



The Impact of Owner Ship Concentration on Financially Distressed Firms Listed on Malaysian Stock Exchange

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ARTICLE INFO

Article history:

Received: 28 May 2015;

Received in revised form:

18 November 2015;

Accepted: 24 November 2015;

Keywords

Concentration of shares,
Corporate default,
Firm performance.

ABSTRACT

After the corporate default of major corporations in the past years such as Enron Lehman Brothers etc the study has been a major area for research the default of US based giants has act as a distress and alarming situation for emerging economies with different areas of research regarding corporate defaults this paper focuses on examining the relationship of ownership structure with the performance of a firm through market performance ratios and firms volume of publically listed companies on Malaysian stock exchanges. Results suggested defaulted firms ownership concentration is unable to show significant relationship with the performance of these firms except for the major shareholder.

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Introduction

Relationship of ownership concentration and firms performance is one of important issues in literature and financial theories. There are studies suggesting that owner ship concentration results in improvement in monitory costs thus ultimately improving performance (Shleifer, 1997) Yet there are counter studies with argument that large concentration of shares result in pursuit of personal motives thus deteriorating firms' performance. Whether firms exhibiting signs of financial distress can be result of impacts of ownership concentration is a major area for research. Empirical researches based upon relationship of ownership concentration and firms performance have shown mixed results. Some researches (Demsetz H. a., 1985) find no impact of ownership concentration on accounting profits while others (McConnell, 1990) found positive effects of corporate ownership. Malaysia being one of leading Asian economies is of significant importance in Asia as well as European market therefor a significant market for the study of companies exhibiting signs of Corporate Distress.

Corporate Distress

A state of company's corporate distress can have different explanations and requirements according to different regulatory authorities in the world. Most of the world's Authorities have their own systematic processes to classify a company as in state of distress or default for example according to Malaysian stock Exchange rules and listing requirements company falling in the category of corporate distress in in a state of not having a core business or has failed to meet the minimum capital or equity and companies shareholders funds are less than 25 % of their paid up capital (www.klse.com). New York Stock Exchange NYSE publishes a list of companies that are in distress and term them noncompliant with NYSE quantitative/ Qualitative listing Standards (Collectively "BC") or that they delayed in filling of their annual report required in accordance with section 13 or 15(d) of securities and exchange Act of 1943 (www.nyse.com). The term Corporate distress is dependent upon the explanation from the Regulatory authorities of a particular country mostly its results from the non compliance of codes of conduct that are setup by these authorities. Malaysian stock exchange "Bursa

Malaysia" classifies companies facing signs of financial distress as PN17 companies.

PN 17 ccompanies

PN 17 companies are the companies that are listed on Malaysian Stock Exchange and are classified under Practice note 17 generally these companies 'exhibit signs of financial distress. In accordance with the Malaysian Stock Exchange code of conduct companies falling under PN17 category have to submit their proposal to the Approving Authority to restructure their and revive their company in order to maintain their status on Malaysian Stock Exchange. There are various reasons resulting in companies shift from normal to PN17 category which can be changes in management, Risk profile, Management team Experience, Foresight, Financial Appetite, Over gearing rtc.

The companies falling under this category become sceptical for the investors thus effecting their decisions related with investment in such company.

Furthermore Malaysian Stock exchange also requires companies shareholders' funds should be more than 25 % of their total paid up capital if company fails to meet this requirement then it can be termed as a PN17 organization further adverse opinion of Auditors, winding up some of subsidiaries and associated companies , default in loans and interest and principal repayments, suspension of companies operations can result in triggering of financial distress ultimately classification of company as PN17.

There are some cases that investors do not notice these chances but are rare (Kok, 2010).

Each year Malaysian stock Exchange enquires and investigates any potential beaches regarding prescribed rules and regulation and noncompliance of Capital Markets and Services Act 2007 to classify status of the companies .These actions by Malaysian stock exchange results in early uncovering of weaknesses in market thus helping to protect the rights of the stakeholders and to avoid financial crisis (Michael, 2007).

