

# The Influence of Foreign Investors on Firm Performance in Malaysia: A Case of Trading and Services Listed Firms

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**Abstract**— Previous studies examining the relationship of foreign investors and firm performance produced inconclusive finding. These studies assumed that a linear relation exists between foreign shareholdings and firm performances. This study examines the relationship between foreign ownership and firm performance of trading and services listed firms in Malaysia. The research utilizes the agency theory and uses ROA and Tobin's Q as the firm performance indicator. Foreign shareholdings had been identified as the predictor variables and firm size and leverage are the controlled variables. It is found that there is a significant relationship between foreign ownership with firm performance. Apart from that, it is also found that higher concentrated foreign ownership enhances firm performance. Malaysia is uniquely suitable for a study on foreign shareholdings as Malaysia is currently embarked on an ambitious journey to transform itself into a high-income economy by 2020 through the Economic Transformation Programme (ETP) by boosting both investments and private consumption.

**Keywords**— *Foreign investors, firm performance, Malaysia*

## 1. Introduction

The increase towards globalization of capital markets has resulted in many countries opening up their capital markets to attract foreign investors [1]; [2]. Due to this, [3] find that besides contributing to capital market or economic development in emerging countries, foreign ownership also acts as important actors in domestic ownership structure systems. Foreign investment contributes positively as it helps to improve productivity and competition besides providing extra resources and various employment opportunities. Further, foreign investment also creates considerable anxiety because it is said foreign investment creates volatility in the local markets, endangers economic sovereignty and expropriates local shareholder

wealth. Due to that, it is still hotly discussed in many countries over the issue of whether foreign ownership contributes to better firm performance. The effects of foreign ownership on firm performance could not be conclusively determined from previous studies. There are studies that show firm performance is not affected by the presence of foreign ownership [4], [5]. The findings from their studies clearly contradict with the findings of most studies on the same issue [6]; [7].

One of the reasons why this issue becomes debatable is because foreign ownership of local firms, known as “outsiders”, differs from domestic ownership. Independence from outside influence is considered a virtue as it promotes a sense of belonging and self-determination among insiders. Nevertheless, foreign investors are able to provide some measures of independence and objectivity. However, the possibility of principal-agent conflict arises with the presence of asymmetrical information stemming from the ownership separation and management functions. [8] state that domestic owners and management have a driven purpose to fulfil their own benefits at the cost of atomistic foreign shareholders, and this will cause substandard firm evaluation. Studies by [9] show that managers with self-interest may lead to the misuse of corporate assets by pursuing risky and imprudent projects at the expense of capital providers. With regard to this, foreign shareholders can act as effective players in monitoring inside shareholders and managers.

## 2. Foreign Ownership and performance

Another aspect that causes the relationship between foreign ownership and firm performance to be debatable is the weightage of shares held by

foreigners in local firms. McConnell and Servaes [10] proposed that the different ownership types in firms have different effects on firm performance. Thus, the distribution of shares among different types of shareholders determines the firm's performance. [6] in their study on 896 companies in Korean Exchange [11] in his study on the effect of foreign ownership on firm performance of listed firms in Vietnam, came to a conclusion of an reversed U shaped relationship between foreign ownership and firm performance. Their findings are parallel with the corporate governance theory that puts forward the idea of monitoring by shareholders and damages from expropriation has a positive impact when shareholders' ownership reaches a certain large level [12]. These results can be interpreted as the presence of minority foreign shareholders play effective monitoring roles in mitigating agency conflict and thus, improving firm performance while majority foreign shareholders may relate to expropriations that will be harmful to firm performance. The study by [13] during the 1997 Korean financial crisis includes a finding that firms with concentrated foreign investors experience a lesser reduction in share values during the crisis. This supports the theory that distribution of shares among various shareholders plays a vital role in enhancing firm performance.

Despite the contradictions in the studies conducted by various researchers, there are a number of ways foreign ownership contributes towards a positive firm performance. One of the ways is by securing foreign representation in the board. A study on Swedish firms by [14] show that foreign directors have indeed given positive impacts on firm performance. On top of that, the convergence of governance and business practices in advanced countries in local firms owned partially by foreigners has shown a positive informational effect on firm performance. Besides that, foreign board membership may lead to improved productivity or better positioning of local firms in competitive global markets.

