Advances in Environmental Biology, 8(9) Special 2014, Pages: 383-388

AENSI Journals

Advances in Environmental Biology

ISSN-1995-0756 EISSN-1998-1066

Journal home page: http://www.aensiweb.com/aeb.html

Corporate Governance and Firm Financial Performance for Malaysian Public Listed Company

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ARTICLE INFO

Article history:
Received 25 January 2014
Received in revised form
2 June April 2014
Accepted 6 June 2014
Available online 15 June 2014

Key words:
Corporate Governance, Board Characteristic, Malaysian Public Listed Companies

ABSTRACT

The study investigates the impact of corporate governance on the firm financial performance among Malaysian Public Listed Companies. There are six characteristics being studied in this study including board of director size, board of director independence, board of director qualification, board of director gender and CEO duality. Besides that, return on equity also is used as a proxy to the firm performance. This study focused mainly on 300 Malaysian Public Listed Companies. The findings show board of director independence, qualification and female gender show positive relationship with the firm performance while board size show negative relationship to firm performance.

To Cite This Article: Amira Syuhaiba Binti Yahya and Siti Norwahida Shukeri., Corporate Governance and Firm Financial Performance for Malaysian Public Listed Company. ***Adv. Environ. Biol., 8(9),*** *383-388, 2014*

INTRODUCTION

The financial reporting also considered as the qualities of financial reporting that support the decision making. Firm performance related with the performance of the particular firm that show the capability and capacity about its financial strength. It shows the good or poor performance according to the financial stability of that firm. In this study also concerns about the factor that influence the firm performance. Firm performance contributes with profit, return on equity (ROE), return on asset (ROA), and net profit before tax and etc. Klein uses return on assets (ROA) and Lo uses return on equity (ROE) as an operating performance indicator. By using the entire list thing, we can analyse the firm performance are in the good condition or not. Return on equity is used to measure an investor how much profit a company generates from the money invested from its shareholders. Corporate governance and firm financial performance have the strong relationship. This is the independence variable that will be tested in this study, which is director size, director independence, director qualification, director gender, and CEO duality.

Based on this study, there are several problems that related with the firm performance. Mostly firm in Malaysia faced with the large number of employee, conflict among the employees and employers, conflict of interest. According to this problems, it can be covered by the component of the corporate governance and the in the same time can improve the firm performance. Board of directors is able to reduce the conflict of interest among the company or organization. When the organization in the good conditions, it can cause the firm performance will increase. Thus, research question is to test the effect of board of directors on firm performance. In the other hand, when the organization with the less number of the employee, it also can reduce the poor firm performance in the same time. Therefore, our research question is to test whether size of director has any effect to firm performance. The main research question is does corporate governance affect the firm financial performance of 300 Malaysian public listed companies. Therefore, the objective of this research is to investigate the impact of corporate governance to the firm financial performance. It is because to know how the company or firms adopt or relate with the financial crisis that are caused by corporate governance. It also to ensure the listed companies exercises corporate governance system within the organizations.

This study will be useful benchmark to identify the relationships between variable of corporate governance and firm performance. It is one of the studies that discuss on how the monitoring functions provide by the corporate governance that can influence the firm financial performance. The other is to describe the distribution of the corporate governance characteristics and the financial performance by sectors and to determine the influence between corporate governance characteristics and the financial performance. It is because the purported that the emergence of the financial crisis in Asia was due to the weak of

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corporate governance. As mention by Nordin (1999), commented that the lack of corporate governance standards and the lack of transparency in the financial system are resulted in the decline of investor confidence in Malaysia. In the other point of view, in the globalized world Evans and Lindsay (2002) said, in the lowest cost of product and service that to serve the needs of customer demands.

