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A CRITICAL REVIEW OF RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FIRM PERFORMANCE: IN MALAYSIAN PERSPECTIVE

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ABSTRACT

The purpose of this paper is to evaluate existing studies on the relationship between corporate governance and firm performance in Malaysia. Existing studies that measure the relationship of corporate governance and firm performance are limited. This study proposes a need for future research on corporate governance in Malaysia. This paper will review and analyze the different empirical and theoretical contributions in establishing the relationship between corporate governance and firm performance. This study reviewed the last 10 years (2006-2015) articles of different referred journals. This paper will create a focus for future research of measuring the impact of corporate governance mechanism on firm performance. The policy makers and regulators will be encouraged to focus on more research for development of corporate governance in listed and non-listed firms of Malaysia.

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1 INTRODUCTION

In 1997-98 financial crises, the activities of the corporate sector affected entire economies, and deficiencies in corporate governance endangered the stability of the global financial system. The financial crises were mainly attributed to poor corporate governance practices [1],[2],[3] and in 2008 global financial crises, although not empirically researched, is thought to have created from inefficient corporate governance practices [4]. Moreover the collapse of some companies in Malaysia such as Renong Berhad in 2000, United Engineers (Malaysia) Berhad in 2001 and Transmile Group Berhad in 2007 were attributed amongst others, to the poor governance practices [5].

Jhonson *et al.*, [6] found that during the crisis, corporate governance variables explained a greater proportion of the variation in exchange rate and stock market performance than did other economic variables. As a consequence, investors have demanded improvements in governance practices which lead to the implementation of corporate governance codes as the guidelines for companies to improve their efficiency. Regulators have put heavy emphasis on companies to comply with the best practices of corporate governance after the Asian Financial Crisis in 1997 [7].

The attention on Corporate Governance (CG) has grown exponentially over the last two decades. In particular, CG is now a first order issue in most of the economies where firms are usually run by controlling shareholders [8] and a growing numbers of companies are attempting to adopt better CG practices [9]. Its significance in terms of the overall value creation for the companies has been widely recognized by researchers.

The urgency on the need to strengthen corporate governance among public listed companies in Malaysia was further triggered by a survey done by Klynveld, Peat, Marwick and Goerdeler (KPMG) on the expected number of fraud cases in Malaysia [10], [11]. The results were alarming and frightening. 78% of the respondents predicted that the financial statement fraud would rise due to the economic crisis and 66% of them considered fraudulent activity was a major threat to their companies. The percentage increased by four 4 % from the survey done in year 2004. The main reason driving their desire to commit the offences was greedy or luxury life style and personal financial problem with a response of 62% and 39% respectively. The main shocking fact of the survey was that 49% of the companies surveyed experienced at least one (1) fraud case during the survey period of January 2006 until December 2008.

2 IMPORTANCES OF CORPORATE GOVERNANCE MECHANISMS

Corporate governance is a regulatory activity that is enforced through different internal and external agencies to resolve the agency conflicts and protect the stakeholder interests of organizations. Corporate governance ensures that firms are run in a responsible and accountable manner that enhances the overall performance. Becht *et al.* [12], has suggested that the rising interest in corporate governance can be attributed to five reasons which are:

1. Worldwide privatization wave;
2. Reforms in pension fund and growth in private savings;
3. The 1980's takeover wave;
4. Deregulation and integration of the capital markets world-wide; and
5. Financial crises.

The corporate governance mechanisms are classified into internal and external mechanisms [13], [14]. The internal mechanisms comprise ownership structure, board of directors, executive compensation, audit committees and financial disclosures. The external mechanisms comprise market for corporate control, managerial labour markets, proxy fights, product market competition and legal infrastructure. There are other classifications as well to the corporate governance mechanisms. The importance of corporate governance mechanisms are addressed by various studies in different countries. It has always been a growing research interest to measure the effect of corporate governance mechanism on firm performance.

Thus, it is important to understand the impact of corporate governance mechanisms on firms' performance. The mechanism could work best for certain firms, or specific environment or even specific time periods. There should be a continuous review of how to strengthen the mechanisms to influence the self-interested managers for aligning with the stakeholder interests. Unless researchers do not take an investigative role, it is impossible to find the future suggestions that benefit and protect the stakeholders.

