EFFECT OF CORPORATE GOVERNANCE FACTORS AND MSWG ACTIVISM ON CUMULATIVE ABNORMAL RETURNS INDUCED BY RELATED PARTY TRANSACTION

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ABSTRACT

This is an event study that examines the effects of related party transaction (RPT) and corporate governance factors in a firm's daily cumulative abnormal return of the stock price (CAR), using a sample of 422 RPTs engaged by 286 listed firms in the Main Market of Bursa Malaysia from 2008 to 2013. Univariate analysis (t-test) is used to determine the RPT's announcement effect on CAR in the short horizon window, and ordinary least squares (OLS) and logistic regression are employed to investigate the relationships between the firm's CAR and exogenous variables of RPT types and size, Minority Shareholder Watchdog Group (MSWG) activism, and corporate governance factors. The univariate result shows significant negative effects on CAR in the post-announcement of RPT, indicating governance discount of stock prices by the market in realizing the occurrence of expropriation, in particular asset acquisition and cash-payment types of RPT. The regression results show that cash ownership of the dominant owner and the divergence of control to cash right for the dominant owner and the directors have a significant negative relationship with CAR. This contributes to extant researches in emerging markets with findings that the problems of expropriation are mainly attributed to circumstances of high dominant family ownerships, which is further exacerbated by the entrenchment of the controlling shareholders and directors. This study also adds to the literature by showing evidence that MSWG activism, which results in higher firm's disclosure quality, has a significant positive effect on CAR in mitigating the expropriating behaviour of the controlling shareholders. Furthermore, the significant positive relationship between board independence and CAR also reinforces previous research findings that increasing the independence of the board enhances its effectiveness as an advocate for minority shareholders' interest. Finally, clear evidence was found that participation of the state's block holders or public investment fund contributes positively to the deterrence of expropriation by the dominant owner.

Keywords: Related party transaction, MSWG, CAR

ABSTRAK

Kajian ini dijalankan untuk menyelidik kesan urusniaga pihak berkaitan (RPT) dan faktor urus tadbir korporat ke atas pulangan abnormal kumulatif harian harga saham (CAR) dengan menggunakan sampel sebanyak 422 RPT yang melibatkan 286 buah syarikat yang tersenarai di Pasaran Utama Bursa Malaysia dari tahun 2008 hingga tahun 2013. Analisis univariat telah digunakan untuk menentukan sama ada pengumuman RPT memberi kesan terhadap CAR dalam tempoh masa yang singkat. Kuasa dua terkecil biasa (OLS) dan regresi logistik digunakan dalam kajian ini untuk meneliti hubungan antara CAR syarikat dengan pemboleh ubah eksogen, iaitu jenis dan saiz RPT, aktivisme Badan Pengawas Pemegang Saham Minoriti (MSWG), dan faktor urus tadbir korporat. Dapatan univariat menunjukkan RPT menyebabkan terdapat kesan negatif yang signifikan terhadap CAR semasa pascapengumuman RPT. Hal ini memperlihatkan bahawa terdapat diskaun urus tadbir ke atas harga saham dan kewujudan ekspropriasi. Hasil regresi pula memaparkan bahawa pemilikan tunai oleh pemegang saham yang dominan dan pemisahan kawalan dari tunai oleh pemegang saham yang dominan dan para pengarah mempunyai hubungan negatif yang signifikan terhadap CAR. Hasil kajian ini menyokong penyelidikan sedia ada yang membuktikan bahawa masalah ekspropriasi yang disebabkan oleh pemilikan keluarga yang dominan serta tinggi. Keadaan ini diburukkan lagi dengan penguasaan daripada pemegang saham majoriti dan para pengarah. Kajian ini turut menambah kosa ilmu sedia ada dengan memperlihatkan bahawa aktivisme MSWG yang menghasilkan kualiti pendedahan firma yang lebih tinggi memberikan kesan positif yang signifikan terhadap CAR. Ini menunjukkan bahawa MSWG dapat mengurangkan masalah ekspropriasi dalam kalangan pemegang saham majoriti. Di samping itu, hubungan positif yang signifikan antara CAR dengan kebebasan lembaga pengarah juga mengukuhkan hasil penyelidikan sebelum ini berhubung kepentingan kebebasan lembaga dalam meningkatkan keberkesanannya untuk melindungi kepentingan pemegang saham minoriti. Akhir sekali, terdapat bukti yang jelas bahawa penyertaan pemegang saham blok atau dana pelaburan awam dapat mengurangkan masalah ekspropriasi oleh pemilik yang dominan secara positif.

Kata kunci: Urusniaga pihak berkaitan, MSWG, CAR

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ACId	:	Audit Committee Independence Dummy
AGM	:	Annual General Meeting
ASRPTd	:	Asset Sales Related Party Transaction Dummy
BIND	:	Board independence
BMSB	:	Bursa Malaysia Securities Berhad
BS	:	Board Size
CAR	:	Cumulative Abnormal Return of Stock Prices
CCM	:	Company Commission Malaysia
CEO	:	Chief Executive Officer
CEODd	:	CEO Duality Dummy
CFO	:	Chief Financial Officer
CG	:	Corporate Governance
CMDF	:	Capital Market Development Fund
COBH	:	Cash Ownership of Block Holders
CODIR	:	Cash Ownership of Directors
CODO	:	Cash Ownership of Dominant Owner
COGLIC	:	Cash Ownership of Government Linked Investor or State Government
CPRPTd	:	Cash Payment Related Party Transaction Dummy
CRRPTd	:	Cash Receipts Related Party Transaction Dummy
DCRDIR=1d	:	Divergence of Control to Cash Right for Director = 1 Dummy
DCRDIR>1d	:	Divergence of Control to Cash Right for Director > 1 Dummy
DCRDO	:	Divergence of Control to Cash Right for Dominant Owner
DOviaUCd	:	Share Held by Dominant Owner via Unlisted Company Dummy
EGM	:	Extraordinary General Meeting
EPF	:	Employee Provident Fund
ESRPTd	:	Equity Sales Related Party Transaction Dummy
FBMEMAS	:	FTSE - Bursa Malaysia Emas Index
FBMKLCI	:	FTSE - Bursa Malaysia Kuala Lumpur Composite Index
FDC	:	Family Director Concentration
FSIZE	:	Firm Size
GLCs	:	Government-Linked Corporations
GLICs	:	Government-Linked Institutional Companies
IPO	:	Initial Public Offering
ISS	:	Institutional Shareholder Services
KWAP	:	Kumpulan Wang Amanah Pencen (Civil Pension Fund)
LEV	:	Leverage
LGRPTd	:	Loan Guarantee Related Party Transaction Dummy
LVDRPTd	:	Likelihood of Value-Destroying Related Party Transaction Dummy
MCCG	:	Malaysian Code of Corporate Governance

MCG	:	Malaysia Corporate Governance
MD	:	Managing Director
MSWG	:	Minority Shareholder Watchdog Group
MSWGd	:	Minority Shareholder Watchdog Group Dummy
NCLS	:	Non-Controlling Large Shareholders
NPV	:	Net Present Value
OLS	:	Ordinary Least Square
PNSBHd	:	Presence of Non-State Block Holder Dummy
ROA	:	Return on Assets
ROE	:	Return on Equity
RPT	:	Related Party Transaction
SOE	:	State-Owned Enterprises
SRPT	:	Size of Related Party Transaction
SRRPTd	:	Subsidiary Relationship Related Party Transaction Dummy
SUBPRIMEd	:	US Subprime Crisis Years (2008 & 2009) Dummy
SWF	:	Sovereign Wealth Funds
TO&JVRPTd	:	Takeover Offers & Joint Ventures Related Party Transaction Dummy
TRRPTd	:	Trading Relationship Related Party Transaction Dummy
VIF	:	Variance Inflation Factor

CHAPTER 1: INTRODUCTION

1.1 Introduction

What is minority interest protection quality, its significance and implication on a country's security market development?

A developed securities market in a country is related to the establishment of a credible governance and enforcement rules designed to protect the interest of the minority investors, (Croci & Petmezas, 2010). From a macroeconomic perspective, poor corporate governance and legal enforcement will result in liquidity and turnover problems, which deprive firms from financing valuable growth opportunities (Modigliani & Perotti, 1997). Besides obtaining less financing, the firm will invest less in intangible assets, whereby Claessens and Laeven (2003) found such pattern will eventually have an adverse influence on the economic expansion of a country. Furthermore, Lemmon and Lins (2008) showed that a crisis or a negative shock in the weak market raises incentive of insiders or controlling shareholders to expropriate minority shareholders to compensate for their loss.

According to the classic *'The Modern Corporation & Private Property'* by Berle and Means (1932/1967), which is the foundational theory of corporate governance and institutional economics, dispersal shareholding ownership will result in management and directors managing the firm's assets and business to the owner's benefits with minimum oversight from investors:

> "The property owner who invests in a modern corporation so far surrenders his wealth to those in control of the corporation that he has exchanged the position of independent owner of one in which he may become merely recipient of the wages of capital.. [Such owners] has surrendered the right that the corporation should be operated in their sole interest..." (p.355, 1932 edition)
>
> "the owners most emphatically will not be served by a profit seeking controlling group" (p.114, 1967 edition)

The implication was they advocate embedded privileges of investors to vote, and a better

disclosure policy and accountability of the firm's managers. However, in today's corporation, management's ownership is much higher, especially in emerging economies. Unlike the classical concept of Berle and Means in describing a "modern corporation", the owner-manager is also actively involved in governing the firm. Therefore, La Porta *et al.* (1999) stressed the shift in focus of attention on finance theory to the ownership and control structure of firms[1]. In line with La Porta *et al.* (1999), Chen *et al.* (2009) observed a significant negative association between corporate governance at firm level and the investment' cost of stock in the developing countries. This explained why block holders and large investment funds are prepared to pay more for shares in firms with good corporate governance. They argued that a firm with good control and governance will result in less incentive for owner-managers to expropriate the firm's wealth at the expense of minority shareholders, hence reducing the non-diversifiable risk. For an insider who is also the major shareholder, the incentive to optimize on investment opportunity is weighed against the cost of expropriation. Consequently, a relevant focus should be on the incentives and opportunity of controlling shareholder, in relation to the benefit and the expropriation of minority shareholders.

Loderer and Waelchli (2010) hypothesized if public companies truly care more for non-controlling shareholders compared to private companies. Such comparative study has reinforced the main essence of minority shareholders' interests' protection inherent in the company's declaration to become a public listed entity. The rationale is listed firms have incentives to attract investors by solving the governance problem of protecting the minority investors via adequate disclosure and accountability in managing the firm. In this respect, the function of minority

[1] Here, the pertinent questions are related to ownership dispersion, ultimate significant owner's identity and voting power, and cross-border difference in pattern among firms.

shareholder rights protection is governed by both firm-level and country-level[2] variables in capital market (Doidge, Karolyi & Stulz, 2004) . However, differences in the maturity, size, socio-political setting and efficiency of the stock markets in the world have resulted in variation of protection they provide in financial contracting (Chandrasekhar *et al.* 2005; Djankov *et al.,* 2008; Hacimahmutoglu, 2007). The broad influence of minority interest protection issues has also led to scattered studies and findings in many different contexts of corporate finance, albeit a frequent linkage to the subject of the valuation effect on firm and financial performance.

Contrary to the general opinions that small non-controlling and non strategic shareholders have no power or incentives to be engaged in monitoring, Kandel, Massa and Simonov (2011) found in a sample of Swedish firms with dispersed ownership, age-similar, non-controlling small shareholders selling more aggressively on negative news. Profitability and the stock price of the firms were positive and significantly associated with the size of such small shareholder base. Reese Jr and Weisbach (2002), Hacimahmutoglu (2007), Croci and Petmezas (2010) and Kandal *et al.* (2011) studies have shown that a capital market with good minority interest protection quality will have an ultimate positive effect reflected in the firm's valuation. Several studies (Martin de Holan & Sanz, 2006; Volpin, 2002; Modigliani & Perotti, 1997) are pointing to the importance of having adequate minority interest protection of the capital market environment in order for firms to function in a rational way, so as to attract participations of new and quality shareholders. This is especially the case in the event new business opportunities arise and the firm needs additional resources and capabilities which it does not own or control. When investors' rights are poorly protected, firms have to forgo profitable new ventures as their ability to raise equity is seriously impaired. Expropriation by controlling shareholder will not only cause dilution of minority interest, but also the scarce participation of retail investors and thin trading

[2] A country-level index aggregates six different shareholder rights and the score is ranging from 0 to 6.

of the stock. Martin de Holan and Sanz (2006) developed a concept to describe the relationship between "protection of minority shareholders' interests" (firm-level corporate governance factors) and "firm's ability to seize business" (firm's valuation), which is mediated by both the quantity and quality of the firm's shareholders.

Croci and Petmezas (2010) also found various groupings of sample at country level, with different stages of securities market growth showed a considerable variation in cumulative abnormal return of stock prices. In previous literatures, La Porta *et al.* (1998) attributed the difference in degree of shareholder's protection as the reason impacting participation and market liquidity. Consequently, improvement in minority shareholder protection's quality becomes an important attribute in the degree of stock market development.

1.2 Problem Statement

Issues of RPT in Bursa Malaysia

This study aims to examine the occurrence of related party transaction in Bursa Malaysia where concentration of family ownership is prevalent. It attempts a direct examination of the firms' RPT engaged by the influential or controlling shareholders, with a likelihood of expropriating via self-dealing behaviour. An event-study will be carried out on incidences of RPT versus their corresponding corporate governance practices. The RPT's announcement effect on the firm's short horizon cumulative abnormal return of stock prices (CAR) will be used as the measure of market reaction to such potential expropriation.

Bursa Malaysia mandates a listed firm to disclose the detail of RPT promptly after agreement on the terms and conditions is sealed. According to Lei and Song (2011), disclosure requirements matter as firms tunnel using RPTs with disclosure exemptions. In particular, the

true value of certain related party transaction which is continuous in nature[3] is difficult to quantify. This nature of the transaction may be prone to manipulation since it tends to recur over a period of time. However, recurrent RPT will not be included in the scope of this research due to its continuing nature of the transaction, which is not suitable for short horizon event study.

In the context of this study, RPT can be classified based on their effect on the minority shareholders of the public companies as follows:

(1) Those that are known to cause expropriation of the minority investors in the firm.

(2) Those possibly beneficial to the public firms and hence the minority investors of the firm.

(3) Those possibly having strategic motivations and are not expropriations.

Table 1.1 provides a summary of these three categories of RPT to be considered in this research.

Despite stringent amendments of RPT rules via Companies Act 1965 since 2007, exploitation of weaknesses in the rules by controlling shareholders to expropriate minority investors remains a key issue in Bursa Malaysia. Evidences from recent years attesting to this concern are examples of abusive RPTs in Genting Malaysia[4], Tai Kwong Yokohama Berhad[5], Ho Hup Construction Company Bhd[6], Tradewinds (M) Bhd[7] and Ceramtec Sdn Bhd[8].

[3] In Bursa Malaysia, it is called recurrent related party transactions.

[4] Genting Malaysia (Resorts) had entered into S&P agreements with parent Genting Berhad to acquire a 25-storey *Wisma Genting office building* for RM259.6m (including RM46.9m debt owed to Genting Berhad), and Segambut land comprising 2 adjoining land parcels with total area of 380,906 sq ft for RM24.6 m (including RM8.6 m debt owed to Genting Berhad). Among the issues raised in the Genting Malaysia (Resorts World) related party transaction with its parent Genting Berhad were the appointment of a single 'independent' property valuer for both of the transactions and the status of the independent directors when they sat on both boards (Genting Malaysia and Genting Berhad). Although the independent adviser for this transaction concluded that this transaction is rather immaterial and would not affect the future cash flow of the firms, alternatively it could be seen as cash extraction by the parent company, Genting Berhad (Abdul Wahab *et al.*, 2011).

[5] The recurrent party transaction was between Tai Kwong Yokohama Berhad and HSG Investments Pte Ltd, a unit of Hup Soon Global Corporation Ltd. However, the nature and extend of transactions are usually not disclosed in the circular to shareholders. Tai Kwong Yokohama Berhad shares plunges 38 percent when they announced the recurrent party transaction on 5th March 2009 (Abdul Wahab *et al.*, 2011).

[6] In the middle of 2009, Ho Hup Construction Company Bhd ("Ho Hup") proposed to sell two pieces of land to Permata Juang (M) Bhd ("Permata") and Santari Sdn Bhd ("Santari") respectively. There was a disclosure that the proposed sale to Permata was a related party transaction for both Ho Hup and the holding company of Permata, Magna Prima Bhd ("Magna") had common directors, hence Ho Hup's shareholders rejected the proposed

Recognizing the significance of corporate governance (CG) in global capital market, the Malaysian government has been active in pursuit of transforming Bursa Malaysia[9] to become a competitive player in emerging economies. Post Asian financial crisis in 1998, Bursa Malaysia took a leading role in enhancing the standard of the Malaysian CG practices by implementing important reforms. This is attested by introducing a Malaysian Code of Corporate Governance (MCCG), and enhancing board independence and the roles and responsibilities of directors sitting on the firm's board. Disclosure rules were strengthened and government-linked corporations (GLCs[10]) were overhauled in 2004 and 2005 respectively (World Bank, 2005). For a capital market to be globally competitive and at par with international jurisdiction, it needs to be recognized as a premier and stable market, which is well-regulated from an investor protection perspective (Modigliani *et al.,* 1997; Hacimahmutoglu, 2007; Chandraesekhar *et al.,* 2005). Modigliani and Perotti (1997) and Croci and Petmezas (2010) examined the relationships

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transaction. However, the shareholders approved the sale of another tract of land to Santari, a dormant company whose shareholders were Hiew Yoke Ching ("Hiew") and Lee Siong Hai. This proposed transaction was not disclosed as a related party transaction, until subsequent events revealed that Hiew was actually the sister-in-law of Lee Kian Seng ("Lee"), who resigned as an independent director of Magna in June 2009. On 10 August 2009, a major shareholder of Ho Hup, Low Chee & Sons Sdn Bhd instituted legal action against Ho Hup. It claimed that Magna was the "shadow" and ultimate purchaser of the land that Santari acquired from Ho Hup (Chan, 2010).

[7] According to its 2008 Annual Report, Tradewind's trade receivables was RM323.2 million, and 60% (RM193.9 million) was due from its transactions with a related party, Bukhary Sdn Bhd, who was given a better credit terms of 90 days compared to normal 60 days, and decreased late payment interest of 6.5% compared to normal 18%. Para 10.09(2) of the Bursa Malaysia Listing Requirements demand that the recurrent related party transactions must be "in the ordinary course of business and are on terms not more favorable to the related party than those generally available to the public". Another related issue is the independence of the audit committee since one of its members has already declared his interest in Bukhary which is a substantial debtor of the group (Chan, 2010).

[8] Ceremtec Sdn Bhd is a family private company holding controlling stake in Goh Ban Huat Bhd (GBH). Ceramtec charged some of its shares in GBH to secure a loan granted to Wan Shalihudin, who was then the third largest shareholder of GBH. The loan guarantee to Wan Shalihudin was not caught by section 133, for Wan was then not a director of GBH (Section 133 pertains to a loan to its director). Since the provisions are not extended to loans granted to substantial shareholders, he may cause the company to give him a loan or provide a security for a loan granted by a third party prior to his appointment as a director. He was appointed subsequent to Ceramtec issuing the loan guarantee. The Ceramtec case is an example of how section 133 or 133A may be circumvented. In this case, the loan guarantees proved to be costly acts made by Ceramtec (Chan, 2010).

[9] Formerly it was called Kuala Lumpur Stock Exchange (KLSE).

[10] In World Bank (2005) report on Malaysia's CG Country Assessment, one of the key challenges highlighted is the high level of government's equity ownership held under GLCs. As of 2002, about 70% of the total institutional holdings in Bursa Malaysia belongs to government-backed public funds (Abdul Wahab *et al.,* 2008).

Table 1.1

Categorization of Related Party Transactions

No	Types of Transaction	Descriptions of Transaction Activities
Category 1: Transactions that are known to cause expropriation of the minority investors in the firm		
1	Asset acquisitions	Transactions that involve the acquisition of tangible or intangible assets by the listed company from a connected person or from a private company majority-controlled by this person.
2	Asset sales	Transactions that involve the sale of tangible or intangible assets of the listed company to a connected person or to a private company majority-controlled by this person.
3	Equity sales	Transactions that involve the sale of an equity stake in the listed company to a connected person or a private company majority-controlled by this person.
4	Trading relationships	Transactions that involve the trade of goods and services between the listed company and a private company (a non-subsidiary) majority-controlled by a connected person. They can be a purchase or sales or both by the listed company.
5	Cash payments	Transactions that involve direct cash payments by the listed company to a connected person or to a company controlled by this person or to a subsidiary (including loans and cash assistance) and the provision of cash guarantees by the listed company for debts owed by the connected person or by the companies controlled by this person.
6	Loan guarantees	Provision of guarantee and indemnity by the listed company to a connected person or to a company controlled by this person or to a subsidiary, for debts owed by the connected person or by the companies controlled by this person
Category 2: Those possibly beneficial to the minority investors of the firm		
7	Cash receipts	Transactions that involve direct cash assistance or loans provided by the connected person to the listed company
8	Subsidiary relationship	Transactions between a listed company and one of its subsidiaries. They could involve acquisitions or sales of equity stakes or assets and trading relationships
Category 3: Those possibly having strategic motivations and is not an expropriation.		
9	Takeover offers and joint ventures	Cases in which the listed company receives a takeover offer by another publicly listed company that holds a toehold, and cases in which the listed company forms a joint venture or strategic alliance with another company that already holds a stake in the listed company.

Source: Cheung *et al.* (2006)

between investors' protection, firm's minority shareholders' return and security market development, and found evidence supporting a positive relationship between them. Table 1.2 shows the position of Malaysia in CG quality ranking in Asia-Pacific markets.

Table 1.2
Market Ranking in Corporate Governance Quality (2007)

Rank	Market	Rules & Practices (%)	Enforcement (%)	Political & Regulatory (%)	Accounting & Audit (%)	CG Culture (%)	Total Score (%)	
							2007	2005[11]
1	HK	60	56	73	83	61	67	69
2	Singapore	70	50	65	88	53	65	70
3	India	59	38	58	75	50	56	61
4	Taiwan	49	47	60	70	46	54	52
5	Japan	43	46	52	72	49	52	-
6	Korea	45	39	48	68	43	49	50
6	Malaysia	44	35	56	78	33	49	56
8	Thailand	58	36	31	70	39	47	50
9	China	43	33	52	73	25	45	44
10	Philippines	39	19	38	75	36	41	46
11	Indonesia	39	22	35	65	25	37	37

Source: Credit Lyonnais Securities Asia (CLSA, 2007)

Value-Destroying RPT

From an investment perspective in Asia, RPTs are generally a fact of life. Specifically, in Malaysia, the prevalence of RPTs is not a surprise because the economy is characterized by a relationship-based system driven by cultural and political forces. Furthermore, since post 1997 Asian financial crisis, it became a norm that RPTs in the Asian region are generally viewed as abusive in nature. This is attributed to reasons of controlling shareholders' ownership of private interests outside of the listed company, the relationship-based corporate governance and business systems, and weak legal protection system in emerging markets. Such negative perceptions of

[11] Recent survey result showed a significant drop in total score to 49%, compared to last survey of 56% in 2005, abeit ranking remained unchanged at 6th position.

RPTs as value-destroying in Asia are supported by the fraud incidences mentioned earlier in Genting Malaysia, Tai Kwong Yokohama Berhad, Ho Hup Construction Company Bhd, Tradewinds (M) Bhd and Ceramtec Sdn Bhd.

As stated in Table 1.1, RPT categorized as "known to cause expropriation" are those engaged by influential or controlling shareholders with a likelihood of expropriation via self-dealing behaviour (Cheung *et al.*, 2006). Unfortunately, research on expropriation has mainly focused on tunneling activities in the developed countries (Bae et al., 2001; Cheung et al., 2006; Facio & Stollin, 2006) indicating CAR or firm values decreased at the announcement of the RPTs. However, none has taken emerging market such as Malaysia into close consideration. Nonetheless, in their Indonesian study, Khanna and Palepu (2000) found even though RPT benefits affiliated group member, the value of the firm is destroyed by tunneling activities at the end, due to poor law enforcement and the culture of corruption in the country.

Extant Researches in Expropriation via RPT

Most academic literatures attempted to measure expropriations indirectly (La Porta et al., 2000 & 2002; Claessens et al., 2002) using proxy indicators such as deviation of cash and control rights. On direct measurement approaches, research results showed mixed evidences of minority shareholding value loss due to specific actions of expropriation. Buysschaert et al. (2004) investigated stock price reaction to announcement of equity sales in Belgian business groups, but found no diversion of resource by controlling shareholders, albeit the sample size was small. In the Korean business groups (Chaebols) tunneling study, Bae et al. (2002) found values of other firms in the group rose, while the affiliated firm declined when instructed by principal to rescue firms in the group with poor performance via merger exercise. However, the controlling shareholder benefited from the overall deal of expropriation. Another study using direct

measurement of expropriation via related party transaction in Hong Kong listed firms was done by Cheung, Rau and Stouraitis (2006). They showed at post announcement, the cumulative abnormal stock return (CAR) was negative in the presence of tunneling, where controlling shareholders seek private benefits at the expense of minority shareholders. On tunneling through inter-corporate loan in China, Jiang, Lee and Yue (2010) showed the firm outstanding inter-corporate loan receivables have a significant negative relationship with return on asset (ROA). Another similar study in China by Berkman, Cole and Fu (2009b) discovered that the likelihood of issuing the loan guarantee is negatively related to the firms' Tobin Q and ROA.

The Corporate Governance Factors

Corporate governance takes different definitions from dissimilar perspectives of scholars. For instance, the Cadbury Committee puts it as, "Corporate governance is the system by which companies are directed and controlled." (Cadbury, 1992), while Gillan and Starks (2000) argue that, "corporate governance is the system of laws, rules, and factors that control activities in a company." On the other hand, taking the typical view of finance literatures, Shleifer et al. (1997) define corporate governance as: "approaches in which financial suppliers assure themselves of getting a return on their company investments". In essence, it is in line with the questions of how minority shareholders to ensure that their capital invested are not stolen by the managers they entrust. The key to the answer lies in how effective the firm's corporate governance mechanism addresses agency conflicts and mitigates the potential expropriation of minority investors' interest by the controlling owners, in particular when it comes to firm's related party transaction and manager's self-dealing. Unlike in US and UK where diffused shareholdings made strong legal protection of investor interest feasible, La Porta (1998) found poor investor protection in the Asian firms are mainly characterized by structure of high ownership concentrations, with the

significance of controlling owners having the power to expropriate. This is attested by Johnson *et al.* (2000) argument of weak investor protection and poor law enforcement as the key attributes to the stock market crashes in 1997-98 East Asian financial crisis. Consequently, studies by Shleifer *et al.* (1997) and Gillan (2006) indicated good governance and control can become effective mitigation of agency problems. It is further supported by evidence from Mitton (2002) that ownership structure and firm's transparency had a strong association with cross-firms stock returns in the Asian financial crisis.

There are internal and external corporate governance factors. Internal governance is characterized by structures and processes controllable by the firm's board of directors and shareholders, such as board's composition and characteristics, ownership and control, and executive compensation. Typically, the external governance is dictated by factors exogenous to the firm[12], which also influences the extent of agency conflicts (Gillan, 2006). In this study, focus of corporate governance will be confined to mainly internal governance factors controllable by the board and shareholders such as board composition, ownership structure[13] and the non-internal shareholder activism by the Minority Shareholder Watchdog Group (MSWG). Numerous empirical studies in the past have attempted to identify and explain the factors affecting the protection of minority shareholders' interests, where most were using indirect measures as proxies to examine expropriations of minority investors' interests by dominant shareholders in related party transactions.

The MSWG Activism

[12] Gillan (2006) defines exogenous as, "the underlying nature of the firm's business and its future investment opportunities, its resources and technology, the legal system and the laws of the land, financial accounting standards and their enforcement, capital markets and their operating rules and protocols, and so forth."

[13] "Ownership structure" can also be considered as external characteristic in relation to the aspects where the firm has no jurisdiction over them.

On 30th August 2000, the MSWG in Malaysia was founded and financially supported as a public company by the Armed Forces Fund Board (Lembaga Tabung Angkatan Tentera), National Equity Corporation (Permodalan Nasional Berhad), Social Security Organisation (Pertubuhan Keselamatan Sosial), and Pilgrimage Board (Lembaga Tabung Haji). In 2005, the Capital Market Development Fund under the Ministry of Finance took over funding of MSWG organization. The ultimate objective[14] of MSWG is to raise shareholder value over time by building knowledge and understanding among Malaysian minority shareholders of their rights to pursue information, voicing their opinion and ask for the remedy. Its core activities of corporate monitoring has over the years progressed to become an independent research and reporting[15] body on matters related to corporate governance, an advisor to minority shareholders on voting at general meetings of listed firms, and as the platform for collective voices of retail and institutional minority investors.

As of 2014, there are 295 companies under its monitoring portfolio[16] comprising about 30% of the total 983 firms listed on Bursa Malaysia, and accounting for 90% of Bursa's total market capitalization, with a total of 400 company meetings (295 AGMs and 105 EGMs) attended by MSWG analyst. Issues related in particular to benefit of minority shareholders in

[14] As set out in the charter of MSWG, its detail objectives are as follows: to act as forum on minority investors experiences, to serve as think-tank on corporate governance issues in Malaysia, to educate investing public on corporate governance, to facilitate a platform for initiation of activism on potential self-dealing practices of listed firms, to act as leader for legitimate rights of minority investors by influencing the listed firm decision-making process, to monitor listed firms non-compliance and violation of corporate governance, to initiate reporting when necessary to regulatory authority on the above (MSWG, 2011).

[15] In year 2014, 367 letters to companies, 300 pre-AGM and 367 post AGM/EGM reports were sent out by MSWG. The pre-AGM report provided a valuable snapshot of companies CG practices' analysis, the proposed resolutions for voting, overview of directors and their roles in various committees, and firm's financial performance highlights. The post AGM/EGM reports overviews meetings' proceeds and responses by board of directors on questions raised. They serve as a valuable third party assessment on what actually transpires in the AGM/EGM, and are made available to all subscribers (MSWG, 2014).

[16] The criteria adopted by MSWG for selection of firms to monitor are: FBMKLCI firms, Malaysia Corporate Governance (MCG) index top 100 firms, firms requested by subscribers for monitoring, and firms warranted monitoring based on complaints received from shareholders and those impacting minority shareholders (MSWG, 2011).

corporate governance, financial, operational and strategic aspects were raised, in which MSWG encourages best practices related to AGM minutes' publication and board diversity. For instance, in key matters related to pricing and valuation in related party transactions that involves assets sales and acquisitions, takeovers and privatizations, and removal of directors that violate corporate governance procedures. It has also become a norm that most companies responded in written replies to the questions and issues raised by MSWG, which enables the content to be posted on MSWG website for the benefit of general public investors in making quick analysis on performance changes and CG best practices of the listed firms. MSWG has also expanded to such effort to publications of its AGM/EGM Weekly Watch in the mainstream newspaper such as The New Straits Times and the Mandarin version Nanyang Siang Pau.

In their study on the effect of MSWG's monitoring on performances of 112 listed firms targeted for activism during 2005 to 2008, Ameer *et al.* (2009) found a significant positive return in the MSWG-targeted firms' stock performance, compared to the 112 non-targeted control firms selected based on matching size and industry classification. Hence, it suggests the market reacts positively to MSWG's activism in the firm likely to have agency problems since MSWG's activism reduced information asymmetries through provision of constructive solution to minority and institutional shareholders. Such explanation is also supported by another Malaysian study using 434 sample firms from year 1999 to 2002 in Bursa Malaysia (Abdul Wahab *et al.*, 2008), where they found MSWG-activism has a positive moderating effect on the relationship between institutional ownership and corporate governance.

The Government Controlled Block Investors

Today's markets have become largely institutionalized[17] where most investment funds

[17] Institutions managing the pooled funds such as pension funds, mutual funds, hedge funds, exchange-traded funds,

are set up to benefit individual investors. Previous studies show the presence of equity block holders could actually provide monitoring benefits (Chen & Nowland, 2010; Erickson *et al.*, 2005; Barucci & Falini, 2005), whereas, others found their credible threat of divestment will result in lower share price, hence alleviate managerial incentive problems (Admati & Pleiderer, 2009; Bharakh *et al.*, 2011; Edmans *et al.*, 2011; Parrino *et al.*, 2003). Therefore, in spite of lacking direct influence on corporate decisions, it seems the mere presence of non-controlling large shareholders improve firm governance. For instance, in a Malaysian study, Che Ahmad *et al.* (2003) found the oversight of outside block holders, especially non-institutional block holding negatively associated with corporate diversification, which could be a potential abusive RPT.

State-owned enterprises[18] (SOE) are important in the emerging world and out of 100 world's largest firms, 28 are SOE. SOEs contribute significantly to the market capitalization of Russia's and China's share markets (Hope, 2013). Similarly, World Bank (2005) report on corporate governance also highlighted the high level of government's equity ownership (about 70% of total institutional holdings) held under government linked institutional companies (GLICs). Studies by Berkman, Cole and Fu (2009b) on tunneling via inter corporate loans, and Jiang *et al.* (2010) on expropriation involving loan guarantee in China found problem of expropriation was less significant in firms with state-owned but non-corporatized controlling block holders and state-owned firms respectively. In similar studies, sovereign wealth funds (SWF) which have the advantage of possessing more superior information over their private counterparts, give a stronger signalling effect to the firm's stock price reactions. For instance, study by Dewenter *et al.* (2010) in both US and non-US firms showed the announcement effect of SWF investment on CAR is significantly positive, whereas the announcement effect of SWF

and financial institutions such as insurance companies and banks.

[18] The United Nations Conference on Trade and Development defines a state-ownership as holding 10% or more of the firm's share by the state.

divestment is just the reverse. Furthermore, when the target firm is a utility, airline, or financial firm, stronger stock price reactions to SWF transactions were observed. However, in Cheung, Rau and Stouraitis (2009) analysis of RPT between Chinese listed firms and their state-owned enterprise (SOEs) shareholder with more than 35% ownership, they found a significant negative market-adjusted CAR of (-2,2) around the RPT announcement, signifying expropriation of minority shareholders of the firm.

Conclusion

Besides the paucity of researches on RPT in Malaysia, results of prior studies did not employ the method of direct measurement on the valuation effect of RPT (Chan, 2010; Liew *et al.*, 2012; Munir *et al.*, 2013)[19] and remain unclear with regards to the effects of RPT on minority shareholders in the Malaysian security market. This study will employ the approach of measuring the firm's cumulative abnormal return of the stock price (CAR) around RPT announcement period as a direct indication of expropriation. Hence, an investigation will be made on the announcement effect of RPT on the firm's CAR and its relationships with MSWG activism, and the firm's corporate governance factors of ownership structure and board composition.

1.3 Research Questions

The research data can verify the impact of RPT in the Malaysian market and provides an understanding of the mechanism through which potential expropriation by the controlling shareholders might take place. An attempt will be made to answer the following questions:

[19] Chan (2010) study involves reviewing Malaysian law pertaining to RPT versus three actual cases of expropriation. Liew *et al.* (2012) study focuses on investigating effect of specific variables (independent director tenure, quantity of local principal bankers, controlling shareholders ownership concentration, and firm risk) on firm valuation (TobinQ, ROA and ROE) in the presence of RPT, which is an indirect measurement method. Lastly, Munir *et al.* (2013) study examined the specific effects of RPT on the earning quality of family firms in Malaysia.

(1) Do different types and sizes of RPT induce different wealth effects on stock return or CARs?

(2) Is MSWG activism effective in influencing expropriation by controlling shareholders as measured by RPT-induced CARs?

(3) Does board composition influence expropriation as measured by RPT-induced CARs?

(4) Does ownership structure influence expropriation as measured by RPT-induced CARs?

(5) Does the presence of block holders, especially the government-controlled block investors[20] protects minority shareholder's interest?

(6) Do firms have a different likelihood of engaging different types of value-destroying RPT under prevailing corporate governance conditions?

1.4 Research Objectives

The overall goal of this study is to investigate the relationship between the RPT's announcement effect on CAR (cumulative abnormal return of the firm's stock price) and MSWG activism and firm-level corporate governance variables, by employing the methodology of event-study on RPT. Under the prevailing legal protection environment in Malaysia, which corporate governance factors and to what extent, are linked to the effective monitoring of controlling shareholder's behaviour in the engagement of related party transaction? Specifically, this research is aimed at achieving the following objectives:

(1) Investigate whether different types and size of RPT will lead to expropriation of minority shareholder in the publicly listed firms of Bursa Malaysia.

(2) Examine whether shareholder activism through MSWG has an influence on RPT-induced CAR.

(3) Investigate the relationships between RPT-induced CARs and the respective firm's board composition.

[20] These institutional investors are government linked investment companies (GLICs) such as the Employee Provident Fund (EPF) and the civil pension fund or Kumpulan Wang Amanah Pencen (KWAP) (Musallam, 2013).

(4) Investigate the relationships between RPT-induced CARs and the respective firm's ownership structures.

(5) Examine whether the block holders, in particular the government-linked investors have an influence on the protection of minority shareholder's interest in mitigating potential expropriation of the founder- and owner-managers.

(6) Investigate the relationships between firms earning a negative CAR and the respective firm's corporate governance factors of MSWG activism, board composition, ownership structure and size and types of RPT.

1.5 Significance of Study

Overall, this study pioneered a contribution, in Malaysian context, to the literature gap by making a comprehensive empirical investigation into the relationship between the firm's stock performance (CAR) and firm-level corporate governance factors in the presence of related party transactions in Malaysian stock market. The insights transpired from analysing the state of corporate governance of listed firms in Bursa Malaysia can be useful to Malaysian regulators to enhance corporate governance, which will have ultimate benefits of the protection of minority investors' right.

The degree of minority interest protection could vary among countries of different legal and cultural origins. In the corporate governance country assessment by the World Bank (2005), Malaysia scored lowest in the subcategory, "Equitable treatment for shareholders", under the CG principal assessment criteria. This clearly indicates room for improvement in the quality of governance on minority shareholder interest protection. Furthermore, Malaysia dropped two places in ranking among 11 key Asian countries in a more recent corporate governance survey by CLSA (2007) [21] as shown in Table 1.2 (from 4th in 2005 to 6th in 2007). Therefore, such an

[21] Results indicated enforcement and cultural factors as among the weakest areas in the quality of a country's level

event study based on direct observation and measurement for incidences of expropriation via RPTs will be a value-added input to policy maker for improvement of corporate governance control, monitoring and reform. Furthermore, as attested by Ibrahim Haidar (2009) study, which covers more than 170 countries around the world, investor protection has a significant positive relationship with economic growth.

This is also the first study to test and examine the impact of the Minority Shareholder Watchdog Group (MSWG)[22] activism on the announcement effect of various types of RPT, reflected by the firm's cumulative abnormal return of the stock price (CAR). It will examine whether such unique role of MSWG activism in Malaysia can mitigate the expropriation of minority investors by the controlling shareholders.

According to reports from the World Bank (2005), Bursa Malaysia has a unique characteristic of high government's equity ownership, in which about 70% of the total institutional holdings belong to the government-backed public fund (Abdul Wahab *et al.*, 2008). Under this backdrop, this is the first study that contributes to examining whether the institutional block investors play a role in the protection of minority interest in the deterrence of potential expropriation by the controlling shareholders via related party transaction in Malaysia.

1.6 Scope of Study

The scope of this thesis is limited to examining the announcement effect of related party transaction (RPT) on the firm's cumulative abnormal return of stock prices (CAR), and the CAR's relationship with the types and size of RPT, MSWG activism, board composition, ownership structure, and the control variables of external economic shocks, firm size and

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corporate governance.

[22] The MSWG was established in 2000 to build knowledge and understanding among Malaysian on minority shareholders' right.

leverage in the publicly listed companies in Malaysia. Sample data from the Main Market of Bursa Malaysia for year 2008 to 2013 is used to cover the impact of general economic conditions on expropriation which could be different between during and after an external shock. The internal corporate governance factors included in the study are the firm's board composition (board size, board independence, family director's concentration, CEO duality and audit committee independence), and ownership structure (cash ownership of dominant owner and directors, divergence of control right for dominant owner and directors, cash ownership of block holders, and cash ownership of government linked investor or state government). Also, nine types of RPT are identified and considered in the study (asset acquisition, asset sales, equity sales, trading relationship, cash payment, loan guarantee, cash receipts, subsidiary relationship and takeover offers & joint ventures).

1.7 Structure of Study

The organization of the other five chapters in this thesis is as follows. Chapter Two describes institutional setting and categories of RPT in this study. Chapter Three reviews the research background and relevant literatures. Chapter Four provides the formulation of research models and their corresponding hypotheses development. Chapter Five presents the sample description and analysis of the results. Finally, Chapter Six summarizes the results and provides conclusions and recommendations.

CHAPTER 2: RELATED PARTY TRANSACTION (RPT)

2.1 Background of RPT

Based on the literatures, there are generally three reasons for firms to conduct related party transactions. The first one is for the legitimate economic motives of minimizing the firm's transaction costs (Cook, 1977; Fisman & Khanna, 1998). The second reason is to manipulate company's earnings via purchase and sales of goods or services (Jian & Wong, 2003; Aharony, Wang & Yuan, 2009), and thirdly, related party transaction is also employed for tunneling purpose (Cheung *et al.,* 2009a, Cheung *et al.,* 2009b; Cheung, Rau & Stouraitis, 2006).

Therefore, according to Gordon *et al.* (2004) and Ryngaert and Thomas (2007), there are both positive and negative aspects of RPT in relation to its effect on firm's valuation. On one hand, it can positively influence the day-to-day business operations by lowering the transaction costs of a firm. This is as suggested by the hypothesis of efficient transaction, in which costs of the firm's transaction by virtue of common control is lower than those of third parties. On the other hand, the hypothesis of conflicting interest regarded RPT as an avenue for firm's controlling shareholders to increase their wealth at the expense of minority shareholders' expropriation. As shown by Johnson *et al.* (2000), majority shareholders in firms with increase ownership concentration can seek private benefits via related party transaction. They can involve acquisition and sales of goods and services with price manipulation, obtaining loans at preferential term collateralised by the listed firm's share, and diluting the value of minority shareholding by transferring assets between firms under their control. In a related party transaction, parent shareholder will potentially gain by transferring subsidiary's assets to the parent corporation. Without adequate compensation to minority shareholder, the gain by parent shareholder will be to the extent of the minority shareholder interest in the assets transferred

(Fama & Jensen, 1983).

This study is motivated to investigate if RPT leads to the expropriation of minority shareholders' interests in a firm.

