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Firm Performance and Family Related Directors: Empirical Evidence from an Emerging Market

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ABSTRACT

Board composition is central to the worldwide corporate governance reforms that have taken place in recent years. The strong emphasis on director independence and board leadership is now part of all corporate governance regimes, including the regimes which has been introduced in Malaysia. It is the effectiveness of such provisions in the Malaysian business environment that provides the motivation for this paper. The literature shows mixed findings on the issues of board independence and board leadership. Our paper studies the role of directors with family connections and its impact on financial outcomes. We find that firms with a high presence of family related directors exhibit superior accounting profitability. However, such dominance is negatively viewed by the market (firm performance based on market measures), indicating that markets tend to perceive that domination of family members on the board could potentially lead to expropriation of wealth at the expense of other shareholders. Our results are supported by additional robustness tests. The findings provide interesting insights into the governance mechanisms of firms in an emerging market and its consequences for investor perceptions. Further implications are also discussed.

KEY WORDS: Firm performance, family related directors, corporate governance, board structure, board composition

JEL Classification: G32, G34

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1. Introduction

The need for director independence and board leadership is an integral part of any corporate governance mechanism and has been emphasized in different regimes across the world, including the regimes of Malaysia. The motivation for this paper is derived from the measurement of the effectiveness of the implementation of these governance regimes. Current findings in the literature further motivate our study, given that Abdullah (2004), Haniffa and Hudaib (2006) and Yatim, Kent, and Clarkson (2006) have failed to find any strong evidence to support the view that board independence and board leadership separation are efficient monitoring mechanisms that improve performance. These results have important policy implications, because the internal governance structures found in Malaysia at present are the result of firms adopting best practice as set down in the Malaysian Code of Corporate Governance (MCCG). This suggests that although

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firms are complying satisfactorily with the MCCG by adopting the prescribed structures, there does not appear to be the kind of positive impact on performance that was expected to result from the reforms now in place (Abdullah, Evans, Fraser, & Tsalavoutas, 2015).

Interestingly, family related directors play an important role in corporate governance in the Malaysian context (Haniffa & Cooke, 2002; Ismail & Manaf, 2016). At the same time, the findings in the US demonstrate that trade-offs between different types of monitoring mechanisms are another important consideration (Agrawal & Knoeber, 2001; Booth, Cornett, & Tehranian, 2002; Mullins & Schoar, 2016). In light the above findings, this paper explores the possibility that family related directors provide an alternative internal monitoring mechanism in the case of Malaysian firms, one that accounts for the missing link between governance and performance.

As suggested above, Malaysia provides a unique opportunity to study the implications of family linkages in corporate governance. This is because Malaysia is characterized by a relationship-based economic system (Abdullah & Ismail, 2016; Rajan & Zingales, 1998), where such arrangements are readily observable. Furthermore, the literature documents the importance of market and financial development in countries such as Malaysia in ensuring the maturity of the market (Chan & Abd Karim, 2016). Although the study of the association between board characteristics and firm performance has already received considerable attention elsewhere, much of the empirical analysis of governance has been based on the open market economic systems that underlie the US and European experiences. Haniffa and Hudaib (2006), in their paper on Malaysian governance, argue that the effect of other countries' governance models is unlikely to be similar when applied in a different environment. This paper thus attempts to address this issue. Specifically, this paper considers whether family related directors add to firm performance

The implications based on the evidence provided in this study regarding the importance of family influence within a board structure would enable policy makers and the investment community to gain a better insight into the extent of the participation of these types of directors in Malaysian corporations. In terms of the involvement of family members in firm governance, this study builds on studies by Lane, Astrachan, Keyt, and McMillan (2006), Lin and Hu (2007) and Miller, Breton-Miller, Lester and Cannella (2007) by introducing a more refined definition of CEO duality. Prior studies have usually defined CEO duality as the situation where the roles of CEO and Chairman are combined, while nonduality implies that different individuals serve as CEO and Chairman (Abdullah, 2004; Baliga, Moyer, & Rao, 1996; Chi, Hung, Cheng, & Lieu, 2015; Kang & Zardkoohi, 2005). This study proposes that even when the positions of CEO and board chair are held by different individuals, it is possible nevertheless that these individuals are family related, in which case board leadership may also be considered as one of 'duality'. This new definition is motivated by the findings of Claessens, Djankov, & Lang, 2000) in their work on the separation of ownership and control in listed corporations in a number of countries. The authors report that 85 percentof the sampled Malaysian corporations had managers who belong to a member of the controlling family or a nominee, and this evidence now suggests that duality may be more form than substance and should be reinterpreted within the relationship framework adopted here (Villalonga, Trujillo, Guzmán, & Cáceres, 2018).The purpose of the study is to determine whether the insertion of family related directors has any impact on firm performance. We find that the appointment of family related directors, i.e., firms with a high presence of these directors, exhibit superior accounting profitability (as measured by ROA). However, the dominance of family related directors is negatively viewed by the market, suggesting that the market perceives that the domination of family members on the board could lead to potential agency issues at the expense of other shareholders.

