EXPROPRIATION OF MINORITY SHAREHOLDERS' RIGHTS: EVIDENCE FROM MALAYSIA

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Abstract

The objectives of this study are to investigate the factors and the extent level of expropriation of minority shareholders' rights in context of Malaysia. Analysis of sixty companies listed from two industries in Bursa Malaysia was selected. Descriptive analysis and ordinary least squares (OLS) regression model are performed in this study The variables tested are ownership concentration, firm size, board independence, profitability, level of leverage and firm growth. From these variables, only three variables can be concluded as factors influencing the expropriation of minority shareholders' rights in Malaysia. The number of independent outside directors increases the potential for expropriation of minority shareholders' rights. However, this relationship became opposite when the directors have a different characteristic among boards that affect their independence level. Profitability and growth are highly correlated. When the model is estimated using either one of them, the result is significantly negative, which means that profitable or growing firms have less incentives to engage in related party transactions.

Keywords: Expropriation, Minority shareholders' rights, Malaysia

1. Introduction

Companies might engage in related party transaction because it offers many returns to their company. One of the returns is acquiring and disposing of substantial assets among the related parties. Related party relationship exists when parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making decision. Nevertheless, related party transactions are often viewed as being detrimental to outside shareholders. Officers, directors and large shareholders are well positioned to use their influence to enter into transactions that expropriate wealth from outside shareholders (Ryngaert, 2007). Even, the misalignment of goals and objectives frequently occurs between the majority and minority shareholders and not from the diverse interests of management and owners (Santiago and Brown, 2007). Furthermore, the minority shareholders would be viewed as an unnecessary burden, an uninteresting weight by majority shareholders. This is not the first time minority shareholders have been in such a predicament. There have been many instances where they were not given a choice or a voice, over matters that could affect the value of their investments (The Edge Malaysia, 2009).

In Malaysia, expropriation of minority shareholder's right by majority shareholders often occur particularly in related party transaction, and nowadays, this issue is still debated in mass media. Thus, this study conducted to gain a deeper knowledge and understanding of the expropriation of minority shareholders' rights in Malaysia. This study tries to achieve these research objectives such as: to identify the extent level of expropriation of minority shareholders' rights in Malaysia and to investigate the factors which are influencing expropriation of minority shareholders' rights.

The structure of this paper will be as follows. Section 2 provides an explanation about the relevant literature. Section 3 discusses the hypotheses development, variables measurement, data collection and analysis that are used in the study. Section 4 presents the results and findings from the study. The final section concludes the study.

2. Literature Review

In emerging markets, minority shareholders have a role to play, whereby they can be a watchdog over the board's actions and help to create effective and well-governed companies. They also can be instrumental in the development and sustainability of capital markets as well. Shkolnikov (2006) states that expropriation of minority shareholders in Asia has been linked to the 1997 financial crisis. Expropriation is defined as the process of using one's control power to maximize own welfare and redistribute wealth from minority shareholders to oneself. According to Santiago and Brown (2007), the expropriation of minority shareholders' rights has been defined as the misalignment of interests between shareholder groups or substantial ownership of cash flow rights, leading to management insulation from external corporate control mechanisms without the necessary qualifications. Johnson et al. (2000), explored instances of expropriation of wealth by controlling shareholders from minority shareholders, among which are the transfers of assets to other companies under the majority shareholders control and the extraction of cash through dubious transactions.

The expropriation of minority shareholders in the mid-1990s resulted in concentrated financial crisis in Asia and the limited ability of family owned firms in the Middle East and Latin America to attract investments have all underscored the importance of having minority shareholders as an oversight mechanism over legal infractions and an assurance tool for investors (Shkolnikov, 2006). According to Santiago and Brown (2007), two factors contribute to why minority shareholders are discouraged from investing among Latin American firms. First, controlling families are reluctant to trade companies' shares since this may result in the dilution of power. Second, the weak legal environment gives rise to the potential for expropriation of minority shareholders' rights. Usually, the issues of expropriation minority shareholders' rights by majority shareholders often occur particularly in related party transaction. Therefore, related party transactions are often viewed as being detrimental to outside shareholders. Officers, directors and large shareholders are well positioned to use their influence to enter into transactions that expropriate wealth from outside shareholders (Ryngaert, 2007). These are evidenced by Cheung, Rau and Stouraitis (2006), which examined related party transactions between Hong Kong listed companies and their controlling shareholders. The researchers show that related party transactions are associated with large losses in value for minority shareholders.

