

Controlling Shareholders' Proxy and Multiple Directorships: Insight Evidence from Related Party Transactions

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ABSTRACT

This study examines the association between controlling shareholders' networks (i.e., controlling shareholders' proxy (CSProxy) and controlling shareholders' multiple-directorships (CSMultiD)) and related-party transactions (RPTs), particularly involving controlling shareholders' interests (RPT-conflict). This study also examines the impact of interaction between CSProxy and CSMultiD on firm engagement with RPTs, and RPT-conflict. The hypotheses are tested using a sample of 548 listed companies in Malaysia over the period 2012-2014 with a total of 1,550 observations. The results show that CSProxy is not associated with RPTs, and RPT-conflict. The CSMultiD is also not associated with RPTs. However, it has a positive relationship with RPT-conflict. Additionally, an interaction between CSProxy and CSMultiD increases the likelihood of firms to engage and disclose more RPTs; in contrast, it discloses lower magnitude of RPT-conflict. The opportunistic controlling shareholders may exploit their conflict of interest for private benefits by hiding their intention behind the RPTs. Overall, these findings provide partial empirical support to the argument that controlling shareholders seek to use their network relationship to influence firms to engage with related parties. These findings raise concerns to the regulators and policy makers, specifically on the ability of the controlling shareholders in utilizing their position and networks opportunistically to expropriate firm resources for personal purposes.

Keywords: controlling shareholder; proxy; multiple directorship; related party transactions; RPT-conflict

INTRODUCTION

Prior evidence showed that controlling shareholders are associated with opportunistic activity to expropriate the wealth of minority shareholders, specifically through related party transactions (RPTs) (Abdul Wahab, Haron, Char, & Yahya 2011; Ariff & Hashim 2013; Dahya, Dimitrov, & McConnell 2008; Munir, Mohd-Saleh, Jaffar, & Yatim 2013). RPTs are performed to enhance a company's daily business operation efficiency (Cheung, Rau, & Stouraitis, 2006; Dahya et al. 2008). However, the use of RPTs as tools to maximize controlling shareholders' personal benefits is more prominent (Ariff & Hashim 2013; Cheung et al. 2006; Johnson, Boone, Breach, & Friedman 2000; Kohlbeck & Mayhew 2010), particularly among family controlled firms (Villalonga & Amit 2006). The ability of controlling shareholders to abuse RPTs is based on theoretical assumption that they benefit from the advantages of concentrated ownership to exercise control through their dominant voting rights (Claessens, Djankov, & Lang 2000).

The dominant voting rights provide the privilege of controlling shareholders to influence any decision made by the entities. They can maintain a control over a chain of firms by positioning themselves as a chief of executive officer

and family members as executive directors on the board (Villalonga & Amit 2006). Controlling shareholders also may become an executive chairman, which usually called as CEO duality (Mohd-Saleh, Iskandar, & Rahmat 2005). In contrast, if the founders or controlling shareholders sit as non-executive chairman, they can appoint their proxies to the executive board, including their family members. The dominant voting rights are claimed to increase the ability and flexibility of controlling shareholders to engage and even abuse RPTs. Controlling shareholders can hide their personal interests behind legal transactions (Gordon, Henry, Louwers, & Reed 2007; Kohlbeck & Mayhew 2010). Nevertheless, no direct empirical evidence has shown that controlling shareholders utilize their social network¹ to engage in RPTs. This gap motivates this study to examine the ability of controlling shareholders to utilize their network relationship to engage in and disclose RPTs among firms listed in Malaysia, particularly, involving controlling shareholders' conflict of interests (hereinafter RPT-conflict).

The objective of this study is to examine the association between two types of controlling shareholders' network relationship and RPTs. The networks include the appointment of controlling shareholders' proxies to the

¹ A social network is a social structure made up of a set of social actors (such as individuals or organizations), sets of dyadic ties, and other social interactions between actors (Kadushin 2012; Wasserman & Faust 1994). This study emphasizes that the social relationships between controlling shareholders and their proxies appointed to the board, and other directors in other firms are due to multiple directorships.

executive board (hereinafter CSProxy), including their family members and controlling shareholders' multiple-directorship in other firms (hereinafter CSMultiD). This study concerns the extent of CSProxy and CSMultiD in the engagement of RPTs. Although the founders and controlling shareholders only sit as a non-executive board chairman, the CSProxy may operate the firm on behalf of the controlling shareholders. This is because the proxies could be of their family members or trusted-persons. Controlling shareholders may also utilize their multiple directorship positions in other firms, specifically the subsidiaries and affiliates, to engage in RPTs. The presence of the controlling shareholders in other firms through directorship can influence the firm's decision-making process, including the entering of a contract with their controlled companies. While controlling shareholders might be concerned that the RPTs disclosure requirements would expose the existence of conflict of interests, the CSProxy and CSMultiD may hide or avoid disclosing such transactions accurately. Alternatively, the CSProxy and CSMultiD may disclose RPT-conflict as RPTs by making up or hiding the controlling shareholders' conflict of interest.

The objectives are examined by using 548 firms listed in Bursa Malaysia over a three-year period from 2012 to 2014 that consisted of a total of 1,550 observations. These firms are selected as RPTs are rampant among listed firms in Malaysia (Abdul Wahab et al. 2011; Rahmat & Ali 2016). The environment and landscape of business in Malaysia are conducive for firms to engage in RPTs due to several reasons. The ownership structure of the majority of listed firms is concentrated, in which those firms are dominated by single controlling shareholder (Cheung et al. 2006; Claessens et al. 2000). Additionally, the majority of these firms are established from family businesses, whereby the domination of family controlling shareholders is very substantial (Munir et al. 2013; Villalonga & Amit 2006). In addition, the implementation of corporate governance practice and enforcement of minority shareholders' protection in Malaysia are considered weak (Abdul Wahab et al. 2011; Claessens et al. 2000; Peng & Jiang 2010). These circumstances create a conducive landscape for firms to enter contracts with related parties (Munir et al. 2013; Rahmat & Ali 2016).

