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AN EMPIRICAL INVESTIGATION ON CORPORATE GOVERNANCE AND CORPORATE PERFORMANCE IN BURSA MALAYSIA

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ABSTRACT

Since last decade the corporate governance has been the focus of many researches worldwide. This stems come from the belief that the better governance of the firms lead to more healthy corporations. The current study will contribute to the growing literature in this field of study and mainly focusing on the impact of corporate governance on corporate performance among public-listed companies in Malaysia. This paper aims to examine the impact of the relationship between corporate governance elements and company performance based on earning per share among top 100 public-listed companies in Malaysia. The study adopts by examines the annual reports from the year 2008 to 2012. Regression analysis was used to examine the relationship between company performance and independent variables of CG namely board size, board independence, audit committee size, audit committee independence and audit committee meeting frequency. Analysis found, the company performance is significant relationship only with audit committee size. In contrast, the corporate performance is insignificant with board size, board independence, audit committee independence and audit committee meeting frequency. The result 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 among public-listed companies in Malaysia.

Keywords: Corporate governance, Corporate performance, Public-listed companies, Bursa Malaysia.

INTRODUCTION

Nowadays, corporate governance is acknowledged as an important factor in economic development and financial markets stability (Sanda et al., 2005). Recently, the much attention due to corporate failures such as Enron and WorldCom has lead to increase shareholder and governmental interest in corporate governance. This financial crisis indicated weak corporate governance practices of many companies such as weak financial structure, inadequate of transparency, disclosure and accountability. The good corporate governance plays a crucial in underpinning the integrity and efficiency of financial markets. Meanwhile, the poor of corporate governance would weaken a firm's potential and at worst can cover the way for financial difficulties and even fraud. According to Ruin (2001), the corporate governance also been referred to as collective group of people united as one body with the power and authority to direct, control and rule an organization.

One of the emerging issues in the field of management is the aspect of corporate governance influence on the value of the firm. Thus, it is significant to have a study focusing on the relationship between corporate governance characteristics and firm performance among public-listed companies in Malaysia. Hence, the objective of this study attempts to examines whether the corporate governance characteristics, namely board size, board independence, audit committee size, audit committee independent and audit committee frequency have a significant relationship with the firm performance. The remainder of this paper proceeds as follows. The next section reviews on the literature review and hypotheses development. The following section describes the research methodology. The data analysis section provides discussion on the findings. Final section concludes the paper.

LITERATURE REVIEW

Corporate Governance

The Malaysian Code on Corporate Governance is the main pillar of the corporate governance reforms agenda in Malaysia. It provides the guidelines on the principles and best practices in corporate governance and the direction for the implementation as well as charts the future prospects of corporate governance in Malaysia. Corporate governance plays the main role in company performance because it assists to control the board's performance in business operations (Ponnu, 2008). The firms which implement sound corporate governance systems provide more useful information to investors and its other stakeholders to reduce information asymmetry as well as to assist the company improve its operations (Chiang, 2005). Claessens et al. (2002) propose that a good corporate governance framework can benefit the firm with easier financing, lower cost of capital, improved stakeholder favor and greater overall company performance.

Moreover, promotion of efficient and effective corporate governance has become an important agenda for businesses in developing countries because it can enhance managerial excellence and help businesses with fragile governance structures to increase capital and attract foreign investors (Okpara, 2011). From the shareholders point of view, they believed that with improved governance practices more of the firm's free cash flow will be returned to them as dividends rather than being expropriated by the managers who control the firm (La Porta et al., 2002;

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Shleifer & Wolfenzon, 2002). The empirical studies support the view that improved governance practices lead to better firm financial performance (MacAvoy & Millstein, 2004).

Hence, it is acknowledged that no single characteristics that explain general pattern of links between corporate governance and firm performance. The relationship between corporate governance and firm performance is more varied and complex than can be covered by any single governance theory (Alhaji et al., 2012). Furthermore, various studies discovered a number of corporate governance components have influence firm performance such as number of independents directors, board leadership structure, board size, audit committee, board attributes and board meeting (Abdullah, 2004; Shukeri et al., 2004).

Firm Performance

The study shows that corporate governance has contributed to the company in enhancing operating performance and preventing fraud (Yeh, Lee & Ko, 2002). Furthermore, Black et al. (2006) stated the companies with better corporate governance have better operating performance than those companies with poor corporate governance. 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). 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.

