Board Characteristics and Malaysian Firm Performance

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Abstract

This study attempts to analyse the trend of board characteristics and try to investigate the relationship of board characteristics and Malaysian firm performance focusing on the elements of board size and proportion of independent non-executive directors (INED). In addition, firm size has been included to control other influential factors. The data are gathered from the analysis of companies’ annual report for a sample of 169 companies over a period of 2009 and 2010. The preliminary results of this study reveal most of Malaysian companies have complied with the recommendation of the MCCG (2000) and MCCG (2007) Code to have an effective of board structure and there is a significant relationship between board size to firm performance. In addition, it provides into which there are no association between proportion of independent non-executive directors to firm performance.

Key words: Board structure, Firm performance, Malaysian companies
JEL Classification: C 19, G13, G 14
1. Introduction

Corporate governance becomes a prominent issue in Malaysia since the 1997 Asian financial crisis. The lesson from this crisis leads to the emergence of corporate governance issues which directly brought an impact to the board structure in a company. This issue arises as a result of separation of ownership from management. Corporate failure and the problems arise in a company have brought an issue to the previous researchers to examine the relationship between corporate performance and structure of the boards adopted by companies (Bhagat and Black, 1999).

The MCCG (2000) and (2007) provides guidelines on the principles and best practices in corporate governance. The purpose is to avoid the board from being conquered and controlled by one group. This is also to ensure that the board being an independent party to shareholders. The survival and the success of a firm is mainly depends on the way in which the company is monitored by its directors. A company with an effective and efficient board will definitely give an assurance on maximizing company’s wealth and securing shareholders’ interest. The board of directors plays a crucial role due to the separation of ownership and control in modern corporations which depend heavily on the external fund and resources (Abdul Rahman, 2009).

The objective of this paper is to analyse the trend of board characteristics in Malaysian firms and to investigate the relationship between board characteristics and Malaysian firm performance.

2. Literature Review

Board size is recognized as one of the elements in the board structures which contribute as a determinant of firm performance (Othman, Ponirin, and K Ghani (2009). Board size is defined as the number of directors sitting on the board (Abdullah 2004). The Code does not specify in detail the exact number of directors on board, but it recommends that the size of board should be sufficient to encourage active participation of directors and can efficiently perform their tasks. A study by Ibrahim and Abdul Samad (2011) established that the board size is important in managing business affairs which may influence the company’s performance. MCCG (revised 2007) described that to have an effective board; size of the board should be examined objectively. Mohd Saad (2010) found that after the implementation of MCCG (2000), majority of the Malaysian companies have 6 to 10 directors on board. On the other hand, studies by Abdullah (2004) and KLSE-PricewaterhouseCoopers (1999) respectively found that the average numbers of directors in Malaysian Public Listed companies is eight. Whereas, Nam & Nam, (2004) found that the average board size is around ten.
Mohd Saad (2010) established that the financial performance of company is improved when have a large number of directors on board because company will have more expertise directors which can work and cooperate together to make a decision for a benefit of the company. Contrary to a study executed by Cheng (2008), where he found that a large number of board sizes is negatively associated with the company’s performance. He argued that a larger board will cause less effective discussion among them to reach any understanding in making a decision.

Ponnu (2008) claimed that to establish an effective board, there must have a balance of directors between executive and non-executive directors to enable the independent directors to work co-operatively with executive members by providing an independent view and judgment. The non-executive directors were appointed because they believed to be independent and free from any conflict of interest as well as assumed to be the most effective directors monitor to the management actions (Ameer, Ramli, and Zakaria, 2010). Further, instead of non-executive directors classifying as independent party to the organization. Ameer et.al. argued that the non-executive directors also have an independent viewpoint and are able to ask questions and probe further about an issue arises in the company. They are also able to bring in an experience from external environment which can be applied in the company (Siladi, 2006).

According to Ali Shah (2008), the existence of non-executives in the board can influence the performance and effect on the decision made by the firm. Moreover, the inclusion of non-executive directors will act as a watchdog to the board which will secure the interest of the stakeholders and indirectly contribute to the performance improvement. On the other hand, a study by Aik Leng and Abu Mansor (2005) reported that the presence of independent directors has not improved firm performance. Among the reasons for contributing the negative relationship are lacks of skills own by independent directors, limited role they can play as well as limited time they spent on company affairs. Contrary, a study by Ponnu (2008) revealed no significant relationship between board independent and Malaysian companies’ performance. There are also other studies which have found inconclusive evidence between board independence and financial performance (Abdullah, 2006 and Ponnu and Karthigeyan 2010). The result explained that the inclusion of independent non-executive directors on board does not bring any influence or any contribution towards the firm performance.

