



UNIVERSITI PUTRA MALAYSIA

**INFLUENCES OF CORPORATE GOVERNANCE AND
CORPORATE STRATEGY ON PERFORMANCE OF
FINANCE COMPANIES IN MALAYSIA**

BASIRU SALISU KALLAMU

GSM 2014 1



**INFLUENCES OF CORPORATE GOVERNANCE AND
CORPORATE STRATEGY ON PERFORMANCE OF
FINANCE COMPANIES IN MALAYSIA**

BY

BASIRU SALISU KALLAMU

MASTER OF SCIENCE

UNIVERSITI PUTRA MALAYSIA

2014



INFLUENCES OF CORPORATE GOVERNANCE AND CORPORATE STRATEGY ON
PERFORMANCE OF FINANCE COMPANIES IN MALAYSIA

BY
BASIRU SALISU KALLAMU

Thesis Submitted to Graduate School of Management, Universiti Putra Malaysia, in Fulfillment
of the Requirements for the Degree of Master of Science

January 2014

All material contained within the thesis, including without limitation text, logos, icons, photographs and all other artwork, is copyright material of Universiti Putra Malaysia unless otherwise stated. Use may be made of any material contained within the thesis for non-commercial purposes from the copyright holder. Commercial use of material may only be made with the express, prior, written permission of Universiti Putra Malaysia.

Copyright © Universiti Putra Malaysia



Abstract of thesis presented to the Senate of the Universiti Putra Malaysia in fulfillment of the requirement for the degree of Master of Science

INFLUENCES OF CORPORATE GOVERNANCE AND CORPORATE STRATEGY ON PERFORMANCE OF FINANCE COMPANIES IN MALAYSIA

By

BASIRU SALISU KALLAMU

January 2014

Chair : Dr Nur Ashikin Mohd Saat
Faculty : Graduate School of Management

This study presents evidence on the influence of corporate governance mechanisms and corporate strategy on performance of finance companies listed on Bursa Malaysia. The sample includes all the finance companies listed on the main market of Bursa Malaysia from the period 1992 to 1996 (pre MCCG period) and from 2007 to 2011 representing period after the Malaysian Code on Corporate Governance (MCCG, 2000) was issued. The study aims to determine whether ownership structure, board subcommittees' attributes and diversification have influence on performance of finance companies in both the period before and after the MCCG was issued. The results indicate a statistically significant relationship between corporate governance and corporate strategy, and firm performance. Firstly, indirect director ownership has significant influence on firm performance in the post MCCG period. This supports agency theory and means that ownership by directors helps align the interest of inside and outside stakeholders' thereby reducing expropriation and enhancing intermediary role and firm performance. The presence of institutional ownership is found to be negatively related with firm performance in the pre MCCG period. Their inactive participation in the monitoring activities of the companies can be related to their holdings of diversified investment portfolio to reduce their risk exposure and protect their investment return.

The presence of high proportion of independent directors on the board enhances firm value when executive board members hold shares in the firm indicating the effectiveness of their monitoring role in aligning inside owners' interests with minority shareholders. When executive board members own shares in the firm, the presence of independent chair is negatively related with firm performance, which could imply redundancy in monitoring role since there is already shareholders on the board to monitor the decision making process. Secondly, the results indicate that composition of audit committee (AC) is positive and significant while interlock of directors on AC and nomination committee (NC) is negatively related with performance in the post MCCG period. This supports agency theory and means that having independent directors on AC enhance monitoring role of the AC thereby enhancing performance. The result also means that interlock of directors on subcommittees can affect their ability to monitor firms effectively. In

the pre MCCG period, directors' expertise and experience is negative and positively related with performance respectively. This means that expertise and experience of the AC members does not enhance performance due to the less complex nature of the activities of the financial institutions in the period before MCCG. Thirdly, composition of risk management committee (RMC) is negatively related with profitability while independent committee chair positively enhances profitability. This means that having independent directors on the RMC does not add value to the firms due to the complex nature of operations of financial institutions and due to lack of technical knowledge and inside information by independent directors about firms' risk activities. In addition, executive experience of directors is positive while executive membership of RMC is negatively related with performance. This means that directors experience positively influence their monitoring of risk while having executive directors on RMC hinders effective monitoring of the risks in firms.