In the next section we discuss the relevant literature as a motivation to our study, followed by a description of the sample, a definition of variables and the empirical model. Next, we discuss the findings from our analysis. Lastly, we conclude the paper with a discussion of the implications and limitations of our study.

2. Literature Review

2.1 Measures of Firm Performance

To date, several different approaches have been adopted in investigating the link between firm performance and governance, particularly regarding board of director characteristics. For instance, some studies have measured this relationship based on accounting ratios and related market indicators such as Tobin's Q (Abdullah, 2004; Haniffa & Hudaib, 2006), while others use only stock market performance (Weisbach, 1988); still others have considered valuations such as the tender offer bid price (Cotter, Shivdasani, & Zenner, 1997; Nekhili, Chakroun, & Chtioui, 2018; Xu, Yuan, Jiang, & Chan, 2015). Most studies have combined both financial accounting ratios and market-based measures to determine the effect of board characteristics on firm performance.

However, previous work stress the ambiguity of the association between board structure and its effectiveness and firm performance. For example, Hermalin and Weisbach (1988), in their review of the topic, refute the claim that board characteristics are the main determinant of firm performance. In terms of a causality relationship between board effectiveness and organizational performance, the relationship remains unclear, as no scientific study has been able to confirm the notion that good governance improves firm performance, or alternatively that good performance leads to better governance (Schmidt & Brauer, 2006). The main problem in interpreting this causal relationship stems from the complexity of the governance structure and lack of sufficient methodological rigor. This study will attempt to address this issue, which is further discussed in the analysis section.

2.2 Firm Performance and Family Related Directors

Family firms are at least as common among public corporations around the world as are diversely held corporations and nonfamily firms (Claessens et al., 2000; Faccio & Lang, 2002; La Porta, Lopez-De-Silanes, & Shleifer, 1999). Interestingly, research by Miller et al. (2007) and Andres (2008) has introduced a new approach to defining family firms. These must have multiple members of a family as officers, directors or large shareholders, either contemporaneously or over the life of the company (as family descendants); as such they are distinguished from 'lone founder' firms, i.e., companies in which one individual is the founder but with no other family members involved. According to both studies, this distinction enables one to examine the relative underperformance of family-controlled firms because 'lone founder' firms tend to outperform the market. The findings are further evidenced in private firms, where lone founders tend to outperform family-controlled firms (López-Delgado & Diéguez-Soto, 2015).

In the case of controlling shareholders, family ownership represents a special class of large block holders that potentially have unique incentive structures, a strong voice in the firm and powerful motives to manage one particular firm. Thus, because of their ownership concentration, family firms are able to successfully mitigate the owner-manager agency problem based on the intrinsic desire to protect their business and ensure its survival compared to other shareholders (Frank, Kessler, Rusch, Suess–Reyes, & Weismeier–Sammer, 2017; Jensen & Meckling, 1976). Early studies view ownership control in family firms as undiversified and, similar to other block holders, as more efficient in monitoring business activities. One reason is that the concentrated ownership by families allows owners and their family members to actively participate on the board. Hence, it is argued that with such an ownership structure and the greater presence of insiders, the cost of monitoring will be lowered and the alignment of interests between agent and principal will not only be optimized but achieved with less friction. Such a setting also allows knowledge and experience to be passed on within families as opposed to being shared with outsiders (Andres, 2008).

Several studies suggest that family-controlled firms may potentially contribute to good governance (van Essen, Carney, Gedajlovic, & Heugens, 2015; Wagner, Block, Miller, Schwens, & Xi, 2015). Nevertheless, others argue that family-controlled firms may potentially involve a number of drawbacks, such as management entrenchment (Martínez-Ferrero, Rodríguez-Ariza, & García-Sánchez, 2016) pyramiding (Hwang & Kim, 2016) and 'tunneling' (Selcuk & Sener, 2018; Xu et al., 2015). There has also been evidence that degree of board independence leads to an inverted U-shaped relationship to firm performance for family firms and is mainly explained by the behavioral aspect (Basco & Voordeckers, 2015).

Family firms often limit their executive positions to family members, and such appointments are common, especially when the family is the major shareholder of the firm (Acero & Alcalde, 2016; González, Guzmán, Pombo, & Trujillo, 2015). In this study, the term 'family related directors' (FRD) refers to directors who have an immediate family relationship with the firm's owners and officers. This is similar to the classification utilized in the literature (Yoong, Alfan, & Devi, 2015). Following the above studies, ours will also categorize FRD as insiders, even though some studies have placed these directors under the category of affiliated (gray) directors (Wu & Hsu, 2018).