The findings indicate that CSProxy and CSMultiD are not associated with firm engaging in more RPTs, including the RPT-conflict. However, they can use their multiple directorship positions in other firms, including the subsidiaries and affiliates' firms, to engage in RPT-conflict. Consequently, the RPT-conflict increases the potential of RPTs' abuses for personal benefits (Gordon, Henry, & Palia 2004). Additionally, an interaction between CSProxy and CSMultiD increases the likelihood of firms to engage and disclose more RPTs, conversely discloses lower magnitude of RPT-conflict. The opportunistic related parties may exploit their conflict of interest for private benefits by hiding their intention behind the RPTs. Overall, these findings provide partial empirical support to the

argument that controlling shareholders seek to use their network relationship to influence firms to engage in RPTs.

This study contributes to the literature in several ways. We extend the literature on agency conflict type II by examining direct associations between the controlling shareholders' network and RPTs entered by firms. The networks can be in the form of CSProxy, including their family members and CSMultiD in other or related firms. Prior studies defined controlling shareholders from a general perspective according to the concentrated ownership (Dahya et al. 2008) and categorised them into family or non-family controlled perspective (Munir et al. 2013; Villalonga & Amit 2006). The controlling shareholders are assumed to only have the capability to influence any decision-making process due to dominant voting rights. However, the situation is not simply about expropriating firm's wealth by controlling shareholders, particularly after the corporate governance reform and specific regulations on RPTs have been strengthened in Malaysia since 2007. This study is extended by further defining and examining the actual ability of controlling shareholders to engage in RPTs, specifically RPT-conflict through their networks (proxy and multiple directorships). Therefore, these findings show empirically that the controlling shareholders may create a conducive network and setting exclusively to facilitate them to engage in RPTs by manipulating CSProxy, including their family members and CSMultiD.

The next section of this article is organized as follows: Section 2 contains background information of RPTs, controlling shareholders, and director remuneration in Malaysia; and Section 3 discusses the literature, theories and hypotheses. Section 4 describes the research design and Section 5 reports the empirical results. The last section discusses the findings and conclusion.

LITERATURE REVIEW AND DEVELOPMENT OF HYPOTHESES

Background of RPTs in Malaysia MFRS124 Related Party Disclosure defines RPTs as transactions between related parties that often include special features in which RPTs stand to be performed at no cost. This definition means that RPTs are allowed to be approved at any price, in which higher or lower than a market price. As a result, the RPTs would provide advantages to certain related parties involved. Meanwhile, MFRS 124 defines a related party as a person or entity connected to other entities through either direct or indirect interests or shareholding. Subsequently, the related party is eligible to influence any decision made by those related firms. RPTs are legal contracts and often used to facilitate firm's efficient operation by sharing a pool of resources and obligations (Jian & Wong 2010; Thomas, Herrmann & Inoue 2004). Natures of RPTs are similar to a firm's normal daily business operation. Consequently, it is difficult to identify and determine the RPTs with firm's other normal transactions with non-related parties (Beasley, Carcello, Hermanson, & Lapidés 2000; Gordon et al. 2004).

Additionally, the permission to violate the non-arm's length transaction provides an opportunity for related parties to design RPT to align with their personal interests. The opportunistic related parties can manipulate the transaction to hide their personal interests by claiming that the RPTs are required to ensure the efficiency of daily business operations. In this case, the efficient use of RPT invites a favorable perception, and the potential for RPT conflict may harm minority shareholders' interests (Kohlbeck & Mayhew 2010). Past studies had debated RPTs from two different points of view; either to represent efficient contract or personal conflict of interest (Cheung et al. 2006; Gordon et al. 2007). The first view argues that RPTs have often been used to facilitate the efficiency of company's daily business operation (Gordon et al. 2004). The group of companies can utilize RPTs as a way to share a pool of resources and obligation (Jian & Wong 2010; Thomas et al. 2004). However, the second view criticizes that the permission of RPTs violates non-arm-length transaction and creates the opportunities for related parties to maximize personal benefits. The RPTs can be designed according to their personal needs (Cheung et al. 2006).

RPT among business to business entities indicates efficient use of resources (Di Carlo 2014). However, the RPT that involves the interest of an individual related-party may signal the possibility of an expropriation of wealth. Additionally, RPT among business entities may also hinder an expropriation of wealth, considered as conflicting if it involves the interests of certain related parties, including directors, controlling shareholders and families (Wong, Kim, & Lo 2015). This study points out that RPT-conflict is defined as any RPTs contract involving company and individual related party, specifically the controlling shareholders. The RPT-conflict also includes any RPTs contract entered by company and other business entities in which involves the interest of the related party, particularly controlling shareholders. Thus, the RPT-conflict is argued to harm the minority shareholder's wealth.

RPTs in Malaysia are governed by the Listing Requirements of Bursa Malaysia and Companies Act 2016. Bursa Malaysia requires RPT to be declared immediately in detail as stated in Part E of the Listing Requirements. Meanwhile, the Companies Act 2016 stipulates that any substantial property transaction with individual related party must be attached with shareholder approval prior to the commencement of the transaction. In the most-recent development, Bursa Malaysia announced that the Practice Note 12 on Recurrent RPTs requires a disclosure to be made on any recurring RPT; that is incurred once every three years, to be declared accordingly. Additionally, MFRS124 requires firms to disclose RPTs by showing the related parties involved; i.e. either subsidiaries, associates or individuals. MFRS 124 also requires firms to separately disclose RPTs involving business entities (subsidiaries) that have individual interest, including, directors or controlling shareholders. While RPTs are allowed to be approved at non-arm's length transaction, there is no specific rule requiring related party's firms to disclose the actual

comparative market price. The missing information may result in the difficulty to identify the nature of the RPTs, i.e. either for efficiency or potentially wealth expropriation.

