



Improving Shareholder Value through Corporate Governance Mechanism in Malaysian Listed Companies

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ABSTRACT

This paper proposes to investigate the postulations of renowned agency theory and shareholder value (SHV) in relation to corporate governance (CG) attributes. SHV is of a great concern to the shareholders of firms. SHV have been investigated by numerous studies of CG but with inconsistent empirical evidence. This study will focus on investigating the impact of CG attributes on SHV measured by Tobin's Q or return on both equity and assets. The paper conceptualized four attributes (Separate leadership, proportion of Independent director, independent chairman, independence of nomination committee) from CG mechanism in relation to SHV in companies listed on BURSA Malaysia. This is a conceptual paper which proposes to investigate the relationship between SHV and separate leadership, SHV and proportion of independent director, SHV and independent chairman, SHV and independence of nomination committee in the context of Malaysia. The proposed study has value for Malaysian government, policy makers, corporate boards, stock exchange and shareholders by highlighting the distinct impact on SHV and its relation with separate leadership, proportion of independent director, independent chairman, and independence of nomination committee.

Keywords: Shareholder Value, Corporate Governance Mechanism, Bursa Malaysia

JEL Classification: G34

1. INTRODUCTION

After the collapse of Enron (2001), WorldCom (2002) and recent financial and economic crises respectively, investors, stakeholders and shareholder lost their confidence which increased the issue of shareholder value (SHV). This issues of SHV, increasing rapidly during the last two decades throughout the world and especially in developed countries like UK, US and Australia, etc. With the opening up of free trade concept and liberalization, the concern for SHV also spread to the developing and emerging countries like Malaysia. A lot of focus has been given from time to time to control the massive governance problems and to come out with good corporate governance (CG) solutions for increasing the SHV.

Good CG is a setup which, enhance equity, transparency and, firm overall performance to the stakeholders. CG leads to maximize the value of the shareholders legally, ethically and on a sustainable basis (Murthy, 2006). It is argued that CG most important functions

is to ensure the quality of overall firm financial performance and thus maximizing the SHV. As CG environment varies from country to country and from firm to firm (Farber, 2005). That is why most of the countries, including Malaysia have laid down their own Malaysian Codes CG (MCCG) (2000; 2007; 2012) CG mechanism to look for suitable opportunities in order to maximize their SHV.

The main objective of this study is to investigate whether internal CG mechanisms such as separate leadership, proportion of independent director, independent chairman, and independence of nomination committee affect SHV or not. The underpinning theory for governance studies is agency theory because it can be used and applied in the area of value maximization and CG (Maseda et al., 2012). Therefore, in this proposed study, the monitoring role of separate leadership, proportion of independent director, independent chairman and, independence of nomination committee are argued to increase the firm financial performance and thus SHV.

2. LITERATURE REVIEW

2.1. CG Mechanism

CG broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed. According to James Wolfensohn, President of the World Bank: "The governance of companies is more important for world economic growth than the government of countries." CG mechanism is an effective monitoring devices for constraining illegal activities and improving shareholder wealth (Hashim and Devi, 2007). The linkages between SHV and CG attributes is important because investors and creditors may wish to invest in firms with good governance to reduce their costs of capital and increase the firm value (Ali Shah et al., 2009). Thus, CG mechanism is like a monitoring system (Gul et al., 2003), which helps in improving the overall performance of the firm (Watts and Zimmerman, 1986), and is linked with firm overall financial performance and SHV (Gul et al., 2003).

CG continues to be an area of importance while SHV still appears to be a problematic issue. It is suggested that for gaining higher financial performance and SHV, the importance of CG cannot be ignored. Studies in developed countries investigated the impact of CG mechanisms on SHV and firm financial performance and found a very effective role of CG mechanism on SHV (Hillman and Keim, 2001). It is important to note that effective CG system is necessary to restore investor's confidence (Shen and Chih, 2007), because it maximize the SHV (Ali Shah et al., 2009). Hence, a common belief is that effective CG mechanism may assist in maximizing the SHV. Therefore, CG mechanism is frequently seen as a major device to minimize the wrong decision and maximize the shareholder wealth.

2.2. SHV

SHV is the value delivered to shareholders due to successful business operation and management's ability to grow earnings, dividends and share price (Stout, 2013). Shareholder primacy theory state that corporations were owned by their shareholders; that directors and executives should do what the company's owners/shareholders wanted them to do; and that what shareholders generally wanted managers to do was to maximize "SHV," measured by share price (Hillman and Keim, 2001).

