Does Corporate Governance Mechanism Improve Shareholder Value? A Panel Analysis of Malaysian Listed Companies

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Abstract
Purpose: This empirical study focuses on investigating the influence of Corporate Governance (CG) mechanism on shareholder value. The construct of CG mechanism is formed by separate leadership, proportion of independent director, independent chairman and independence of nomination committee based on renowned agency theory.
Design/methodology/approach: The sample for this empirical study consists of 100 firms listed on Bursa Malaysia over the period 2010-14. The data regarding CG mechanism (separate leadership, proportion of independent director, independent chairman and independence of nomination committee) collected from the annual reports of the companies. While, we used earning per share as a proxy for shareholder value that is extracted from DataStream for the corresponding period (2010-2014).
Findings: The models analyzed by ordinary least squares (OLS), found significant positive relation between chairman independence and shareholder value measured by earning per share. The results further revealed that independence of nomination committee has a significant negative relationship with shareholder value while, firm total assets have a significant and positive impact on shareholder value (earning per share). However, separate leadership and proportion of independent director has no impact on shareholder value. However, separate leadership and proportion of independent director showed no significant relationship with shareholder value.
Originality/value: The results of the study has value for Malaysian government, policy makers, corporate boards, stock exchange, and shareholders by highlighting the distinct impact of corporate governance mechanism on shareholder value. The empirical result will also contribute to help in recommendation and improvement of Malaysian code of corporate governance (MCCG-2012) based on the extant and latest literature.

Keywords: Shareholder Value, Corporate Governance Mechanism, Ordinary Least Square

Introduction

The beginning of the first decade of the 21st century was marked by several scandals, fraud and manipulating all kinds of information by big firms like Enron (2001) and WorldCom (2002) in the United States, HIH and OneTel in Australia, and Perwaja Steel, Technology Resources Industries (TRI), Transmile, Megan, Malaysian Airlines System (MAS), Port Klang Free Zone (PKFZ) in Malaysia (Norwani *et al*., 2011, DeFond *et al*., 2007, González and García-Meca, 2014).

These, scandals are established in the presence of misdeeds committed by director belonging to the large companies and normally supposed to be trustworthy person. These poor practices by directors and failure of big firms are considered an evidence of the failure of corporate governance.

The issues of firm shareholder value, increasing rapidly during the last two decades throughout the world and especially in developed countries like UK, USA and Australia etc. Similarly, with the opening up of free trade concept and liberalization, the concern for shareholder value also spread to the developing and emerging countries like Malaysia. Malaysia as an emerging market issued its own code on corporate governance in (2000, 2007, 2012), for the betterment of the firm overall performance and individual shareholder wealth. Nonetheless, Malaysian-listed companies have been subject to criticism concerning their role in improving shareholder value and firm performance in the Malaysian economy(Panasian *et al*., 2003, Wahab *et al*., 2007). Moreover, the corporate governance mechanisms have been argued to affect the overall corporate performance (Chuanrommanee and Swierczek, 2007) and contribute to the improvement of shareholder value (Petra, 2007). The linkages between shareholder value and corporate governance mechanism is important because investors and creditors may wish to invest in firms with good corporate governance practices to reduce their costs of capital and to maximize their wealth (Ali Shah *et al*., 2009).

It is suggested that for gaining higher shareholder value and maximizing the owner wealth, the importance of corporate governance cannot be ignored. Most studies in developed countries investigated the impact of corporate governance mechanisms on firm financial performance and found a very effective role of corporate governance attributes for improving firm financial health (Beekes and Brown, 2006). Keeping in view the problem of firm financial performance, corporate governance mechanism plays a vital role in maximizing firm financial performance (Balsam *et al*., 2003).

The objective of this empirical paper is to analyze whether internal corporate governance mechanisms such as separate leadership, proportion of independent director, independent chairman and independence of nomination committee affect firm shareholder value. The underpinning theory for this study is agency theory because it can be used and applied in the area of value maximization and corporate governance mechanism (San Martin-Reyna and Duran-Encalada, 2012). Therefore, in this study, the monitoring role of separate leadership, proportion of independent director, independent chairman and independence of nomination committee are argued to reduce and constrain overall problems and maximize shareholder value and firm financial performance.

