

THE PRESENCE AND FORMATION OF BUSINESS - POLITICAL CONNECTIONS IN THAILAND

Thitima Sitthipongpanich *

ABSTRACT

Thailand would be a representative country in emerging economies to discuss about formation and existence of connections because it demonstrates institutional settings of weak legal system, ownership concentration, business groups and close ties between politicians and businessmen. The development of family business framework demonstrates how ownership relations influence the structure of economic concentration. At the same time, business expansion is conducted together with political patronage. On the one hand, it is evident that the Thai economy grows with the capital accumulation of groups which have developed connections with the government. The economic boom in Thailand and being one of the Asian tigers were an evidence to prove the prosperity of the country. On the other hand, corruption and collusive actions between businessmen and politicians are most likely to lead to unfair competition and created unstable political situations for some periods in the past. In Thailand, the evolution of the country's politics influences the presence and form of connections and determines the industrialization and economic development. Furthermore, nowadays, a controversial issue about the close ties between politicians and businessmen is widely disputed and becomes a major concern in corporate governance area.

* Ph.D. student, Manchester School of Accounting and Finance, The University of Manchester, United Kingdom

Introduction

It is evident to perceive the existence of close ties in business context, particularly in emerging markets because connections help increase enforcing contract and alleviate asymmetric information problems and transaction costs. Key institutional characteristics, namely ownership control and business group structure, are believed to influence the formation of connections. Ownership concentration and relations tend to strengthen role of controlling shareholders in building relationships with influential parties, capital providers and the government. Besides, large business groups are likely to influence the industrial development of the country and easily obtain privileges to respond to economic policies.

I intend to review literature, books and newspaper to show the existence and formation of connections in Thailand in this paper, which is organized as follows. Firstly, I will provide background of Thai institutional settings in ownership concentration structure. Next, the family business groups and development of capitalism is discussed. The third section is the evolution of political connections, followed by the legislation with regard to the involvement of politicians in business.

1. Distinct structure of ownership concentration

A highly concentrated ownership and family businesses is common in Thailand. Wiwattanakantang (2000) examines equity ownership of Thai non-financial firms listed in the Stock Exchange of Thailand in 1996 and finds that the ownership of Thai firms is highly concentrated¹ and controlling shareholders are principally families, who are the largest shareholders of the firms. Thailand has a relatively complex ownership structure. The ultimate shareholders in Thai firms do not directly disclose in the majority shareholder list, but finding the controlling shareholders has to be done by tracing through a chain of companies that are privately held as well. The family relationships are not identified only by surnames, but also linked up by in-law families. Controlling shareholders participate in firms' management in approximately 75 percent of sample firms. Moreover, a longer term study of ownership structure is investigated by Khanthavit et al. (2003). They examine the ownership structure of Thai listed firms from 1995 to 2000 and suggest that ownership structure of firms in Thailand before and after the crisis has not changed much. Ownership concentration in hands of controlling shareholders and dominance of family owned business are embedded in corporate form in Thailand. This may hinder the improvement of corporate governance system and transparency in the fear of power dilution.

¹ According to Claessens et al. (1999), families have control over the majority of Thai companies and firms in Thailand, compared to those in other East Asian countries, have the most concentrated cash flow rights and the most ownership concentration in hands of the largest block holder.

Evidence of the relationship between ownership structure and firm performance is further examined by Wiwattanakantang (2001). Using the same sample of listed companies in 1996, she finds that the presence of controlling shareholders is related to higher accounting performance (ROA and seals-asset ratio) and the higher performance is clearly indicated in family controlled firms before the crisis. Turning aside from the benefit of family controlled firms in Thailand, she indicates that when controlling shareholders participate in the management team, firm's accounting performance is lower, stating potential entrenchment problem.

