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RESEARCH ARTICLE

Ownership Concentration and Share Repurchase: Evidence from Malaysia

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Abstract

This study presents the impact of ownership concentration on share repurchase for Malaysian listed companies by using the pooled panel data analysis for a period of six years (2005 to 2010). The result shows concentrated ownership is insignificant in influencing company share repurchase decision. On the other hand, The larger the size of company, the more they intend to do share repurchase. While high debt and older firms prefer to have low share repurchase.

Keywords: *Board governance mechanism, Ownership structure and remuneration, Share repurchase.*

JEL Classification: G32, G35, G39

Background of Study

Share repurchase has becoming a preferred choice by companies both in United States and European countries. Eije and Megginson [1] studied cash dividend and share repurchases from year 1989 to 2005 of 15 nations, which were the members of European Union. It was found that the number of European companies that pay dividends has declined similar to the United States although the total real dividends paid increased and share repurchase surged.

Malaysian stock market was deeply hit during the Asian Financial crisis in 1997. As a strategy to regain investors' confidence, share repurchase or stock buyback was actively traded ever since the crisis. Share repurchase offers an opportunity to the investors to enjoy capital gain when the share prices are perceived to be undervalued. With less number of shares outstanding, share repurchase would drive up share prices [2]. The share repurchase transaction would then be reported in the financial statement as stipulated by Malaysian Accounting Standard Board (MASB) in April 1999, through a 'share-buy back accounting and disclosure' circular.

It is also observed that many companies in Malaysia practiced share buyback program during the global economic crisis in 2008 and 2009. Based on the report by The Star in January 30, 2010, share repurchase in Malaysia has been at increasing trend from 12 companies practicing share repurchase in 1999 to 196 companies in 2010. Dialog Group Bhd, IGB Corp Bhd, Multi-Purpose Holding Bhd, QL Resources Bhd, and YTL Corp Bhd. were some of the companies which actively exercising shares buyback. When companies make buybacks, they expect to sell their shares back at a higher market value. Dialog Group Bhd bought back 20,000 of its own shares at RM0.845 each on Feb 25, 2009. The shares buyback program has helped to increase its market value; Dialog's share price went up to RM1.33 per share as at October 16, 2009.

Many public listed companies in East Asian countries including Malaysia have high concentration of ownership in the hands of a single large shareholder or a group of shareholders as controlling owners [3-5]. A large shareholder as a controlling owner found in East Asian countries is inconsistent with the concept of the separation of ownership and control pointed out by Berle and Means [6].

Research on share repurchase in Malaysia is mostly focusing on ownership concentration and dividend payout or firm value [7-9]. As evidenced by Maury and Pajuste [10], companies may experience lower dividend payouts when CEOs who are controlling large number of shares may become entrenched and decide on low dividend payouts. Therefore, it is interesting to examine the influence of concentrated ownership firms on share repurchase decision.

Empirical Reviews and Hypothesis

Earlier studies indicated the preference of companies on share repurchase over dividend payment. Most of firms substituted dividend with share repurchase because repurchase adjusts quickly to earnings change [11]. It is argued that there is positive relationship between strong shareholder right and share repurchase [12]. With strong shareholder right, managers are forced to disgorge cash in the form of share repurchase with reduced intention for self-interest. Jain et al. [13] have researched on the choice of payout initiation mechanism for IPO companies. The authors show that IPO companies prefer share repurchase instead of dividend as initiation mechanism. According to Brennan & Thakor [14] if the effective personal income tax rate on dividends is not too high, shareholders with sufficient low ownership holding will prefer dividends, whereas those with sufficiently high ownership holdings (and high tax rate) will prefer repurchases.

One of the main purposes of share repurchase is to discourage unfriendly takeovers [15]. With repurchase, firm value increases and consequently, the potential acquirer will need to pay a higher price in order to pursue the takeover activities [16]. Therefore, share repurchase may help to protect incumbent controlling shareholders from takeover attempt or even without any takeover threats. According to Joh and Ko [17], when high insider ownership buys stocks, it lowers free cash flows. In a situation of lower free cash flows, the firm would be less likely to waste resources on negative NPV projects. Therefore, stock repurchases can be beneficial to shareholders.

Share repurchase is also responded by the capital market in with different perception subject to the motive of the repurchase. They would respond positively if that share purchase is exercised for value enhancing reasons or reducing agency problems. This is consistent with Ikenberry and Vermaelen [18] who argued that managers who are concerned about shareholder wealth in the long term tend to buy back shares. However, if the main reason is to protect controlling shareholders, it is expected that entrenched controlling shareholders would be more likely to engage in value destroying activities. Therefore, the market would respond to the news negatively.

