International Journal of Psychosocial Rehabilitation, Vol. 24, Issue 02, 2020
ISSN: 1475-7192

Impact of Corporate Governance Practices on Firm Performance in Malaysia

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Abstract-- *Maintaining good corporate governance practices are significant to prevent firm failures. The corporate governance dilemma has raised concerns in both developed and developing countries. This paper examined the impact of corporate governance practices on firm performance in Malaysia. There are four main corporate governance practices to be tested in this study, which composed of boards independence, size of board, board diversity and board remunerations.*

Keywords--*Corporate Governance, Boards Independence, Size of Board, Board Diversity, Board Remunerations, Corporate Failures.*

I. INTRODUCTION

The Cadbury Report (1992) has provided us an academic definition of corporate governance, which is defined as how firms are directed and controlled. According to Goergen and Renneboog (2006), "corporate governance system is the combination of mechanisms which ensure that the management runs the firm for the benefit of one or several stakeholders. Such stakeholders may cover shareholders, creditors, suppliers, clients, employees and other parties with whom the firm conducts its business." The relationship between corporate governance and firm performance have been broadly discussed in the context of developed countries. Despite that, in the recent years, this issue has also been emphasized in a developing countries context like Malaysia due to recent corporate governance dilemma. Companies that fall into corporate failures are mainly resulting from poor corporate governance system which highlighted the essential of corporate governance improvement and restructuring. Good corporate governance system reduces the possibility of accounting frauds while firms with poor corporate governance systems in turn are more prone to accounting frauds (Arora and Sharma, 2016). However, the present corporate governance rules, structures and systems have been doubted on its effectiveness as it failed to avoid these corporate scandals (Sun, Steward and Pollard, 2011).

Corporate governance practices are what companies can do to add value to their performances. One of the usual ways to examine corporate governance practices is to review and evaluate companies' annual reports. The conduct of studies on corporate governance practices is very limited due to the analyzing of these practices are heavily relying on publicly available companies' annual reports only. Though the actual corporate governance practices go beyond the public information that are available in firms' annual reports, but this is the common

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DOI: 10.37200/IJPR/V24I2/PR200399
Received: 18 Dec 2019 | Revised: 03 Jan 2020 | Accepted: 15 Jan 2020

approach for most of the researchers in analyzing corporate governance practices. To examine the impact of corporate governance practices on firm performance in Malaysia, this study will focus on the corporate governance practices which includes determining the relationship between board independence, size of the board, board diversity and board remunerations.

II. PROBLEM STATEMENT

On April 2017, Securities Commission Malaysia (SC) has introduced the latest Malaysian Code on Corporate Governance (MCCG) to improve corporate culture, particularly on accountability and transparency (sc.com.my, 2017). Despite the efforts made by Malaysia's government and SC, companies are still weak, at embracing the legislations or code into enforcement and implementations. One of the notable and largest corporate governance failures in Malaysia was the Perwaja and Pan Electric Inc. This corporate scandal happened due to the misconduct of the directors and most of it is because of the internal control system within Perwaja in which there were some conflicts within the directors (Mat Norwani, Mohamad and Chek, 2011). According to the former deputy prime minister Tun Musa Hitam, "After all our training, Malaysia still suffers one corporate scandal after another." He also said that transparency, accountability and act in the interest of shareholders are significant to ensure a good corporate governance (thestar.com.my, 2016). If firms do not implement good corporate governance practices, it will have an impact on the firms' performance. Therefore, this study investigates how corporate governance practices give an impact on firm performance in Malaysia.

According to Dashew (2011), it is always a good practice to have independent directors on boards. Prior studies also found that there is a positive relationship between board independence and firm performance (Nahar Abdullah, 2004; Robert, Khondkar and Lu, 2016). According to Sharifah, Syahrina and Julizaerma (2016) and Ponnu and Karthigeyan (2016), there is no practical study in Malaysia that prove a real relationship between board independence and firm performance. Since different countries apply different corporate cultures, we must not conclude the results showed in other countries will have the same result in Malaysia. To fill in the contextual gap, a study on the relationship between board independence and firm performance in Malaysia must be done. Involvement of women on the boards have recently became the trend. There is even a campaign held to increase women directorship in U.S called Women on Boards 2020 (Price, 2018).Therefore, a thorough study must be done to see the importance of board diversity, especially in term of gender towards the firm performance in Malaysia.

Appiah and Badu (2017) recognized the importance of board size,which will give a positive impact on the firm performance. However, there are limited studies on this topic have been done by the researchers. Based on agency theory, board remuneration is considered important for the board of directors to overcome the agency problem. There are few studies that found a positive relationship between board remuneration and firm performance (Ruparelia and Njuguna, 2016; Rampling, 2015 and Ismail, Yabai and Hahn, 2014). However, studies by Gupta, Kennedy and Weaver (2009) and Sami, Wang and Zhou (2011) in China shows conflicting results. Thus, further analysis and evaluation is needed to find out their relationship.

