CORPORATE GOVERNANCE AND FIRM PERFORMANCE: EVIDENCE FROM CIDB MALAYSIA

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ABSTRACT

The objective of this research is to determine if there is any significant relationship between corporate governance mechanism (board composition, board size, remuneration committee, risk management committee and gender diversity) and firm performance measured by return on assets (ROA) among companies registered among one large government industry (Construction Industry Development Board – CIDB) in Malaysia. Quantitative survey method is employed and data are collected from 124 companies. Descriptive statistics is reported and model estimation is performed using logistic regression. The results show that board size, board composition and risk management committee has significant impact on firm performance. Evidence suggests that corporate governance mechanism has significant effect on firm performance in CIDB registered companies Malaysia.

Keywords: corporate governance mechanism, remuneration committee, board composition, firm performance, construction industry development board (CIDB).

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1: Introduction

Corporate governance is a technique and structure used to control business exercises of the economic system of the organization towards expanding business triumph. Corporate responsibility with the extreme target of acknowledging shareholder value, whilst bringing under record the interest for different stakeholders. (MFC) defines Corporate Governance is a framework that eventually used to control and guided by the organizations. Top managerial staff is answerable for the governance of organizations. The shareholders' part for governance is to engage those executives and the auditors for the benefit of the firm and fulfill themselves to guarantee that a competent corporate structure is developed- Cadbury Report 1992. Corporate governance bargains with those components that guarantee that enterprises get a return based on their ventures (Shleifer et. al, 1999). Corporate governance arrangements not only the internal administration of the firms, it also connected with a firm's relationship with its suppliers, customers, and other stakeholders. The developing need for stocks and other assets from organizations expanded the vitality of corporate governance around the planet. Raising investment fund, liquidity with the view of profitability is highly competitive for the organizations.

Corporate governance turned a well known finance exchange platform in the modern world. Generally, corporate governance determines firm establishment that defend and flourish the expcetations of stakeholders which expanding worldwide considerations. However, those possibilities of corporate governance varies between countries, relying upon the economic, radical and furthermore social contexts. Organizations in rich economic countries divide shareholders jurisdictions that works in stable political, budgetary financial structures and developed legislative frameworks of corporate governance.

Corporate governance varies from entity to entity and geographical region of countires. Its ultimate goal is to standardize, gain high rate of return and to prevent financial structure in attaining their targets at the expense of the investors (Luo, 2007). It must be acknowledged that feeble corporate governance or non compliance of its doctrine could prompt financial abuses, corporate frauds and generate heavy losses for the companies (Jill, 2008).

We explore the literature review based on corporate governance and firm performance. So far, no study exists related to return on asset measured as a binary variable in corporate governance characteristics. This study is the first effort explaining corporate governance issue in CIDB Malaysia registered companies with regards to return on assets as a binary variable.

2: Literature Review

Corporate governance channalize the vitality of ownership concentration, board structure and also impact of stakeholders on the organizations. Over more diminutive companies, managers assume to play a critical part alongwith forming corporate esteem frameworks that effect organizations peformance from months to years. Previously, bigger organizations that separate concentrated ownership, supervisors and their controls that assume to play a capable role (Steen, 2004). The conceptual framework of corporate governance of earlier studies supports agency theory. This theory based on the fact that stakeholders targets can be accomplished if administrator's speculation is under control (Jensen and Meckling, 1976). Company performance is found to be positively related to the directors' collective and individual attributes which are associated with access to information, effectiveness of board, observance of fiduciary responsibility and performance evaluation (Veysel et. al, 2006).

Bruce et. al, (2002) concede that structural changes to corporate governance conventions, including stupendous execution and strategy formulation, more freedom about compelling audit reviews, effective transparency in the selection of top-executive appointments that would bring firm performance at top level. Compliance with and disclosure of good CG practices varies substantially among the different companies, and CG standards have generally improved over the period. The researcher also finds that block ownership is negatively perform against voluntary CG disclosure, while board committee size, audit firm value, cross-listing, the availability of a CG board committee, ownership of institutional and regulatory bodies are positively respond to voluntary CG disclosure listing (Collins et. al, 2012).

