Board Governance and Corporate Financial Policy

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Abstract

This paper reviews a research framework to examine the role of board governance in influencing corporate policy of listed companies in Malaysia. The framework is an important area of research as it will highlight the significance of corporate governance practices in the aspect of board of directors as a major element in determining the corporate policy of a firm and this in turn will affect the firms’ performance. It is in light of the Malaysian Code of Corporate Governance 2012 (MCCG 2012) that focuses on strengthening board structure and its composition. The study is also unique in a way that board governance and financial policy is studied in a country with highly concentrated ownership setting. The framework relies on the agency theory as the underpinning theory for this study.

Key words: Financing Policy, Corporate Governance, Payout Policy
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1. Introduction

East Asian economic downfall in 1997 had been attributable to failure in corporate governance mechanisms. Malaysia who was not immune from the unpleasant economic period had experienced failures of “blue chip” companies, such as UEM, Renong and KFC. Corporate abuses which involved poor financial management by directors, incidences of sudden and unaccountable decision making and related party transactions by corporate leaders and lack of disclosure on asset shifting are parts of ineffective corporate governance structures. Other cases in East Asia such as Taiwan’s Procomp Informatics Ltd in 2004, Rebar Group, Hyundai and Samsung shared the similar feature of weak, non-transparent corporate governance.

These crises had caused significant lost of trust and confidence of the companies’ stakeholders and consequently tarnished their corporate reputation that adversely impact the company’s share prices and their abilities to maintain relationship with stakeholders. Board of director plays an important role to lead the company and to ensure that their main responsibility is well executed. The board of directors is the highest governing authority in the firm which served to protect the shareholder’s interest. Thus, this will enable them to influence the decision making and policy because of board of directors who made the decision in the firm. The board characteristics will determine the effectiveness of their duties known as board governance such as board size, board independent and CEO duality as identified by Sulong (2009). Previous studies on board of directors focused on their impact to the performance of the firm (Adam & Mehran, 2005; Elsayed, 2007; Ponnu, 2008; Abidin, Kamal & Jusoff, 2009; Belkhir, 2009) but limited study focused on the policies of the firm (Saad, 2010; Heng, Azrbaijani & San, 2012).

As most of board’s studies directed towards understanding the influence of its structure and firm’s performance, this study is intended to measure its relationship with corporate financial policies in an emerging market; Malaysia. The research framework in this study offers an internal mechanism in corporate governance based on board of directors in influencing the corporate financial policies of the firm. Moreover, this study will also provide additional evidence on agency problems based on board governance in highly concentrated ownership settings of Malaysian firms. Accordingly, this framework proposes an objective of identifying the influences of board governance through board size, board independent and CEO duality on corporate financial policies in forms of investment, financing and dividend decisions. Therefore the findings of this study can be an added value to Bursa Malaysia, Securities Commission and the companies as guideline in designing a proper governance mechanism.
1.1 Agency Theory

The original concept of agency problem was initiated by Berle and Means (1932). The authors addressed the concept of agency theory and applied in the large corporation. It became popular among researchers during 1960’s and early 1970’s who address the problem of risk sharing between two parties that have different perception on risk (Eisenhardt, 1988). The main issue raised in the agency theory is the divergence of interest between principal and agent. According to the theory, this divergence can be minimized by giving appropriate incentives to the agents and to monitor on every action made by agents (Jensen & Meckling, 1976). Agency theory has been widely used in the fields of economics, finance, marketing, political science, organization behavior and sociology.

Berle and means (1932) discusses the agency theory on relationship between principal and agent. The principal authorized the agent to represent him/her with certain pre-determined conditions. In general agency problem is a common phenomenon in any firm when there is a separation of ownership and management. The basic form of a firm comprises of three distinct groups, namely shareholders who control the firm regarding the direction, policies and activities of a firm; board of directors who elected by shareholders; top management who are appointed by the board of directors. The effect of board governance on the various corporate financial policies is vital due to the linkage between shareholders and directors since the board of directors is elected by the shareholders. Notably, the board of directors is the highest governing authority in the management structure of a public listed company.

