

Determinants of Corporate Governance and Corporate Performance among Consumer Product Industry in Malaysia: A Theoretical Model

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Abstract *This study discusses on the relationship between corporate governance mechanisms and corporate performance of public listed companies in Bursa Malaysia among the consumer product industry. It investigates the corporate governance mechanisms such as ownership concentration, audit quality, board independence and CEO duality, are used to test on the relationship between both corporate governance and corporate performance. The proposed model indicates that the proportion of independent non-executive director might result in different decisions and the appropriate decisions made will improve the corporate performance. However, board size, firm size and leverage act as control variables on relationship between corporate governance and corporate performance. This study contributes to the literature by demonstrating the significant factors that determine the relationship between corporate governance and corporate performance. The findings are also relevant to the listed companies in understand the importance of corporate governance applied.*

Key words Corporate performance, chief executive officer duality, board independence, ownership concentration, audit quality and Malaysia

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1. Introduction

The government has launched New Economic Model (NEM) in 2010 in order to advance up the economy to a higher income status by 2020. According to Neac (n.d.), the Malaysian government has not solely contributed in achieving the goal, but the private business sector should contribute and take part in the economic transformation process in Malaysia. Indeed, as of 1st July 2013, the gross national income of Malaysia is classified as upper-middle class economies (The World Bank, 2013).

Bursa Malaysia (2010) reported consumer product industry is a highly competitive industry in which all the companies in the industry are trying to attract as much customers as possible by using different marketing strategies. Consumer goods are the final products after processing through the manufacturing process, and they are ready to be sold to final users ("Consumer Goods", 2013). Company's sustainability has become an issue in determining the survival and continued growth of a company. The sustainability issues that may positively affect the consumer product industry include environmental friendly advantage, energy efficiency, and utilization of natural resources. All the same, some challenges would be confronted by the troupe and they endanger the company sustainability positions, such as climate change, market placement, government imposed regulation and policy, change of customer preference, resource scarcity, strategic investment and communication with stakeholders ("Eleven Risk", n.d).

2. Problem statement

The financial crisis is the situation where the value of a financial institution or asset declines quickly. Financial crises which happened in 1997 and 2008 have a great negative impact on the global economy

(Salvatore & Campano, 2010). As the global economy is facing downturn, it will eventually cause the performances of most companies to drop tremendously. Researchers found that corporate governance has a significant effect on the corporate performance. Kirkpatrick (2009) found that failures of corporate governance are one of the major causes of the financial crisis. Kumar and Singh (2013) concluded that corporate governance is one of the major factors that cause the crisis and it is due to failure of several aspects of corporate governance such as a risk management system, transparency and disclosure.

According to Latif, Shahid, Haq, Waqas and Arshad (2013) documented that corporate governance has a significant impact on the firm performance. Besides, Rashid and Lodh (2011) found that the implementation of good corporate performance practices is determinants of efficient firm performance. Indeed, Sheikh, Wang & Khan (2013) argues that there is existence of material effect between internal governance mechanism (board size, managerial ownership and so on) and firm performance.

Nevertheless, in that respect are several limitations found among the past research conducted in terms of the sample size, targeted population and different variables. Hence, one of the research conducted by Latif *et al.* (2013), relatively use small sample sizes in which 12 sugar companies were selected out of 84 sugar companies located in Pakistan. In summation, a survey led by Rashid and Lodh (2011) focused solely on small and medium firms (SME). Furthermore, the research carried out by Sheikh *et al.* (2013) concentrates on the internal governance mechanism but other external governance mechanisms such as audit type were tested in their subject area. In summary, enforcement of corporate performance is a must in order to address the issues of the financial crisis and weak corporate performance as part of the reform program (Salvatore & Campano, 2010). This study may appear to be an extension of all areas carried out earlier and eliminate the limitations which arise from past studies on the relationship between corporate governance and corporate performance. This survey points to extend the relatively larger size of samples among the PLCs and some external governance mechanisms will be integrated to limit the impact of corporate governance on corporate performance among various Malaysian PLCs in the consumer product manufacture.

3. Corporate performance

The World Bank (2006) stated that corporate governance includes two mechanisms, internal and external corporate governance. As stated, internal corporate governance focus on the priority of shareholders' interest, engage with the board of directors to oversee top management, whereas, external corporate governance engages on force and external regulations in order to control and oversee managers' behavior.