Literature Review

Shareholder Value

Shareholder value is the value delivered to shareholders due to successful business operation and management's ability to grow earnings, dividends and share price (Stout, 2013). Shareholder primacy theory state that corporations were owned by their shareholders; that directors and executives should do what the company's owners/shareholders wanted them to do; and that what shareholders generally wanted managers to do was to maximize "shareholder value," measured by earning per share (Hillman and Keim, 2001).

Improving the shareholder value is of prime importance for the management of a company. The management must have the interests of shareholders in mind while making decisions. The higher the shareholder value, the better it is for the company and management. For this to happen, corporate governance mechanism is considered the most important devices for monitoring the firm financial performance and increasing the shareholder value (Shen and Chih, 2007).

Therefore, this study have focused on the impact of corporate governance mechanism (separate leadership, proportion of independent director, independent chairman, independence of nomination committee), as part of corporate governance mechanism, and relate them to corporate performance and shareholder value. Study conducted on the relationship of corporate governance mechanism yield mixed result for instance, empirical results indicate that separate leadership is positively related to the shareholder value but this finding is incongruent with most empirical studies in developing economies (Pfeffer, 1973). Similarly, proportion of independent directors is also positively related to shareholder value which support the finding and arguments of (Saleh *et al*., 2005), that large proportion of independent directors have a positive relationship with firm performance while opposing the finding of (Benkel *et al*., 2006). Empirical results shows that independent chairman plays a very positive role in shareholder value maximization and firm financial performance.

Finally, many studies suggest that nomination committee can affect the shareholder value negatively (Lang and Stulz, 1993). Hence shareholder value seen as a major concern by the investor, shareholders and stakeholder.

Corporate Governance Mechanism

Fama and Jensen (1983) and Jensen and Meckling, (1976) theorize that corporate governance mechanisms that are well practiced could benefit shareholders financially by exercising more control on the company's management. Corporate governance (CG) broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed. James Wolfensohn, President of the World Bank in his speech, "The governance of companies is more important for world economic growth than the government of countries". Hence, corporate governance mechanism is the combination of internal directors of board, internal audit committee, structure of Aamir, and the external auditor. Corporate governance mechanism is very effective as a monitoring system (Gul *et al*., 2003).

It is suggested that for gaining higher financial performance and shareholder value, the importance of corporate governance cannot be ignored. Studies in developed countries investigated the impact of corporate governance mechanisms on shareholder value and found a very effective role of corporate governance mechanism on shareholder value (Hillman and Keim, 2001). The overall condition and environment of corporate governance mechanism varies from firm to firm and from country to country (Farber, 2005). Due to different environment and condition of corporate governance standards, most of the countries, including Malaysia have laid down their own MCCG (2000, 2007 and 2012) corporate governance mechanism to look for suitable opportunities in order to maximize their shareholder value.

Empirically, it is widely accepted that governance practices increase a manager's ability to work for maximization of shareholder wealth (Peasnell *et a*l., 2005; Jaggi *et al*.; 2009, Lo *et al*., 2010). In order to restore the investor trust and confidence on stock market tight corporate governance

practices is utmost important for gaining the investor confidence and improving the firm financial performance.
After reviewing the literature I found a scarcity of research on EM in the Malaysia. A few studies exist based on previous old data of Malaysian listed companies with methodological and theoretical limitation such as neglecting the effect of mediation and moderation.

Gap Identification
I found a gap on the basis of methodology, data, sample size, recent business cases in Malaysia, type two agency theory and improvements which strengthens my motivation to conduct the study for fulfilling the research gap.

Question/Objective
The main question / objective of this study is to examine that "Is there any impact of corporate governance mechanism (separate leadership, proportion of independent director, independent chairman and independence of nomination committee) on shareholder value?"