Literature Review:

From the previous research, corporate governance is an obligatory adherence function in the present turbulent business environment [26]. According to Shleifer and Vishny define corporate governance (CG) as a way in which suppliers of finance to corporations assure themselves of getting a return on their investment. Denis (2001, 192) posits that CG exists to address the problems that the separation of ownership and control in corporations creates. She states that CG "encompasses the set of institutional and market mechanisms that induce self-interested managers (the controllers) to maximize the value of the residual cash flows of the firm on behalf of its shareholders." As mention by, corporate governance mechanism for each country is determined with a number of internal and external factors. External factors such as level of capital flows from outside to inside, the world economy, shares offered in foreign exchange market, and cross-border institutional investors have influence on the CG mechanism in a country. Meanwhile, the internal factors that are determine the CG mechanisms are corporate ownership structure, economic status, legal system, government policies and culture. By the way, the most major and determining factor in CG mechanism is corporate ownership structure [3].

According to Rezaee, the governance structure referred to the previous section that are based on corporate governance principles that no globally accepted the set of principles that can applied to the board structures. The changes to the board structures and procedures to make the firm more accountable to the shareholders and introduction of board committees. According to this principle, it also provides guidance in developing good corporate governance for those interested. The good governance can benefit a company through better flow of funds and improved access to low capital and might achieve better credit ratings that can lead to lower debt funding. To promote financial and economic stability, arrange companies properly governed that are supported by deep and transparent financial markets, robust legal systems and efficient resources allocation. The other side according to, the good corporate governance bring the better performance of management and prudent allocating of that company resources and increasing the value of shareholders holding.

Corporate governance and firm financial performance have the strong relationship. It is because when the company or organization that have the higher number of their board of directors, it can increase the company operation. Besides that, it also cans the firm performance of that company increase and gain the high profit. According to the previous study, it that claimed that when the board size increase, the conflict of interest will arise and ultimately deteriorate the firm performance. In the other perception, Coles, Naveen and Naveen mention that the larger firms, diversified firms and firms that are rely more on the debt financing will derive the greater firm value from having the larger boards. Indeed the more board size will emphasized and help to improve the company's financial and nonfinancial performance. Based on the previous study, no one has investigated the gender of the board of directors, thus these studies try to fill the gap by including this factor as our explanatory variables. That variable can give great impact to firm performance. Besides, most of the researcher more focuses on the board of directors' independent and size. Gender is one of the important parts in the organizations that are needs to be concern because different gender have their own perception or skills to manage or organized the company or organizations. In the real world of business, the majority of the CEO in the organization is man and the minority is women. According to this gap of study, it can show the truth and the real that women also can manage the organization very well.

Research Methodology:

The effective corporate governance particularly is the role of board of directors that may improve the firm performance. Good governance take place there should be active participation of all parties including board of directors to continuous improvements. Meanwhile, the poor or lack of strong corporate governance may cause the performance in the bad conditions and internal control of the organization since all business function interrelated with each other's.

3.1 Hypothesis development:

3.1.1 Director Size:

Coles, Naveen and Naveen (2008) find the evidence that the large firms, diversified firms and firms that will derive greater firm value from having larger boards. According to Nicholson and Kiel, 2007 mention about some of researchers have argued that the large board size can improve the performance of the company. Thus, the following hypothesis is developed to show the relationship between firm performances and board of director size.

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

3.1.2 Board Independence:

Board of directors' role is to monitor management decisions. Beasley explained that independent directors hold better judgment and fair representation of shareholder's interest, suitability as a reliable governing mechanism and their potential ability to concentrate on ensuring the maximization of shareholder value. Besides that, the outside board of directors could strengthen the firm value by leading experienced and by monitoring services that are supposed to be guardians of the monitoring and control the shareholders interest. The greater board independence can ensure the high value of the firm and this hypothesis is as follows:
H2: There is positive relationship between firm performance and board independence.

3.1.3 Director Qualification:

Malaysia Code on corporate governance stresses that nominating committees should consider recruiting the directors that have their own skill, experiences and qualifications. Firms should look for the quality of superior directors to monitoring the management [13]. Therefore, based on the past literature, this study predicts that director's expertise plays a significant role in enhancing the performance of family companies. The experts with special skill and qualification can advise family companies better than other directors. Therefore, this study expects that:
H3: There is a positive relationship between firm performance and director qualifications.

