HOW IS FIRM PERFORMANCE RELATED TO FAMILY OWNERSHIP IN MALAYSIA AND DOES BOARD INDEPENDENCE MODERATE THE RELATIONSHIP?

Sin-Huei Ng*, Tze San Ong**, Boon Heng Teh, Wei Ni Soh******

Abstract

This paper explores whether the performance of publicly-listed family-controlled firms in Malaysia is related to the extent of the families' ownership. It also explores whether there are any moderating effects from the various attributes of board independence on the ownership-performance relationship of these firms. The findings indicate that increasing families' ownership is related to better firm performance under the condition that the families do not have absolute ownership and control over their firms. However, giving more control via majority ownership that causes the families to become the only dominant party might enhance their ability to expropriate and cause firm performance to deteriorate. Therefore, proposal to increase ownership as a mean to reduce the classical agency-theory problems should be caveated under the principal-principal perspective. It is also found that the various board independence attributes do not exhibit any moderating influence on the family ownership-firm performance relationship. This finding may indicate the powerlessness of the boards of director in Malaysia when encountered with the influential controlling families whom the directorship tenures and opportunities of the non-family directors depend on. Decisions made by the controlling families which have bearing on firm performance may not have been effectively counter checked by the boards due to the lack of truly independent nature of the boards.

Keywords: Family-Controlled Publicly-Listed Firms, Firm Performance, Board Independence, Family Ownership, Agency Theory, Malaysia

* *Faculty of Business, Communication & Law, INTI International University*
** *Faculty of Economics and Management, Universiti Putra Malaysia*
*** *Faculty of Management, Multimedia University*
**** *Faculty of Economics and Management, Universiti Putra Malaysia*

1 Introduction

As opposed to the 'widely-held' ownership structure in Anglo- Saxon countries, concentrated ownership structure is the norm in East Asia including Malaysia (World Bank, 2005; Claessens and Fan, 2002; Zhuang *et al*., 2000; Ng and Yeoh, 2012). It refers to the concentration of share ownership being held by a few substantial shareholders (known as the block-holders). World Bank, in its 2005 assessment of corporate governance in Malaysia (World Bank, 2005), pointed out the nature of concentrated ownership by stating that in half of the ten largest publicly-listed firms in Malaysia, over 60% of outstanding shares are owned by the top five largest block-holders. Fazilah *et al.* (2002) also states that the largest shareholder of a typical listed firm in Malaysia (with the majority of them family shareholders) on average holds close to one-third of the firm's outstanding shares. A controlling shareholder is referred to as the largest shareholder who has the capacity to influence the policies and course of action of the firm. It is reported that up to 67.2% of the publicly-listed firms in Malaysia have family as the controlling shareholder (Haslindar and Fazilah, 2009). Thus, families (either consisting of a single person or multiple family members) are the most common type of controlling shareholders in Malaysia. The families are termed as the 'controlling families' in this study. It is also noted that the presence of other block-holders in the family-controlled firms such as institutional investors and the government may also influence the performance of the firms (Thomsen and Pederson, 2000; Filatotchev *et al*., 2005; Borokhovich *et al.*, 2006; Ng *et al*., 2012).

Family ownership may bring along some significant benefits or advantages to the firms and the advantages could be enhanced with an increase in the level of ownership (Anderson and Reeb, 2003; Andres, 2008). This is because concentrated family ownership is able to alleviate the agency problems

commonly found in the dispersed ownership structure and in addition, it also provides the controlling families with both the power and incentive to improve firm efficiency and performance. Families as the largest block-holders also exhibit unique attributes which could not be found in other types of block-holder. Such attributes are believed to be able to give rise to greater competitive advantage to the firms and improve their performance (Habbershon *et al*., 2003). However, at the same time, an increase in family ownership also means an increase in the control (voting) power of the families. Therefore, as the largest shareholders with substantial concentrated ownership and control, the controlling families have the 'ability and inclination' to carry out strategies/activities or practices that benefit them but may not benefit, or may even be detrimental to, the efficiency and performance of firms and thus minority shareholders (Claessens *et al*., 2000; Young *et al*., 2008).

There is a lack of past research with regard to the moderating roles of the company board, especially in emerging economies such as Malaysia. Moreover, the inconclusive findings from the literature on the relationship between board independence and firm performance might be due to the existence of interdependent relationships amongst governance mechanisms (Rakider and Seth, 1995). For instance, the important role of the board as a monitoring system may rely on the presence of other strong monitoring mechanisms such as ownership structure. Though concentrated ownership is able to reduce the free-riding problems of a dispersed ownership structure, it may cause the board's monitoring to be affected if the controlling families intend to use their control power to interfere with the board's supposedly independent decision making.

2 Objectives of study and research framework

The objectives of this study are two-fold: (i) To examine the influence of the controlling family's ownership on firm performance (Hypotheses H1a-H1b). (ii) To examine the moderating influence of board independence on the effects of family ownership on firm performance (Hypothesis H2).

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 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. The diagram shows that in addition to the hypotheses on the direct influence of ownership structure on firm performance, the moderating influence of board independence on the relationship between controlling family ownership and firm performance is also examined.

