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The Impact of Board Characteristics on Firm Performance: A Post-MCCG2012 investigation

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Abstract
Good corporate governance is linked to the corporate performance of corporations. This study seeks to determine if corporate governance characteristics implemented improved company performance and to determine if a positive or negative relationship exists. Multiple Regression Analysis was applied to determine whether certain corporate governance characteristics relate to company performance in Malaysia. Company performance is measured using Return on Assets (ROA) and Total Shareholder Return (TSR). Data was collected from Bursa Malaysia from 2012 to 2015. In conclusion, there is no evidence of any significant relationship between corporate governance characteristics and company performance measures.

Keywords: Corporate Governance, Board Characteristics, Total Shareholder Return, Return on Assets

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1.0 Introduction

Corporate governance is said to have contributed significantly to the impact on the growth and development perspective of an economy. Reliable and stable corporate governance practices allow the economy to achieve higher performance, contribute towards sources for capital investment by increasing the creditability of shareholders. The Malaysian Code on Corporate Governance (MCCG), first issued in March 2000 (Code), marked a significant milestone in corporate governance reform in Malaysia. The Code was later revised in 2007 (2007 Code) to strengthen the roles and responsibilities of the Board of Directors, Audit Committee and the Internal Audit function. The Malaysian Code on Corporate Governance 2012 (MCCG 2012) focuses on strengthening Board structure and composition, recognizing the role of directors as active and responsible fiduciaries. The MCCG 2012 specifically targets companies listed on Bursa Malaysia. All companies are encouraged to adopt the principles and recommendations of MCCG 2012 and make excellent corporate governance an integral part of their business dealings and culture. The MCCG 2012, maintains the definition of corporate governance as set out in the High-Level Finance Committee Report 1999. MCCG 2012 was revised after taking into account changing market dynamics, international developments and the need to continually recalibrate and enhance the effectiveness of the corporate governance framework. Key areas strengthened in the MCCG 2012 are:

- Roles and responsibilities of the board
- Composition of the board
- Independence of independent directors
- Separation of Chairman and CEO

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MCCG 2012 defined corporate governance as "The process and structure used to directly 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 while taking into account the interest of the stakeholders." Poor corporate governance destroyed investors' confidence in capital markets (Jensen & Meckling, 1976; Daily & Dalton, 1994). This was evident when Malaysia's stock market or Kuala Lumpur Composite Index (KLCI) fell by 68.58% from 1031.64 points in July 1997 to 324.17 points in September 1998 (Hassan, 2002). Additionally, the Bank Negara Malaysia annual report also stated that the country's gross domestic production (GDP) reduced from 45.5% in 2007 to 28.1% in 2008 (Taghizadeh & Saremi, 2013). Lai (2004) stated that Malaysian regulators must improve the companies' corporate governance practices to attract more new foreign investors and regain their confidence after the financial crisis of 1997. Hsiang-tsui (2005) mentioned that sound governance is a useful tool which can minimize the agency problem in a company. Epps and Cereola (2008) also explained that corporate governance arises because there was a lack of transparency and accountability in the business environment. To achieve sound corporate governance, society cannot solely rely on the strength of regulations. Regulations, gatekeepers, shareholders and Board of Directors are the essential/major parties in the corporate governance ecosystem.

2.0 Hypothesis Development

To analyze corporate governance, a different number of theoretical frameworks were introduced. Each of these frameworks comes from different discipline through numerous studies that were conducted.

