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**OWNERSHIP STRUCTURE IN THE
MALAYSIAN CORPORATION SECTOR:
ITS IMPACT ON CORPORATE
GOVERNANCE, PERFORMANCE,
FINANCING AND INVESTMENT
PATTERNS**

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OWNERSHIP STRUCTURE IN THE MALAYSIAN CORPORATE SECTOR: ITS IMPACT ON CORPORATE GOVERNANCE, PERFORMANCE, FINANCING AND INVESTMENT PATTERNS

1. INTRODUCTION

Corporate governance is a key policy issue that has been blamed for the financial crisis of 1997 in East Asian countries. Many contend that weakened corporate governance led to poor investment decisions, excessive diversification of large business groups and excessive exposure to debt, especially unhedged short-term foreign debt and risky financing practices.

Generally, the problem of corporate governance arises because of the separation of ownership and control. This agency or moral hazard problem can arise not just between shareholders and managers, but also between controlling and minority shareholders, between shareholders and creditors, and between controlling shareholders and other stakeholders, including suppliers and workers. A sound corporate governance system should provide effective protection for shareholders and creditors such that they can assure themselves of getting a return on their investment. It should also help to create an environment conducive to the efficient and sustainable growth of the corporate sector.

In Malaysia, reforms in corporate governance were a focus of government responses to the crisis. The recommendations of the high-level Finance Committee on Good Governance (FCGG) constituted the main agenda for reforms in corporate governance covering the entire corporate sector, whether publicly listed or privately owned. In March 2001, the Ministry of Finance launched the Financial Sector Master Plan (FSMP) to chart the future direction for the financial system over the next ten years. Its objective is to develop a more resilient, competitive and dynamic financial system with best practices, that supports and contributes positively to the growth of the economy throughout the economic cycle. In order to bring in greater innovation, flexibility and dynamism into the Malaysian financial system, the FSMP has made a number of recommendations to be implemented over the plan period. Among the recommendations are to develop the best domestic institutions by building the capabilities of domestic institutions and increasing the incentives for domestic institutions to drive performance; and to maintain stability

of the financial system through an efficient infrastructure, more resilient institutions as well as strong prudential regulations and supervision.

In addition to that, there are also a number of reforms instituted by Securities Commission and the Kuala Lumpur Stock Exchange (KLSE) for better disclosure and greater transparency of information. The Securities Commission initiated the Capital Market Master Plan in October 1999 to chart the strategic positioning and future directions of the Malaysian capital market for the next ten years. Its key objective is to determine the strategic positioning of the Malaysian capital market. Its formulation was driven by the need to provide market participants with strategic clarity as to the vision and objectives for the capital market amid the changing market place. It is also intended to ensure that the capital market is well positioned to play its part in supporting national growth needs and aspirations, as well as meeting the challenges of relevant externalities such as regional competition and increasing globalisation.

Nevertheless, a recent study¹ found that weaknesses in corporate governance in selected East Asian countries owe much to their very concentrated ownership structure, excessive government interventions, under-developed capital markets, and weak legal and regulatory framework for investor protection.

This study outlines some major findings on ownership concentration, and investment and financing decisions which may raise some questions with respect to corporate governance in Malaysia.

2. LITERATURE REVIEW

The problem of corporate governance arises because of the separation of ownership from control in modern corporations. Berle and Means (1932) conducted the pioneering study on ownership and control. In their study they highlighted the potential conflict of interest between managers and diffuse shareholders when managers do not have any ownership interest in the firm. They recognised that more concentrated ownership will establish a stronger link between managerial behaviour and owner interests, thus leading to higher profit rates. When salaried managers are running companies with dispersed ownership, they may not act in the best interests of

shareholders. A sound corporate governance system should provide effective protection for shareholders and creditors such that they can assure themselves of getting a good return on their investments². It should consist of a set of rules that define the relationships between shareholders, managers, creditors, government and other stakeholders (i.e., their respective rights and responsibilities) and a set of mechanisms that help, directly or indirectly, to enforce these rules.

Ownership structure is the most important factor in shaping the corporate governance system of any country. In particular, it determines the nature of the agency problem, that is, whether the dominant conflict is between managers and shareholders, or between controlling and minority shareholders.

The degree of ownership concentration determines the distribution of power between managers and shareholders in a company. When ownership is dispersed, shareholder control tends to be weak because of inadequate shareholder monitoring. The inadequacy of shareholder monitoring is due to the so-called free-rider problem, that is, a small shareholder would bear all the monitoring costs, but only share a small proportion of the benefit; therefore, he or she would not be interested in monitoring. If all small shareholders behave in a similar way, no monitoring of managerial efforts would take place. When ownership is concentrated, large shareholders could play an important role in monitoring management.

However, a fundamental problem for corporate governance under concentrated ownership is how to protect minority shareholders from expropriation by controlling shareholders. Controlling shareholders may act in their own interests at the expense of minority shareholders and other investors. Morck, Shleifer and Vishny (1988) found an inverted “U-shaped” relationship between the degree of ownership concentration and corporate profitability. A possible interpretation of this relationship is that as ownership concentration rises to a certain level, its costs may outweigh its benefits, leading to a fall in profitability.

Using Tobin’s Q^3 ratio in their study, McConnell and Servaes (1990) found a curvilinear relationship between the Q ratio and the degree of insider ownership, which suggests a positive

effect of institutional ownership on corporate performance. However, in an earlier study, Holderness and Sheehan (1988) found no evidence to suggest that corporate performance can be explained by the degree of ownership concentration.

Another key aspect of corporate ownership structure is its composition, namely, who are the shareholders, and more importantly, who are the controlling or significant shareholders. A shareholder can be an individual, a family or family group, a holding company, a bank, an institutional investor, or a non-financial corporation. A family or family group as a significant shareholder is more likely to be interested in control benefits as well as profits. On the other hand, an institutional investor as a significant shareholder is more likely to be interested only in profits. Fama and Jensen (1983) demonstrated various possibilities that managers who own enough stock to dominate the board of directors could expropriate corporate wealth while Stulz (1988) explained how owning large blocks of shares makes it easier for managers to be entrenched. Thus, greater stock ownership by managers increases the power of internal constituency, but decreases the power of the external constituency in influencing corporate performance.

Several studies had been conducted on the effect of ownership structure and corporate performance in Malaysia. In a similar study in nine East Asian Countries including Malaysia, Claessens, Djankov, Fan and Lang (1998), found a positive and significant relationship between ownership concentration and corporate performance, while Yee (1998) found the effect of ownership concentration to be insignificant.

Earlier studies on corporate governance found that very concentrated ownership structure leads to weak corporate governance. While some studies suggested that concentrated ownership would lead to better corporate performance, other studies also indicate that the composition of ownership is an important element to spurring better corporate performance. Corporate performance depends very much on the investment and financing strategies of a firm. A firm that strives towards maximising shareholder wealth would select its investment and financing strategy with care. By outlining some major findings on the degree of ownership concentration in publicly listed companies, as well as corporate performance, investment and financing patterns,

this paper intends to provide some insight into the relationship between concentrated ownership and weak corporate governance in Malaysia.

3. RESEARCH FINDINGS

3.1 Corporate Ownership

3.1.1 Ownership Concentration in the Public Listed Corporate Sector

The concentration of ownership of public listed companies in the KLSE is shown in *Table 1: Total Shareholdings of the Five Largest Shareholders in the KLSE (As at December 1998)*.

Ownership data for 731 out of 736 companies were available as at December 31, 1998. The five largest shareholders held about 58.8 per cent of total equity in the corporate sector. In an extreme case, the five largest shareholders accounted for 92.3 per cent of the outstanding shares⁴. About half of the publicly listed companies had five shareholders owning about 60.4 per cent of the outstanding shares. From these findings, it is clear that the Malaysian corporate sector has been highly concentrated in terms of ownership. The largest five shareholders accounted for more than half the voting shares or stocks in an average company. It implies that minority shareholders are practically powerless to prevent large shareholders from implementing their plans for the company. The largest shareholder held, on average, about 30.3 per cent of the shares of an average company. It further suggests that because the Malaysian corporate sector is dominated by large shareholders, protection of minority shareholders may be a problem.

| Table 1: Total Shareholdings of Five Largest Shareholders in KLSE Companies (Percentages, as at December 1998) | | | | | | |
|---|-------|-------|-------|-------|-------|--|
| Statistics | 1st | 2nd | 3rd | 4th | 5th | Percent of Total Shares Owned by Five Largest Shareholders |
| Mean | 30.30 | 12.47 | 7.32 | 5.01 | 3.74 | 58.84 |
| Minimum | 2.35 | 0.00 | 0.00 | 0.00 | 0.00 | 7.99 |
| Max | 79.29 | 37.81 | 23.81 | 16.94 | 14.72 | 92.28 |
| Median | 27.80 | 11.51 | 6.94 | 4.84 | 3.65 | 60.43 |
| Std. Dev. | 15.62 | 6.42 | 3.81 | 2.59 | 2.01 | 16.53 |

Source: Calculated using data from KLSE

Table 2: Ownership Concentration at Critical Levels of Shareholder Control for Publicly Listed Companies in the KLSE (1998) shows the number of companies whose five largest shareholders held various levels of ownership: majority ownership, two-thirds and 80 per cent of outstanding shares. Analysis of shareholdings of public listed companies is based on board categories - namely, main board companies and second board companies. The total sample of 731 companies consisted of 512 main board companies and 218 second board companies. The results clearly indicate that ownership of the publicly listed corporate sector is highly concentrated in the hands of a few shareholders. Some 522 companies or 71.4 per cent of all companies were under majority ownership and control by their five largest shareholders. Second board companies had even more concentrated ownership than main board companies. About 76.1 per cent of second board companies were under majority ownership by their largest five shareholders.

