

The Board of Directors and Firm Growth of Small and Medium Enterprises in Malaysia

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Abstract: *Prior studies on the role of board of directors and the performance of firm are conducted in large firms. Board of directors' attributes comprising of board size, board independency and board ownership are used in these previous studies. In addition, accounting ratio such as return on asset and return on equity are employed in these previous studies as the performance indicator. Nevertheless, the study on the role of board of directors and firm performance using growth as an indicator in Small Medium Enterprises (SMEs) has yet to take its ground. Thus, this present study aims to assess the role of the board of directors and firm growth in Malaysia SMEs' context. This present study has examined the roles of board of directors, namely, board transparency, board guanxi and board entrepreneurial orientation in relation with SMEs' firm growth as a performance indicator. The objectives of this study are to predict overall SMEs' firm growth based on the roles of the board of directors. Survey questionnaire was used to collect data from a total of 205 respondents. The empirical results revealed that board transparency, board guanxi and board entrepreneurial orientation are positively and significantly associated with SMEs' firm growth.*

Keywords: *Small and Medium Enterprises, Board of Directors, Firm Growth, Transparency, Guanxi and Entrepreneurial Orientation.*

I. INTRODUCTION

In the Asia-Pacific Economic Cooperation (APEC) region, Small and Medium Enterprises (SMEs) have been delivering for ninety percent (90%) of businesses and sixty percent (60%) of the workforce to the region development. Furthermore, the economic growth in ASEAN region is increasingly being driven by SMEs. In Malaysia, the Small and Medium Enterprises (SMEs) play an important role in the national economic development and contribute significantly to employment and Gross Domestic Product growth. The Malaysia' SMEs contributes approximately thirty-two percent (32%) of Gross Domestic Product to the country [1].

Malaysia SMEs are an important element of Malaysia's economic growth. In Malaysia, SMEs contribute thirty-two percent (32%) of Gross Domestic Product (GDP), fifty-nine percent (59%) of employment and nineteen percent (19%) of export. In addition, SMEs constitute ninety-seven and three percent (97.3%) of overall business establishments in Malaysia [1]. As such, the contribution of SMEs is vital for Malaysia to achieve as a high-income nation by the year 2020. The Malaysia's SMEs has contributed thirty-two per cent (32%) in Malaysia Gross Domestic Product (GDP). In view of the vital

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contribution of SMEs to growth of the Asia-Pacific Economic Cooperation (APEC) region and Malaysia, it is crucial to also examine the governance of SMEs in the APEC region in general, and the Malaysia context in particular.

II. LITERATURE REVIEW

2.1 Firm Growth

Firm growth is vital for the value creation of a firm for long-term survival [2]. Most entrepreneurs are motivated by the potential to grow and growth is crucial to the entrepreneurial success. Moreover, the potential to grow is the main criteria to differentiate an entrepreneurial firm from a traditionally run business entity [3]. The growth of a firm is one of the most vital discussed topics in business studies. Moreover, the growth of a firm is very crucial to gain competitive advantages and initiate innovation and technical change within the firms [4]. A broad range of views has been provided by numerous researchers to define firm growth. [5] proposes that firm growth comprising of two dimensions; 1), firm growth refers to increase of amount in terms of the firm output: sales and export volume; 2) firm growth refers to an expand of the size of the firm as a result of process development. However, the factor approach model researchers propose that the growth of the firm is influenced by multiple factors [6].

2.2 Transparency

The link between governance and transparency is clear in the public and regulators perceptions; transparency is increased for the purpose of improving governance [7]. Nevertheless, there are still lack of regulations and practices on the governance of SMEs, an alternative of many proposed corporate governance reforms in SMEs is to increase transparency within the SMEs firms. The benefit of transparency is that it reduces asymmetric information and the quality of information the firm discloses as a choice variable that affects the contracts the firm and its managers. As such, increased transparency reduces a firm's cost of capital. Thus, more transparency should improve firm financial performance [8]. A corporation's board of directors bears direct responsibility for creating a culture of transparency. They diligently monitor implementation, decisively intervene to ensure completeness, ensure that facts are not obscured and that conflicts of interest are eliminated. Transparency requires constant refinements in response to new market requirements and increasing organizational competencies [9]. Most countries generally agree on the need for directors to disclose to shareholders whether in an annual report or in another document of their own interests, as well as the financial performance of the corporation [10]. [11] conduct a company reporting transparency and Firm Performance in Nigeria. This study reveals that there is a positive relationship between transparency and performance of non-financial listed companies in Nigeria. As such, a hypothesis is formulated based on the above discussion:

H1: *Board transparency has a direct positive effect on SMEs firm growth.*

2.3 Guanxi

An interlocking directorship is when one director who sits on multiple boards of firms, and is considered as one type of board network which establishes vital links among firms [12]. Across the literature review, the study to examine *guanxi* in regard to the board of directors' attribute is lack of study in relation with SMEs firm growth. To address this gap in the literature, this study examines how *guanxi* to be linked to the board of directors and improve SMEs firm growth. [13] define *guanxi* as the ideas of a relationship comprising of reciprocity, and ongoing long-term commitment and personal networks. The study also refutes that *guanxi* facilitates the positive relationship of inter-firm trust and external financing performance. Thus, a hypothesis is formulated as below:

H2: *Board guanxi has a direct positive effect on SMEs firm growth.*

2.4 Entrepreneurial Orientation

Entrepreneurial firms usually involve in specific strategic actions including innovation, proactiveness, and risk-taking [14]. With the relationship between entrepreneurial orientation (EO) and firm performance are widely accepted by scholars, researchers are now increasingly focus on the contextual factors that change the nature of the relationship between EO and various manifestations of organizational performance. In this vein, this study adopts EO into the board of directors' study to investigate small and medium enterprises (SMEs) firm growth. This study aims to investigate the potential boundary conditions on the relationship between board EO and SMEs firm growth. Moreover, previous empirical studies on the firms' strategic with a posture to be innovative, proactive and risk-taking which covers EO dimensions are considered to be a significant driver of firm performance [15]. Another study

conducted by [16] in the context of SMEs in Southwestern Nigeria also shows a positive relationship between entrepreneurial orientation and growth performance. Previous empirical research, however, scarcely addresses the effect of EO and firm growth link from the board of directors' in SMEs' perspective. Thus, the researcher proposes the following hypothesis:

H3: *Board entrepreneurial orientation is positively related to SMEs firm growth.*

III. METHODOLOGY

3.1. Measurement

This present study employed perceptual measure or self-report to collect data in measuring dependent variable and independent variables. Measurement scales for this study were adapted from previous studies. In measuring firm growth, the scale was adapted from [17], which consisted of four items. Board transparency scale was adapted from [17] for reason of data collection efficiency and this scale comprised five items. On the other hand, board guanxi scale was adapted from [13]. This scale contained five items. Finally, to measure board entrepreneurial orientation, a eleven-item scale was adapted from [18]. The scale represents entrepreneurial orientation as an aggregate of three dimensions comprising of 1) innovativeness; 2) proactivity; and 3) risk taking. All study constructs were measured using a five-point Likert scale which ranged from "1=strongly disagree" to "5=strongly agree". In this study, internal consistency reliability measured by Cronbach's coefficient alpha for all constructs exceeded the suggested cut off value of 0.7 by [19] and ranged from 0.822 to 0.919.

3.2. Data Collection

Data in this study were collected by surveying a pool of 603 SMEs' companies from Peninsular Malaysia. Since the purpose of this study is to obtain theoretical generalizability over population generalizability, present study employed non-probability sampling as the sampling technique. All together 603 questionnaires were distributed and 226 questionnaires were collected. After eliminating the outliers and incomplete questionnaires, 205 usable questionnaires were used for further analysis. Among 205 respondents, 87% are male and the rest are female (13%) which reveal that majority of SMEs' directors are male. Most of the respondents' age ranges from 46 – 55 years (39.5%) and follow by 36 – 45 years (34.6%) the rest are ranged between 26 – 35 years (25.9%). In regard to ethnicity, 68.3% respondents are Chinese, 20.5% respondents are Malay, 10.2% are Indian and the rest are other races (1%). With respect to size of SMEs in term of annual sales, 76.4% respondents reported that annual sales ranged from RM 300,000 and Less than RM 15 million. Another 25.4% of SMEs' annual sales are reported from RM 15 million to not exceeding RM 50 million.

