



Faculty of Economics and Business

**THE IMPLEMENTATION OF MALAYSIAN CODE OF
CORPORATE GOVERNANCE (MCCG) 2000 & 2007: DOES IT
IMPROVE THE PERFORMANCE OF MALAYSIA FIRMS?**

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**A STUDY ON
THE IMPLEMENTATION OF MALAYSIAN CODE OF CORPORATE
GOVERNANCE (MCCG) 2000 & 2007: DOES IT IMPROVE THE
PERFORMANCE OF MALAYSIA FIRMS?**

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Statement of Originality

The work described in the Final Year Project, entitled
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is to the best of the author’s knowledge that of the author except
where due reference is made.

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ABSTRAK

PELAKSANAAN KOD TATA URUS SYARIKAT MALAYSIA 2000 & 2007: ADAKAH KOD TERSEBUT MENINGKATKAN PRESTASI SYARIKAT DI MALAYSIA?

Oleh

Voon Kian Tark

Objektif utama tesis ini adalah untuk mengkaji hubungan antara saiz lembaga pengarah dan prestasi syarikat yang berdaftar serta disenaraikan di Bursa Malaysia. Kajian ini menunjukkan prestasi syarikat sebagai pembolehubah dependen kajian yang terdiri daripada tiga proksi (iaitu Pulangan Ekuiti, Pulangan Aset dan Bayaran Dividen) serta Pengarah Eksekutif dan Pengarah Bukan Eksekutif sebagai pembolehubah bukan dependen kajian. Saiz sampel kajian ini terdiri daripada 582 syarikat yang berdaftar serta disenaraikan di Bursa Malaysia pada tahun 2004 hingga tahun 2008. Pengumpulan data Panel digunakan dalam metodologi kajian ini malah data tersebut dianalisis dan ditafsirkan dengan Statistik Deskriptif, Analisis Korelasi Pearson dan Analisis Kuadrat Panel. Keputusan tesis ini menunjukkan hubungan positif antara saiz lembaga pengarah berserta dengan Pulangan Ekuiti, Pulangan Aset dan Bayaran Dividen. Selain itu, Kod Tata Urus Syarikat Malaysia 2000 & 2007 turut dinyatakan bahawa tidak sesuai diaplikasikan bagi syarikat yang berdaftar serta disenaraikan di Bursa Malaysia pada tahun 2004 hingga tahun 2008. Akhir sekali, Kesimpulan, pembatasan kajian dan cadangan untuk kajian masa depan juga akan dibincangkan dalam tesis ini.

ABSTRACT

THE IMPLEMENTATION OF MALAYSIAN CODE OF CORPORATE GOVERNANCE (MCCG) 2000 & 2007: DOES IT IMPROVE PERFORMANCE OF MALAYSIA FIRMS?

By

Voon Kian Tark

The main objective of this thesis is to study the relationship appear between the Board Size and the performance of the listed firms in the Malaysia. This study indicate firm performance as study dependent variable which is consisted three proxies (ROE, ROA and Dividend Yield) and two Board Size mechanisms (Executive Directors and Non Executive Directors). A sample size of 582 companies listed on the Bursa Malaysia between 2004 and 2008 is used. Panel data methodology is employed and the data collection were coded and interpreted by using Descriptive Statistic, Pearson correlation analysis and Panel Least Squares Regression Analysis. The study found that there is a positive relationship between Board Size and Return on Equity; Return on Assets and Dividend Yield. Moreover, the Malaysia Code of Corporate Governance is not applicable for the listed companies in Bursa Malaysia from the year 2004 to year 2008. The conclusion, limitations of the research, and recommendations for future research are discussed lastly in this thesis.

CHAPTER 1

INTRODUCTION

1.1 Introduction

Management perspective plays a significance role to help corporate to formulate, communicate and monitor business strategy while it also sustained strategic goals that set up by the board of directors. Normally, the action plans organized by the business management group mostly concerned with the term of 'cause and effect' on corporate vision, mission and strategic objective. Theoretically, there are 4 type of management perspectives which are financial, customer, internal process and learning and growths to covers up all business essential elements for its operation survival. Other than management, the leadership also has the equal responsibility for the succession of business task. In general, Leadership who are board of directors that will endorse new member for board, monitor or control management implementation and business goal achievement supervision. Leader also can be referring as good coaches, facilitators and supporters of employee development. The leadership and management group have a linkage and affect each other interest whereas it was extremely supported by the agency theory. If the management group done essential tasks efficiently and this meant that there are a group of board of directors obsessed creative and effectiveness characteristics

to monitor and control its management team with a clear, understandable and appropriate communication message.

