefits of control can be illustrated by the phenomenon of profit or resource redistribution in business groups. Creating a business group allows controlling families to redistribute profits or resources from one member corporation to another member corporation at the expense of certain groups of minority shareholders. Profit redistribution can be carried out, for example, in the form of business loans which are injected from one member corporation which is more profitable to a member corporation which is less profitable, so that the less profitable corporations can continue to survive, therefore ensuring the survival of the entire business group (Estrin *et al*., 2009). The survival of the business group provides continuous opportunity to enjoy the private benefits of control to be gained from running a business group for controlling families.

Essentially, the low transparency of sprawling, loosely-affiliated business groups makes it hard to determine where control resides, as well as identifying and challenging unfair intra-group transactions (Chang, 2003) in which *"such networks provide significant opportunity for collusion or other unethical transactions"* (Young *et al*., 2008, p.206). The expanded control (over a number of listed member corporations) made possible by business groups increases the chances of expropriation of minority shareholders. The more complicated the structure of the business group, the more serious the problem outlined above may be. This is especially true in Malaysia where it is widely known that the controlling families of many business groups, particularly the large ones, have close relationship with influential senior politicians or government officials (Gomez, 2006; Gomez and Jomo, 1999). The relationship provides 'political patronage and protection' to facilitate the expropriation activities by the owner-managers. The principal-principal problems can therefore be more serious in this case. Qian *et al.* (2010) find that corporations with political connections perform poorer than corporations without such connections because controlling shareholders who have political connections *"steal more than political ties can bring in"* (p.5). In other words, political connection is more detrimental than beneficial as far as the public minority shareholders are concerned. According to Claessens and Fan (2002), in countries where politicians and businessmen collude to extract or protect 'rents', it is unlikely to achieve high quality corporate governance practices.

Thus more in-depth understanding of the agency problems facing family-controlled corporations can be achieved by examining the business group affiliation issue in some detail.

3 Objectives of Study and Research Framework

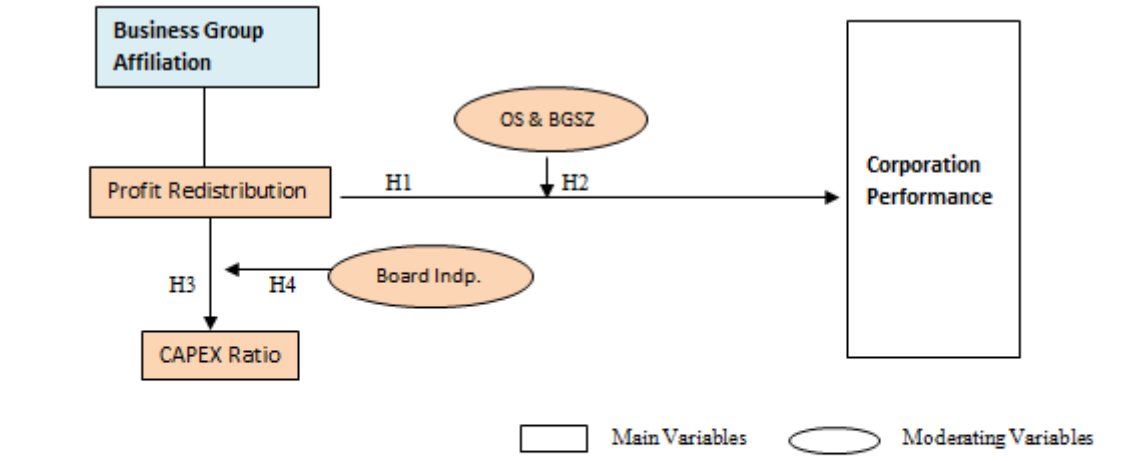
The objectives of this study are two-fold: (i) To examine the phenomenon of profit/resource redistribution in business groups and the efficiency of profit/resource redistribution in group-affiliated corporations compared to non-group corporations (as efficiency can impinge on corporation performance) (Hypotheses H1, H2 and H3). (ii) To examine the moderating influence of board independence on the efficiency of profit redistribution in group-affiliated corporations is also examined (Hypotheses H4).

The conceptualization of the study and the relationship between the objectives of the study and the hypotheses can be seen in the flowchart diagram of research conceptual framework (see Figure 1). The diagram depicts the conceptual variables[32] involved in the study as indicated by the numbered hypothesis. The development of the hypotheses as numbered in the diagram is explained and justified in the hypotheses development section.

[31] Detailed discussion of business group affiliation is available in the ensuing section.

[32] The operational variables pertaining to the conceptual variables are discussed in Section 6.

Figure 1. Conceptual Framework of the Study



1. Board Indp. = Board Independence.
2. OS & BGSZ= Ownership Structure and Size of Business Group.
3. Arrow lines (⟶) coming out from the main (moderating) variables indicate that the variables are hypothesized as having an influence (moderating influence) on firm performance.
4. Solid lines joining two variables (———) indicate association between the variables.

4 Literature Review and Hypotheses Development

As discussed earlier, the internal market of business groups facilitates the transfer of resources and cash flows from one affiliated corporation to support the operation of another. It is not surprising therefore to note that "poorly performing member corporations can access valuable group resources, including capital, managerial talent or even preferential access to government favours at the expense of better performing members" (Estrin et al., 2009, p.400-401). The redistribution of profits and resources occurs due to several possible reasons.

One cause of redistribution is where families are concerned with the profit stability of the group rather than the profit maximization of member corporations. Corporations with low profits need to be assisted in order to continue to exist, thus the profit stability of the group is more likely to assure the group's survival (and perhaps political power) so that the family can continue to accrue benefits from the group (Ferris et al., 2003; Estrin et al., 2009).

Ferris et al. (2003), who examine Korean chaebols conclude that the costs associated with chaebols outweigh the benefits and thus chaebol-affiliated firms' return of assets is lower and they suffer a value loss relative to non-affiliated firms. In other words, group-affiliated firms have lower value relative to comparable firms without affiliation. They suggest three reasons for the value loss: (i) the controlling shareholders are more concerned about the profit stability of the group rather than the profit level of individual member firms. In other words, evening out returns across member firms in order to stabilize the entire group's profits is more important because this is more likely to assure the group's survival so that the family can continue to accrue benefits from the group. Estrin et al. (2009) also find such 'variance-reducing' redistribution among Russian business groups, (ii) the over-investment in member firms operating in low growth industries. This is consistent with Jensen's (1986) free cash flow hypothesis that managers who have at their disposal ample free cash flows tend to over-invest in empire building and pet projects and, (iii) the existence of cross-subsidizing the unprofitable and troubled member firms of the group. This practice of 'propping up' the poor-performing firms in business groups is also documented in Cheung et al. (2009b), Jian and Wong (2010), Friedman et al. (2003) and Johnson et al. (2000).

Bertrand et al. (2002) examine tunnelling activities within business houses in India and find evidence of earnings being transferred from member corporations in which the controlling families have low cash flow rights to corporations in which they hold high cash flow rights. Transfer of earnings takes place through non-operating items, such as nonrecurring gains and losses (Cheung et al., 2009a, 2009b, 2006). The transfer or redistribution of profits and resources can be done in many ways such as the manipulation of transfer price, asset transactions between member corporations at above or below market prices and intra-group loans at a rate different to the market rate, etc.

The above 'dark side' of redistribution suggests that the internal monitoring mechanisms established in

groups are not effective in addressing agency problems that arise from business activities, including capital investment and project selection activities (Ferris et al., 2003). Though anecdotal evidence shows that it is not uncommon for the redistribution or transfer of profits or resources to take place, it is very difficult to prove such activities empirically because they are normally executed discreetly (George and Kabir, 2008). This study will use the method employed by Gedajlovic and Shapiro (2002) and Lincoln et al. (2004, 1996) in an attempt to test the inter-affiliates profit redistribution hypotheses. These studies deem that the outcome of profit redistribution is that affiliates with previously high profits will subsequently experience reduced profitability, while corporations with previously low profits will subsequently gain.