This study investigates the relationship between foreign ownership and firm performance in Malaysian listed trading and services firms using the panel data for the period 2006 to 2015. In Malaysia, there are studies on ownership concentration and firm performance [15]; [16], foreign direct investment and economic growth [17] and foreign portfolio investment and economic growth [18] however, there is no research done solely focusing on foreign ownership and firm performance of Malaysian listed trading and services firms. Trading and services firms are

chosen for this study as it is the main sector that contributes to the nation's Gross Domestic Product (GDP). According to the Department of Statistics Malaysia (2015), trading and services sector is targeted to remain as the primary driver in the economic growth during the Eleventh Malaysia Plan from 2016 to 2020 and currently it is contributing 53 percent out of the total GDP. Malaysia is uniquely suitable for a study on foreign ownership as Malaysia is currently embarked on an ambitious journey to transform itself into a high income economy by 2020 through the Economic Transformation Programme (ETP) by boosting both investments and private consumption. Through collaborations between the public and private sector, the ETP aims to create a vibrant and competitive business environment for investments. Besides that, five domestic stock market crashes experienced by Malaysia in 1973, 1981, 1987, the devastating 1997 and the global financial crisis in 2008, have put Malaysia through a tough journey.

The purpose of this research is to examine how foreign ownership affects firm performance. The objectives of this study is to investigate the relationship between foreign ownership and firm performance of listed trading and services firms in Bursa Malaysia. Foreign investment can affect a host country economy through its various linking effect via the domestic capital market. According to [19], mainstream economists suggest that foreign investment provides an upward thrust to the domestic stock market price. This has, in turn impacted the price-earning (P/E) ratios of firms. In general, higher P/E ratio suggests that investors are expecting higher earnings growth in the future. Consequently, it will lead to a higher investment as a booming share market will attract new investments. Thus, with new equity investment also comes in better knowledge and skills. According to Djankov and Hoekman [20], foreign investment is associated with the provision of generic knowledge (management skills and quality systems) and specific knowledge (which cannot be transferred at arm's length). Generally, foreign multinationals apply uniformly the governance policies and management they practice into their local subsidiaries. Hence, the subsidiaries will have access to managerial talents and skills from the home base, which can be effectively deployed to improve firm performance. Sarkar and Sarkar [21], found that the ability in capital, labour and technology provide foreign investors with better position to exploit the advantages to influence firm performance positively. Hence, this study states the following hypothesis:

H<sub>1</sub>: There is a significant relationship between foreign ownership and firm performance.

Foreign ownership plays a high-flying role in a firm's financial policy in emerging countries [22]. In Malaysia, due to the market liberalization, a lot of firms in Malaysia possess significant foreign ownership. The ownership held varies from small ownership percentage by institutional investors to block holdings by subsidiaries of multinational firms. Due to this, it is vital to evaluate how far investors are willing to monitor and persuade the management to improve the value of the firm. Lee, Liu, Roll and Subrahmanyam [23] state that there is evidence foreign ownership has a significant impact on firm performance. Their findings are in line with the agency theory that states agency costs are reduced and monitoring role is increased with the presence of foreign investors with substantial share. As the consequence, the performance of the firm is increased [24]. Hence, this study puts forward a third hypothesis as follows:

H<sub>2</sub>: Higher concentrated foreign ownership exhibits better firm performance.

### 3. Methodology and Data

As for data sources, this research focuses on trading and services firms listed on Bursa Malaysia, with available data and annual reports from 2006 to 2015. This period is chosen as it includes the year when the global financial crisis occurred. This study is more significant as it captures three separate economic situation stages; namely pre-crisis in 2006, during crisis from 2007 to 2008 and post-crisis from 2009 to 2015. The International Monetary Fund (IMF) estimates it takes between eight to ten years for global recession to recur. Thus, we might be facing another global financial crisis soon. It is hoped that the findings of this research are able to guide current and future investors in making the crucial decision.

The statistics on foreign shareholdings and other types of financial data and assets are obtained from Bursa Malaysia and companies' annual reports. This study adopts the assumption that data from annual reports are reliable as all important data such as financial information and board of directors' information have been audited and validated by professional parties before being disclosed to public. Besides that, according to [25], one of the benefits of using secondary data is it saves cost and time compared to using primary

data, without compromising the validity and reliability of the source.