2.2 Institution of RPT in Malaysia

Introduction of new provisions[23] in 1986 and 1987 of the Company Act 1965 to restrain the conduct of controlling insiders was a first major revamp in the history of Malaysian legislation on corporate governance. Following the Asian financial crisis in 1998, the Malaysian stock market suffered overwhelming loss of investors' confidence, as a result of corporate abuses such as RPT and asset transfer with conflict of interests between the controlling and minority shareholders (Chan, 2010; BMSB, 1999). Consequently, the Security Commission embarked on a major reform by implementing the code of corporate governance in March 2000. One of the key prescriptions of the code is the establishment of an audit committee with majority independent members, whereby one of its major functions is the oversight of RPT activities. To further improve investor protection, the Malaysian Code of Corporate Governance (MCCG) 2007 was enacted and subsequently enhanced in stages from 2008 to 2011. The key areas of code's revision for improvement are board independence, director's roles and responsibilities and rules of RPT disclosure. In November 2012, Bursa Malaysia made further amendment to the corporate governance rules by mandating poll voting[24] for RPTs which require specific shareholder approval, and the establishment of the nominating committee with its key duties on selection and assessment of directors, in the revised MCCG 2012. In 2014, the role of

[23] The provisions can be found in sections 132C, 132E and 133A of the Company Act 1965.

[24] In 'poll voting', each equity share issued by a company shall be conferred the right to one vote at a poll at any meeting of the company. Contrary to voting by 'show of hands', poll voting enforces greater shareholders' right. This is as stipulated in Chapter 10, Part E, 10.08(7A) of the *Main Market Listing Requirements* (BMSB, 2015). It is also consistent with the principal of 'one share one vote', and in accordance to Section 55 (1) of Companies ACT 1965 (Revised -1973).

independent advisor in RPT was further emphasized in the area of transaction's assessment and advice-giving to the minority investors on whether the RPT is a justifiable one, with the aim to further safeguard the interest of non-controlling shareholders. However, in January 2015, Bursa Malaysia revised the ruling on disclosure threshold for RPT's value of consideration from RM250000 to RM500000, signifying a relaxation of control.

RPT versus Recurrent RPT

A related party transaction (RPT) means "a transaction entered into by the listed issuer or its subsidiaries which involves the interest, direct or indirect, of a related party[25]" (BMSB, 2015). In Bursa Malaysia listing requirement, when the percentage ratio[26] and value of transaction equals or exceed the requisite thresholds respectively, a disclosure to shareholders must be made. On the contrary, arm's length transaction or non-RPT is generally defined in the context of this study, as a transaction of the company that does not involve any related party as defined above.

A recurrent related party transaction (RRPT) means "a related party transaction which is recurrent, of a revenue or trading nature and which is necessary for day-to-day operations of a listed issuer or its subsidiaries." (BMSB, 2015). It usually occurs in the ordinary course of business for the listed firms, involving financial assistance or goods and services provisions on a continuing basis, and is expected to recur over an extended period of time. The requisite thresholds for disclosure to shareholders are percentage ratio of 1% or more over the firm's net assets, or the transaction value worth RM 1 million and above.

This research only focuses on analysing the announcement effect of RPT on the short

[25] In the definitions of related party transaction, the firm's director or substantial shareholders (own at least 5% stock), or a person connected with a director or a substantial shareholder are defined as a related party.

[26] "Percentage ratio" means the figures, expressed as a percentage, resulting from the calculation as stipulated in Chapter 10, 10.02(g) of the Main Market Listing Requirements (BMSB, 2015). For example, in 10.02(g)(i), a percentage ratio is determined from asset's value which is transaction's consideration, compared with the company's net assets.

horizon event windows (between -30 to +30 days), where RPT data from the Bursa Malaysia public listed firms are employed. On the other hand, recurrent RPT which occurs over an extended period of time requires the analysis of long horizon event windows (between -12 months to +12 months), which is beyond the scope of this study, hence, data of recurrent RPT will not be considered and used. Furthermore, since the transactions are recurrent in nature, some of the effects might be impounded in the prices when the transactions are first announced. Thus, subsequent RPT announcements might not capture the full impact of the valuation effect.

2.3 Rules, Regulation and Disclosure of RPT

Shaped by political and cultural landscape, one of the distinct features in Asian economies is their relationship-based systems, in which RPTs are not only common but prevalent. As such, applications of rules and regulation of listed entities entering into RPT are required to ensure chief executive, directors and substantial shareholders do not take advantage of their positions to expropriate the interests of minority shareholders.

According to Chapter 10 of Listing Requirement, "related party transaction" (RPT) refers to a deal made by a listed firm or by a company it owns, involving either the direct interest or indirect interest, of a "related party" (BMSB, 2015). The "related party" is defined as a director[27], a substantial shareholder (holding 5 percent or more of the entire voting share), or someone related to a director or a substantial shareholder. It covers the transactions such as the acquisition or disposal of assets[28] or their developmental or control rights[29]. It does not include

[27] It includes the director who is in charge at the time the deal is made, or the director who was still in charge not more than 6 months before the date of the dealing.
[28] "asset" refers to any kind of assets which include securities and business commitments.
[29] The transactions by a listed issuer or its subsidiaries which cover: (a) granting, accepting, exercising or discharging an option or any other right or obligation, present or future, conditional or unconditional, to dispose of a listed issuer's developmental right, all or substantial rights, benefits or control in an asset. (b) set-up joint business ventures; granting financial support, granting or receiving services; or entering into or any business dealing or arrangement.

normal business deal of the firm, or dealing between a listed firm (or a company it fully owned) and its fully-owned companies[30]. The Main Market Listing Requirements[31] of the Bursa Malaysia Securities Berhad (BMSB, 2015) obligate public companies to disclose timely and fully all information affecting the stakeholders' interests. In particular, minority shareholders are expected to be treated fairly and equitably in relation to facts and information that have a material effect on the stock prices, stock trading activities and the firm's valuation.

A listed firm is required to disclose the detail of RPT to Bursa Malaysia promptly after the terms and conditions of the deal is sealed, when the percentage ratio and value of transaction equals or exceed 0.25% and 500,000 Ringgit requisite thresholds respectively. When the RPT percentage ratio is 5% or more[32], a circular is required to be sent to shareholders and Bursa Malaysia with pertinent information as stipulated in Appendix[33] 10-B and 10-D of the Market Listing Requirement (BMSB, 2015). Prior to closing the deal with agreed terms and conditions, an independent advisor[34] with corporate financial expertise will be engaged based on the Security Commission's Principal Advisor Guidelines. Furthermore, an extraordinary general meeting will be called for shareholders to approve the deal.

In addition to the above disclosure to shareholders, for an RPT where any one of the percentage ratio is 25% or more, the public company is required to engage a 'Principal Advisor' prior to closing the related party transaction. The 'Principal Advisor' duty is to ensure fair and

[30] Refer to Chapter 10 section 10.02 (l) (iii) of Listing Requirements. Section 10.08 (11) provides a full reference of all other transactions not normally regarded as RPT.
[31] The principals, application and documentations of the listing regulation are stated in Main Market Listing Requirements, Chapter 2 (BMSB, 2015), which was updated to incorporate amendments issued up to January 2015.
[32] According to section 10.08(9), if the RPT is between a subsidiary of a public company and another person, the listed issuer is exempted from making these disclosures.
[33] Appendix 10-B is the content of circular to shareholders on the RPT; Appendix 10-D is the additional information on the RPT.
[34] The independent advisor must, in relation to the transaction, comment on (a) fairness and reasonable to shareholder (b) detriment to minority shareholder (c) give an objective and educated opinion to minority shareholder on whether they should support the resolution during the EGM's approval voting, and (d) have satisfactory basis for (a) and (b).

reasonable terms and conditions of transactions, compliance with all applicable policies or guidelines, make certain all required information is available in the official notice and circular, and verify and validate with the Bursa Malaysia on the completion of transactions with all the necessary approvals.

According to Lei and Song (2011), disclosure requirements matter as firms tunnel using RPTs with disclosure exemptions. In particular, the true value of certain related party transaction which is continuous in nature[35] is difficult to quantify. This nature of the transaction may be prone to manipulation since it tends to recur over a period of time.

2.4 Classification of Related Party Transaction

In this study, RPT are classified into three broad categories according to their possible valuation effect on stock price. In Table 1.1, there are six types of transactions under Category 1, namely, asset acquisition, asset sales, equity sales, trading relationships, cash payments and loan guarantees, which are known to cause expropriation. On the other hand, cash receipts and subsidiary relationship, classified under Category 2 are considered as possibly beneficial to the minority shareholders of the firm. In Category 3, transactions of takeover offers & joint ventures are regarded as having strategic motivations and not an expropriation as well. Figure 2.1 to 2.6 provide schematic illustrations of the various examples of related party transaction taken from the study sample. The following sections provide explanations of their effect on firm's valuation with supporting evidence from previous studies.

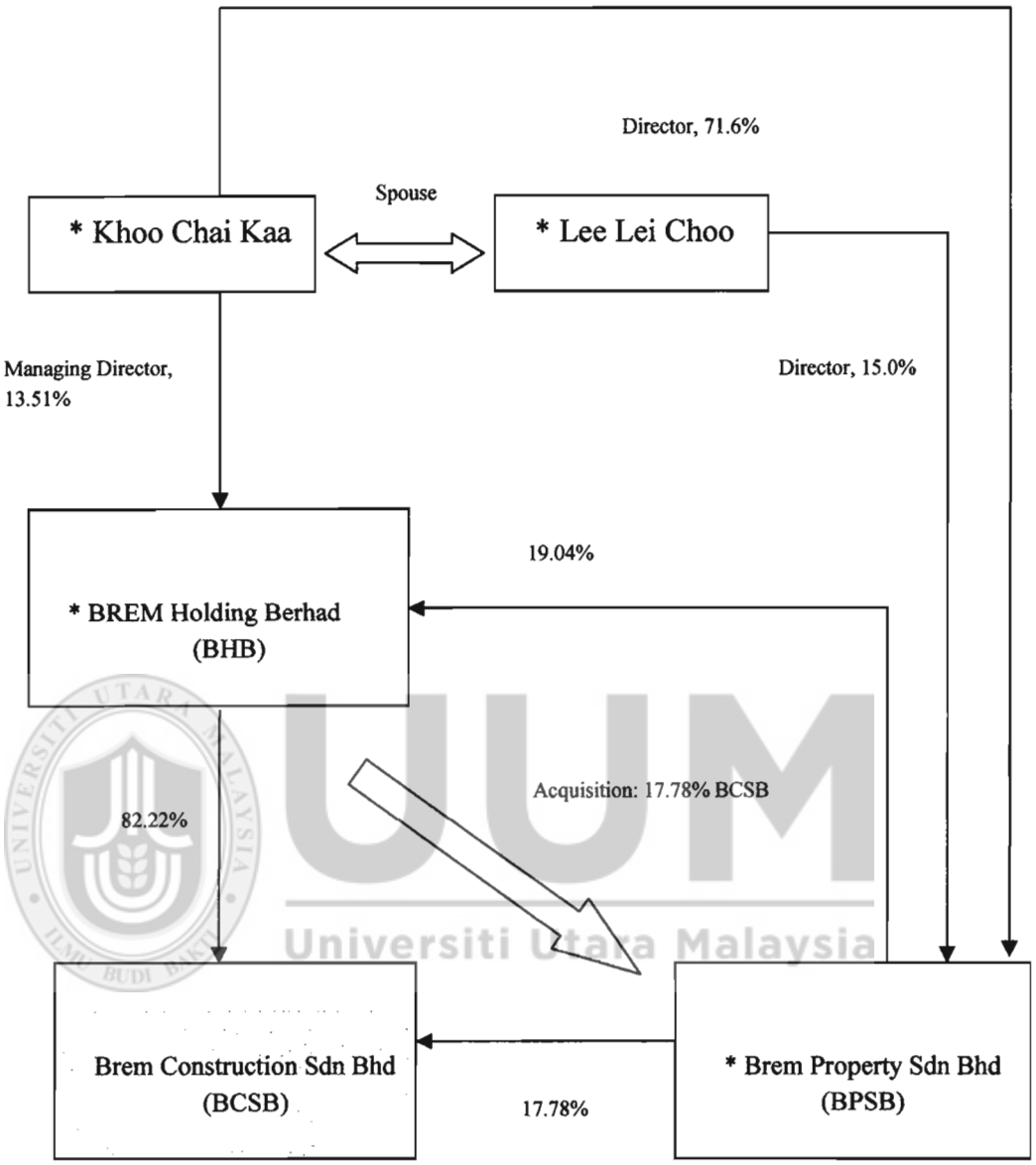
2.4.1 Category 1: RPT Known to Cause Expropriation

In asset acquisition, asset sales and trading relationship RPTs, extraction of cash through self dealing transaction can occur by acquiring or selling assets (properties, equity stakes in other

[35] In Bursa Malaysia, it is called recurrent related party transactions.

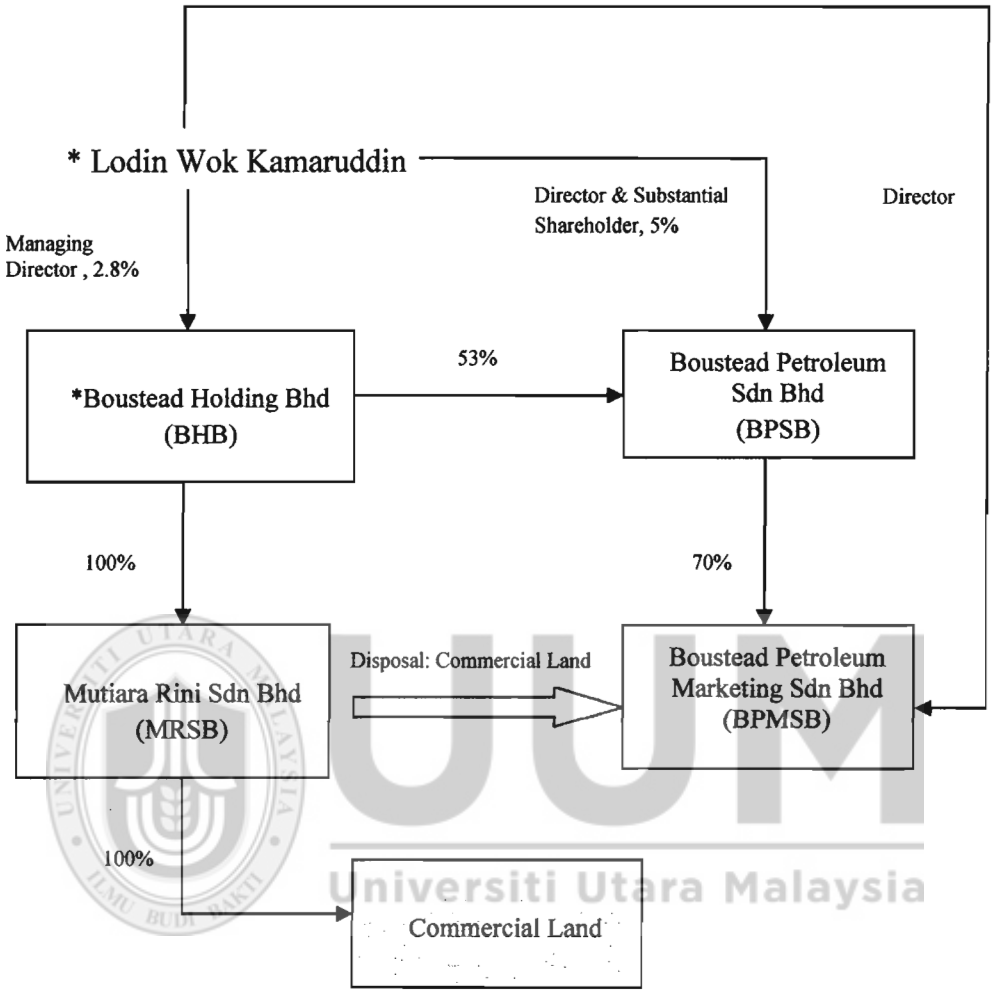
firms or equipments), goods or services from or to parties related to the listed company.

Asset acquisition and sales can occur in the form of asset transfer of the listed company to the other companies under the dominant owners' control or vice versa, for instance a sample of asset acquisition and asset sales from this study is shown in Figure 2.1 and 2.2 respectively. In the asset acquisition RPT, the controlling shareholder (Khoo Chai Kaa) of listed firm Brem Holding Berhad acquired 17.78% stake in BCSB from Brem Property Sdn Bhd, in which he is also a major controlling shareholder. In the case of asset sales RPT, the managing director or the influential party of listed firm Boustead Holding Bhd (Lodin Wok Kamaruddin), who is also indirectly a major controller of BPMSB via BPSB (in which he has both the influence as a director and interest as a substantial shareholder) is involved in the sales of a commercial land from Boustead Holding Berhad (via MRSB) to BPMSB. Johnson *et al.* (2000) term movement of assets by controlling or influential shareholders of the listed firm where their ownership is low to the firm where they have higher ownership as tunneling. Furthermore, acquisition's consideration in the form of stock will incur dilution on interests of minority shareholders (Cheung *et al.*, 2006). Another example was the evidence found on controlling shareholders of Korean business groups (chaebols) using tunneling to increase their wealth at the expense of minority shareholders. Therefore, when a chaebol affiliated firm makes an acquisition, its stock price on average falls, resulting in a negative return to investors. However, the controlling shareholder of that firm benefited because the acquisition enhances the value of controlling shareholder's other firms in the group (Bae *et al.*, 2002).



Note: '*' is used to indicate the listed firm and influential/dominant owner or director having connection to the related party or the related party in the transaction.

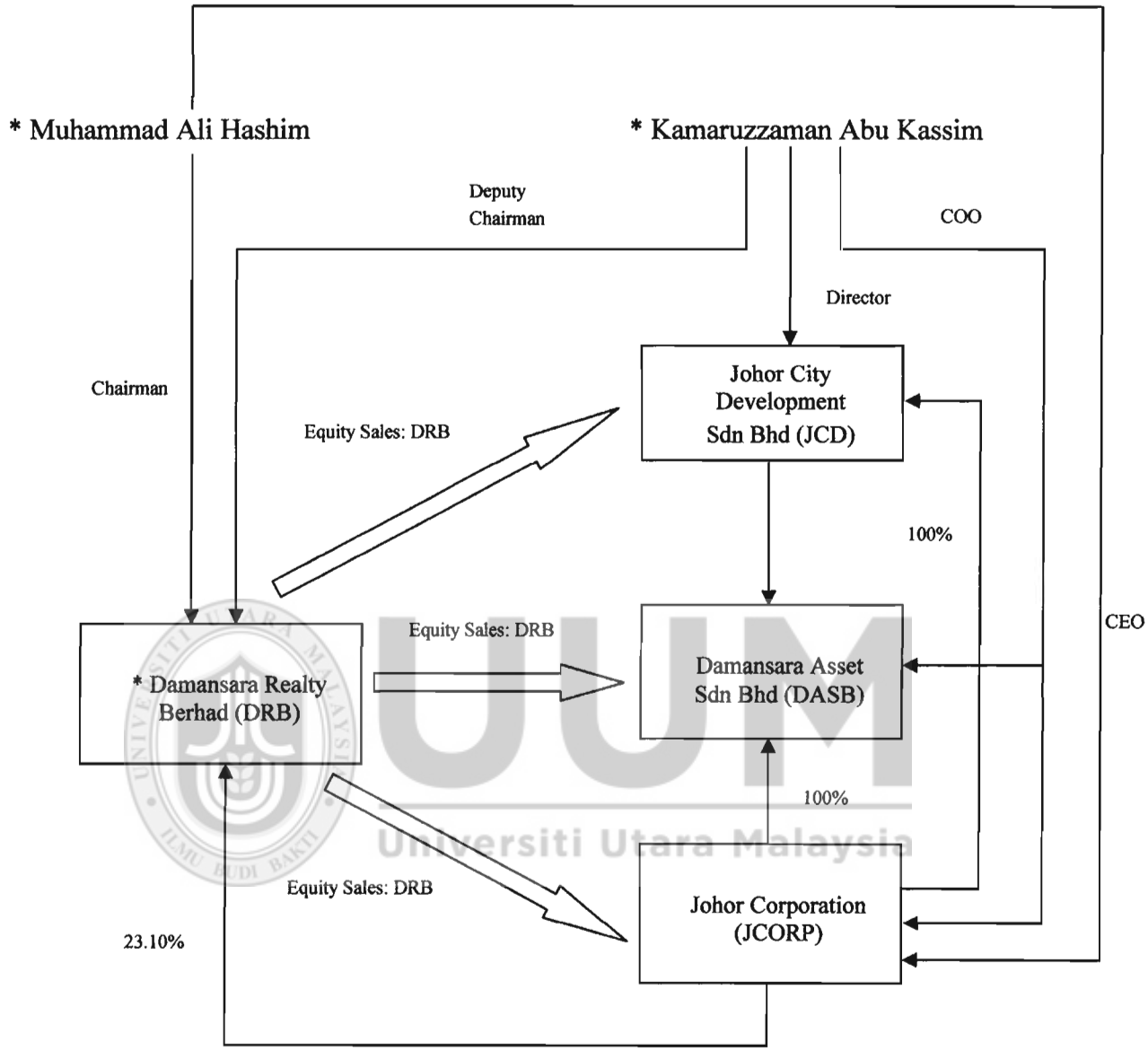
Figure 2.1
Example of Type 1 RPT (Asset Acquisition)
Source: Brem Holding Berhad (2009), *Annual Report, Bursa Malaysia.*



Note: '*' is used to indicate the listed firm and influential/dominant owner or director having connection to the related party or the related party in the transaction.

Figure 2.2
Example of Type 2 RPT (Asset Sales)
Source: Boustead Holding Berhad (2009), *Annual Report, Bursa Malaysia.*

Figure 2.3 is a sample of equity sales RPT in Damansara Realty Bhd. The related parties are the Chairman (Muhammad Ali Hashim) and Deputy Chariman (Kamaruzzaman Abu Kassim) of DRB. One of the main purposes of the new DRB share issuance was to raise funds for repayment of debt to JCD, among other business commitment. Even though technically it was JCD, DASB and JCORP which is fully state owned entities that participated in the equity sales transactions, the related parties involved in the decision making of debt issuance and the corresponding business dealings are highly influential in all these companies. In the case of listed firm's equity sales to a related party, influential manager or controlling shareholder can cause dilution to the interests of minority investors when they acquire the new share issued at a privileged price, via a related party or a private company majority-controlled by the listed firms. Hence, the controlling shareholder can increase his share of the firm through dilutive share issues, minority freeze outs or insider trading that discriminates against minority shareholders. Friedman *et al.* (2003) model of tunneling shows that negative market reaction occurred when a listed firm announces the right to issue new share. This is because the controlling shareholder chooses to tunnel when the external economic shock is very small or non-existent. On the other hand, studies in China (Cheung *et al.*, 2009; Cheng & Chen, 2006; Ying & Wang, 2013) and Turkey (Gonenc & Hermes, 2008) shows the potential of firm's market timing in equity issuance. In this case, controlling shareholder or influential managers propped up share prices prior to date of new share issuance, and followed by serious engagement in tunneling activities. Therefore, they found share issuance predicts the stock's low future returns which was preceded by high returns before its issuance.



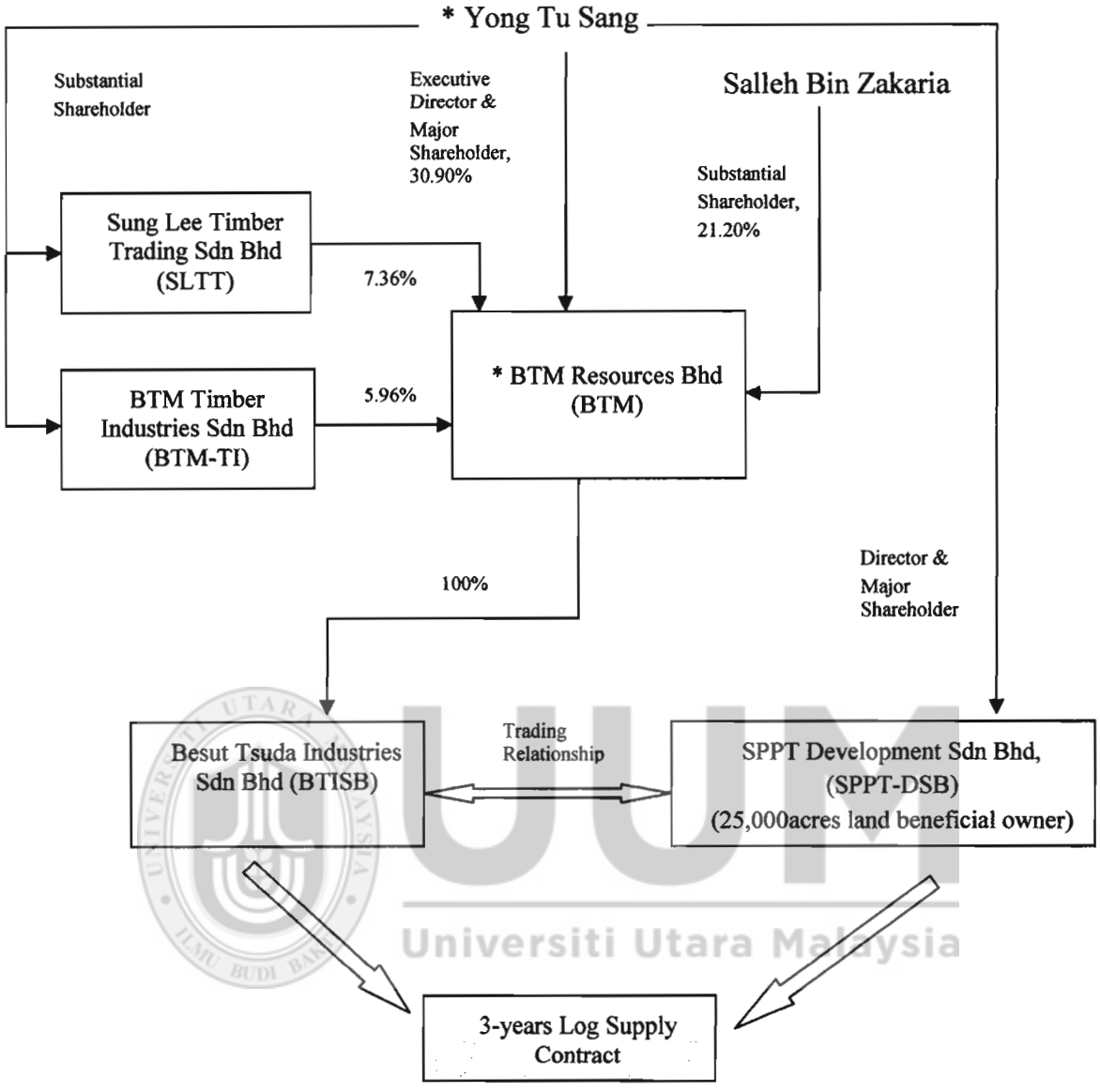
Note: '*' is used to indicate the listed firm and influential/dominant owner or director having connection to the related party or the related party in the transaction.

Figure 2.3
Example of Type 3 RPT (Equity Sales)
Source: Damansara Realty Bhd (2007), *Annual Report, Bursa Malaysia.*

The trading relationship transaction[36] (either recurring or one-time nature) could be used as a channel for cash flow diversion from a firm in which the controlling shareholder has low cash-flow rights to firms which they have high cash-flow rights (Bertrand *et al.*, 2002). Figure 2.4 shows an example of trading relationship RPT, where the controlling owner-manager (Yong Tu Sang) engaged in a contractual log's supply by SPPT-DSB to BTISB, a fully owned subsidiary of the listed firm BTM. Since the controlling shareholder owns majority shares and holds an executive position in the board of both SPPT-DBS and BTM, he is in a highly influential situation for potential self dealing behaviour. Nevertheless, it is also noteworthy for the presence of a substantial non-controlling block holder (Salleh Bin Zakaria) who has a cash ownership of 20.20% in BTM. In the trading activities, controlling shareholder can potentially gain from the related party transactions by tunneling resources between the two companies under his majority control, via execution of contracts such as transfer pricing in a manner advantageous to the controlling shareholder. Therefore, without adequate compensation to minority shareholder, the gain by controlling shareholder will be to the extent of the minority shareholder interest in the consideration of the transactions.

For cash payment RPT, listed company pays cash directly or gives loans to a related party or to a company controlled by the person. The transaction can also occur in the form of cash guarantee provision by the listed firms. Therefore, instead of being an efficient transaction, the RPT is seen as a clear consequence of interest's divergence between controlling and non-controlling shareholders. This view is supported by Gordon *et al.* (2006) and Cheng and Chen (2006) studies in the US and China respectively, where industry-adjusted CAR was found negatively associated with the values of lending to firm's directors under preferential terms.

[36] It is a transaction involving the trade of goods and services between the listed firm and a private company majority-controlled by a related party.



Note: '*' is used to indicate the listed firm and influential/dominant owner or director having connection to the related party or the related party in the transaction.

Figure 2.4
Example of Type 4 RPT (Trading Relationship)
Source: BTM Resources Berhad (2008), *Annual Report, Bursa Malaysia.*

Lee and Xiao (2004) also found state-owned enterprises (SOE) used cash dividend as a channel to liquidate the non-negotiable[37] shares it holds, hence expropriating the minority shareholders. This was despite large transaction costs incurred under the condition of working capital shortage in the listed firms. Consequently, the stock market shows positive reaction to cash dividend decline, especially for firms with high concentration of SOE's shareholding.

Loan guarantee RPT is the provision of a debt guarantee and indemnity by the listed company to a related party or to a company controlled by this person. A loan guarantee[38] refers to a guarantee issued to ensure repayment of a loan to a bank. Typically, the listed firm pledges its assets as collateral for the block holder's loan. Besides benefiting the related party to obtain financing at a lower interest rate, the repayment guarantee will also give her the option to default, hence placing the loan settlement burden on the listed company. Past studies in European countries, Korean chaebols and Indian firms by Johnson *et al.* (2000), Bae *et al.* (2002) and Bertrand *et al.* (2002) respectively, provide clear evidences on use of the loan guarantee to expropriate minority shareholders.

2.4.2 Category 2: RPT Possibly Beneficial to Minority Shareholders

In the cash receipts RPT, a related party provides direct cash assistance or loans to the listed firms, in the form of private resources' transfer by controlling shareholders into firms that have minority shareholders. The heavy reliance of firms on debt financing in countries with weak legal system increases the potential for propping. This is because debt becomes

[37] In China's stock market, most listed firms are carved out from state-owned enterprises (SOEs). To uphold the fundamental doctrine of Socialism, in which all economic means belong to "The People", the parent SOE holds the state share of the listed firm after public listing. However, the share held by the parent SOE are ruled by the State Council as non-tradable (or non-negotiable), and can only be bought and sold through private placement with special approval from the government (Lee and Xiao, 2004).

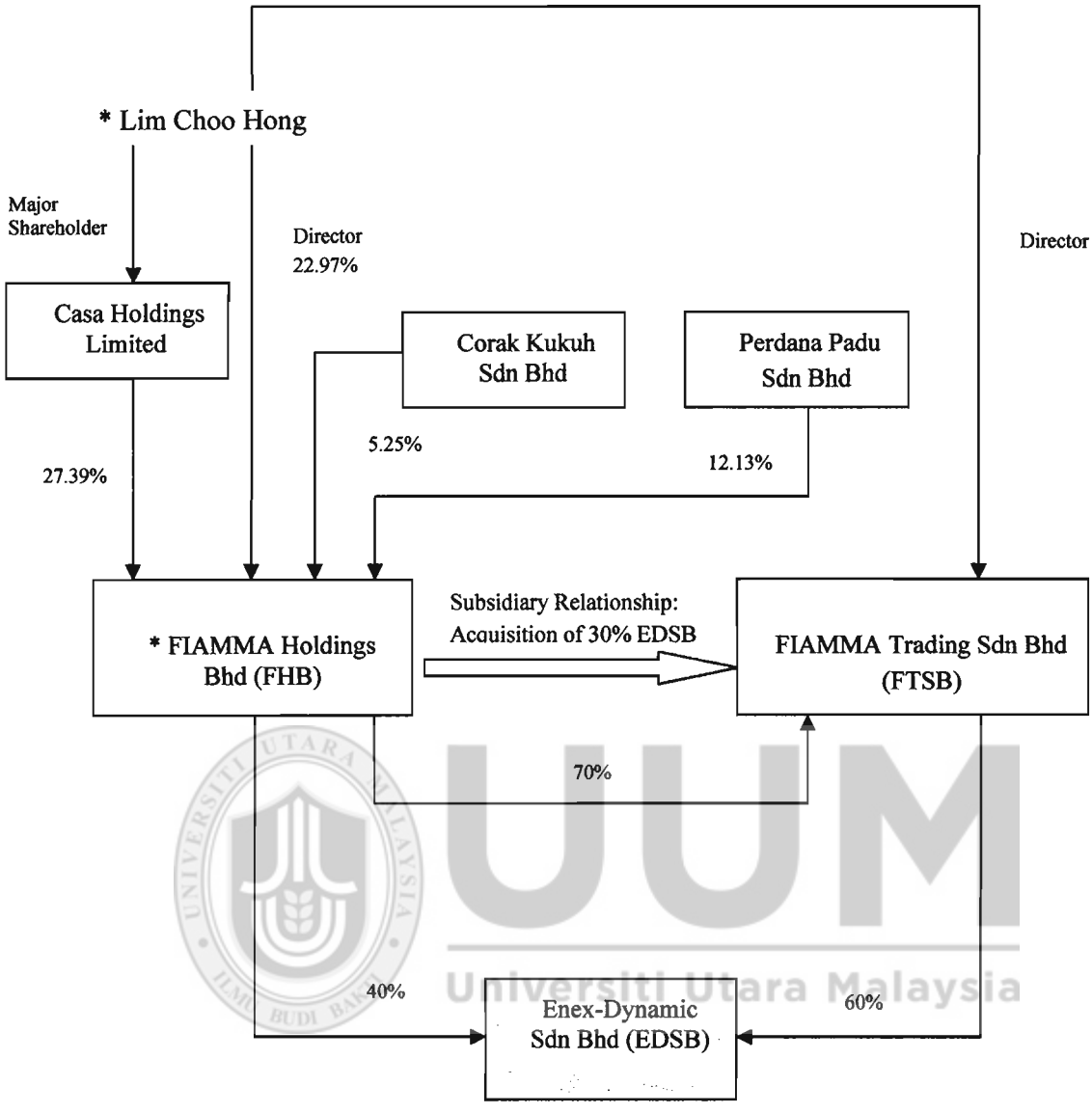
[38] The guarantee is usually made to a controlling block holder of the listed firm, or an entity controlled by the block holder or a party related to the controlling block holder.

unappealing when creditors are unable to effectively take control of collateral, in an environment where enforcement of contracts by courts is weak (Friedman *et al.,* 2003). Under such backdrop, the propensity for propping up is high if it makes debt issuance attractive to the controlling shareholders and for minority or outside investors to participate in financing the firm. However, in this case, the debt which represents a commitment to bail out the firm also becomes a proxy for the likelihood of being abandoned or looted by the controlling shareholder when the external shock is bad.

The other type that could benefit the minority investor is a subsidiary relationship RPT between a listed firm and its subsidiary, which involve acquisition or sales of equity stake or assets and trading activities. As the majority or sole voting stock holder, the parent maintains control of its independent operating subsidiary through its subsidiary's board of directors who are accountable for its performance. The parent also has the power to elect and remove the entire subsidiary's board of directors. By virtue of the majority or sole stock holding of the listed parent firm on its subsidiary, any RPT relationship between the two entities are generally construed as beneficial to the listed firms and minority investors. Figure 2.5 shows a subsidiary relationship RPT from the sample involving acquisition of equity stake (30% EDSB) by the listed firms FHB from its 70% owned subsidiary FTSB. The acquisition has been deemed a related party transaction since the controlling shareholder (Lim Choo Hong) has a 50.36% control right of listed firm, and holds the positions of director in both FHB and FTSB.

2.4.3 Category 3: RPT Having Strategic Motivations

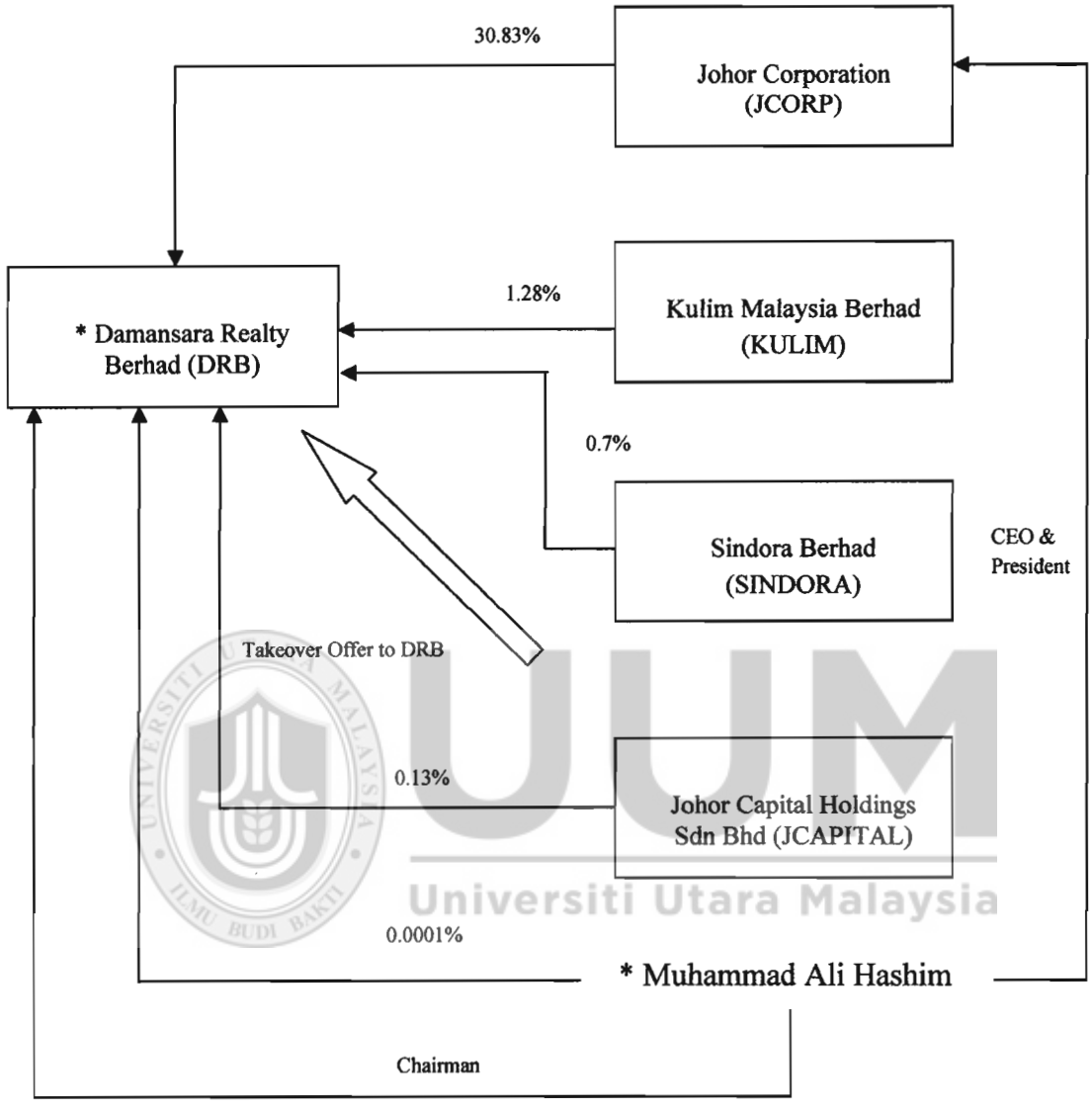
In takeover offers & joint ventures RPT, the listed firm received a takeover offer from another listed company, or the listed firm forms a joint venture with another company. In both



Note: '*' is used to indicate the listed firm and influential/dominant owner or director having connection to the related party or the related party in the transaction.

Figure 2.5
Example of Type 8 RPT (Subsidiary Relationship)
Source: FIAMMA Holdings Berhad (2007), *Annual Report, Bursa Malaysia.*

cases, the party offers to take over and joint venture partner have already held a toehold in the listed firm. Figure 2.6 shows a sample of takeover offer RPT involving listed firm Damansara Realty Berhad (DRB). In this case, a few listed companies formed a pack with joint shareholdings of more than 33%, hence making a mandatory takeover-offer to acquire all the remaining shares of DRB. Even though the JCORP's CEO (Muhammad Ali Hashim) that joined the other three parties in making the takeover offer does not hold a substantial share in both DRB and JCORP, he is highly influential in the transaction by virtue of his Chairman and CEO/President position in DRB and JCORP respectively. RPT involving a firm's investment, joint ventures or partnership are more complex in nature comparing to the others. They are considered as having strategic rationales and may not be an expropriation; hence, the market generally does not appear to value the stock return negatively. These are as attested by the US firm's study (Kohlbeck & Mayhew, 2010) where the market did not discount the firms' stock price, and Hong Kong firm's study (Cheung *et al.*, 2006) where positive CAR was observed over the (0,1) day window after the RPTs' announcement.



Takeover offerers pac: JCAPITAL, SINDORA, KULIM & Muhammad Ali Hashim

Note: '*' is used to indicate the listed firm and influential/dominant owner or director having connection to the related party or the related party in the transaction.

Figure 2.6
Example of Type 9 RPT (Takeover Offer and Joint Venture)
Source: Damansara Realty Bhd (2009), *Annual Report, Bursa Malaysia.*

CHAPTER 3: LITERATURE REVIEW

3.1 Agency Theory

3.1.1 Introduction

The stakeholder theory, originally detailed by Freeman (1984) in his Strategic Management book, relates to organizational management and business ethics. The main rationale behind it is to address morals and values in managing an organization. The theory identifies and models the groups which are stakeholders[39] of a corporation, with the aim to describe and recommend methods by which management can give due regard to the interests of all groups. Every stakeholder is perceived as bringing in or contributing resources or capital significant to the company and in return each demand for fulfilment of its interests (March & Simon, 1958).

According to Wearing and Wearing (2005), the stakeholder theory emphasizes on all people who are directly or indirectly in contact with the activities of the firm, outcomes and its results. In short, it attempts to address the principle of "who or what really counts." In this respect, all legally binding agreements between firm's managers and all other key interested parties of the firm become relevant. Besides having a binding relationship with everyone, the managers are the only stakeholder responsible for directing and controlling the firm's business affairs. Hence, any fundamental disagreements within the firm are intrinsic to the relationship between managing executives and the rest of the stakeholders. In his Stakeholder-Agency Theory, Hill and Jones (1992) describe managers as having the unique role of agents of all stakeholders. The theory further suggests claims[40] made by other interest groups in the company

[39] According to Hill and Jones (1992), "Stakeholders include stockholders, creditors, managers, employees, customers, suppliers, local communities, and the general public."

[40] Satisfying employee claims for higher wages, consumer claims for greater quality and/or lower prices, supplier claims for higher prices and more stable ordering patterns, and the claims of local and community at large for less polluting activities to improve life's quality, involving resources' consumptions, or else managers might re-channel them to pursue firm's expansion via diversification (Hill & Jones, 1992).

that, if realized, will decrease the assets and resources the dominant stakeholder cum managers can re-channel to pursue firm's expansion via diversification[41].

However, Jensen and Meckling (1976) have the view that, "the implicit contract between stockholders and managers as one of the nexus of contracts that forms the legal fiction known as the modern corporation". Thus, the principal-agent relationships of agency theory, is considered a subdivision of the overall stakeholder-agent relationship described above. The definition of agency theory by Jensen and Meckling will be adopted in this study.