2. Literature Review and Hypothesis Development

2.1 Corporate Governance

Corporate governance refers to a system that is controlled and directed for a company (The Cadbury Report 1992). This definition is accepted by the Malaysia Finance Committee 1999. Finance Committee on Corporate Governance in Malaysia in the Report on Corporate Governance (2002) as quoted in Singam (2003) defined the term as “the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value, whilst taking account the interests of other stakeholders”. Corporate governance mechanisms that are used to monitor the processes can be classified into internal and external mechanisms. Weir, Laing and McKnight (2002) discussed further in their study the board of directors variables which comprise of duality, proportions of non-executive directors and executive director shareholding. On the other hand, the external governance mechanisms put more emphasis on external parties that include
regulatory and external auditors and external rating agencies (Zulkafli, 2007) to monitor the corporate governance practices.

In Malaysia, every public listed company is required to have a board of director by the regulator. According to the Malaysia Companies Act, 1965 (CA), “the business and affairs of a company must be managed by, or under the direction of, the board of director”. In addition CA also states that “the board of directors has all the powers necessary for managing and directing and supervising the management of business and affairs of the company”. Malaysia has taken initiative to strengthen its corporate governance system since 1996. It begins when the Kuala Lumpur Stock Exchange (KLSE) introducing the directors Code of Ethics. This followed by the establishment of Malaysian Code Corporate Governance (MCCG 2000) in order to restore investor’s confident after Asian economic crisis in 1997. In addition, in 2001, Bursa Malaysia Listing Requirement requires all listed companies to include a Corporate Governance Statement in their annual report. Furthermore, MCCG was revised in 2007 and several amendments related to the board of directors have been made. Moreover, Securities Commission (SC) also issued the guideline in 2008 related to listing of companies on KLSE in order to have good corporate governance practice. This guideline is also linked with the board of directors in order to ensure the integrity and public accountability of public listed company’s directors. In 2009 SC has introduced sections 317A and 320A of Capital Markets and Services Act 2007 (CMSA) to enhance corporate governance. Section 317A empowers the SC to act against errant director and officers of Public Listed Companies (PLCs) for causing wrongful loss to the company. Section 320A, on the other hand, allows the SC to act against anyone who influences the preparer and auditor of financial statements, causing them to be false and misleading”. The Audit Oversight Board (AOB) has been introducing in 2010 to develop a robust audit oversight framework for Malaysia over PLCs. Recently, MCCG 2012 is the first major deliverable of Corporate Governance Blueprint 2011 that focuses on strengthening board structure and composition recognizing the role of directors as active and responsible fiduciaries. The MCCG 2012 has included some of the best practices from the MCCG 2007.

2.2 Corporate Financial Policies

The goal of corporate finance is to maximize the value of the firm. Corporate financial performance depends very much on the corporate financial decision made by the management. In order to maximize shareholder’s wealth, managers should be careful in their decision regarding these policies. There are three types of policy viewed by finance theory in maximizing the firm’s value: the investment, financing and dividend policies.

Recent studies such as Cohen and Yagil (2007), Y.C. Tu et al. (2007) and Pindado and Torre (2006) employed investment policies, financing policies and dividends policies in their
research as corporate financial policies as viewed by finance theory. Apart from that, Cohen and Yagil (2007) examined the importance of corporate financial policies using investment, financing and dividend policies in an international survey based on the five countries such as U.S., U.K., Germany, Canada and Japan. Based on their survey, they found that investment policy was the most important policy due to the business operation and growth of the company which was closely related to this policy.

2.3 Investment Policy

Among the three types of financial policies viewed by finance theory, investment policy seemed to be the most important policy. Investment decisions must be made with caution because it requires estimating the value of the project which comprise of size, timing and predictability of future cash flows. This process is known as capital budgeting process to select an appropriate investment project that can maximize shareholders wealth.

Wang (2010) argued that the trilogy of financial decision (investment, financing and dividend policies) could have influence on the firm’s performance. The authors measured the investment policies by the value of capital and R&D expenditures deflated by total asset. They revealed that investment policy had significant impact on firm performance. Naser (2010) and Cronqvist and Fahlenbrach also used similar investment policy measurement in their study.

2.4 Financing Policy

Corporate investment should be financed appropriately in order to achieve the goal of the corporation. The financing policy is one of the important policies that will influence the company’s value. Company must determine their financing mix which will impact on the valuation of companies. The preference source of financing for the company is based on pecking-order theory. According to this theory, company will utilize internal sources of financing and rather than employing external financing (debt and equity) because it is the cheapest way to raise fund.

Company has two sources of financing such as internal financing (equity) and external financing (debt). Financing investment project through equity is less risky with respect to cash flow commitment. When debt is used as a source of funding the company is obliged to service its debt. A company with more debt than equity is considered to be highly leveraged company. Company that is highly leveraged may be at risk of bankruptcy if it is unable to service its debt appropriately. From the perspective of shareholders financial leverage is not always bad but it can increase the shareholders’ return on investment because of tax advantage associated with debt.