Schultz and Tang (2004) emphasized that firms will only disclose RPTs after considering the benefits and costs associated with the disclosure. Since disclosing RPT-conflict invites a negative market perception (Kohlbeck & Mayhew 2010; Nekhili & Cherif 2011), management may hide any committed RPT-conflict. Otherwise, the controlling shareholders may expropriate RPTs for their own wealth; but legitimate the transaction as if it is required and needed for business purposes. Past evidence indicated that RPTs engaged by Malaysian listed firms were frequently used to increase private wealth, specifically among family's business entities, although the transaction is soundly needed to increase firm's efficiency (Abdul Wahab et al. 2011; Ariff & Hashim 2013). The above circumstances are a result from the collusive Malaysia business environment; that is, concentrated ownership among families and facilitated by poor legal protection and governance enforcement (Claessens et al. 2000; Munir et al. 2013).

Background of Controlling Shareholders, Proxy and Multiple Directorships Malaysia is an emerging and developing economy in which numerous listed firms were incorporated from family businesses (Claessens et al. 2000). The founders and controlling shareholders often dominate the firms through concentration of ownership (Akhtaruddin, Hossain, Hossain, & Yao 2009; Anum 2010; Claessens et al. 2000; Gliberman, Peng, & Shapiro 2011). Additionally, the majority of controlled firms in Malaysia are controlled by a single shareholder, particularly by a group of families (Bertrand, Johnson, Samphantharak, & Schoar 2008). Family controlling shareholders dominated more than 67% of listed firms in Malaysia, in which 28% of market capitalization being controlled by 15 families only (Claessens et al. 2000). Generally, the nature of concentrated ownership implies the families' dominant power in Malaysia (Munir et al. 2013).

Similar to the majority of East Asian countries, the controlling shareholders in Malaysian listed firms exercise their control through pyramidal or cross holding structures of ownership due to a divergence between controlling and voting rights (Claessens et al. 2000; Sarkar, Sarkar, & Sen 2008). Therefore, the number of shares in the firm does not necessarily equal to the voting rights that are held by the controlling shareholder. In most cases, controlling shareholders utilize the pyramidal ownership structure to avoid receiving an unfavorable response from investors. Controlling shareholders are allowed to minimize their direct holding in the firms and maximize the indirect ownership through another controlled entity. Although the number of direct ownership in subsidiaries is not substantial, the controlling shareholders of a holding company have substantial power to influence subsidiaries' activities through controlled entity's voting rights.

Prior studies such as Morck, Shleifer, and Vishny (1988), Loh (1997) and Barclay, Holderness, and Sheehan (2007) found that different level of ownership is required for the major shareholders to exercise their control. Morck et al. (1988) found that entrenchment effect of managerial ownership begins at 23 percent to 25 percent. Loh (1997) stated that 15 percent to 25 percent of voting rights are sufficient to exercise control. Overall, they argued that effective control occurs at around 20 percent of equity ownership, including in Malaysia (Barclay et al. 2007; Lim, How, & Verhoeven 2014; Morck et al. 1988). Nevertheless, the stock exchange regulator, Bursa Malaysia defines a controlling shareholder as the one who exercises control for more than 33% of the voting rights.

The founders and/or the controlling shareholders often participate in management activities by holding top positions at the company such as chief executive officer or executive director (Villalonga & Amit 2006). There are also firms that practice CEO duality, in which the founders or controlling shareholders become the board chairman and the firm's CEO, particularly before the corporate governance reform in the year 2007. In some firms, the founders or the controlling shareholders may sit as non-executive board chairman, or alternatively, they appoint proxies from their family members or trusted connections to the executive board (Munir et al. 2013; Villalonga & Amit 2006). Additionally, controlling shareholders may have a directorship position in other firms (multiple directorships), including the subsidiaries and affiliates' firms. These circumstances, hence, would enhance the controlling shareholder's ability to exercise control over the firms' activities, including obtaining the approval for any business contracts with related parties.

Additionally, market feature and landscape in Malaysia are unique, conducive and provide greater opportunities for controlling shareholders to expropriate the minority shareholders' wealth, specifically through RPTs. The best practice's code on corporate governance had been implemented and revamped twice since 2000. However, the degrees of corporate governance practices and enforcement of legal shareholder protection are not sufficient enough in Malaysia (Abdul Wahab et al. 2011; Peng & Jiang 2010). Consequently, the opportunistic controlling shareholders may utilize their authority and power to enable them to expropriate firm resources for personal benefits. The minority shareholders will suffer due to the costs incurred (Dahya et al. 2008). As a developing country, it is highly likely that RPTs are abused by controlling shareholders in Malaysia in which the issues are severe and rampant (Ariff & Hashim 2013; La Porta, Lopez-de-Silanes, Shleifer, & Vishny 2000). Despite those assumptions and claims, the actual relationships between controlling shareholders' executive directorship, proxies and multiple directorships are insufficiently explored, which requires further attention.

