GOVERNANCE AMONG MALAYSIAN HIGH PERFORMING COMPANIES

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Abstract

Well performed companies have always been linked with effective governance which is generally reflected through effective board of directors. However many issues concerning the attributes for effective board of directors remained unresolved. Nowadays diversity has been perceived as able to influence the corporate performance due to the likelihood of meeting variety of needs and demands from diverse customers and clients. The study therefore aims to provide a fundamental understanding on governance among high performing companies in Malaysia.

Keywords : Corporate Governance, Board of Directors, Malaysia

1. INTRODUCTION

Corporate performance has been the focal subject amongst a range of parties like shareholders, managements, investors, analysts, potential investors etc ever since the founding of corporations. Throughout these years good corporate performance has always been synonymous with effective structures of corporate governance. At this juncture, effective board of directors is the structure that people have generally associated with when discussing about corporate performance. Indeed such an association is well documented in the literature[101]. Nevertheless, many issues concerning the attributes for effective board of directors remained unresolved.

In today's corporate world, the issue of diversity (e.g. gender or ethnicity) has attracted the attention of not only the managements but also the scholars or academics. Many of them begin to discern that diversity in the pool of human resources like board of directors and top level managers in one way or another influence the way the corporations are operated and eventually said to determine the effectiveness of their operations.

Such an influence could be especially true and applicable in the context of where the corporations exist and operate in multicultural society. Dissimilar way of thinking, approaches and cultures bring in by such a diversity of directors and top level managers indeed have paved in the so called a "new beckon" working culture that perhaps has led to a better probability of meeting the diverse needs and demands from clients and customers.

In view of the above, the study generally attempts to provide a fundamental understanding on the association between the diversity of board and corporate financial performance in Malaysia. We particularly examine the impacts of genders and ethnic of the board members on performance of their corporations. The paper proceeds with a section that discusses relevant literature in this area. We then present the research method used in the next section. Subsequently, we present and provide the discussion on the research findings of the study. We conclude and present the limitations of the study in the last section.

2. LITERATURE REVIEW

2.1. Corporate Governance and the Introductory to Review of Literature

Corporate governance denotes a "mechanism of managing, directing and monitoring a corporation with the goal of creating shareholder value while protecting the interests of other stakeholders" (Rezaee 2003: 26). Such a definition or concept is actually stems from the separation between the owners and the firms. This separation implies that the firm is not being managed and controlled by the owners. Instead, the owners appoint somebody else (i.e. managers) to act on behalf of them to manage the operations as well as the resources of the firms.

Here, the vital role of board of directors in overseeing and monitoring firm performance has been well recognised. Board of directors is therefore seen as central for an effective corporate governance structure. The literature nevertheless has shown or produced mixed findings to date with regards to the association between firm performance and board composition. As a matter of fact, a number of studies seem to spot other factors to be considered in a search for an effective board composition although the fundamental theory[102] of corporate governance suggests a positive relationship between outside directors and firm performance.

Hermalin and Weisbach (1991) for instance find that board composition has no relationship with firm performance. Their study examines the association between firm performance and top management in public utilities. Such finding seems to be supported by the findings of Klein (1998) in which the author fails to find a significant association between board composition and firm performance. The study basically examines the

[101] The literature refers to research papers that fall within the areas of accounting, corporate governance and finance.

[102] In other words, the theory basically states that high number of outside directors on the board will lead to better firm performance.

committee structure of boards and the roles of directors within these committees with corporate performance.

Moreover, Bhagat and Black (1999) seem to discover even more appealing findings to note. They suggest a negative relationship between board composition, structure and firm performance. According to them the result could be explained by the supermajority-independent boards which eventually lead to poor firm performance. The findings of Vafeas and Theodorou (1998) are more or less similar to those found in the above studies. They find that corporate performance had no significant relationship with board composition.

