Institutional Ownership and Corporate Sustainability Reporting in Malaysia

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ABSTRACT

This study investigates the influence of institutional ownership between family ownership and corporate sustainability reporting. Content analysis was used to analyze the Annual reports of 771 listed companies from 2014 to 2016. Two theories were applied in this study: agency theory and signaling theory for the predictions. The study found that family ownership is negatively related to corporate sustainability reporting. However, the relationship is weakened by the presence of institutional ownership in a family-owned company. This finding shows that institutional ownership able to influence the relationship between family ownership and corporate sustainability reporting. The results of this study can be used as a reference by regulatory bodies to further investigate the means as to how the institutional investor can further contribute toward CSR initiatives. The institutional investors have inherent authorities and decision-making power that are expected to provide inputs to authorities especially in factors that could enhance corporate sustainability reporting primarily in family-owned companies.

Keywords: Sustainability reporting, Family ownership, Corporate governance, Independent director

INTRODUCTION

Corporate sustainability reporting (CSR) has become increasingly important among listed companies to ensure the long-term viability of the company as well as provide a strategic platform for companies to interact with stakeholders such as consumers, employees, and the community (Coluccia, Fontana & Solimene 2017). Corporate sustainability reporting is defined by Bursa Malaysia (2015) as the company's commitment to operating in a socially, environmentally, and economically sustainable manner while balancing the interests of various stakeholders. According to the GRI 2013, corporate sustainability reporting consists of three dimensions such as social sustainability reporting, environmental sustainability reporting, and economic sustainability reporting. Many efforts have been taken by government to encourage the listed companies to report their corporate sustainability reporting in the company's annual report (Ministry of Finance 2006). The initiatives include tax relief and amendments to the Code of Corporate Governance in 2001, 2007, 2012, and 2017 are seen as ongoing efforts made by the government to improve the practice of Corporate Governance by publicly listed companies in Malaysia.

Malaysia has a centralized ownership structure in which the family owner is a "dominant" shareholder in a listed company in Malaysia (Mustapha & Che Ahmad, 2011). Agency conflicts arise when controlling shareholders or their family members are directly involved in the management and have high equity and control over the company. There is a possibility of agency issues arise between principals and principals or conflicts of agency-level II (Liew et al.2014). The family owner manages and controls the company in the interests of their own and neglects the interests of minority shareholders (Filatotchev, Zhang, & Piesse 2011). These include ways of obtaining personal benefits through managers (Gomez-Mejia, Nunez-Nickel, & Gutierrez, 2001; Shleifer & Vishny, 1997), related party transactions (Liew et al., 2014), excessive salaries or perks for members family or insider (Bhaumik & Gregoriou, 2010; Lim & Yen, 2011). Therefore, family owners have more access to information than minority shareholders (Hafiza Aishah Hashim 2011). Company managers seek opportunities that benefit their own family owners by avoiding high-cost social investments such as the CSR (Chan, Watson & Woodliff 2014).

Malaysia has a relatively low level of investor protection and less developed capital markets (Claessens et al., 2000; La Porta, Lopez-De-Silanes, & Shleifer, 1999). Institutional investors have been suggested by classical agency theory (Fama & Jensen, 1983) and recent studies as effective monitoring mechanisms to reduce conflicts between company owners and minority shareholders (Securities Commission Malaysia, 2012). Institutional investors are among the largest shareholders of listed companies in Malaysia. They have the power to vote and have the ability to influence senior management of family-owned companies in the decision-making process such as corporate sustainability reporting as it will enhance investment opportunities and give them a competitive edge in the market. In 2018, foreign investment in Malaysia was 614.7 billion in the third quarter of 2018 compared with 590.3 billion recorded in the second quarter of 2018 (Department of Statistics Malaysia 2018). Institutional investors are said to have the ability to influence family-owned companies as institutional investors have easy access to the company's internal information, enabling them to perform supervisory duties within the company (Bae et al. 2018). The presence of institutional investors in family-owned companies is expected to alleviate agency problems that exist between family owners and minority shareholders.