The study by Estrin et al. (2009) shows that corporations affiliated with business groups in Russia are more profitable than non-affiliated corporations. Moreover, their analysis also testifies that groups practice 'profit redistribution' from stronger to weaker group members. As an emerging economy that is undergoing transition, Russia has many similar characteristics with other emerging economies such as high concentration of corporate ownership and inefficient external markets.

It must be acknowledged that besides the above value-destroying causes, some of the motives behind profit and resources redistribution may add value for the shareholders and improve corporation performance. For instance, Lewellen's (1971) 'co-insurance effect', as discussed in an earlier section, would increase the affiliated corporations' debt capacity which would incur higher tax shields and correspondingly less payment of tax. Gramlich et al. (2004) concur with the idea and add that the shifting of profits among member corporations allows the group to reduce its combined tax burdens. Another sensible reason for redistribution is the requirement of funds to finance new investments for affiliated corporations that are financially constrained (George and Kabir, 2008). Ferris et al. (2003) find that chaebols-affiliated corporations have significantly higher leverage than non-affiliated corporations and lower tax burdens. Cestone and Fumagalli (2005) show that funds are channelled to affiliated corporations in business groups to help increase the group's competitiveness in the industry.

From the above discussion, the hypothesis is:

H1: Redistribution within a business group leads to corporations with previously high (low) profitability seeing their profitability reduced (improved) in the subsequent period.

Generally, larger business groups are involved in an extensive range of industries and have a higher number of affiliated corporations that also vary in size. Consequently, the difference in profitability (profitability variance) between member corporations will be greater for larger business groups and thus larger business groups may engage more in redistribution of earnings and resources (such as capital) than smaller business groups (George and Kbir, 2008).

In addition, the literature also highlights that larger business groups are more inclined to have political connections (Faccio, 2006; Johnson and Mitton, 2003; Agrawal and Knoeber, 2001) and these connections may strengthen the profit redistribution efforts of the controlling families. Moreover, the strength or intensity of the distribution effect could be moderated by the strength of family control in the affiliate corporations (Lincoln, 1996). Generally, the higher the level of family control over an affiliate, the more dominant the family will be and the easier it will be for them to perform more redistribution activities. Thus the hypothesis that follows is:

H2: The strength of the profit redistribution effect is affected by the size of the business group and the strength of family control; the larger the size of the business group and the greater the strength of family control, the more likely profit redistribution will be.

Finally, if expropriation is expected to be more serious in group-affiliated family corporations than in non-group family corporations, some of the costs of expropriation could manifest through the inefficient reallocation of resources from one member corporation to another member corporation within the 'internal market' of the business group (George and Kabir, 2008). In other words, resources will be reallocated from high-performing corporations (with good investment prospects) to low-performing corporations (with poor investment prospects)[33].

Oppositely, if resource allocation is efficient, more business group resources will be allocated to deserving good-performing corporations, whereas poor-performing corporations will not be subsidized. Following this reasoning, the implication is that if resource allocation among member corporations is inefficient, cash flows and other resources allocated for capital investments (capital expenditure) of good-performing corporations, on average, will not be greater than poor-performing corporations (they will be either the same or lower). Conversely, without the 'internal market', non-group corporations need to rely on the external market for their capital expenditure and therefore only good-performing corporations have both the need and ability to invest in capital expenditure than poor-performing corporations. Thus in non-group corporations, capital expenditure will be significantly higher for those performing well and lower for corporations performing poorly.

This study also intends to examine whether in group-affiliated corporations there is a difference in

[33] Good investment prospects or opportunities refer to investments that yield positive NPV and *vice versa*. Thus corporations with good investment prospects generally perform better than corporations with poor investment prospects.

the capital expenditure of 'corporations with high board independence' compared to 'corporations with a lack of board independence'. A board with a higher proportion of independent directors would have stronger empowerment to monitor inappropriate company activities or decisions such as capital expenditure on poor performing projects. As a result, the inefficient reallocation of resources (reallocation from good-performing to poor-performing corporations) can be monitored and curbed. The outcome is that more resources and cash flows will be channelled to deserving corporations (good-performing corporations) from undeserving corporations and vice versa. Consequently, the high performance-high capital expenditure and low performance-low capital expenditure relationship will be restored in group-affiliated corporations with such attribute.

Based on the above discussion, the following two hypotheses are proposed:

H3: Due to the presence of inefficient resource (profit) redistribution only in group-affiliated corporations, capital expenditures of good-performing corporations will not be greater than poor-performing corporations among group-affiliated corporations; whereas capital expenditures of good-performing corporations will be greater than poor-performing corporations for the non-group corporations.

H4: The board of a group-affiliated corporation with certain attribute of independence curtails inefficient resource redistribution and thus the capital expenditures between good and poor-performing corporations are differentiable with good-performing corporations, on average, having higher capital expenditure than poor-performing corporations.

5 Sample Selection and Data Collection

The sample was drawn from the 632 companies listed on the Main Board of Bursa Malaysia, the sole stock exchange in Malaysia, as in September 2007. All listed companies are classified by Bursa Malaysia into 'sectors' based on their core business. This sector classification enables sector effects to be taken into account in the regression analysis later. Companies from the Second Board were excluded from the selection because the listing requirements of the Second Board are different from the Main Board, rendering them incomparable.

Of the eleven sectors that were identified by Bursa Malaysia, four sectors, namely 'Finance', 'Hotels', 'Mining' and 'IPC' were excluded from the study. The finance sector is excluded from the study because corporations in this sector are governed by a different set of rules and regulations and thus make them incomparable to corporations in other sectors. The exclusion of the finance sector is also consistent with previous studies in this area (for instance in Estrin et al., 2009 and Claessens et al., 2006). The other three sectors were excluded because the number of corporations in each sector is too small to provide any meaningful analysis. The remaining 565 corporations were from the seven core sectors namely the 'Consumer Products', 'Industrial Products', 'Technology', 'Properties', 'Trading', 'Plantations', and 'Construction'.

This study uses Krejcie and Morgan's (1970) method as a starting point in selecting the sample size.[34] The final sample of 314 corporations in this study is derived based on the selection process as shown in Table 1 below. The advantage of the above process of data sampling is that it ensures that all seven core sectors in the stock exchange are included, with the number of observations in each sector as proportionate as possible to the actual number of corporations in each sector of the stock exchange. It also ensures that corporations of various sizes are satisfactorily covered in the sample.

6 Variables

6.1 Business Group Affiliation Variable

Group-affiliated corporations are defined in this study as corporations that are under the control of the same/common controlling family. Control can be achieved by the controlling family either by direct or indirect holding of shares through another corporation(s) (which can be publicly-listed or privately-held). A family or an individual is considered as the 'controlling family' when they hold at least a 10% cut-off level of the total shares of the corporation and serve as the largest shareholder of the company. In short, listed corporations that share the same ultimate controlling owner are considered as affiliated to the same business group.

Information on whether a corporation is affiliated to a business group can be traced from company annual reports under the sections 'Corporate Structure' and 'Directors' Profile' (for some business groups some of their affiliated corporations have the name of the group as part of their names and thus can be easily identified, for instance Lion Diversified, Lion Industries, Lion Corporation and Lion Forest Industries are corporations affiliated to the Lion Group). Corporations are required to disclose in their annual report (usually in the 'Directors' Profile' section) whether a board director also hold the directorship in another corporation(s) and the name of that corporation must be disclosed if it is publicly-listed. These disclosures enable the researcher to link corporations that are affiliated to one director. Corporations affiliated to the same business group can then be identified once it is confirmed that the director is a member of the controlling family. It is found that most members of controlling families with multiple

[34] Haniffa and Hudaib (2006), for instance, also make use of Krejcie and Morgan (1970) as a guideline for sample size selection.

directorships in more than one listed corporation are directors occupying senior positions such as board chairman, vice chairman or managing director/CEO.

