Independent Directors’ Tenure, Expropriation, Related Party Transactions, and Firm Value: The Role of Ownership Concentration in Malaysian Publicly Listed Corporations

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Chapter 9

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ABSTRACT

This chapter analyses the relationship between related party transactions (RPT) and firm value and whether independent directors’ tenure (IDT) strengthens or weakens this relationship. Further, it examines ownership concentration’s role on this moderating effect of IDT in Malaysian family and non-family corporations. It is found that that IDT weakens the relationship between RPT and firm value. However, ownership concentration strengthens this moderating effect of IDT. Interestingly, family corporations are more likely to show a stronger impact of ownership concentration which we allude to concerns of maintaining reputation. The research results remain after controlling for technology corporations. The findings have important implications for policy makers, practitioners and regulators, especially in emerging economies globally. Keywords: Agency Conflict, Corporate Financial Valuation, Independent Directors’ Term in the Office, Corporate Governance, Family Corporations, Emerging Markets

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INTRODUCTION

We build on prior corporate governance (CG) research to assess the role of ownership concentration on the moderating effect of independent directors’ tenure (IDT) on the relationship between related party transactions (RPT) and firm value in an emerging market. The Malaysian institutional context provides an interesting case. Its equity market exhibits predominantly high ownership concentration (Claessens et al., 2000). Generally, corporate Malaysia exhibits unique characteristics of ownership, namely, family, government-linked or state-owned, institutional and retail (widely held)(Ishak and Napier, 2006).

Extant CG literature generally focuses on the typical manager-shareholder agency problem known as Agency Problem Type I. This strand of research assumes that greater insider ownership enhances corporate governance (Morck and Yeung, 2003) because managers with high ownership in their corporations may be less inclined to take actions that reduce their equity value (Jensen and Meckling, 1976). Whilst this proposition is certainly relevant in most developed economies with diffused ownership (Morck and Yeung, 2003), its application in emerging markets with highly ownership concentration and mostly family-controlled (Morck and Yeung, 2003) has been questioned (Al-Bassam et al., 2018). Such ownership structure in emerging markets with lack of effective external CG mechanisms culminate in conflict between controlling shareholders and minority shareholders or Agency Problem Type II (Morck et al., 2005; Villalonga and Amit, 2006). These conflicts are evidenced by the occurrence of expropriation inflicted by the controlling shareholders (La Porta et al., 2000; Faccio et al., 2001; Mitton, 2002; Lemon and Lins, 2003; Krishnamurti et al., 2005). However, these studies do not explain empirically how expropriation occurs. We examine expropriation evidenced by RPT.

Increasingly, the issue of corporate directors’ independence has received attention in the Malaysian CG reforms (SC, 2017). IDT may influence directors’ independence and oversight role. Therefore, IDT is expected to influence corporate decision-making such as the decision to undertake RPT and hence, its relationship with firm value (Nor and Ismail, 2015). Whilst previous studies analysed the role of other internal CG mechanisms as moderating variables on the relationship between RPT and firm value, evidence on the role of independent directors’ tenure is limited (Ahrens, Filatochev and Thomsen, 2011). The question remains as to whether the tenure of independent directors impacts expropriation (Jiang et al. 2010).

This chapter contributes to the family business and CG literature in two ways: Firstly, it extends a relatively unexplored issue of expropriation via RPT and evidences whether the independent director’s tenure plays a role in the relationship between RPT and firm value. Secondly, it highlights the relevance of the understanding of the institutional context to examine the role of ownership concentration.

The balance of this chapter is structured as such. Part two sets out the Malaysian institutional context. Part three discusses the extant literature, identifies the research gaps and develops the related hypotheses. Part four elaborates on the data, research method, the descriptive statistics, and issues with respect to endogeneity. Part five provides the results. The implications of the research findings are discussed in part six and finally part seven concludes.

Institutional Context of Malaysia: Legal Framework and Corporate Governance Development

The Malaysian Code of Corporate Governance (MCCG) established in 2000 was a response to the 1997 Asian financial crisis. Since then this code has undergone revisions in 2007, 2012 and 2016 (SC, 2007; SC,