3 Literature review and hypotheses development

Thus far, the literature does not come to a consensus on the influence of family ownership concentration on firm performance. Nonetheless, more recent studies have indicated that concentration of ownership in the hands of controlling families initially enhances a firm's performance but the performance declines once expropriation is extensive and the family becomes clearly entrenched (Bhaumik and Gregoriou, 2010; Anderson and Reeb, 2003; Thomsen and Pederson, 2000; Morck *et al*., 1988).

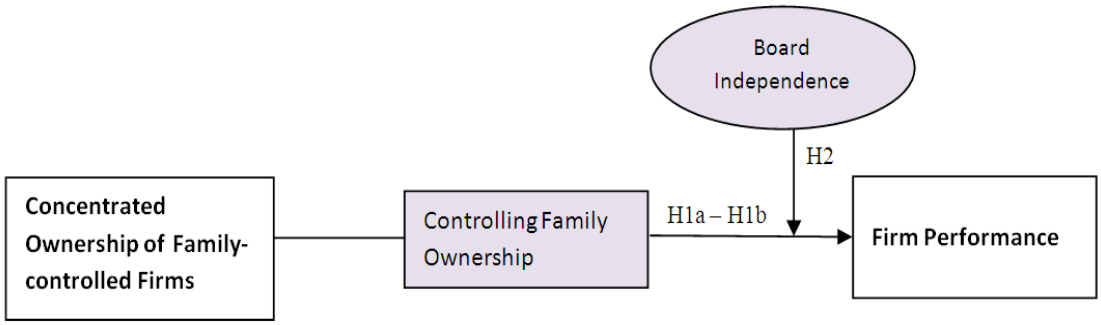
Family ownership may bring along some significant benefits or advantages to the firms and the advantages could be enhanced with an increase in the level of ownership (Anderson and Reeb, 2003; Andres, 2008). This is because concentrated family ownership is able to alleviate the agency problems commonly found in the dispersed ownership structure and in addition, it also provides the controlling families with both the power and incentive to improve firm efficiency and performance. Families as the largest block-holders also exhibit unique attributes which could not be found in other types of block-holder. Such attributes are believed to be able to give rise to greater competitive advantage to the firms and improve their performance (Habbershon *et al*., 2003).

In a widely-held ownership structure, individual shareholders do not have the power or will to play an active role in the governing and monitoring of firms. Subsequently, shareholders will be subject to the free-riding problem as each of them will 'hope' for others to make the effort to monitor management and then reap the benefits of any corrected management behaviour. It is believed that concentrated ownership of family firms in many Asian countries overcomes the free-rider problem of widely-held ownership structure in which controlling shareholders are non-existent (Shleifer and Vishny, 1997).

In contrast to Anglo-Saxon countries in which the free-riding problem is abated through strong legal protection and enforcement, shareholders in many Asian countries need to depend on controlling shareholders (whether they like it or not) to address the free-riding problem because the governments of

these countries thus far have not been successful in providing 'public goods' (effective law enforcement). The reduction of free-rider agency costs from concentrated ownership will lead to more savings and surplus resources for firms and increases financial returns (Miller and Le- Breton Miller, 2006).

Figure 1. Framework of the study



Note to Figure 1:

- Arrow lines (⟶) coming out from the main (moderating) variables indicate that the variables are hypothesized as having an influence (moderating influence) on firm performance.
- Solid lines joining two variables (——) indicate association between the variables.

With the substantial ownership and control rights that they have, family firms will ensure that their interests will be maintained and protected. Moreover, drawing upon resource-based view (RBV), Carney (2005) states these are the 'Personalism' and 'Particularism' qualities owned by family firms. Personalism refers to the unique power which results from the combination of ownership and control held by the controlling family. Thus, the higher the ownership and control of the family over their firm, the less need they have *"to account for their actions to other constituencies, giving them the discretion to act as they see fit"* (Poza, 2010, p.23). Particularism refers to the product of the concentration of control rights and its resulting discretion as elaborated by Poza (2010) that *"family businesses... have the* particular *ability to use idiosyncratic criteria and set goals that deviate from the typical profit-maximisation concerns of nonfamily firms"* (p.23). It is contended that both qualities lead to advantages for family firms as they enhance overall efficiency of the company. Thus it is believed that the greater the family ownership and control, the more prevalent will be the Personalism and Particularism qualities of family firms.

From the agency theory perspective, the association between ownership structure and firm performance can be viewed from two different effects working in opposition to each other: the incentive or alignment of interest effect and the entrenchment effect (Morck *et al*., 1988; Shleifer and Vishny, 1997). A higher level of ownership by 'insiders' (such as owner-managers in family-controlled firms) will reduce the agency conflict because the interests of the insiders will converge with those of the shareholders (Jensen and Meckling, 1976). In other words, insiders (the controlling family) will have the incentive to improve their respective firms' performance and share prices as they reap the benefits from doing so. Also, increases in ownership of the largest shareholder (the controlling family) indicate that more and more family wealth is tied into the business and thus there will be greater incentive to increase the performance/value of the firm.

Furthermore, families are more likely to have *strategic interests* rather than *financial interests* in the firm – in other words, family ownership is motivated not only by short term financial interest but also longer term non-financial goals such as creating sustainable competitive advantages and capabilities. As controlling shareholders, families exercise their ownership stakes as a means of pursuing the strategic interests of their organisations such as securing new markets and protecting managerial autonomy so that the owner-managers are able to *"make tough decisions"* more effectively (Aguilera and Jackson, 2003, p.457). Overall, firm performance is expected to improve and the improvement is sustainable in long term.

