RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND ECONOMIC VALUE ADDED (EVA): EVIDENCE FROM PUBLIC LISTED COMPANIES IN SARAWAK

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RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND ECONOMIC VALUE ADDED (EVA): EVIDENCE FROM PUBLIC LISTED COMPANIES IN SARAWAK

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This thesis is submitted in fulfilment of the requirement for the degree of Master of Science

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DECLARATION

I, Abdullah Al Mamun, hereby declares that this thesis entitles “Relationship between corporate governance and economic value added (EVA): Evidence from public listed companies in Sarawak” is my own account of my research. To the best of my knowledge, the thesis contains no materials that have been previously published by another person, except where due references have been given.

Abdullah Al Mamun

Date
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ABSTRACT

Financial scandals and collapses of large and established firms have become the impetus for better corporate governance. Prior studies have shown that good corporate governance plays a significant role in attracting local and foreign investments since a sound corporate governance system can help to enhance firm performance.

Although there have been several studies conducted on corporate governance and firm performance, there are very limited researches conducted on the effect of corporate governance on the firms' true economic profit, measured in term of EVA (economic value added), a value-based measurement tool. Thus, the purpose of this study is to investigate the relationship between corporate governance and the economic profit of 25 public listed companies in Malaysia. A series of multiple regression analyses were employed to investigate the extent to which corporate governance influences on firm performance.

The results explained that not all the mechanisms had direct effect on firm performance. Chief executive officer (CEO) non-duality, audit committee independence, and audit committee meeting frequency appeared to have no effect on firm performance, while board size and board independence had significant relationship with firm performance. Various regulatory bodies should concern the independent board members, with their knowledge and expertise can elevate firm performance as well as the practice of better corporate governance in Malaysia.
The scope of the study was limited to Sarawak-based firms listed on Bursa Malaysia and relied on secondary data. Due to missing data, the study could not assess and analyse the effect of resignation or retirement of specific director, CEO, or audit committee members on EVA. Hence, this study recommends that such information, together with the number of meetings held over the year by audit committee members and board of directors, to be included in future studies. It might be true for a larger sample as well to investigate the effect of corporate governance on firm performance in term of EVA in Malaysia.
ABSTRAK

Skandal kewangan dan keruntuhan firma besar telah menjadi dorongan bagi penambahan baik tadbir urus korporat. Kajian lepas menunjukkan bahawa tadbir urus korporat yang baik memainkan peranan penting dalam menarik pelaburan tempatan dan asing untuk meningkatkan prestasi firma.

Walaupun terdapat beberapa kajian yang telah dijalankan mengenai tadbir urus korporat dan prestasi firma, penyelidikan dijalankan ke atas kesan tadbir urus korporat terhadap keuntungan ekonomi sebenar firma masih kekurangan. Oleh itu, tujuan kajian ini adalah untuk mengkaji hubungan antara tadbir urus korporat dan keuntungan ekonomi bagi 25 buah syarikat awam yang tersenarai di Malaysia. Analisis regresi berganda telah digunakan untuk menyiasat setakat mana tadbir urus mempengaruhi prestasi firma korporat.