However, the above evidence contradicts the evidence of family firms in East Asia. Claessens, Djankov, Fan, and Lang (1999) report that family control in East Asia leads to severe conflict with other residual claimants and impedes firm performance. Chen et al. (2005), in their study of family firms and firm performance (proxies by Return on Assets, Return on Equity and Market-to-Book ratio) in Hong Kong, fail to find any significant results. The problems faced by East Asian firms result from the prevalence of cross-holdings, pyramidal structure and dual class shares (Chi et al., 2015; Hashim & Amrah, 2016). It has also been suggested that family firms engage in low transparent deals which relate to connection-based transactions (Mulyani Singh, & Mishra, 2016). This may suggest that the impact of family-owned firms on governance and performance in these countries may not be as significant as in the US.

2.3 The Malaysian Context

The main publication dealing with the reform process in Malaysia is the Malaysian Code of Corporate Governance (MCCG). Ow-Yong and Guan (2000), in their comparison of standards between Malaysia and the UK, find that the Malaysian codes are regulatory-driven, whereas UK codes are voluntary and largely business-driven. The MCCG emphasizes the transparent and timely flow of information, the procedures for appointments and the role and powers of the board, along with executive directors' remuneration, financial reporting, internal controls and the relationship between the shareholders and the board. The MCCG represents the main private initiative taken to enhance corporate governance in publicly held firms. It seeks to create an enabling environment for the growth of private enterprises and for attracting foreign investment. In response to the changes in the business environment and to improve its effectiveness, the MCCG was further revised in 2007, with key amendments of the code aimed at strengthening boards of directors and audit committees. Among the amendments in the revised MCCG 2007 are that executive directors will no longer be allowed to become members of the audit committee and that there will be greater clarity in the aspects which the nominating committee should consider when recommending candidates for directorships. The code was further revised in 2012 with a focus on corporate dealings and culture. Furthermore, firms were required to have a disclosure policy as well as a commitment to shareholders' rights.

As mentioned earlier, the Malaysian corporate governance model and commercial law are largely influenced by the UK experience. Hence, it is likely that many similarities can be found in board characteristics and in the general corporate landscape between Malaysia and the UK. For instance, the board model is similar in both Malaysia and the UK – a single tier or unitary board (Shim, 2006). The general view of Malaysian corporate ownership is largely that of control by a small group of related parties or by owner-managers. The ownership structure is usually highly concentrated among a few individuals or their families, with some state involvement (AlQadasi & Abidin, 2018)

In terms of board size, the published findings in the Malaysian context are similar to the US experience. On average, Malaysian firms have seven members on the board of directors (Wan Mohammad, Wasiuzzaman, & Nik Salleh, 2016). In addition, the literature documents that Malaysian firms have a high concentration of ownership compared to those in the UK and the US (Hooy, Hooy, & Chee, 2019). Their finding indicates that the ownership structure of companies in Malaysia is less diffuse and is dominated by companies with substantial shareholders, and these are typically families. Similar to evidence from earlier international studies, the relationship between ownership structure and firm performance in Malaysia also produces mixed results. Studies have also shown find that ownership concentration in Malaysian firms is negatively related to firm performance as measured by Tobin's Q and return on assets (Alias, Yaacob, & Jaffar, 2017; Wang & Shailer, 2015). In contrast, the literature is also contentious where studies document a positive correlation between block holder ownership (five percent or more of the common stock) and firm performance, and it can be inferred that block holders can act as effective monitors and enhance performance (Hooy et al., 2019). The appointment of independent directors on a Malaysian corporate board may not be due primarily to their expertise and experience; rather they may be for political reasons or for the purpose of legitimizing business activities, for wider directorate interlocking and for preferential treatment in securing contracts (Choong, Chan, & Pek, 2016; Yatim, Iskandar, & Nga, 2016).

In the Malaysian context, leadership structure is found to be associated with ownership type. Tam and Tan (2007) find that the combined roles of CEO and Chairman are considerably more prevalent in firms where the concentration of ownership is held by individuals and family investors. Family shareholders tend to preserve their interests in firms by engaging in management themselves. Even though it is generally accepted that nonduality promotes better governance, this is not well supported empirically. For example, Haniffa and Cooke (2002) report that disclosure by Malaysian firms is negatively associated with the nonduality structure. The result implies that a nonexecutive chairman may prefer less disclosure and the associated benefits, with a tendency to keep private information secret. This evidence seems to be contradicted by agency theory, however, which suggests that nonexecutive chairs provide an internal mechanism of checks and balances through their independent role. These authors infer that the combined roles of CEO and Chairman can improve the effectiveness of monitoring efforts, as less contracting is involved and because of the potential decrease in information asymmetry.