Increasing the SHV is of prime importance for the management of a company. The management must have the interests of shareholders in mind while making decisions. The higher the SHV, the better it is for the company and management. For this to happen, CG mechanism is considered the most important devices for monitoring the firm financial performance and increasing the SHV (Shen and Chih, 2007).

Therefore, this study have focused on the impact of CG mechanism (separate leadership, proportion of independent director, independent chairman, independence of nomination committee), as part of CG mechanism, and relate them to corporate performance and SHV. Study conducted on the relationship of CG mechanism yield mixed result for instance, empirical results indicate that separate leadership is positively related to the SHV but this

finding is incongruent with most empirical studies in developing economies (Pfeffer, 1973). Similarly, proportion of independent directors is also positively related to SHV which support the finding and arguments of Saleh et al. (2005), that large proportion of independent directors have a positive relationship with firm performance while opposing the finding of Benkel et al. (2006). Empirical results shows that independent chairman plays a very positive role in SHV maximization and firm financial performance. Alternatively, outside directors is negatively related to the firm performance.

Finally, many studies suggest that nomination committee can affect the SHV negatively (Lang and Stulz, 1993). Hence SHV seen as a major concern by the investor, shareholders and stakeholder.

3. RESEARCH OBJECTIVES

- To analyze the association between separate leadership and SHV
- To analyze the association between proportion of independent directorship and SHV
- To analyze the association between independent chairmanship and SHV
- To analyze the association between independence of nomination committee and SHV.

4. RESEARCH QUESTION

This main question of this study is to examine that "What is impact of internal CG mechanism (separate leadership, proportion of independent directorship, independent chairmanship, and independence of nomination committee) on SHV?"

The following conceptual framework is developed based on the above discussion to examine the relationship between CG mechanism (separate leadership, proportion of independent director, independent chairman, and independence of nomination committee) and SHV. The links between CG mechanism and firm financial performance are illustrated in Figure 1.

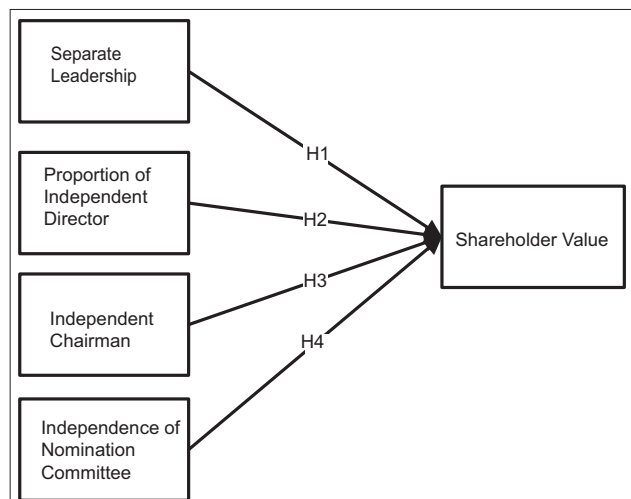
In the above conceptual framework, SHV is a dependent variable, while CG mechanism (separate leadership, proportion of independent director, independent chairman, and independence of nomination committee) are independent variables respectively. The proposed study concentrate to fill the gap by providing the basic concepts, relation, and impact of CG mechanism (separate leadership, proportion of independent director, independent chairman, and independence of nomination committee) on firm financial performance.

5. HYPOTHESIS OF THE PROPOSED STUDY

5.1. Separate Leadership and SHV

Agency theory postulates that separation of decision and control functions of the board is an effective monitoring device of managers for better performance of firms (Fama and Jensen, 1983).

Figure 1: Corporate governance internal mechanisms and shareholder value conceptual framework



Hence, agency theory is applicable to board leadership structure in relation to SHV (Daily and Dalton, 1997). By separation of leadership we mean, that chairman cannot perform dual role as a chairman as well as a chief executive officer (Shakir, 2009). Based on MCG (MCG, 2012), recommendation “The positions of chairman and CEO should be held by different individuals and the chairman must be a non-executive member of the board.”