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III. RESEARCH OBJECTIVE

This study provides an overview on the impact of corporate governance practices on firm performance in Malaysia. Specifically, this study focuses in board independence, board size, board diversity and board remunerations on the firm performance based on proxies like Return on Assets (ROA) and Return on Equity (ROE).

IV. LITERATURE REVIEW

Corporate governance is an interesting topic that discussed by many Asian researchers, particularly after the economic crisis in 1990s. Corporate governance has also become increasingly significant in developing countries like Malaysia as it contributes a lot in the economic sector. Bushee, Carter and Gerakos (2009) also concluded that corporate governance is a crucial approach and element for institutional investments. The combination of corporate governance mechanism can be categorized into two internal mechanisms and external mechanism. This study focuses only on the internal mechanism which includes board independence, board size, board diversity and board remunerations.

Some researchers found a positive relationship between board independence and firm performance (Nahar Abdullah, 2004; Robert et al., 2016; Dashew, 2011) while others disagree (Haniffa and Hudaib, 2006; Conger and Lawler, 2009). Dehaene, De Vuyst and Ooghe (2001) also claimed that there is positive relationship between board independence and ROE. According to Nahar Abdullah (2004), the increase in the number of non-executive directors can increase independency of an organization. Rhoades, Rechner and Sundaramurthy (2000) also proved that these outside directors can reduce agency problems and managerial self-interest.According to Bonn, Yoshikawa and Phan (2004), board size is a significant element for a firm to practice a good corporate governance. Appiah and Badu (2017), Alabede (2016), Shukeri, Shin and Shaari (2012) and Kiel and Nicholson (2003) concluded that board size is positively correlated with the firm performance. Size of board has a significant relationship with the firm performance, particularly for both ROA and ROE (Mohd Razali, 2018). Alabede (2016) also proved that size of the board has a positive effect on the operating performance, by using ROA. There was also studies showed positive results but weak relationship between size of board and firm performance (Lakhal, 2005; Shukeri et al., 2012). Sanda, Mikailu and Garba (2005) also argued that larger size of the board is negatively correlated with the firms' performance. However, Mishra, Randoy and Jenssen (2001) and Singh and Davidson III (2003)found anegative relationship between board size and firm performance.

Joecks, Pull and Vetter (2012) and Mahadeo, Soobaroyen and Hanuman (2011) showed a positive relationship between women on boards and firm performance. They proved that women on boards can diversify the boards. The results are consistent with prior researchers (Carter, Simkins and Simpson, 2003; Erhardt, Werbel and Shrader, 2003; Conyon and He, 2016). On the other hand, Ahern and Dittmar (2012) and Bøhren and Staubo (2014) had come out with a contrary result. They argued that the increasing women on boards has a negative effect on the firm performance. The results are consistent with another researcher who did their studies in the U.S.(Adams and Ferreira, 2008). Yatim (2012) supported that directors' remunerations have a significant effect on the firm's performance in

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ISSN: 1475-7192

Malaysia particularly on ROA. According to Jaafar, Wahab and James (2012), they found a positive relationship between directors' remuneration and firm performance in Malaysia as well. However, they focused on the family-owned companies.

Despite the positive relationship between these two variables, there are also negative results discovered in prior studies. Duffhues and Kabir (2008) found that the board remunerations are negatively correlated with firm performance while using cash-based remunerations as an approach in their model. During the Asian economic crisis, researchers found that there is negative relationship between directors' remuneration and firm performance in Malaysia (Hassan, Christopher and Evans, 2003).

V. RESEARCH METHODOLOGY

The Quantitative Research Method with secondary data are applied in this research.The secondary data obtained from annual reports from Bursa Malaysia andrespective companies' websites. Besides, financial data such as number of shares, share price, ROA, ROE, and book value of total assets are obtained from the DataStream. The accounting data such as the percentage of independent board members, board size, board remunerations and percentage of women on boards also downloaded from the same database. There are11 listed companies randomly chosen from the list of top 100 companies with good disclosures. Ranks are determined by the Minority Shareholders Watch Group (MSWG). Multiple linear regression model is being used in this research to investigate thecorporate governance practices on firm performance in Malaysia via Eviews.The multiple regression equation is:

$Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon_i$

Y	Dependent variable	Return on Asset (ROA)	Net Profit/Total Assets
		Return on Equity (ROE)	Net Profit/Total Equity
X1	Independent variable 1	Board Independence (BI)	Number of Independent Directors/Total Number of Directors on Board
X2	Independent variable 2	Board Size (BS)	The total number of board members
X3	Independent variable 3	Board Diversity (BD)	Total compensation of the non-executive board members
X4	Independent variable 4	Board Remuneration (BR)	Percentage of women on board
ε	Error term		
β	Beta		

VI. RESEARCH FINDINGS

The study uses Ordinary Least Square (OLS) as the estimation tool for multiple regression model. There are two multiple regression models in this study, which are ROA and ROE.

