



THE 3rd POSTGRADUATE RESEARCH SYMPOSIUM

Symposium Research Ideas Guideline

You are required to submit a maximum of **7 pages** in written MS words (excluding reference page) describing your initial research idea with the following content:

1. Abstract (not more than 200 words)
2. Keyword(s)
3. Introduction/ Background of the Study
4. Problem Statements
5. Research Question/s
6. Research Objectives
7. Significance of the Research
8. Scope of the research
9. Literature Review
10. Research Methodology (if any)
11. Research Findings (if any)
12. Conclusion

Please write using 'Times New Roman' font type with size of 12 point throughout the manuscript. Use single spacing for your manuscript. Try to constantly use of all capital letters for headings with appropriate numbering. You are adhering on APA style writing format for citations, quotations, and references.

Please include a cover page with the following information:

1. Possible title of manuscript
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BOARD GOVERNANCE AND COMPANY PERFORMANCE: MALAYSIAN EVIDENCE

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ABSTRACT

Most shareholders are unable to get involved in management decision making due to the separation of ownership and control in modern public listed companies. Shareholders are disadvantaged if the decisions turn out to be inefficient and very risky. Therefore, they have to depend on board of directors as the board is one of the important mechanisms that could monitor the managements' decisions and protect shareholders' interests. In order to measure the effectiveness of the board, attention is given to how directors discharge their duties and this is referred to as board process. This study examines the effect of board process on company performance of Malaysian public listed companies. Four variables under board process namely performance of independent directors, board's risk oversight, CEO's performance evaluation and accessibility of information by the directors are included. Two types of data are used; a survey to Malaysian directors and company annual reports. In total, 175 companies responded to the questionnaires. The results of the study provide evidence that board's risks oversight and performance of independent directors are associated to company performance. The findings provide some implications for policy makers in assessing the existing guidelines particularly on board effectiveness.

Keywords: Directors; board process; company performance

I. INTRODUCTION

Directors are persons appointed or elected according to the law. The whole of directors collectively, form the board of directors. The board of directors is expected to monitor the management decisions and protect the shareholders' interests as well as the company as a whole. However, shareholders are under disadvantage if the decision turns out to be inefficient and very risky due to poor monitoring by the directors (King & Wen, 2011). The study aims to determine the effect of board process and managerial ownership on company performance. This paper is organized as follows. In section II, the interrelationships between company performance and corporate governance mechanisms; board process and managerial ownership are provided. Section III discusses the research methodology and data collection. The results are presented in section IV. The discussion and conclusion remarks are set out in the final section.

II LITERATURE REVIEW

Board process is about the way directors discharging their duties in steering the board (Macus, 2008) and reflects the decision making activities, style of board, quality of meetings and evaluation of directors' performance (Korac-Kakabadse, Kakabadse & Kouzmin, 2001). This study incorporates four pertinent variables as the proxy of board process namely board's risks oversight, accessibility of information, Chief Executive Officer (CEO)'s performance evaluation and performance of independent directors.

Board's risks oversight: A business risk relates to the inability of a company to predict the future performance in uncertain environment (Sobel & Reding, 2004). The board roles in risk management are very important so as to ensure that the company will survive in uncertain economic condition. Therefore, board should regularly question the management on risks that they perceive the company will be facing (Raber, 2003). Sobel and Reading (2004) argue that board must actively involve in risk management process by providing expertise and judgment to the strategic process. In addition, the senior management should be given the autonomy to manage the risks within the accepted risk tolerance by the board. Apparently, the director's ability in analytical thinking skills and strategic perceptions are important in risk management and these criteria have influence on company performance (Kula and Tatoglu, 2006). Therefore, this study assumes that board that evaluates current and future risks of the company provides a positive impact on company performance.

Accessibility of information: Directors must have sufficient access to information in order for the board to function effectively. Hence, directors must ensure that they are given relevant materials which will be discussed in the meeting by the management or company secretary. Having more access to information allows directors to improve their problem solving ability during board deliberation (Macus, 2008), provide constructive arguments (Zahra & Pearce, 1989) and enhance their accountability to the shareholders (Kula, 2005). Therefore, the directors' ability to get access to company information is expected to have effect on company performance.