The number of KLSE companies that had two-thirds ownership level by the top five shareholders was much less. In 272 companies, or 37.2 per cent of the total, the largest five shareholders owned more than two-thirds of the outstanding shares. The proportion is about the same for main board and second board companies. Finally, in 62 companies, or 8.5 per cent of the total, the largest five shareholders owned more than 80 per cent of the outstanding shares. The latter case points out the importance of the shareholder spread ruling by the KLSE requiring a shareholder spread of a minimum of 25 per cent of outstanding shares in public hands. At this time, companies still have very concentrated ownership since the shareholder spread ruling only affects companies who have sought to be listed on the KLSE after February 1998.

| Table 2: Ownership Concentration at Critical Levels of Shareholder Control for KLSE Publicly Listed Companies, 1998 | | | | | | | |
|--|-------------------|---|---------|---|---------|---|---------|
| Board | No. of Companies | Operating Control | | Strategic Control | | Nominally Public | |
| | | No. of Shareholders Controlling more than 50% | | No. of Shareholders Controlling more than 66.7% | | No. of Shareholders Controlling more than 80% | |
| | | No. | Percent | No. | Percent | No. | Percent |
| Main | 512 | 356 | 69.5 | 189 | 36.9 | 49 | 9.6 |
| Second | 218 | 166 | 76.1 | 83 | 38.0 | 13 | 6.0 |
| Total | 731 ^{1/} | 522 | 71.4 | 272 | 37.2 | 62 | 8.5 |

Source: Calculated using data from KLSE Annual Handbook

3.1.2 Composition of Corporate Ownership

A profile of the category or type of large shareholders in Malaysia's publicly listed sector is shown in *Table 3: Top Five Shareholdings of Publicly Listed Companies by Shareholder Types and by Industry Sector, 1998*⁵. Based on the total market capitalisation of companies with ownership data as, it classifies the top five shareholders category companies as nominees, government, foreign, individual, non-financial companies and finance companies. Nominee shareholders are clearly the largest in terms of market capitalisation-weighted average ownership of both financial and non-financial, owning about 47.3 per cent of all public listed companies on the KLSE in 1998. However, with amendments to the Securities Act 1983 requiring identification of beneficial owners, there could be a reduction in the practice of using nominee accounts in the future. On an industry sector basis, nominee companies owned an even higher proportion of capitalisation in certain sectors. Nominees held 65.2 per cent of the construction sector, 57.2 per cent of the hotel sector, 48 per cent of the industrial products sector and 45.2 per cent of the property sectors. Construction sector involves large government projects and the award of these contracts may be highly controversial, thus this could be part of the reason behind high concentration of nominee shareholders in the construction sector compared to other sectors.

Non-financial companies are the second largest shareholders in terms of average market capitalisation-weighted ownership, with 30 percent of total shareholdings. Non-financial companies are the largest shareholders in the plantations (39.8 percent), hotels (33.8 percent), consumer products (33.8 percent) and properties (27.5 percent) sectors. Government was the third largest shareholder type in 1998, holding about 16.8 percent of shares of the corporate sector in terms of market value. Government was the largest shareholder in the mining sector with 57.2 percent of outstanding shares in terms of market capitalisation. It was prominent in the plantation (18.7 percent), properties (15.7 percent) and industrial products (13.8 percent) sectors. Individual shareholders were the fourth largest group, with an 11.4 percent ownership share. Individual shareholders were prominent in the consumer product sector, holding 17.8 percent of shares of consumer product companies. Their other large holdings were in the industrial products (5.7 percent) and construction (5.6 percent) sectors.

Financial companies owned about 7.4 percent of publicly listed companies. They were prominent shareholders in the plantations (9.1 percent), properties (8.3 percent), construction (8.0 percent) and consumer products (7.9 percent) sectors. Foreign shareholders do not appear as large shareholders in any sector except in consumer products (5.4 percent) and industrial products (4.9 percent). However, this result could be due to the reluctance of foreign shareholders to figure among the top five shareholders of a publicly listed company. Foreigners are more likely to own more than what the table indicates.

| Industry Sector | Total Market Capitalisation of Companies with Ownership Data (RM million) | Percentage Share by Type of Five Largest Shareholders | | | | | |
|---|---|---|------------|---------|------------|-------------------------|-------------------|
| | | Nominees | Government | Foreign | Individual | Non-Financial Companies | Finance Companies |
| A. Financial Companies | | | | | | | |
| Banks and other financial institutions | 16,201 | 47.98% | 15.56% | 2.26% | 2.99% | 14.60% | 16.61% |
| B. Non-financial Companies | | | | | | | |
| Construction | 6,789 | 65.23% | 7.23% | 0.00% | 5.56% | 14.01% | 7.97% |
| Consumer Products | 9,636 | 29.06% | 6.41% | 5.36% | 17.80% | 33.42% | 7.95% |
| Industrial Products | 16,656 | 48.00% | 13.75% | 4.90% | 5.74% | 24.07% | 3.54% |
| Hotels | 1,211 | 51.15% | 5.56% | 0.00% | 0.02% | 33.75% | 3.51% |
| Mining | 1,010 | 43.49% | 52.27% | 0.00% | 0.04% | 3.18% | 1.02% |
| Plantation | 6,227 | 30.51% | 18.73% | 0.11% | 1.73% | 39.81% | 9.11% |
| Properties | 10,323 | 45.65% | 16.65% | 0.13% | 2.82% | 27.48% | 8.27% |
| Total | 68,053 | | | | | | |
| Market Capitalisation-Weighted Average Ownership of Non-Financial Companies | | 42.27% | 16.84% | 5.01% | 11.35% | 29.27% | 7.38% |

Source: Kuala Lumpur Stock Exchange Annual Handbook

3.2 Growth and Financial Performance of the Corporate Sector⁶

3.2.1 Aggregate Trends

The performance of non-financial companies listed on the Kuala Lumpur Stock Exchange over the period from 1989 to July 1998 is shown in *Table 4: Growth and Financial Performance of*

the Aggregate Corporate Sector – Non-financial Companies. The financial indicators are net sales, net income, fixed assets, total assets, total liabilities, shareholders' equity, and retained earnings. On average, all these indicators showed double-digit growth during the period 1989 through 1997. However, most financial indicators indicated negative growth between 1997 and 1998, except for shareholders' equity and retained earnings. Net income for non-financial companies was reduced by 98 percent, while total assets were reduced by almost 50 percent. Between 1989 and 1990, non-financial companies were profitable, registering 51 percent growth of net income.

Even with the crisis, the non-financial corporate sector performed well in terms of growth of revenue, earnings and assets during the period 1989 through 1998. In that period, revenue and investment in corporate assets grew by 14 and 17.5 percent annually, respectively. Capital grew annually by 14.5 percent, but liabilities increased at a higher annual rate of 21.9 percent. The corporate sector has been investing at a slightly higher rate than revenue growth, and has been heavily financing these investments with debt. Return on equity increased from 1989 levels of 9.4 percent to its peak in 1994 of 12.2 percent. Thereafter, ROE declined to only 7.6 percent in 1997 and became negative at -3.4 percent in 1998. Similar trends were evident in the return to assets ratio, indicating diminishing efficiency in use of investments by the Malaysian non-financial corporate sector in the years preceding the Asian crisis. There was a significant increase in the leverage ratio of the corporate sector. From a level of 43 percent of equity, debt increased to 70 percent by 1996 and then to 112 percent in 1998. Debt-to-equity ratio more than doubled in the three-year period 1995 to 1998. The positive response of the stock market to corporate sector performance is evident in the price-to-earnings ratios. In 1989, the average P-E ratio was 27.6 but by 1993, investors had begun to value the earnings of publicly listed companies by a multiple of 33. During 1997, the P-E multiple went down to 24 times, and became negative when the corporate sector suffered losses in 1998.