Firms performance can be measured using long-term market performance measures and other performance measures that are non market-oriented measures or short-term measures such as market value added (MVA), economic value added (EVA), cash flow growth, earnings per share (EPS), dividend growth and sales growth (Coles et al., 2001; Abdullah, 2004). Judge et al. (2003) used a series of indicators including financial profitability, customer satisfaction, product or service quality, capacity utilization and process improvements to assess firm performance.

Corporate Governance Characteristics

Board Size

Board size refers to the number of directors with voting rights sitting on the board (Levrau & Van den Berghe, 2007; Pugliese & Wenstop, 2007). Generally, the optimum number of board members should be appropriately determined by the whole board to ensure that there are enough members to discharge responsibilities and perform various functions (Malaysian Code of Corporate Governance, 2000). The board of a company is considered as one of the primary internal corporate governance mechanisms (Brennan, 2006). The board of directors plays an important role in the operation of a company as it oversees top management and entrusted with

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the responsibility of monitoring and supervising the company's resources and operation (Abdullah, 2006).

Lipton and Lorch (1992) recommended limiting the number of directors on board to seven or eight, as numbers beyond that would be difficult for the CEO to control. Shakir (2008) stated that boards with a large number of directors can be a disadvantage and expensive for the firms to maintain. It was further explained that planning, coordination, decision-making and holding regular meetings can be difficult with a large number of board members. Moreover, many results shown that the relationship between board size and firm performance is not significant (Beiner et al., 2004; Bhagat & Black, 2001). Additionally, studied by Al-Matari et al. (2012), the result was found that the relationship between board size and firm performance is insignificant among the firms' in Kuwait. Moreover, the studied by Cheema and Din (2013) in Pakistan showed that the board size had negative relationship with firm performance. Finally, Ehikioya (2009) found insignificant relationship between board size and firm performance in Nigeria. Thus, it is hypothesize that:

H1: There is no significant relationship between board size and firm's earnings per share.

Board Independence

Generally, the value of independent directors related to their ability to judge firm performance independently (Sheikh et al., 2013). It was further explained that independent directors may contribute both expertise and objectivity in evaluating manager's decisions. The previous studied found that although the proportion of independent directors on the board is high but the level of board independence and professionalism is not necessarily good (Chen, Fan & Wong, 2004). Furthermore, a few studies had found that independent directors on board are negatively related to firm performance (Ehikioya, 2009; Coles et al., 2001 and Agrawal & Knoeber, 1996). It is supported findings by Bhagat and Black (1999) found that majority outside directors performed badly in the firms. Furthermore, the studied by Tham and Romuald (2012) showed that there is no significance relationship between the proportion of independent non-executive directors in the board and firm performance among public-listed companies in Malaysia. Thus, it is hypothesize that:

H2: There is no significant relationship between board independence and firm's earnings per share.

Audit Committee Size

Prior studies support a positive relationship between the presence of an audit committee and financial reporting quality (Lin and Hwang, 2010; Koh et al., 2007 & Dechow et al., 1996). The major duty of the audit committee is to assist the board of directors in watching and reporting the transparency and openness of the financial reporting process (Klein, 2002). Moreover, with the presence of the audit committee, it is more likely to voluntarily disclose information (Ho and Wong, 2001) and more reliable financial reporting (McMullen, 1996). Some researchers proposed that the larger of the audit committee, the more information can be obtained and promotes stronger organizational structure (Karamanou and Vafeas, 2005; Kalbers and Fogarty, 1993). Collier and Gregory (2000) stated that larger boards should obtain greater monitoring benefits from effective audit committee than smaller boards. This reflects the operational efficiencies gained from assigning certain board responsibilities to the audit committee. Thus, it is hypothesize that:

H3: There is a significant relationship between audit committee size and firm's earnings per share.

Audit Committee Independence

The effectiveness of the audit committee could be recognized through independence and had been emphasized a lot for good corporate governance. A study suggested that the existence of independent audit committee could reduce agency problems which could eventually improve the firm's performance (Erickson et al., 2005). An effective audit committee is to have qualified and well informed members, with a majority of independent members and having the authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal accounting controls and risk management through its diligent oversights efforts (Vera-Munoz, 2005; DeZoort et al., 2002). The quality of audit committee can be strengthened by increasing their independence, expertise, activity and size (Baxter, 2010). Beasley and Salterio (2001) in their studied among the firm's in Canada showed that audit committee independence was positively associated with larger boards and the board members comprised more outside directors. Thus, it is hypothesize that:

H4: There is a significant relationship between audit committee independence and firm's earnings per share.