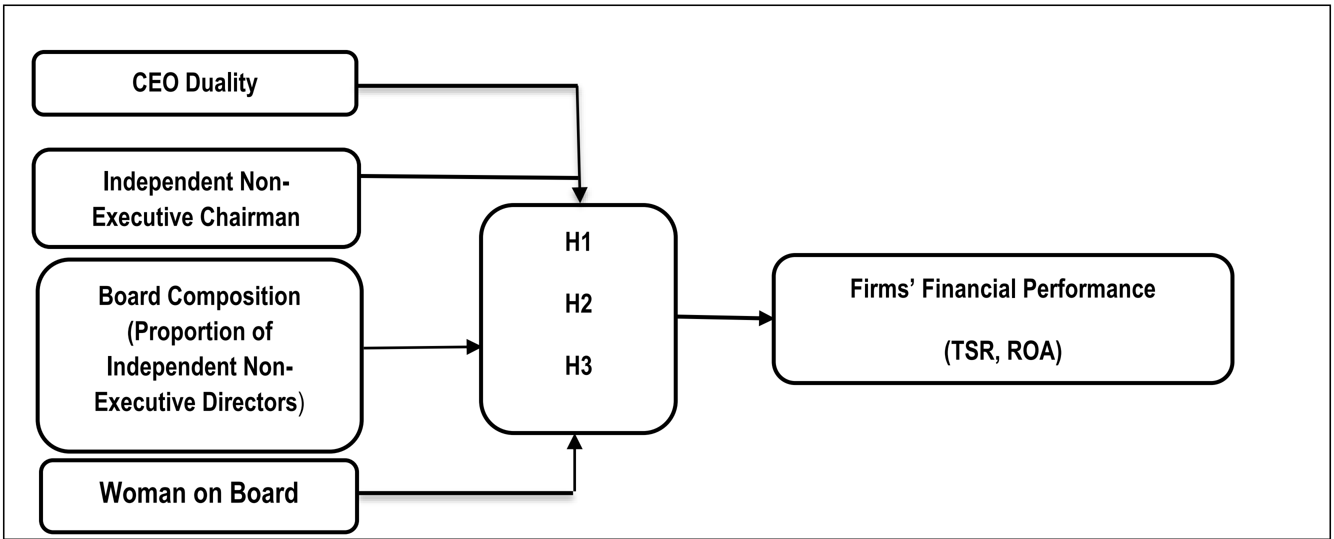

Figure 1: Proposed Theoretical Framework

2.1 Relationship between CEO duality, independent chairman and company performance

One of the reasons for the existence of corporate governance codes is the prevention of having Duality of the Board. CEO Duality occurs when the CEO is also Chairman of the Board of directors and majority of the Board are also made up of executive directors. An argument in favour of abolishing CEO Duality is the view that the Board of directors is the apex of decision making in a corporation. Having CEO Duality runs the risk that this decision-making process is interfered by the agency problem. Therefore, not having CEO Duality could mitigate agency problem and prevents the conflicting interest of CEOs from maximizing shareholder's wealth. (Fama & Jensen, 1983) This is also recommended in principle 3.4 of MCCG 2012 where the position of Chairman and CEO are held by different individuals and the Chairman must be a non-executive member of the Board. Since these CEOs are often employees of the company, they usually do not own much shares in the company. (Lipton & Rosenblum, 1991) As a result, they will often put their own compensation in the first place by promoting short term earnings, which will impact the long-term growth of the company. There is empirical studies showing that when there is CEO duality, there would be a conflict of interest, allowing for CEO to be paid more but having lower sensitivity to the company's turnover. (Core et al., 1999; Goyal and Park, 2002) Separate leadership could also bring the benefits of specialization, where the CEO has the expertise to run the company while the Chairman of the Board has the expertise to run the Board. (Dalton et al., 1998) According to Crawford (2009), another reason why a Board with a duality of Chairman is unhealthy is the reluctance of the Board to police any misconduct by the managers. The Enron scandal is a stark example where fraud occurs because the Board has done almost nothing to detect and prevent fraud, partly because some of the directors are involved and partly because they are reluctance to discipline their own colleague. Therefore, if CEO Duality exists in a company, then there must also be a strong counterbalance in terms of having a majority of independent directors to sit on the Board in order to provide a more transparent and quality disclosure. The CEO also faces more difficulty in misusing his power to obtain more personal gain, which would help to prevent future scandals such as Enron. Having CEO Duality and non-Independent Chairman in the company will therefore negatively affect the

company performance. This study therefore hypothesizes that there is a negative relationship between CEO Duality and non-Independent Chairman with the company performance. The hypothesis is as follows:
H11A: non-CEO Duality is positively related to TSR post-MCCG 2012.
H11B: non-CEO Duality is positively related to ROA post-MCCG 2012.
H12A: Independent Chairman is positively related to TSR post-MCCG 2012.
H12B: Independent Chairman is positively related to ROA post-MCCG 2012.

2.2 Relationship Between Board Composition and Company Performances

The MCCG2012 Code requires that in cases where the Chairman of the company is not an independent director, the Board has to comprise of a majority of independent directors. In other cases, there was no requirement that independent directors should constitute a majority. The management of a company plays a vital role in ensuring the company's success. An equally important factor to ensure success is by having a concrete company structure that could provide sufficient supervisory role to ensure that the management indeed does have the best interest of the company at its heart. Being the body that supervises the action of managers, the Board must compose of a majority of outside independent directors. Clifford & Evans (1997) defines outside an independent director as a person who has no other connection with the company other than his capacity as the director of the company. This means that to be an outside independent director, the person involved could not be, for example, an accountant, secretary, auditor, customer or creditor of the company to preserve their independence. Studies from Beasley (1996) and Klein (2002) indicate that by having more outside independent directors on the Board, there will be a lower risk that managers will manipulate the finances and earnings in the company's account. The more the number of outside independent directors, the better should the company performance be. (Pearce & Zahra, 1992). Contradictory to that above is a study by Rashid et al. (2010), where the paper examined 274 companies in Bangladesh and determined that having outside independent directors could not add economic value to the company and has no effect in improving the company performance. Arguments from Nicholson and Kiel (2007) also indicates that having independent directors from outside of the company could not help the company to perform better compared to having inside directors as asymmetrical information prevents outside directors from knowing the day-to-day operations of the company. Brennan (2006) also agrees as he views these outside directors as part-timers, and they may fail to perform their duties because they do not have inside information of the company. Wagner et al. (1998) supported this view as he sees that insiders will have better professional knowledge, abilities and familiarity with the company's operation. Results of the relationship relating to the number of independent directors on the Board and company financial performance have not been solidly conclusive which requires further investigation particularly post MCCG 2012 in Malaysia. Thus, the following hypothesis is formulated to test the above arguments and evaluate the relationship post context of the Code between Board Composition and company performance.
H13A: Having a majority of Independent Directors positively relates to TSR post-MCCG 2012.
H13B: Having a majority of Independent Directors positively relates to ROA post-MCCG 2012.