Corporate governance in established market economies has been fabricated regularly over several centuries as a value of the economic growth of industrialized entrepreneurship (Chowdary, 2002). CG assumes a main role in the execution of MFIs and the autonomy of the board and acceptable detachment of the role of a Chief Eecutive Officer and board chairperson that have a positive association with performance processes (Anthony et. al, 2008).

The origin of construction industry in Malaysia linked back to the British Organization. The highly qualified engineers from Britain and workers are supported by the foreign Government of Indian sub-continent to build a massive meter gauge railway track in the year 1882. The group of contractor consists of a small number of individuals from two to five people contributing facilities and working with the direction of an engineer or architect, engaged by the client (Sundaraj 2006; Tan 2004). The main contractors well managed and hire sub-contractors who tender for and acquire ventures to consequently leased portion of the projects in segments had been started from the beginning. It is still prevailing in present times (Sundaraj 2006; Tan 2004). The Malaysian administration preferred learning from other developed countries like Japan and Korea and continue the struggle to stand with the developed countries of Asia. Dayabumi building is one of the best examples of that strategy (Tan 2004).

Conversely, a Bumiputra engineering company complains that there are no actual technology transfer took place, they are also partner of Japanese contractors acclaimed that it is also just to maintain a good relationship with the government (Lavender 1996). The tourism industry also increased rapidly due to big development projects in non-residential areas like hotels, resorts, malls and golf courses which plays a vital role in economic growth (BNM 1999). During the period of 1990-1997, the constructions of building projects become double especially in the Clang Valley. Therefore, the government took preventive measures in early 1995 to address the nation about asset bubble (BNM 1999). The procedure of foreign proprietorship for residential properties become relaxed with the new rulings introduced by the Government. The purchase of a house by a foreigner above RM250,000 exempted from approval of the Foreign Investment Committee. The construction industry is affected in 2006 due to these initiatives (BNM 2007). During the period of recession, most of these entities are not able to sustain because all of the related corporations would be exaggerated, ultimately, the whole of the organizations at survival threat during the period (Tan 2004).

The Cadbury Code (1992) originates as a consequence of the corporate disasters in the 1980s in United Kingdom. It suggests modifications to the board structures and measures to make the entity more liable to the stockholders, advises growth in the number of independent directors on the board, separation of the chairman and CEO, and overview of board committees (Chowdary, 2002).

Mansoor et al. (2013) concludes that the corporate governance mechanisms are able to overcome earnings management activities specifically from the perspective of family owned companies and the non-family owned companies. Corporate governance is widely practiced in general in Malaysia. Weak corporate governance structure makes shareholders control and protection inadequately provided in the Malaysian corporate sector (Kamini, 2003). The World Bank calls Malaysia a regional leader in corporate governance**,** but there are lots of rooms for improvement**.** However, there are some gaps and omissions in the Companies Act and revising the Malaysian Code on Corporate Governance and Bursa Malaysia's Listing Requirements will help to reinforce board independence and support ongoing reform (Corporate Governance Report on the Observance of Standards and Codes for Malaysia, 2012). Therefore, this study is undertaken to fill this knowledge gap and to evaluate the impact of corporate governance on firm performance in construction industry Malaysia.

2.1: Board Composition

Masood et. al., (2013) states that board independency has positive relationship with firm performance. Board composition is a vital mechanism of board structure, which points to the executive and non-executive directors’ demonstration on the board. The agency theory and stewardship theory, both apply to board composition where boards that have more of non-executive directors are mainly grounded in agency theory which suggests that an operational board should consist of a majority of non-executive directors expected to perform higher due to their freedom from the company administration (Dalton et al. 1998).

On the other hand, the executive director representation on the board is grounded in stewardship theory as it supports the claim that leaders are good stewards and therefore, put so much effort in making profit and ensuring stakeholder returns (Donaldson et al., 1994). Beasley (1996) reports that boards with a mainstream of external directors justify their observing role in respect to financial reporting. Weir et al., (2001) stated in their study that there are a number of reasons why practical proof might be inadequate to support the positive connection that exists between non-executive directors and enactment.

