Chapter 10

Corporate Governance and Firm Performance in an Emerging Market: The Case of Malaysian Firms

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ABSTRACT

This study examines the corporate governance mechanisms and how they affect firm performance in Malaysia. After the financial crisis in 1997/98, the CG issues have been the most debated, discussed, and researched in the attempt to improve the CG structure accommodating every economy regardless of the economic landscapes. Using a rich and huge data on Malaysian firms for 16 observation years, this study found that the MCCG has been of a closely referred blueprint by firms in Malaysia to improve firms’ performance. Certain CG mechanisms do have significant impact on firm performance. Firms seem to operate in a large board size indicating a positive relationship with performance and board independence. CEO duality is negatively related, in support of separation of roles, complementing the result of board independence and ownership structure as positively related to performance. Agency theory seems to be the dominant theory influencing the CG structure of firms in Malaysia.

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INTRODUCTION

Literature has been documenting evidences that effective corporate governance (CG) structure has eminent influence in improving firm performance in both developed as well as emerging economies (CG Watch Report, 2018; Zhou et al., 2018; Al-ahdal et al., 2020). Nevertheless, the liaison between CG and firm performance has never been conclusive for different nature of relationship between the two has been evidenced, due to different CG structure being practiced depending on the institutional differences of each country being examined (Rouf et al., 2010; AlQadasi and Abidin, 2018; Nomran and Haron, 2019). Different social, economic, market behaviour and regulatory conditions of each country do at some point result in differing CG structures being practiced, thus it is imperative to study and understand the relationship between CG and performance to ensure maximum performance of firm as different firm operating in a different setting may need different CG structure (Black et al., 2014; Hussain et al., 2018).

The inconclusive empirical evidences on the relationship between CG structure and firms’ performance imply that there is no one fit all CG structure, thus creates gaps in the literature (Zhou et al., 2018; Uribe-Bohorquez et al., 2018). Although enormous studies have been done on the relationship between CG structure and firm performance in Malaysia, majority of the studies used a shorter study period of maximum five years with quite a limited number of observations. Hence, this study sets forth with the objectives to examine the relationship between CG structure and firm performance, using a rich, huge and recent data of 742 firms in Malaysia within a wide study period of 16 years (2000 to 2015) and characterize certain CG mechanism in this relationship without neglecting the endogeneity issues that may arise en-route the analyses and deal with the issue by employing the General Method of Moments (GMM) in the methodology. To ensure the robustness of the findings, this study employs various performance measurements to measure firm performance (ROA, ROE and Tobin’s Q) and to meet its objective, four CG mechanisms are incorporated in this study, which are board-independence, board size, CEO duality and ownership concentration besides controlling for some firm level determinants like firm size, growth, age of firm and leverage. These CG mechanisms are common variables used by researchers in the studies of CG and are generally accepted in the literature. Ownership concentration in particular, is interestingly unique to emerging market such as Malaysia where highly concentrated ownership is evidently prominent (see, for examples; Ting et al., 2017, AlQadasi and Abidin, 2018; Haron, 2018) and ownership structure is the imperative determinant of CG in Southeast Asia (Lukviarman and Johan, 2018). The average ownership concentration for Malaysian listed firms in fact stood at 61.67%, much higher compared to the average of 54.19% for other 38 countries (including Malaysia) for the period 2006-2009 (Moshirian et al., 2014). Hence, such investigation is crucially important in addressing the issue of inconclusiveness reported in the body of knowledge and will enrich the existing literature especially on emerging market (Liu et al., 2015; Zhou et al., 2018) for research on the influence of corporate governance practices and firm performance in emerging market is still lacking (Zhou et al., 2018).

When discussing the relationships between CG mechanisms and firm performance, Sanda et al. (2005) propose four theories that primarily govern these relationships which are the agency theory, the stewardship theory, the stakeholder theory and the resource dependency theory. These four theories basically emphasize on the role of board of directors in improving firm performance. Agency theory which mainly concerns with agency issues regards board as necessary, economical yet effective monitoring tool over opportunist managers (Fama and Jensen, 1983; Jensen and Meckling, 1976). Contrasting to that, the stewardship theory sees managers as a dependable and reliable agent thus according to Donaldson and Davis (1991) will not need the board to monitor or supervise. The stakeholder theory as