3.1.2 Agency Relationship and Agency Cost

The foundation of agency theory is that it assumes divergence of the principal's and agent's interests since they have different goals, self-interested behaviours, and willingness to take varying degrees of risk. Bergen, Dutt and Walker (1992) describe the agency relationship as, "it is present whenever one party (*the principal*) depends on another party (*the agent*) to undertake some action on the principal's behalf."

Agency theory attempts to describe this relationship using the metaphor of a contract (Jensen & Meckling, 1976). According to Fama and Jensen (1983), employer (or principal) who were not able to run all the activities, assigned the decision making responsibility for distribution of financial and economic resources to the employees (or agent). The problem here is that the principal and the agent may prefer different actions because of the different risk preference. As a result, uncertainty was created for the principals, who, however, knew it as a right for them to control and monitor the agent. However, since it is impossible to have a perfect contract for agent's every action, agency problems arise and incur agency costs which become a value loss to

[41] Fama (1980) theorized that management claims its interest via growing the firm (compensation, authority, secured permanent job and status have positive association with the firm size). A principal mode preferred by manager to grow the company is via expansion into new areas of business or diversifications (Amihud & Lev, 1981; Aoki, 1984; Marri, 1964).

shareholders.

Jensen and Meckling (1976) defined agency costs as, "the sum of monitoring[42] costs, bonding[43] costs, and residual loss[44]." They claim a reduction in these costs will occur when managers are incentivized to maximize decisions that increase company's value. As the manager's dealings cannot be observed ex ante, it is not practical to have a full contract covering all aspects of the job. Such incomplete contracting set up makes the study of agency relationship even more critical. Hence, in practice, the principal can at best minimize the residual loss, representing a trade-off between putting excessive constraints on the manager, and an appropriate degree of enhancing effectiveness of contractual mechanisms in reducing the agency problems. Williamson (1988) further clarifies that residual loss is the key cost that the principal would seek to reduce. Just like the rest of a firm's issues, the costs associated with such conflict of interests will be factored into the stock markets and manifested in the trading value of the firm's stock.

Research on delegation (Lupia & McCubbins, 1998) shows this agency problem can only be minimized if both the principal and agent share a common outcome (Niskanen, 1971; Romer & Rosenthal, 1978). Furthermore, the company performance will increase and improve, if the principal and the agent can work together and cooperate well towards the same objective (Jensen & Meckling, 1976).

[42] Monitoring cost are expenses incurred to evaluate, monitor and direct an agent's behavior. For instance, audits expenditures and writing executive compensation contracts. It also includes costs of setting budget restrictions, operating rules, and firing managers.

[43] Bonding cost are borne by agents but not always financial. For instance, resources spent in guaranteeing agents not taking harmful actions on the principal (Examples are the bond and additional information disclosures to shareholders provided by the agent).

[44] Inspite of terms and conditions in contract set by the principal to control and ensure agent's behaviors, residual loss from agency problems will still incur. This is due to the natural non-alignment of goals between principal and agents and the impossibility to realize a full contract and the total enforcement of it.

Past researches have focused on identifying situations where principal-agent conflicting goals are likely to occur and then describing the governance mechanisms that limit the agents' self-serving behaviour. From an economic perspective, such divergence of interests is viewed as the two groups having different utility functions. Baumol (1959) and Marris (1964) theorize shareholders will maximize the value of their stock holdings by improving the firm's operational efficiency (Fama, 1980). However, a hired manager is a maximizer of a function which consists of compensation, authority, secured permanent job and position, which are in turn the function of firm size. A primary mode preferred by manager to grow the company is via expansion into new areas of business or diversifications (Amihud & Lev, 1981; Aoki, 1984; Marris, 1964).

In the economic theory of agency, firm owners transfer decision authority to the hired managers who are entrusted to efficiently run the business on behalf of all shareholders. However, under conditions of incomplete and asymmetric information, conflict of interests which is called the principal-agent problem occurs (Jensen & Meckling, 1976), presuming the principal hires the agent to pursue the principal's interests. The way a particular company is managed and controlled consists of techniques and systematic processes designed for aligning the shareholders and managers incentives, when owners transfer firm's management to the hired manager. Conflicts of interest have resulted in agency problems which are almost limitless in nature, in the areas of moral hazard[45], earnings retention[46], risk aversion[47], and time-horizon[48] (Jensen & Meckling, 1976).

[45] Moral hazard: agent deficient in effort agreed-upon. Therefore, the agent is shirking.
[46] Jensen (1986) argument on earning retention is "that managers prefer to retain earnings, whereas shareholders prefer higher level of cash distributions, especially where the company has few internal positive NPV investment opportunities."
[47] Denis *et al.* (1997) and Jensen (1986) suggest that majority of a company's directors are risk averse to ensure sustainable company's performance to secure their compensation. Hence, pursuit of investment that will diversify risk becomes their preference.
[48] While managers will only focus on short term for the sake of their employment, shareholders will look at the longer term future of the firm.

3.1.3 Type II Agency Problem: Principal-Principal Conflicts

The agent can also be a principal if he owns a substantial share or even become a controlling shareholder, such as the manager-owner of a family-controlled firm. In this case, the problem becomes a principal-principal conflict of interest between the controlling and non-controlling shareholders, or called the Type II agency problem. According to Mitton (2002), power lies at the firm's controlling shareholder (agent) to provide greater protection to minority shareholders (non-controlling shareholders who are also the principal). La Porta (1999) suggested corporate finance theory to focus on the motivation and positive prospects of controlling shareholders, as well as benefits and expropriation of the minority shareholders. As agency risks are necessarily lower for a controlling shareholder, the focus should be on the protection of minority shareholders' interests, in which a critical area of research concern is on the expropriation of minority investors' interests by dominant shareholders.

Johnson *et al.* (2000) described expropriations in their study as, "taking the form of extracting cash through self-dealing transactions involving assets, goods or services; obtaining loans on preferential terms; transferring assets from the listed company to other companies under their control; and diluting the interests of minority shareholding's value by acquiring additional shares at a preferential price." Hence, the purpose of agency theory in corporate governance is to identify points of conflict between corporate interest groups, and resolve them so that the company's performance will increase. As such, the agency theory's application in corporate governance focus on integrating the roles of controlling shareholders (agent) to maximize all shareholders' interests (Nicholson, 1998). In short, it concerns inducing the agent to behave in the way so as to maximize the firm's efficiency. This can be achieved via various regulatory mechanisms of corporate governance monitoring and control, and the establishment of policies

and objectives of the firm's board of directors.

La Porta *et al.* (1998) strongly argued that shareholders' interests should be protected. This will greatly motivate investors' to finance positive net present value (NPV) firm's projects, hence resulting in lower cost of capital due to increase availability of external funding. In their study, Modigliani and Perotti (1997) showed that in an environment where minority investors' rights are poorly protected, firms had to forgo profitable new ventures as their ability to raise equity is seriously impaired. Expropriation by controlling shareholder will not only caused value dilution of the minority interest, but also the scarce participation of small investors and thin trading of the stock. Furthermore, a stock with poor liquidity and unsuppressed insider trading has depressed prices and increased required yield, which is an obstacle for financing through security markets. In a separate study by Kandel *et al.* (2011) on Swedish firms with dispersed ownership, it was found that age-similar, non-controlling small shareholders sell more aggressively on negative news. Firms that could attract larger number of age-similar small shareholders (or retail investors) were more profitable. Also, the stock price increased significantly with an increase in the number of age-similar small shareholders.

3.2 Value-Destroying RPT

In the hypothesis of conflicting interest, controlling shareholders expropriate minority shareholders via RPT to increase their wealth, hence negatively affect the firm's valuation (Ryngaert and Thomas, 2007). This is also attested by findings from Cheung *et al.* (2006) and Gordon *et al.* (2004) that firms involving in such value-destroying RPT tends to report poor performance, which destroy shareholder value. Therefore, Cheung *et al.* (2006) found RPT such as asset acquisitions, asset sales, equity sales, trading relationships' transaction, and cash payments to controlling owners most likely to result in expropriation of minority shareholders,

hence earning a negative cumulative abnormal return of the stock price (CAR). Such view of value-destructive RPT is supported by Cheng and Chen (2006) study in China, where industry-adjusted CAR was found negatively associated with size of cash payment RPT. Similarly, Gordon, Henry and Palia (2006) examined the relationship between firms' CAR and RPT used a sample of 878 transactions in 112 listed firms in the US from 2000 to 2001, a period preceding the Sarbane-Oxley. They found industry-adjusted CAR having a significant negative relationship with the size of RPT. CAR also has a significant negative association with RPT involving loan or cash assistance to the firm's directors. They also found a strong negative relationship between CAR and other type of RPT such as trading relationships. Instead of being an efficient transaction, the above supports the view of value-destroying RPT as a clear consequence of interest's divergence between controlling and non-controlling investors.

3.3 Factors Influencing Expropriation of Minority Shareholders

In this study, five groups of independent variables are considered in the theoretical framework. First is related party transaction which is the key variable of this event study. The other three key corporate governance variables known to affect the firm valuation are MSWG activism, board composition and ownership structure, where their relationships with CAR are being examined. External economic shock and firm characteristics are also incorporated into the study as control variables. Subsequent sections provide literature reviews for each of these five groups of independent variables.

3.3.1 Valuation Effect of RPT

In Indonesian market, Utama *et al.* (2009) investigated effects of the investment decision announcement on firm's cumulative abnormal returns (CAR) of stock price using 91 samples in

year 2000 to 2005. The investments sample involved both RPT and non-RPT activities of merger & acquisition, asset acquisitions and business re-allocation. Overall, the study found CAR for RPT samples was lower than non-RPT's for event windows of (-10,10), (-5,5) and (-1,5). It suggests market perceived RPT as wealth expropriation by controlling shareholders on minority investors. Further investigation also showed CAR for subsample with group affiliation is lower than that of non-group affiliation, implying expropriation was easier and more difficult to detect by the regulator for group affiliated firms, when supervision is inadequate and law enforcement is ineffective. For instance, tunneling of resources within group affiliated firms via unrelated diversification from one firm to another within the group and benefiting only the dominant owner. This is in line with Ishak *et al.* (2006) study on expropriation via diversification in Malaysia, where firm valuation has a significant negative relationship with the control right of ultimate owners. On the other hand, results from regressing CAR of same event windows on RPT and firm size showed a significant negative relationship at 1% and 5% levels for both variables in Utama *et al.* (2009) study. The negative significant coefficient of RPT implied the average CAR for RPT is 15.7 per cent lower than that for non-RPT, after controlling for other independent variables.

Using related party transactions[49] (RPT) data from China, Peng, Wei and Yang (2011) tested the implication of Friedman *et al.* (2003) model[50] on tunneling and propping. In their study, propping is defined as a temporary boosting of a firm's performance via the means of RPT engagement. Under the country's regulation, a Chinese firm in poor financial condition faces the

[49] The RPT sample are from firms listed in Shanghai and Shenzhen Stock Exchanges during the period 1998 to 2004, covering five types of transactions (asset acquisition, asset sales, asset displacement, cash payment and equity transfer). The two key sub groups of interest are (1) RPT from firms with poor financial conditions (n=238), and (2) RPT from firms with sound financial conditions and has obtained the right to issue new share (n=80).

[4]The model suggests that controlling shareholders may choose either tunneling or propping of their listed companies depending on the magnitude of adverse shock and the magnitude of the private benefits of control Friedman *et al.* (2003).

risk of delisting and losing the right to issue new shares, hence a potential loss of the private benefits of control. CAR with event windows between -10 to 10 days were used as measures of investors' reaction to the RPT announcement. They hypothesized a positive CAR to associate with propping in firms with poor financial conditions, whereas, a negative CAR with tunneling in firms with sound financial conditions with the right to issue new share. Result from the univariate analysis showed average CAR (-5,5) of 2.27% for the former, and -2.82% for the latter. Sub-sample analyses for asset acquisition and asset sales RPT also show significant results with a similar pattern as the overall sample. Therefore, in line with their hypotheses, when investors perceived controlling shareholders as having the tendency to tunnel in a healthy firm under small or no external shock environment, they discounted the stock price. On the other hand, a listed firm with the poor financial condition has positive CAR suggesting a favourable market reaction to the RPT announcement, supporting the argument of propping by controlling shareholders to avoid delisting of the firm. Further, multiple regression result also showed CAR (-5,5) has a significant positive relationship with the size of RPT and leverage, suggesting highly levered firms are more prone to RPT with the motivation of propping, and possibly with a more pronounced market reaction as reflected in the significant positive coefficient of RPT size variable.

3.3.1.1Tunneling

Tunneling is the moving of assets by dominant shareholders of the firm where their ownership is low to the firm where they have higher ownership (Johnson *et al.,* 2000). Other evidence of direct measurement of tunneling activities by controlling shareholders in the literatures is: Bertrand *et al.* (2002) who made a groundbreaking analysis method of cash flow diversion from low to high cash-ownership firms; Bae *et al.* (2002) using CAR to measure

reaction to the announcement of intragroup acquisition. Cheung *et al.* (2006) and Cheung *et al.* (2009) examined related-party dealings of controlling shareholders in Hong Kong and China public listed companies respectively. In China, Cheung *et al.* (2009) showed at post announcement, the CAR was negative in the presence of tunneling or expropriation by controlling shareholders. They found RPT used for tunneling by controlling shareholders in the listed firms include asset sales and acquisitions, asset swap, trade of goods or services, direct cash payment, and loan or loan guarantees. Cheung, Qi, Rau and Stouraitis (2009a) examined asset transfer pricing in the related party transactions in Hong Kong market. They found controlling shareholder of publicly listed firms transferring assets to extract private benefits at the expense of minority shareholders. Other than the presence of the audit committee, which seems to limit expropriation, the rest of the corporate governance characteristics have limited impact on the asset transfer price.

On the other hand, Lei and Song (2011) argued such resource transfer normally went through connected transactions that are exempted from disclosure to the regulator. As such, shareholders discounted the firm's share price when recognizing the conflict of interest in companies involving in RPTs, especially those showing intention to avoid disclosure and query. They found the CAR was lower for RPTs with disclosure exemptions, and the corresponding firm's valuations are considerably inferior. Hence, their result suggests that unless the firm adopts the practice of transparency by disclosing details of RPTs, investors will impose governance discount for suspicion of tunneling activities, even though such transaction is exempted from disclosure under the security exchange's regulation.

In examining asset expropriation[51] via related party transaction in the Chinese market,

[51] Tunneling is proxied by difference of related party transaction in accounts payable and receivable divided by total assets.

Gao and Kling (2008) found the governance mechanisms of board independence, clean audit opinion and ownership dispersion have negative associations with tunneling operations. While the firms' characteristics of size were also negatively related to tunneling, leverage was found to have a positive relationship. Presence of institutional ownership or blockholders per se showed no significant influence on firm to install sound governance mechanism, and neither do they enhance tunneling. However, competition of several blockholders to control a firm has decreased the likelihood of embezzlement. Furthermore, state-owned enterprise (SOE) as principal shareholder was found to have no significant effect on asset expropriation, which was again contrary to Chen *et al.* (2005) argument of SOE as principal owner tends to facilitate tunneling. Nevertheless, the economic reform in 2001 (Quing, 2003) which brought about improvement in corporate governance and limited the state influence in listed firms had resulted in a decline in tunneling.

In firms with concentrated ownership in China, Qian, Pan and Yeung (2011) found the announcement effect of RPT[52] measured by CAR on (5,-5) day window associated negatively with firm's political connection. However, despite their expropriation behaviour of self-dealing and tunneling via RPT, which are far more severe than firms without political connection, the firms still have advantages to secure bank loan access using political influence, as shown by the significant positive relationship between CAR and bank loans (leverage). Such lack of fear of capital market penalty contradicted the conventional understanding that a firm's leveraging position will affect the quality of governance control. In another similar study, Sari *et al.* (2014) specified four criteria[53] for use to classify an RPT as tunneling and examined which corporate

[52] These are related party transactions which are likely to hurt the listed firms.

[53] The author identified as key criteria: (1) negative CAR around announcement of RPT, (2) transactions involving asset, cash payment, receivable, trading and loan guarantee, (3) similarity of controlling owners of listed company and its related party, and (4) difference in cash flow right of controlling shareholder and related party, whereby

governance mechanism can best explain tunneling activities in Indonesia. Using 55 sub samples that met the four tunneling criteria as the dependent variable, the result of logistic regression showed a positive significant coefficient for single shareholder explanatory variable at 5% level. This suggests a high tendency for tunneling to occur in firms with concentrated ownership.

Merger, Acquisition & Privatization

Researches in merger and acquisition generally show target firms earning positive CAR under various types of deals and motivations, whereas, findings for acquiring firms are more ambiguous with mixed results of negative, zero or positive returns (Servaes, 1991; Franks *et al.*, 1991). However, the value maximizing theory suggests that the expectation of a positive economic gain would result in target firm's shareholders gaining and at least a normal rate of return for the acquirers (Halpern, 1983). In Chi, Sun and Young (2009) study of merger and acquisition via related party transaction in the Chinese stock market, a significant positive CAR for the window (-2,2) was found, which was mainly due to political advantages the acquiring firms had.

However, according to Bae *et al,* (2002), rather than resolving or mitigate agency issues, certain mergers in Asia occurred due to agency issues. For example, evidences were reported on the controlling shareholders of Korean business groups (chaebols) using tunneling to seek private benefits while minority investors suffer. Therefore, when a company associated with chaebol acquires assets, the share price is discounted. However, the ultimate controlling firm benefited from the value enhancement of other firms under its control in the group, which is an evidence of tunneling hypothesis.

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earning outflow from company with lower cash flow right Sari *et al.* (2014)

Earning Management

Using 1,012 firm-year observations in Chinese stock exchange from year 2001 to 2005, Shan (2014) examined the relationship between firm's stock price (at fiscal year end), corporate governance index[54], and earning management of RPT through sales of goods. Two-stage least square regression result showed that firm's stock price has a significant negative relationship with earning management RPT, which in turn has the same relationship with the corporate governance index. This suggested a greater negative value impact for companies engaged in earning management RPT than those did not. Similarly, using 66 ST[55] designated firms during the period 1998 to 2000 as a sample, Liu and Lu (2007) examined how corporate governance factors are related to the earning management[56] RPT when a firm is in crisis. They used monthly abnormal stock market return as a proxy for the amount of wealth injected into an ST firm by controlling shareholder to save it from de-listing. Univariate analysis showed, on average, an ST firm's monthly stock price outperforms the market by as much as 31.81 percentage points, as a result of propping which takes the form of cash or quality asset injection. Regression results also showed that earning management has an inverse U-shape relationship with the largest shareholder ownership, implying the opportunistic earning management behaviour increases only until a threshold where the incentive to further expropriate is offset by the increase in his share of the firm's wealth.

In examining the negative effect of related party transaction on the earning quality[57],

[54] The corporate governance index components consists of state ownership concentration, foreign ownership concentration, board size, independent director, independent audit committee, supervisory board, professional supervisor and big4 auditor.

[55] According to Chinese Stock Exchange guideline (1999), a listed company will be designated an "ST" firm if it reports a net loss for two consecutive years, and suspended from trading in third year, and completely de-listed in fourth year, if remains in the net loss position.

[56] Earning management is measured by total accruals, industry-adjusted accruals and discretionary accruals.

[57] Earnings quality is measured using the discretionary accruals quality model (DAQ) as proposed by Francis, LaFond, Olsson and Schipper (2005).

Munir, Mohd Salleh, Jaffar and Yatim (2013) found a non-linear relationship between earning quality and family's ownership in the presence of RPT. This implies lower family ownership has a positive impact that outweighed the negative effect of RPT on earning quality. However, at a higher level of family ownership, the negative effect of RPT becomes substantially higher. A similar study by Jian and Wong (2004) also showed firms reporting abnormally high levels of RPT sales were motivated by earning management either to avoid being delisted or before new equity issuance. However, under free cash flow condition, diversion of resources to major shareholders occurred via generous trade credits and loans to related affiliates. Evidently, Chinese investors were aware of such engagement of RPT sales by mainly group-controlled firms, and eventually imposed a governance discount to their share price when they engaged in more related party lending later on.

Ge *et al.* (2010) examined whether the value consideration of RPT is relevant on sales of tangible and intangible assets in Chinese corporations. They found the reported earnings of firms with these RPT during 1997 to 2000 have lower valuations coefficient compared to those without such transaction. However, such trend was not observed during 2001[58] to 2003, after the imposition of new restriction on the accounting for related party transactions, suggesting effectiveness of the new ruling to curb misuse of RPTs for earnings management purposes.

3.3.1.2 Propping

In contrast to tunneling as a form of control for private benefits, propping view generally treats RPT as a mean to enhance value with the intention to reduce transaction cost and improve efficiency (Friedman, Johnson & Mitton, 2003). In Cheung, Jing, Lu, Rau and Stouraitis (2009)

[58] The Ministry of Finance in China, the China's accounting standard setter imposed a new restriction on the accounting for related party transactions. The new regulation states that if the price of a related party transaction is above its fair value, the price differential cannot be recognized as current earnings (Ge *et al.*, 2010).

study of RPT in China, they found state ownership is positively associated with RPT. Larger companies which are targets for propping have the worse off fiscal year operating performance preceding the announcement of RPT, with higher likelihood of foreign shareholdings and oversea cross-listing. Types of RPT used by listed companies for propping were cash payments, loans or loan guarantees, and transactions with its subsidiaries. On the other hand, smaller companies are subjected to tunneling, with tendency to disclose considerably less information, in comparison to RPT that involves propping up. In the study of Turkish business groups where pyramid structures are common, controlling shareholders used the offering of cash rights share issues to prop up cash in the distressed firms under a period of moderate macroeconomic shocks (Gonenc & Hermes, 2008).

In the China's study, Cheng and Chen (2006) found controlling shareholder propped up firm revenue and profit with a large percentage ratio of RPT before the IPO period, and began to obtain a large amount of cash loans with preferential terms from the post IPO subsidiaries. Such RPT is negatively associated with the industry-adjusted operating performance of the listed subsidiaries. State-controlled companies having high ownership concentration and low board independence are more likely to be expropriated by the controlling shareholder. Similarly, Ying and Wang (2013) found that the state-owned firms' propping behaviour of controlling shareholders was motivated by maintenance of shell resources for refinancing qualification. Later on, it will be followed by more serious engagement in tunneling by such state-owned firm, resulting in declining performance.

In an ownership–concentrated economy of Taiwan, Yeh, Shu and Su (2012) explored how corporate governance affects the level and motives of RPT that expropriate minority shareholder wealth. They found when there is a plan to issue new shares under conditions of

earning deterioration, RPT based on sales were used to prop up firm performance, as suggested by the prop-up hypothesis by Friedman *et al.* (2003) which has negative connotations. Hence, the empirical results showed good corporate governance practices have a negative relationship to the RPT of sales with negative motive.

3.3.1.3 Joint Venture & Partnership

In their study of S&P 500 firms in the US that disclose RPT, Kohlbeck and Mayhew (2010) found market assigns lower values and returns to firms that engage in simple transactions with a director, officer or shareholders. This is in comparison to more complex RPT such as those involving a firm's investment or partnership and joint ventures that the market generally does not appear to value negatively.

In the related party transaction of Hong Kong public listed firms, transactions such as takeover offers, joint venture arrangement, acquisition of leftover shares from other joint venture associate, and disposition of joint venture share to other joint venture associate, were considered as having strategic rationales and may not be an expropriation. In fact, positive CARs were observed over the next 10 days in (0,1) and (0,10) windows after announcing the RPT of takeover offers and joint ventures (Cheung *et al.,* 2006).

3.3.2 MSWG[59] Activism

"Shareholder activism can be viewed as representing a continuum of responses to corporate performance", as quoted from Gillan and Starks (1998). Besides having rights to

[59] MSWG stands for Minority Shareholder Watchdog Group, established on 30th August 2000 as a public company. It was founded and also financially supported by the Malaysian investment funds, namely: Armed Forces Fund Board (Lembaga Tabung Angkatan Tentera), National Equity Corporation (Permodalan Nasional Berhad), Social Security Organisation (Pertubuhan Keselamatan Sosial), and Pilgrimage Board (Lembaga Tabung Haji). Since 2005, the Capital Market Development Fund under the Ministry of Finance took over funding of MSWG organization (Ameer & Abdul Rahman, 2009).

appoint directors to the board, shareholders who are dissatisfied with the performance of firms have the choice to either sell off their stock, speak out their dissatisfaction, or simply hold on their shares, where Hirschman (1971) described the three actions as, "exit, voice and loyalty" respectively. Monitoring of firms via shareholder's activism can be achieved by combinations of measures such as: regular annual report, circulars and resolution reviewing process, attending company meetings, and giving direct feedback in written form to management regarding the social policies and operations aspects of a firm (Kim & Nofsinger, 2005).

In a dispersed shareholding public corporation, transfer of firm's decision control from owners to managers is intimately linked to the common problem of agency (Fama & Jensen, 1983; Jensen & Meckling, 1976), hence providing the basis for shareholder activism that focus on corporate governance issues. Since small shareholders develop a rather transient relation with the organization, their dominant strategy is to sell their shares or free-ride off the activism of others, in the event of an increase or decrease in their invested firm's stock price (Admati, Pfleiderer & Zechner, 1994).

However, large block holders are considered the most likely to engage in "voice" activism, as they cannot easily sell without negatively impacting the firms' market value (Shleifer & Vishny, 1986). Previous studies directly related to the impact of shareholder activism on announcement effect of related party transaction are unavailable, albeit there are some that relates CAR to the shareholder activism. For instance, Becht *et al.* (2006) analysed firms engaged by fund activists and measured their impact on the firm's CAR in various windows (varies from 3 to 11 days) around the available announcement date of engagement outcomes. The engagement program and objectives were to seek significant changes in the company's strategy such as large asset sales, divestment and payout policy. In the absence of other difficult

information such as profit warning or unfavourable earning announcement, they found a positive CAR averaging 5.3% for the (-3,3) windows. Largest positive excess returns were associated with streamlining activities which included sales of assets and divisions, and the CEO and chairman turnover. This suggests block holders' activism is value increasing for the firm.

In the Korean market, Kim *et al.* (2009) focused on non-control-related activism measures of outside block holders who switch their investment purpose from passive to active. During post disclosure, the average abnormal return over an 11-day event window (from -5 to +5 days) was 3.73%. A significant increase in dividend payout ratios was observed in certain sub-groups with a wider scope of activism and with high free cash flow. According to Park, Selvili and Song (2008), strategizing of business alliance and enhancement of firm value via shareholder activism are the intents of block holders when making partial acquisitions. The respective evidences were found in the statistically significant 3-day CAR of more than 15 percent in stock prices after the announcement of the acquisition. Such market reactions suggest the existence of monitoring and synergy benefits in the presence of large outside block holders. In the owner-initiated-privatization of Italian public listed firm, the accepted bid offers premium were significantly greater if institutional investors have major involvement in the bid process. On the contrary, factors of external validation of the offer price, and threat to merge if the bid fails, had no impact on the premium paid by the bidder (Bajo *et al.*, 2013). This suggests that institutional investors can act as effective activist cum guardians for minority shareholders.

In Malaysia, MSWG was established in 2000 as a public company by the Malaysian investment funds[60] with the long term ultimate objective of raising shareholders' value. Initially founded and backed by these institutional bodies, MSWG possess the distinct advantages of

[60] When Capital Market Development Fund (CMDF) of Ministry of Finance took over funding of the organization in 2005, MSWG was transformed into an independent, self-governing, and nonprofit professional watchdog body licensed under the Capital Market & Services Act 2007.

better government's information for its management, and a superior knowledge and understanding of shareholders' right. Such credibility has enabled MSWG to act as a leader for the rights of minority investors by influencing the listed firm's decision-making process, and to monitor listed firms' non-compliance to corporate governance procedures, which is in line with its main charter. Furthermore, the unique role of MSWG activism also serves as a key source of investment's education to the general public, especially the retail investors.

Ameer *et al.* (2009) assessed the effect of MSWG's role[61] on performances of firms targeted for activism. The main objective of the study was to examine how the market reacts to MSWG's activism in the firm likely to have agency problem. A sample[62] of 112 companies listed on Bursa Malaysia during 2005 to 2008 was selected as the target, with each matched to a control company similar in size and industry classification. During the first two years of MSWG involvement[63], these targeted companies were found to be positively associated with stock returns and earning increase, whereas, the non-targeted or control companies were not. The results implied MSWG's activism reduced information asymmetries through provision of constructive solution to minority and institutional shareholders. Using 434 sample firms from year 1999 to 2002 in Bursa Malaysia, Abdul Wahab *et al.* (2008) investigated the MSWG-activism's effect on the relationship between institutional ownership and corporate governance. Regression results showed such activism having a positive impact on the relationship between institutional ownership and corporate governance.

[61] MSWG represents the voices of minority investors during firm's general meeting, and also facilitates proxy-voting services to shareholders (Ameer *et al.*, 2009).

[62] Descriptive statistics on ownership type and percentage (sample mean) of targeted-firm: family (10.6%), Institution (52.9%) and Foreign (7.7%). It shows the majority of firms' controlling shareholders are institutional investors.

[63] The authors acknowledged the fact that, in the overall sample, institutional investors mean ownership were significantly higher at 52.9% (meaning at individual firm level, some are actually the dominant or controlling shareholders), and they formed coalition of activism with MSWG (Ameer *et al.*, 2009). However, in a firm where the institutional investor is also the controlling shareholder, such coalition theory does not apply since shareholder activism is aimed at monitoring the controlling or dominant shareholder.

3.3.3 Board Composition

3.3.3.1 Board Size

The board of directors is elected by shareholders and made up of either internally chosen company's employee (CEO, CFO or managers who works for the company), or those chosen externally and independent from the company. The board advocates for the shareholders and monitors the managers to make sure shareholders' interests are well served. However, no collective consensus can be found on one ideal board size which is considered best for all firms. An oversized board poses the challenge of effective coordination with meaningful participation of individual directors. Most board sizes range from 3 to more than 30 members. Sometimes, for staffing requirements of various committees, such as nominating or governance, additional people may be necessary.

Lipton and Lorsch (1992) argued a board bigger than nine directors is considered oversized and will become ineffective. This is due to the directors spending more time and resource negotiating and compromising during the process of decision-making, and free-riding among them. Overall, the directors have major roles and responsibilities in firm's corporate governance. The board is responsible to support and approve the company's strategic plan; develop policy and steer company's direction; appoint, supervise and remunerate senior executives; and ensure accountability to shareholders and regulators. However, Barucci and Ceccacci (2005) and Erickson *et al.* (2005) found wide empirical evidences that firm's market value has negative associations with board size and ownership concentration albeit the relationship between size of board and governance is still ambiguous. Hence, *Board Size* was also found to negatively relate to the firm's value (Yermack, 1996).

However, there is no previous study found that directly examines the effect of board size

on RPT. Hence, this study intends to fill the gap by including *Board Size* as an independent variable affecting CAR, the announcement effect of RPT.

3.3.3.2 Board Independence

A board which is effective should consist of mostly independent or outside directors. An outsider director is someone who has never been employed by the firm before. Furthermore, the outside director has no connection to any senior staff in the firm, and did not work for the firm's major vendor, client or service providers, such as an attorney, accountant, consulting specialist, financial institution, et cetera. According to Barucci and Falini (2005), a dominant shareholder is more likely to prefer controlling a small board. In this respect, a small board with a large percentage composition of independent directors could be an indication of good governance, since their key roles are supposed to protect minority interests by balancing executive interests while pursuing the shareholders' value. They also found in the Italian study that institutional stakes correlated positively with board independence. Using an Asian sample firms with high family-ownership concentration, Chen and Nowland (2010) found the firm's performance (TobinQ) had a "concave" relationship with board independence, with an optimal level of board monitoring at 38% board independence[64]. The "concave" relationship also implied difference in relative costs and benefits of the firm's performance monitoring. It showed that more monitoring, represented by the high percentage of board independence is not necessarily good for minority shareholders[65]. A Malaysian study indicates a positive relationship between number

[64] Result showed the optimal level is less in the non-family owned firms. It suggests under conditions of non-CEO duality and presence of audit & remuneration committees, board independence in excess of 38% will create interference with the family group's long and successful wealth creation dynamics.

[65] On the other hand, optimal level increased for entrenched family ownership (wedge control-right to ownership-rights), and lower when interests of family group with higher cash flow and minority shareholders are better aligned. The optimal board level is also expected to be lower when block holders or debt holders shared some of the governance role.

of directors and earnings management[66] (Abdul Rahman *et al.,* 2006). The managerial hegemony theory explained that controlling managerial dominance over board members hiring and board decision matters resulted in low levels of board independence, hence ineffective in monitoring and preventing earning management.

In examining asset expropriation[67] via related party transaction in the Chinese market, Gao and Kling (2008) found the governance mechanisms of board independence, clean audit opinion and ownership dispersion have negative associations with tunneling operations. Kohlbeck and Mayhew (2004) who found loan as one of the most common RPT concluded that higher board independence is associated with lower likelihood of RPT, as stronger board monitoring mitigates occurrence of RPT and discipline disclosure when they occur. However, when investigating factors affecting expropriation in the publicly listed firms of Bursa Malaysia, Mustafa, Abdul Latif and Taliyang (2011) found the value of related party transaction (RPT) increases with higher board independence. A possible explanation is that an increasing independent board actually approved more RPT transactions since they believe the interest of minority shareholders was not neglected. Since the sample data was based on 2009 which is a period of economic shock, such findings of high RPT may also be attributed to increased internal mobilization of resources in managing bad earnings. Nevertheless, Janggi and Leung (2004) argued that differences in characteristics of boards will affect their true independence level, which might result in a different actual relationship with expropriation of minority shareholders' right. In addition, the inefficient selection process of outside directors due to lack of time, expertise or incentives will also lead to engaging directors with poor or inappropriate

[66] It refers to management of the public firm's earnings report which is biased to the interest of controlling shareholders.
[67] Tunneling is proxied by difference of related party transaction in accounts payable and receivable divided by total assets.

characteristics, resulting in compromising the independence of board members (Agrawal & Knober, 1996; Patton & Baker, 1987).

In his model involving trade-off of inside versus outside board members, Raheja (2005) considered the board as the functions of project monitoring ability and making CEO succession decisions. While outsiders are not well informed on the company's projects, they have an independent relationship with the CEO. Inclusion of insiders on the board can lead to a more effective administrative decision because of their familiarity with the firm-specific situation. However, due to a possible lack of independence from the CEO, insiders may not divulge key information easily and might require incentive to do so for reasons of private benefits extractions (Fama & Jensen, 1983). Since the inception of the MCCG code by Security Commission Malaysia in 2000, and its subsequent revisions in 2007 and 2012 from lessons learnt, the main emphasis has been on the enhancement of board effectiveness and reinforcement of its independence.

3.3.3.3 Family Director Concentration

No study was found that directly examines the effect of family director's concentration (FDC) on RPT. Hence, it is also the intention of this study to fill the gap by examining the relationship between the announcement effect of RPT (CAR) and the family director's concentration. In this study, family director's concentration is defined as the ratio of directors who are family members of dominant controlling shareholders to total directors on board. In the context of this research, the closest proxy[68] for FDC is possibly the cash ownership of directors, which is another independent variable in this study under the corporate governance factor of

[68] Refer to Table 5.5 of Correlation Matrix between Independent Variables, where total percent cash ownership of all directors (CODIR) was found to have a positive significant correlation at 1% level (Pearson correlation coefficient = 0.401) to FDC.

ownership structure.

Nevertheless, the pros and cons of a firm run by family are well researched in the literatures. Family business has advantages over non-family firms such as alignment of objectives between managers and owners, as they are same individual or a kin relationship. Certain study also found active involvement of the family in management responsibilities as positive for the firms (Anderson & Reeb, 2003) in spite of the long held belief that family-owned companies under perform the non-family-owned. However, in the absence of market's disciplinary effects, firm's opacity due to over reliance on trust in place of external control (like accounting data and audits) can obstruct access to external financing, hence hinders growth. Thus, the lower levels of professionalism will result in management and governance of firms less effective (Martinenz *et al.,* 2007).

In their Hong Kong's investigation, Cheung, Chung, Tan and Wang (2013) found connected directors or family members of controlling shareholders have negative associations with good governance practices, especially among family controlled firms. These firms' value suffered discount as the market penalized their vulnerability to expropriation by the controlling shareholders, in an environment of high family director concentration. A Malaysian study by Wan Mohamad and Sulong (2010) found a significant negative relationship between family director concentration and corporate governance disclosure.

On the other hand, according to Silva and Majluf (2008), at lower ownership concentrations, family ownership[69] adds value to the firm, and firm performance is enhanced further with increasing family directors' participation, whereas, the effect is opposite when the ownership concentration is high. Thus, for low ownership concentration, the advantage of family

[69] It represents the two dimensions of ownership concentration and family director concentration (Silva & Majluf, 2008).

over non-family firms is clear as long as they are under market scrutiny. On the contrary, performance in non-family firms increases with concentration of ownership because the heterogeneous major shareholders that own and manage the firm have different interest[70], in which only the firm itself is their common interest. It was also found that institutional relatedness[71] impact firm performance positively.

3.3.3.4 CEO Duality

The tradition of having the same individual holding CEO and chairman position is called "duality". It connotes a conflict of interest when the CEO chairs the board, since the concurrence of the two roles will result in no independent figure acting in the interests of all shareholders, hence a bad governance feature. A code of best practice from Cadbury (1992) recommends two different persons as chairman and CEO. Similarly, codes of MCCG 2012 also require the positions of CEO and Chairman (who must also be a non-executive board member) to be held by different individuals (Recommendation 3.4 of Principal 3), and in cases where the chairman is not an independent director, board independence must be greater than 50% (Recommendation 3.5 of Principal 3) (SCM, 2012). Nevertheless, although the responsibilities of an organization's CEO[72] are determined by the board, as a leader, the CEO also advises the board of directors. In some European Union countries, the two-tiered executive and supervisory boards are presided by the CEO and chairman respectively, who are two different people. While the executive board runs day-to-day operations, the supervisory board[73] is empowered to hire and fire the members of the executive board and determine their compensation. In the UK, CEO and chairman are

[70] This includes institutional investors, national and foreign firms.
[71] According to Peng *et al.* (2005), institutional relatedness refers to the extent of interconnections with other relevant firms or dominant institutions that can bestow resources and legitimacy to the firm.
[72] It is normally called CEO in US, and MD in UK. We will use CEO as head of a corporation in this study.
[73] Consist of all non-executive directors who stand for investors and firm's employees.

normally two different individuals, whereas in US dual role is the norm and the board of directors is largely chosen by the chairman/CEO[74]. The corporate governance survey by Credit Lyonnais Securities Asia (CLSA, 2007) revealed more than 80% of the eleven countries in Asia Pacific did not have separate chairman and CEO, with the chairman being independent of the CEO. On the other hand, the Italian market study by Barucci and Falini (2005) showed large firms or pyramidal group tend to separate the positions of CEO and chairman. However, since past studies showing significant results of the direct effect of CEO duality on RPT are unavailable, this independent variable will also be included in the analysis of CAR.

In studying the relationship between corporate diversification strategy and corporate governance's quality in Malaysia, Che Ahmad *et al.* (2003) found CEO duality has a significant positive correlation with diversification. It signified separation of CEO and chairman will ensure appropriate balance of power and increase management's accountability in curbing non-value added diversification activities which were rampant at the time of study, and potentially involving abusive RPTs. The similar negative relationship was also observed between CEO duality and corporate governance disclosure in the Malaysians companies by Wan Mohamad et al. (2010).

Chen *et al.* (2010) investigated the existence of optimal board monitoring in firms with dominant family ownership in Malaysia, Hong Kong, Singapore and Taiwan. They found CEO duality negatively associated with firm performance (TobinQ) for both family and non-family owned firms. In family-owned companies with high cash flow rights, the regression results indicated a negative correlation between CEO duality and TobinQ. For the entrenched[75] family-

[74] It is contrary to MCCG 2012, and from the corporate governance standpoint, it is near impossible for institutional investor to "fire" the chief executive.

[75]Entrenchment is proxied by the control to cash ownership rights ratio which is greater than one. It is also known as control wedge.

owned companies, a strong negative relationship was observed. The former implied for firms without CEO duality, interests of minority and controlling shareholders are better aligned when ownership rights of controlling shareholder increased. In the latter case, control wedge exacerbated the extraction of private benefits by owner-managers in the presence of CEO duality. Furthermore, in the presence of a block holder[76], Chen *et al.* (2010) also found CEO duality negatively associated with firm's valuation, which means outside block holders tend to see CEO duality as not being conducive to the enhancement of firm value, hence discouraged such a leadership structure.

3.3.3.5 Audit Committee Independence

An audit committee is tasked by the board to oversee and ensure all matters related to finance are properly reported and disclosed. Its members are selected from the board of directors where one of them, with preference for someone with a qualified accountancy background, will chair the committee. Usually, they are given the authority to appoint consultants and experts considered mandatory from the regulatory standpoint in discharging their duties. They also oversee activities such as RPT, managing firm's risk to ensure compliance with the security exchange regulation. In their survey of corporate governance in Asia, Claessens and Fan (2002) found audit committee played the key roles of monitoring and bonding of management to mitigate agency problems in the organizations. For instance, in their examination of asset transfer pricing RPT in Hong Kong market, Cheung, Qi, Rau and Stouraitis (2009a) found the presence of the audit committee limits extraction of private benefits by controlling shareholders at the expense of minority shareholders. In Malaysia, the codes in MCCG 2007 only mandate the audit committees to fully comprise of non-executive directors. Subsequent revision in MCCG

[76] Non-controlling block holder owing more than 10 percent of the total share (Chen & Nowland, 2010).

2012 also does not recommend any specific requirements on the percentage of independent directors in audit committee (SCM, 2012), which is the most important function of the board. Since there is no prior specific study on the direct effect of *Audit Committee Independence* on RPT, inclusion of this variable in the analysis of CAR will help to fill the research gap. Hence, this study also intends to investigate the effect of a fully independent audit committee that consists of only independent directors on CAR.

Nevertheless, in analysing the effect of corporate control on East Asian companies during the financial crisis, Mitton (2002) found that firm stock price has a significant positive relationship with firms offered higher disclosure quality[77], implying the presence of effective audit committee, whereas, Chen *et al.* (2010) also showed that the audit committee has a positive significant relationship with the firm valuation. In examining the effectiveness of audit committees, Erickson *et al.* (2005) found that audit committee independence has positive associations to firm value, in particular with presence of outside director of a financial institution. In a Malaysian study of corporate control of earnings management, the audit committee factor was found to be insignificant, implying ineffectiveness in the oversight of firms in generating accurate accounting report (Abdul Rahman *et al.,* 2006). The main reason for such weakness was dominant owners tend to dictate the selection of external directors, hence compromising the independence of the audit committee.

