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Corporate Governance and Performance: Evidence from Industrial Product and Service Sector in Bursa Malaysia

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Abstract

An empirical study was conducted to investigate the corporate governance variables (board size, board independence, board meeting and duality) that are related to the firm performance (ROA) in industrial product and service sector companies in Bursa Malaysia, with a particular focus on the Main Market. This paper will examined on firm performance based on return on assets (ROA) public-listed firms' industrial product and service sector. The study adopts by examines the annual reports from the year 2014 to 2018. A multiple regression analysis was conducted on the whole population of listed companies in this sector. The empirical results suggest firm performance had significant relationship with board size, board independence and duality. In contrast, the firm performance is insignificant with board meeting. The outcome of this study could provide insight for the evidence to relevant regulatory bodies in Malaysia to look further on the effectiveness on the code of corporate governance particularly public-listed firms' from industrial product and service sector in Bursa Malaysia. Furthermore, the research performed for this study specifically focused on identifying governance mechanisms that have a proven impact on enhanced firms' performance, regardless of whether they are marked as a good practice in regulation or codes. The results provide practical guidance for company directors, as well as a useful guidance for the people empowered with formulating governance regulation and codes.

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Introduction

Corporate governance, as an instrument, has been one of the issues of attraction to many scholars to ease the conflicts of interest between management and the investors. Furthermore, corporate governance mechanisms and regulations have been given an extensive attention worldwide and it is no unique case for Malaysian public-listed firms as well. The Asian financial crisis in 1997/98 had affected investor confidence on Malaysia particularly weak corporate governance practices of many firms such as weak financial structure, inadequate of accountability, disclosure and transparency. Due to that, then policy makers had raised the standards of corporate governance. As a result, it was brought forward by the issuance of the Malaysia Code on Corporate Governance in 2000. The code marked a significant milestone in corporate governance reform in Malaysia in order to strengthen the roles and responsibilities of the board of director functions. The code concentrates on reinforcement board creation and composition, distinguishing the function of directors as active and responsible fiduciaries. The code states that the directors are effective custodians and caretakers of the firm. To one side from establishing strategic direction and supervising the conduct of business, the board of directors also has to pledge that the company is operated in compliance with laws and ethical values, while upholding an effective governance structure in order to ensure the appropriate management of risks and level of internal controls.

Corporate governance was deemed that it can enhance the performance of the firm. Furthermore, it also can safeguard the shareholders' benefit and postulate a good relationship of firm and the atmosphere which to protect their precarious resource by drawing new stakeholders and capital assets. In addition, corporate governance also acts as instruments of internal governance and observing the management. Consequently, it indicated that by carrying out good corporate governance, it will enrich the firm performance. As a result, the corporate board is one of the most important corporate governance mechanisms that monitor and advise management in carrying responsibilities to protect shareholder interests. However, the linkage between board of directors and firm performance was still much discussed (Francis et al., 2012). Therefore, the objective of this research attempts to explore whether board size, board composition, board independence and duality have a significant relationship with the firm performance.

LITERATURE REVIEW

Firm Performance

The performance of a company can be seen from the financial statement presented by the company. Disclosure of financial information will provide useful information for users of financial statements. Subsequently, a company with a good performance will support the management to make a quality disclosure (Herly & Sisnuhadi, 2011). Firm performance is greatly influenced by CG. If the functions are suitably set up for the corporate governance system, it will help in attracting investment, aid in increasing company's funds, strengthen the pillars of the company and in turn, this will proceed to the automatic increase of the performance of the firm. The study by Yeh et al. (2002) showed that corporate governance has contributed to the company in enhancing operating performance and preventing fraud. Moreover, this was concurrent with the view that better governed firms might have more efficient operations resulting in higher expected returns (Jensen & Meckling, 1976; Fama & Jensen, 1983). Furthermore, they found that corporate governance helps owners to exert control over corporate affairs and given powerful position to the owners to manage corporate insiders and managers. In this study, the return on assets (ROA) is used as the measurement of corporate governance in order to measure firm performance. The ROA indicates to a firm's capacity to purify profit from the firm's assets which indicates the level of profitability. A higher ROA signifies a more effective use of assets that are in favor of shareholders' advantages (Hudaib & Haniffa, 2006). The ROA has been used widely in corporate governance studies such as (Khatri et al., 2002; Sunday, 2008). Shin and Chin (2012) who was studied outside director experience, compensation and performance used return on assets as their performance measurement and the result showed a positive and significant relationship between outside board experiences to return on assets which measured firm performance. Yermack (1996) also used return on assets as one of the explanatory variables in his regression model and contended that return on asset should be used as a measurement of company's profitability since it was related to the market value where there is a positive relationship.