Prior empirical evidence concerning Malaysian firms shows an inverse relationship between board size and firm performance (Low, Roberts, & Whiting, 2015). Hence, board size does not influence the strength of corporate governance practice in Malaysian firms. Studies of Malaysian firms by Yatim et al. (2006) and Hashim and Devi (2008) have included board meeting frequency as a control variable. Yatim et al. (2006) apply board meeting frequency to measure board activity, and they hypothesize that boards of directors that are more independent have a smaller number of members, establish a risk management committee, meet more frequently and pay lower external audit fees. Their investigation was unable to find any significant relationship between the external audit fees and financial performance and board meeting frequency. Hashim and Devi (2008) fail to find a relationship between board meeting frequency and earnings quality. In summary, the intensity of board meetings does not promote management's oversight efforts (Cai, Liu, Qian, & Yu, 2015). The use of debt financing as a governance mechanism in Malaysia has been largely established in previous studies (Haniffa & Hudaib, 2006; Hussain, Abidin, Ali, & Kamarudin, 2018; Tam & Tan, 2007). Debt financing through banking institutions has been the dominant form in Malaysia (Alqadasi & Abidin, 2018). However, according to Suto (2003), the use of debt as a mechanism to discipline management has not been successful in Malaysian firms, although Haniffa and Hudaib (2006) find a positive relationship between gearing and Tobin's Q. This implies that the market perceives gearing as an effective mechanism to control and improve performance. In one survey, Tam and Tan's (2007) findings support the argument put forward by Suto (2003) that debt is not an efficient governance tool in Malaysia. The authors suggest this is because Malaysia's market is still immature. Tam and Tan (2007) also document that the employment of debt is higher in firms where board leadership is separated. This implies that the firm may utilize an outside and independent chairman to gain access to critical external funding (Bhatt & Bhatt, 2017).

3. Methodology

3.1 Data and Sample Selection

The sample incorporates 10 industry sectors, namely, construction, consumer products, hotels, infrastructure, industrial products, mining, plantations, properties, technology and trading/services. For the purposes of consistency with previous work, this study applies criteria similar to those of Mak and Li (2001) and Abdullah (2004), whereby firms in sectors that are classified under finance, unit trusts, closed funds and warrants are excluded from the sample, mainly because financial firms are differently regulated; further, because the financial performance indicators are not comparable, firms must be active throughout the observation years, the annual reports must be available on the Bursa Malaysia website, and the financial data are available from the Worldscope database. Data are obtained for the years 2001 to 2018, where pre-2001 data are excluded due to the introduction of the MCCG in 2000. In addition, we eliminate firms where the ROA and ROE observed are outliers (more than 100 percent and less than -100 percent. After the data refinement process, the sample comprises 605 firms operating in 10 different industries and 10,128 firm-year observations.

For the ease of computation of firm performance indicators, previous empirical work on the Malaysian governance system, e.g., by Haniffa and Hudaib (2006), Abdullah et al. (2015) and Jong and Ho (2018), has excluded the data for firms with recorded negative equity book value and negative earnings. However, this study includes those firms with negative net worth and earnings as the primary interest is the relationship between the structure of the board and financial performance, and there is specific interest in the effects of family related directors, rather than the precise financial structure of the firm. The estimation using unbalanced panel methods is designed to enrich the evidence of internal governance mechanisms in Malaysian firms. The advantages of applying panel data methods as suggested by Hsiao (2014) include (a) controlling for individual heterogeneity, (b) modeling the dynamics of adjustment in the variables, and (c) measuring effects that are simply not detectable with pure cross-section and pure time-series data.

3.2 Variables

For this study, 11 variables are selected for use in the investigation, and these variables are from two categories, i.e., board characteristics and financial variables. For board characteristics and control variables, the variables are family related directors (FRD), the percentage of independent directors, board leadership structure, board size and board meeting frequency. Other control variables include firm size, the percentage of ownership stake held by the top five shareholders and leverage as control variables. Financial variables are based on return on assets, market-to-book ratio and the modified Tobin's Q.

Board characteristics are manually accessed from the company's annual report and the corporate database available at the Bursa Malaysia website. The inclusion of the percentage of equity held by the top five largest shareholders is motivated by the work of Haniffa and Hudaib (2006) and Dinh and Calabrò (2019). For firm performance indicators, we select three profitability and market valuation proxies, which are widely used in much governance literature, namely, Return on Assets (ROA), Market-to-Book Ratio (MTB) and the Modified Tobin's Q (MTQ). The definition of variables utilized in the model are provided in Table 1 below.

3.3 Hypothesis and Model Specification

Based on the arguments put forward by Fama and Jensen (1983) and DeAngelo and DeAngelo (1985), family-controlled firms are likely to be more effective at aligning interests between managers and shareholders. The risk of a managerial decision acting against the shareholders' interests is expected to be minimal in family-controlled firms, and this may result in more efficient operations and superior performance. Halim, Mustika, Sari, Anugerah, and Mohd-Sanusi (2017) further argue that firm performance can be measured via accounting ratios as well as market-based indicators.