3.1.4 Director Gender:

Some have revealed positive relationships between financial performance and presence of female directors in the board [6]. The women participation in all most all the activities around the world is increasing. Verner stated that woman directors may better understand particular market condition than man, which brings more creativity and quality to board decision making. Larger gender diversity may generate a better public image of the firm and improve firm performance.
H4: There is a positive relationship between firm performance and director gender.

3.1.5 CEO DualityI

CEO duality describes a situation in which CEO and the board chair is one and the same person. The CEO is more likely to use his power as board chairman to make selection of their directors of the favour. Mary mention that, the absence of the separation of the decision management and decision control and the board will be unable to the effectively monitor and evaluate the CEO. Besides that, the separation of the role is to ensure the balance of power and to avoid conflict of interest. When CEO control the board, it is more likely to lead the agency problems and the poor performance.
H5: There is a negative relationship between firm performance and director CEO duality.

Research design:

The latest annual report that be used in this study are considered as archival data that provide the enough information regarding to the board of director size, board of director independence, board of director qualification, board of director gender and CEO duality that will eventually be testing the hypothesis. This study used the annual reports for the year 2012 of the companies listed on Bursa Malaysia.

Sample selection:

The main sources of the information analysis for this study mainly used the secondary data and collected the data according to the Bursa Malaysia. The information relating to the proportion of the board of director size, board of director independence, board of director qualification, board of director gender and CEO duality were collected from the 2012 annual report for each of the companies according to their sectors. In the same time, this study was study of 300 companies in the 7 sectors which is technology, industrial product, properties, trading and service, plantation, consumer product and construction. This sampling technique permits a better understanding of the companies' practices in the Bursa Malaysia. The reason of the mixing all sectors is to ensure all the industries in the Bursa Malaysia are included. The study sample comprised seven main sectors as shown in the following table.

Operationalization of variables and equation model:

This study used the multiple regression analysis by modelling return on equity as a function of the explanatory variables. Besides that, in this model also will used board of director size, board of director independence, board of director qualification, board of director gender and CEO duality as the independent variables. From the previous study, [23] also used the return on equity as the dependent variable model. The ROE model for this study is as follows:

$$ROE = \beta 0 + \beta 1\ (BODS) + \beta 2\ (BODI) + \beta 3\ (BODQ) + \beta 4\ (BODF) + \beta 5\ (CEOD) + \epsilon$$

The variable definitions of the dependent variable and independent variables will be summarized in table 2.

Table 1: Sectors of study sample.

Sectors	Total Listed Companies	Frequency (%)
Technology	33	11
Industrial Product	63	21
Properties	47	15.67
Trading and Services	78	26
Plantation	20	6.67
Consumer	44	14.67
Construction	15	5
Total	300	100%

Table 2: Summary of the Operationalization of Variables.

Variables	Operational Measures
Dependent Variables: Return on Equity (ROE)	The income before interest expense for the fiscal period divided by total shareholders' equity for that same period.
Independent Variables: Board of Director Size (BODS)	Total number of directors in the company.
Board of Director Independence (BODI)	The proportion of non – executive directors to the total number of directors.
Board of Director Qualification (BODQ)	The directors that have their own skill, experiences and qualifications and look for the quality of superior directors to monitoring the management.
Board of Director Female (BODF)	The proportion of the female directors to the total number of directors.
CEO Duality (CEOD)	Assigned as 1 for a CEO is not a chairman and 0 for CEO is also a chairman.

Findings: Descriptive analysis:

Table 3 present the value of mean and standard deviation of all variables in this study. The mean for all variables range between 0.31 to 1.1422 and standard deviation range between 0.21765 to 2.22950. These studies are using 300 companies as the sample size that want to test for year 2012. Return on equity as dependent variable for this study, has an average percentage of 1.1422 with standard deviation 2.22950, and signified the good performance of Malaysia firm.