2.2: Board Size

Masood et. al., (2013) found that board size has no significant relationship with firm performance. Using panel data regression, Ujunwa (2012) points out that size of the board, CEO/Chairman duality functions are negatively related to firm performance, whereas board independence have positive impact on firm performance and corporate governance. Similarly, corporate governance research has mainly influenced by agency theory. We studied before board size by way of a variable which can make affect corporate governance performances plus financial statements in this research. That is, recognizing that the board size as well as firm size remains interconnected (Dalton et al. 1999; Yarmack 1996) with board size is associated with the firm presentation (Kiel and Nicholson 2003).

Since an organization viewpoint, bigger corporations need superior boards to observe and regulate the administration's activities (Kiel and Nicholson 2003). For example, proposed through agency philosopher (Jensen 1993), an ideal edge ought to be around 8 administrators plus Lipton as well as Lorsch (1992) proposed that the extreme size of the board ought to be 10 followers, by way of the bigger records will restrict to the team subtleties also the obstruct board presentation. Another vision is about that which is not to size and it is significant, somewhat this is the quantity of outdoor administrators (Dalton et al. 1999).

2.3: Remuneration Committee

Muhammad et. al., (2009) study found a positive relationship between directors' remuneration with the board executive committee, remuneration committee, the nomination committee and corporate governance committee. Board committees consist of audit, remuneration and nomination committees. It is acclaimed by the Cadbury report (1992) that a board should consist of separate committees for auditing of the financial statements, observing the remuneration of executive directors and engaging new directors to the board. The existence or absence of committees is offered by dummy variables in earlier studies (Laing and Weir 1999). Dalton et al. (1998) also described the addition of remuneration committees lead to better enactment. Hence this study supports the board committee arrangement for better enactment.

2.4: Risk Management Committee

Risk management committee has the ability for the immediate identification, prioritization and oversaw economic risk, and in addition backing internal audit review functions of the audit review committees (Fraser and Henry, 2007). The stakeholders can hope their personal satisfaction of financial instruments regulations are higher alongwith organizations existing RMCs over to organizations having no such committees. This may be as a result RMC oversees different financial dangers that confronted towards the firm, Subsequently those financial reporting value may be significantly improved (Yatim 2010). Research on risk management committee is very limited. Previously, majority of moments, role of risk assessment falls under audit committee review. However, Yatim (2010) proposes that the development of risk assessment board in Malaysia is not just connected with competent structure of board, extent of the entity and the unpredictability of a company's operations, but also their role linked with big 4 audit review firms which have been connected with high-quality regulations. Likewise Risk management committee have been accounted for to a competent board of directors (Yatim 2010).

2.5: Gender Diversity

Wang and Clift (2009) explain that women directorship has no significant impact on firm performance. The share of females farming the position of the board of administrators is going to be decreased from the year 2005 till 2007 at the speed of 10.2%, 7.6%, and 5.3% severally. Though, this share is marginally boosted in 2008 to 7.41% (according to kpwkm). The shortage of the contribution of Malaysian women dorectorship in important board decisions is disclosed at the World Economic Forum's in World Gender Gap Index 2009, wherever Malaysia gets 5 places to a hundred and one from out of one hundred fifteen countries surveyed linked to a recent year (Hunt, 2010). It is consistent with an investigation carried out by Soares, et. al., (2010) that presented Malaysia is within the 9th rank of female on the board of directors level between Asia Pacific organizations.

Moreover, analysis by Catalyst (2008) demonstrated that on the average, Forty five hundred corporations with a lot of ladies administrators had considerably accomplished big financial targets than those with the smallest amount by 53% over return on equity, 42% over return with sales, 66% over return on invested capital. (Julizaerma and Zulkernain 2012) demonstrates the policy of Malaysian government for minum requirement of 30 percent women directorship in the board decisions of the financial departments. Additionally, women directorship has significant relation on companys' profitability in case of categorical data which is consistent with (Shrader et. al, 1997 and Maran and Indraah, 2009). While Julizaerma and Zulkarnain. (2012) find a significant positive relation between firm performance and women directorship.