Table 1. Selection Process of Sample

	Total number of listed corporations on Bursa Malaysia (Main Board) as in Sept 2007	632
less	Finance, IPC, Hotel and Mining Sectors	67
	Remaining Corporations in the Main Board	565
	Corporations stratified into sectors and two-thirds selected from each sector using systematic sampling	379
less	Corporations whose largest ultimate owner is NOT family or individual (state, foreign corporations, widely-held corporations and corporations without ultimate owners)	65
	Final sample	314

To illustrate, the managing director of the 'Lion Industries Corporation'[35] is Datuk Cheng Yong Kim and according to the disclosure in the 'Directors' Profile' section of the company's annual report:

Datuk Cheng's other directorships in public companies are as follows:

- *Managing Director of Lion Diversified Holdings Berhad, a public listed company*
- *Director of Lion Corporation Berhad, a public listed company*
- *Director of Silverstone Corporation Berhad and Hy-Line Berhad, both public companies*

... Datuk Cheng is the nephew of Y. Bhg. Tan Sri Cheng Heng Jem, a major shareholder of the Company, and his brother, Mr Cheng Yong Liang, is also a Director of the Company.

(Lion Industries Corporation Annual Report, 2007, p.5)

From the above information, the two publicly-listed companies' ('Lion Diversified' and 'Lion Corporation') annual reports will be examined for further data on affiliated corporations. Upon examination, Tan Sri Cheng Heng Jem is identified as the chairman of 'Lion Diversified' and below is another excerpt from his profile in the 'Lion Diversified' annual report:

Tan Sri William Cheng Heng Jem's other directorships in public companies are as follows:

- *Chairman of Lion Forest Industries Berhad and Silverstone Corporation Berhad*
- *Chairman and Managing Director of Parkson Holdings Berhad, Lion Corporation Berhad and Silverstone Berhad*
- *Director of Amsteel Corporation Berhad*

Save for Silverstone Corporation Berhad, Silverstone Berhad and Amsteel Corporation Berhad, all the above companies are listed on Bursa Malaysia Securities Berhad. (Lion Diversified Annual Report, 2007, p.6)

After verifying that Tan Sri Cheng Heng Jem's family is the controlling shareholder of the Lion Group, the above two excerpts allow us to compile the publicly-listed corporations under the group; three from the first excerpt (Lion Industries, Lion Diversified, and Lion Corporation) plus another two from the second excerpt (Lion Forest Industries and Parkson Holdings Berhad), resulting in a total of five affiliated listed corporations in the group.

6.2 Corporation Performance Variables

Due to the lack of consensus in the literature with regard to the choice of corporation performance measure, it is thus difficult to identify a single indicator for corporation performance. This study opts to use both the accounting-based return on assets (ROA) and the stock-market-based simplified Tobin's Q (also known as Q) as the proxies to measure corporation performance. It is intended that using alternate measures also helps to verify the robustness of the results (Haniffa and Hudaib, 2006). Both measures are widely used as the only performance measures in the past studies [such as in Khanna and Palepu (2000a), Anderson and Reeb (2003), Haniffa and Hudaib (2006), George and Kabir (2008), Andres (2008) and Masulis *et al*. (2011)].

For the ROA data, due to the presence of extreme values at both ends of the data (very high negative and positive ROA values), it is winsorized at its 1st and 99th percentiles. Whereas for the data of simplified Tobin's Q, due to the presence of extreme values only at one end of the data (very high positive Q value)[36], winsorization is applied only to the extreme positive values. Winsorization has the advantage of correcting the skewness in the distribution of the data and improves their statistical properties (such as the normality) (Salkind, 2010). It also *"preserves the information that a case had among the highest (or lowest) values in a distribution but protects against some of the harmful effects of outliers"* (Salkind, 2010, p.1637). The method to winsorize data at their 1st and 99th percentiles is used, for instance, by Guest and Sutherland (2010) in their study of business group affiliation and corporation

[35] The chairman of Lion Industries Corporation is an independent director and is thus disregarded in this case. Thus the next person in line is the managing director.

[36] The fact that Tobin's Q cannot take a negative value leads to an extreme value only at one end of the Tobin's Q data.

performance in China. Chen and Chen (2012) winsorize their data at the 5th and 95th percentiles in their study of how various aspects of corporate governance structures affect the resource allocation efficiency of diversified corporations.

6.3 Control Variables

6.3.1 Family Ownership Variable

Since the sample in this study consists of publicly-listed corporations that are family-owned and controlled, further clarification of family ownership in this study is essential. The criterion used to define a corporation as family-owned and controlled is based on the '10% cut-off level' definition used in two often cited influential studies: La Porta *et al.* (1999) and Claessens *et al.* (2000). According to the studies, using the 10% cut-off level, a corporation is said to have an ultimate controlling shareholder if this shareholder's direct and indirect voting rights in the corporation exceed 10% (La Porta *et al*., 1999).[37] Since members of a family are seen as persons acting in concert, a family corporation is defined as corporation that is owned by a single individual or two and above family members who collectively own 10% or more of the shareholdings. Thus, shareholdings of family members are aggregated and treated as shareholdings of *the* family.

The data related to ownership structure and control are hand-collected from the 2007 company annual reports under the section 'Analysis of Shareholdings' as per the substantial shareholder disclosure requirement of Section 69D(1), Companies Act 1965. Since the influence of ownership structure on corporation performance may only be apparent after a year, to capture this effect, corporation performance data are collected for 2008. Using this 'lagged' measure of ownership and control data also implies the assertion that 'ownership' influences 'corporation performance' and not the other way around.

Following Claessens *et al.* (2000) and La Porta *et al.* (1999), this study employs the 'ultimate owner' approach in determining the shareholdings of a family. Direct ownership reported in annual reports is often inappropriate and insufficient to determine the ownership level of a family, as many individuals and members of their family maintain indirect ownership of the listed corporation through other corporations, particularly through private companies that they own.[38] Thus, when the principal shareholders of a corporation are themselves corporate entities, the major shareowners of these entities will be identified; then the major shareowners of the major shareowners will be identified and so on, until the identity of the ultimate owners/controllers of the votes are identified (La Porta *et al.* 1999). In addition, as part of the disclosure requirements, family members who own the corporation indirectly through their privately-held or publicly-listed company(ies) will be reported in the annual reports as having indirect holdings in the corporation with the percentage of those holdings disclosed.

6.3.2 Other Control Variables

This study includes several other control variables that are considered important in affecting corporation performance. These variables are corporation size (total sales in log), age, gearing ratio and sector classification. They are frequently used as control variables in multiple regression analysis in relevant literature. For instance, the control variables used in Khanna and Palepu (2000a), Douma *et al.* (2006) and George and Kabir (2008) are very similar to those mentioned above. The business sector in which a corporation operates could possibly influence its performance. A broad range of sector classification as per Bursa Malaysia's sector classification system is used due to the reliability issue of classifying corporations into more refined groupings. This is also consistent with common practice in the literature involving Malaysian corporations (for instance in Tam and Tan, 2007 and Haniffa and Hudaib, 2006). Sectors are dummy-coded for the purpose of regression analysis where one of the sectors serves as the control.

7 Methods and Model Specifications

Following Gedajlovic and Shapiro (2002) and Lincoln *et al.* (1996, 2004), the following regression specification is used to test the profit redistribution hypotheses in group-affiliated corporations (Hypothesis 1):

[37] Both La Porta *et al.* (1999) and Claessens *et al.* (2000) also use a 20% equity stake as another cut-off level besides the 10% level. In contrast, Anderson and Reeb (2003) and Villalonga and Amit (2006) do not set any specific cut-off level to define a family corporation in their study, as long as the person or family is the largest block-holder of the corporation (block-holder = at least a 5% equity stake).

[38] These private companies which are wholly owned by the family and close friends are used as 'vehicles' to facilitate the control of other corporations by the family.

$$PERM_{i,t} = \alpha + ß\ (control)_{i,t} + \theta\ X_{i,t} + \lambda\ PERM_{i,t-1} + \Phi\ (control)_{i,t}* PERM_{i,t-1} + \varepsilon_{i,t} \quad (1)$$

Where: $X_{i,t}$ is a vector of control variables that accounts for differences in the following: corporation size, age, gearing and business sector effects. Theta (θ) is the corresponding vector of the estimated coefficient for the control variables. PERM is corporation performance as measured by ROA and Tobin's Q. '*Control*' refers to the strength of family control in which FAMOWN and CF/CONT are used respectively as the proxy.

