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Corporate Governance Mechanisms and Company Performance: Evidence from Malaysian Companies

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The aim of the paper is to examine the effect of corporate governance mechanisms on Malaysian firms' performance. The sample size is 424 companies on Bursa Malaysia. The findings reveal that in terms of board governance mechanisms, family-controlled companies are shown to have smaller board size and practise duality leadership in running their businesses. In contrast, for non-family controlled companies, director's qualification helps to enhance firm performance. Based on the findings, regulators and investors need to be aware that the corporate governance practised by family-controlled companies differs to that of non-family controlled companies.

Field of Research: Corporate governance mechanisms, Performance, Family-companies, Malaysia.

1. Introduction

Family companies support the wealth generation in most countries around the world. In Asia, the literature shows that family firms reflect a high performance in Taiwan, Australia, Hong Kong, Singapore and China (Filatotchev, Lien & Piesse 2005; La Porta, Lopez-De-Silanes & Shleifer 1999). Names like the Ayala family (Phillipines), Li Ka-Shing (Hong Kong) and Kyuk Ho Shin (South Korea) are well-known among family group companies.

In Malaysia, family companies contribute to more than half of the Malaysian Gross Domestic Product (Ngui 2002). It is estimated that 80% of 890 companies listed on Bursa Malaysia are family-owned businesses, with the exception of quasi-government owned firms, state development corporations, banks and multinationals (Soo 2003). The majority of Malaysian family firms evolved from traditional family owned enterprises. These firms do not embrace openness in firms' practices and continue to be managed as if they are still owned by their founders (Ow-Yong & Cheah 2000). Some prominent Malaysian family businessmen are Robert Kuok (Kuok Brothers), Quek Leng Chan (Public Bank Group), Tunku Abdullah Tuanku Abdul Rahman (Melewar Group) and Tan Sri Shamsuddin Abdul Kadir (Sapura Holdings Bhd).

Studies relating to family and non-family firms' performance were found to have mixed results. Empirical studies in the US concluded that family firms outperform non-family firms (Anderson & Reeb 2003; Miller & Breton-Miller 2006; Villalonga & Amit 2006). However, there are few studies on family companies' performance in Malaysia. Local studies by Samad, Amir and Ibrahim (2008) evidence that family ownership experiences a higher value than non-family ownership when using ROE, but not with Tobin's Q and ROA. Samad et al. (2008) only consider three variables

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(board size, independent directors and duality performance) in their study. Amran and Ahmad (2009) conducted a similar study using a 2000 to 2003 dataset. They evidence that family-businesses and non-family businesses have different corporate governance practices. Family businesses with separate leadership structure perform better, whilst larger board size enhances non-family companies' performance.

The inconclusive findings and the fact that a significant number of Malaysian companies are family owned has motivated the researcher to further explore the effect of corporate governance mechanisms and performance on Malaysian family-controlled companies. This study includes two new variables (directors' qualification and directors' professional affiliation) that are not yet captured by previous studies, even though they may influence company performance. The Revised Code of Corporate Governance (2007) recommends that directors must have qualities such as skills, knowledge, experience, professionalism and integrity in carrying out their duties.[i] Conducting this study, enriches the literature review relating to family companies in Malaysia, and creates greater awareness for regulators, academicians, investors and the public that family controlled companies and non-family companies share slightly different corporate governance practices.

The presentation of this study is as follows. First, the introduction section highlights the problem statement and motivation of the study. Then, discussion on corporate governance mechanisms and performance will be deliberated in the literature review section. The research methodology is then explained. Then the research findings and discussion are presented. Finally, the research findings are summarized followed by limitations of the study, and recommendations for future study are made.

2. Literature Review

Corporate Governance Mechanisms and Performance

Board governance is one of the important controls in managing the firms operations (Fama 1980; Fama & Jensen 1983). Previous studies by Western researchers (Anderson & Reeb 2003; Miller & Breton-Miller 2006; Villalonga & Amit 2006) and local studies (Amran & Ahmad 2009; Samad et al., 2008) found mixed findings on corporate governance mechanisms and firm performance. Therefore, in this study, several elements of internal governance mechanisms, such as board size, board independence, board qualification, director's professional qualification and leadership structure are tested.