Thus, our hypotheses are as follows:

Hypothesis 1: FRD is positively related to ROA

Hypothesis 2: FRD is positively associated with the MTB

Hypothesis 3: FRD is positively related to MTQ

Our model is specified as follows for firm performance (FP), measured alternately by ROA, MTB and MTQ and is inclusive of time and industry dummies [1, 0]:

$$FP_{it} = \beta_1 CONST_{it} + \beta_2 FRD_{it} + \beta_3 IND_{it} + \beta_4 DUALITY_{it} + \\ + \beta_5 BSIZE_{it} + \beta_5 OWN5_{it} + \beta_7 MEET_{it} + \beta_8 FSIZE_{it} + \\ + \beta_9 LEV_{it} + \varepsilon_{t+1} \quad (1)$$

4. Empirical Results and Discussion

4.1. Describing the sample and univariate analysis

Table 2 below reports the descriptive statistics for all variables used in this study. The raw data for ROA displays a serious asymmetric distribution and outlier problems. To mitigate this, we trim all the variables. This has been achieved by setting a cut-off percentage of -100 and 100 for ROA, which thus allows statistical estimations that avoid the effect of extreme values

Table 1. Definition of variables

Variables	Label	Definition
1. Board and firm characteristics		
Family related directors	*FRD*	Total number of directors who have a family relationship with other directors on the board.
Independent directors (percentage)	*IND*	Percentage of independent nonexecutive directors on the board.
CEO/Chairman duality roles	*DUALITY*	A dummy variable takes on the value 1 if the CEO is also the Chairman of the board and/or if CEO and Chairman are related in terms of a family relationship; otherwise it is 0.
Board size	*BSIZE*	Total number of directors on the board.
Top 5 shareholders (percentegae)	*OWN5*	The proportion of shares owned by the five largest shareholders to total shares outstanding in the company.
Board meeting frequency	*MEET*	Number of board meetings held during the financial year.
Firm size	*FSIZE*	Natural log of total assets measured in 2008 prices.
Leverage	*LEV*	The ratio of total debt over total assets.
2. Accounting profitability and market valuation		
Return on assets	*ROA*	The ratio of earnings before interest and taxes to book value of total assets.
Market-to-Book ratio	*MTB*	Market value of equity divided by total book value of equity at year t.
Modified Tobin's Q	*MTQ*	Market value of equity plus book value of total debt divided by book value of total assets.

Source: Adapted from "Corporate governance structure and performance of Malaysia listed companies" by Haniffa and Hudaib (2006) in *Journal of Business Finance and Accounting*, 33(7-8), 1040; "Asian family firms through corporate governance and institutions: a systematic review of the literature and agenda for future research" by Dinh and Calabrò (2019), *International Journal of Management Reviews*, 21(1), 56.

of ROA (Kothari, Laguerre, & Leone, 2002). Furthermore, naive interpretation of statistics derived from data sets that include outliers may be misleading.

This study focuses on FRD where the median is two, as reported above. The maximum number for FRD throughout the analysis is eight. This preliminary analysis is consistent with earlier evidence described by Johnson and Mitton (2003) and Haniffa and Cooke (2002) of the extent of family related directors' involvement in public corporations in Malaysia. Both studies came to the conclusion that a significant number of family related members are evident on the boards of Malaysian companies. However, our interpretation is that while such directors can be numerous in some firms, as the maxima show, the key feature seems to be the expectation of two FRD, further demonstrating that linked directorships are usual in public corporations but not necessarily a dominant feature. It can be

Table 2. Descriptive Statistics

	FRD	IND	Duality	BSIZE	OWN5	MEET	FSIZE	LEV	ROA	MTB	MTQ
Mean	1.52	48.45	0.35	7.62	47.10	5.37	19.66	0.23	0.03	1.78	0.85
Median	2.00	47.50	-	7.00	48.99	5.00	19.43	0.21	0.04	1.87	0.73
Min	0.00	0.20	-	3.00	0.00	0.00	15.35	0.00	-0.63	0.91	0.06
Max	8.00	100.00	-	17.00	98.76	27.00	24.87	0.87	0.66	2.02	7.83
Std Dev	1.74	10.80	0.48	1.95	20.86	2.21	1.33	0.18	0.09	0.26	0.55

seen that the FRD data distribution shows an overall mean (1.52) that is relatively low by comparison with the standard deviation (1.74). There are two points to note here. First, as FRD is a count variable, the descriptive statistics are indicative only, as the lower bound is zero. Consequently, in the statistical analysis reported later in the paper, the variable is logged (Guest, 2009). A similar approach is adopted for BSIZE and MEET (Yermack, 1996). In addition, we employ a median regression model (Guest, 2009). Second, it should be emphasized that FRD is defined in this study by the existence of a family relationship among any of the board members. Therefore, FRD may be recorded as zero or as two or more but never as one. In this study, we classify a firm as having a joint leadership structure if it falls under one of two conditions. The first condition has been commonly used in many previous studies, i.e., when the CEO and Chairman roles are combined, and the second condition is when the CEO and Chairman of the board have a family relationship to one another. As far as we are aware, none of the previous studies on corporate governance structure have applied this approach. The definition used here is more appropriate, and justifiable, because the independence of leadership structure is questionable when the CEO and Chairman are related. In addition, the correlation matrix is reported in Table 3 below.