Corporate Governance in Malaysia

Malaysia corporate governance landscape has transformed along the introduction of the amendments in Companies Act 1965 and Bursa Malaysia Listing Requirements. The first version of Malaysian Code on Corporate Governance (MCCG) was published as component of the Bursa Malaysia Securities Rules in March 2000. This publication triggers an activity in reforming of corporate governance system in Malaysia (Securities Commission Malaysia. (2012). The Malaysian Code of Corporate Governance serves as the basis for corporate governance development in Malaysia. It has set out the principles and best practices for company to comply.
Hereafter, the corporate governance code was amended and republished in year 2007 to reinforced the obligation and roles of the core management, the board of directors and audit committee, thus to enhance the audit's internal control function (Securities Commission Malaysia (2012). Till today, the code highlight on the activeness and fiduciaries of the board of directors and emphasize on strengthening the board structure. The board was given responsibility to maintain an effective corporate governance system to assure the adequate risk management and internal audit function. Besides, the board is also entitled to be actively involved in stewardship in the organization by ensuring the strategic decision conducted is compliance with government regulations and ethical values.

The code recommends the board of directors of the companies should inspire election voting, setting put the expectations of the directors and establish protocols for accepting new directorships, strategies on promoting sustainability announcement, promoting the code of ethical conduct and board charter, safeguarding the access for appropriate continuous education programs and applicable corporate disclosure policies placed on information technology distribution should be inspired and carried on (Securities Commission Malaysia (2012). In short, the Code on Corporate Governance 2012 focus on strengthening board structure as well as composition and the fiduciary obligation designated to the company board of directors.

Board Size

Board size refers to the number of directors with voting rights sitting on the boards (Pugliese & Wenstop, 2007). Previous studies done on relationship between board size and firm performance have produced varied results. Bhagat & Black (2000) the findings show that there is weak relationship between board size and firm performance. Furthermore, Jackling & Johl (1998) found a positive correlation between board size and the performance. In addition, study conducted by Pearce and Zahra (1989), it is learned that large boards contribute to better firm performance due to skill variation and experiences. Coles et al. (2008) opined that large conglomerate companies were benefited by large board because it can help to improve the company's financial and non-financial performance. On the other hand, Bennedsen et al. (2008) studied the causal effect and found out negative relationship between board size and firm performance in medium-sized firms. Neng & Li (1999) found that there was no any evidence that showed that board should have a certain size as the optimal size and the result of their study did not show any relationship between board size and firm performance. Finally, Ranasinghe (2010) found that board size had a negative relationship with return on assets and market to book value, which was used as proxies for firm performance. As the literature above, thus we hypothesize as the following:

H1: There is positive relationship between board size and firm performance.

Board Independence

Board independence is described as the number of independent non-executive directors having a seat on the board relative to the total number of directors (Lawal, 2012). Neng & Li (1999) stated that board independence was very essential in order to have an effective monitor and a disciplined management team. The board independence also assists in reducing agency problem that shareholders should request to replace internal directors by external ones to achieve effective management monitoring (Hermalin & Weisbach, 1991). A study conducted by Rong et al. (2012) found a positive effect of board independence against corporate performance. Beasley (1996) opined that non-executive director can improve board effectiveness and reduce the chances of fraud in accounting. These studies indicate that non-executive director's monitor and control management which can improve company performance.