Board Size

Size refers to the number of directors who serve on the board. Large boards are claimed to be superior to small ones because larger groups have more capabilities and resources, and wider external contracting relationships. Haleblian and Finkelstein (1993) explained that large groups could enhance problem solving capabilities, provide more solution strategies and critical judgement to correct for errors.

However, firms with small board size have higher stock market value (Yermack 1996). A small board is more effective than a larger one in making executive replacement decisions. However, the source of information, experience and contact

with outside parties will be limited, thus, small groups face difficulty in finding suitable candidates for replacements, especially from outside (Borokhovich, Brunarski, Donahue & Harman 2006). In terms of number, seven or eight executives on the board are sufficient to ensure board effectiveness. Too many executives on the board could also create more problems (Lipton & Lorsch 1992). Based on the arguments, it is posited that:

> H_{1a}: Family-controlled firms with smaller board size have higher firm performance than family-controlled firms with larger board size.
> H_{1b}: Non-family-controlled firms with larger board size have higher firm performance than non-family-controlled firms with smaller board size.

Board Independence

Corporate governance views that boards must have at least two directors or one third of the board must be independent.[ii] For family companies, they prefer to have independent non-executive directors on the board because the independent non-executive directors provide unbiased views, a fresh and creative perspective and bring a new dimension of experience that may not be found among family directors (Hillman & Dalziel 2003; Felton & Watson 2002). Newell and Wilson (2002) found that half of the board should comprise non-executives, and Abdullah (2001) evidenced that Malaysian companies were largely dominated by non-executive directors.

In contrast, there are drawbacks to having a high proportion of non-executive directors on boards. The arguments are that non-executive directors can create stifling strategic actions, excessive monitoring, lack of business knowledge and lack of real independence (Baysinger & Butler 1985; Goodstein, Gautam & Boeker 1994). In contrast, family executives provide rich firm-specific knowledge and strong commitment to the firm compared to non-executive directors (Sundaramurthy & Lewis 2003). Research by Klein, Shapiro and Young (2005) found no evidence that board independence affects firm performance. In addition, Chin, Vos and Casey (2004) claimed that the percentage of non-executive directors has little impact on overall firm performance. Based on the arguments, it is hypothesized that:

> H_{2a}: Family-controlled firms with a lower percentage of independent non-executive directors have higher firm performance than family-controlled firms with a higher percentage of independent non-executive directors.
> H_{2b}: Non-family-controlled firms with a higher percentage of independent non-executive directors have higher firm performance than non family-controlled firms with a lower percentage of independent non-executive directors

Board Qualification

The Malaysian Code on Corporate Governance (Revised 2007) recommends that directors have certain qualities (skills, knowledge, experience, professionalism and integrity) in carrying out their duties.[iii] Directors with higher education are better in managing the business operation than less educated counterparts (Sebora & Wakefield 1998). Educational background and skills may also influence family firms' performance (Castillo & Wakefield 2006). Based on the arguments, it is hypothesized that:

H_{3a}: There is a relationship between family-controlled firms with a higher number of educated directors' and firm performance than family-controlled firms with a lower number of educated directors'.
H_{3b}: Non-family controlled firms with a higher number of educated directors' have higher firm performance than non-family-controlled firms with a lower number of educated directors'.

Director's Professional Qualification

Directors' educational background and competency contribute positively to the success of family firms (Johanission & Huse 2000). Nevertheless, companies face a challenge in searching for qualified directors to sit on the board (Hartvigsen 2007). A survey by Ernst & Young shows that many firms in Europe and America struggle to find qualified directors (The Economist 2006). Raber (2005) claimed that there is no shortage in qualified directors, but stringent laws and rules pertaining to directorship and litigation by shareholders that make directors to be more careful in accepting their job. Nowadays, firms can no longer be satisfied with directors who simply put in a token appearance (Berube 2005). Firms seek qualified directors, together with their expertise. A report by Christian & Timbers in New York reflects the tough competition for recruiting qualified outside directors (Bates 2003). Hence, it is expected that:

H_{4a}: Family-controlled firms with a lower number of professional directors have higher firm performance than family-controlled firms with a higher number of professional directors.
H_{4b}: Non-family-controlled firms with a higher number of professional directors have higher firm performance than non-family-controlled firms with a lower number of professional directors.