2.2. Agency perspective and corporate governance

The relationship between the management and shareholders are seen and interpreted apparently in the agency theory. The agency costs arise because of the divergence of interest between the principle and the agent. Thus, according to Jensen and Meckling (1976), in a situation where the agents are the utility maximizers, the possibility that they will not act in the best interest of the principle is high.

In a firm, board structure is one of the most recognized mechanisms to control agency conflict in principle-agent relationship (Tricker, 1994). Further, Tricker (1994) asserted that the board structure should stress on the number of independent non executive directors in various committees (i.e. audit committee, directors' remuneration committee) as well as the separation of roles between chief executive officer (CEO) and chairman.

As a whole, it can be said that the theoretical literature agree with the influence of higher number of non executive directors on board effectiveness (i.e. Rosenstein & White, 1990; Zahra & Pearce II, 1989). The literatures also support that CEO and Chairman of the board should be a different person (i.e. Jensen 1993; Rechner & Dalton, 1991).

However, due to the limited scope in explaining sociological and psychological mechanisms innate in principal-agent interactions (Davies et al. 1997) the agency perspective has been under debated quite recently (see Hoskisson et al. 2000). To enlighten this outside directors may not have the ample and appropriate skills or expertise in carrying out their duties. Moreover, they may hardly ever get connected to the top managers which are essential element in agency perspective.

Managers in the agency perspective as asserted by Donaldson and Davies (1994) is perceived as superior steward of the firm because they are the trustworthy and to work diligently in maximizing business profit and shareholders' wealth.

2.3. Resource dependence perspective and corporate governance

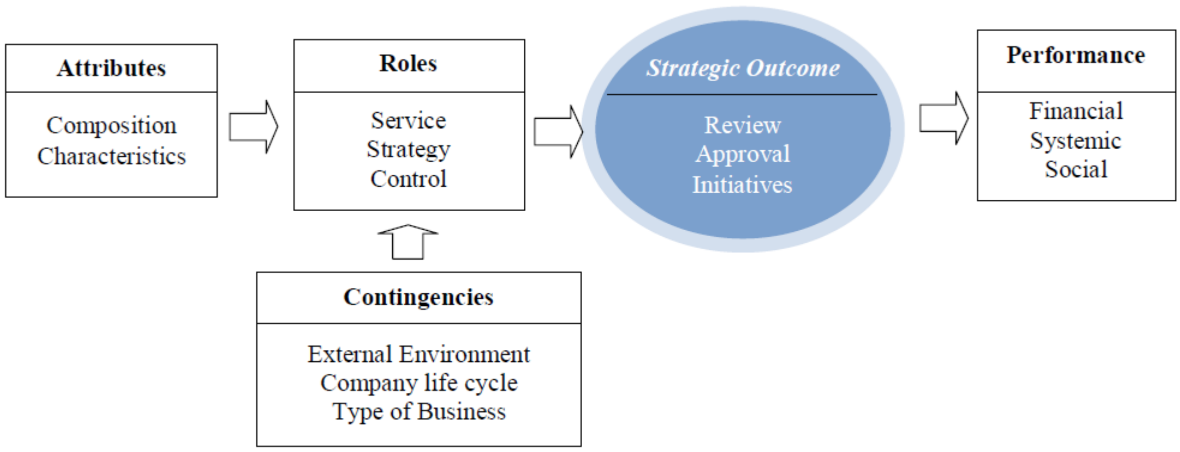
In general sense the theory asserts that the decisions made pertaining to the board's composition are very much influenced or shaped by the attributes of the environments where the boards operate (Pfeffer & Salancik 1978). According to Aldrich (1979) the theory also suggests that organisational success depends upon its ability to get access and control over the external resources. Based on such assertions the diversity of board is perhaps ideal in a situation where companies operate in a multicultural society.

The above conjecture is based on the assumption that board of directors are viewed as tools for co-opting crucial external organisations, also have a role to forms an association between organisations and external environment and have the ability to reduce environmental ambiguity (see Pfeffer & Salancik 1978). As such, the roles are able to attract specific resources i.e. customers (Penning 1980), elite in business (Useem 1984) and capital (Mizruchi & Stearns 1988).