3.3.4 Ownership Structure

In their study involving 4000 European corporations from fourteen countries, Bennedsen and Nielson (2010) analysed the association between disproportional ownership structure and value discount of firms. In line with the theory of incentive and entrenchment effect, presence of

[77] This is due to presence of effective internal audit committee that sourced for reputable (the big 6) external auditor.

wedge in control and cash ownership rights was strongly correlated to firm's valuation discount, more significant in family-owned companies, companies having low cash flow, and companies in high amenity value category. The feature of voting premium[78] in the Italian stock market represents poor investor protection, whereby Caprio and Croci (2008) found the largest shareholder's identity to be the main attribute that accounts for the price premium of voting share[79]. Family-controlled firms, where the founder is also the CEO and/or Chairman, have higher voting premium. Results from these studies demonstrate the great importance family shareholders placed on control compared to other types of shareholders, and firms are more prone to expropriating the minority shareholders. In addition, the presence of high ownership concentration of pyramidal and cross-holding structures will further entrench controlling owners, hence giving a negative mediating effect on the relationship of firm valuation and corporate governance practice, as shown by the respective studies in the East Asian countries and Thailand by Fan and Wong (2002) and Connelly, Limpaphayom and Nagarajan (2012).

3.3.4.1 Cash Ownership of Dominant Owner & Directors and Divergence of Control Rights

According to Claessens, Djankov and Fan (2000), family interests dominate ownership structures in many jurisdictions, and 60% of the non-widely held firms[80] were managed by executives who are relatives of the dominant shareholders. In studying worldwide corporate ownership, La Porta *et al.* (1999) concurred firms are typically controlled by families or state, in particular countries with poor shareholder protection, in line with Fogel (2006) argument that family ownership prevails in countries with weak legal framework of law for investors' right

[78] Voting premium is defined as difference of voting and non-voting shares price divided by price of voting shares.
[79] Shares with voting right usually trades at a premium relative to non-voting shares.
[80] Claessens *et al.* (2000) examined the separation of ownership and control in a sample of 2980 public listed firms selected from eight countries in Asia (including Malaysia). Study found they are generally family-owned, dispelling the notion of older firms are more dispersed.

protection. This is contrasting the classical widely held image of Berle and Means (1932), where diverse share ownership will result in management and directors, managing the firm's resources to the owner's best interest without effective investor scrutiny. La Porta *et al.* (1999) and Claessens *et al.* (2000) defined a widely held corporation as one with no ultimate controlling owner, someone who is not controlled by anybody else. In identifying the ultimate owners of corporation from 27 countries, they found that 64 percent of firms in the sample have a controlling shareholder, having at least 20 percent control or voting right, regardless of their actual ownership rights or cash flow rights, which are usually much lower. It is argued that firms with founder-shareholders having family interests can provide better quality oversight, and governed differently than firms without such influence. Using samples of US firms between 1992 and 2000, Anderson and Reeb (2003) and Villalonga and Amit (2006) found one-third of S&P 500 firm have dominant founding family ownership and accounted for 18 percent of outstanding equity. They showed firm valuation is positively related to founding-family holdings, and firm with family member served as CEO or chairman, suggesting CEO's cash ownership incentivize his performance. In line with Jensen and Meckling (1976) characterization of agency conflicts between owner-manager and outside shareholders, it supports the fact of manager's tendency to expropriate increases when his ownership claims fall, as there is less incentive to devote significant effort in searching out new profitable venture.

Amzaleg and Barak (2013) investigated 218 related party transactions (RPTs) of 129 different firms from year 2001 to 2003 in Israel, an economy characterized by a high percentage of closely-held family owned firms with average holdings of 78.7%. RPT announcement effect on the cumulative abnormal return of the stock price (CAR) for (-5,5) day window was 1.73% for non-family firms versus -0.96% for family-owned firms. Regression results also show that

family ownership has a significant negative effect of lowering the CAR by approximately 4% in comparison to non-family's ownership. The result indicates that RPTs in family firms are more likely to be sub-optimal (tunneling) transactions, suggesting the existence of private benefits consumption at high family ownership concentration. Besides, ownership concentration, poor disclosure of information were found to have significant association with negative CAR in the investigation of connected party transactions in public listed companies of Hong Kong by Cheung, Rau and Stouraitis (2006).

Using 151 RPT and non-RPT samples in the Indonesian market, Utama *et al.* (2010) examined the market reaction via cumulative abnormal return (CAR) of stock prices for firms with RPT announcements around (-1,5) day window. Regression results showed efficient RPT has a positive association with CAR, whereas, RPT perceived as expropriation are negatively associated with CAR. They further explain that market regarded RPT with disclosure of the transaction value as the efficient one, hence reflected by positive CAR. On the other hand, RPT that does not provide such disclosure was considered as abusive with negative CAR when investors imposed a governance discount on stock price.

Furthermore, Utama *et al.* (2010) also found concentrated share ownership of directors have a significant negative association with CAR. Such increase in board members' ownership implies entrenchment effect and a possible wedge in control and cash ownership rights which will result in a higher tendency for firms to engage in abusive RPT. Xiao (2009) examined the relationship between market-adjusted CAR and agency costs[81] around the announcement of related party transactions, using samples of 156 Chinese listed firms with individual ultimate owners. The regression results showed variables of cash ownership of dominant owner and divergence between control and cash right for dominant owners have a significant negative

[81] In this study, agency cost is proxied by the divergence between control right and cash flow right of the firm.

association with CAR for windows of (-10,1), (-2, 2) and (0,5). Such effect of governance discount is highly pronounced for RPTs involving loan guarantees and fund transfer. The corresponding positive significant result of a divergence factor in logistic regression of CAR[82] also suggests a high likelihood the firm will engage in the value-destroying RPT with increasing agency cost or divergence in control to cash right of the ultimate owner.

However, La Porta *et al.* (1998) explained that ownership concentration may also become a substitute for the weak shareholder protection laws, whereby large owners of firms have the power to oversee and control firms, as attested by Chen & Nowland (2010). This is also in line with Kim *et al.* (2007) findings in the European study where the relations between ownership concentration and quality of minority shareholder protection law were negatively associated, suggesting large owners and shareholder protection law are substitutes. However, their existence may not necessarily be good for the minority shareholders if the larger owners' interest is to benefit themselves, rather than bringing value to the firm. Burkart and Panunzi (2006) argued that since quality of legal rules also shapes the large shareholders' incentive to monitor, which in turns weakens managerial incentives, both effects (quality of legal rules and monitoring incentives) will jointly determine the relationship between legal protection and ownership concentration.

In the Western Europe characterized by strong legal protection environment, Pindalo, Requejo and Torre (2013) found a positive association between a company's value and concentration of family control, which is contrary to the expropriation hypothesis. However, the relationship was nonlinear but follows an inverted U-shape, with the optimal level of family control at about 55 percent ownership. Excessive concentration beyond this level may be

[82] In the regression, CAR is the dependent dummy variable with value '1' if CAR< 0 (signifying value-destroying) and '0' otherwise.

interpreted as a sign of entrenchment with accumulation of too much power, hence experiences firm value discount. This is in comparison to countries of weak minority investor protection, where the substitution effect of family influence on firm value is mostly positive regardless of the level of ownership concentration.

3.3.4.2 Cash Ownership of Block-Holders

In the past, worldwide investors were typically individuals or families[83]. Today's markets have become largely institutionalized[84] where most investment funds are set up to benefit individual investors. Most of these funds maximize on diversification through a large portfolio of corporations with adequate liquidity, thus eliminating individual firm's financial risk. There are substantial variations on the importance of institutional shareholders across the world. For instance, the retirement funds of Anglo-American countries are usually "large" shareholders dominating big corporations' stocks. An exception is the Japanese market, where the majority of the shares are held by the financial companies and industrial corporations[85].

Ishak and Napier (2006) classified direct block holders[86] into, "institution, state, financial institution, foreign company, individual/family and corporation", when examining the relationship between ownership composition and corporate diversification in Malaysian listed firms. Such categorizations[87] are tailored in Malaysian context and suitable for use as a basic reference for this study. On the other hand, Bushee (1998) classified institutional investors into

[83] This is either through an individual or a controlled entity.
[84] Institutions managing the pooled funds such as pension funds, mutual funds, hedge funds, exchange-traded funds, and financial institutions such as insurance companies and banks.
[85] Industrial corporations are not considered institutional investors if their holdings are largely within their own affiliated business group.
[86] In their study, it is defined as minority shareholders who owned at least 5 percent of share in the firm.
[87] *Institution* shareholders cover insurance firms, retirement funds and fund managers. Financial institutions are licensed bankers regulated by Bank Negara. *State* is a legal body at federal or state level (example: Urban Development Authority, Malaysian Industrial Development Authority, Petroliam Nasional Berhad, and various State Economic Development Corporations. This includes companies owned by the government through Ministry of Finance via entities such as Khazanah Nasional Berhad. *Foreign company* are firms incorporated outside Malaysia but having place of business in Malaysia and registered with Company Commision of Malaysia, CCM.

three groups[88] of transient, dedicated and quasi-indexers, who have differing objectives and information needs for their investments. In reviewing literatures on corporate governance from a UK perspective, McColgan (2001) acknowledged the need for more researches into a greater understanding of the distinctive types of block holders. Only a few have researched the impact of institutional owners on firm value, for example, Allen and Phillips (2000) and Musallam (2013), and no previous work investigates the effect of these block holders and institutional investors on shareholder's expropriation via RPT. Despite the lack of research on this subject, Atanasov, Boone and Haushalter (2010) argued that understanding the institutional block holder's behaviour is particularly important because intercompany transactions offer them ways to operate that are simply not available to other types of block holders. For instance, the incentives of a corporate parent (and its controlling executives) to expropriate wealth from a subsidiary can differ significantly from the incentives of individuals.

Hope (2013) explained the heterogeneity of concentrated ownership by families, institutions, governments and employee with respect to the importance of their difference in the roles of firms' level corporate governance. The roles played by institutional shareholders vary among countries due to differences in the legal protection system and the structure and organization of economic activities[89], and generally extant theoretical literatures tend to predict big institutional shareholders as efficient watchdog. Agency costs will incur as a result of divergent interests between the controlling and outside shareholders. Jensen and Meckling (1976) argued that incentive for any individual shareholder to monitor managerial activities for

[88] "Transient" institution focuses on short term trading profits with high portfolio turnover; "dedicated" and "quasi-indexer" institutions focus on long term and holds high stakes in a few firms, thus providing stable ownership that will incentivize monitoring activities (Hope, 2013).

[89] According to Jensen and Meckling (1976), when individuals and organizations enters a contract under the boundary of a country's statutory law, they focus on how the relevant authority enforce non-performance of contract and the corresponding collection of damages. The kinds of contracts being execute and their reliability are affected by the precedence set by courts' judgment on conflicts between contracting parties.

the agency cost reduction is proportional to the percentage of share ownership. Also, Pagano and Roell (1998) specified circumstances of block holders monitoring roles and predicted that increasing concentration of non-controlling shareholder is associated with less severe expropriation of minority shareholders. Martin de Holan and Sanz (2006) suggested the key determinant of a firm's ability to seize business depended on its access to the resources and capabilities not already controlled by it. Consequently, the existence of a strong pool of potential participants for new minority partnership is a positive attribute, strongly pointing to the benefits of knowledge and expertise from block holder's investment. Very often, contrary to Jensen and Meckling (1976) idea of outside investors monitoring activities of corporate insiders, such institutional shareholders are usually not keen to directly govern the firm. Normally, they are assumed to react by simply selling out their interest.

This study will add to the existing scarce literatures on the relationship between share ownerships of block holders with the valuation effect of RPT's announcement. Nevertheless, in a related study, Utama *et al.* (2010) found ownership of foreign major shareholders having significant negative association with CAR, when the foreign major shareholder utilized RPT to engage in transfer pricing activities. Such transaction was perceived as non-beneficial to minority investors who subsequently discounted the stock price upon RPT's announcement. In his study of the ownership structure in the emerging markets of Latin America (Brazil and Chile) which is characterized by weak shareholder protection, Cueto (2013) found the institutional investors assume monitoring roles and helped curtailing asset expropriation by the controlling shareholders. This was indicated by the positive significant coefficient of the block holders' governance variable[90] in the regression of firm value (TobinQ ratio). It supported the findings[91]

[90]It is a proxy made up of combined percentage of voting rights held by institutional and government investors excluding dominant shareholders.

of Erickson *et al.* (2005) and Chen and Nowland (2010), where the presence of other large non-bank[92] shareholders play the governance role to reduce the ability of dominant banks to obtain private benefits. Similarly, Barucci and Falini (2005) also observed positive relationship between governance's quality and stake of institutional investors such as bank, insurance and investment funds in the Italian financial market.

Even though it is common for many firms to have multiple block holders, there are only scarce and mixed empirical findings that assessed how firm valuation is affected by the function of non-controlling large shareholders (NCLS). Studies in East Asia (Attig *et al.,* 2009), Italy (Volpin, 2002) and Western Europe (Laeven & Levine, 2008) found higher economic premium is associated with NCLS. However, in their analysis of US data, Konijn *et al.* (2011) found the relationship otherwise; raising the question of whether firm's valuation was hurt by the NCLS's collusion with controlling shareholders. Using data from the China's market, Cheng *et al.* (2013) examined those NCLS related to dominant shareholder in terms of their connection at workplace, family, ownership and voting agreements. They found a significant negative association of Tobin-q with relational NCLS and ownership/board representation. Situation worsens in companies where agency conflicts are more pronounced. Similarly, in the study of financially constrained firms announcing an equity offering in China, their short and long term average stock price returns was found to associate negatively with high block holdings (especially non-governmental), hence, suggesting a signalling on the issuers' future financial constraints (Cheung *et al.,* 2012).

[91] Chen and Nowland (2010) found the optimal level of board monitoring became lower in the presence of equity block holders or debt holders, suggesting some of the governance load were possibly borne by institutional investor. Erickson *et al.* (2005) found directors from large minority shareholders such as financial institution could actually provide monitoring benefits.

[92] However, besides bank, result also showed that the presence of other major shareholders with similar interest as the dominant bank shareholder can lead to coalitions that reduce firm value, since such alignment of interests can be used to obtain common private benefits.

However, in another different situation of concentrated ownership environment, Ruiz-Mallorqui and Santana-Martin (2011) analysed how firm value is impacted by control of the dominant banking institution and investment funds, using samples of non-financial companies in the Spanish market. The study considered the level of voting rights held by the dominant institutional owners and other large shareholders. Results showed that firm value was negatively related to the voting right of dominant bank's institutional shareholder. Under the environment of weak legal protection of minority shareholders, this suggests likely extraction of private benefits by the dominant banking institution, which also had business relations with the firm. Such finding is supported by Abdul Wahab *et al.* (2008) study in Malaysia where institutional ownership without other business relation with the firm was found to correlate positively with corporate governance.

When it comes to decision making that involves investment, executive compensation and takeover activity, owner-managers will not alienate large shareholders who play the role of disciplining and refraining management from the inefficient opportunistic behaviour. This is as attested by studies of Admati and Pleiderer (2009), Bharakh *et al.* (2011), Edmans *et al.* (2011), Parrino *et al.* (2003) and Musallam (2013) that found large shareholders' credible threat of divestment which will lower firm's share price, hence, alleviating managerial incentive problems. Therefore, despite having no direct visible influence on corporate decisions, non-controlling large shareholders seem to improve firm governance with their mere presence. For example, on ownership structure versus corporate diversification in Malaysia, Che Ahmad *et al.* (2003) found outside block holders, especially non-institutional block holding negatively associated with diversification, a potential involvement of abusive RPT, which again suggesting their important role in overseeing the behaviour of management.

Presence of block holders playing a disciplinary role on different governance perspective can be found in other studies. For instance, Fagernas (2006) showed CEO's pay in India was positively associated with his relationship with the controlling group, a proxy for other rent-seeking activities that take place in the family-managed firms. However, presence of nominee directors of government-owned financial institutions or insurance companies had counter effect. In another cross-country[93] study, Aggarwal *et al.* (2011) found foreign institutional investor holdings positively related to the firm-level governance of companies in host countries. Foreign institutional investors from strong legal origin[94] countries were found to promote governance improvement and their outcomes. They found in firms where institutional ownership is high, poor performing Chief Executive Officers (CEOs) were more likely to be replaced, and subsequently the firm showed valuation's improvement. Similarly, in Volpin (2002) study on the sensitivity of a firm's performance to top executive turnover in Italy, firm values were found to have positive associations with the voting rights of dominant investment fund. He found large minority shareholder would only have a governance role to sensitize the firm's performance-turnover relationship in the presence of the voting syndicate, which signified a contestable corporate control. This also suggests the cost of expropriation was greater than any corresponding benefit when the primary objective of the investment fund was to enhance firm value. Interestingly, he also found firm values were further maximized by the presence of other large investment fund shareholder. However, it was otherwise, if the other large shareholder is

[93] The sample of focus are non-US firms (accounting for 71% of world market capitalization in 2008) covering 22 countries (mostly developed nations: Asia-4, Europe-17 & North America-1) for the period 2003 – 2008.

[94] England developed its own legal system which spreaded to US, Canada, Australia, New Zealand, Africa and South East Asia as the ***Common Law System***. France, Spain and their former colonies (include Latin American) adopted the ***Civil Law Tradition***. Germany and countries in Europe and East Asia use the ***German Civil Law Tradition***, while the Scandinavian countries formed their own legal tradition. Common law are most protective for outside investors, shareholders and creditors, whereas, French civil law are the weakest. German civil law and Scandinavian countries are in between, albeit relatively stronger protection for creditors (La Porta *et al.,* 1998, 2002).

not an investment fund.

3.3.4.3 Cash Ownership of Government Linked Investors or State Government

State-owned enterprises[95] (SOE) are important in the emerging world and out of 100 world's largest firms, 28 are SOE. Especially in the oil and gas industry, SOEs contribute significantly to the market capitalization of Russia's and China's share markets (Hope, 2013). However, such trend contrasts with the property rights theory which advocates for ownership and control right in favour of parties with ex-ante specific investments (Hart & Moore, 1996), rather than SOE's managers who generally lacks profit maximization's motive when the company is majority owned by the state. Schmidt (1996) argued that in exchange for the benefits of better information for government on its management, the firm suffers from potential excessive interference on political reasons, hence a trade-off for the state owned firm. On the other hand, Boubakri, Guedhami and Mishra (2010) found the equity capital cost of firms have a negative association with political connection or majority state-ownership, indicating better insulation from financial difficulties, and protection by government's bail-out. Such evidence was found in their study of the indirect equity's cost before and after the financial crisis in eight Asian countries including Malaysia.

At the point this research is undertaken, no previous studies in Malaysian context can be found in the relationship between ownership of government linked investors or state government and the firm's valuation effect of RPT's announcement. Nevertheless, in Cheung, Rau and Stouraitis (2009) analysis of RPT between Chinese listed firms and their state-owned enterprise (SOEs) shareholder with more than 35% ownership, they found a significant negative market-adjusted CAR of (-2,2) around the RPT announcement, signifying expropriation of minority

[95] The United Nations Conference on Trade and Development defines a state-ownership as holding 10% or more of the firm's share by the state.

shareholders of the firm. However, in his Malaysian investigation of the effects of ownership structure on firm's market performance, Musallam (2013) found shareholding of most government linked investment companies (GLICs) are positively associated with the firm's performance measures such as ROE and ROA.

In their China's study, Berkman, Cole and Fu (2009a) found in firms with weaker governance, CAR around the announcement period of regulatory change to improve minority shareholder protection was positive. However, the CAR result was insignificant for firms with strong ties to government, suggesting minority investors did not expect effective enforcement of new regulations on firms where institutional block holders have strong political connection. As shown by other similar studies (Claessans & Fan, 2002; Morck & Yeung, 2004; Morck, Wolfenzon & Yeung, 2005), weak corporate governance plus government interference will induce negative incentive effects on dominant institutional owners or block holders with high voting rights, such as influencing lawmakers and judges, and currying favour with civil servants.

On the other hand, Berkman, Cole and Fu (2009b) and Jiang *et al.* (2010) respectively examined tunneling via inter corporate loans, and expropriation involving loan guarantee in China's publicly listed companies, where state ownership was high. In the presence of state-owned but non-corporatized controlling block holders and state-owned firms they found the problem of expropriation less significant. In a similar respect, Dewenter *et al.* (2010) found sovereign wealth funds (SWF) that manage investment portfolios on behalf of governments have the advantage of possessing more superior information over their private counterparts; hence, their transactions give a stronger signalling effect to the firm's stock price reactions.

3.3.5 External Economic Shock

Incentive of controlling shareholders to expropriate minority shareholders to compensate

for their loss increases in weak market at a time of external shock (Lemmon & Lins, 2008). Furthermore, the impact of general economic conditions on expropriation could be different during between and after any financial crisis.

The global markets were adversely affected during the critical period of US subprime crisis (September 2008 to March 2009), where Dow Jones Industrial Average had dropped 54% to 6469 before beginning to recover in March 2009. Even though a co-integration study indicates that the Malaysian market has a weak interdependence with other Asian-Pacific or developed markets, it shows US has a dominant role in influencing Malaysian market during the peak of the subprime crisis (Lee & Isa, 2014).

3.3.6 Firm Characteristics

3.3.6.1 Size

Amzaleg & Barak (2013) found firm size effect is positive and significant in the regression of RPT's announcement effect on CAR at the window (-5,5). This suggests bigger firms which are better publicized by the media tend to have a more positive impact by the RPT's announcement. On the other hand, factors associated with direct measurement of expropriation such as tunneling and inter-corporate loan (Berkman *et al.,* 2009b; Jiang *et al.,* 2010) were found negatively related to firm size. Also, in examining asset expropriation[96] via related party transaction in the Chinese market, Gao and Kling (2008) found the firms' characteristics of size negatively related to tunneling.

3.3.6.2 Leverage

Using broad-based comprehensive governance metrics from Institutional Shareholder

[96] Tunneling is proxied by difference of related party transaction in accounts payable and receivable divided by total assets.

Services[97] (ISS), Jiraporn, Kim, Kim and Kitsabunnarat (2012) examined the association between aggregate corporate governance quality and leverage. It showed the governance's quality is inversely related to leverage. Hence, poorly governed firms were found to be significantly more leveraged. Conversely, stronger governance will influence the choice in capital structure decisions making in favour of low leveraging.

Studies by Cheung *et al.* (2006) and Bae *et al.,* (2002) involving direct measurements of tunneling acts in Hong Kong showed a positive significant relationship between CAR and leverage. From the corporate governance viewpoint, debt factor in the above case was expected to have a positive valuation effect on the stock price of the firm due to the associated monitoring effect of lending financial institutions. One unique example is the study by Qian, Pan and Yeung (2011) in firms with concentrated ownership in China. Using CAR on (5,-5) day window as the measure of the announcement effect of RPT[98], they found CAR has a positive significant association with the interaction terms of bank loan and firm's political connection. It suggested these firms have advantages to secure bank loan access using political connections, in spite of their severe expropriation behaviour. However, such lack of fear of capital market penalty contradicted the conventional understanding that a firm's leveraging position will affect the quality of governance control. Similarly, Gao and Kling (2008) found leverage having a positive relationship with tunneling operations when investigates asset expropriation[99] via related party transaction in the Chinese market. On the other hand, investigation of propping via RPT in China by Peng, Wei and Yang (2011) showed CAR (-5,5) has a significant positive relationship with firm's leverage, suggesting highly levered firms are more prone to RPT with the motivation of

[97] The ISS governance standards include 51 factors under 8 corporate governance categories, "audit, board of directors, charter/bylaws, director education, executive and director compensation, ownership, progressive practices and state of incorporation."

[98] These are related party transactions which are likely to hurt the listed firms.

[99] Tunneling is proxied by difference of related party transaction in accounts payable and receivable divided by total assets.

propping.

The other China's study by Bailey *et al.* (2009) found firms with high state ownership and frequent engagement in RPT suffered significant negative CAR around loan announcement window period, and subsequently showing poor financial performance. In a separate emerging market study in Russia, Godlewski (2010) investigated the stock market reaction to debt (issuance of loans and bonds) using a sample of 76 listed companies in 2004 to 2008. The study shows a negative abnormal return (CAR) of -1.2%, -1.3% and -5.3% upon announcement of the debt arrangements for event windows (0,0), (-1,1) and (-2,2) respectively. It implied high likelihood of controlling shareholders' moral hazard behaviour which is in favour of debt expansion at the expense of debt holders. Contrary to positive CAR result from the developed country such as Hong Kong, these findings also suggest that the institutional frameworks in emerging countries influence stock market reactions to debt announcements.

CHAPTER 4: RESEARCH DESIGN AND METHODOLOGY

4.1 Introduction

Past researches used cumulative asset returns as the reflective indicator of a firm's performance or the dependent variable. For instance, Cheung *et al.* (2006), Morck *et al.* (1990), Jiang *et al.* (2010) and Berkman *et al.* (2009) focused on tunneling activities (such as asset acquisitions, inter-corporate loans' issuance and loan guarantee) by directly examining the related party transaction of listed companies in Hong Kong, China and US markets using the cumulative abnormal return of the stock price (CAR) as the dependent variable of studies. On the other hand, similar studies, but cross-countries in nature were conducted by Lemmon and Lins (2008) and Croci and Petmezas (2010) which involved Malaysia as well.

This study of related party transaction is differentiated by its Malaysian context, a representation of the emerging economy. It is a direct measurement of the likelihood of expropriation by controlling shareholders by measuring CAR as the announcement effect of RPT. The research framework focuses on the unique role of shareholder activism by the Minority Shareholders Watchdog Group (MSWG), corporate governance factors of board composition and ownership structure, and ownership of block holders in particular the government linked investors, which is a proxy for the large government's level equity ownership in Malaysia.

4.2 Cumulative Abnormal Return of Stock Price (CAR)

Minority shareholders discounting of stock price could be explained by information asymmetries between the majority and minority shareholders. In this research model, cumulative abnormal return (CAR) of stock price is the observed variable reflecting the effect of RPT. CAR

will be estimated based on announcement day as a reference point, where $d^{100} = 0$. Around the event announcement period, negative return of stock price suggests the market perceives transaction as unfavourable to the firm, hence discounting the stock price. In the same token, the opposite is true for a positive return of stock price.

4.2.1 Definition of Abnormal Return

In order to determine the impact of the transaction, measurement of abnormal return is required. The abnormal return is the actual ex post return of the security over the event window minus the normal return of the firm over the event window (MacKinlay, 1997). Therefore, for the firm i and event date t, the abnormal return is

$$AR_{it} = R_{it} - E(R_{it} \mid X_t)$$

where AR_{it} is the abnormal return, R_{it} is the actual return, and $E(R_{it} \mid X_t)$ is the normal return for a time period t, where X_t is the conditioning information for the normal return model. The constant mean return model (assume the mean return of a given security is constant through time) and market model (assume a stable linear relation between market return and the security return) are the two common choices for modelling the normal return. This study adopts the more popular market model approach to enable drawing of overall inference for the event, where cumulative abnormal returns (CARs) are aggregated along two dimensions – through time and across securities (MacKinlay, 1997).

4.2.2 Estimation of Abnormal Stock Returns

Fama *et al.* (1969) introduced and popularized the market model in event studies which many researchers used to focus on how stock prices respond to information in a short window (a

[100] For short-horizon, d is ranging from -30 to 30 days; and for long-horizon, d is ranging from -12 to 12 months.

few days). The advantage of studies focusing on short window returns is, the less effect the daily returns has on inferences about abnormal return, since the daily expected returns are close to zero. According to Fama *et al.* (1998), the key assumption in short window studies is that any lag in the response of prices to an event is short-lived[101]. As part of the regulatory requirements, a listed firm must announce the related party transaction to the security exchange and make known the announcement date of the transaction. Brown and Warner (1985) recommended several approaches for estimating the daily cumulative abnormal returns of stock prices[102]. The daily abnormal returns in this study will be estimated using the approaches of OLS market-model residuals[103], where an estimated period of 170 trading days will be used, from day -200 to -31 relative to the date of announcement, $d = 0$. The market index is the FTSE – Bursa Malaysia Kuala Lumpur Emas Index (FBMEMAS).

4.2.3 CAR as Indicator of Minority Investors Protection

In their direct examination of tunneling[104], propping[105] and expropriation in the Hong Kong public listed companies, Cheung *et al.* (2006) found significant negative excess CAR for firms only after the announcement of the connected transaction, suggesting investor could only predict expropriation after its occurrence. The percentage of major ownership and poor disclosure of information were also found to have a significant negative association with CAR.

[101] Based on *efficient market hypothesis* where stock market quickly and completely incorporates public information into the stock prices (Fama, 1970).

[102] For mean-adjusted return, security i at day t, abnormal return, $AR_{it} = R_{it} - R_i$, where, R_{it} = Observed arithmetic return; and R_i = the simple average of security i's daily return in the (-200, -31) estimation period. For market-adjusted return, security i at day t, abnormal return, $AR_{it} = R_{it} - R_{mt}$, where, R_{it} = Observed arithmetic return; and R_{mt} = the return of Kuala Lumpur Stock Index for day t.

[103] For security i at day t, abnormal return, $AR_{it} = R_{it} - \alpha_i - \beta_i R_{mt}$, where, R_{it} = Observed arithmetic return; α_i and β_i are OLS values from the (-200, -31) estimation period; and R_{mt} = the return of Kuala Lumpur Stock Index for day t.

[104] Tunneling occurs when dominant shareholder shift resources out from his low stakes firm to the one with high stake (Johnson, Boone, Breach & Friedman, 2000).

[105] Propping is a transfer between firms from high to lower level in the control chain, with the intention of bailing out receiving firm from bankruptcy (Friedman, Johnson & Mitton, 2003).

In examining the relation between firm-level corporate governance (CG) and cumulative abnormal returns (CAR) of stock price to announcement of rules and regulation's violation, Kouwenberg and Phunnarungsi (2013) observed significant differences between firms with low and high past violation track records. For low CG firms with very low or no past violation record, the CAR showed the most negative (-8.1%). Such CAR pattern suggests the market relied on past violation records, and did not fully discount governance policy until a firm with good track records commits a violation. This explained the low (-8.1%) CAR for good track record firm with low CG, compared to an average -0.3% CAR for good firm (low or no past violation record) with high CG, in response to an announcement of violation[106].

Fidrmuc *et al.* (2013) studied insider transactions across 15 European countries and the USA to analyse the link between country-level shareholder protection and abnormal returns following insider buying, which are found to be positively related, thus, supporting the information-content hypothesis. It suggests transparency and trustworthiness of insiders' actions limits the possibilities for direct profit diversion during insider purchases. Likewise, stronger shareholder protection decreases negative information content by strengthening the diversification and liquidity reasons when there is insider selling.

Modigliani and Perotti (1997) argued if small investors can anticipate the future dilution of their claim due to poor protection, they will only purchase the securities at a discounted price, albeit with the negative feedback effect on the development of the security and the market. In their study on impact of increase-in-ownership's acquisition by controlling shareholder versus the wealth effect (CAR) of minority shareholders, Croci and Petmezas (2010) found CAR positively correlated to the stock market development, while differing greatly across countries

[106] However, no significance difference was found between the overall two groups of firms with low and high CG scores.

with different legal protection origin. It suggested policy makers' improvement on stock market participation and increase market liquidity[107], will serve as an effective disciplinary mechanism, even to the bidder that already controls the target company for acquisition.

4.3 Theoretical Frameworks

The frameworks for this study are depicted in Figure 4.1 and 4.2. These schematic diagrams describe the relationship between the dependent variables of cumulative abnormal return of the stock price (CAR) and likelihood of firms undertaking value-destroying RPT (LVDRPT) with their corresponding independent variables of corporate governance, in the presence of related party transaction. While research framework in Figure 4.1 reflects research questions 1 to 5, framework in Figure 4.2 reflects research question 6. The main research framework in Figure 4.1 where the hypotheses development of this study is based on, consists of twenty seven independent variables, whereas, the second framework in Figure 4.1 has nineteen independent variables. The main focus of multivariate analysis is on the five groups of firm level corporate governance variables, namely, related party transactions, shareholder activism, board composition, ownership structure and block holders. Besides, the external economic shock factor of the US subprime crisis year (2008 & 2009) and firm characteristics of size and leverage are also used as control variables in this study.

4.4 Hypotheses Development

In this study, hypotheses are proposed using the framework in Figure 4.1 to examine the effects of corporate governance factors on the cumulative abnormal return of stock prices under the influence of related party transaction in Bursa Malaysia. They serve to answer the research questions discussed earlier in Chapter 1. The overall approach used in the hypotheses

[107]Liquidity is a key measure of stock market development.

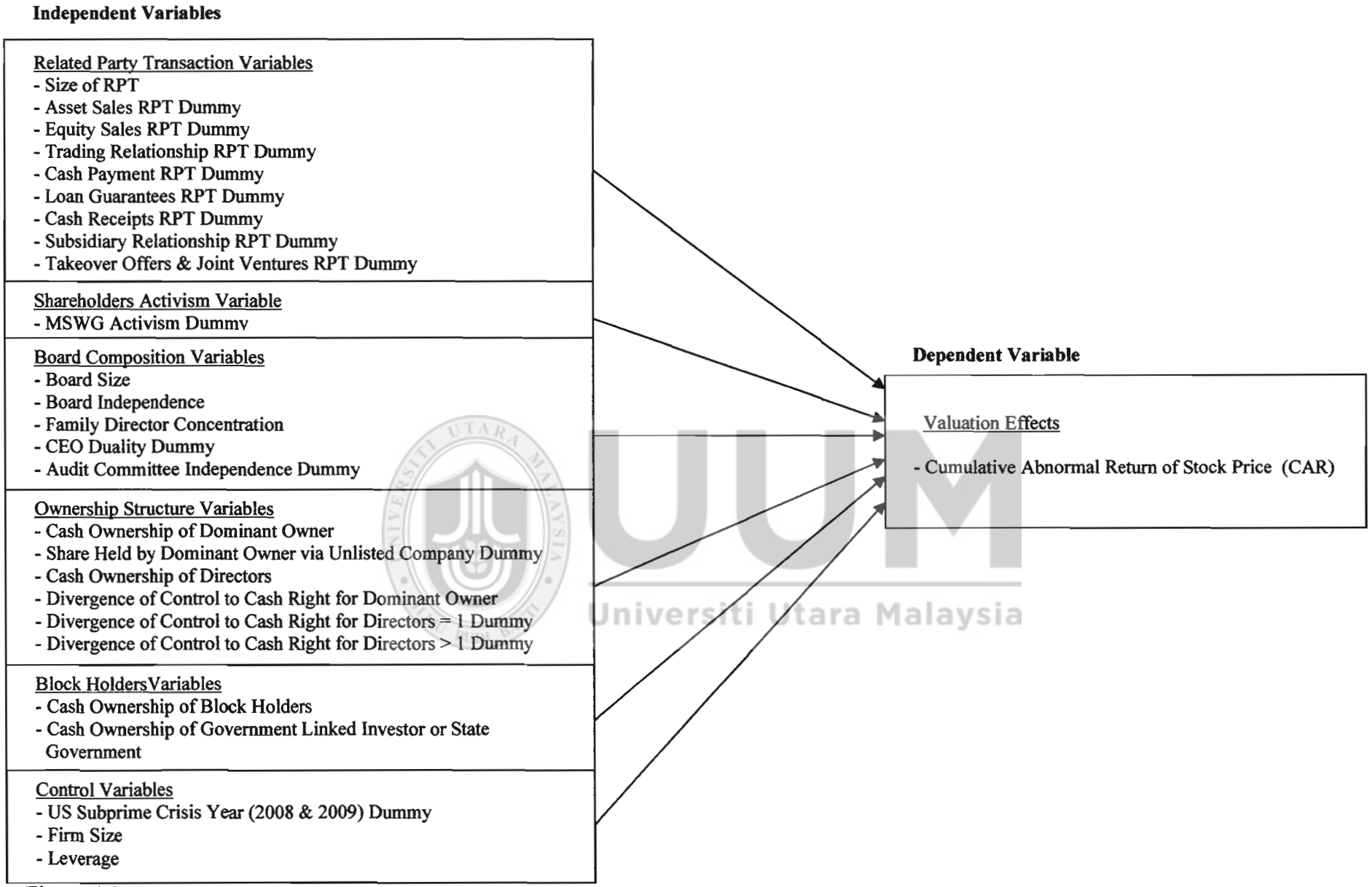

Figure 4.1:

Effect of Corporate Governance Factors and RPT on the Valuation Effects of Cumulative Abnormal Return of Stock Price (CAR)

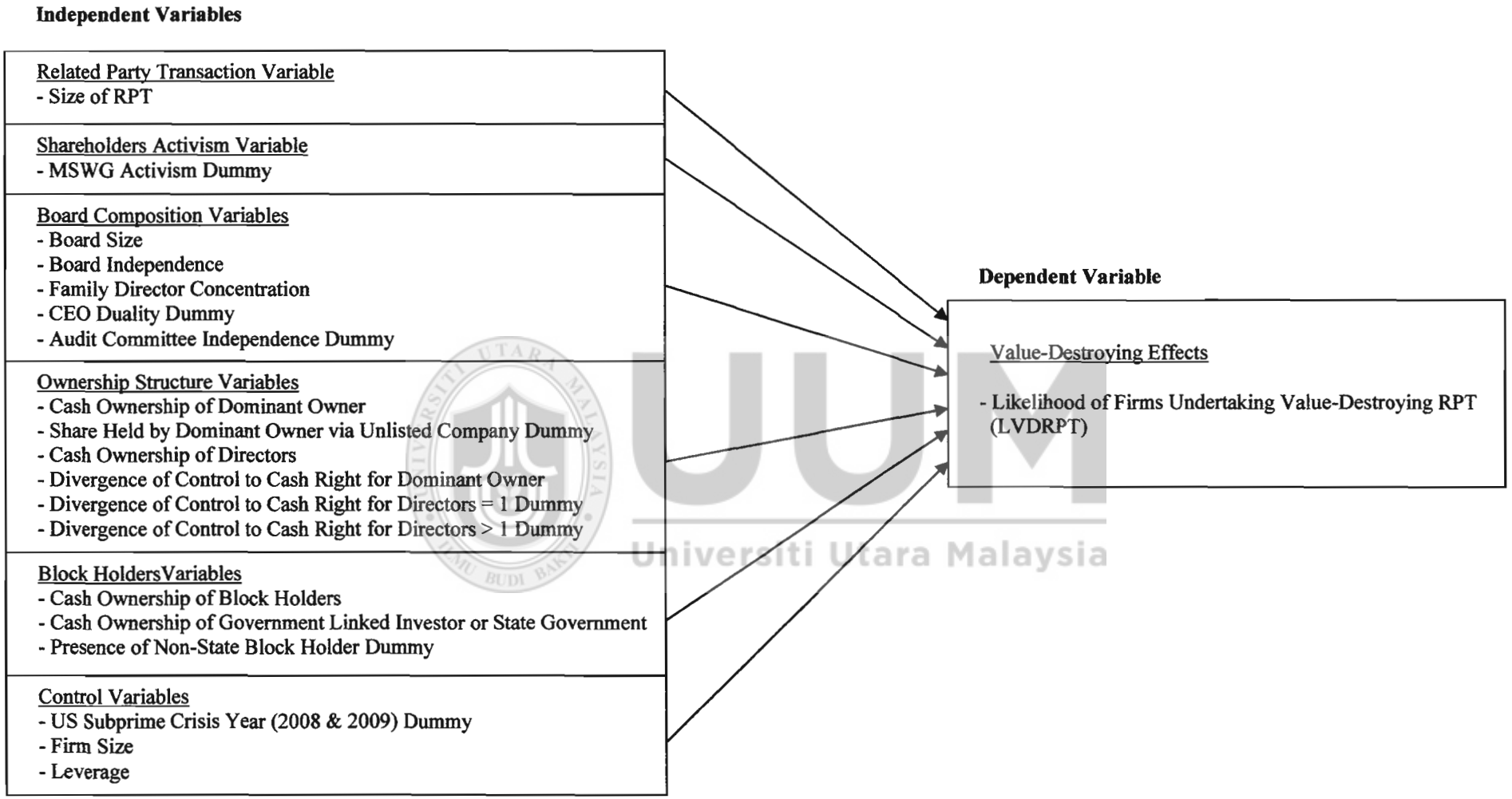

Figure 4.2:

Effect of Corporate Governance Factors and RPT on the Likelihood of Firms Undertaking Value-Destroying RPT (LVDRPT)

development is based on the outcomes of past researches related to RPT and/or CAR. For the variables with clear findings in the direction of impact without major contradictory evidences from previous researches, the same suggested direction of impact on CAR will be adopted in the hypotheses of this study. Otherwise, a non-directional hypothesis will be used.

Based on main constructs of the theoretical framework in Figure 4.1, the main hypotheses of this study are as follows:

H_A : The size and types of related party transaction (RPT) will have relationships with their corresponding cumulative abnormal return of stock price (CAR) which is induced by the RPT's announcement.

H_B : The MSWG activism will have a positive influence on mitigation of expropriation as measured by the corresponding cumulative abnormal return of stock price (CAR) which is induced by the RPT's announcement.

H_C: The board composition of firms will have relationships with the the corresponding cumulative abnormal return of stock price (CAR) which is induced by the RPT's announcement.

H_D : The ownership structure of firm's controlling shareholders will have relationships with the corresponding cumulative abnormal return of stock price (CAR) which is induced by the RPT's announcement.

H_E : The presence and cash ownership of non-controlling block holders will have relationships with the corresponding cumulative abnormal return of stock price (CAR) which is induced by the RPT's announcement.

The rest of the sections explain the development of corresponding testable sub-hypotheses which are derived from the above main hypotheses. Nevertheless, the other factors of external economic shocks (US subprime crisis year 2008 & 2009) and firm characteristics (size

and leverage) are also included as control variables in the analysis.

4.4.1 Related Party Transaction Hypotheses (H_A)

Firms engage in related party transactions (RPT) for reasons of either minimizing transaction costs (Cook, 1977; Fisman & Khanna, 1998), earnings manipulation via sales and purchasing activities (Jian & Wong, 2003; Aharony, Wang & Yuan, 2009) or tunneling purposes (Cheung *et al.,* 2009a, Cheung *et al.,* 2009b; Cheung, Rau & Stouraitis, 2006). The above transactions are driven by two contrasting motivations, which can be explained by the efficient transaction hypothesis in the case of minimizing transaction cost, and the conflict of interest hypothesis for the cases of earning manipulations and tunneling purposes (Gordon *et al.,* 2004). Hence, according to Ryngaert and Thomas (2007), there are both positive and negative aspects of RPT in relation to its effect on firm's valuation. On the former, it can positively influence the day-to-day business operations by lowering the transaction costs of a firm. On the latter, RPT become an avenue for firm's controlling shareholders to increase their wealth at the expense of minority shareholders' expropriation.

4.4.1.1 Size of RPT

In examining the relationship between firms' CAR and RPT using a sample of 878 transactions in 112 listed firms in the US from 2000 to 2001, Gordon, Henry and Palia (2006) found the industry-adjusted CAR associates negatively to the *size of RPT.*

Ge *et al.* (2010) investigated RPT involving earning management in the Chinese corporation prior to the year 2001. Their result shows firm valuation has a significant negative relationship with the value consideration of asset sales RPT, where firm overstated transaction prices to prop-up sales revenue. However, when China's Ministry of Finance imposed new

regulation[108] since 2001 to restrict such accounting manipulation of related party transaction, such trend was not observed in sample data in the year 2001 to 2003, suggesting effectiveness of the new ruling to curb misuse of RPTs for earnings management purposes. The following hypothesis is made:

H_{A1}: There will be a relationship between Size of RPT and firm's CAR.