CEO's performance evaluation: Performance evaluation is a process of managing performance in which it incorporates regular evaluation, feedback and counseling (Gomez, 2010). Agency theory supports that management as well as the CEO's actions and decisions should be monitored and evaluated by the board (Jensen and Meckling, 1976). The process is crucial as it influences the decisions that relate to promotions, transfers or terminations of the CEOs. Further, the evaluation provides feedback to CEO on how company views their performance (Robbins & Judge, 2009; Dulewicz & Herbert, 2004).

The MCCG also recommended that every board member including the CEO need to be assessed. Therefore, the CEO will put extra attention on decision making process as their performance will be accessed through the outcome of their decisions. Hence, this study expects a positive relationship between CEO's performance evaluation and company performance.

Performance of independent directors: The agency perspectives support the view that the greater the proportion of outside directors is essential for effective monitoring of management performance and self-interest actions. Besides, the management decisions must be monitored vigorously by the board to avoid any expropriation of minority interests (Baysinger & Butler, 1985). Effective independent directors with the ability to understand the company business, provide unbiased judgment and bring in practical ideas based on their professional experience during board deliberation are able to improve company performance (Yeap, 2009; Hasnah & Hasnah, 2009; McCabe & Nowak, 2008). In addition, independent directors with the capability in communicating with those people who involve directly in the decision making are more likely to get update on any major

events that have detrimental effects to the company such as example bankruptcy, merger or any changes in regulations (Finkelstein & Mooney, 2003). These positive attitudes of effective independent directors are able to contribute to positive company value.

Managerial ownership: In Malaysia, insider shareholdings are very common (Haniffa & Hudaib, 2006). The owners are normally appointed as the managers (Mazlina & Ayoib, 2011). High levels of managerial ownership allow the owners-managers to participate actively in the decision making process. Besides, they have high motivation to bring more profits into the company (Jensen & Meckling, 1976). Such mechanism enables the interest of shareholders to be protected (Harris & Raviv, 2008). Therefore, the study assumes that company with high managerial ownership is expected to have a positive effect on company performance.

Control variables: Larger companies are able to establish various diversifications in business and remain stable cash flow. The accesses to capital markets are also easier for large companies. However, companies that have established in the market for a long period tend to become more conservative in the strategies, therefore, affect company performance. Meanwhile, companies with high level of leverage are unable to invest in profitable projects, thus, such situation affects company performance. Therefore, three variables; company size, age and leverage are included in the analysis. The variables are expected to have influence on company performance.

III RESEARCH METHODOLOGY

Sample size and data collection

The study was conducted on companies listed on main market of Bursa Malaysia as at 31 December 2009. The study combines a survey approach and secondary data. For survey approach, the questionnaires were disseminated to the company chairman, independent director, executive director and non-independent non-executive director in order to get a balance directors' perception on board process. Once the researcher received the completed questionnaire, it will be matched with the secondary data for that particular company. The information of managerial ownership, company characteristics and performance were extracted from the annual report of 2007 to 2009. From 687 companies (after excluding companies which were listed under financial sector, new companies listed in 2007, 2008 and 2009 as well as PN17 and Amended PN17 companies) a total of 175 companies (27 per cent) participated in this study.

Construction of questionnaire and measurement of variables

The questionnaire was developed based upon the literatures and inputs from two risk specialists and an executive chairman of a committee from regulatory bodies and three public listed directors. Besides, the items in the questionnaires were adapted from MCGG, Carey, Patsalox-Fox and Useem (2009), Wyman (2009), Ingley and Van der Walt (2005), Epstein and Roy (2005), Sang-Woo and Il (2004), Sobel and Reding (2004), Dulewicz and Herbert (2004), Raber (2003) and Finkelstein and Mooney (2003). Four proxies of board process namely board's risks oversight, accessibility of information,

Chief Executive Officer (CEO)'s performance evaluation and performance of independent directors are used in the study.