Zahra and Pearce (1989) note a few other influence like the ability to serve as spanners boundary which provide channels for communication between firms and external organisations, assist firm in extracting resources as well as gain support or commitment from stakeholders especially the external ones who are vital to boost performance of the organisations and its ability to establish and enhance organisational legitimacy.

The resource dependence perspective on the influence of boards and company performance as can be illustrated in the figure 1 below.

Figure 1. Resource Dependence Perspective : The Influence of Boards on Corporate Performance



Source : Zahra and Pearce (1989)

In the above figure it is viewed that the resource dependence perspective stresses on two boards attributes namely composition and characteristics. These attributes provide essential roles in terms of service, strategy and control to the organization. The roles however depend on three contingencies like external environment, company life cycle and type of business. The directors' influence on company performance will come about through the impact on the strategic initiatives of executive choices.

In order to shape the initiatives, the directors can propose brand new business concepts or they can embark on the analysis. And as the company performance under the resource dependence perspective allude to a multidimensional definition it is therefore consists of financial, systemic and social components.

Boyd (1990) and Hillman et al. (2000) further suggest of the need for corporate boards to mirror the environment in which the firms are operate. It is thus hold up one of the fundamental propositions of resource dependence theory that states the direct function of the levels and types of outside dependence facing by organisations on the need for linkages of environment. Perhaps the change in board composition is perceived as necessary in a more complex environment.

2.4. Empirical evidence on governance diversity and corporate performance

The finding of a paper carried out by Burke (1997) suggests that women contacts and visibility to male board members is viewed as essential. Also it is noted that women's board service is motivated by company or industry interest and broadening skills and knowledge. The author concludes that such an effort to bring in more qualified women may benefit not only the women but also the organisations.

In the same year Shrader et al. (1997) conduct a study that examine the relationship between the percentage of women on board of directors and firm value. They find that in some tests there is a significant negative relationship between them. Perhaps the results are due to the limited roles performed by such directors. The findings of Zahra and Stanton (1988) the early study which is almost similar to Shrader et al. (1997) however find no statistically significant association between the percentage of ethnic minority directors and financial values like ROE and EPS.

Ng and Tung (1998) on the other hand find that despite of lower scores on job satisfaction, organizational commitment and workplace coherence, as well as higher rates of turnover, the culturally heterogeneous branches experience lower level of absenteeism and achieve higher productivity and financial profitability. In addition Richard[103] (2000) finds that racial diversity does determine the firm performance by interacting with business strategy in three diverse ways such as productivity, return on equity and market performance.

With respect to women and organisational performance Zelechowski and Bilimoria (2003) suggest two independent dimensions i.e. influence[104] and inclusion[105] can either enhance or restrict the performance and contributions of women in the companies examined. And, they note that the convergence of both dimensions most effectively has impacts on the function of women at the top of companies. Erhardt et al. (2003) further examine the impact of diversity (i.e. women and minorities of boards) on return on asset and investment. Their analysis point out that board diversity is positively associated with firm financial performance.

Similarly Carter et al. (2003)[106] gauge the effects of board diversity on firm value and note that the fraction of women or minorities on the board has a significant positive association with firm value. This result is after controlling the variables like size, industry and measures of corporate governance. They also find that the proportion of women and minorities on boards increases with firm and board size but decreases as the number of insiders increases.

Smith et al. (2006) continue the effort of seeking the effect of women in top management on firm performance. They document that the proportion of women have positive influence on firm performance. The result is found to be strongly linked to the qualifications of women themselves. In the study they have controlled various corporate characteristics and firm causality before concluding to the results.

The results of Smith et al. (2006) seem to be supported by a preliminary analysis by Nguyen and Faff (2007) in which they note that gender diversity promotes shareholder value. They conclude this since the presence of women directors that they examine in their study is linked to higher firm value.