The expropriation of minority shareholders' rights will be analyzed using agency theory, whereby agency relationship arises when there is a contract where one party (the principal) engages another party (the agent) to perform some service on the principal's behalf (Jensen and Meckling, 1976). The agency conflict arises due to corporate insiders have an incentive to pursue self-interests at the expense of corporate outsiders. In widely held firms, these conflicts exist between the managers and shareholders (Jensen and Meckling, 1976). In firms that are controlled by majority shareholders with large stakes, the interests of the firms' controlling shareholders often clash with the firms' minority shareholders. Given the dominance of concentrated cash flow and control rights in East Asia, the primary agency conflict for large corporations is that of restricting expropriation of minority shareholders by the controlling shareholders, rather than that of restricting empire building by unaccountable managers. According to Claessens, Djackov, Fan and Lang (1999), the scope for this conflict and the resulting expropriation depends on the wedge between cash flow and control rights.

3. Research Methodology

3.1 Hypotheses Development

3.1.1 Ownership Concentration

According to Santiago and Brown (2007), the ownership structure, board size and CEO ownership are positively related with the expropriation of minority shareholders' rights. However, Claessens et al. (1999) found that there is no significant evidence of expropriation for state control and control by widely held corporations.

H1: Ownership concentration positively affected the expropriation of minority shareholders' rights.

3.1.2 Firm Size

Berkman et al. (2009) found that firms are less likely to engage in expropriation when they are smaller, which is consistent with hypothesis that larger firm is more likely to be the targets of expropriation. From a theoretical point of view, firm size is expected to be positively associated with an expropriation level (Ahmed and Courtis, 1999).

H2: There is a positive relationship between firm size and expropriation of minority shareholders' rights.

3.1.3 Level of Board Independence

Cravens and Wallace (2001) found that the percentage of independent directors on the board and the size of the board have both been positively associated with levels of expropriation of minority shareholder (Janggi and Leung, 2004). However, a negative relationship found by Santiago and Brown (2007), between the measures of board independence and the expropriation of minority shareholders' rights. The different characteristics of boards indirectly affect the potential for expropriation of minority shareholders' rights.

H3: The level of board independence has negative influence on expropriation of minority shareholders' rights.

3.1.4 Profitability

Berkman et al. (2009) expect a negative relation between profitability and expropriation. On the other hand, since more value can be expropriated in profitable firms, one might expect a positive relation between profitability and expropriation. Berkman et al. (2009) found that firms are less likely to engage in expropriation when they are more profitable and when they have better growth opportunities.

H4: Profitability level is expected to have negative relationship in expropriation of minority shareholders' rights.

3.1.5 Level of Leverage

The higher cost of external finance and default risk of highly leveraged firms implies that these firms are less likely to commit to high dividend payments. The inability to pay dividends by highly leveraged firms reduced the level of expropriation of minority shareholders' rights (Jensen, 1986). **H5: There is a negative relationship between level of leverage and expropriation of minority shareholders' rights.**

3.1.6 Firm Growth

A study by Berkman et al. (2009) indicates that expropriation is more likely at firm with poor growth opportunities. The result from Akhtaruddin and Hossain (2008) also indicates that growth reduced expropriation activities. Due to this result, Akhtaruddin and Hossain (2008) summarized that a negative relation between growth opportunity and expropriation. Firm that has high growth opportunity is more likely to avoid the expropriation activities, especially towards minority shareholders' rights compared to firms that have low growth opportunity.

H6: Growth opportunity has negative relationship with expropriation of minority shareholders' rights.

3.2 Variable Measurement

3.2.1 Dependent Variable

Measuring expropriation of minority shareholders' rights as a dependent variable can be complicated given its several definitions. Thus, this study used related party transactions to represent expropriation of minority shareholders indirectly. Specifically, it follows Cheung et al. (2006) in identifying related party transactions that could amount to expropriation of minority shareholders. However, for this study, only Panel A is used as a proxy of transaction to measure expropriation indirectly than three panels that introduced by Cheung et al. (2006). This involves acquisitions of assets by the listed company from connected parties, asset sales by the listed firm to connected parties, sales of equity stakes in the listed company to connected parties, trading relationships between the listed firm and connected parties and direct cash payments or loan guarantees from the listed firm to a connected party. Information on these transactions is available in the section of notes to the accounts in firms' annual reports. This study collected the monetary value of each transaction and calculated the total value of these transactions. Then, this total value divided with total sales for each firm.

3.2.2 Independent Variables

There are six independent variables in this study, i.e., ownership concentration, firm size, board independence, profitability, level of leverage and growth.

i. Ownership Concentration - this study only concentrated on director ownership. Thus, director ownership was determined based on the percentage of share hold in the companies as at the end of 2009 financial year.
ii. Firm Size - the firm size was measured by the total assets of the company.
iii. Board Independence - the proportion of independent board members is calculated from the number of independent directors divided by the number of commissioners' on the board.
iv. Profitability - profitability is measured through the ratio of operating profit (EBITDA) to total assets.
v. Level of Leverage - the leverage level is measured by the ratio of total liabilities over total assets as at the end of the 2009 financial year.

vi. Firm Growth - the growth is measured by market to book value (MTBV) of common shares. MTBV is defined as the ratio of market price per share to value of equity per share at financial year ended 2009.