There are six items on demographic information and 31 items on board process. The questions on board risks oversight, accessibility of information and CEO's performance evaluation are designed to measure the degree of directors' agreement using 5-point scales ranging from "1" as strongly disagree to "5" as strongly agree. In relation to the performance of independent directors, the statements were measured using a Likert-scale ranging from very "1" as very poor to "5" as outstanding. Higher scores indicate higher level of independent directors' performance. Company performance is proxied by return on equity (ROE). The ratio is determined by dividing net profit to the average common shareholders' equity. Managerial ownership refers to the proportion of shares own by all executive directors to total outstanding shares (Mazlina & Ayoib, 2011). For the purpose of analysis, companies with at least 5 per cent of executive directors' shareholdings were coded as 1, otherwise 0. In addition, the total asset is used as proxy for company size. Company age is measured by referring to the year of listed and it is subtracted with the date of financial year end in 2007, 2008 and 2009. Meanwhile, company leverage is measured by dividing total debts to total assets.

IV RESULTS

Table 1 presents the results of factor analysis. Internal reliability test indicates strong Cronbach Alpha values from every factor ranging from 0.722 to 0.935. Meanwhile, table 2 provides descriptive statistics of board process attributes, managerial ownership, company characteristics and performance.

Table 1: Factor analysis

			Cumulative	Alpha
Factor 1: Performance of independent directors		12.720	19.067	0.935
Ability to provide strategic vision	0.775			
How effective the independent directors represent the interest of shareholders?	0.757			
Relationship with senior management	0.696			
How effective the independent directors represent the interest of stakeholders?	0.688			
Understanding on company business	0.677			
Contribution in board committees	0.650			
Record of constructively challenging and debating issues during board meetings	0.650			
Relationship with the CEO	0.601			
Ability to apply his or her industries experience	0.601			
Interactive communication of independent directors with other board members	0.536			
Factor 2: CEO's performance evaluation				
Board communicates to the CEO on his/her success based on the evaluation result	0.835	3.09	36.385	0.925
Board evaluates CEO by using KPI	0.786			
Board establishes an exit mechanism which is tied up with CEO's performance	0.737			

Board implements a reward system which is based on long term performance	0.724			
Board communicates to the CEO on his/her failures based on the evaluation result	0.721			
Board provides avenue for CEO to explain on the state of CEO's performance	0.712			
Board communicates their expectations clearly to the CEO	0.708			
Board accepts feedback from CEO during the process of setting KPI	0.677			
Factor 3: Board's risk oversight		1.99	52.309	0.911
Board requires senior management to deliberate on emerging risks that the management perceived the company will be facing	0.789			
Board gets update from senior management on risk management matters	0.731			
Board raise concern on risk management	0.712			
Board communicate on risk tolerance to senior management	0.699			
Board attends relevant risk management training	0.678			
Board reviews its strategy during crisis	0.648			
Members of board ask the senior management to use scenario analysis in identifying potential vulnerabilities	0.614			
Board has necessary financial knowledge to analyze the financial statement	0.584			
Factor 4: Accessibility of information		1.89	63.501	0.722
Directors discuss issues thoroughly	0.830			
Directors have access to information via managers	0.816			
At time where directors need to refer to company business records and books, their access is denied	0.726			
When outside professional services is needed, the expenses will be borne by the company	0.726			
Directors received sufficient materials/ information before board meetings	0.759			

Note: K-M-O measure of sampling = 0.911 Barlett's Test of Sphericity is significant; $p < 0.000$

Table 2: Descriptive statistics for company characteristics and board attributes

Variables	Mean	SD	Min	Max
Return on equity	2.61	28.47	-213.89	62.58
Board's risks oversight	3.97	0.42	2.80	5.00
Accessibility of information	3.68	0.48	2.32	5.00
CEO's performance evaluation	3.83	0.46	2.48	5.00
Performance of independent directors	3.81	0.43	2.58	4.80
Company size (RM)	1,880M	6,787M	25M	69,643M
Age of company (years)	15.28	11.64	2.00	48.00
Leverage (ratio)	41.61	20.63	4.63	89.64
Managerial ownership:				
At least 5%				
Frequency (%)	77 (44%)			
Less than 5%:				
Frequency (%)	98 (56%)			

Before running the regression analysis, the company size and leverage are transformed into logarithm to prevent the heteroscedasticity problem. Besides, test for multicollinearity was carried out. Independent variables with variance inflation factor (VIF) values more than 10 show a serious multicollinearity (Chatterjee, Hadi and Price,

2000). The result shows that there is no evidence of multicollinearity since the VIF value is between the range of 1.157 and 1.469.

