



Board Characteristics and Firm Performance: Malaysian Evidence

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ABSTRACT:- This study investigates the relationship between traditional board characteristics such as non-executive directors and board meeting as well as other organizational characteristics such as CEO tenure, and member of professional body and performance of Malaysian companies. The authors used Generalized Least Squares (GLS) regression analysis. The panel data set consisted of 1206 year observations among 2007 to 2012 in 201 companies listed in Bursa Malaysia. The authors considered Tobin's Q for proxy of performance. It was found that CEO tenure, board meeting, and member of professional body had a significant negative relationship with performance but the authors failed to establish any relationship between percentages of non-independent directors and firm performance. Moreover, the authors investigated the impact of some control variables such as leverage ratio, and managerial shareholdings on firm performance. Some of the findings were consistent with previous studies but there were some others which were inconsistent with the previous studies. Overall, the findings indicate that the consideration of both board effectiveness and board experience characteristics play an essential role in better performance of companies. The results of this study should be of interest to practitioners and shareholders who want to ingeniously consider the impact of board characteristics on firm performance.

Keywords:- board characteristics, corporate governance, managerial shareholdings, Tobin's Q

I. INTRODUCTION

The crisis of 1997 forced Asian countries to improve their corporate governance mechanism, and disclosure levels (Ho & Wong, 2001). Following the poor performance of corporate governance, different scandals and failures have occurred for corporations and led to the creation of many losses for stakeholders. Along with this corporation's financial scandals, the board of directors seems to be the major blame for having the poor performance; therefore, to improve the performance of boards in corporations, the corporate governance reform was established (Salloum & Azoury, 2009). In today's modern corporation, the separation of ownership and control mechanism has led to conflict of interest. As a result, management follows its own self-interest and involves in activities which reduce the wealth of the stakeholders (Jensen & Meckling, 1976). Consequently, agency cost will arise and leads to reduction in value of a firm. In Malaysia, the Malaysian Code of Corporate Governance (MCCG) was established formally in 2000. Although in the area of corporate governance, a great number of useful researches have been done for shareholders and investors about the relationship of board of directors and firm performance, there are still some debates about these associations. Interestingly, in contrast to some studies which considered only the financial variables, in this study, the authors considered both financial and non-financial variables. The authors used Tobin's Q as a proxy to measurement of performance; moreover, they took into account a combined set of board characteristics as the board effectiveness which contained the percentage of independent non-executive directors and board meeting, and as the board experience which included CEO tenure, and member of professional body. In addition, the authors investigated the potential impact of some control variables such as leverage ratio, and managerial shareholdings on firm performance.

II. LITERATURE REVIEW

Despite the extensive literature about the association of board of directors' characteristics and firm performance, and the day-to-day progress in the area of corporate governance, there are still some inconclusive results in studies. Some facts from various empirical researches during the two decades support different

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suggestions about this issue. For instance, Kiel and Nicholson (2003) and Gompers, et al. (2003) found a positive link between board composition and firm performance. On the other hand, Chang and Leng (2004) reported that in Malaysian companies there was a negative relationship among ownership concentration, gearing ratio, board independence, and firm performance. As a result, the aim of present study is to explore the association between board characteristics and firm performance in another developing country, i.e. Malaysia. In a relation of corporate governance issue and board characteristics, leadership theories and different types of management have engaged the mind of some industrial psychology experts. What factor or factors cause some organizations to achieve significant levels of efficiency and profitability while other organizations are faced with problems? The answer can be found in leadership theories. Nowadays, several potentially useful models of leadership are emerging. The authors have mentioned some brief examples of leadership theories and they are as follows: Leadership traits theory: In this theory, it is believed that successful leaders have particular social leadership traits of personality, and characteristics. The results of the research have shown that, personality factors such as ability to communicate well with others can lead to have a crucial role in effective and successful leadership (Saatchi Mahmoud, 1995). Another famous theory is contingency theory of leadership which it is led by Fiedler with the purpose of giving comments on both leader character and the complexity of a situation. This theory implies that leader effectiveness depends on the interaction between the two factors. These factors include motivational and personality characteristics of a leader and the influence that a leader has on the situation of his or her control.