2.3 Relationship between the number of Women on Board and Company Performances

Compared to other corporate governance characteristics, the literature on Women on Board is a relatively new area of research However, Women on Board is gaining prominence as more and more women are recognized for their ability and are given more responsibilities in the management of a company. The number of Women on Board is still significantly lower than their male counterparts. The Dutch Female Board Index (2007) indicates that by 2008, only 5 per cent of the directors in Dutch companies are female. This issue has been recognized in European countries and corporate governance codes in Dutch, Spain and Norway have introduced a balanced Board composition in terms of sex as part of their code. Evidence shows that diversity is as good for businesses performance as it is for women - diverse organisations reflect their customers better, understand them better and offer better products and services as a result. Researchers (Adams & Ferreira, 2009; Sealy, Singh, & Vinnicombe, 2007) argued that having a homogenous all-male Board of Directors will not be able to reflect the current society and the business environment the company is operating in, contributing to weak corporate governance and missed opportunities. One of the arguments by recent literature suggests that having Women on Board would be able to improve company performance due to better decision making in the boardroom. A diverse team with the presence of Women Directors lead to a more diverse viewpoint, which would lead to a better decision, business value and company performance. (Burgess & Tharenou, 2002; Singh & Vinnicombe, 2004). There is another viewpoint from researchers that having to consider more perspectives can be lead to an increase in time cost and conflicts among Board members, delay decision making and divide the Board members, all of which would impede the growth of a company (Rose, 2007). Dwyer, Richard & Chadwick (2003) also observed that a more diverse top management team cost more to operate and coordinate, and the cost arising from coordination end up neutralising the financial benefits obtained from diversity. Thus, in order to examine the relationship between the number of Women on Board and the company performance, the following hypothesis is formulated:
H14A: Having more Women on Board positively relates to TSR.
H14B: Having more Women on Board positively relates to ROA.

2.4 Measurement of Companys' financial Performance

Selecting appropriate performance measures necessitates better and meaningful analysis of governance mechanisms and performance relationship. Biasness in measuring firm performance must be avoided for better diagnosis (Yusoff & Alhaji, 2012). Many studies which examined the relationship between board characteristics (composition and independence) and firm performance have used measures of return on equity (Kajananthan, 2012) and earnings per share (Karpagam, 2013; Yusoff & Alhaji, 2012). This paper also proposes to use total shareholder return (TSR) and return on assets (ROA) for measuring firm financial performance. These profitability ratios will update investors regarding the impact of the corporate governance variables on firm financial performance as they are more interested in firm profitability (Khanna & Zyla, 2010).

3.0 Method

An examination of corporate governance mechanisms with its relationship on firm performance in Malaysia is investigated. For this purpose, data is collected from 2012-2015 from annual reports of public listed companies. Total sample size was 180 firms. All these firms are listed on Bursa Malaysia. Multiple Regression analysis is applied on the data examining the relationship among corporate governance mechanisms (CEO duality, Independent Chairman, Board Composition and Women on Board)) with firm performance (Total Shareholder Return and Return on Assets). The regression for each of the dependent variable (TSR & ROA) is as follows:

$$TSR_n = \beta_0 + \beta_1 CEO_n + \beta_2 INEC_n + \beta_3 BC_n + \beta_4 WOB_n \quad (1)$$

$$ROA_n = \beta_0 + \beta_1 CEO_n + \beta_2 INEC_n + \beta_3 BC_n + \beta_4 WOB_n \quad (2)$$

CEO is the existence of CEO duality;
INEC is the existence of independent chairman;
BC is the board composition
WOD is the number of women directors on the Board.

Table 1: Dependent and independent variables constructed showing the formula used for each of the construct.