According to Shakir (2008), Board Size defined as the total number of corporate directors of board whichever inclusive outside directors, Executive Directors and non-Executive Directors. As similarity, Shakir (2008) classification was described alike as the classification of Board Size used by Hermalin and Weisbach (1991) and Bhagat and Black (2002). Otherwise, the directors also can refer as the person that was initially election by the other committee members and depended on Memorandum of Association with the term and condition of re-election at least once in every three years.

The board of directors principally disapproved about the shareholders' wealth reduction and business failure of a corporate. They mostly concerned and highlighted the fraud of foremost corporate breakdown globally such as Enron, WorldCom and Global Crossing while the Malaysia nation's big players also faced on the failure onto the failure in their business such as Malaysian Airlines System (MAS), Perusahaan Otomobil Nasional (PROTON) and also the scandals surrounding corporate figures like Tan Sri Halim Saad and Tan Sri Eric Chia. There are few reasons that mentioned by the Abidin et al. (2009) have a linkage with the failures of corporate which are board of directors were lack to cautious the management functions mistake while they also surrendered with the corporate managers control and supervision whoever only followed with their own self-interests and negligent about the stakeholders accountability.

In Malaysia, government was established the Malaysian Code on Corporate Governance (2000) to control the problem of imbalance of executive and non-Executive Directors and avoidance domination problem among the board members which is focused on the Best Practices in corporate Governance.

The earliest literature on Board Size and corporate performance was appeared a negative sign among each other while it was proven by Lipton and Lorch (1992) and Jensen and Meckling (1993) study. Jensen and Meckling (1993) argued that the lesser Board Size will stop from technological and organizational transformation leads to cost cutting and downsizing. Hermalin and Weisbach (2003) also stated that the larger boards brought less effective than boards due to agency problems. There are few empirical study shows that a negative relationship appeared between Board Size and corporate performance held same as Malaysia condition which is Yermack (1995), Eisenberg et al (1998) and Barnhart and Rosenstein (1998). Based on Mak and Yuanto (2003), they study was reported that listed firm valuations of Singaporean and Malaysian firms are highest when the board only consist five members of directors which this can define that smaller Board Size will maximize a corporate value.

1.2 Background

This study is mainly examined the influences Board Size of 1,074 firms in Malaysia which is derived from the listed companies in Bursa Malaysia against the several times in a year regarding to the firm problems solving and legal responsibilities towards the corporate performance.

According to the Ho and Williams (2003) study, most Asian countries were reinforce their corporate governance, transparency and disclosure level after the period of 1997 financial crisis. However, this situation was difference compare with Malaysia which meant that Malaysia firm's corporate governance involved Board Size still acquired a poor standards and lack of transparency in the financial system. This result was shown that negative correlation between firm value and the firm Board Size whichever supported by Yermack (1995) study and partially confirmed by Bhagat and Black (2002) study.

Shakir (2008) study was stated that formation of Malaysian Institute of Corporate Governance been created to overcome the problem regarding with the poor standards of corporate governance involved Board Size and lack of financial system transparency in year 1998.

For instance, Transmile Sdn Bhd accounting fraud collectively with the Malaysian Airlines System (MAS) and Perusahaan failed to obtain as the nation's main player

Otomobil Nasional (PROTON) and also the Tan Sri Halim Saad and Tan Sri Eric Chia corporate figures scandals was extremely attributed as the poor standards of corporate governance system involved Board Size and lack of financial system transparency in Malaysia. Generally, Malaysian Institute of Corporate Governance plays a main role to educate and conscious the corporate sector and public sector on the best practices of corporate governance. In March 2000, the Malaysian Code on Corporate Governance (MCCG) was released.

According Abidin et al. (2009), The Malaysian Code on Corporate Governance (MCCG) of 2000 recommended solving and controlling the problem of imbalance in power and authority of Executive Directors and non-Executive Directors' decision making and board domination issues. The Malaysian Code was focused on corporate board of directors, directors' remuneration, shareholders, accountability and audit aspects.

Normally, The Malaysian Code on Corporate Governance (MCCG) of 2000 was organized an orientation and education program such as training to generate awareness among the corporate sector and public sector about the best practices of corporate governance. Otherwise, set of regulations and recommendation of proposal had been created to ensure that the existing corporate was performed effectively and efficiency onto its boards with emphasized responsibilities of stewardship and shareholders' interest protection while the code was aim to achieve the positive impact of the board structure on the company performance. The reason that stated accomplishment of the

Malaysia Code of Corporate Governance 2000 is to reduce the free riding possibility and increase the accountability for board of directors.