Table 3: Regression results

	Coef.	t-value
Board’s risks oversight	0.175	2.103**
Accessibility of information	0.075	0.947
CEO’s performance evaluation	0.031	0.364
Performance of independent director	0.139	1.716*
Managerial ownership	0.078	0.309
Company size	0.200	2.561**
Company age	-0.100	-1.323
Leverage	-0.144	-1.704*
R-square	0.187	
Adjusted R-square	0.148	
F statistic	4.788***	

***, **, *indicates regression analysis is statistically significant at 1%, 5% and 10% respectively

The results of regression analysis are shown in Table 3. With regards to board process, board’s risks oversight and performance of independent directors have significant influence on company performance. The results show no significant association between company performance and the independent variables of accessibility of information and CEO’s performance evaluation. However, the expected direction of the relationship remains the same. Out of three control variables, only two variables namely company size and leverage indicate significant relationships with company performance. Company age indicates insignificant result.

V DISCUSSIONS AND CONCLUSION

The study aims to examine the influences of board process and managerial ownership on company performance. The result indicates that board’s risks oversight is associated with company performance. In that regard, board that raises concern on risks management, gets the senior management to use scenario analysis in identifying potential vulnerabilities, encourage the management to deliberate on emerging risks that the management anticipates the company will be facing and review strategy during crisis contribute to company performance.

In addition, company performance is also related to performance of independent directors. Independent directors who are able to provide strategic vision, prepare for board meetings and constructive challenge to the ideas of management team bring positive effect to company performance. The finding is consistent with Hasnah and Hasnah (2009) who assert that directors that are able to independently influence the decision making process are found in high performing companies. Besides, independent

directors with sufficient knowledge on accounting and finance are able to have better understanding on company financial statement.

The CEO's performance evaluation however, could not influence company performance. The possible reason is due to different procedures of CEO's evaluation between one company and another. The approach and procedures to evaluate the CEO is not standardized as 191 directors who responded to the questionnaire informed that the evaluation process is conducted formally. Meanwhile, 72 directors answered the process is conducted informal. Besides, the company ownership also influences the evaluation process. Directors that have family ties with the controlling shareholders reduce the procedure in CEO's evaluation (Westphal, 1999). The result also indicates that the accessibility of information is not related to company performance. The possible reason is that the effectiveness of board in interpreting the meaning of the information is important rather than just accepting the information.

Besides, the result does not support that there is significant relationship between managerial ownership and company performance. One explanation for the lack of correlation between managerial ownership and company performance could be that this study does not differentiate between those who hold the shares for a long and short period of time. This may suggest that companies with owner- managers who hold the shares for a long period are more established and well-known.

Besides, company size and leverage are other influential factors that influence company performance. Larger companies tend to have easy access of various resources which in turn, gives positive effect to company performance (Kula, 2005). Meanwhile, company performance is negatively related to company leverage. The result indicates that companies with high dependency on debt financing are unable to invest in more risky and profitable projects; thus, such situation affects company performance.

There are few limitations related with the methodology of the study. Directors who answered the questionnaires may not give honest responses as they might think that there is a risk that their answers could be revealed to the shareholders, regulatory bodies or competitors. However, guarantees are given in the cover letter that the directors' answers will be kept confidential. With regards to future research, studies on the influence of board's risks oversight and performance of independent directors on company performance are still scanty. Therefore, studies could be done to verify the result. Besides, the analysis based on the company sector may also constitute for future research.

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