In contrast, according to Clarke (2006) in the study, found did not show any positive correlation between independent directors on board and the corporate performance in China. This result was coherent with Bhagat and Black (1999) where they did not find any strong correlation between board independence and firm profitability and the board independence was negatively correlated with the firm's performance. Rachdi & Ameur (2011) found that board independence did not improve bank performance and results indicated a negative, but not statistically significant relationship between independent directors and firms' performance. As the literature above, thus we hypothesize as the following:

H2: There is positive relationship between board independence and firm performance.

Board Meeting

The board meeting represents the number of meetings the board has during a year (Liang et al. 2013). Board meetings are necessary because boards conduct meetings on behalf of the firm and there is a process demanding the board's mutual action, which includes disseminating of resolution on board meetings. The board competence is determined by on the occurrence of its meetings as this can improve the performance of the firm, given the circumstances that the board offers with more chance of scrutinizing and evaluating the performance of management (Hsu & Petchsakulwong, 2010). Davidson (1998) revealed positive correlation of financial performance and the number of board meetings. The studied by Godard (2002) among the French companies also discovered increase in the number of board meetings, which have also positively impacted the financial performance. The more regular board meetings are, the more likely it is that directors are to perform more diligently and as per shareholders' interests (Lipton & Lorsch, 1992). Furthermore, the board meetings can be beneficial in bring up the performance of the board and the organization for instance where the auditing tasks can be done at board meeting which can boost the quality in profit (Carcello et al. (2002).

On the other hand, certain studies by Wu et al. (2007) revealed negative relationship the board meeting and firm performance. Furthermore, studied by Horvath & Spirollari, 2012) showed no effect of the frequency the board meeting with the firm performance. Similar studied by Kyereboah and Biekpe (2006) showed that board meetings may be a cause of low performance of an organization. Vafeas (1999) finds that frequent board meetings may cause lower profitability and performance in the firm. Finally, Jackling and Johl, (2010) discovered that no correlation between the frequency of board meetings and firm performance the firms in India. Based on the above discussion, it is reasonable to hypothesize the following hypotheses.

H3: There is positive relationship between the number of board meetings and firm performance.

Duality

There have been a number of concerns regarding the duality of the CEO role, where it is considered that no one person has unfettered powers. Separation of the CEO and chairman of the board's duties offers a separate leadership structure. If chairman and CEO is the similar person, there is a risk of insufficient separation of duties. Nonetheless, Imhoff (2003) asserts that the governance of a board is greatly compromised if incumbent CEO also performs as chairman of the board. Haniffa and Cooke (2002) suggest that firm management is more effective when there is a presence of duality leadership owing to the fact that there is decreased information asymmetry and less bureaucracy. The study carried out by Daily and Dalton (1994) further supports that the existence of non-executive chairpersons and non-CEO presidents also improves the overall valuation of the firm.

Contrary to the above, Laing and Weir (1999) that there is a lack of support to suggest that duality impacts firm performance. In the context of Malaysia, it was established by Abdullah (2004) that leadership structure has no impact on the performance of the business. Shukeri et al. (2012) opined that there is a negative relationship between CEO duality with the company's financial performance. Since role duality may have positive influence the company's performance. Hence, the following hypothesis for this study is formulated:

H4: There is negative relationship between role duality and corporate performance.

Conceptual Framework

Based on extensive literature, board size, board independence, board meeting and duality representing corporate governance components have been identified as possibly having an impact on firm performance and these components are set as independent variables in the framework. The dependent variable set in the framework used to measure the firm performance is Return on Assets (ROA).

Research Methodology

This research will examine on corporate governance practice for recent years in Malaysia and used panel data study to all industrial product and service sector listed in Main Market Bursa Malaysia for the period from 2014 to 2018. Using panel data for the five consecutive years, where the same companies serve on the panel over five years, gives advantage to measurement of the changes that take place between points in time (Cavana et al., 2001). The final list of data comprising 218 public listed under industrial product and service sector for five years in a row selected from annual reports excluding several companies that does not meet the requirement of the research. The firms that do not have complete financial data and information on directors or certain year of annual reports that were unavailable was also excluded from the list. The industrial product and service is chosen for the purpose of this study due to this sector makes up 30% of Bursa Malaysia listed companies. The sample selected in this study based on classification made by Bursa Malaysia. Furthermore, this sector is suitable to provide better indicators of the relationships between the application of corporate governance and firm financial performance.