IV. RESULTS

PLS approach was utilized to analyze the data since predicting the relationship was the main concern, rather than theory testing [20]. Smart PLS M3 Version 3.0 software was used in this regard with the application of a bootstrapping technique

to determine the significance levels for loadings, weights, and path coefficients. Following the general convention, a two step approach was considered to assess the conceptual model, measurement model and the structural model[20]. In the first stage, the measurement model was examined by evaluating psychometric properties of the measurement items. Subsequently, the structural model was evaluated to test the hypothesized relationships.

4.1 Measurement Model

Confirmatory factor analysis (CFA) was conducted to test the measurement model. In this regard, reliability and validity were tested. Convergent validity which is the degree to which observed variables are loaded on their underlying construct was assessed through factor loadings [20], composite reliability (CR) and average variance extracted (AVE) [21]

4.1.1 Convergent Validity and Discriminant Validity

As shown in Table 1, all items are loaded adequately on their underlying construct and exceeded the recommended cut-off value by [22] of 0.4. Additionally, CR values which represent the extent to which the construct indicators indicate the latent construct exceeded the suggested value of 0.7[21]. On the other hand, AVE which demonstrates the overall amount of variance in the indicators accounted for by the latent construct was above the recommended cut-off value of 0.5[21].

For the present study, discriminant validity at the construct level was assessed using criterion. Conversely, as suggested by [20], item level discriminant validity was assessed by observing the cross loadings. The findings suggest that each of the measuring items for a particular latent construct was greater than its loadings on any other constructs. Next, criterion was assessed which recommends that the square-root of AVE for each construct is needed to be greater than other constructs' correlation coefficient. Results provided in Table 2 demonstrate that all inter-construct correlation value were less than the value of square-root of AVE.

Table 1. Test results of convergent validity

Constructs	Indicators	Outer loadings	Composite Reliability (CR)	Convergent Validity (AVE)
Firm Growth (FG)	FG1	0.882	0.925	0.756
	FG2	0.935		
	FG3	0.93		
	FG4	0.712		
Board Guanxi (GUAN)	GUAN1	0.685	0.836	0.509
	GUAN2	0.78		
	GUAN3	0.778		
	GUAN4	0.754		
	GUAN5	0.542		
Innovativeness (INNO)	INNO1	0.804	0.885	0.615
	INNO2	0.556		
	INNO3	0.933		
	INNO4	0.684		
	INNO5	0.882		
Proactivity	PROA1	0.925		

(PROA)	PROA2	0.706	0.88	0.712
	PROA3	0.884		
Risk taking (RISK)	RISK1	0.902	0.891	0.733
	RISK2	0.908		
	RISK3	0.747		
Board Transparency (TRANS)	TRANS1	0.891	0.872	0.639
	TRANS2	0.802		
	TRANS3	0.527		
	TRANS4	0.916		

Note: Composite Reliability (CR) = (square of the summation of the factor loadings)/{(square of the summation of the factor loadings) + (square of the summation of the error variances)} b Average Variance Extracted (AVE)= (summation of the square of the factor loadings)/{(summation of the square of the factor loadings)+ (summation of the error variances)}

Table 2. Assessment of discriminant validity at the construct level

	EO	FG	GUAN	INNO	PROA	RISK	TRANS
EO	Formative						
FG	0.412	0.87					
GUAN	0.219	0.207	0.713				
INNO	0.791	0.254	0.238	0.784			
PROA	0.611	0.331	0.161	0.167	0.844		
RISK	0.643	0.3	0.002	0.198	0.311	0.856	
TRANS	0.25	0.468	-0.033	0.156	0.17	0.211	0.799

Note: Diagonals represent the square root of the AVE while the off-diagonal values represent the Correlations

Table 3: Significance of EO as formative indicators

Second Order	First Order	Weight	T - statistics	VIF	Tolerance
EO	INNO	0.649	7.194	1.053	0.950
	PROA	0.379	6.231	1.117	0.896
	RISK	0.396	5.968	1.135	0.884

Note: p<0.05

In this present study, the construct of entrepreneurial orientation (EO) is defined by three dimensions, namely innovativeness (INNO), proactivity (PROA) and risk-taking (RISK). Thus, EO is considered as a formative construct in the present study. In the context of PLS-SEM, a tolerance value exceeds 0.20 and VIF value less than 5 indicated that the formative indicators do not have multicollinearity problem [22]. Table 3 depicted that VIF value is lower than 5 for all three constructs (INNO, PROA, RISK). Meanwhile, the tolerance values of all the formative indicators are more than 0.2. Hence, the multicollinearity issue was not a problem for the second order construct in this study.