Based on non-financial public listed companies' data from 2002 to 2006, the author signifies that companies make higher dividend payouts as the shareholding of the largest shareholder increases. In addition, the author also reports that dividend payout also increases when there is a presence of a second largest shareholder in the company. As indicated by Claessens et al. [3], La Porta et al.[4] and Faccio et al., [5] ownership structure in Malaysia is highly concentrated. Therefore, in protecting these incumbent controlling shareholders, firms with higher payouts are expected to increase share repurchase. In this setting, it is hypothesized that there is a positive relationship between concentrated ownership and share repurchase.

Methodology

This research use the data from Datastream and the annual report of companies listed on the main board of Kuala Lumpur Stock Exchange (Bursa Malaysia) from 2005 to 2010. Information on ownership is extracted from the companies' annual reports and. Datastream is used to collect information regarding Return on Equity (ROE), Market-to-Book Equity Ratio (MTBV), Firm Size (FZ) and Debt to Equity Ratio (LEV). From the original population, companies which do not have complete data, financial institutions, disposed off or taken over, and under PN4 and PN17 during the period of study will be excluded from the sample.

During the period under study, out of 682 companies in the Main Board, there were 327 companies with complete data on total payout. In order to analyze the factors that influence share repurchase, we only take into account companies that have complete data on share repurchase during the period of the study. Thus, finally only 71 companies are examined. Pooled panel regression analysis is used to measure the relationship of all the variables with the share repurchase with 426 observations.

$$Y_{it} = \beta_0 + \beta_1 X_{it} + \beta_2 X_{it} + \ldots + \beta_n X_{it} + \varepsilon_{it} \quad (1)$$

Where i denotes the firm (cross section dimension) and t denotes time (time series dimension). Therefore, Y_{it} is the dependent variable of pooling N cross sectional observations and T time series observations, and X_{it} s are the independent variables pooling N cross sectional observations and T time series observations. B_0 is the constant term or intercept across cross sectional observations, and ε_{it} is the error term.

Previous researchers have employed several techniques as a proxy in measuring ownership concentration. According to Short [19], the earliest study to describe ownership structure was conducted by Berle and Means [6] based on binary variables (known as dichotomous variables, or fixed rules). The authors used certain cut-off points to measure larger shareholding. For example, Strimling and Mirakhor [20] used a cut-off point to distinguish between owner and management controlled firms. A company is classified as managerial controlled if shareholders hold not more than 5% of company shares, whereas, a company will be classified as owner controlled if shareholders hold more than 20% of company shares. However, Bothwell [21] used a different cut-off point, where a company is in managerial control if there is less than 10% holding and owner controlled if the holding is more than 30% company shares. Thus, when a cut-off point is used to measure ownership structure, several problems may occur such as the measurement has arbitrary cut-off points, which depend on the judgment of the researchers [19]. Dichotomous variables or fixed rules are unable to produce significant result and are not suitable to measure ownership structure [22]. According to Soboleva [23], concentration ratios and Herfindahl index can be used to measure ownership concentration. Hence, this study employed these two methods as measurement for ownership concentration.

Soboleva [23] stated that concentration ratios are the cumulative shares of *n* largest holdings, and it is the easiest method to calculate ownership concentration. The concentration ratio of 5 (CR5) which is measured by the percentage of shares owned by largest shareholder (Top1) divided by sum of shares of top five shareholders (Top5) as applied by Mat Nor and Sulong [7]. According to Khan [24], ownership concentration that is based on Herfindahl index can be measured based on total shares owned by the largest five shareholders. Herfindahl index is the sum of the squares of shares held by largest five shareholders.

The empirical model used in this study can be described as follows:

$$SR_i = \beta_0 + \beta_1 HI5 + \beta_2 CR5 + \beta_3 MTBV + \beta_4 RK + \beta_5 ROE + \beta_6 FZ + \beta_7 LEV + \beta_8 AGE + \varepsilon_{it} \qquad (2)$$

Where; β_0 = constant term; *SR* = Share Repurchase for firm I; *HI5* = Concentration based on Herfindahl Index; *CR5* = Concentration ratio; *MTBV* = Market-to-Book Equity Ratio; *ROE* =

Return on Equity; *FZ* = Firm Size; *LEV* = Leverage; *AGE* = Firm Age.