2.6: Firm performance (Return on Assets)

The current study uses firm performance as dependent variable. (Norman, 2012) demonstrates that firm performance is negatively related to Corporate Governance reporting. Kevin et al. (1994) states that the level of return on assets rises when the concentrated ownership achieves a level of 68.2%, after that, return on assets declines. Morck et al. (1988), states that the entity role of performance inclines to increase when administation ownership tends to raise from 0% to 5%, and additionally, it declines when administration ownership expands from 5% to 25%.

The following is the firm performance measures investigated in this study, namely; return on assets (ROA), which is also considered as representative for profitability returns and market returns. Bilal et. al., (2013) reveals that there is a significant impact on board size, CEO/Chairman Duality on ROA, and there is an insignificant impact of Board Composition on ROA, whereas Return on asset that is also an accounting measure, is used to measure the productivity of assets engaged in firm performance (Haniffa et al., 2006). Less than 4% of Brazilian firms have "good" corporate governance practices, and that firms with better corporate governance have significantly higher (return on assets) performance (Andre et. al. 2005).

3: Methodology

The study uses quantitative approach utilizing primary data with convenient sampling procedure involving a sample size of 124 companies (Aminah et. al, 2012) among small and medium enterprises (SMEs) in one large government industry (Construction Industry Development Board – CIDB) in Malaysia. Board of directors and managers were targeted in this study because they are directly involved in the overall running of the businesses, and their views often represent the views of the entire firm. A total of 124 questionnaires were collected and answered by either the company's directors or managers. Since the response variable (dependent variable) is dichotomous in nature, the study employed logistic regression (Takiah et. al, 2011). The logistic regression model uses the predictor variables (independent variables), which can either be categorical or continuous, in order to predict the probability of specific outcomes.

The return on asset variable is analyzed on a nominal scale. This variable is dichotomous in nature fulfilling the basic assumption of logistic regression. Return on asset considered 1 if increases than 5 percent (ROA >5%) and considered 0 if decreases than 5 percent (ROA <5%). (Richard, 2005) proposed that as a rule of thumb, investors are interested in those companies which have ROA more than 5%. (Ben, 2005) also stated that investors are reluctant to those companies whose ROA is less than 5%. (Dhanuskodi, 2014) also explained that as a fixed rule, expected level of ROA for companies is equal to or more than 5% which is considered good by banks.

The target population for this research is the companies registered on Construction Industry Development Board (CIDB) Malaysia. The survey questionnaire consists of two sections. The first section contains information related to respondents. The second section based on attributes of corporate governance mechanism and firm performance. Which mainly contains close ended question, “Yes” or “No”. The construct related to categorical data. The complete structure of questionnaire can be seen from Table 6. A total of 124 contractors of construction industry agreed and have participated in the current research. Upon receiving the consent from CIDB head office, the survey questionnaires are then courier to state offices. The total respondents according to CIDB states are shown in Table 1.

Table 1: Respondents of the Study

CIDB state offices	Planned sample	Real respondents	Rate of response
Selangor	105	78	74.0%
Wilayah Persekutuan	55	30	55.0%
Melaka	5	1	2.0%
Perak	5	2	4.0%
Sabah and Sarawak	5	3	6.0%
Pahang	5	2	4.0%
Pulao Pinang	10	5	5.0%
Johor Bahru	5	2	4.0%
Kedah	5	1	2.0%
Total	200	124	62.0%

The different types of grades are assigned to companies registered under CIDB. Grade 1 relates to small scale and then proceeds to large scale until grade 7 (CIDB, 2015). The breakdown of the respondents according to the level of grades (G1 to G7) and their measurements are listed in Table 2.