3.3 Data Collection

Sixty companies from two industries in the Bursa Malaysia: Industrial Product and Consumer Product are selected randomly as the sample. Thirty companies from each industry are drawn as samples. Annual reports of 2009 are chosen to extract the relevant information. Data is also gathered through the DataStream database where the information regarding the company's financial data such as total sales, total assets, total liabilities and other information are obtained. Apart from annual reports and DataStream, other sources used were Bursa Malaysia websites, Minority Shareholder Watchdog Group (MSWG) website, revised Malaysian Code of Corporate Governance (MCCG), Financial Reporting Standards (FRSs) and the database of the Commission of Companies Malaysia (CCM). To enhance data accuracy, data collected from one source was verified by reference to other sources whenever it is possible.

3.4 Data Analysis

3.4.1 Descriptive Analysis

The first part is the analysis on describing the demographic and financial characteristics of the sample firms. Descriptive analysis is carried out using statistical package for the social science (SPSS).

3.4.2 Regression Analysis

To determine the connection between ownership concentration, firm size, board independence, profitability, level of leverage and firm growth, with expropriation of minority shareholders' rights, the linear regression with robust standard errors was carried out to better characterize the associations among these variables. The linear regression with robust standard errors, using simple ordinary least squares (OLS) model, it is often designed to generate estimators and other statistics in regression analysis. Statistics of Analysis Data (Stata) is used to run the OLS regression model.

Thus, the OLS regression that is used in this study for testing the hypothesis is estimated as follows:

$$\text{RPT } i = \alpha + \beta_1 \text{ (Ownership) } i + \beta_2 \text{ (Size) } i + \beta_3 \text{ (Independence) } i + \beta_4 \text{ (Profitability) } i + \beta_5 \text{ (Leverage) } i + \beta_6 \text{ (Growth) } i$$

Where;

RPT = Proxy of expropriation of minority shareholders' right in company *i*
Ownership = Percentage of directors ownership in company *i*
Size = Size of company *i*
Independence = Percentage of board independence in company *i*
Profitability = Profit of company *i*
Leverage = Level of leverage of company *i*
Growth = Growth of company *i*

4. *Results and Findings*

4.1 Descriptive Analysis

Table 1 and Table 2 present the descriptive analysis of the variables. Table 1 summarizes the descriptive statistics for the whole sample regarding to the variables namely: RPT, OWNERSHIP, SIZE, INDEPENDENCE, PROFITABILITY, LEVERAGE and GROWTH.

Table 1: Descriptive Statistics

	Mean	Std. Deviation	Min	Max
RPT	0.1704	0.3389	0.0035	1.8210
OWNERSHIP	0.1768	0.2080	0.0000	0.8704
SIZE	19.1080	1.1927	17.2000	22.9000
INDEPENDENCE	0.4482	0.1352	0.2200	0.8300
PROFITABILITY	0.0610	0.2006	-1.2125	0.4021
LEVERAGE	0.4329	0.2244	0.0962	1.0601
GROWTH	0.3765	2.4125	-16.8100	4.1600

For a better comprehension, the Table 2 shows the distribution of the sample industries i.e. Industrial Product and Consumer Product for all variables. Result reported in the tables includes the mean, standard deviation, minimum and maximum value of the variables.

Table 2: Descriptive Statistics – Industries Group

	Industrial Product				Consumer Product			
	Mean	Std. Deviation	Min	Max	Mean	Std. Deviation	Min	Max
RPT	0.1106	0.2414	0.0035	1.2129	0.2302	0.4098	0.0039	1.8210
OWNER-SHIP	0.1765	0.2301	0.0000	0.8704	0.1771	0.1873	0.0000	0.5231
SIZE	19.1100	1.0814	17.2000	21.6000	19.1060	1.3133	17.2000	22.9000
INDEPEND-ENCE	0.4610	0.1593	0.2200	0.8300	0.4353	0.1071	0.2500	0.7500
PROFIT	0.0775	0.1197	-0.3153	0.4021	0.0446	0.2588	-1.2125	0.3280
LEVERAGE	0.4740	0.2323	0.0962	1.0601	0.3917	0.2122	0.1023	1.0176
GROWTH	0.5187	0.9119	-2.9400	2.3300	0.2343	3.3117	-16.810	4.1600

The mean of RPT that acts as a proxy of expropriation of minority shareholders' rights is 17.04 percent indicated in Table 1. Referring to Table 2, there is a small difference about 11.96 percent in means of RPT between both of industries. The Industrial Product Industry shows about 11.06 percent of the mean of RPT while the Consumer Product Industry shows a value of 23.02 percent.