Therefore, it is very important to know the amount of leverage being used by a company. Debt ratio is commonly used to determine whether the company is highly leverage or
otherwise. It indicates how company finance its asset whether to use debt or common equity. Recent study conducted by Pindado and Torre (2006), L. Mancinelli et al. (2006), Y.C. Tu et al (2007), Cronqvist and Fahlenbrach (2009) Sulaeman (2008) and Nasser (2010) considered debt ratio as their measurement for financing decision. They used market value of the long term debt divided by market value of long term debt plus equity.

2.5 Dividend Policy

In deciding dividend payment, firm need to consider as how large these dividends should be, how frequent it is and in what form dividends should be distributed. In agency theory, dividend payments will reduce agency cost between managers and shareholders whereby excess profits generated by the company be used to pay dividend. According to Easterbrook (1984) dividend policy was used as align mechanism in equity agency problem. This would avoid manager from using the excess fund for investment or project that was not profitable (Jensen, 1986). In the financial literature, much had been debated about the dividend policy that could affect the value of the company. Under certain conditions, Modigliani and Miller (1958) argued that the firm’s value was not affected by the firm dividend policy.

Y.C. Tu et al. (2007), Claessen et al (2000) and Jensen et al. (1992) defined dividend policy as dividend payout ratio (DPR) derived from cash dividend payout ratio plus stock dividend payout ratio. However, in the other study conducted by Mancinelli (2006), the author introduced an alternative measure of dividend payout. They used dividend over market capitalization to overcome the accounting practice problem as well as dividend over net income. The authors argued about the role played by dividend payout in order to monitor and discipline the management by paying a high dividend. Wang (2010) measured the dividend policies by the value of the cash dividend per share over earnings per share. Pindado and Torre (2006) measured dividend with the inclusion of share repurchases.

2.6 Board Governance and Corporate Financial Policies

Stockholders have the right to appoint board of directors to monitor the company. The right to vote on the election of directors is an important right to shareholders who will ensure that right persons are selected (Thillainathan et al., 1999). Generally, the role of the board is to monitor the management of a company with regard to the hiring, assessing and promoting or to terminate the CEO. According to Jensen and Meckling (1976), agency problem occurred when there was a separation between ownership and management that would resulted the existence of agency cost. The board of directors will be accountable that the top management of the company carry out their duties properly in providing optimum value to shareholders (Coles et al. 2001). Boards of directors as the highest governing authority in the management structure should carry out their duties effectively to protect the shareholders’ assets and to ensure that fund invested by shareholders will ensure a worthwhile return. Among the main
responsibility of board of directors as stated by MCCG 2007 are to review and approve business objectives, strategies, policies and plan as well as monitoring against that. As pointed out by Forbes and Milliken (1999), the main task of the board was to provide advice and counseling to the CEO and other top management as well as actively participate in the company strategy formulation.

Corporate financial policy deals with important policies that must be made with caution because it will affect the corporate financial performance as well as shareholders wealth. Decision making relating to financial policy is one of the most important decisions to be decided by the board. Therefore, the board of directors is the people who represent shareholders to select a set of financial policies in the best interest of shareholders. In a study by Richardson (2003), it was identified that the presence of certain directors had affected the corporate financial policies. Recent study by Ginglinger al. (2011) examined the impact of directors that represent the employee in the board on payout policy. This study based on French law which provides special provision for employees in the large public listed firm to elect director to represent them. According to Jaskiewics and Klien (2007), the size and composition of the board of directors could affect the decision making process and the overall efficiency of the board of directors due to their role that representing the group’s of decision making in order to reduce the agency conflict of the firm. This indicates that the presence of directors who represent a particular group had an impact on corporate financial policy.

2.7 Board Size and Corporate Financial Policies

Findings from the previous studies related to the impact of board size on corporate policy are limited. Cheng (2008) pointed out that the presence of large board size had a significant negative relationship with R&D spending but insignificant for capital expenditure. It indicates that firms with large boards’ size have lower level of R&D spending and seem to be not related to the capital expenditure. Graham et al. (2011) conducted a study to examine the relationship between board characteristics and corporate investment of US listed firms before, during and after the depression era (1926-1941). The study showed that there was a positive relationship between board size and corporate investment. According to Hutchinson and Monroe (2010), large board size will contribute to a better decision making due to the knowledge and skill as well as different perspectives of views among the board of directors, hence will make better investment decision.