Lincoln *et al.* (1996, 2004) suggest that the coefficient λ on the 'lagged' profitability term ($PERM_{i,t-1}$) would reflect the ability of business groups to redistribute profits. The lower the coefficient, the greater the redistribution effect, as explained by Gedajlovic and Shapiro (2002), that *"(r)edistribution from high-profitability corporations to low-profitability corporations smoothes out performance over time and lowers the estimated coefficient on the lagged term" (*p.568).

Since profit redistribution is associated with the strength of family control over the corporation (Lincoln, 1996), the ownership level of the controlling family (FAMOWN) is used to indicate the strength of family control in examining the profit redistribution hypothesis (Gedajlovic and Shapiro, 2002; George and Kabir, 2008). The degree to which family ownership influences the extent of redistribution can be estimated by coefficient Φ, on the interaction term ($FAMOWN_{i,t}* PERM_{i,t-1}$) between family ownership and past performance (Lincoln *et al*., 1996, 2004). If Φ is a negative value and significant, then it implies that 'family ownership' is associated with the redistribution of profits from higher to lower-profit corporations. Put simply, higher performance of a group-affiliated corporation in a particular year is followed by reduced performance in the ensuing year. Alternative measures of the strength of family control based on the cash flow-to-control rights ratio (CF/CONT) and the dummy variable of cash-flow-to-control rights ratio (CF/CONT_DUM) are also employed in separate regressions to examine the above profit redistribution hypothesis.

To test the hypothesis that the strength of the profit distribution effect could be affected by the size of business groups as well as the strength of family control (Hypothesis 2), the following specifications are applied to group-affiliated corporations:

$$PERM_{i,t} = \alpha + \zeta\ GRSZ + \theta\ X_{i,t} + \lambda\ PERM_{i,t-1} + FAMOWN_{i,t} + \Phi\ FAMOWN_{i,t}* PERM_{i,t-1}* GRSZ + \varepsilon_{i,t} \quad (2a)$$

$$PERM_{i,t} = \alpha + \zeta\ GRSZ + \theta\ X_{i,t} + \lambda\ PERM_{i,t-1} + \text{cash-to-control ratio}_{i,t} + \Phi\ \text{cash-to-control ratio}_{i,t}* PERM_{i,t-1}* GRSZ + \varepsilon_{i,t} \quad (2b)$$

$$PERM_{i,t} = \alpha + \zeta\ GRSZ + \psi\ Family_{i,t} + \theta\ X_{i,t} + \lambda\ PERM_{i,t-1} + \Phi\ Family_{i,t}*PERM_{i,t-1}* GRSZ + \varepsilon_{i,t} \quad (2c)$$

Where: GRSZ consists of three group size dummies – GR_A for corporations affiliated to small business groups (small business groups refer to business groups with two listed affiliates), GR_B for corporations affiliated to medium business groups (business groups with three to four listed affiliates), and GR_C for corporations affiliated to large business groups (business groups with five or more listed affiliates). The categorization of group size in this case is somewhat arbitrary as in Khanna and Palepu (2000a). Specifications (2a) and (2b) use FAMOWN and 'divergence of cash flow and control rights' respectively as the measure of the strength of family control. The interaction terms employed in both specifications test the joint effect of group size and family control strength.

In order to further examine the relationship between the rising thresholds of family control and profit redistribution, ownership of controlling families (FAMOWN) is split into two different variables: FAMOWN1 for family ownership of less than 50% and FAMOWN2 for family ownership of 50% and above. The choice of 50% as the cut-off point is sensible as an ownership level of 50% and above indicates majority ownership. The explanatory variable '*Family*' in Specification (2c) includes FAMOWN1 and FAMOWN2. The interactions term ($\Phi\ Family_{i,t}* PERM_{i,t-1}* GRSZ$) is employed to test the joint effect of *'Family'* and 'GRSZ' on profit redistribution. For instance, the joint effect of the interaction between FAMOWN2 and GR_C could be tested.

Next, to test the hypothesis on the inefficiency of profit redistribution (Hypothesis 3), both categories of group and non-group corporations are further split into two separate sub-categories based on their median ROA (Q) values: a sub-category with high ROA (Q) and a sub-category with low ROA (Q). The capital expenditures of the two sub-categories from the *group-affiliated* corporations are then compared, with a similar comparison then made for the *non-group* corporations. If profit redistribution is inefficient in group-affiliated corporations, capital expenditure for the group-affiliated corporations with high Q *will not* be statistically higher than the group-affiliated corporations with low Q (the capital expenditure will be either the same or lower). Based on the discussion in the earlier section, it is noted that inefficient profit redistribution is only associated with group-affiliated corporations and not with non-group corporations. Hence, without the hypothesized inefficient profit redistribution, capital expenditures of good-

performing corporations should be greater than poor-performing corporations in non-group corporations.

To test the effects of board independence on capital expenditure between good and poor-performing corporations in *group-affiliated* corporations (Hypothesis 4); the corporations are first split into two sub-categories: corporations with high ROA (Q) and corporations with low ROA (Q) based on the median ROA (Q) value of the sample (corporations with ROA (Q) above the median value are considered as high-performing corporations and *vice versa* for low-performing corporations). Within each sub-category, corporations are further split into two sub sub-categories: 'corporations with board independence' and 'corporations without board independence'. Board independence is operationalized by PrINED variables.

A comparison on the level of capital expenditure is then made between the high ROA (Q) corporations and low ROA (Q) corporations between high and low board independence. A higher level of capital expenditure (statistically significant) for the high ROA (Q) corporations compared to low ROA (Q) corporations in the 'corporations with high board independence' and not in the 'corporations with low board independence', suggests that board independence has the ability to curb inefficient profit redistribution and restore a high-performing/high capital expenditure and low-performing/low capital expenditure relationship.

8 Descriptive Statistics

For ease of reference, a list of abbreviations used in this study, together with a definition/explanation, is presented in Table 2 below.

Table 2. List of Abbreviations, Variables and Operationalization

Abbreviation	Variable	Operationalization
ROA	Return on Assets	EBITDA / Total assets
Tobin's Q or Q	Simplified Tobin's Q	(Market value of equity + Book value of total liability) / Book value of assets
FAMOWN	Controlling Family Ownership	Percentage of shareholding by the controlling family or individual person. A firm is defined as family-controlled if the family is the largest block-holder with at least 10% of shareholdings.
PrINED	Proportion of Independent Directors	Number of independent directors / Total number of directors on the board
CF/CONT	Cash Flow-to-Control Rights	Cash flow rights / control rights
CF/CONT_DUM	Cash Flow-to-Control Rights Dummy	Dummy is 1 if the ratio of cash flow-to-control right is below 1.00; zero if the ratio is 1.00.
Lag (ROA)	Previous year ROA	ROA for fiscal year 2007
Lag (Tobin's Q)	Previous year Tobin's Q	Tobin's Q for fiscal year 2007
GR_A	Small size business group	Dummy is 1 if the firm is affiliated to a business group with only two publicly-listed affiliates; 0 otherwise.
GR_B	Intermediate size business group	Dummy is 1 if the firm is affiliated to a business group with three to four publicly-listed affiliates; 0 otherwise.
GR_C	Large size business group	Dummy is 1 if the firm is affiliated to a business group with five or more publicly-listed affiliates; 0 otherwise.
FAMOWN1	Controlling family without majority ownership	Percentage of family shareholding below 50%.
FAMOWN2	Controlling family with majority ownership	Percentage of family shareholding of 50% and above.
CAPEX Ratio	Capital Expenditure Ratio	Capital expenditure/ Total assets
Sales	Total Sales	Total sales or revenues in Ringgit Malaysia
Gearing	Gearing Ratio	Total debts / Total assets
Age of firm	Age of firms in years	Number of years since incorporation of a firm

Descriptive statistics on the variables of the sample firms are depicted in Table 3 below. To begin with, the distribution of the corporation performance statistics is centred at the value of 9.19% (0.87) with the median of 9.07% (0.76) for ROA (Tobin's Q). The maximum value of ROA (Tobin's Q) is close to 53% (7.00) whereas the lowest value is close to -80% (0.33). The statistics also show that the ownership level of family-controlled firms in Malaysia is highly concentrated with a mean of 37.97%. This figure is comparable to the 38.45% average ownership of family-controlled firms reported by Tam and Tan

(2007) with their sample size of 150 listed firms in Malaysia.