DOI: 10.37200/IJPR/V24I2/PR200399
Received: 18 Dec 2019 | Revised: 03 Jan 2020 | Accepted: 15 Jan 2020

Dependent Variable: ROA
Method: Least Squares
Date: 05/13/19 Time: 21:26
Sample: 2008 2018
Included observations: 11

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BD	-0.258273	0.109211	-2.364904	0.0559
BI	0.226195	0.158692	1.425364	0.2039
BR	-5.85E-08	5.36E-07	-0.109207	0.9166
BS	5.019232	3.925931	1.278482	0.2483
C	-48.76130	38.56020	-1.264550	0.2529

R-squared	0.685144	Mean dependent var	7.820083
Adjusted R-squared	0.475240	S.D. dependent var	2.128348
S.E. of regression	1.541782	Akaike info criterion	4.006710
Sum squared resid	14.26265	Schwarz criterion	4.187571
Log likelihood	-17.03690	Hannan-Quinn criter.	3.892702
F-statistic	3.264086	Durbin-Watson stat	1.741089
Prob(F-statistic)	0.095369		

The result above shows R^2 equals to 0.685. There is around 68.5% variation in dependent variable known as ROA can be explained by other independent variables, namely after BD, BI, BR and BS while 31.5% variation of ROA is explained by other factors. On the other hand, the p-value shows that all independent variables are higher than the significant level at 5%, which is also indicated that the independent variables are not significant to the dependent variable. Thus, null hypotheses for all independent variables will not be rejected.

On the other hand, data is transformed by using first differencing. After experiencing the first differencing, ROE model shows that there is at least one independent variable, namely board diversity is significant to ROE while others are not significant to ROE. Therefore, H_0 is accepted for three independent variables which are the board independence, board size and board remuneration. There is no relationship between these independent variables and firm performance. There is exception on board diversity. This is because board diversity shows it is not significant in ROA model, but it is significant in ROE model. This is indecisive whether board diversity is significant or not significant to the firm performance in general. Thus, no hypotheses can be drawn or concluded for this variable. Specifically, there is no significant relationship between board diversity and ROA, but significant relationship is found between board diversity and ROE. The results also indicate that there is around 72.1% variation of ROE can be explained by BD, BI, BR and BS while the rest will be explained by other factors. Conclusively, only board diversity (BD) is significant to return on equity (ROE).

Dependent Variable: ROE
Method: Least Squares
Date: 05/09/19 Time: 14:30
Sample (adjusted): 2009 2018
Included observations: 10 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DLBD	27.48968	8.088269	3.398709	0.0193
DLBI	-40.99261	35.28632	-1.161714	0.2978
DLBR	2.890298	3.488658	0.828484	0.4451
DLBS	-33.82436	132.7483	-0.254801	0.8090
C	27.23094	2.776271	9.808462	0.0002

R-squared	0.720760	Mean dependent var	28.89064
Adjusted R-squared	0.497368	S.D. dependent var	9.015893
S.E. of regression	6.391958	Akaike info criterion	6.854811
Sum squared resid	204.2857	Schwarz criterion	7.006104
Log likelihood	-29.27406	Hannan-Quinn criter.	6.688844
F-statistic	3.226433	Durbin-Watson stat	2.385921
Prob(F-statistic)	0.115451		

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VII. RECOMMENDATIONS

Increase of sample size are strongly recommended for the next researcher. Since the observation for this study is too less, descriptive analysis is not suggested to apply in this study. The descriptive analysis eases the result for the researchers as it becomes more generalized and summarization of the sample can be done instead of using the data itself to study on the population which is more complicated. By using descriptive analysis, the sample of the data represents the whole population. However, it can only be carried out as the suggested observation number is suggested to be at least 50 or above. It is more suggested if the study includes a large number of observations. Therefore, this data analysis method could not be applied in this study. Besides, increase of sample size can draw a conclusion that is more generalized on this topic. Moreover, the researcher can take more input variables into considerations for future advance studies. Combination of model that include various factors can significantly improve the accuracy of the study.

VIII. CONCLUSION

The study focuses on how board independence, size of board, board diversity and board diversity will have an impact on the firm performance, especially on return on asset and return on equity in Malaysia. The study used time series data to proceed with the data analysis through correlation testing and OLS. Based on correlation testing, all of input variables showed a relationship with firm performance. Some of them matched the results from prior researchers, some are not. For instance, some of the variables proved consistent results with prior researcher, showing that there is a positive or negative relationship with firm performance while some of the input variables are contradicted with the findings. On the other hand, all the independent variables showed that they are not significant to firm performance, except of board diversity is significant to return on equity based on multiple regression ordinary least square. This result tends to be ignored by the study as it is almost not consistent with most of the past studies by prior researchers. It might be because of the small sample size involved in this study that lead to inconsistency of the results.

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DOI: 10.37200/IJPR/V24I2/PR200399
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