Board composition, directors' share ownership, Chief Executive Officer (CEO) duality and Board Size was stated as the board characteristics whichever might bought the impact of on corporate performance through value-added efficiency resources. Intellectual capital is the significance element to increase performance and resources of the companies.

Accordance to the Malaysian Code of Corporate Governance (MCCG) 2000 (Revised 2007), Bursa Malaysia required all public listed company to complied and disclosed board of directors in their annual reports which is it must included the board composition, Board Size and board meeting. Meanwhile, the board's Non Executive Directors should comprise at least one-third of the board membership to eliminated board's decision making domination. The reasons are Non Executive possessed ability, credibility, skill and experience of independent judgments to tolerate corporate strategy, performance and resources issues.

Due to the Malaysian Code of Corporate Governance (MCCG) 2000 (Revised 2007), most of the companies assigned 6 members to 10 members on board of directors which is comply 79.5 percent respectively while only 1.3 percent companies assigned more than 16 members of the Board Size during post MCCG 2000 (Revised 2007).

Based on Ponnu (2008) study, he stated that the efficiency of the corporate developed directional strategy, employment, administration and senior executive's remuneration and corporate shareholder, authorities or stakeholder's accountability of the organization to its shareholders, authorities and other stakeholders of corporate governance has a reflective effect on business performance. This meant that most of the corporate governance literatures classified board characteristics will affected the corporate performance. This statement was supported by the previous studies such as Dalton et al, (1999), Pfeffer (1972), Singh and Davidson (2003) and so forth.

1.3 Problem Statement

Organization problems occur when ownership is separated from management. This situation automatically that effect the way of effectively and efficiency monitor of managers to implement a control approach while this will affect the probability to maximize the shareholder interest (maximize the wealth and value of the corporate) and manager interest (rise up the opportunity of self-determination in order to make a business decision). The subsistence of a board of director is an important system for shareholding monitoring and controlling where Board Size is the most common aspect discussed. Lee and Filbeck (2006) study has mentioned that traditional corporate illustrate a weakest performance in the US-style corporate but there are difference scenario illustrated which is a strength performance in Japanese-style corporate. There are agency problem occurred onto the US style-traditional corporate as a barrier or inefficiencies in communication and coordination caused of business entity separation purposes. This research is to investigate the relationship between Board Size and performance of listed companies at Bursa Malaysia. Specifically, the research was question about Board Size will going effect on firm performance positively, negatively or no relationship on it.

The Malaysian Code on Corporate Governance (MCCG) of 2000 and the KLSE (KLSE renamed as Bursa Malaysia on 2004) Listing have been set up a fixed requirement and regulation to solve and control the imbalance in power problem of board of directors' decision making and issues on board domination. For instance,

KLSE listing requirement have been restricted the directorships number in 2002 which is a only maximum 10 directorships in public listed companies and 15 directorships in private companies are allowed to ensure that participated companies were perform effectively and efficiency in all their administration and management flow. The code was suggested that the Board Size be supposed to 'not be too big not too small but is sufficient and adequate to perform their duties actively and effectively'. (Abidin et al., 2009) For example, Ponnu and Karthigeyan (2010) resulted the outsider number (Independent Non Executive Directors) did not play any important or failed to play role any improvement towards the firm performance because of the Malaysian Code of Corporate Governance (MCCG) 2000 was indefensibility. This situation was became the doubted issues for the listed companies about the implementation on the code and the regulation issues that set up by Bursa Malaysia. This study was examined the Board Size and corporate performance relationship after the code and the regulation have been established to the public after a year later. The effectiveness and efficiency level of the Malaysian Code on Corporate Governance (MCCG) of 2000 and the KLSE Listing fixed requirement and regulation can be proved after this study have been done and ensure that either the code and the regulation were brought beneficial against the public listed companies or not.

1.4 Objective of the study

1.4.1 General Objective

The study is to examine the relationship appear between the Board Size and the performance of the listed firms in the Malaysia which is the disciplining management and the relationship of board of director to influence the listed firms' performance.

1.4.2 Specific objectives

I, This research is to identify there are a relationship of the board Executive Directors and the firm's performance of the Bursa Malaysia's listed firms.

II, This research is to identify there are a relationship of board non - Executive Directors and the firm's performance of the Bursa Malaysia's listed firms.

III, This research is to identify the applicable of the Malaysia Code of Corporate Governance 2000 (Revised 2007) accomplishment towards the effectiveness and efficiency of Bursa Malaysia's firms' performance.

1.5 Significance of the study

The significance of the study for this research has brought some benefits to government, public sector as well as community. This study may help the government or the public whoever interested in investment to the Bursa Malaysia's firms to help them make a perfect or ideal financial investment decision which is this study might help in the efficiency and effectiveness against controlling and monitoring management for the board of director towards management team and while it will also rising up the performances of the firms (ROA, ROE and Dividend Yield).