The findings of Wang and Clift (2009) nonetheless is a bit different from a study carried out by Carter et al. (2003) where they found that gender and racial diversity have no strong relationship or influence on firm financial performance. They assert that this may be simply due to a less number of female and minorities on the board.

3. RESEARCH METHOD

3.1. Hypothesis

Diversity of board has generally received an increasing recognition in organisations particularly in Malaysia where the composition of workers is basically shaped by the attributes of environment in which the companies operate. This could also be due to the belief that suggests how diversity able to bring different kind of working culture that eventually leads to better organisational performance. Due to this Bilimoria (2000) recommends that the impact of diverse directors on corporate bottom line to be specifically gauged. And within the proper context it is suggested that diversity does adds value to the firm competitive advantages (Richard, 2000).

[103] The study examines the association amongst racial diversity, business strategy and firm performance in the banking industry.

[104] The themes include (i) the role in the board decision making, (ii) the bases of influence and (iii) influence strategies used.

[105] The themes (experience) include (i) support and acceptance, (ii) exclusion and (iii) the nature of the advice they received.

[106] In the paper board diversity refers to the percentage of women, African Americans, Asians and Hispanics on the board of directors.

Such discussions lead to the following alternative hypothesis:

There is a positive association between diversity of board and corporate performance

3.2. Model Specification

The study will use multivariate regression model which is estimated as follow:

$$ROE = \alpha_0 + \beta_1 BD_i + \beta_2 BS_i + \beta_3 BDi_i + \beta_4 CCD_i + \beta_5 ID_i + \beta_6 IO_i + \beta_7 FS_i + \beta_8 ROA_i + \beta_9 Sector_{1i} + \beta_{10} Sector_{2i} + \beta_{11} Sector_{3i} + \beta_{12} Sector_{4i} + \beta_{13} Sector_{5i} + \beta_{14} Sector_{6i} + \varepsilon_i$$

In the estimation above we refer return on equity (ROE) which is the dependent variable as the percentage of return over equity. ROE has been used as a measure of firm or financial value in a number of studies for examples Wang and Clift (2009), Shrader et al. (1997), Zahra and Stanton (1988) and Baysinger and Butler (1985). Meanwhile diversity of board (BD) which is the independent variables denotes the percentage of women and ethnicity on the board of directors.

In the study, we also include a number of corporate control variables that have been studied previously (by for instances Wang & Clift, 2009, Smith et al., 2006, Erhardt et al., 2003, Carter et al., 2003, Vafeas, 1999, Perry 1999, Yermack, 1996, Borokhovic et al. 1996 and Brickley et al., 1994) like board size (BS) – number of directors, board diligence (BDi) – number of meetings in the year, CEO or Chair Duality (CCD) – percentage of firm practice different person for CEO and chairman, independence directors (OD) -percentage of outside directors, insider ownership (IO) – percentage of ownership by insiders, firm size (FS) – total assets, return on assets (ROA) – return over assets and sectors as a dummy variable.

For sectors, they are classified into seven namely (1) Consumer Products -CP, (2) Industrial Products -IP, (3) Trading/Services -TS, (4) Plantation and Mining – Plant., (5) Construction – Const., (6) Properties – Prop., and (7) Infrastructure Project Companies (IPC).

3.3. Selection of Sample and Data Collection

We undertake this study based on the companies listed on the main board of Bursa Malaysia as of 31st December 2006. The study hence uses the annual reports for the financial year ended 2006. In this study, we have examined 117 top companies according to the market capitalization.

A few methods are used to obtain the data for this study. We use Bursa Malaysia website and a stock performance guide to collect data pertaining to the dependent and independent variables in this study. We also use the hardcopy of the annual reports to counter check the information provided in the website and vice versa.

3.4. Data Analysis

This study makes use of descriptive statistics namely mean, median, mode and standard deviation to measure the central tendency and the dispersion of the data. We also conduct the correlation among the variables tested as we are aware of the detrimental effect of multicollinearity problem on multiple regression (see Cooper & Schindler 2003). And finally we run the multiple regression analysis, which is the main statistical technique in this study to see the influence of a set of independent variables tested on the dependent variable.

