

REVIEW ON OWNERSHIP STRUCTURE, CORPORATE GOVERNANCE AND FIRM PERFORMANCE

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ABSTRACT

With intention to identify the important components that applied in the reforms of the Malaysia corporate governance, a study is needed as a tool to proof whether the ownership structures and corporate governance practices are truly influenced firm performance. The purpose of the study is to investigate the relationship between firms' ownership structures, corporate governance practices and firm performance. Specifically, this study narrows the ownership structures categories into; institutional, government, family, foreign, managerial and concentrated. Besides, this study focuses on ten corporate governance components which include board structure, CEO duality, board size, independent board of directors, directors' professionalism/qualification, board meeting, board committee, directors' remuneration, transparency and disclose, merger and acquisition. Firm performance will be measured in the aspect of accounting profitability- return on asset and return on equity; and market performance- Tobin-Q, price to earnings and price to book value.

Key words: Ownership structure, corporate governance, bursa Malaysia

1. INTRODUCTION

The subject of financial performance has received significant attention from scholars in the various areas of business and strategic management. High performance reflects management effectiveness and efficiency in making use of company's resources and this in turn contributes to the country's economy at large. With the mixed result from previous research papers, the study of the ownership structures and corporate governances are great important to explore as they brings impact on firm performance. Different types of ownership structures and corporate governances components that applied in each firms resulted in diverse firm's performance. From a risk tolerance perspective, it is important to consider the identity and position of each entity in the ownership structure and how it may be exposed to firm performance or other risks through their involvement in the board. Indeed, the relationship between ownership structure and firm performance has been an issue of interest among academics, investors and policy makers because it is also a key issue in understanding the effectiveness of alternative governance system. Implementing a good corporate governance practice could ensure the

flow of firm operation and the return on investment of owner and investors. Denoted from agency theory, corporate governance problem arises with self interest behaviour [1]. The agency problem in this context refers to the investors concerns on their funds are not expropriated or wasted on unattractive projects. In order to minimize firm agency costs, a good corporate governance system should provide some kind of legal protection for the rights of both large and small investors [2].

Using various measures of corporate governance, researchers have examined the extent to which corporate governance environment is related to the firm's financial performance ([3], [4], [5], [6] and [7]). Generally, their results tend to show that corporate governance practices, as measured by different variables: board structure, board size, independent board of directors, directors' remuneration, are positively associated with financial performance. However, virtually most of the previous studies concentrated on specific aspect of governance, such as executive compensation ([8] and [9]), board size or board composition ([10], [11] and [12]).

The existing corporate governance literatures has largely dealt with an analysis of institutional arrangements in American, British, Australian, German and Japanese firms, with much less attention paid to firms from emerging markets ([13], [14] and [15]). According to [16], the corporate governance environment in East Asian is much more different in develop markets such as United States and United Kingdom. As a result, the study of relationship between corporate governance and firm's performance does not reach a consensus among researchers. Nevertheless, the variance in results may be related to the firm's sector and time framework in which the studies were conducted. [17] pointed out that corporate governance research in Asia has not received attention from Western researchers and publications, making Asia a fertile ground for future research in corporate governance mechanisms. Further, due to structural differences in the national political economies, corporate governance practices needs to be understood in the context of specific legal, political, and regulatory systems. Against this backdrop, it is far less known about the corporate governance mechanisms in emerging markets such as Malaysia.

This study will empirically implement a comprehensive analytical framework of firm performance in the case of listed firms on Bursa Malaysia. This study meant to answer the question of which type of ownership structure and corporate governance practice have the greatest impact on the firm performance in the aspect of accounting profitability and market performance in each sector. In other words, this study tends to identify which type of ownership structure and corporate governance practice are more feasible, practical and profitable in each type of economic sector in Malaysia. The information of the study can be used as a guideline for firms in considering which types of ownership structures and corporate governance practice will benefit most to the firm and drive the firm into competitive edge.

2. LITERATURE REVIEW

Ownership Structure and Corporate Governance

The theory of agency is one part of a broad research program in evaluating firm performance. Although the agency framework is quite broad, however, it provides the applications and fertile ground for further work. The basic issue is whether principal and

agent relationship can persist with generating efficient outcomes in the firm. This study focuses on isolating the extent of the principal-agent problem. The oriented towards enrichment of the theory may improve modeling methods and therefore, clarification of existing theoretical work. To address this problem, this study includes ownership structure and corporate governance variables in explaining firm performance. According to [18], they defined ownership structure in terms of capital contributions. The statement supported by [19] and [20], the definition of ownership relies on voting rights (proportion of share ownership). Consequently, be expected that study of the agency relationship will aid the understanding on ownership structures and therefore to identify the most efficient way to govern a firm.