Audit Committee Meetings Frequency

The audit committee meeting frequency is often considered in the literature as a proxy for the level of monitoring activity delivered (Sharma et al., 2009; Collier and Gregory, 2000). According to Raghunandan and Rama (2007), the number of meeting increases as the size of board and audit committee increases. The increase in meeting frequency and number of members is argued to be able to provide a more effective monitoring and hence improving the firm's performance. According to Carcello et al., (2002), the meeting frequency would give several benefits to shareholders such as enhanced level of oversight on the financial reporting process

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and greater transparency about the executive compensation practices. Furthermore, it is also perceived that the more frequent the audit committee meet, the more effective is the overseeing functions and eventually increases the firm's performance (Aldamen et al., 2012). Thus, it is hypothesize that:

H5: There is a significant relationship between audit committee meeting frequency and firm's earnings per share.

Conceptual Framework

Based on the extensive literature, board size, board independence, audit committee size, audit committee independence and audit committee meeting frequency representing corporate governance characteristics have been identified as possibly having an impact on firm performance and these characteristics are set as independent variables in the framework. The dependent variable set in the framework used to measure the firm performance is earnings per share (EPS).

RESEARCH METHODOLOGY

This research will examine the top 100 public-listed companies in Main Board of Bursa Malaysia. The secondary data were extracted from annual reports from the year 2008 till 2012. The final list of data comprising the top 100 public-listed companies for five years in a row selected from annual reports excluding several companies that does not meet the requirement of the research. For instance, companies that 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.

Research Sampling

The top 100 public-listed companies in Malaysia were based in terms of highest increase in turnover, highest net profit, biggest change in profit, highest return of turnover, highest return on asset and highest return on equity (Malaysian Business, 2012). The research sampling was drawn from the total 814 public-listed companies in Bursa Malaysia. The reasons of this selection due to most of these companies were make up the composite index, which is very important to determine the firm performance. Furthermore, the annual reports disclose more reliable information of the companies and the level of disclosure in the annual report is essential to the functioning of corporate governance (Short and Keasey, 1999).

Regression Analysis

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

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$$EPS = \beta 0 + \beta 1BS + \beta 2BI + \beta 3AS + \beta 4AI + \beta 5AM + \varepsilon$$

where;

EPS = Earning Per Share (Corporate Performance)

BS = Board size

BI = Board independence

AS = Audit committee size

AI = Audit committee independence

AM = Audit committee frequency meetings

ε = error terms

EMPIRICAL RESULTS

Descriptive Statistics

Table 1 provides the descriptive statistics of the dependent and the explanatory variables. The descriptive statistics includes such as minimum, maximum, mean and standard deviation. The result for the mean of company performance which is earning per share is 0.342 which are generally low. The maximum ratio of board size is 15 and minimum is 5. The mean of the board size is 8.70 and the mean value of board size is consistent with the study by Abidin et al. (2009) in Bursa Malaysia based on the data from 2003. It is noted that, the average level of board independence variable is 0.91 which is much higher. Moreover, the average level of board independence shows that most of the companies were comply with the Malaysian Code on Corporate Governance recommendation of the needs to be balance on the board of directors with at least one third on the board members being independent directors. Meanwhile, the mean value of audit committee size is 3.61 which is moderate composition and showed that most of the companies fulfill the requirements of Bursa Malaysia where an audit committee should comprise at least three directors which the majority of whom are independent. The maximum value is 9 and minimum of 3. Furthermore, the mean value of audit committee independence is 5.80 which are generally high. It shows that more than half of the public-listed companies do comply with the Malaysian Code on Corporate Governance recommendation of majority of the audit committee members being independent directors. The mean value of an audit committee meeting frequency is 5.80 with maximum value of 21 and minimum is 1 and showed that the companies have more than four meetings. Lastly, the mean value of earnings per share is 0.342 with a minimum of -3.978 and maximum of 2.843 with standard deviation of 0.510 which are very

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much lower. It is mean that the portion of the companies' profit allocated to each outstanding share of common stock from the year 2008 till 2012 is average at 0.342 cents.