CSPProxy and RPTs Some founders or controlling shareholders sit as non-executive chairman on the board

of directors. However, they can use their control to appoint proxies as executive board members to act on their behalf. The proxy can be appointed from among their family members or any trusted person to purposely dominate the decision making process and safeguard the controlling shareholders' interests (Moore & Craig 2008). The participation of the proxies in the board can influence the decision-making process and consequently, increase the occurrence of opportunistic transactions (Moore & Craig 2008). The proxy's involvement in any contract of RPTs would increase the likelihood of the firm's resources being expropriated. Thus, the presence of proxies in RPTs would result in a more serious conflict between controlling shareholders and minority shareholders. Nevertheless, there is no empirical evidence to date that directly demonstrates the relationship between the CSPProxy and RPTs. Aligned with the theory and past studies, this study assumes that CSPProxy would act on behalf of the controlling shareholders, and may result in increase firm engagement in RPTs. Thus the hypothesis is formed as below:

H1: The CSPProxy in the executive board is positively related to RPTs disclosure.

In contrast, the CSPProxy might be concerned that the RPTs disclosure requirements would expose the presence of the controlling shareholders' conflict of interest. Consequently, the CSPProxy may manipulate and avoid disclosing the existence of conflict of interest appropriately as RPT-conflict. Therefore, hypothesis H1 (a) is developed as below:

H1(a): The CSPProxy in the executive board is negatively related to RPT-conflict disclosure.

CSMultiD and RPTs Multiple directorships could be a measure of the director's reputation in monitoring the managers (Beasley 1996), which signals a good and superior performance of the directors (Bedard, Chtourou, & Courteau 2004; Hasnan, Daie, & Hussain 2016). Directors who hold multiple directorship positions in other various firms could benefit and have extensive knowledge and experience about the board of directors' best practices obtained from other firms. These experiences could enhance the transparency of the top management and the board decision-making process (Haniffa & Cooke 2002). Multiple directorships provide the opportunities to compare policies and management practices (Beasley 1996) and expose directors to different management styles. Mohd-Saleh et al. (2005) also recommended multiple-directorship as important governance mechanism. This is because it reduces the opportunistic activities by top management such as earnings management.

On the other hand, Ferris, Jagannathan, and Pritchard (2003) found that multiple-directorship to be less effective in monitoring top management activities. The directors who served for many firms may not be able to understand each

business activity and hence undermines the effectiveness of their duties (Bathala & Rao 1995). Additionally, multiple directorships may result in less time for effective monitoring (Ferris et al. 2003; Morck et al. 1988). In fact, multiple-directorship is also seen as a means to facilitate them to commit fraud between firms (Pfeffer & Salancik 1978). Basically, past studies discussed multiple directorships from the agency perspective as a monitoring function. In fact, a social network perspective emphasizes that multiple directorships provide the opportunity to establish networking among the directors (Granovetter 1983; Martinez & Aldrich 2011; McCallum, Forret, & Wolff 2014).

The opportunistic controlling shareholders may utilize the directorship network to benefit personal goals, specifically through RPTs. The controlling shareholders may use their network relationship through directorship to expropriate firm resources. Alternatively, they can also influence the decision-making process of directors in other directorship firms. Additionally, despite serving unrelated firms, multiple directorships involved related entities under the same corporate umbrella, specifically subsidiaries, associates or other affiliates. Thus, the CSMultiID may result in more RPTs. The presence of a CSMultiID is expected to threaten the effectiveness of the firm's corporate governance. The presence of controlling shareholders with multiple directives will challenge the effectiveness of the firm's governance. Through their extensive directorship and network positions, the directors have the ability and power to expropriate firm's resources such as transferring assets to firms under their control for self-interest; hence, waiving other shareholders' rights. This is in line with the study conducted by Haniffa and Hudaib (2006) which found multiple directorships to not improving the performance of firms; in fact, it even facilitates the mismanagement and misconduct of the director (Ferris & Jagannathan 2001; Ferris et al. 2003; Harris & Shimizu 2004).

However, there is a lack of evidence to demonstrate that multiple directorships, particularly by the controlling shareholders, are associated with RPTs. This study is aligned with the argument that CSMultiID can influence other related parties to seize firm's resources. Consequently, CSMultiID exposes the occurrence of non-transparent RPTs and increases expropriation risk of firm's resources. Aligned with the notion that the presence of CSMultiID is expected to increase firm participation in RPTs, H2 is formed as below:

H2: The CSMultiID is positively related to RPTs.

Although, the CSMultiID may be concerned that the RPTs' disclosure requirements would expose the presence of their conflict of interest, they may not be capable of manipulating the RPTs disclosure, particularly when they do not sit in any executive position. Therefore, the hypothesis H2 (a) is developed as below:

H2a: The CSMultiID is negatively associated with RPT-conflict disclosure.

Interaction of CSProxy and CSMultiID This study also argues that the ability of CSProxy to engage in RPTs is easier if the controlling shareholders have multiple directorship positions in other entities, specifically the subsidiaries or affiliates. The CSProxy can negotiate with the CSMultiID to influence the entities to enter a contract with the firm. Moreover, the situation would be more conducive if controlling shareholders also have a substantial ownership in the other entities (subsidiaries or affiliates). It aligns with the theory that CSProxy engagement in RPTs increases when the controlling shareholders also have multiple directorship positions in other related or unrelated entities. Therefore, hypothesis H3 is formed as below:

H3: An interaction between CSProxy and CSMultiID is positively associated with RPTs.

As predicted, CSMultiID would increase firm engagement in RPTs, including RPT-conflict. However, the presence of CSProxy may influence CSMultiID from disclosing RPT-conflict appropriately as the CSProxy has the capability to manipulate disclosures. Therefore, hypothesis H3 (a) is developed as below:

H3a: An interaction between CSProxy and CSMultiID is negatively associated with RPT-conflict disclosure.

