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

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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 financial performance ratios and default 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.

Keywords: concentration of shares, corporate default, firm performance

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. Someresearches(Demetz 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 companiesshareholders 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 noncompliance 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 companies.

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 etc.

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 investorsdo 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

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

Corporate governance mechanisms are different around the word 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.

In spite of all these efforts when it comes to some Asians 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 company’s official websites. The distress classified firms are in accordance with PN17 laws of Malaysian stock exchange.

**Variable selection**

Using pooled data first of all different financial ratios were calculated as a measure of firms performance the financial ratios include ROE, ROA, Tobins Q, Market to Book Value (MBR). Tobins Q and MBR show Market performance while ROE and ROA are used to measure Accounting performance of the firms. 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.

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
<th>Mode</th>
<th>Standard Deviation</th>
<th>Range</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Sum</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>C1</td>
<td>24.1947</td>
<td>21.84</td>
<td>53.38</td>
<td>12.665</td>
<td>59.89</td>
<td>6.85</td>
<td>66.74</td>
<td>3459.84</td>
<td>143</td>
</tr>
<tr>
<td>C2</td>
<td>34.6363</td>
<td>32.56</td>
<td>30.39</td>
<td>13.737</td>
<td>60.48</td>
<td>11.78</td>
<td>72.26</td>
<td>4953</td>
<td>143</td>
</tr>
<tr>
<td>C3</td>
<td>42.1812</td>
<td>39.14</td>
<td>61.46</td>
<td>14.312</td>
<td>65.08</td>
<td>16.15</td>
<td>81.23</td>
<td>6031.91</td>
<td>143</td>
</tr>
<tr>
<td>C5</td>
<td>51.1604</td>
<td>50.3</td>
<td>63.49</td>
<td>14.7538</td>
<td>68.24</td>
<td>24.11</td>
<td>92.35</td>
<td>7315.93</td>
<td>143</td>
</tr>
<tr>
<td>HERF</td>
<td>6947.91</td>
<td>5287.86</td>
<td>8157.03</td>
<td>4508.65</td>
<td>22081</td>
<td>1027.81</td>
<td>23108.8</td>
<td>993551</td>
<td>143</td>
</tr>
</tbody>
</table>
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

**Table II Description of variables**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>Net income/total assets</td>
</tr>
<tr>
<td>ROE</td>
<td>Net income/ total equity</td>
</tr>
<tr>
<td>Tobins Q</td>
<td>Tobin’s Q (Market value of equity + book value of debt)/book value of assets</td>
</tr>
<tr>
<td>MBR</td>
<td>Market value of equity/book value of equity</td>
</tr>
<tr>
<td>SIZE</td>
<td>Firm size Logarithm of the total assets</td>
</tr>
<tr>
<td>AGE</td>
<td>Firm’s age Log of years</td>
</tr>
<tr>
<td>TD/TE</td>
<td>Total debt/total equity</td>
</tr>
<tr>
<td>LTD/TA</td>
<td>Long-term debt/total assets</td>
</tr>
<tr>
<td>NI/CAP</td>
<td>Net income/capitalization</td>
</tr>
<tr>
<td>TD/TA</td>
<td>Total debt/total assets</td>
</tr>
<tr>
<td>C5</td>
<td>Largest five shareholders</td>
</tr>
<tr>
<td>HERF</td>
<td>Herf index The sum of squared percentage of shares controlled by each top five shareholders</td>
</tr>
</tbody>
</table>

**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

\[
Y = \beta_0 + \beta_1 \log(\text{Assets}) + \beta_2 (\text{AGE}) + \beta_3 (\text{TD/TE}) + \beta_4 (\text{LTD/TA}) + \beta_5 (\text{MBR}) + \beta_6 (\text{ROA}) + \beta_7 (\text{ROE}) + \beta_8 (\text{Tobins Q}) + \beta_9 (\text{NI/CAP}) + e
\]

WHERE Y is C1, C2, CE and HERF.

In order to measure the effect of owner ship concentration on firms under distress simple regression model was used on Eviews statistics.

**Results**

Following tables show the results of the model
The results of concentration of First major shareholder shows R value of 0.17 which shows existence of weak correlation among the variables similarly the adjusted R square shows that only a very small portion of this relationship is explained by this variable the probability of statistics are significant however the relationship of firms age and size are significant which shows that as the firm becomes more aged the share concentration amount the top individuals becomes less concentrated as the coefficient of the variable is negative / firms size shows that with the increase of firms size more shares get concentrated ie the people with largest number of shares buy more share with expansion of the firm. Moreover Tobins Q ratio also shows significant results stating that measure of market performance increases with accumulation and concentration of shares.

When it comes to share holder concentration of first 2 largest shareholders the R value shows that relationship is even weaker compared to major first share holder and R square value shows that only 0.03 percent relationship is explained by major two shares holders impact on performance of financially distressed firms the prob(stat) value is greater than 0.05 which shows relationship is insignificant.
Largest third shareholders concentration of financially distressed firms and their relationship with performance there is weekly correlated the results are also insignificant.

Major five shareholders also fail to show any significant relationship with financially distressed firms.