4.2. Structural Model

Based on the above results, the reliability and validity evaluations performed on the measurement models are considered satisfactory. All of the present study's reliability and validity of the measurement models' tests are valid and can be further used to estimate the structural model. The structural model can only be estimated after all the reflective measurement models and formative measurement models have been validated successfully [22].

Path coefficients were obtained using PLS algorithm. Additionally, bootstrapping technique was utilized to assess the level of significance of the structured paths. The results of bootstrapping indicated that all paths coefficients were significant at 0.05 levels. The R2 value was 0.369 suggesting that 36.9% of the variance in SMEs' firm growth can be explained by board transparency, board guanxi and board entrepreneurial orientation. According to [23], a value of coefficient of determination (R²) at around 0.26 is considered *substantial*.

According to [24], the path coefficient value for each of the relationships should exceed 0.10 and has a confidence level of at least 0.05. Subsequently, refer to Table4, board transparency ($\beta = 0.448$, $t=6.583$) and board guanxi ($\beta = 0.171$, $t=3.055$) are positively and significantly related to SMEs firm growth. These results provide support for H1 and H2. Additionally, the effect of board entrepreneurial orientation is found to be a significant predictor of SMEs firm growth ($\beta = 0.276$, $t=3.714$). Thus, H3 is supported.

Table 4: Hypotheses Testing

Hypotheses	Relationships	(β) Path Coefficients	<i>t</i> values	Results
H1:	TRANS -> FG	0.448	6.583*	supported
H2:	GUAN -> FG	0.171	3.055*	supported
H3:	EO -> FG	0.276	3.714*	supported

Note: * $p < 0.05$

V. DISCUSSION AND CONCLUSION

The board transparency (TRANS) variable found to be significant predictors of SMEs firm growth (FG). It also depicted that the more positive the board transparency, the greater the growth of the SMEs firm. Furthermore, this present study result is also in consistent with [25] study which demonstrates that transparency and the reliable of financial reporting determine the firm performance. Furthermore, board transparency has the highest score on the effect size (f^2) value of particular predictor on the endogenous variable (firm growth). This result confirms that board transparency (TRANS) has a highest impact on firm growth compares to board entrepreneurial orientation and board guanxi. Hence, in term of firm strategy planning, SMEs firm can pay more attention to board transparency rather than board guanxi or board entrepreneurial orientation in order to enhance the SMEs firm growth. This outcome could be due to the firm's financial reports are presented in details to ease auditing process.

The outcome of this study confirmed that board *guanxi* (GUAN) positively and significantly affects SMEs firm growth (FG). It also implied that the more positive the board *guanxi*, the greater the SMEs firm growth. This present study is also in consistent with another recent empirical study conducted by [13] which is based on 205 samples revealed that *guanxi* has

a positive impact on the performance of a firm using financial indicators. Furthermore, this present study also in line with a study conducted by With regard to this issue, SMEs firms should deliberately focus on board guanxi to increase firm growth. The good relationship of the board of directors including a personal relationship with the buyers or vendors can enhance firm growth.

The study conducted by [26] revealed that EO has influence towards business performance. Moreover, in a business world of increasingly driven by new opportunities and threats, firms are encouraged to promote Entrepreneurial Orientation to increase the performance of firms [27](Covin and Lumpkin, 2011). With regard to this issue, SMEs firms should deliberately focus on board entrepreneurial orientation to increase firm growth. The result of this study also suggests that the board of directors engages in product and market innovation, takes risky ventures, and adopts proactive measures to defeat its competitors tend to increase the firm growth in SMEs. The board of directors favors a strong emphasis on innovation can improve firm growth. Similarly, the board of directors usually initiate actions to competitors, then the competitors respond to it is also likely to increase the firm growth in SMEs. This study also suggests that the board of directors strongly prefers high-risk projects with chances of very high return tend to increase firm growth.

VI. REFERENCES

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