1. Board independence and firm performance

Specific attention of board independence comes from agency theory. It shows that by separation of control and companies ownership, incapability will arise. Generally, managers of corporations don't have enough equity to be motivated to turn their full attention to maximization of profits. Ararat et al. (2010) defined independent directors or outside directors as director who should not have any specific relationship with firm. Moreover, they stated that independent directors should not have any privileges and should not be the owner of more than 1% of shares in company. Consistently, in Malaysia, Malaysian Code on Corporate Governance and also listing requirements of Bursa Malaysia require that as a minimum, one third of boards of directors should be outside independent directors. A huge number of researchers have found that a higher level of proportion of non-executive director (NEDs) has positive impact on firm performance. Pye (2000) in UK research has shown that the percentage of outside directors is increasing more and more. Amusingly, similar event happen in the US stock market and market reacts positively on the appointment of outside directors (Rosenstein & Wyatt, 1990). In contrast, Hermalin and Weisbach (2003) presented a negative relationship between them. On the other hand, Trevor (2004) and Mace (1986) did not find any significant relationship between outside directors and firm performance. So, based on these literatures, NED's may have either strong positive or negative association or have not any significant association with firm performance.

H1: There is a positive relationship between the proportion of outside directors and firm performance.

H01: There is a negative relationship between the proportion of outside directors and firm performance.

2. Board meeting and firm performance

Board meeting is regarded as a significant factor in the area of effective corporate governance. Conger et al. (1998) reported that in improving the effectiveness of the board, the number of board meeting is an essential resource. MCCG in 2007 stated that when boards have meeting less than four times a year, it almost leads to ineffective board. Conversely, Lipton and Lorsch (1992) and Jensen (1993) argued that due to allocation of limited time on board meeting, directors cannot exchange their ideas significantly, so it reduces the effectiveness of the board. Therefore, board meeting is important for profit seeking as boards have extra time to discuss strategy setting.

H2: There is a positive relationship between board meetings and firm performance.

H02: There is a negative relationship between board meetings and firm performance.

3. CEO tenure and firm performance

Over the years, many questions have been raised on the effect of CEOs lifespan on a company and how that affects the performance of a corporation. The title of CEO carries much responsibility and accountability which makes it an ever expensive process in hiring one. Not too long ago, Brookman and Thistle (2009) examined the effect of firm's value on tenure and found that the superior related performance may increase as expected tenure increases. Studies carried out by Shen (2003) stated that the optimum occupancy which was correlated with returns of the shareholder was around eight years. An attentive board might help stabilize the protection of corporation-specific human capital in the chase of acquisitions of value-enhancing. Therefore, some scholar believe that when CEO tenure increases due to CEOs power by board selection and good choices

of investment, this will lead to decreases in CEO's termination risk. The clear results about impact of CEO tenure on firm performance are rare but according to above literature the authors hypothesize that:

H3: there is a positive relationship between CEO tenure and firm performance.

H03: there is a negative relationship between CEO tenure and firm performance.

4. Member of professional body and firm performance

Empirical study illustrates that being a member of professional body does matter in board. Australian Council of Professions defines professional body as occupation when the body which has been made for the specific goal contains essential practitioners in this field. They are usually non-profit organizations that are created for advanced particular profession, for the purpose of protecting the public interest and also professional's interests. Being a member of professional body is an essential element for members of the audit committee which finally leads to having a superior performance. There are many professional bodies in Malaysia such as: ACCA, ICAEW, MIT, MAICSA, and MICPA. Based on the statements of Bursa Malaysia Securities in paragraph 15.09, board's audit committee should have a minimum of one member of Malaysian Institute of Accountants (MIA). If none of them is a member of MIA, there are other obligations they have to follow such as having at least working experience of three years, or passing some specific examinations. In the global area, MIA is a part of the International Federation of Accountants (IFAC). It adopts the extent that is possible in the IFAC statements in Malaysia and supports the vocation of this body. Cohen et al. (2002) and Knapp (1987) believed that audit committee's essential role can be substituted by the roles of external auditors. Based on Abbott, Parker and Peters' (2004) reports audit committees' experience will reduce the probability of failure of the conditions that cause the restatement, this leads to last hypothesis:

H4: there is a positive relationship between the member of professional body and firm performance.

H04: there is a negative relationship between the member of professional body and firm performance.

III. RESEARCH DESIGN

In this research, based on the data of variables and by the use of Eviews software, the authors employed panel data with the purpose of finding the relationship between board of director's characteristics and firm performance through regression analysis. The Descriptive statistics test including standard deviation, mean, and variance were checked for each model.

The authors considered the following regression model:

$$Q \text{ Ratio} = \alpha_0 + \beta_1 \text{INDNED} + \beta_2 \text{BM} + \beta_3 \text{CEOT} + \beta_4 \text{MOPB} + \beta_5 \text{MOWN} + \beta_6 \text{LEV} + \varepsilon$$

Where Q Ratio (Tobin's Q) is market measurement as a proxy of performance; INDNED is the percentage of non-executive directors on the board; BM is the annual number of board's meetings; CEOT is the number of years that a person is positioned as a firm CEO; MOPB is coded '1' if board of director's member is a member of professional body or '0' if they are not; MOWN is the percentage of total shares outstanding held by officers and directors; LEV percentage of total debt to total assets of the company. The dependent variable in this study was Tobin's Q as the proxy for market return and firm performance. Q-ratio is calculated as the return of market value ratio plus book value of total debt to the book value of total assets. Kapopoulos and Lazaretou (2007) stated that Tobin's Q was the foundation for awareness of investors. Previous studies such as Yermack, (1996); Weir et al., (2002); Kiel and Nicholson (2003), examined the role of boards they have used Tobin's Q for measures performance. The board characteristics variables are proportion of independent non-executive directors on the board (INDNED), board meetings (BM), CEO tenure (CEOT), and the member of professional body (MOPB). Moreover, the authors considered the potential impact of some control variables which have been used in previous studies. The included control variables are managerial ownership or shareholdings (MOWN) and leverage ratio (LEV).

IV. EMPIRICAL RESULTS

1. Descriptive Statistics

Table 1 point out the descriptive statistics. The average of Tobin's Q is 0.680 with a minimum of 0.006 and maximum of 8.542. The average percentage of the non-executive director's (INDNED) is 0.418. Board meeting (BM) has a mean value of 5.055, CEO tenure (CEOT) has a mean value of 9.536 and the highest tenure in this sample is 43 years. Leverage ratio (LEV) has a mean value of approximately 0.297. In this sample the mean value of percentage of executive director's shareholders (EDSH) is 12.344 with highest range of 69.19. And the percentages of independent director's shareholders (IDSH) mean value is 0.305 with the highest range of 8.11. In the second part, the Member of Professional Body (MOPB) has a mean of 0.817.

Table 1: Descriptive Statistics

	Mean	Median	Maximum	Minimum	Std. Dev.
Panel A-Continuous Variables					
Q-Ratio	0.680838	0.446724	8.542986	0.006197	0.868221
INDNED	0.418769	0.4	5	0.142857	0.206042
BM	5.055348	5	27	0	1.732618
CEOT	9.536484	7	43	0	8.145966
LEV	0.297355	0.262795	2.889324	0.005252	0.210476
EDSH	12.34434	5.155	69.19	0	16.08578
IDSH	0.30557	0	8.11	0	0.816133
Panel B-Dichotomous Variables					
MOPB	0.817579	1	1	0	0.386352