According to one definition, corporate governance is the system by which business corporations are directed and controlled. Corporate governance delimits the distribution of rights and duties amongst the different participants in the firm, and sets rules and procedures for making decisions. Corporate governance also provides structures through which aims and objectives are set, and through which monitoring is carried out. [4] stated that

corporate governance decreases shareholder risk through the legal protection of shareholder rights and creating mechanisms of company management that allow shareholders to be assured that the management uses the investment efficiently. In other words, corporate governance is generally considered to be important in contributing to owners' rights and benefits and through strategic policies enhancing performance and creating wealth. A firm's corporate governance practices affect its overall operation and performance. Comprehensive cross-industry comparisons of corporate performance are extremely difficult to carry out and to interpret. In order to extend the literatures, this study tends to examine the association between ownership structures and a comprehensive set of corporate governance variables.

The concept of corporate governance presumes a fundamental tension between shareholders and corporate managers. The objective of a corporation's shareholders is a return on their investment while managers are likely to have other goals, such as the power and prestige of running a large and powerful organization, or entertainment and other perquisites of their position [18]. Corporate

governance has become an issue of global significance. The term corporate governance has been identified to mean different things to different people. Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled ([21] and [22]). Quoted from [23], corporate governance is defined as "the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value, whilst taking account the interests of other stakeholders". This indicates that corporate governance is not only applied to the shareholders but the other stakeholders as well.

Firm Performance

Accounting Profitability

In accounting, profit is the difference between the purchase and the component costs of delivered goods and/or services and any operating or other expenses ([24] and [25]). Measuring profitability is the most important measure of the success of the business as a business that is highly

profitable has the ability to reward its owners with a large return on their investment ([26] and [27]). Generally, a profitability ratio is used to measure a firm's ability to generate earnings relative to sales, assets and equity. In other words, profitability ratios highlight how effectively a company is being managed. Common examples of profitability ratios include return on assets (ROA), return on equity (ROE), return on investment (ROI), return on gross profit margin and net profit margin ([28] and [29]). Different profitability ratios provide different useful insights into the financial health and performance of a company. For example, ROI tells whether the company is generating enough profits for its shareholders; gross profit and net profit ratios tell how well the company is managing its expenses; return on capital employed (ROCE) tells how well the company is using capital employed to generate returns. ([27] and [28]). All of these ratios indicate how well a company is performing at generating profits or revenues relative to a certain metric. Besides, these ratios, created from the income statement and can be compared with industry benchmarks ([30] and [31]). This means that profitability ratios give meaningful information when they are analyzed in

comparison to competitors or compared to the ratios in previous periods. Therefore, trend analysis and industry analysis is required to draw meaningful conclusions about the profitability of a company. For meaningful conclusions, the profitability ratios of a firm should be compared to the profitability ratios of similar firms in the same economic sector.

Evaluating the firm performance through its accounting information provides additional insight into the impact of firm ownership structure and corporate governance. Referred to past studies that focus on evaluating firm performance, the most used accounting measures of financial performance were ROA and ROE ([30], [31], [32] and [33]). Previous studies indicated that ROA and ROE are widely used by market analysts as a measure of financial performance, as it measures the efficiency of assets and capital in producing income. In this study, the firm performance will be based on the accounting profitability which is on the value of ROA and ROE. This method is vastly employed by many previous researches including [32], [33], [34], [35] and [36].

Market Performance

Measuring firm market performance has been part and parcel of any successful business entity. It is strategic because the long run survival of any organization depends on its accounting and market performance [37]. Besides, the analysis of the firm market performance is part of a process of information whose fundamental objective is to provide data for decision making. Financial analysis provides guidance to businesses and individuals making investment decisions. Board committee, shareholders and investors could look at the stock price of a firm since the figure contains unique information about a firm market performance [38].

Many studies have used the Tobin Q (defined as the market to book ratio), price to earnings (PE) and price to book value (PTBV) as the measures of firm performance ([15], [39], and [40]). Substituting with other measures of market performance such as stock pricing and dividend yield, these measurements is accepted as a better measure of a firm performance as it reflects the status of firm in particular sector. The evaluations of market performance are the sources of information on the basis of a firm status. It is true that firm status plays a very