Table 4 below presents a comparison between firms with FRD. We find that there is a difference in ROA between firms with and without FRD. The T-test reveals a significant difference at the 1percent significance level. The result suggests that the appointment of FRD is related to higher firm performance, which is also reported by Hashim and Devi (2008), who found that the representation of family members on boards is likely to enhance earnings quality, as these directors have greater expertise of the firm's operations and thus effectively monitor the firm's activities more closely.

Table 4 also shows that firms with FRD have lower market values as measured by MTQ and MTB. The results suggest firms with FRD are valued lower than their counterparts as a result of FRD's influence on the firm's risk-averse strategy. However, this in turn could prevent the firm from suffering severe economic losses during the crisis. At the same time, we know that FRD is also viewed as a strong factor in firm survival (Ibrahim & Samad, 2011; Neckebrouck, Schulze, & Zellweger, 2018).

4.2. Modeling Profitability

We report the results for regressing our model in Table 5 below for the first performance measure. To estimate the model, we employ the OLS methods, which include time and industry dummies as reported in the first column for firm profitability (ROA). White (1980) standard errors are reported in parentheses. Our regressions include time and industry dummies. Independent directors (IND) are negatively related to ROA, confirming the results of Zabri, Ahmad, and Wah (2016) and Germain, Galy, and Lee (2014). Our findings, however, are in contrast with Fooladi, Abdul-Shukor, Saleh, and Jaffar (2014), which could be because our definition of independent directors differs from their study. This result indicates that the presence of IND may not have the intended influence on the quality of directors' deliberations and decisions and

Table 3. Pairwise correlation of variables used in panel data analysis

	FRD	*IND*	*BSIZE*	*OWN5*	*MEET*	*FSIZE*	*LEV*	*ROA*	*MTB*
IND	-.239***								
BSIZE	.201***	-.269***							
OWN5	0.031	-.147***	.163***						
MEET	-.019	.019	.031	-.037*					
FSIZE	.002	-.073***	.100***	.036*	.209**				
LEV	.077***	-.049**	-0.025	-.058***	0.025	.153***			
ROA	0.029	-.056***	.068***	.105***	-0.029	.175***	-.321***		
MTB	.065***	-.095***	.037*	0.029	0.028	149***	-.534***	-.188***	
MTQ	-.038*	.056***	0.002	0.014	-0.019	-.177**	-.074***	.182***	-.156***

Note: *** Significant at the 0.01 level, ** significant at the 0.05 level, *significant at the 0.1 level

Table 4. Univariate comparison of firms with *FRD* and firms without *FRD*

Mean	**Firms with *FRD***	**Firms without *FRD***	**T-test**
ROA	.04	.03	3.22***
MTB	1.75	1.79	2.18**
MTQ	.84	.87	2.04**

Note: *** Significant at the 0.01 level, ** significant at the 0.05 level, *significant at the 0.1 level

provide strategic direction and improvement in performance. This may also suggest that these directors lack real independence in enforcing monitoring. Interestingly, we find that after accounting for the influence of family relationships, DUALITY is not a significant determinant of firm performance, thus defeating the purpose of this particular form of corporate governance mechanism to safeguard shareholders' interests. Meeting frequency is negatively associated with ROA. A possible explanation of this situation is that a firm may increase its meeting frequency as a result of lower efficiency in assets investment. Ownership concentration is positively associated with ROA. This outcome is not consistent with findings by Tam and Tan (2007) and Ahmed Haji and Mubaraq (2015), who found a negative association between these variables. Our results differ because the measure of the ownership concentration used by both studies was computed solely for the ultimate owner of a firm. Nevertheless, our result reveals that the concentration of ownership control is linked to an efficient use of firm assets. Firm size has a positive coefficient while leverage has a negative coefficient.

The results for the key explanatory variable, i.e., for firm related directors (FRD), is statistically significant. The log coefficient of 0.0038 implies that if a firm with 2 family related directors were to increase by 2 (100 percent increase), the profitability of the firm would increase by approximately 0.004. Thus, the existence of family related directors has a positive impact on firm

Table 5. The impact of family related directors on return on assets (ROA).