Leadership Structure

The Malaysian Code on Corporate Governance (2001) states there should be a separate power and authority for Chairman and CEO. CEO duality arises when the post of CEO and Chairman are managed by one person. Agency theory evidences that a separate leadership structure could curb agency problems, and, thus, enhance the firm value (Fama & Jensen 1983; Rechner & Dalton 1991; Fosberg & Nelson 1999). A survey conducted by PriceWaterhouse Coopers (1999) shows that the majority of Malaysian listed companies have separate leadership. Local studies also evidence that Malaysian firms' exercise separate leadership (Abdullah 2001; Ayoib, Nor Aziah & Zuaini 2003; Abdul Rahman & Mohd Haniffa 2005).

In contrast, duality leadership is common among family companies (Chen, Cheung, Strouraitis & Wong 2005). Family companies feel that the founder-CEOs are more concerned about the survival of their firms to protect their legacy for future generations. In the US, Moore (2002) found that some firms practise duality leadership. They argue that by splitting the role of the Chairman and CEO, the CEO's freedom of action is reduced (Felton & Watson 2002). Studies also found that stewards that hold duality have significantly higher corporate performance because the power to determine strategy and responsibility is in the hands of the stewards (Donaldson & Davis 1991; Finkelstein & D'Aveni 1994; Chen et al., 2005). Therefore, it is posited that:

H_{5a}: Family-controlled firms that practise separate leadership have lower firm performance than family-controlled firms that practise duality leadership.
H_{5b}: Non-family controlled firms that practise separate leadership have higher firm performance than non-family controlled firms that practise duality leadership.

3. Data and Research Methodology

Sample Selection

The sampling frame consists of 424 public listed companies on Bursa Malaysia (excluding financial companies)[iv] that represent the total companies in Malaysia for the year ended 2003. The period of 2003 to 2007 was selected to examine the implementation effect of the revised Malaysian Code on Corporate Governance (2007) on family-controlled and non-family controlled companies. A family-controlled company is defined consistently by the Malaysian rules and regulations. A company must fulfil three criteria: (1) Founding CEO is the CEO or the successor of the CEO is related by blood or marriage, (2) with at least two family members in its management, and (3) family directors have equity ownership of a minimum of 20% in the company (Amran 2010). Other companies were categorised as non-family controlled companies. The data were hand-collected from the companies' annual reports. In order to ensure the accuracy of the data, the hand-collected data were cross-referenced to the KLSE Annual Handbook and Datastream.[v]

Panel Data Regression

This paper employs the panel data approach as it eliminates unobservable heterogeneity that different firms in the sample data could present, less collinearity among the variables and a better measurement than pure cross section or pure time series data (Gujarati 2003; Baltagi 2001).

The proposed research model includes two new variables – board with degree (BDEG) and board with professional qualification (BPRO) – compared to previous works done by Anderson & Reeb (2003); Miller & Breton-Miller (2006); Villalonga & Amit (2006); Samad et al. (2008); Amran & Ahmad (2009). The model used is as follows:

$$Q_{it} = b_0 + b_1BSIZE_{it} + b_2BIND_{it} + b_3BDEG_{it} + b_4BPRO_{it} + b_5LSHIP_{it} + b_6DEBT_{it} + b_7FAGE_{it} + b_8FSIZE_{it} + \varepsilon_{it}$$

Whereby;

Q = Market value of ordinary shares plus book value of preferred shares and debt/ book value of total assets.
BSIZE = Number of directors on the board.
BIND = % of independent non-executive director/total directors.
BDEG = % of directors' with degree/total directors.
BPRO = % of director with professional qualification/total directors.
LSHIP = Leadership (separate = 1, duality = 0).
DEBT = Book value of long-term debt/total assets.
FAGE = Number of years since incorporated.

FSIZE = Natural log of the book value of total assets.
ε_{it} = The disturbance or error term.

Model Specification

For corporate governance variables Board size (H_{1a} and H_{1b}), Board independence (H_{2a} and H_{2b}), Director's with degree (H_{3a} and H_{3b}), Professional directors (H_{4a} and H_{4b}) and a dummy variable were used to measure Leadership structure (H_{5a} and H_{5b}). The control variables in this study were debt, firm age and firm size.