RESEARCH DESIGN

Sample Selection Sample of this study consists of 517 firms that were listed on Bursa Malaysia from 2012-2014. The population is based on all companies listed on the main market in Bursa Malaysia at the end of year 2014. The financial institutions are eliminated because of their specific regulatory requirement (Saad, 2010). The listed companies are then screened to exclude companies with incomplete data for the three-year period of observations, primarily information regarding RPTs. Data of RPTs were collected manually from companies' annual reports because these types of data are not available in most digital databases. An archival of non-financial data such as previous corporate governance structure, ownership structure and audit quality was also collected manually from the companies' annual reports. Thus, we finally omitted certain observations because of incomplete specific information such as capital market value to calculate company's growth. The elimination and screening processes resulted in a final sample of 1,550 observations over the three year period. The final sample includes various major industries that are classified by Bursa Malaysia, including trading and services, industrial products, consumer products, property, construction, plantation, technology and others.

Peng and Jiang (2010) emphasized that Malaysia lacks the protections for minority shareholders because of the ineffective implementation of corporate governance

practices and enforcement of regulations. Additionally, most firms are established with a concentrated type of ownership, and belong to single controlling shareholder (Claessens et al. 2000; Munir et al. 2013; Villalonga & Amit 2006). The controlling shareholders or founders often sit as a board chairman or chief executive officer (Sarkar et al. 2008), and appoint their family members or proxies to dominate key top management positions (Munir et al. 2013; Villalonga & Amit 2006). The business environment and landscape in Malaysia encourage firms to engage in RPTs.

Nevertheless, corporate governance practices in Malaysia have been strengthened twice, in 2007 and 2012 (Anum 2010; Germain, Galy, & Lee 2014; Lim et al. 2014; Sulong & Nor 2010). The reforms include the amendment of the Malaysian Companies Act 2016 in 2007 to ban RPT loans to or from directors (related parties). Nowadays, the corporate governance practice in Malaysia is more advanced than other East Asian countries. The quality of reporting among Malaysian listed firms is better and more reliable. Bursa Malaysia also requires listed firms in Malaysia to disclose RPTs by documenting the existence of a director's or other related party's interest. However, listed firms in Malaysia are still unwilling to disclose the actual market price of the disclosed RPTs. Additionally, the corporate governance reforms in other countries may be in distinctive stages; therefore, the above settings demonstrate that Malaysia is an appropriate location to conduct this study.

This study defines controlling shareholders as individuals, organizations or a group of families who have a minimum holding of 23 percent of direct ownership in a firm. The use of 23 percent as a baseline to the ownership structure aligned with prior reviews such as Morck et al. (1988), Barclay et al. (2007), Chen and Chuang (2009), and in Malaysia like Sulong and Nor (2010), Yunos, Smith, and Ismail (2010), Chu and Song (2012), and Lim et al. (2014). They argued that effective control for Malaysia occurs at around 20 percent. In addition, (Loh 1997) stated that 15 percent to 25 percent of voting rights are sufficient to control. Morck et al. (1988) found that entrenchment effect of managerial ownership begins at 23 percent to 25 percent.

The individual controlling shareholders often sit as either an executive or non-executive director or board chairman. The detailed biographies of the controlling shareholders disclosed in the annual report are analyzed to identify whether they have multiple directorships in other companies (CSMultiD), including subsidiaries and other affiliates. For the institutional or controlling shareholders that do not sit as the executive board, they will appoint CSProxy. The CSProxy is determined by identifying the presence of controlling shareholders' family members in the board. Otherwise, the detailed biographies of all executive directors are analyzed to identify any specific information or relationship that may indicate the executive directors are being appointed by controlling shareholders.

Regression model and Variable Measurements We use a pooled regression to examine the hypotheses. The regression model is as follows:

$$\begin{aligned}
 RPT_{it} = & \alpha + \beta_1 CSProxy_{it} + \beta_2 CSMultiD_{it} + \\
 & \beta_3 CSProxy_{it} * CSMultiD_{it} + \beta_4 ROA_{it} \\
 & + \beta_5 FSize_{it} + \beta_6 Growth_{it} + \beta_7 Lev_{it} + \\
 & \beta_8 AudQ_{it} + \beta_9 BSize_{it} + \beta_{10} BInd_{it} + \\
 & \beta_{11} ACSize_{it} + \beta_{12} ACFInd_{it} + \beta_{13} CFirm_{it} \\
 & + \beta_{14} \Sigma Ind_{it} + \beta_{15} \Sigma Year_{it} + e
 \end{aligned}$$

Where, RPT_{it} represents a vector that describes RPT and RPT-conflict. RPT, a total magnitude of RPTs disclosed in the financial statement in a year t, scaled by the beginning of total assets of year t. This measurement is consistent with Kohlbeck and Mayhew (2010) and Rahmat and Ali (2016). All RPTs are considered as representing opportunistic transactions, which probably used as tools to maximize personal benefits. Nature of RPTs is unique in which it allows to be executed at non-arm length transaction. Thus, the RPTs could be agreed at a price below or higher than the market rate. Nevertheless, firms are usually unwilling to disclose the market price in their financial reports that resulted in either tunneling or propping of RPTs could represent firm's wealth expropriation.

RPT-conflict is any contract of RPT that directly or indirectly involves an individually related party (controlling shareholders or directors) and a business to business, including subsidiaries or associates in which the related parties hold an interest in either business. RPT-conflict is measured as a total magnitude of RPT-conflict disclosed in the financial statement in a year t, scaled by the beginning of total assets of year t. CSProxy is measured as a dummy, equal to one if there are family members or individual related to the controlling shareholder on the board, otherwise 0. CSMultiD is measured as a dummy variable, equal to 1 when the controlling shareholders have any directorship position in other firms, including the subsidiaries or affiliate firms, and coded as 0 if otherwise.