Dependent Variables	Formula	Adopted From
Total Shareholder Return (TSR)	$\frac{SP_n - SP_{n-1}}{SP_n}$	Donaldson & David (1991) Lazonick & Mary O'Sullivan (2000)
Return of Total Assets (ROA)	$\frac{Net\ Income}{Total\ Asset}$	Velnampy (2013)

Independent Variables	Formula	Adopted From
CEO duality	0= CEO duality, 1= No CEO duality	Yang & Zhao (2014) Goyal and Park (2002)
Independent Chairman	0= No independent chairman, 1= Independent chairman	Hsu, Wang & Hsu (2012)
Board Composition	Number of Independent Directors	Rashid et.al. (2010) Liu et.al. (2015)
Women on Board	Number of Women Directors	Singh & Vinnicombe (2004)\ Rose (2007)

4.0 Results and Discussion

Table 2: Hypothesis Testing Summary for TSR Result

	2012	2013	2014	2015
	Sig	Sig	Sig	Sig
(Constant)	0.376	0.001	0.000	0.173
CEO Duality	0.254	0.316	0.322	0.469
Independent Chairman	0.375	0.519	0.121	**0.070***
Board Composition	0.704	**0.061***	0.805	**0.032****
Women on Board	0.279	0.353	0.301	0.438

**. Correlation is significant at the 0.05 level (2-tailed).
*. Correlation is significant at the 0.1 level (2 tailed).

Table 3: Hypothesis Testing Summary for ROA Result

	2012	2013	2014	2015
	Sig	Sig	Sig	Sig
(Constant)	0.232	0.545	0.188	0.265
CEO Duality	0.331	**0.017****	0.654	**0.019****

Independent Chairman	**0.070***	0.622	0.294	0.213
Board Composition	**0.091***	0.400	0.236	0.183
Women on Board	0.565	0.283	0.910	0.433

**. Correlation is significant at the 0.05 level (2-tailed).
*. Correlation is significant at the 0.1 level (2 tailed).

Hypothesis 1
$H1_{1A}$: non-CEO duality is positively related to TSR.
$H1_{1B}$: non-CEO duality is positively related to ROA.

The results generated by the Multiple Linear Regression indicated that for TSR, there is no sufficient evidence to reject the null hypothesis H01A and H01B. However, for ROA, it was significant for 2013 and 2015. There is inconclusive evidence to reject H01B. From the analysis, it can be concluded that the results for CEO Duality are mixed. CEO Duality does not affect the companies' profitability, both TSR and ROA. This is consistent with the study of Chen, Lin & Yi (2008) and Dekker (2013).

Hypothesis 2
$H1_{2A}$: Independent chairman is positively related to TSR
$H1_{2B}$: Independent chairman is positively related to ROA

From the analysis, the study observed an effect in 2015 for TSR and 2012 for ROA. There is no sufficient evidence to reject the null hypothesis H02A and H02B as generated by the Multiple Linear Regression. Having an independent Chairman does not affect the companies' profitability, both TSR and ROA.

Hypothesis 3
$H1_{3A}$: Having a majority of independent directors positively influences TSR.
$H1_{3B}$: Having a majority of independent directors positively influences ROA.

From the analysis, there is inconclusive evidence to reject the null hypothesis H03A but no sufficient evidence to reject H03B from the results generated by the Multiple Linear Regression. It can be concluded that having majority of independent directors does not affect the companies' profitability in terms of TSR and ROA. This is consistent with the study of Rashid et al. (2010), Nicholson and Kiel (2007), Brennan (2006) and Wagner et al. (1998).

Hypothesis 4
$H1_{4A}$: Having more women directors on the board positively influences TSR.
$H1_{4B}$: Having more women directors on the board positively influences ROA.

The results generated by the Multiple Linear Regression indicated that overall, there is no sufficient evidence to reject the null hypothesis H04A and H04B. It can be concluded that the number of Women Directors on Board does not affect the companies' profitability, both TSR and ROA. This is consistent with the study of Lückerath-Rovers (2013), Pletzer et.al. (2015) and Gallucci, D'Amato & Santulli (2015).

5.0 Conclusion and Recommendations

The objective of the study was to examine whether if certain corporate governance characteristics influences company performance among public listed companies in Malaysia. A summary of conclusive notes was drawn. The performance implications of CEO duality, Independent Chairman, Board composition, and Woman on Board provide in-depth analysis of the nature and its implications. Non-CEO Duality has a significant positive impact on ROA in 2013 and 2015. No impact was observed on TSR during 2012-2015. Board composition has significant and positive impact on TSR's firm performance in 2013 and 2015 and ROA in 2013. Independent Chairman reveals on positive impact in 2015 with TSR while ROA observed a positive impact in 2012. Women on Board did not reveal any significance. Results were mixed with no apparent consistency and little significant relationship on firm performance. Further research should be conducted by introducing additional corporate governance characteristics using larger samples and a longer time series.

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