Fourthly, independent remuneration committee (RC) chair is significant but negatively related with performance meaning that independent RC chair does not enhance firm profitability. Fifthly, directors' expertise and executive membership of NC are significant but positively and negatively related with performance respectively. This means that expert directors on NC enhance profitability by improving the process of selecting competent directors to the board while negative relationship means that having executive directors on NC affects director selection which affects board monitoring and firm performance. Sixthly, diversification is negative while formation of separate risk committee is positively related with performance respectively. This implies that diversification does not necessarily enhance profitability while separating RMC from AC helps enhance firm performance by enhancing the monitoring of risks inherent in the intermediary role of finance firms and their operations. The results also indicate significant difference in corporate governance of finance firms between the period before and after MCCG was issued.

The findings contribute to literature and our understanding of the benefits of director ownership, independent directors on board and its subcommittees, independent board and committee chair, expertise and experience of the directors on subcommittees, diversification and separate RMC on the intermediary role of financial institutions by showing an association between corporate governance mechanisms, corporate strategy and firm performance. Management, board of companies and regulators may use the findings to make appropriate choices about governance mechanisms and strategy that enhance firms' intermediary role in order to improve performance.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Master Sains

Oleh

BASIRU SALISU KALLAMU

Januari 2014

Pengurus : Dr Nur Ashikin Mohd Saat
Fakulti : Sekolah Pengajian Siswazah Pengurusan

Kajian ini membentangkan bukti pengaruh mekanisme tadbir urus korporat dan strategi korporat terhadap prestasi syarikat kewangan yang disenaraikan di Bursa Malaysia. Sampel kajian terdiri dari semua syarikat kewangan yang disenaraikan di pasaran utama Bursa Malaysia sejak 1992-1996 dan 2007-2011 iaitu tempoh selepas Kod Tadbir Urus Korporat Malaysia dikeluarkan. Kajian ini bertujuan untuk menentukan sama ada struktur pemilikan, sifat jawatankuasa kecil lembaga pengarah dan kepelbagaian mempunyai pengaruh ke atas prestasi syarikat kewangan dalam tempoh sebelum dan selepas MCCG dikeluarkan. Keputusan menunjukkan ada hubungan antara tadbir urus korporat dan strategi korporat dan prestasi firma dan kaitannya signifikan dari segi statistik. Secara khusus, pemilikan pengarah secara tidak langsung mempunyai pengaruh besar ke atas prestasi firma dalam tempoh selepas MCCG dikeluarkan. Ini menyokong teori agensi dan bermakna pemilikan oleh pengarah membantu menyelaraskan pemegang kepentingan di dalam dan di luar syarikat dengan itu mengurangkan penyelewengan dan meningkatkan peranan pihak perantara dan prestasi firma. Kehadiran pemilikan institusi didapati mempunyai kaitan negatif dengan prestasi firma dalam tempoh pra MCCG. Mereka didapati tidak aktif dalam aktiviti pemantauan syarikat dan keadaan ini boleh dikaitkan dengan pegangan portfolio pelaburan yang pelbagai untuk mengurangkan pendedahan risiko dan melindungi pulangan pelaburan mereka.

Peratusan kehadiran pengarah bebas yang tinggi dalam lembaga pengarah meningkatkan nilai firma apabila ahli eksekutif lembaga pengarah memegang saham dalam firma. Ini menunjukkan keberkesanan peranan pemantauan mereka menyelaraskan kepentingan pemilik dalam dengan para pemegang saham minoriti. Apabila ahli eksekutif lembaga memegang saham firma itu sendiri, kehadiran kerusi bebas mempunyai kaitan yang negatif dengan prestasi firma menunjukkan peranan pemantauan tidak diperlukan kerana sudah ada pemegang saham di dalam lembaga pengarah untuk memantau proses membuat keputusan. Kedua, hasil kajian menunjukkan peranan komposisi Jawatankuasa Audit (AC) adalah positif dan signifikan manakala percampuran pengarah dalam AC dan Jawatankuasa pencalonan (NC) mempunyai kesan negatif dengan prestasi dalam tempoh selepas MCCG dikeluarkan. Ini menyokong teori agensi dan bermakna mempunyai pengarah bebas di dalam AC meningkatkan peranan pemantauan AC sekali gus meningkatkan prestasi. Hasil kajian juga bermakna bahawa percampuran pengarah dalam jawatankuasa-jawatankuasa kecil boleh menjejaskan keupayaan