The impact of board size on financing policy has been proven by several previous studies (Saad, 2010; Abor, 2007; Wen et al., 2002). Saad (2010) conducted a study to investigate the effect of corporate governance on capital structure among public listed companies in Malaysia. This study found that there was a significant positive relationship between board size and debt to equity ratio. The results of Wen et al. (2002), Abor (2007) and Graham
(2011) also found there was a positive relationship between board size and debt ratio. They assumed that firms with large board size were more efficient since they would use high debt in order to enhance the firm’s value.

In terms of dividend policy, there are few studies linking the board size on dividend policy. Feng et al. (2007) study the relationship between CEO entrenchment and dividend policy of real estate investment trust. The authors reveal that the presence of large board was associated with dividend policy. In the study conducted by Chen et al. (2011) found that the coefficient of board size is positive to dividend policy. Furthermore, Agrawal and Nasser (2011); and Mansourinia et al. (2013) concluded that the presence of large board size had a significant positive relation with dividend. It indicates that larger board size will have greater tendency to the pay cash dividend to the shareholders. Based on the above arguments, board size is expected to have an impact on policies formulation. For this study it is hypothesized that:

\[ H1a: \text{There is a positive relationship between large board size and financing policy.} \]

\[ H1b: \text{There is a positive relationship between large board size and investment policy.} \]

\[ H1c: \text{There is a positive relationship between large board size and dividend policy.} \]

### 2.8 Independent Board and Corporate Financial Policies

Agrawal and Nasser (2011) defined independent director as a director who is neither a current company employee nor is affiliated director who is a former employee of the company or a majority-owned subsidiary. The presence of independent director is expected to influence the decision making regarding the policies with their independent opinion and professional judgments as well as information, extensive knowledge and experiences (Schellenger, et al. 1989; Le Walters and Kroll, 2006; Jaskiewicz & Klien, 2007). In strengthening the composition of board of directors, MCCG (2012) recommends that the board must comprise a majority of independent directors while the tenure of an independent director should not exceed a cumulative term of nine years. The relationship between independent directors and financial policies has been identified in several previous researches (Schellenger, et al., 1989; Chen et al., 2011; Feng, 2007; Y.C. Tu et al., 2007; Wen et al., 2002; Berger et al., 1997; Abor, 2007; Anderson et al., 2004; Agrawal & Nasser, 2010).

Independent board could contribute to the success of investment project by providing the valuable input in form of information and knowledge towards the best investment decision making (Le et al., 2006; Hutchinson & Monroe, 2010). A study was conducted by Hutchinson and Monroe (2010) using data from Australian firms to correlate between firm’s investment decision and internal governance practice. They revealed that board independence was significantly positive related to the investment policy measured by capital expenditure. Graham et al. (2011) examined the association between board characteristics and corporate

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investment during depression era (1930-1938). They discovered that outside directors had a significant positive associated with investment decision. This indicates that the presence of independent directors can reduce and is able to offset the dominance of insider directors in determining the policies. Hence it meets their role to protect the interest of all shareholders with their independent opinion, professional judgments, information, extensive knowledge and experiences in determining appropriate corporate policies.

If the firms had higher proportion of outside directors, the level of leverage would be higher in order to support a high dividend payment and the expansions. In another study conducted in Taiwan, Y.C. Tu et al. (2007) found that external board size was positively significant in relation to the debt ratio. It indicated that with the presence of higher external directors, company would use higher debt to finance their expansion. This situation occurs due to the fact that most of external directors were from the financial institutions. Therefore, such company would favor debt arrangement to finance their expansion with the assistance of the external directors. Additionally, Berger et al. (1997) concluded that a firm with a low proportion of outside directors and no blockholders was having significantly lower level of leverage. This situation occurred because of the fact that top management does not face a strong monitoring by outside director or blockholders. Recent study conducted by Heng, Azrbaijani and San (2012) documented that there was a significant positive relationship between independent directors and debt ratio because of an effective supervision by independent directors to put pressure on manager to select optimum level of debt for benefit of shareholders. These clearly support the argument that the presence of independent directors will affect the financing policy.