Table 1: Description of variables

Variables	Authors
Share Repurchase (SR) = Log (Total amount paid to repurchase shares)	Oswald and Young [25]; Eije and Megginson [1]
Concentration p The squared of sum of shares of largest top five shareholders. (HI) $Herf\_Index = \sum_{i=1}^{5} r_i^2$ Concentration ration 5 (CR5) $CR5 = Top1/Top5$	Fazlzadeh et al. [26]; Sulong and Ahmed [27]
Market-to-book equity ratio (MTBV) = Market value of equity / Book value of equity	Skinner [11]; Linck [28]; Adjaoud and Ben-Amar [29].
Risk (RK) Dummy 1 if BBB and above, 0 otherwise.	Guedes and Opler [30]; Opler et al. [31].
Profitability Return on Equity (ROE) = Net Income / Shareholder Equity	Ling et al. [32]
Firm Size (FZ) The logarithm of total assets	Jiraporn [12]; Ahmed and Javid [33];
Leverage (Lev) Debt to Equity Ratio	Sanders and Carpenter [34].
Firm Age (Age) The logarithm of listing age	Linck et al. [28]; Sulong and Ahmed [27]

Findings

Descriptive Statistic

Table 1 presents the descriptive statistics for variables used in the study for the period 2005 to 2010. On average, during this 6-year period, share repurchase records RM16,192,723 in total payout with maximum payout at RM108 million and minimum at RM81 million. The concentrated ownership is based on two measurements which are herfindahl index (HI5) and concentration ratio (CR5). Both measures show that the average (median) percentage holding for few individuals is 50.6 percent (49.52 percent) and 51.26 percent (46.19 percent), respectively. It shows that companies that are involved in share repurchase during 2005 until 2010 are tied to concentrated ownership

Table 2: Descriptive statistics

Variables	Mean	Median	Maximum	Minimum	Standard Deviation
SR (RM)	16,192,723	1,345,524	108,000,000	81.00	85,329,362
HI5 (%)	50.6	49.52	82.55	16.05	15.68
CR5 (%)	51.26	46.19	93.88	22.26	19.00
RK	0.13	0.00	1.00	0.00	0.34
MTBV	1.22	0.86	25.72	(38.57)	2.79
ROE (%)	9.83	9.94	74.71	(52.66)	10.28
FZ	8.91	8.81	12.46	6.18	0.64
LEV (%)	55.91	34.44	376.46	0.00	65.34
AGE (Year)	16.10	12.93	47.34	0.41	10.24

As for Market-to-Book Equity value (MTBV), the average (median) is 1.22 percent (0.86 percent) with 25.72 percent being the highest Looking at companies' profitability, it showed on average (median) percentage of return on equity (ROE) of 9.83 percent (9.94 percent), with as high as 74.71 percent profitability. However, during this time overall average is at 55.91 percent. As for, the age of firm listed in Bursa Malaysia, the oldest is 47.34 years with an average of approximately 16 years.

Regression Result

Table 3 reports the regression result with F-statistic is significant at 1 percent level. The results showed that concentrated ownership is insignificant to influence repurchases decision in both methods, thus the hypothesis is rejected. It showed that concentrated ownership firms in Malaysia are not influencing share repurchase decision. This may be consistent with the prior results obtained by Sulong and Mat Nor [35] based on Malaysian listed firms for year 2002 until 2005. The findings showed that a company with high concentrated ownership is more willing to monitor managers to avoid agency problem through the distribution of profit as dividend payout to shareholders.

Table 3: Panel regression result on share repurchase

Independent Variable	Coeff	S.E
CONSTANT	4.728	2.961
HI5	-0.103	0.200
CR5	0.001	0.010
MTBV	-0.004	0.025
RK	0.367	0.361
ROE	-0.007	0.011
FZ	0.421**	0.192
LEV	-0.002*	0.001
AGE	-2.081***	0.811
R^2	0.549	
Adjusted R^2	0.447	
F-Statistics	5.406***	
DW	1.94	

The result from this study is also inconsistent with the entrenchment hypothesis proposed by Morck et al. [36] which stated that when owners hold a large portion of company shares, it creates enormous controlling power. In this situation, there is higher tendency for the majority shareholder to generate private benefits at the expense of minority shareholders. Thus, this type of company may announce high amount of share repurchase to avoid agency problem. In terms of company size, it is positively related to share repurchase and total payout. This indicates that large-sized firm focus more on these share repurchase. On the other hand, the higher the company's debt level and the older the company is, the higher the tendency that the company will reduce its share repurchase to shareholders [37-46].

Conclusion

This paper employed two measurement of ownership concentration namely her findahl index (HI5) and concentration ratio (CR5). Contrary to our hypothesis, both measure of ownership concentration show insignificant association with share repurchase in different sign of coefficient. Based on 72 Malaysian companies from year 2005 to 2010, herfindahl index (HI5) is negatively insignificant in explaining share repurchase in Malaysia. Though concentration ratio (CR5) is positively influencing share repurchase, the relationship is insignificant.

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