2. Endogeneity Test

When the number of time series observations in each cross section is high, it is possible to investigate endogeneity for each of the cross sections. But, the efficiency of "Unit Root Test" (endogeneity) is extremely low when the data's duration period is short. Therefore, unit root test is essential to increase test's efficiency based on panel data. The common unit root tests are Augmented Dickey–Fuller test (ADF) is a test for a unit root in a time series sample (Greene, 1997) and also Phillips–Perron test. In addition, these tests have lower efficiency and also there is a bias to accept the null hypotheses. This problem will be intensified while the sample is small. One of the suggested methods to solve this problem is the use of panel series data to increase sample size and also testing for endogeneity in panel data. Consequently, before estimation of research model it is critical to test endogeneity of all the variables because the existence of a unit root in variables will lead to auto regression problems. So, it is vital to use at least one of these five methods for endogeneity testing, which are Levin, lin and chu test, Im, Pesaran and Shin test, ADF-Fisher Chi-square test and PP-Fisher Chi-square test, and also Hadri test. Except Hadri method the investigation of endogeneity for all of the methods are same and with rejection of H0 hypothesis the unendogeneity will be rejected and the endogeneity will be accepted and in a situation of at the level, with one difference, or with two differences it will become endogenous. For identification of this section the focus should be on their probability results, which should be less than five percent. In this study to investigation of existence of unit root in variables, three tests are used. According to Table 2 the statistics amount and their acceptance probability have shown that, all the variables except CEOT and IDSH become endogenous at level, but these variables become endogenous with two differences.

Table 2: Results of Endogeneity Test

Variables	PP - Fisher Chi-square		ADF - Fisher Chi-square		Im, Pesaran & Shin W-stat		Levin, Lin & Chut	
	Prob. level	t-Statistic	Prob. level	t-Statistic	Prob. level	t-Statistic	Prob. level	t-Statistic
Q-Ratio	0.000	173.066	0.000	137.347	0.000	15.48-81	0.000	26.326-4
INDNED	0.000	152.375	0.000	109.8634	0.000	27.56-34	0.000	100.8-67
BM	0.000	190.187	0.000	103.067	0.000	6.76-18	0.000	32.567-7
CEOT Second difference	0.0047	53.3053	0.1588	412.800	0.1211	1.301-60	0.000	5.990-64
MOPB	0.000	184.077	0.000	148.458	0.000	16.59-92	0.000	37.437-5
LEV	0.000	162.485	0.000	117.563	0.000	28.79-84	0.000	111.6-43
EDSH	0.000	82.4796	0.000	79.3009	0.000	3.301-14	0.9747	1.95451
IDSH Second difference	0.0026	69.5565	0.1070	51.3905	0.1110	1.221-42	0.000	8.599-56