Thus, the findings of this paper is hoped to provide significant contributions and can be used by regulators, investors, companies and others who are not clear with corporate governance board structures as an important element and valuable to improve corporate performance as well as to instill investors confidence.
3. Methodology

3.1 Data Collection Design

This study is based on content analysis of the individual companies’ annual reports. The data required for the purpose of this study is collected from 2009 and 2010 annual reports of the chosen publicly companies listed on Bursa Malaysia since this study is conducted after the implementation of revising the MCCG in 2007 and after the merging of the second and main board known as main market.

3.2 Population of the Study

This study looks into the four largest industries of listed companies in the Main Market of Bursa Malaysia; they are consumer, industrial product, trading/services and properties industries. These four largest industries were chosen because of the largest market capitalization which indirectly can provide an overall picture for other companies. The total population from these four industries is 672 companies. The sample size of this study is determined by referring to the table of Krejcie and Morgan (1970). As the total population in this study is $N = 672$, therefore the sample size in this study was chosen as 169.

3.3 Sample Description

A disproportionate stratified random sampling procedure was used to draw a subject from the strata (industry). For each industry, 40 companies will be chosen randomly except for Industrial industry where 49 companies were chosen to represent a large number of samples from a big population within four industries selected.

3.4 Statistical Analysis

The findings of the study will be analyzed using the Statistical Package for the Social Sciences (SPSS) computer program for windows Version 16. The analysis of the data was performed by using three statistical procedures: descriptive statistic and multiple regression analysis.

3.5 Measurement of Variables

This study focuses on the two independent variables which are board size and proportion of INED. Board size is measured by the number of directors sitting in a board. Proportion INED was chosen as the second independent variable and it was measured by the proportion of INED on the board expressed as percentage where the number of INED divided by the total number of directors on the board of the company. The dependent variable of this study is the firm performance which is proxied by ROA. This variable is measured by the ratio of Earning before Interest and Tax (EBIT) over total assets. The size of company is chosen as a control variable which is proxied by total annual sales of the company.
4. Results and Discussion

Table 1 presents the descriptive statistics of board size. The table shows that the board size for Malaysian companies ranged from 5 to 15. The result described that as the minimum number of directors sit on board is 5 persons and the maximum number is 15 persons. The average board size of 169 firms used in this study is 7.25. From the result, it indicates that the average number of directors sit in a board for companies on the main market is 7.

Table 1: Descriptive Statistics of Board Size

<table>
<thead>
<tr>
<th>Variables</th>
<th>n</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size</td>
<td>69</td>
<td>5</td>
<td>15</td>
<td>7.25</td>
<td>1.77</td>
</tr>
</tbody>
</table>

Table 2 below presents the descriptive statistics on the proportion of INED. The table shows the proportion of INED sit in the board of Malaysian companies ranged from 20 percent to 77 percent. It shows that the minimum composition of independent non-executive directors on board is around 20% and the maximum composition is 77%. The average proportion of INED of 169 firms used in this study is 43.81 percent. From the result, it indicates that the average proportion of INED sit in a board for companies on the main market is 43.81%.

Table 2: Descriptive Statistics of Proportion of INED

<table>
<thead>
<tr>
<th>Variables</th>
<th>n</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>% INED</td>
<td>169</td>
<td>20</td>
<td>77</td>
<td>43.81</td>
<td>11.44</td>
</tr>
</tbody>
</table>

As indicated in Table 3 below, the finding of this study reveals that most of the Malaysian companies have the number of directors sit on boards range from 5-10 members. The Malaysian companies is complied with the requirement MCCG (revised 2007) as the board of directors should consist of at least one-third of Independent Non-Executive directors sit on the board. It is proved from the result obtained when 93% of the companies have at least and more than 33% of independent non-executive directors sitting on the board.

Table 3: Frequency Distribution of Board Structures

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Board Size</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5-10</td>
<td>163</td>
<td>96%</td>
</tr>
<tr>
<td>11-15</td>
<td>6</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Proportion of INED</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 33%</td>
<td>12</td>
<td>7%</td>
</tr>
<tr>
<td>More than 33%</td>
<td>157</td>
<td>93%</td>
</tr>
</tbody>
</table>

In Table 4, the result of the two models, Model 1 and Model 2 are showed. Referring to that, Model 1 represents a model that includes only the control variable (FSIZE) to the
dependent variable (ROA), while Model 2 includes all the variables (FSIZE, BSIZE and INED). The ANOVA table indicates that, the model as a whole (which includes both blocks of variables) is significant \( [F(6,331) = 14.772, p < .005] \). It means that the model used as a whole has a relationship with the dependent variable.