Hypothesis Development
Separate leadership and shareholder value
Agency theory postulates that separation of decision and control functions of the board is an effective monitoring device of managers for better performance of firms (Fama and Jensen, 1983). Hence, agency theory is applicable to board leadership structure in relation to shareholder value (Daily and Dalton, 1997). By separation of leadership we mean, that chairman cannot perform dual role as a chairman as well as a chief executive officer (Shakir, 2009). Based on Malaysian Codes on Corporate Governance (MCCG, 2012), recommendation "The positions of chairman and CEO should be held by different individuals and the chairman must be a non- executive member of the board."
Empirical findings showed mixed and inconclusive relationship between leadership structure and shareholder value (Dulewicz and Herbert, 2004; Weir and Laing, 2000; Weir *et al*., 2002). For instance, Rechner and Dalton (1991) found that firms with the separate board leadership structure increase value and performance. Similarly in line with previous, separate leadership has a positive and significant relationship with shareholder value (Marn and Romuald, 2012, Bhagat and Bolton, 2008). But on the other hand, firms with separate leadership yield lower shareholder value (Dey *et al*., 2011), and thus there is negative relationship between separate leadership and shareholder value (Ponnu, 2008). Furthermore, dual role of chairman has a negative impact on maximizing shareholder value and overall firm performance (Jackling and Johl, 2009; Yusoff and Alhaji, 2012). Whilst, in contrast to previous lines duality has no negative impact on shareholder value (Shukeri *et al*., 2012)
Hence, upon reviewing the literature, it can be concluded that there is inconclusive, mix, and unclear empirical findings regarding the relationship between separate leadership and shareholder value which necessitate its further investigation. Therefore, based on agency theory, the author proposes and support further empirical investigation of the relationship between separate leadership and shareholder value through following hypotheses:

H1: Separate leadership has positive impact on shareholder value.

Proportion of Independent director and shareholder value

Agency theory advocate that, an independent board of director is more likely to be vigilant for agency problems and is dedicated to monitor management performance and behavior for maximizing the shareholder value (Fama and Jensen, 1983). Similarly, the Malaysian Codes on Corporate Governance (MCCG, 2000, 2007 and 2012) recommends "ensuring the value and effectiveness of independent director on the board of the company". Research conducted on the relationship between proportion of independent director and shareholder value yield mixed and inconclusive results. For example, (Panasian *et al*., 2003), stated that if proportion of independent director on board increased then it will be more beneficial for firm agent principal problem and shareholder value. Thus, independent director is positively correlated with shareholder value of the firm (Rosenstein and Wyatt, 1990). Similarly, studies conducted in US, Australia, Europe and Pakistan also suggested the same positive correlation between independent director on the board and shareholder value (Ritchie, 2007). Furthermore, other empirical studies also support that for increasing overall firm value the director independence is utmost important and cannot be ignored (Peasnell et al., 2005; Agrawal and Knoeber, 1996; Baysinger and Butler, 1985). Therefore, recent research shows a positive relation between independent director on the board and shareholder value (Coombes and Wong, 2004; González and García-Meca, 2014).

But on the other hand, (García Lara *et al*., 2007), supported that independent director on the board have a negative impact on shareholder wealth. it is also argued that in many cases independent director on the board tend to be related to fraud which in turn reduce the shareholder value (Beasley, 1996). Similarly, another study also found a negative relation between board independence and shareholder's wealth (Bhagat and Black, 2000; Linck *et al*., 2008). While (Van Ees *et al*., 2003), found no relation in between independent director on the board and shareholder value. At the end it can be argued that studies concerning the effect of independent directors on shareholders' value come to no end. Hence based on agency theory and above inconclusive literature the author support and develop the following hypothesis:

H2: Independent director has a positive impact on shareholder value.

Independent Chairman of the board and shareholder value

The standard principal-agent model suppose that chairman independence is important for minimizing the agency problem which effect the overall performance and shareholder value of the firm (Fama, 1980). Similarly, based on the recommendation of Malaysian Codes on Corporate Governance (MCCG, 2012), "The positions of chairman and CEO should be held by different individuals and the chairman must be a non-executive member of the board". There is always a positive response from stakeholders if a firm announce independent chairman of the boards (Balsam *et al*., 2011b, Coles and Hesterly, 2000), because firms can be effectively monitor through an independent chairman of the board (Alkdai and Hanefah, 2012). Upon reviewing the literature some evidence support the hypothesis that independent chairman on board is improving shareholder value; some got the result that an independent board had a reversely impact on management performance and shareholder value, other evidence suggest there is no significant relation.

Thus, previous empirical finding about the relationship of independent chairman and shareholder value provide inconclusive and mixed result. For example, according to (Coles and Hesterly, 2000), agency problem will be a big issue in the absence of independent chairman of the board (Balsam *et al*., 2011b). While, on the other hand, separate chairman of the board has less value in firm financial

performance and shareholder value (Jackling and Johl, 2009). Further added that outside independent chairman of the board is costly than that of its value creation (Balsam *et al*., 2011a).
Therefore, based on agency theory and inconclusive mix result we shall further try to explore the relation between independent chairman and shareholder value to see if our conclusion is consistent with any of the above results. Thus, based on the above discussion the author develops and support the following hypothesis:
H3: Independent chairman has a positive impact on shareholder value.