mereka memantau firma dengan berkesan. Dalam tempoh sebelum MCCG dikeluarkan, kesan kepakaran dan pengalaman pengarah adalah negatif tetapi mempunyai kaitan positif dengan prestasi. Ini bermakna kepakaran dan pengalaman ahli AC tidak meningkatkan prestasi kerana sifat aktiviti institusi kewangan yang kurang kompleks dalam tempoh sebelum MCCG . Ketiga, kaitan komposisi jawatankuasa pengurusan risiko (RMC) dengan keuntungan adalah negatif manakala kerusi jawatankuasa bebas meningkatkan keuntungan. Ini bermakna bahawa mempunyai pengarah bebas dalam RMC tidak menambah nilai kepada firma kerana sifat operasi institusi kewangan kompleks dan pengarah bebas tidak mempunyai pengetahuan teknikal dan maklumat dalaman mengenai aktiviti berisiko firma. Di samping itu, kesan pengalaman eksekutif pengarah adalah positif manakala kaitan keahlian eksekutif RMC dengan prestasi adalah negatif. Ini bermakna pengalaman pengarah mempengaruhi pemantauan risiko secara positif dan mempunyai pengarah eksekutif dalam RMC menghalang pemantauan yang berkesan bagi risiko di firma.

Keempat, kerusi Jawatankuasa Ganjaran bebas (KM) adalah penting tetapi berkaitan negatif dengan prestasi dan ini bererti bahawa kerusi KM bebas tidak meningkatkan keuntungan firma . Kelima, kepakaran pengarah dan ahli eksekutif NC adalah penting tetapi berkaitan positif dan negatif dengan prestasi masing-masing. Ini bermakna kepakaran pengarah NC meningkatkan keuntungan dengan meningkatkan proses memilih pengarah berwibawa untuk lembaga dan hubungan negatif ini bermakna mempunyai pengarah eksekutif NC memberi kesan kepada pemilihan pengarah yang menjejaskan pemantauan dan prestasi firma. Keenam, kepelbagaian mempunyai kesan negatif manakala pembentukan jawatankuasa risiko berasingan mempunyai kesan positif dengan prestasi. Ini menunjukkan bahawa kepelbagaian tidak semestinya meningkatkan keuntungan manakala memisahkan RMC dari AC membantu meningkatkan prestasi firma dengan meningkatkan pemantauan risiko yang wujud dalam peranan perantara firma kewangan dan operasi mereka. Keputusan juga menunjukkan perbezaan yang signifikan dalam tadbir urus korporat firma kewangan antara tempoh sebelum dan selepas MCCG dikeluarkan.

Hasil kajian menyumbang kepada sastera dan pemahaman kita tentang faedah pemilihan pengarah, pengarah bebas dalam lembaga dan jawatankuasa kecilnya, lembaga dan kerusi jawatankuasa yang bebas, kepakaran dan pengalaman para pengarah pada jawatankuasa kecil , kepelbagaian dan RMC berasingan pada peranan perantara institusi kewangan dengan menunjukkan kaitan antara mekanisme tadbir urus korporat, strategi korporat dan prestasi firma . Pengurusan, lembaga syarikat dan pengawal selia boleh menggunakan hasil kajian untuk membuat pilihan yang sesuai mengenai mekanisme tadbir urus dan strategi yang boleh meningkatkan peranan perantara firma untuk meningkatkan prestasi.

ACKNOWLEDGEMENTS

In the name of Allah, the most gracious, the most merciful. All praises and thanks be to Allah the lord of the worlds. All praises and thanks be to Allah for making it possible to complete this Thesis. I would like to thank my supervisors Dr. Nur Ashikin Mohd Saat and Dr. Rosmila Senik for their support and guidance in completing this thesis. I would also like to acknowledge the support of Dr Lee chin and Dr. Normaz Wana for giving me time to ask some questions regarding statistical analysis. I would also like to thank my parents for their patience, support, guidance and encouragement which gave me the encouragement to carry on with the postgraduate education. To, my uncles, I thank you for the advice and encouragement which encouraged me to pursue further education. To my aunties, brothers and sisters I appreciate your advice, support and encouragement.

In addition, I would like to acknowledge the patience and support of my family without whose support completing the Thesis would have been much difficult. I am also indebted to my friends, class mates and colleagues at Putra Business School such as Dr. Abubakar Sambo Junaidu, Dr. Said Mzee Saif, Johari, Suhaili, Lim, Khoo, Balamurugan and others too numerous to mention thank you all for making my time at Putra Business School a memorable one.

I certify that the Thesis Examination Committee met on 21 January 2014 to conduct the final examination of **Basiru Salisu Kallamu** on his **Master of Science** thesis entitled “**Influences of Corporate Governance and Corporate Strategy on Performance of Finance Companies in Malaysia**” in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U. (A) 106] 15 March 1998. The Committee recommends that the candidate be awarded the Master of Science.