Table no V Dependent Variable C3

<table>
<thead>
<tr>
<th>Variable</th>
<th>C</th>
<th>FIRMS_AGE</th>
<th>FIRMS_SIZE</th>
<th>LTD_TA</th>
<th>MBR</th>
<th>NI_CAP</th>
<th>ROA</th>
<th>ROE</th>
<th>TD_TE</th>
<th>TOBIN</th>
<th>YEA RS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coefficient</td>
<td>-66 4.2</td>
<td>-0.6</td>
<td>2.4</td>
<td>1.3</td>
<td>0.9</td>
<td>-0.5</td>
<td>0.1</td>
<td>0.2</td>
<td>-0.2</td>
<td>0.5</td>
<td>0.3</td>
</tr>
<tr>
<td>Std. Error</td>
<td>86 2.5</td>
<td>1.9</td>
<td>1.2</td>
<td>7.9</td>
<td>0.6</td>
<td>1.3</td>
<td>0.2</td>
<td>0.7</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>t-Statistic</td>
<td>-0.8</td>
<td>-0.3</td>
<td>2.0</td>
<td>0.2</td>
<td>1.4</td>
<td>-0.4</td>
<td>0.6</td>
<td>0.2</td>
<td>-0.8</td>
<td>1.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Prob.</td>
<td>0.4</td>
<td>0.8</td>
<td>0.0</td>
<td>0.9</td>
<td>0.2</td>
<td>0.7</td>
<td>0.5</td>
<td>0.8</td>
<td>0.5</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.1</td>
<td>Adjusted R-squared</td>
<td>0.0</td>
<td>F-statistic</td>
<td>1.1</td>
<td>Prob(F-statistic)</td>
<td>0.3</td>
<td>Durbin-Watson stat</td>
<td>0.4</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

R-squared | 0.1 | Adjusted R-squared | 0.0 | F-statistic | 1.1 | Prob(F-statistic) | 0.3 | Durbin-Watson stat | 0.4 |

Table VI dependent variable C5

<table>
<thead>
<tr>
<th>Variable</th>
<th>C</th>
<th>FIRMS_AGE</th>
<th>FIRMS_SIZE</th>
<th>LTD_TA</th>
<th>MBR</th>
<th>NI_CAP</th>
<th>ROA</th>
<th>ROE</th>
<th>TD_TE</th>
<th>TOBIN</th>
<th>YEA RS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coefficient</td>
<td>-549 5.5</td>
<td>0.6</td>
<td>2.3</td>
<td>4.2</td>
<td>1.1</td>
<td>-0.5</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.3</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>Std. Error</td>
<td>891 8.6</td>
<td>2.0</td>
<td>1.2</td>
<td>8.1</td>
<td>0.6</td>
<td>1.3</td>
<td>0.2</td>
<td>0.7</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>t-Statistic</td>
<td>-0.6</td>
<td>0.3</td>
<td>1.8</td>
<td>0.5</td>
<td>1.6</td>
<td>-0.4</td>
<td>0.6</td>
<td>0.0</td>
<td>-1.1</td>
<td>1.2</td>
<td>0.6</td>
</tr>
<tr>
<td>Prob.</td>
<td>0.5</td>
<td>0.8</td>
<td>0.1</td>
<td>0.6</td>
<td>0.1</td>
<td>0.7</td>
<td>0.5</td>
<td>1.0</td>
<td>0.3</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.1</td>
<td>Adjusted R-squared</td>
<td>0.0</td>
<td>F-statistic</td>
<td>1.1</td>
<td>Prob(F-statistic)</td>
<td>0.4</td>
<td>Durbin-Watson stat</td>
<td>0.4</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Major five shareholders also fail to show any significant relationship with financially distressed firms.

Table VII

<table>
<thead>
<tr>
<th>Variable</th>
<th>C</th>
<th>FIRMS_AGE</th>
<th>FIRMS_SIZE</th>
<th>LTD_TA</th>
<th>MBR</th>
<th>NI_CAP</th>
<th>ROA</th>
<th>ROE</th>
<th>TD_TE</th>
<th>TOBIN</th>
<th>YEA RS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coefficient</td>
<td>-1853 69.8</td>
<td>-629.6</td>
<td>698.1</td>
<td>647.8</td>
<td>334.8</td>
<td>-184.6</td>
<td>32.6</td>
<td>-18.6</td>
<td>-87.6</td>
<td>215.1</td>
<td>89.9</td>
</tr>
<tr>
<td>Std. Error</td>
<td>2692 00.8</td>
<td>597.3</td>
<td>377.1</td>
<td>2459.9</td>
<td>193.9</td>
<td>394.0</td>
<td>69.2</td>
<td>223.6</td>
<td>76.1</td>
<td>93.4</td>
<td>133.8</td>
</tr>
<tr>
<td>t-Statistic</td>
<td>-0.7</td>
<td>-1.1</td>
<td>1.9</td>
<td>0.3</td>
<td>1.7</td>
<td>-0.5</td>
<td>0.5</td>
<td>-0.1</td>
<td>-1.2</td>
<td>2.3</td>
<td>0.7</td>
</tr>
<tr>
<td>Prob.</td>
<td>0.5</td>
<td>0.3</td>
<td>0.1</td>
<td>0.8</td>
<td>0.1</td>
<td>0.6</td>
<td>0.6</td>
<td>0.9</td>
<td>0.3</td>
<td>0.0</td>
<td>0.5</td>
</tr>
</tbody>
</table>

http://www.ijmsbr.com
Herfindal index of the Malaysian stock Exchanges PN17 classified firms show very minor correlation with financial performance also the probability statistics shows that results are insignificant.

**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. 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 however overall the model proves insignificant results.

**References**