The proportion of managerial ownership matters in Thai firms and supports both alignment and entrenchment hypothesis. The interest alignment effect is demonstrated by empirical research of Kenneth et al. (2002). They investigate the relation between managerial ownership and operating performance of Thai IPO firms during 1987-1993 by using non-linear model or cubic form. They find that firms with low and high level of managerial ownership appear to have a positive relation between managerial ownership and the change in performance after going public. Nonetheless, concentrated ownership structure possibly drives likelihood of expropriation of minority shareholders in some cases. They also illustrate a negative impact of ownership concentration on firm performance and likelihood of expropriation of minority shareholders after a family business goes public. Their findings demonstrate a curvilinear relationship between managerial ownership and the post IPO change in performance. At intermediate levels of managerial ownership, there is a negative association between managerial ownership and the change in performance, representing the managerial ownership entrenchment effect of post IPO firms. The family and controlling shareholders may be less concerned about risky operations and they are likely to extract private benefits because they are financed by other people's money.

Controlling shareholders play a key role to manage firms and create wealth. Their managerial involvement and decisions would influence firm's strategies in business expansion and sustainability. It is also interesting to further go through evidence about how family business groups have been formed and influenced the Thai capitalism.

2. Family business groups and capitalism

Ownership relations explain the formation of business groups and network structure. According to Phipatseritham and Yoshihara (1983), the evolution of capitalism in Thailand shows that market competition and industrialization were originally dominated by firms of Chinese and local-born Chinese businessmen. The formation of business groups has been driven by trading network and joint ownership. Trust and reputation among members in the same network or community ensure firms to make business contacts. In their research, top twenty business groups and characteristics of large business

groups in Thailand in 1979 are demonstrated. They emphasize on the ownership concentration, trading network and political support in facilitating an expansion of family business. Patterns of business expansion and accumulating capital are shown by several big families. The rice industry seems to be an origin where some families took off the business as rice millers. To facilitate rice operations, an expansion into transporting, exporting, shipping, insurance and banking came afterwards. Some of large families were successful in pooling capital through trading networks to operate a banking business. The big families, which were dominated in banking industry, normally had closed relationships with other connected firms as major financing providers for business operation and expansion, resulting in a larger and closer interpersonal network and ownership relations.

To indicate the existence of closed ties among large families, Suehiro (1989) demonstrates a family tree of intermarriage among leading capitalists of tax farmers in the mid of 1850s and of big rice millers in 1930s and 1940s. Business expansion relatively lied on shared ownership of powerful families. It was obvious that ownership relations built power and prestige to the groups, but also an oligopolistic competition in the market. He also notes a change of ownership and capital structure of big groups which transformed to conglomerates after 1960s. Groups that were set up through interlocking of ownership or directorship and personal ties became under control of a single family. The family injected capital to firms in order to increase its management control and equity ownership. Examples can be found in the banking industry. This strengthens the ownership concentration in Thai business to be prevalent and, since then, the ownership structure and control has adjusted to be more complex through a structure of holding companies and associates.

An example of an influential single family is the Charoen Pokphand group (CP) which started its family business as a small seed shop in China Town, Bangkok and expanded their empire into various businesses by means of ownership cross-holdings and business opportunities from government policies. Supported with policies of investment promotion and a number of joint ventures, the group is involved in various kinds of business activities such as agribusiness, trading, distribution, telecommunication and manufacturing and it has eventually been expanded into a global conglomerate.

In addition, Charumilind et al. (2003) provide evidence to support that reputation and role of controlling shareholders of family business groups are crucial to form connections and lead to higher benefits. Controlling shareholders tend to form connections with high reputed groups or with capital providers/banks. They examine the impact of large-family connections on debt financing by using a sample of 270 non-financial firms listed in the Stock Exchange of Thailand in 1996 and define a firm with connections to banks if the firm is owned by one of the country's richest families. They believe that the country's richest families that own business empires are well connected to bankers. Their

findings demonstrate that close ties between firms and banks determine an easy access to long term bank debt. Connected firms, which obtained preferential credits from banks, were less vulnerable to the crisis and experienced less financial distress compared to firms without connections.