Independence of Nomination committee and Shareholder Value

Overall, the customer citizenship behavior is an important source of gaining competitive advantage for the Agency theory suggests that the major function of a board is to monitor firm management. Nomination committees can play a vital role in enhancing board members independence and reducing the influence of management (Westphal and Zajac, 1995; Cotter and Silvester, 2003). Thus, nomination committee independence is more likely to be watchful for agent and principal conflict which in turn will increase the overall firm value. The Malaysian Codes on Corporate Governance (MCCG, 2000, 2007 and 2012) also highlight the importance, value and effectiveness of the nomination committee independence. Research conducted on the relation between nomination committee independence and shareholder value provided mixed and inconclusive results. For Example, there is a positive relationship between independence of nomination committee and shareholder value (Golden and Zajac, 2001; Shivdasani and Yermack, 1999). Similarly, independence of nomination committee will improve firm financial performance and shareholder value (Cotter and Silvester, 2003; Chhaochharia and Grinstein, 2009). But on the other hand there is a negative effect of nominating committee independence on shareholder value (Vafeas, 1999). Furthermore, (Beasley, 1996), also find the same negative correlation in between independence of nomination committee and shareholder value.
Hence upon reviewing the literature, we found different result some evidence support that nomination committee have an positive impact on shareholder value; some study postulating that independence of nomination committee have no significant impact on shareholder value while other got the result that an independent nomination committee on board had a reversely impact on the overall performance of the firm. Thus, the relation between nomination committee independence and shareholder value has been examined in numerous studies but provide a mixed result.
Accordingly, in keeping with our prior literature, we expect that if an independent director is a member of the nomination committee, this will have a positive impact on the shareholder value. Therefore, based on agency theory and previous mix empirical findings discussed above the author develop and support the following null hypothesis:

H4: Independence of nomination committee has a positive impact on shareholder value.

Model Specification and tests

EPSit = α + β1SEPLEDRSHIPit + β2BODINDit + β3CHAIRINDit+ β4 NOMCOMMINDit + β5FSIZit+ eit
Where:
EPS= Earnings per share,
SEPLEDRSHIPit = Separate Leadership
BODIND= Board of director independence
CHAIRIND= Chairman Independence

NOMCOMMIND= Nomination Committee Independence
FSIZE= Firm SizeFSIZE= Firm Size

Research Design and Data Analysis

Data and sample

This study uses quantitative methods to investigate the impact of internal corporate governance mechanism (separate leadership, proportion of independent director, independent chairman and independence of nomination committee) on shareholder value. The data for this study is extracted from the annual reports of one hundred (100) companies which is available on company's websites or through BURSA Malaysia website. The accounting data for shareholder value (Earning per share) is downloaded from DataStream as a proxy of earning per share. The data collected is for a 5-year period from year 2010 to the year ended 2014, with five hundred observations from four different sectors i.e. consumer, construction, technology and plantation. Financial institutions and insurance firms are excluded, as is common in this type of studies because of their particular accounting practices (González and García-Meca, 2014). The data will be analyzed through descriptive statistics, correlation and multiple regression for relationship and results interpretation.

Empirical Results

Table 1: Descriptive Statistics

Variable	Observations	Mean	Std. Dev.	Min	Max
Shareholder Value (EPS)	500	0.179	0.369	0	4.58
Separate Leadership	500	0.806	0.396	0	1
Board of director independence	500	46.186	13.049	0	100
Chairman independence	500	0.406	0.4916	0	1
Nomination committee independence	500	85.788	18.809	0	100
Size	500	1013682	2283966	0	1.86

Table 1, gives descriptive statistics for the dependent and explanatory variable. The mean value for dependent variable (earning per share) is 0.1785. The average of separate leadership in year is 0.806 time which is near the minimum requirement in Malaysia (Haniffa and Cooke, 2000; Coles *et al*., 2001). About 46.136 percent of board of director are independent in the sample while on other hand the calculation shows chairman independence as 40.60. Similarly, on average the independence of nomination committee is calculated 85.788 percent of the sample.