As a result of the crisis, financial performance ratios declined abruptly from 1997 to 1998. Many performance ratios were already declining even before 1997. For example, return on assets had declined since 1992, indicating declining financial productivity in investments. Earnings per share (EPS) were highest in 1995 at RM0.25 rising from RM0.13 in 1989. Non-financial

companies had their first negative EPS of -RM0.07 during the first half of 1998, a direct effect of the financial crisis of 1997 - 1998.

| | <u>1989</u> | <u>1990</u> | <u>1991</u> | <u>1992</u> | <u>1993</u> | |
|---|-------------|-------------|-------------|-------------|------------------------------------|--------|
| <i>Financial Indicators (billion ringgit)</i> | | | | | | |
| Net Sales | 51.31 | 69.85 | 91.09 | 109.51 | 137.16 | |
| Net Income | 6.04 | 9.11 | 12.31 | 15.65 | 19.85 | |
| Fixed Assets | 33.79 | 45.56 | 54.80 | 80.52 | 97.78 | |
| Total Assets | 78.68 | 111.95 | 140.21 | 189.33 | 314.78 | |
| Total Liabilities | 33.34 | 45.85 | 61.12 | 80.66 | 101.59 | |
| Shareholders' equity | 22.72 | 31.14 | 35.77 | 44.46 | 51.09 | |
| Retained earnings | 17.86 | 28.50 | 35.84 | 54.61 | 67.50 | |
| <i>Financial Performance Ratios</i> | | | | | | |
| Return on equity (percent) | 9.39 | 10.06 | 11.80 | 11.19 | 11.54 | |
| Return on assets (percent) | 4.59 | 5.10 | 5.64 | 5.56 | 5.67 | |
| Earnings per share (RM) | 0.13 | 0.14 | 0.17 | 0.18 | 0.20 | |
| Price earnings ratio | 27.60 | 21.39 | 18.59 | 23.25 | 33.04 | |
| Debt to equity ratio | 0.43 | 0.40 | 0.45 | 0.45 | 0.42 | |
| Number of non-financial companies | 234.00 | 259.00 | 294.00 | 332.00 | 352.00 | |
| | | | | | Compound Growth Rate , 1989– 98, % | |
| | 1994 | 1995 | 1996 | 1997 | 1998 | |
| <i>Financial Indicators (billion ringgit)</i> | | | | | | |
| Net Sales | 154.74 | 197.86 | 249.66 | 301.52 | 166.63 | 13.98 |
| Net Income | 22.67 | 27.97 | 34.57 | 33.42 | 0.58 | -22.92 |
| Fixed Assets | 122.38 | 153.90 | 177.25 | 223.31 | 145.66 | 17.63 |
| Total Assets | 269.09 | 350.69 | 490.99 | 658.86 | 334.51 | 17.45 |
| Total Liabilities | 139.38 | 209.94 | 261.78 | 376.44 | 197.71 | 21.87 |
| Shareholders' equity | 59.10 | 69.70 | 55.60 | 64.59 | 76.69 | 14.47 |
| Retained earnings | 87.42 | 113.03 | 78.43 | 102.15 | 131.38 | 24.82 |
| <i>Financial Performance Ratios</i> | | | | | | |
| Return on equity (percent) | 12.18 | 11.93 | 11.99 | 7.57 | -3.38 | 9.43 |
| Return on assets (percent) | 5.63 | 5.22 | 4.71 | 2.92 | -1.23 | 4.38 |
| Earnings per share (RM) | 0.22 | 0.23 | 0.25 | 0.18 | -0.07 | 0.16 |
| Price earnings ratio | 29.55 | 23.92 | 25.60 | 24.02 | -30.97 | 19.60 |
| Debt to equity ratio | 0.46 | 0.49 | 0.71 | 0.88 | 1.12 | 0.58 |
| Number of non-financial companies | 413.00 | 462.00 | 520.00 | | | |

Source: Calculated using data from KLSE

3.2.2 Corporate Sector by Firm Size

Financial Performance data for the corporate sector categorised by firm size is shown in *Table 5: Growth and Financial Performance of Selected Public Listed Companies by Firm Size*⁷.

The large-sized firms accounted for about 33.1 percent of the companies selected for this study. Sales of large-sized firms grew at an average rate of 16.3 % per year, higher than medium- and

small-sized firms. On average, the medium-sized sector outperformed the large- and small-sized sector in terms of net income and reserves. This is further reflected by the 22.7 % average growth of the medium-sized sector's net profit margins.

The large-sized firms showed higher return on equity (ROE), as compared to the medium- and small-sized sector, averaging 11.17 percent for the period 1989 to 1998. Although the medium-sized sector had a stronger profit position, it was not able to outperform the large-sized sector in terms of ROE due to its lower share of shareholders' equity compared to the large-sized sector.

The Asian Financial Crisis of 1997–1998 affected the large firms severely. This effect can be seen in the financial indicators and ratios of 1998, where net income showed a loss of RM5,489 million, ROE had a negative value of –6.4 percent, Return on Assets (ROA) had a negative value of –1.3 percent, and net profit margin also had a negative value of –4.5 percent. It is important to note here that items reported in 1997 were only officially published in 1998.

| Table 5 : Growth and Financial Performance of Selected Public Listed Companies by Firm Size , 1989–1998 | | | | | | | | | | | |
|--|--------|--------|--------|---------|---------|---------|---------|---------|---------|---------|----------------------|
| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Compound Growth Rate |
| Large-sized companies | | | | | | | | | | | |
| <i>(RM million)</i> | | | | | | | | | | | |
| Net Sales | 31,377 | 35,431 | 40,585 | 46,742 | 53,344 | 63,007 | 80,636 | 99,928 | 116,544 | 121,871 | 16.27% |
| Net Income | 2,455 | 3,339 | 4,780 | 4,403 | 5,390 | 7,243 | 8,516 | 9,694 | 9,584 | -5,489 | -9.35% |
| Fixed Assets | 17,322 | 19,667 | 22,904 | 26,078 | 32,009 | 37,859 | 49,869 | 49,005 | 72,104 | 86,881 | 19.62% |
| Total Assets | 61,498 | 86,381 | 97,186 | 115,083 | 113,101 | 272,086 | 226,076 | 313,295 | 411,761 | 411,736 | 23.52% |
| Total Liabilities | 37,057 | 44,804 | 58,447 | 68,860 | 83,872 | 105,589 | 142,898 | 209,480 | 286,118 | 279,623 | 25.18% |
| Shareholders' Equity | 19,679 | 24,460 | 30,703 | 34,624 | 49,632 | 49,885 | 60,539 | 71,693 | 89,600 | 86,021 | 17.81% |
| Reserves | 10,530 | 13,033 | 17,696 | 20,482 | 27,990 | 34,600 | 42,857 | 51,477 | 68,218 | 60,891 | 21.53% |
| Financial Performance | | | | | | | | | | | Average |
| Leverage | 0.60 | 0.52 | 0.60 | 0.60 | 0.74 | 0.39 | 0.63 | 0.67 | 0.69 | 0.68 | 0.61 |
| Return on Equity | 12.48% | 13.65% | 15.57% | 12.72% | 10.86% | 14.52% | 14.07% | 13.52% | 10.70% | -6.38% | 11.17% |
| Return on Assets | 3.99% | 3.87% | 4.92% | 3.83% | 4.77% | 2.66% | 3.77% | 3.09% | 2.33% | -1.33% | 3.19% |
| Asset Turnover | 0.51 | 0.41 | 0.42 | 0.41 | 0.47 | 0.23 | 0.36 | 0.32 | 0.28 | 0.30 | 0.37 |
| Net Profit Margin | 7.82% | 9.42% | 11.78% | 9.42% | 10.10% | 11.50% | 10.56% | 9.70% | 8.22% | -4.50% | 8.40% |
| Number of Companies | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48.0 |
| Average Sales per Company (RM mil) | 654 | 738 | 846 | 974 | 1111 | 1313 | 1680 | 2082 | 2428 | 2539 | 1436 |
| Medium-sized companies | | | | | | | | | | | |
| <i>(RM million)</i> | | | | | | | | | | | |
| Net Sales | 7,182 | 10,093 | 12,211 | 12,606 | 12,977 | 15,262 | 19,019 | 21,956 | 25,518 | 24,197 | 14.45% |
| Net Income | 334 | 662 | 829 | 1,218 | 1,161 | 1,834 | 2,740 | 2,802 | 3,413 | 353 | 0.62% |
| Fixed Assets | 4,720 | 5,358 | 6,118 | 6,131 | 6,904 | 8,003 | 9,252 | 11,228 | 13,050 | 16,506 | 14.92% |
| Total Assets | 13,142 | 15,069 | 18,196 | 19,598 | 21,845 | 25,808 | 32,699 | 40,806 | 49,236 | 56,027 | 17.48% |
| Total Liabilities | 5,371 | 6,247 | 7,562 | 7,796 | 8,224 | 10,040 | 12,490 | 16,328 | 21,429 | 24,835 | 18.55% |
| Shareholders' Equity | 7,426 | 7,822 | 10,047 | 11,271 | 12,599 | 15,386 | 19,561 | 23,421 | 27,249 | 29,289 | 16.47% |
| Reserves | 2,807 | 3,187 | 3,972 | 4,907 | 5,726 | 7,129 | 10,214 | 13,114 | 16,004 | 18,047 | 22.97% |
| Financial Performance | | | | | | | | | | | |
| Leverage | 0.41 | 0.41 | 0.42 | 0.40 | 0.38 | 0.39 | 0.38 | 0.40 | 0.44 | 0.44 | 0.41 |
| Return on Equity | 4.50% | 8.46% | 8.25% | 10.81% | 9.22% | 11.92% | 14.01% | 11.96% | 12.53% | 1.21% | 9.29% |
| Return on Assets | 2.54% | 4.39% | 4.56% | 6.21% | 5.31% | 7.11% | 8.38% | 6.87% | 6.93% | 0.63% | 5.29% |
| Asset Turnover | 0.55 | 0.67 | 0.67 | 0.64 | 0.59 | 0.59 | 0.58 | 0.54 | 0.52 | 0.43 | 0.58 |
| Net Profit Margin | 4.65% | 6.56% | 6.79% | 9.66% | 8.95% | 12.02% | 14.41% | 12.76% | 13.37% | 1.46% | 9.06% |
| Number of Companies | 49 | 49 | 49 | 49 | 49 | 49 | 49 | 49 | 49 | 49 | 49.0 |
| Average Sales per Company (RM mil) | 147 | 206 | 249 | 257 | 265 | 311 | 388 | 448 | 521 | 494 | 329 |
| Small-sized companies | | | | | | | | | | | |
| <i>(RM million)</i> | | | | | | | | | | | |
| Net Sales | 4,505 | 5,392 | 6,371 | 6,682 | 6,952 | 7,502 | 9,006 | 14,556 | 10,850 | 10,965 | 10.39% |
| Net Income | 246 | 209 | 275 | 368 | 426 | 748 | 764 | 837 | 708 | -444 | -6.78% |
| Fixed Assets | 2,500 | 2,686 | 2,962 | 3,290 | 3,522 | 3,675 | 4,238 | 4,798 | 6,071 | 7,183 | 12.44% |
| Total Assets | 5,977 | 7,869 | 7,209 | 7,652 | 8,733 | 10,080 | 12,007 | 14,069 | 17,034 | 18,807 | 13.58% |
| Total Liabilities | 2,547 | 2,737 | 3,080 | 3,268 | 3,729 | 3,799 | 4,466 | 6,265 | 7,211 | 8,715 | 14.65% |
| Shareholders' Equity | 3,618 | 3,723 | 4,146 | 4,356 | 5,037 | 6,187 | 7,275 | 8,449 | 9,539 | 9,579 | 11.43% |
| Reserves | 995 | 1,101 | 1,261 | 1,363 | 1,908 | 2,725 | 3,794 | 4,582 | 5,459 | 5,370 | 20.60% |
| Financial Performance | | | | | | | | | | | |
| Leverage | 0.43 | 0.35 | 0.43 | 0.43 | 0.43 | 0.38 | 0.37 | 0.45 | 0.42 | 0.46 | 0.41 |
| Return on Equity | 6.80% | 5.61% | 6.63% | 8.45% | 8.46% | 12.09% | 10.50% | 9.91% | 7.42% | -4.64% | 7.12% |
| Return on Assets | 4.12% | 2.66% | 3.81% | 4.81% | 4.88% | 7.42% | 6.36% | 5.95% | 4.16% | -2.36% | 4.18% |
| Asset Turnover | 0.75 | 0.69 | 0.88 | 0.87 | 0.80 | 0.74 | 0.75 | 1.03 | 0.64 | 0.58 | 0.77 |
| Net Profit Margin | 5.46% | 3.88% | 4.32% | 5.51% | 6.13% | 9.97% | 8.48% | 5.75% | 6.53% | -4.05% | 5.20% |
| Number of Companies | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48 | 48.0 |
| Average Sales per Company (RM mil) | 94 | 112 | 133 | 139 | 145 | 156 | 188 | 303 | 226 | 228 | 172 |