Although it can be said that ownership concentration and relations lead to the business group expansion, several large business groups may not be sustained if family owners had not obtained political connections and supports since the rise of capitalist groups. Several researchers agree that the expansion of Thai business groups highly depends on political patronages. Next, I will review the development of the linkage between business and politics in Thailand.

3. Evolution of political connections

Political connections and the evolution of political system and capitalism have developed together overtime. At the beginning of the rise of capitalists from the 1850s to the early of 1900s, major businesses in Thailand were under royal patronages and owned by the King. The Thai capitalism in this period was influenced by European and Chinese merchants. As a consequence of the constitutional revolution in 1932, the country's politics was dominated by military governments and state-led industrialization became a key driver to develop the economy in Thailand until the 1960s. After that, private enterprises and multinational corporations appeared to drive the Thai capitalism.

According to Suehiro (1989), the royal family and aristocrats were major capitalist groups from the 1850s to the beginning of 1900s. These groups influenced the development of the Thai capitalism in several businesses such as land investment, manufacturing, transportation and commercial bank, of which were managed by the Privy Purse Bureau, currently called the Crown Property Bureau. In the same period of time, among the other two rising industries, namely rice and teak wood industries, the tin mining industry shows the pattern of political connection and family business under the royal patronage. The Na Ranong family was dominant as tax farmers and governors in several provinces in the southern region of Thailand. With political appointment and connections, the family obtained a concession of tin mines and operated several family businesses in the industry. It also increased the market dominance through joint ventures with foreign alliances. In addition, the network structure is stated to be a major mechanism in creating a business in Thailand during this period. Chinese merchants, who operated export and import businesses and were in contact with other traders in Asia, applied the connections and trading networks and obtained foreign capital to invest and dominate in the rice industry.

In 1932, it was a historical year of the Thai's politics when the absolute monarchy was changed to the constitution by military coups. The business framework after the augmentation of the first government in Thailand was changed because of the concern of communist, especially from China. Suehiro (1989) documented that the government took a serious restriction on Chinese immigration by enacting the Aliens Act and several businesses which used to be dominated by Chinese people were taken over by the government such as salt, bird's nest and tobacco. The bureaucrat capitalist groups were established during this period of time. Since the government plays a key role on the development of industrialization and economic policies, connections with the government provide firms trade benefits, privileges and protection for new business entry. As a result of the nationalism, in particular in the government of the Prime Minister Phibun Songkhram, "the Thai economy for Thai people" became a fundamental idea. Baker and Phongpaichit (2002) also provide evidence that political connections were highly formed by Thai and local-born Chinese entrepreneurs. Few of business associations were established and led by domestic leading merchants, namely Nai Lert, Nai Boonrawd and Nai Mangkorn. These groups lobbied the government to support local business by introducing an import-substitution strategy to help domestic entrepreneurs compete with foreign business. Moreover, connections with leading military politicians had been developed to become business alliances. As appointed as a director in connected firms, politicians would receive dividends, fees and bonuses, while private businessmen would obtain political support in forms of State capital, business protections and opportunities. Evidence revealed by Baker and Phongpaichit (2002) that several cases of unusual wealthy had been found after the fall or death of leading politicians. This confirms the incidence of private benefits that were taken by political connections and corruption.

When the country was controlled by the military governments, the involvement of powerful generals and bureaucrats in business were evidently employed through directorship and ownership. Firms appointed leading politicians into their board of directors or supplied a certain number of shareholdings in order to gain preferential treatment from the government and receive insurance or protection from market competition. In a book of Suehiro (1989), lists of business involvement, equity ownerships and directorships by military leaders confirm the existence of political connections and close ties between politicians and businessmen that have been developed for a long time. Phipatseritham and Yoshihara (1983) assert that the political connections were important and crucial to business sustainability and growth. They note that the impact of evolved military governments put the connected owners into trouble in the banking industry, namely cases of Chin Sophonpanich of the Bangkok Bank and of Churin Lamsam of the Thai Farmers Bank.