Moreover, this study information could be useful as it could be the reference for the firms and industry to improve their performance. In addition, it may also help public firms to plan or do their investment proper management proposal as a reference and make earlier and faster way in the progress of searching the information for the management or investment materials in the future time. Once this research is done, all firms and the market of financial industry could obtain the information gained whichever it might be conscious the public about the significance role of agency problem towards a corporate board of director and business performance, lay out a chance to obtain an improvement with a rapidly flow and optimum cost of administration.

1.6 Theoretical Framework

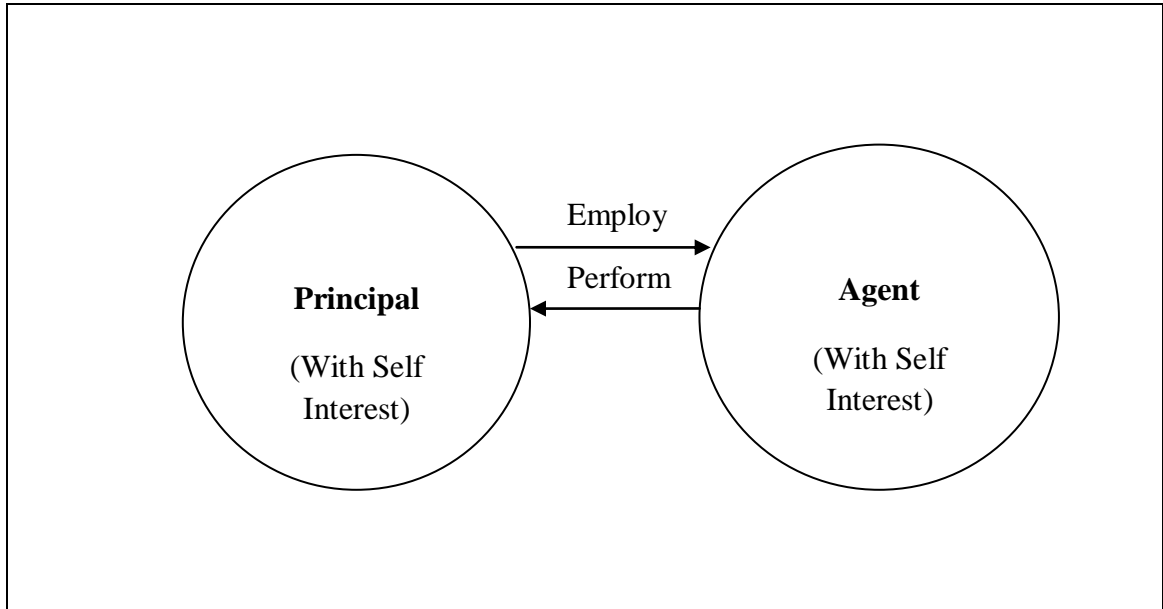
This study was emphasized on the Agency Theory to support investigation of the methodology and empirical result of the relationship between the Board Size and the corporate performance study.

1.6.1 Agency Theory

Generally, Agency Theory was originated from Berle and Means (1932) thesis which is entitled “The Modern Corporation and Private Property”. The Berle and Means (1932) thesis was explained about the primary agency problem inbuilt in firms of modern era wherever caused by the ownership and control or management separation subsisted. The theory was suggested that survive of a corporate in this competitive business environment depend on the financial capability whichever they stated that ‘small private firms grew further than the sole owner financial capability’.

Based on Dalton et al (1999) and Shleifer and Vishny (1997), they mentioned that Agency theory was the most common and recognized theoretical perception that used in the studies related with corporate governance (Board Size was one of the corporate governance characteristics) topic.

Figure 1: Agency Theory Framework



Sources: (Berle and Means, 1932)

According to Dalton et al (1999), an efficient and effective of corporate management and control team (agent) regarded with the business cost will rise up the corporate funds and this condition might expand of business operations and maximize shareholders (principals) returns in future. On the other hand, this power allocation may offer an opportunity towards the manager to take possession wealth of shareholders' by choosing their self interest investment projects that might bring beneficial to them rather than the principle (interest of agent).

There are few earlier agent-principal or agency theorists make an argument about the corporate governance based on the Agency Theory such as Demsetz and Lehn (1985), Jensen and Meckling, (1976) and Fama and Jensen (1983). They were suggested the board of director appointment will affect the effectiveness of the corporate governance system and stated that management team must be controlled and monitored by board of directors to ensure that management team was not discharge from their duties (interest of principle).