Source: Calculated from KLSE Data

3.2.3 Corporate Sector by Corporate Control Structure

Information collected for this study enables classification of the selected public listed companies according to corporate control structure as shown in *Table 6: Growth and Financial Performance of Selected Public Listed Companies by Corporate Control Structure*. It is expected that companies belonging to conglomerate groups tend to enjoy economies of scale and economies of scope. It appears that net sales for the conglomerate were greater compared to independent companies.

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Compound Growth Rate |
|--|--------|--------|--------|---------|--------|---------|---------|---------|---------|---------|----------------------|
| Conglomerate | | | | | | | | | | | |
| <i>Financial Indicators (RM million)</i> | | | | | | | | | | | |
| Net Sales | 27,476 | 31,107 | 36,254 | 40,980 | 46,825 | 53,141 | 69,027 | 86,215 | 100,373 | 99,613 | 15.39% |
| Net Income | 1,947 | 2,898 | 4,261 | 3,603 | 4,728 | 5,711 | 7,077 | 8,342 | 10,068 | -6,055 | -13.44% |
| Fixed Assets | 13,748 | 15,752 | 18,764 | 21,126 | 27,026 | 31,963 | 41,716 | 47,126 | 56,723 | 71,568 | 20.12% |
| Total Assets | 53,360 | 65,685 | 87,001 | 103,385 | 98,718 | 253,050 | 196,955 | 275,499 | 363,407 | 356,104 | 23.48% |
| Total Liabilities | 32,843 | 40,015 | 53,243 | 63,401 | 76,863 | 95,935 | 125,011 | 185,182 | 255,192 | 249,664 | 25.28% |
| Shareholders' Equity | 16,382 | 20,376 | 26,418 | 29,313 | 43,115 | 41,470 | 50,161 | 60,404 | 75,397 | 73,327 | 18.12% |
| Reserves | 7,573 | 9,678 | 14,206 | 16,398 | 22,770 | 27,646 | 34,537 | 42,339 | 56,018 | 50,589 | 23.49% |
| <i>Financial Performance</i> | | | | | | | | | | | |
| Leverage | 0.62 | 0.61 | 0.61 | 0.61 | 0.78 | 0.38 | 0.63 | 0.67 | 0.70 | 0.70 | 0.63 |
| Return on Equity | 11.88% | 14.22% | 16.13% | 12.29% | 10.97% | 13.77% | 14.11% | 13.81% | 13.35% | -8.26% | 11.23% |
| Return on Assets | 3.65% | 4.41% | 4.90% | 3.49% | 4.79% | 2.26% | 3.59% | 3.03% | 2.77% | -1.70% | 3.12% |
| Asset Turnover | 0.51 | 0.47 | 0.42 | 0.40 | 0.47 | 0.21 | 0.35 | 0.31 | 0.28 | 0.28 | 0.37 |
| Net Profit Margin | 7.09% | 9.32% | 11.75% | 8.79% | 10.10% | 10.75% | 10.25% | 9.68% | 10.03% | -6.08% | 8.17% |
| Number of Companies | 56 | 56 | 56 | 56 | 56 | 56 | 56 | 56 | 56 | 56 | 56.0 |
| Average Sales per Company (RM mil) | 491 | 555 | 647 | 732 | 836 | 949 | 1233 | 1540 | 1792 | 1779 | 1055 |
| Independent | | | | | | | | | | | |
| <i>Financial Indicators (RM million)</i> | | | | | | | | | | | |
| Net Sales | 15,589 | 19,810 | 22,915 | 25,060 | 26,448 | 32,631 | 39,635 | 50,225 | 52,539 | 57,420 | 15.59% |
| Net Income | 1,089 | 1,312 | 1,624 | 2,387 | 2,249 | 4,115 | 4,949 | 4,991 | 3,638 | 475 | -8.81% |
| Fixed Assets | 10,794 | 11,959 | 13,220 | 14,372 | 15,409 | 17,574 | 21,640 | 26,905 | 34,503 | 39,002 | 15.34% |
| Total Assets | 27,257 | 43,634 | 35,589 | 38,948 | 44,962 | 55,177 | 73,828 | 92,672 | 114,624 | 130,466 | 19.00% |
| Total Liabilities | 12,132 | 13,774 | 15,845 | 16,523 | 18,962 | 23,493 | 34,968 | 46,890 | 59,567 | 63,510 | 20.19% |
| Shareholders' Equity | 14,340 | 15,629 | 18,478 | 20,938 | 24,153 | 29,989 | 37,264 | 43,160 | 50,991 | 51,563 | 15.28% |
| Reserves | 6,759 | 7,643 | 8,723 | 10,353 | 12,854 | 16,808 | 22,329 | 26,834 | 33,663 | 33,719 | 19.55% |
| <i>Financial Performance</i> | | | | | | | | | | | |
| Leverage | 0.45 | 0.32 | 0.45 | 0.42 | 0.42 | 0.43 | 0.47 | 0.51 | 0.52 | 0.49 | 0.45 |
| Return on Equity | 7.59% | 8.39% | 8.79% | 11.40% | 9.31% | 13.72% | 13.28% | 11.56% | 7.13% | 0.92% | 9.21% |
| Return on Assets | 4.00% | 3.01% | 4.56% | 6.13% | 5.00% | 7.46% | 6.70% | 5.39% | 3.17% | 0.36% | 4.58% |
| Asset Turnover | 0.57 | 0.45 | 0.64 | 0.64 | 0.59 | 0.59 | 0.54 | 0.54 | 0.46 | 0.44 | 0.55 |
| Net Profit Margin | 6.99% | 6.62% | 7.09% | 9.53% | 8.50% | 12.61% | 12.49% | 9.94% | 6.92% | 0.83% | 8.15% |
| Number of Companies | 89 | 89 | 89 | 89 | 89 | 89 | 89 | 89 | 89 | 89 | 89.0 |
| Average Sales per Company (RM mil) | 175 | 223 | 257 | 282 | 297 | 367 | 445 | 564 | 590 | 645 | 385 |

Source: Calculated from KLSE Data

Although companies belonging to a conglomerate enjoy certain benefits, it appears that in times of economic downturn, they are adversely affected more severely. Comparing the net income figure for both groups in the sample, it can be seen that conglomerate companies suffered a total loss of RM 6,055 million in 1998, while independent companies only suffered a decrease in their net income. Due to the loss incurred by conglomerate companies, their average net profit margins declined tremendously from 10.0 percent in 1997 to –6.1 percent in 1998.