A family firm of an average size (mean value) in the sample generates about RM813 million of annual sales. However, the median firm size is much smaller at around RM293 million. The large difference between the mean and the median indicates that the distribution of sales is skewed and not symmetrical. Thus data transformation is made by taking the natural log for the variable in order to normalize the distribution before multivariate analysis is performed. The average gearing ratio is 23% and the mean age of firms is 24.5 years which is slightly younger than the mean of 28.8 years reported by Claessens *et al*. (2000) for Malaysian firms. It also shows that family firms in Malaysia are relatively young compared to, for example, the average age of 82 years reported in Andres (2008) for Germany firms.

Table 4 exhibits the distribution of corporations and business groups according to three different group sizes. Of the 314 corporations in the study, 152 are business group affiliated and the rest are non-affiliated corporations. Of the 152 group-affiliated corporations, the group size is determined by the number of listed corporations in a business group. The highest percentage of corporations (37%) are affiliated to GR_A (small business groups with two listed corporations) followed by GR_B (intermediate business groups with three to four listed corporations) (34%) and GR_C (large business groups with at least five listed corporations) (29%). As for the distribution of groups across the three group sizes, the majority of business groups (41 out of the total of 80 business groups or 51.25%) belong to GR_A, 28 groups or 35% belong to GR_B and 11 groups or 13.75% belong to GR_C.

Table 3. Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Standard Deviation
ROA (%)	9.19	9.07	52.74	-79.76	9.18
Tobin's Q	0.87	0.76	6.91	0.33	0.53
FAMOWN	37.97	37.36	71.77	6.00	15.14
Sales (RM '000)	813,623	293,335	14,665,369	8,740	1,524,205
Gearing ratio	0.230	0.228	0.789	0.000	0.170
Age of firm (years)	24.5	19	95	1	17.33

Table 4. Descriptive Statistics – Size of Business Groups

Group Size	**Corporations**		**Groups**	
	Number	Percentage	Number	Percentage
GR_A – Small	56	36.84	41	51.25
GR_B - Medium	52	34.21	28	35.00
GR_C – Large	44	28.95	11	13.75
Total	152	100.00	80	100.00

Table 5 presents the performance statistics of group-affiliated corporations based on group size. Correspondingly, GR_B (the intermediate size business group) has the highest mean of ROA while GR_C has the highest mean of Tobin's Q.

Non-group corporations are included in the table for comparison purposes. The comparison shows that the difference in mean and median for ROA between each of the sub-groups and the non-group corporations are statistically insignificant while the differences in mean and median for Tobin's Q are statistically significant at the 10% level.

Table 5. Descriptive Statistics - Group Size and Group Complexity with Corporation Performance

	Mean		**Median**		**Standard Deviation**	
Group Size	ROA	Q	ROA	Q	ROA	Q
GR_ A	8.91	0.75	8.57	0.70*	5.88**	0.29
GR_ B	9.34	0.89	8.22	0.80*	6.90	0.31
GR_ C	8.55	0.91	8.12	0.82*	8.07	0.34
Non-group corporations	9.74	0.83	10.13	0.74	7.62	0.33

* significant at 10%; ** significant at 5%; ***significant at 1%. Comparisons of mean, median and standard deviation are made with non-group corporations. The mean difference is tested with the t-test, the median difference with the Wilcoxon-test and standard deviation difference with the F-test.

Table 6 below shows the statistics related to the breakdown of controlling family ownership (FAMOWN) into low (FAMOWN1) and high (FAMOWN2) ownership levels in group-affiliated corporations. It shows that 123 of 152 group-affiliated corporations (or 80.92%) have family ownership of below 50% and only 29 group corporations (or 19.08%) have family ownership of 50% and above.

Table 6. Descriptive Statistics – Family Ownership Classification for Group-affiliated Corporations

FAMOWN	Corporation	
	Number	Percentage of Total
FAMOWN1	123	80.92
FAMOWN2	29	19.08
Total	152	100.00

Finally Table 7 presents the Pearson correlation matrix for the group-affiliated sample in the study. The correlation matrix is performed before the multiple regression analysis is conducted with the purpose of checking for potential multicollinearity as well as the 'one-to-one relationship' between firm performance and the explanatory variables. The table depicts that overall; the correlations between the explanatory variables are low. Only a small number of explanatory variables show comparatively higher correlations between themselves. Variance Inflation Factors (VIFs) are computed for these variables before the multiple regression analysis is conducted and any serious multicollinearities as indicated by the VIF value are appropriately addressed. The table shows that ROA is significantly positively related to FAMOWN1, and Log Sales and negatively related to Gearing whereas Tobin's Q is significantly positively related to Log Sales and negatively related to CF/CONT and GR_A (shaded area).

9 Analysis and Findings

9.1 Analysis on Profit/Resource Redistribution and Corporation Performance

The findings on the effects of profit redistribution in group-affiliated corporations are presented in Table 8. As asserted by Lincoln *et al.* (1996, 2004), profit redistribution is facilitated by the extent or strength of family control. In Models (1) and (4), the strength of family control is proxied by the controlling family's ownership level (FAMOWN). FAMOWN′, which equals to (FAMOWN - mean value of FAMOWN), is used in substitution of FAMOWN to alleviate the multicollinearity problem.[39]

It is observed that the coefficients of the interaction terms in Model (1) and Model (4) are insignificant. Thus there is no evidence to suggest that 'family ownership' is used to facilitate the redistribution of profits in business groups.

The divergence of cash flow-to-control rights can enhance a family's control over its corporations (Andres, 2008) and greater divergence of cash flow-to-control rights is associated with stronger incentives to expropriate (Bertrand *et al.*, 2002). In Model (2) and Model (5), the strength of family control is proxied by such divergence (CF/CONT). Similarly, as in the case of FAMOWN, multicollinearity is substantially reduced to an acceptable level by employing CF/CONT′ which equals to (CF/CONT - mean value of CF/CONT).[40]

It is observed that the interaction term in Model (2) is statistically insignificant but that the interaction term in Model (5) is statistically significant at the 1% level. This finding infers that a group affiliate with greater (poorer) Tobin's Q in one year experiences a decline (an increase) in Tobin's Q in the following year. Specifically, when the divergence of cash flow-to-control rights increases; the more likely a decline (which is statistically significant) in Tobin's Q will occur in the case of corporations with previous higher Tobin's Q and the more likely an improvement (which is statistically significant) in Tobin's Q will occur in the case of corporations with previously lower Tobin's Q.

The significant finding of profit redistribution with Tobin's Q which is insignificant with ROA does not come as a total surprise. As it was already been reported in the Pearson correlation, the correlation between both performance measures is only 0.42 for the sub-sample of group-affiliated corporations. Both measures are thus not closely correlated. As Tobin's Q depends on market perception (and also market sentiment) of what the management of a corporation is capable of doing in the coming years (which in turn depends on factors such as macroeconomic outlook), it is therefore distinguishable from ROA which is solely based on the earnings generated from past corporation activities and market condition. The failure of ROA to capture profit redistribution might also be due to the practice of 'earnings management' to mask the effect of such redistribution.

[39] 'Mean-centring' is recommended as a way to alleviate the multicollinearity problem involving interaction terms (Aiken and West, 1991; Jaccard and Turrisi, 2003).

[40] For comparison, regression is run with CF/CONT and re-run with CF/CONT'. It is found that the significant level of the interaction term remains unaffected.