In Malaysia the Malaysia Code on Corporate Governance has been released by Securities Commission Malaysia and put forward all public listed companies are needed to comply with MCCG in order to meet the minimal requisite of the firm corporate governance. It stated the principles and best practices of good governance among the companies and enhances the corporate performance (MCCG 2000).

As mentioned by Mobius (1994), as good corporate governance prominently to an increase in price and demand of company share normally comes from the strong connection between corporate governance and corporate performance. Supported by Solomon (2010), corporate governance is defined as a good management of internal company and careful decision of resource allocation can reinforce company performance. Investors are more willing to make huge investments in a well-governed firm when good corporate governance leads to good corporate performance (Solomon, 2010).

The results from Mollah, Al-Farooque and Karim (2012) noted that ownership and auditing committee's positively firm performance, while executive committees have a negative relationship with corporate performance. Supported by Mashayekhi and Bazaz (2008) indicated that there is a significant relationship between corporate governance mechanism and firm performance. Along with Haniffa and Hudaib (2006) indicate that board dominated has no relationship with corporate performance, while board size, role duality, concentrated shareholding and managerial ownership have a negative relationship with corporate performance. The research that investigate relationship between firm performance and corporate governance in the non-traditional export (NTE) sector stated that there is a positive relationship between board composition and ownership structure, however board size and CEO duality result inconclusively regarding the firms in NTE sector (Kyereboah-Coleman & Biekpe, 2006). On the other hand, Abor and Biekpe (2007) examined the relationship between corporate governance, and ownership structure on the performance of

SMEs in Ghana. The generated results show that there is a significant positive relationship between corporate governance (board size, CEO duality, board composition, inside ownership, family ownership, and foreign ownership, management skill) and corporate performance. In contrast, Guo and Kumara (2012) found a negative relationship between board size and percentage of non-executive directors on the boards with corporate performance, whereas; firm size and directors have a significant relationship to firm performance. The results, based on listed companies in Sri Lanka.

4. Ownership concentration

According to Shleifer and Vishny (1986) ownership concentration is mostly taken as a major element of the corporate organization which has a substantial force on corporate performance. The results support the fact that large corporations' shareholders were encouraged to collect more internal information to avoid the free rider problem. They found that agency theory does propose that ownership concentration can anyway improve the corporate performance by reducing the agency cost to a desirable level.

The study of Ke and Isaac (2007) tested how ownership is interrelated to firm performance. The research was also designed to investigate the relationship between ownership concentration and corporate performance among the listed property companies. Their outcome shows that there is a significant relationship between ownership concentration and corporate performance. Seitan & Tian (2007) examined the relationship between the role of ownership structure and concentration on corporate performance. Their finding shows that there is a positive relationship between ownership concentration and firm performance, which is measured using accounting profit indicated by ROA.

Furthermore, according to Manawaduge, Zoysa and Rudkin (2009) they found a positive relationship between ownership concentration and firm performance from the investigation the impact of ownership concentration and structure on firm performance. Supported by Sheikh, Wang and Khan (2013), they investigated on how ownership concentrations affect the firm performance. Their research shows that there is a significant positive relationship between ownership concentration and ROE as well as ROA which represent on behalf of corporate performance. On other than, results found by Leung, Richardson & Jaggi (April 2014) are contrasted. They found that no significant relationship between the independence board committees and firm performance in family ownership concentration. Their sample based on Hong Kong firms. Supported by Omran, Bolbol and Fatheldin (2008), they stated that ownership concentration has no significant relationship to corporate performance. Their study based on different sectors from the Arab country group (Egypt, Jordan, Oman and Tunisia).

5. Audit quality

Inquiry, led by Gao & Kling (2012) mentioned the Chinese government in ways to improve corporate governance and the external audit quality and led to the better government performance. They carried the research using the data from Shenzhen Stock Exchange from 2001 until 2007. The answer indicates that internal administration was improved and delivered a positive relationship that effect on firms' when comply to disclose the requirements.

In the study of Zulkafli and Samad (2007), larger audit firms tend to protect their image and reputation because of the size of the organization and the resources available to them. Thus, they will always furnish a better audit quality which may result in good corporate governance and ultimately push the corporate performance upwards. According to Lin and Hwang (2010) the quality audit is required to cut down the danger of material misstatement or omission and the stage of creative accounting and earning management. Their results show that the quality of audit is determined by audit independence, professional care exercised, and competency. Supported by Sarens, Abdolmohammadi, & Lenz (2012), they investigate the relationship between internal audit function and role in corporate governance. They found that is a significant relationship between internal audit function and role in corporate governance led to good audit quality.