Empirical findings showed mixed and inconclusive relationship between leadership structure and SHV (Dulewicz and Herbert, 2004; Weir and Laing, 2000; Weir et al., 2002). For instance, Rechner and Dalton (1991) found that firms with the separate board leadership structure increase value and performance. Similarly in line with previous, separate leadership has a positive and significant relationship with SHV (Marn and Romuald, 2012; Bhagat and Bolton, 2008). But on the other hand, firms with separate leadership yield lower SHV (Dey et al., 2011), and thus there is negative relationship between separate leadership and firm performance (Ponnu, 2008). Furthermore, dual role of chairman has a negative impact on maximizing SHV and overall firm performance (Jackling and Johl, 2009; Yusoff and Alhaji, 2012). Whilst, in contrast to previous lines duality has no negative impact on SHV (Shukeri et al., 2012).

Hence, upon reviewing the literature, it can be concluded that there is inconclusive, mix, and unclear empirical findings regarding the relationship between separate leadership and SHV which necessitate its further investigation. Therefore, based on agency theory, the author proposes and support further empirical investigation of the relationship between separate leadership and SHV through following hypotheses:

H1: Separate leadership has positive association with SHV.

5.2. Proportion of Independent Director and SHV

Agency theory advocate that, an independent board of director is more likely to be vigilant for agency problems and is dedicated to monitor management performance and behavior for maximizing the SHV (Fama and Jensen, 1983). Similarly, the MCG

(MCG, 2000; 2007; 2012) recommends “ensuring the value and effectiveness of independent director on the board of the company.”

Research conducted on the relationship between proportion of independent director and SHV yield mixed and inconclusive results. For example, Panasian (2003), stated that if proportion of independent director on board increased then it will be more beneficial for firm agent principal problem and SHV. Thus, independent director is positively correlated with SHV of the firm (Rosenstein and Wyatt, 1990).

Similarly, studies conducted in US, Australia, Europe and Pakistan also suggested the same positive correlation between independent director on the board and SHV (Ritchie, 2007). Furthermore, other empirical studies also support that for increasing overall firm value the director independence is utmost important and cannot be ignored (Peasnell et al., 2005; Agrawal and Knoeber, 1996; Baysinger and Butler, 1985). Therefore, recent research shows a positive relation between independent director on the board and SHV (Coombes and Wong, 2004; González and García-Meca, 2014).

But on the other hand, Klein (2002) and García Lara, Osma et al. (2007) supported that independent director on the board have a negative impact on shareholder wealth. It is also argued that in many cases independent director on the board tend to be related to fraud which in turn reduce the SHV (Beasley, 1996). Similarly, another study also found a negative relation between board independence and shareholder’s wealth (Bhagat and Black, 2000; Linck et al., 2008). While Postma (2001), found no relation in between independent director on the board and SHV.

At the end it can be argued that studies concerning the effect of independent directors on shareholders’ value come to no end. Hence based on agency theory and above inconclusive literature the author support and develop the following hypothesis;

H2: Independent director has a positive impact on SHV.

5.3. Independent Chairman of the Board and SHV

The standard principal-agent model suppose that chairman independence is important for minimizing the agency problem which effect the overall performance and SHV of the firm (Fama, 1980). Similarly, based on the recommendation of MCG (MCG, 2012), “The positions of chairman and CEO should be held by different individuals and the chairman must be a non-executive member of the board.” There is always a positive response from stakeholders if a firm announce independent chairman of the boards (Balsam et al., 2011b; Coles and Hesterly, 2000), because firms can be effectively monitor through an independent chairman of the board (Alkdai and Hanefah, 2012).

Upon reviewing the literature some evidence support the hypothesis that independent chairman on board is improving SHV; some got the result that an independent board had a reversely impact on management performance and SHV, other evidence suggest there is no significant relation.

Thus, previous empirical finding about the relationship of independent chairman and SHV provide inconclusive and mixed result. For example, according to Coles and Hesterly, (2000), agency problem will be a big issue in the absence of independent chairman of the board (Balsam et al., 2011b). While, on the other hand, separate chairman of the board has less value in firm financial performance and SHV (Jackling and Johl, 2009). Further added that outside independent chairman of the board is costly than that of its value creation (Balsam et al., 2011a).

Therefore, based on agency theory and inconclusive mix result we shall further try to explore the relation between independent chairman and SHV to see if our conclusion is consistent with any of the above results. Thus, based on the above discussion the author develop and support the following hypothesis;

H3: Independent chairman has a positive impact on SHV.