4.4.1.2 Types of RPT

In the context of this study, RPT can be classified based on their effect on the minority shareholders of the public companies. Table 1.1 provides a detailed summary of these three categories of RPT to be considered in this research. They are (1) those that are known to cause expropriation of the minority investors in the firm, (2) those possibly beneficial to the public firms and hence the minority investors of the firm, and finally (3) those possibly having strategic motivations and are not expropriations (Cheung *et al.*, 2006).

Category 1: RPT Known to Cause Expropriation

Gordon, Henry and Palia (2006) found the industry-adjusted CAR negatively associated with RPT involving loan or cash assistance to the firm's directors. Similarly, RPT such as trading relationships were found to have stronger significant negative relationship with CAR. In Cheung *et al.* (2009) study of connected party transaction in China, their results implied tunneling and expropriation by controlling shareholders, as suggested by the negative valuation effect of CAR in the post RPT announcement. RPTs such as asset sales and acquisitions, asset swap, trade of goods or services, direct cash payment, and the loan or loan guarantees were used for tunneling by controlling shareholders in the listed firms. Similarly, Cheung, Qi, Rau and

[108] Since 2001, Ministry of Finance in China imposed a new restriction on the accounting for related party transactions. The new regulation states that if the price of a related party transaction is above its fair value, the price differential cannot be recognized as current earnings (Ge *et al.*, 2010).

Stouraitis (2009a) found controlling shareholder of publicly listed firms in Hong Kong transferred assets to extract private benefits at the expense of minority shareholders, when examining the RPT involving asset transfer pricing. In another Hong Kong study by Cheung *et al.* (2006) on expropriation by controlling shareholders, the market adjusted CAR for equity sales RPT were -5.8% and -10.1% for (0,1) and (0,10) windows respectively, implying evidence of large value loss incurred by minority shareholders in the sales of equity to related parties.

Hence, the view of conflicting interests' hypothesis (Gordon *et al.,* 2004) is supported by the evidences from these types of RPT known to cause expropriation, which is a clear consequence of interest's divergence between controlling and non-controlling investors. Therefore, the following hypotheses are made:

H_{A2}: There will be a negative relationship between Asset Sales RPT and firm's CAR

H_{A3}: There will be a negative relationship between Equity Sales RPT and firm's CAR

H_{A4}: There will be a negative relationship between Trading Relationship RPT and firm's CAR

H_{A5}: There will be a negative relationship between Cash Payment RPT and firm's CAR

H_{A6}: There will be a negative relationship between Loan Guarantees RPT and firm's CAR

Category 2: RPT Possibly Beneficial to Minority Shareholders

In Cheung *et al.* (2009) study of the firm's revenue propping in China's state-owned firms, operating performance was found to have positive associations with *cash receipts* and *subsidiaries relationship RPT*. Prior to the RPT announcement, most of these firms targeted for propping are larger with worse off fiscal year operating performance, have a higher likelihood of foreign shareholdings, and are cross-listed oversea. Similarly, in Turkish business groups where pyramid structure is common, cash proceeds from equity sales were used to prop up distressed firms during moderate macroeconomic shocks period (Gonenc & Hermes, 2008).

However, numerous studies of state-owned firms in the China's market found firms controlling shareholder propped up firm revenue and profit with large amount of *cash receipts RPT* before equity sales or IPO. It was then followed by obtaining a large amount of cash loans with preferential terms from the post IPO subsidiaries (Cheng & Chen, 2006). It was also found that the other motive of the controlling shareholder's propping behaviour was to maintain the shell resources for refinancing qualification to enable more serious engagement in tunneling later on by the state-owned firm (Ying & Wang, 2013). Such RPTs were negatively associated with the industry-adjusted operating performance of the listed subsidiaries, as suggested by the prop-up hypothesis by Friedman *et al.* (2003) which has negative connotations.

Similarly, Yeh, Shu and Su (2012) explored the effects of corporate governance on the expropriating motives of RPTs in Taiwanese market with concentrated ownership feature. They found in firms with earning deterioration, but with a committed plan to issue new share (equity sales), trading relationship (sales) RPT were used to prop-up firm performance. Subsequently, their empirical results showed good corporate governance practices have a negative relationship to the *trading relationship* RPT (sales) with negative motive. Nevertheless, as a majority or sole voting stock holder, the listed company has a full control over its subsidiary's board of directors and their accountability for performance. Hence, such *subsidiary relationship* RPT between the two entities are generally construed as beneficial to the listed firms and minority investors. Hence, the following hypotheses are made:

H_{A7}: There will be a relationship between Cash Receipts RPT and firm's CAR

H_{A8}: There will be a relationship between Subsidiary Relationship RPT and firm's CAR

Category 3: RPT Having Strategic Motivations

According to the value maximizing theory, target firms in merger and acquisition

generally earn positive CAR (Servaes, 1991; Franks *et al.*, 1991) owing to the expectation of its positive economic gain (Halpern, 1983). In their study of merger and acquisition RPT in China involving politically linked firm, Chi, Sun and Young (2009) found the target firm has a significant positive CAR for window (-2,2) around the announcement of RPT.

Furthermore, Kohlbeck and Mayhew (2010) show in a US study that market generally not valuing negatively the more complex RPTs such as firm's investment, partnership and joint ventures, which is contrary to simple transactions with a related party of director, officer or shareholder. Such findings are supported by the Hong Kong RPT's study by Cheung *et al.* (2006), where a transaction, such as takeover offers and joint ventures were considered as having strategic rationales and non-expropriation. Subsequently, the result shows the positive valuation effect on CARs over the (0,1) and (0,10) windows announcing period. Therefore, the following hypothesis is made:

H_{A9}: There will be a positive relationship between Takeover Offers & Joint Ventures RPT and firm's CAR

4.4.2 Shareholders Activism Hypothesis (H_8)

Shareholders who are dissatisfied with the performance or corporate governance of firms can voice out by giving their direct feedback to management. Since large block holders cannot easily sell without negatively impacting the firms' market value, they are most likely to engage in "voice" activism (Shleifer & Vishny, 1986). On the other hand, small shareholders will sell their shares or free-ride off the activism of others, owing to their rather transient relationship with the organization (Admati, Pfleiderer & Zechner, 1994). Previous studies directly related to the impact of shareholder activism on announcement effect of related party transaction are unavailable, albeit there are some that relates CAR to the shareholder activism, such as Becht *et*

al. (2006) who found firms engaged by fund activists has a positive average announcement effect on CAR of 5.3% for (-3,3) window period.

Established in the year 2000 as a public company by the Malaysian investment funds, MSWG is an independent, self-governing, and nonprofit professional watchdog body licensed under the Capital Market & Services Act 2007. It has the long term ultimate objective of raising the shareholders' value, by representing the voices of minority investors during the firm's general meeting, and facilitates proxy-voting services to shareholders. In assessing the effect of MSWG's role on performances of firms targeted for activism in the year 2005 to 2008, Ameer *et al.* (2009) found targeted companies positively associated with stock returns and earning increase, whereas, the non-targeted or control companies were not. Similarly, in his regression analysis, Abdul Wahab *et al.* (2008) showed *MSWG activism* having a positive impact on the relationship between institutional ownership and corporate governance, using 434 sample firms from year 1999 to 2002 in Bursa Malaysia. This suggests *MSWG activism* has the unique role of value increasing for the firm, besides providing investment's education to the general public, especially the retail investors. Therefore, the following hypothesis is made:

H_{B1}: There will be a positive relationship between MSWG Activism and firm's CAR.

4.4.3 Board Composition Hypotheses (H_C)

In this study, the board composition factor is characterized by 5 variables which are *board size, board independence, family director concentration, ceo duality,* and *audit committee independence*. Their relevant hypotheses are discussed in the following section.

4.4.3.1 Board Size

The key function of the board of directors is to monitor the managers to make sure

interests of the company are properly handled, and to advocates for the interests of all stakeholders, in particular the shareholders. There is no consensus on one ideal *board size* which is considered best for all firms. However, Lipton and Lorsch (1992) argued a board is oversized when it has more than nine directors, making it ineffective. This is due to more time and resources spent by directors' free-riding among each other when negotiating and compromising during the decision making process. Hence, Yermack (1996) found *board size* negatively related to the firm's value. Similarly, Barucci and Ceccacci (2005) and Erickson *et al.* (2005) also found wide empirical evidences that firm's market value has negative associations with *board size* albeit the relationship between size of board and governance is still ambiguous. Since there is no previous study found that directly examines the effect of *board size* on RPT, it is therefore hypothesized that:

H_{C1}: There will be a relationship between Board Size and firm's CAR.

4.4.3.2 Board Independence

Following the Asian financial crisis in 1998, a major reform implemented by the Security Commission of Malaysian Exchange is the code of corporate governance in March 2000. One of the key prescriptions of the code is the establishment of an audit committee with majority independent members to oversee RPT activities, hence the recommendation of an effective board which should consist of mostly independent or outside directors. Dominant owners in firms with high ownership concentration most likely prefer to control a small board. Since their key roles are supposed to protect minority interests by balancing executive interests while pursuing the shareholders' value, a small board with a large percentage composition of independent directors could imply good governance (Barucci & Falini, 2005). However, in Claessens and Fan (2002) study of corporate governance in Asia, where insiders typically dominate, *board independence*

was found to have negative associations with ownership concentration. Similarly, Kim *et al.* (2007) and Erickson *et al.* (2005) found fewer independent board members at both firm-level and across countries, suggesting dominant owners prefer having inside directors within the firm that would align with them.

Nevertheless, Janggi and Leung (2004) argued that the level of board's true independence is determined by its characteristics, which might result in a different actual relationship with expropriation of minority shareholders' right. For instance, Kohlbeck and Mayhew (2004) who found loan as one of the most common RPT concluded that higher *board independence* is associated with lower likelihood of RPT, as stronger board monitoring mitigates occurrence of RPT and discipline disclosure when they occur. Similarly, Gao and Kling (2008) also found the governance mechanisms of *board independence* negatively related to tunneling operations, in their examination of asset expropriation[109] via related party transaction in the Chinese market.

Even though numerous RPT studies in the past examined the direct impact of board independence on CAR (Amzaleg & Barak, 2013; Cheung *et al.*, 2006; Peng *et al.*, 2011) in the Israel, Hong Kong and China market respectively, none has finding with a statistically significant result. Therefore, the following hypothesis is made.

H_{C2}: There will be a relationship between Board Independence and firm's CAR.

4.4.3.3 Family Director Concentration

Anderson and Reeb (2003) found active involvement of the family in management responsibilities are good for the firms despite the belief that family-owned firms generally under performed the non-family-owned. However, the disadvantage of over reliance on trust in place of external control (like accounting data and audits), lower levels of professionalism and opacities

[109] Tunneling is proxied by difference of related party transaction in accounts payable and receivable divided by total assets.

in family-owned companies in the absence of market's disciplinary effects will result in management and governance of firms less effective (Martinenz *et al.,* 2007).

Related studies in Hong Kong found connected directors in family controlled firms negatively associated with good governance practices, hence the firm's value suffered discount when market penalized their vulnerability to expropriation by the controlling shareholders (Cheung, Chung, Tan & Wang, 2013). In a similar token, Jaggi, Leung and Gul (2009) also found the effectiveness of independent board in monitoring RPT of earnings management negatively moderated by concentration of family directors in family-controlled firms. Furthermore, corporate governance disclosure was found to have a significant negative relationship with *family director concentration* in a Malaysian study by Wan Mohamad and Sulong (2010).

However, Silva and Majluf (2008) argued when ownership concentrations are low, increasing family directors' participation enhanced firm performance, whereas the effect is opposite when the ownership concentration is high. Thus, for low ownership concentration, the advantage of family over non-family firms is clear as long as they are under market scrutiny. Previous studies on the direct impact of *family director concentration* on CAR is scarce except for the investigation by Lei and Song (2011) on RPT disclosure in China. However, the regression result of CAR on the corporate governance variable of *family director concentration* did not yield any statistically significant relationship. Hence, the following is hypothesized.

H_{C3}: There will be a relationship between Family Director Concentration and firm's CAR.

4.4.3.4 CEO Duality

The tradition of having the same individual holding CEO and chairman position is called "duality", which connotes a conflict of interest when the CEO chairs the board. This is due to the

fact that the responsibilities of an organization's CEO[110] are determined by the board, albeit as the organizational leader, the CEO also advises the board of directors. Furthermore, the Cadbury (1992) code of best practice recommends two different persons as CEO and chairman to prevent concurrent of the two roles, which will result in bad governance feature where no independent figure is acting in the interests of all shareholders.

In the Malaysian studies by Che Ahmad *et al.* (2003) on the relationships between corporate diversification strategy and quality of corporate governance, *CEO duality* had a significant positive association with non-value adding diversification, which is a potential avenue for abusive RPT. Such similar negative relationship was also observed between *CEO duality* and corporate governance disclosure in the Malaysians companies by Wan Mohamad et al. (2010).

In the study by Chen *et al.* (2010) which covers multiple countries of Malaysia, Hong Kong, Singapore and Taiwan, *CEO duality* was found negatively associated with firm performance (TobinQ), with a strong negative relationship observed in the entrenched[111] family-owned companies. Furthermore, in the presence of a block holder[112], Chen *et al.* (2010) also found *CEO duality* negatively associated with firm's valuation, suggesting outside block holders see *CEO duality* as not conducive to the firm value enhancement, hence discounting the stock price to discourage such a leadership structure. Therefore, it is hypothesized that:

H_{C4}: There will be a negative relationship between CEO Duality and firm's CAR.

4.4.3.5 Audit Committee Independence

Post Asian financial crisis in 1998, corporate abuses such as RPT and asset transfer with conflict of interests between the controlling and minority shareholders had resulted in

[110] It is normally called CEO in US, and MD in UK. We will use CEO as head of a corporation in this study.
[111] Entrenchment is indicated by the ratio of control to cash ownership rights greater than one. It is also known as control wedge.
[112] Non-controlling block holder that owns more than 10 percent of the total share (Chen & Nowland, 2010).

overwhelming loss of investors' confidence in the Malaysian stock market (Chan, 2010; BMSB, 1999). Consequently, the Security Commission implemented a major reform by mandating the audit committee to comprise of majority independent members under the code of corporate governance 2000. An audit committee is tasked by the board to oversee and ensure all matters related to finance are properly reported and disclosed, where one of its major functions is the oversight of RPT activities.

In Asia, Claessens and Fan (2002) argued that audit committee mitigates agency problems in the organizations via its key roles of monitoring and bonding of management. Studies supporting the argument are Mitton (2002), Chen *et al.* (2010) and Erickson *et al.* (2005), where firm values are found to have a positive relationship with the impact of audit committee's function. In particular, Erickson *et al.* (2005) also found that *audit committee independence*, which is denoted by the presence of outside director of a financial institution, has positive associations with firm value.

However, in a Malaysian study, Abdul Rahman *et al.* (2006) found audit committee ineffective in the oversight of firms generating accurate accounting report to control earnings management. Besides lacking relevant knowledge and skills, it was found that the selection of external directors tends to be dictated by the dominant owner. Thus, it is hypothesized that:

H_{C5}: There will be a relationship between Audit Committee Independence and firm's CAR

4.4.4 Ownership Structure Hypotheses (H_D)

As illustrated in Figure 4.1, there are six variables under the factor of ownership structure that affects CAR. They are characterized by *cash ownership of dominant owner, share held by dominant owner via unlisted company, cash ownership of directors, divergence of control to cash right for dominant owner, divergence of control to cash right for directors = 1, divergence*

of control to cash right for directors > 1. The following section discusses these variables and their corresponding hypotheses.

4.4.4.1 Cash Ownership of Dominant Owner & Directors

Anderson and Reeb (2003) and Villalonga and Amit (2006) found one-third of US S&P 500 firms have dominant founding family ownership that is positively related to firm's valuation, especially those firms with family members serving as CEO or chairman. This suggests cash ownership incentivizes CEO's performance, in line with Jensen and Meckling (1976) argument of manager's tendency to expropriate decreases with increasing ownership claims. Contrary to the expropriation hypothesis, Pindalo, Requejo and Torre (2013) found markets in a strong legal protection's environment of Western Europe portray positive association between a company's value and ownership concentration, albeit a nonlinear inverted U-shape curve, with the optimal level at about 55 percent ownership. Therefore, firms experience value discount when ownership concentration is beyond the optimal level, a sign of dominant owner's entrenchment when accumulate too much power.

In the RPT study of the Israel market characterized by firms with high average family ownership of 78.7%, Amzaleg and Barak (2013) investigated RPT announcement effect on the cumulative abnormal return of the stock price (CAR) for (-5,5) day window. Univariate analysis shows CAR for non-family firms was 1.73%, while that of family-owned firms was -0.96%. Regression analysis also shows that family ownership has a significant negative effect of lowering the CAR by approximately 4% in comparison to non-family owned. Such results indicate that the existence of private benefits consumption and tunneling through RPT are more likely to occur under high family ownership concentration. Similarly, Cheung, Rau and Stouraitis (2006) found ownership concentration and poor disclosure of information have a

significant negative association with CAR when examining the connected party transactions in public listed companies in Hong Kong.

Using 151 RPT and non-RPT samples in the Indonesian market, Utama *et al.* (2010) examined the market reaction to the RPT announcement via cumulative abnormal return of the stock price (CAR) around (-1,5) day window, and found share ownership concentration of directors have a significant negative association with CAR. It implies entrenchment effect caused by increase board members' ownership resulted in a higher tendency for firms to engage in abusive RPT. In a similar token, Lee and Yeh (2005) also found the percentage of directors that are controlling shareholders positively related to corporate financial distress which subsequently lead to minority interest expropriation.

Dominant shareholders indirectly own share of listed firm through unlisted companies, where their actual cash ownership in these private firms is not publicly disclosed. Therefore, an additional dummy variable of *share held by dominant owners via unlisted company* is used to account for the unknown factor in this study, where the following hypotheses are developed:

H_{D1}: *There will be a negative relationship between Cash Ownership of Dominant Owner and firm's CAR.*

H_{D2}: *There will be a negative relationship between Shares Held by Dominant Owner via Unlisted Company and firm's CAR.*

H_{D3}: *There will be a negative relationship between Cash Ownership of Directors and firm's CAR.*

4.4.4.2 Divergence of Control to Cash Right for Dominant Owner & Directors

In the Bennedsen and Nielson (2010) study involving 4000 European corporations on association between disproportional ownership structure and value discount of firms, presence of wedge in control and cash ownership rights was strongly related to firm's valuation discount, in

line with the theory of entrenchment effect. Their findings show that such effect is more significant in family-owned companies, companies having low cash flow, and companies in high amenity value category. Similarly, in the Italian market where the existence of voting premium[113] which characterized poor investor protection, family shareholders placed great importance on garnering higher voting shares to secure ownership's control, and consequently firms are more prone to expropriation (Caprio & Croci, 2008). Other studies in East Asian countries and Thailand also found high ownership concentration of pyramidal and cross-holding structures entrenches controlling owners, hence negatively affecting the relationship between firm valuation and corporate governance practices (Fan & Wong, 2002; Connelly, Limpaphayom & Nagarajan, 2012).

Around the announcement of related party transactions, Xiao (2009) examined the relationship between market-adjusted CAR and agency costs[114] in Chinese listed firms with ultimate owners. Regression results showed divergence between control and cash right for ultimate owners have a significant negative association with CAR for windows of (-10,1), (-2, 2) and (0,5), with highly pronounced governance discount for loan guarantees and fund transfer (cash payment) RPT. Using logistic regression of CAR[115], positive significant coefficient for divergence of the control variable suggest a high likelihood the firm will engage in the value-destroying RPT with increasing agency cost or divergence in control to cash right of the ultimate owner. Similarly, results from Lee and Yeh (2005) study of Taiwan's listed firms suggested that corporate financial distress leading to expropriation of minority interest is positively related to wedge in control and cash flow rights of directors.

[113] Voting premium is defined as difference of voting and non-voting shares price divided by price of voting shares. Shares with voting right usually trades at a premium relative to non-voting shares.
[114] In this study, agency cost is proxy by the divergence between control right and cash flow right of the dominant owner.
[115] In the regression, CAR is the dependent variable with value '1' if < 0, and '0' otherwise.

In this study, dummy variables representing the three categories of ratio for divergence of control to cash rights for directors are defined as zero (*divergence of control to cash right for director=0*), one (*divergence of control to cash right for director=1*) and greater than one (*divergence of control to cash right for director>1*). The first category represents directors having zero shareholdings, and is used as the "comparison or reference category" in the regression analysis, where the following hypotheses are made:

H_{D4}: *There will be a negative relationship between Divergence of Control to Cash Right for Dominant Owner and firm's CAR.*

H_{D5}: *There will be a relationship between Divergence of Control to Cash Right for Director=1 and firm's CAR.*

H_{D6}: *There will be a negative relationship between Divergence of Control to Cash Right for Director>1 and firm's CAR.*

4.4.5 Block Holders Hypotheses (H_E)

Unlike the past, today's markets are dominated by institutionalized[116] investors who maximize their investment funds on diversification through a large portfolio of companies. Besides the need for more researches into the distinctive type of block holders (McColgan, 2001), and their impact on firm value, for instance, studies by Allen and Phillips (2000) and Musallam (2013), there are no previous work that investigates the effect of block holders or institutional investors on shareholder's expropriation via RPT. According to Atanasov, Boone and Haushalter (2010), institutional block holders have the privilege to operate in inter-company transactions in ways not available to other types of investors. For instance, the incentives of a corporate parent or its controlling executives to expropriate wealth from a subsidiary can differ significantly from the incentives of individuals. Nevertheless, extant theoretical literatures tend

[116] They are institutions managing the pooled funds such as pension funds, mutual funds, hedge funds, exchange-traded funds, and financial institutions such as insurance companies and banks.

to generally predict big institutional shareholders as efficient watchdog, albeit there are variations in the roles played by institutional shareholders among countries with different legal protection system. Jensen and Meckling (1976) argued that incentive for any individual shareholder to monitor managerial activities is proportional to the share ownership, which is supported by Pagano and Roell's (1998) finding of a positive association between the concentration of non-controlling large shareholder (block holders) and a less severe expropriation of minority investors. Similarly, Cueto (2013), Erickson *et al.* (2005), Chen and Nowland (2010) and Barucci and Falini (2005) found the block holders assume monitoring roles and helped curtailing asset expropriation and private benefits seeking by the controlling shareholders.

In studies related to Malaysia, Abdul Wahab *et al.* (2008) and Musallam (2013) found evidence of large shareholders having a positive association with corporate governance and valuation of firms, while Che Ahmad *et al.* (2003) found outside block holders, especially non-institutional block holding negatively associated with diversification, a potential involvement of abusive RPT, hence suggesting their important role in the oversight of management's behaviour.

On the other hand, in the Indonesian market, Utama *et al.* (2010) examined the RPT announcement effect on the cumulative abnormal return of the stock price (CAR) around (-1,5) day window period. They found ownership concentration of foreign major shareholders have a significant negative association with CAR, pointing to the evidence of foreign controlling shareholder utilized RPT to engage in transfer pricing activities, which was perceived by the market as unfavourable to the firm. Furthermore, other studies on multiple block holders by Konijn *et al.* (2011) in the US and Cheng *et al.* (2013) in China have found a negative relationship between non-controlling large shareholders (NCLS) and TobinQ, which raised the

question of whether the firm's value was hurt by the NCLS's collusion with controlling shareholders.

In order to examine the difference in impact of state- and non-state owned block holdings, the dummy variable of *presence of non-state block holders* is also included in the following hypotheses:

H_{E1}: There will be a relationship between Cash Ownership of Block Holders and firm's CAR.

H_{E2}: There will be a relationship between Presence of Non-State Block Holders and firm's CAR.

4.4.5.1 Cash Ownership of Government Linked Investors or State Government

According to Schmidt (1996), there is a trade-off for the state owned firm which suffers from potential excessive interference on political reasons, in exchange for the benefits of better information for government on its management. However, the fact of 28 out of 100 world's largest firms are state-owned enterprises[117] reflects the importance of state ownership in the emerging world (Hope, 2013). At the point this research is undertaken, no previous studies in Malaysian context can be found in the relationship between *cash ownership of government linked investor or state government* and the valuation effect of RPT's announcement.

In examining the effects of ownership structure on firm's market performance in Malaysia, Musallam (2013) found share ownership of government linked investment companies (GLICs) positively associated with the firm's performance measures of ROE and ROA. In the high state-ownership environment of China, Berkman, Cole and Fu (2009b) and Jiang *et al.* (2010) examined tunneling via inter corporate loans, and expropriation involving loan guarantee respectively in the publicly listed firms. The results show the problem of expropriation is less significant when there are ownerships by state that are non-corporatized controlling block

[117] The United Nations Conference on Trade and Development defines a state-ownership as holding 10% or more of the firm's share by the state.

holders and state-owned firms. In a similar respect, Dewenter *et al.* (2010) found transactions of sovereign wealth funds (SWF) managing investment portfolios on behalf of governments, give a stronger signalling effect to the firm's stock price reactions. This is due to the advantage of SWF possessing more superior information over their private counterparts. Hence, the following hypothesis is made:

H_{E3}: There will be a positive relationship between Cash Ownership of Government Linked Investor or State Government and firm's CAR.

4.4.6 Control Variables (External Economic Factors & Firm Characteristics)

Besides the corporate governance variables, this study will also take into consideration aspects related to the general economic conditions surrounding the sampling period of year 2008 to 2013, and the other key characteristics of the sample which are the firm's size and leverage.

4.4.6.1 US Subprime Crisis Year (2008 & 2009)

According to Lemmon and Lins (2008), period of external economic shock will increase the incentive of dominant owners to expropriate minority investors, in order for them to compensate for losses incurred in a weak market. Furthermore, the impact of general economic conditions on expropriation could be different between during and after any financial crisis. At the peak of the US subprime crisis from September 2008 to March 2009, Dow Jones Industrial Average dropped 54% to 6469, adversely affecting the global markets. Study by Lee and Isa (2014) shows that US has a dominant role in influencing Malaysian market during the peak of the subprime crisis, albeit Malaysia has a weak interdependence with other Asian-Pacific or developed markets. Hence, the following hypothesis is made:

H_1: There will be a negative relationship between US Subprime Crisis Year (2008 & 2009) and firm's CAR.

4.4.6.2 Firm Size

In Utama *et al.* (2009) investigation of the announcement effects of CAR involving both RPT and non-RPT investment decisions, regression of CAR on *firm size* showed a significant negative relationship at 1% and 5% levels for RPT investment perceived as wealth expropriation.

However, Gao and Kling (2008) examination of asset expropriation via RPT in the Chinese market found the *firm size* negatively related to tunneling. Such finding is supported by a study of state-owned firms in China by Cheung, Jing, Lu, Rau and Stouraitis (2009) that showed smaller firms which tend to disclose fewer information are prone to tunneling, whereas, larger firms with worse off fiscal year operating performance, and have a higher likelihood of foreign shareholdings and oversea cross-listing are targeted for propping.

Similarly, a recent study by Amzaleg and Barak (2013) with significant positive *firm size* effect on CAR at the window (-5,5), possibly suggests better media access by larger firms tend to have a more positive impact on the RPT's announcement. Therefore, the following hypothesis is made:

H_2: There will be a relationship between Firm Size and firm's CAR.

4.4.6.3 Leverage

Cheung *et al.* (2006) and Bae *et al.,* (2002) direct measurements of tunneling acts in Hong Kong showed a positive significant relationship between CAR and *leverage*, implying the associated monitoring effect from lending financial institutions. Similarly, investigation of RPT[118] data from China from Peng, Wei and Yang (2011) also showed CAR (-5,5) has a

[118] The RPT sample are from firms listed in Shanghai and Shenzhen Stock Exchanges during the period 1998 to 2004, covering five types of transactions (asset acquisition, asset sales, asset displacement, cash payment and equity transfer). The two key sub groups of interest are (1) RPT from firms with poor financial conditions (n=238), and (2) RPT from firms with sound financial conditions and has obtained the right to issue new share (n=80).
[4]The model suggests that controlling shareholders may choose either tunneling or propping of their listed companies

significant positive relationship with firm's *leverage*, suggesting highly levered firms are more prone to RPT with the motivation of propping. However, Gao and Kling (2008) found *leverage* having a positive relationship with tunneling[119] when examining asset expropriation via RPT in China. Hence, the following hypothesis is made:

H_3: There will be a relationship between Leverage and firm's CAR.

4.5 Research Design

This is an event-study research that employs quantitative methods of independent sample t-test and ordinary least square and logistic regression analysis. It explores the relationships between cumulative abnormal returns (CAR) of firm's stock price and corporate governance variables in the presence of related party transaction. It will use mainly data from secondary sources: company's annual report published on the Bursa Malaysia website (detail on related party transaction, shareholding & ownership structure), Datastream (firms' stock prices), and MSWG database (companies under the activism program).

The population of the study will be the public listed companies in Bursa Malaysia covering only firms on the Main Market. Firms on the ACE market are excluded due to their highly speculative nature. Financial and insurance companies that are under different regulatory control requirements are also excluded from the study. Overall, firms from a wide coverage of sectors are included. The study identifies and gathers samples starting from 2008 to 2013 on related party transaction.

The impact of general economic conditions on expropriation could be different between during and after any financial crisis (Lemmon & Lins, 2008). It is noteworthy that global

depending on the magnitude of adverse shock and the magnitude of the private benefits of control Friedman *et al.* (2003).

[119] Tunneling is proxied by difference of related party transaction in accounts payable and receivable divided by total assets.

markets were adversely affected during the critical period of US subprime crisis (Sept 2008 to Mar 2009), where Dow Jones Industrial Average had dropped 54% to 6469 before it began to recover in March 2009. Furthermore, Boubakri, Guedhami and Mishra (2010) found a strong evidence for the higher cost of capital in affected countries, including Malaysia in post East Asian financial crisis, suggesting the lack of awareness from investors of potential expropriation before the crisis.

4.6 Data Collection

Access to sufficient firms' data to enable meaningful treatment of variables and testing of hypothesis is the most crucial process in this study. MSWG is essentially a corporate governance watchdog group, tasked with the role of promoting shareholder activism. Therefore, it is another important source of additional information on this specific aspect of corporate governance in the country.

The most important source of data was the manual collection of firms' annual reports from Bursa Malaysia database. A considerable amount of time was spent on identifications of all the related party transaction announced by the companies. Other databases used are the Datastream for firms' stock daily closing prices, and MSWG database for identification of whether the firm was a target of MSWG activism. A mass gathering of the data was done via reviewing annual reports from the year 2008 to 2013. This step is the most tedious and time consuming as 100% of the data collection tasks were performed via hand collection by individual verification of pertinent information disclosed by the firm for each RPT sample. In this case, a full time duration of 6 months was spent to collect the 422 samples for use in the analysis.

4.7 Data Analysis Techniques

First, descriptive statistics of the dependent and independent variables are examined and summarized. Then, univariate analysis (t-test) is used to determine whether the announcement effect of different types of RPT on CAR is significant under the short-horizon windows between -30 to 30 days of announcement date at 0 day. For multicollinearity check, Pearson's correlation matrix and variance inflation factors between the 27 independent variables are generated using all the 422 RPT samples. Ordinary least square (OLS) regression is employed to investigate and test hypotheses of the relationships between CAR and the RPT types and size, MSWG activism, corporate governance variables of board composition and ownership structure, and control for external economic shock, firm size and leverage. Finally, for robustness check of the above analysis results, an alternative estimation using logistic regression analysis is performed to determine the likelihood of firms undertaking value-destroying related party transaction, in which value-destroying transactions refers to firms earning negative CAR in the (-5,1) day window.

The section below describes the univariate and multivariate models employed in the regression analysis and hypothesis testing. The descriptions of the variables and their operationalization for the OLS and logit models can be found in Table 4.1 and Table 4.2 respectively.

(1) Univariate Analysis

In this study, the market model is used to predict the firm's stock return based on the assumption of a linear relationship between the stock return and return of the market portfolio as follows:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad \text{---------- Equation (4.1)}$$

R_{it} = *Actual return observed for firm i at day t.*

α_i *and* β_i = *Market model parameters estimated using 170 days of the trading (t = -200 to -31) preceding the event window period of 60 days (t = -30 to +30), whereby t=0 is the day of RPT's announcement date.*

R_{mt} = *The return of market at day t based on FTSE-Bursa Malaysia Emas Index (FBMEMAS).*

ε_{it} = *Error term for firm i.*

whereas under non-event or normal condition, the market model expected return is defined as follows:

$$E(R_{it}) = \alpha_i + \beta_i R_{mt} \quad \text{---------- Equation (4.2)}$$

Therefore, the abnormal return is calculated as the difference between Actual returns observed (R_{it}) in equation (4.1) and the market model expected returns in equation (4.2) which can be obtained from the formula, $AR_{it} = R_{it} - E(R_{it})$.

Substitute $E(R_{it})$ in equation (4.2) into the above formula, the abnormal stock return becomes:

$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt}) \quad \text{---------- Equation (4.3)}$$

After computing the abnormal returns for the entire sample using equation (4.3), the average abnormal return (AAR_t) can be calculated by taking the cross-sectional mean of daily abnormal return for the N number of firms at day t as follows:

$$AAR_t = 1/N \sum_{i=1}^{N} AR_{it} \quad \text{---------- Equation (4.4)}$$

Hence, the cumulative average abnormal return between the short-horizon window period of T1 and T2 can be calculated using formula below:

$$CAAR_{T1,T2} = \sum_{\tau=T1}^{T2} AAR_{\tau} \quad \text{---------- Equation (4.5)}$$

Finally, the statistical significance of $CAAR_{T1,T2}$[120] can be determined by using independent sample t-test with the following null and alternative hypotheses:

H_0: CAAR $_{T1,T2}$ is equal to zero. *H_1: CAAR $_{T1,T2}$ is different from zero.*

(2) OLS Regression Analysis

To examine the relationship of corporate governance variables with CAR that arises from the announcement effect of RPT, ordinary least square regression of cumulative abnormal return of the stock price (CAR) for the window period of (-5,1) or (0,10) on the independent variables is carried out using the model in equation (4.6) below. The independent variables are the types of RPT, size of RPT, MSWG activism, board composition factors, ownership structure factors and corporate governance factors, with control for external economic shock (US subprime crisis year) and firm characteristics (size and leverage). In order to determine the impact of different category of RPT on CAR, dummy coding procedure is used. As no prior information on which category of RPT is considered as normative, the asset acquisition RPT category which is the largest subsample will be selected by default as the reference category (Garson, 2006). In this case, asset acquisition RPT category is also known as the control group in the multivariate analysis. Nevertheless, univariate result for asset acquisition subsample (Table 5.3) also indicates negative significant CAR in the post announcement windows (0,10) and (0,30), consistent with the hypothesis of category 1 RPTs which are known to cause expropriation. Since there are a total nine types of RPT, it is only necessary to create eight (9-1) dummy variables for the OLS regression, so as to avoid the dummy variable trap of perfect collinearity if all nine variable are included (Hardy, 1993).

[120] In the rest of the chapters in this study, $\boldsymbol{CAAR_{T1,T2}}$ will be abbreviated as CAR for the cumulative abnormal return of stock price, whereas, 'T1,T2' will be denoted by (T1,T2) which means days T1 to T2 window period for the CAR.

Prior to performing OLS regression analysis, Pearson's correlation matrix and variance inflation factors for the 27 independent variables were generated to identify and assess the presence of multicollinearity. Thereafter, in OLS regression, heteroscedasticity-robust standard error procedure is applied to eliminate potential estimation biases before an optimization is carried out using the sequential search method.

$$CAR_{it} = \beta_0 + \beta_1 SRPT_{it} + \beta_2 ASRPTd_{it} + \beta_3 ESRPTd_{it} + \beta_4 TRRPTd_{it} + \beta_5 CPRPTd_{it} + \beta_6 LGRPTd_{it} + \beta_7 CRRPTd_{it} + \beta_8 SRRPT_{it} + \beta_9 TO\&JVRPTd_{it} + \beta_{10} MSWGd_{it} + \beta_{11} BS_{it} + \beta_{12} BIND_{it} + \beta_{13} FDC_{it} + \beta_{14} CEODd_{it} + \beta_{15} ACId_{it} + \beta_{16} CODO_{it} + \beta_{17} DOviaUCd_{it} + \beta_{18} CODIR_{it} + \beta_{19} DCRDO_{it} + \beta_{20} DCRDIR{=}1d_{it} + \beta_{21} DCRDIR{>}1d_{it} + \beta_{22} COBH_{it} + \beta_{23} PNSBHd_{it} + \beta_{24} COGLIC_{it} + \beta_{25} SUBPRIMEd_{it} + \beta_{26} FSIZE_{it} + \beta_{27} LEV_{it} + \varepsilon_{it}$$

---------- *Equation (4.6)*

Where, t = time, i = firm, β_i = estimates and ε_{it} = error terms.

(3) Logistic Regression Analysis

As an alternative estimation for the announcement effect of RPT, logistic regressions are employed to examine whether any firm characteristics determine the likelihood of expropriation, where the dependent variable is defined as the likelihood of the firm undertakes a value-destroying RPT. Hence, binary logit models with dependent variable (LVDRPTd) taking the value of '1' for negative CAR and '0' otherwise in the (-5,1) and (0,10) windows are used. Besides testing the overall sample (n=422), logit models for the likelihood to engage in value-destroying RPT in different types of transactions, namely asset acquisition subsample (n=189), asset sales subsample (n=81) and trading relationship subsample (n=61) will also be analysed.

However, estimation could not be made for RPTs in categories of equity sales (n=20), cash payment (n=7), loan guarantee (n=7), cash receipt (n=5), subsidiary relationship (n=23) and takeover offers & joint ventures owing to insufficient sample size.

The independent variables are the size of RPT, MSWG activism, board composition factors, ownership structure factors and corporate governance factors, with control for external economic shock (US subprime crisis year) and firm characteristics (size and leverage). The corresponding logit model is defined in equation (4.7) below. Prior to performing regression analysis, Pearson's correlation matrix and variance inflation factors for the 19 independent variables were generated to identify and assess the presence of multicollinearity. In the regression, heteroscedasticity-robust standard error procedure is applied to eliminate potential estimation biases before an optimization is carried out using the sequential search method.

$$\begin{aligned} LVDRPTd_{it} = {} & \beta_0 + \beta_1 SRPT_{it} + \beta_2 MSWGd_{it} + \beta_3 BS_{it} + \beta_4 BIND_{it} + \beta_5 FDC_{it} + \\ & \beta_6 CEODd_{it} + \beta_7 ACId_{it} + \beta_8 CODO_{it} + \beta_9 DOviaUCd_{it} + \beta_{10} CODIR_{it} + \\ & \beta_{11} DCRDO_{it} + \beta_{12} DCRDIR{=}1d_{it} + \beta_{13} DCRDIR{>}1d_{it} + \beta_{14} COBH_{it} + \\ & \beta_{15} PNSBHd_{it} + \beta_{16} COGLIC_{it} + \beta_{17} SUBPRIMEd_{it} + \beta_{18} FSIZE_{it} + \\ & \beta_{19} LEV_{it} + \varepsilon_{it} \end{aligned}$$

---------- *Equation (4.7)*

Where, t = time, i = firm, β_i = estimates and ε_{it} = error terms.

The descriptions and operationalization of the variables are shown in Tables 4.1 and 4.2 respectively.

Table 4.1
Descriptions of Variables

Variables	Descriptions
Dependent Variables	
CAR_{it}	Cumulative abnormal return of stock price of firm *i* in day *t*
$LVDRPTd_{it}$	Likelihood of firms undertaking value-destroying related party transaction dummy of firm *i* in day *t*
Independent Variables	
$SRPT_{it}$	Size of related party transaction of firm *i* in day *t*
$ASRPTd_{it}$	Asset sales related party transaction dummy of firm *i* in day *t*
$ESRPTd_{it}$	Equity sales related party transaction dummy of firm *i* in day *t*
$TRRPTd_{it}$	Trading relationship related party transaction dummy of firm *i* in day *t*
$CPRPTd_{it}$	Cash payment related party transaction dummy of firm *i* in day *t*
$LGRPTd_{it}$	Loan guarantee related party transaction dummy of firm *i* in day *t*
$CRRPTd_{it}$	Cash receipts related party transaction dummy of firm *i* in day *t*
$SRRPTd_{it}$	Subsidiary relationship related party transaction dummy of firm *i* in day *t*
$TO\&JVRPTd_{it}$	Takeover offers & joint ventures related party transaction dummy of firm *i* in day *t*
$MSWGd_{it}$	Minority shareholder watchdog group activism dummy of firm *i* in day *t*
BS_{it}	Board size of firm *i* in day *t*
$BIND_{it}$	Percent board independence of firm *i* in day *t*
FDC_{it}	Family director's concentration of firm *i* in day *t*
$CEODd_{it}$	CEO duality dummy of firm *i* in day *t*
$ACId_{it}$	Audit committee independence dummy of firm *i* in day *t*
$CODO_{it}$	Cash ownership of dominant owner of firm *i* in day *t*
$DOviaUCd_{it}$	Share held by dominant owner via unlisted company dummy of firm *i* in day *t*
$CODIR_{it}$	Cash ownership of directors of firm *i* in day *t*
$DCRDO_{it}$	Divergence of control to cash right for dominant owner of firm *i* in day *t*
$DCRDIR{=}1d_{it}$	Divergence of control to cash right for director = 1dummy of firm *i* in day *t*
$DCRDIR{>}1d_{it}$	Divergence of control to cash right for director > 1 dummy of firm *i* in day *t*
$COBH_{it}$	Cash Ownership of Block Holders of firm *i* in day *t*
$COGLIC_{it}$	Cash ownership of government linked investor or state government of firm *i* in day *t*
$PNSBHd_{it}$	Presence of non-state block holder dummy of firm *i* in day *t*
$SUBPRIMEd_{it}$	US subprime crisis years (2008 & 2009) dummy of firm *i* in day *t*
$FSIZE_{it}$	The natural logarithm of total assets of firm *i* in day *t*
LEV_{it}	Leverage ratio of firm *i* in day *t*

Table 4.2
Measurements of Variables

Variables	Operationalization
Valuation Effect Variables	
CAR_{it}	Percent cumulative abnormal return of stock price for firm based on Equation (5) above.
$LVDRPTd_{it}$	Dummy variable '1' for negative CAR in the (-5,1) or (0,10) window, and '0' otherwise.
Related Party Transaction Variables	
$SRPT_{it}$	Value consideration of related party transaction normalized as a percentage of the Total assets of firm (Total asset of firm = Net Current Asset + Long Term Asset).
$ASRPTd_{it}$	Category dummy variable '1' for firm engaging asset sales related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$ESRPTd_{it}$	Category dummy variable '1' for firm engaging equity sales related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$TRRPTd_{it}$	Category dummy variable '1' for firm engaging trading relationship related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$CPRPTd_{it}$	Category dummy variable '1' for firm engaging cash payment related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$LGRPTd_{it}$	Category dummy variable '1' for firm engaging loan guarantees related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$CRRPTd_{it}$	Category dummy variable '1' for firm engaging cash receipts related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$SRRPT_{it}$	Category dummy variable '1' for firm engaging subsidiary relationship related party transaction, and '0' for otherwise. The reference category is asset acquisition related party transaction.
$TO\&JVRPTd_{it}$	Category dummy variable: '1' for firm engaging takeover offers & joint ventures related party, and '0' for otherwise. The reference category is asset acquisition related party transaction.
MSWG Activism Variable	
$MSWGd_{it}$	Dummy variable: '1' for firm covered by MSWG activism, and '0' otherwise between the year (t-1) to (t+1) for event occurs in year t.
Board Composition Variables	
BSit	The total number of directors in the board.
$BIND_{it}$	Ratio of independent directors to total directors on the board.
FDC_{it}	Ratio of directors who are family members of dominant controlling shareholders to total directors on the board.
$CEODd_{it}$	Dummy variable '1' for CEO and board chairman the same person and '0' for otherwise.
$ACId_{it}$	Dummy variable '1' for audit committee chairman and all members are independent directors and '0' for otherwise.
Ownership Structure Variables	
$CODO_{it}$	Percent cash ownership of the dominant controlling shareholder.
$DOviaUCd_{it}$	Dummy variable '1' for dominant controlling shareholders with shareholding via unlisted company, and '0' for otherwise.
CODIRit	Total percent cash ownership of all directors.
$DCRDO_{it}$	Ratio of control right to cash flow rights for dominant controlling shareholder.