In Malaysia, Haniffa and Hudaib (2006) find that the higher the concentration of ownership, the better the accounting performance of the listed firms but they do not report any significant findings in the relationship between managerial ownership and market-based performance. Tam and Tan (2007) find that, under the concentrated ownership setting in Malaysia, different types of owners exhibit distinct

preferences of corporate governance practices. For instance, family owners are found to have a preference for CEO duality and such practice is found to have an impact on firm performance. However, their study does not consider the effects of other block-holders in family-controlled firms. Ng *et al*. (2012) find that the performance of family-controlled firms are significantly influenced according to the distinct characteristics that they have such as ethnicity of the controlling families, and whether there is a presence of other block-holders.

On the contrary, an increase in family ownership also means an increase in the control (voting) power of the families. Therefore, as the largest shareholders with substantial concentrated ownership and control, the controlling families have the 'ability and inclination' to carry out strategies/activities or practices that benefit them but may not benefit, or may even be detrimental to, the efficiency and performance of firms and thus minority shareholders (Claessens *et al*., 2000; Young *et al*., 2008).

It is contended that the inclination of controlling shareholders to extract private benefits increases with the increase in their controlling interest (Shleifer and Vishny, 1997; Claessens *et al.*, 2002; Lemmon and Lins, 2003, Teh *et al*., 2013; Ong *et al*., 2014). In other words, the higher the ownership concentration and therefore control, the more likely is the expropriation of minority shareholders or the firm's resources going to occur. A large controlling family may be wealthy enough that they prefer to maximize their private benefits of control (for instance diversifying into unrelated activities for various non-value maximization purposes such as empire building), rather than maximize their wealth. Unless the family owns the entire firm, they will not internalize the cost of these control benefits to the other shareholders (Thillainathan, 1999). Expropriation activities may subsequently jeopardize firm performance.

Overall, the expropriation of firm resources by the controlling families at the expense of minority shareholders suggests a negative impact of family ownership on firm performance. However, the 'incentive or alignment effect' and the distinctive family qualities or 'familiness' suggest that higher family ownership is beneficial to firm performance. In summary, it is difficult to conjecture the overall impact of family ownership on firm performance, *a priori.* This study infers that all the above-mentioned advantages of family ownership should outweigh the possibility of expropriation and thus the following hypothesis is proposed:

H1a: The stake of ownership by the controlling family positively affects the performance of family-controlled firms.

However, when the insiders achieve a certain level of effective control in their ownership, they may have a tendency to start to engage in non-value maximising behaviour to create private benefits, especially when the costs of creating private benefits that they must bear are lower than the private benefits they enjoy (Shleifer and Vishny, 1997). Empirically, by combining the two opposite effects (incentive effect and entrenchment effect), Morck *et al.* (1988) and McConnell and Servaes (1990) show that ownership structure and firm performance has an inverted U-shaped relationship: to begin with firm performance improves as ownership level increases, but performance will eventually reach a peak and additional ownership levels beyond that will result in a decline in performance. This is interpreted thus: increases in managerial ownership initially provide incentives to managers to strive for improvement of firm performance, but thereafter managers become entrenched and pursue private benefits at the expense of shareholders.

La Porta *et al*. (1999) in their survey of ownership structure around the world assert that the greatest source of agency costs of high concentrated ownership structure is the tendency of controlling shareholders to 'tunnel' the firm's resources for their own private benefits; in other words, expropriation of minority shareholders' wealth. Dharwadkar *et al.* (2000) also agree with this view. Firms experiencing greater expropriation of resources are likely to exhibit poorer performance (Joh, 2003) because expropriation is executed at the expense of the firm's efficiency. Anderson and Reeb (2003)'s study on family ownership and firm performance among the S&P 500 firms in the US indicates that the relationship is non-linear i.e. firm performance increases until families' share ownership reaches around one-third of the total share ownership, after which firm performance begins to decline. They thus conclude that *"when families have the greatest control of the firm, the potential for entrenchment and poor performance is the greatest"* (Anderson and Reeb, 2003, p.1324).
From the above discussion, the following hypothesis is proposed:

H1b: There is an inverted U-shape relationship between family ownership and firm performance in family-controlled firms i.e. ownership by family positively affects firm performance only up to a certain threshold level beyond which the effect will be reversed.

Since the board of directors is the highest authority of a firm, it has the ability to exert monitoring power to curb 'unscrupulous' activities, provided it is independent from the owner-managers' influence (Lee and Pica, 2010). Agency theory asserts that having a sufficient number of independent directors is critical to ensure effective 'checks and balances' to curb agency problems (such as self-serving activities) and improve firm performance (Fama and Jensen, 1983). Board independence is also enhanced when the chairman himself is an independent non-executive director (INED). Various aspects of board independence in family-controlled firms can be examined, including the percentage of independent directors, whether the board chair is an independent director, and whether the audit committee is free from non-independent directors. Ramdani and Witteloostuijn (2010) investigate the effects of board independence on different levels of firm performance in four East Asian countries including Malaysia. They claim that, among others, the effect of board independence on firm performance is different at different levels of firm performance. Prabowo and Simpson (2011) on the other hand find that, in Indonesia, there is no significant relationship between the proportion of independent directors on the boards of family-controlled firms and firm performance. There are many other empirical studies that do not agree with the opinion that an independent board adds value and thus increases firm performance or shareholder returns (for instance Nicholson and Kiel, 2007 and Wintoki's *et al*., 2010). In short, the evidence as to whether that board independence affects firm performance is unclear and inconsistent.