Table 2: Respondents by Grades

Grade Registration	**Construction Project limit (RM)**	**Actual respondents**	**Response rate**
G1	200,000 and less than	17	14.0%
G2	200,001 to 500,000	21	17.0%
G3	500,001 to 1,000,000	37	30.0%
G4	1,000,001 to 3,000,000	19	15.0%
G5	3,000,001 to 5,000,000	9	7.0%
G6	5,000,001 to 10,000,000	7	6.0%
G7	More than 10,000,000	14	11.0%
Total		124	100.0%

To ascertain the evaluation of firm performance (Return on Assets), the return on asset considered 1 if ROA is equal to or greater than 5% and return on asset considered 0 if ROA is less than 5%.

The SAS (9.4) statistical program is employed to test the relationship between dependent and independent variables with empirical model of logistic regression.

The final model that was fit to the data is given by

logit FP = $\beta 0 + \beta 1BC + \beta 2BS + \beta 3RC + \beta 4RMC + \beta 5GD$

where β_0 is the intercept of the model, $X1 \ldots, X5$ are the predictor variables board composition, board size, remuneration committee, risk management committee and gender diversity respectively and P denoted the probability that the CIDB firm performance, is used.

The results indicate that board composition; board committee size and risk management committee has a significant coefficient in Table 8, whereas for other variables, they are found to be statistically insignificant.

3.1 Measures

All questions were answered from directors and managers by CIDB registered companies. The research is made for the purpose of evaluating the effects of corporate governance mechanism on firm peformance among companies in construction industry in Malaysia.

4: Empirical Findings

This section presents corporate governance mechanism involving six elements: board composition, board size, remuneration committee, risk management committee, gender diversity and firm performance. All these predictor variables are analyzed against firm performance in each construction company. Observing the p-values, only board composition, board committee size and risk management committee provides evidence of a significant association with firm performance.

Gender information of the construction company is provided in Table 3.

Table 3: Respondents by Gender

Gender	Responses	%
Male	67	54
Female	57	46
Total	124	100

Table 3 implies that 54% respondents are male and the rest belongs to female. This is consistent with the policy of Malaysian government to accommodate minimum 30 % women directorship at the judgemental level of the financial industry (Julizaerma and Zulkernain 2012).

Table 4 provides information on the status of enterprise or Serdian Berhad construction company.

Table 4: Responses on Enterprise / Serdian Berhad

Status	Responses	%
Enterprise	44	35
Serdian Berhad	80	65
Total	124	100

About 65% are registered as Serdian Berhad and the rest belongs to Enterprise. As stated by Finance Minister II Datuk Seri Ahmad Husni Mohamad Hanadzlah, Small and medium enterprises consists of 99.2 % of the aggregate enlisted corporations in the country and subsidize 56.4 % on employment level, but their contribution at the GDP level is only 32 % and 19 % of the aggregate trade for the financial year 2005 (SMIDEC, 2008).

Table 5 provides information about the nature of ownership and management of construction companies.

Table 5: Responses on Ownership

Management by	Responses	%
Directors	120	96
Managers	4	4
Total	124	100

About 96% respondents indicated that CIDB construction industry sector is managed by directors and the rest of 4% by managers. The findings are inline with Bruce et al., (1998) where he stated that more than 80% of small and medium corporations are shifted from family shareholders.

Table 6: Descriptive Statistics for variables

Variables	Dimensions	Respondents	Percentage
Board composition	*Independent directors*	66	53.23
	Executive directors	58	46.77
Board size	*4 directors*	73	58.87
	5 directors	39	31.45
	6 directors	8	6.45
	> 6 directors	4	3.23
Remuneration committee	*Yes*	73	58.87
	No	51	41.13
Risk management committee	*Yes*	79	63.71
	No	45	36.29
Gender diversity	*1 female director*	57	45.97
	2 female director	64	51.61
	> 2 female director	3	2.42
Firm performance	*Yes, (ROA > 5%).*	59	47.58
	No, (ROA < 5%).	65	52.42

Table 6 shows the descriptive statistics of the variables employed in the study. The table shows percentage of respondents for different levels of each variable. With respect to board composition, 53% of respondents agreed with independent directors and 47% with executive directors. In terms of board size, 69% of respondents are agreed with 4 directors and around 32% agreed with 5 directors. The next one is remuneration committee, 59% respondents agreed with the presence of this committee. The latter is risk management committee, 64% respondents agreed with the importance if this committee. The majority of respondents around 52% agreed with 2 female directors should be on the board in the case of gender diversity. With respect to firm performance, around 53% respondents agreed that their companies accruing return on assets below 5%.