Regression Analysis

Based on the discussion of dependent and independent variables, the following regression model is developed:

ROA = β0 + β1BS + β2BI + β3BM + β4DU + ε where;
ROA = Return on Assets (Firm Performance)
BS = Board size
BI = Board independence
BM = Board meeting
DU = Duality
ε = error terms

Findings and Discussions

Table 4.1: Descriptive Statistics

	N	Min.	Max.	Skewness	Kurtosis	Mean (2014-2018)	Mean				
							2018	2017	2016	2015	2014
ROA (%)	218	-30.0	28	-0.62	6.01	4.83	4.17	4.54	5.22	5.30	4.90
BS	218	6	14	0.89	0.72	7.33	7.29	7.19	7.30	7.35	7.50
BI	218	0	1	0.65	0.85	0.90	0.85	0.90	0.97	0.86	0.92
BM	218	6	12	0.79	0.63	7.34	7.50	7.29	7.33	7.45	7.12
DU	218	.00	1.00	0.66	-1.33	32.54	27.65	31.12	33.60	35.7	34.65

Table 4.1 present the descriptive analysis for industrial product and service sector. The dependent variable made up represent by return on assets (ROA). The independent variables consist of corporate governance such as board size, board independence, board meeting and duality. The mean value of return on assets (ROA) for the period from 2014 to 2018 is 4.83%. The mean value of board size (BS) is 7.33% from period of 2014 to 2018 and average is within the range suggested by Jensen (1993). Hence, for the period from 2014 to 2018, the minimum board size is 6 members and maximum board size is 14 members.

In relation to board independence (BI) is about 90% suggesting that the public-listed firms in this sector contain a mixture of inside and outside directors. This is essentially good for the effectiveness of a board according to Fama and Jensen (1983) who argued that the mixture of inside and outside director will enhance the effectiveness of the board director's. The frequency of board meeting (BM) had a mean of 7.34 with a minimum and maximum of 6 and 12 respectively. It's indicated that the higher number of board director's meeting leads to better in term of financial performance. In regards to the firm's with CEO duality (DU), the mean has decreased from 34.65% in 2014 to 27.65% in 2018 and mean value for the whole period is 32.54% showed that role duality is getting less popular among firms in this sector. It does conclude that more firms are adopting recommendation in Malaysian Code of Corporate Governance (MCCG) 2012 to separate the role of chairman and CEO.

Table 4.2: Pearson correlation matrix

	ROA	BS	BI	BM	DU
ROA	1				
BS	0.22**	1			
BI	0.45	0.02	1		
BM	-.025	-.075	-.055	1	
DU	-.23*	.12	.21	.12	1

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

The table 4.2 above showed the correlations between the independent variables and firm financial performances which return on assets (ROA) are the dependent variable. From the analysis, it can be seen that board size (BS) and board independence (BI) are positively correlated with return on assets (ROA) and board meeting (BM) and duality (DU) are negatively correlated. From the table above, the correlation coefficient between board size (BS) and return on assets (ROA) is 0.22**. It shows a positive relationship between board size and ROA where ROA will increase as the board size increases. This is consistent with the finding of Jackling and Johl (2009) where the correlation between board size and ROA was positive. Nevertheless, board size and ROA are not strongly correlated because the value of correlation (.22) is very low indicating that it is not significant at .05 using the 2-tailed test. Hence, there is no significant correlation between board size and ROA.

The value for correlation between board independence (BI) and return on assets (ROA) is a positive (.45). The positive sign means that ROA increases as the board independence increases and vice versa. In order to see the strength of the relationship between ROA and board independence is assessed using the 2-tailed test. Based on the value .45, it can be concluded that there is a weak relationship between board independence and ROA at .05 using the 2-tailed test. The other study by Masulis et al. (2012) found a positive relationship between board independence and ROA.