Variables	1	2	3	4
Intercept	0.0084***	0.0009	-0.1922***	-0.3345***
	(0.0021)	(0.0405)	(0.0275)	(0.1288)
FRD	0.0038***	0.0044***	0.0031***	0.0035***
	(0.0006)	(0.0011)	(0.0010)	(0.0009)
IND	-0.0015***	-0.0008	-0.0003***	-0.0001
	(0.0005)	(0.0003)	(0.0001)	(0.0001)
DUALITY	0.0141	0.0089	-0.0007	0.0005
	(0.1099)	(0.0818)	(0.0389)	(0.0012)
BSIZE	-0.0025	-0.0019	-0.0013	-0.0008
	(0.0269)	(0.0385)	(0.0012)	(0.0682)
MEET	-0.0028***	-0.0036***	-0.0020***	-0.0023***
	(0.0009)	(0.0008)	(0.0007)	(0.0008)
OWN5'	0.0010***	0.0006**	0.0003***	0.0008**
	(0.0004)	(0.0003)	(0.0001)	(0.0004)
FSIZE	0.0245***	0.0231***	0.0181***	0.0088
	(0.0108)	(0.0099)	(0.0019)	(0.0191)
LEV	-0.3114***	-0.2645***	-0.1671**	-0.1232***
	(0.1258)	(0.1028)	(0.0846)	(0.0401)
ROA_{t-1}	-	-	-	0.3899***
	-	-	-	(0.1028)
Adjusted R^2	0.1828	0.2406	0.1682	0.4844
Sargan (p-value)	-	-	-	0.1288
Serial correlation (p-value)	-	-	-	0.2890

Note: *** Significant at the 0.01 level, ** significant at the 0.05 level, *significant at the 0.1 level

performance in Malaysia, thus extending and justifying the findings of Amran and Ahmad (2016) and Sharif, Kyid, and Wei (2015). The effect is also economically significant, as it would lead to an increase of about RM 21 million, which contradicts the findings of Ibrahim and Samad (2011). However, the authors' measure of family related firms was based on the ownership structure rather than control point of view. Our findings also provide a rationale for the lackluster compliance to the MCCG by Malaysian firms as evidenced by Ahmed Haji (2014), given that the literature documents a large number of family related firms in the market.

Our results were obtained based on the OLS methods, which suffer from endogeneity concerns given that the FRD variable and firm profitability are jointly determined by firm-specific variables which may not be observable and thus are not captured in our model. Furthermore, OLS results tend to be biased in investigating the causality relationship between corporate governance mechanisms and firm performance. Thus, we opt for a fixed-effects model, which is commonly used in the literature to control for the bias introduced by omitted variable bias (Born & Breitung, 2016; Yermack, 1996). The results are reported in the second column, with standard errors clustered at both firm and year levels, i.e., two-way clustering (Petersen, 2009; Thompson, 2011). This approach maximizes the efficiency gains from panel data observations while providing a more stringent method to test for significance. The coefficient is slightly reduced and remains statistically significant at the 1 percent level. Other results do not change qualitatively.

The literature further documents the possibility that our estimates are biased due to past and current performance determining board characteristics (Guest, 2008; 2009). The OLS and fixed effect approach would be an inappropriate tool for dynamic and simultaneous endogeneity concerns (Guest, 2009). Thus, we employ the instrumental variable method (IV), as reported in the third column. We utilize OWN5, FSIZE and LEV as instruments. However, the IV approach would still suffer from not utilizing all potentially available moment conditions, leading to the estimations being inefficient (Roodman, 2009). Thus, we also report the results based on 2 step-system GMM estimates for dynamic panel data in order to resolve issues of heterogeneity which are unobservable, as well as the simultaneous and dynamic potential for endogeneity. The dynamic model allows us to capture the impact of past and present performance and thus is the appropriate approach (Bun & Windmeijer, 2010). The results for GMM estimations are reported in the fourth column, where standard errors are based on the corrections for small sample bias (Windmeijer, 2005). Similar to the IV approach, our coefficient is slightly reduced but remains significant both economically and statistically, which validates our results from OLS estimates.

4.3. Market Measures of Firm Performance

To capture the impact of FRD on market measures, we report the results for regressing the modified market-to-book ratio (MTB). The model utilizes a similar set of explanatory and control variables, as reported in Table 6. Results for OLS estimates are reported in the first column. We find that firms with family related directors tend to have a negative impact on market measures. The results are robust given that the finding does not change as we employ more efficient methods: firm fixed effects, IV and the GMM approach. We further utilize the modified Tobin's Q (MTQ) measure and find similar results in the next column.