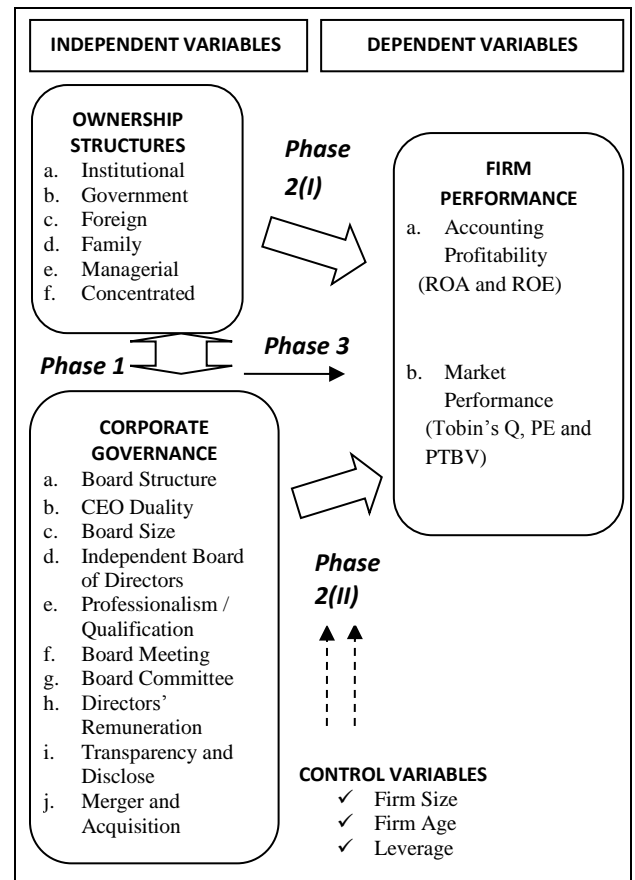
important role in the sphere of business to grow and bring the firm position at the top. If the market performance of a firm is good, there is no doubt that firm will grow faster in its industry. Similar to the method used by [39], [41], [42], [43] and [44], the firm performance (market performance) in this study will be based on the measurements of Tobin's Q, PE and PTBV.

While many previous studies have examined the direct effect of ownership structure, corporate governance and firm performance, there is a need of comprehension on how the different types of ownership structures and corporate governance practices impact on the firm performance. Hence, this study intends to investigate the joint effects of corporate governance mechanisms on the relationship between types of ownership structure and firm performance. In addition, this study tends to identify which type of ownership structure and corporate governance practice are more feasible, practical and profitable in each type of economic sector in Malaysia since most researchs concentrating on ownership structure, corporate governance and firm performance were conducted

overseas with little research actually taking place in Malaysia.

In competitive business environment, the ownership structure and corporate governance have played and will continue to play a strong role in facilitating business growth by putting in place procedures and regulations that will support a business-friendly environment. This study aims to achieve few results, firstly, to identify the relationship between ownership structures and corporate governance, secondly, to examine the effects of ownership structure on firm performance, thirdly, to examine the effects of corporate governance on firm performance, and lastly, to identify the relationship between ownership structure, corporate governance and firm performance associate with control variables. In sum, the relations between these variables in this study is summarized in the reseach conceptual framework (Diagram 1.0).

Figure 1.0 Research Conceptual Framework



The phase 1 of framework deals with the finding and examining the effects of ownership structures on corporate governance components. The phases 2 and 3 of framework deals with the finding and examining the effects of independent variables (IVs): ownership structures and corporate governance components on dependent variables (DVs): firm performance.

3. RESEARCH METHODOLOGY

This study conduct long-term post-performance evaluation which covering five years financial data period starting from year 2010 to the end of year 2014. Specifically, the study will be carried out by empirical analysis which is based on the available firms' data provided by Bursa Malaysia. According to [45], five years post-performance evaluation provide more current information about areas that have changing population and/or characteristics because they are based on the data from the previous year and data that are less than five years old. Moreover, long-term post-performance evaluation is based on larger sample sizes and will therefore be more reliable ([46] and [47]).

Using the multiple linear regression and panel analysis, all operating performance determinants (ROE, ROA, Tobin's Q, PE and PTBV) are treated as dependent variables (DVs). Using descriptive analysis, all these operating performance determinants will be analyze, where their mean, min, maximum value and standard deviation will be compared based on each sector in order to conclude whether there is any changes in the period of observation.

4. CONCLUSION

This study will empirically implement a comprehensive analytical framework of firm performance in the case of listed firms on Bursa Malaysia. In other words, this study tends to identify which type of ownership structure and corporate governance practice are more feasible, practical and profitable in each type of economic sector in Malaysia. On the surface, every economic sector is different. To understand sector competitiveness and profitability, one must look beyond their differences and view industries at a deeper level. There is a need of comprehension on the different types of ownership structures and corporate governance practice that suitable to each economic sector. Thus, this study os to address the problem regarding the ownership structure and corporate governance practices in Malaysia context and how they affect on firm performance. The information of the study can be used as a guideline for firms in considering which types of ownership structures and corporate governance practice will benefit most to the firm and drive the firm into competitive edge.

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