3. GLS Regression Results

The most usual and simplest way for linear regression models is using ordinary least squares method (OLS). After doing OLS, if the statistical tests leave approval on violations of one classical assumption, the authors are not allowed to use OLS to estimate the value of the model any more. In this condition, they should change the method of estimation. If the authors observe autocorrelation or differences in variance, they can use the method of generalized least squares (GLS) to estimate coefficients. Table 3 presents the fixed effects GLS results that evaluate the impact of board of directors' characteristics on firm performance. By considering Q-ratio in the model, the authors find that the coefficient of (INDNED) is -0.032. According to T-Statistic of this independent variable and p-value of 0.2512, the results indicate that the correlation is insignificant at 0.05 level of probability. It means that there is no significant relationship between (INDNED) and firm performance. In the case of board meeting, there is a negative sign of T-Statistic in the model which implies that board meeting has a significant negative relationship with Q-Ratio, at p-value of 0. So, this result is consistent with H02 hypothesis which emphasizes that there is a negative relationship between board meeting and firm performance. The association of CEO tenure (CEOT) and performance shows that p-value is less than 0.05, and the sign of T-Statistic is negative; therefore, there is a significant negative relation between CEO tenure and firm performance in this model. So, the H03 hypothesis is supported. Similarly, p-value of member of professional body (MOPB) is 0.0006 and the sign of T-Statistic is again negative, so there is a significant negative relationship between MOPB and Q-Ratio. In addition, based on the results of GLS regression in Table 3, it is clear that the amount of p-value related to Prob (F-Statistic) indicate the significance of the whole regression is equal to 0.000, this implies that the model in the level of 99% is significant. Moreover, the value of Adjusted R-squared is 0.881 it means that at least 88% of variation in Q-Ratio can be explained by all independent variables. Similar to the most of scholars who used Durbin –Watson to understand the lack of autocorrelation between variable, the Durbin –Watson in below table is 1.40. If this statistic is in range of 1.5 to 2.5, it means that H0 of test means lack of autocorrelation between residuals, therefore it is accepted. Otherwise, H0 is rejected meaning it is acceptable that there is a correlation between residuals. According to these statistics, the authors can state that in this model the lack of autocorrelation is acceptable between residuals. Also, it means that there is no autocorrelation problem in model.

Table 3: Results of GLS Regression

Q-Ratio			
Independent Variables	Coefficient	t-Statistic	Prob.
Board Effectiveness Variables			
INDNED	-0.032105	-1.148005	0.2512
BM	-0.012355	-6.494828	0.0000
Board Experience Variables			
CEOT	-0.012862	-9.312172	0.0000
MOPB	-0.052343	-3.447416	0.0006
Control Variables			
LEV	-0.443574	-10.61059	0.0000
EDSH	-0.002055	-2.658978	0.0080
IDSH	-0.014714	-2.015090	0.0442
Period Fixed (dummy variables)	Yes		
R-squared	0.902095		
Adjusted R-squared	0.881313		
Prob (F-Statistic)	0.000000		
Durbin -Watson	1.406092		

V. CONCLUSION

According to recent scandals and failures of some corporations around the world, the impact of board effectiveness and experience was motivated with different interests. Most of the countries pay a considerable attention to the transparency and accountability of corporations, so this matter caused the creation of some regulations in the case of corporate governance and its related issuing principals and codes. Based on this assumption, these guidelines would lead to superior performance on corporations. Due to continuous importance of board of director, in this study the authors examined the effects of some boards of director's characteristics on firm performance in Malaysia. The authors found that board meeting was negatively and significantly associated with Tobin's Q. Similar to their result, Nikos Vafeas, (1999) stated that there was a negative association between board meeting and firm performance. In the case of CEO tenure, the result of this study implies that CEO tenure has a significant negative relationship with firm performance. This result is in line with the findings of Bruce, Walters, Kroll and Wright (2007) who stated that there was a strong negative association between CEO tenure and firm performance. Similarly, the authors found that the presence of directors who were the member of professional body were negatively associated with Tobin's Q. The authors found that leverage ratio is the strongest determinants of board characteristics and there is a significant and negative correlation between leverage ratio and Tobin's Q. Similarly, Leng and Abu Mansor (2005) in a study in Malaysia found that borrowing had a negative effect on earnings and performance of Malaysian firms. Moreover, this finding was consistent with the findings of McConnell and Servaes (1990) and also Khanna and Tice (2005) who stated that the larger leverage ratio led to the poorer performance of corporations. The authors found remarkable results from the impact of managerial shareholdings on firm performance. The percentage of executive directors' shareholders and also independent directors' shareholders show a significant negative relationship with firm's performance. Similar to the findings of Cho (1998) who found that percentage of independent directors' shareholders had a strong negative association with Tobin's Q. Overall, the results of this study imply that obviously board of director's effectiveness and experience characteristics have major impact on firm performance. However, in other study, one can obtain different consequences by considering the contingency situations. Finally, the association between board characteristics and performance in different countries is different and dependent on the situation and method of the performance measurement.

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