Table 1: Summary of statistics of continuous variables

	N	Min.	Max.	Mean	Std. Deviation
Firm Performance	440	-3.98	2.84	.34	.51
Board Size	440	5	15	8.70	2.06
Board Ind.	440	0	1	.91	.28
Audit Size	440	3	9	3.61	.78
Audit Ind.	440	0	1	1.0	.04
Audit Mtg.	440	1	21	5.80	2.64
Valid N (listwise)					

Correlation Analysis

As can be seen in Table 2, the correlations between the independent variables and firm performance as dependent variable. From the output we can see that three of the five independent variables (Board independence, Audit size and Audit independence) are positively correlated with firm performance, while the other two (Board size and Audit meeting) are negatively correlated.

Table 2: Correlations Analysis

	Firm Performance	Board size	Board ind.	Audit size	Audit ind.	Audit mtg.
Firm Performance	1	-.230**	.400**	.178	.332**	-.038
Board size		1	-.055	-.456**	-.202	.004
Board ind.			1	-.048	.170	-.073
Audit size				1	.026	-.014
Audit ind.					1	-.196
Audit mtg.						1

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The Test of Regression Coefficients

Table 3: The Result of Regressions Analysis

Variable	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
Constant	.649	.548		1.185	.237
Board size	-.021	.013	-.085	-1.626	.105
Board ind.	.097	.089	.055	1.091	.276
Audit size	.028	.033	.043	.832	.02
Audit ind.	-.340	.522	-.032	-.651	.516
Audit mtg.	.004	.009	.023	.480	.632

a. Dependent Variable: Earnings per share (RM)

Result of Hypothesis Testing

Earning Per Share and Board Size

Based on the regression analysis, the board size is found to have no significant relationship with the firm's earnings per share as the p-value is greater than 0.05. In other words, the board size does not influence the firm's earnings per share. This result is supported by the studies of Alhaji et al. (2012), Al-Matari et al. (2012), Beiner et al. (2004) and Bhagat and Black (2001). Thus, the H1 is accepted.

Earning Per Share and Board Independence

The result of board independence is found to have no significant relationship with the firm's earning per share as the p-value is greater 0.05. In other words, with regards to the corporate governance characteristics, board independence does not influence the firm's earnings per share. This result is supported by the studies of Aljahi et al. (2012), Tham and Romuald (2012), Hermalin and Weisbach (2001) and Klein (1998). Thus, the H2 is accepted.

Earning Per Share and Audit Committee Size

The audit committee size has significant influence on the firm's earning per share. The significance value is equal to 0.02 which is less than the threshold standard that indicates that a p

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value should be ≤ 0.05 to be significant. This result is support of Lin and Hwang (2010), Dechow et al. (1996) and Koh et al. (2007). Thus, the H3 is supported.

Earning Per Share and Audit Committee Independence

The result in this study appears have no significant influence on the firm's earning per share. The significance value is equal to 0.516 which is more than the threshold standard that indicates that p value should be ≤ 0.05 to be significant. The result is in contrast of Chan and Li (2008) and Erickson et al. (2005). Thus, the H4 is rejected.

Earning Per Share and Audit Committee Meeting Frequency

Based on the regression analysis, the audit committee meeting frequency is found have no significant influence with the firm's earnings per share. The significance value is equal to 0.632 which is more than the threshold standard that indicates that p value should be ≤ 0.05 to be significant. The result is in contrast of Aldamen et al. (2012). Thus, the H5 is rejected.

CONCLUSIONS AND DISCUSSION

This study analyses the specific characteristics the corporate governance of the firm in relation to the firm's performance (earning per share). However, the results based on the full regression model showed that only audit committee size were associated with the extent of firm's earning per share. The findings provide evidence that the majority of the firms seem to have a preference for small boards to avoid information asymmetry and large board most likely less effective among the board of directors' discussion in managing the firms. Meanwhile, for board independence, it is found there is no significant relationship with firm performance. The insignificant result in relation to the board independence may due to the fact that directors appointed to the boards are not independent as they may have some connection with the management. Generally, among the public-listed companies in Malaysia, it is very difficult to find directors who are truly independent as Malaysian public-listed companies are very closely held and mostly are family controlled. The insignificant results for the audit committee independence may be explained by the fact that members of the committee are not really independence and were selected not on the quality and performance. Lastly, the audit committee meeting was negatively related to company performance suggesting that higher diligence of the audit committee, the lesser earning per share. Thus, the audit committee meeting has no effect on corporate performance.

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