4.2 OLS Regression Model

The regression results for the expropriation of minority shareholders' rights and their factors are presented in Table 3, Table 4 and Table 5, using one-tailed test.

Table 3: Linear Regression Result

RPT	Coef.	Robust Std. Error	t	P= value (one-tailed test)
OWNERSHIP	-0.0758207	0.1458425	-0.52	0.3025
SIZE	0.0098957	0.0388423	0.25	0.4000
INDEPENDENCE	0.6360407	0.4888332	1.30	0.0995 *
PROFITABILITY	-0.3986084	0.3696569	-1.08	0.1430
LEVERAGE	-0.1551883	0.1494248	-1.04	0.1520
GROWTH	-0.0341292	0.0289298	-1.18	0.1215

R-squared = 0.1911
*** significant at 1 percent
** significant at 5 percent
* significant at 10 percent

Table 3 shows that the only significant coefficient is the INDEPENDENCE variable. The coefficient of the INDEPENDENCE is 0.636 with $p < 0.10$, showing that it is marginally significant since 'p' is close to 0.10.

For further analysis, some adjustments have been made in the data used in this study. Since there are high percentage of correlation between PROFITABILITY and GROWTH, thus the next tests delete one of these two variables. By deleting these variables, the model is re-estimated and the new results are shown in Table 4 and Table 5.

Table 4: Linear Regression Result – Delete GROWTH

RPT	Coef.	Robust Std. Error	t	P= value (one-tailed test)
OWNERSHIP	-0.0704470	0.1444654	-0.49	0.3140
SIZE	0.0106846	0.0374845	0.29	0.3885
INDEPENDENCE	0.6592813	0.4890636	1.35	0.0915 *
PROFITABILITY	-0.7583662	0.2485572	-3.05	0.0020 ***
LEVERAGE	-0.1529432	0.1510551	-1.01	0.1580

R-squared = 0.1767

By deleting the GROWTH variable, the result as shown in Table 4, found that there are two significant relationships, which are between RPT with board INDEPENDENCE, the coefficient of which is 0.6592 with $p < 0.10$; and PROFITABILITY, with a coefficient of -0.7584 and $p < 0.01$. However, for INDEPENDENCE, it is marginally significant since 'p' is close to 0.10.

Table 5: Linear Regression Result – Delete PROFITABILTY

RPT	Coef.	Robust Std. Error	t	P= value (one-tailed test)
OWNERSHIP	-0.0841629	0.1464750	-0.57	0.2840
SIZE	0.0015491	0.0402093	0.04	0.4845
INDEPENDENCE	0.5579177	0.4862876	1.15	0.1280
LEVERAGE	-0.0939236	0.1280231	-0.73	0.2330
GROWTH	-0.0590844	0.0150627	-3.92	0.000 ***

R-squared = 0.1794

In Table 5, when the variable PROFITABILITY is removed from data, the result shows that the GROWTH variable is statistically significant. The coefficient of the GROWTH is -0.0591 and significant with $p < 0.01$.

5. Discussion and Conclusion

The issue of related party transaction in Malaysia provides an interesting scenario to expand research on expropriation of minority shareholders' rights. Moreover, the issue about expropriation of minority shareholders right is still debated in mass media. Therefore, the purpose of this study is to empirically identify the extent level of expropriation and to examine the factors that affect expropriation of minority shareholders' rights in Malaysia. It can be concluded that the extent level of the expropriation of minority shareholders' rights in Malaysia is 17.04 percent of total sales, where there is a small difference about 11.96 percent between both of industries. Overall, the study found some evidence that related party transactions could influence expropriation of minority shareholders' rights. The finding suggests that earnings quality of a company would be worse if the companies engage in real expropriation activities, for example through certain types of related party transactions, such as asset acquisitions, asset sales, equity sales, transactions that result from trading relationship and any transactions that involve cash payment made to the controlling owners. Thus, the Securities Commissions, active institutional investors and MSWG may have role to monitor such transactions from occurring in order to protect the interest of minority shareholders.

The relationships could be highlight potential problem of expropriation when there is a high degree of ownership concentration, board independence and firm size, and also low level of profitability, leverage and growth. From six variables that tested only three variables can be concluded as factors that affect expropriation of minority shareholders' rights in Malaysia. They are board independence, profitability and growth. It appears that as the number of directors' independence that serving on the board increase through the inclusion of additional independent outside directors, value of RPT is also increased. It is possible that this independent board of directors have approved through the RPT and assumed that these transactions would not neglect the interest of minority shareholders' rights. In fact, it is possible during bad earnings, which it is the best interest of all shareholders to have higher level of RPT in order to cut costs and mobilize internal resources. The increases of profitability and growth opportunity also gave benefit to companies to reduce the potential for expropriation of minority shareholders' rights.

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