Table 2: Correlation Results

Correlations						
	Earnings per share	Sep Leadrship	BOD Ind	Chairman Ind	NCI	Size
Earnings per share	1					
Separate leadership	.046	1				
Board of director independence	.143**	-.025	1			
Chairman independence	.125**	.358**	.007	1		

Nomination committee independence	-.013	.100*	.277**	.183**	1	
Size (Log of Assets)	.328**	.053	-.025	.329**	.050	1
** Correlation is significant at the 0.01 level (2-tailed).						
* Correlation is significant at the 0.05 level (2-tailed).						

The correlation coefficients are presented in Table 2, which indicate that there is no serious multicolinarity problem because none of the coefficient among the explanatory variable is more than 0.7. However, for observing the multicolinearity and heteroscedasticity problem in the data we employed variance inflation (VIF) tolerance levels and group wise heteroscedasticity tests through statistical package STATA 13.0. The results of sample firm data have no multicolinarity problem because the values are below the threshold level (Mean VIF=1.13).
But on the other hand the result indicated that there is heteroscedasticity problem lying in the data through (Breusch-Pagan/Cook-Weisberg test for heteroscedasticity: Chi2 (1) = 45.80; Prob. > chi2 = 0.000 which was corrected with random effect robust model). This study is based on panel data for hypothesis testing, and ordinary least squares (OLS) regression method is used for results and interpretation. Thus, for the hypotheses testing H1-H4 we run the OLS model to reflect our earlier discussions regarding hypotheses developed.

Table 3: Ordinary Least Squares (OLS) Results

Dependent Variable: Shareholder value (Earning per share)	
Separate Leadership	-.023
	(0.024)
Board Independence	0.003
	(0.002)
Chairman Independence	0.067***
	(0.036)
Nomination Committee Independence	-0.009***
	(0.0005)
Firm Size	5.64***
	(8.26)
Constant	.039***
	(.101)
R-Square	0.1626
F	17.34
Prob.	0.000
Sample	100
Observations	500

Standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Table 3, shows the results of ordinary least squares (OLS) regression. The analysis in Model revealed significant positive impact of chairman independence on shareholder value ($\beta = 0.067$, $p < 0.01$) which supports H3. In the Model, we test nomination committee independence with shareholder value and found significant but negative results ($\beta = -0.009$, $p < 0.01$), while firm size also showed a significant and positive result by indicating ($\beta = 5.64$, $p < 0.01$). However, separate leadership and proportion of independent director showed no significant relationship with shareholder value. These results endorse that corporate governance practices in business increases share price and thus improve overall firm financial performance. These results support the statement of previous researchers (Vafeas, 1999; Hahn and Lasfer, 2007; De Miguel *et al*., 2004). In hypotheses testing the effect of firm size is controlled and has statistical significant impact in the model which oppose the previous findings that firm's size has no impact on share price (Moeller *et al*., 2004). However, the results indicate that the bigger size by market capitalization and firm's assets are producing valuable information that can increase firm's overall financial performance.

Table 4: Summary of all Hypotheses

	Significant level	Hypothesis	Results
Separate leadership		H 1	Rejected
Board of director independence		H 2	Rejected
Chairman independence	(***)	H 3	Accepted
Nomination committee independence	(***)	H 4	Accepted

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Contribution

This paper reports empirical evidence of the effectiveness of corporate governance mechanism (separate leadership, proportion of independent director, independent chairman, and independence of nomination committee) on improving shareholder value in Malaysian listed firms over the period of five years from 2010 to 2014. In general, these findings suggest that firms with effective corporate governance mechanisms improve shareholder value and firm financial performance. Particularly, chairman independence and nomination committee independence are very much effective and significant to shareholder value. Overall, although not all corporate governance variables support the stated hypotheses; but this study has achieved its objective by identifying the attributes that answer the research question. Because, the sample companies reviewed in this study suggest that shareholder value in Malaysian listed companies are improving after following the proper road map of corporate governance structure. This study investigated that how a good corporate governance structure can influence firm financial performance and shareholder. Moreover, this empirical study produced the results of separate leadership, proportion of independent director, independent chairman and independence of nomination committee after regressing with shareholder value (earning per share). After empirical study it is cleared that no doubt corporate governance practices are utmost important for maximizing the share price and firm financial performance.

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