4. FINDINGS AND DISCUSSIONS

4.1. Descriptive Statistics

The breakdown of companies according to sector is provided in Table 1 below.

Table 1. Breakdown of Companies by Sector

Sectors	*No. of Companies*	*Percentage*
1. CP	13	11.1
2. IP	28	24.0
3. TS	36	30.8
4. Plant.	14	12.0
5. Const.	6	5.1
6. Prop.	17	14.5
7. IPC	3`	2.6
Total	117	100.0

Based on the Table above, most of the sample are companies from trading / services sector that represents 36 companies or 30.8%. This is followed by 28 or 24.0% companies from the industrial sector. The third highest sector is properties with 17 companies or equivalent to 14.5%. The remaining sectors are plantation, consumer products and IPC as in order with 14 or 12.0%, 13 or 11.1 and 3 or 2.6% respectively.

The descriptive statistics for the variables under study is provided in Tables below.

Table 2. Descriptive Statistics for Dependent and Independent Variables

	ROE (%)	*Women Director*	*Ethnic Director*	*BD*
Minimum	.08	.00	.00	.00
Maximum	35.61	25.00	66.70	69.20
Mean	11.4793	5.6513	29.2402	34.8915
Median	10.780	.0000	28.5700	37.5000
Mode	4.38[a]	.00	.00	50.00
Standard Deviation	7.08957	7.88811	17.49111	18.36192

In the Table above, the mean for ROE is 11.4793% and could reach the maximum of 35.61%. While for diversity of directors the mean is 34.8915% and the percentage can go as high as 69.20%. Diversity of board denotes the percentage of women and ethnic directors on the board.

Table 3. Descriptive Statistics for Control Variables

	BS	*BDi*	*CCD*	*OD*	*IO*	*FS*	*ROA*
Minimum	4	2	0	37.50	.00	93265060	-8.49
Maximum	15	15	1	100.0	26.00	3E+010	28.20
Mean	8.39	6.09	.90	71.5282	3.1122	3.0E+0.09	7.8080
Median	8.00	5.00	1.00	72.7000	.2700	1.8E+009	7.7900
Mode	8	4	1	75.00	0.00	93265060[a]	13.50
Standard Deviation	2.161	2.657	.305	15.57773	6.16343	3.8E+009	5.64910

The mean for main corporate variables in the study are relatively high board size (8), outside directors (71.52%) and board diligence (6). Outside directors variable manifests that companies have an average of 71.52% outsiders on the board of directors. For board size, it shows that generally the selected companies have a total number of 8 directors. In terms of board diligence, the statistic denotes that in general the boards of directors hold 6 meeting throughout the year.

The descriptive statistics also suggest that the number of companies that do not practice CEO/Chair duality is very high. The result shows that 90% companies under study practice a different person for the position of CEO and Chairman. For another board's variable which is the insiders' ownership, the result manifests a low percentage (3.11%) for the companies under scrutiny. This indicates that on average, directors only have 3.11% ownership in the companies they attached to. In terms of size, most of the companies have high total assets i.e. 3.0E+0.09 and the maximum is 3E+010. For ROA, on average, companies under scrutiny have 7.8080% returns over their total assets and it can go up to 28.20% which is considerably high.

4.2. Results of Regression Analysis

We examine the correlation between the independent variables using the results derived from the bivariate correlation to detect the presence of multicollinearity problems before conducting the multiple regression analysis. If the coefficient of correlation between the variables is at 0.8 or higher, the variables can be considered as highly correlated to each other (Gujarati, 2003). According to De Vaus (2002) if the coefficient of correlations is 0.95, the variables can be regarded as very highly correlated and therefore will produce a collinearity problem. Based on the results of bivariate correlations it appears that the variables used in this study are free from multicollinearity problems.

The result of multiple regression analysis is presented in Table 4 below.