Despite a negative ROE for the conglomerate companies in 1998, their average ROE for the period 1989 to 1998 were still higher than for independent companies, as the conglomerate companies were consistently reported higher ROE values. However, the ROA for independent companies outperformed the conglomerate companies as their net sales continued to increase in 1998 even though by less. Net sales for conglomerate companies declined by approximately One percent in 1998.

3.3 Patterns of Corporate Investment

3.3.1 Aggregate Trends

A summary of aggregate investment indicators⁸ of the non-financial corporate sector is presented in *Table 7: Investment Patterns in the Aggregate Corporate Sector Non-Financial Companies (1989-1998)*. The average rate of new investment in fixed assets for the ten-year period was 36 percent. From 1989 to 1993, this rate has been high, averaging about 40 percent per year. From 1994 to 1998, this rate went down to 30 percent per year. An opposite pattern appears for other assets. The rate of new investments in other assets is 64 percent for the ten-year period. The rate of investment in other assets grew from 60 percent per year in 1989-93 to 70 percent per year in 1994-98. These data suggest that there was a slowdown in investment in fixed capacities prior to the crisis and a corresponding growth in other assets. As a result, other assets grew while fixed assets accounted for a declining proportion of total assets. From a high level of 43 percent of total assets in 1992, its share of total assets went down to 32 percent by 1998. Investments in fixed assets grew at a stable rate of about 26 percent between 1989 and 1998. By comparison, total assets grew at a much faster rate, at 34 percent. Thus prior to the crisis, growth in total assets was comparatively high, and this growth was not in the form of fixed assets.

| Table 7: Aggregate Investment Patterns, Non-financial Companies, Corporate Sector, 1989-1997 For the Years Ending December 31 | | | | | | | | | | | | |
|--|------|------|------|------|------|----------------|------|------|------|------|------|----------------|
| Investment Flow Indicators | 1989 | 1990 | 1991 | 1992 | 1993 | 1989 - 93 Ave. | 1994 | 1995 | 1996 | 1997 | 1998 | 1994 - 98 Ave. |
| Rate of New Investment - Fixed Assets | 0.37 | 0.35 | 0.36 | 0.49 | 0.41 | 0.40 | 0.35 | 0.28 | 0.30 | 0.27 | 0.29 | 0.30 |
| Rate of New Investment - Other Assets | 0.63 | 0.65 | 0.64 | 0.51 | 0.59 | 0.60 | 0.65 | 0.72 | 0.70 | 0.73 | 0.70 | 0.70 |
| Growth Rate - Fixed Assets | 0.21 | 0.35 | 0.20 | 0.47 | 0.21 | 0.29 | 0.25 | 0.26 | 0.15 | 0.26 | 0.22 | 0.23 |
| Growth Rate - Other Assets | 0.24 | 0.42 | 0.23 | 0.38 | 0.22 | 0.30 | 0.30 | 0.37 | 0.19 | 0.34 | 0.32 | 0.30 |
| Fixed Assets/ Total Assets | 0.43 | 0.41 | 0.40 | 0.43 | 0.42 | 0.42 | 0.41 | 0.37 | 0.36 | 0.34 | 0.33 | 0.37 |

Source: KLSE

3.3.2 Corporate Investment Patterns by Firm Size

Corporate investment indicators by firm size are shown in *Table 8: Corporate Investment Patterns of Selected Public Listed Companies by Firm Size*. The large-sized firms invested least in fixed assets. Due to the huge deficit in fixed asset investment by the large-sized firms in 1998, its average is pulled down to a negative figure. However, incremental investment in fixed assets by the medium- and small-sized firms is 26 percent. This indicates that medium- and small-sized firms outgrew their large-sized counterparts.

The total assets of large-sized firms contracted in 1993 and 1995, and their total assets remained constant in 1998. This suggests that large-sized firms tend to invest less or not at all during economic booms and troughs.

| Table 8: Corporate Investment Patterns of Selected Public Listed Companies by Firm Size (1989 –1998) | | | | | | | | | | |
|---|------|-------|------|-------|------|-------|-------|------|---------|--------|
| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Ave |
| Large sized companies | | | | | | | | | | |
| <i>Corporate Investment Indicators</i> | | | | | | | | | | |
| Incremental Investments in Fixed Assets | 0.09 | 0.30 | 0.18 | -2.99 | 0.04 | -0.26 | -0.01 | 0.23 | -591.08 | -65.94 |
| Incremental Investments in Total Assets | 0.91 | 0.70 | 0.82 | 3.99 | 0.96 | 1.26 | 1.01 | 0.77 | 592.08 | 66.94 |
| Average Growth Rate of Fixed Assets | 0.14 | 0.16 | 0.14 | 0.23 | 0.18 | 0.32 | -0.02 | 0.47 | 0.20 | 0.20 |
| Average Growth Rate of Total Assets | 0.40 | 0.13 | 0.18 | -0.02 | 1.41 | -0.17 | 0.39 | 0.31 | 0.00 | 0.29 |
| Medium sized companies | | | | | | | | | | |
| <i>Corporate Investment Indicators</i> | | | | | | | | | | |
| Incremental Investments in Fixed Assets | 0.33 | 0.24 | 0.01 | 0.34 | 0.28 | 0.18 | 0.24 | 0.22 | 0.51 | 0.26 |
| Incremental Investments in Total Assets | 0.67 | 0.76 | 0.99 | 0.66 | 0.72 | 0.82 | 0.76 | 0.78 | 0.49 | 0.74 |
| Average Growth Rate of Fixed Assets | 0.14 | 0.14 | 0.00 | 0.13 | 0.16 | 0.16 | 0.21 | 0.16 | 0.26 | 0.15 |
| Average Growth Rate of Total Assets | 0.15 | 0.21 | 0.08 | 0.11 | 0.18 | 0.27 | 0.25 | 0.21 | 0.14 | 0.18 |
| Small sized companies | | | | | | | | | | |
| <i>Corporate Investment Indicators</i> | | | | | | | | | | |
| Incremental Investments in Fixed Assets | 0.10 | -0.42 | 0.74 | 0.21 | 0.11 | 0.29 | 0.27 | 0.43 | 0.63 | 0.26 |
| Incremental Investments in Total Assets | 0.90 | 1.42 | 0.26 | 0.79 | 0.89 | 0.71 | 0.73 | 0.57 | 0.37 | 0.74 |
| Average Growth Rate of Fixed Assets | 0.07 | 0.10 | 0.11 | 0.07 | 0.04 | 0.15 | 0.13 | 0.27 | 0.18 | 0.13 |
| Average Growth Rate of Total Assets | 0.32 | -0.08 | 0.06 | 0.14 | 0.15 | 0.19 | 0.17 | 0.21 | 0.10 | 0.14 |

Source: Calculated from KLSE

From Table 8, it can also be observed that average values of the corporate investment indicators do not differ much between medium- and small-sized firms, although their investment composition may differ within the ten-year period. However, these two groups did in fact invest heavily in other assets during the economic boom in 1993, and switched their investments to fixed assets during the crisis in 1998.

3.3.3 Corporate Investment Patterns by Corporate Control Structure

Whether a company belongs to a conglomerate or independent influences its corporate investment patterns. This is shown in *Table 9: Corporate Investment Patterns of Selected Public Listed Companies by Corporate Control Structure*.

| Table 9: Corporate Investment Patterns of Selected Public Listed Companies by Corporate Control Structure, 1989–1998 | | | | | | | | | | |
|---|------|-------|------|-------|------|-------|------|------|-------|-------|
| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Ave |
| Conglomerate | | | | | | | | | | |
| <i>Corporate Investment Indicators</i> | | | | | | | | | | |
| Incremental Investments in Fixed Assets | 0.16 | 0.14 | 0.14 | -1.26 | 0.03 | -0.17 | 0.07 | 0.11 | -2.03 | -0.31 |
| Incremental Investments in Other Assets | 0.84 | 0.86 | 0.86 | 2.26 | 0.97 | 1.17 | 0.93 | 0.89 | 3.03 | 1.31 |
| Average Growth Rate of Fixed Assets | 0.15 | 0.19 | 0.13 | 0.28 | 0.18 | 0.31 | 0.13 | 0.20 | 0.26 | 0.20 |
| Average Growth Rate of Total Assets | 0.23 | 0.32 | 0.19 | -0.05 | 1.56 | -0.22 | 0.40 | 0.32 | -0.02 | 0.30 |
| Independent | | | | | | | | | | |
| <i>Corporate Investment Indicators</i> | | | | | | | | | | |
| Incremental Investments in Fixed Assets | 0.07 | -0.16 | 0.34 | 0.17 | 0.21 | 0.22 | 0.28 | 0.35 | 0.28 | 0.20 |
| Incremental Investments in Other Assets | 0.93 | 1.16 | 0.66 | 0.83 | 0.79 | 0.78 | 0.72 | 0.65 | 0.72 | 0.80 |
| Average Growth Rate of Fixed Assets | 0.11 | 0.11 | 0.09 | 0.07 | 0.14 | 0.23 | 0.24 | 0.28 | 0.13 | 0.16 |
| Average Growth Rate of Total Assets | 0.60 | -0.18 | 0.09 | 0.15 | 0.23 | 0.34 | 0.26 | 0.24 | 0.14 | 0.21 |

Source: Calculated from KLSE

The fixed assets of conglomerate companies experienced a negative incremental investment, averaging –31 percent compared to the independent companies' average of 20 percent. Independent companies invested in fixed assets rather consistently, except in 1992. Besides that, fixed assets average growth rate ranged between 9 and 28 percent, with an annual average of 16 percent.