4.8 Conclusion

In today's modern corporation, views on agency theory has evolved to focus on incentives and opportunities of controlling shareholders to the benefit of better protections for minority investors (La Porta *et al.,* 1999). Extant researches on corporate governance versus principal-agent and principal-principal conflicts have been on factors determining the expropriation of minority shareholders via tunneling and propping by controlling shareholders in the complex business organization. However, mixed evidences were found in the literatures on expropriations of minority investors by the influential owners. A contribution to better understanding of such phenomenon in Malaysian context is proposed in this study through direct measurement of expropriation using the cumulative abnormal return of stock prices (CAR) as indicators of announcement effect for the incidences of related party transaction. This study will also add to previous work in emerging markets by featuring the unique role of Minority Shareholder Watchdog Group (MSWG) activism, and an environment setting with high state-controlled ownership of the Malaysian stock market.

CHAPTER 5: DATA ANALYSIS & FINDINGS

5.1 Introduction

The data analysis focuses on six objectives. Firstly, the research aims to investigate whether different types and size of RPT lead to expropriation of minority shareholder via measuring the cumulative abnormal return of stock prices (CAR) around RPT's announcement. Such direct CAR measurement will not only substantiate the occurrence of real tunneling in Bursa Malaysia, but also enable detailed understanding of the mechanisms employed by controlling shareholders to extract private benefits at the expense of minority shareholders. Secondly, it determines whether shareholder activism from MSWG will have an effect on CAR. Thirdly, it investigates the relationship between CAR and the internal corporate governance factors of board composition and ownership structure. Finally, it will examine whether institutional block holders (government controlled or/and private) have a positive association with the protection of minority shareholder's interest by mitigating the negative effect of RPT.

5.2 Overview of Data Collected

The detail for sample of all related party transactions (RPT) from year 2008 to 2013 is obtained from annual reports published and maintained on the Bursa Malaysia website. The website also provides a listing for various types of announcements such as the mandatory disclosure and circulars on the related party transactions of the publicly listed companies. Initially, a total of 891 RPT samples involving 405 companies was identified from the database for the six-year period. Of these, 422 RPT samples involving 286 companies, with the RPT percentage ratio of 2 percent and above are used for this study. For each of these samples, company's filings consisting of a detailed description of the transaction and their annual reports for corresponding year of the transaction were retrieved from the Bursa database. Data on

Table 4.2 (Continued)

Variables	Operationalization
$DCRDIR=1d_{it}$	Category dummy variable '1' for ratio of control right to cash flow rights of directors equals 1, and '0' for otherwise. The reference category is directors having zero total shareholdings.
$DCRDIR>1d_{it}$	Category dummy variable '1' for ratio of control right to cash flow rights of directors greater than 1, and '0' for otherwise. The reference category is directors having zero total shareholdings.
$COBH_{it}$	Combine percent cash ownership of all block shareholders with more than 5% shareholding.
$COGLIC_{it}$	Percent cash ownership of government linked investment companies or state government.
PNSBHdit	Dummy variable: '1' when there is a presence of at least one block shareholder which is non-government linked or non-state government, and '0' for otherwise.
Control Variable (External Economic Shock)	
$SUBPRIMEd_{it}$	Dummy variable '1' for firm's related party transaction engaged during the US subprime crisis period in year 2008 to 2009, and '0' for otherwise.
Control Variables (firm characteristics)	
$FSIZE_{it}$	The natural logarithm of the firm's total assets' value in Ringgit Malaysia.
LEV_{it}	Ratio of firm's total liabilities to total shareholder fund.

ownership structure, corporate governance and finance for the public listed firms are extracted from company annual reports. The shareholder activism data are obtained from the website of MSWG. Daily stock returns of companies and market indices are from Datastream.

The sampling period of 2008 to 2013 is chosen to cover the impact of general economic conditions on expropriation which could be different between during and after an external shock such as the subprime crisis in the United States during late 2008 to early 2009. For instance, firms faced an increase in likelihood of expropriation in a situation where the economic prospects are worse (Johnson, Boone, Breach & Friedman, 2000). Firms that were de-listed or newly listed during the sampling period are also included as long as their information is available.

5.3 Descriptive Analysis

5.3.1 Related Party Transactions (RPT)

The total value of RPT incurred for the six year period was RM83.432 billion. Table 5.1 summarized the three categories of RPT (refer to Table 1.1 for explanation of RPT types). First are transactions that are expected to cause expropriation of the minority investors in the firm. They are asset acquisitions (189 transactions worth RM22.468 billion), asset sales (81 transactions worth RM21.207 billion), equity sales (20 transactions worth RM4.881 billion), trading relationship (61 transactions worth RM12.985 billion), cash payment (7 transactions worth RM138 million), and loan guarantee (7 transactions worth RM1.370 billion). Second are transactions that are possibly beneficial to the minority investors of the firm. They are the cash receipts (5 transactions worth RM201 million), and subsidiary relationship (23 transactions worth RM8.892 billion). Third are transactions that possibly have strategic motivations and are not an expropriation, which is takeover offers and joint ventures (29 transactions worth

Table 5.1

Characteristics of a Sample of 422 Related Party Transactions (RPT) by Firms in Bursa Malaysia During 2008 to 2013

Characteristics	All RPT	***Transactions that are known to cause expropriation***							***Transactions that are possibly beneficial to the minority investors***			***Transactions that possibly have strategic motivations***
		Asset acquisition	Asset sales	Equity sales	Trading relationship	Cash payments	Loan guarantee	**Overall Category**	Cash receipts	Subsidiary relationship	**Overall Category**	Takeover offers & joint ventures
Sample size	422	189	81	20	61	7	7	**365**	5	23	**28**	29
Amount (millions of RM)												
Total	83,423	22,468	21,207	4,881	12,985	138	1,370	**63,049**	201	8,892	**9,093**	11,292
Mean	197.3	118.9	261.8	244.0	212.9	19.7	195.7	**173.2**	40.2	386.6	**357.6**	389.4
Median	29.2	21.4	35.5	52.6	23.4	15.6	29.5	**25.2**	44.8	48.1	**95.0**	138.9
Original[121] Percentage Ratio of RPT												
Mean	53.1	19.9	29.3	145.6	133.7	14.1	11.5	**47.5**	12.6	114.1	**89.9**	84.0
Median	8.4	5.0	7.6	32.2	5.4	6.7	5.3	**6.7**	6.7	8.7	**23.2**	52.7

[121] "Original" refers to the highest percentage ratio declared by the listed firm to Bursa Malaysia. The highest percentage ratio is selected from the highest value obtained from calculations using all applicable criteria stipulated under Chapter 10, 10.02(g) of the Main Listing Requirements. The percentage ratio is defined as the ratio of value consideration of RPT to either (i) net assets (ii) net profit (iii) equity share capital in issue (iv) market value of all ordinary share or (v) total assets of the listed firm.

RM11.292 billion).

It is noteworthy that almost 70 percent (290/422) of the total number of transactions, accounting for 58 percent (RM48.556 billion) of the total value of RPT is related to acquisition and sales of the firm's assets and equity. There were more than twice as many transactions in asset acquisition (189) compared to asset sales (81) to related parties. Asset acquisition is the most common type of RPT involves 45% of all transactions in the sample, in which outflow of cash from the listed company will occur.

Transactions that involve operating items such as trading relationship and certain subsidiary relationship constitute only about 20% of the total RPT. Overall, it is in line with the Indian study by Bertrand *et al.* (2000) where tunneling happens primarily through the non-operating business activities such as sales and acquisition of assets and equity. In this study, 304 transactions or 72% are considered as non-operating related and under the category that is known to cause expropriation of minority shareholders in the firm. However, only about 3.3% (14/422) of the total transactions are cash payment or loan guarantee, which are also in the transaction category that is known to cause expropriation.

5.3.2 Firm Characteristics and Corporate Governance Factors

Table 5.2 describes the firm characteristics and corporate governance factors for the sample of 422 RPT. The overall mean and median *firm size* is RM2.985 billion and RM494.5 million respectively. In terms of debt, the firms have a mean (median) *leverage* (total liabilities to total shareholder fund) of 1.212 (0.84).

Not surprisingly, the data show that occurrence of assets and equity sales transactions are closely associated with highly levered firms (mean leverage of 1.593 and 1.718 respectively, versus 1.212 for overall sample), possibly to reduce the firm's gearing ratio. Similarly, the firms

Table 5.2

Firm Characteristics and Corporate Governance Descriptive Statistics for Sample of 422 RPT During 2018 to 2013

Types of Related party Transactions (RPT)	**All RPT**	***Transactions that are known to cause expropriation***							***Transactions that are possibly beneficial to the minority investors***			***Transactions that possibly have strategic motivations***
		Asset acquisition	Asset sales	Equity sales	Trading relationship	Cash payments	Loan guarantee	**Overall Category**	Cash receipts	Subsidiary relationship	**Overall Category**	Takeover offer & joint ventures
Sample size	422	189	81	20	61	7	7	**365**	5	23	**28**	29
MSWG Activism mean (median)	0.400 (0.000)	0.386 (0.000)	0.506 (1.000)	0.400 (0.000)	0.344 (0.000)	0.286 (0.000)	0.286 (0.000)	0.403 (0.000)	0.600 (1.000)	0.261 (0.000)	0.368 (0.000)	0.414 (0.000)
Board Composition mean (median)												
Board Size	7.8 (7.0)	7.7 (7.0)	7.8 (7.0)	8.3 (8.0)	7.1 (7.0)	8.1 (8.0)	10.0 (10.0)	7.7 (7.0)	7.6 (7.0)	8.3 (8.0)	8.1 (8.0)	8.1 (8.0)
Board Independence	0.452 (0.429)	0.450 (0.429)	0.456 (0.429)	0.469 (0.437)	0.488 (0.500)	0.393 (0.400)	0.438 (0.429)	0.458 (0.429)	0.452 (0.429)	0.419 (0.400)	0.417 (0.400)	0.409 (0.375)
Family Director Concentration	0.168 (0.000)	0.165 (0.000)	0.167 (0.000)	0.111 (0.000)	0.156 (0.000)	0.205 (0.000)	0.244 (0.300)	0.163 (0.000)	0.130 (0.000	0.315 (0.330)	0.203 (0.200)	0.126 (0.000)
CEO Duality	0.156 (0.000)	0.180 (0.000)	0.148 (0.000)	0.000 (0.000)	0.115 (0.000)	0.143 (0.000)	0.429 (0.000)	0.156 (0.000)	0.200 (0.000)	0.174 (0.000)	0.158 (0.000)	0.138 (0.000)
Audit Committee Independence	0.520 (1.000)	0.508 (1.000)	0.469 (0.000)	0.600 (1.000)	0.607 (1.000)	0.429 (0.000)	0.571 (1.000)	0.521 (1.000)	0.800 (1.000)	0.565 (1.000)	0.509 (1.000)	0.414 (0.000)

Table 5.2 (Continued)

Types of Related party Transactions (RPT)	**All RPT**	Asset acquisition	Asset sales	Equity sales	Trading relationship	Cash payments	Loan guarantee	**Overall Category**	Cash receipts	Subsidiary relationship	**Overall Category**	Takeover offers & joint ventures
Sample size	422	189	81	20	61	7	7	**365**	5	23	**28**	29
Ownership Structure mean (median)												
Cash Ownership of Dominant Owner	41.66 (30.02)	42.97 (42.61)	44.47 (44.36)	38.86 (34.15)	35.83 (30.00)	38.54 (23.43)	46.89 (49.65)	41.87 (40.93)	43.98 (47.60)	45.38 (47.00)	40.42 (40.41)	35.87 (33.48)
Cash Ownership of Directors	29.72 (30.02)	31.59 (35.15)	28.33 (24.25)	23.13 (21.10)	26.39 (27.57)	21.24 (16.94)	28.59 (32.03)	29.28 (27.86)	51.14 (31.03)	41.42 (44.36)	32.45 (34.38)	22.11 (25.60)
Divergence of Control to Cash Right for Dominant Owner	1.237 (1.000)	1.370 (1.000)	1.204 (1.000)	1.012 (1.000)	1.129 (1.000)	1.000 (1.000)	1.000 (1.000)	1.259 (1.000)	1.000 (1.000)	1.000 (1.000)	1.099 (1.000)	1.195 (1.000)
Divergence of Control to Cash Right for Directors	0.957 (1.000)	0.998 (1.000)	0.992 (1.000)	0.753 (1.000)	0.978 (1.000)	0.714 (1.000)	0.714 (1.000)	0.964 (1.000)	1.000 (1.000)	0.957 (1.000)	0.908 (1.000)	0.853 (1.000)
Cash Ownership of Block Holders	14.73 (11.63)	13.59 (10.68)	13.90 (7.52)	12.82 (7.93)	20.68 (19.31)	11.95 (11.63)	14.06 (12.81)	14.78 (11.58)	6.95 (0.00)	14.04 (11.22)	14.30 (15.03)	15.78 (19.88)
Cash Ownership of Government Linked Investor or State Government	3.62 (0.00)	3.14 (0.00)	3.69 (0.00)	4.44 (0.00)	4.21 (0.00)	3.54 (0.00)	4.81 (0.00)	3.55 (0.00)	0.00 (0.00)	4.87 (0.00)	4.15 (0.00)	4.30 (0.00)
Presence of Non-State Block Holders mean (median)	0.537 (1.000)	0.545 (1.000)	0.432 (0.000)	0.400 (0.000)	0.705 (1.000)	0.429 (0.000)	0.714 (1.000)	0.540 (1.000)	0.400 (0.000)	0.609 (1.000)	0.509 (1.000)	0.448 (0.000)

Table 5.2
(Continued)

Types of Related party Transactions (RPT)	**All RPT**	Asset acquisition	Asset sales	Equity sales	Trading relationship	Cash payments	Loan guarantee	**Overall Category**	Cash receipts	Subsidiary relationship	**Overall Category**	Takeover offer & joint ventures
Sample size	422	189	81	20	61	7	7	**365**	5	23	**28**	29
Firm Characteristics Mean (median)												
Firm Size	2984.9 (494.5)	2490.0 (494.2)	4093.8 (773.7)	2641.6 (403.5)	3105.8 (408.1)	412.9 (347.8)	4686.9 (461.4)	2959.4 (504.5)	1805.7 (678.6)	5204.8 (431.5)	2921.2 (454.9)	1302.4 (454.9)
Leverage	1.212 (0.840)	1.091 (0.765)	1.593 (1.059)	1.718 (0.801)	1.140 (0.579)	0.789 (0.557)	1.058 (0.973)	1.229 (0.848)	2.230 (1.255)	1.159 (0.942)	1.114 (0.832)	0.885 (0.652)

MSWG Activism: dummy variable: "1" for firm covered by MSWG activism and "0" otherwise, ***Board Size:*** total number of directors in Board, ***Board Independence:*** ratio of independent director to total directors on board, ***Family Director Concentration:*** ratio of directors who are family members of controlling shareholder to total directors on board, ***CEO Duality:*** dummy variable: "1" for duality of CEO and "0" for non-duality of CEO, ***Audit Committee Independence:*** dummy variable: "1" for audit committee chairman and all members are independent and "0" otherwise, ***Cash Ownership of Dominant Owner:*** percent cash ownership of the controlling shareholder, ***Cash Ownership of Directors:*** percent cash ownership of all directors, ***Divergence of Control to Cash Right for Dominant Owner:*** ratio of control over cash flow right for dominant owner, ***Divergence of Control to Cash Right for Directors:*** ratio of control over cash flow right for directors, ***Cash Ownership of Block Holders:*** combine percent cash ownership of all institutional and block shareholders with > 5%, ***Cash Ownership of Government Linked Investor or State Government:*** percent cash ownership of government linked Investor or state government, ***Presence of Non-State Block Holders:*** dummy variable "1" for presence of non-state block holder and "0" otherwise, ***Firm Size:*** total assets of the firm million Ringgit Malaysia, ***Leverage:*** ratio of firm's total liabilities to total shareholder fund.

receiving cash assistance from a related party have the highest mean leverage of 2.23, which is almost twice the overall sample average. The average size in terms of total asset (RM1.806 billion) of firms receiving cash is also substantially smaller than the overall sample mean of RM2.985 billion.

In the takeover offer & joint venture RPT (29 transactions) the mean and median leverage is 0.885 and 0.652 respectively, which has a significantly lower gearing ratio than the overall sample average of 1.212 and median of 0.84.

MSWG Activism

For *MSWG activism*, the mean frequency of its presence in the overall sample is 40%. RPT such as asset sales and cash receipts induce a higher level of shareholder activism, notably 50.6% and 60.0% respectively. It seems when firms engaged in more sensitive RPT such as asset sales, which is a non-operating business activities, the concerns for the likelihood of tunneling becomes more pronounced (Bertrand *et al.*, 2000), hence resulting in an increase level of the firms' monitoring via MSWG's activism.

Board Composition

The mean and median *board size* of sample is 7.8 and 7.0 respectively, while the average percentage of *board independence* is 45.2%[122]. On average the *family director concentration* which is the percentage of directors on the board having family relation to the controlling shareholder is 16.8%, but RPT for cash payment (20.5%), loan guarantee (24.4%) and subsidiary relationship (31.5%) has a significantly higher concentration of family director. Of the total

[122] Since the inception of MCCG code by Security Commission Malaysia in 2000, and its subsequent revisions in 2007 and 2012 from lessons learnt, the main emphasis has been on enhancement of board effectiveness and reinforcement of its independence. However, the code does not specify a recommended range of board size.

sample, an average 15.6% of the transactions involve firms with *CEO duality*[123], which contradicts the principle of non-CEO duality in MCCG 2012. Furthermore, 42.9% of the firms that engaged in a loan guarantee transaction has CEO duality, which is almost three times the average. Finally, the mean proportion of firms with a full *audit committee independence* is 52%. Other than not allowing executive directors on the audit committee, MCCG does not recommend other more restrictive requirement such as allowing only independent directors in the audit committee[124].

Ownership Structure

The mean and median cash or actual ownership of the dominant owner is 41.66% and 30.02%, respectively. Dominant owners can be either families or institutions with the largest controlling stakes[125]. This percentage is high in comparison to the 27.3% broader market average of family controlling shareholdings according to Munir and Salleh (2010). This is also in line with Claessens *et al.* (2000) findings of firms in the East Asian emerging market which are not widely held as a result of rampant family ownership. Furthermore, the variation in mean ownership across different types of related party transactions is wide ranging from 35.83% to 46.89%. On the other hand, the mean ratio of divergence between control and cash right for the dominant owner is at a moderate 1.237. About 10.7% (45) of the total sample have a divergence

[123] In MCCG 2012, Recommendation 3.4 of Principal 3 requires the positions of CEO and Chairman (who must also be a non-executive board member) to be held by different individuals. In addition, for cases where the chairman is not an independent director, Recommendation 3.5 requires greater than 50% board independence (SCM, 2012).

[124] MCCG 2007 only requires the audit committees to fully comprise of non-executive directors. Also, no specific requirements on the percentage of independent directors in audit committee were recommended in the subsequent MCCG revision in 2012 (SCM, 2012).

[125] Referencing La Porta *et al.* (1999) and Claessens *et al.* (2000), a controlling shareholder is defined as having at least 20 percent control or voting right. In this study, 91.9% of the total sample (388) has a dominant owner with more than 20% control right. Of this, about 99.5% (386) are under family control, while only 0.5% (2) is under the majority control of government-linked institutional companies (GLICs). The corresponding average control ownership right is 45.83% for the former involving 242 firms, and 24.1% for the latter involving only 2 firms. Nevertheless, there are a total of 127 samples (12.1%) involving 90 firms that has GLIC's ownership of at least 5% and above (defined as substantial shareholders in Bursa Malaysia). Of the 127 samples, only 5.0% (21 samples) do not have dominant family owners with at least 20% control right.

of control to cash right greater than 1, in which all of them have a dominant owner with 20% or greater control right.

The mean and median *cash ownership of block holders*[126] is 14.73% and 11.63% respectively. Firms engaged in the trading relationship RPT have a higher mean (20.68%) and median (19.31%) of block holders' cash ownership. On the contrary, firms engaged in cash receipts RPT have the smallest mean block holders' cash ownership (6.95%) and are highly levered (mean leverage, 2.230). Evidently, the average ownership of directors in these firms is also the highest at 51.14% compared to the overall sample average of 29.72%. It seems that high share ownership concentration of directors and owner-managers have incentivized bailing out of the highly levered firm possibly in financial distress (La Porta *et al.,* 1998). However, since the sample size of cash receipts RPT is very small (n=5), caution is required in interpreting the descriptive statistics for this group of RPT.

Cash Ownership of Block Holders and Government Linked Investors or State Government

While the overall frequency of *presence of non-state block holder* is high at 53.7%, *Cash ownership of government linked investor or state government* is relatively low at 3.62% for firms engaging in RPT. Coincidentally, about 70% of the total institutional holdings in the broad market of Bursa Malaysia belong to the government-backed public funds (Abdul Wahab *et al.*, 2008). This could suggest in state ownership's absence, tendency for engagement of RPT is higher in the listed firms.

5.4 Announcement Effects of Related Party Transaction

5.4.1 Univariate Analysis

[126] In this study, block holders represent the combine holdings of all the other substantial shareholders (>5%) besides the majority shareholder.

It cannot be discounted that before the event is made public, leakage of information could occur, hence affecting the stock price even before disclosure by the listed firm was made. Besides, the market could react for several days after the announcement. Owing to uncertainties of when the information will actually be known by the public and the duration of the market reaction, several event windows were used to measure the abnormal return of stock price. On the other hand, care was taken to ensure window period were not too long to avoid capturing unrelated event announcement into the abnormal stock price return[127].

The overall cross sectional sample (All RPT, Table 5.3) gives a t-test result with significance at 5% or 10% level for four out of seven event window periods. This shows the cumulative abnormal return (CAR) of the stock price has a significant relationship with the short horizon's announcement effect of related party transaction. As denoted by the positive CARs over (-30,1), (-10,1) and (-5,1) windows, the investors in general reacted favourably to the firm until the initial announcement of the RPT, earning an average abnormal return of 1.49% (p-value 0.022) for the window period of (-5,1). However, in the succeeding post announcement period, negative returns of stock price ensued as indicated by the negative CAR over (0,30) day window, earning an overall significant average abnormal return of -1.50% (p-value 0.069). In particular, the largest subsample asset acquisition RPT with a highly significant negative CAR of -1.79% (p-value 0.018%) for post announcement window (0,10).

The above positive returns earned by firms engaged in the RPT during pre-announcement period show that the market realized the occurrence of expropriation by the influential firms' owners only after the formal announcement of RPT. This is in line with Cheung, Rau and Stouraitis (2006) findings in their direct examination of tunneling, propping and expropriation in

[127] The plots of CAR versus event window period of -30 to 30 days for each of the RPT category are illustrated in the Appendix A (the corresponding data are in Appendix B)

Table 5.3

Cumulative Abnormal Returns (CAR) for a Sample of 422 Announcements of Related Party Transaction (RPT) by Firms in Bursa Malaysia During Year 2008 to 2013.

Cumulative average abnormal returns (CARs) over different windows, market-model (t-statistic)	***All RPT (n=422)***	***Transactions that are known to cause expropriation***							***Transactions that are possibly beneficial to the minority investors***			***Transactions that possibly have strategic motivations***
		Asset acquisition (n=189)	Asset sales (n=81)	Equity sales (n=20)	Trading relationship (n=61)	Cash payments (n=7)	Loan guarantee (n=7)	**Overall Category (n=365)**	Cash receipts (n=5)	Subsidiary relationship (n=23)	**Overall Category (n=28)**	Takeover offers & joint ventures (n=29)
Days (-30,1)	3.80 (0.011)**	0.11 (0.923)	2.95 (0.206)	11.07 (0.007)***	16.74 (0.060)*	-1.41 (0.715)	-1.28 (0.669)	4.06 (0.018)**	-7.29 (0.299)	1.41 (0.537)	-0.14 (0.951)	4.30 (0.194)
Days (-10,1)	1.95 (0.019)**	0.70 (0.268)	-0.12 (0.893)	6.36 (0.002)***	7.88 (0.110)	-1.34 (0.642)	1.58 (0..563)	2.02 (0.030)**	-5.49 (0.023)**	0.66 (0.493)	-0.44 (0.660)	3.45 (0.231)
Days (-5,1)	1.49 (0.022)**	0.26 (0.642)	0.48 (0.530)	4.27 (0.040)**	5.58 (0.131)	-1.69 (0.392)	2.95 (0.253)	1.43 (0.046)**	-6.15 (0.003)***	1.55 (0.093)*	0.18 (0.858)	3.48 (0.174)
Days (-1,1)	0.53 (0.143)	-0.33 (0.499)	0.44 (0.411)	1.48 (0.467)	2.11 (0.100)*	-1.79 (0.000)***	3.05 (0.143)	0.38 (0.305)	-3.98 (0.109)	0.07 (0.927)	-0.66 (0.441)	3.53 (0.114)
Days (0,1)	0.42 (0.171)	-0.51 (0.291)	1.08 (0.044)**	2.72 (0.137)	0.91 (0.280)	-1.13 (0.001)***	3.24 (0.088)*	0.32 (0.335)	-3.21 (0.075)*	0.02 (0.976)	-0.56 (0.424)	2.60 (0.054)*
Days (0,10)	-0.98 (0.101)	-1.79 (0.018)**	-0.26 (0.764)	0.21 (0.940)	-0.21 (0.938)	-3.07 (0.232)	2.13 (0.330)	-1.03 (0.113)	-3.67 (0.492)	-3.30 (0.138)	-3.37 (0.095)*	1.96 (0.359)
Days (0,30)	-1.50 (0.069)*	-2.59 (0.029)**	0.75 (0.679)	-0.09 (0.961)	-1.30 (0.601)	-11.13 (0.016)**	0.77 (0.857)	-1.59 (0.063)*	-25.99 (0.152)	-0.06 (0.984)	-4.69 (0.257)	2.76 (0.408)
Day (-1)	0.11 (0.576)	0.18 (0.558)	-0.64 (0.105)	-1.24 (0.084)*	1.20 (0.088)*	-0.66 (0.154)	-0.19 (0.611)	0.07 (0.762)	-0.77 (0.472)	0.05 (0.907)	-0.10 (0.789)	0.93 (0.365)
Day (0)	0.18 (0.399)	-0.28 (0.410)	0.10 (0.759)	2.04 (0.024)**	0.83 (0.241)	-0.32 (0.598)	2.30 (0.194)	0.16 (0.486)	-1.23 (0.183)	0.21 (0.698)	-0.05 (0.918)	0.56 (0.241)
Day (1)	0.24 (0.273)	-0.22 (0.455)	0.97 (0.040)**	0.69 (0.689)	0.08 (0.884)	-0.81 (0.112)	0.94 (0.397)	0.15 (0.501)	-1.98 (0.070)*	-0.19 (0.785)	-0.51 (0.401)	2.04 (0.126)

Significance level: *** (1%), ** (5%), and * (10%) in two-tailed tests. "n" in bracket denotes sample size. CARs are estimated using the market model where FBMEMAS Index is used as the proxy for market return.

Hong Kong public listed firms, where they found investors could not predict the firm's expropriation prior to the announcement of the RPT. Post announcement, investor discounting of stock price could be explained by information asymmetries (Jensen & Meckling, 1976) between the majority and minority shareholders during the pre-announcement period. A possible explanation is insider trading took place prior to the RPT announcement. Realizing that after the RPT announcement, the less informed minority outsiders who earlier did not have the privileged access to the insiders, imposed a governance discount on the stock price (Easley *et al.,* 1997).

However, interpretation of results of sub-samples in Table 5.3 is constrained by the limitation of small sample sizes for the RPT type of equity sales (n=20)[128], cash payment (n=7), loan guarantee (n=7)[129], cash receipts (n=5) and subsidiary relationship (n=23)[130], and takeover offers & joint ventures (n=29)[131]. Without a large enough sample size (minimum n=30), the stringent assumption of a normally distributed sample population for using the parametric test is not being met. Hence, non-parametric tests (Mann-Whitney U-test and Median test) were used along side with parametric test (t-test) to examine whether there are any differences between the three categories of RPT[132]. Results from both parametric and non-parametric test indicate no significant difference in mean, distribution and median between the three categories of samples. However, the small sample size problem becomes less severe when using the results in the overall category of sub-sample as shown in columns 8, 11 and 12 of Table 5.3. The following sections explain the result of univariate analysis for the three categories of RPT.

[128] Equity sales are RPTs classified under category 1 of transactions that are known to cause expropriation.
[129] Cash payment and loan guarantee are RPTs classified under category 1 of transactions that are known to cause expropriation.
[130] Cash receipts and subsidiary relationship are RPTs classified under category 2 of transactions that are possibly beneficial to minority investors.
[131] Takeover offers & joint ventures is RPT classified under category 3 of transactions that possibly have strategic motivations.
[132] As defined in footnotes 129, 130, 131 and 132 above, the three categories of RPT (n=365, 28 and 29 respectively) were tested for difference in mean (t-test), distribution (Mann-Whitney U-test) and median (Median test).

Transactions That are Known to Cause Expropriation

This category has the largest sample size (n=365), which accounts for 86% of the overall sample. It is not a surprise the overall result of category 1 univariate analysis resembles the pattern of the total sample (All RPT). In this category of RPT, all six types of RPTs, namely, asset acquisition, asset sales, equity sales, trading relationship and cash payments and loan guarantee show significant t-test for CAR for certain window periods. In the post event announcement period, all the four types of RPT (asset acquisition, equity sales, trading relationship and cash payments) have negative CAR even though only the asset acquisition and cash payments show significant test results at the 5 % level. Over the (0,10) and (0,30) window, firm acquiring assets earned market-adjusted abnormal return of -1.79% (p-value 0.018) and -2.59% (p-value 0.029) respectively, while firm engaging in cash payments RPT earned a very high -11.13% (p-value 0.016) abnormal return albeit with small sample size. These findings support our hypotheses, where governance discount is imposed on stock price when the investors became aware of potential expropriations in post announcement of RPT.

Asset acquisition RPT shows negative significant relationship with CAR for a window period (0,10) and (0,30). Hence, firms suffered value loss in response to the transaction's announcement. In line with the hypothesis, the asset acquisition of the listed firm from a related party is seen as a conflict of interest in the companies, and regarded by the shareholders as an act of expropriation. Subsequent to the RPT announcement, the firm's share price was discounted by investors.

Cash payment RPT is hypothesized to have a negative impact on CAR, the results are highly significant for the post announcement period of (0,1) and (0,30) day windows, which are in line with our hypothesis. It also has a negative CAR throughout the entire short term event

window period. Such a finding also supports the study by Gordon *et al.* (2006) in US listed firms, where CAR had a significant negative relationship to the frequency and dollar value of lending to all the firm's directors. In Table 5.2, the cash payment transaction was found to be closely associated with smaller firms, albeit at a small sample size of 7 for this transaction category. These firms also have the lowest median leverage of 0.557 compared to the overall sample median of 0.840 (sample range 0.557 to 1.059)[133]. Hence, being relatively cash rich makes the firms more prone to engaging in this highly value-destroying transaction.

On the other hand, not only the overall t-test result shows that loan guarantee RPT has no statistically significant impact on the CAR except for the window (0,1) with CAR of 3.24% (p-value 0.088), which is different from the hypothesis. One possible explanation was the market perceived such related party transaction as something not immediately unfavourable to the firm in the short term, hence, not discounting the firm's stock price. However, the small sample size of seven RPTs warrants that the result should be interpreted cautiously.

Contrary to the hypothesis, the RPT of equity sales has shown an interesting high positive significant effect on CAR during the period from the pre-announcement until the initial announcement, as indicated by the event window (-30,1), (-10,1) and (-5,1). Firm undertakes equity sales over the pre-announcement day window earned an average of 11.07% (p-value 0.007), 6.36% (p-value 0.002) and 4.27% (p-value 0.040) abnormal return respectively, suggesting a probable positive impact of monitoring action by the new shareholders. Such market's reaction pattern showed a high resemblance to findings[134] from studies in China

[133] Besides, Table 5.2 also shows that firms engaging in a cash payment transaction have the lowest mean board independence (39.3% versus a sample average of 45.2%), the third highest family director concentration (20.5% versus a sample average of 16.8%), the lowest audit committee independence (42.9% versus a sample average of 52.0%) and lowest median cash ownership by major owners (23.43% versus sample average 30.02%) and directors (16.94% versus a sample average of 30.02%).

[134] Even though t-test result show CAR turned negative in the post announcing period (0,30) day windows, it is not statistically significant.

(Cheung *et al.*, 2009; Cheng & Chen, 2006; Ying & Wang, 2013) and Turkey (Gonenc & Hermes, 2008) in which propping behaviour of controlling shareholders were followed by serious engagement in tunneling activities. However, from the result of this study, no evidence of tunneling can be established since the negative CAR in post announcement is not statistically significant.

The trading relationship RPT has a significant high positive CAR of 16.74% (p-value 0.060) in the pre-announcement period of (-30,1)[135] day window. It is noteworthy that the median leverage of the firms engaged in this RPT is 0.579, which is considerably lower than the overall sample median of 0.84. Such low gearing signal a high likelihood firms are free from financial distress. Besides, the frequency of the presence of non-state blockholders[136] in these firms is the second highest at 70.5% (overall sample average is 53.7%), and the average (median) combined share ownership of blockholders is also the highest at 20.68 (19.31) compared to the overall sample of 14.73 (11.63). This high presence of non-state blockholders possibly incentivizes internal collusion between the controlling and other substantial shareholders, resulting in a higher frequency of the trading relationship RPT. Therefore, the factors of low leverage and high non-state blockholders ownership very likely caused the market to perceive the RPT as routine or necessary business dealing, beneficial to the business operations of the listed firms. Hence, despite the presence of incomplete and asymmetric information phenomenon between the majority and minority shareholders during the pre-announcement period, firms still earn a favourable response of very high positive CAR from the market's investors. Finally, the t-test result shows CAR of asset sales has a positive, statistically

[135] Nevertheless, the t-test result of the trading relationship RPT in post announcement window period has a negative CAR albeit not statistically significant in windows (0,30).
[136] Non-state block holders is defined as all the other substantial shareholders (>5%) besides the ownership of majority shareholder and government linked investors.

significant CAR for the day (0,1) window, hence earning an abnormal return of 1.08% (p-value 0.044). This finding is contrary to the expropriation hypothesis[137].

Transactions That are Possibly Beneficial to the Minority Investors

Friedman, Johnson and Mitton (2003) termed ''propping up'' such as cash receipts by the listed company from the dominant owner as the transactions that are likely beneficial to the minority shareholder. However, Table 5.3 shows result contrary to previous research findings, with a highly significant and strong negative CAR for cash receipt RPT subsample. Over (-10,1), (-5,1) and (0,1) day windows, the firms earned market-adjusted abnormal return of -5.49% (p-value 0.023), -6.15% (p-value 0.003) and a -3.21% (p-value 0.075) respectively. This suggests the market might distrust the actions and was highly suspicious of the motive[138] of controlling shareholder who provided direct financial support to the listed firms. Hence, investors imposed a governance discount on the stock. An alternative explanation is the firms might have been already in a financial distress which explains the negative market reaction upon announcement. However, the small sample size of five RPTs requires that the result be interpreted cautiously.

On the other hand, the subsidiary relationship transactions show a positive significant relationship with CAR for the event window (-5,1), earning a 1.55% (p-value 0.093) abnormal return, which supports our hypothesis of non-expropriation. However, when the two subsamples are tested as one combined overall category, its t-test result of the overall category transaction is

[137] However, in an unreported specification using days (2,5) window, a post announcement negative significant CAR of -1.20% (p-value 0.005) was obtained. Such trend is in line with the hypothesis of expropriation, suggesting firms suffered value loss as a result of governance discount imposed by shareholders in post transaction's announcement.

[138] According to Friedman *et al.* (2003), the propensity of propping up is high if it makes debt issuance attractive to the controlling shareholders, especially in the environment of weak legal protection. Even though debt represents a commitment to bail out the firm, it also makes the firm more susceptible to being abandoned or looted by the controlling shareholder when the external shock is bad. Evidently, it can be observed in Table 5.2 that the firms undertaking cash receipt RPT has the highest leverage ratio of 2.230 compared to overall sample average of 1.212.

not significant for all the seven CAR window periods except (0,10) which is negatively significant at -3.37% (p-value 0.095). Even though the larger subsample of subsidiary relationship RPT (n=23) has a significant positive CAR, its positive CAR impact is likely negated by the effect of the highly significant negative coefficients of CARs for cash receipts RPT subsample.

Transactions That Possibly Have Strategic Motivations

The t-test result of takeover offers and joint ventures RPT is statistically significant with a positive CAR of 2.6% (p-value 0.051) for day (0,1) window. This is in line with the hypothesis and findings from previous researches by Cheung *et al.* (2009) in Hong Kong and Kohlbeck and Mayhew (2010) in the US. They found the market generally does not appear to value negatively the more complex RPT such as those involving a firm's investment or partnership and joint venture.

5.4.2 Monitoring by MSWG Activism

The univariate analysis results in Table 5.4 show the overall presence of MSWG activism has a significant association with the firm's CAR during the pre-announcement period. It indicates most firms under the influence of MSWG activism (MSWG=1) has a significant positive CAR in the pre-announcement window period of (-30,1), (-10,1), (-5,1) and (-1,1), and such significant positive CARs continued up to the day after the announcement of (0,1). However, in post announcement, it seems the impact of MSWG activism on CARs becomes negative as shown in the window for (2,5) period. On the other hand, firms without the MSWG activism (MSWG=0) shows only significant CARs for window (-10, 1), (2,5) and

Table 5.4

Cumulative Abnormal Returns (CAR) for Sample of Announcements of Related Party Transaction (RPT) by Firms Under MSWG Monitoring in Bursa Malaysia During Year 2008 to 2013

Cumulative average abnormal returns (CARs) over different windows, market-model (t-statistic)	***Panel A (Firms with Activism, MSWG = 1)***				***Panel B (Firms without Activism, MSWG = 0)***			
	All RPT (n=168)	***Transactions that are known to cause expropriation* (n=147)**	***Transactions that are possibly beneficial to the minority investors* (n=9)**	***Transactions that possibly have strategic motivations (n=12)***	***All RPT (n=254)***	***Transactions that are known to cause expropriation* (n=218)**	***Transactions that are possibly beneficial to the minority investors* (n=19)**	***Transactions that possibly have strategic motivations (n=17)***
Days (-30,1)	6.79 (0.044)**	7.89 (0.040)**	-3.2 (0.461)	0.77 (0.716)	1.82 (0.104)	1.48 (0.223)	1.31 (0.626)	6.79 (0.212)
Days (-10,1)	3.25 (0.080)*	3.78 (0.073)*	-2.44 (0.228)	1.02 (0.626)	1.10 (0.083)*	0.83 (0.189)	0.51 (0.633)	5.16 (0.273)
Days (-5,1)	2.55 (0.065)*	2.97 (0.059)*	-2.32 (0.250)	1.08 (0.486)	0.79 (0.163)	0.40 (0.481)	1.36 (0.203)	5.18 (0.221)
Days (-1,1)	1.02 (0.061)*	1.28 (0.033)**	-3.14 (0.110)	1.01 (0.349)	0.21 (0.670)	-0.22 (0.646)	0.52 (0.367)	5.31 (0.153)
Days (0,1)	0.85 (0.044)**	1.01 (0.029)**	-2.69 (0.129)	1.64 (0.069)*	0.13 (0.759)	-0.15 (0.750)	0.46 (0.338)	3.27 (0.142)
Days (0, 10)	-1.39 (0.101)	-1.35 (0.147)	-6.04 (0.102)	1.65 (0.122)	-0.71 (0.387)	-0.81 (0.361)	-2.10 (0.384)	2.18 (0.547)
Days (0, 30)	-1.20 (0.334)	-0.23 (0.854)	-19.88 (0.036)**	0.89 (0.745)	-1.70 (0.122)	-2.52 (0.032)**	2.51 (0.426)	4.08 (0.450)
Days (2, 5)	-1.08 (0.034)**	-1.00 (0.074)*	-2.28 (0.260)	-1.01 (0.047)**	-1.06 (0.020)**	-1.23 (0.013)**	0.00 (0.977)	-0.17 (0.927)
Day (-1)	0.17 (0.456)	0.27 (0.276)	-0.44 (0.487)	-0.63 (0.426)	0.08 (0.798)	-0.07 (0.820)	0.06 (0.896)	2.03 (0.214)
Day(0)	0.53 (0.132)	0.64 (0.111)	-0.81 (0.149)	0.27 (0.615)	-0.06 (0.821)	-0.15 (0.591)	0.31 (0.630)	0.77 (0.295)
Day(1)	0.32 (0.282)	0.37 (0.181)	-1.89 (0.223)	1.37 (0.027)**	0.19 (0.567)	0.00 (0.977)	0.15 (0.756)	2.51 (0.266)

Significance level: *** (1%), ** (5%), and * (10%) in two-tailed tests.

(0,30). It is noteworthy the sub sample (that are known to cause expropriation) with the most significant positive CAR windows as shown in column 2 has a large sample size (n=147), in comparison to the other sub samples.

Independent sample t-test was conducted to compare the two groups of sample (MSWG =1 & 0) and found no significant difference in their means. Due to small sample size of the two sub-categories[139], non-parametric test were employed (Mann-Whitney U-test and Kolmogorov-Smirnov Z-test), but found no significant difference in terms of the distribution and median of the two groups (overall Panel A & B). Further tests on the sub-categories of RPT also show no difference in their respective mean[140] and median[141] except for category 2 subsample[142] (refer footnote 143 for detail of test result). Hence, the information could only help to partially explain the impact of the MSWG activism factor.

Nevertheless, a possible explanation for the above result (Panel A sample) could be due to shareholders generally favorable response to firms engaging in MSWG activism during the pre-announcement period, since their concern is under the oversight of a professional watchdog. This could be either with the voluntary or involuntary involvement of the listed firm with MSWG (the latter case could be in the form of a query made by MSWG when a complaint is made by minority investors). Usually a follow-up query or comment by MSWG would signal suspicion of unfair treatment in a planned RPT, whereby the listed firm is expected to openly

[139] The two sub-categories in comparison are: transactions that are possibly beneficial to the minority investors (n=9,19), and transactions that possibly have strategic motivations (n=12, 17)

[140] *Parametric t-test for mean difference of CAR (0,30) yields p-value of 0.003 at 1% significance level.*

[141] Non-parametric Mann-Whitney U test for median comparison of CAR (0,30) yields p-value of 0.061 at 10% significance level.