According to the list given at the website of Malaysian stock exchange there are 26 PN 17 companies at the moment. PN17 Companies

List updated: 5 may 2014**AUTOAIR holdings BERHAD**

1. BINA GOODYEAR BERHAD
2. BIOSIS GROUP BERHAD
3. ECM LIBRA FINANCIAL GROUP BERHAD
4. GLOBAL CARRIERS BERHAD
5. GW PLASTICS HOLDINGS BERHAD
6. HAI SAN RESOURCES BERHAD
7. HB GLOBAL LIMITED
8. HEXAGON HOLDINGS BERHAD
9. HIGH-5 CONGLOMERATE BERHAD (formerly known as SILVER BIRD GROUP BERHAD)
10. HYTEX INTEGRATED BERHAD
11. INTEGRATED RUBBER CORPORATION BERHAD
12. IRM GROUP BERHAD
13. KEJURUTERAAN SAMUDRA TIMUR BHD
14. LFE CORPORATION BERHAD
15. LION CORPORATION BERHAD
16. MAA GROUP BERHAD (formerly known as MAA HOLDINGS BERHAD)
17. MALAYSIAN AE MODELS HOLDINGS BERHAD
18. MAXTRAL INDUSTRY BERHAD
19. OCTAGON CONSOLIDATED BERHAD
20. PAN MALAYSIAN INDUSTRIES BERHAD
21. PERWAJA HOLDINGS BERHAD
22. PETROL ONE RESOURCES BERHAD
23. SUMATEC RESOURCES BERHAD
24. TPC PLUS BERHAD
25. VTI VINTAGE BERHAD

These companies are classified as PN17 companies due to following main reasons

- a) The shareholders equity of the listed issuer on a consolidated basis is 25 % or less of the issued and paid-up capital of the listed issuer and such shareholders equity is less than RM40 million. Receivers or managers have been appointed over the asset of the listed issuers its subsidiaries or associated company which assets accounts for at least 50 % of total assets employed of the listed issuer on consolidated basis
- b) A winding up of a listed issuers subsidiary or associated company which accounts for the least 50 % of total assets employed by the listed issuers on a consolidated basis.
- c) The auditors have expressed an adverse or disclaimer opinion in the listed issuers latest audited financial statements.
- d) The auditors have expressed a modified opinion with emphasis on the listed issuers on going concern in the listed issuers latest audited financial statements and the shareholders equity of the listed issuers on a consolidated basis is 50% or less of the issued and paid up capital of the listed issuer.
- e) A defaulted in payment by a listed issuer its major subsidiary or major associated company.
- f) The listed issuer has been suspended or ceased all of its business or its major business or its entire or major operations

Literature Review

Ownership and firm performance relationship have been of significance importance research area for last decades. Researches (Berle, 1932) motivated the concept of firm performance due to separation of ownership and controls in an organization research findings suggested existence of inverse correlation between ownership concentration and firms performance which is central to the idea of Agency theory. Other researches (Jensen, 1976) argued that the relative amount of shareholders of the management and outsiders results in managements tilt towards achievement of their own interests.

According to their hypothesis increase of inner management results in increase of firms performance and ownership. Further researchers (Demsetz H. a., 1985) challenged this idea and suggested that ownership structure of the corporate is outcome of the decisions of the shareholders so there should be no systematic relationship between ownership structure and variation in firms performance. Further strengthen the idea (Demsetz H. a., 1985) researchers provided evidence by measuring profit rate on a fraction of shares owned by five largest shareholder interests they found no evidence between profit rate and the ownership concentration.

The literature showed mixed findings as other researchers (Shleifer, 1997) showed existence of relationship between ownership concentration and firms performance they showed significant role played by large shareholders and how the prices of shares increased as these owners took more and more shares. Similar to these studies there have been further more work examining the concentration of ownerships impact on firms performance such as research (Hill C. a., 1988) showed significance positive effects of ownership structure on firms performance measured by probability through strategic structure. A research (Hill C. , 1989) based upon data set of US firms taking productivity as a measure of performance confirmed existence of positive relationship among ownership concentration and performance while others (McConnell, 1990) showed no significant impact of ownership structure and performance. (Agrawal, 1990) Findings confirmed the existence of relationship among the highly concentrated shareholders and better management and further better performance of firms especially when ownership is concentrated in institutional investors rather than individual investors.

Further work (Leech, 1991) done on UK firms found negative and significant relationship between ownership concentration and firms value and profitability this research described ownership concentration through several measures and control types. Another study related to British Firms (Mudambi, 1998) confirms this negative relationship between ownership concentration and performance.

Conflating results gave rise to concerns such as non linear relationship among the variables. (Morck, 1989) reexamined the relationship by taking cross sectional data of 371 Fortune500 firms in 1980 the performance measures used by researchers were Tobin's Q and the accounting profit rate as alternative measure of performance. Further (Holderness and Sheehan; 1988) analyzed 114 NYSE listed corporations in which majority shareholders own 50.1 percent of common stocks findings suggested that Tobin's Q is higher when majority of shares are held by corporate and lower when the majority of shares are held by individuals.