After 1960s, the government was scaled down its monopolies and enacted the Investment Promotion Act. With the support of World Bank and the financial aids from

the US, the government led by the Prime Minister Sarit Thanarat introduced an export oriented industrialization and tended to bring Thailand to the world competition. Firms that rely on political connections would influence the government through their connected government officials to issue regulation or to approve projects for their groups. During the period of investment promotions, close ties with the government provided valuable information and preferential taxation. It was common to see domestic business groups enjoy the oligopolistic market structure due to privileges for selective groups (Suehiro, 1989). In addition, Baker and Phongpaichit (1998) contend that firms, which had close ties with banks and generals, were obviously granted the government contracts. This, at the end, drew attention of foreign investors to establish partnerships or joint ventures with firms and, somehow, benefits from the connections were shared to politicians who aided firms in the process of awarding an investment promotions and establishing foreign alliances.

The Thai politics was fairly changed again when student demonstrations against the military government took place in the early 1970s. An era of civil governments has been brought to replace military governments since then. Urban demand, industrialization and powerful technocrats appeared to influence economic policies. In 1980s and 1990s, labor intensive industries and manufacturing exports drove the country's GDP growth. Demand for foreign markets and opened economy grew with the wave of globalization. Baker and Phongpaichit (2002) describe that the relationship between businessmen and bureaucrats remained dominant during this period and it was developed through kinship, friendship and intermarriage. Lobbying activities are conducted by leading bureaucrats and technocrats who are invited to become executive managers or directors of the company. This allows firms with connections influence the country's economic policies. From the period of import substitution industrialization to the time of export oriented industrialization, political connections are still significant when domestic firms seek for foreign partners and vice versa. This is consistent with the notion that doing business in a country where several industries are under-regulated requires good relationships with the government to be advantageous than others in terms of better information and preferential treatment.

Hewison (2000) articulates that while the export-led economy drove the growth of capitalism, at the same time, the Stock Exchange of Thailand (SET), which was set up in 1975, had arisen as an active capital market where both domestic and international investors highly participated in. He affirms that close ties between businessmen and elected politicians were commonly found in 1990s because of the expansion of political parties that need a financial support for elections. This is where businessmen come into play as major financial sponsors or donators. Handley (1997) provides additional evidence to support the existence of political connections through the rise of the SET. New business groups such as in media, communications and finance sectors depended highly

on financing from the SET and used it as a channel to form political connections. The SET was perceived to be a market for wealth creation. During the time when strong regulation was lacking in the SET, businessmen intended to allocate their stocks to connected politicians and applied inside information to manipulate stock prices for both of them to gain huge profits. In his points of view, these connected parties would gain quite a large amount because they were given shares at the initial public offering with a cheap price and the price would rise when there were a heavy demand and a belief of price upsurge at the beginning and at the following chain listing stages.

“..in the initial offering, shares would be placed with big market players and well-connected members of elite, such as the military, politicians and business people...it is important to note that no one, and no authority, in the 1987-92 period attempted to interfere with this practice – it was considered “normal”.
(Handley (1997) p. 100)

In a book of Baker and Phongpaichit (1998), it is stated that although, during the economic boom, Thai entrepreneurs intended to participate in the global competition, they concurrently continued seeking for economic rents for domestic markets. A distinct example is an establishment and expansion of a new leading business group of Thaksin Shinawatra. It is said that Thaksin Shinawatra becomes a rich and powerful businessman in Thailand due to networks of kinship and friendship which he has developed since his position as a police officer. During the growth of the SET and demand of high technology products in the domestic market, he expanded his company into various kinds of telecommunication businesses under government concessions. In addition to this, it is noteworthy to say that, in 1990s, new generations of both political teams and business groups were obviously linked together to fulfill their interests. Handley (1997) illustrates few examples of political networks such as a group of economists, banks and a group of real estate and manufacturing companies in the new Eastern industrial area with a network with banks and the leader of the government (p. 99).