[142] Nevertheless, when both parametric (t-test) and non-parametric (Mann-Whitney U test) were performed on the subsamples of category 2 RPT (representing RPTs that are possibly beneficial to minority investors), the two sub-groups (MSWG = 0, 1) shows significant difference in mean and median. Such difference in impact of MSWG activism factor is reflected in the highly significant CAR of -19.88% (p-value 0.036) for the (0,30) window for Panel A (MSWG =1) subsample. In contrast, the corresponding subgroup shows non-significant result of 2.51% (p-value 0.426) in Panel B (MSWG = 0).

address the minority investors' concern. In many cases, listed firms are reprimanded and strongly requested by MSWG to abort or to consider restructuring the planned RPT. Therefore, it is not a surprise that shareholders impose governance discount on the stock price after the RPT announcement. Most likely, this is when the firm decided to proceed with the planned transaction without any constructive rectification of the issue feedback by MSWG, and outright ignored the minority shareholders' concern.

However, it is found the category 2 RPT (Panel A sample) which are transaction possibly beneficial to minority investors suffered a very high governance discount of -19.88% (p-value 0.036) during post announcement period of window (0,30), albeit the sample size requires careful interpretation of its result. It shows the relative sell-down by investors is far more severe in post announcement, when the firm that engage in this category RPT is being queried under the MSWG activism. The imposition of much larger governance discount for category 2 RPTs suggests investors are overwhelmingly surprised by the firm's action which was contrary to their initial expectation. Besides, the act of reprimand from shareholder activism very likely further catalyzed the market to respond with a heavy discount on the stock. On the contrary, category 1 RPT, which are transactions known to cause expropriation, suffered a correspondingly lower governance discount of -1.00% (p-value 0.074) in post announcement period of window (2,5)[143]. Possibly, the category 1 RPTs which are known to cause expropriation with acts of self-dealing by controlling shareholders is within the market's expectation, hence the less surprised investors were not as negatively reactive to the eventual announcement of RPT.

Result in panel B sample which comprises effect of the RPT announcement without the influence of MSWG activism, shows a significant CAR of 1.10% (p-value 0.083) for the overall

[143] The CAR is -0.23% (p-value 0.854) for the compatible window of (0,30) albeit not statistically significant.

sample (ALL RPT) for a day (-10,1) window only. Nevertheless, for category 1 sub-sample, the result also shows a statistically significant CAR of -2.52% (p-value 0.032) for the post announcement period for day (0, 30) window.

5.4.3 Multicollinearity Tests

Presence of multicollinearity in multiple regression in which two or more independent variables in the model are highly correlated will result in the estimates of regression coefficients to be unreliable (Sekaran & Bougie, 2009). Pearson's correlation matrix in Table 5.5 is used for the initial identification of collinearity between the 27 independent variables of the 422 RPT samples. Results show none of the coefficients are greater than 0.7[144], the threshold value indicating the first sign of collinearity. Nevertheless, the highest correlation obtained is 0.664 between the COBH (*cash ownership of block holder*) and PNSBHd (dummy variable for the *presence of non-state block holders*), in which presence of additional substantial shareholders is expected to contribute to a higher combined block holder's ownership.

To further assess the presence of multicollinearity in the sample from the combined effect of two or more variables, variance inflation factor (VIF) for each independent variable is generated. The result in Table 5.6 shows all the values of VIF are below 10[145] (Hair, Black, Babin & Anderson, 2010), with the COBH having the highest value of only 3.019, hence confirming absence of multicollinearity in the model.

5.5.4 Multivariate Analysis

As discussed in Section 5.4.1 (univariate analysis), factors such as uncertainties of when

[144] Generally a correlation of 0.70 and above is considered high, in which multicollinearity could exist (Sekaran & Bougie, 2009).
[145] The common cut-off threshold value for VIF that denotes high collinearity is 10 (Hair, Black, Babin & Anderson, 2010).

the public will actually receive the information and duration of the market reaction, have resulted in the choice of most suitable event window period within -30 to 30 day range for use in the regression analysis a key consideration. In this research, the outcome of univariate analysis on various types of RPT subsamples were used as the supporting indicators for best choice of window. CAR for window (-5,1) which yielded the most significant result in 5 out 12 RPT categories, and CAR for window (0,10) which represents extended days of the post announcement effect of RPT were chosen as the dependent variables of multivariate analysis.

Results from OLS regression of cumulative abnormal return (CAR) of stock prices on proxies for corporate governance factors (board composition and ownership structure and shareholder activism), types and size of related party transaction and firms' characteristics are summarized in Table 5.7. CAR is based on the market-adjusted returns for window of days (-5,1) relative to the announcement day. The objective is to examine the relationship and impact of these corporate governance variables on CAR that arose from the announcement effect of related party transaction. Likewise, the same process was applied to estimate an alternate estimation model with a window of (0,10) days, representing extended days of the post-announcement effect of RPT (result is reported in Table C.1 of Appendix C). Such alternative specification serves to examine the robustness of the result. The results of this alternate regression analysis will be explained concurrently under the respective section or footnotes for the corresponding corporate governance factors.

Models 1 for a window (-5,1) days is first estimated using the normal OLS regression. Heteroscedasticity tests using both White's and Breush-Pagan approaches were carried out. The p-values of White's and Breusch-Pagan tests are zero, which shows the existence of heteroscedasticity. Subsequently, an improved version which is the model 2 was derived using

Table 5.5

Pearson's Correlation Matrix between Independent Variables

Variable	LEV	FSIZE	BS	BIND	FDC	CEODd	ACId	CODO	DOviaUCd	DCRDO	COBH	CODIR	DCRDIR=1d	DCRDIR>1d	COGLIC	PNSBHd
LEV	1															
FSIZE	0.186**	1														
BS	0.104*	0.356**	1													
BIND	0.039	0.016	-0.233**	1												
FDC	-0.088	-0.132**	0.129**	-0.250**	1											
CEODd	0.013	-0.042	-0.018	0.009	0.034	1										
ACId	-0.011	-0.040	0.112*	0.275**	0.051	-0.018	1									
CODO	0.018	0.276**	0.119*	-0.076	0.085	0.062	-0.149**	1								
DOviaUCd	0.051	-0.009	0.103*	-0.026	0.159**	0.092	0.013	0.177**	1							
DCRDO	-0.020	0.076	-0.082	0.008	-0.051	-0.031	-0.033	-0.249**	-0.066	1						
COBH	-0.066	-0.180**	-0.020	-0.049	-0.142**	-0.032	0.042	-0.440**	-0.087	0.011	1					
CODIR	-0.016	-0.261**	0.058	-0.165**	0.401**	0.137**	0.186**	0.223**	0.367**	-0.145**	0.038	1				
DCRDIR=1d	0.030	-0.228**	-0.107*	0.083	0.136**	0.114*	0.175**	-0.014	0.211**	-0.227**	0.111*	0.359**	1			
DCRDIR>1d	-0.018	-0.004	-0.006	-0.084	0.084	-0.042	-0.031	-0.183**	-0.165**	0.237**	-0.039	0.007	-0.457**	1		
COGLIC	-0.049	0.219**	0.069	-0.042	-0.162**	-0.146**	-0.009	-0.095	-0.155**	0.002	0.334**	-0.201**	-0.170**	0.067	1	
PNSBHd	-0.043	-0.298**	-0.057	0.018	0.004	0.007	0.168**	-0.422**	0.032	0.005	0.664**	0.136**	0.229**	-0.061	-0.1053	1
MSWGd	0.006	0.516**	0.068	0.144**	-0.244**	-0.124*	0.023	0.172**	-0.027	0.090	-0.162**	-0.199**	-0.063	-0.082	0.1362	-0.208
SRPT	-0.070	-0.153**	-0.134**	0.147**	-0.079	-0.021	0.072	-0.114*	-0.025	-0.009	0.153**	-0.042	0.032	-0.015	0.1348	0.089
ASRPTd	0.113*	0.114*	-0.007	0.017	0.006	0.006	-0.039	0.077	0.090	-0.015	-0.029	-0.018	-0.022	0.021	-0.0048	-0.091
ESRPTd	0.073	-0.035	0.057	0.031	-0.062	-0.096*	0.035	-0.033	-0.034	-0.035	-0.030	-0.060	-0.088	-0.002	0.0277	-0.062
TRRPTd	-0.019	-0.098*	-0.135**	0.117*	-0.025	-0.047	0.070	-0.126**	-0.070	-0.031	0.169**	-0.056	0.066	-0.036	0.0373	0.138**
CPRPTd	-0.035	-0.043	0.023	-0.060	0.023	-0.005	-0.024	-0.022	0.036	-0.021	-0.025	-0.045	-0.046	-0.031	-0.0012	-0.029
LGRPTd	-0.013	0.016	0.141*	-0.014	0.047	0.097*	0.013	0.035	-0.001	-0.021	-0.006	-0.006	-0.046	-0.031	0.0234	0.046
CRRPTd	0.072	0.017	-0.010	0.001	-0.020	0.013	0.061	0.013	0.005	-0.018	-0.059	0.094	0.047	-0.026	-0.0586	-0.030
SRRPTd	-0.008	0.037	0.062	-0.062	0.168**	0.012	0.021	0.046	0.037	-0.040	-0.012	0.112*	0.075	-0.056	0.0454	0.034
TO&JVRPTd	-0.057	-0.012	0.038	-0.092	-0.055	-0.014	-0.059	-0.083	-0.051	-0.008	0.020	-0.084	-0.038	-0.022	0.028	-0.049
SUBPRIMEd	0.041	-0.014	-0.016	-0.106*	0.048	0.112*	-0.181**	0.003	0.106*	0.023	0.031	-0.013	-0.029	0.016	0.0094	0.017

Significance level of correlation: ** (1%) and * (5%) in two-tailed tests.

Table 5.5 (Continued)

Variable	MSWGd	SRPT	ASRPTd	ESRPTd	TRRPTd	CPRPTd	LGRPTd	CRRPTd	SRRPTd	TO&JVRPTd	SUBPRIMEd
LEV											
FSIZE											
BS											
BIND											
FDC											
CEODd											
ACId											
CODO											
DOviaUCd											
DCRDO											
COBH											
CODIR											
DCRDIR=1d											
DCRDIR>1d											
COGLIC											
PNSBHd											
MSWGd	1										
SRPT	0.002	1									
ASRPTd	0.095	-0.062	1								
ESRPTd	0.001	0.016	-0.109*	1							
TRRPTd	-0.045	0.171**	-0.200**	-0.092	1						
CPRPTd	-0.030	-0.021	-0.063	-0.029	-0.053	1					
LGRPTd	-0.030	-0.022	-0.063	-0.029	-0.053	-0.017	1				
CRRPTd	0.045	-0.018	-0.053	-0.024	-0.045	-0.014	-0.014	1			
SRRPTd	-0.067	0.064	-0.117*	-0.054	-0.099*	-0.031	-0.031	-0.014	1		
TO&JVRPTd	0.009	0.053	-0.132**	-0.061	-0.112*	-0.035	-0.035	-0.031	-0.065	1	
SUBPRIMEd	-0.110	-0.060	0.002	-0.039	-0.046	0.066	0.066	-0.035	0.075	-0.072	1

Significance level of correlation: ** (5%) and * (10%) in two-tailed tests.

LEV: Leverage of firm in ratio of total liabilities to total shareholder fund, ***FSIZE:*** Firm size in logarithm of total assets of firm in Ringgit Malaysia. ***BS:*** Board size in total number of directors in board, ***BIND***: Board independence in ratio of independent director to total directors on board, ***FDC:*** Family director concentration in ratio of directors who are family members of controlling shareholder to total directors on board, ***CEODd:*** CEO duality dummy variable '1' for duality of CEO and '0' for non-duality of CEO, ***ACId:*** Audit committee independence dummy variable '1' for audit committee chairman and all members are independent and '0' otherwise, ***CODO:*** Cash ownership of dominant owner in percent cash ownership of the controlling shareholder, ***DOviaUCd:*** Share held by dominant owner via unlisted company dummy variable '1' for yes, '0' for no, ***DCRDO:*** Divergence of control to cash right for dominant owner in ratio of control over cash flow right of dominant owner, ***COBH:*** *Cash ownership of block holders in* combine percent cash ownership of all institutional and block shareholders with > 5% shareholdings, ***CODIR:*** Cash ownership of directors in percent cash ownership of all directors, ***DCRDIT=1d:*** Divergence of control to cash right for directors = 1 dummy variable '1' for yes, '0' for no, ***DCRDIR>1d:*** Divergence of control to cash right for directors > 1 dummy variable '1' for yes, '0' for no, ***COGLIC:*** Cash ownership of government linked investors or state government in percent cash ownership of government linked investor or state government, ***PNSBHd:*** Presence of non-state block holders dummy variable '1' for presence of non-state block holder and '0' otherwise, ***MSWGd:*** MSWG activism dummy variable '1' for firm covered by MSWG activism and '0' otherwise, ***SRPT***: Size of RPT in ratio of RPT value to company's total assets, ***ASRPTd:*** Asset sales RPT dummy variable '1' for yes, '0' for no, ***ESRPTd:*** Equity sales RPT dummy variable '1' for yes, '0' for no, ***TRRPTd:*** Trading relationship RPT dummy variable "1" for yes, '0' for no, ***CPRPTd***: Cash payments RPT dummy variable '1' for yes, '0' for no, ***LGRPTd:*** Loan guarantee RPT dummy variable '1' for yes, '0' for no, ***CRRPTd:*** Cash receipts RPT dummy variable '1' for yes, '0' for no, ***SRRPTd:*** Subsidiary relationship RPT dummy variable '1' for yes, '0' for no, ***TO&JVRPTd:*** Takeover offers & joint ventures RPT dummy variable '1' for yes, '0' for no, ***SUBPRIMEd***: US subprime crisis year (2008 & 2009) dummy variable "1" for yes, '0' for no.

Table 5.6
Multicollinearity Test with Variance Inflation Factor (VIF)

Independent Variables	VIF
LEV	1.123
FSIZE	2.117
BS	1.426
BIND	1.366
FDC	1.449
CEODd	1.085
ACId	1.329
CODO	1.923
DOviaUCd	1.275
DCRDO	1.216
COBH	3.019
CODIR	2.072
DCRDIR=1d	1.773
DCRDIR>1d	1.554
COGLIC	1.658
PNSBHd	2.603
MSWGd	1.583
SRPT	1.141
ASRPTd	1.217
ESRPTd	1.117
TRRPTd	1.237
CPRPTd	1.048
LGRPTd	1.074
CRRPTd	1.049
SRRPTd	1.136
TO&JVRPTd	1.133
SUBPRIMEd	1.108

Table 5.7

Regression of Cumulative Abnormal Return (CAR) on Variable of Corporate Governance, Firm Characteristics and RPT for a Sample of 422 Related Party Transactions by Firms Listed in Bursa Malaysia During 2008 to 2013

	Independent Variables	Model 1 Market-adjusted CAR for days (-5,1)	Model 2 Market-adjusted CAR for days (-5,1)	Model 3 Market-adjusted CAR for days (-5,1)	Model 4 Market-adjusted CAR for days (-5,1)	Model 5 Market-adjusted CAR for days (-5,1)
	Intercept	0.2440 (0.024)**	0.2440 (0.103)	0.2850 (0.065)*	0.2566 (0.079)*	-0.0348 (0.322)
	Size of RPT	0.0031 (0.512)	0.0031 (0.783)	-	0.0050 (0.664)	-
	Asset Sales RPT Dummy	-0.0000 (0.999)	-0.0000 (0.998)	-	-	-
	Equity Sales RPT Dummy	0.0263 (0.401)	0.0263 (0.279)	-	-	-
	Trading Relationship RPT Dummy	0.0377 (0.060)*	0.0377 (0.168)	-	-	-
Related Party Transaction (RPT)	Cash Payment RPT Dummy	-0.0198 (0.696)	-0.0198 (0.424)	-	-	-
	Loan Guarantees RPT Dummy	0.0392 (0.445)	0.0392 (0.209)	-	-	-
	Cash Receipts RPT Dummy	-0.0599 (0.318)	-0.0599 (0.025)**	-0.0784 (0.002)***	-	-
	Subsidiary Relationship RPT Dummy	0.0327 (0.271)	0.0327 (0.085)*	-	-	-
	Takeover Offers & Joint Ventures RPT Dummy	0.0293 (0.271)	0.0293 (0.286)	-	-	-
MSWG Activism	MSWG Activism Dummy	0.0435 (0.008)***	0.0435 (0.110)	0.0433 (0.097)*	0.0413 (0.121)	-
	Board Size	0.0013 (0.727)	0.0013 (0.615)	-	0.0016 (0.521)	-
	Board Independence	0.1718 (0.003)***	0.1718 (0.063)*	0.1746 (0.063)*	0.1748 (0.045)**	0.1884 (0.078)*
	Family Director Concentration	-0.0140 (0.702)	-0.0140 (0.592)	-	-0.0063 (0.812)	-
Board Composition	CEO Duality Dummy	-0.0028 (0.878)	-0.0028 (0.839)	-	-0.0039 (0.778)	-
	Audit Committee Independence Dummy	-0.0014 (0.924)	-0.0014 (0.890)	-	-0.0010 (0.922)	-

Table 5.7 (Continued)

	Independent Variables	Model 1 Market-adjusted CAR for days (-5,1)	Model 2 Market-adjusted CAR for days (-5,1)	Model 3 Market-adjusted CAR for days (-5,1)	Model 4 Market-adjusted CAR for days (-5,1)	Model 5 Market-adjusted CAR for days (-5,1)
Ownership Structure	Cash Ownership of Dominant Owner	-0.0004 (0.437)	-0.0004 (0.197)	-0.0006 (0.014)**	-0.0004 (0.178)	-0.0007 (0.011)**
	Share Held by Dominant Owner via Unlisted Company Dummy	0.0160 (0.272)	0.0160 (0.390)	-	0.0147 (0.409)	-
	Cash Ownership of Directors	-0.0001 (0.808)	-0.0001 (0.772)	-	-0.0002 (0.612)	-
	Divergence of Control to Cash Right for Dominant Owner	-0.0033 (0.502)	-0.0033 (0.093)*	-0.0043 (0.046)**	-0.0039 (0.067)*	-0.0037 (0.064)*
	Divergence of Control to Cash Right for Directors = 1 Dummy	-0.0152 (0.508)	-0.0152 (0.312)	-0.0197 (0.089)*	-0.0157 (0.271)	-
	Divergence of Control to Cash Right for Directors > 1 Dummy	0.0222 (0.529)	0.0222 (0.267)	-	0.0169 (0.360)	-
	Cash Ownership of Block Holders	0.0007 (0.328)	0.0007 (0.397)	-	0.0008 (0.365)	-
	Cash Ownership of Government Linked Investor or State Government	-0.0006 (0.644)	-0.0006 (0.641)	-	-0.0004 (0.715)	-
	Presence of Non-State Block Holder Dummy	-0.0133 (0.514)	-0.0126 (0.407)	-	-0.0118 (0.439)	-
External Economic Shock	US Subprime Crisis Year (2008 & 2009) Dummy	-0.0033 (0.814)	-0.0033 (0.763)	-	-0.0048 (0.642)	-
Firm Characteristics	Firm Size	-0.0156 (0.005)***	-0.0156 (0.090)*	-0.0158 (0.084)*	-0.0158 (0.080)*	-
	Leverage	-0.0021 (0.630)	-0.0021 (0.456)	-	-0.0023 (0.443)	-
Sample size		422	422	422	422	422
Adjusted R^2		0.044	0.044	0.066	0.045	0.040
P-value (F)		0.015	0.158	0.024	0.331	0.091
VIFs		1.048 - 3.019	1.048 - 3.019	1.049 - 2.117	1.108 – 3.019	1.366 – 1.923

Significance level: *** (1%), ** (5%) and * (10%) in two-tailed tests are based on Whites (1980) heteroskedasticity consistent standard errors.

Model 1: OLS regression with White's test and Breush-Pagan test for heteroskedasticity.

Model 2: OLS regression using Heteroskedasticity-robust standard errors.

Model 3: Optimized OLS regression by sequential search method (backward estimation) using Heteroskedasticity-robust standard errors.

Model 4: OLS regression using Heteroskedasticity-robust standard error (exclude RPT types independent variables).

Model 5: Optimized OLS regression by sequential search method (backward estimation) using Heteroskedasticity-robust standard errors (exclude RPT types independent variables).

Size of RPT: ratio of RPT value to company's total assets, ***Asset Sales RPT:*** dummy variable '1' for yes, '0' for no, ***Equity Sales RPT :*** dummy variable '1' for yes, '0' for no, ***Trading Relationship RPT :*** dummy variable "1" for yes, '0' for no, ***Cash Payments RPT:*** dummy variable '1' for yes, '0' for no, ***Loan Guarantee RPT:*** dummy variable '1' for yes, '0' for no, ***Cash Receipts RPT:*** dummy variable '1' for yes, '0' for no, ***Subsidiary Relationship RPT:*** dummy variable '1' for yes, '0' for no, ***Takeover Offers & Joint Ventures RPT:*** dummy variable '1' for yes, '0' for no. ***MSWG Activism:*** dummy variable: '1' for firm covered by MSWG activism and '0' otherwise, ***Board Size:*** total number of directors in board, ***Board Independence:*** ratio of independent director to total directors on board, ***Family Director Concentration:*** ratio of directors who are family members of controlling shareholder to total directors on board, ***CEO Duality:*** dummy variable: '1' for duality of CEO and '0' for non-duality of CEO, ***Audit Committee Independence:*** dummy variable: '1' for audit committee chairman and all members are independent and '0' otherwise, ***Cash Ownership of Dominant Owner:*** percent cash ownership of the controlling shareholder, ***Share Held by Dominant Owner via Unlisted Company***: dummy variable for '1' = yes, '0' = no, ***Cash Ownership of Directors:*** percent cash ownership of all directors, ***Divergence of Control to Cash Right for Dominant Owner:*** ratio of control over cash flow right for dominant owner, ***Divergence of Control to Cash Right for Directors = 1:*** dummy variable '1' for yes, '0' for no, ***Divergence of Control to Cash Right for Directors > 1:*** dummy variable '1' for yes, '0' for no, ***Cash Ownership of Block Holders:*** combine percent cash ownership of all institutional and block shareholders with > 5% shareholdings, ***Cash Ownership of Government Linked Investors or State Government:*** percent cash ownership government linked investor or state government, ***Presence of Non-State Block Holders:*** dummy variable '1' for presence of non-state block holder and '0' otherwise, ***US Subprime Crisis Year (2008 & 2009):*** dummy variable "1" for yes, '0' for no, ***Firm Size:*** logarithm of total assets of firm in Ringgit Malaysia. ***Leverage:*** ratio of firm's total liabilities to total shareholder fund.

the heteroschedasticity-robust standard error procedure to eliminate potential estimation biases. Further optimization of model 2 with the sequential search method (backward estimation) resulted in the reduced version of final estimation which is the model 3.

Regression analysis is also performed in model 4 and 5 using the same procedure, but excluding the eight RPT type dummy independent variables. Based on comparison of model 2 and 4 (Table 5.7), the regression results of the two models produce the same type of significant variables with the same direction, albeit showing minor differences in magnitude in their corresponding coefficients[146].

In model 3, the F-test is performed on the omitted variables to test the hypotheses that all omitted variables are jointly equal to zero. The result of the F-test shows that the null hypothesis is not rejected as the F-value of 0.594 is not significant (p-value 0.911). Even though the adjusted R^2 value of optimized model 3 is small at 0.066, it is as good as other studies of comparable sample size and independent variables (Cheung *et al.,* 2006; Amzaleg & Barak, 2013). Regression outcomes based on model 3 of Table 5.7 for each category of explanatory variables will be explained in the following sections.

Size and Type of RPT

The coefficient for *size of RPT* (Table 5.7), a measure of the value consideration of related party transaction is non-significant. This variable represents all types of RPT irrespective of whether a priori they are known to cause expropriation or beneficial to the minority investors. However, in specification using (0,10) window (refer Table C.1, model 3), the coefficient was found negative and statistically significant (p-value 0.001). The negative relationship observed is

[146] Further analysis using window (-5,1) and (0,10) were made, in which the RPT type dummies are excluded, and include only subsample from category 1 RPT (n=365) which are known to cause expropriation (refer Table C.2 in Appendix C, model 1 and 4). Results shows the same significant variables with similar directions as shown in Table 5.7 (model 3) and Table C.2 (model 2).

in line with the hypothesis H_{A1} of this study. This could suggest RPTs with larger values consideration are more publicity's sensitive, hence attracts more intensive shareholder activism, which will in turn induce a stronger negative market reaction. It also supports study by Gordon *et al.* (2006) in US listed firms, where the larger dollar amount of RPTs was found to significantly associate with a negative industry-adjusted CAR.

Of the eight dummy variables in the OLS regression representing the 9 types of RPT namely, asset acquisition (defined as the reference category), asset sales, equity sales, trading relationship, cash payment, loan guarantee, cash receipts, subsidiary relationship and takeover offers & joint ventures, only the coefficient of *cash receipt RPT* (Table 5.7) is statistically significant at the 1% level (p-value 0.002). The result of significant negative coefficient for the *cash receipt RPT* variable supports the hypothesis H_{A7}, positing a relationship between *cash receipt RPT* and firm's CAR. The negative relationship is also in line with the univariate results reported in Table 5.3 earlier, albeit at a small sample size. The statistically significant coefficient of *cash receipts RPT* which is -0.0784 represents its magnitude of impact on CAR is 7.84% less than the impact of *asset acquisition RPT*. Overall, in spite of its supposedly beneficial nature, *cash receipts RPT* negative association with CAR implies market distrusted the prop-up actions and is highly suspicious of the motive of controlling shareholder who provide direct financial assistance to listed firms, hence, imposing governance discount on the stock. This can be explained by the prop-up hypothesis with negative connotations as suggested by Friedman *et al.* (2003), where firms receiving large amount of cash receipt RPT are negatively associated with operating performance. For instance, propping studies in China are attesting to controlling shareholders self-dealing motives of cash extraction in post IPO (Cheng & Chen, 2006), and refinancing the firm to enable more serious engagement in tunneling later (Ying & Wang, 2013).

Evidently, it can be observed in Table 5.2 that firms undertaking cash receipts have the highest leverage ratio of 2.230 (overall sample average is 1.212) suggesting debt-ridden, possibly due to poor operating performance, and the very high average cash ownership of directors at 51.14% (overall sample average is 29.72%) could have incentivized billing-out. Coincidentally, it is also the only RPT category with zero cash ownership of government linked investors, which are known to be an effective corporate governance watchdog (Dewenter *et al.,* 2010). Hence, it is not surprising that these RPTs attracted the highest level of MSWG activism at 60% compared to the overall sample average of 40%. Such findings of the fact that the firms are very likely in financial distress, provide a strong ground to support the negative connotation of earlier mentioned Friedman *et al.* (2003) prop-up hypothesis, with consequences of expropriation of minority interests by the controlling shareholders.

However, in an alternative specification using (0,10) window (refer Table C.1, model 3), only the coefficient of *takeover offers & joint ventures RPT* became positive statistically significant (p-value 0.096). This is in line with the posited positive association with firm's CAR of the corresponding hypothesis (H_{A9}), and supports findings from previous researches by Cheung et al. (2009) in Hong Kong and Kohlbeck and Mayhew (2010) in the US. Since the market generally considered such RPT as having strategic rationales and non-expropriation, expectation of its positive economic gain has resulted in the effect of firm's positive revaluation by the market (Halpern, 1983).

MSWG Activism

The dummy variable of firms covered by *MSWG activism* also has a positive coefficient that is statistically significant. It supports the hypothesis of this study in explaining the positive impact on market reaction to the announcement of a related party transaction in model 3. This

variable is a proxy for the quality and disclosure of information via activism of shareholders under the leadership of the MSWG. Therefore, official disclosure of quality information is associated with positive abnormal return, and vice versa. The result indicates that firms under MSWG activism experience a positive market reaction when announcing related party transaction. In line with suggestion from Meyer *et al.* (2009) for emerging economies, high quality disclosures from companies make it more difficult for major shareholders to expropriate, hence safeguarding minority shareholders' interest. It also complements the findings by Ameer *et al.* (2009) and Abdul Wahab *et al.* (2008) on MSWG's role in Bursa Malaysia. In their studies, MSWG's activism was found not only having a positive association with the firm's performance, it also has a positive impact on the relationship between institutional ownership and corporate governance.

The above OLS regression result in which MSWG activism variable was found to have a significant positive association with CAR, is in line with and support the result of earlier univariate analysis (refer to page 133 and Table 5.4). Even though there is no significant t-test result for the overall two groups of data (MSWG = 0,1), results in Panel A (Table 5.4) show that the overall presence of MSWG activism has a significant positive impact on firm's CAR, as reflected in the pre-announcement period windows of (-30,1), (-10,1), (-5,1) (-1,1) and (0,1). Furthermore, in the alternate OLS regression using window (0,10) in Table C.1 (Appendix C), representing the post-announcement period, coefficient of *MSWG activism* variable turned negative albeit non-significant. Such a result, is also not inconsistent with the univariate analysis outcome of CAR for window (0,10) in Table 5.4, which are also negative albeit insignificant.

Board Composition

Under the board composition factor, the coefficient of the *board independence* variable

(model 3) is positive and statistically significant (p-value 0.063), as hypothesized in this study (H_{C2}). This shows a higher degree of board independence or a larger number of independent directors has a positive relationship with the RPT-induced CAR. Hence, the increased independence of the board will make it a more effective advocate for the interests of shareholders. For instance, the board's mandatory monitoring role in the audit function that comprises of only non-executive directors (MCCG, 2007). This finding supports Barucci and Falini (2005) argument that a good governing board should be small in size (less than nine members, while this study sample median is seven), with large compositions of independent directors. Furthermore, it is also in line with Gao and Kling (2008) study, which found *board independence* negatively associated with tunneling operations (connotes negative CAR) involving asset expropriation via RPT in China. The coefficients of remaining board composition variables which are *board size* (p-value 0.619), *CEO duality* (p-value 0.805), *audit committee independence* (p-value 0.913), and *family director concentration*[147] (p-value 0.569) are not statistically significant.

Although *the board size* was postulated to have a relationship with CAR, the result shows insignificant announcement effect. Barucci and Ceccaci (2005) and Erickson *et al.* (2005) found board size and corporate governance relationship ambiguous. They found firm with a larger ownership concentration (which is similar to this study with an average of 41.66%) have lower market value at large board size. The sample of this study has average (median) board size of 7.8 (7.0) which is not considered large or oversized (>9), hence cannot be considered ineffective (Lipton & Lorch, 1992). Thus, the offsetting positive effect of board size and negative effect of

[147] However, in an alternative specification using (0,10) window (refer Table C.1, model 3), the positive coefficient of *family director concentration* variable was statistically significant (p-value 0.037), as hypothesized in this study. The finding of positive significant coefficient for *family director concentration* variable in the model is in line with Anderson and Reeb (2003) study, where the active involvement of the family in management responsibilities resulted in positive market reaction on stock prices of the firms.

ownership concentration has resulted in the insignificance for the *board size* variable.

CEO duality which was hypothesized to have a negative relationship with CAR is found insignificant in this study. While various studies concluded that *CEO duality* is negatively associated with firm performance (TobinQ ratio), Chen *et al.* (2010) suggested the presence of block holders (which is high in this study with an average frequency of 53.7%) will negate the presence of CEO duality in the firm. Such impact could have possibly caused the insignificance of *CEO duality* in the regression analysis.

We hypothesized *family director concentration* (FDC) to have a relationship with CAR. Anderson and Reeb (2003) showed involvement of the family is positive for the firm, and Silva and Majluf (2008) found firm performance is enhanced by the increased family director's participation when ownership concentration is low. However, most other studies in the past suggested FDC has a negative association with good governance practice (Cheong *et al.*, 2013; Wan Mohd, 2010; Janggi *et al.*, 2001). In the same token, using the same argument from Chen *et al.* (2010), the strong presence of block holders could have been an effective internal governance mechanism to mitigate divergence of interest, hence limiting the self-serving behaviour of the controlling family directors. Consequently, the offsetting effect of block holders gives insignificant regression result for FDC.

The key function of the audit committee is to oversee the proper utilization of the firm's resource. However, biased and influential owner most probably selected independent directors that lack adequate skills and knowledge, so that he can dictate them. Consequently, even though the audit committee might comprise of fully independent directors, they were ineffective (Abdul Rahman, 2006). Hence, despite reasonably high average *audit committee independence* of 52%, it fails to significantly impact the CAR in a positive manner.

Ownership Structure

For the ownership structure category, variables of *cash ownership of the dominant owner* (p-value 0.014), *divergence of control right of dominant owners* (p-value 0.046), and *divergence of control right for directors=1*[148] (p-value 0.089), have negative coefficients that are statistically significant in model 3. These results indicate increasing ownership of dominant owner is associated with firms experiencing more negative market reaction when announcing a related party transaction. Such negative market reaction is further exacerbated by the divergence of control to cash right for controlling shareholders and directors. This is in accordance with the entrenchment effect theory of the disproportional structure of family-owned firms, where the presence of wedge in control and ownership rights was strongly correlated to firm's valuation discount (Bennedsen & Nielson, 2010; Cheung *et al.*, 2006).

However, the coefficients of the other variables in model 3, which are *cash ownership of block holders* (p-value 0.407) and *cash ownership of directors* (p-value 0.780), *divergence of control right for directors>1* (p-value 0.291), *share held by dominant owner via unlisted company* (p-value 0.397), *cash ownership of government linked investor or state government*[149] (p-value 0.701) and *presence of non-state block holders* (p-value 0.423) are not statistically significant.

The extant theoretical researches which tend to predict big institutional shareholders as

[148] This is one of the two dummy variables representing the three categories of ratio for divergence of control to cash rights for directors (DCRDIR=0, =1 & >1), where DCRDIR=0 (means directors have zero shareholdings) is defined as the "comparison or reference category" in this regression analysis. The statistically significant negative coefficient for DCRDIR=1d represents its magnitude of impact on CAR is 1.97% lower than when DCRDIR=0.

[149] However, in the alternate specification using (0,10) window (refer Table C.1, model 3), the coefficients for *ownership of government linked investor or state government* is found positive and statistically significant (p-value 0.042). This is contrary to Jensen and Meckling (1976) idea of non-controlling block holders not keen to directly monitor or govern the activities of corporate insiders. Instead, it supports Pagano and Roell (1998) study where the increasing concentration of non-controlling block holders was associated with less severe expropriation of minority shareholders. This provides the evidence that, presence of state's block holders or public investment funds with good knowledge and expertise on investment is a positive attribute for deterrence of private benefits seeking by the controlling shareholders.

efficient watchdog prompted the hypothesis of *cash ownership of block holders* having a relationship with firm's CAR in this study. The incentive to monitor by non-controlling block holders were found proportional to their share ownership (Jensen & Meckling, 1976; Erickson *et al.,* 2003), which was also shown by Cueto (2013) to positively associate with firm value (Tobin Q). In line with this, Pagano and Roell (1998) showed increased concentrations of non-controlling block holders could reduce expropriation, and supported by Che Ahmad *et al.* (2003) study, which found outside block holders in Malaysia have a negative association with diversification, possibly an RPT with the intention to tunnel. However, other recent studies from US (Konijn, 2011), China (Cheung *et al.,* 2013) and Spain (Ruiz-Mallorqui & Santana-Martin, 2011) indicated conflicting results of negative associations between block holder's ownership and the corresponding firm valuation. Hence, the inconsistent findings of the above could possibly suggest the presence of offsetting effects leading to the insignificant regression result for *cash ownership of block holders.*

Since a very high percentage of the data, 91.5% (386) have a dominant family owner (with > 20% control right), it was expected that corresponding ownership of director will also be high at an average (median) of 29.72% (30.02%). Fahlenbrach and Stulz (2008) found a large increase in managerial (director) ownership and changes of TobinQ ratio are positively related. Even though past studies by Jensen and Meckling (1976), Morck *et al.* (1988) and Stulz (1998) shows increase director's ownership gave incentives to upgrade firm performance, a non-linear relationship between firm valuation and managerial ownership are typically found in their cross-section data. Furthermore, Amzaleg and Barak (2013) study of RPTs in Israel found a non-linear inverted U-shape connection between the valuation effect of RPT (CAR) and the level of firm's ownership concentration, a strong proxy for directors' share ownership. However, additional

testing for the existence of the non-linear quadratic relationship between CAR and *cash ownership of directors* (by adding square of CODIR as a control variable in the regression) shows the insignificant result. *cash ownership of directors* also has a strong correlation with FDC and DOviaUCd (Pearson correlation coefficients of 0.401 and 0.367 respectively at the 5% significance), hence, a possible indication of the presence of the inherent endogeneity of the variable that contributes to its insignificant association with CAR.

It was noted that DCRDIR>1d has a strong negative significant correlation (Pearson correlation coefficient -0.457 at the 5% significance) to DCRDIR=1d (representing no divergence of control to cash right for directors who has shared ownership of the firm), whereas, a strong positive significant correlation (Pearson correlation coefficient 0.237 at the 5% significance) to DCRDO (*divergence of control to cash right for dominant owner*). Hence a possible offsetting effect of the two relationships resulting in the insignificance of DCRDIR>1d in regression of CAR. Besides, the number of samples with DCRDIR>1d dummy variable equals 1 is relatively small (22/422), further reducing the sensitivity of the test.

Cash ownership of government linked investors or state government (COGLIC), for instance the sovereign wealth fund, have the advantage of processing more superior information over their private counterparts. Hence their presences will generally give a stronger signalling effect to the firm's stock price (Dewenter *et al., 2010*). This study hypothesizes a relationship between COGLIC and firm CAR. The average (median) ownership of COGLIC is very low at 3.62% (0.00%), with only two firms has GLICs as dominant owner with greater than 20% control right. Even though there are 127 samples involving 90 firms that have GLICs ownership of at least 5% and above, only 21 samples are without dominant family owners with at least 20% controlling right. Consequently, the effect of the influence of the CODO variable, which is

significant in the regression, has possibly offset the impact of COGLIC variable, making it insignificant in the regression result.

It was hypothesized the *presence of non-state block holders* have a relationship with CAR. Ownership participation of large outside block holder can provide monitoring benefits to the minority shareholders. Studies by Park *et al.,* (2008) and Kim *et al.,* (2009) in the Korean market found such evidences with CAR of 3.73% and 15% respectively after their corresponding events' announcement. However, in the US study by Konijn (2011), the effect was otherwise, suggesting governance discount by market due to possible collusion between controlling shareholders and block holders to expropriate the firm. Even though sample data shows 53.7% (refer to first column of Table 5.2) *presence of non-state block holders*, the effect on CAR is insignificant. Furthermore, block holders and institutional holder are also not keen to directly govern the firm due to lack of relevant skills and knowledge, and would react in the worst case by simply selling off their interest. This could again be explained by the offsetting effect of the above mixed empirical findings possibly relevant to this study, and the abstinent behaviour of block holders when it comes to effective shareholder activism.

Firm Characteristics & External Economic Shock

While both *firm size* and *leverage* variables of firms show a negative relationship with CAR, only *firm size* is found to have a statistically significant negative coefficient. This finding is consistent with the study by Murphy *et al.* (2004) of market imposed penalties on publicly traded firms with alleged misconducts, where wealth loss is found to increase with bigger firm size. This is due to larger firms with more subsidiaries have a higher probability of engaging in RPTs that are prone to become a target for expropriation. Cheung *et al.* (2006) and Bae *et al.* (2002) also indicated in their respective Hong Kong and Korean studies that CAR has a

significant negative association with *firm size*. However, Croci *et al.* (2010) study of acquisition deals in 47 countries showed *firm size* positively related to CAR for (-2,2) day event window.

On the other hand, previous studies also found the firm leverage factor having a mixed relationship with CAR or firm's valuation, even though in this study, it is not particularly significant in explaining the market's response. Overall, the *US subprime crisis year (2008 & 2009)* variable does not have a significant relationship with CAR, which is contrary to Lee and Isa (2014) findings of the dominant role of US in influencing Malaysian market during the financial crisis.

5.4.5 Logit Models for Engagement in Value-Destroying RPT

In Table 5.8, logistic regressions are also employed to determine the likelihood of expropriation as an alternative estimation for the announcement effect of RPT. In this case, the dummy dependent variable is the likelihood of firms undertaking value-destroying related party transaction. For this study, value-destroying transactions refers to firms earning a negative CAR in the (-5, 1) window. Likewise, the same process was applied to estimate an alternate model with a window of (0,10) days, representing extended days of the post-announcement effect of RPT (result is reported in Table C.3 of Appendix C). Such alternative specification serves to examine the robustness of the result.

Of the total 9 types of RPT, only three (asset acquisition, asset sales and trading relationship) with sufficiently large sub-sample size of 189, 81 and 61 respectively were considered in the logit model estimation[150]. Models 5a to 7a utilized only the sub-samples from the three categories of RPT. For all the above 4 logit models, the independent variables in the

[150] The logit model estimation could not be employed for the RPT categories of equity sales (n=20), cash payment (n=7), loan guarantee (n=7), cash receipts (n=5), subsidiary relationship (n=23) and takeover offers & joint ventures (n=29) owing to their insufficient sample size as indicated in the bracket.

logistic regressions are factors related to RPT, MSWG activism, board composition, ownership structure, proxy for the period of poor economic prospect and firm characteristics. It is noteworthy that when regression using combine samples (n=422) were done with result in model 4, none of the corporate governance variables are significant, except for the positive coefficient of *share held by the dominant owner via an unlisted company, and* negative coefficient of *cash ownership of government linked investor or state government* variables. However, when sub-samples were used, the regression results became significant, with an increase number of variables under the factors of firm characteristics, board composition, ownership structure, shareholder activism and proxy for periods of economic prospects found to be statistically significant in models 5a, 6a and 7a. Hence, the majority of these independent variables has a significant association with the likelihood of firms undertaking value-destroying RPT. The rest of this section explains the outcomes of the regression on these corporate governance variables.

Size of RPT

The *size of RPT* has a highly significant negative coefficient in model 6a (p-values 0.011) in the asset sales RPT subsample. This result possibly suggests that asset sales RPTs with a high value consideration are less likely to result in negative CAR market response, which is value-destroying. Besides the probable incentive effect of ownership concentration, an alternative explanation could be the possible occurrence of a more intensified shareholder activism. Such deterrence effect is likely induced by the sensitive nature of the high value consideration in asset sales, hence resulting in less likelihood of the controlling shareholder to expropriate.

MSWG Activism

Contrary to our earlier findings, the dummy variable representing firm covered by *MSWG activism* has a positive significant coefficient in model 5a and (p-value 0.086) for asset acquisition RPT in the (-5,1) window. A possible explanation could be during the pre-announcement period, the MSWG activism possibly provides public disclosure of early information, hence leading to a governance discount of the stock[151] by investors.

Board Composition

Under board composition factors, the positive and statistically significant coefficient of *family director concentration* in model 5a (p-value 0.061) implies the strong presence of family directors on board will likely result in a governance discount of stock in response to RPT involving an asset acquisition. This is due to the entrenchment effect of controlling shareholders, which will induce self-dealing behaviour to expropriate the minority shareholders' interest. On the other hand, the coefficient of *audit committee independence* in models 7a is negative and significant (p-value 0.020) for a trading relationship RPT. This shows that the occurrence of value-destroying RPT, especially those in the nature of the trading relationship, is less probable, when firm audit committee consisting of only independent directors could provide effective oversight on these transactions[152].