The model also includes control variables to represent firm-specific characteristics, performance, corporate governance patterns, and audit quality levels that may affect a company's engagement in RPTs. Firm return on assets (ROA), leverage (Lev), growth ($Growth$), and sizes ($FSize$) are included to control cross-sectional firm characteristics and performance differences. ROA is measured as earnings after tax of year t divided by the year-end total assets. Gaio and Raposo (2011) reported that the quality of those companies' earnings that engaged in RPTs is associated with poor performance. Lev is measured based on total debt of year t divided by total assets (Ahmed, Hossain, & Adams 2006) and $Growth$ is measured based on the market value of a firm divided by the beginning book value of total assets for the year (Collins & Kothari 1989). $FSize$ is measured using the

natural logarithm for the book value of year-end total assets. AudQ represents audit quality, and is measured as a dummy variable and coded as 1 if the firm is audited by Big 4 audit firm, and coded as 0 if otherwise.

In order to control cross-sectional differences in corporate governance characteristics, board size (*BSize*) is measured as number of board members. Board independence (*BInd*) is measured as the ratio of independent non-executive directors to total board members. It represents the presence of independent monitoring of RPTs from outside directors (Gordon et al. 2004). Audit committee size (*ACSize*) is measured as number of audit committee members. Audit committee full independence (*ACFInd*) is measured as a dummy variable and coded as 1 if all the audit committee members are independent non-executive directors, and coded as 0 if otherwise. *CFirm* is representing controlled firms, measured as a dummy variable and coded as 1 if the firm is the controlled firm, and coded as 0 if otherwise. A firm is categorised as controlled firm when the largest shareholders hold the firm's ownership at 23% and above. Consistent with Mitton's (2002) approach, this study controls for the differential effects of *Year* and *Industry*. The Year indicator is a vector of year indicator variables (2012, 2013 and 2014). The Industry indicator is a vector of industry indicator variables based on the Bursa Malaysia industry classification. Summaries of the variable definitions and measurements are exhibited in Appendix 1.

RESULTS

DESCRIPTIVE ANALYSIS, CORRELATION AND MULTICOLLINEARITY

Panel A of Table 1 shows the descriptive statistics for the sample of 1,550 firm-years. The result shows that the

mean value of RPTs is 0.12; indicating that the total of RPTs engaged by listed firms in Malaysia, on average over the three years, is about 12% of the firm's total assets. The result shows that only about 1% (mean value 0.01) out of 12% is disclosed as RPT-conflict. The statistic shows that there are 1,046 (67.5%) observations of appointed CSProxy as shown in Panel B. This illustrates that, most of the controlling shareholders in Malaysian firms positioned their proxies, especially their family members or trusted persons, to the executive board. In the meantime, there are only 363 (23.4%) observations of CSMultiD; indicating that only about 23.4% of the controlling shareholders sit on other directorship positions in other firms, including the subsidiaries or affiliates.

Table 1, Panel B also shows that about 1,145 (73.9%) observations from the sample are controlled firms. Other results for controlling variables can be referred in Table 1. Overall, the data do not have critical normality problem (the Skewness and Kurtosis value are untabulated). Table 2 tabulates the result from Pearson's correlation test in which shows that no variables are highly correlated with each other. The results indicate that there is no significant multicollinearity problem. The highest correlation is between *Growth* and ROA at 0.48 and correlations with other explanatory variables fall well below 0.48, suggesting that the variables are not being affected by multicollinearity issues (Cohen, Cohen, West & Aiken, 2013; Montgomery, Peck & Vining 2012). Additionally, this study runs Variant Inflation Factor (VIF) analysis to ensure that there is no multicollinearity issue. The results are not tabulated.

However, the findings confirmed that there is no multicollinearity problem in the regression model. The maximum VIF value is only 3.38, which is lower than the maximum VIF value, 10 (Cohen et al. 2013; Montgomery et al. 2012).

TABLE 1. Descriptive Statistic (n= 1,550)

Variable	Panel A				Panel B			
	Mean	Maximum	Minimum	Std. Dev.	Yes	%	No	%
RPTs	0.12	9.09	0.00	0.66				
RPTconflict	0.01	0.85	0.00	0.08				
CSProxy					1,046	67.5	504	32.5
CSMultiD					363	23.4	1,187	76.6
ROA	3.63	51.90	-27.17	8.54				
FSize	15.22	24.83	9.81	3.52				
Growth	0.61	5.65	0.00	0.75				
Lev	0.54	30.80	0.00	1.91				
AudQ					752	48.5	798	51.5
BSize	7.00	15	4	1.67				
BInd	0.47	0.89	0.14	0.13				
ACSize	3.18	6	3	0.44				
ACFInd					1,042	67.2	508	32.8
CFirm					1,145	73.9	405	26.1

Notes: Please refer to Appendix 1 for variables' definition and measurement. Year and Industry are not reported for brevity.