Members of the Examination Committee are as follows:

Foong Soon Yau, PhD

Professor
Putra Business School
University Putra Malaysia
(Chairman)

Bany Ariffin Amin Nordin, PhD

Associate Professor
Faculty of Economics and Management
University Putra Malaysia
(Internal Examiner)

Junaina Muhammad, PhD

Senior Lecturer
Faculty of Economics and Management
University Putra Malaysia
(Internal Examiner)

Suhaiza Ismail, PhD

Associate Professor
Kulliyah of Economics and Management Sciences
International Islamic University Malaysia
(External Examiner)

Nur Ashikin Mohd Saat, PhD

Senior Lecturer
Faculty of Economics and Management
University Putra Malaysia
(Main Supervisor / Observer)

PROF. DATUK DR. MAD NASIR SHAMSUDIN

Deputy Vice Chancellor (Academic & International)
Universiti Putra Malaysia

Date:

On behalf of,
Graduate School of Management, UPM

This Thesis submitted to the Senate of the Universiti Putra Malaysia has been accepted as fulfillment of the requirements for the Degree of Master of Science. The members of the Supervisory Committee are as follow:

Nur Ashikin Mohd Saat, PhD

Senior Lecturer

Department of Accounting and Finance
Faculty of Economics and Management
Universiti Putra Malaysia
(Chairman)

Rosmila Senik, PhD

Senior Lecturer

Department of Accounting and Finance
Faculty of Economics and Management
Universiti Putra Malaysia
(Member)

PROF. DATUK DR. MAD NASIR SHAMSUDIN

Deputy Vice Chancellor (Academic & International)
Universiti Putra Malaysia

Date:

On behalf of,
Graduate School of Management, UPM

DECLARATION

Declaration by Graduate Student

I hereby confirm that:

- this thesis is my original work;
- quotations, illustrations and citations have been duly referenced;
- this thesis has not been submitted previously or concurrently for any other degree at any other institutions;
- intellectual property from the thesis and copyright of thesis are fully-owned by Universiti Putra Malaysia, as according to the Universiti Putra Malaysia (Research) Rules 2012;
- written permission must be obtained from supervisor and the office of Deputy Vice-Chancellor (Research and Innovation) before thesis is published (in the form of written, printed or in electronic form) including books, journals, modules, proceedings, popular writings, seminar papers, manuscripts, posters, reports, lecture notes, learning modules or any other materials as stated in the Universiti Putra Malaysia (Research) Rules 2012;
- there is no plagiarism or data falsification/fabrication in the thesis, and scholarly integrity is upheld as according to the Universiti Putra Malaysia (Graduate Studies) Rules 2003 (Revision 2012-2013) and the Universiti Putra Malaysia (Research) Rules 2012. The thesis has undergone plagiarism detection software.

Signature : _____

Date : _____

Name : BASIRU SALISU KALLAMU

Matric No.: GM04370

Declaration by Supervisory Committee

This is to confirm that:

- the research conducted and the writing of this thesis was under our supervision;
- supervision responsibilities as stated in the Universiti Putra Malaysia (Graduate Studies) Rules 2003 (Revision 2012-2013) are adhered to.

Chairman of Supervisory Committee

Signature :
Name : DR. NUR ASHIKIN MOHD SAAT
Faculty : Economics and Management

Member of Supervisory Committee

Signature :
Name : DR. ROSMILA SENIK
Faculty : Economics and Management

TABLE OF CONTENTS

ABSTRACT	Page III
ABSRAK	V
ACKNOWLEDGEMENTS	VII
APPROVAL	VIII
DECLARATION	X
LIST OF TABLES	XV
LIST OF FIGURE	XVI
LIST OF ABBREVIATIONS	XVI

1.0 CHAPTER ONE: INTRODUCTION

1.1 Introduction	1
1.2 Corporate governance and finance companies	1
1.3 Background of the study	2
1.4 Statement of the problem	6
1.5 Research objectives	8
1.6 Significance of the study	8
1.7 Organization of the thesis	9

2.0 CHAPTER TWO: REGULATORY ENVIRONMENT IN MALAYSIA

2.1 Introduction	10
2.2 Companies Commission of Malaysia	10
2.3 Securities Commission	11
2.4 Bursa Malaysia Berhad	12
2.4.1 Bursa Malaysia listing requirements	13
2.5 Bank Negara Malaysia	13
2.5.1 Banking and financial institutions act 1989 (BAFIA)	14
2.6 Malaysian code on corporate governance (MCCG)	15
2.7 Roles of finance companies in an economy	17
2.8 Corporate governance in finance companies	19
2.9 Summary	22