In addition Haat, Rahman and Mahenthiran (2008), investigated the relationship between corporate governance practices and corporate transparency and performance among Malaysian PLCs. The results show a negative association between audit quality and performance of Malaysian companies. In the study of Al-Ajmi (2009), survey on 300 credits and financial analyst, he found that effective audit committees and Big 4 auditing firm provide best quality led better corporate performance.

In contrast, a study of Hassan and Halbouni (2013) examined the relationship between audit type and firm performance by taking into consideration of 95 financial and non-financial corporations. However, the result shows that there is no significant relationship between audit type and firm performance due to the fact that the operational decision of the client is not affected by the external auditor. But the research conducted by Gardner, Hussin, Sanusi, Sulong and McGowan (2013) found that there is a positive relationship between audit quality and firm performance. They focus on the relationship between audit quality and firm performance by taking into consideration of 82 companies listed in the Malaysian ACE market from the year 2007-2009.

6. Board independence

The MCGG, *inter alia*, emphasize on the need for board independence to ensure transparency and accountability of management. Hence, the MCGG recommends that independent non-executive directors make up at least one-third of the board memberships. The effective independence board remains important in corporate governance. Klein (2002), presented evidence suggesting that effective governance and firm performance increase with board independence (for example, see Brickley *et al.*, 1994; Byrd and Hickman, 1992; Weisbach, 1988). B. Jaggi *et al.* (2009) has documented in his written reports that independent corporate boards of Hong Kong firms provide effective monitoring of earning management, which hints that despite differences in institutional environments, corporate board independence is important to assure high-quality financial reporting. The effective independence board remains important in corporate administration.

Lahlou & Navette, (2013) has documented that a majority of independent non-executive directors among the board of directors constitute to board independence. Furthermore, independent non-executive director play a major role in overseeing the financial performance of the company as well as assisting the company in terms of long-run strategy development, risk management and remuneration planning (Kumar & Singh, 2012). However, Ramdani and Witteloostuijn (2009) documented that agency theory argues that a larger proportion of independent non-executive directors in the board will eventually promote a better firm performance. Hence a study conducted by Mashayekhi and Bazaz (2008), which looked into the relationship between corporate governance and firm performance among companies listed under Tehran Stock Exchange (TSE) in Iran, found there is a positive relationship.

All the same, there are prior studies indicating that independent non-executive directors are the external directors who do not accept any responsibility in operation the company (Whitehead, April 10, 2013). Furthermore, Shukeri *et al.*, (2013) has investigated the relationship between board independence and corporate performance and found there are negative associations. In summation, a survey conducted by Ponnu and Karthigeyan (2010) on the relationship between board independence and corporate governance among public listed companies in Malaysia found there is no significant relationship.

7. CEO duality

CEO duality is defined as “the practice of one person serving both as a firm’s CEO and board chair” (MOSCU, 2013). CEO Duality-the practice of a single individual serving as both CEO and board chair which has been one of the favorite topics for more and more research conducted since the early nineties till to date. Krause and Semadeni (2013) documented one of the central reasons that CEO duality is such an attractive subject for scholarly is that it is pronged in nature. The author also emphasis an investigation on CEO Duality and firm performance has attracted more scholars to conduct research.

In summation, from agency theory perspective, the company owner or shareholders will segregate authority to the management team (Solomon, 2010). Thus, this encouraging chairman and board of directors to segregate some authority to the CEO rather than solely held the office. Indeed, there are prior studies that in line with the agency theory perspective. Established on an investigation by Valenti, Luce and Mayfield (2011) on the issue of board composition and governance structure towards firm performance indicate that in order to improve the corporate performance, CEO duality should be nullified.

A studies conducted by Ballinger and Marcel (2010) by using 540 CEO succession events at S&P 1500 firms between 1996 and 1998 found weakened the negative result of interim CEO successions on firm performance. However, research by Quigley and Hambrick (2012) on 181 CEO succession events in publicly traded U.S. high-technology firms between 1994 to 2006 found the former CEO staying on as board chair

reduced performance change following a CEO succession. Indeed, a recent research by Krause and Semadeni (2013) documented their CEO-board chair separation had a positive effect following weak performance, but negative effect following strong performance; held in the first place for “demotion” separations.