The population in this research comprises all the trading and services firms listed on Bursa Malaysia from 2006 to 2015. This sector is chosen as it is the biggest contributor to the country's Gross Domestic Product (GDP), where in 2014 it contributed 53.8 percent to Malaysia's GDP (Central Intelligence Agency World Factbook, 2015, Department of Statistics Malaysia). Besides, according to Malaysian Investment Development Authority (MIDA), foreign investment in the services sector surged by 112.1 percent in the first quarter of 2015 and has attracted the largest portion of foreign investment.

For this research, firms which do not have complete data and meet the set criteria will be excluded from the samples. Initially, there were 211 firms from the trading and services sector. After taking into consideration various exclusion aspects, it is found that 155 firms do not have foreign ownership, 8 firms have not been listed since 2009 and 18 firms do not have complete data and annual reports. Hence, these samples are excluded from the research. The total samples for this research is 30 firms with foreign ownership and foreign directors. The total number of firm-year observation is 300.

#### 3.1 Variables

In this research there are three types of variables involved; dependent, independent and control variables. Independent variables are stimulus variables or variables that influence other variables. These variables are measured, manipulated or chosen to determine their relationship with an observed phenomenon. On the other hand, dependent variables are variables that respond to the independent variables. These variables are observed and measured to determine the influence caused by the independent variables. Meanwhile control variables are variables that are held constant to clarify the relationship between other variables.

Variables	Abbreviations	Description
<b>Dependent</b> Return on Assets	ROA	Net income divided by total assets
Tobin's Q	Q	The ratio of market value plus debt divided by total assets
<b>Independent</b> Foreign Ownership	FO	The percentage of shares held by foreign investors
<b>Control</b> Firm Size	SIZE	Total assets of a firm
Leverage	LEV	Total debt divided by total assets

### 3.2 Empirical Model

This study uses secondary data in determining the relationship between foreign ownership and firm performance that is measured through ROA and Tobin's Q. This empirical model is constructed to measure firm performance of Malaysian trading and services firms listed on Bursa Malaysia. The empirical models below are used to test the hypotheses.

$$ROA = \alpha + \beta_1(FO) + \beta_2(FD) + \beta_3(SIZE) + \beta_4(LEV) + \varepsilon \quad (1)$$

$$Q = \alpha + \beta_1(FO) + \beta_2(FD) + \beta_3(SIZE) + \beta_4(LEV) + \varepsilon \quad (2)$$

Where:

ROA	Return On Assets
Q	Tobin's Q
$\alpha$	Intercept
FO	Foreign ownership
SIZE	Firm size
LEV	Leverage

### 3.3 Descriptive statistic

Based on the analysis in Table 1, the average value of the firms' performance, as measured by ROA, in the sample for this research is 8.02 percent with the minimum and maximum value obtained is -23.62 percent and 48.36 percent, respectively. As for the other firms' performance indicator, Q shows an average value of 0.25 while providing a minimum value of 0.01 and maximum value of 0.69. Meanwhile, for the independent variables, foreign ownership shows an average value of 31.54 percent with a minimum value of 0.20 percent and maximum value of 79.60 percent. This shows that

an average of 31.54 percent of Malaysia's trading and services firms' shares are held by foreigners. This is consistent with the Malaysia's stand which allows up to 70 percent foreign ownership for firms exporting between 51 percent to 79 percent of their production. On the other hand, the average value for foreign directorship is 23.86 percent with a minimum and maximum value of 10.00 percent and 54.55 percent respectively. Leverage and firm size are the control variables for this research. The leverage of the firms shows an average value of 0.45 and 9.01 is the average value for firm size. Minimum and maximum values for leverage and firm size are between 0.10 and 0.90 and 6.89 and 11.08 respectively.

**Table 1.** Descriptive Statistics

Variables	Mean	Min	Max	Standard Deviation	Skewness	Kurtosis
FO	31.54	0.20	79.60	22.96	0.53	-0.74
Lev	0.45	0.10	0.90	0.19	0.20	-0.64
Size	9.01	6.89	11.08	0.82	0.27	-0.56
ROA	8.03	-23.62	48.36	8.95	0.54	1.89
Q	0.25	0.01	0.69	0.17	0.61	0.55

Notes: FO is the portion of shares held by foreign investors. Lev is leverage and calculated by total debt divided by total assets. Size is firm size based on total assets. ROA calculated by net income divided by total assets. Q calculated based on ratio of market value plus debt divided by total assets.

