

## Corporate Governance, International Diversification and Organizational Performance: A Study on Malaysian Property Industry

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### Abstract

Currently, the housing sector is one of the Malaysian government's main concerns as it is continuously facing various problems. This sector is endlessly struggling with enormous difficulties that have caused negative implications to the industry's performance. Since a well governed corporate governance is said to be associated with better company performance, a number of corporate governance mechanisms are being employed in this study so as to test on their impact on the firms' performance. Independence of board of directors (BOD) and audit committee (AC) members, non-duality and frequency of board meetings held per annum are among the CG mechanisms tested in relation to the firms' performance, Tobin's Q. The three-year period (2013-2015) data is taken from the annual reports and Thomson Reuters Data stream for all the companies in the property industry in Bursa Malaysia. Number of board meetings, CEO/Chairman non-duality, Independence of BOD members. These empirical evidences from this study would enhance the importance of incorporating corporate governance mechanisms and international diversification in relation to organizational performance for property industry.

**Keywords:** Corporate governance; Organizational performance; Property industry; International diversification.



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### 1. Introduction

The vast number of corporate scandals, such as Enron, Tyco and HealthSouth, have caused large scale of workers retrenchment, huge investment losses to the shareholders and have encouraged massive white collar crimes that led to enormous record-breaking bankruptcy filings (Solomon, 2010). Thus, in such chaos business situations, engaging corporate governance mechanisms is of importance as a well-governed corporate governance is said to be associated with better firm performance Core *et al.* (1999).

The Malaysian property industry especially the housing sector is the local government's main concern as it is continuously facing various problems. Ever since two decades ago, this sector has struggled with enormous difficulties such as frequent quality defects complaints, and overdue, sick or abandoned projects. These incidences have caused negative implications to the industry's performance which simultaneously has tarnished their image severely. In fact, the house buyers are also facing hardship too. For instance, in 2015, for the period up to 31 March 2015, it was reported that there were 39,070 housing schemes which could not be completed as per scheduled due to delay and sick projects involving 15,206 units of houses involving 10,403 buyers. Accordingly, the Ministry of Urban Wellbeing, Housing and Local Government has blacklisted 1004 developers and 4005 individuals who were serving as directors in the companies that were involved in delayed and abandoned projects. (<http://ehome.kpkt.gov.my/index.php/pages/view/43>). Despite the fact that these abandoned projects may be caused by the unpredictable market situations and economic uncertainty, such as increment in the costs of building materials and labor, there are also huge number of cases where the developers have themselves to be blamed for most of the problems that have happened.

Since good practice of corporate governance by management can enhance transparency and thus, improve firm's financial performance (Ong, 2014), therefore the purpose of this study is to identify the relationship between the mechanisms of corporate governance and firm performance particularly in the property industry.

The article starts off with Section 2.0 that deliberates on background and hypotheses development. Section 3.0 then highlights the research methodology being employed. This is followed by Section 4.0 that elaborates on the results and discussion, and it ends with Section 5.0, the conclusion.

## 2. Background and Hypotheses Development

In Malaysi, Minority Shareholder Watchdog Group (MSWG) was formed in 2000, mainly to promote good corporate governance practices in the capital market and also to safeguard the interests of minority shareholders. Further, (Malaysia Code on Corporate Governance, 2000) (MCCG 2000) was introduced and it emphasized on the risk management and the responsibilities of the board of directors to achieve proper balance between risk and return to shareholders (Ghazali and Manab, 2001). In 2007, the code has been revised where it focused more on strengthening the board of directors, audit committee and internal audit function (Abdifatah and Sanni, 2015). This is then followed by the issuance of MCCG 2012 that superseded the (Malaysia Code on Corporate Governance, 2007) and the latest review being the (Malaysia Code on Corporate Governance, 2017), so as to ensure that it remains relevant in the current globalized and borderless economy environment. Among the corporate governance mechanisms taken into consideration in this study include:

### 2.1. Board Meetings

Corporate board meetings play a crucial role in the governance, conformance and performance of the firms (Jensen, 1993; Noor Afza and Al Damrat, 2014). According to Wijethilake *et al.* (2015), regular board meetings would facilitate board of directors to observe effectively as they become more conversant and closer to the firm's activities. During these meetings, they could enhance their information processing and improve their interaction among themselves as well as with the company's managers (Eisenhardt, 1989). Hence, it is hypothesized that:

H1: Firm performance is positively related to board meetings.