3.4 Patterns of Corporate Financing

3.4.1. Aggregate Financing Patterns for the Non-financial Companies

Aggregate financing indicators⁹ for the publicly listed non-financial corporate sector in Malaysia are summarized in *Table 10: Financing Patterns in the Aggregate Non-financial Corporate Sector (1989-1998)*. Self-financing ratio (SFR) for fixed assets is high, averaging 70 percent of growth in fixed assets for 1989 – 1998. It suggests that internal funds are sufficient to finance fixed assets requirements of the corporate sector. SFR (fixed assets) fluctuated from year-to-year. Prior to the financial crisis, the SFR (fixed assets) was at its peak, reaching 112 percent. By 1997 however, the ratio went down to only 44 percent because companies did not make much profit during this crisis year, and by 1998 a negative ratio is observed.

The self-financing ratio for total assets on average is much lower at three percent. This indicates that income net of dividends is not sufficient to finance the growth of total assets of publicly

listed companies. Over the years, this level had not exceeded 8 percent and was even negative in the crisis year 1997 and 1998. Publicly listed companies seem to be relying more on new equity finance of total assets growth, especially in 1992 when the new equity financing ratio was as high as 56 percent. On average, during 1989 to 1998, companies relied on new equity financing to finance 43 percent of growth in total assets. Incremental debt financing ratio ranged between 38 percent to 68 percent during the period up to the crisis. Between 1989 and 1990 new equity was preferred to debt in financing growth in total assets. However, by 1993 we could see a trend towards preference for debt compared to equity to finance asset growth. In 1994 54 percent of total asset growth was financed by debt but by 1995 the percentage increased to 63 percent. Prior to the financial crisis, 68 percent of total assets growth, (i.e., the highest in the period of study), was financed by debt. In short, debts financed about two-thirds of total asset growth of the corporate sector. By 1998, the percentage decreased to negative 19 percent because during this period, banks started to impose strict credit requirements and require more collateral for loan applications.

| Financial Flow Indicators | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Ave |
|--|------|------|------|------|------|------|------|------|-------|-------|------|
| 1. Self-financing Ratio - Fixed Assets | 0.75 | 0.62 | 0.96 | 0.49 | 0.94 | 0.79 | 0.77 | 1.12 | 0.44 | -0.29 | 0.70 |
| 2. Self-financing Ratio - Total Assets | 0.08 | 0.07 | 0.04 | 0.06 | 0.07 | 0.04 | 0.02 | 0.03 | -0.04 | -0.10 | 0.03 |
| 3. New Equity Financing Ratio | 0.51 | 0.57 | 0.41 | 0.56 | 0.47 | 0.40 | 0.32 | 0.32 | 0.27 | 0.45 | 0.43 |
| 4. Incremental Debt Financing Ratio | 0.39 | 0.38 | 0.60 | 0.38 | 0.50 | 0.54 | 0.63 | 0.66 | 0.68 | -0.19 | 0.48 |
| 5. Incremental Equity Financing Ratio | 0.61 | 0.62 | 0.40 | 0.62 | 0.50 | 0.46 | 0.37 | 0.34 | 0.32 | 1.19 | 0.54 |

Source: KLSE

3.4.1 Corporate Financing Patterns by Firm Size

Corporate financing indicators by firm size are presented in *Table 11: Corporate Financing Patterns for Selected Public Listed Companies by Firm Size*.

| Table 11: Corporate Financing Patterns for Selected Public Listed Companies by Firm Size, 1989 –1998 | | | | | | | | | | |
|--|------|-------|-------|-------|-------|-------|--------|------|---------|--------|
| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Ave |
| Large sized companies | | | | | | | | | | |
| <i>Financing Patterns Indicators</i> | | | | | | | | | | |
| Self-financing Ratio (Fixed Assets) | 1.42 | 1.48 | 1.39 | 0.91 | 1.24 | 0.71 | -11.22 | 0.41 | -0.37 | -0.45 |
| Self-financing Ratio (Total Assets) | 0.10 | 0.43 | 0.16 | -3.79 | 0.04 | -0.18 | 0.10 | 0.17 | 293.08 | 32.23 |
| New Equity Financing Ratio | 0.09 | 0.15 | 0.06 | -3.78 | -0.04 | -0.05 | 0.03 | 0.01 | -149.92 | -17.05 |
| Incremental Debt Financing Ratio | 0.31 | 1.26 | 0.58 | -7.57 | 0.14 | -0.81 | 0.76 | 0.78 | 259.80 | 28.36 |
| Incremental Equity Financing Ratio | 0.69 | -0.26 | 0.42 | 8.57 | 0.86 | 1.81 | 0.24 | 0.22 | -258.8 | -27.36 |
| Medium sized companies | | | | | | | | | | |
| <i>Financing Patterns Indicators</i> | | | | | | | | | | |
| Self-financing Ratio (Fixed Assets) | 1.04 | 1.09 | 93.69 | 1.50 | 1.67 | 2.19 | 1.42 | 1.87 | 0.10 | 11.62 |
| Self-financing Ratio (Total Assets) | 0.20 | 0.25 | 0.67 | 0.36 | 0.35 | 0.45 | 0.36 | 0.34 | 0.30 | 0.36 |
| New Equity Financing Ratio | 0.01 | 0.46 | 0.21 | 0.23 | 0.35 | 0.16 | 0.12 | 0.11 | 0.00 | 0.18 |
| Incremental Debt Financing Ratio | 0.45 | 0.42 | 0.17 | 0.19 | 0.46 | 0.36 | 0.47 | 0.61 | 0.50 | 0.40 |
| Incremental Equity Financing Ratio | 0.55 | 0.58 | 0.83 | 0.81 | 0.54 | 0.64 | 0.53 | 0.39 | 0.50 | 0.60 |
| Small sized companies | | | | | | | | | | |
| <i>Financing Patterns Indicators</i> | | | | | | | | | | |
| Self-financing Ratio (Fixed Assets) | 1.12 | 1.00 | 1.12 | 1.84 | 4.89 | 1.36 | 1.49 | 0.56 | -0.40 | 1.44 |
| Self-financing Ratio (Total Assets) | 0.06 | -0.24 | 0.23 | 0.50 | 0.61 | 0.55 | 0.38 | 0.30 | -0.05 | 0.26 |
| New Equity Financing Ratio | 0.00 | -0.40 | 0.24 | 0.13 | 0.25 | 0.01 | 0.19 | 0.07 | 0.07 | 0.06 |
| Incremental Debt Financing Ratio | 0.10 | -0.52 | 0.42 | 0.43 | 0.05 | 0.35 | 0.87 | 0.32 | 0.85 | 0.32 |
| Incremental Equity Financing Ratio | 0.90 | 1.52 | 0.58 | 0.57 | 0.95 | 0.65 | 0.13 | 0.68 | 0.15 | 0.68 |

Source: Calculated from KLSE

The self-financing ratio for fixed assets is the highest for the medium-sized firms, with an average rate of more than 1000 percent. This shows that the net income of medium-sized firms had the ability to finance up to more than ten times the growth of its fixed assets. However, the self-financing ratios for large-sized firms indicate that they are unable to finance its growth in fixed assets solely with net income. The large-sized firms are also unable to finance growth in total assets just by obtaining additional new equity. Therefore, they relied mainly on debt financing for assets growth.

Medium- and small sized firms relied more on equity financing rather than debt financing, with an average 60 to 40 ratio for medium-sized firms, and an average 68 to 32 ratio for small-sized firms. However, medium- and small-sized firms did not rely heavily on new equity financing, with averages of only 18 percent and 6 percent respectively.

3.4.2 Corporate Financing Patterns by Corporate Control Structure

Most conglomerates have financing arms, an example, Sime Darby's financing arm was Sime Bank (until 1998), while AMMB Holdings has Arab-Malaysian Finance. Conglomerates are

deemed to have an advantage in financing as they are able to relocate funds within the group and obtain better access to credit facilities on behalf of the group as a whole. Corporate financing indicators by corporate control structure are shown in *Table 12: Corporate Financing Patterns for Selected Public Listed Companies by Corporate Control Structure*.