## 4. Results of Correlation

Table 2 shows the results of Pair-wise Pearson Correlation matrix for the dependent, independent and control variables in this research. From the results, even though there is a significant relationship between the variables, the correlations between the variables are relatively low. According to [26], multi-collinearity could be a problem when the correlation exceeds 0.80. In Table 2, it can be seen that the highest correlation is 0.390 between Lev and Size. The low inter-correlation among the variables indicates no suspicion of serious multi-collinearity. The inter-correlation analysis results between Return on Assets (ROA) and Foreign Ownership (FO) show a positive but weak correlation where  $r$  is 0.25 and it is significant at  $p < 0.01$ . A positive correlation here means that when FO increases ROA also increases. This finding is consistent with the research conducted by [11][27][28] that utilizes ROA as the criterion variable and FO as the predictor variable. This positive and significant correlation supports hypothesis H1 of this study

that there is a significant relationship between foreign ownership and firm performance. In analyzing the correlation between the other firm performance indicator, Tobin's Q, it is found that it also has a positive relationship with the independent variables. The correlation between Tobin's Q (Q) with FO shows the value of r as 0.22 and it is significant at the 0.01 level. This finding is consistent with Viet [11] and [29].

**Table 2.** Pearson Correlation Matrix

		1	2	3	4	5
1	FO	1.000				
2	Lev	0.111	1.000			
3	Size	-0.043	0.390**	1.000		
4	ROA	0.247**	-0.130*	-0.034*	1.000	
5	Q	0.220**	0.121*	0.393**	0.529**	0.097

\*\*Correlation is significant at the 0.01 level (2-tailed)  
 \* Correlation is significant at the 0.05 level (2-tailed)  
 Notes: FO is the portion of shares held by foreign investors. Lev is leverage and calculated by total debt divided by total assets. Size is firm size based on total assets. ROA calculated by net income divided by total assets. Q calculated based on ratio of market value plus debt divided by total assets.

**5. Results of Multiple Regression Analysis**

Table 3 depicts the multiple regression results for the dependent variable, ROA, independent variables; FO and control variables; Size and Lev. The test is conducted to assess the effect of FO on firm performance indicator, ROA, as hypothesized. The multiple regression analysis results show that the four predictor variables, which are the independent variables; FO and the control variables; Size and Lev are the predictors for ROA. The Durbin Watson test is also conducted to check for autocorrelation between errors. The test reports a test statistic with a value from 0 to 4, with a value of 2 showing there is no autocorrelation. According to Field (2009), values less than 1 or greater than 3 are a definite cause for concern. For this study, with regards to ROA as the dependent variable, the Durbin Watson value is 1.219. Thus, the value is considered as relatively normal with no serious autocorrelation detected. Besides that, the R<sup>2</sup> value of 0.139 shows that 13.9 percent of the change in the dependent variable; ROA is due to the change in the independent variables. The results of the F-test of 11.892 shows that there is a significant relationship between each of the four independent variables and dependent variable at a p

< 0.05 level of significance. The regression findings reported in Table 3 imply that foreign ownership has a positive relationship with firm performance, ROA and it is statistically significant at 5 percent (p < 0.05). The foreign ownership coefficient of 0.178 implies that one percent increase in foreign ownership causes a 0.178 percent increase in ROA. Thus, this finding reinforces hypothesis H2 that higher concentrated foreign ownership exhibits higher firm performance and it also further supports hypothesis H1 that there is a significant relationship between foreign ownership and firm performance. This finding is consistent with studies conducted by Viet [11] and Jusoh [30] where they found higher percentage of foreign ownership leads to higher firm performance.

**Table 3.** ROA

Variables	Beta	t	Sig.
FO	0.178	3.030	0.003
Size	0.080	1.353	0.177
Lev	-0.175	-2.948	0.003
Durbin Watson	1.219		
R square	0.139		
Adj. R square	0.127		
F	11.892		