Other researches (Wu, 2002) followed similar approach and studied the Tobins Q relation ship with managerial Ownership and board concentration.

Corporate governance mechanisms are different around the world and can results in different results on firm's performance A research (Shleifer, 1997) defined at least three different kind of mechanism in the world economies. In USA and UK firms rely on the legal protection of investors. While in Europe and Japan legal protections are not relied on more significantly rather they relied more on investors and banks. While in other parts of the world it is majorly concentrated within families. Due to this type of significance differences around corporate governance structures researches around the world show different types of results.

Table 1

	Mean	Median	Mode	Standard Deviation	Range	Minimum	Maximum	Sum	Count
c1	24.1947	21.84	53.38	12.665	59.89	6.85	66.74	3459.84	143
c2	34.6363	32.56	30.39	13.737	60.48	11.78	72.26	4953	143
c3	42.1812	39.14	61.46	14.312	65.08	16.15	81.23	6031.91	143
c5	51.1604	50.3	63.49	14.7538	68.24	24.11	92.35	7315.93	143
HERF	6947.91	5287.86	8157.03	4508.65	22081	1027.81	23108.8	993551	143

Table 2. Description of variables

Tobins Q	Tobin's Q (Market value of equity p book value of debt)/book value of assets
SIZE	Firm size Logarithm of the total assets
AGE	Firm's age Log of years
C1	Largest shareholder
C2	Largest two shareholders
C3	Largest three shareholders
C5	Largest five shareholders
HERF	Herf index The sum of squared percentage of shares controlled by each top five shareholders

In spite of all these efforts when it comes to some Asian countries such as Malaysia little research is done on the impact on ownership concentration of firms performance especially PN17 companies enlisted on Malaysian stock exchange.

Data and Estimation frame work

Data

The Malaysian stock exchange PN17 company list contains 26 companies out of which date related to 13 companies was selected for this study the selected data range was 11 years from the year 2003 to 2013 the reason for selection of 11 companies was unavailability of financial reports of other companies of this time series. These companies belong to different sectors such as manufacturing trading utilities real estate and transport.

The data set contains information about the corporation major areas of interest linked with this study are balance sheets, income statements, percentages of shareholding of major 5 shareholders this information was gathered from financial statements that are publically available on companies official websites. The distress classified firms are in accordance with PN17 laws of Malaysian stock exchange.

Variable selection

First of all to calculate the market performance of firms Tobins Q ratio was calculated that is ratio of value of assets to the replacement cost of firms assets. For measuring firms size log of assets of firm is taken and firms age is also considered as independent variable.

To determine ownership concentration the measure used the percentages of share held by the largest shareholder that is C1 , the percentage of two largest shareholders C2, percentage of first three Largest shareholders C3 and percentage of first five Largest shareholders C5. Also in order to represent ownership concentration HERFINDL index was used which is the sum of squared percentages of the shares controlled by each five top shareholders. Table I represents the basis statistics for these measures and variables.

When it comes to companies under distress the largest concentration of shareholding is about 24% of the total share and the first two largest shareholders add up to 34 % at the 5 largest shareholders up to 51% the data set also includes a with standard deviation of 12 % which is also reflected in maximum and minimum values. Table II shows different financial ratios and variable descriptions used under the study.

Empirical Equation

Accounting ratios and Tobin's Q are used to measure firms performance the ratios include ROA, ROE , MBR, TD/TA,

LTD/TA, NI/CAP , firms AGE, Firms SIZE. These variables are taken as Independent variables. While dependent variables include ownership concentration C1, C2, C3, C5 and HerfIndex.

So following Equation is developed

$$Y = \beta_0 + \beta_1 \log(\text{Assets}) + \beta_2 (\text{AGE}) + \beta_3 \text{Tobins Q} + e$$

WHERE Y is C1, C2, C3 , C5 and HERF .

In order to measure the effect of owner ship concentration on firms under distress multivariate regression model was used calculated using STATA.