Keputusan menjelaskan bahawa tidak semua mekanisme mempunyai kesan langsung terhadap prestasi firma (EVA). Ketua pegawai eksekutif (CEO) bukan berbelah bahagi, jawatankuasa audit kemerdekaan dan kekerapan mesyuarat jawatankuasa audit kelihatan tidak mempunyai kesan ke atas prestasi firma, manakala saiz lembaga dan lembaga kemerdekaan mempunyai hubungan yang signifikan dengan prestasi firma. Pelbagai badan-badan kawal selia perlu faham bahawa ahli lembaga pengarah bebas, dengan pengetahuan dan kepakaran mereka, boleh meningkatkan prestasi firma serta praktis tadbir urus korporat yang lebih baik di Malaysia.
Skop kajian ini adalah terhad kepada firma-firma Sarawak yang tersenarai di Bursa Malaysia dan bergantung kepada data sekunder. Oleh kerana terdapatnya data yang hilang, kajian ini tidak dapat memeriksa kesan perletakan jawatan atau persaraan pengarah tertentu, Ketua Pegawai Eksekutif atau ahli jawatankuasa audit terhadap EVA. Oleh itu, kajian ini mengesyorkan bahawa maklumat sedemikian berserta dengan bilangan mesyuarat yang diadakan sepanjang tahun oleh ahli jawatankuasa audit dan lembaga pengarah untuk dimasukkan dalam kajian masa depan. Hal ini juga termasuk sampel yang lebih besar untuk menyiapkan kesan tadbir urus korporat mengenai prestasi firma dari segi EVA.
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<tr>
<td>ANOVA</td>
<td>Analysis of Variance</td>
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<tr>
<td>CCM</td>
<td>Companies Commission of Malaysia</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CFROI</td>
<td>Cash Flow Return on Investment</td>
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<td>CSRC</td>
<td>China Security Regulation Commission</td>
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<tr>
<td>CSV</td>
<td>Created Shared Value</td>
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<tr>
<td>EPS</td>
<td>Earnings per share</td>
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<td>EVA</td>
<td>Economic value added</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
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<td>KCC</td>
<td>Korean Commercial Code</td>
</tr>
<tr>
<td>MICPA</td>
<td>Malaysian Institute of Certified Public Accountants</td>
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<tr>
<td>MIA</td>
<td>Malaysian Institute of Accountants</td>
</tr>
<tr>
<td>MICG</td>
<td>Malaysian Institute of Corporate Governance</td>
</tr>
<tr>
<td>MICSA</td>
<td>Malaysian Institute of Chartered Secretaries and Administrators</td>
</tr>
<tr>
<td>MID</td>
<td>Malaysian Institute of Directors</td>
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<tr>
<td>MSWG</td>
<td>Minority Shareholder Watchdog Group</td>
</tr>
<tr>
<td>NASDAQ</td>
<td>National Association of Securities Dealers Automated Quotations</td>
</tr>
<tr>
<td>NETC</td>
<td>National Economic and Trade Commission</td>
</tr>
<tr>
<td>NOPAT</td>
<td>Net Operating Profit After Tax</td>
</tr>
<tr>
<td>NUBS</td>
<td>Newcastle University Business School, Malaysian Campus</td>
</tr>
<tr>
<td>NYSE</td>
<td>New York Stock Exchange</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Asset</td>
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SPSS  Statistical Package for the Social Sciences
VBM    Value-Based Measurement
WACC  Weighted Average Cost of Capital
CHAPTER ONE
INTRODUCTION

1.0 Introduction

Corporate scandals and corruptions have led to the major collapses of corporations such as Enron and WorldCom in the US, Marconi in the UK, and most recently the Royal Ahold in Netherlands (Mir & Souad, 2008). Such events have caught the attention of corporate leaders, regulators, scholars, and academics all over the world to examine the meagre disclosure, misuse of power, and huge payments for the executives. In the study of Yang et al., (2011) that covers both government and corporate bodies, the authors have mentioned that poor corporate governance practices should be restrained to ensure the sustainability of an organization.

Berle and Means (1932) seems to be the first scholars who have regarded corporate governance as a significant issue in the business world in their book entitled *The Modern Corporation and Private Property* published in 1932. However, debate on corporate governance has only received greater attention in the last two decades due to collapses of major corporations similar to the above-mentioned. Numerous researches have since been conducted to justify the significance of corporate governance in the global context.

Corporate leaders have generally ignored the importance of practising standard corporate governance in pursuit of superior performance, competitive
advantage, and exponential growth rate (Gerry et al., 2008). Fortunately, ever since the last few decades, regulatory bodies and practitioners worldwide have given more attention to corporate governance, though the rhythm is very inconsistent. Firms in Asia have so far been managed successfully (Henry, 2002), but poor corporate governance and regulatory system continue to be the major reasons that have caused corporate failures in the region, as supported by some academicians and regulatory bodies (Entebang et al., 2010). Moreover, recent regional and global financial crisis and corporate collapses have also pulled the trigger once again to implement good corporate governance practices in firms.

The East Asian financial crisis in 1997/98 is a wake-up call to both reform corporate governance and encourage its compliance with international best practices. After the financial crisis, the Malaysian government has also taken the initiative to adopt corporate reforms that can help to enhance the quality of good corporate governance practices (Abidin & Ahmad, 2007) in the form of code and rules that suit the local climate. The regulatory bodies involved in this reform include the Ministry of Finance, Kuala Lumpur Stock Exchange (currently named as Bursa Malaysia), Securities Commission, and Companies Commission of Malaysia (CCM).