TABLE 2. Pearson Correlation (n=1,550)

Variable	RPTs	RPTConflict	CSProxy	CSMultiD	ROA	FSize	Growth	Lev	AudQ	BSize	BInd	ACSize	ACFInd
RPTConflict	0.44***												
CSProxy	0.03	-0.01											
CSMultiD	0.02	-0.01	0.04										
ROA	0.02	0.14***	0.05	-0.01									
Fsize	0.02	0.01	0.07***	-0.05*	-0.22***								
Growth	0.02	0.05*	0.04	-0.02	0.48***	-0.19***							
Lev	0.32***	0.31***	0.01	-0.02	-0.06**	-0.07***	0.12***						
AudQ	0.02	0.06**	0.02	0.01	0.12***	0.10***	0.07***	0.03					
BSize	0.02	0.11***	0.17***	-0.03	0.12***	0.07***	0.14***	0.04	0.07***				
BInd	0.00	0.02	-0.22***	0.03	-0.06**	-0.02	-0.04	0.02	-0.03	-0.28***			
ACSize	0.19***	0.06**	0.07***	0.02	0.11***	-0.06**	0.11***	0.14***	0.06**	0.14***	0.08***		
ACFInd	-0.02	0.02	-0.10***	0.00	-0.10***	0.03	-0.09***	0.01	-0.06**	0.01	0.19***	-0.20***	
CFirm	0.05*	0.07***	0.13***	-0.09***	0.05*	-0.01	0.12***	0.06**	0.06*	0.05*	-0.07***	0.04	0.00

Notes: Please refer to Appendix 1 for variables' definition and measurement. Year and Industry are not reported for brevity. ***significant level p<0.01, **significant level

MULTIVARIATE REGRESSIONS

Table 3 shows the results for the multivariate regression on the relationship between controlling shareholder's network variables (*CSPProxy* and *CSMultiD*) and RPTs, including RPT-conflict. The adjusted R^2 for the RPTs and RPT-conflict models are 12.9% and 13.4% respectively; and the F-test values are 11.40 and 11.88, respectively and both are significant at $p < 0.01$. These values indicate that the model is fit enough to explain 12.9% and 13.4% changes in the tested relationships.

Based on RPTs model, the results show that *CSPProxy* and *CSMultiD* are insignificant and do not associate with RPTs. Thus, H1 and H2 are not supported. There is no evidence to claim that controlling shareholders may appoint their proxies to engage in RPTs. Similarly, there is no evidence to support the argument that controlling shareholders may use their directorship position in other entities or affiliate firms to engage in RPTs. However, an interaction between *CSPProxy* and *CSMultiD* has a positive and significant relationship with RPTs. The coefficient (t-value) is 0.097 (3.313), and is significant at $p < 0.01$. The result supports H3. Hence, indicating that the presence of *CSPProxy* in the executive board of the controlled firm in which the controlling shareholders have multiple directorship positions in other affiliates increases firm engagement in RPTs. The appointment of *CSPProxy* either through family members or trusted-persons could facilitate the execution of RPTs by the controlling shareholders only when they have the advantage of multiple directorships. This will consequently increase the likelihood of minority shareholders' wealth expropriation by controlling shareholders through *CSPProxy* and *CSMultiD*. The controlling shareholder may use their proxies on the executive board to cooperate in implementing the expulsion of RPTs.

The controlling shareholders have a great opportunity to exploit the firm's resources; that is by manipulating RPTs because they have the option to disclose, conceal or manipulate the transactions in the firm's financial statements. Additionally, the disclosure requirements require firms to report RPTs by disclosing the existence of conflict of interest among related parties, specifically controlling shareholders. This may result in the RPTs not being disclosed appropriately. Based on the exhibited RPT-conflict model in Table 3, *CSPProxy* is also found to be insignificant; suggesting no association with RPT-conflict. Thus H1a is rejected as there is no evidence to show that *CSPProxy* avoids disclosing RPT-conflict. In contrast, the result exhibits that *CSMultiD* has a positive relationship with RPT-conflict. The coefficient is 0.007 (t-statistic = 2.043) and significant at $p < 0.05$, in which the result contradicts hypothesis H2a. The finding indicates that *CSMultiD* increases firms' possibilities to engage in RPT-conflict, but *CSMultiD* is not opportunistic in disclosing RPT-conflict inappropriately.

The *CSMultiD*, specifically in subsidiaries or other affiliates provide the opportunities for the controlling shareholders to engage in RPTs, but they are willing to

disclose the RPTs-conflict appropriately. This evidence is in line with the findings from the study by Haniffa and Hudaib (2006) which found that multiple directorships facilitate directors to perform mismanagement and misconduct on firms. Although, the firms disclose RPT-conflict properly, the transaction is most probably used to meet personal goals; thus, the transaction increases the risk of minority shareholders' wealth expropriation.

Table 3 shows that the result of interaction between *CSPProxy* and *CSMultiD* (*CSPProxy***CSMultiD*) is negatively associated with RPT-conflict; the coefficient is -0.006 ($t = -2.003$) and significant at $p < 0.05$. This evidence supports hypothesis H3a that suggests the interaction between *CSPProxy* and *CSMultiD* is negatively associated with RPT-conflict. The presence of *CSPProxy* may influence *CSMultiD* to reduce the magnitude of RPT-conflict disclosed. Generally, these findings suggest that *CSPProxy* and *CSMultiD* do not have issues with the disclosure of RPTs; however, they are reluctant to disclose transactions involving controlling shareholders' interest accurately such as RPT-conflict.

DISCUSSION AND CONCLUSION

The corporate ownership structure in the majority of listed firms in Malaysia is concentrated on single controlling shareholder. This phenomenon raises an agency conflict involving controlling shareholder and minority shareholders (Fan & Wong 2005); in which claimed that the controlling shareholders exercise their dominant voting rights to expropriate firm resources for personal gain, specifically through RPTs. RPTs conducted by the firm are one of the main causes of a conflict of interest between related parties and other stakeholders, which in turn creates agency problem (Gordon et al. 2004). Based on the views of a conflict of interest, related party can use their power to expropriate firm resources for personal gains through RPTs. The opportunistic behavior among related parties will increase agency costs and reduce the wealth of other stakeholders. The controlling shareholders are assumed to have the power and authority to appoint their proxies to the executive board, particularly their family members, but this has not been empirically proven.