5.4. Independence of Nomination Committee and SHV

Agency theory suggests that the major function of a board is to monitor firm management. Nomination committees can play a vital role in enhancing board members independence and reducing the influence of management (Westphal and Zajac, 1995; Cotter and Silvester, 2003). Thus, nomination committee independence is more likely to be watchful for agent and principal conflict which in turn will increase the overall firm value. The MCGG (MCCG, 2000; 2007; 2012) also highlight the importance, value and effectiveness of the nomination committee independence.

Research conducted on the relation between nomination committee independence and SHV provided mixed and inconclusive results. For example, there is a positive relationship in between independence of nomination committee and SHV (Golden and Zajac, 2001; Shivdasani and Yermack, 1999). Similarly, independence of nomination committee will improve firm financial performance and SHV (Cotter and Silvester, 2003; Chhaochharia and Grinstein, 2009).

But on the other hand there is a negative effect of nominating committee independence on SHV (Vafeas, 1999). Furthermore, Beasley (1996), also find the same negative correlation in between independence of nomination committee and SHV.

Hence upon reviewing the literature, we found different result some evidence support that nomination committee have an positive impact on SHV; some study postulating that independence of nomination committee have no significant impact on SHV while other got the result that an independent nomination committee on board had a reversely impact on the overall performance of the firm. Thus, the relation between nomination committee independence and SHV has been examined in numerous studies but provide a mixed result.

Accordingly, in keeping with our prior literature, we expect that if an independent director is a member of the nomination committee, this will have a positive impact on the SHV. Therefore, based on agency theory and previous mix empirical findings discussed above the author develop and support the following null hypothesis;

H4: Independence of nomination committee has a positive impact on SHV.

6. SCOPE AND METHODOLOGY OF THE STUDY

The proposed study uses sample size comprises of 320 firms listed on Malaysia stock market, during the period 2010-2013. The study selects these firms for their relevance in Malaysian economy. Financial institutions and insurance firms are excluded, as is common in this type of studies because of their particular accounting practices (González and García-Meca, 2014). The accounting data on financial statements is secondary in nature and will be obtained from DataStream database, while data on CG mechanism (separate leadership, proportion of independent director, independent chairman, independence of nomination committee) come directly from company's annual reports, which are available on the companies websites or through BURSA Malaysia website. The data will be analyzed through multiple regression, correlation and descriptive analysis for relationship and results interpretation.

7. MEASUREMENT OF VARIABLES

Following Table1 shows the measurement of dependent and independent variable of the study with their respective references, i.e. dependent variable (shareholders value will be measure through Tobin's Q while separate leadership and independent chairman will be measured by a dummy variable (1 and 0).

Similarly, proportion of independent director will be measure by percentage of independent director to total director. Moreover, nominating committee independence will be measured by the proportion of independent non-executive director in nomination committee to total committee members.

7. CONCLUSION AND SIGNIFICANCE

The proposed study will empirically examine how CG mechanism (separate leadership, proportion of independent director, independent chairman, and independence of nomination

Table 1: Measurement of variables

Variables	Measurement with reference (s)
Dependent variable: SHV	Will be obtained using Tobin's Q model. i.e., Total market value of firm divided by total assets value (Davies et al., 2005)
Separate leadership	Dummy: If separate leadership than 1 otherwise 0 ((Alzoubi and Selamat, 2012))
Proportion of independent director	Percentage of independent directors out of total board of directors (Luan and Tang, 2007)
Independent chairman	Dummy: If independent chair than 1 otherwise 0 (Aggarwal et al., 2010)
Nomination committee independence	Independent non-executive Director in Nomination Committee/Total Committee Members (Habbash, 2013)

SHV: Shareholder value

committee) will impact SHV and help in maximizing the overall financial performance and SHV in Malaysian listed firms. Secondly this proposed study will contribute the latest literature to SHV and CG. Thirdly the proposed study will give a clue on how much MCCG (MCCG, 2012) has impacted the CG standards in maximizing the SHV and firm performance because MCCG (2012) is introduced during this era. Hence this paper proposes to examine the impact of separate leadership, proportion of independent director, independent chairman, and independence of nomination committee on SHV in Malaysian listed firms for 2010-2013. Moreover the results of this proposed study will help board of directors, policy makers, Government, Security Commission of Malaysia and Bursa Malaysia for further improvements of the relevant policies and regulations in future.

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