This study focuses on family ownership in Malaysia as the majority of companies listed on Bursa Malaysia comprise 45% of family-owned companies (Carney & Child, 2013) and contribute to 67% nominal GDP (Fan et al. 2011). Thus, this study was conducted to investigate the relationship between family ownership and corporate sustainability reporting and whether institutional ownership affects those relationships. The first objective of this study is to examine the relationship between family ownership and corporate sustainability reporting. Second, institutional ownership plays a role in influencing firms to reduce agency costs and information inequities by reporting corporate sustainability. This study, therefore, seeks to see whether institutional ownership moderates the relationship between family ownership and CSR. This study differs from previous studies because although there are studies on the relationship between family ownership and CSR, the findings are mixed. It shows that there might be other factors that will influence the relationship between family ownership and corporate sustainability reporting. Therefore, this study proposes institutional ownership as moderators in these relationships which have not been explored in previous studies. Second, this study uses a sample of public companies listed on Bursa Malaysia, thus the findings of this study will enrich the literature on the relationship between family ownership and CSR from the perspective of developing countries such as Malaysia. Third, the findings of the study may provide evidence on how institutional ownership can play a role in the decision-making process in influencing family-owned companies to provide better CSR reporting. The remainder of the paper is organized as follows. Section two presents the relevant theories and hypothesis

development, followed by a discussion on research methods. Next, this paper reports the findings and discussion, and the final sections is the conclusion.

THEORY AND HYPOTHESIS DEVELOPMENT

Agency theory has emerged since the 1970s to address the conflict between owners and managers and to suggest possible solutions (Nurul Yasmin et al. 2017). Agency theory describes the principal-agent conflict between the owner and the management of the company that is more prevalent in developed countries. The second stage (type II agency theory) describes the principal-principal conflict between majority and minority shareholders that are more prevalent in developing countries (Claessens et al. 2002). The structure of ownership in Malaysia is more concentrated, which is based on type II agency theory where conflict of interest exists in family-owned companies between majority shareholders and minority shareholders (Ali, Chen & Radhakrishnan 2007).

Family Ownership and Corporate Sustainability Reporting

Concentrated ownership is a common ownership structure found in most East Asian countries (Chau & Gray 2002). According to Ghazali and Weetman (2006), the presence of family members on board can reduce agency problems as family members have greater control over the management of the company, have equity interests in the company, and have a longer-term investment horizon than other investors. Shamsul Nahar Abdullah et al. (2011), and Haniffa and Cooke (2002) find that family-owned companies are less likely to make voluntary reporting because the information is available internally when most managers are also family members. This will increase the information gap between family owners and minority shareholders. Majority shareholders make policies based on their interests when they have the largest shareholder in the company (Oh & Chang 2011). The decision was made to maximize their wealth by disregard the interests of minority shareholders (Shamsul Nahar et al. 2011). Therefore, the proposed hypothesis is:

H1: Family ownership is negatively related to the level of corporate sustainability reporting in Malaysia..

Institutional ownership in the relationship between family ownership and corporate sustainability reporting.

Institutional investors play a role as governance mechanisms that oversee managerial activities as well as ensure good governance practices (Afzalur Rashid 2018; Salloum & Azzi 2013). Institutional investors have a large equity stake in most companies that enable them to play an important role in corporate governance (Majeed, Aziz & Saleem 2015). As such, they have an incentive to monitor the shares they own against other investors, especially those involving high business costs. Institutional investors are also expected to provide insights and advice to corporate management including issues related to social responsibility (Mallin et al. 2013). The presence of institutional ownership in the company is expected to affect the relationship between family ownership and corporate sustainability reporting. Institutional ownership is therefore expected to weaken the negative relationship between family ownership and corporate sustainability reporting in Malaysia. Therefore, the proposed hypothesis is:

H2: Institutional ownership weakens the negative relationship of family ownership with corporate sustainability reporting.

METHODOLOGY

The total sample for this study was 771 company-year for three years i.e. from 2014 to 2016 (a balanced panel of 260 companies per year) as they are the most recent corporate sustainability reporting information conducted in accordance with the latest corporate sustainability reporting framework released by Bursa Malaysia in 2015. The company data obtained from Bursa Malaysia included information on 161 family firms and 96 non-family firms. This method is consistent with previous studies such as Clarkson et al.(2008) and Aras et al. (2010). The independent variables are measured using a dummy variable that is one (1) if the firm is a family firm and zero (0) otherwise. The measurement of institutional investors as a moderating variable is calculated based on the percentage of more than five percent (Eng and Mak, 2003). The control variables are the board size, CEO duality, company size, female director and profitability.

Research Model

Regression analysis models are conducted to provide empirical evidence of how institutional ownership influences family ownership and corporate sustainability reporting relationship. The dependent variable in this study is corporate sustainability reporting (CSR). The independent variable is family ownership, board size (BSIZE), CEO duality (DUAL), company size (CSIZE), profitability (PRFT), and female director (FD). The model used in this study is as follows (Dharmadi & Sodikin 2013).