### 2.2. CEO/Chairman Non-Duality

Bhuiyan (2015), states that firms that are having CEO/chairman duality would be confronting greater number of difficulties. This is because when the CEO himself is to monitor his own activities and decisions, then the board would be less effective because the dominant CEO would have a say towards the directors' independence (Bliss, 2011). Hence, it is hypothesized that:

H2: Firm performance is positively related to CEO/Chairman non-duality.

### 2.3. Independence of Board of Directors

Independent non-executive director is free from being economically dependent on the company and from the influence of firm's management (Gaur *et al.*, 2015). Hence, his presence would be effective in monitoring the management's activities (Fama and Jensen, 1983). Thus, it is hypothesized that:

H3: Firm performance is positively related to the independence of board of directors.

### 2.4. Independence of Audit Committee

Wijethilake *et al.* (2015) highlight that the audit committee size and its independence are beneficial to shareholders as their presence facilitates a reduction in information asymmetry between owners and managers (Donnelly and Mulcahy, 2008). However, by having outsiders on the board is not beneficial as these outsiders do not have enough knowledge of the strengths and weaknesses of the firm to provide useful direction (Shamsudin *et al.*, 2015); (Gaur *et al.*, 2015); (Davis *et al.*, 1997). Hence, it is hypothesized that:

H4: Firm performance is positively related to the independence of audit committee.

### 2.5. Control Variables

The control variables included in this study are firm size and international diversification.

Firm size: According to Tongli *et al.* (2005) as quoted by Mohd Tahir and Razali (2011), firm size is related to firm performance. This is because larger firms could increase their current size rapidly due to past performance.

International diversification: A company is said to be diversifying internationally when it ventures into business operations in several countries (Yazid *et al.*, 2012). International diversification has both benefits and costs associated to it. Prior studies have shown that firms experience benefits like economies of scale and scope, increase in market power over buyers and suppliers, and organizational learning through exploration (Wiersema and Bowen, 2011). These benefits increase with the increasing scale of international diversification and firms experience higher performance with increasing scale of international operations. On the other hand, there are costs related to liabilities of foreignness such as costs associated with learning about foreign markets and seeking legitimacy in different institutional environments (Kostova and Zaheer, 1999).

### 2.6. Organizational/firm Performance Via Tobin's Q

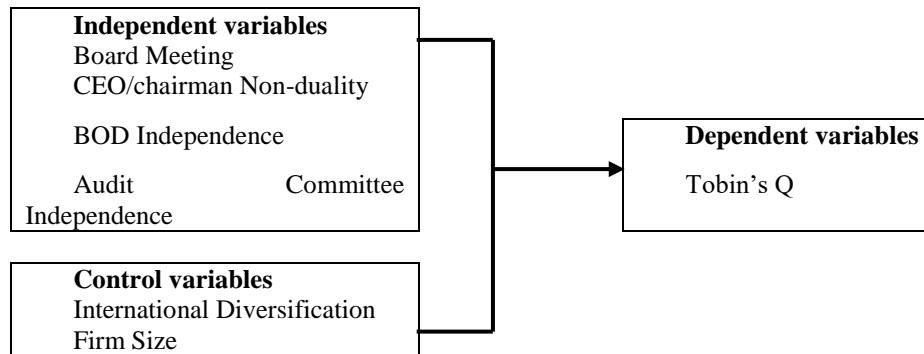
Tobin's Q is the most popular tool to measure firm value or firm performance (Mohd Tahir and Razali, 2011). This measurement is used in the traditional economic theory which measure the percentage of firm's market value (i.e. assets) to the replacement cost of the firm's assets. It is a market value based measure of performance which is

measured as the ratio of sum market value of equity plus total debt divided by book value of total assets (Shamsudin *et al.*, 2015). Tobin's Q measures the market's valuation of the quality of a firm's corporate governance practices, with a higher Q suggesting greater effectiveness of a firm's practices (Conheady *et al.*, 2014).

### 3. Research Methodology

This research studies on the impact of corporate governance mechanisms, i.e. board meeting, CEO/chairman non-duality, independence of board of directors (BOD) and independence of audit committee onto the firm performance of property companies in Malaysia. Therefore, the theoretical framework proposed for this study is as follow:

**Figure-1.** Theoretical framework for impact of corporate governance mechanisms on organizational performance of Malaysian property companies



#### 3.1. Description of Data Collection

The sample firms used in this study are drawn from the property companies listed in the Main Market of Bursa Malaysia. The observation period for this study is chosen from the last three years, starting from 2013 until 2015. From the population of 79 companies, 15 companies are excluded due to unavailability of data and thus resulted in 64 sample companies. This study uses secondary data. Information on mechanisms of corporate governance are collected from respective companies' annual reports, available at Bursa Malaysia's website. While the financial information of these companies is obtained from the data stream.