Results and Discussion

when it comes to the majority shareholders c1 the model shows f value of 8 which means the model is significant coefficient of determination is 0.14 which means 14 percent variation in dependent variable is explained by these independent variables p value shows that model is significant. According to regression results if Tobins Q changes by 1 unit then dependent variable changes by 0.74 units alternatively increase in 1 unit accumulation of shares of major shareholder of these firms results in increase of 0.74 market performance the variable having a t value greater then 2 shows significant results .firm size which is ln of Assets shows a beta of 2.06 which means that if firm size increases 1 percent the dependent variable major shareholders shares increase by 2.06 units this result is obvious as increase with firms size accumulation of shares has major chances of increase as the major shareholder has the major stake in the firm.

Firms age shows an inverse relationship increase of firms age by 1 unit results in decrease of shares by 4 units .the possible explanation of this can be as the firms are in financial distress financial distress does not occur overnight the major stake holders usually have a long sight on firms performance these firms show detreating performance credentials due to which the major shareholders with passage of time start to lose interest in their shares thus with passage of increase in firms age the major shareholders have started to forgo their part of share all the t values of variables are significant. when it comes to largest two shareholders c2 the results start of change a bit with decrease in overall significance of the model from 8 to 4 which is almost half regarding the t values of the variable the relationship is still negative but becomes insignificant and the market performance that is Tobins Q s value drops from 74 to .64 yet the results are significant while firms age shows a slight increase its value being 2.4 if further largest 3 shareholders are taken the overall model becomes insignificant and firms all the values of coefficients of beta deteriorate moving further with c3

majority 3 shareholders, c5 and herf the trend continues and models become insignificant with only firms size the only variable significant in c3 and Tobins Q and Firms size in c5 and Herf are significant but overall models become insignificant.

Equation	Obs	Parms	RMSE	"R-sq"	F	P
C1	143	4	11.82026	0.1474	8.007181	0.0001
C2	143	4	13.2942	0.0832	4.205411	0.0070
C3	143	4	14.05077	0.0565	2.776478	0.0436
C5	143	4	14.56899	0.0455	2.208746	0.0898
HERF	143	4	4396.591	0.0692	3.443535	0.0186

	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
C1					
TOBINSQ	.7481765	.2369738	3.16	0.002	.2796373 1.216716
FIRMSSIZE	2.060341	.7726877	2.67	0.009	.5326006 3.588082
FIRMSAGE	-4.895203	1.491933	-3.28	0.001	-7.845018 -1.945387
_cons	-.7395183	14.84425	-0.05	0.960	-30.08925 28.61021
C2					
TOBINSQ	.6184264	.2665234	2.32	0.022	.0914624 1.14539
FIRMSSIZE	2.411496	.8690385	2.77	0.006	.6932523 4.129739
FIRMSAGE	-2.657147	1.67797	-1.58	0.116	-5.974792 .660498
_cons	-4.127025	16.69527	-0.25	0.805	-37.13654 28.88249
C3					
TOBINSQ	.49508	.2816913	1.76	0.081	-.0618738 1.052034
FIRMSSIZE	2.369248	.9184957	2.58	0.011	.5532183 4.185277
FIRMSAGE	-.7506468	1.773464	-0.42	0.673	-4.2571 2.755806
_cons	-1.768919	17.6454	-0.10	0.920	-36.65701 33.11917
C5					
TOBINSQ	.3631955	.2920805	1.24	0.216	-.2142996 .9406906
FIRMSSIZE	2.27084	.9523714	2.38	0.018	.3878327 4.153848
FIRMSAGE	.2600611	1.838872	0.14	0.888	-3.375716 3.895838
_cons	6.026757	18.29619	0.33	0.742	-30.14807 42.20158
HERF					
TOBINSQ	214.3158	88.14328	2.43	0.016	40.04081 388.5907
FIRMSSIZE	634.6439	287.4041	2.21	0.029	66.39493 1202.893
FIRMSAGE	-731.9869	554.93	-1.32	0.189	-1829.182 365.2083
_cons	-3226.885	5521.376	-0.58	0.560	-14143.63 7689.857

The possible explanation for this trend is with increase in shareholder wealth distribution the powers also diffuse in the form of shareholder rights the governance mechanisms in such cases becomes difficult to predict especially in case of defaulted firms due to their volatile nature and continuously changing environment.

Conclusion

When it comes to Malaysian firms classified as PN17 organizations the ownership concentrations fails to provide any significant evidences of link of firm's performance expect for the major shareholder of the organizations. However firms age and firms size do have provided significant results with ownership concentration the individuals who own more share have their share in age and size of these firms also Tobins Q significance shows that ownership concentration does have impact on market performance.

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