Model 1

$CSR_{it} = \beta o + \boldsymbol{\beta_1 FF_{it}} + \beta_3 BODSIZE_{it} + \beta_4 DUAL_{it} + \beta_5 CSIZEB_{it} + \beta_6 PRFT_{it} + \beta_7 FD_{it} + \epsilon$…………………….….(1)

Model 2

$CSR_{it} = \beta o + \beta_1 FF_{it} + \beta_2 IO_{it} + \boldsymbol{\beta_3 FF_{it} * IO_{it}} + \beta_4 BODSIZE_{it} + \beta_5 DUAL_{it} + \beta_6 CSIZE_{it} + \beta_7 PRFT_{it} + \beta_8 FD_{it} + \epsilon$……………………….(2)

Where:
CSR = Corporate sustainability reporting
FF = Family ownership
IO = Institutional ownership
BODSIZE = Board of director size
DUAL = CEO duality
CSIZE = Company size
FD = female director
PRFT = Profitability
β_1-β_{10}= Regression Coefficient
Є = Model Error

EMPIRICAL RESULTS AND DISCUSSION ON FINDINGS

Correlation analysis

Table 1 reports the correlation analysis for the study. The interaction between the family firm and institution are negatively correlated. Board size, duality, and company size are positively associated with CSR disclosure. The positive association shows the ability of these variables

to help improve the quality of CSR disclosure. The correlation coefficients among other independent variables show a value of less than 0.4. It shows that the multicollinearity issue is still under control as the correlations are below 0.80.

Table 1: Correlation Test (N=771)

	CSR	FF	BODSIZE	CSIZE	FD	DUAL	PRFT
CSR	1						
FF	-0.154**	1					
IO	0.66	0.071*					
FFXIO	-0.150**	0.560**					
BODSIZE	0.219**	0.054	1				
DUAL	0.085*	0.165**	0.041	1			
CSIZE	0.247**	0.022	0.053	0.282**	1		
PRFT	0.059	0.362**	0.182**	0.027	0.102	1	
WD	0.003	0.060	0.051	0.053	0.027	0.046	1

**Correlation is significant at 0.01 level
* Correlation is significant at 0.05 level

Notes:
Corporate sustainability reporting is measured using social sustainability reporting guidelines based on the Global Reporting Initiative. IO = Institutional ownership (shareholding owned by institutional investors in a company), BSIZE = Board size (ratio of directors), DUAL = Chief executive officer (1 = chief executive officer, 0 = vice versa), CSIZE = Company size (log of total assets), PRFT = Profit (total profit after tax / total assets), FD = Female director (1 = female director, 0 = and vice versa).

Regression analysis

Table 2: Result Regression Analysis Model

	Model 1	Model 2
Constant	-2.711	3.069
FF	-0.182(-4.930)***	-0.147(-2.228)
IO		0.216 (4.008)***
FFXIO		0.262(4.905)***
BODSIZE	0.169 (4.757)***	0.154(4.367)***
DUAL	0.165(4.262)*	0.093(2.727)*
CSIZE	1.192(5.324)***	0.187(5.278)***
PRFT	-0.026(-0.705)	-0.025(-0.699)
FD	-0.007(-0.210)	-0.008(-0.223)
R^2	0.120	0.112
R^2 Adjusted	0.119	0.132
F Value	8.442	16.283
P Value	0.000	0.000

Note *** significant at 0.01, ** significant at 0.05, significant at 0.1

Table 2 shows that the model explains only 15% of the relationship. The findings from regression analysis (Table 2) show a negative and significant relationship (model 1 to model 2) between family ownership and corporate sustainability reporting. The findings from the analysis of model 1 conducted (Table 2) found that family ownership (FF) had a negative relationship ($\beta = -0.182$; $t = -4.930$) and was significant at a $P < 0.05$ value with corporate sustainability reporting. Table 2 also shows that model 1 is significant at $p = 0.000$ with F value of 8.442. The adjusted R^2 value was 11.9% (0.119) explaining that only 12% of the relationships were explained by the variables tested in this study. Table 2 indicates that family ownership has a significant negative relationship with sustainability reporting. Hence

hypothesis 1 is accepted. The finding suggests the higher family ownership in listed companies, the lower level of sustainability reporting. The findings of this study support the theory of the second type of agency that states that there is a conflict between the principal (family owner) and the principal (minority shareholder). The results are also consistent with previous studies in Malaysia such as Nazli Anum Mohd Ghazali (2007) and Darmadi & Sodikin (2013). However, this decision is not in line with socio-emotional wealth theory which argues that family relationships in family-owned companies can improve practices and reporting of more sustainable information. This result also shows that the characteristics of family ownership in Asia are different compared to those of western families with strong love and family ties and loyalty to the company (Campopiano & De Massis 2015).