3 CORPORATE GOVERNANCE AND FIRM PERFORMANCE

There are many studies on the relationship between corporate governance and firm performance. One study shows that corporate governance has contributed to the company in enhancing operating performance and preventing fraud [15]. The issue has also been evidenced that the performance of a firm is directly related to good corporate governance. Companies with better corporate governance have better operating performance than those companies with poor corporate governance [16]. Similarly, better governed firms might have

more efficient operations, resulting in higher expected returns [17]. It is also believed that good corporate governance helps to generate investor goodwill and confidence. Another study had demonstrated that the likelihood of bankruptcy is related to poor corporate governance characteristics [18].

4 LITERATURE REVIEW

Abdullah [19] did an empirical research to investigate the extent to which firm's performance, the structure of the board of directors and ownership determine directors' remuneration in Malaysia among distressed firms. The data used a sample of 86 distressed firms and matched 86 non-distressed firms for 2001 financial year. It was found that the directors' remuneration was not associated with firm's profitability, as measured by ROA. A negative and significant association was observed between directors' remuneration and lagged ROA. With regard to corporate governance, board independence and the extent of non-executive directors' interests were found to have negative influence on directors' remuneration. In addition, findings also revealed that directors' remuneration was positively associated with firm's growth and size.

Ponnu [20] investigated the effects of corporate governance structures, particularly board structure and CEO duality, on the performance of Malaysian public listed companies measured by return on assets (ROA) and return on equity (ROE). Using samples of large publicly traded Malaysian companies, the study showed that there was no significant relationship between corporate governance structures and company performance.

Ghazali [21] analyzed the impact of the implementation of corporate governance code on corporate performance. By using data from the year 2001 annual reports of 87 non-financial listed companies included in the composite index, the results showed that none of the corporate governance variables was statistically significant in explaining corporate performance. However, two ownership variables, namely the government as a substantial shareholder and foreign ownership, were statistically significantly associated with Tobin's Q.

Kamardin and Haron [22] studied the relationship between internal corporate governance mechanisms and board performance in monitoring roles. The study used both primary and secondary data to gather data on board performance and internal corporate governance mechanisms. It was found that non-independent non-executive directors and managerial ownership were found to be positively related to both dimensions of monitoring roles: management oversight roles and performance evaluation roles. While the multiple

directorships of non-executive directors were negatively related to management oversight roles.

Marn and Romuald [23] investigated the relationship between corporate governance and company performance using panel data from 20 public listed companies in Malaysia. Panel data was used and the data gathered were analyzed using descriptive statistics, correlation, and regression. Five main corporate governance variables were analyzed in terms of their relative impact on corporate performance as defined by Earnings per Share (EPS) namely: board size, board composition, audit committee, CEO status and Ownership structure. The results of the study showed that both Board Size and Ownership structure variables have a significant effect on firm performance.

Haji [24] examined the relationship between corporate governance attributes and firm performance of Malaysian listed companies before and after the revised code in 2007. The study involved analyses of 170 observations in a two-year period, 2006 and 2009. The firm performance was measured by return on assets and return on equity. By multiple regression analysis, the findings revealed a decreasing trend of the financial performance of the sample companies over the two-year period. In terms of corporate governance compliance, the results showed that there were cases of non-compliance of the basic requirements of the corporate governance code in Malaysia even after the revised code in 2007. In addition, results showed that only board meetings had significant negative association with firm performance following the revised code. None of the other variables had significant impact on firm performance before and after the revised code.

Kallamu and Saat [25] investigated audit committee attributes and firm performance in Malaysian finance companies. The data were collected from all finance companies in the year 2012. The findings suggested a significant positive relationship between independent Audit Committee members and profitability. While dual membership of directors on audit and nomination committee was significant and negatively related with profitability. The result also showed that independent directors provide effective monitoring of the management thereby enhancing profitability and performance of the companies.

Fauzi and Musallam [26] examined the effects of corporate ownership (government-linked investment companies, GLICs), linearity of GLICs, board ownership and linearity of board ownership on company performance. The study Used panel data from companies that are listed on the Malaysian Stock Exchange during the period of 2000 to 2009. The results showed that GLICs ownership is positively and significantly related to company performance, while board ownership is negatively and significantly related to company

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performance. It also showed that GLICs ownership improved company performance, while board ownership destroyed company performance. The results also showed that while GLICs ownership had an inverted U-shaped relationship with company performance, board ownership had a U-shaped relationship with company performance.