Furthermore, it is important to note that the country's politics scheme has currently pushed forward by amalgamated connections between businessmen and politicians. Several businessmen and tycoons have become politicians and take part in the country's politics, arguably, in order to directly seek for economic rents, sustain their business and increase their group wealth. Pathmanand (1998) emphasizes on a case study of the Thaksin Shinawatra group to describe the formation of political connections of this group and suggests that the group overperformed its peer during the Thai economic crisis. In his research, he states that Thaksin was able to supply computers from his company to the Police department and other governmental offices via the relationship of his father-in-law, who was the Deputy Police Chief General. During the period of open market and deregulation of telecommunications, Thaksin secured several licenses and concessions to

expand his business groups and later in the early of 1990s, four of his companies were listed in the SET. From the author's perspective, while other competitors of the Thaksin's group developed close ties with political parties and pushed a stiff competition in the industry, Thaksin decided to take part in the country's politics himself. When he was appointed to a Ministry of Foreign Affairs in 1994, he applied his power in the cabinet to protect his business interests by putting his closed friend to a Ministry of Communications. According to a newspapers review documented in this study (p. 70-71), one of Thaksin group's major competitors, the CP group that also expanded its empire into telecommunications during the deregulation, made connections with few political parties that were in power in following governments and exploited its connections to obtain a license to operate another mobile phone system to directly compete with a main business of the Thaksin's group. However, these two groups have currently connected after the crisis by means of a merger of one of their business lines and a linkage in the new political party, Thai Rak Thai, which Thaksin set up in 1998.

The current state of the Thai politics strengthens the presence of connection between businessmen and the government. The election in February 2001 brought Thaksin to become the Prime Minister with an aggressive management image and a policy of populism. Although this new government has placed in mind of most of Thai population, at the same time, some controversial issues about potential conflicts of interest and private benefits have been argued, in particular by academics and journalists. It has been criticized that members of Thaksin's family and relatives who are in the army, business, and bureaucracy have highly prospered since his appointment of the Prime Minister. Additionally, an article in the Matichon Weekly reports that equity shares of 14 companies in 2003 had risen up about 50-100% on the first trading date of their initial public offerings. An interesting issue is that several of these firms and individuals whose shares had been allocated at par value are connected with leading politicians of the Thai Rak Thai party. (Pathmanand, 2003).

Since 1850s to present, political connections have been widely developed as a major tool to facilitate business operations, increase market power and obtain preferential treatment and as a driver to develop the country's capitalism. It is also clearly demonstrated that crony capitalism has long been set in Thailand. Since close ties between politicians and businessmen potentially lead to corruption and conflicts of interest, regulatory authorities do not overlook this concern and attempt to amend legislation to prevent such collusive activities.

4. Regulation on the involvement of politicians in business

In Thailand, corruption problem has been widely well-known as a result of the collusion among politicians, State officials and businessmen and is facilitated by their authority and power in the country through loopholes in legislation. The main authority to investigate corruption of State officials and politicians is the office of the National Counter Corruption Commission whose main responsibilities are to declare and inspect assets and liabilities of State officials and politicians and to prevent and suppress corruption. This office obtains the rights to deal with main functions according to the Constitution 1997 and the Organic Act on Counter Corruption 1999.

From the questionnaire conducted in a research of Faccio (2003), it is asserted that Thailand, among 47 countries in the sample, has a certain degree of restrictions to alleviate potential conflict of interests and corruption in regard to ownership and directorship by politicians. The regulation score aggregates 6 main restrictions imposed to public officials who are members of parliament and ministers. The index of Thailand is in the middle of the league with 3 score out of 6, compared to a score of 2 of the UK and a score of 4 of the US.