Table 4. Multiple Regression Results

Variables	*Coefficients*	*t-statistics*	*Significance*
BD	.029	.946	.347
BS	-.028	-.103	.918
BDi	.308	1.443	.152
CCD	2.549	1.379	.171
ID	-.053	-1.449	.137
IO	.051	.586	.559
FS	8.62E-011	.606	.546
ROA	.783	8.447	.000***
CP	2.568	.122	.903
IP	.131	.043	.966
TS	1.583	.549	.584
Plant.	-1.655	-.538	.592
Const.	.450	.122	.903
Prop.	-2.672	-.842	.402
IPC	6.129	1.632	.106
R-Square	.526		
Adjusted R-Square	.445		
F-Statistics	6.472(.000)		

****Significant at .01 level*

From the Table above, the overall satisfactory fit of the regression is significant at 1% level. This is mirrored by the value of F-Statistics (i.e. 6.472 significant at 0.000). The R-square on the other hand shows that the regressed factors explain .526 of the variation in the dependent variable. And the considerably quite close adjusted R-square i.e. .445 denotes that the there is not much deflation occurs among the variables tested.

From the results, only ROA is found to be significant at 1% level in explaining the firm financial performance and it is a positive association. For the main variable – an independent variable which is the diversity of board, it has a positive association with ROE as anticipated; however the association is not significant.

The results on corporate control variables imply almost all (i.e. BDi, CCD, IO, and FS) of them has a positive association with ROE except for BS and ID which shows negative associations. For dummy variable – sectors, only Plant. and Prop. show negative associations with ROE the rest i.e. CP, IP, TS, Const., and IPC have manifested positive associations with ROE.

4.3. Discussions of Findings

The main finding of the study reflects the acceptance of our hypothesis in which we have anticipated that diversity of board will lead to better corporate financial performance. Such a positive non significant association is consistent with the result by Wang and Cliff (2009) in which they note down of a less number of women and minorities that lead to no strong relationship or influence of gender and minorities on corporate financial performance.

A positive association also support the finding of Erhardt et al. (2003) and thus in line with the assertion that states diversity of board does add value to the firm competitive advantages within a proper context (Richard 2000) thus support the resource dependence theory on diversity and corporate performance although the association is not significant.

The results of corporate control variables mostly suggest positive association with ROE. The significant positive association of ROA and ROE indicates that those companies having high ROA are capable of increasing the value of their corporations by means of ROE (see Erhardt et al. 2003). Those with remaining positive non significant associations are BDi, CCD, IO and FS. For BDi, it seems to note that, more frequent meeting held able to improve firm financial performance (Vafeas 1999).

Similarly, the findings of corporate variables such as IO and FS have pointed out that higher insider ownership and bigger total assets able to enhance the firm performance (Carter et al. 2003). For the CCD, the result implies that those companies with different person holding the positions of CEO and chairman are found to have performed well (Carter et al. 2003). The negative associations as shown by BS and ID could be due to the inefficient working capacity of the directors (Bhagat and Black 1999) perhaps in a situation where there are excessive number of total directors and independent directors.

In terms of sectors, many of them have positive association with ROE i.e. CP, IP, TS, Const., and IPC. However Plant. and Prop. imply a negative association with ROE. In general this result has suggested that industries or sectors have contributed to healthier corporate financial performance for the companies. For Plant. and Prop. the negative associations could be due to the slow progress or growth within the sectors.

5. CONCLUSION AND LIMITATION OF THE STUDY

The study reports the fundamental understanding on governance i.e. diversity among top 117 companies listed on the main board of Bursa Malaysia according to market capitalization as of financial year ended 2006. The main findings of the study denote the acceptance of our hypothesis that posits diversity of board will lead to better corporate financial performance. Although the influence is not significant as consistent with Wang and Clift (2009), it seems to pave a ground on the influence or effects of diversity on corporate financial performance in Malaysia. Nevertheless, as the sample used in this study is pinched on high performing or top corporations in Malaysia the findings may not generalize to small corporations.

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