Available online at www.sciencedirect.com

ScienceDirect

Procedia
Social and Behavioral Sciences

Procedia - Social and Behavioral Sciences 219 (2016) 580 – 588

3rd Global Conference on Business and Social Science-2015, GCBSS-2015, 16-17 December 2015, Kuala Lumpur, Malaysia

Foreign ownership, foreign directors and the profitability of Malaysian listed companies

Tee Peck-Ling*[a], Aik Nai-Chiek[a], Lim Chee-Seong[a]

[a]*Universiti Tunku Abdul Rahman, Faculty of Accountancy and Management, Lot PT21144, Jalan Sungai Long, Bandar Sungai Long, Cheras, 43000, Selangor, Malaysia.*

Abstract

With an overall panel of 4,176 firm-year observations drawn from a sample of 348 Malaysia listed companies over the period 1999-2010, fixed-effect panel data regression found that percentage of foreign equity ownership, appointments of foreign chairman and foreign chief executive director did not have any significant relationship with firm's return on equity (ROE). However, increase in percentage of foreign directors sitting on the board significantly improved ROE. Besides, only when foreign investors have dominant (above 50%) voting rights, ROE increased. Construction and wholesale trade sectors sub-panels showed the appointments of foreign chairman and foreign chief executive director negatively influenced ROE.
© 2016 The Authors. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).
Peer-review under responsibility of the Organizing Committee of the 3rd GCBSS-2015

Keywords: foreign chairman; foreign executive director; foreign equity ownership; return on equity; upper echelon theory

1. 1. Introduction

Inward foreign direct investment (FDI) plays a crucial role in capital formation and economic development, particularly in developing and emerging economies (Gorg & Greenaway, 2004). Since early 1990s, Southeast Asia has been one of the most attractive regions of FDI inflows, due to abundance of natural resources and relatively cheaper factors of production. The World Factbook (2009) reveals that Singapore is by far the highest ranked Southeast Asia country in terms of accumulated stock of inward FDI as at the end of year 2009 (ranked 16th in the world), followed by Thailand (34th), Malaysia (35th), Indonesia (41st), Vietnam (48th) and Philippines (60th). This is unsurprising because Singapore does not impose any restriction on foreign equity ownership and does not experience any political instability ever since its independence, unlike some of its regional neighbours. Realising the important contribution of inward FDI in the era of globalisation and intensified competition, Malaysian government has liberalised the regulations on foreign equity ownership in its local companies.

* Corresponding author. Tel.: +6-012-2657331
E-mail address: teepl@utar.edu.my, teepl888@gmail.com

1877-0428 © 2016 The Authors. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/).
Peer-review under responsibility of the Organizing Committee of the 3rd GCBSS-2015
doi:10.1016/j.sbspro.2016.05.037

In Malaysia, Foreign Investment Committee (FIC) has allowed foreign investors to hold up to 100% of a firm's equity in all manufacturing sectors during the period from 31st July 1998 to 31st December 2003, except for seven specified manufacturing activities. Prior to this, Industrial Coordination Act 1975 had capped foreign equity ownership in a company at 30%. Subsequently, in June 2003, Malaysia Industrial Development Authority (MIDA) permitted 100% foreign ownership on a permanent basis (Rajenthran, 2002).

Growing trend of globalisation and business expansion by multinational corporations (MNCs) has prompted more studies on foreign ownership structure in developed economies such as United Kingdom (Harris, 2002) and Japan (Kimura & Kiyota, 2007), as well as developing and emerging economies such as India (Chhibber & Majumdar, 1999), Argentina, Brazil, Chile, Colombia and Peru (Pressman, 2004), China (Greenaway, Guariglia & Yu, 2009) and Indonesia (Takii, 2004). However, similar studies on Malaysian firms were very limited. Detragiache and Gupta (2004) is the nearest study of foreign ownership in Malaysia, nevertheless it is conducted on banks rather than non-financial firms. Foreign ownership of banks in Malaysia is separately regulated by Bank Negara Malaysia instead of MDA.

Besides providing some new empirical evidence on the effect of foreign equity ownership on firm's profitability in Malaysia, this paper also aims to explore on whether the appointments of foreign chairman and foreign chief executive director as well as the presence of foreign directors on the company's board of directors influence firm's profitability. Most of the previous studies of foreign ownership structure have overlooked the possibility that executive directors who actually control the daily operations and strategic decision makings might have maximised personal wealth at the expense of shareholders. Studies carried out by Chien (2008) in Taiwan and Masulis, Wang and Xie (2011) in the United States were the only exception. To close out research gap left out by previous researches, this paper ponders to answer the following research questions: (i) does foreign equity ownership influence firm's profitability?; (ii) does a non-linear relationship exist between different categories of foreign equity ownership (below 20%, between 20% to 50%, and above 50%) and firm's profitability?; (iii) are foreign chairman, chief executive director and directors valuable advisors who enhance firm's profitability or ineffective monitors who jeopardise firm's profitability?; (iv) does the effects of foreign equity ownership and presence of foreign directors on firm's profitability vary among different SIC-defined sectors in Malaysia?

2. Literature Review

With various competing theories of how foreign ownership and presence of foreign directors affect firm performance, empirical evidences from previous studies were somehow mixed. Internalisation theory, resource-based theory and upper echelon theory generally predict positive influence, whereas agency theory and rescue acquisition hypothesis predict the opposite.

Internalisation theory, developed by Rugman (1981), explained that MNCs will benefit from creating their own internal market where intra-group transactions can be carried out at lower cost and hence increase profit. Generally, local firms are more knowledgeable about local market, consumer preferences and business practices, thus foreign owners must possess some specific advantages such as managerial expertise or technological advancement in order to be able to compete with them. These intangible assets will be transferred through internalisation and expansion abroad, leading to higher profitability and productivity of foreign-owned firms compared to domestic-owned firms in a host country. Blomström and Kokko (1998) supported internalisation theory, where they concluded that transfer of technology from foreign owners had contributed to higher operating efficiency of domestic firms, through introduction of new know-how and transfer of techniques for inventory and quality controls. Besides that, Dunning (1977) claimed that possession of knowledge is the necessary advantage for a firm to become a multinational and internalise it to improve profitability.

Building a stronger foundation to resource-based theory developed by Wernerfelt in year 1984, Barney (1991) used VRIN model to explain that for a firm to have sustainable competitive advantage in the long run and achieve above average profits, its bundle of resources have to be value-creating, rare, inimitable and non-substitutable by competitors. In today globalized business environment, a firm's access to valuable resources such as cheaper cost of capital, larger customer base, reliable suppliers and strategic business partners could be enhanced through personal networks of its foreign owners and foreign directors. Study by Pfaffermayr and Bellak (2000) found that foreign-owned firms generally possess greater amount of financial capital than domestic-owned firms, thus more likely to set up research and development department to develop better innovative products which suit consumers' needs at greater production

Download English Version:

https://daneshyari.com/en/article/1108065

Download Persian Version:

https://daneshyari.com/article/1108065

Daneshyari.com