A study conducted by Schellenger, et al. (1989) and Feng (2007) revealed that the presence of independent directors had an impact on dividend policy. This finding was also supported by the studies conducted by Agrawal & Nasser (2010), Chen et al. (2011) and Yarram (2012) which found that there was a significant positive relationship between proportion of independent directors and cash dividend policy. Therefore, the greater proportion of independent director in the firm tends to increase its probability to pay dividend to shareholders. Based on the above argument the hypotheses are formed as follows:

\[ H2a: \text{There is a positive relationship between independent board and investment policy.} \]

\[ H2b: \text{There is a positive relationship between independent board and financing policy.} \]

\[ H2c: \text{There is a positive relationship between independent board and dividend policy.} \]

### 2.9 CEO Duality and Corporate Financial Policies

MCCG (2012) recommends that the positions of chairman and CEO should be held by different individuals. CEO duality had impact on the investment policy as evidenced by Hutchinson and Monroe (2010) who found that Australian firms had significantly positive
relationship between capital expenditure and separating roles of CEO and board chair. Chen et al. (2009) also found that firms with separating roles of CEO-chair had positive association with corporate investment decision as measured by R&D investment. This finding denotes that firms with separating roles of CEO and board chairman have increased their capital expenditure.

Study conducted by Y.C. Tu et al. (2007) revealed that the presence of CEO duality had a significant positive impact on financing policy measure by debt ratio. This was due to controlling factor where the controlling shareholders preferred to use debt instead of issuing new shares in order to retain their controlling power in the company. Saad (2010) conducted a study on the effect of implementation best practice code of corporate governance in Malaysia. It was found that firms with CEO duality had a significant negative relationship with capital structure before and during implementation. However, the result changed to a significantly positive relationship after the implementation of corporate governance. This finding was consistent with a study conducted by Abor (2007) where it also found that there was a significant positive relationship between the presence of CEO duality and leverage measured by debt ratio in Ghanaian listed firms and Iranian listed firms. This indicated that firm with CEO duality tended to employ high proportion of debt.

Further, the relationship between dividend payout ratios and CEO duality was negative according to the finding revealed by Chen et al. (2011) and Bolbol (2012). This indicates that firms with CEO duality and controlling shareholders will have great influence on dividend policies. Therefore, CEO would become more powerful in controlling the board of directors as well as to pursue their private benefit instead of shareholders interest especially if they represented the controlling shareholders of the firm. Based on that argument the following hypotheses are developed:

- **H3a**: Firms with CEO duality are negatively related to investment policy.
- **H3b**: Firms with CEO duality are positively related to financing policy.
- **H3c**: Firms with CEO duality are negatively related to dividend policy.

Based on the above discussions, it is clear that board governance as explained by its three main variables i.e. board size, board independence and CEO duality do influence financial decisions i.e. investment, financing and dividend decisions. As the appointment of directors is directly connected to the controlling shareholders of the companies, it is interesting to identify the relationship between board governance and the trilogy of financial decisions of highly concentrated ownership structure in Malaysia. It is expected to offer an explanation of whether the role of board governance in highly concentrated ownership is consistent with findings of the previous study.
3. Proposed Methodology

3.1 Dependent Variables

3.1.1 Investment Policy

Investment policy is typically associated with the capital expenditure. Capital expenditure is incurred when a company invests and will create future return for the company for the benefit of shareholders. A number of previous studies have used capital expenditure (CAPEX) to measure the investment policies (Naser, 2010; Cronqvist et al., 2007; Ghachem, 2008; Sulaeman, 2008; Y.C. Tu et al., 2007). This study will follow the earlier studies to measure the investment policy. It is defined as capital expenditures over lagged net property, plant and equipment.

3.1.2 Financing Policy

Debt ratio will determine either a company is highly leveraged or under leveraged. The debt ratio is explain by the total of long term debt and current liabilities divided by the total of long term debt, current liabilities and the book value of common equity. This measurement is extensively used to measure the financing policy in prior studies such as Pindado et al. (2006), Mancinelli et al. (2006), Naser (2010), Cronqvist et al., (2007), Ghachem (2008) and Y.C. Tu et al. (2007). Therefore this study will employ the same definition in measuring the financing policy.

3.1.3 Dividend Policy

Dividend is primarily measured by dividend payout that is the total dividend paid to preferred and common stockholders. The dividend payout ratio is generally the total of preferred and common stock dividend over earnings before depreciation, interest and tax. There are several past studies that employed dividend payout as a measure of dividend policy such as Pindado et al. (2006), Mancinelli et al. (2006), Thomsen (2005), Cronqvist & Fahlenbrach (2007) and Ghachem (2008).

