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

BY

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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 intuk ijazah Master Sains

Oleh

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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 menjelaskan 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 pemilikan 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.
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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.

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Declaration by Graduate Student

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