The regression model 2 (Table 2) showed that there was a negative relationship ($\beta = -0.147$; $t = -2.288$) and significant at the $p < 0.05$ level between family ownership and corporate sustainability reporting. When the interaction variables between family and institutional ownership (FF * IO) were included, the study showed a positive relationship ($\beta = 0.262$; $t = 4.905$) and significant at the $p < 0.01$ level with corporate sustainability reporting. This indicates that the presence of institutional ownership influences corporate sustainability reporting in family-owned companies. Therefore, the second hypothesis is accepted.

The findings of this study are consistent with previous studies such as Ali et al. (2007), Chau and Gray (2002), Chen and Hsu (2009), Ho and Wong (2001), Mahmood et al. (2018), Young and Marais (2012). This indicates that family-owned companies are less likely to disclose corporate sustainability in Malaysia. This may be due to the weakness of the legal system in the country which was found to be inadequate to protect the interests of minority shareholders, resulting in their lack of corporate sustainability reporting, including in Malaysia (Hassan 2009). However institutional ownership influences the relationship between family ownership and sustainability reporting. This is consistent with other prior studies such as Nirwanto, Mirza, Zulaikha and Rahardja (2011) and Mustaruddin Saleh et al. (2010) who found that institutional ownership and corporate sustainability reporting in Malaysia were positively related. This indicates that institutional ownership influences corporate sustainability reporting by listed companies in Malaysia.

The finding shows that corporate sustainability reporting is an important source of institutional investors in making a decision to invest in a company (Mustaruddin Salleh et al. 2010). This is also in line with agency theory that institutional investors can oversee and encourage more information reporting including corporate sustainability reporting because institutional investors have high equity in the company (Ntim et al. 2013). The value of the company increases as the company makes additional reporting such as corporate sustainability reporting to increase the credibility of the company while reducing the information gap with outsiders (Connelly et al. 2011; Mahoney 2012). This indicates that institutional ownership reduces the negative impact of family ownership on corporate sustainability reporting.

There are five control variables tested in model 1 where only the board size, duality, and company size have significant relationships with sustainability reporting. Board size has a significant value at $p < 0.01$ with a coefficient of 0.169 (4.757). This shows that the more directors in the company the higher the percentage of corporate sustainability reporting. Larger board members reduce existing agency problems due to a variety of communication skills and knowledge (Elinda Esa & Nazli Anum Mohd Ghazali 2012), which in turn increases the company's transparency in reporting on corporate sustainability. Duality also had a positive relationship ($\beta = 0.165$; $t = 4.262$) and was significant at the $p < 0.01$ level. This study is in line with the study of Sundarasen et al (2016) who found that separation of leadership will lead to a higher level of CSR and disclosure of information. The size (CSIZE) of the company was positively related ($\beta = 1.192$; $t = 5.324$) and significant at the $p < 0.01$ level. Company size is positively and significantly related to corporate sustainability reporting. This indicates that the

size of the company is one of the important factors that influence corporate sustainability reporting. Studies have found that large companies are reporting more information in annual reports to meet the demands of stakeholders (Darmadi & Sodikin 2013).

CONCLUSION

The objective of this study is to examine if there is any relationship between family ownership and CSR and whether institutional ownership could moderate the relationship. The analysis shows there is a negative relationship between family ownership and sustainability reporting. The results are consistent with agency theory that the interests of family owners may be in conflict with the interest of other stakeholders. Decision making in a family-owned company comes from a family member with authority in the company. Family members are more interested in strengthening the company's financial performance than considering the social, environmental, and economic sustainability effects (Faller & Zu Knyphausen-Aufseß 2016; Oh et al. 2011; Nekhili et al. 2016). This is contrary to the socio-emotional theory that states that family-owned companies are more likely to make CSR reporting because they not only consider financial aspects but also take into account non-financial aspects based on family ties, maintaining the company's long-term reputation and social engagement with various stakeholders. they create more CSR reporting (Ding & Wu 2014). On the other hand, decision making by family-owned companies in Malaysia is controlled by family members. They are seen as lacking in accountability and visibility, making them less active in CSR reporting (Khan et al. 2013).

In contrast, the presence of institutional ownership affects the interests of family owners and minority shareholders. Institutional investors are found to influence CSR in family-owned companies in Malaysia. This is in line with the theory that companies will increase CSR as a signal to stakeholders that the company has a good reputation and image (Harjoto & Jo 2011). This supports the theory of stage II agency which states that there are problems between principals and principals in family-owned companies. The findings confirm a recent study that family-owned companies in Malaysia are still confidential because of the lack of a tendency to report additional information such as corporate sustainability reporting to stakeholders. The findings of this study are expected to provide opportunities for future research on corporate sustainability reporting, especially in other developing countries. The study hopes to raise awareness of the company's top management that the company's goal is not only to maximize profits but that the company also has the responsibility to make corporate sustainability reporting to meet the needs of the stakeholders.

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