Table 7. Pearson Correlation Matrix for Group-affiliated Corporations

	FAMOWN 1	FAMOWN 2	CF/CONT	Lag(ROA)	Lag(Q)	GR_A	GR_B	GR_C	FAMOWN	Log Sales	Log Age	Gearing	ROA	Q
FAMOWN1	1.00													
FAMOWN2	**-0.76**	1.00												
CF/CONT	**0.17**	**0.26**	1.00											
Lag(ROA)	**0.21**	-0.09	0.07	1.00										
Lag(Q)	0.11	-0.13	**-0.18**	**0.51**	1.00									
GR_A	-0.06	0.01	**0.17**	0.08	-0.13	1.00								
GR_B	0.06	-0.08	-0.04	-0.09	-0.02	**-0.55**	1.00							
GR_C	0.01	0.07	-0.15	0.01	0.15	**-0.49**	**-0.46**	1.00						
FAMOWN	-0.15	**0.76**	**0.55**	0.07	-0.09	-0.04	-0.06	0.11	1.00					
Log Sales	0.12	-0.02	0.00	**0.32**	**0.26**	**-0.23**	0.05	**0.19**	0.09	1.00				
Log Age	-0.02	0.05	0.07	-0.05	-0.05	-0.11	-0.01	0.13	0.06	0.12	1.00			
Gearing	-0.04	0.03	0.04	-0.13	-0.05	-0.11	0.05	0.07	0.00	**0.39**	0.13	1.00		
ROA	**0.16**	-0.01	0.05	**0.59**	**0.41**	0.00	0.04	-0.04	0.15	**0.33**	0.03	**-0.20**	1.00	
Q	0.04	-0.03	**-0.17**	**0.35**	**0.77**	**-0.23**	0.10	0.13	-0.02	**0.32**	0.06	0.05	**0.42**	1.00

Correlation coefficients greater than or equal to 0.16 (bold figures in the table) are significant at $p < 0.05$

Table 8. Profit Redistribution Effects and Corporation Performance

Explanatory Variable	(1) ROA	(2) ROA	(3) ROA	(4) Tobin's Q	(5) Tobin's Q	(6) Tobin's Q
Lag (ROA)	0.371***	0.389***	0.332***			
Lag (Q)				0.455***	0.468***	0.529***
FAMOWN′	0.007	0.040	0.043	-0.004	0.001	0.001
FAMOWN′ * Lag (ROA)	0.003					
FAMOWN′ * Lag (Q)				0.004		
CF/CONT′		1.421			-0.647***	
CF/CONT′ * Lag (ROA)		-0.232				
CF/CONT′ * Lag (Q)					0.468***	
CF/CONT_DUM			-1.023			0.268***
CF/CONT_DUM* Lag (ROA)			0.166			
CF/CONT_DUM* Lag (Q)						-0.222***
Adjusted R^2	0.427	0.417	0.423	0.624	0.642	0.643
F-statistic	7.614***	6.563***	6.703***	15.770***	14.967***	15.006***
Observations	152	141	141	152	141	141

* significant at 10%; ** significant at 5%; ***significant at 1%.
The values in the table show the coefficients of the variables.
All control variables and sector effects are included in the regression (not shown above).

Based on the theoretical models of Lincoln *et al*. (1996) and Gedajlovic and Shapiro (2002), the above finding is considered consistent with evidence of profit redistribution from good-performing affiliates to poor-performing affiliates. Adopting the explanation put forward by Bertrand *et al.* (2002), the finding indicates that the market, to some extent, recognizes and 'prices in' the practice of profit/resources redistribution. In other words, even though ROA failed to reflect the practice of profit redistribution in this study, the market (i.e. Tobin's Q) may still be aware (and probably has long been aware) of such practice of tunnelling out of resources from good performing corporations and transferring them to (prop up) weak performing corporations. In this case, the awareness and anticipation of the market toward profit redistribution may not be necessarily formed or created based on the reported accounting figures but instead on the market's ability to recognize profit redistribution which may be learned from experience, anecdotal evidence or dissemination of information through media.[41] Ultimately, corporations with good (poor) previous performance that have more resources/profit tunnelled out (tunnelled in) are valued less (more) by the market in the current period. The finding is overall consistent with the 'tunnelling and propping' hypothesis suggested in the literature (Friedman *et al*., 2003; Cheung *et al*., 2009b).

The above finding remains qualitatively similar when the variable CF/CONT is substituted with a dummy variable (CF/CONT_DUM). It suggests that in corporations that are associated with divergence of cash flow-to-control rights (dummy value is 1), a decline in Tobin's Q will be observed in the case of corporations with previously higher Tobin's Q, while an improvement in Tobin's Q will be observed in corporations with previously lower Tobin's Q. The use of a dummy variable (CF/CONT_DUM) in this case is comparable to the use of the business group dummy variable in Estrin's *et al.* (2009) model. The finding is consistent with Estrin *et al.* (2009) who also obtain a statistically significant result for profit redistribution in business groups in Russia.

9.2 Group Size Effect and Family Ownership Effect

Tables 9 and 10 present further findings on the issue of profit redistribution by examining the relationship between different sizes of business group and profit redistribution. Models (1) to (3) utilize FAMOWN as the measure of family control whereas Models (4) to (6) and Models (7) to (9) use CF/CONT and the dummy of CF/CONT respectively to measure enhanced family control.

Key interest lies in the interaction terms in each of the nine models in the tables. The results show that the interaction terms in all nine models are statistically insignificant based on the ROA measure. However, the interaction terms involving the large group size (GR_C) are statistically significant based on Tobin's Q [see Models (3), (6) and (9)]. Thus, the findings from the three models imply that a greater strength of family control, as proxied by the FAMOWN and CF/CONT variables, facilitates profit redistribution in large business groups. The finding that large business groups are more inclined towards profit redistribution is consistent with George and Kabir (2008) who find

[41] The Genting's case as highlighted at the beginning of this study is an example of such public awareness (as spearheaded by the MSWG) of the potential profit redistribution.

similar results. Overall, with the significant findings in Tobin's Q but not in ROA, *Hypothesis 2* is partially supported.

As earlier findings evidence that large business groups (GR_C) are involved in profit redistribution, it is thus important to examine whether such profit redistribution in large business groups is associated with different strengths in family control. For this purpose, family ownership (FAMOWN) is split into two variables: FAMOWN1 (family ownership below 50%) and FAMOWN2 (family ownership of 50% and above) as shown in Table 11.[42]

The findings show that only the interaction terms associated with FAMOWN2 [see Model (2) and Model (4) in Table 11] are statistically significant. The negative coefficients indicate that corporations with good (poor) previous performance experience a decline (an improvement) in their performance the following year. The interaction terms associated with FAMOWN1 [Model (1) and Model (3)] are statistically insignificant. This observation suggests that the occurrence of profit redistribution is prevalent in corporations that are members of large business groups (GR_C) where the controlling families have outright (majority) control of corporations. The finding is in line with Anderson and Reeb's (2003, p.1324) argument that the potential for entrenchment is the greatest *"when families have the greatest control of the corporation"*. Overall, the finding is consistent with *Hypothesis 2* that greater strength of family control facilitates profit redistribution.

9.3 Corporation Efficiency Issue

Findings on the efficiency of profit redistribution are presented in Table 12. The comparison of the CAPEX Ratio between group and non-group corporations shows that the mean values of CAPEX Ratio for group-affiliated corporations with 'high' and 'low' ROA (Tobin's Q) are 5.71% (5.64%) and 4.57% (4.64%) respectively. The mean difference is statistically insignificant in both performance measures. In contrast, the equivalent mean values for the non-group corporations with 'high' and 'low' ROA (Tobin's Q) are 7.11% (8.47%) and 5.05% (3.69%) respectively. The mean difference is statistically significant in both performance measures.

It can thus be interpreted that the lack of significant difference in the CAPEX Ratio between the high-performance and the low-performance *group-affiliated* corporations suggests considerable inefficiency in the allocation of resources in group-affiliated corporations. The finding thus justifies and complements the earlier finding of underperformance of group-affiliated corporations. Specifically, the underperformance of group-affiliated corporations can be partly explained by the inefficient redistribution of resources from the more deserving (high-performing) affiliates to the less deserving (low-performing) affiliates. *Hypothesis 3* is thus supported.