Table 4: ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>2640.441</td>
<td>2</td>
<td>1320.220</td>
<td>13.197</td>
<td>.000</td>
</tr>
<tr>
<td>Residual</td>
<td>33414.765</td>
<td>335</td>
<td>100.044</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>36047.371</td>
<td>337</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 5 Model 1 shows that after the control variable (FSIZE) has been entered, the overall model explains 7.3% of the variance (0.073 x 100). However, referring to table 4.5 Model 2, after independent variables (BSIZE and INED) have also been included, the model as a whole explains 21.1% (0.211 x 100). The second R square value of 21.1% includes all the variables from both blocks (control variables and independent variables). This means that the equation explains 21.1% of variability in firm performance.

In the table presented below, on the table marked Model 2, the R Square Change values is .138. This means that all independent variables (BSIZE and INED) explain an additional 13.8% of the variance in firm performance, even when the effects of control variable like firm size comes into.

By looking at the Model 2 table, focusing on the Sig. column, there are only two variables that make a statistically significant contribution (less than .05), with the BSIZE recording a higher Beta value (Beta = .367), followed by FSIZE (Beta = .187). Board size which is measured by the number of directors sit on the board is significantly influence firm performance. The result is in line with the previous literature from Othman R. et. al. (2009) and Zainal Abidin et. al., (2009). The results generated from the regression show that for control variables included in the analysis (FSIZE) is significant as p < .005. As expected, the relationship between firm size and firm performance is positive. This is similar with the result found by Zainal Abidin et. al., (2009) and Van der Walt, Ingle, Shergill and Townsend (2006).

Table 5: Regression Analysis of the Firm Performance on the Various Explanatory Control Variables

<table>
<thead>
<tr>
<th>Model 1</th>
<th>Beta</th>
<th>t</th>
<th>Sig.</th>
<th>R Square</th>
<th>R Square Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>3.470</td>
<td>1.397</td>
<td>.052</td>
<td>.073</td>
<td>.073</td>
</tr>
<tr>
<td>FSIZE</td>
<td>.261</td>
<td>4.898</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Dependent Variable: ROA
To conclude, the multiple regression model for firm performance in relation to board characteristic while taking into consideration of control variable were as follows:

\[ \text{ROA} = -13.504 + 0.367 \times \text{FSIZE} + 0.187 \times \text{FSIZE} \]

This model suggested that, the overall performance of the Malaysian companies could be significantly enhanced by improving and increasing size of the board because company will have more expertise directors on board which can work and cooperate together to make a decision for a benefit of company (Mohd Saad, 2010). The more fresh ideas and skills shared and contributed among the directors would make them work more efficient in directing and managing business activities. Other factor which brings an impact to the Malaysian firm performance is size of the firm. A big size of the companies also plays an important role in determining the performance of the companies. A big company is assumed to have a good performance because they have more resources and facilities to become competitive. Hence, we can say that larger firm tends to perform better in terms of the profitability as the firm has more resources to be competitive in the market. From the results, it shows that it is more efficient to have a large number of directors to control and managing company activities and finance resources. The result provides a signal to the Malaysian companies to pay more attention on the appropriate number of board of directors in the companies.

5. Conclusions and Recommendations

This study has been able to reach some conclusions about the trend or characteristic of Malaysian companies’ board structures as well as able to reach the conclusion on the association of board structures to firm performance. The study has specifically found that a larger board size may be associated with the company’s performance. In terms of the involvement of the independent non-executive directors do provide inconclusive result relating to the better company performance as a whole. It shows that the requirement of MCCG to the effectiveness of board structure by having at least one-third independent non-executive directors does not provide any significant impact to the firm value. Moreover, board governance structures in Malaysian company is provided and fully complied with the requirement recommended by the Code.
The study is not able to fully explain the relationship of board characteristics to Malaysian firm performance. Due to that, the improvement and the extending of the study is a must and important. The study can be extended by increasing the sample size of the companies as the current sample is not normally distributed. It is also highly recommended to take into consideration the companies from different industries available in Bursa Malaysia as this study only focus on four industries. Next, it is recommended that the study period should be extended for a longer time period to get more accurate result as this study only focusing for two years. This study also can be extended to examine other variables of board structures which are remuneration, cross directorship, ownership structures and qualification. On the other hand, performance indicator in this study is only limited to ROA, therefore, future research can use other performance indicators such as ROE, EPS, as well as it is recommended to include market-based measurement such as stock return and Tobin’s Q as it is more comprehensive in measuring the firm’s value.

References