Table 7 shows less multicollinearity problem, due to low correlation coefficients (Takiah et. al, 2011). The highest absolute correlation coefficient between the independent variables is (0.672) between board committee size and gender diversity. Normality of the given research data has been tested through skewness and kurtosis values (Hair et al. (2014).

Table 7: Pearson Correlation with two tailed p – values

	CO	FP	BC	BCS	RC	RMC	GD
CO	1.000	-0.17662	0.106	0.045	-0.306	-0.026	0.18982
FP		1.000	-0.369*	-0.088	0.271	-0.254	-0.258
BC			1.000	0.463*	-0.389*	-0.102	0.514**
BCS				1.000	-0.402*	0.037	0.672**
RC					1.000	0.050	-0.537**
RMC						1.000	0.049
GD							1.000

**Correlation is significant at the 0.01 level (two-tailed), *correlation is significant at the 0.05 (two-tailed).

On the basis of p-value in Table 8 that Cox and Snell Pseudo R square and Nagelkerke R square have a moderate value for the data. Nagelkerke R square is 0.3611 indicating that the independent variables in the model explain 36% of the change in the dependent variable. We can see that remuneration committee, gender diversity are found to be statistically insignificant. While board size, board composition, risk management committee are found to be statistically significant.

Table 8: Logistic Regression Results

Parameter	**Coefficient**	**P- value**
Intercept	-3.6726	0.0146
BC	2.0038	0.0002*
BCS	-0.9083	0.0227*
RC	-0.9481	0.0648
RMC	1.7302	0.0004*
GD	0.6141	0.2757
Cox and Snell Pseudo- *R* square		0.2706
Nagelkerke- *R* square		0.3611

*****significant at 5% level

5: Discussion and Conclusion

The findings reveal that remuneration committee has no significant impact on firm performance which is in line with Vafeas and Theodorou, (1998). The findings also reveal that gender diversity has no significant impact which is in line with Wang and Clift (2009).

Additionally, board size has significant impact on firm performance in case of which is consistent with Haniffa and Cooke (2002). Board composition has significant impact on firm performance which is consistent with Akhtaruddin et al. (2009), states that a bigger board size has significant impact on company performance. Risk management committee has significant impact on firm performance in case of categorical data which is consistent with (Wang, 2012). Additionally, remuneration committee also approaching to the significant level. It means that remuneration committee also effect firm performance.

Andersen et. al., (1989) postulates that successful business plan starts by exploring firm's underlying assets. The focal point of cost benefit analysis for every entity over its competitors is all of its resources must not be counterfeit by the contenders as these competitive advantages under the circumstances significantly take part in the susccessful company's profitability (Barney, 1991). Therefore, the firm's ability to attain low cost, greater adaptability and nature is a capacity of manufacturing policy and also corporate governance (Anderson et. al. , 1989; Hayes et. al, 1984; Hill, 2000).

Though the study has theoretical contributions to the literature, it also consists of quite a few limitations. Initially, the sample selection in this study is limited (n=124). A very limited amount of respondents of CIDB registered companies take part which makes it harder to recognize the population represented by the given sample. The results cannot be generalized. Second, only Wilayah Persekutuan and Negeri Selangor shows good proportion but others contribution very less. Only directors or managers of the entities are chosen to gather the data for the research. Although the directors or managers may be the main person in the small enterprises, an individual's ability cannot represent the whole approach of the entity. Furthermore, the perceptual thoughts of the directors or managers may be partial because of their independent judgments. The third limitation is the use of only one accounting measure (return on assets) instead of more than one like Tobin's Q to increase the validity of results.

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