The new constitution of Thailand in 1997 amended regulation to prohibit corruption and the involvement of politicians in business. The restrictions on the involvement of ministers in business are strictly enforced and are stated in the constitution although this is not the case for members of parliament. However, the constitution states qualifications of members of parliament to prevent corruption as follows.

“Section 110. A member of the House of Representatives shall not:

(1) hold any position or have any duty in any State agency or State enterprise, or hold a position of member of a local assembly, local administrator or local government official except other political official other than Minister;

(2) receive any concession from the State, a State agency or State enterprise, or become a party to a contract of the nature of economic monopoly with the State, a State agency or State enterprise, or a become partner or shareholder in a partnership or company receiving such concession or becoming a party to the contract of that nature;

(3) receive any special money or benefit from any State agency or State enterprise apart from that given by the State agency or State enterprise to other persons in the ordinary course of business.

The provisions of this section shall not apply in the case where a member of the House of Representatives receives military pensions, gratuities, pensions, annuities or any other form of payment of the same nature, and shall not apply in the case where a member of the House of Representatives accepts or holds a position of committee member of the National Assembly, the House of

Representatives or the Senate, or committee member appointed as a qualified member under the provisions of law or committee member appointed in the course of the administration of the State affairs in case he or she holds a position of other political official other than Minister.”

As you can see, the sentence of (2) is clearly asserted that members of parliament must not be involved in any activities related to concession and contract from the State, State agency and State enterprise.

The involvement of politicians in business is restricted to the cabinet according to the constitution as follows.

“Section 208. A Minister shall not hold a position or perform any act provided in section 110, except the position required to be held by the operation of law, and shall not hold any other position in a partnership, company or any organization which engages in a business with a view to sharing profits or incomes or be an employee of any person.

Section 209. A Minister shall not be a partner or shareholder of a partnership or a company or retain his or her being a partner or shareholder of a partnership or a company up to the limit as provided by law. In the case where any Minister intends to continue to receive benefits in such cases, such Minister shall inform the President of the National Counter Corruption Commission within thirty days as from the date of the appointment and shall transfer his or her shares in the partnership or company to a juristic person which manages assets for the benefit of other persons as provided by law.

The Minister shall not do any act which, by nature, amounts to the administration or management of shares or affairs of such partnership or company.”

To reduce potential conflict of interests, the constitution of Thailand obliges that the involvement of ministers in business is definitely not allowed. Therefore, after the appointment of ministers, the ownership and directorship of ministers in the corporate sector must be withdrawn. Possibly in some cases, the ownership shareholding can continue but ministers must declare their assets to the National Counter Corruption Commission.

Even though, the constitution of Thailand 1997 and the Organic Act on Counter Corruption 1999 impose issues to prohibit conflict of interests and corruption of politicians, there are rooms in the current legislation for politicians to conduct preferential treatment to individuals and firms which are linked by close ties. First of all, it is not identified in the constitution about restrictions on ownership and directorship by member

of parliaments as same as those by ministers. Second, although the shareholdings of ministers are prohibited according to the constitution, there exist several practices conducted by politicians to transfer their equity ownership to spouse, daughters, sons or relatives to avoid the law violation. This would result in low transparency, conflict of interest and corruption. Finally, there is no a specific period to forbid politicians and high ranked State officials to involve in business after their vacation. It is possible that these groups of people remain powerful and are connected to existing politicians and State officials, especially in the context of close ties and crony capitalism.

Conclusion

Connections happen to embed in institutional characteristics, the politics and the economy system in Thailand. Conflict of interests and private benefits are arguable and become a hot topic these days. Evidence shows that political connections are prevalent in the Thai business context and the impact of connections on firm value seems to be crucial. Nevertheless, there is no clear evidence to indicate the significance of political connections in Thailand, an empirical study about causes and consequences of connections would directly contribute to policy makers in legislation amendment or issuance in the future. Besides, it may drive the development of corporate governance system in order to increase transparency and investor's confidence in the direction of globalization.



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