Even though the *board independence* variable does not have a statistically significant coefficient in all models, the alternate estimation using window (0,10) as shown in model 7 of

[151] However, alternate specification using window (0,10) reported in Table C.3 (Appendix C), model 5a shows the coefficient turned negative and significant (p-value 0.045) during the post announcement period, representing a less likelihood of engaging in value-destroying asset acquisition RPT. This could possibly suggest a change in the investor's attitude towards the firm as a result of positive impact from MSWG activism.

[152] In another alternate analysis using (0,10) window (refer Table C.3, model 4,5 & 7), the coefficients of *audit committee independence* for samples of all RPT, asset acquisition and trading relationship regression panels are negative and significant (p-value 0.023, 0.011 and 0.041 respectively). This also shows generally a less probable occurrence of value-destroying RPT on these transactions, in particular asset acquisition and trading relationship, when under the effective oversight of firm's audit committee that consist of only independent directors.

Table 5.8

Logit Models for Regression of Likelihood of Engaging in a Value-Destroying RPT for a Sample of 422 Related Party Transactions by Firms Listed in Bursa Malaysia During Year 2008 to 2013

		All RPT		Asset Acquisition		Asset Sales		Trading Relationship	
	Independent Variables	**Model 4** CAR for (-5,1) days window	**Model 4a** CAR for (-5,1) days window	**Model 5** CAR for (-5,1) days window	**Model 5a** CAR for (-5,1) days window	**Model 6** CAR for (-5,1) days window	**Model 6a** CAR for (-5,1) days window	**Model 7** CAR for (-5,1) days window	**Model 7a** CAR for (-5,1) days window
	Intercept	-0.5089 (0.763)	-0.2311 (0.166)	0.4775 (0.865)	-0.5970 (0.065)*	-2.7027 (0.603)	0.907 (0.009)***	192.458 (0.000)***	204.576 (0.000)***
Related Party Transaction (RPT)	Size of RPT	-0.0219 (0.813)	-	0.0701 (0.937)	-	-5.3606 (0.040)**	-3.6866 (0.011)**	0.1501 (0.061)*	-
MSWG Activism	MSWG Activism Dummy	0.0872 (0.728)	-	0.7371 (0.080)*	0.5970 (0.086)*	-0.9433 (0.229)	-	-1.9174 (0.139)	-
Board Composition	Board Size	-0.0594 (0.299)	-	0.0433 (0.646)	-	-0.1058 (0.540)	-	-0.0145 (0.964)	-
	Board Independence	-1.4242 (0.120)	-	-2.1028 (0.178)	-	-1.3260 (0.649)	-	3.9234 (0.266)	-
	Family Director Concentration	0.6205 (0.280)	-	2.0360 (0.038)**	1.5036 (0.061)*	-4.5964 (0.034)**	-	1.1024 (0.578)	-
	CEO Duality Dummy	-0.0042 (0.988)	-	0.0383 (0.929)	-	0.4622 (0.654)	-	-0.9187 (0.445)	-
	Audit Committee Independence Dummy	0.0257 (0.914)	-	0.0568 (0.882)	-	1.0907 (0.182)	-	-1.8237 (0.091)*	-1.6419 (0.020)**
Ownership Structure	Cash Ownership of Dominant Owner	-0.0003 (0.967)	-	-0.0043 (0.710)	-	0.0010 (0.968)	-	0.0355 (0.418)	-
	Share Held by Dominant Owner via Unlisted Company Dummy	0.4184 (0.067)*	0.4524 (0.025)**	0.8040 (0.037)**	0.6691 (0.035)**	-1.2105 (0.126)	-	0.5068 (0.593)	-
	Cash Ownership of Directors	-0.0013 (0.814)	-	-0.0135 (0.115)	-	0.0285 (0.109)	-	0.0030 (0.929)	-

Table 5.8 (Continued)

	Divergence of Control to Cash Right for Dominant Owner	0.1976 (0.178)	-	0.2556 (0.310)	-	2.1319 (0.170)	-	-218.562 (0.000)***	-218.848 (0.000)***
	Divergence of Control to Cash Right for Directors = 1 Dummy	0.3384 (0.388)	-	0.8471 (0.175)	-	0.7625 (0.472)	-	15.400 (0.000)***	14.8132 (0.000)***
	Divergence of Control to Cash Right for Directors > 1 Dummy	-0.7864 (0.274)	-	-2.5673 (0.109)	-2.2246 (0.025)**	-0.4645 (0.777)	-	378.078 (0.000)***	233.112 (0.000)***
	Cash Ownership of Block Holders	-0.0075 (0.514)	-	0.0058 (0.757)	-	-0.0078 (0.776)	-	-0.0747 (0.027)**	-0.0823 (0.001)**
	Cash Ownership of Government Linked Investor or State Government	-0.0286 (0.153)	-0.0363 (0.021)**	-0.0082 (0.782)	-	-0.1263 (0.067)*	-0.1006 (0.046)**	-0.0525 (0.446)	-
	Presence of Non-State Block Holder Dummy	0.2195 (0.486)	-	-0.2449 (0.615)	-	0.7447 (0.466)	-	2.3900 (0.173)	2.5182 (0.025)**
External Economic Shock	US Subprime Crisis Year ('08 & '09) [153]	-0.2315 (0.307)	-	-0.7205 (0.045)**	-0.5477 (0.095)*	-0.5875 (0.499)	-	-0.1050 (0.921)	-
Firm Characteristics	Firm Size	0.0456 (0.596)	-	-0.0639 (0.645)	-	0.1372 (0.661)	-	0.4504 (0.303)	-
	Leverage	0.0824 (0.319)	-	0.2410 (0.099)*	-	0.1435 (0.472)	-	-0.4293 (0.157)	-
Sample size		422	422	189	189	81	81	61	61
McFadden R^2		0.044	0.021	0.120	0.075	0.248	0.086	0.370	0.293
Chi-square χ^2		25.9331 [0.132]	12.4722 [0.002]	31.4131 [0.036]	19.7289 [0.001]	27.726 [0.089]	9.673 [0.008]	30.5531 [0.045]	24.2002 [0.001]

Significance level: *** (1%), ** (5%) and * (10%) in two-tailed tests
Model 4, 5, 6 & 7: Logistic regression using heteroskedasticity-robust standard errors.
Model 4a, 5a, 6a & 7a: Optimized logistic regression by sequential search method (backward estimation).

[153] In analysis using CAR window (0,10) as alternative specification (refer Table C.3, model 6) for the logit model to examine the determinants of the likelihood to engage in value-destroying asset sales RPT, it was found the *US subprime crisis years ('08 & '09)* variable has a highly significant positive coefficient (p-value 0.039), suggesting very high likelihood for firms to reduce debt via asset sales during the period of financial stress, which are perceived as value-destroying by investors who discounted the stock price.

Size of RPT: ratio of RPT value to company's total assets, ***MSWG Activism:*** dummy variable: '1' for firm covered by MSWG activism and '0' otherwise, ***Board Size:*** total number of directors in board, ***Board Independence:*** ratio of independent director to total directors on board, ***Family Director Concentration:*** ratio of directors who are family members of controlling shareholder to total directors on board, ***CEO Duality:*** dummy variable: '1' for duality of CEO and '0' for non-duality of CEO, ***Audit Committee Independence:*** dummy variable: '1' for audit committee chairman and all members are independent and '0' otherwise, ***Cash Ownership of Dominant Owner:*** percent cash ownership of the controlling shareholder, ***Share Held by Dominant Owner via Unlisted Company***: dummy variable for '1' for yes, '0' for no, ***Cash Ownership of Directors:*** percent cash ownership of all directors, ***Divergence of Control to Cash Right for Dominant Owner:*** ratio of control over cash flow right for dominant owner, ***Divergence of Control to Cash Right for Directors = 1:*** dummy variable '1' for yes, '0' for no, ***Divergence of control to cash right for directors > 1:*** dummy variable '1' for yes, '0' for no, ***Cash Ownership of Block Holders:*** combine percent cash ownership of all institutional and block shareholders with > 5% shareholdings, ***Cash Ownership of Government Linked Investor or State Government:*** percent cash ownership government linked investor or state government, ***Presence of Non-State Block Holders:*** dummy variable '1' for presence of non-state block holder and '0' otherwise, ***US Subprime Crisis Year (2008 & 2009):*** dummy variable "1" for yes, '0' for no, ***Firm Size:*** logarithm of total assets of firm in Ringgit Malaysia. ***Leverage:*** ratio of firm's total liabilities to total shareholder fund.

Table C.3 (Appendix C) gave a positive and significant coefficient (p-value 0.089) in the trading relationship RPT subsample. It indicates a more likelihood for the firm to engage in value-destroying trading relationship RPT as the proportion of independent directors increases. Such finding appears contradictory to the earlier mentioned result of negative significance coefficient of *audit committee independence* variable, which is a function of *the board independence variable*. One possible explanation is the engagement of independent directors with poor or inappropriate characteristics which result in compromising the true independence of board members (Agrawal & Knober, 1996; Patton & baker, 1987). Another noteworthy point is trading relationship RPT's subsample has the highest average (median) cash ownership of block holders at 20.68% (19.31%) compared to the overall sample of 14.73% (11.63%). It is very probable that such a high presence of non-state block holders incentivized internal collusion between the controlling and other substantial shareholders, hence increasing the likelihood of engaging value-destroying RPTs (Konijn *et al.*, 2011; Cheng et al., 2013)

The coefficient of *the CEO duality variable* is not statistically significant, but the alternate estimation model using (0,10) window gives a significant negative coefficient (p-value 0.058) for asset sales RPT subsample (model 6 of Table C.3 in Appendix C). This could suggest the dominant owner who holds the dual roles of chairman and CEO of the firm will less likely engage in asset sales which are value-destroying to the firm. Possibly, the CEO who is also the controlling shareholder has a high cash ownership, which is in line with the theory of incentive effect (Jensen & Meckling, 1976), whereby the interests of controlling and non-controlling shareholders are better aligned.

Finally, the *board size* variable in all models is statistically non-significant. Most previous studies implied *board size* has a negative relationship with firm's valuation (Yermack,

1996) but the subsamples at an average range of 7.1 to 7.8 are not considered oversized (>9). However, it was also found that the high ownership concentration (38.86% - 44.47% for the subsamples) have negative associations with market values (Barucci & Ceccacci, 2005; Erickson *et al.,* 2005). Hence, the insignificance of *the board size variable* is probably due to the offsetting outcome of positive board size effect and negative ownership concentration effect on firm's valuation.

Ownership Structure

The coefficients of the dummy variable representing *share held by dominant owner via an unlisted company* in Table 5.8 are positive and statistically significant (models 4a and 5a). It suggests controlling shareholders with share ownership held via an unlisted company are likely to engage in value-destroying RPT, especially asset acquisition transaction.

However, the negative significant coefficient for *divergence of control to cash right for director>1*[154] in model 5a (p-value 0.025) appears to suggest the extent of incurring value destroying asset acquisition RPT could be less severe, even though the directors have excess of control over cash right ownership of shares in the firm, compared to when they have none. On the other hand, the very high positive significant coefficient of *divergence of control to cash right for director>1* in the trading relationship RPT of model 7a (p-value 0.000) suggest the opposite effect. This is because even when directors own share in the firm, the wedge in control to cash right, which signifies entrenchment, will likely result in expropriation in the case of the trading relationship RPT, hence causing the negative market response, in comparison to when the directors do not own share in the firm. On the other hand, the negative significant coefficient

[154] Dummy variables representing the divergences of directors ownership where the "comparison variable" is defined as {*divergence of control to cash right for directors = 0*}, signifying cases where the directors having zero share ownership.

of *divergence of control to cash right for the dominant owner* suggests less likelihood for an entrenched controlling shareholder to engage in value-destroying trading relationship RPT in model 7a (p-value 0.020). The result is contrary to the above mentioned negative impact of divergence factor for director. A possible explanation is that the entrenched controlling shareholder might not be actively involved in the operations of the firm, compared to the case of an entrenched owner-manager (director) who is actively involved in the firm's routine business dealings, where trading relationship RPT occurs.

Cash ownership of block holders has a negative significant coefficient in model 7a (p-value 0.001), suggesting the presence of block holders in the trading relationship RPT will be less likely to result in the value-destruction of the firm. Similarly, the negative significant coefficient of the variable, *cash ownership of government linked investor or state government* in model 6a (p-value 0.046) indicates the presence of mitigating factors to negate the potential expropriating behaviour of the controlling shareholders in asset sales RPT.

Interestingly, the presence of positive significant coefficient for *presence of non-state block holders* in model 7a (p-value 0.025) seems to suggest a high likelihood that the occurrence of the trading relationship RPT will lead to the value-destruction of the firm. It raises the question of whether the block holders colluded with controlling shareholder to hurt firm's valuation (Konijn *et al.,* 2011; Cheng *et al.,* 2013; Ruiz-Mallorqui & Santana-Martin, 2011).

Other variables such as *cash ownership of dominant owner* and *cash ownership of director, do* not have statistically significant coefficients. Even though past researches in US shows dominant founding family ownership has a positive association with firm's valuation (Anderson & Reeb, 2003; Pindalo et al., 2013), a study on the RPT announcement effect on CAR in Israel and Hong Kong markets characterized by high average family ownership shows

otherwise with result of negative relationship (Amzaleg & Barak, 2013; Cheung *et al.*, 2006). While the above represent developed markets with strong legal protection environment, empirical study in emerging markets by Utama et al. (2010) in Indonesia also found share ownership of directors have a significant negative association with CAR. Most likely, the above negative impacts of likelihood to expropriate are offset by the negating effects of the other variables of *audit committee independence* (model 7a & 5a[155]) and *cash ownership of government linked investor or state government* (model 4a & 6a), which are found negative and significant in the logit model.

Firm Characteristics & External Economic Shock

Regression results in model 4a shows the coefficient of both *firm size* and *leverage* is not statistically significant, suggesting they have no significant association with the value-destroying RPTs.

However, the statistically significant negative coefficient of *US subprime crisis year (2008 & 2009)* variable in model 5a (p-value 0.095) for asset acquisition RPT is not a surprising one. It shows that it is unlikely firm will invest at the time when business risk is high. Hence, it is also less likely value-destruction of firm will occur[156].

5.5 Conclusions

Contrary to the widely held image[157] of Berle and Means (1932) where firms have

[155] In the alternate estimation using CAR (0,10) window, coefficient of audit committee independence variable is negative and highly significant (p-value 0.005) in model 5a (Table C.3, Appendix C).

[156] On the other hand, the positive coefficient (p-value 0.039) of the subprime crisis year variable for asset sales RPT subsample (refer Table C.3, model 6)) in an alternate specification using (0,10) window seems to suggest firms are very likely to engage in asset sales to reduce their debt, and as a result, investors impose governance discount on the firm's stock price.

[157] According to the classic study (Berle and Means, 1932), this will result in management and directors, managing the resources to the owner's best interest without effective investor scrutiny.

diverse share ownership, La Porta *et al.* (1999) contended that worldwide corporate ownership of firms is typically controlled by families or state, with an ultimate owner[158]. In this study, firms undertaking a related party transaction have the mean and median cash ownership of 41.66% and 30.02%, respectively (refer column 1 of Table 5.2), which are high in comparison to the 27.3% broader market average of family-controlled shareholdings in Bursa Malaysia (Munir & Salleh, 2010).

Even though it was argued that firms with founder-shareholders having a family interest can provide better quality oversight, and governed differently than firms without such influence, their existence might not necessarily be good for the minority shareholders if the larger owners' interest is to benefit themselves, rather than bringing value to firms (Claessens *et al.,* 2000; Chen & Nowland, 2010; Kim *et al.,* 2007). Therefore, it appears that in Bursa Malaysia, dominant shareholder's ownership has a negative association with CAR in the related party transaction. Furthermore, the negative relationship is exacerbated by the divergence of the owners and directors control to cash flow right. This combination of findings provides strong support for the presence of minority shareholders' expropriation[159].

On the other hand, the presence of MSWG activism has a positive announcement effect on CAR, which seems to suggest firms with higher disclosure quality via engagement of shareholder activism mitigates expropriation of minority shareholders (model 3 of Table 5.7). Similarly, the board independence factor which could be an indication of good governance was also found to have a positive impact on protecting the interest of minority shareholders. The high

[158] An ultimate owner is someone who is not controlled by anybody else, and having at least 20 percent control or voting right as defined in studies by La Porta *et al.* (1999) and Claessens *et al.* (2000).

[159] However, from an alternate specification result using (0,10) window (Table C.3, model 4a), the highly significant negative coefficient of *size of RPT* variable shows such private benefit seeking behavior of the controlling shareholders becomes more pronounced as the value consideration of RPT (expressed in a percentage of company's total assets) increases.

positive coefficient of *board independence* variable in regression model 3 (Table 5.7) denotes the importance of having a large percentage composition of independent directors, in order to negate the private benefit seeking behaviour of the controlling shareholders. In the same token, the result of logit model also shows that the *audit committee independence* (model 7a, Table 5.8) has a strong association with positive market response of CAR for the announcement of trading relationship RPT.

Besides, the positive association[160] of *family director concentration* (FDC) appears to be an advantageous factor in the family business, possibly due to better alignment of objectives between managers and owners (Anderson & Reeb, 2003). This is contrary to findings from other studies such as Martinenz *et al.* (2007), Cheung *et al.* (2013) and Wan Mohamad and Sulong (2010) that have implied negative firm's valuation in an environment of high family director concentration. However, the logistic regression result in model 5a of Table 5.8 appears to show evidence that, most likely, high FDC will lead to expropriation through RPT in asset acquisition, and destroy the firm's value. On the contrary, in RPT of other nature, such as asset sales, the highly significant and negative coefficient of FDC suggest value-destruction is less likely to occur with these types of transactions (model 6 of Table 5.8).

Even though past studies on the function of large non-controlling shareholders' effect on firm valuation is scarce and mixed, it raises the question of whether at times the block holders colluded with controlling shareholder to hurt firm's valuation (Konijn *et al.,* 2011; Cheng *et al.,* 2013; Ruiz-Mallorqui & Santana-Martin, 2011). However, in this study, there is clear evidence

[160] In another alternate specification (Table C.3, model 7) using (0,10) window, the coefficient of FDC was negative and significant (p-value 0.030) in trading relationship RPT subsample. However, past studies produced mixed results on the effect of *family director concentration* on firm's valuation. Martinenz *et al.* (2007), Cheung *et al.* (2013), and Wan Mohamad and Sulong (2010) suggest that high family directors' concentration has negative effects on governance practices. On the other hand, Silva and Majluf (2008) argued that at lower ownership concentration, family directors' participation adds value to the firm.

from the estimation results (model 6a of Table 5.8) pointing to the participation of state's block holders or public investment fund as a positive attribute for deterrence of expropriation by the dominant owner in asset sales RPT. On the governance's effect of institutional holdings, it attests to Aggarwal *et al.*'s (2011) suggestion, that the cost of expropriation was greater than any corresponding benefit when the primary objective of the public investment fund was to enhance firm value. This is also in line with findings by Cueto (2013), Erickson *et al.* (2005) and Chen and Nowland (2010) where institutional block holders assume monitoring roles and help curtail asset expropriation by the dominant shareholders.

Apart from the dummy variables[161] of *cash receipts RPT* in model 3 (Table 5.7) having a significant coefficient, other types of RPTs are not statistically significant in driving the market reaction to related party transaction. Even though the *cash receipt RPT* is categorized as not an expropriation type of transaction, the negative coefficient (p-value 0.002) is consistent with our earlier univariate analysis. It suggests the market regarded the financial support from related party to the possibly distressed firm as a propping-up activities with the intention of expropriation by the controlling shareholders, hence, imposed a governance discount on the firm's stock price. Therefore, investors should be vigilant when the firms they invested in undertaking cash receipt RPT, whereas, regulator should be more alert to monitor this financial red flag that could undermine the investments of minority shareholders.

[161] These are categorical dummy representing the different types of RPT identified in this study, where *asset acquisition RPT* is defined as the "comparison or reference category" in regression analysis. For instance, the statistically significant coefficients of *cash receipts RPT* (p-value 0.002) which is -0.078 represents its magnitude of impact on CAR is 7.8% less than the impact of *asset acquisition RPT* on CAR. Similarly, for *takeover offers & joint ventures RPT* (p-value 0.100), the positive coefficient of 0.037 signifies its impact on CAR is 3.7% more than the impact of *asset acquisition RPT* on CAR.

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

This chapter provides conclusions of the study and is divided into five sections. The first section gives an overview of the research process, followed by a summary of the findings in the second section. The third section discusses implications transpired from the research results and their contributions. Fourth section states the limitations of this study and recommends potential areas for further research in the future. Finally, an overall conclusion of the research is presented in the fifth section.

6.2 Overview of Research Process

The objective of this study is to examine the occurrence of minority shareholders expropriation as a result of the negative consequence of related party transaction (RPT) in Bursa Malaysia. Using the event-study approach, it investigates the engagement of RPT by the influential or controlling shareholders in listed firms by examining the RPT's announcement effect of CAR (cumulative abnormal return of the firm's stock price) and its relationship with the firm-level corporate governance variables of board composition and ownership structure, and MSWG shareholder activism. The short horizon announcement effect of RPT on the firm's CAR is used as the measure of market reaction to such potential expropriation.

The conceptual framework and hypotheses of the study is developed based on the agency theory as described by Jensen and Meckling (1976) which assumes the problem of interest's divergence between principal and agent. In this study, the agent could also be a principal who owns a substantial share or even becomes a controlling shareholder, hence, a problem of principal-principal conflict of interest between the controlling and non-controlling shareholders,

or called the Type II agency problem.

This study uses 422 sample of RPT with a percentage ratio of 2 percent and above from 286 companies in the Main Market of Bursa Malaysia from year 2008 to 2013. For each sample, a detailed description of the transaction and the corresponding data on board composition, ownership structure and finance for the public listed firms are extracted from company annual reports. The shareholder activism data are obtained from the website of MSWG. Daily stock returns of companies and market indices are from Datastream. Firms that were de-listed or newly listed during the sampling period are also included as long as the information are available. The sample period of 2008 to 2013 is chosen to cover the impact of general economic conditions on expropriation which could be different between during and after an external shock.

The data analysis of this study involves descriptive statistics for the dependent and independent variables, testing for existence of multicollinearity between the independent variables using Pearson's correlation and variance inflation factor (VIF), univariate analysis of dependent variable (CAR), OLS regression of CAR on corporate governance factors for hypothesis testing, and robustness check using logistic regression to determine the likelihood of expropriation as an alternative estimation on the announcement effect of RPT.

6.3 Summary of Findings

The total value of RPT incurred during the six year period was RM83.432 billion. 365 transactions (86.5%) worth RM63.049 billion (75.6%) are transactions that are expected to cause expropriation of minority shareholders, 28 transactions (6.6%) worth RM9.093 billion (10.9%) are transaction possibly beneficial to the minority investors, and 29 transactions (6.9%) worth RM11.292 billion (13.5%) are transaction that are possibly having strategic motive and are not

an expropriation. Furthermore, 68.9% (290/422) or 58.2% of the total value of RPT is related to acquisition and sales of firm's asset and equity, which are non-operations activities related, whereas, operations activities related RPT such as trading relationship and certain subsidiary relationship constitute only 20% of total RPT.

On the firms' characteristics, the overall mean and median *firm size* is RM2.985 billion and RM494.5 million, respectively, with a mean and median *leverage* of 1.212 and 0.84 respectively. Firms receiving cash assistance RPT have the highest mean leverage of 2.230, which is almost twice the overall sample average, and also having substantially smaller average size of RM1.806 billion compared to overall sample mean of RM2.985 billion. Finally, takeover offers & joint ventures RPT has a significantly lower mean and median leverages of 0.885 & 0.625 respectively.

On the corporate governance factors, the overall board composition is on average characterized by *board size* of 7.8, *board independence* of 45.2%, *family director concentration* of 16.5%, *CEO duality* of 15.6%, and *audit committee independence* which is 52%. On the other hand, the ownership structure has mean characteristics of 41.66% *cash ownership of dominant owner* (91.9% or 388/422 samples has a controlling shareholder with more than 20% control right), a ratio of 1.237 for *divergence of control to cash right for dominant owner*, 14.73% *cash ownership of block holders*, and 51.14% *cash ownership of directors*. Overall, despite the high average *presence of non-state block holder* at 53.7%, *cash ownership of government linked investor or state government* is relatively low at 3.62%. The overall mean frequency of firms covered by *MSWG activism* is 40%, in which more sensitive RPT such as asset sales and cash receipts, which are non-operating activities, induced a higher level of activism at 50.6% and 60% respectively.

In the univariate analysis of the overall sample, CARs are positively significant for pre-announcement windows of (-30,1), (-10,1) and (-5,1), with a 1.49% (p-value 0.022) value gain for the window (-5,1). However, in a post-announcement period of (0,30) and (0,10), CAR turns significantly negative at -1.50% (p-value 0.069) for overall RPT and -1.79% (p-value 0.018) for asset acquisition RPT respectively. This shows that in general, the market realized the occurrence of expropriation by controlling shareholders only after the formal announcement of RPT, which is in line with Cheung, Rau and Stouraitis (2006) finding in their study of Hong Kong market.

In the overall category of transactions that are known to cause expropriation, a CAR trend similar to the overall sample is found (column 8 of Table 5.3). At sub-sample level of this RPT category, only asset acquisition and cash payments show negative significant t-test results over the (0,10) and (0,30) windows. The firm CAR for asset acquisition was -1.79% (p-value 0.018) and -2.59% (p-value 0.029), and -11.13% (p-value 0.016) for cash payment, albeit with small subsample size. For the loan guarantee subsample, CAR for t-test results are not statistically significant except for the window (0,1) with a 3.24% (p-value 0.088). On the contrary, during pre-announcement periods, equity sales RPT earns high positive significant CAR of 11.07% (p-value 0.007), 6.36% (p-value 0.002) and 4.27% (p-value 0.040) for windows of (-30, 1), (-10,1) and (-5,1) respectively. Similarly, the trading relationship RPT has a significant high positive CAR of 16.74% (p-value 0.060) in the pre-announcement period of (-30,1) window. Finally, the CAR of asset sales RPT has a positive, statistically significant CAR for the day (0,1) window, earning an abnormal return of 1.08% (p-value 0.044). The t-test result of the overall category transaction that is possibly beneficial to the minority investors is not significant for all CAR window periods except (0,10) which is -3.37% (p-value 0.095) as shown

in column 11 of Table 5.3. Even though the subsample of subsidiary relationship RPT shows a significant positive CAR of 1.55% (p-value 0.093) for window (-5,1), cash receipt RPT shows a highly significant negative CAR of -5.49% (p-value 0.023), -6.15% (p-value 0.003) and -3.21% (p-value 0.075) over (-10,1), (-5,1) and (0,1) windows respectively, inducing the overall significant negative effect of this RPT category. A possible explanation for the negative significant result is the discounting of stock price by investors of the firms engaging in cash receipts RPT, whereby these firms might be already in financial distress, and in dire needs for cash assistance. Finally, the t-test result of takeover offers & joint ventures RPT subsample is statistically significant with a positive CAR of 2.6% (p-value 0.054) for (0,1) window, supporting the hypothesis of efficient transaction which has strategic motivation, and not an expropriation.

In further univariate analysis, segregation of data into two different panel shows the monitoring effect of MSWG activism has a significant positive association with firm's CAR for windows (-30,1), (-10,1), (-5,1) and (-1,1) and (0,1) of pre-announcement period (Panel A of Table 5.4). However, the impact of MSWG activism on CARs turns negative as shown in the window (2,5) and (0,30) of the post announcement period. In particular, the transaction that is possibly beneficial to minority investors (column 3 of Table 5.4) suffered a very high governance discount of -19.88% (p-value 0.036) for the window (0,30), compared to the overall sample average of -1.08% (p-value 0.034) for the window (2,5) (column 1 of Table 5.4).

OLS regression of CAR at the window (-5,1) on corporate governance variables (board composition, ownership structures and MSWG activism), RPT size and types, by controlling for firm characteristics (size and leverage) and external shock of US subprime crisis, found the coefficients of 7 out of 27 independent variables are statistically significant (Model 3 of Table

5.7). In the firms' characteristics, *firm size* has a significant negative relationship with CAR (p-value 0.084), while *leverage* is not significant. On the other hand, the dummy variable of firms covered by *MSWG activism* has a positive significant relationship with CAR (p-value 0.097). For board composition factor, only *board independence* has a positive and significant relationship with CAR (p-value 0.063), whereas, the other variables of *board size*, *family director concentration, CEO duality* and *audit committee independence* are insignificant. Under ownership structure factor, three variables which are *cash ownership of the dominant owner* (p-value 0.014), *divergence of control to cash right for the dominant owner* (p-value 0.046), and *divergence of control to cash right for directors =1* (p-value 0.089) are found to have a significant negative relationship with CAR. The other six variables which are *share held by the dominant owner via unlisted company, cash ownership of block holders, cash ownership of directors, divergence of control to cash right for directors>1, cash ownership of government linked investor or state government,* and *presence of non-state block holder*, are found insignificant. Finally, besides the *cash receipts RPT* dummy which has a significant negative relationship with CAR (p-value 0.002), all the other variables of RPT types dummy (*asset sales RPT, equity sales RPT, trading relationship RPT, cash payment RPT, loan guarantees RPT, subsidiary relationship RPT* and *takeover offers & joint ventures RPT*), *size of RPT* and the *US subprime crisis year (2008 & 2009)* are found to have no significant relationship with CAR.

In the OLS regression of CAR using the alternate window of (0,10), the coefficients of a different set of independent variables (4 out of 27) are found statistically significant (model 3 of Table C.1). The *size of RPT* (p-value 0.001) is found negatively associated with CAR, and the *takeover offers & joint venture RPT* dummy (p-value 0.096) has a positive significant relationship with CAR, which are in line with hypotheses. Apart from the *family director*

concentration (p-value 0.037) and *cash ownership of government linked investor or state government* (p-value 0.042) which have significant positive coefficients, the rest of the independent variables are statistically insignificant in the regression. Therefore, such results suggest the occurrence of a change in the significance of the corporate governance variables impacting CAR, in the extended days of the post announcement effects of RPTs. Apparently, the market efficiency factor such as when the RPT information is fully received by the public and the actual duration of market response have resulted in the changes. As such, the effect of independent variables which were earlier found significant in OLS regression using (-5,1) window, could have been offset by other dominant variables at the later RPT post announcement period of (0,10).

In analysing the robustness of univariate and multivariate results, logit models which determine the likelihood of engaging value-destroying RPT (with negative CAR in (-5, 1) and (0,10) windows) are used as an alternative estimation for the announcement effect of RPT (Table 5.8). When using a combined sample (n=422), only variables of *share held by dominant owner via unlisted company*, and *cash ownership of government linked investor or state government* are significant (model 4a of Table 5.8). However, when sub-samples were used, the regression results show a marked increase in the number of significant variables (models 5a, 6a & 7a of Table 5.8). Under board composition factors, *family director concentration* has a positive and statistically significant coefficient, suggesting the strong presence of family directors on the board increases likelihood of expropriation in asset acquisition RPT (model 5a). On the other hand, the negative significant coefficient of *audit committee independence* suggests a less probable occurrence of value-destruction in a fully independent audit committee in trading relationship RPT (models 7a). Other variables of *board size, board independence* and *CEO*

duality are not significant.

For ownership structure, all variables are significant in at least one of the samples, except *cash ownership of dominant owner* and *cash ownership of directors*. The dummy variable of *share held by dominant owner via unlisted company* is positive and statistically significant, suggesting generally controlling shareholders with indirect ownership are prone to engage in value-destroying RPT, especially via asset acquisition transaction (models 4a and 5a). Contrary to earlier findings, the negative significant coefficient of *divergence of control to cash right for dominant owner* suggests less likelihood for an entrenched controlling shareholder to engage in value-destroying trading relationship RPT (model 7a). Furthermore, *cash ownership of block holders* also has a negative significant coefficient, indicating the presence of block holders in the trading relationship RPT will be less likely to result in the value-destruction of firm (model 7a). In asset acquisition RPT, negative significant coefficient for *divergence of control to cash right for director>1* appears to suggest when directors have ownership of shares in the firm compared to having none, the extent of incurring value-destruction could be less severe (model 5a). The negative significant coefficient for *divergence of control to cash right for director>1* appears to suggest even though directors are entrenched in comparison to those without share ownership, they could possibly help to mitigate value destroying asset acquisition RPT. However, in the trading relationship RPT, this same variable which is highly positive significant appears to suggest the opposite effect, which is a higher likelihood to expropriate (model 7a). On the other hand, the negative significant coefficient of *cash ownership of government linked investor or state government* generally indicates a high possibility that state ownership could negate the potential expropriating behaviour of the controlling shareholders, especially asset sales RPT (model 4a & 6a). Finally, the presence of positive significant coefficient for *presence of non-*

state block holders seems to suggest a high likelihood of occurrence of trading relationship RPT which are value destroying, possibly due to the collusion behaviour of block holders and controlling shareholder (model 7a).

In spite of earlier findings, the *MSWG activism* has a positive significant coefficient in asset acquisition RPT, suggesting public disclosure of early information will more likely lead to a governance discount on the stock by investors (model 5a). Consistent with earlier analysis, the *size of RPT* has a significant negative coefficient for asset sales RPT, hence less likelihood of asset sales RPT with higher percentage value to encounter a value-destroying market response (model 6a). Lastly, it is not surprising to find a statistically significant negative coefficient for variable of *US subprime crisis years (2008 & 2009)* in asset acquisition RPT, since it is less likely of firm to invest at the time when business risk is high, and even when it occurs, it is less probable the asset acquisition RPT will be a value-destroying one (model 5a).

In the alternate specification of logit model using (0,10) window, results indicate significant coefficients that are largely different in type or direction of independent variables in the extended days of the post announcement effects of RPTs (refer to the corresponding footnotes in section 5.4.5 for detail explanation of the respective variable). Such a result, is also attributed to the similar reasons of offsetting effect as mentioned earlier in the case of alternate OLS regression using (0,10) window (paragraph 1, page 169).

6.4 Contributions and Implications of the Study

Overall, this study pioneered a contribution, in Malaysian context, to the existing pool of literature on expropriation of minority shareholders via related party transaction (RPT). It employs the short-horizon window event-study approach, which directly measures the firm's cumulative abnormal return of the stock price (CAR) around the firm's RPT announcement

period. Prior to this research, results with regards to expropriation of minority investors in the presence of RPT remain mixed and unclear in the Malaysian security market.

First, this study provides a comprehensive treatment of RPT in Malaysian public listed companies, by providing a better understanding of the associations between potential expropriation by controlling shareholders, characteristics of firms, and the effectiveness of corporate governance practices in the Malaysian listed firms. This is due to the fact that minority shareholder right protection is a function of corporate governance variables that vary across stock markets because of differences in maturity, size, socio-political setting, and most of all market efficiency. Complementing the objectives of the revised Malaysian Code of Corporate Governance (MCCG) which was enacted in 2007, and subsequently enhanced in stages from 2008 to 2014, it sheds some light on the type of RPT, their seriousness and circumstances firms are prone to expropriation. The overall results show that CAR has a significant relationship with the short horizon's announcement effect of RPT, in which the market generally realized the occurrence of expropriation by the influential firms' owners only after the formal announcement of RPT. Almost 70 percent of total RPT classified as transactions known to cause expropriation is related to acquisition and sales of the firm's assets and equity, which are non-operating business activities. The problem of expropriation is mainly due to high dominance of family ownership with low board independence, which is further exacerbated by the entrenchment of controlling shareholders.

Second, in spite of its supposedly beneficial nature, *cash receipts RPT* was found in OLS regression to negatively associate with CAR, which implies market discounting the stock price in the presence of this RPT. Possibly, investors distrust the actions of propping up and are highly suspicious of the controlling shareholder's motive behind providing direct financial assistance to

the listed firms. Evidently, leverage ratios of the firms are almost doubling the sample's average, indicating very likely, the firms are already in the state of financial distress. This provides a strong ground to support the negative connotation of Friedman *et al.* (2003) prop-up hypothesis on firms engaging cash receipts RPT, where the consequences of expropriation by the controlling shareholders were found (Cheng & Chen, 2006; Ying & Wang, 2013). Hence, investors should be vigilant when the firms they invested in undertaking cash receipt RPT, whereas, regulator should be more alert to monitor this financial red flag that could undermine the investments of minority shareholders.

On the other hand, all the other coefficients of category 1 type RPT independent dummy variables (transaction that are known to cause expropriation: *asset sales RPT, equity sales RPT, trading relationship RPT, cash payment RPT, loan guarantee RPT*) are found insignificant in the OLS regression of CAR (-5,1) and (0,10) windows. However, in univariate result (Table 5.3), even though CAR of an individual subsample of RPT (for asset sales, equity sales, trading relationship and loan guarantee) shows significant positive result in certain pre announcement windows, all became insignificant and mostly turned negative (albeit still insignificant) in the post-announcement period of (0,10) and (0,30) days. Furthermore, the univariate result of the overall category 1 RPTs (Table 5.3, column 8) earned a negative significant CAR of -1.59% (p-value 0.063) in post announcement, which supports the RPT hypothesis of conflicting interest and implies possible occurrences of minority investor's expropriation via these transactions. The investors discounting of stock price in post announcement are caused by information asymmetries (Jensen & Meckling, 1976). This can be explained by possible insider trading taking place prior to RPT announcement, hence, in post announcement, the less informed minority outsiders who did not have the privileged access to insiders imposed a governance

discount on the stock price. Perhaps, risk averse investors had better take a free-ride off these RPT-induced gains during the pre-announcement period, in anticipation of controlling shareholder engagement in these RPTs.

Third, this is also the first study to test and examine the impact of the Minority Shareholder Watchdog Group (MSWG) activism on the firm's cumulative abnormal return of the stock price (CAR) in response to the announcement effect of various types of RPT. The MSWG was established in 2000 to build knowledge and understanding among Malaysian minority shareholders on their right to pursue information, voicing their opinion and ask for the remedy. It was found that the presence of MSWG activism has a positive announcement effect on CAR, suggesting firms with higher disclosure quality via engagement of shareholder activism mitigates expropriation of minority shareholders.

Fourth, Malaysian market has a unique characteristic of high level government's equity ownership held under government-linked companies and government backed public funds (Abdul Wahab *et al., 2008)*. About 70 percent of the total institutional holdings belong to government-backed public funds. This study contributes in examining whether institutional block investor, in particular ownership of government linked investors or state government play a role in mitigating potential expropriation by the controlling shareholders in RPT. Results show clear evidence that the participation of state's block holders or public investment fund contributes positively to the deterrence of expropriation by the dominant owner in asset sales RPT.

Finally, this study also contributes to testing the impact of external economic shock due to 2008-2009 US subprime crisis, and provides additional understanding of the effect of economic conditions on expropriation through RPT. Logistic regression results show the effect

of US subprime crisis in Malaysia was mainly related to asset acquisition RPT, where firms adopt a risk averse positioning by consolidating their business growth strategy and reduce the firm's leverage to ease financial distress. In the latter case, the minority shareholders become highly susceptible to potential expropriation of their interest by the dominant owner facing financial crisis, in line with findings of Lemmon and Lins (2008) and Boubakri *et al.* (2010).

6.5 Limitations and Recommendations for Future Research

Just like other studies, this research has its limitation due to difficulties of research access. First, certain sub-sample size which is far less than 30 (n=5 for cash receipts, n=7 for cash payments and loan guarantee) were too small to justify a conclusive analysis, albeit producing statistically significant results in hypothesis testing. Second, in determining the actual cash ownership of the dominant owner via unlisted company, difficulties were faced in tracing their actual ownership since such private information is unavailable to public. Due to this reason, the assumption was made that the dominant owner holds a 100 percent stake in the unlisted company. Consequently, the computed percentage of cash ownership for dominant owner, and its ratio of divergence of control to cash right do not necessarily reflect the actual figures. Therefore, the multiple regression result might not represent the true relationship between CAR and the corporate governance variables. Furthermore, to overcome the constraints of small subsample size, future research can consider enlarging them by including RPT with a percentage ratio less than 2 percent. Similarly, the accuracy of cash ownership and divergence factor of dominant owner can be improved by obtaining the ownership data on the unlisted firm's from the Companies Commission of Malaysia (CCM). However, more time and also higher research cost will incur from these additional efforts in data collection, since each sample has to be hand-collected by manually extracting RPT information and the corresponding corporate governance

and financial data from the company's annual reports. On the other hand, the existing Bursa's regulation requires disclosure of RPT information by the listed firms via public announcement with adherence to a specific format and content of the disclosed information. Improvement in the facilitation of the disclosed information in a sorted database format for easy access will encourage the undertaking of more such RPT researches in the future, hence boosting the breadth and depth of such RPT studies in the Malaysian stock market. For instance, the data used by a similar study in Hong Kong market by Cheung *et al.* (2007) was facilitated by the Hong Kong securities exchange, whereby accurate and well sorted information on the RPT disclosure was made available to researchers.

Third, study sample only covers CAR of RPT, whereas a compatible set of CAR of non-RPT was unavailable for use as control in regression analysis. It would be ideal to include such control set of non-RPT sample in the regression to ensure the findings can be attributed to RPT and not the transaction per se. In the event of limited availability of compatible non-RPT control sample, additional data can be obtained via a bootstrapping sampling process, or picking a compatible one from another similar size company in the same industry.

Fourth, literature references for certain variable could only be based on ROE or TobinQ as the firm's valuation criteria which are presumed equivalent to CAR, the dependent variable of this study. This is due to the scarce availability of previous literatures that use CAR as the dependent variable to proxy for firm's stock valuation. As such, it would be useful to also include the corresponding regression of ROE or TobinQ as a robustness check on the regression of CAR. Finally, for other related robustness checking of result, variables such as dummy for industry effect, more detail information of MSWG activism such as the nature, frequency and timing of its activities, and compliance of disclosure rules by firm, could be incorporated in the

analysis.

6.6 Conclusion of the Study

This study aims to investigate the occurrence of minority investor's expropriation by dominant shareholders through the engagement of related party transactions (RPT), using the firm's cumulative abnormal return of stock prices (CAR) as direct indicators of market reaction around the RPT's announcement period. It adds to previous work of emerging markets by featuring an environment of high state-controlled institutional ownership with a unique role of Minority Shareholder Watchdog Group (MSWG) in the Malaysian stock market. Overall, univariate analysis shows significant negative CAR in the post-announcement of RPT, indicating governance discount of stock prices by the market in realizing potential occurrence of expropriation. The same significant trend of negative CAR is also found in the overall category of transaction that is known to cause expropriation, in particular asset acquisition and cash payments RPT subsamples. Similarly, MSWG activism was found to have a significant effect on CAR at both before and after the announcement of RPT. The problem of expropriation is mainly attributed to circumstances of high dominant family ownership and low board independence, which is further exacerbated by entrenchment of the controlling shareholders. Nevertheless, the results also show that both factors of MSWG activism and ownership of government-linked investors or state government mitigate expropriating behaviour of the controlling shareholders.

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