Table 1: Summary and critical analysis of literature on corporate governance practices in Malaysia:

Authors	Critical review
Abdullah [19]	The study investigated the extent to which firm's performance, the structure of the board of directors and ownership determine directors' remuneration in Malaysia among distressed firms. The data under study were only for the year of 2001 which does not give a meaningful interpretation. The study considered only 86 distressed firms and matched 86 non-distressed firms. But the total number of firms more than 800. Thus, the results of the study lose its importance.
Ponnu [20]	This was an empirical study to measure the effect of board structures and CEO duality on firm performance. The data under study were for 100 listed firms and for two year period of 1999 and 2005. So, The results cannot be generalized. Also, the use of ROA and ROE as proxies for financial performance has its limitations. A more robust indicator would include more than two proxies for financial performance. This study focused only on the internal processes of a company. But external factors have a significant impact on company performance.
Ghazali [21]	The paper evaluated the impact of the implementation of new regulations on corporate performance. The sample size under study was small and those companies not listed were not covered. The data under study were only for 2001 which do not give a meaningful interpretation. The financial firms were excluded from study. Corporate performance was measured by Tobin's Q. only. There are some accounting based measures also important to evaluate company performances that are ignored.
Kamardin and Haron [22]	This paper examined the relationship between internal corporate governance mechanisms and board performance in monitoring roles. This administered a questionnaire to the listed companies only. The study considered only internal governance mechanism to measure the relation but external mechanisms were ignored. There was no investigation of corporate governance mechanism impact on firm performance.
Marn and Romuald [23]	This paper investigated the relationship between corporate governance and company performance using panel data from 20 public listed companies in Malaysia. The data under study were for a period of 2006-2010. The period under study gives a meaningful interpretation due to five years of data. It

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	covered only four types of industry. The results cannot be interpreted to all types of firms.
Haji [24]	This paper examined the relationship between corporate governance attributes and firm performance of Malaysian listed companies before and after the revised code in 2007. For measuring performance only accounting indicators (ROA and ROE) were used but market based indicators like Tobin's Q, Economic Value Added (EVA) also important for measuring performance. The data were collected from two different years only.
Kallamu and Saat [25]	This study examined the impact of audit committee (AC) attributes on the performance of finance companies in Malaysia. The period of study was only one year (2012) and data were collected from 37 finance companies. The major limitations of this study are one-year study and one sector only. The results cannot be extended to all sectors of Malaysia.
Fauzi and Musallam [26]	It was a study to examine the effects of corporate ownership (government-linked investment companies, GLICs), linearity of GLICs, board ownership and linearity of board ownership on company performance in Malaysia. This is the first study examined the linearity effects of GLICs and board ownerships on company performance. It was also a useful study, as the period under study was from 2000 to 2009. The period under study gives a meaningful interpretation due to ten years of data, but it does not differentiate the impact on financial and non-financial firms.

Source: Own interpretation

5 CRITICAL ANALYSIS OF THE EXISTING STUDIES ON CORPORATE GOVERNANCE PRACTICES IN MALAYSIA

Table I examines the current studies of corporate governance performs in Malaysia. The most of the current research is subjected to various limitations; we found that a lot suggest need for detailed empirical analysis. In order to support the policymaker suggestions about how to make a greater compliance with too improvement, experimental research in the field of Malaysia's corporate governance.

6 RESEARCH LIMITATIONS/IMPLICATIONS

The existing studies are valid and practicable for Malaysia only. The results need not be applicable for other business environments. In addition, the evolving business and economic environment have always brought about inconsistent conclusions. Thus, the period of study may give varied results.

7 PRACTICAL IMPLICATIONS

The analysis undertaken in this paper will address the literature gaps for the different firms in Malaysia. The results of the study may play an instrumental role for future studies by researchers and regulators.

8 ORIGINALITY/VALUE

This paper identifies the literature gaps of corporate governance in Malaysia and analyses the most applicable existing studies that can be useful for the regulators, policy makers for corporate governance improvement. This paper also will create opportunities for the future researchers.

9 CONCLUSION

There are many researches done on corporate governance and those previous studies in corporate governance suggest that there are several limitations such as a single-period study, non-segregation of financial and non-financial firms, limited data or not specifically measuring the impact of corporate governance mechanisms on firm performance. Because of these limitations, the country cannot provide meaningful and relevant suggestions for the development and protection of the different firms. As a developing country, Malaysia needs to keep in line with the developments of the corporate governance practices in the developed and emerging markets. This paper suggests that future research has to be undertaken for sector-specific investigation and cross country analysis of corporate governance impact on firm performance in Malaysia. The period under study should be a minimum of five years, and there should be a possibility of including non-listed firms in the study as well.

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