3.0 CHAPTER THREE: LITERATURE REVIEW

3.1 Introduction	23
3.2 Theories of corporate governance	23
3.2.1 Agency theory	23
3.2.1.1 Agency cost	24
3.2.1.2 Information asymmetry	25
3.2.2 Theory of financial intermediation	26
3.2.3 Stewardship theory	29
3.3 Corporate governance monitoring mechanisms and firm performance	30
3.3.1 Internal monitoring mechanisms	31
3.3.1.1 Ownership structure	31
3.3.1.2 Board of directors	34
3.3.1.2.1 Board composition	35

3.3.1.2.2 Board structure	36
3.3.1.3 Directors interlock on subcommittees and firm performance	43
3.3.1.4 Presence of executive on subcommittees and firm performance	45
3.4 Corporate strategy and firm performance	46
3.5 Gaps in the literature	48
3.6 Summary	49

4.0 CHAPTER FOUR: RESEARCH METHODOLOGY

4.1 Introduction	50
4.2 Research framework	50
4.3 Development of hypotheses	51
4.3.1 Relationship between ownership structure and firm performance	51
4.3.1.1 Moderating role of board attributes in the relationship between ownership structure and firm performance	53
4.3.2 Relationship between audit committee attributes and firm performance	55
4.3.3 Relationship between risk management committee attributes and firm Performance	56
4.3.4 Relationship between remuneration committee attributes and firm performance	57
4.3.5 Relationship between nomination committee attributes and firm performance	58
4.3.6 Corporate strategy and performance of finance companies	58
4.3.6.1 Moderating role of separate risk management committee	59
4.4 Population and sample selection	60
4.5 Sources of data	61
4.6 Measurement of variables	62
4.6.1 Dependent variable- Firm performance	62
4.6.1.1 Accounting based measure of performance	62
4.6.1.2 Market based measure of performance	63
4.6.2 Independent variables	64
4.6.3 Control variables	64
4.7 Statistical tools for data analysis	65
4.8 Econometric problem of endogeneity	68
4.9 Summary	69

5.0 CHAPTER FIVE: RESULTS AND DISCUSSION

5.1 Introduction	70
5.2 Descriptive statistics for all the variables	70
5.3 Empirical results for ownership model	71
5.3.1 Results of descriptive statistics for ownership model	71
5.3.2 Results of regression analysis for ownership model based on ROA	73
5.3.3 Results of regression analysis for ownership model based on Tobin's Q	76
5.3.4 Results of regression analysis for the moderating role of independent directors based on ROA	78
5.3.5 Results of regression analysis for the moderating role of independent directors based on Tobin's Q	79

5.3.6 Results of regression analysis for the moderating role of independent chair based on ROA	80
5.3.7 Results of regression analysis for the moderating role of independent chair based on Tobin's Q	81
5.4 Empirical results for audit committee model	82
5.4.1 Results of descriptive statistics for audit committee model	82
5.4.2 Results of regression analysis for AC model based on ROA	84
5.4.3 Results of regression analysis for AC model based on Tobin's Q	86
5.5 Empirical results for risk management committee model	88
5.5.1 Results of descriptive statistics	88
5.5.2 Results of regression analysis for RMC model based on ROA	88
5.5.3 Results of regression analysis for RMC model based on Tobin's Q	90
5.6 Empirical results for remuneration committee model	91
5.6.1 Results of descriptive statistics	91
5.6.2 Results of regression analysis for RC model based on ROA	92
5.6.3 Results of regression analysis for RC model based on Tobin's Q	93
5.7 Empirical results for nomination committee model	94
5.7.1 Results of descriptive statistics	94
5.7.2 Results of regression analysis for NC model based on ROA	95
5.7.3 Results of regression analysis for NC model based on Tobin's Q	95
5.8 Empirical Results for corporate strategy model	96
5.8.1 Results of descriptive statistics	97
5.8.2 Results of regression analysis for corporate strategy based on ROA	97
5.8.3 Results of regression analysis for corporate strategy based on Tobin's Q	99
5.8.4 Moderating role of RMC in the relationship between corporate strategy and firm performance based on ROA	100
5.8.5 Multivariate regression for the moderating role of RMC based on Tobin's Q	101
5.9 Results of further analysis	102
5.10 Summary	108

6.0 CHAPTER SIX: SUMMARY, CONCLUSION AND RECOMMENDATIONS

6.1 Introduction	109
6.2 Summary of research and research findings	109
6.3 Significance of the study	113
6.3.1 Theoretical contributions	113
6.3.2 Practical contributions and policy implications	114
6.4 Limitations of the study	115
6.5 Suggestions for future research	116
6.6 Summary	117
Bibliography	118
Appendices	148
Biodata of the student	155
List of publications	156