**Table-1.** Sample Selection Process

	Firm year	Percentage
Initial samples (79 x 3 years)	237	100
Less:		
Missing data (15 x 3 years)	(45)	18.99
Final sample	192	81.01

#### 3.2. Multiple Regression Model

The selected corporate governance mechanisms acting as the independent variables are, board meeting (BMEET), CEO/chairman non-duality (NDUAL), proportion of independent non-executive directors on the Board (BINED) and proportion of independent non-executive directors in audit committee (ACINED). The dependent variable is Tobin's Q which is employed as a proxy for the market performance. International diversification (ID) and firm size (CSIZE) are used as the control variables for this study. For the purpose of this research, the following regression model is developed:

$$\text{Tobin's Q} = \beta_0 + \beta_1\text{BMEET} + \beta_2\text{NDUAL} + \beta_3\text{BINED} + \beta_4\text{ACINED} + \beta_5\text{ID} + \beta_6\text{CSIZE} + \varepsilon$$

Where,

**Table-2.** Measurement of Variables

Variables	Definition	Operationalization
BMEET	Number of board meetings annually	Number of board meetings
NDUAL	None existence of duality role of chairman and chief executive officer	'1' for companies that have non-duality and '0' for otherwise.
BINED	Independent non-executive director (INED)	'1' for companies that have at least one third of the board members being INED and '0' for otherwise.
ACINED	Independent non-executive director in the audit committee (AC)	'1' for companies that have at least two-third of the AC members being INED and '0' for otherwise.
ID	International diversification	'1' for companies that have international investment and '0' for otherwise.
CSIZE	Firm size	Log total assets of the company
Tobin's Q	Fair value of stock market	market value of equity plus the book value of debt divided by the book value of total assets

## 4. Results and Discussion

This section follows the following flow of discussion: firstly, the descriptive analysis; secondly, the correlation analysis, and thirdly the regression analysis.

### 4.1. Descriptive Analysis

Table 3 presents the descriptive statistic of the variables used in this study. Based on the sample of 64 firms, the minimum and maximum of the Tobins Q are 0.00036 and 0.68564, respectively. In average, almost all companies (97%) have fulfilled requirement of independence of audit committees and independence of board of directors. This is in line with recommendation in the MCCG. The results also show that 72% of the samples apply non duality role for their Chairman, which indicate only 28% of the companies are served by the same person as for the Chairman and Chief Executive Officer (CEO). This is in line with requirement of MCCG that requires the positions of Chairman and CEO should be held by different individuals, and the Chairman must be a non-executive member of the board. With regard to the number of board meetings, the minimum number of the meeting is two while the maximum is ten. For international diversification, half of the companies are involved in foreign investment which represent by 52% in average. Having high percentage of board and audit committee independence and non-duality, as well as holding regular board meetings, minimum of two, would be a consolation to the shareholders.

Table-3. Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
TOBINSQ	0.00036	0.68564	0.20924	0.15079
ACINED	0.00000	1.00000	0.97000	0.16000
NDUAL	0.00000	1.00000	0.72000	0.45100
BMEET	2.00000	10.00000	5.32000	1.29400
BINED	0.00000	1.00000	0.97000	0.16000
ID	0.00000	1.00000	0.52000	0.50100
CSIZE	5.13099	7.21209	6.01400	0.45459

### 4.2. Correlation Analysis

The Pearson Correlation is conducted to identify the degree of the correlation exist between the variables. The low correlation between independent variables suggests that there is no multi-collinearity exists between the variables since none of the variables correlate above 0.50.

### 4.3. Regression Analysis

Table 4 reports the adjusted R<sup>2</sup> for the model as 20.3%, implying that the model is able to explain 20.3% of the total variance in the firm performance (Tobin's Q). The overall explanatory power for the defined model was statistically significant at 1% level (p-value 0.000). Further, for corporate governance mechanisms, CEO/Chairman non-duality (NDUAL) is significant (p<0.05), while numbers of board meetings held annually (BMEET) and the presence of independent non-executive director in the board (BINED) are significant (p<0.1) and positively correlated to firm performance. In contrast, it can be seen that audit committee independence (ACINED) is significant (p<0.05) and negatively correlated to the firm performance. As for control variables, both variables; international diversification and firm size are significant (p<0.05) and (p<0.01) respectively, and are positively related to firm performance.