As the economies and corporate structures of many organizations evolve over time, the models developed for corporate governance have also changed simply by following the convention or environmental influences such as worldview, culture, the legislative and political framework (Alejo, 2000). Nevertheless, it should be reminded that typically, these models are not specifically planned to achieve particular objectives to maximise efficiency and economic benefit of shareholders or to protect
the minorities (Liu, 2006). Malaysia is a particular case in point where corporate governance is evolving (Robert, 2010). Therefore, there are ample numbers of issues linked to corporate governance that have to be researched (Todd, 2002), and one them is the financial performance measurement mechanism (Vincent & Peter, 2011).

According to David (2006), any proper organisational strategy, planning, and reporting process can be a financial performance measure. It provides feedback to decision makers to assist them in improving performance and to key stakeholders to observe whether the management (decision makers) is delivering its commitments or not. From a practical standpoint, performance measurement is a process where the drivers and results of key activities within a board and management are measured using different types of information (Fulvio, 2012). It can be conducted from different stand-points, for instance from a financial, non-financial, quantitative, and qualitative perspective. Financial performance is again divided into two dimensions - accounting and economic profit (Katarina & Lajos, 2006).

This study aims to examine the extent to which corporate governance mechanisms may have a perceived effect or influence on the financial performance of the public listed companies in Malaysia through a appropriate analysis. The data analysis suggests that corporate governance practices have a significant effect on firm performance in terms of economic profit.
1.1 Brief Literature Review

Corporate collapses and financial scandals around the world have shaken the confidence of researchers, regulatory bodies as well as investors. Hence, reformation of rules and regulations in managing firms is urgently needed to reform corporate governance. This has fuelled the formation of the Cadbury Committee in 1992. The committee claimed that no system of corporate governance can be totally proven against fraud or incompetency, but its risk can be likely minimised by making the regulators more accountable and increasing the organization’s transparency to its stakeholders. Hence, properly constituted boards, separation of the functions of chairman and chief executive officer (CEO), and effective audit committee constitute the parts of an important corporate governance mechanism that will eventually improve the organization’s performance. Using this mechanism, the shareholders’ wealth can be safeguarded and more thorough and timely disclosure can be provided.

There have been numerous studies conducted on corporate governance mechanisms and firm performance in developed countries (Jensen, 1993; Beasley, 1996; James et al., 1997; Bhagat & Black, 1999; Klein, 2002; Abbott et al., 2004; Aggarwal & Samwick, 2006; Bradbury et al., 2006; Wiparat & Fredric, 2007; Mir & Souad, 2008; Chen et al., 2008; Yoon et al., 2012). Extensive empirical studies on the leadership structure, audit committee independence, and firm performance have been mostly carried out developed economies such as the US, UK, and Australia since these countries have higher awareness on these influences on an organization’s corporate governance than most emerging markets (Zeitun & Gary, 2007). However, concern remains in whether the theories developed from these studies are irrelevant.
for emerging markets due to the difference in political, economic, and institutional conditions (Robert et al., 2000). Moreover, the results reported so far also significantly vary among these countries.

In the local climate, corporate governance mechanisms have been addressed in the Malaysian Code on Corporate Governance (2000; and revised in 2007 and 2012). Immediately after the 1997 East Asian financial crisis, more studies on corporate governance have been carried out in Malaysia (Rahman & Haniffa, 2005; Abdullah, 2006; Rashidah & Mohamed, 2006; Saleh et al., 2007; Abidin et al., 2009; Adibah et al., 2009). For example, Abdullah (2004) conducts a research on the relationship among leadership structure, board independence, board size, and firm performance. The studies used financial ratios to measure firm performance, but debate arose in the sense that such ratios might not be able to measure and capture the firms’ value created over a time period. Their studies also claim that independence of the board and shareholder’s interest are closely related to corporate performance. However, it seems that the results reported do not indicate enough.

Though there are arguments in favour of governance mechanisms, corporate governance is also a part of an agency problem. This is because CEO duality, board size, board independence and other mechanisms could be involved in an agency problem. Conflicts of interest between management and shareholders can result in the appointment of board of directors as agent (agency theory) to make sure that the shareholders’ interest is safeguarded. However, if the members of the audit committee are not independent, the accountability, transparency, and fairness of the board can be questioned since these factors are closely related to corporate performance (Holly &