4. Findings and Discussions

Descriptive Analysis

Table 1: Frequency and Per cent for Family-Controlled and Non-Family Controlled Companies

	Frequency	Per cent
Family companies (FC)	955	43.08
Non-family companies (NFC)	1165	56.92
Total	2120	100.0

Based on Table 1, the sample size for family-controlled companies represents 43.08%, comprising 955 observations (191 companies on Bursa Malaysia). Meanwhile, non-family controlled companies amounted to 1,165 observations (233 companies) with 56.92% of the total sample. From this analysis, it shows that family and non-family companies are players on Bursa Malaysia. This finding reveals that family companies do contribute significantly to the Malaysian economy, even though the percentage was slightly lower than previous works by Ngui (2002) and Sooi (2003).

Table 2: Frequency and Per cent of Companies by Industry

NFC			FC		
	Frequency	Per cent		Frequency	Per cent
Industrial Product	350	30.2	Industrial Product	321	33.6
Trading Services	295	25.5	Consumer Product	196	19.5
Consumer Product	171	14.8	Properties	125	13.7
Properties	123	10.6	Trading Services	117	12.3
Plantation	80	6.9	Construction	95	10.4
Construction	70	6	Plantation	66	7.2
Technology	35	3	Technology	20	2.2
Infrastructure Projects	20	1.7	Hotels	10	1.1
Hotels	15	1.3	Infrastructure Projects	5	0.5
Total	1165	100.0		955	100.0

Table 2 summarises the statistics for non-family controlled and family-controlled companies in relation to the industries listed on Bursa Malaysia. For non-family controlled companies, the highest sector is for industrial product (30.2%), followed by trading services (25.5%) and the consumer product (14.8%) sectors. While the majority of family-controlled companies sample are highly involved in industrial product (32.9%), consumer product (20.3%) and properties (13.7%). Furthermore, trading services (11.7%) and construction (10.4%) are in the fourth and fifth place for family-controlled companies. In sum, companies in Malaysia are well diversified and family companies do play a role in boosting the Malaysian economy (Ngui 2002).

Table 3: Transform Variables for Mean, Standard Deviation, Minimum and Maximum

	Mean	Std. Dev	Min	Max
Q	0.79	0.11	0.27	1.00
BSIZE	7.87	1.99	3.00	17.00
BINED	0.38	0.11	0.00	1.00
BDEG	0.73	0.21	0.13	1.00
BPROF	0.30	0.17	0.00	1.67
LSHIP	0.90	0.30	0.00	1.00
DEBT	0.09	0.13	0.45	0.75
LNFSIZE	12.85	1.33	9.13	18.03
FAGE	8.96	10.80	0.00	64.00

* significant at 0.1 (2 tailed), ** significant at 0.05 (2 tailed), ***significant at 0.01 (2 tailed).
Q = Market value of common equity plus book value of preferred shares and debt divided by book value of total assets, BSIZE = Number of directors on the board, BIND = Percentage of independent non-executive directors divided by total directors, BDEG = Percentage of directors' with degree and above divided by total directors, BPRO = Percentage of independent directors with professional qualification divided by total directors, LSHIP = Type of leadership that a firm practices, whether separate leadership or duality leadership, DEBT = The book value of long-term debt by total assets, LNFSIZE = Natural log of the book value of total assets, FAGE = Number of years since incorporated.

From Table 3, the average value for Tobin's Q is 0.79 for 424 companies. This indicates that the performance value for companies on Bursa Malaysia is considered strong. The average number of directors sitting on the board is eight people per board. The minimum board size is three members and the maximum number is 17 members. Therefore, this finding supports previous studies that recommend seven or eight executives on the board to ensure its effectiveness (Lipton & Lorsch, 1992; Jensen, 1993; Yermack, 1996).

For board independence, on average, 38% of board composition consists of independent directors. This indicates that companies do comply with The Code (2001), which suggests that at least one-third of boards must be independent directors. The result also shows that 73% of Malaysian directors do have a degree qualification. The finding supports The Code (Revised 2007) that encourages companies to search for directors who possess qualifications. Furthermore, it is hoped that with a higher number of directors with a degree, companies may utilise the human resources for the benefit of the company and the nation at large. Nearly 30% of companies do have professional directors sitting on the board. However, the number is still low and the reason for a low percentage of professional directors may be due to the difficulty in identifying suitable candidates and because directors are more careful in accepting the roles (Raber 2005; Hartvigsen, 2007).