This study does not intend to look for additional evidence on the issue (the direct effect of board independence on firm performance) due to the vast amount of literature already available. There is however a lack of past research with regards to the moderating roles of the company board, especially in emerging economies such as Malaysia. This study thus intends to fill the gap by examining whether board independence moderates the effects of controlling families' ownership stakes on firm performance. Board independence and controlling family ownership may influence each other to affect firm performance. Thus more insights could be obtained by observing how they interact with each other; for instance, whether higher board independence can positively moderate the effects of ownership stake on firm performance. Thus:

H2: The effect of the controlling family's ownership stake on firm performance is moderated by board independence.

4 Research methodology

4.1 Data

The sample was drawn from the 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.

Ownership and board-related data are hand-collected from the annual reports published by the listed firms for the fiscal year 2007. Though this process of data collection is time-consuming, it has a number of benefits as highlighted in Fraser *et al.* (2006). Cross-sectional studies are common in the previous studies related to this area. For instance, Nazli and Weetman (2006) utilize data from 2001 for 87 companies in Malaysia to examine the issue of ownership structure, board characteristics and voluntary disclosures. Filatotchev *et al*. (2005) use a sample of 228 Taiwanese firms in 1999 to study the effects of ownership structure and board characteristics on firm performance. Kim *et al.* (2008) use a stratified random sampling to select 290 firms from the 2002 list of Fortune 1000 firms in their cross-sectional study pertaining to ownership structure and firm diversification. Mak and Kusnadi (2005) select 279 firms from a total of 795 in Malaysia in their cross-sectional study related to corporate governance and firm value for the year 2000.

The final sample of 314 firms in this study is derived based on the following selection process: first, all firms from the various sectors of Bursa Malaysia except finance sector are stratified into their respective sectors.[1] Then, firms in each sector are arranged based on their size (as measured by their total assets

[1] The finance sector is excluded because it is governed by a different set of rules and regulations and thus make them incomparable to firms in other sectors. The exclusion of the finance sector is also consistent with previous studies in this

value) from the smallest to the largest. The researcher then employed systematic sampling in order to select firms in each sector (from the smallest to the largest firm in each sector) in such a way that two-thirds of firms from each sector are selected. This yields a total of 379 firms. Of the 379 firms, 65 (or 17%) are firms where the largest shareholder is not a family or an individual but is instead government, foreign corporations (affiliates of foreign firms), institutional investors, widely-held corporations or firms without an ultimate owner.[2] Since these firms are not in the scope of this study, they are excluded from the sample. The final sample derived therefore consists of 314 firms which are known as 'family-owned and controlled firms' or simply 'family-controlled firms'.
Financial data necessary for the study are collected for the fiscal year 2008. This includes the market value and book value of ordinary shares, total debts, earnings before interest, taxes, depreciation and amortisation (EBITDA), total assets, year of firm incorporation (firm age) and total sales, which are all largely obtained from the Worldscope Database.

4.2 Family ownership and firm performance variables

The criterion used to define a firm as family-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). Following La Porta *et al.* (1999) and Claessens *et al.* (2000), firms are known as family-controlled in this study if an individual or more family members are collectively identified as the largest shareholders of the firm and own at least a 10% equity stake of the company. As many controlling families maintain indirect ownership of publicly-listed firms through their privately-held companies, the ultimate ownership approach is used to determine their actual ownership of listed firms. Family relationship is identified as per the disclosure in the company annual reports. Inclusion of firms which are controlled by individual entrepreneurs into 'family-controlled firms' in this study is consistent with previous studies such as Anderson and Reeb (2003), Andres (2008), and Masulis *et al*. (2011).

This study opts to use the accounting-based return on assets (ROA) as the proxy to measure firm performance. ROA is widely used as performance measure in the past studies [such as in Khanna and Palepu (2000), Anderson and Reeb (2003), Haniffa and Hudaib (2006), George and Kabir (2008), Andres (2008), Masulis *et al*. (2011), Ng *et al*. (2012)]. ROA is defined as earnings before interest, taxes, depreciation and amortization (EBITDA) divided by book value of total assets. EBITDA is used to assess the operating efficiency of firms without being influenced by debt policy and associated amounts of interest.

One of the common problems of empirical studies involving firm performance data is the presence of outliers. Outliers in the data may distort the analysis and findings of the study. One way to solve the problem is to remove them from the sample. However, removing the outliers will cause the number of observations to decrease, hence loss of information. Winsorization provides an alternative method of dealing with outliers. Instead of removing outliers from the sample, this study winsorizes the firm performance (ROA) data at its 1st and 99th percentiles.

4.3 Control variables

Several control variables that are considered important in affecting firm performance are included. These variables are firm size, 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 (2000), Douma *et al*. (2006) and George and Kabir (2008) are very similar to those mentioned above.