This study uses 1,550 observations of listed firms to examine the relationship between controlling shareholders' network attributes (*CSPProxy* and *CSMultiD*) and RPTs, specifically the RPT-conflict. This study gives a broader picture on the ability of controlling shareholder to manipulate their networking via their proxies and multiple directorships to expropriate firm resources through RPTs. The study found no evidence to express that the presence of *CSPProxy* increases firm's engagement in RPTs or RPT-conflict. Additionally, the *CSMultiD* is found to increase firms' likelihood to engage in and disclose RPT-conflict, although overall, *CSMultiD* has no association with all RPTs. The evidence contributes to the knowledge by exhibiting that controlling shareholders cannot directly utilize their *CSPProxy* to accomplish RPTs, particularly

TABLE 3. Multivariate Regression Results (n=1,550)

Variable	RPTs		RPT-conflict	
	Coefficient	t-statistic	Coefficient	t-statistic
Constant	-1.019***	-7.991	-0.084***	-5.068
CSPProxy	-0.003	-0.258	-0.003	-1.420
CSMultiD	-0.016	-0.671	0.007**	2.043
CSPProxy*CSMultiD	0.097***	3.313	-0.006**	-2.003
ROA	0.006	1.560	0.002***	3.996
FSize	0.014***	14.436	0.013***	10.224
Growth	-0.058	-1.363	-0.009***	-2.769
Lev	0.110***	3.876	0.001***	9.144
AudQ	-0.007	-0.320	0.004**	2.067
BSize	-0.006*	-1.710	0.004***	44.960
Bind	-0.065***	-4.223	0.018***	3.150
ACSize	0.233***	7.869	-0.003	-0.925
ACFInd	0.028	0.992	0.003	0.473
CFirm	0.047***	7.408	0.011***	5.470
Industry	Included		Included	
Year	Included		Included	
R-squared	14.1%		14.6%	
Adjusted R-squared	12.9%		13.4%	
F-statistic	11.40***		11.88***	
N	1,550		1,550	

Please refer to Appendix 1 for variables' definition and measurement. Year and Industry are not reported for brevity. We report t-statistics based on White's (1980) consistent estimator. ***significant level $p < 0.01$, **significant level $p < 0.05$, *significant level $p < 0.10$.

the RPT-conflict. However, they can use their multiple directorship positions in other firms, including the subsidiaries and affiliates to engage in RPT-conflict. Consequently, the RPT-conflict increases the potential of RPTs being abused for maximizing personal interests (Gordon et al., 2004). This study's findings also suggest that firms with CSPProxy and CSMultiD engage and disclose more RPTs, but are disclosing lower magnitude of RPT-conflict. The opportunistic related parties can exploit RPTs for private benefits by hiding their intention behind the legal transactions.

This study also has some limitations that should be taken into consideration in assessing and interpreting the results. First, the study examines the firms listed on Bursa Malaysia for the years 2012, 2013 and 2014 and the results may not be generalized to other contexts and settings. In addition, there are two different views on RPTs, either representing "conflict of interest" or "efficient transaction." However, this study only focuses on the views of a conflict of interest with regard to RPTs being an opportunistic contract that can be used by related parties to maximize personal gains. The findings from this study provide some implications for practices and future research. Concentrated ownership by controlling shareholders through pyramidal is complex and cannot be identified easily. Although the controlling shareholders may not sit in any executive

position on the board, the appointed proxies are expected can help them to realize their personal interests. The insignificant relationship found in our study may require further exploration. While controlling shareholders are found to utilize their multiple directorships to engage in RPT-conflict, the regulators and shareholder activist must seriously be aware about the potential consequences, and take the right steps to minimize the expropriation risk.

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APPENDIX 1: Definition and Measurement of the Variables

Variable	Description
<i>RPT</i>	RPT is a total magnitude of RPTs disclosed in the financial statement in year t, scaled by the beginning of total assets of year t.
<i>RPT-conflict</i>	RPT-conflict is a total magnitude of RPT-conflict disclosed in the financial statement in a year t, scaled by the beginning of total assets of year t.
<i>CSProxy</i>	A proxy of the controlling shareholders in the executive board. It is measured as a dummy, equal to one if there are family members or trusted-individual related to the controlling shareholder on the board, otherwise 0.
<i>CSMultiD</i>	The controlling shareholders multiple directorship, measured as a dummy variable, equal to 1 when the controlling shareholders have seat at any directorship position in other firms, including the subsidiaries or affiliate firms, and coded as 0 otherwise.
<i>ROA</i>	Measured as earnings after tax of year t divided by the year-end total assets of year t.
<i>FSize</i>	Measured using the natural logarithm for the book value of the beginning total assets of year t.
<i>GROWTH</i>	Measured based on the market value of a firm divided by the beginning book value of total assets for the year.
<i>LEV</i>	Measured based on total debt of year t divided by total assets year t.
<i>AudQ</i>	AudQ is representing audit quality, is measured as a dummy variable and coded as 1 if the firm is audited by Big 4 audit firm, and coded as 0 otherwise.
<i>BSize</i>	Board size is measured as number of board members.
<i>BInd</i>	Measured as the ratio of independent non-executive directors to total board members.
<i>ACSize</i>	Audit committee size is measured as number of audit committee members.
<i>ACFInd</i>	A remuneration committee, which is measured as the ratio of independent non-executive directors to total remuneration committee members. It represents the independent the remuneration committee.
<i>CFirm</i>	Representing controlled firms, measured as a dummy variable and coded as 1 if the firm is the controlled firm, and coded as 0 otherwise. The firm is categorised as the controlled firm when the largest shareholders held the firm ownership in excess of 23% or above.
<i>Industry</i>	The Industry indicator is a vector of industry indicator variables based on the Bursa Malaysia industry classification
<i>Year</i>	A vector of year indicator variables (2012, 2013 and 2014)