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Ave |
|--------------------------------------|------|-------|------|-------|-------|-------|------|------|-------|------|
| Conglomerate | | | | | | | | | | |
| <i>Financing Patterns Indicators</i> | | | | | | | | | | |
| Self-financing Ratio (Fixed Assets) | 1.45 | 1.41 | 1.53 | 0.80 | 1.16 | 0.73 | 1.54 | 1.05 | -0.41 | 1.03 |
| Self-financing Ratio (Total Assets) | 0.17 | 0.21 | 0.13 | -1.37 | 0.03 | -0.12 | 0.10 | 0.16 | 0.74 | 0.01 |
| New Equity Financing Ratio | 0.15 | 0.07 | 0.04 | -1.59 | -0.04 | -0.03 | 0.03 | 0.01 | -0.46 | 0.20 |
| Incremental Debt Financing Ratio | 0.58 | 0.62 | 0.62 | -2.88 | 0.12 | -0.52 | 0.77 | 0.80 | 0.76 | 0.10 |
| Incremental Equity Financing Ratio | 0.42 | 0.38 | 0.38 | 3.88 | 0.88 | 1.52 | 0.23 | 0.20 | 0.24 | 0.90 |
| Independent | | | | | | | | | | |
| <i>Financing Patterns Indicators</i> | | | | | | | | | | |
| Self-financing Ratio (Fixed Assets) | 1.13 | 1.29 | 2.07 | 2.17 | 1.90 | 1.22 | 0.95 | 0.48 | 0.11 | 1.26 |
| Self-financing Ratio (Total Assets) | 0.05 | -0.13 | 0.49 | 0.42 | 0.39 | 0.30 | 0.24 | 0.31 | 0.00 | 0.23 |
| New Equity Financing Ratio | 0.02 | -0.22 | 0.25 | 0.12 | 0.18 | 0.09 | 0.07 | 0.05 | 0.03 | 0.07 |
| Incremental Debt Financing Ratio | 0.10 | -0.26 | 0.20 | 0.41 | 0.44 | 0.62 | 0.63 | 0.58 | 0.25 | 0.33 |
| Incremental Equity Financing Ratio | 0.90 | 1.26 | 0.80 | 0.59 | 0.56 | 0.38 | 0.37 | 0.42 | 0.75 | 0.67 |

Source: Calculated from KLSE

The tabulations show that self-financing ratios for fixed assets of independent companies are slightly higher than for conglomerates. Net income financed 103 percent of the conglomerate companies' fixed assets growth, while reserves covered only 1 percent of total assets growth. Comparatively, independent companies used more of their reserves, an average of 23 percent, to finance total asset growth.

Generally, companies under both corporate control structures tend to rely more on equity financing. However, conglomerates used up to 90 percent equity financing on average, while independent companies used two-thirds equity with respect to debt on average. This indicates that investments were mainly financed internally. These results support the findings in Part 3.1.3 that conglomerate companies were substantially more leveraged than independent companies.

3.5 Weak Corporate Governance with Corporate Performance, Investment and Financing Patterns¹⁰

This study confirms the results of earlier analysis on corporate performance, investment patterns and financing patterns. Indicators representing corporate performance, investment patterns and financing patterns are analysed relative to three corporate governance variables, namely firm size, corporate control structure and industry sector.

3.5.1 Weak Corporate Governance and Corporate Performance

Results of the regression analysis for corporate performance, using ROE, ROA and leverage as proxies, are shown in *Table 13: Corporate Performance Relative to Corporate Governance Variables*. ROE, ROA and leverage are each regressed with firm size, corporate control structure and industry sector.

| Table 13: Corporate Performance Relative to Corporate Governance Variables | | | | |
|--|-------------|----------------|---------|--------------------|
| Regression Variables | Coefficient | Standard Error | t-value | Significance Level |
| 1. <i>Dependent Variable:</i> Return on Equity | | | | |
| <i>Independent Variables :</i> | | | | |
| a. Firm Size | 0.02883 | 0.012 | 2.493 | 0.014 |
| b. Corporate Control Structure | -0.01971 | 0.019 | -2.266 | 0.309 |
| c. Industry Sectors | -0.01099 | 0.005 | -1.021 | 0.025 |
| <i>Overall Regression Statistics:</i> | | | | |
| a. Adjusted R ² = 0.072 | | | | |
| b. F | | | 4.726 | 0.004 |
| 2. <i>Dependent Variable:</i> Return on Assets | | | | |
| <i>Independent Variables :</i> | | | | |
| a. Firm Size | 0.00375 | 0.006 | 0.660 | 0.511 |
| b. Corporate Control Structure | -0.00512 | 0.009 | -0.540 | 0.590 |
| c. Industry Sectors | -0.00627 | 0.002 | -2.629 | 0.010 |
| <i>Overall Regression Statistics:</i> | | | | |
| a. Adjusted R ² = 0.032 | | | | |
| b. F | | | 2.602 | 0.054 |
| 3. <i>Dependent Variable:</i> Leverage | | | | |
| <i>Independent Variables :</i> | | | | |
| a. Firm Size | 0.05119 | 0.024 | 2.120 | 0.036 |
| b. Corporate Control Structure | -0.03604 | 0.040 | -0.894 | 0.373 |
| c. Industry Sectors | -0.01933 | 0.010 | -1.909 | 0.058 |
| <i>Overall Regression Statistics:</i> | | | | |
| a. Adjusted R ² = 0.048 | | | | |
| b. F | | | 3.426 | 0.019 |

From the regression results, ROE and ROA are each significantly positively related to firm size, but significantly negatively related to industry sectors. Leverage is significantly positively related to firm size and industry sectors. This implies that as companies become larger in terms of total assets, ROE and ROA increased i.e. returns on investment increase, and they also tend to rely more on debt financing. This substantiates the statistical data presented in *Table 5: Growth and Financial Performance of Selected Public Listed Companies by Firm Size*. However, even though regression results show that ROE, ROA and leverage are each negatively related to corporate control structure, the results are not significant enough for us to conclude that weak corporate governance can be linked to corporate performance.

3.5.2 Weak Corporate Governance and Corporate Investment Patterns

Each of the corporate investment indicators, i.e. incremental investment in fixed assets, incremental investment in other assets, average growth rate in fixed assets and average growth rate in total assets, was regressed with corporate governance variables, i.e. firm size, corporate control structure and industry sectors. The statistical results are shown in *Table 14: Corporate Investment Patterns Relative to Corporate Governance Variables*.

The regression results show that incremental investment in fixed assets and the average growth in fixed assets are negatively related with firm size, with the former showing significant statistical results ($p < 0.10$). This implies that as companies grew larger in terms of total assets, they tend to invest less in fixed assets relative to total assets growth. On the other hand, the results are reversed when analysing incremental investment in other assets. When the growth rate of total assets was regressed on firm size, significant results were obtained which show that, as firms grew larger in terms of their total assets, average growth rate of their total assets increased. However, when the average growth rate in fixed assets was regressed with the three corporate governance variables, the results show that they were negatively related, but not significantly.

Although the statistical relationships correspond with the descriptive analysis, the regression results between corporate investment indicators and corporate governance variables do not produce statistically significant results.

| Table 14: Corporate Investment Patterns Relative to Corporate Governance Variables | | | | |
|--|-------------|----------------|---------|--------------------|
| Regression Variables | Coefficient | Standard Error | t-value | Significance Level |
| 1. Dependent Variable: Incremental Investment in Fixed Assets | | | | |
| Independent Variables: | | | | |
| a. Firm Size | -0.15100 | 0.082 | -1.848 | 0.067 |
| b. Corporate Control Structure | -0.20700 | 0.137 | -1.514 | 0.132 |
| c. Industry Sectors | 0.05676 | 0.034 | 1.654 | 0.100 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = 0.025 | | | | |
| b. F | | | 2.244 | 0.086 |
| 2. Dependent Variable: Incremental Investment in Other Assets | | | | |
| Independent Variables: | | | | |
| d. Firm Size | 0.15100 | 0.082 | 1.848 | 0.067 |
| e. Corporate Control Structure | 0.20700 | 0.137 | 1.514 | 0.132 |
| f. Industry Sectors | -0.05676 | 0.034 | -1.654 | 0.100 |
| Overall Regression Statistics: | | | | |
| c. Adjusted R ² = 0.025 | | | | |
| d. F | | | 2.244 | 0.086 |
| 3. Dependent Variable: Average Growth Rate in Fixed Assets | | | | |
| Independent Variables: | | | | |
| a. Firm Size | -0.36100 | 0.789 | -0.457 | 0.648 |
| b. Corporate Control Structure | -0.02806 | 1.316 | -0.155 | 0.983 |
| c. Industry Sectors | -0.03813 | 0.331 | -0.021 | 0.908 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = 0.013 | | | | |
| b. F | | | 0.081 | 0.970 |
| 4. Dependent Variable: Average Growth Rate in Total Assets | | | | |
| Independent Variables: | | | | |
| d. Firm Size | 0.16900 | 0.080 | 2.113 | 0.036 |
| e. Corporate Control Structure | 0.09998 | 0.134 | 0.748 | 0.456 |
| f. Industry Sectors | 0.01484 | 0.034 | 0.442 | 0.659 |
| Overall Regression Statistics: | | | | |
| c. Adjusted R ² = 0.013 | | | | |
| d. F | | | 1.608 | 0.190 |

Hence, based on the strict criteria imposed in the sample selection, the null hypothesis stating no relationship between weak corporate governance and investment patterns cannot be rejected, since results of the regressions were generally insignificant. Therefore, it can be concluded that while there might be a relationship between weak corporate governance and corporate investment patterns, they are not statistically significant.