4.4 Method of analysis

Specifically, the ordinary least square (OLS) regression technique is used to test the hypotheses in this study. Masulis *et al*. (2011), Claessens *et al*. (2006) and Khanna and Palepu (2000) also rely on OLS in their analyses. OLS is appropriate as it is the most straightforward regression technique and the estimation is reliable as long as common regression problems are accounted for. All issues commonly associated with regression such as normality, multicollinearity and heteroscadasticity are addressed in the study using appropriate steps or measures.

area (for instance in Anderson and Reeb, 2003; Claessens *et al*., 2006; Jiraporn *et al*., 2006; Andres, 2008; Estrin *et al*., 2009).

[2] Firms are considered as 'without an ultimate owner' when the equity stake of the largest shareholder is below 10%.

4.5 Model specification

In order to gain insight into the relationship between ownership structure and firm performance, this study uses the following regression specification:

ROA = function (ownership variables, other control variables)

---------- (Specification 1)

where ROA is a measure of firm performance and is a function of ownership variables and other control variables.

The family ownership variable is denoted as the percentage of the controlling family's ownership (FAMOWN).

The following regression specification is used to test the moderating effects of board independence on the association between the controlling family's ownership stake and firm performance:

PERM = function (ownership variables, BDINDP, FAMOWN*BDINDP, other control variables)

---------- (Specification 2)

where BDINDP refers to board independence variables.

The focus in this specification is on the interaction term (FAMOWN*BDINDP) that shows the moderating effect of board independence. Four measures are used to indicate various aspects of board independence. They are: *Proportion of Independent Non-executive Directors on Board* (PrINED)[3], dummy variable *Independent Chairman* (INDP_CHR), dummy variable *Audit Committee consists of All Independent Directors* (INDP_ADT) and dummy variable *Highly Independent Board* (H_INDP_B). H_INDP_B is created for firms possessing all three traits of board independence simultaneously.

A statistically significant positive value for the coefficients of the interaction term involving the board dummy variable (INDP_CHR, INDP_ADT, or H_INDP_B) indicates that the presence of (certain aspect of) board independence positively moderates the effects of FAMOWN on firm performance. An insignificant coefficient of the interaction term suggests that board independence does not have any moderating effect on the FAMOWN-Performance link. As for the interaction term involving PrINED (which is a continuous variable), a positive significant coefficient value can be interpreted as follows: the greater the degree of board independence, the greater (more positive) the effect of FAMOWN on firm performance. An insignificant coefficient indicates the lack of moderating effect of PrINED on the relationship between FAMOWN and firm performance.

4.6 The issue of endogeneity

A common concern in the estimation of ownership structure and firm performance as presented above is the possibility of endogeneity problems (Demsetz & Lehn, 1985). Not only could performance be affected by the ownership structure, but the ownership structure itself might be affected by the performance of the firm. In other words, the controlling shareowners may want to increase their holdings when the firm perform well and *vice versa*. However, La Porta *et al*. (1999) observe that ownership structures of family firms in East Asian (including Malaysian) corporations is relatively stable over both the short and long term. For instance, family ownership remained intact even during and after the 1997 Asian Financial Crisis. Moreover, shareholdings by controlling families in Malaysia were stable during the four decades since the inception of the NEP and it is therefore illogical to believe that controlling families have super-human ability and can see into the future and foretell their firm's performance, hence success or otherwise, of their shareholdings.

Anderson and Reeb (2003) and Andres (2008) also cast doubt on the reverse causality of ownership structure and firm performance. Andres (2008) contends that ownership structure is stable over the long term *"even in economically bad times"* (p.443) among family firms in Germany and thus shows that the reverse causality that performance causes ownership structure is unjustifiable. Thomsen and Pedersen (2000), in investigating the effects of ownership structure on company performance in Europe, discover that ownership structure is remarkably stable even during turbulent periods. Maury and Pajuste (2005)

[3] Information on whether a director is independent is disclosed in the company annual report. The Bursa Malaysia Listing Requirements define an independent director as a person who is not involved in the management of the firm and does not have any direct or indirect interest.

also assert that ownership structures tend to be stable over the time. From the above, it is therefore sensible to consider ownership structure as exogenous and thus the endogeneity issue should not be a concern in this study.

5 Descriptive statistics

For ease of reference, a list of abbreviations used in this study, together with a definition/explanation, is presented in Table 1 below.

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 (ROA) is centred at the value of 9.19% with the median of 9.07%. The maximum value of ROA is close to 53% whereas the lowest value is close to -80%. 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.

As for the board independence variables, on average, about 43% of board directors are categorized as independent non-executive directors. This percentage is above the one-third independent directors requirement set by the Malaysian Code on Corporate Governance (MCCG). For the board independence dummy variables, the data shows that about 32% of the firms have independent chairmen, about 32% of the firms have their audit committee consisting of only independent directors, and only 22 or 7% of the firms are considered as having a 'highly independent board' (H_INDP_B). The dummy variable FAMONLY depicts that 195 firms (or 62% of firms) have the controlling family as the sole or only block-holder in the firm.