In addition, in a recent study of 154 listed companies in Karachi Stock Exchange Pakistan, Sheikh et al. (2013) examined whether internal attributes of corporate governance such as CEO Duality affects the corporate performance in Pakistan. In fact the findings show CEO Duality would weaken board control and negatively affect the firm performance.

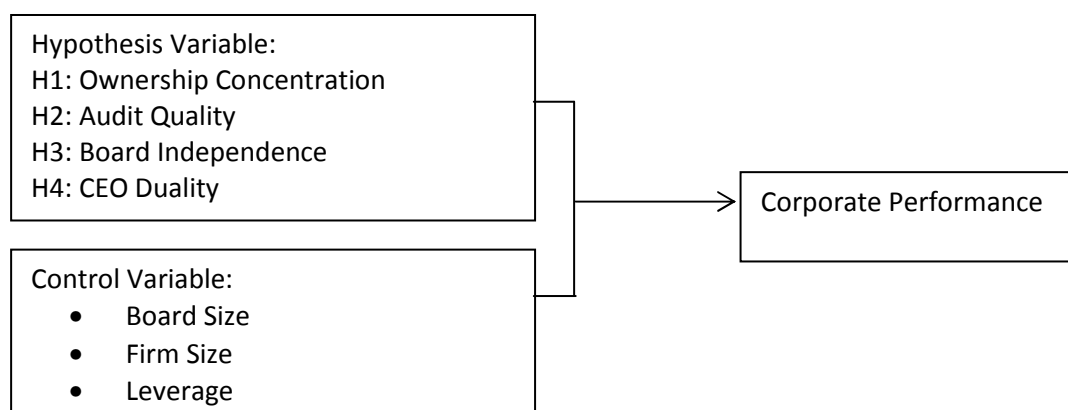
8. Control variable

Based on Mori & Olomi (2012) board size is interpreted as the total number of board of director which includes internal and external director. Furthermore, the board of directors is familiar as the official and legal entity governing the company which is occupied by non-executive and executive directors (Diamond, 2013). The executive director is employed to operate and run the company whereas non-executive directors are usually employed to oversee and monitor the operation of the company. They are expected to work for the best interest of the company on behalf of shareholders. There is also a study which shows that the size of board contributes a major impact on the board's ability to function (Daniel, Coles & Naveen, 2006). Vintila and Gherghina (2012) examined on the relationship between corporate governance mechanism, CEO characteristics and PLCs' performance. The result of their study shows a negative relationship between the size of the board of directors and Tobin's Q which is one of the techniques used to measure corporate performance. In Nakano and Nguyen (2012)'s study, the authors analyzed the relationship between both board size and corporate risk-taking by taking into consideration of 1324 Japanese firms listed on the Tokyo Stock Exchange from 2003 to 2007. The outcome of their research demonstrates that larger board size will contribute to lower corporate performance. Supported by Shukeri, Shin and Shari (2012) their research shows that there is a negative relationship between board size and firm performance.

Meanwhile, several studies indicated that the firm size may eventually affect the firm performance. Based on Mashayekhi and Bazaz (2008) stated that there were solid and important relationships between firm size and corporate operation. The results of Sheikh *et al.* (2013) explorations indicate that firm size shows a positive linkage with various performance indicators. The primary ground is because large firms are more potent to enjoy benefits such as economies of scale which may amend the corporate performance significantly. According to research conducted by Rashid, De Zoysa, Lodh and Rudkin (2010), the authors found that firm size is classified as one of the major variable as large firms could be influenced by having more capacity in order to generate internal funds.

On the other hand, Sheikh et al (2013) defined the leverage as the method that the company applied to obtain financial capital. Companies with a higher leverage ratio are more risky and may have difficulties in meeting their obligations. This also indicates that the company might have higher possibility to default in repaying the amount borrowed. In the research done by Sheikh *et al.* (2013), the authors found that there was a negative relationship between leverage and corporate performance. Supported by Foroughi and Fooladi (2011), they found that firm performance is negatively linked to company leverage. Meanwhile, Mashayekhi and Bazaz (2008) concluded that leverage has a negative relationship with solid performance and firm profitability.

9. Research framework



10. Conclusions

The purpose of this article is to determine the impact of corporate governance on corporate performance among various Malaysian PLCs in the consumer product industry. This article outlines the drivers of corporate performance.

On the basis of the literature review, a conceptual model has been developed. Further research should be carried out to test, validate and enhance the model. The results obtained will be presented in a later article.

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