3.2 Independent Variables

3.2.1 Board Size

This study employs the total number of directors on the board (BS) to measures the size of board of directors. A number of previous studies have used the total number of directors on the board to measure the board size of the company (Y.C. Tu et al., 2007; Mak & Yuanto, 2005; Shakir, 2008; Sulong, 2009).

4. Independent Directors

This study employs board independent that refers to the size of independence directors, as measured by the total numbers of independent directors on the board (INDBOD). Independent directors refer to directors who have no relationship with management such as employee or large shareholders in the firm that will represent the interest of all shareholders in the firm
(Zulkafli, 2007; Klein, 2002; Bursa Malaysia Listing Requirement, 2009). There are several past studies that also employed total numbers of independent (outside) directors on the board as proxy for independent board such as Brickley et al (1994), Richardson (2003), Y.C. Tu (2007, Ponnu (2008), Sulong (2009) and Chen (2011).

4.1 Duality

Duality is measured by a dummy variable which refers to the role of Chief Executive Officer (CEO) and Board Chairman by a same individual. If CEO acts as a board chairman, the variable takes the value of 1 and 0 for the separation of his role. A number of previous studies measured CEO duality as a dummy variable such as Sulong (2009), Zulkafli (2007), Y.C. Tu et al. (2007), Ogbechie et al. (2009) and Chen et al. (2011).

4.2 Control Variables

Control variables are the variables that have significant effects on dependent variables in the study. By using the control variable, we wish to balance its effect across subjects of the study and allow us to just study the relationship between the independent and dependent variables.

4.2.1 Firm Size

In this study, firm size is employed to control the size effect. It is because of the possibility that the size of the firm will affect the corporate financial policies. Sulong (2009) argued that larger companies have better growth opportunities and access to financing opportunities, less information asymmetry due to availability of information, wider share spread and ownership profile. Pandey (2002) reported that firm size had a positive relationship with debt ratio in Malaysia due to the fact that large firms had lower bankruptcy risk and transaction cost. Logarithm of corporation’s total assets is employed to proxy the firm’s size effect.

4.2.2 Firm Growth

The firm’s growth can be considered as one of the important factors that may influence corporate financial policies. Brailsford, Oliver and Pua (2002) pointed out that growth is one of the indicators of the firm’s success and profitability. In this regard, firm with higher growth will generate higher internal fund and thus sufficient internal fund to finance its investment. Therefore, firm with higher growth is expected to demand less debt due to sufficient internal fund available for investment. This is evidenced by Kim and Sorensen (1986) that reported high growth firm would use less debt and high operating risk firm would use more debt. In this study, the annual percentage change in total asset is employed as a proxy for the firm growth.
4.2.3 Profitability

Brailsford et al. (2002) argued that firms with high level of profit had more earning available for retention and hence firm preferred internal financing to debt. According to Sulong (2009) dividend would be paid based on the ability of the firm’s level of profitability. A number of previous study have examined the effect of profitability on the firm’s corporate financial policies such as Moh’d et al (1998), Brailsford et al (2002) and Sulong (2009). This study employs the operating income to total asset as a proxy for profitability as used by Moh’d et al (1998) and Brailsford et al (2002).

4.2.4 Industry sector

The final variable in this study is the industry. For each firm, the industry’s dummy variables are equal to one and zero based on the industry sectors. It was argued that different industry sector would differ with respect to dividend payout (Moh’d et al. 1995). Brailsford et al. (2002) argued that industry as determinant of capital structure in which firms in the same industry could have similar risk characteristics due to similar demand and supply conditions. According to Ronnengberg and Trojanowski (2005), the reliability of the result could be assured by controlling the industry-specific effect since the study sample included firms operating in a variety of sectors. Sulong (2009) used industry categorization provided by Bursa Malaysia to control the industry differences.

5. Conclusion

The objective of this paper is to review a research framework linking board governance practices as the independent variable and corporate financial policies as the dependent variable. It is in line with the release of MCCG (2012) which emphasized on strengthening board composition and reinforcing its independence. The relationships between the variables will be analyzed based on the agency theory, where, the investigation is conducted on the setting of whether the influence of the firms’ board governance practices will have an effect on the firms’ investment, financing and dividend decisions. The literature has provided strong evidence to support the framework. The proposed theoretical model is expected to contribute towards a better understanding on corporate governance mechanism and corporate financial policies as addition to the existing study that relates governance and firm performance.

References