[42] Piecewise method as per Morck *et al*. (1988) is used in grouping FAMOWN1 and FAMOWN2.

Table 9. Profit Redistribution and ROA – Group Size Effect

Explanatory Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Lag (ROA)	0.365***	0.401***	0.312***	0.414***	0.399***	0.399***	0.399***	0.413***	0.385***
FAMOWN	0.036	0.045*	0.033	0.056**	0.056**	0.055**	0.054**	0.056**	0.056**
CF/CONT′				-1.429	-2.937	-2.006			
CF/CONT_DUM							0.682	1.350	0.762
GR_A	1.077	1.238		1.528	1.454		1.083	1.494	
GR_B	1.669	2.710*	0.353	2.003*	2.050*	0.641	2.006*	2.307*	0.630
GR_C			-2.788*			-1.420			-1.898
FAMOWN* Lag (ROA)*GR_A	0.000								
FAMOWN* Lag (ROA)*GR_B		-0.003							
FAMOWN* Lag (ROA)*GR_C			0.004						
CF/CONT′ * Lag (ROA)*GR_A				-0.407					
CF/CONT′ * Lag (ROA)*GR_B					0.175				
CF/CONT′ * Lag (ROA)*GR_C						-0.094			
CF/CONT_DUM * Lag (ROA)*GR_A							0.118		
CF/CONT_DUM * Lag (ROA)*GR_B								-0.084	
CF/CONT_DUM * Lag (ROA)*GR_C									0.116
Adjusted R^2	0.436	0.440	0.445	0.431	0.428	0.427	0.431	0.430	0.433
F-statistic	9.324***	9.475***	9.637***	8.070***	7.985***	7.969***	8.063***	8.036***	8.113***
Observations	152	152	152	141	141	141	141	141	141

* significant at 10%; ** significant at 5%; ***significant at 1%.
The values in the table show the coefficients of the variables.
Control variables and sector effects are included in the regression (not shown above).

Table 10. Profit Redistribution and Tobin's Q – Group Size Effect

Explanatory Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Lag (Q)	0.399***	0.452***	0.477***	0.448***	0.473***	0.494***	0.457***	0.458***	0.500***
FAMOWN	-0.001	0.001	0.002*	0.002*	0.002*	0.002**	0.002	0.002*	0.002*
CF/CONT′				-0.155	0.084	-0.265			
CF/CONT_DUM							0.045	-0.019	0.085*
GR_A	-0.165**	-0.025		-0.012	-0.021		0.004	-0.019	
GR_B	0.036	0.063	0.072*	0.071	0.063	0.066*	0.071	0.021	0.070*
GR_C			0.156*			0.031			0.084*
FAMOWN* Lag (Q)*GR_A	0.004								
FAMOWN* Lag (Q)*GR_B		0.000							
FAMOWN* Lag (Q)*GR_C			-0.003**						
CF/CONT′ * Lag (Q)*GR_A				0.183					
CF/CONT′ * Lag (Q)*GR_B					-0.372				
CF/CONT′ * Lag (Q)*GR_C						0.374***			
CF/CONT_DUM * Lag (Q)*GR_A							-0.044		
CF/CONT_DUM * Lag (Q)*GR_B								0.132	
CF/CONT_DUM * Lag (Q)*GR_C									-0.143***
Adjusted R^2	0.639	0.619	0.629	0.622	0.639	0.653	0.617	0.630	0.645
F-statistic	20.116***	18.524***	19.272***	16.335***	17.529***	18.552***	16.066***	16.864***	17.921***
Observations	152	152	152	141	141	141	141	141	141

* significant at 10%; ** significant at 5%; ***significant at 1%.
The values in the table show the coefficients of the variables.
Control variables and sector effects are included in the regression (not shown above).

Table 11. Profit Redistribution– Large Group Size and Family Ownership Classification Effects

Explanatory Variable	(1) Tobin's Q	(2) Tobin's Q
Lag (Q)	0.450***	0.437***
FAMOWN1	0.000	0.000
FAMOWN2	0.001	0.002*
GR_B	0.077*	0.078**
GR_C	0.030	0.062
FAMOWN1*Lag(Q)*GR_C	0.000	
FAMOWN2*Lag(Q)*GR_C		-0.003**
Adjusted R^2	0.617	0.627
F-statistic	17.226***	17.887***
Observations	152	152

* significant at 10%; ** significant at 5%; ***significant at 1%.
The values in the table show the coefficients of the variables.
Control variables and sector effects are included in all regression (not shown above).

Table 12. Corporation Performance and Capital Expenditure Ratio – Comparison Between Group and Non-group Corporations

	Group Corporations			Non-Group Corporations		
Corporation Performance: ROA	Number of corporations	Mean ROA	CAPEX Ratio: Mean value	Number of corporations	Mean ROA	CAPEX Ratio: Mean value
Corporations with High ROA	76	14.13%	5.71%	81	15.59 %	7.11%
Corporations with Low ROA	75	3.79%	4.57%	81	3.89 %	5.05%
p-value (mean difference between high and low performing corporations)			0.157			0.036**
Corporation Performance: Tobin's Q						
Corporations with High Q	76	1.069	5.64%	81	1.056	8.47%
Corporations with Low Q	75	0.619	4.64%	81	0.594	3.69%
p-value (mean difference between high and low performing corporations)			0.187			0.000***

* significant at 10%; ** significant at 5%; ***significant at 1%.
CAPEX Ratio = Capital Expenditures/Total Assets

9.4 Board Independence Moderating Effect

The findings on the influence of board independence on the CAPEX Ratio of high performance and low performance corporations in group-affiliated corporations are shown in Table 13. Board independence is measured by the proportion of independent directors (PrINED). The results are presented in Table 13.

The mean of CAPEX Ratio in corporations with 'high' performance (High ROA as well as High Q) is statistically significantly (at the 5% level for ROA and the 10% level for Tobin's Q) higher than the mean of CAPEX Ratio in the corporations with 'low' performance (Low ROA as well as Low Q) in the corporations associated with a high proportion of independent directors (50% and above) (shaded in the table). In comparison, no such significant difference is found in corporations associated with low proportion of independent directors (below 50%).

Thus the finding suggests that a corporate board containing a majority of independent directors is able to positively moderate the allocation of resources in group-affiliated corporations in which affiliates that are more deserving (good-performing affiliates)[43]

[43] Good-performing corporations deserve higher allocation of capital expenditure because they are more capable of finding and investing in projects with greater positive NPVs that in turn lead to the corporation's improved performance.

receive more allocation on capital expenditures and affiliates that are less deserving (poor-performing affiliates) receive less allocation. In other words, boards with a majority of independent directors may be able to alleviate the inefficient allocation of resources in business groups as found in earlier sub-section. Thus *Hypothesis 4* is supported.

Table 13. Corporation Performance and Capital Expenditure Ratio in Group-affiliated Corporations– Board Independence Moderating Influence

Proportion of Independent Director				
	50% and above		Below 50%	
	Number of corporations	CAPEX Ratio: Mean value	Number of corporations	CAPEX Ratio: Mean value
Corporations with High ROA	32	6.99%	43	4.76%
Corporations with Low ROA	32	2.70%	44	5.94%
p-value (mean difference between high and low performing corporations)		0.016**		0.414
Corporations with High Q	34	6.46%	41	4.97%
Corporations with Low Q	30	3.01%	46	5.70%
p-value (mean difference between high and low performing corporations)		0.054*		0.611

* significant at 10%; ** significant at 5%; ***significant at 1%.
CAPEX Ratio = Capital Expenditures/Total Assets

10 Literature Revisited and Policy Implications

The evidence of profit redistribution in business groups in this study is mixed. There is significant evidence of profit redistribution from good-performing group affiliates to poor-performing affiliates when Tobin's Q is used as the performance measure but not when the ROA is used. The significant finding with Tobin's Q implies that the market is able to price in the practice of profit redistribution which is facilitated by the divergence of cash flow-to-control rights. The overall finding on profit redistribution in this study is thus partially in line with the significant evidence found in Lincoln *et al.* (1996), Gedajlovic and Shapiro (2002), Bertrand *et al.* (2002) and George and Kabir (2008). The finding is also consistent with the 'propping up hypothesis' of Friedman *et al.* (2003) and Cheung *et al.* (2006, 2009b) in which profits or resources are redistributed to 'prop up' underperforming corporations.