The mean for leadership structure is 0.90 and the standard deviation is around 0.3. Most Malaysian companies do practise separate leadership compared to duality leadership. This practice is in line with The Code (2001). In terms of debt, the usage of debt is low and is reported as having a mean of 0.09 and a standard deviation of 0.13. Companies do not use debt to any great extent and prefer other means to finance the business. The mean for firm size is 13, with a minimum of 9 and maximum of 18. On average, the majority of Malaysian companies have experience of 9 years on the market and there are companies that have survived and continued to do business for 64 years.

Multivariate Regression Analysis

The panel Generalized Least Square (GLS) method was used over the five-year period (2003-2007). The GLS was adopted because it is a better estimation method and effectively standardizes the observations (Baltagi, 2001; Greene, 2000).

Table 4: Multivariate Regression Analysis (dependent variable = Tobin's Q)

	FCF $_{(a)}$	NFCF $_{(b)}$
BSIZE (H_1)	-0.003***	-0.001
BINED (H_2)	0.011	-0.017
BDEG (H_3)	0.006	0.057***
BPROF (H_4)	-0.004	-0.020
LSHIP (H_5)	-0.023***	-0.011
DEBT	0.015	0.025
LNFSIZE	-0.016***	-0.015***
FAGE	-0.001***	0.001***
_CONS	0.918***	0.920***
Overall R^2	0.1516	0.2072
N	233	191

* significant at 0.1 (2 tailed), ** significant at 0.05 (2 tailed), ***significant at 0.01 (2 tailed).
Q = Market value of ordinary shares plus book value of preferred shares and debt divided by book value of total assets, BSIZE = Number of directors on the board, BIND = Percentage of independent non-executive directors divided by total directors, BDEG = Percentage of directors with degree and above divided by total directors, BPRO = Percentage of independent directors with professional qualification divided by total directors, LSHIP = Type of leadership that a firm practices, whether separate leadership or duality leadership, DEBT = The book value of long-term debt by total assets, LNFSIZE = Natural log of the book value of total assets, FAGE = Number of years since incorporated.

The analysis in Table 4 shows that hypotheses H_{1a}, H_{3b} and H_{5a} are not supported. For board size, it is as predicted that family-controlled companies do have a smaller board size compared to non-family controlled companies. This finding supports previous studies by Lipton and Lorsch (1992), Jensen (1993) and Yermack (1996) in that small board size enhances firm value. The findings also reveal that directors

with a degree do significantly impact firm performance for non-family controlled companies. This interesting finding indicates that non-family controlled companies do choose qualified directors of calibre to sit on the board, as it would enhance firm performance. However, family-controlled companies practising a duality leadership structure have higher firm performance. Earlier studies also found that stewards who hold the position of both Chairman and CEO have higher performance because he/she can determine the strategy, focus on the company leadership and protect the family legacy for future generations (Donaldson & Davies 1991; Finkelstein & D'Aveni 1994; Haniffa & Hudaib 2006; Samad et al., 2008). However, board independence (H_{2a} and H_{2b}) and directors with professional qualification (H_{4a} and H_{4b}) do not influence company performance.

The control variables, LNFSIZE and FAGE, do affect the firm performance of family-controlled and non-family controlled companies, and firm size is negatively related with performance. Large firms do show lower firm value compared to small firms. This may be because companies may not be able to fully control and monitor the business as the companies become larger in size. Thus, the performance slowly decreases. For firm age, as a firm becomes older on the market, the performance declines. This shows that firms cannot sustain too long on the market to meet the demand, thus, the firm value decreases.

5. Conclusion and Limitations

This study evidences that family-controlled companies have a smaller board size and practise duality leadership in running the family business. Furthermore, for non-family controlled companies, the qualification of the directors significantly influences firm performance. In sum, family-controlled companies do actually use different strategies and have a high sense of family ties among their families. Regulators and investors need to be sensitive to the fact that the corporate governance practised by family-controlled companies differs slightly from that of non-family controlled companies. One limitation of this study that future research may consider is looking at the qualitative aspects of the data so that they are more reflective and informative to readers.

Endnotes

[i] Part 2 – Best Practices in Corporate Governance, VIII.
[ii] Malaysian Code on Corporate Governance (2001, Part 2, AA III).
[iii] Part 2 – Best Practices in Corporate Governance, VIII).
[iv] The industry is regulated under the Banking and Financial Act (BAFIA), 1989 (Chu & Cheah, 2004).
[v] The Datastream database is available in Sultanah Bahiyah Library, Universiti Utara Malaysia. Financial data were downloaded using Datastream.

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