We find that family related directors are associated with a lower market valuation, which is line with the expectations based on the literature (Claessens et al. 1999; Mullins & Schoar, 2016); this association suggests that other than the CEO and Chairman position, the appointment of family members on boards is likely to induce self-selection and low transparency deals (Claessens & Fan, 2002; Kotlar, Signori, De Massis, & Vismara 2018). Consequently, this condition could increase barriers to external sources of funding (mainly from equity sources) due to the threat of expropriation by family owners. In addition, we observe that a large number of family directors are commonly appointed as nonexecutive directors, a type of appointment sometimes referred to as a 'symbol' of a family 'business legacy' (Huang, Meschke, & Guthrie 2015). Apparently, such a situation could also be due to the reluctance of the older generation to pass on its ownership and management power to its successors (Ghosh & Tang, 2015; Singam, 2003;). This could explain why firms with dominant family members lack professional directors and are viewed negatively in the market. In addition, this type of board characteristics imposes difficulties in terms of allowing external investment in the firms, given the potential of agency conflicts with minority shareholders (Chu, Lai, & Song, 2016; De Cesari, Gonenc, & Ozkan, 2016). This is evidenced by firms with a higher representation of FRD being related to a higher debt ratio (LEV). This may signify that the controlling shareholders are using debt as an alternate means of funding its internal operation (Díaz-Díaz, García-Teruel, & Martínez-Solano, 2016; Pindado, Requejo, & de La Torre, 2015). This also serves as an anti-dilution mechanism of their shareholding dominance. Thus, the representation of these directors has adverse consequences on a firm's valuation (Burgstaller & Wagner, 2015).

Table 6. The impact of family related directors on market measures (MTQ & MTB)

Variables	1	2
Intercept	0.0245***	2.833***
	(0.0081)	(0.8469)
FRD	-0.0903***	-0.2185***
	(0.0252)	(0.0634)
IND	0.0124**	0.0021
	(0.0060)	(0.0322)
DUALITY	0.0408**	0.1192***
	(0.0205)	(0.0372)
BSIZE	0.0382**	0.0245
	(0.0190)	(0.0535)
MEET	0.0508***	0.0311***
OWN5'	0.0191**	0.0399***
	(0.0096)	(0.0108)
FSIZE	0.0363***	0.0892***
	(0.0129)	(0.0255)
LEV	0.8129***	0.2422***
	(0.0415)	(0.0375)
Adjusted R^2	0.1828	0.2406

Note: *** Significant at the 0.01 level, ** significant at the 0.05 level, *significant at the 0.1 level

The director's independence has a positive coefficient, suggesting that markets view this as a positive move, contrary to Liew, Alfan, and Devi (2017) and despite our earlier results indicating that director's independence has a negative impact on firm performance. However, these discrepancies could be because our study treats nonexecutive directors who are related as nonindependent directors in order to fulfill our objective of studying the effect of family related directors' impact on performance. Thus, our findings highlight that market expectations may not necessarily be reflected in superior firm profitability. Investors thus tend to place a heavy reliance on independent directors to safeguard their interests. We observe a similar effect for duality. In addition, we find that board size and frequency of meetings have a positive and significant relationship, which is in line with Ibrahim and Samad (2011).

5. Conclusion

This study was motivated by the conclusions of several earlier studies, as discussed above, regarding governance mechanisms, specifically board independence and board leadership in Malaysia. However, these studies fail to find a strong link between board independence and board leadership structure and their effect on firm performance. Meanwhile, previous evidence has also shown that the integration of directors with family relationships into the commercial world is commonplace.

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We question the possibility that the affiliation of directors with family influence could influence Malaysian firms' financial performance. In addition, the extent of the effect of these directors on firm performance has not been empirically studied elsewhere, especially within emerging developing countries. Our study thus aims to fill this gap, given that Malaysia provides a unique opportunity to observe these factors. This study also introduces a new approach to identifying board leadership structure. Unlike previous studies, this study considers the family affiliation between CEO and Chairman in determining the leadership structure. This method accurately reflects the duality and nonduality structure. Hence, our measurement of independence also differs from previous studies.

Our findings suggest that the high involvement of FRD is related to the high efficiency of management in using its assets to generate earnings (as measured by ROA). From this finding, we argue that family directors possess superior information about the firm's operations and have a longer investment horizon, leading to greater investment efficiency. Thus, the first hypothesis is supported. On the other hand, the results also indicate that firms are valued less as a result of an increase in family related director representation, suggesting that the market perceives that the domination of family members on the board could lead to the potential expropriation of wealth at the expense of other shareholders. Therefore, the second and third hypotheses are rejected.

In other words, investors may perceive that firms with dominant family directors are lacking in the protection of minority stakeholders' interest because uncontested power rests with family owners. The mechanisms deployed to abuse the rights of minority stakeholders are numerous and quite well-known, and they range from the internal consumption of profits to the transfer of assets at below-market prices ("tunneling"); they also include other well-known tricks, among them the manipulation of transfer prices within conglomerates, the internal consumption of profits and the transfer of assets at below-market prices. However, it may also be argued that investors perceive the investment growth in firms with dominant family directors as unattractive as a result of owners being overly cautious in protecting their business legacy, while at the same time these firms are averse to venturing on big projects that may be risky.

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