Table 2 also shows that 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.[4] 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 1. List of abbreviations, variables and operationalization

Abbreviation	Variable	Operationalization
ROA	Return on Assets	EBITDA / Total 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
INDP_CHR	Independent Chairman	Dummy is 1 if chairman of the board is an independent director; 0 otherwise.
INDP_ADT	Independent Audit Committee	Dummy is 1 if all the audit committee members are independent directors; 0 otherwise.
H_INDP_B	Highly Independent Board	Dummy is 1 if the following are satisfied: at least half of the board members are independent directors, chairman is an independent director, and all the audit committee members are independent directors; 0 otherwise.
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

[4] Claessens's *et al.* (2000) sample selection criterion is not based solely on family-controlled firms. Their sample includes all types of firms.

Table 2. Descriptive statistics

Variable	Mean	Median	Maximum	Minimum	Standard Deviation
ROA (%)	9.19	9.07	52.74	-79.76	9.18
FAMOWN	37.97	37.36	71.77	6.00	15.14
PrINED	0.43	0.41	0.75	0.22	0.11
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
Board Independence (Dummy Variables)		Yes (1)	Percentage	No (0)	Percentage
INDP_CHR		99 Firms	31.5%	215 Firms	68.5%
INDP_ADT		99 Firms	31.5%	215 Firms	68.5%
H_INDP_B		22 Firms	7.0%	292 Firms	93%

Tables 3 present the Pearson Correlation Matrix for the 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 tables depict 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 multicollinearity as indicated by the VIF value is appropriately addressed. The table shows that the ROA is significantly positively related to FAMOWN and Log Sales and significantly negatively related to gearing at the 5% significance level. However, these relationships need to be tested again in the multivariate analysis as many other factors must be accounted for.

Table 3. Pearson correlation

Variable	FAMOWN	Log Sales	Log Age	Gearing	PrINED	ROA
FAMOWN	1.00					
Log Sales	0.07	1.00				
Log Age	-0.03	**0.17**	1.00			
Gearing	-0.06	**0.33**	0.03	1.00		
PrINED	-0.09	0.01	0.04	-0.01	1.00	
ROA	**0.15**	**0.27**	-0.05	**-0.25**	-0.06	1.00

Note: Correlation coefficients greater than or equal to 0.11 (bold figures in the table) are significant at $p < 0.05$

6 Analysis, findings and discussion

6.1 Controlling family

The results of the multiple regression for *Specification 1* are presented in Tables 4. Sector dummies are included in all five models in the tables [Model (1) to Model (5)] to account for any sector-specific factors that could influence firm performance. Heteroscedasticity is diagnosed by the White-test[5] and any heteroscedasticity problems in the regression, the standard errors are corrected using 'White's Heteroscedasticity-consistent Standard Errors'.

[5] Heteroscedasticity is present when the χ^2 statistic of homoscedasticty is rejected at the 5% significant level (Griffiths *et al.*, 2011; Gujarati, 2004).

Table 4. Influence of Ownership Structure on ROA

Explanatory Variable	(1)	(2)	(3)
FAMOWN		0.054**	0.218**
$FAMOWN^2$			-0.002*
Log Sales	2.251***	2.175***	2.131***
Log Age	-0.950**	-0.875*	-0.854*
Gearing	-16.121***	-15.643***	-15.984***
Sector Effect Included			
	Yes	Yes	Yes
Adjusted R^2	0.258	0.265	0.266
F-statistic	13.080***	11.234***	8.079***
Observations	314	314	314

1. * significant at 10%; ** significant at 5%; ***significant at 1%.
2. The values in the table show the coefficients of the variables.

Model (1) is the base model with only control variables included. It shows that ROA is significantly positively related to firm size, as measured by log sales; thus the larger the firm size, the better the firm performance. Firm performance is also significantly negatively related to the age of firms and the gearing ratio. This suggests that younger firms outperform older firms and firms with higher debt levels underperform firms with lower debt. The F-test indicates that the explanatory variables are overall statistically significant in explaining firm performance in the model. The adjusted R^2 in the range of 10% to 30% is comparable to past studies in similar areas such those by Andres (2008) and Charkrabarti *et al.* (2007).

Model (2) shows the results of including the controlling family's ownership level (FAMOWN) in the analysis. It is observed that the FAMOWN coefficient is positive and statistically significant. The coefficient of 0.054 can be interpreted as: an increase of 1% in the ownership of controlling families will lead to a 0.054% increase in the ROA, in other words, a family-controlled firm with an ownership level of 10% higher will have an improved ROA of 0.54%.

Thus the finding supports the idea that the advantages brought about by family ownership, namely the 'incentive or alignment of interest effect' from agency theory, as well as the distinct qualities of 'personalism' and 'particularism' as suggested by Carney (2005) and Poza (2010), are more prevalent than the costs associated with family ownership, namely expropriation and entrenchment effects. The finding in this study is also consistent with that of Haniffa and Hudaib (2006) in their study on the positive relationship between the combined ownership of the top five shareholders and firm performance in Malaysia. In conclusion, *Hypothesis (1a)* is supported in this study as the positive family ownership-performance link is found to be significant.

6.2 Non-linearity issue

The square term of FAMOWN is included in Model (3) in the table to examine the potential non-linear relationship of FAMOWN and firm performance. The use of the square term to measure the non-linear relationship is consistent with past studies such as Andres (2008), Mak and Yusnadi (2005), Anderson and Reeb (2003) and McConnell and Servaes (1990). The result shows that there exists weak evidence of a non-linear relationship between the controlling family's shareholdings (FAMOWN) and ROA. Specifically, the ROA improves as FAMOWN increases, up to a level beyond which the relationship is reversed, in which ROA begins to decline with further increases in FAMOWN. The inflection point of FAMOWN is found at 50.82% which is computed based on the maximization rule.[6].