3.5.3 Weak Corporate Governance and Financing Patterns

The corporate financing patterns indicators were each regressed with firm size, corporate control structure and industry sectors. The results of the regression analysis are presented in *Table 15: Corporate Financing Patterns Relative to Corporate Governance Variables*.

Table 15: Corporate Financing Patterns Relative to Corporate Governance Variables

| Regression Variables | Coefficient | Standard Error | t-value | Significance Level |
|--|-------------|----------------|---------|--------------------|
| 1. Dependent Variable: Self-financing Ratio (Fixed Assets) | | | | |
| Independent Variables : | | | | |
| a. Firm Size | -0.78000 | 2.831 | -0.275 | 0.783 |
| b. Corporate Control Structure | -4.33100 | 4.723 | -0.917 | 0.361 |
| c. Industry Sectors | 0.34600 | 1.187 | 0.291 | 0.771 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = -0.015 | | | | |
| b. F | | | 0.303 | 0.823 |
| 2. Dependent Variable: Self-financing Ratio (Total Assets) | | | | |
| Independent Variables : | | | | |
| a. Firm Size | -0.54400 | 0.480 | -1.134 | 0.259 |
| b. Corporate Control Structure | 0.49700 | 0.800 | 0.621 | 0.536 |
| c. Industry Sectors | 0.12800 | 0.201 | 0.634 | 0.527 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = -0.003 | | | | |
| b. F | | | 0.875 | 0.456 |
| 3. Dependent Variable: New Equity Financing Ratio | | | | |
| Independent Variables : | | | | |
| a. Firm Size | 0.33200 | 0.372 | 0.894 | 0.373 |
| b. Corporate Control Structure | -0.30700 | 0.620 | -0.746 | 0.621 |
| c. Industry Sectors | -0.11600 | 0.156 | -0.495 | 0.457 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = -0.020 | | | | |
| b. F | | | 0.642 | 0.589 |
| 4. Dependent Variable: Incremental Debt Financing Ratio | | | | |
| Independent Variables : | | | | |
| a. Firm Size | 0.20200 | 0.129 | 1.574 | 0.118 |
| b. Corporate Control Structure | -0.20700 | 0.214 | -0.965 | 0.336 |
| c. Industry Sectors | -0.02338 | 0.054 | -0.434 | 0.665 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = 0.013 | | | | |
| b. F | | | 1.620 | 0.188 |
| 5. Dependent Variable: Incremental Equity Financing Ratio | | | | |
| Independent Variables : | | | | |
| a. Firm Size | -0.21200 | 0.120 | -1.764 | 0.080 |
| b. Corporate Control Structure | 0.18900 | 0.200 | 0.945 | 0.346 |
| c. Industry Sectors | 0.01127 | 0.050 | 0.224 | 0.823 |
| Overall Regression Statistics: | | | | |
| a. Adjusted R ² = 0.013 | | | | |
| b. F | | | 1.833 | 0.144 |

The regression analysis shows that the self-financing ratio for fixed assets, self-financing ratio for total assets and the incremental equity financing ratio are negatively related to firm size, with the coefficient for incremental equity financing ratio being significant at the 10 percent level. This indicates that the larger the company in terms of total assets, the less it relied on equity financing. On the other hand, the incremental debt financing ratio is positively related to firm size, implying that as companies grew larger in terms of total assets, they relied more on debt financing, even though the results are not statistically significant. These conclusions confirm the

statistical data presented in *Table 11: Corporate Financing Patterns for Selected Public Listed Companies by Firm Size*.

When corporate financing patterns indicators are regressed with corporate governance variables, the statistical results are generally insignificant. Hence there is sufficient evidence not to reject the null hypothesis stating no relationship between weak corporate governance and financing patterns. Again, as mentioned earlier, the results were not statistically significant. Therefore, it can be concluded that there might be a relationship between weak corporate governance and corporate financing patterns, but they are generally not statistically significant.

The regression analysis sought to establish the relationships between weak corporate governance with corporate performance, investment and financing patterns. However, statistical tests only show a significant relationship for weak corporate governance and corporate performance. Statistical results for corporate investment and financing patterns were generally insignificant.

4. SUMMARY AND CONCLUSION

This study analyses corporate performance, investment and financing patterns in relation to corporate governance variables from 1989 to 1998. Over this ten-year period, the Malaysian corporate sector grew in terms of company size and formation of conglomerates in all industrial sectors. The profitability and performance of these companies presumably reflected in the way these companies were managed and governed by their agents.

Corporate governance variables considered in this study are firm size, corporate control structure and industry sectors. Based on the findings of the study, weak corporate governance is related to corporate performance, investment and financing patterns.

The relationship between weak corporate governance and corporate performance shows statistically significant results. The regression results between financial performance indicators such as return on equity (ROE), return on assets (ROA) and leverage and corporate governance variables show that as companies grew larger, they attained higher returns on investment and

relied less on debt financing. This conclusion confirmed those of previous research carried out by Saldana (1999), Xu and Wang (1997) and Emmons and Schmid (1999).

The relationship between weak corporate governance with corporate investment patterns and corporate financing patterns is also established in this study. Descriptive analysis has suggested that the Malaysian corporate sector was relatively efficient in investment and financing activities. However, the statistical results testing the relationship between weak corporate governance with respect to corporate investment patterns and corporate financing patterns were generally insignificant. This could be due to the strict criteria used in the sample selection for this study, causing the null hypothesis not to be rejected. Hence, this might explain the weak statistical relationship between weak corporate governance with investment and financing patterns.

The Asian Financial Crisis had very unusual effects. This study only found a significant relationship between weak corporate governance and corporate performance. Perhaps removing the crisis effect could lead to more significant results. A study with a narrower scope encompassing the years 1994 to 1996 (a three-year study) may give rather different results. This could then be compared with an earlier time period say, between 1990 and 1992, for comparative purposes.

Notes

¹ Asian Development Bank (1999), "Corporate Governance and Financing in Selected Developing Countries in East Asia" unpublished report.

² Webb, D. (1998), Some Conceptual Issues in Corporate Governance and Finance, ADB report November 1998.

³ The market value of debt plus the market value of equity divided by the replacement cost of all assets.

⁴ Since the KLSE requires that at least 25 per cent of the shares should be public, it means that the largest five shareholders control the supply of publicly traded shares in this case.

⁵ Limiting the analysis to the largest five shareholders results in a bias against small shareholders. Consequently, it is likely that the analysis understates the importance of categories where there are many small shareholders like individuals and foreigners.

⁶ The author wishes to acknowledge the assistance of Ms Lim Sue Lin for this section.

⁷ Large-sized companies had total assets of over RM1,000 million. Medium-sized companies had average total assets of RM 390 to RM 1,000 million, and those companies with average total assets of less than RM 390 million are classified as small-sized firms.

⁸ The non-financial corporate sector's investments are evaluated using investment pattern indicators such as incremental investment in fixed assets, incremental investment in other assets and average growth rates in fixed assets and total assets. Thus fixed assets and total assets are the main proxies for investment patterns. Incremental investments in fixed assets are measured by the change in fixed assets relative to the change in total assets. It describes the significance of growth in fixed assets relative to total investment needs of the corporate sectors. Incremental investments in other assets measure the importance of working capital and other investments in the corporate sector. The key limitation of these indicators is that it does not indicate the direction of investments. Large government privatisation projects in the 1990s may also have had great influence on the pattern of investments in the corporate sector.

⁹ Five indicators of corporate financing patterns are self-financing ratio (fixed assets), the self-financing ratio (total assets), the new equity financing ratio, the incremental debt financing ratio and the incremental equity financing ratio¹. Self-financing ratio (fixed assets) or SFR is defined as the ratio of net income change in fixed assets. It measures the capacity of net income to finance growth in fixed assets. The self-financing ratio (total assets) is defined as the ratio of the change in retained earnings to the change in total assets. It measures the capacity of increases in retained income to finance growth in total assets. The increase in retained earnings is equal to net income minus dividends declared during the year. The new equity financing ratio is the ratio of the change in stockholders' equity (net of change in retained earnings) to the change in total assets. It measures the degree of financing of total asset growth from new equity. This definition of capital includes all sources of capital including revaluation capital, a non-cash item. The incremental debt financing ratio is the ratio of the change in total liabilities to the change in total assets. It measures the degree of financing growth in total assets by additional debts (net of debt repaid during the year). Incremental equity financing ratio is the ratio of change in stockholders' equity to change in total assets. It measures the degree of financing growth in total assets by additional equity, consisting of internally generated capital (retained earnings) and new equity capital. The patterns of aggregate corporate financing for the non-financial sector are reviewed from 1989 through 1997. The analysis uses data from the combined profit and loss and balance sheet statements published by KLSE as performance statistics for its member companies. Analysis reveals the patterns of corporate financing based on historical fund flows in the non-financial corporate sector.

¹⁰ The author wishes to acknowledge Ms Lim Sue Lin for her contribution in this section.

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