Table 4 depicts the multiple regression results for the dependent variable, Q, independent variables; FO and control variables; Size and Lev. The test is conducted to assess the effect of FO on firm performance indicator, Q, as hypothesized. The multiple regression analysis results show that the four predictor variables, which are the independent variables; FO and the control variables; Size and Lev are the predictors for Q. For this study, with regards to Q as the dependent variable, the Durbin Watson value is 1.427. Thus, the value is considered as relatively normal with no serious autocorrelation detected. Besides that, the R<sup>2</sup> value of 0.386 shows that 38.6 percent of the change in the dependent variable; Q is due to the change in the independent variables. The results of the F-test of 46.358 shows that there is a significant relationship between each of the four independent variables and dependent variable at a p < 0.05 level of significance. The regression results depicted in Table 4 imply that foreign ownership shows a positive relationship with firm performance, Q and it is statistically significant at 5 percent (p < 0.05). The foreign ownership coefficient of 0.273 shows that one percent increase in foreign ownership leads to 0.273 percent increase in Q. This finding supports hypothesis H2 that higher concentrated foreign ownership exhibits better firm performance and it also further supports hypothesis H1 that there is a significant relationship between foreign ownership and firm performance. This finding is

consistent with studies conducted by [11][30] where they found higher percentage of foreign ownership leads to higher firm performance.

**Table 4.** Tobin's Q

Variables	Beta	t	Sig.
FO	0.273	5.499	0.000
Size	0.445	8.862	0.000
Lev	-0.185	-3.701	0.000
Durbin Watson	1.427		
R square	0.386		
Adj. R square	0.378		
F	46.358		

### 5.1 Foreign Ownership and Firm Performance

The hypothesis states that there is a significant relationship between foreign ownership and firm performance. The correlation and multiple regressions analysis results showed that there is a significant relationship between foreign ownership and firm performance. This proves that foreign ownership has a positive relationship with firm performance based on ROA and Tobin's Q in trading and services listed firms in Malaysia and these findings clearly support the first hypothesis. This shows that foreign ownership in trading and services firms in Malaysia has led to superior firm performance. [31] supports the findings of this research where they found that foreign ownership portrays as an important player in the corporate ownership structure in emerging economies. There are quite a number of past researches that support the findings of this research. A study done by [32] which investigated the effect of various types of ownership on firm performance in Kenya concluded that there is a significant positive impact between foreign ownership and firm performance. [32] argued that foreign investors help to improve management system and have access to massive resources. There is also a study done on firms in Croatia by [33]. They concluded that listed firms controlled by foreign investors perform better than domestic firms. This is also supported by a study carried out by [34] where they contended that firms in Russia with foreign ownership have higher productivity than domestic firms. [35] also find that foreign owned firms show higher performance compared to other types of ownerships. Furthermore, a study conducted by [36] on companies in Indonesia Stock Exchange from 2009 to 2011 also found that foreign ownership has a positive and significant influence on firm value.

The findings on the firms in these emerging markets are closely related to Malaysia as Malaysia is an emerging market as well. [20] stated that

foreign investment is associated with the provision of generic knowledge and specific knowledge. Thus, it is understood that foreign ownership brings in new equity investment as well as better knowledge and skills. With better investment, knowledge and skills, foreign investors are in a better position to exploit the advantages of firms in order to influence firm performance. This is supported by [21].

## 6. Conclusion

This research examines the relationship between foreign ownership and firm performance of trading and services listed firms in Malaysia for 2006 to 2015. The research utilizes the agency theory and uses ROA and Tobin's Q as the firm performance indicator. Foreign ownership and foreign directorship have been identified as the predictor variables and firm size and leverage are the controlled variables. It is found that there is a significant relationship between foreign ownership and foreign directorship with firm performance. Apart from that, it is also found that higher concentrated foreign ownership enhances firm performance. Since this research only focuses on the trading and services firms, it is suggested that for future research, the analysis could be extended to other sectors as well. According to the Department of Statistics Malaysia (2016), the manufacturing sector is the next biggest contributor to Malaysia's overall GDP at 23 percent. Perhaps future research can be done on the manufacturing sector. Apart from that, it would be interesting if future research could capture the impact of foreign ownership on firm performance for pre, during and post 2008 global financial crisis. This research covers a span of ten years from 2006 to 2015. Thus, it is vital to study how foreign investors have affected Malaysia's firms and economy during those three separate economic stages in order to prepare the firms in Malaysia from adversities and to further improve the firms' performance and effectiveness in the global market. It is also suggested that further research to take into consideration the impact of other types of ownership structure on firm performance such as state-owned and family-owned firms. This is because these two types of ownership structure are the top dominators in Bursa Malaysia.

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