Meanwhile, the board meeting (BM) shows an insignificant negative (-.025) correlation with return on assets (ROA) at .05 using the 2-tailed test. Thus, it implies there is no significant correlation between board meeting and firm financial performance as measured by ROA. The past studies which also revealed negative relationship between the board meeting and firm financial performance are Garchia-Sanchez (2010) and Danoshana and Ravivathani (2014). Finally, the correlation between duality (DU) and return on assets (ROA) is -.23 depicting a negative (-.25) relationship between CEO duality and ROA at .05 using 2-tailed test. This is consistent with study by Ujunwa et al. (2013).

The Test of Regression Coefficients

Table 4.3: The Coefficient of Multiple Regressions Analysis

Variable	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	-.183	.115		-.175	0.057
BS	.013	.004	.087	2.545	0.017
BI	.144	.068	-.102	2.042	0.021
BM	.004	.073	.024	.627	0.326
DU	-.075	.250	.415	-2.903	0.074

a. Dependent Variable: Return on Assets (ROA)

From the equation of firm financial performance (ROA) in table 4.3, it is noted that if the board size (BS) increases by 1%, then the firm financial performance (ROA) will increase by about 1.3%. If board independence (BI) increases by 1% also the firm financial performance (ROA) increases by 14%. Additionally, if CEO duality increases by 1% then the firm financial performance (ROA) will decrease by about 7.5%.

In the above table 4.3, the result of board size on this study has a positive impact on ROA. This result is similar to what has been found in other study by Haniffa and Hudaib (2006). Pertaining the board independence, the result show that it is significantly related to firm financial performance measured using ROA. This result is consistent with prior studies as Bhagat and Black (2001) and Haniffa and Hudaib (2006).

In addition, there is no relationship between a board meeting and firm financial performance. This is consistent with previous study by Kyereboah-Coleman (2007). Finally, in terms of duality, the result shows that there is a significant negative relationship between duality and ROA. This finding is in line with Kyereboah-Coleman and Biekpe (2005).

Result of Hypothesis Testing

Board size and firm performance

Based on regression analysis, the board size is significant influence on the firms' performance (ROA) where the significance value is equal to 0.017 which less than threshold standard that indicates p value should be ≤ 0.05 to be significant. Consequently, this finding supported the hypothesis and fully achieved the objective. This is consistent with the previous studies such as Dalton and Dalton (2005) and Kyereboah-Coleman and Biekpe (2005) which found a positive relationship between board size and firm financial performance. Thus, H1 is supported.

Board independence and firm performance

The result of board independence is found to have significant relationship with the firm's performance (ROA) as significance value is equal to .021which is less than threshold standard that indicates p value should be ≤ 0.05 to be significant.

As a result, this finding supported the hypothesis. This result is consistent with previous studies such as Lefort and Urzua (2008). Thus, H2 is supported.

Board meeting and firm performance

According to the regression analysis, the result board meeting had no significant relationship with firm financial performance. The significance value is equal to 0.326 which is more than threshold standard that indicates that p value should be ≤ 0.05 to be significant. As a result this finding does not support the hypothesis. This result is consistent with the previous studies Kyereboah-Coleman (2007). Thus, H3 is rejected.

Duality and firm performance

The result in this study appears that no significant influence with the firm financial performance. The significance value is equal to 0.074 which is more than the threshold standard that indicate p value should be ≤ 0.05 to be significant. Thus, this finding support the hypothesis and in line with previous study by Schmid and Zimmermann (2007). Thus H4 is accepted.

Conclusions and Discussions

This study analyses the specific characteristics the corporate governance of the firm in relation to the firm's performance (Return on Assets). Based on the full regression model showed that board size has an important role in enhancing the firm financial performance especially the firms from industrial product and service sector. Furthermore, the larger board size the better performance can be achieved and would provide extra board monitoring and subsequently corporate players could perform their duties effectively and efficiently in enhancing shareholders value. Secondly, the board independence can enhance better performance of the firm. This is probably due to the function of non-executed director to bring in outsiders' perspective and spot potential business which management has not discovered. Thirdly, it can be concluded that a lower number of board meeting will enhance firm's financial performance. Finally, with regard to duality when one personality is holding two important positions, the person is likely to pursue strategies which advance their own personal interests over those of the firm. In conclusion, the separation of power individuals holding the position of chairman and CEO is important for enhancing the firm financial performance.

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