Further analysis revealed that profit redistribution is found to be associated with large business groups rather than small and intermediate size business groups. The finding is consistent with George and Kabir (2008) who also find a similar result in India. It is found that the extent of family ownership positively moderates profit redistribution in large business groups, particularly when the controlling families have outright (majority) ownership control over the corporations. It can be argued from the finding that since large business groups are generally more inclined to political connections, profit redistribution with the intention to stabilize a group's profitability becomes more critical for large business groups because, as explained by Estrin *et al.* (2009), group stability would be seen as a means to maintain a group's (and thus its controlling family's) political power and political connections. It can therefore be suggested that profit redistribution serves more the agenda of controlling families at the expense of the performance of good-performing affiliates and their minority shareholders.

The findings on group affiliation issues imply that our regulators such as the Securities Commission should pay more attention to business group activities, particularly those carried out by business groups that are large in size and complicated in their group structure. Authorities such as Bursa Malaysia may need to revise their listing requirements and regulations to curb potential expropriation by controlling shareholders. One potential area of abuse, particularly by the controlling families of large and complex business groups, is related party transactions (RPTs). Profit redistribution is often an RPT. Due to the large number of affiliates and the complex relationships among them, transparency in RPTs may be low in large and complex business groups. Thus Bursa Malaysia needs to upgrade its regulations on RPTs in order to ensure that public shareholders and the affiliates of business groups will not be taken for granted by controlling shareholders in RPTs.

The experiences of the US and the UK in dealing with pyramidal business groups by relying on takeover rules (in the case of the UK) and tax reform (in the case of the US) are illuminating. Pyramidal business

groups persisted in the UK until the 1970s when the takeover rule was amended by the British government to 'get rid' of business groups, after pressure from institutional investors who were dismayed over corporate governance problems in business groups (Morck, 2005). In the US, pyramidal business groups disappeared from the corporate scene much earlier. It is believed that the existence of pyramidal business groups is one of the factors which lead to the 1929 Great Depression in the US (Morck, 2005). Business groups were prevalent in the US prior to the corporate tax reform by the Roosevelt Administration in 1935. The tax reform caused the earnings of corporations at the lower tier of the pyramid to be taxed repeatedly as they moved up the multiple tiers of the pyramidal structure. This caused the structure to be unviable and pyramidal business groups were forced to sell off subsidiaries or buy them outright and consequently pyramids became extinct (Schneider, 2009).

Though drastic reform, as seen in the US and UK, to eliminate pyramidal business groups may not be practical in Malaysia for the foreseeable future due to the different institutional background, the lesson that can be learned is for government to consider minor reform initially, for example, of takeover rules or the tax policy to create incentives for business groups to retain a certain size or level of group structure complexity, or otherwise penalize them if their group structure exceeds a certain size or level of complexity. Since the findings in this study have shown that family-controlled business groups that are large in size and complicated in group structure are associated with high agency problems and thus poorer corporation efficiency and performance, a plausible solution is to control their group size and complexity. To achieve that objective, government reformers must be fully empowered to execute the task despite expected resistance from certain groups such as political elites or government officials who are allies of the controlling families of the business groups. For that to happen, political will is important to first reform public governance in order to effectively control problems such as cronyism, corruption and money politics and to reduce political interference in businesses.

Finally, the finding that board independence is able to exert the positive moderating effect is comparable to Dahya *et al.* (2008) who find a significant positive relationship between the proportion of independent directors and Tobin's Q based on their study across 22 countries, and Chen and Chen (2012) who find a significant positive relationship between the investment efficiency of diversified firms and an audit committee composed entirely of independent directors. It is thus suggested that regulators in this country should implement a more stringent policy which requires corporations to have at least half of their board consist of independent directors. It is believed that through implementation of effective director trainings and enhanced public shareholders awareness, corporate Malaysia will be able to produce more credible independent directors in the future and a clearer positive relationship between greater board independence, efficient capital expenditures or redistribution and firm performance will be observed.

11 Limitations of Study

As far as profit redistribution in business groups is concerned, this study relies only on the analysis of a one-year interval. However, the assumption that the one-year gap is sufficient for finding evidence (if any) of profit redistribution may not be true for some affiliated corporations as a gestation period longer than one year may be required. This means that the findings on profit redistribution may not capture all possibilities of profit redistribution that occur for longer than a single year.

The size of business groups in this study is proxied by the number of publicly-listed corporations affiliated to the group. However, the size of business groups can also be measured differently, such as by total value. It is possible that some business groups may be large in terms of their total group value but have few listed affiliates as most of the member corporations are unlisted. Thus measuring business groups solely by the number of listed corporations may not reflect the true size of the business group in terms of its total group value. The inability to include unlisted corporations in the analysis may cause biased results. This is acknowledged by Claessens *et al.* (2002) who also only include the listed corporations in their study of ownership and business groups in Asia. This limitation is however not believed to be serious as large business groups usually tend to have many member corporations; therefore the chances of more member corporations being listed in the exchange are also higher.

Since the 2008 data on corporation performance is used in the analysis, the findings in this study may thus be more reflective of the slower pace of Malaysian economic growth of 4.6% recorded for that year than the stable economic growth of around 6% for the country.[44] Future research may investigate the finding differentials under different economic conditions. This is because according to Johnson and Mitton (2003) and Lins (2003), the inclination of controlling shareholders to expropriate a corporation's resources will be higher during a period of economic downturn. Though the economic climate of 2008 for Malaysia is not considered as 'bad', it was by no means a satisfactory growth for the country. Thus by conducting further study for a different time period when economic growth is stable; comparison with the findings in this study can be drawn in order to verify

[44] The slower economic growth in 2008 was due to global financial turmoil and the deterioration of the global economic environment.

whether they have changed or remain unaffected. This has an implication for our understanding of shareholder expropriation and corporation performance.

12 Conclusion

This paper investigates the phenomenon of profit redistribution and the related issues. It is found that inefficient profit redistribution occurs where profits/resources are redistributed or transferred from good-performing corporations, as measured by high Tobin's Q, to poorer performing corporations as measured by low Tobin's Q. Moreover, the higher the divergence of cash flow-to-control rights, the greater the enhanced family control over the affiliates to facilitate such redistribution within the business group.

It is also suggested that inefficient profit redistribution is concentrated mainly in large business groups rather than in small and intermediate size business groups, as far as Tobin's Q is concerned. The occurrence of profit redistribution within large business groups is 'facilitated' by the extent of family ownership as well as the divergence of cash flow-to-control rights. In other words, the greater the family ownership or the divergence of cash flow-to-control rights, the greater the strength of family control over the affiliates to facilitate the redistribution, and thus more such redistribution will occur. Inefficient profit redistribution is most severe in large business groups in which the controlling families have outright (majority) control ownership of the affiliates.

Inefficient profit redistribution is also indicated by an inefficient allocation of capital expenditure in group-affiliated corporations, exhibited by a lack of significant difference between the capital expenditure ratio of high-performing affiliates and low-performing affiliates. In contrast, this difference is significant in non-group affiliated corporations, indicating that without business group-driven profit redistribution, efficient allocation of capital expenditure can be attained. Board independence is found to be significant in moderating the allocation of capital expenditure between high-performing and low-performing group-affiliated corporations.

In short, the finding implies that controlling families with excessive or enhanced control exploit their power to facilitate profit redistribution with the likely intention of stabilizing overall group profitability and thus the survivor of the group[45] at the expense of the profitability of good-performing affiliates. This entrenched behaviour of controlling families adversely affects the interests of minority shareholders of good-performing affiliates.

[45] The continuing survivor of the entire business group will ensure continuous private benefits for the controlling families of large business groups.

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