Table 3: Descriptive Analysis.

Variable	Minimum	Maximum	Mean	Standard Deviation
Return On Equity	0.8933	1.6892	1.1422	2.22950
Board Of Director Size	4.00	14.00	7.34	1.962
Board of Director Independence	0.1700	0.8300	0.4557	0.13243
Board of Director Qualification	0.1700	1.2000	0.7172	0.21765
Board of Director Gender	0.0000	0.4000	0.890	0.11806
CEO Duality	0.00	1.00	0.31	0.463

Correlative analysis:

Correlation is a term that refers to the strength of a relationship between two variables and interpreted a strong or high correlation means that two or more variables have a strong relationship with each other by Ashley Crossman. This method can identify the relation among variable and detect if two or more variables are highly correlated.

The suggested correlation value from Pearson Correlation Model are between one variable with another not more than 0.8, otherwise it very likely problem exist. According table 4, all the values are not more than 0.5, and the highest value falls to correlation between board of director qualification and board of director independence which is 0.102.

Multivariate analysis:

According to the result shown on table 5, it show that board of director size is negative and significantly related with the firm performance measured by ROE at significant 1% (t=0.735). Based on this result also show the positive relationship between board of director independence and CEO duality with ROE is 1.182 and 1.789.

H1 stated that the board of director size has the positively relationship with firm performance. According to table 5, it show the negatively relationship between board of director size with firm performance and it will rejected. H2 is accepted because there is a positive relationship between firm performances with board of director independence. Followed by H3, the hypothesis will be accepted because it show the positively relationship between firm performance and board of director qualifications. The positive relationship between firm performance and board of director female gender H4 are accepted according to the result show on the regression analysis in table 5. Lastly, H5 is rejected because according to the result it shows the positive relationship between firm performance and CEO duality. Board of director size, board of director independence, board of director qualification, board of director female gender and CEO duality only explained 2.1% (R square = 0.021) factor of affect the firm performance.

Table 4: Pearson Correlation Model.

	ROE	BODS	BODI	BODQ	BODF	CEOD
ROE	1	-0.081	0.085	-0.001	0.010	0.104
BODS		1	-0.341**	-0.019	-0.011	-0.100
BODI			1	0.102	0.021	-0.050
BODQ				1	-0.005	-0.198**
BODF					1	-0.049
CEOD						1

,. Correlation is significant at 0.05 level 5% (0.01 levels 1% 2-tailed).*
Return on Equity (ROE) The income before interest expense for the fiscal period divided by total shareholders' equity for that same period.
Board of Director Size (BODS) Total number of directors in the company.
Board of Director Independence (BODI) The proportion of non – executive directors to the total number of directors.
Board of Director Qualification (BODQ) The directors that have their own skill, experiences and qualifications and look for the quality of superior directors to monitoring the management.
Board of Director Female (BODF) The proportion of the female directors to the total number of directors.
CEO Duality (CEOD) Assigned as 1 for a CEO is not a chairman and 0 for CEO is also a chairman.

Conclusion:

According to this study, the implication that occurs are related to the independent variables which are board of director size, board of director independence, board of director qualification, board of director female gender, and CEO duality. Based on the descriptive analysis, board of director size has the highest amount of standard deviation and mean but board of director size have the negative relationship by using Pearson Correlation Model.

Besides, it has limitation that occurs based on the sample size. It is because the sample size that is collected only 300 companies for year 2012. The year that is analyse only focus on single year.

According to Shukeri and all (2012) said that the high inflation rate in 2011 may weaken firm performance but it was not cause by the board characteristics.

For the future research, it need to develop more and better by expending the sample size and used more years to collect the data. The data from more than one year can make more input or data were collected and can identify the growth performance. By using different type of measurement, it can show the different result for the study.

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