From the regression analysis, all H1, H2 and H3 are being supported. H1 states that there is a positive relationship between number of board meetings held annually and firm performance. As hypothesized, the study found a positive and significant relationship indicating that by having regular board meetings, it would enable the board of directors to be well versed with the firm's activities (Wijethilake *et al.*, 2015) as well as with the actions taken by company's managers (Eisenhardt, 1989). As such, corrective measures could be taken when needed, and as a result, the interest of the owners, i.e. obtaining annual positive organizational performance, is being achieved.

Further, H2 indicates there is a positive relationship between CEO/chairman non-duality and firm performance. As hypothesized, the study found a positive and significant relationship between the two variables, supporting agency theory that states by splitting the roles of CEO and chairman, it would assist in separating the managerial decision from that of control decision. The presence of this job segregation allows better transparency in the running of the firms' activities. Thus, this would reduce the degree of conflict of interests between the agent, managers, and the owners, shareholders, and provide better clarity in the direction of the firm (Bhuiyan, 2015); (Bliss, 2011) via obtaining better organizational performance.

Additionally, H3 also reports a positive relationship between the board independence (BINED) and firm performance. As hypothesized, the study found a positive and significant relationship between these variables. The result shows that indeed being economically independent, and free from the influence of firm's management (Gaur *et al.*, 2015), their presence would be effective in monitoring the management's activities (Fama and Jensen, 1983) in achieving positive organizational performance.

Table-4. Regression results when Tobin's Q is the dependent variable

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-.544	.216		-2.513	.013
BMEET	.017	.010	.107	1.626	.106 * <sup>b</sup>
NDUAL	.065	.030	.147	2.215	.028** <sup>b</sup>
BINED	.146	.089	.116	1.650	.101* <sup>b</sup>
ACINED	-.200	.090	-.160	-2.222	.027** <sup>b</sup>
ID	.050	.030	.124	1.668	.097** <sup>b</sup>
CSIZE	.141	.032	.319	4.377	.000*** <sup>a</sup>
R-squared	0.228				
Adjusted R Square	0.203				
F-statistic	9.101				
P-value	0.000***				

Dependent Variable: NTOBINSQ

\*\*\* Significant at 0.01 level; \*\* Significant at 0.05 level; \* Significant at 0.10 level; a = one-tail-test; b = two-tail-test

As for H4, it investigates the association between the proportion of independent directors on audit committee and corporate performance. Contradict with the hypothesis, results reveal a negative significant relationship correlation. Thus, H4 is not supported. The result supports the stewardship theory that argues against having outsiders on the board as they do not have adequate knowledge concerning the firm to provide useful directions (Gaur *et al.*, 2015); (Davis *et al.*, 1997).

As for the control variables, both international diversification (ID) and firm size (CSIZE) have significant and positive associations with firm performance. With  $p < 0.05$  and  $p < 0.01$  respectively, these evidences indicate that larger firm size is able to generate better firm performance (Tongli *et al.*, 2005) and experience benefits via internationalization (Wiersema and Bowen, 2011). Hence, with the current scenario of globalization and borderless economy, indeed large organizations with international diversification would reap better organizational performance.

## 5. Conclusion

Property industry especially housing sector is very important as it provides homes to the society. Practising good corporate governance is a must for firms that are involved in this industry so as to ensure that their projects would be completed on time as per schedule and this in return would also benefit them in terms of their firm performance. In this study, the corporate governance mechanisms tested against the firm performance (Tobin's Q) are board meeting, non-duality role of chairman and CEO, the proportion of independent non-executive directors on the board and also the proportion of independent non-executive directors on the audit committee. Firm size and international diversification are used as the control variables. Overall, based on the aspect of corporate governance mechanisms investigated in this study, it can be concluded that in Malaysian property industry, number of board meetings held per year, separation of CEO and chairman responsibilities, i.e. non-duality and having board independence are important mechanisms that could assist in having good organizational performance. In fact, firm size and international diversification are found to be positively related to organizational performance too. However, this study is not without any limitations. Future study could include more corporate governance mechanisms to identify other mechanisms of corporate governance that would enhance the organizational' performance of property developers.

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