6.3 Board independence moderating effect

Table 5 presents the results for the moderating influence of board independence on the ownership-performance link. Four attributes of board independence (PrINED, INDP_CHR, INDP_ADT and H_INDP_B) are used for the purpose. In Model (1), interaction term (FAMOWN′ *PrINED) is used to

[6] Maximization rule is performed by first taking the differentiation of ROA with respect to FAMOWN [d(ROA)/d(FAMOWN) and then the maximum (inflection) point of FAMOWN can be found by equating the equation to 0 and solving for FAMOWN.

test the moderating effect of PrINED. Since the use of interaction term increases the chances of multicollinearity, all regression models are first checked for multicollinearity by calculating the VIF. The calculation shows that multicollinearity in Model (1) is high with the VIF value exceeding 10.0. Thus the mean-centring approach is used where the variable FAMOWN is replaced by FAMOWN′ which is equal to (FAMOWN - mean value of FAMOWN) and PrINED is replaced with PrINED′ which is equal to (PrINED - mean value of PrINED).[7] The recalculation of VIF using these centred variables shows that VIF has declined to only 1.23, an acceptable level.[8]

The results for all four models [Model (1) to Model (4)] in the table show that all four interaction terms are statistically insignificant. Thus it can be concluded that overall, board independence does not have any moderating effect on the ownership-performance link. Thus *Hypothesis 2* is not supported.

The findings complement the prior study by Zunaidah and Fauzias (2008) in Malaysia who investigate the moderating effects of board duality, board independence and board size on the effects of three types of ownership (government, foreign and managerial) on firm value. Overall, the findings in this study are consistent with Zunaidah and Fauzias (2008), who also report a statistically insignificant moderating effect of board independence on the effects of government, foreign, and managerial ownerships respectively on firm value.

Table 5. Moderating influence of board independence on ROA

Explanatory Variable	(1)	(2)	(3)	(4)
FAMOWN′	0.050	0.048*	0.052**	0.049**
FAMOWN′ *PrINED′	0.000			
FAMOWN′ *INDP_CHR		0.022		
FAMOWN′ *INDP_ADT			0.008	
FAMOWN′ *H_INDP_B				0.053
PrINED′	-5.688*			
INDP_CHR		0.076		
INDP_ADT			-0.591	
H_INDP_B				-0.321
Adjusted R^2	0.264	0.258	0.259	0.259
F-statistic	7.619***	7.405***	7.439***	7.430***
Observations	314	314	314	314

1. * significant at 10%; ** significant at 5%; ***significant at 1%.
2. The values in the table show the coefficients of the variables.
3. All other block-holder ownership variables, control variables and sector effects are included in the regression (not shown above).

The insignificant role of the above four attributes of board independence in moderating the effects of ownership on firm performance renders dubious the independent status and capacity of independent directors. Specifically, many scholars and practitioners have been questioning whether independent directors, especially in the emerging economies, are truly independent and capable of monitoring controlling shareholders. For instance, the professional body for investment professionals, the CFA Institute, admits that the lack of truly independent directors on corporate boards is a major issue throughout Asia and they elaborate that *"(t)his problem originates in the substantial power a controlling shareholder has to influence director nomination and appointment"* (Lee and Pica, 2010, p.5). The fact that some independent directors have been serving for over three decades, as is the case with about 20 listed firms in Malaysia, is seen as a governance issue as *"the risk that independence may be undermined by long tenure cannot be disregarded,"* as noted by the Securities Commission Malaysia in its Capital Market Masterplan 2 (The Star, 18 June 2011). Moreover, since most of the controlling families in Malaysia also occupy at least one of the two senior positions in their firms (CEO or board chairmanship),

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

[8] VIF=1/ (1-R_j^2) where R_j^2 is the coefficient of determination of the 'auxiliary regression' that includes all the explanatory variables except the *j*th explanatory variable. As a comparison, regressions were first run using the original interaction terms (FAMOWN*PrINED) and then re-run using the 'centred variables' (FAMOWN′ *PrINED′) and the results were compared. The results from the comparison shows that the coefficient value of the interaction term and its corresponding p-value remain much the same.

an independent director will be *"completely at the will of the owner and has no effective way to override (the family's) decisions"* (Kennon, 2004, p.2).

7 Further discussion and literature revisited

In general, the finding in this study shows that family ownership *per se* is beneficial to firm performance (as measured in ROA). Increasing ownership by controlling families not only helps to curb the traditional agency problem of dispersed ownership structure, but the 'incentive or alignment of interest effects' from concentrated ownership are more than offsetting the effects of owner-managers' entrenchment and expropriation. This finding is consistent with the incentive or alignment of interest effects from agency theory (e.g. Jensen and Meckling, 1976; Morck, 1988; Shleifer and Vishny, 1997) as well as the personalism and particularism effects of resource-based view (Carney, 2005; Poza, 2010). In principle, higher family ownership indicates a higher commitment of controlling families to improve firm performance as their wealth increases in tandem with improved performance. Empirically, it is consistent with other family ownership-related studies such as Anderson and Reeb (2003) in the US and Andres (2008) in Germany. The finding in this study implies that improved firm performance derived from the advantages associated with family ownership can occur in both developed economies as well as emerging economies, such as Malaysia.

The finding is however inconsistent with that of Filatotchev *et al*. (2005) who assert that the cancelling out of entrenchment and incentive effects results in the 'non-relationship' finding in their study on family ownership and firm performance in Taiwan. Finally, the finding is also in line with Haniffa and Hudaib (2006) who find a significant positive relationship between the combined ownership of the top five shareholders and accounting performance (ROA) but not the market-based performance (Tobin's Q) in Malaysian corporations.

There is also evidence (albeit weak) from the findings in this study that supports the original proposal of Morck *et al*. (1988) and Stulz (1988) that when controlling shareholders have achieved a high level of effective control in their ownership, they could become more entrenched and more engaged in self-benefit or expropriation activities at the expense of firm performance. This finding is in line with Shleifer and Vishny's (1997) observations that controlling shareholders that have 'near full control' of firms may be wealthy enough to prefer to make use of the firms to maximize the private benefits of control rather than their wealth. Other previous findings by authors such as Anderson and Reeb (2003) and McConnell and Servaes (1990) also support such an observation. In other words, the positive relationship of family ownership and firm performance may not be entirely linear, but may instead exhibit a concave downward relation especially towards the high end of family holdings when the deterioration of firm performance sets in. Nonetheless, other researchers, such as Andres (2008) and Chen *et al*. (2004), do not find a non-linear relationship between family ownership and firm performance. Thus, overall, it can be concluded that the presence of non-linearity in the ownership and performance relationship is an empirical issue that depends on the context in which the relationship is examined.

The findings on the moderating roles of board independence show that, overall, the influence of board independence in moderating the effects of ownership on firm performance is rather limited. Unlike developed countries, Malaysia lacks a credible market for independent directors. In fact, the pool of independent directors in Malaysia has always been confined to individuals with backgrounds that are associated with politics, government and royal families. It can thus be asserted that the appointment of many board directors in Malaysia is a result of their background. With many of them serving in the figurehead role, there is virtually no risk of forfeiting directorship opportunities in other firms even if their 'duty to monitor' is essentially non-existent. Thus, in general, the finding on the moderating influence of independent directors in Malaysia implies that they may not be truly independent from the controlling families, to exert effective monitoring for the enhancement of firm performance.

8 Conclusions

8.1 Policy implications

The findings in this study reflect that corporate governance issues in emerging economies such as Malaysia may require different solutions from those produced by the conventional agency theory perspective that neglects institutional differences (Lubatkin *et al.*, 2005; Ng and Yeoh, 2012; Ong *et al.*,

2014). Using policy designed for developed countries may not necessarily be effective and may even be counterproductive for developing countries. For instance, using increasing ownership to solve the agency problem as suggested in the Jensen and Meckling hypothesis (1976) may not work in the case of principal- principal conflicts. The findings in this study indicate that giving more control to already powerful controlling families (e.g. when they have the majority ownership and control) may further enhance their ability to expropriate and cause firm performance to deteriorate.

However, the findings at the same time also point out that when controlling families do not have the absolute ownership and control over the firm (i.e. non-majority ownership); increasing their ownership level is actually beneficial to firm performance. Therefore, it is proposed that regulators formulate policies that are able to encourage controlling families to keep their ownership level below majority. For instance, incentive measures such as tax incentives can be considered for such purpose. At the same time, policy-makers should have a clear direction in addressing the 'ownership-performance' issue in family-controlled firms. It is therefore proposed that policy-makers should be striving towards exploiting the strength of family ownership as a governance mechanism. This can be done by directing policies and plans that help to curb the potential power-abusing of controlling families but nonetheless preserve the uniqueness/traits of 'familiness' and the positive characteristics of the family form of governance (such as personalism and particularism) that give advantages to family-controlled firms. For instance, promoting a second block-holder with shareholding of at least ten percent or above in family-controlled firms is an example in which the dominance of controlling families may be counter-balanced with their 'familiness' remains intact.

8.2 Limitations and suggestions for further research

The measure of 'family' used in this study can be fine-grained to provide more insight into the issues involved. Specifically, Miller *et al.* (2007) comment that a distinction can be made between family-controlled firms that are controlled by lone individuals in which no relatives of the individual are involved in the ownership or management, and 'true' family businesses in which multiple family members participate either as substantial shareowners or/and managers. In addition, family-controlled firms can also be refined based on whether the firms are run by the family members or professional managers. More and more family businesses have begun to recruit outside professional managers though the families are still the *de facto* controllers of the firms. It would thus be interesting for future study to examine the effects of the above 'variations' of family-controlled firms on the issues involved and in doing so adding to the diversity and richness of literature on family firms.

The lack of evidence on the moderating role of board independence in this study may be due to the fact that many independent directors are not truly independent in exerting their monitoring roles. Future work can focus on the effort of collecting primary data to find out how an independent director is appointed (though it may be a daunting task in collecting such data). Some independent directors are appointed as they are recommended by the controlling family or its affiliates and some are appointed based on their connection to the government or politics. Thus it is intriguing to segregate these so-called independent directors from the rest and examine whether the moderating influence of independent directors is affected by such segregation. Future work can also extend the concept in this study of board independence to include other board qualities such as board integrity and diversity.

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